

Annual Report  
2006



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## Financial Highlights

Advantest Corporation and Consolidated Subsidiaries

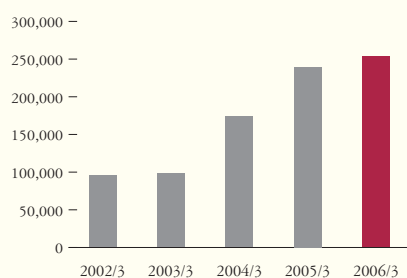
Years ended March 31:	2002	2003	2004	2005	2006	2006
	Yen (in millions, except per share and share data)					U.S. Dollars (in thousands, except per share and share data)
<b>Consolidated Statement of Operations Data:</b>						
Net sales	¥95,244	¥97,740	¥174,218	¥239,439	¥253,922	\$2,161,590
Operating income (loss)	(37,105)	(16,743)	30,960	60,719	64,458	548,719
Income (loss) before income taxes	(38,480)	(18,688)	28,878	61,808	67,454	574,223
Net income (loss)	(23,906)	(12,994)	17,329	38,078	41,374	352,209
<b>Net income (loss) per share:</b>						
Basic	(240.38)	(131.99)	176.37	389.54	446.34	3.80
Basic weighted average shares outstanding	99,453,203	98,445,111	98,250,830	97,750,345	92,694,513	92,694,513
<b>As of March 31:</b>						
Total assets	¥307,562	¥281,224	¥330,808	¥296,769	¥350,776	\$2,986,090
Total stockholders' equity	240,716	210,663	221,768	206,749	257,927	2,195,684

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

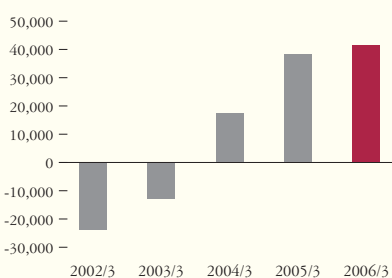
Note 2: In this annual report, amounts reported in Japanese yen have been translated into U.S. dollars for the convenience of readers.

The rate used for this translation was \$1.00=¥ 117.47, the approximate exchange rate in Japan on March 31, 2006.

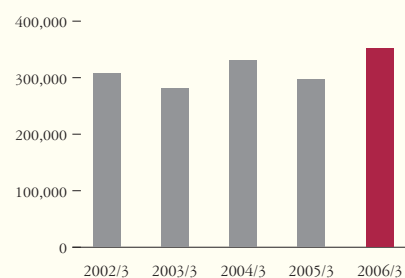
**Net Sales**  
(Millions of yen)



**Net Income (loss)**  
(Millions of yen)



**Total Assets**  
(Millions of yen)



## Our Core Competence

Committed to our corporate mission, “Technology Support on the Leading Edge,” Advantest provides test systems for semiconductors and a host of related products and services that ensure the reliability of semiconductor and electronic components products. Advantest provides high technology companies with the most advanced test and measurement technologies in the world. In the half-century since Advantest’s founding in 1954, we have honed our core strengths and constantly introduced new products incorporating the latest test and measurement technologies.

## Parallel-testing of 512 devices

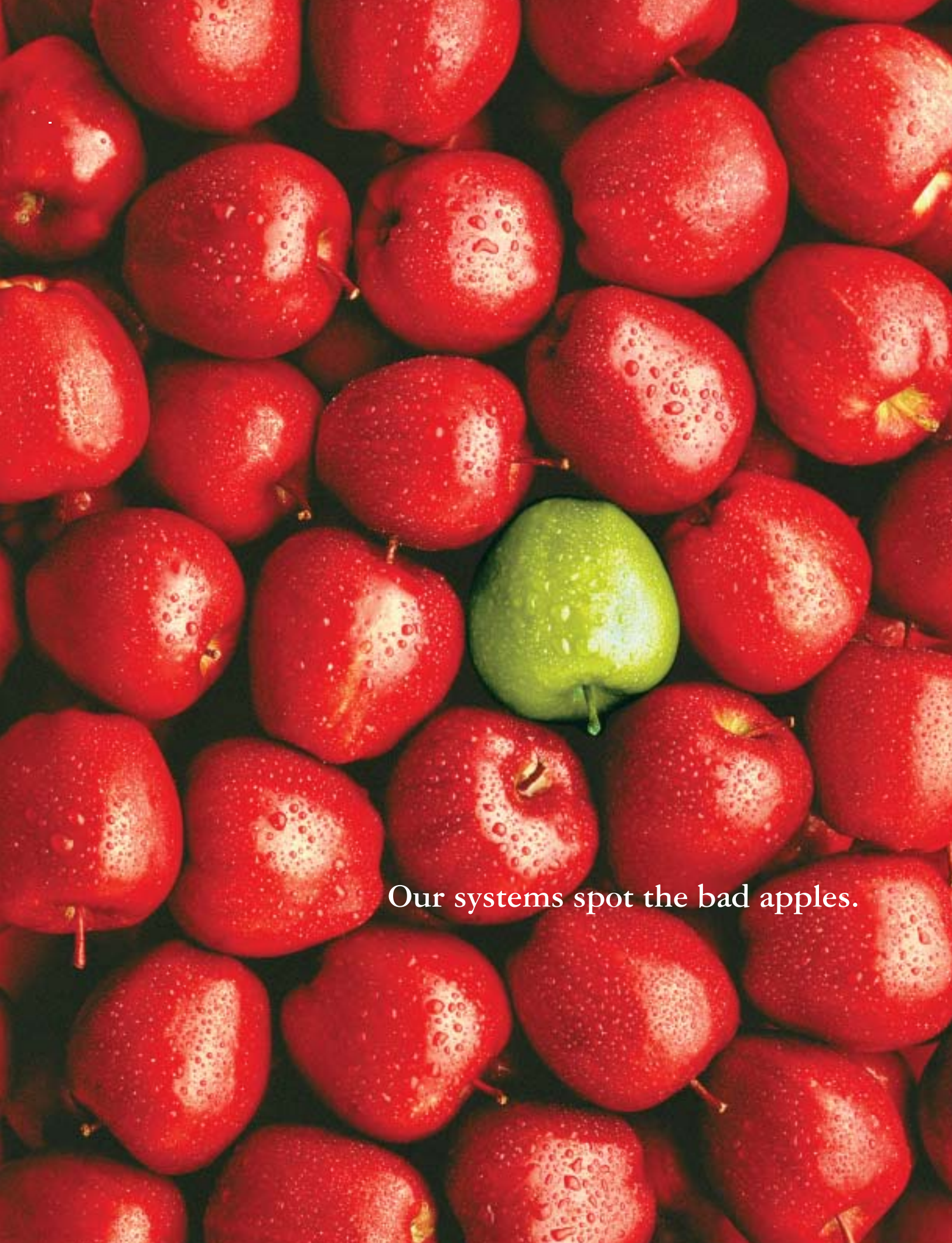
Representative of Advantest’s high-performance, high-added-value ethos is our T5588 test system for memory semiconductors. Launched in May 2005, the T5588 is capable of parallel-testing 512 DDR2-SDRAM semiconductors, the current mainstream technology for the DRAM semiconductors that drive personal computers, servers, and other technologically sophisticated equipment. The performance of the T5588 is unmatched in the ATE industry. Our strength and standards of excellence inform our willingness to compete head-to-head on functionality, performance, and product quality. However, our offerings extend far beyond our individual products. We provide test solutions that combine our comprehensive capabilities in sales, development, production, maintenance, and other fields, enabling our customers to build optimal test environments.

State-of-the-art products and superior test technology express Advantest’s dedication to performance and quality.

Insightful and timely assessments of customers’ ever-changing needs...

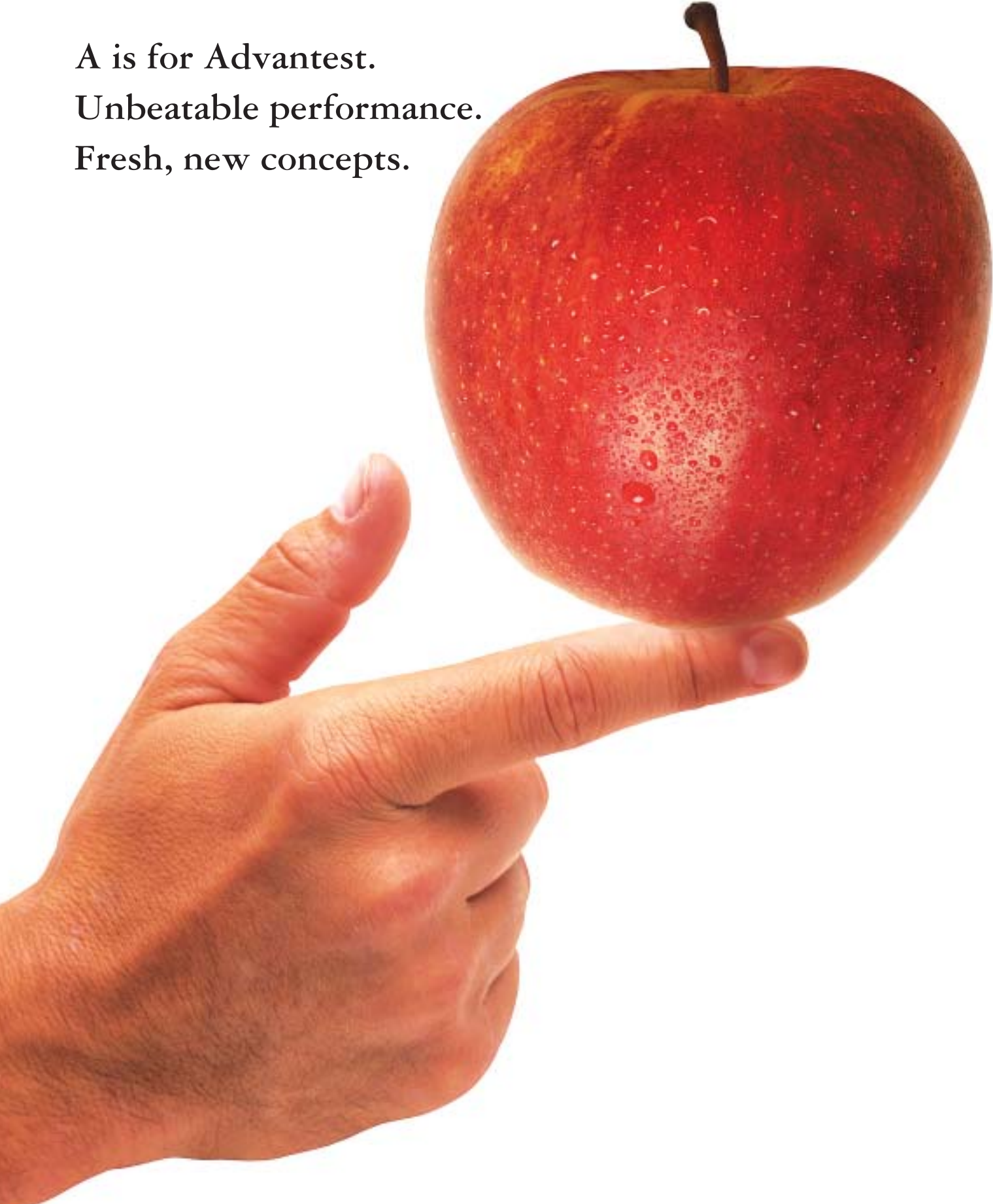
Future-oriented, customized test solutions...

Only Advantest, with half a century of experience and deep test and measurement expertise, can provide it all.



Our systems spot the bad apples.

A is for Advantest.  
Unbeatable performance.  
Fresh, new concepts.



## Sustained Investment in Research and Development

At Advantest, we provide test systems for semiconductors for wafer test and package test of all types of semiconductors. We pride ourselves on offering the most advanced test technologies on the market. Yet an equally important aspect of Advantest's success is our capacity to be a "one-stop shop" for semiconductor test resources and solutions including test handlers, device interfaces, and maintenance services. Our R&D facilities are crucibles of the innovation that drives our products. The next-generation core technologies that will empower the future of semiconductor testing are already being incubated at the Gunma R&D Center and Advantest Laboratories.

**R&D expenses:**

**29.0**

**billion yen**

We are able to provide high-performance, high-quality products that our competitors cannot hope to imitate due to our consistently high level of investment in R&D. For example, despite the extremely sharp downturn in results during fiscal 2001 and 2002, we invested 26.6 billion yen and 23.6 billion yen respectively in R&D in those years. Later, when the market recovered, our sustained R&D investment enabled us to launch a wide range of successful, well-timed new products, including the T2000, OPENSTAR<sup>®\*</sup> compatible test systems for SoC semiconductors, the T6372 test system for LCD driver ICs, and the T5588 and T5501 test systems for memory semiconductors.

In fiscal 2006, we plan to invest 29 billion yen in R&D.

\*OPENSTAR<sup>®</sup> is a registered trademark of the Semiconductor Test Consortium.

## Facing a Cyclical Business Environment

In the semiconductor industry, growth is dictated by cyclical fluctuations known as the “Silicon Cycle,” which is driven by economic conditions, consumer trends, technical innovations, and other factors. Advantest has always endeavored to achieve steady growth in the face of these cyclical ups and downs.

Recently, semiconductor applications have expanded significantly, particularly in the areas of consumer electronics and automobiles. This has created strong price pressures on end-user products, which in turn force semiconductor prices down. Test system makers face the same powerful calls for lower prices. Meanwhile, demand for higher performance, greater functionality, and more diverse IC capabilities has not only increased development costs for test system makers, but also pushed up material and other manufacturing costs.

# Activate 21

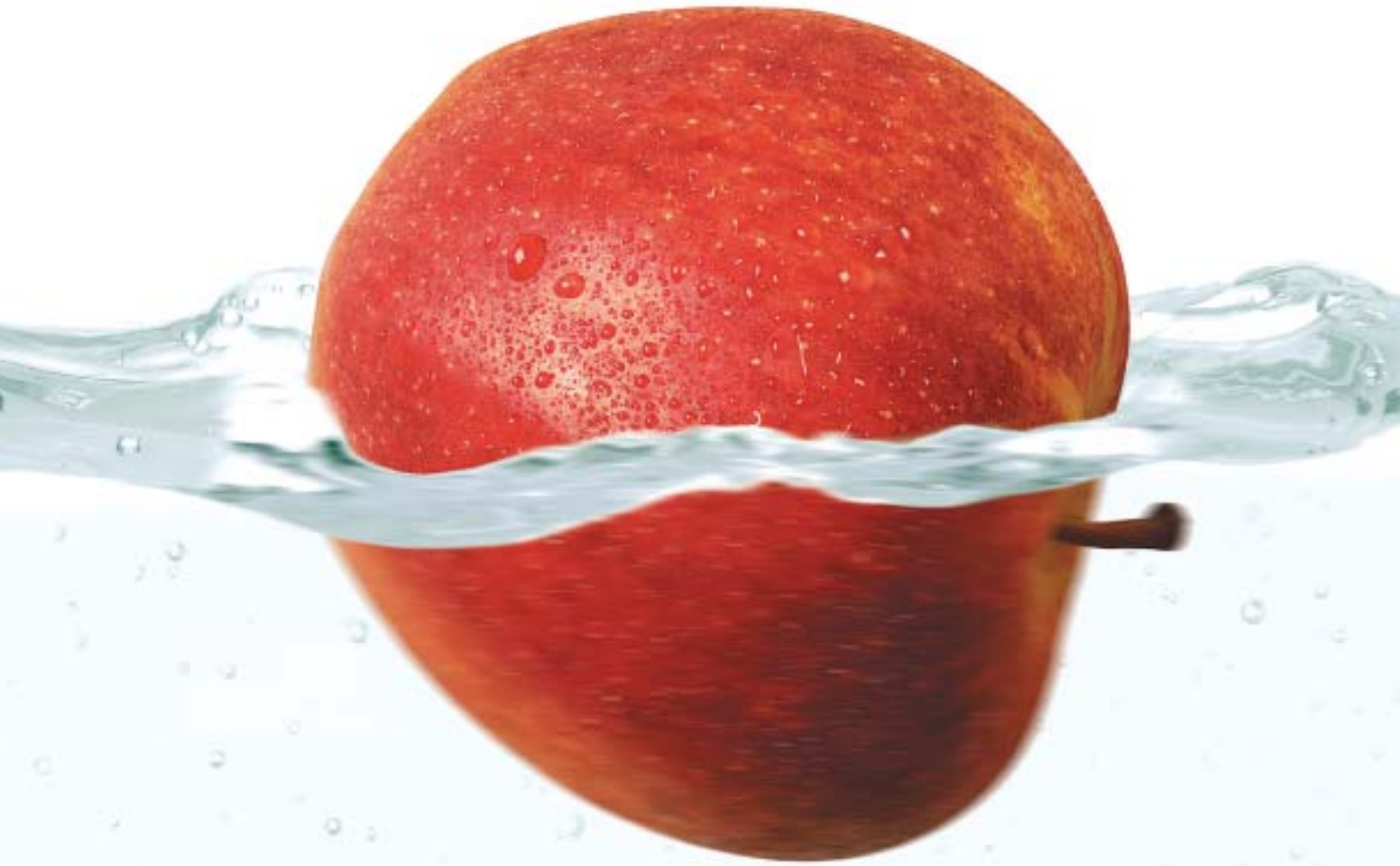
Advantest is responding to this dilemma with a two-pronged strategy of aggressive business expansion and cost-efficiency improvements. In October 2005, we launched a new corporate initiative, “Activate21”. Setting our medium-term goals through to the end of March 2009, this initiative aims to further boost Advantest’s market competitiveness and profitability by focusing on cost and efficiency from a global perspective.

First, we are introducing cost planning methods in the product-planning and development stages.

Second, we are using data obtained through ABCM (Activity Based Costing and Management) procedures and evaluations based on API (Advantest Performance Indicator) to eliminate any wasted expenses and to dramatically increase the efficiency of business processes across all departments.

Third, building on the efficiency gains achieved through our introduction of the “just-in-time” production system in August 2003, we are achieving more efficient production through development and design that emphasizes procurability and productivity. This is resulting in shorter production times and closer integration of vendor supply chains.

Despite our cyclical business environment, Advantest has developed a unique business model to achieve steady growth.



**Riding the waves of change  
with unsinkable quality.**

## Advantest's Business

Today, Advantest's key business segment is the semiconductor and component test system. This segment accounted for about 75% of our sales in fiscal 2005\*. The business of this segment is broadly divided into test systems for memory semiconductors and test systems for non-memory semiconductors.

Test systems for memory semiconductors include test systems for DRAM semiconductors used in computers and other devices, as well as test systems for flash memory semiconductors mainly used in memory cards and portable music players.

### Semiconductor and component test system sales to total sales ratio

75%

Test systems for non memory semiconductors include the T2000, as well as test systems for LCD driver ICs and other semiconductors used in consumer electronics. Sales in our semiconductor and component test system segment were historically dominated by test systems for memory semiconductors, but our intensified R&D investment in test systems for non memory semiconductors has paid off: Through new product launches, our sales of test systems for non memory semiconductors in fiscal 2005 rapidly approached the level of test systems for memory semiconductors.

As semiconductors diversify, and the market demands higher test speeds and greater parallel-test volumes, there is an increased need not only for test systems, but also for integrated solutions such as test handlers, which automatically transport devices during testing, and device interfaces, which connect devices and test systems. These types of products are a part of our mechatronics system segment, which now comprises about 19% of our sales.

\*FY2005: Year ending March 2006

No matter how you slice it,  
our customers come first.

75%

Semiconductor and  
Component Test System

19%

Mechatronics System

Services, Support  
and Others



## Leader in the Global Memory Test Systems Market

Our share of the global memory test system market in 2005 was about 70%, giving Advantest an overwhelming lead over our competitors. Retention and expansion of market share is a vital part of our strategy.

Compared to other industries, the semiconductor business has an extremely high rate of change in technology and market requirements. In this industry, the key to success is the ability to develop products that meet customer requirements precisely when they are needed and contribute to lower test costs.

## Global share of test systems for memory semiconductors

# No.1

Our dominant market position gives us an advantage in terms of unmatched access to customer feedback and data. This helps us to accurately predict future market trends. By applying to product development to enable the timely launch of the products that our customers need, we have established a trend of positive expansion through a cycle of higher sales and a still widening market.

Advantest's high market share, unmatched in the test industry, is key to our strategy for further improvement of our profitability. We continue to aggressively expand our sphere of activities.





**Leading the industry.  
And still hungry.**



High mix, low volume?  
We've got it in the bag.

## World Leadership in Non memory Test Systems Within Reach

To further improve our results, we recognize that we must expand our sales and market share in test systems for non memory semiconductors. Our approximately 10% share of this market in 2003 expanded to approximately 28% by 2005, an advance chiefly driven by our T2000 and our T6300 series of test systems for LCD driver ICs.

The market of test systems for non memory semiconductors is around twice the size of the market of test systems for memory semiconductors. To enhance our position in this market, we aim to introduce low-cost mainframes and expand the range of modules for our T2000, which is currently successful in the high-end market. By taking the T2000 into the middle and low-end market, we anticipate an influx of new customers.

## Share of test systems for non memory semiconductors

Approximately

28%

Another of our strategies has been the establishment of a new R&D center for test systems for non memory semiconductors in the United States in 2005 to bring our R&D operation into direct contact with numerous potential customers. With the benefit of geographically closer relationships to users, our R&D has been proceeding more rapidly.

In Japan and Asia, meanwhile, we have been focusing on expanding our sales of test systems for LCD driver ICs, demand for which is on an upward trend, and the T6500 series for consumer electronics semiconductors.

Advantest continues to “Support Technology on the Leading Edge” by providing high-performance, high-quality testing solutions for semiconductors that match our customers’ needs.



*Nothing gets past us.*



## To Our Stakeholders

### Strong Results in Fiscal 2005

In fiscal 2005, global markets experienced increased demand for flat-panel televisions, portable music players, laptop computers, and other consumer electronics. This resulted in strong capital investment by semiconductor makers as they boosted volumes to meet demand. The weaker yen also helped to create favorable business conditions for us.

We thus increased our sales based on new products, focusing in particular on expanding our market share in test systems for non memory semiconductors — the key to our growth. To achieve even higher productivity and profitability, we also converted more of our manufacturing facilities to the “just-in-time” production system, which enables us to achieve shorter production lead time, complete inventory management, lower costs, and higher quality.

As a result, sales for this fiscal year increased by 6% to 253.9 billion yen, income before tax increased by 9.1% to 67.5 billion yen, and net income rose 8.7% to 41.4 billion yen. These strong results surpassed even the favorable results of the previous fiscal year.

Our basic dividend policy has been to deliver stable dividends despite severe fluctuations in our business environment. They are determined by an overall assessment of the results for each term and our financial situation. Our dividend for this term increased by 20 yen from last year’s 50 yen to 70 yen for the entire year. As we paid an interim dividend of 25 yen, our fiscal 2005 year-end dividend was 45 yen.

### Fiscal 2006 Forecast

In fiscal 2006, analysts predict increased demand as the generational changeover to DDR2-SDRAM takes hold in DRAM semiconductors, and in the second half, computers and game consoles are launched incorporating new operating systems with comparatively vast memory requirements. Demand is also expected to rise for non memory semiconductors and flash memory semiconductors used in mobile phones, portable music players, flat-panel televisions, and other consumer electronics.

Some risk factors that could negatively impact our results include limited capital investment due to a poor balance between supply and demand, common in the semiconductor industry; higher costs for materials due to soaring oil prices; yen appreciation; and widespread downward pressure on prices from customers due to these factors.

To be prepared for these contingencies, we will strive to enhance our marketing and development structures, and perfectly time our launches of new products that anticipate customer needs. To improve cost-competitiveness, we will follow our corporate initiative, “Activate 21”, to review our business processes and improve productivity company-wide.

## Incorporating CSR Activities into Sustainable Management

At Advantest, we help people to live in safety and comfort by providing reliability assurances for semiconductors and electronic components. Yet for many years, we have not been satisfied with the traditional manufacturer's role of developing and selling products. We continue to work to preserve our natural heritage by reducing the environmental impact of our products throughout their whole life cycle. Moreover, aware of the relationship between impeccable corporate ethics and product reliability, we have established an official Code of Conduct and improved our corporate governance.

In fiscal 2003, we established a CSR (Corporate Social Responsibility) Committee that oversees the various committees dealing with disclosure, internal control, environmental issues, information security, human rights, and other issues. The following year, in fiscal 2004, we established the Corporate Ethics Committee to clarify our corporate ethics and improve our compliance system. We have also focused increasing attention on environmental issues. In fiscal 2004, we implemented the Advantest Recycling System for our products which were used in Japan, and we also achieved zero emissions at eight facilities in Japan.

In fiscal 2005, widespread concern about corporate ethics and enforcement of laws and regulations pertaining to corporate governance led us to publish the Second Edition of the Advantest Code of Conduct (following the First Edition in 1999). Distributed in booklet form to all Advantest Group employees around the world, these updated ethical guidelines help each individual employee to assume social responsibility and actively conduct corporate activities with integrity.

We will continue to develop our CSR activities to improve the sustainability of our business and to ensure the safety and comfort of all our stakeholders around the world.

\*For details about our environmental activities and social contributions, please visit our web site:

<http://www.advantest.co.jp/environment/en-index.shtml>

## In Conclusion

Advantest has established a solid financial system and a flexible management structure, designed to respond rapidly to market fluctuations on a global scale. Nevertheless, we perennially strive to improve our profitability. While firmly grounded in our core competence of test and measurement technologies, we are currently focused on developing next-generation technologies. We will continue to launch superior products that tap into market needs to further expand our market share and work vigorously to boost our corporate value.

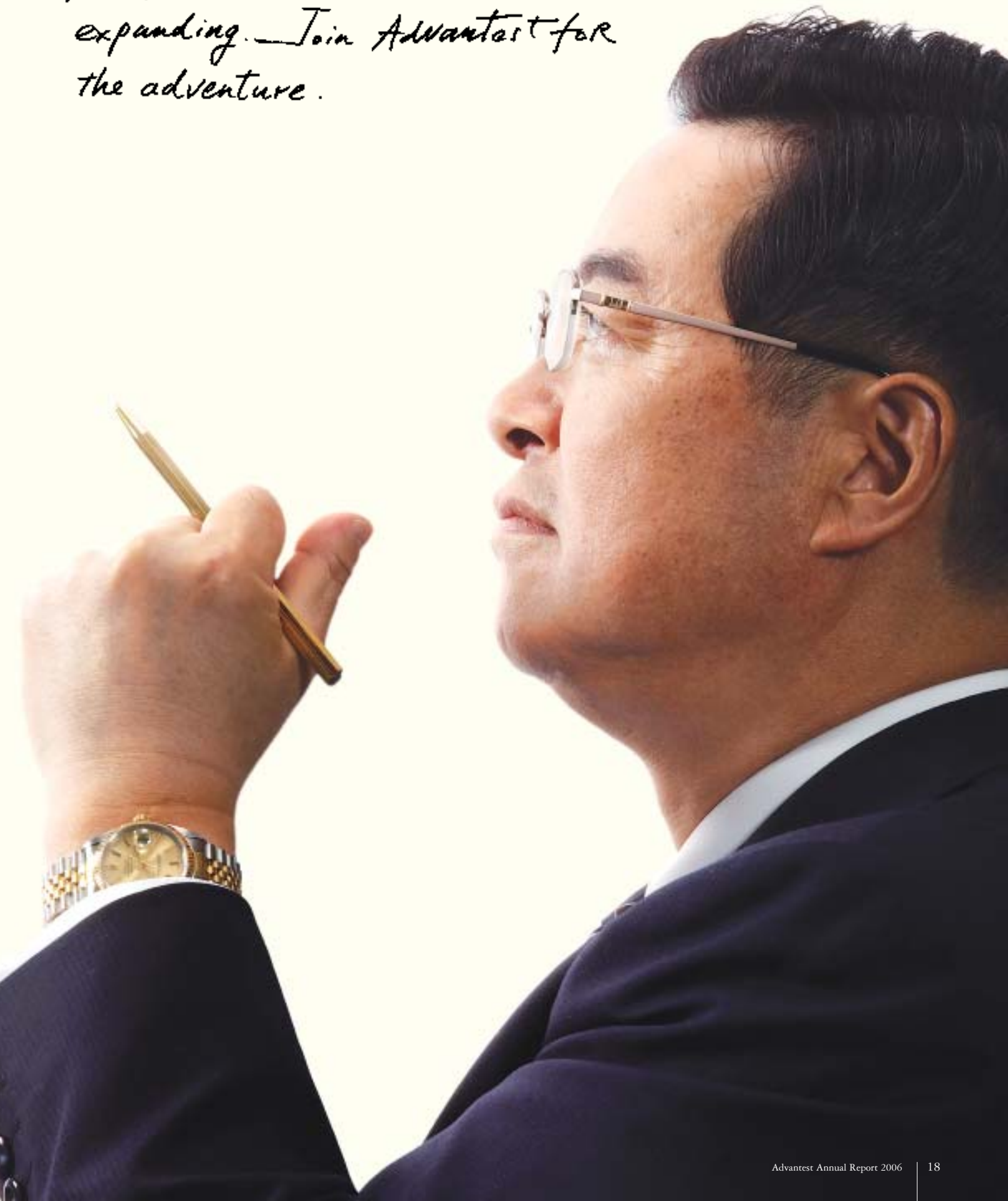


Toshio Maruyama

Representative Board Director

President and CEO

*The test and measurement universe is expanding. Join Advantest for the adventure.*



## Board of Directors & Corporate Auditors



Representative Board Director  
President and CEO  
Toshio Maruyama

Chairman of the Board  
Shimpei Takeshita

Director and Senior Executive Advisor  
Hiroshi Oura



Director  
and Senior Executive Officer  
Takashi Tokuno

Director  
and Senior Executive Officer  
Junji Nishiura

Director  
Naoyuki Akikusa

Director  
Yasushige Hagio

Director  
and Senior Executive Officer  
Hiroji Agata

Director  
and Managing Executive Officer  
Hitoshi Owada



Corporate Auditor  
Takashi Takaya

Standing Corporate Auditor  
Noboru Yamaguchi

Standing Corporate Auditor  
Tadahiko Hirano

Corporate Auditor  
Megumi Yamamuro

## Board of Directors

---

Shimpei Takeshita  
Chairman of the Board

Toshio Maruyama  
Representative Board Director

Hiroshi Oura  
Director and Senior Executive Advisor

Naoyuki Akikusa  
Director

Yasushige Hagio  
Director

Junji Nishiura  
Director

Hiroji Agata  
Director

Takashi Tokuno  
Director

Hitoshi Owada  
Director

## Corporate Auditors

---

Noboru Yamaguchi  
Standing Corporate Auditor

Tadahiko Hirano  
Standing Corporate Auditor

Takashi Takaya  
Corporate Auditor

Megumi Yamamuro  
Corporate Auditor

## Corporate Executive Officers

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Toshio Maruyama  
President and CEO

### Senior Executive Officers

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Junji Nishiura  
Technology and Production

Hiroji Agata  
Sales and Marketing

Takashi Tokuno  
Products

### Managing Executive Officers

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Hitoshi Owada  
Corporate Affairs (CFO)

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  
Senior Vice President,  
SE Group

Hiroshi Tsukahara  
Senior Vice President,  
1st Test System Business Group

### Executive Officers

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Masao Shimizu  
Senior Vice President, DI Business Group

Masao Araki  
Chairman of the Board, Advantest (Suzhou) Co., Ltd.

Yuichi Kurita  
Senior Vice President, Corporate Planning Group

Yoshiro Yagi  
Vice President, Sales and Marketing Group

Hideaki Imada  
Senior Vice President,  
2nd Test System Business Group

Shinichiro Umeda  
Senior Vice President, Software Development Group

Akira Hatakeyama  
President, Advantest Manufacturing, Inc.

Yasuhiro Kawata  
General Manager, 2nd SoC Tester Business Division,  
1st Test System Business Group

Takashi Sugiura  
Senior Vice President, FA Business Group

Shinichiro Kuroe  
Vice President, Sales and Marketing Group

Takashi Sekino  
Vice President, Technology Development Group

Hiroshi Nakamura  
Vice President, Corporate Affairs Group

Yoshiaki Yoshida  
President and CEO,  
Advantest Finance Inc.

\* As of June 27, 2006

## Corporate Governance

### 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 ten. Directors are elected at a general meeting of shareholders, and the standard term of directors is one year. 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.

Pursuant to the Company Law and Advantest's articles of incorporation, and to the extent permitted by the laws and regulations, Advantest may, by resolution of the Board of Directors, exempt liabilities of its directors (including persons who have previously served as Advantest's directors) for failing to perform their duties. Advantest may enter into contracts with outside directors to limit their liabilities for a failure to perform their duties, provided that the maximum amount of liabilities under such contracts shall be the total of the amounts provided in each item of Article 425, Paragraph 1 of the Company Law.

### Corporate Auditors

Advantest's articles of incorporation provide for no more than five corporate auditors and Advantest currently has two standing corporate auditors and two outside corporate auditors. Corporate auditors are elected at the general meeting of shareholders and the standard term of office of corporate auditors is four years. Under the Company law, at least half of the corporate auditors are required to be persons who have not been a director, accounting counselor (if an accounting counselor is a corporation, an employee of such corporation who executes its duties), executive officer, manager, or employee of Advantest or any of its subsidiaries at any time in the past. Corporate auditors may not at the same time be directors, accounting counselors (if an accounting counselor is a corporation, an employee who executes its duties), 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 shareholders 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 shareholders 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 of Advantest's business conditions and financial standing and other matters concerning the performance of the corporate auditors' duties.

Pursuant to the Company Law and Advantest's articles of incorporation, and to the extent permitted by the laws and regulations, Advantest may, by resolution of the Board of Directors, exempt liabilities of its corporate auditors (including persons who have previously served as Advantest's corporate auditors) for failing to perform their duties. Advantest may enter into contracts with outside corporate auditors to limit their liabilities for a failure to perform their duties, provided that the maximum amount of liabilities under such contracts shall be the total of the amounts provided in each item of Article 425, Paragraph 1 of the Company Law.

## **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. 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 in November 2003, as further amended in November 2004. 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, (c) Advantest's CEO must notify the NYSE of material non-compliance with (a) and (b), and (d) Advantest must submit annual and interim written affirmations to the NYSE. 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 has two independent directors on its board of directors. Unlike NYSE Corporate Governance, the Company Law of Japan and related legislation (hereinafter in Item 6.C, the "Company Law"), 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 Company Law does not require, and accordingly Advantest does not have, an internal corporate organ or committee comprised of only independent directors.

### **2. Committees**

Advantest has not established committees responsible for director nomination, corporate governance and executive compensation as required by NYSE Corporate Governance, but it has adopted a system of corporate auditors based on the Company Law and integrated such system into Advantest's corporate governance structure. In addition, in connection with such system of corporate auditors, Advantest has elected to establish a nomination and compensation committee, which is an optional committee under the Company Law.

Pursuant to the Company Law, Advantest's board of directors nominates and submits a proposal for appointment of directors for shareholder approval. The shareholders vote on such nomination at Advantest's general meeting of shareholders. The Company Law requires that the respective total amount of remuneration, among others, (remuneration, bonus, and other consideration for services related to employment) to be paid to all directors and all corporate auditors must be determined by a resolution of the general meeting of shareholders, 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 the board of corporate auditors.

### **3. Audit Committee**

Advantest avails 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 Company Law, Advantest elects its corporate auditors through a resolution adopted at a general meeting of shareholders. Advantest currently has four corporate auditors, which exceeds the minimum number of corporate auditors required pursuant to the Company Law.

Unlike NYSE Corporate Governance, the Company Law, 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 Company Law, the board of corporate auditors may determine the auditing policies, method of examination of Advantest's business conditions and financial standing, 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 corporate auditors who satisfy the requirements of "outside corporate auditor" under the Company Law. Unlike NYSE Corporate Governance, under the Company Law, at least one-half of the corporate auditors of Advantest must be "outside corporate auditors", which is a person who was not a director, an accounting counselor (if an accounting counselor is a corporation, an employee of such corporation who carries out its duties), executive officer, general manager, or any other employee of Advantest or any of its subsidiaries at any time in the past. Corporate auditors may not at the same time be directors, an accounting counselor (if an accounting counselor is a corporation, an employee who carries out its duties), executive officer, general manager, or any other employee of Advantest or any of its subsidiaries.

#### **4. Corporate Governance Guidelines**

Advantest is required to adopt or disclose corporate governance guidelines under Japanese laws and regulations, including the Company Law and the Securities and Exchange Law of Japan or stock exchange rules. Pursuant to the Company Law, Advantest is required to decide to implement a structure as required by an ordinance of the Ministry of Justice (the "Internal Control System") in order to ensure directors' compliance with applicable laws and regulations and Advantest's articles of incorporation while executing their duties and joint stock companies' proper business operation, and is required to disclose the decision to implement the Internal Control System, policies and the present conditions of its corporate governance in its business report, annual securities report and certain other disclosure documents in accordance with the Company Law, the Securities and Exchange Law, and applicable Cabinet ordinances 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 Company Law 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, in accordance with the Company Law, Advantest has decided to implement the Internal Control System as a structure to ensure that director's execution of their duties at meetings of the Board of Directors complies with applicable laws and regulations and Advantest's articles of incorporation. Furthermore, Advantest has established a code of ethics consistent with Section 406 of the Sarbanes-Oxley Act.

#### **6. Shareholder Approval of Equity Compensation Plans**

Unlike NYSE Corporate Governance, in which material revisions to equity-compensation plans of the listed companies are subject to shareholder approval, pursuant to the Company Law, if a joint stock company desires to adopt an equity-compensation plan for directors as compensation to directors other than cash, such company is generally required to obtain shareholder approval by an "ordinary resolution". In addition to the above approval, when Advantest previously desired 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 shareholders on a pro-rata basis at the same time), then Advantest has obtained shareholder approval by a "special resolution" of a general meeting of shareholders, 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.

## 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 28, 2006.

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

## Overview

Advantest manufactures and sells semiconductor and component test systems and mechatronics-related products such as test handlers and device interfaces. Advantest also engages in research and development activities and provides maintenance and support services associated with these products.

The semiconductor and component test system segment provides customers with test system products for the semiconductor industry and the electronic parts industry. Product lines in the semiconductor and component test system segment include test systems for memory semiconductors for memory semiconductor devices test systems for SoC semiconductors for non memory semiconductor devices. This reportable business segment is the most important segment, with sales accounting for 75.4% of Advantest's net sales in fiscal 2005.

The mechatronics system segment provides product lines such as test handlers, mechatronic-applied products, for handling semiconductor devices, device interfaces that serve as interfaces with the devices that are measured and operations related to nano-technology products. This business segment accounted for 19.0% of Advantest's net sales in fiscal 2005.

The services, support and others segment consists of comprehensive customer solutions provided in connection with the semiconductor and component test systems and mechatronics system segments, support services, equipment lease business and others. This segment accounted for 7.5% of Advantest's net sales in fiscal 2005.

## *Semiconductor and Component Test System Segment*

The market for semiconductor and component test systems is highly cyclical and competitive, and depends on the appetite for capital expenditures of customers. Their capital expenditures depend, to a large extent, on:

- demand for semiconductors and electronic components;
- innovation in semiconductor and electronic component technology; and
- changes in semiconductor and electronic component manufacturing processes.

During fiscal 2005, conditions affecting Advantest's semiconductor and component test system segment were generally favorable due to an increase in capital expenditures in the semiconductor manufacturing industry and as stimulated by the substantial sales of digital consumer products, including flat-panel TVs and portable music players, and improved demand for personal computers (especially notebooks). The trend towards a weaker yen against the U.S. dollar at the beginning of fiscal 2005 also had a positive impact on this segment.

Due to the market expansion of NAND type flash memory semiconductors used in products such as portable music players, sales in test systems for flash memory semiconductors remained strong domestically and overseas. With respect to test systems for DRAM semiconductors, sales remained strong throughout the fiscal year in terms of test systems for DRAM used in consumer digital products and personal computers. In particular, demand for test systems for high-speed memory semiconductors increased domestically and in Taiwan. Semiconductor manufacturers generally implemented, in the second half of the fiscal year, a full scale production of DDR2-SDRAM semiconductors that is high-speed and low energy consuming.

In the area of test systems for non memory semiconductors, stimulated by strong sales in personal computers, sales of the T2000, a test system compatible with OPENSTAR®, continued to remain strong from the previous fiscal year. Due to an increase in demand for personal computer monitors and flat-panel TVs, sales of non memory test systems for LCD driver ICs increased significantly domestically and in Taiwan. Sales of SoC semiconductor test systems for devices used in consumer digital products and test systems for automotive analog ICs increased.

As a result of the above, net sales of the semiconductor and component test system segment increased 5.9% to ¥191,415 million in fiscal 2005, as compared to the previous fiscal year.

While Advantest's net sales, results of operations and financial conditions in fiscal 2005 were affected by price pressure, results of operations improved significantly over fiscal 2004. Net sales of test systems for memory semiconductors in fiscal 2005 decreased by 19.0% as compared to the previous fiscal year, while net sales for test systems for non memory semiconductors increased by 60.3% as compared to the previous fiscal year. Advantest's best selling test system for non memory semiconductor test systems in fiscal 2005 was the T2000, a test system for SoC semiconductors based on OPENSTAR®, an industry-wide, open architecture, the T6300 series, a tester for LCD driver ICs, and the T6500 series, Advantest's relatively lower cost test systems for SoC semiconductors. Demand for these semiconductor and component test systems was driven by expanded production during 2004 and 2005 of digital consumer electronics that incorporate

semiconductors, including wireless handsets and flat-panel TVs. These semiconductors typically are mass-produced and carry per unit market prices that are lower than high-end SoC semiconductors and high-bandwidth DRAM semiconductor and SRAM semiconductor products. Therefore, Advantest's customers that produce these semiconductors required less expensive semiconductor and component test systems in order to reduce their overall manufacturing costs.

Advantest believes that demand for its newer products 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 semiconductor devices. In most cases, the sales prices of semiconductor and component test systems gradually decreases as their commercial life becomes longer.

Advantest believes that price pressure with respect to semiconductor and component test systems 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 from fiscal 2001 to 2003. In fiscal 2004 and fiscal 2005, price pressure continued to exist. 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 products.

### ***Mechatronics System Segment***

Although Advantest's sales of test handlers for memory semiconductors in the test handler business remained low in the first half of the fiscal year, sales increased in the second half of fiscal 2005 due to the introduction of the M6300, a test handler for memory semiconductors that allows for the simultaneous measurement of 256 test systems.

Net sales of test handlers for SoC semiconductors also increased with increased sales of the TAB handler M7521A for LCD driver ICs designed for fine pitch packages and the M4741A series of test handlers for SoC semiconductors, the latter with vision alignment functions. Demand was enhanced primarily through the strong performance of digital consumer devices in the market.

Net sales of device interfaces rose approximately 15% in fiscal 2005. Net sales in Japan, Korea and Taiwan were particularly strong in fiscal 2005 compared to fiscal 2004. Among others, Advantest believes that improvement in technologies by Advantest's local subsidiaries enhanced competitive advantage over competitors reflecting lower production costs and introduction of device interfaces with lower running costs for component replacement of measured devices resulted in significant market acceptance in Korea and Taiwan.

As a result of the above, net sales of the mechatronics system segment increased by 4.0% compared to fiscal 2004 to ¥48,260 million in fiscal 2005.

### ***Services, Support and Others Segment***

In the services, support and others segment, Advantest has focused on maintenance services such as installation and repairs of Advantest's products and lease and rental services of its products as a part of Advantest's effort to provide customers with comprehensive solutions. Net sales of this segment decreased by 3.1% compared to fiscal 2004 to ¥19,062 million in fiscal 2005.

### ***Research and Development***

Research and development expenses represent a significant portion of Advantest's annual operating expenses. Advantest's research and development expenses were ¥21,637 million, ¥26,280 and ¥26,927, or 12.4%, 11.0% and 10.6% of net sales, in fiscal 2003, 2004 and 2005 respectively.

### ***Personnel***

As of March 31, 2006, Advantest had a total of 3,595 full-time employees, an increase of 30 persons, or 0.8%, over March 31, 2005.

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 semiconductor and component test system segment and mechatronics system segment to support the growth of Advantest's businesses. Other new hires are expected to join Advantest's maintenance support division 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 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 accounting 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 and component test systems, in Japan. A small portion of the components and parts used in Advantest's semiconductor and component test systems is purchased in currencies other than the yen, predominantly the U.S. dollar.

Advantest enters into foreign exchange forward contracts to hedge 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 from fiscal 2003 to fiscal 2004, but weakened in fiscal 2005.

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 2003, fiscal 2004 and fiscal 2005 were included in its Japanese Securities Reports filed with the Director of the Kanto Local Finance Bureau.

	Year ended March 31,					
	2002	2003	2004	2005	2006	2006
	(in millions, except per share and share data)					(thousands, except per share and share data)
<b>Consolidated</b>						
<b>Statement of</b>						
<b>Income Data:</b>						
Net sales .....	¥ 95,244	¥ 97,740	¥ 174,218	¥ 239,439	¥ 253,922	\$ 2,161,590
Operating income						
(loss) .....	(37,105)	(16,743)	30,960	60,719	64,458	548,719
Income (loss) before						
income taxes .....	(38,480)	(18,688)	28,878	61,808	67,454	574,223
Net income (loss) .....	(23,906)	(12,994)	17,329	38,078	41,374	352,209
Net income (loss) per						
share:						
Basic .....	(240.38)	(131.99)	176.37	389.54	446.34	3.80
Diluted .....	(240.38)	(131.99)	176.02	388.51	443.96	3.78
Basic weighted						
average shares						
outstanding .....	99,453,203	98,445,111	98,250,830	97,750,345	92,694,513	92,694,513
Diluted weighted						
average shares						
outstanding .....	99,453,203	98,445,111	98,446,136	98,010,739	93,191,540	93,191,540
<b>As of March 31,</b>						
	2002	2003	2004	2005	2006	2006
	(in millions)					(in thousands)
<b>Consolidated</b>						
<b>Balance Sheet</b>						
<b>Data:</b>						
Assets .....	¥ 307,562	¥ 281,224	¥ 330,808	¥ 296,769	¥ 350,776	\$ 2,986,090
Current installments						
of long-term debt....	43	2,243	4,543	20,043	30	255
Long-term debt, less						
current installments	26,868	24,626	20,083	40	10	85
Stockholders' equity ...	240,716	210,663	221,768	206,749	257,927	2,195,684
<b>Year ended March 31,</b>						
	2002	2003	2004	2005	2006	2006
	(in millions, except percentages)					(in thousands)
<b>Other Data:</b>						
Capital expenditures .....	¥ 13,254	¥ 7,564	¥ 5,621	¥ 9,348	¥ 8,327	\$ 70,852
Research and development						
expenses .....	26,674	23,615	21,637	26,280	26,927	229,224
Cash flows provided by						
operating activities .....	9,009	4,967	28,215	90,327	59,480	506,342
Cash flows used in investing						
activities .....	(18,573)	(8,419)	(5,070)	(8,250)	(8,542)	(72,716)
Cash flows used in financing						
activities .....	(9,463)	(14,488)	(6,376)	(63,036)	(18,336)	(156,091)
Operating margin <sup>(1)</sup> .....	(38.96)%	(17.13)%	17.77%	25.36%	25.38%	
Net income margin <sup>(2)</sup> .....	(25.10)%	(13.29)%	9.95%	15.90%	16.29%	

- (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 surplus 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.

Six months ended/Record date	Dividend per Share	
	Yen	Dollars
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
September 30, 2004 .....	25	0.23
March 31, 2005 .....	25	0.23
September 30, 2005 .....	25	0.22
March 31, 2006 .....	45	0.38

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, 2005 and 2006**

	2005	2006	2006
	Yen (Millions)		U.S. Dollars (Thousands)
<b>Assets</b>			
Current assets:			
Cash and cash equivalents.....	¥ 120,986	157,925	\$ 1,344,386
Trade receivables, net.....	56,702	69,567	592,211
Inventories.....	29,585	29,911	254,627
Deferred tax assets .....	13,673	13,708	116,694
Other current assets .....	2,985	4,522	38,494
Total current assets .....	223,931	275,633	2,346,412
Investment securities.....	7,772	12,273	104,478
Property, plant and equipment, net .....	51,364	50,793	432,391
Deferred tax assets.....	8,438	7,378	62,808
Intangible assets, net.....	3,090	2,858	24,330
Other assets.....	2,174	1,841	15,671
Total assets .....	¥ 296,769	350,776	\$ 2,986,090

See accompanying notes to consolidated financial statements.

**ADVANTEST CORPORATION  
AND SUBSIDIARIES**

**Consolidated Balance Sheets**

**March 31, 2005 and 2006**

	2005	2006	2006
	Yen (Millions)		U.S. Dollars (Thousands)
<b>Liabilities and Stockholders' Equity</b>			
Current liabilities:			
Current portion of long-term debt .....	¥ 20,043	30	\$ 255
Trade accounts payable .....	23,196	32,584	277,381
Income taxes payable .....	7,278	19,970	170,001
Accrued expenses .....	13,865	12,781	108,802
Accrued warranty expenses .....	4,090	4,776	40,657
Deferred revenue .....	2,220	2,979	25,360
Other current liabilities .....	3,302	3,625	30,860
Total current liabilities .....	73,994	76,745	653,316
Long-term debt, excluding current portion .....	40	10	85
Accrued pension and severance cost .....	12,605	12,292	104,639
Other liabilities .....	3,381	3,802	32,366
Total liabilities .....	90,020	92,849	790,406
Stockholders' equity:			
Common stock,			
Authorized 220,000,000 shares; issued 99,783,385 shares in 2005 and			
2006 .....	32,363	32,363	275,500
Capital surplus .....	35,263	37,147	316,225
Retained earnings .....	210,121	245,090	2,086,405
Accumulated other comprehensive income (loss) .....	(4,878)	1,344	11,441
Treasury stock, 7,359,770 shares in 2005 and 6,456,736 shares in 2006, at			
cost .....	(66,120)	(58,017)	(493,887)
Total stockholders' equity .....	206,749	257,927	2,195,684
Total liabilities and stockholders' equity .....	¥ 296,769	350,776	\$ 2,986,090

See accompanying notes to consolidated financial statements.

**ADVANTEST CORPORATION  
AND SUBSIDIARIES**

**Consolidated Statements of Income**

**Years ended March 31, 2004, 2005 and 2006**

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2006</u>
		Yen (Millions)		U.S. Dollars (Thousands)
Net sales.....	¥ 174,218	239,439	253,922	\$ 2,161,590
Cost of sales.....	85,513	115,994	121,429	1,033,702
Gross profit.....	88,705	123,445	132,493	1,127,888
Research and development expenses.....	21,637	26,280	26,927	229,224
Selling, general and administrative expenses.....	36,108	36,446	41,108	349,945
Operating income.....	30,960	60,719	64,458	548,719
Other income (expense):				
Interest and dividends income.....	339	597	1,760	14,983
Interest expense.....	(469)	(441)	(290)	(2,469)
Minority interests.....	(214)	(84)	—	—
Equity in losses of affiliates.....	(117)	—	—	—
Other.....	(1,621)	1,017	1,526	12,990
	(2,082)	1,089	2,996	25,504
Income before income taxes.....	28,878	61,808	67,454	574,223
Income taxes.....	11,549	23,730	26,080	222,014
Net income.....	¥ 17,329	38,078	41,374	\$ 352,209
	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2006</u>
		Yen		U.S. Dollars
Net income per share:				
Basic.....	¥ 176.37	389.54	446.34	\$ 3.80
Diluted.....	176.02	388.51	443.96	3.78

See accompanying notes to consolidated financial statements.

**ADVANTEST CORPORATION  
AND SUBSIDIARIES**

**Consolidated Statements of Stockholders' Equity**

**Years ended March 31, 2004, 2005 and 2006**

	2004	2005	2006	2006
		Yen (Millions)		U.S. Dollars (Thousands)
<b>Common stock:</b>				
Balance at beginning of year .....	¥ 32,363	32,363	32,363	\$ 275,500
Balance at end of year .....	32,363	32,363	32,363	275,500
<b>Capital surplus:</b>				
Balance at beginning of year .....	32,973	32,973	35,263	300,187
Stock option compensation expense .....	—	2,290	1,884	16,038
Balance at end of year .....	32,973	35,263	37,147	316,225
<b>Retained earnings:</b>				
Balance at beginning of year .....	162,547	177,404	210,121	1,788,721
Net income .....	17,329	38,078	41,374	352,209
Cash dividends .....	(2,456)	(4,915)	(4,625)	(39,372)
Loss on disposal of treasury stock .....	(16)	(446)	(1,780)	(15,153)
Balance at end of year .....	177,404	210,121	245,090	2,086,405
<b>Accumulated other comprehensive income (loss):</b>				
Balance at beginning of year .....	(4,055)	(8,061)	(4,878)	(41,526)
Other comprehensive income (loss), net of tax .....	(4,006)	3,183	6,222	52,967
Balance at end of year .....	(8,061)	(4,878)	1,344	11,441
<b>Treasury stock:</b>				
Balance at beginning of year .....	(13,165)	(12,911)	(66,120)	(562,867)
Treasury stock purchased .....	(32)	(54,513)	(55)	(468)
Exercise of stock options .....	180	1,302	8,157	69,439
Decrease in treasury stock upon share exchange .....	105	—	—	—
Treasury stock sold .....	1	2	1	9
Balance at end of year .....	(12,911)	(66,120)	(58,017)	(493,887)
Total stockholders' equity .....	¥ 221,768	206,749	257,927	\$ 2,195,684
<b>Disclosure of comprehensive income:</b>				
Net income .....	¥ 17,329	38,078	41,374	\$ 352,209
Other comprehensive income (loss), net of tax .....				
Foreign currency translation adjustments .....	(3,976)	1,635	5,074	43,194
Net unrealized gains on securities .....	1,366	152	1,148	9,773
Minimum pension liability adjustments .....	(1,396)	1,396	—	—
Total other comprehensive income (loss) .....	(4,006)	3,183	6,222	52,967
Total comprehensive income .....	¥ 13,323	41,261	47,596	\$ 405,176

See accompanying notes to consolidated financial statements.

**ADVANTEST CORPORATION  
AND SUBSIDIARIES**

**Consolidated Statements of Cash Flows**

**Years ended March 31, 2004, 2005 and 2006**

	2004	2005	2006	2006
		Yen (Millions)		U.S. Dollars (Thousands)
Cash flows from operating activities:				
Net income .....	¥ 17,329	38,078	41,374	\$ 352,209
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization.....	9,328	8,285	8,275	70,444
Deferred income taxes.....	6,703	13,540	1,005	8,555
Impairment loss on long-lived assets.....	3,030	—	—	—
Stock option compensation expense.....	—	2,290	1,884	16,038
Changes in assets and liabilities:				
Trade receivables.....	(35,285)	20,953	(11,072)	(94,254)
Inventories .....	(14,570)	20,218	108	919
Trade accounts payable.....	29,190	(16,375)	7,627	64,927
Income taxes payable.....	1,997	3,311	12,506	106,461
Accrued expenses .....	2,536	4,445	(1,261)	(10,735)
Accrued warranty expenses .....	709	969	610	5,193
Deferred revenue .....	3,441	(2,456)	548	4,665
Accrued pension and severance cost.....	2,639	(3,409)	(329)	(2,801)
Other .....	1,168	478	(1,795)	(15,280)
Net cash provided by operating activities .....	28,215	90,327	59,480	506,341
Cash flows from investing activities:				
Proceeds from sale of available-for-sale marketable securities...	323	1,428	2,977	25,343
Proceeds from sale of non-marketable securities.....	387	50	—	—
Purchases of marketable securities.....	—	—	(2,256)	(19,205)
Purchases of non-marketable securities .....	(1,288)	—	(1,900)	(16,174)
Proceeds from sale of property, plant and equipment.....	435	132	258	2,196
Purchases of intangible assets .....	(358)	(470)	(523)	(4,452)
Purchases of property, plant and equipment .....	(5,068)	(8,738)	(7,071)	(60,194)
Other .....	499	(652)	(27)	(230)
Net cash used in investing activities.....	(5,070)	(8,250)	(8,542)	(72,716)
Cash flows from financing activities:				
Principal payments on long-term debt .....	(3,811)	(4,543)	(20,043)	(170,622)
Proceeds from sale of treasury stock.....	90	939	6,378	54,295
Payments to acquire treasury stock.....	(31)	(54,511)	(57)	(485)
Dividends paid .....	(2,462)	(4,907)	(4,622)	(39,346)
Other .....	(162)	(14)	8	68
Net cash used in financing activities .....	(6,376)	(63,036)	(18,336)	(156,090)
Net effect of exchange rate changes on cash and cash equivalents..	(2,961)	799	4,337	36,920
Net change in cash and cash equivalents .....	13,808	19,840	36,939	314,455
Cash and cash equivalents at beginning of year.....	87,338	101,146	120,986	1,029,931
Cash and cash equivalents at end of year.....	¥ 101,146	120,986	157,925	\$ 1,344,386
Supplemental data:				
Cash paid during the year for:				
Income taxes.....	¥ 1,936	6,740	12,096	\$ 102,971
Interest.....	473	447	401	3,414

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***

The Company and subsidiaries (collectively “Advantest”) manufacture and sell semiconductor and component test system product group and mechatronics-related product group such as test handlers and device interfaces. Advantest also engages in research and development activities and provides maintenance and support services associated with these products.

Description of the business by segment is as follows:

The semiconductor and component test system segment provides customers with test system products for the semiconductor industry and the electronic parts industry. Product lines provided by the semiconductor and component test system segment include test systems for memory semiconductors for memory semiconductor devices and test systems for SoC semiconductors for non memory semiconductor devices.

The mechatronics system segment provides product lines such as test handlers, mechatronic-applied products, for handling semiconductor devices, device interfaces that serve as interfaces with the devices that are measured and operations related to nano-technology products.

The services, support and others segment consists of comprehensive customer solutions provided in connection with the above segments, support services, equipment lease business and others.

***(b) Principles of Consolidation***

The Company and its domestic subsidiaries maintain their records and also prepare their statutory 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 accounts of the Company and its majority owned subsidiaries. Advantest is not involved with any variable interest entities as defined by FASB Interpretation No. 46 (revised December 2003) “Consolidation of Variable Interest Entities”. All significant intercompany balances and transactions have been eliminated in consolidation.

***(c) Cash Equivalents***

Cash equivalents primarily consist of deposits and certificates of deposit with an initial maturity of three months or less from the date of purchase. 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 an allowance for doubtful accounts to ensure that trade receivables are not overstated due to uncollectability, which represents Advantest’s best estimate of the amount of probable credit losses in Advantest’s existing trade receivables. 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 by the equity method. All significant intercompany profits from affiliates have been eliminated.

### ***(g) Investment Securities***

Investment securities at March 31, 2005 and 2006 consist of marketable and non-marketable equity securities. Advantest classifies its marketable equity securities as available-for-sale.

Available-for-sale securities are recorded at fair value. Unrealized gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a 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 an impairment loss. 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, 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 the date of evaluation compared to that of the 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. The 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 average cost method.

Non-marketable investment securities are carried at cost. On a periodic basis, Advantest evaluates the investments for the possible impairment. If the fair value of the investment securities is estimated to have declined and such decline is judged to be other than temporary, Advantest recognizes the impairment of the investment and the carrying value is reduced to its fair value. The impairment is charged to earnings and a new cost basis for the security is established.

### ***(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 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, 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 receivables. 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.

Depreciation is computed principally using the declining-balance method except for buildings 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. 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.

Depreciation expense was ¥7,563 million, ¥7,231 million and ¥7,517 million (\$63,991 thousand) in the years ended March 31, 2004, 2005 and 2006, respectively.

#### ***(j) Intangible Assets and Other Assets***

Intangible assets principally consist of licenses, goodwill and computer software for internal-use. Other assets consist of investments (other than investment securities), 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 Semiconductor Test Systems 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 on a straight-line basis over the estimated useful life, which is generally five 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 March 31, 2005 and 2006 and identified no indication of impairment.

#### ***(k) Impairment of Long-Lived Assets***

Advantest evaluates the impairment of 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 undiscounted 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.

For the year ended March 31, 2004, one of the former independent cash flow-generating units, the measuring instruments' assets group reported operating losses for two consecutive years, and future operating results of the assets group was not expected to be profitable, due to the customers' continuously inactive industries such as wireless communications. Since 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, 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 was ¥3,030 million and is included in selling, general and administrative expenses for the year ended March 31, 2004. The impairment loss consisted of ¥1,226 million from buildings, ¥175 million from machinery and equipment, ¥683 million from furniture and fixtures, ¥681 million from software, and ¥265 million 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 and support during warranty periods, estimated repair and support expenses over the warranty period are accrued based on the historical ratio of actual repair and support 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. 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 (17) to the consolidated financial statements for further discussion.

### ***(n) Revenue Recognition***

In accordance with the guidance provided by the Securities and Exchange Commission's Staff Accounting Bulletin No. 104, "Revenue Recognition," Advantest recognizes revenue when there is persuasive evidence of an arrangement, title and risk of loss have passed, delivery has occurred or the services have been rendered, the sales price is fixed or determinable and collection of the related receivable is reasonably assured.

#### Revenue from Sales of Products

Revenue from sales of products which require installation work is recognized when the related installation work is completed. The revenue recognized upon completion of installation is limited to the amount that is payable based on customer acceptance. Revenue from sales of products and component 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.

For equipment sales involving software that is more than incidental to the product, revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection of the related receivable is probable in accordance with American Institute of Certified Public Accountant ("AICPA") Statement of Position ("SOP") No. 97-2, "Software Revenue Recognition," as amended by SOP No. 98-9, "Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions." Revenue for the separate elements is only recognized when the functionality of the undelivered element is not essential to the delivered element.

#### Revenue from Long-term Service contracts

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 primarily 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.

Advantest enters into certain revenue arrangements with multiple deliverables, which include combination of 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 from the adoption of such provisions was insignificant.

### ***(o) Shipping and Handling Costs***

Shipping and handling costs totaled ¥1,011 million, ¥1,329 million and ¥1,451 million (\$12,352 thousand) for the years ended March 31, 2004, 2005 and 2006, respectively, and are included in selling, general and administrative expenses in the consolidated statements of income.

**(p) Research and Development**

Research and development costs totaled ¥21,637 million, ¥26,280 million and ¥26,927 million (\$229,224 thousand) for the years ended March 31, 2004, 2005 and 2006, respectively, and are expensed as incurred.

**(q) Advertising Costs**

Advertising costs totaled ¥384 million, ¥798 million and ¥469 million (\$3,993 thousand) for the years ended March 31, 2004, 2005 and 2006, respectively, and are expensed as incurred.

**(r) Stock-Based Compensation**

Prior to April 1, 2004, the Company accounted for stock-based compensation plans by applying the intrinsic value-based method of accounting under the recognition and measurement provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations, as permitted by SFAS No. 123, "Accounting for Stock-Based Compensation." No stock-based employee compensation cost was recognized in the statement of income for the year ended March 31, 2004. Effective April 1, 2004, the Company early adopted the fair value recognition provisions of SFAS No. 123 (revised 2004) ("SFAS No. 123R"), "Share Based Payment", using the modified-retrospective method. The fair value of the options is estimated using a Black Scholes option pricing model and amortized to expense over the options' vesting periods.

The following table illustrates the effect on net income and earnings per share as if Advantest had applied the fair value recognition provisions of SFAS No. 123 to options granted under the stock option plans for the year ended March 31, 2004.

	Yen (Millions, except for per share data)
Net income:	
As reported.....	¥ 17,329
Deduct: stock-based employee compensation expense.....	(1,963)
Pro forma.....	¥ 15,366
Basic net income per share:	
As reported.....	¥ 176.37
Pro forma.....	156.39
Diluted net income per share:	
As reported.....	¥ 176.02
Pro forma.....	156.08

No stock-based compensation expense was reflected in net income, as reported, for the year ended March 31, 2004. Stock based compensation expense of ¥2,290 million and ¥1,884 million (\$16,038 thousand) were included in selling, general and administrative expenses for the years ended March 31, 2005 and 2006, respectively.

The per share weighted average fair value of stock options granted during the years ended March 31, 2004, 2005 and 2006 were ¥2,570, ¥2,993 and ¥2,437 (\$21) on the date of grant using the Black Scholes option pricing model with the following weighted-average assumptions:

	2004	2005	2006
Expected dividend yield.....	0.8%	0.5%	0.5%
Risk free interest rate.....	0.6%	0.6%	0.4%
Volatility.....	69.5%	56.6%	51.0%
Expected life.....	4 years	4 years	2.4 years

Prior to April 1, 2005, the Company had used certain assumptions to determine the expected term of the Company's stock option plan. However, because of the changes in grantees' exercise behaviors for the year ended March 31, 2006, the previous assumptions no longer provide a reasonable expected term. Accordingly, the Company determined the expected term for stock options granted after April 1, 2005 by using "simplified" method accepted by the SEC Staff Accounting Bulletin(SAB) No. 107. Under this method, the expected term is assumed to be the mid-point between the vesting date and the end of the contractual term. The use of the simplified method is only permitted for stock options granted through December 31, 2007.

***(s) 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. Advantest records a valuation allowance to reduce the deferred tax assets to the amount that is more likely than not realizable.

***(t) Net Income per Share***

Basic net income per share is calculated by dividing net income 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, 2004, 2005 and 2006, Advantest had outstanding stock options and warrants exercisable into 329,500, 7,000 and 2,000 shares of common stock, respectively, which were anti-dilutive and excluded from the calculation of diluted net income per share but could potentially dilute net income per share in future periods.

***(u) 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, assets and liabilities of non-Japanese subsidiaries, which have a functional currency other than the Japanese yen, are translated at the rate of exchange on the balance sheet date. Revenue and expense accounts are translated at the average rate of exchange in effect during the year. Resulting translation adjustments are included as a component of accumulated other comprehensive income (loss).

***(v) Foreign Currency Transactions***

Assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable current rate prevailing at that date. All revenue and expenses associated with foreign currencies are converted at the rate 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.

***(w) 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 statements 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 receivables, inventories and deferred tax assets, various accruals such as accrued warranty expenses, and assets and obligations related to employees retirement and severance plans. Actual results could differ from those estimates.

***(x) New Accounting Standards***

In November 2004, the FASB issued SFAS No.151, "Inventory Costs-an amendment of ARB No. 43, Chapter 4" ("SFAS 151"). SFAS 151 amends the guidance in ARB No.43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Among other provisions, the new rule requires that items such as idle facility expense, excessive spoilage, double freight, and rehandling costs be recognized as current period charges regardless of whether they meet the criterion of "so abnormal" as stated in ARB No. 43. Additionally, SFAS 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for fiscal years beginning after June 15, 2005 and is required to be adopted by Advantest in the first quarter beginning April 1, 2006. Advantest is currently evaluating the effect that the adoption of SFAS 151 will have on its consolidated results of operations and financial condition but does not expect SFAS 151 to have a material impact.

In December 2004, the FASB issued SFAS No.153, "Exchange of Nonmonetary Assets-an amendment of APB Opinion No.29" ("SFAS 153"), which eliminates the exception from fair value measurement for nonmonetary exchanges of

similar productive assets in paragraph 21(b) of APB Opinion No.29, "Accounting for Nonmonetary Transactions", and replaces it with an exception for exchanges that do not have commercial substance. SFAS 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 is effective for the fiscal periods beginning after June 15, 2005 and was adopted by Advantest in the second quarter beginning July 1, 2005. The adoption of SFAS 153 did not have a material impact on the consolidated results of operations and financial condition.

In May 2005, the FASB issued SFAS No.154, "Accounting Changes and Error Corrections" ("SFAS 154"). SFAS 154 replaces APB Opinion No.20, "Accounting Changes" and SFAS No.3 "Reporting Accounting Changes in Interim Financial Statements," and provides guidance on the accounting for and reporting of accounting changes and error corrections. SFAS 154 establishes retrospective application, or the latest practicable date, as the required method for reporting a change in accounting principle and the reporting of a correction of an error. SFAS 154 is effective for accounting changes and corrections of errors made in the fiscal years beginning after December 15, 2005 and is required to be adopted by Advantest in the first quarter beginning April 1, 2006. Advantest is currently evaluating the effect that the adoption of SFAS 154 will have on its consolidated results of operations and financial condition but does not expect SFAS 154 to have a material impact.

In November 2005, the FASB issued FASB Staff Position FAS 115-1 and FAS 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("FSP 115-1"), which provides guidance on determining when investments in certain debt and equity securities are considered impaired, whether that impairment is other-than-temporary, and on measuring such impairment loss. FSP 115-1 also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. FSP 115-1 is required to be applied to reporting periods beginning after December 15, 2005 and was adopted by Advantest in the fourth quarter beginning January 1, 2006. The adoption of FSP 115-1 did not have a material impact on the consolidated results of operations and financial condition.

## (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, a rate of ¥117.47 per U.S.\$1, the approximate current exchange rate at March 31, 2006, was used for the convenience translation of the accompanying financial results of Advantest as of and for the year ended March 31, 2006.

## (3) Trade Receivables

Trade receivables at March 31, 2005 and 2006 are as follows:

	2005	2006	2006
	Yen (Millions)		U.S. Dollars (Thousands)
Notes.....	¥ 14,133	4,905	\$ 41,755
Accounts .....	44,743	66,779	568,477
	58,876	71,684	610,232
Less allowance for doubtful accounts.....	2,174	2,117	18,021
	¥ 56,702	69,567	\$ 592,211

## (4) Allowance for Doubtful Accounts

Changes in the allowance for doubtful accounts for the years ended March 31, 2004, 2005 and 2006 were as follows:

	2004	2005	2006	2006
	Yen (Millions)			U.S. Dollars (Thousands)
Balance at beginning of year .....	¥ 1,240	2,464	2,174	\$ 18,507
Amount written off .....	(17)	(51)	(12)	(102)
Reversal of doubtful accounts.....	(212)	(397)	(84)	(715)
Provision for doubtful accounts.....	1,453	158	39	331
Balance at end of year.....	¥ 2,464	2,174	2,117	\$ 18,021

## (5) Inventories

Inventories at March 31, 2005 and 2006 are composed of the following:

	2005	2006	2006
	Yen (Millions)		U.S. Dollars (Thousands)
Finished goods.....	¥ 7,347	6,974	\$ 59,369
Work in process.....	16,879	15,944	135,728
Raw materials and supplies.....	5,359	6,993	59,530
	¥ 29,585	29,911	\$ 254,627

## (6) Property, Plant and Equipment

Property, plant and equipment at March 31, 2005 and 2006 is composed of the following:

	2005	2006	2006
	Yen (Millions)		U.S. Dollars (Thousands)
Land.....	¥ 19,192	18,995	\$ 161,701
Buildings.....	49,641	49,175	418,618
Machinery and equipment.....	27,162	30,350	258,364
Furniture and fixtures.....	22,934	24,335	207,159
Construction in progress.....	349	69	587
	119,278	122,924	1,046,429
Less accumulated depreciation.....	67,914	72,131	614,038
	¥ 51,364	50,793	\$ 432,391

## (7) Goodwill and Other Intangible Assets

The components of acquired intangible assets excluding goodwill at March 31, 2005 and 2006 were as follows:

	2005		2006	
	Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated amortization
	Yen (Millions)			
Intangible assets subject to amortization:				
Software.....	¥ 4,976	3,668	¥ 5,551	4,425
Other.....	1,473	1,343	422	342
Total.....	¥ 6,449	5,011	¥ 5,973	4,767

	2006	
	Gross carrying amount	Accumulated amortization
	U.S. dollars (Thousands)	
Intangible assets subject to amortization:		
Software.....	\$ 47,255	37,670
Other.....	3,592	2,911
Total.....	\$ 50,847	40,581

Intangible assets not subject to amortization at March 31, 2005 and 2006 were insignificant.

Aggregate amortization expense for the years ended March 31, 2004, 2005 and 2006 was ¥1,765 million, ¥1,054 million and ¥758 million (\$6,453 thousand), respectively. Estimated amortization expense for the next five years ending March 31 is: ¥557 million (\$4,742 thousand) in 2007, ¥286 million (\$2,435 thousand) in 2008, ¥184 million (\$1,566 thousand) in 2009, ¥109 million (\$928 thousand) in 2010, and ¥42 million (\$358 thousand) in 2011, respectively.

Changes in the carrying amount of goodwill for the years ended March 31, 2005 and 2006 were as follows:

	2005	2006	2006
	Yen (Millions)		U.S. Dollars (Thousands)
Balance at beginning of year .....	¥ 1,426	1,426	\$ 12,139
Acquisition during the year.....	—	—	—
Balance at end of year.....	¥ 1,426	1,426	\$ 12,139

The goodwill relates to the semiconductor and component test system segment.

### (8) Investment Securities

Marketable securities consist of equity securities. The acquisition cost, gross unrealized gains, gross unrealized losses and fair value at March 31, 2005 and 2006 were as follows:

2005				
	Acquisition cost	Gross unrealized gains	Gross unrealized losses	Fair value
Yen (Millions)				
Noncurrent:				
Available-for-sale:				
Equity securities .....	¥ 3,803	2,516	—	6,328
2006				
	Acquisition cost	Gross unrealized gains	Gross unrealized losses	Fair value
Yen (Millions)				
Noncurrent:				
Available-for-sale:				
Equity securities .....	¥ 4,424	4,559	8	8,975
2006				
	Acquisition cost	Gross unrealized gains	Gross unrealized losses	Fair value
U.S. dollars (Thousands)				
Noncurrent:				
Available-for-sale:				
Equity securities .....	\$ 37,661	38,810	69	76,402

Gross realized gains and losses on available-for-sales equity securities for the years ended March 31, 2004, 2005 and 2006 were as follows:

2004				2005	
	Gross realized gains	Gross realized losses	Gross realized gains	Gross realized losses	
Yen (Millions)			Yen (Millions)		
Noncurrent:					
Available-for-sale:					
Equity securities .....	¥ 178	2	¥ 934	—	

	2006		2006	
	Gross realized gains	Gross realized losses	Gross realized gains	Gross realized losses
	Yen (Millions)		U.S. dollars (Thousands)	
Noncurrent:				
Available-for-sale:				
Equity securities .....	¥ 1,040	—	\$ 8,853	—

Gross realized gains and losses based on the averaged cost method 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.

Proceeds from the sale of available-for-sales equity securities for the years ended March 31, 2004, 2005 and 2006 were ¥323 million, ¥1,428 million and ¥2,977 million (\$25,343 thousand), respectively.

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, 2006, were as follows:

	Less than 12 months		12 months or longer	
	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses
	Yen (Millions)			
Noncurrent:				
Available-for-sale:				
Equity securities .....	¥ 280	8	—	—

	Less than 12 months		12 months or longer	
	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses
	U.S. dollars (Thousands)			
Noncurrent:				
Available-for-sale:				
Equity securities .....	\$ 2,384	68	—	—

Advantest maintains non-marketable investment securities, which are recorded at cost. The carrying amounts of non-marketable investment securities were ¥1,444 million and ¥3,298 million (\$28,076 thousand) at March 31, 2005 and 2006, respectively. For the year ended March 31, 2006, Advantest recognized impairment losses of ¥51 million (\$434 thousand) on non-marketable investment securities, which were considered other-than-temporarily impaired and wrote them down to the fair value. The remaining investment securities with an aggregate cost of ¥3,147 million (\$26,790 thousand) did not have indicators of impairment.

## (9) Derivative Financial Instruments

Derivative financial instruments are utilized by Advantest primarily to reduce foreign currency exchange risk. Advantest does not hold or issue derivative financial instruments for trading purposes. Advantest generally does not require or place collateral for these derivative 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 foreign exchange forward contracts to exchange currencies among Japanese yen, U.S. dollars and Euro at March 31, 2005 and 2006. The notional amounts of these contracts were ¥7,603 million at March 31, 2005 and ¥10,929 million (\$93,037 thousand) at March 31, 2006. The fair values of these contracts at March 31, 2005 are ¥1 million and ¥49 million, which are included in other current assets and other current liabilities, respectively. The fair values of these contracts at March 31, 2006 are ¥57 million (\$485 thousand) and ¥15 million (\$128 thousand), which are included in other current assets and other current liabilities, respectively. 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 value are recognized in earnings under the caption of other income (expense).

### (10) Fair Value of Financial Instruments

The following table presents the carrying amounts and estimated fair values of Advantest's financial instruments at March 31, 2005 and 2006, except for cash and cash equivalents, trade receivables, other current assets, trade accounts payable and accrued expenses for which fair value approximate their carrying amounts. 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.

	2005		2006	
	Carrying amount	Fair value	Carrying amount	Fair value
	Yen (Millions)			
Financial assets:				
Investment securities for which it is:				
Practicable to estimate fair value .....	¥ 6,328	6,328	¥ 8,975	8,975
Not practicable to estimate fair value .....	1,444	—	3,298	—
Foreign exchange forward contracts .....	1	1	57	57
Financial liabilities:				
Foreign exchange forward contracts .....	49	49	15	15
Long-term debt including current portion .....	20,083	20,354	40	43
			2006	
			Carrying amount	Fair value
			U.S. Dollars (Thousands)	
Financial assets:				
Investment securities for which it is:				
Practicable to estimate fair value .....		\$ 76,402	76,402	
Not practicable to estimate fair value .....		28,076	—	
Foreign exchange forward contracts .....		485	485	
Financial liabilities:				
Foreign exchange forward contracts .....		128	128	
Long-term debt including current portion .....		340	366	

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 receivables, 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 long-term debt is estimated by discounting 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.

### (11) Leases—Lessor

Advantest provides leases that enable its customers to use semiconductor test systems. 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 under operating leases as of March 31, 2005 and 2006 were as follows:

	2005	2006	2006
	Yen (Millions)		U.S. Dollars (Thousands)
Machinery and equipment .....	¥ 8,221	9,687	\$ 82,464
Less accumulated depreciation .....	3,450	4,890	41,628
	¥ 4,771	4,797	\$ 40,836

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 under noncancelable operating leases as of March 31, 2006 is as follows:

Year ending March 31	Yen (Millions)	U.S. Dollars (Thousands)
2007 .....	¥ 1,526	\$ 12,991
2008 .....	556	4,733
2009 .....	160	1,362
2010 .....	24	204
2011 .....	1	9
Total minimum lease income .....	¥ 2,267	\$ 19,299

## (12) Leases—Lessee

Tangible and intangible assets under capital leases at March 31, 2005 and 2006 were insignificant.

Advantest also has several noncancelable operating leases, primarily for office space and office equipment that expire within the next five years. Rent expense, including rental payments for cancelable leases, for the years ended March 31, 2004, 2005 and 2006 was ¥1,352 million, ¥1,423 million and ¥1,408 million (\$11,986 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, 2006 are as follows:

Year ending March 31	Yen (Millions)	U.S. Dollars (Thousands)
2007 .....	¥ 296	\$ 2,520
2008 .....	188	1,600
2009 .....	130	1,107
2010 .....	98	834
Total minimum lease payments.....	¥ 712	\$ 6,061

## (13) Short-Term and Long-Term Debt

Long-term debt at March 31, 2005 and 2006 consists of the following:

	2005	2006	2006
	Yen (Millions)		U.S. Dollars (Thousands)
Partially secured borrowings by mortgage of property, plant and equipment, due 2005 to 2008 with annual interest rates ranging from 1.05% to 4.125% in 2005 and 2006	¥ 83	40	\$ 340
Unsecured 1.88% bonds, due December 14, 2005.....	20,000	—	—
Total long-term debt.....	20,083	40	340
Less current portion.....	20,043	30	255
Long-term debt, excluding current portion.....	¥ 40	10	\$ 85

At March 31, 2005, property, plant and equipment with a carrying amount of ¥393 million was pledged as collateral for certain debt obligations in the amount of ¥24 million.

The aggregate maturities of long-term debt for each of the five years subsequent to March 31, 2006 are as follows:

Year ending March 31	Yen (Millions)	U.S. Dollars (Thousands)
2007 .....	¥ 30	\$ 255
2008 .....	10	85
Total long-term debt.....	¥ 40	\$ 340

#### (14) Income Taxes

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

	2004	2005	2006	2006
		Yen (Millions)		U.S. Dollars (Thousands)
Income before income taxes:				
The Company and domestic subsidiaries .....	¥ 20,096	47,020	54,877	\$ 467,157
Foreign subsidiaries.....	8,782	14,788	12,577	107,066
	¥ 28,878	61,808	67,454	\$ 574,223
Provision (benefit) for income taxes:				
Current:				
The Company and domestic subsidiaries .....	¥ 1,356	5,719	19,831	\$ 168,818
Foreign subsidiaries.....	3,490	4,471	5,244	44,641
Deferred:				
The Company and domestic subsidiaries .....	6,749	13,424	747	6,359
Foreign subsidiaries.....	(46)	116	258	2,196
	¥ 11,549	23,730	26,080	\$ 222,014

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 7.2% and 10.1%, which in the aggregate resulted in a statutory income tax rate of 40.3% for the year ended March 31, 2005 and 2006. 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 40.3% effective from the year beginning April 1, 2004. Consequently, the statutory tax rate was to be lowered to 40.3% applicable for deferred tax assets and liabilities expected to be settled or realized subsequent to April 1, 2004. The adjustment of deferred tax assets and liabilities for this change in the tax rate was ¥143 million and reflected in the consolidated statements of operations 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:

	2004	2005	2006
Statutory tax rate.....	42.0%	40.3%	40.3%
Increase (reduction) in income taxes resulting from:			
Earnings of foreign subsidiaries taxed at different rate from the statutory rate in Japan.....	(2.7)	(2.3)	(1.8)
Tax credits earned .....	(0.5)	(1.4)	(3.8)
Expenses not deductible for tax purposes .....	1.2	1.7	1.3
Tax on undistributed earnings .....	—	—	2.2
Change in valuation allowance.....	(0.3)	(0.3)	(0.0)
Tax rate change .....	(0.5)	—	—
Other, net.....	0.8	0.4	0.5
	40.0%	38.4%	38.7%

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at March 31, 2005 and 2006 are presented below.

	2005	2006	2006
	Yen (Millions)		U.S. Dollars (Thousands)
Deferred tax assets:			
Inventories.....	¥ 4,950	4,379	\$ 37,278
Tax effect on intercompany profit.....	2,534	2,651	22,567
Accrued warranty expenses.....	1,060	1,696	14,438
Accrued pension and severance cost.....	5,049	4,970	42,309
Accrued expenses.....	4,543	4,891	41,636
Research and development expenses capitalized for tax purposes.....	1,957	1,361	11,586
Operating loss carryforwards.....	444	330	2,809
Property, plant and equipment and intangible assets.....	689	1,528	13,008
Tax credits.....	2,048	18	153
Other.....	2,241	2,533	21,563
Total gross deferred tax assets.....	25,515	24,357	207,347
Less valuation allowance.....	3,025	1,263	10,752
Net deferred tax assets.....	22,490	23,094	196,595
Deferred tax liabilities:			
Net unrealized gains on marketable securities.....	874	1,807	15,383
Tax on undistributed earnings.....	—	1,467	12,488
Other.....	44	46	392
Total gross deferred tax liabilities.....	918	3,320	28,263
Net deferred tax assets.....	¥ 21,572	19,774	\$ 168,332

Included in other current liabilities and other liabilities are deferred tax liabilities of ¥539 million, ¥1,312 million (\$11,169 thousand) at March 31, 2005 and 2006, respectively.

The net changes in the valuation allowance for the years ended March 31, 2004, 2005 and 2006 were increases of ¥509 million and ¥876 million and a decrease of ¥1,762 million (\$15,000 thousand), respectively.

Net operating loss carryforwards utilized during the years ended March 31, 2004, 2005 and 2006 were ¥24,510 million, ¥31,132 million and ¥777 million (\$6,614 thousand), respectively.

At March 31, 2006, Advantest had net operating loss carried forwards for income tax purposes of approximately ¥821 million (\$6,989 thousand) which are available to reduce future income taxes, if any. These operating losses will expire starting from the year ending March 31, 2009 through the year ending March 31, 2013.

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 deferred tax liabilities has been recognized on undistributed earnings of these subsidiaries not expected to be remitted in the foreseeable future, aggregating ¥53,951 million (\$459,272 thousand) at March 31, 2006. Deferred tax liabilities will be recognized when Advantest expects that it will realize those undistributed earnings in a taxable manner, such as through receipt of dividends or sale of the investments. The related deferred tax liability would have been ¥8,621 million (\$73,391 thousand) at March 31, 2006.

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, 2006, Advantest has recorded on its consolidated balance sheet, net deferred tax assets of ¥19,774 million (\$168,332 thousand). 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 market and semiconductor and component test systems market prospects and other factors, management believes it is more likely than not that Advantest will realize the benefits of these deductible differences, net of the existing valuation allowance, at March 31, 2006. 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.

### (15) Other Comprehensive Income (Loss)

The accumulated balances for each classification of other comprehensive income (loss) for the years ended March 31, 2004, 2005 and 2006 are as follows:

	Foreign currency translation adjustments	Net unrealized gains on securities	Minimum pension liability adjustments	Accumulated other comprehensive income (loss)
	Yen (Millions)			
Balance at April 1, 2003 .....	¥ (4,111)	56	—	(4,055)
Change during the year .....	(3,976)	1,330	(1,396)	(4,042)
Reclassification adjustments for realized portion .....	—	36	—	36
	<u>(3,976)</u>	<u>1,366</u>	<u>(1,396)</u>	<u>(4,006)</u>
Balance at March 31, 2004 .....	¥ (8,087)	1,422	(1,396)	(8,061)
Change during the year .....	1,635	583	1,396	3,614
Reclassification adjustments for realized portion .....	—	(431)	—	(431)
	<u>1,635</u>	<u>152</u>	<u>1,396</u>	<u>3,183</u>
Balance at March 31, 2005 .....	¥ (6,452)	1,574	—	(4,878)
Change during the year .....	5,074	1,862	—	6,936
Reclassification adjustments for realized portion .....	—	(714)	—	(714)
	<u>5,074</u>	<u>1,148</u>	<u>—</u>	<u>6,222</u>
Balance at March 31, 2006 .....	¥ (1,378)	2,722	—	1,344
	U.S. Dollars (Thousands)			
Balance at March 31, 2005 .....	\$ (54,925)	13,399	—	(41,526)
Change during the year .....	43,194	15,851	—	59,045
Reclassification adjustments for realized portion .....	—	(6,078)	—	(6,078)
	<u>43,194</u>	<u>9,773</u>	<u>—</u>	<u>52,967</u>
Balance at March 31, 2006 .....	\$ (11,731)	23,172	—	11,441

The related tax effects allocated to each component of other comprehensive income (loss) for the years ended March 31, 2004, 2005 and 2006 are as follows:

	Before-tax amount	Tax (expense) or benefit	Net-of-tax amount
	Yen (Millions)		
<b>Year ended March 31, 2004:</b>			
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 .....	36	—	36
Net unrealized gains .....	<u>1,974</u>	<u>(608)</u>	<u>1,366</u>
Minimum pension liability adjustments .....	(2,339)	943	(1,396)
Other comprehensive income (loss) .....	<u>¥ (4,341)</u>	<u>335</u>	<u>(4,006)</u>
<b>Year ended March 31, 2005:</b>			
Foreign currency translation adjustments .....	¥ 1,635	—	1,635
Net unrealized gains on securities:			

Net unrealized gains arising during the year .....	857	(274)	583
Less reclassification adjustments for net gains realized in earnings .....	(431)	—	(431)
Net unrealized gains .....	426	(274)	152
Minimum pension liability adjustments.....	2,339	(943)	1,396
Other comprehensive income (loss).....	¥ 4,400	(1,217)	3,183
<b>Year ended March 31, 2006:</b>			
Foreign currency translation adjustments .....	¥ 5,074	—	5,074
Net unrealized gains on securities:			
Net unrealized gains arising during the year .....	3,119	(1,257)	1,862
Less reclassification adjustments for net gains realized in earnings .....	(1,076)	362	(714)
Net unrealized gains .....	2,043	(895)	1,148
Minimum pension liability adjustments.....	—	—	—
Other comprehensive income (loss).....	¥ 7,117	(895)	6,222
	<b>Before-tax amount</b>	<b>Tax (expense) or benefit</b>	<b>Net-of-tax amount</b>
	<b>U.S. Dollars (Thousands)</b>		
<b>Year ended March 31, 2006:</b>			
Foreign currency translation adjustments .....	\$ 43,194	—	43,194
Net unrealized gains on securities:			
Net unrealized gains arising during the year .....	26,552	(10,701)	15,851
Less reclassification adjustments for net gains realized in earnings .....	(9,160)	3,082	(6,078)
Net unrealized gains .....	17,392	(7,619)	9,773
Minimum pension liability adjustments.....	—	—	—
Other comprehensive income (loss).....	\$ 60,586	(7,619)	52,967

## (16) 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 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 directors and selected employees of the Company and its subsidiaries. By exercising a warrant, directors and selected employees could purchase the shares of the Company, the number of which was 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 prices 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 and 2001 expired in accordance with their original terms during the years ended March 31, 2004 and 2005.

In July 2002, stock options were issued to directors, corporate auditors and certain employees of the Company and its subsidiaries 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 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 are exercisable from 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 are exercisable from May 1, 2003.

In June 2003, stock options were issued to directors, executive officers, corporate auditors and certain employees of the Company and its subsidiaries 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 are exercisable from 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, those 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 are exercisable from April 1, 2004.

In July 2004, stock options were issued to directors, executive officers, corporate auditors and certain employees of the Company and its subsidiaries under a stock option plan approved by the Board of Directors. The number of granted shares totaled 761,000. Options were granted with an exercise price of ¥7,464 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 are exercisable from April 1, 2005.

In November 2004, stock options were issued to certain employees of foreign subsidiaries under a stock option plan approved by the Board of Directors. The number of granted shares totaled 4,000. Options were granted with an exercise price of ¥7,464 per share that is equal to the exercise price of the July 2004 options. The options have an exercise period of 4 years and are exercisable from April 1, 2005.

In April 2005, stock options were issued to certain employees of foreign subsidiaries under a stock option plan approved by the Board of Directors. The number of granted shares totaled 4,000. Options were granted with an exercise price of ¥7,464 per share that is equal to the exercise price of the July 2004 options. The options have an exercise period of 4 years and are exercisable from April 1, 2005.

In July 2005, stock options were issued to directors, executive officers, corporate auditors and certain employees of the Company and its subsidiaries under a stock option plan approved by the Board of Directors. The number of granted shares totaled 759,000. Options were granted with an exercise price of ¥8,600 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 are exercisable from April 1, 2006.

In December 2005, stock options were issued to certain employees of foreign subsidiaries under a stock option plan approved by the Board of Directors. The number of granted shares totaled 8,000. Options were granted with an exercise price of ¥8,600 per share that is equal to the exercise price of the July 2005 options. The options have an exercise period of 4 years and are exercisable from April 1, 2006.

In February 2006, stock options were issued to certain employees of foreign subsidiaries under a stock option plan approved by the Board of Directors. The number of granted shares totaled 2,000. Options were granted with an exercise price of ¥13,403 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) ¥8,600 per share that is equal to the exercise price of the July 2005 options. The options have an exercise period of 4 years and are exercisable from April 1, 2006.

The exercise price of the stock options is subject to adjustment, if there is a stock split or consolidation of shares, or if new shares are issued or treasury stocks are sold at a price that is less than the market price.

Stock option activity during the years ended March 31, 2004, 2005 and 2006 is as follows:

	2004		2005		2006	
	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price	Number of shares	Weighted average exercise price
Outstanding at beginning of year.....	1,113,800	¥ 10,942	1,772,500	¥ 7,973	2,064,000	¥ 7,021
Granted .....	764,000	5,288	765,000	7,464	773,000	8,607
Exercised .....	(21,000)	(8,148)	(152,000)	5,632	(908,000)	7,023
Expired.....	(84,300)	(21,060)	(321,500)	13,981	—	—
Outstanding at end of year .....	<u>1,772,500</u>	7,973	<u>2,064,000</u>	7,021	<u>1,929,000</u>	7,656
Exercisable at end of year.....	1,022,500	¥ 9,982	1,299,000	¥ 6,760	1,160,000	¥ 7,021

Cash received from option exercises under stock option plans for the years ended March 31, 2005 and 2006 was ¥937 million and ¥6,377 million (\$54,286 thousand), respectively.

At March 31, 2006, all of the outstanding stock options were as follows:

Exercise price	Outstanding			Exercisable		
	Number of options	Weighted average exercise price	Weighted average remaining contractual life	Number of options	Weighted average exercise price	Weighted average remaining contractual life
¥ 5,160	310,000	¥ 5,160	2.0 years	310,000	¥ 5,160	2.0 years
7,464 - 9,220	1,617,000	8,127	3.1 years	850,000	7,700	2.3 years
13,403	2,000	13,403	4.0 years	—	—	—
	<u>1,929,000</u>	7,656	2.9 years	<u>1,160,000</u>	7,021	2.2 years

The aggregate intrinsic values of stock options outstanding and exercisable at March 31, 2006 were ¥12,296 million (\$104,674 thousand) and ¥8,130 million (\$69,209 thousand), respectively.

### (17) 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 certain subsidiaries are entitled to lump-sum payments.

The Company and its domestic subsidiaries also had a contributory defined benefit retirement and severance plan covering substantially all employees. The contributory plan 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.

In January 2003, the Emerging Issues Task Force reached a final consensus on Issue No. 03-2 ("EITF 03-2"), "Accounting for the Transfer to the Japanese Government of the Substitutional Portion of Employee Pension Fund Liabilities," which addresses accounting for a transfer to the Japanese government of a substitutional portion of an EPF. On October 1, 2004, the Company and certain of its consolidated domestic subsidiaries received approval from the Minister of Health and Labor to return the substitutional portion of its EPF for the prior employees' services under the transfer of its EPF to the defined benefit corporate pension plan, and made the payment of the amount pertinent to the return (minimum liability reserve) to the national treasury on February 24, 2005. Advantest accounted for the elimination of future benefits and relief of past obligations with the transfer of assets as the culmination of a series of steps in a single settlement transaction and recognized a net gain of ¥3,317 million through these transactions for the year ended March 31, 2005, which is included in selling, general and administrative expenses and consists of ¥6,116 million of a subsidy from the government, calculated as the difference between the obligation settled and the plan assets transferred to the government, and ¥2,799 million of a settlement loss on recognition of related unrecognized actuarial loss.

Effective April 1, 2005, the Company and its domestic subsidiaries amended their severance indemnity plan by introducing a "point-based benefits system," under which benefits are calculated based on accumulated points allocated to employees each year according to their job classification and their performance.

Effective April 1, 2005, the Company and its domestic subsidiaries amended their defined benefit pension plans, and a cash balance pension plan was established. Under a cash balance pension plan, the benefits are calculated based on

accumulated points allocated to employees each year according to their job classification and their performance with a certain interest rate calculated based on the upper and lower limit of a market interest rate. These amendments resulted in a decrease in the Company's projected benefit obligation.

Information about the retirement and severance plans of Advantest for the years ended March 31 are as follows:

	2004	2005	2006	2006
		Yen (Millions)		U.S. Dollars (Thousands)
Components of net periodic benefit cost:				
Service cost .....	¥ 1,691	1,710	1,843	\$ 15,689
Interest cost .....	860	853	565	4,810
Expected return on plan assets .....	(495)	(583)	(478)	(4,069)
Amortization of unrecognized:				
Net transition obligation .....	214	—	—	—
Net actuarial (gain) or loss .....	317	547	249	2,120
Prior service cost .....	(116)	(144)	(229)	(1,950)
Settlement loss .....	—	2,799	—	—
Net periodic benefit cost .....	¥ 2,471	5,182	1,950	\$ 16,600

The following table sets forth the plans' benefit obligation, fair value of plan assets, funded status at March 31, 2005 and 2006.

	2005	2006	2006
	Yen (Millions)		U.S. Dollars (Thousands)
Change in benefit obligation:			
Balance at beginning of year .....	¥ 42,976	28,687	\$ 244,207
Service cost .....	1,710	1,843	15,689
Interest cost .....	853	565	4,810
Plan amendment .....	(1,912)	—	—
Actuarial (gain) or loss .....	(2,169)	289	2,460
Benefits paid .....	(379)	(413)	(3,516)
Transfer of the substitutional portion .....	(12,392)	—	—
Balance at end of year .....	28,687	30,971	263,650
Change in plan assets:			
Balance at beginning of year .....	19,441	15,922	135,541
Employer contributions .....	2,348	2,075	17,664
Actual return on plan assets .....	667	3,736	31,804
Benefits paid .....	(258)	(226)	(1,924)
Transfer of the substitutional portion .....	(6,276)	—	—
Balance at end of year .....	15,922	21,507	183,085
Funded status .....	(12,765)	(9,464)	(80,565)
Unrecognized prior service cost (benefit) .....	(3,482)	(3,253)	(27,692)
Unrecognized net actuarial loss .....	3,642	425	3,618
Net amount recognized .....	¥ (12,605)	(12,292)	\$ (104,639)

	2005	2006	2006
	Yen (Millions)		U.S. Dollars (Thousands)
Pension plans with accumulated benefit obligations in excess of plan assets:			
Projected benefit obligation .....	¥ 28,687	30,971	\$ 263,650
Accumulated benefit obligation .....	26,614	28,965	246,574
Fair value of plan assets .....	15,922	21,507	183,085

Other 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:

	<u>2005</u>	<u>2006</u>
Weighted-average assumptions used to determine benefit obligations as of March 31:		
Discount rate .....	2.0%	2.0%
Rate of compensation increase .....	3.1%	3.1%
	<u>2004</u>	<u>2005</u>
Weighted-average assumptions used to determine net periodic benefit cost for the years ended March 31:		
Discount rate .....	2.5%	2.0%
Expected return on plan assets .....	3.0%	3.0%
Rate of compensation increase .....	3.3%	3.1%

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

Plan assets:

Advantest's domestic benefit plans' weighted-average asset allocation at March 31, 2005 and 2006 by asset category are as follows:

	<u>2005</u>	<u>2006</u>
Equity securities.....	63.8%	67.7%
Debt securities .....	27.2	22.1
Cash .....	2.2	2.5
Life insurance company general accounts .....	6.8	7.7
	<u>100.0%</u>	<u>100.0%</u>

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 an 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 ¥2,107 million (\$17,936 thousand) to its domestic defined benefit plans during the year ending March 31, 2007.

Estimated future benefit payments:

The following benefit payments, which reflect expected future service, as appropriate, are expected:

<u>Year ending March 31</u>	<u>Yen</u> <u>(Millions)</u>	<u>U.S. Dollars</u> <u>(Thousands)</u>
2007 .....	¥ 522	\$ 4,444
2008 .....	459	3,907
2009 .....	581	4,946
2010 .....	655	5,576
2011 .....	707	6,019
2012 - 2016.....	4,566	38,869

## (18) Stockholders' Equity

Changes in the number of shares issued and treasury stock during the years ended March 31, 2004, 2005 and 2006 are as follows:

	Total shares of common stock	Shares of treasury stock
Number of shares as of April 1, 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 .....	—	(139)
Number of shares as of March 31, 2004 .....	99,783,385	1,507,745
Purchase of shares.....	—	6,004,290
Exercise of stock options .....	—	(152,000)
Sale of shares .....	—	(265)
Number of shares as of March 31, 2005 .....	99,783,385	7,359,770
Purchase of shares.....	—	5,098
Exercise of stock options .....	—	(908,000)
Sale of shares .....	—	(132)
Number of shares as of March 31, 2006 .....	99,783,385	6,456,736

The Commercial Code of Japan 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, 2004, 2005 and 2006 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 ¥45 (\$0.38) per share, aggregating ¥4,120 million (\$35,073 thousand), subsequently proposed by the Board of Directors in respect of the year ended March 31, 2006.

The amount available for dividends is determined under the Commercial Code of Japan and amounted to ¥126,129 million (\$1,073,712 thousand) at March 31, 2006.

### (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, 2005 and 2006 were summarized as follows:

	2005	2006	2006
	Yen (Millions)		U.S. Dollars (Thousands)
Balance at beginning of year .....	¥ 3,121	4,090	\$ 34,817
Addition .....	6,087	7,645	65,080
Utilization .....	(5,174)	(7,035)	(59,888)
Translation adjustments .....	56	76	648
Balance at end of year.....	¥ 4,090	4,776	\$ 40,657

### (20) Operating Segment and Geographic Information

Advantest manufactures and sells semiconductor and component test system product group and mechatronics-related product group such as test handlers and device interfaces. Advantest also engages in research and development activities and provides maintenance and support services associated with these products. In accordance with SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information", Advantest has three operating and reportable segments, which are the design, manufacturing, and sale of semiconductor and component test system, mechatronics system and services, support and others. These operating segments are determined based on the nature of the products and the markets.

The semiconductor and component test system segment provides customers with test system products for the semiconductor industry and the electronic parts industry. Product lines provided by the semiconductor and component test system segment include test systems for memory semiconductor devices and test systems for SoC semiconductors for non memory semiconductor devices. The mechatronics system segment provides product lines such

as test handlers, mechatronic-applied products, for handling semiconductor devices, device interfaces that serve as interfaces with the devices that are measured and operations related to nano-technology products. The services, support and others segment consists of comprehensive customer solutions provided in connection with the above segments, support services, equipment lease business and others. Fundamental research and development activities and headquarters functions are represented by Corporate.

As of 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”. Accordingly, the segment information for the year ended March 31, 2004 has been restated based on the three new business segments.

Operating segment information during the years ended March 31, 2004, 2005 and 2006 are as follows:

	Semiconductor and Component Test System Business	Mechatronics System Business	Services, Support and Others	Elimination and Corporate	Total
Yen (Millions)					
<b>As of and for the year ended March 31, 2004:</b>					
Net sales to unaffiliated customers.....	¥ 119,765	33,988	20,465	—	174,218
Inter-segment.....	3,724	237	—	(3,961)	—
Sales.....	123,489	34,225	20,465	(3,961)	174,218
Depreciation and amortization.....	3,676	1,144	3,627	881	9,328
Operating income (loss).....	28,690	11,233	(2,587)	(6,376)	30,960
Expenditures for additions to long-lived assets .....	1,457	913	3,161	90	5,621
Equity in losses of affiliates.....	(117)	—	—	—	(117)
Total assets .....	118,838	29,191	17,472	165,307	330,808

	Semiconductor and Component Test System Business	Mechatronics System Business	Services, Support and Others	Elimination and Corporate	Total
Yen (Millions)					
<b>As of and for the year ended March 31, 2005:</b>					
Net sales to unaffiliated customers.....	¥ 173,938	45,821	19,680	—	239,439
Inter-segment.....	6,747	574	—	(7,321)	—
Sales.....	180,685	46,395	19,680	(7,321)	239,439
Depreciation and amortization.....	3,225	1,220	3,361	479	8,285
Operating income (loss).....	50,624	13,662	3,402	(7,996)	59,692
Expenditures for additions to long-lived assets .....	2,431	654	5,709	554	9,348
Total assets .....	86,104	22,587	16,197	171,881	296,769

<b>As of and for the year ended March 31, 2006:</b>					
Net sales to unaffiliated customers.....	¥ 187,136	47,724	19,062	—	253,922
Inter-segment.....	4,279	536	—	(4,815)	—
Sales.....	191,415	48,260	19,062	(4,815)	253,922
Depreciation and amortization.....	2,993	1,058	3,680	544	8,275
Operating income (loss).....	57,517	11,966	3,853	(6,994)	66,342
Expenditures for additions to long-lived assets .....	2,649	1,177	4,203	294	8,323
Total assets .....	94,745	27,444	16,722	211,865	350,776

	Semiconductor and Component Test System Business	Mechatronics System Business	Services, Support and Others	Elimination and Corporate	Total
U.S. Dollars (Thousands)					
<b>As of and for the year ended March 31, 2006:</b>					
Net sales to unaffiliated customers.....	\$ 1,593,054	406,265	162,271	—	2,161,590
Inter-segment.....	36,426	4,563	—	(40,989)	—
Sales.....	1,629,480	410,828	162,271	(40,989)	2,161,590
Depreciation and amortization.....	25,479	9,007	31,327	4,631	70,444

Operating income (loss).....	489,632	101,864	32,800	(59,539)	564,757
Expenditures for additions to long-lived assets ....	22,550	10,020	35,779	2,503	70,852
Total assets .....	806,546	233,626	142,351	1,803,567	2,986,090

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.

The operating income in the business segment information for the year ended March 31, 2005 does not match the consolidated statements of income as the business segment information does not include a net gain on settlement of substitutional portions of EPF of ¥3,317 million and the stock option cost of ¥2,290 million, and for the year ended March 31, 2006 does not match the consolidated statements of income as the business segment information does not include the stock option cost of ¥1,884 million (\$16,038 thousand). Profit and loss from these are not included in management's analysis of results.

As discussed in Note 1 (k) to the consolidated financial statements, an impairment charge of ¥3,030 million for long-lived assets was included in the operating income (loss) of semiconductor and component test system and services, support and others 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.

One customer and its related entities mainly in the semiconductor and component test system segment and the mechatronics system segment accounted for approximately 8%, 15% and 17% of total consolidated net sales for the years ended March 31, 2004, 2005 and 2006. Another customer accounted for approximately 12%, 10% and 4% for the years ended March 31, 2004, 2005 and 2006.

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, 2004, 2005 and 2006 are as follows:

	2004	2005	2006	2006
		Yen (Millions)		U.S. Dollars (Thousands)
Japan .....	¥ 57,990	60,025	81,140	\$ 690,729
Americas .....	16,264	23,024	25,516	217,213
Europe .....	10,401	12,270	14,558	123,930
Asia .....	89,563	144,120	132,708	1,129,718
Total .....	¥ 174,218	239,439	253,922	\$ 2,161,590

Net sales to unaffiliated customers are based on the customer's location. Net sales indicated as Asia are generated in Taiwan, Korea and China and others in the amount of ¥31,819 million, ¥28,613 million and ¥29,131 million for the year ended March 31, 2004, and ¥51,774 million, ¥39,767 million and ¥52,579 million for the year ended March 31, 2005, and ¥54,391 million (\$463,020 thousand), ¥35,754 million (\$304,367 thousand) and ¥42,563 million (\$362,331 thousand) for the year ended March 31, 2006, respectively. Substantially all net sales indicated as Americas are generated in the United States of America.

Long-lived assets as of March 31, 2004, 2005 and 2006 are as follows:

	2004	2005	2006	2006
		Yen (Millions)		U.S. Dollars (Thousands)
Japan .....	¥ 48,226	50,096	47,661	\$ 405,729
Americas .....	1,552	1,153	1,222	10,403
Europe .....	707	427	667	5,678
Asia .....	3,787	2,778	4,101	34,911
Total .....	¥ 54,272	54,454	53,651	\$ 456,721

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 Americas are located in the United States of America.

### (21) Related Party Transactions

Advantest sells products and purchases raw materials from Fujitsu Limited, its 10.8% stockholder as March 31, 2006 and its group companies (collectively "Fujitsu"). 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 software products for internal use, information system related services, research and development materials and services from Fujitsu. Advantest had the following transactions with Fujitsu as of and for the years ended March 31:

	2004	2005	2006	2006
		Yen (Millions)		U.S. Dollars (Thousands)
Sales of products.....	¥ 2,766	2,933	3,618	\$ 30,799
Purchases of raw materials .....	10,028	9,500	10,378	88,346
Receivables.....	1,882	1,552	3,100	26,390
Payables.....	6,746	4,648	4,392	37,388
Purchases of software, hardware and others.....	262	235	201	1,711
Research and development expenses, computer rentals, maintenance and other expenses.....	2,048	1,786	1,569	13,357

### (22) Per Share Data

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

	2004	2005	2006	2006
		Yen (Millions) except for per share data		U.S. Dollars (Thousands) except for per share data
Numerator:				
Net income .....	¥ 17,329	38,078	41,374	\$ 352,209
Denominator:				
Basic weighted average shares of common stock outstanding .....	98,250,830	97,750,345	92,694,513	
Dilutive effect of exercise of stock options and warrants .....	195,306	260,394	497,027	
Diluted weighted average shares of common stock outstanding .....	98,446,136	98,010,739	93,191,540	
Basic net income per share .....	¥ 176.37	389.54	446.34	\$ 3.80
Diluted net income per share .....	176.02	388.51	443.96	3.78
Cash dividends per share .....	¥ 40.00	50.00	70.00	\$ 0.60

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

### (23) Concentrations of credit risk

Advantest is exposed to credit risk in the event of default by financial institutions to cash and cash equivalents, but such risk is considered mitigated by the high credit rating of the financial institutions.

At March 31, 2005 and 2006, one customer accounted for approximately 12% and 11% of consolidated trade receivables, respectively. Although Advantest does not expect that the customer will fail to meet its obligations, Advantest is potentially exposed to concentrations of credit risk if the customer failed to perform according to the terms of the contracts.

## **(24) Commitments and Contingent Liabilities**

Advantest provides guarantees to third parties mainly for customers lease obligations. Advantest would be required to satisfy customers lease obligations in the event of default. The maximum amount of undiscounted payments is ¥232 million (\$1,975 thousand) at March 31, 2006. The guarantees are collateralized by the leased equipment. At March 31, 2006, Advantest has not accrued any obligation with respect to such guarantees as it estimates the fair value of its obligations to be insignificant.

Advantest is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on Advantest's consolidated financial position, results of operations, or cash flows.

### **Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders of  
Advantest Corporation

We have audited the accompanying consolidated balance sheets of Advantest Corporation and subsidiaries (the “Company”) as of March 31, 2006 and 2005, and the related consolidated statements of income, stockholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. The consolidated statements of income, stockholders' equity and cash flows of Advantest Corporation and subsidiaries for the year ended March 31, 2004 were audited by other auditors whose report dated April 26, 2004, except for note 20, as to which the date is July 21, 2005, expressed an unqualified opinion on those statements.

We conducted our audits in accordance with the 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. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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

As discussed in Note 1 to the consolidated financial statements, in 2005 the Company changed its method of accounting for stock-based compensation.



Tokyo, Japan  
June 23, 2006

#### 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.

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