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Tokyo 100-0005

Japan

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(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

<u>Title of each class:</u>	<u>Name of each exchange on which registered:</u>
Common Stock	The New York Stock Exchange
Securities registered or to be registered pursuant to Section 12(g) of the Act: None	

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: 93,326,649 Common Stock at March 31, 2006

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark which financial statement item the registrant has elected to follow: Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Table of Contents**TABLE OF CONTENTS**

	Page
<u>PART I</u>	
ITEM 1.	1
ITEM 2.	1
ITEM 3.	1
3.A	1
3.B	3
3.C	3
3.D	3
ITEM 4.	11
4.A	11
4.B	12
4.C	29
4.D	30
ITEM 4A.	30
ITEM 5.	30
5.A	30
5.B	44
5.C	45
5.D	47
5.E	47
5.F	47
5.G	47
ITEM 6.	48
6.A	48
6.B	53
6.C	53
6.D	56
6.E	57
ITEM 7.	60
7.A	60
7.B	62
7.C	62
ITEM 8.	62
8.A	62
8.B	63
ITEM 9.	63
9.A	63
9.B	63
9.C	64
9.D	64
9.E	64
9.F	64

ITEM 10.	<u>ADDITIONAL INFORMATION</u>	64
10.A	<u>SHARE CAPITAL</u>	64
10.B	<u>MEMORANDUM AND ARTICLES OF ASSOCIATION</u>	64
10.C	<u>MATERIAL CONTRACTS</u>	72

Table of Contents

	<u>Page</u>
10.D	<u>EXCHANGE CONTROLS</u> 72
10.E	<u>TAXATION</u> 73
10.F	<u>DIVIDENDS AND PAYING AGENTS</u> 79
10.G	<u>STATEMENT BY EXPERTS</u> 79
10.H	<u>DOCUMENTS ON DISPLAY</u> 79
10.I	<u>SUBSIDIARY INFORMATION</u> 79
ITEM 11.	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u> 79
ITEM 12.	<u>DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES</u> 82
12.A	<u>DEBT SECURITIES</u> 82
12.B	<u>WARRANTS AND RIGHTS</u> 82
12.C	<u>OTHER SECURITIES</u> 82
12.D	<u>AMERICAN DEPOSITARY SHARES</u> 82
<u>PART II</u>	
ITEM 13.	<u>DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES</u> 83
ITEM 14.	<u>MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS</u> 83
ITEM 15.	<u>CONTROLS AND PROCEDURES</u> 83
ITEM 16.	<u>[RESERVED]</u> 83
ITEM 16A.	<u>AUDIT COMMITTEE FINANCIAL EXPERT</u> 83
ITEM 16B.	<u>CODE OF ETHICS</u> 84
ITEM 16C.	<u>PRINCIPAL ACCOUNTANT FEES AND SERVICES</u> 84
ITEM 16D.	<u>EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES</u> 85
ITEM 16E.	<u>PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS</u> 85
<u>PART III</u>	
ITEM 17.	<u>FINANCIAL STATEMENTS</u> 86
ITEM 18.	<u>FINANCIAL STATEMENTS</u> 86
ITEM 19.	<u>EXHIBITS</u> 87

As used in this annual report, the term "fiscal year" preceding a year means the twelve-month period ended March 31 of the year subsequent to the year referred to. For example, "fiscal 2005" refers to the twelve-month period ended March 31, 2006. All other references to years refer to the applicable calendar year.

In parts of this annual report, amounts reported in Japanese yen have been translated into U.S. dollars for the convenience of readers. Unless otherwise noted, the rate used for this translation was \$1.00 = ¥117.47. This was the approximate exchange rate in Japan on March 31, 2006.

Unless otherwise noted, all references and discussions of Advantest's financial position, results of operations and cash flow in this annual report are made with reference to Advantest's consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States, or U.S. GAAP. The segment sales figures included in this annual report are presented before eliminating intercompany transactions.

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See Information on the Company Business Overview Glossary for a description of certain technical terms used in this annual report.

ii

Table of Contents

Cautionary Statement 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 statements include, among other things, the discussion of Advantest's business strategy, outlook and expectations as to market and business developments, production and capacity plans. Generally, these forward-looking statements can be identified by the use of forward-looking terminology such as anticipate, believe, estimate, expect, intend, project, should and similar expressions. Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that may cause Advantest's actual results, levels of activity, performance or achievements to be materially different from those expressed or implied by such forward-looking statements, including:

changes in demand for the products and services produced and offered by Advantest's customers, including semiconductors, communications services and electronic goods;

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;

significant changes in the competitive environment in the major markets where Advantest purchases materials, components and supplies for the production of its products or where its products are produced, distributed or sold; and

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.

These risks, uncertainties and other factors also include those identified in Operating and Financial Review and Prospects, Key Information Risk Factors and Information on the Company set forth elsewhere in this annual report. Advantest does not undertake to release the results of any revisions of forward-looking statements to reflect future events or circumstances.

Table of Contents**PART I****ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION**3.A SELECTED FINANCIAL DATA**

You should read the U.S. GAAP selected consolidated financial information presented below together with Operating and Financial Review and Prospects and Advantest's consolidated financial statements as of March 31, 2005 and 2006 and for each of the years in the three year period ended March 31, 2006, together with the notes to such financial statements, included elsewhere in this annual report.

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)
Consolidated Statement of Income Data:						
Net sales	¥ 95,244	¥ 97,740	¥ 174,218	¥ 239,439	¥ 253,922	\$ 2,161,590

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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

As of March 31,

	2002	2003	2004	2005	2006	2006
	(in millions)				(in thousands)	
Consolidated Balance Sheet Data:						
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

Table of Contents

	Year ended March 31,					
	2002	2003	2004	2005	2006	2006
	(in millions, except percentages)					(in thousands)
Other Data:						
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 ⁽¹⁾	(38.96)%	(17.13)%	17.77%	25.36%	25.38%	
Net income margin ⁽²⁾	(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.

Exchange Rates

In parts of this annual report, yen amounts have been translated into U.S. dollars for the convenience of investors. Unless otherwise noted, the rate used for the translation was \$1.00 = ¥117.47. This was the approximate exchange rate in Japan on March 31, 2006.

Table of Contents

The following table sets forth, for the periods and dates indicated, information concerning the noon buying rate for Japanese yen announced by the Federal Reserve Bank of New York, expressed in Japanese yen per \$1.00. The noon buying rate as of June 21, 2006 was \$1.00 = 114.76. Advantest does not intend to imply that the Japanese yen or U.S. dollar amounts referred to in this annual report could have been or could be converted into U.S. dollars or Japanese yen, as the case may be, at any particular rate, or at all.

<u>Fiscal year ended/ending March 31,</u>	<u>At end</u>	<u>Average</u>			
	<u>of period</u>	<u>(of month-end rates)</u>		<u>High</u>	<u>Low</u>
		(¥ per \$1.00)			
2002	¥ 132.70	¥	125.64	¥ 134.77	¥ 115.89
2003	118.07		121.10	133.40	115.71
2004	104.18		112.75	120.55	104.18
2005	107.22		107.28	114.30	102.26
2006	117.48		113.67	120.93	104.41
2007 (through June 21, 2006)	114.76		113.60	118.66	110.07

<u>Month ended</u>	<u>High</u>	<u>Low</u>	
		(¥ per \$1.00)	
December 31, 2005	¥ 120.93	¥	115.78
January 31, 2006	117.55		113.96
February 28, 2006	118.95		115.82
March 31, 2006	119.07		115.89
April 30, 2006	118.66		113.79
May 31, 2006	113.46		110.07

3.B CAPITALIZATION AND INDEBTEDNESS

Not applicable.

3.C REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

3.D RISK FACTORS**Risks Related to Advantest's Business**

Advantest's business and results of operations are subject to significant cyclicality in the semiconductor industry

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Advantest's business depends largely upon the capital expenditures of semiconductor manufacturers, test houses and foundries. These companies, in turn, determine their capital expenditure and investment levels largely based on current and anticipated market demand for semiconductors and demand for products incorporating semiconductors. Historically, the percentage reduction in capital expenditures by semiconductor manufacturers during downturns in the semiconductor industry, including investment in test system, has typically been much greater than the percentage reduction in worldwide sales of semiconductors. The semiconductor industry has been highly cyclical with recurring periods of excess inventory, which often have had a severe effect on the semiconductor industry's demand for semiconductor and component test systems and other test systems, including those of Advantest. The market for memory semiconductors, or semiconductors that contain only memory circuits, is especially cyclical as compared to non memory semiconductors, or semiconductors that contain circuits other than memory circuits. In fiscal 2005, 52.4% of Advantest's net sales from semiconductor and component test systems were derived from the sale of semiconductor test systems for memory semiconductors. Although this figure is less than the 68.5% from fiscal 2004, it still remains over 50%. Any cyclical downturns in the memory semiconductor market will therefore be likely to adversely affect Advantest's business more than that of its competitors which sell a lower proportion of memory semiconductors.

Table of Contents

The worldwide semiconductor market contracted significantly during 2001 and grew by only 1.3% in 2002 compared to 2001. The semiconductor market recovered significantly, however, recording 18.3% growth in 2003 and 28.0% growth in 2004. Compared with the significant increase in 2004, the growth of the semiconductor market moderated to 6.8% in 2005. Worldwide sales of memory semiconductors, which declined by 49.5% in 2001 as compared with 2000, increased by 8.7% in 2002 as compared with 2001 and further increased by 20.2%, 45.0% and 2.9% in 2003, 2004 and 2005, respectively on a year-on-year basis, primarily due to the increase in demand for flash memory semiconductors used in digital consumer products and for DRAM semiconductors used in personal computers. Worldwide sales of non memory semiconductors, which declined by 26.5% in 2001 compared to 2000, declined by 0.4% in 2002 as compared with 2001, but increased by 17.8% and 23.9% in 2003 and 2004, respectively on a year-on-year basis, primarily due to the increase in demand for personal computers and other digital consumer products such as digital cameras, digital versatile disc, or DVD recorders and flat-panel TVs. Net sales of memory semiconductors and non memory semiconductors were sluggish after the summer of 2004 due to adjustments of excess inventory by semiconductor manufacturers. However, demand recovered as the adjustment of excess inventory stabilized after the spring of 2005 and the market for personal computers (especially notebooks) and digital consumer devices (especially flat-panel TVs and portable music players) expanded. Accordingly, net sales of semiconductors increased by 7.9% in fiscal 2005, as compared with the previous fiscal year.

The cyclicity of the market for semiconductors is affected by various factors such as:

the overall state of the global economy;

the consumer demand for digital consumer products such as flat-panel TVs and DVD recorders;

the sales levels in the personal computer industry;

the levels of investment in communications infrastructure and the effect on the mobile telephone industry; and

currency exchange rate fluctuations.

After recording record sales and profits in fiscal 2000, Advantest experienced a 65.6% decrease in net sales in fiscal 2001. More recently, in fiscal 2003, due to the recovery of investments in semiconductors, Advantest recorded an increase of 78.2% compared to fiscal 2002. Net sales for the first half of fiscal 2004 was of ¥146,589 million, which is the highest net sales Advantest achieved in any interim six-month period. Reflecting the adjustment of excess inventories by semiconductor manufacturers, however, net sales for the second half of fiscal 2004 dropped to ¥92,850 million. Net sales for the full fiscal 2004 stood at ¥239,439 million, representing a 37.4% increase over fiscal 2003 and contributing to current net income of ¥38,078 million. In fiscal 2005, the adjustment of excess inventory by semiconductor manufacturers ended, and net sales resumed its increase. Net sales for the first half of fiscal 2005 was ¥107,099 million, and net sales for the second half of fiscal 2005 was ¥146,823 million. Throughout fiscal 2005, net sales increased by 6.0% as compared with the previous fiscal year to ¥253,922 million, and net income achieved ¥41,347 million in fiscal 2005.

Accordingly, Advantest believes that its results are significantly impacted by the highly cyclical nature of the semiconductor industry. Significant downturns in, among others, the semiconductor industry would therefore adversely affect Advantest's financial condition and results of operations.

If Advantest does not introduce new products meeting its clients' technical requirements in a timely manner and at competitive prices, its products will become obsolete and its financial conditions and results of operations will suffer

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Advantest sells its products to several industries that are characterized by rapid technological changes, the frequent introduction of new products and services, varying and unpredictable product lifecycles and evolving industry standards. Advantest anticipates that future demand for its products will be driven, in large part, by

Table of Contents

advances in semiconductor technology, which create new testing requirements that are not adequately addressed by currently installed semiconductor test systems. These advances and customers' needs include:

the introduction of system-on-a-chip, or SoC, semiconductors that incorporate more advanced memory, logic and analog circuits;

investment by memory semiconductor manufacturers in facilities that are used to produce memory semiconductors such as DDR2-SDRAM and the next generation DDR3-SDRAM;

investment by semiconductor manufacturers in mechatronics related products which transport devices faster, more accurately and more stably;

the use of self-test technologies that employ circuit designs incorporated into the circuits of semiconductor chips; and

prompt response and quick repair in the event of failure.

Advantest also believes demand for its products, including semiconductor and component test systems, will continue to be strongly affected by the level of demand for personal computers, high-speed wireless and wireline data services and digital consumer products. It is likely that advances in technologies used in those products and services require new testing systems. Without the timely introduction of semiconductor test systems capable of effectively testing and measuring equipment that use new technologies, Advantest's products and services will become technologically obsolete over time.

The failure of Advantest to meet its customers' technical requirements at a competitive price or to deliver conforming equipment in a timely manner can result in its products being replaced by equipment of a competitor or an alternative technology solution. Accordingly, Advantest's inability to provide a product that meets requested performance criteria at an acceptable cost when required by its customers would severely damage its reputation with that customer and could adversely affect future sales efforts with respect to that customer.

Advantest may not recoup costs incurred in the development of new products

Enhancements to existing products and the development of new generations of products are, in most cases, costly processes. Furthermore, because the decision to purchase semiconductor and component test systems products and mechatronics systems generally involves a significant commitment of capital, the sale of this equipment typically involves a lengthy sales period and requires Advantest to expend substantial funds and sales efforts to secure the sale. Advantest's enhancements or new generations of products may not generate net sales in excess of development and sales costs if, for example, these new enhancements or products are quickly rendered obsolete by changing customer preferences, the introduction by Advantest's competitors of products embodying new technologies or features, the introduction by Advantest's customers of new products that require different testing functions or the failure of the market for Advantest's customer's products to grow at the rate, or to the levels, anticipated by Advantest. This risk is believed to be particularly acute with respect to test systems for SoC semiconductors because, in general, new SoC semiconductors product lines are introduced to market more frequently than new memory semiconductor product lines. In some cases, Advantest must anticipate industry trends and develop products in advance of the commercialization of its customers' products. This requires Advantest to make significant investments in product development well before it determines the commercial viability of these innovations. If Advantest's customers fail to introduce their devices in a timely manner or the market rejects their devices, Advantest may not recover its investments in product development through sales in significant volume.

Advantest faces substantial competition in all areas of its businesses and, if Advantest does not compete effectively, its business may be harmed

Advantest faces substantial competition throughout the world. Advantest's primary competitors in the semiconductor and component test system market include, among others, Yokogawa Electronic Corporation,

Table of Contents

Teradyne, Inc., Verigy Pte. Ltd. and Credence Systems Corporation. In the mechatronics system market, Advantest has also been competing with TechWing Inc., Delta Design and Yokogawa Electronic Corporation. In addition, in the services, support and others segment, Advantest has been competing with competitors providing similar businesses. Some of Advantest's competitors have greater financial and other resources than Advantest.

Advantest faces many challenges in its businesses, including increased pressure from customers to produce semiconductor and component test systems and mechatronics systems that reduce testing costs. To compete effectively, Advantest must continue to enhance its business processes to lower the cost of its products, as well as introduce enhancements that lower overall testing costs. Advantest also expects its competitors to continue to introduce new products with improvements in price and performance, as well as increase their customer service and support offerings. Significant increases in competition may erode Advantest's profit margin and weaken its earnings.

Advantest's product lines are facing significant price pressure

Price pressure in Advantest's businesses is adversely affecting Advantest's operating margins. Advantest believes that price pressure with respect to semiconductors continues to grow even during periods when demand, in terms of volume, for semiconductors is increasing, resulting in continuous pressure on the market price for products in the Semiconductor and Component Test System Segment and Mechatronics System Segment. During these periods, Advantest's customers seek to increase their production capacities while minimizing their capital expenditures. Advantest believes that, despite the continued recovery in the semiconductor market since fiscal 2003, price pressure continues to persist. In addition, increased competition in the market for digital consumer products and personal computers drove down prices of these goods, subsequently creating significant price pressure on Advantest's product lines. A further increase in price pressure will adversely affect Advantest's future financial conditions and results of operations.

The market for Advantest's major products is highly concentrated, and Advantest may not be able to increase sales of its products because of limited opportunities

The market for test systems for memory semiconductors in the semiconductor and component test system segment is highly concentrated, with a small number of large semiconductor manufacturers, test houses and foundries accounting for a large portion of total sales in the semiconductor test system industry. Advantest believes that this market concentration will become even more severe in the future as a move towards consolidation in the semiconductor industry has recently begun, with larger semiconductor device manufacturers, foundries and test houses acquiring smaller, often financially-troubled, semiconductor market participants. Advantest's ability to increase sales will depend in large part upon its ability to obtain or increase orders from large-volume customers.

Advantest's largest customers currently account for a significant part of its net sales, and the loss of one or more of these customers could harm its business

Advantest's success depends on its continued ability to develop and manage relationships with its major customers, a small number of which currently accounts for a significant portion of its net sales. Sales to Advantest's largest customer as a percentage of its total sales were approximately 12% in fiscal 2003, approximately 15% in fiscal 2004 and approximately 17% in fiscal 2005. Sales to the Advantest's five largest customers accounted for approximately 37% of total net sales in fiscal 2003, approximately 42% in fiscal 2004, and approximately 41% in fiscal 2005. The loss of one or more of these major customers could materially harm Advantest's business.

Fluctuations in exchange rates could reduce Advantest's profitability

Advantest derives a majority of its net sales from products sold to customers located outside of Japan. Approximately 68% of Advantest's fiscal 2005 net sales were from products sold to overseas customers. Most of

Table of Contents

Advantest's products are manufactured in Japan, but approximately 31% of Advantest's net sales in fiscal 2005 were made in currencies other than the yen, predominantly the U.S. dollar. A strengthening in the yen relative to the U.S. dollar and, to a much lesser extent, currencies of those other countries where Advantest sells its products would increase the prices of Advantest products as stated in U.S. dollars and in those other currencies and could hurt sales in those countries. In addition, significant fluctuations in the exchange rate between the yen and foreign currencies, especially the U.S. dollar, could require Advantest to lower its prices with respect to foreign sales of its products that are priced in yen, and reduce the yen equivalent amounts of its foreign sales for products that are based in U.S. dollars or other foreign currencies, and thus reduce its profitability. These fluctuations could also cause prospective customers to push out or delay orders because of the increased relative cost of Advantest's products. In the past, there have been significant fluctuations in the exchange rate between the yen and the currencies of countries in which Advantest does business.

The failure by Advantest to meet demand for its products upon a significant expansion in the semiconductor and component test systems and mechatronics system markets would likely adversely affect its future market share and financial results

If the market for semiconductor and component test systems and mechatronics systems were to suddenly expand, Advantest would require a significant increase in production capabilities, including personnel, in order to fully capitalize on such a recovery. The failure of Advantest to adjust to such unanticipated increases in demand for its products during any such a recovery could result in Advantest losing one or more of its existing large-volume customers or losing the opportunity to establish a strong relationship with large-volume customers with which it currently does little or no business. Any such failure would likely adversely affect Advantest's future market share and its financial results.

Advantest may not recoup its investment in OPENSTAR[®], as it may not be broadly accepted, or otherwise benefit from the successful adoption of OPENSTAR[®]

Advantest is now striving to enhance the adoption of OPENSTAR[®], an industry-wide, open architecture, because it believes that OPENSTAR[®] will provide an opportunity for late entrants to the test systems for SoC semiconductors market, such as Advantest, to increase their market share and thus improve their operation results.

However, even if OPENSTAR[®] is broadly accepted by the semiconductor industry, the consequences of the adoption of OPENSTAR[®] on Advantest's business are uncertain. OPENSTAR[®] is an open architecture that can be used by all semiconductor industry participants. The adoption of the new standard could therefore result in an increase in the number of market participants and in a loss of market share for Advantest. In addition, OPENSTAR[®] is a new standard that will require all test system manufacturers, including Advantest, to re-design their products. There can be no assurance that Advantest will be able to design and manufacture products based on this new standard that meet the cost and technical requirements of SoC semiconductor manufacturers. These and other uncertainties that can result from the adoption of OPENSTAR[®] could adversely affect Advantest's test systems for SoC semiconductors business.

Advantest's dependence on subcontractors and on sole source or a limited number of suppliers for its components and parts may prevent it from delivering an acceptable product on a timely basis

Advantest relies on subcontractors to perform the low-end assembly requirements for its products. For example, Advantest has been outsourcing the assembly of the numerous circuit boards. In addition, many of the components used in Advantest's semiconductor and component test systems and mechatronics systems are produced by suppliers based on Advantest's specifications. Advantest's reliance on these subcontractors and suppliers gives it less control over the manufacturing process and exposes it to significant risks, especially inadequate manufacturing capacity, late delivery, substandard quality, lack of labor availability and high costs. In addition, Advantest depends on sole source or a limited

number of suppliers for a portion of its components and

Table of Contents

parts. Advantest does not maintain long-term supply agreements with most of its suppliers, and it purchases most of its components and parts through individual purchase orders. If suppliers become unable to provide components or parts in the volumes needed and at acceptable prices, Advantest would have to identify and procure acceptable replacements. Furthermore, the markets for semiconductors and other specialized components have, in the past, experienced periods of inadequate supply to meet demand. The process of selecting subcontractors or suppliers and of identifying suitable replacement components and parts is a lengthy process and can result in Advantest being unable to deliver products meeting customer requirements on a timely basis. Advantest has, in the past, been unable to deliver its products according to production schedules due to the inability of suppliers to supply components and parts based on Advantest's specifications and due to other shortages in components and parts.

If Advantest's main facilities for research and development, production or information technology systems for all of the Advantest's businesses, or the facilities of its subcontractors and suppliers, were to experience catastrophic loss, its results of operations would be seriously harmed

Advantest's main facilities for research and development for its semiconductor and component test systems and mechatronics systems segments production, as well as many of Advantest's services bases, are located in Japan. In addition, the main system server and parts of the network hub are maintained in system centers approved by the Information System Management System, or ISMS, and local network servers are located in operations offices throughout Japan. Japan suffers from relatively frequent earthquake activity.

If Advantest's facilities, particularly its semiconductor and component test system manufacturing factories, were to experience a catastrophic loss, it would materially disrupt Advantest's operations, delay production, shipments and revenue, and result in large expenses to repair or replace the facility. Advantest has insurance to cover most potential losses at its manufacturing facilities, other than those that result from earthquakes. However, this insurance may not be adequate to cover all possible losses. Similar disruptions to Advantest's business may occur if the facilities of Advantest's subcontractors and suppliers or if the facilities of Advantest's information system network were to experience a catastrophic loss.

Advantest's business is subject to economic, political and other risks associated with international operations and sales

Advantest's business is subject to risks associated with doing business internationally because it sells its products, and purchases parts and components from, around the world. In fiscal 2005, 52.3% of Advantest's total net sales came from Asia (excluding Japan), a majority of which consisted of sales in Taiwan, the People's Republic of China and Korea, 10.0% from the Americas and 5.7% from Europe. Advantest anticipates that net sales from international operations will continue to represent a substantial portion of its total net sales. In addition, some of Advantest's distribution and support subsidiaries are located in the Americas, Europe, and Asian countries including Singapore, Taiwan, the People's Republic of China and Korea and some of Advantest's suppliers are also located overseas. Accordingly, Advantest's future results could be harmed by a variety of factors, including:

political and economic instability, natural calamities or other risks related to countries where Advantest procures its components and parts or sells its products;

trade protection measures and import or export licensing requirements;

potentially negative consequences from changes in tax laws;

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difficulty in staffing and managing widespread operations;

differing protection of intellectual property; and

difficulties in collecting accounts receivable because of distance and different legal rules.

Table of Contents

Advantest's financial conditions and results of operations are subject to factors relating to its marketing and sales capabilities and its branding

Advantest's financial conditions and results of operations are negatively affected by factors relating to its marketing and sales capabilities and its branding, including:

the long selling process involved in the sale of semiconductor and component test systems;

the relatively small number of total units sold in the semiconductor and component test system market;

order cancellations or delays by customers;

delays in collection of, or increases in provisions for, accounts receivable due to the financial condition of customers;

increases in required provisions for product warranty costs and write-downs of inventory;

any real or perceived decrease in performance and reliability of Advantest products, which leads to a decline in Advantest's reputation; and

uncertain market acceptance of products developed by its customers.

Chemicals used by Advantest may become subject to more stringent regulations, and Advantest may be required to incur significant costs in adapting to new requirements

Advantest uses chemicals in the manufacturing of its products, the manufacture, processing and distribution of which are subject to environmental related laws, regulations and rules of Japanese governmental agencies, as well as by various industry organizations and other regulatory bodies in other countries. These regulatory bodies may strengthen existing regulations governing chemicals used by Advantest and may also begin to regulate other chemicals used by Advantest. For example, Advantest uses lead solder for mounting electronic parts and components for its products. Beginning August 2005, the European Union implemented regulations on the collection, treatment, recycling and recovery of electrical and electronic equipment waste and beginning July 2006, will implement regulations on the usage of lead, mercury, cadmium and other hazardous substances in electrical and electronic equipment. Further, as a method to cool some of its semiconductor and component test systems, Advantest uses a type of perfluorocarbon, or PFC, that is not currently regulated by laws related to the ozone layer protection and global warming. Advantest believes that it is in compliance with current regulations; however, Advantest must be prepared to adapt to regulatory requirements in all relevant countries as requirements change. Advantest may be required to incur significant cost in adapting to new requirements. Any failure by Advantest to comply with applicable government or industry regulations could result in the imposition of fines or restrictions on its ability to carry on or expand its operations.

Advantest could suffer significant liabilities, litigation costs or licensing expenses or be prevented from selling its products if it is infringing the intellectual property of third parties

Advantest may be unknowingly infringing the intellectual property rights of third parties and may be held responsible for that infringement. To date, Advantest has not been the subject of a material intellectual property claim. However, any future litigation regarding patents or other intellectual property infringement could be costly and time consuming and divert management and key personnel from Advantest's business operations. If Advantest loses a claim, it might be forced to pay significant damages, pay license fees, modify its products or processes, stop making products or stop using processes. A license could be very expensive to obtain or may not be available at all. Changing Advantest's products or processes to avoid infringing the rights of third parties may be costly or impractical.

Advantest may be unable to protect its proprietary rights due to the difficulty of Advantest gaining access to, and investigating, the products believed to infringe Advantest's intellectual property rights

Advantest relies on patents, utility models, design rights, trademarks and copyrights obtained in various countries to actively protect its proprietary rights. For instance, with respect to the device interface market,

Table of Contents

Advantest has taken legal action based on its patent and utility model rights against manufacturers that sell replicas of Advantest's products and, in some instances, has obtained injunctions against sales of such replicas. However, in general, it is difficult for Advantest to gain access to, and investigate, the products believed to infringe its intellectual property rights. Therefore, Advantest cannot ensure that its intellectual property rights will provide meaningful protection of its proprietary rights. Nevertheless, Advantest is focused on protecting its intellectual property rights from third party infringement and will continue to monitor and enforce its rights.

The technology labor market is very competitive, and Advantest's business will suffer if Advantest is unable to hire and retain engineers and other key personnel

Advantest's future success depends partly on its ability to attract and retain highly qualified engineers for its research and development and customer service and support divisions. If Advantest fails to hire and retain a sufficient number of these personnel, it will not be able to maintain and expand its business. Advantest may need to revise its compensation and other personnel related policies to retain its existing officers and employees and attract and retain the additional personnel that it expects to require.

Investor confidence and the value of Advantest's ADRs and ordinary shares may be adversely impacted if Advantest's independent registered public accounting firm is unable to provide adequate attestation over the adequacy of the internal control over Advantest's financial reporting as of March 31, 2007 as required by Section 404 of the Sarbanes-Oxley Act of 2002

The Securities and Exchange Commission, as directed by Section 404 of the Sarbanes-Oxley Act of 2002, adopted rules requiring public companies to include a report of management on the company's internal control over financial reporting in its Annual Report on Form 10-K or Form 20-F, as the case may be, that contains an assessment by management of the effectiveness of the company's internal control over financial reporting. In addition, the company's independent registered public accounting firm must attest to and report on management's assessment of the effectiveness of the company's internal control over financial reporting. These requirements will first apply to Advantest's Annual Report on Form 20-F for the fiscal year ending March 31, 2007. Although Advantest intends to diligently and vigorously review its internal controls over financial reporting in order to ensure compliance with Section 404 requirements, if Advantest's independent registered public accounting firm is not satisfied with Advantest's internal control over its financial reporting or the level at which its controls are documented, designed, operated or reviewed, then they may decline to attest to management's assessment or may issue a report that is qualified. Any of these possible outcomes could result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of Advantest's financial statements, which ultimately could negatively impact the market price of Advantest's ADRs and ordinary shares.

Risks Related to Ownership of ADSs or Common Stock

Yen-dollar fluctuations could cause the market price of the ADSs to decline and reduce dividend amounts payable to ADS holders as expressed in U.S. dollars

Fluctuations in the exchange rate between the Japanese yen and the U.S. dollar will affect the U.S. dollar equivalent of the Japanese yen price of the shares on the Tokyo Stock Exchange and, as a result, are likely to affect the market price of the ADSs. Advantest has historically paid dividends on its shares twice a year. If Advantest declares cash dividends, dividends on the shares represented by the ADSs will be paid to the depository in Japanese yen and then converted by the depository into U.S. dollars. Therefore, exchange rate fluctuations will also affect the dividend amounts payable to ADS holders following conversion into U.S. dollars of dividends paid in Japanese yen on the shares represented by the ADSs.

As a holder of ADSs, you will have fewer rights than a shareholder has, and you must act through the depositary to exercise those rights

The rights of shareholders under Japanese law to take actions, including voting their shares, receiving dividends and distributions, bringing derivative actions, examining Advantest's accounting books and records

Table of Contents

and exercising appraisal rights, are available only to holders of record on Advantest's register of shareholders or Advantest's register of beneficial shareholders. Because the depositary, through its custodian agents, is the registered holder of the shares underlying the ADSs, only the depositary can exercise those rights in connection with the deposited shares. The depositary will make efforts to vote the shares underlying a holder's ADSs as instructed by the holder and will pay to the holder the dividends and distributions collected from Advantest. However, in the holder's capacity as an ADS holder, that holder will not be able to bring a derivative action, examine Advantest's accounting books and records or exercise appraisal rights through the depositary.

There are restrictions on the withdrawal of shares from Advantest's depositary receipt facility

Under Advantest's ADS program, each ADS represents the right to receive one-fourth of one share. To withdraw any shares, a holder of ADSs has to surrender for cancellation American Depositary Receipts, or ADRs, evidencing 400 ADSs or any integral multiple thereof. Each ADR bears a legend to that effect. As a result, holders of ADSs are unable to withdraw fractions of shares or units or receive any cash settlement from the depositary in lieu of withdrawal of fractions of shares or units. Holders of shares representing less than one unit, or 100 shares, may require Advantest to repurchase those shares, whereas holders of ADSs representing less than one unit of shares are unable to exercise this right because the holders of these ADSs are unable to withdraw the underlying shares. Under Advantest's ADS program, an ADS holder cannot cause the depositary to require Advantest to repurchase fractions of shares or units on its behalf. For a further discussion of the ADSs and the ADS program, see "Description of American Depositary Receipts" set forth in Advantest's registration statement on Form F-1 filed with the Securities and Exchange Commission on July 22, 2002. For a further discussion of the Japanese unit share system, see "Additional Information Memorandum and Articles of Association The Unit Share System".

Enforcement of Civil Liabilities

Advantest is a limited liability, joint-stock corporation incorporated under the laws of Japan. Almost all of Advantest's directors, executive officers and corporate auditors reside in Japan. All or substantially all of Advantest's assets and the assets of these persons are located in Japan and elsewhere outside the U.S. It may not be possible, therefore, for investors to effect service of process within the U.S. upon Advantest or these persons or to enforce against Advantest or these persons judgments obtained in U.S. courts predicated upon the civil liability provisions of the federal securities laws of the U.S. Advantest's Japanese counsel, Nagashima Ohno & Tsunematsu, has advised Advantest that there is doubt as to the enforceability in Japan, in original actions or in actions for enforcement of judgments of U.S. courts, of liabilities predicated solely upon the federal securities laws of the U.S.

ITEM 4. INFORMATION ON THE COMPANY

4.A HISTORY AND DEVELOPMENT OF THE COMPANY

Advantest commenced operations in July 1954, and was incorporated in December 1954 under the name Takeda Riken Industry Co., Ltd. as a limited liability, joint-stock company in Japan under the Commercial Code of Japan. At the time of incorporation, Takeda Riken's primary business was the design, manufacture and sale of measuring instruments for Japanese electronics manufacturers. Takeda Riken started focusing on semiconductor test equipment for the semiconductor industry in 1968 and was the first to domestically produce semiconductor test equipment in 1972. In 1971, Takeda Riken entered into its first distribution agreement with a foreign distributor and, in 1973, established its first representative office in the U.S. to gather information on technology and distribution and to establish dealer relationships. These two milestones launched the company's long-term goal of becoming a global manufacturer of testing and measuring products. Takeda Riken has been listed on the Tokyo Stock Exchange since February 1983. Takeda Riken changed its registered name to Advantest Corporation in October 1985.

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Laws within the Commercial Code relating to companies were replaced by the Company Law as of May 2006, and a company that previously existed under the Commercial Code, such as Advantest, continues to exist under the Company Law.

Table of Contents

Advantest applies its capital expenditures chiefly to the streamlining of development, production of new products, energy saving initiatives and the expansion of production capacity. Advantest's capital expenditures were ¥5.6 billion, ¥9.3 billion and ¥8.3 billion in fiscal 2003, 2004 and 2005, respectively. As of June 1, 2006, Advantest does not have any major capital expenditures in progress.

Advantest's principal executive offices are located at Shin-Marunouchi Center Building, 1-6-2, Marunouchi, Chiyoda-ku, Tokyo 100-0005 Japan. Advantest's telephone number in Japan is (81-3) 3214-7500.

4.B BUSINESS OVERVIEW

Overview

The Advantest group is comprised of Advantest Corporation and its 40 consolidated subsidiaries and conducts its business in the following segments:

semiconductor and component test system segment;

mechatronics system segment focusing on peripheral devices including test handlers and device interfaces; and

services, support and others.

Semiconductor and Component Test System Segment

The semiconductor and component test system segment provides customers with test system products for the semiconductor industry and the electronic component industry. The products in this segment include test systems for memory semiconductors and test systems for non memory semiconductors. The test systems for non memory semiconductors are divided into test systems for SoC semiconductors and other test systems. This segment incorporates constituent technologies, sophisticated engineering teams, and other resources developed from the measuring instrument business.

Mechatronics System Segment

The mechatronics system segment focuses on peripheral devices to the semiconductor and component test systems. This business includes test handlers applying mechatronics technologies, which handle semiconductor devices and automate the tests, device interfaces with measured devices, and operations related to nano-technology.

Services, Support and Others Segment

The services, support and others segment consists of comprehensive customer solutions provided in connection with the semiconductor and component test system and mechatronics system segments, support services and an equipment lease business.

Sales by Segment

The following table illustrates net sales by each segment for the last three fiscal years.

Segment	Fiscal 2003		Fiscal 2004		Fiscal 2005	
	Sales		Sales		Sales	
	(in millions)	%	(in millions)	%	(in millions)	%
Semiconductor and Component Test System Segment	¥ 123,489	70.9	¥ 180,685	75.5	¥ 191,415	75.4
Mechatronics System Segment	34,225	19.6	46,395	19.4	48,260	19.0
Services, Support and Others Segment	20,465	11.8	19,680	8.2	19,062	7.5
Intercompany transactions elimination	(3,961)	(2.3)	(7,321)	(3.1)	(4,815)	(1.9)
Total Net Sales	¥ 174,218	100.0%	¥ 239,439	100.0%	¥ 253,922	100.0%

Table of Contents

Industry Overview

Advantest offers products in semiconductor and component test systems, mechatronics systems, and services, support and others. Advantest's main customers are semiconductor and electronic components manufacturers, foundries and test houses. Advantest believes that the following factors will promote growth of the business carried out by its main customers.

the move to lower-cost, smaller, faster and more powerful and energy efficient semiconductors and electronic components;

the increase in demand for higher performance servers and personal computers;

the increase in demand for digital consumer products such as flat-panel TVs, DVD recorders and portable music players;

the emergence of new models of high-performance game machines;

the increasing levels of wireless communications penetration worldwide due to the expansion of the mobile phone industry;

the development of higher speed communications infrastructure;

the use of fiber optic networks to provide high-speed voice, data and video services;

the increasing focus on the production of electronic devices that incorporate semiconductor and communications technologies; and

the increase in demand for electronic components including semiconductors and sensors, in response to technological advancement of automobiles.

Advantest believes that these factors will continue to provide it with long-term growth opportunities because they should lead to additional capital expenditures by its customers, resulting in an expansion of businesses for Advantest. However, the capital expenditures of Advantest's customers may be adversely affected by the following factors:

the level of demand for semiconductors and electronic components;

advancements in semiconductor and electronic components technology; and

changes in semiconductor and electronic components manufacturing processes.

Demand for Semiconductors and Electronic Components

Demand for semiconductor and component test systems and mechatronics systems is closely related to the volume of semiconductors and electronic components produced and the resulting capital expenditure of semiconductor manufacturers and others.

Semiconductors are generally classified as either memory semiconductors or non memory semiconductors. Memory semiconductors are used in electronic systems to store data and programs. Non memory semiconductors include various semiconductors that incorporate non memory circuits, which include logic and analog circuits. Logic circuits process digital data to control the operations of electronic systems. Analog circuits process analog signals translated from real world phenomena such as sound, light, heat and motion. SoC semiconductors are a subset of non memory semiconductors that combine advanced logic circuits with analog and/or memory circuits on a single chip. SoC semiconductors are used in a variety of sophisticated products, including wireless communications, fiber optic equipments and digital consumer products.

Semiconductor sales have increased significantly over the long-term. However, semiconductors, particularly memory semiconductors, have experienced significant cyclical variations in growth rates. According to World Semiconductor Trade Statistics, the worldwide sales of all semiconductors increased from approximately

Table of Contents

\$50 billion in 1990 to approximately \$204 billion in 2000, with cycles of growth and contraction occurring during the period. In 2001, worldwide semiconductor sales fell by approximately \$65 billion, or approximately 32%, compared to the previous year to approximately \$139 billion. While sales in 2002 increased only marginally compared to the previous year, sales climbed sharply by approximately \$25 billion or 18% compared to the previous year to \$166 billion in 2003. Sales in 2004 increased by approximately \$46.6 billion or 28% to \$213 billion, and sales in 2005 increased by \$14.5 billion or 6.8% to \$227.5 billion, compared to the previous year, due to continuing demand in major applications such as personal computers. The following table sets forth the size of the market for memory semiconductors, non memory semiconductors (including SoC semiconductors) and all semiconductors between 1999 and 2005 and the projected market size between 2006 and 2008 as compiled and estimated by World Semiconductor Trade Statistics as of May 2006.

	Actual Year ended December 31,							Projected Year ending December 31,		
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
	(in millions)							(in millions)		
Memory	\$ 32,286	\$ 49,227	\$ 24,875	\$ 27,041	\$ 32,506	\$ 47,136	\$ 48,519	\$ 55,301	\$ 62,947	\$ 70,921
Non memory	117,093	155,167	114,088	113,672	133,920	165,891	178,965	195,158	215,054	242,579
Total	\$ 149,379	\$ 204,394	\$ 138,963	\$ 140,713	\$ 166,426	\$ 213,027	\$ 227,484	\$ 250,459	\$ 278,001	\$ 313,500

The market for semiconductors improved significantly in 1999 and the first half of 2000. However, in the second half of 2000, market prices for both memory semiconductors and SoC semiconductors began to decrease significantly. This downturn continued and deepened throughout 2001 and, despite increased demand generated by some segments of the digital consumer electronics market, in particular the flat-panel TVs, DVD recorder and high-end wireless handset markets, market prices for semiconductors remained depressed and the overall market for semiconductors remained weak in 2002 as well. This weakness in demand was a result of, among other factors, the global economic downturn, sluggish sales of personal computers and continued low levels of investment in communications infrastructure.

The non memory semiconductor market is less volatile than the memory semiconductor market because these semiconductors are used in a larger variety of consumer products and equipment. In periods of rapid decline in the semiconductor market, the capital expenditures of semiconductor manufacturers, including their purchases of test systems, generally decline at a faster pace than the decline in semiconductor sales. In addition, sales of test systems generally do not experience significant increases following a downturn in the semiconductor market until semiconductor manufacturers determine that the market for semiconductors is experiencing a real recovery.

The semiconductor market bottomed out in the second half of fiscal 2001 and then improved from fiscal 2002 to the first half of fiscal 2004. However, the market slowed down beginning in the second half of fiscal 2004 due to the adjustment of excess inventories by semiconductor manufacturers. However, the market recovered sooner than expected, improving in the first half of fiscal 2005 and expanding further in the second half of fiscal 2005. According to data published by World Semiconductor Trade Statistics as of May 2006, the market for memory semiconductors will grow at a compound annual growth rate of approximately 13.5% over the next three years to approximately \$70.9 billion in 2008. Advantest believes that demand for memory semiconductors will be generated in the foreseeable future by the prevalence of DDR2-SDRAM, which has a higher operating speed than DDR-SDRAM, the next generation DDR3-SDRAM, flash memory and other high-end semiconductors. While World Semiconductor Trade Statistics estimates that the non memory semiconductor market will grow at a compound annual growth rate of approximately 10.7% over the next three years to approximately \$242.6 billion in 2008. Advantest believes that the demand for non memory semiconductors will generally grow in the foreseeable future, led by the further prevalence of digital consumer products, including flat-panel TVs, DVD recorders, and the new developments in personal computers or high performance mobile phones.

Table of Contents

Advancements in Semiconductor and Electronic Component Technology

Advantest believes that demand for semiconductor and component test systems and mechatronics systems is also affected by the rate of change and development in semiconductor and electronic component technology. Current changes in the semiconductor and electronic component industry relate to the innovation of digital consumer products and communications technologies. Demand for faster semiconductors and electronic components that are smaller in size, incorporate more functions and require less power to operate is being driven by:

growing demand for, and continuous improvements in, consumer electronics products, such as flat-panel TVs, DVD recorders, digital cameras, television game consoles and mobile phone handsets; and

requirements of communications network equipment, such as network routers, switches and base stations, as well as wireless handsets and other Internet access devices, to enable advances in Internet hardware and software applications, increases in infrastructure performance and simplification and miniaturization of Internet access devices.

Demand for personal computers and servers with higher performance and capabilities is also driving changes in the memory semiconductor sector. This demand is causing manufacturers to shift to the production of memory semiconductors, including memory semiconductors that allow higher-speed data transfer such as DDR2-SDRAM and the next generation DDR3-SDRAM, and flash memory that feature large capacity and nonvolatility. Advantest believes that this shift is creating demand for test systems for memory semiconductors capable of handling these new types of memory semiconductors. In addition, Advantest believes that additional demand for mechatronics systems, including test handlers and device interfaces connecting semiconductor devices and test systems, will be created and will grow in line with advances in semiconductor technologies.

The development of SoC semiconductors with lower cost, smaller size, higher performance and lower power consumption has created demand for sophisticated semiconductor and component test systems that can simultaneously test SoC semiconductors logic, analog and memory circuits. Further innovations in non memory semiconductor technologies including SoC semiconductor technology are expected, and Advantest believes these innovations will create demand for new, high-performance semiconductor and component test systems optimized for use with these advanced semiconductors.

Advantest also believes that the integration of SoC semiconductors into a range of digital consumer products will drive demand for low-cost test systems for SoC semiconductors. SoC semiconductors are often customized for applications in specific products, which results in a large variety of SoC semiconductors that are often produced in relatively smaller volumes.

Changes in Semiconductor and Electronic Component Manufacturing Technologies

Semiconductor and electronic component manufacturers are promoting production outsourcing, technological innovation in manufacturing processes and testing technology to improve productivity.

Production Outsourcing

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In recent years, semiconductor manufacturing and testing processes have become more complex and capital intensive. As a result, an increasing portion of the manufacturing and testing functions are being subcontracted out, by companies that design, but outsource the production of, semiconductors, namely fabless design companies, in order to reduce capital expenditures. This trend has resulted in an increase in the number of test houses that accept test process outsourcing and foundries that accept manufacturing process outsourcing. Foundries either perform testing in-house or outsource their testing needs to test houses. This trend towards production outsourcing, particularly to test houses, has increased the number of potential customers for semiconductor and component test system manufacturers, although it has not significantly affected total demand for Advantest's products. In addition, Advantest believes that semiconductor and component test systems which have been used for the product lines of multiple semiconductor designers are deemed most appropriate by fabless

Table of Contents

design companies, foundries and test houses. Advantest believes this compatibility requirement on the part of fabless design companies and test houses or foundries gives semiconductor and component test system manufacturers with broader product lines and larger market shares an advantage over smaller competitors. Outsourcing has also been utilized for electronic component manufacturing.

Technological Innovation in Manufacturing Processes

One of the recent innovations in semiconductor manufacturing processes is the production of semiconductors using 300 millimeter wafers. Wafers are circular flat pieces of silicon from which multiple semiconductor chips are constructed using photo-etching and other manufacturing processes. The use of 300 millimeter wafers will allow manufacturers to increase average semiconductor production per wafer by 125% when compared to production using conventional 200 millimeter wafers. Many manufacturers announced delays in investment in 300 millimeter wafer factories beginning in the second half of 2000 due to negative trends in the semiconductor market. However, investment in these factories by some manufacturers resumed at the end of 2002, investment increased from 2003 to 2005, and is expected to continue to increase during 2006. Investment in these facilities is expected to lead to demand for new semiconductor and component test systems and test handlers with increased throughput capabilities for semiconductor manufacturers to capture fully the cost efficiencies associated with the use of 300 millimeter wafers.

New Testing Technologies

Semiconductor designers and manufacturers are striving to further reduce costs through the development of self-test technologies. Self-test technologies are designed into circuits which are added on to semiconductor chips and simplify testing process and reduce the aggregate time and cost required for testing. However, Advantest believes that testing using self-test technologies is less reliable than that using semiconductor and component test systems. Advantest believes that self-test technologies will be used primarily in flash memory semiconductors and high value-added semiconductors, such as certain SoCs, that are expected to have large future production volumes.

Advantest believes that semiconductor and electronic component manufacturing processes will continue to evolve. The introduction of new manufacturing processes will likely cause test costs to occupy a higher percentage of the total cost of manufacturing and, therefore, increase price pressure on the test system industry. Advances in the semiconductor and electronic component industry will also require test systems with new and more sophisticated testing functions. Advantest believes that these trends provide it with an opportunity to distinguish itself from its competitors through the delivery of new products that are priced and designed to meet the specific needs of its customers.

Business Strategy

Advantest's core business goals include:

focusing on the development of test systems which can respond to changes in memory and SoC semiconductors;

growing its market share for test systems for SoC semiconductors and maintaining high market share for test systems for memory semiconductors;

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growing its market share for test handlers for SoC semiconductors;

developing, designing and supplying high quality device interfaces in a shorter period of time;

enhancing its operating efficiency to improve profitability, through promotion of production innovations; and

strengthening its ability to provide comprehensive solutions to satisfy client needs.

Table of Contents

To achieve these goals, Advantest plans to:

Continue to address industry trends, identify customer needs and deliver new products ahead of its competitors

Advantest will continue to work closely with major semiconductor manufacturers from their product design stage of semiconductor and component test systems to understand customer needs relating to emerging technologies and applications. Based on this knowledge and its technological expertise, Advantest seeks to develop more advanced semiconductor and component test systems, test handlers, device interfaces and comprehensive solutions ahead of its competitors. For example, Advantest is pursuing the following strategies:

developing semiconductor and component test systems with increased test speeds and throughput capabilities and test handlers in line with the technological development of memory semiconductors, SoC semiconductors and other semiconductors;

designing the next generation semiconductor and component test systems for 300 millimeter semiconductor wafer production that will achieve improved throughput by simultaneously testing higher numbers of dies;

proactively developing products to address the recent shift in emphasis in the semiconductor industry toward front-end testing of dies;

actively applying analog technology developed for measuring instruments for wireless communications market to test systems for non memory semiconductors including test systems for SoC semiconductors;

offering semiconductor and component test systems with high throughput in order to test recent devices incorporating interfaces with data rates of several gigabits per second; and

developing device interfaces that can optimize the performance of semiconductor and component test systems and test handlers in responding to the semiconductors with higher speed and large pin counts.

Strengthen the test system business for SoC semiconductors

Advantest believes that the market for test systems for SoC semiconductors in 2005 was approximately twice the size of the market for test systems for memory semiconductors. Advantest has therefore devoted its resources to develop test systems for SoC semiconductors to meet the demands of a large number of manufacturers for the testing of a wide variety of SoC semiconductors.

Advantest continues to promote the adoption of OPENSTAR[®], an industry-wide, open architecture for test systems for SoC semiconductors. Advantest believes that the primary benefits of OPENSTAR[®] for users of semiconductor and component test systems will be reduced testing costs and greater procurement options. In addition, Advantest hopes that the reduction in testing costs, and thus the lowering of overall manufacturing costs of SoC semiconductors, will help foster further demand for SoC semiconductors to be used in digital consumer products and other products. Finally, Advantest believes that the adoption of a new open architecture will provide an opportunity for late entrants to the test systems for SoC semiconductors market, such as Advantest, to increase their market share.

Focus sales and support efforts on key customer accounts

Advantest believes that a small number of large semiconductor manufacturers, test houses and foundries account for a large portion of total sales in the semiconductor and component test system industry. Advantest sells semiconductor and component test systems and mechatronics systems to many of these customers and supports them on a regular basis. Advantest is seeking to expand its business with these high-volume customers and develop new relationships with the remaining potential major customers. Over the past several years, Advantest has opened additional overseas sales and support offices, many of which are located near the corporate headquarters or main research and development and manufacturing facilities of these high-volume customers. These offices are expected to facilitate Advantest's efforts to continue conducting collaborative development activities with leading semiconductor manufacturers.

Table of Contents**Products**

As of fiscal 2005, Advantest's main products are products developed, manufactured and sold in the semiconductor and component test system segment and mechatronics system segment. They are as follows:

Semiconductor and Component Test Systems Segment***Semiconductor and Component Test Systems***

Semiconductor and component test systems are used during the semiconductor and electronic component manufacturing process to confirm that a semiconductor functions properly. Semiconductor and component test systems consist of test systems for memory semiconductors and test systems for non memory semiconductors.

The following table sets forth the amount of net sales of Advantest's semiconductor and component test systems, for memory and non memory semiconductors for the periods presented.

Category	Fiscal 2003	Fiscal 2004	Fiscal 2005
		(in millions)	
Test systems for memory semiconductors	¥ 87,739	¥ 123,856	¥ 100,311
Test systems for non memory semiconductors	35,750	56,829	91,104
Total	¥ 123,489	¥ 180,685	¥ 191,415

Test Systems for Memory Semiconductors

Advantest's test systems for memory semiconductors are test systems designed to test high-speed/high performance memory semiconductors used in applications such as personal computers and servers, as well as memory semiconductors used in digital consumer products.

Test systems for memory semiconductors consist of a mainframe and one or more test heads. During testing, a device interface is attached to the test head. During the front-end testing process, wafers are attached to and detached from the device interface by a prober. Electric signals are transmitted between the die and the test systems for memory semiconductors through probe pins located in the device interface. After front-end testing is completed, the wafer is diced into separate dies and properly functioning dies are packaged. During back-end testing, test handlers are used to load these devices onto the device interface, and electric signals are transmitted between the semiconductor chips and the semiconductor test system via the device interface. The results are stored in a database, and then analyzed by the test systems for memory semiconductors hardware circuits and software programs. Each different semiconductor design requires a customized software program to analyze the test data.

Characteristics of the performance and other characteristics of test systems for memory semiconductors that are important to customers include:

Throughput. Throughput is measured by the number of semiconductors that can be tested by test systems for memory semiconductors during a specified time.

Test Speed. Test speed is the speed at which the test systems for memory semiconductors test semiconductors during testing. Test speed is measured in terms of megahertz, or MHz.

Timing Accuracy. Timing accuracy is the test system for memory semiconductors accuracy of control over the timing of testing signals generated.

Maximum Pin Count. Maximum pin count is the number of channels for test signals (at the maximum) used by test systems for memory semiconductors.

Table of Contents

Size. Smaller machines reduce the amount of floor space occupied and electricity consumed by the test systems for memory semiconductors.

Temperature. Semiconductor manufacturers perform tests on semiconductors at varying temperatures to ensure proper operation under extreme conditions.

Compatibility. Test systems for memory semiconductors that are compatible with predecessor systems cut down on the time required to develop new test programs and otherwise allow for effective utilization by customers of existing resources.

Quality. Quality is determined by the reliability of test results produced and whether the equipment can maintain stable operation under different testing environments.

Advantest estimates that its market share in test systems for memory semiconductors was approximately 69% in 2005 as compared with approximately 70% in 2004. Since fiscal 2005 experienced negative growth in response to rapid growth in the market for test systems for memory semiconductors, Advantest believes that it maintained its overall market share primarily by increasing sales of its test systems for DRAM semiconductors and flash memory semiconductors. Advantest has a substantially larger market share in back-end test systems for memory semiconductors than in front-end test systems for memory semiconductors. Advantest is currently seeking to increase its market share in front-end test systems for memory semiconductors.

Advantest's main product lines of test systems for memory semiconductors are the T5500 series, the T5300 series and the T5700 series.

T5500 Series. The T5593 is a test system targeted at the market for high speed memory semiconductors such as the DDR2-SDRAM and SGRAM. SGRAM is a memory semiconductor for use in graphical processor units. The T5588/87, introduced in fiscal 2005 as the successor to the T5585, makes possible simultaneous measurement of up to 512 DDR2-SDRAM devices, twice that of the T5593, and is the latest test system for mass production. Advantest can also accommodate a greater variety of memory semiconductors by using testing functions for flash memory which are already long used in connection with the T5370 series and its newly developed throughputs enhancement functions. The top-of-the-line device in the T5500 series is the T5501, a memory semiconductor test system most suitable for testing and production of ultra high-speed memory semiconductor such as the next generation SGRAM. This model allows twice as much spectrum band to be covered in terms of testing speed as the T5593 and thus enhances the measurement accuracy.

T5300 Series. The T5375 and T5377 are multi-functional test systems for memory semiconductors that reduce testing costs for semiconductor manufacturers. The T5375 and T5377 are used for the front-end testing of DRAM semiconductors and for back-end testing of flash memory semiconductors. By increasing the functions of the system, Advantest has succeeded broadening its customer base. The T5375 and T5377 can test up to 256 devices at one time. The T5375 and T5377 are aimed at capturing an increased market share in front-end DRAM semiconductor testing and have twice the throughputs capabilities of the T5371, the predecessor to the T5375, thereby lowering overall testing costs for Advantest's customers. In particular, the T5377 optimizes its memory repair analytical structure to a user's memory repair algorithm and, due to its higher throughput capabilities, is suited for the production of semiconductors in manufacturing facilities that use 300 millimeter wafers. Advantest introduced the T5377S in response to customers' needs for a smaller sized model of the T5377. Also in fiscal 2005, Advantest introduced the T5372 to meet demand for 200mm wafer production lines as a successor model to the T5371. In addition to these products, the T5300 series is Advantest's best selling test systems for memory semiconductors product line for front-end testing of DRAM semiconductors and for back-end testing of flash memory semiconductors.

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T5700 Series. Flash memory semiconductors require more types of front-end testing than other types of semiconductors. Advantest's latest front-end test system for flash memory semiconductors is the T5724. The

Table of Contents

T5724 is capable of simultaneously testing up to 2,048 flash memory semiconductors with the Built-in-Self-Test, or BIST, function, which is sixteen times greater than the capacity of previous models, and significantly lowers test costs. The increase in capacity is due to the T5724's use of a probe card that allows for aggregate wafer contact which increases test speed.

Test Systems for Non Memory Semiconductors

Advantest's main line of test systems for non memory semiconductors relates to test systems for SoC semiconductors and other test systems for non memory semiconductors.

Test Systems for SoC Semiconductors

Test systems for SoC semiconductors test semiconductors with specific functions, such as SoC semiconductors that combine analog and/or memory circuits on a single semiconductor chip and LCD driver ICs that display images on LCD panels. The factors that are important to customers in the performance and other characteristics of test systems for memory semiconductors described above also apply to test systems for SoC semiconductors. Advantest's market share in test systems for SoC semiconductors increased from approximately 17% in 2004 to approximately 28% in 2005.

T2000. In 2004, Advantest brought to market a test system for SoC semiconductors that is based on component modules compatible with OPENSTAR® open architecture. Advantest believes that the development of OPENSTAR® compatible semiconductor test systems for SoC semiconductors will increase Advantest's market share in test systems for SoC semiconductors. Currently, Advantest's OPENSTAR® compatible test systems for SoC semiconductors is the T2000. Main compatible component modules for the T2000 are the 250 MHz Digital Module, the Low Current DPS, the High Current DPS and 6.5Gbps Digital Module. The 6.5Gbps Digital Module primarily targets the testing of MPU and high speed interface used for chips and operates at a maximum of 6.5Gbps.

T6500 Series. The T6577 test systems for SoC semiconductors in the T6500 series are primarily designed to test MCU and SoC semiconductors that control digital consumer products at the production lines. The T6500 series is approximately one-third in size, and uses approximately 50% less power, as compared to Advantest's predecessor product line. The T6500 series operates on software that is compatible with the T6600 series.

T6300 Series. The T6362 and T6372 are test systems for non memory semiconductors for semiconductors used with high-definition LCD displays. This system can simultaneously test multiple semiconductors for LCD driver integrated circuits (ICs) with a total of up to 1,536 pins.

T7720 Series. The T7721 and T7722 are test systems for non memory semiconductors for mixed signal integrated circuits. The T7721 targets highly complex semiconductors used in car electronics and results from the development of Advantest's constituent technology that measures analog signals. The T7721 uses a direct current signal generator with a range of 150V to 64V and utilizes up to a maximum of 256 pins, and the T7721 has the capacity to simultaneously measure multiple devices.

T8571. The T8571 is a test system for non memory semiconductors that is primarily used to evaluate and analyze CCDs that are image sensors. These semiconductors are used in digital consumer products, such as high-resolution digital cameras, mobile phone handset cameras and digital video cameras.

Mechatronics System Segment

Main products in the mechatronics system segment are test handlers which handle semiconductor devices and automate the testing, and device interfaces which are the interfaces with devices being tested.

Table of Contents

Test Handlers

Test handlers are used with semiconductor and component test systems to handle, thermally condition, contact and sort semiconductors and other electronic components during the back-end testing of the semiconductor manufacturing process.

Advantest's test handlers are sold primarily in conjunction with the sale of its semiconductor and component test systems. During fiscal 2004, a majority of test handlers, measured in units, were sold to customers of Advantest's semiconductor and component test systems. Advantest's test handlers are compatible with the semiconductor and component test systems of its competitors.

Test handlers are designed with different characteristics for memory and non memory semiconductors. Memory semiconductors require relatively long test times. Advantest's test handler for memory semiconductors handle up to 256 semiconductors per test head at a time. Non memory semiconductors, including SoC semiconductors, require relatively short test times and Advantest's test handlers handle up to eight semiconductors at a time.

Test Handlers for Memory Semiconductors. Advantest's test handler for test systems for memory semiconductors is the M6300 that handles up to 256 semiconductors at a time. The M6300 achieves maximum throughput of up to 12,000 semiconductors per hour through the use of a new high-speed handling technology that shortens the time between tests to approximately half of the time associated with Advantest's ordinary model. Semiconductor manufacturers can decide to use two M6300 test handlers per semiconductor and component test system to double the handling capacity per semiconductor and component test system. The M6542AD is another test handler for memory semiconductors designed to be used during back-end testing of DDR-SDRAM and other high-speed SDRAM that handles up to 128 semiconductors at a time. The M6542AD is designed to prevent the generation of excessive heat during simultaneous measuring by employing a newly developed temperature control technology. Advantest also has other test handler product line-up for test systems for memory semiconductors that meet varying cost and functional needs of its customers.

Test Handlers for Non Memory Semiconductors. Advantest's test handlers for test systems for non memory semiconductors, including SoC semiconductors, are the M4541A and the M4541AD. Both test handlers for non memory semiconductors achieve maximum throughput of up to 6,000 semiconductors per hour. The M4541A can simultaneously handle up to four devices and the M4541AD, up to eight devices.

M4741A is a back-end test handler for non memory semiconductors that utilizes vision alignment and can be used for small, narrow pitch semiconductors. The M4741A achieves maximum throughput of up to 4,000 semiconductors per hour. The M4741A can simultaneously handle up to four devices.

M7521A is a test handler that can be used for chip on film, or COF, and tape automated bonding, or TAB of integrated circuit drivers used in flat-panel displays. The M7521A can test devices used in 35 millimeter, 48 millimeter, 70 millimeter, wide and superwide tapes.

Device Interfaces

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A device interface is a mechanism through which test signals are transmitted between the device being tested and a semiconductor and component test system. Well-designed device interfaces that are compatible with various types of devices enhance the utility of a semiconductor and component test system by allowing it to test different semiconductor product lines and therefore reducing the cost for semiconductor and component test system users.

Advantest manufactures device interfaces for semiconductor and component test systems and is continuously developing and supplying new device interfaces, such as high performance connectors and socket boards, featuring increased throughput, precision and ease of maintenance to meet the demands of next-

Table of Contents

generation semiconductors that are becoming more high-speed. Advantest believes that the rate at which new semiconductor designs are introduced to market will continue to increase in the long term, and demands for main parts of device interfaces that are compatible with such new semiconductor designs will increase accordingly.

Advantest competes with numerous small and independent electronics manufacturers in providing device interfaces for its semiconductor and component test systems. However, Advantest believes that as the complexity of the testing requirements of next-generation semiconductors increases, Advantest will enjoy competitive advantages by applying its technical knowledge, such as high speed signal transmission derived from designing and manufacturing semiconductor and component test systems to device interfaces.

Customers

Advantest's semiconductor and component test systems and mechatronics systems are shipped and delivered to many of the world's leading semiconductor manufacturers, as well as a number of foundries and test houses. Advantest's largest customer accounted for approximately 12% of net sales in fiscal 2003, 15% in fiscal 2004 and 17% in 2005. Advantest's five largest customers, all of which are semiconductor and component test system customers, accounted for approximately 37% of net sales in fiscal 2003, approximately 42% in fiscal 2004 and approximately 41% in fiscal 2005.

Geographic Sales

Approximately 68% of Advantest's fiscal 2005 net sales were derived from products sold to customers located outside Japan. The following table sets forth Advantest's net sales by geographic area, as well as net sales by geographic area as a percentage of total net sales, for Advantest's last three fiscal years. Net sales are classified into geographic areas based on the location to which the products are shipped.

Market	Fiscal 2003		Fiscal 2004		Fiscal 2005	
	Net Sales		Net Sales		Net Sales	
	(in millions)	%	(in millions)	%	(in millions)	%
Japan	¥ 57,990	33.3	¥ 60,025	25.1	¥ 81,140	32.0
Asia (excluding Japan)	89,563	51.4	144,120	60.2	132,708	52.3
Americas	16,264	9.3	23,024	9.6	25,516	10.0
Europe	10,401	6.0	12,270	5.1	14,558	5.7
Total	¥ 174,218	100.0%	¥ 239,439	100.0%	¥ 253,922	100.0%

Japan. Advantest believes that its most substantial customer relationships are with semiconductor manufacturers in Japan. Advantest enjoys a significant market position in Japanese markets for test systems for memory semiconductors, with its market share of approximately 78% in 2005. In addition, Advantest had an approximately 56% market share in the Japanese test systems for SoC semiconductors market in 2005. Advantest currently expects sales of test systems for SoC semiconductors used in DVD recorders and flat-panel TVs and sales of test systems for SoC semiconductors for LCD driver ICs used to display images on LCD panels comprised a substantial portion of total sales of test systems for

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non memory semiconductors in Japan in fiscal 2005. Advantest is working to solidify its market leadership in Japan by continuing to work closely with its major customers to identify their needs during the early stages of their product development cycles.

Asia (excluding Japan). Asia is the largest market for semiconductor and component test systems and mechatronics systems, with semiconductor manufacturers located in Taiwan, Korea, the People's Republic of China, and Singapore accounting for a majority of semiconductor production in Asia. Advantest views its relationships with these companies as critical to its semiconductor and component test system and mechatronics system business. Many Japanese, U.S. and European semiconductor manufacturers have shifted production to Asia, either to subsidiaries or foundries and test houses. Capital expenditure decisions for subsidiaries are usually made at the company's headquarters. Foundries and test houses, a majority of which are located in Taiwan, often

Table of Contents

consult with their customers before investing in semiconductor and component test systems. Therefore, Advantest's performance in Asia will also depend on its ability to maintain strong relationships with customers in Japan, the U.S. and Europe. In addition, some of Advantest's customers have partnered with semiconductor manufacturers in Asia and outsourced manufacturing processes, thus shifting net sales to the Asia geographic market.

Americas. Advantest's marketing efforts in this region are centered in the U.S., which accounted for approximately 10% of its total sales in fiscal 2005. Advantest's market share of semiconductor and component test systems sold in the U.S. was approximately 24% in 2005 and approximately 23% in 2004. Semiconductor and component test systems are marketed and sold in the Americas through Advantest's subsidiary, Advantest America Inc.

Europe. Sales in Europe constituted approximately 6% of Advantest's sales in fiscal 2005. Advantest's market share of semiconductor and component test systems sold in Europe increased to approximately 29% in 2005 from approximately 20% in 2004. Advantest's principal European markets are Germany, Italy and France.

Sales and Marketing

Advantest sells its semiconductor and component test systems and mechatronics systems globally through direct sales channels. Advantest's direct sales department includes engineers who have in-depth knowledge of the customer's business and technology needs. Some of these engineers are account managers for Advantest's largest customers. Currently, Advantest has six sales offices in Japan, seven in Asia (excluding Japan), nine in the Americas and seven in Europe. Advantest maintains its sales and support centers in close physical proximity to key customer sites to identify its customers' needs in the early stage of product development and to provide required support in a timely fashion. Advantest is also strengthening its relationships with test houses through limited minority investments as a part of its sales and marketing strategy. In addition, Advantest offers operating lease contracts for semiconductor and component test systems through its subsidiary, Advantest Finance Inc.

Advantest believes that the best marketing strategy is to demonstrate the ability to develop products that meet the customer's specific needs, produce and deliver them in the required time and quantity, and support the customer and the product with sufficient technical and maintenance support. Advantest holds exhibitions from time to time to demonstrate and market its products to target customers. Advantest also markets by participating in industry trade shows and advertising in trade magazines.

Support and Customer Service

Advantest's support and customer service programs are designed to respond to all of the semiconductor testing-related needs of its customers. Advantest provides its services through its worldwide network of sales and customer support offices. These services consist the following elements:

Semiconductor Design Phase Support. Advantest engineers work with semiconductor manufacturing companies during the design phase of new semiconductor product lines and provide support to enable the use of semiconductor and component test systems for large-scale production.

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Application Software Support. Each different semiconductor design requires customized software programs for analysis of test data. Advantest engineers assist customers in designing application software and test programs that optimize production throughput, reliability and capacity.

Procurement Support. The procurement process for semiconductor and component test systems and mechatronics systems is time consuming and complicated. Semiconductor and component test systems consist of a combination of multiple components, including test handlers or probers, device interfaces and software. Advantest sales personnel and engineers work with customers to identify the semiconductor and component test systems and mechatronics systems and related optional functions that best address their needs.

Table of Contents

Installation and Upgrade Support. The introduction of a new line of semiconductors by a manufacturer typically requires either the purchase of new semiconductor and component test systems and mechatronics systems or an upgrade of the customer's existing system. Upon the sale of a new system, Advantest's engineers provide installation services and work with the customer to integrate the purchased system with the customer's existing manufacturing infrastructure.

Training Support. Advantest offers on-site training, as well as training at Advantest's facilities, on the operation and maintenance of its semiconductor and component test systems and mechatronics systems.

Maintenance Support. Advantest's maintenance support services consist of:

Call Center Support. Advantest currently offers call center support services for hardware and software in Japan. This call center also offers support to the customer support centers that Advantest has overseas.

Internet Support. The Advantest customer support website offers maintenance tips and access to a database with possible solutions to semiconductor and component test system problems. Advantest customers can also make on-line requests for maintenance work and check on the status of equipment sent in for repair through Advantest's web page.

Repairs and Parts. Requests for repairs or parts can be made through the Advantest website or by phone, and Advantest has established a system under which it endeavors to deliver requested parts to customers in Japan within 24 hours of request. And for customers in Asia (excluding Japan), the Americas and Europe within 48 hours of request.

Remote Surveillance. Advantest can equip its semiconductor and component test systems with a remote surveillance function. This function allows Advantest engineers to remotely monitor the performance of its customers' semiconductor and component test systems for more timely and effective maintenance.

Worldwide Presence. Advantest provides maintenance support through ten customer support centers in Japan, nine in other parts of Asia, eight in the Americas and five in Europe.

Manufacturing and Supplies

Advantest's principal manufacturing factories for semiconductor and component test systems are its Kumagaya Factory located in Saitama prefecture, Japan and its Gunma Factory located in Gunma Prefecture, Japan. At the Kumagaya Factory, printed circuit boards for eventual use in test systems are manufactured, while the Gunma Factory produces test systems as final products. The production base for mechatronics systems is the Otone R&D Center located in Saitama prefecture, Japan. The Gunma Factory is highly automated and testing and production systems within the factory are interconnected by a sophisticated local area network using advanced data management software. This network allows Advantest factory managers to check on the status of systems under production at any given time.

Advantest uses an enterprise resource planning system that processes new information on a real time basis and uses sophisticated data management software that converts sales orders into production specifications and manufacturing plans. This system also interconnects Advantest's multiple production and warehousing facilities to its information network.

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Advantest has integrated many production processes in an effort to introduce a new production system based on the just-in-time production system and to improve upon the existing production system with a view to attaining a shorter production cycle, cost reduction and reduction of inventories.

Advantest purchases substantially all of its components and parts from outside suppliers.

The average costs of components and parts used by Advantest during the last three fiscal years have remained relatively stable. Advantest believes this relative price stability results from the fact that Advantest

Table of Contents

negotiates the terms of the purchase orders directly with its suppliers and the fact that the prices of the made-to-order components set forth in the purchase orders are primarily influenced by the technical specifications of the relevant components and parts.

Device interfaces, one of Advantest's products in its mechatronics system segment, are manufactured in Japan as well as overseas, including in Germany, Korea, Taiwan and Malaysia, in order to reduce the time required for shipment to customers and to reduce manufacturing costs.

Seasonality

As Advantest's sales levels of semiconductor and component test systems and mechatronics systems are not dependent on any particular season and are subject, in large part, to sales levels of the semiconductors in the market that can fluctuate significantly from year to year, Advantest does not traditionally experience seasonality in the sense of higher sales during any certain period of the year as compared to other periods of the year.

Competition

Advantest faces substantial competition throughout the world in all of its business segments. Advantest believes that the principal factors of competition are:

Performance. The performance of products is determined by its accuracy, test speed, throughput and ability to test semiconductors with large pin counts. High performance products reduce the customer's cost of testing.

Reliability. Products that operate with minimal downtime allow semiconductor production and engineering work to proceed without frequent intervention and provides more cost-effective operation.

Delivery Time. Semiconductor manufacturers require timely delivery of products, especially in periods of high demand.

Price. The need for more sophisticated products often translates into higher testing costs for semiconductor manufacturers. In addition, as a result of increased efficiency of the fabrication process and lower market prices for semiconductors, test costs have come to represent a higher proportion of the total cost of manufacturing. Advantest currently faces significant price pressure in its semiconductor and component test system segment.

System Architecture. Product architecture that is modular expands the product life because the system can be adapted to meet the customer's new requirements, while largely retaining compatibility with existing test programs.

Software. Products that use software that is easier to use and more powerful reduce the amount of engineering resources needed to develop and operate test programs.

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Customer Support. Customer specific applications programs, worldwide service and customer training contribute to the efficient use of products and minimize the customer's cost of testing.

Qualified Technical Personnel. Having in place a team of highly qualified engineers and other customer service and support personnel is essential for securing sales and maintaining and developing strong relationships with key customers.

Advantest's primary competitors in the semiconductor and component test system market include, among others, Yokogawa Electronic Corporation, Teradyne, Inc., Verigy Pte. Ltd. and Credence Systems Corporation. In addition, Advantest also competes in the mechatronics system market with, among others, TechWing Inc., Delta Design and Yokogawa Electronic Corporation. Advantest also faces additional competition in the market for both the test systems for memory semiconductors and test systems for non memory semiconductors from start-up companies with newer technologies or products.

Table of Contents

Licenses and Intellectual Property Rights

Advantest has a policy of seeking licenses and intellectual property rights worldwide on technology considered of particular strategic importance. While Advantest does not consider any one or group of licenses and intellectual property rights to be so important that their expiration or termination would materially affect Advantest's business, Advantest considers all of its licenses and intellectual property rights to be important.

Legal Proceedings

Based on information currently available to Advantest, Advantest believes that its losses from any legal proceedings would not have a material adverse effect on Advantest's financial position, operating results or cash flows.

Environmental

Advantest has established an Environmental Management Plan for 2004-2006, under which Advantest has committed to realizing a balance of corporate management and environmental protection activities. Advantest's primary environmental activities during fiscal 2005 are as follows:

ISO 14001 Certification. Advantest has received ISO 14001 Certification for all of its domestic manufacturing and research and development activities.

Environmental Measures for Products. Advantest is actively involved in the development of environmentally friendly product lines. Advantest conducts environmental assessments of its products from their development stages.

Reduce Waste. Advantest achieved less than 2% industrial output at all eight of its research and development and manufacturing facilities.

Use of Safe Components. Advantest has established an internal procurement standard for parts and components and has made efforts to procure parts and components for its new products that do not contain specified toxic substances. Advantest has conducted inspection on approximately 26,000 parts used in its manufacturing processes.

Prevention of Global Warming. Through usage of energy efficient equipment and the re-evaluation of manufacturing processes, Advantest strives to reduce levels of carbon dioxide emissions resulting from energy consumption relating to its business activities. Advantest's carbon dioxide emissions resulting from its business activities decreased by approximately 10% per sales unit in fiscal 2005 as compared with fiscal 2000.

Environmental Activities. Advantest has implemented a second round of the reforestation of seedlings to assist in the rehabilitation of tropical forests in Southeast Asia, which have been severely impacted by commercial deforestation.

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Advantest has been addressing issues of corporate management, social activities and environmental issues from a global perspective. With increased attention in recent years on corporate ethics, Advantest believes that it should focus more on the issue of CSR (Corporate Social Responsibility). Advantest has established a CSR Committee, under which it promotes CSR initiatives through seven subcommittees (Disclosure Committee, Personnel Mediation Committee, Human Rights Protection Committee, Information Security Committee, Committee on Environmental Conservation, Internal Control Committee and Corporate Ethics Committee).

Advantest spent approximately ¥1,093 million during fiscal 2005 to further implement its environmental policies. Advantest expects to have similar levels of expenditures related to its environmental policies during fiscal 2006.

Table of Contents

Glossary

Analog circuits	Circuits on a semiconductor that monitor, condition, amplify or transform analog signals, which are signals that vary continuously over a wide range of values. Analog circuits process analog signals translated from real world phenomena such as sound, light, heat and motion.
BIST	Built-in-Self-Test. A self-diagnostic testing mechanism that is incorporated within an integrated circuit.
COF	Chip on Film. A technology that allows for integrated circuits to be imprinted onto a tape film.
CMOS	Complementary Metal Oxide Semiconductor. A semiconductor that uses both negative and positive circuits.
DDR-SDRAM	Double Data Rate Synchronous Dynamic Random Access Memory. Memory semiconductor that can be read from, or written to, at double the rate of traditional SDRAM semiconductors.
DDR-SRAM	Double Data Rate Static Random Access Memory. Memory semiconductor that can be read from, or written to, at double the rate of traditional SRAM semiconductors.
DDR2-SDRAM	Advanced DDR-SDRAM semiconductors that can be read from, or written to, at a significantly higher rate than DDR-SDRAM semiconductors.
DDR3-SDRAM	The next generation DDR-SDRAM semiconductors that be read from, or written to, at a significantly higher rate than DDR2-SDRAM semiconductors.
Digital circuits	Circuits that perform binary arithmetic functions on data represented by a series of on/off states.
DRAM	Dynamic Random Access Memory. Devices that store a large volume of data and can read and write data freely. Because of their volatile characteristics, periodic re-writing of data is required to maintain memory information.
Foundries	Semiconductor manufacturing service providers that manufacture semiconductors based on their customers' semiconductor designs.
Fabless	Manufacturers that outsource their entire production to external entities, instead of having their own manufacturing facilities.
Flash memory	Memory devices that electrically erase or write data freely. Devices with nonvolatile memory which is maintained even when the power is turned off.

Integrated circuit

An electric part made of a combination of many transistors on a silicon wafer.

Table of Contents

LCD driver integrated circuits	Integrated circuits that operate LCD (Liquid Crystal Display)
Logic circuits	Circuits that perform binary arithmetic functions.
Memory circuits	Circuits that store data and programs.
MPU	Micro Processing Unit. An integrated circuit that has data processing capability and forms the central technology of computers.
MCU	Micro Controller Unit. An integrated circuit that contains all necessary functions required for a small-scale computer system.
NAND	A type of flash memory that is primarily used for data storage due to its large storage capability.
NOR	A type of flash memory that is primarily used for memorization of programs due to its speedy capability to read and write.
OPENSTAR®	OPENSTAR is the name of the open architecture standard made publicly available by STC (Semiconductor Test Consortium, Inc.). It is a registered trade mark or brand name in the U.S., Japan, and other countries.
SoC	System on a Chip. A chip that integrates functions, including logic, memory and signaling, that are conventionally executed with multiple chips and requires smaller space and significantly less electricity.
STN	Super Twisted Nematic liquid crystal display. A type of LCD that uses simple matrix formation and has low manufacturing costs.
TAB	Tape-Automated Bonding. A technology that allows integrated circuit chips to be thinly mounted using tape film.
Test houses	Providers of semiconductor test services.
TFT	Thin Film Transistor liquid crystal display. A type of LCD that forms a membrane transistor on glass and has better display quality than STN.

Table of Contents**4.C ORGANIZATIONAL STRUCTURE**

As of June 1, 2006, Advantest had 23 Japanese subsidiaries and 17 overseas subsidiaries. The following table sets forth for each of Advantest's principal subsidiaries, the country of incorporation and the principal activities of the subsidiary.

<u>Name of Subsidiary</u>	<u>Country of Incorporation</u>	<u>Principal Activities</u>
Advantest Laboratories Ltd.	Japan	Research and development of measuring and testing technologies
Advantest Customer Support Corporation	Japan	Maintenance service of Advantest's products
Advanmechatec Co., Ltd.	Japan	Manufacture of Advantest's products
Advantest Manufacturing, Inc.	Japan	Manufacture of Advantest's products
Advantest DI Corporation	Japan	Manufacture of Advantest's products
Japan Engineering Co., Ltd.	Japan	Development, manufacture and sales of Advantest's products
Advantest Finance Inc.	Japan	Leasing of Advantest products
Advantest America, Inc.	U.S.	Sales of Advantest's products
Advantest (Europe) GmbH	Germany	Sales of Advantest's products
Advantest Taiwan Inc.	Taiwan	Sales of Advantest's products
Advantest (Singapore) Pte. Ltd.	Singapore	Sales of Advantest's products
Advantest Korea Co., Ltd.	Korea	Maintenance and manufacturing of Advantest's products
Advantest (Suzhou) Co., Ltd.	China	Marketing and technological support services of Advantest's products

Each of the subsidiaries listed above is a direct or indirect wholly-owned subsidiary of Advantest.

Table of Contents**4.D PROPERTY, PLANTS AND EQUIPMENT**

Set forth below is a list of each of Advantest's material properties, the use and location of the property and the approximate size of the property on which the facility is located.

Name	Location	Approximate Size (m²)	Use
Gunma R&D Center	Gunma, Japan	250,887	Research and development of semiconductor and component test systems and device interfaces
Otone R&D Center	Saitama, Japan	85,817	Research and development for and manufacturing of mechatronics systems
Advantest Laboratory	Miyagi, Japan	66,904	Basic technology research
Gunma Factory	Gunma, Japan	88,512	Manufacture of semiconductors and component test systems
Kumagaya Factory	Saitama, Japan	63,788	Manufacture of interim phase products for semiconductors and component test systems

In addition to the above-mentioned manufacturing facilities, Advantest has manufacturing facilities in the U.S., Korea, and Malaysia, sales offices and customer support centers throughout the world, and owned or leased research facilities in Japan, the U.S. and France. Advantest owns each of its significant properties.

Advantest considers all of its principal manufacturing facilities and other significant properties to be in good condition and adequate to meet the needs of its operations. Advantest does not maintain internal records of the exact productive capacity and extent of utilization of its manufacturing facilities. It would require unreasonable effort and expense to determine this information because Advantest alters the volume, quantity and nature of its manufactured products as necessary in response to changes in demand and other market conditions, and revamps its manufacturing processes to take advantage of technological innovations. However, Advantest believes that its manufacturing facilities are currently operating at utilization levels that are substantially in line with prevailing market demand for its products.

Advantest believes that there does not exist any material environmental issues that may affect the company's utilization of its assets.

As of June 1, 2006, Advantest does not have any material plans to construct, expand or improve its facilities.

ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

5.A OPERATING RESULTS

You should read the following discussion and analysis of Advantest's financial condition and results of operations with Key Information Selected Financial Data and its audited consolidated financial statements at March 31, 2006 and for each of the three years then ended and the notes to such consolidated financial statements appearing elsewhere in this annual report. These consolidated financial statements have been prepared under accounting principles generally accepted in the U.S.

Table of Contents

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. For a detailed discussion of these factors, see [Information on the Company Business Overview Industry Overview](#).

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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.

Table of Contents

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.

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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.

Table of Contents

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.

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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.

Table of Contents

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.

Critical Accounting Policies and Estimates

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 in preparing its consolidated financial statements in conformity with U.S. GAAP. Critical accounting policies are accounting policies that require the application of management's most difficult, subjective or complex judgments and often require management to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. The following is not intended to be a comprehensive list of all of Advantest's accounting policies. Advantest's significant accounting policies are more fully described in note 1 to Advantest's consolidated financial statements included elsewhere in this annual report. In many cases, U.S. GAAP specifically dictates the accounting treatment of a particular transaction, with no need for judgment in its application. There are also areas in which management's judgment in selecting an available alternative would not produce materially different results. Set forth below is a description of accounting policies under U.S. GAAP that Advantest has identified as critical to understanding its business and the reported financial results and condition of the company.

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

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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.

Table of Contents

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.

Inventories

Advantest's inventories consist of on-hand inventory, including inventory located at customer sites, and inventory that is on-order and subject to a contract that is non-cancelable. Advantest states its inventories at the lower of cost or market. Cost is determined using the average cost method. Advantest determines the market for finished goods by determining net realizable value and for raw materials by identifying replacement cost. Advantest reviews its inventories and determines the appropriate amount of any inventory write-downs periodically based on these reviews. Write-downs occur from the discontinuation of product lines, inventory in excess of estimated usage, the release of new products which renders inventory obsolete and declines in net realizable value of Advantest's inventory leased to customers. Advantest recognizes inventory write-downs in cost of sales.

Advantest's inventories increased by ¥326 million, or 1.1%, during fiscal 2005 to ¥29,911 million as of March 31, 2006. Advantest recorded inventory write-downs in the amount of ¥1,287 million in fiscal 2005 and write-downs of ¥855 million in fiscal 2004. Advantest may be required to take additional charges for excess and obsolete inventory in fiscal 2006 or other future periods if future weakness in its businesses causes further reductions to Advantest's inventory valuations. In addition, unexpected changes in testing technology can render Advantest's inventories obsolete. Advantest evaluates its inventory levels based on its estimates and forecasts of demand for its products.

Trade Receivables

Advantest's trade receivables, less allowance for doubtful accounts was ¥69,567 million as of March 31, 2006, up from ¥56,702 million as of March 31, 2005. Advantest maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Advantest provides an allowance for doubtful accounts for all specific accounts receivable that it judges are probable of not being collected. Advantest has not recorded any allowances for trade receivables for its major customers, a majority of which are large, well-capitalized semiconductor manufacturers, test houses and foundries. Advantest receives deposits from most of its distributors for its other test systems. Advantest believes that the amounts of these deposits are sufficient to offset the amounts of any possible defaults on accounts receivable of these customers.

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 significant changes in the financial condition of Advantest's significant customers and the semiconductor industry.

Table of Contents

While the semiconductor market experienced an increase in fiscal 2005, certain Advantest customers continued to improve their cash flows that impacted their ability to make required payments. At the end of fiscal 2005, Advantest decreased its allowance for doubtful accounts by ¥57 million to ¥2,117 million. The increase in allowance for doubtful accounts is charged to selling, general and administrative expenses. However, additional allowances may be necessary if conditions in the industries of some of Advantest's customers do not improve in the near-term. Conversely, a reversal of allowances made for accounts receivable that are later collected, depending upon the recovered financial status of its customers and Advantest's collection efforts, will decrease the selling, general and administrative expenses for the accounting period during which such collection takes place.

Accrued Warranty Expenses

Advantest's products are generally subject to a 12-month free repair warranty. In addition, under certain circumstances, Advantest is responsible for the repair of defective components and parts. Advantest provides an allowance for estimated product warranty expenses when product revenue is recognized as part of its selling, general and administrative expenses. The allowance for estimated product warranty expenses represents management's best estimate at the time of sale of the total costs that Advantest will incur to repair or replace components or parts that fail while still under warranty. Advantest records its allowance for estimated product warranty expenses based on the historical ratio of actual repair and support expenses to corresponding sales. The foregoing evaluations are inherently uncertain as they require estimates as to maintenance costs and failure rates related to different product lines. Consequently, actual warranty costs may differ from the estimated amounts and could result in additional product warranty expenses. If actual warranty costs significantly exceed the amount of Advantest's allowance for product warranty expenses, it would negatively affect the future results of operations of Advantest. Accrued warranty expenses were ¥4,776 million in fiscal 2005, up from ¥4,090 million in fiscal 2004.

Stock-Based Compensation

Prior to April 1, 2004, Advantest Corporation 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. Therefore, no stock-based employee compensation cost was recognized in the statement of operations until fiscal 2003. Effective April 1, 2004, Advantest Corporation evaluated the fair value of stock-based employee compensation based on SFAS No. 123 (revised 2004) (SFAS No. 123R), Share Based Payment, and recognized it as compensation cost in the statement of operations. Advantest Corporation retroactively applied this accounting method from fiscal 2004 as provided under such standard in relation to the application of the modified-retrospective method from April 1, 2004. The value of the options is estimated using a Black Scholes option pricing model and amortized to expense over the options' vesting periods. Stock based compensation expense of ¥1,884 million was charged to selling, general and administrative expenses for the fiscal year ended March 31, 2006.

Accrued Pension and Severance Cost

Advantest Corporation 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.

On October 1, 2004, Advantest Corporation and certain of its consolidated domestic subsidiaries received approval from the Minister of Health and Labor to return the substitutional portion of its Employees' Pension Fund (EPF) for the prior employees' services under the transfer of its EPF

to the defined benefit corporate

Table of Contents

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. See Note 17 to the consolidated financial statements for further discussion.

Deferred Tax Assets

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, 2005, Advantest has recorded on its consolidated balance sheet, net deferred tax assets of ¥21,572 million of which ¥444 million represents net operating losses, or NOL, carried forward available to offset future taxable income. 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, respectively. At March 31, 2006, Advantest has recorded on its consolidated balance sheet, net deferred tax assets of ¥19,774 million. Based upon projections for future taxable income over the periods in which the deferred tax assets are deductible including management's expectations of future semiconductor and 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.

Results of Operations Fiscal 2005 Compared with Fiscal 2004***Net Sales***

Advantest's net sales increased by ¥14,483 million, or 6.0%, compared with fiscal 2004, to ¥253,922 million in fiscal 2005. This increase was primarily due to strong sales throughout fiscal 2005, within the semiconductor and component test system segment, of test systems for SoC semiconductors for MPUs, of test systems for non memory semiconductors used for LCD driver ICs and of test systems for SoC semiconductors for consumer digital devices. Sales of test systems for memory semiconductors, led by sales of test systems for flash memory semiconductors, were also strong. The estimated effect of changes in exchange rates during fiscal 2005 was to increase Advantest's net sales by ¥2,978 million.

The following is a discussion of net sales for Advantest's semiconductor and component test system, mechatronics system and services, support and others segments. Net sales amounts discussed include intercompany sales between segments.

Semiconductor and Component Test System Segment

In fiscal 2005, net sales of Advantest's semiconductor and component test system segment accounted for 75.4% of total net sales. Net sales of Advantest's semiconductor and component test system segment increased by ¥10,730 million, or 5.9%, compared with fiscal 2004, to ¥191,415 million in fiscal 2005. Advantest's net sales in this segment in the second half of fiscal 2005 were ¥110,583 million, resulting in an increase by ¥29,751 million, or 36.8%, compared to the first half of fiscal 2005. The estimated effect of changes in exchange rates during fiscal 2005 was to

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increase Advantest's net sales from its semiconductor and component test system segment by ¥2,067 million.

Net sales of test systems for memory semiconductors decreased by ¥23,546 million, or 19.0%, compared with fiscal 2004 to ¥100,311 million in fiscal 2005. This decrease was mainly due to lower than expected

Table of Contents

demand, particularly in the first half of fiscal 2005, for Advantest's DRAM semiconductor test systems for super high-speed memory devices (such as the T5500 series test systems) targeting the next-generation SDRAM semiconductors. Lower than expected demand was attributable, in part, to lower capital expenditures by semiconductor manufacturers resulting from falling DRAM prices and the shift of a higher than expected portion of their production to DDR2-SDRAM. Test systems for flash memory semiconductors, however, enjoyed strong sales throughout fiscal 2005, led by test systems for NAND type flash memory semiconductors, such as the T5370 series multi-functional test systems for high-speed memory semiconductors. For a discussion of sales mix and price pressure, see Overview Semiconductor and Component Test System Segment .

Net sales of test systems for non memory semiconductors increased by ¥34,276 million, or 60.3%, compared with fiscal 2004 to ¥91,104 million in fiscal 2005. This increase was mainly due to an increase in sales of T2000 series test systems for SoC semiconductors, based on OPENSTAR®, led by a strong performance in the U.S. throughout fiscal 2005. This increase was also due to strong sales, primarily in Japan, Korea and Taiwan, especially during the first half of fiscal 2005, of the T6300 series test systems for non memory semiconductors used for LCD driver ICs and the T6500 series test systems for SoC semiconductors used in mobile phones and digital consumer products.

Mechatronics System Segment

Net sales of the mechatronics system segment such as test handlers and device interfaces increased by ¥1,865 million, or 4.0%, compared to fiscal 2004 to ¥48,260 million in fiscal 2005, reflecting increased sales of semiconductor and component test systems generating an increased need for test handlers and device interfaces.

The sales of test handlers for memory semiconductors were slow in the first half of the fiscal year primarily because the demand for DDR2-SDRAM semiconductors picked up slowly, but sales recovered with the growth in sales of test systems for DRAM semiconductors. Sales of test handlers for non memory semiconductors were steady in response to increased sales of the T2000 and test systems aimed at digital consumer devices. Also, sales of device interface products were steady, reflecting strong demand for flash memory semiconductors and SoC semiconductors.

Services, Support and Other Segment

Net sales of the services, support and other segment decreased by ¥618 million, or 3.1%, compared with fiscal 2004 to ¥19,062 million in fiscal 2005. Main businesses in the services, support and others segment for fiscal 2005 focused on, and performed well in, maintenance services and leases and rentals. However, because net sales of other products decreased during fiscal 2005, total net sales in fiscal 2005 decreased as compared with fiscal 2004.

Geographic Markets

Advantest experienced an increase of 6.0% in its net sales in fiscal 2005, with sales in Japan experiencing the largest increase.

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Net sales in Japan increased by ¥21,115 million, or 35.2%, compared with fiscal 2004 to ¥81,140 million in fiscal 2005. This increase was due to increased sales throughout fiscal 2005, of test systems for non memory semiconductors, particularly the sales of test systems for non memory semiconductors used for LCD driver ICs, mobile phones and digital consumer devices, and test systems for flash memory semiconductors.

Net sales in the Americas increased by ¥2,492 million, or 10.8%, compared with fiscal 2004 to ¥25,516 million. Although the sales of test systems for memory semiconductors remained low, the sales of test systems for non-memory semiconductors to major semiconductor manufactures significantly increased. Accordingly, the total sales increased. The estimated effect of changes in exchange rates during fiscal 2005 was to increase Advantest's net sales from sales in the Americas by approximately ¥934 million.

Table of Contents

Net sales in Europe increased by ¥2,288 million, or 18.6%, compared to fiscal 2004 to ¥14,558 million in fiscal 2005. The sales of test systems for DRAM semiconductors and test handlers for SoC semiconductors contributed to the increased sales in Europe. The estimated effect of changes in exchange rates during fiscal 2005 was to increase Advantest's net sales from sales in Europe by approximately ¥200 million.

Net sales in Asia (excluding Japan) decreased by ¥11,412 million, or 7.9%, compared with fiscal 2004 to ¥132,708 million. Net sales in Korea decreased by ¥4,013 million, or 10.1%, compared with fiscal 2004. This decrease was primarily due to decreased sales of test systems for DRAM semiconductors to major semiconductor manufacturers in Korea. Net sales in China and the rest of Asia (excluding Japan, Taiwan and Korea) decreased by ¥10,016 million, or 19.0%, compared with fiscal 2004. This decrease is primarily the result of lower sales of test systems for memory semiconductors to major semiconductor manufacturers in Singapore and Malaysia. On the other hand, net sales in Taiwan increased by ¥2,617 million, or 5.1%, compared with fiscal 2004. The estimated effect of changes in exchange rates during fiscal 2005 was to increase Advantest's net sales from sales in Asia by ¥1,823 million.

As a result of a significant increase of sales in Japan, Advantest's overseas sales as a percentage of total sales became 68.0% for fiscal 2005, in comparison to 74.9% for fiscal 2004.

Operating Expenses

Advantest's operating expenses increased by ¥10,744 million, or 6.0%, compared with fiscal 2004 to ¥189,464 million in fiscal 2005.

Cost of sales increased by ¥5,435 million, or 4.7%, compared to fiscal 2004 to ¥121,429 million in fiscal 2005. While this increase can be attributed to the increase of ¥14,483 million in net sales from fiscal 2004 to fiscal 2005, such increase was partially offset by the improvement in sales cost ratio attained by cost reduction and improved product mix amidst an ongoing price pressure.

Research and development expenses increased by ¥647 million, or 2.5%, when compared to fiscal 2004, to ¥26,927 million in fiscal 2005. This rise in research and development expenses reflects additional resources required for the increased research and development themes for future products as well as to increased expenses for research and development subcontractors.

Selling, general and administrative expenses increased by ¥4,662 million, or 12.8%, compared to fiscal 2004 to ¥41,108 million in fiscal 2005. In fiscal 2004, Advantest accounted for ¥3,317 million as a deduction from its selling expenses due to the transfer of the substitutional portion of its EPF plan to the Japanese government and the resulting transition by Advantest to its defined benefit plans, but in fiscal 2005 there was no such deduction. This fact, along with the increase of ¥1,556 million in accrued warranty expenses, accounts for the significant increase over the previous fiscal year.

Operating Income

Operating income increased by ¥3,739 million, compared to ¥60,719 million in fiscal 2004, to ¥64,458 million in fiscal 2005.

Other Income and Expenses

Interest and dividend income increased by ¥1,163 million, or 194.8%, compared with fiscal 2004 to ¥1,760 million in fiscal 2005. This increase was primarily due to the increase in interest rates in the U.S. and Singapore.

Interest expense decreased by ¥151 million, or 34.2%, compared with fiscal 2004 to ¥290 million in fiscal 2005. This decrease was primarily due to lower interest rate payments as a result of repayment of bonds in the amount of ¥20,000 million during fiscal 2005.

Table of Contents

Other income improved by ¥593 million, compared with fiscal 2004, to ¥1,526 million in fiscal 2005. Improvement in the non-operating income was mainly due to the weakening of the dollar against the yen, which resulted in improving foreign currency exchange gains and losses by ¥834 million over fiscal 2004 to ¥757 million in fiscal 2005. This represents the difference between the value of foreign currency-denominated sales translated at prevailing exchange rates and either (i) the value of sales amounts settled during the year, including those settled using foreign exchange forward contracts, or (ii) the value of accounts receivable and payables outstanding remeasured at the exchange rate in effect at March 31, 2006.

Income Taxes

Advantest's effective tax rate was 38.4% in fiscal 2004 and 38.7% in fiscal 2005. Advantest's statutory tax rate was 40.3% for fiscal 2005. The difference between the statutory tax rate of 40.3% in fiscal 2005 and the effective tax rate of 38.7% in fiscal 2005 was primarily due to the availability of a tax exemption for testing research fees. For a more detailed discussion of income taxes of Advantest in fiscal 2005 and fiscal 2004, see note 14 to Advantest's consolidated financial statements.

Net Income

Advantest's net income increased by ¥3,296 million, or 8.7% compared to fiscal 2004, resulting in a net income of ¥41,374 million in fiscal 2005. The change in net income for fiscal 2005 compared to fiscal 2004 reflect the factors discussed above.

Other Comprehensive Income (Loss)

Advantest's other comprehensive income improved by ¥3,039 million, compared to fiscal 2004, to ¥6,222 million in fiscal 2005. One of the reasons for this improvement was a ¥3,439 million increase in foreign currency translation adjustment from an income of ¥1,635 million in fiscal 2004 to an income of ¥5,074 million in fiscal 2005 as the yen became weaker against the euro. Another reason for this improvement was a ¥996 million increase in unrealized holding gain on investment. These gains were partially offset due to the elimination in fiscal 2004 of unfunded accumulated benefit obligations, which resulted in ¥1,396 million in additional minimum pensions liabilities being returned as profit in fiscal 2004. In fiscal 2005 there was no such return.

Results of Operations Fiscal 2004 Compared with Fiscal 2003

Net Sales

Advantest's net sales increased by ¥65,221 million, or 37.4%, compared with fiscal 2003, to ¥239,439 million in fiscal 2004. This increase was primarily due to an increase in its sales of test systems for memory semiconductors for DRAM semiconductors and flash memory semiconductors in the semiconductor and component test system segment as well as test systems for SoC semiconductors for MPUs, and the strong sales, mainly for the first half of fiscal 2004, of test systems for SoC semiconductors for consumer digital devices and test systems for non memory semiconductors used for LCD driver ICs. Strong sales in the mechatronics system segment led by the performance of memory testers

also contributed to this increase. The estimated effect of changes in exchange rates during fiscal 2004 was to decrease Advantest's net sales by ¥3,105 million.

The following is a discussion of net sales for Advantest's semiconductor and component test system and mechatronics system segments. Net sales amounts discussed include intercompany sales between segments.

Semiconductor and Component Test System Segment

In fiscal 2004, net sales of Advantest's semiconductor and component test system segment accounted for 75.5% of total net sales. Net sales of Advantest's semiconductor and component test system segment increased by ¥57,196 million, or 46.3%, compared with fiscal 2003, to ¥180,685 million in fiscal 2004. Advantest's net

Table of Contents

sales in this segment in the second half of fiscal 2004 were ¥67,513 million, resulting in a decrease by ¥45,659 million, or 40.3%, compared to the first half of fiscal 2004. This slowdown in the second half of fiscal 2004 reflects reduced customer demand resulting from inventory adjustments. The estimated effect of changes in exchange rates during fiscal 2004 was to decrease Advantest's net sales from its semiconductor and component test system segment by ¥2,431 million.

Net sales of test systems for memory semiconductors increased by ¥36,117 million, or 41.2%, compared with fiscal 2003 to ¥123,856 million in fiscal 2004. This increase was mainly due to increased orders, both in Japan and overseas, for new products such as the T5593, a test system for super high-speed memory semiconductors for the next generation DDR-SDRAMs and the T5370 series general purpose test systems for high-speed memory semiconductors, despite the inventory adjustment on the part of our clients in DRAM semiconductor test system in the late first half of fiscal 2004. The flash memory testers attained strong sales through the middle of the first half of fiscal 2004, continuing the trend from fiscal 2003; however sales were adversely affected by semiconductor manufacturers restraining their capital expenditures amidst inventory adjustment for IT-related products beginning in the second half of fiscal 2004. Advantest's sales of test systems for memory semiconductors performed well throughout fiscal 2004, although the increased sales of test systems for memory semiconductors were partially offset by the adverse effects of sales mix and price pressure. For a discussion of sales mix and price pressure, see [Overview Semiconductor and Component Test System Segment](#).

Net sales of test systems for non memory semiconductors increased by ¥21,079 million, or 59.0%, compared with fiscal 2003 to ¥56,829 million in fiscal 2004. This increase was mainly due to a significant increase in sales of testers in Japan, Korea and Taiwan. Net sales of the T6300 series test systems for non memory semiconductors used for LCD driver ICs and the T6500 series test systems for SoC semiconductors used in mobile phones and digital consumer products increased mainly for the first half of fiscal 2004. In addition, the new concept T2000 series test systems for SoC semiconductors, based on OPENSTAR®, performed well in the U.S. and other countries throughout fiscal 2004. In fiscal 2004, Advantest introduced new products for CCD and in-car device markets.

Mechatronics System Segment

Net sales of the mechatronics system segment such as test handlers and device interfaces increased by ¥12,170 million, or 35.6%, compared to fiscal 2003 to ¥46,395 million in fiscal 2004, reflecting increased sales of semiconductor and component test systems generating an increased need for test handlers and device interfaces.

This increase mainly reflected the strong sales of test handlers for memory semiconductors with functions such as cooling and simultaneous handling of multiple devices, despite inventory adjustments by Advantest's customers in the second half of fiscal 2004. In addition, sales of device interface products remained strong over fiscal 2004 as a result of diversification of Advantest's devices generating increased demand.

Services, Support and Others Segment

Net sales of the services, support and others segment decreased by ¥785 million to ¥19,680 million in fiscal 2004, compared to ¥20,465 million in fiscal 2003. Main businesses in the services, support and others segment for fiscal 2004 focused on, and performed well in, maintenance services, and leases and rentals. However, as net sales of other products recognized in the fiscal 2003 declined significantly, overall net sales of the services, support and others segment decreased in fiscal 2004.

Geographic Markets

Advantest experienced an increase in its net sales in fiscal 2004 in each of its geographic markets, with sales in Asia (excluding Japan) experiencing the largest increase.

Table of Contents

Net sales in Asia (excluding Japan) increased by ¥54,557 million, or 60.9%, compared to fiscal 2003 to ¥144,120 million in fiscal 2004. Net sales in Taiwan increased by ¥19,955 million, an increase of 62.7% compared to fiscal 2003. Net sales in Korea increased by ¥11,154 million, or 39.0%, compared to fiscal 2003. Net sales in China and the rest of Asia (excluding Japan, Taiwan and Korea) increased by ¥23,449 million, or 80.5%, compared to fiscal 2003. These increases were primarily due to increased sales of test systems for DRAM semiconductors and flash memory semiconductors to foundries in Taiwan as well as to major semiconductor manufacturers in Korea. The increase in the sales of test systems for SoC semiconductors for MPUs contributed greatly to the increased sales in China and the rest of Asia (excluding Japan, Taiwan and Korea). The estimated effect of changes in exchange rates during fiscal 2004 was to decrease Advantest's net sales from sales in Asia by ¥2,291 million.

Net sales in the Americas increased by ¥6,760 million, or 41.6%, compared to fiscal 2003 to ¥23,024 million in fiscal 2004. These increases were primarily due to increased sales of test systems for memory semiconductors and test systems for non memory semiconductors, which was led by increased capital expenditures by major U.S. semiconductor makers. The estimated effect of changes in exchange rates during fiscal 2004 was to decrease Advantest's net sales in the Americas by approximately ¥896 million.

Net sales in Japan increased by ¥2,035 million, or 3.5%, compared to fiscal 2003 to ¥60,025 million in fiscal 2004. This slight increase was due to increased sales, primarily for the first half of fiscal 2004, of test systems for non memory semiconductors, particularly the sales of test systems for non memory semiconductors used for LCD driver ICs, mobile phones and digital consumer devices, and test systems for flash memory semiconductors and DRAM.

Net sales in Europe increased by ¥1,869 million, or 18.0%, compared to fiscal 2003 to ¥12,270 million in fiscal 2004. The sales of test systems for DRAM semiconductors and test handlers for SoC semiconductors contributed to the increased sales in Europe. The small increase in sales in Europe, compared to areas other than Japan, was primarily because sales in Europe have been shifting to Asia due to increased outsourcing of manufacturing processes in Asia by Advantest's customers in the test systems for memory semiconductors market. Due to the depreciation of the yen in comparison to the Euro, the estimated effect of changes in exchange rates during fiscal 2004 was to increase Advantest's net sales from sales in Europe by approximately ¥82 million.

As a result of increased sales in each of Advantest's geographic markets especially outside of Japan, its overseas sales as a percentage of total sales increased to 74.9% in fiscal 2004 from 66.7% in fiscal 2003.

Operating Expenses

Advantest's operating expenses increased by ¥35,462 million, or 24.8%, compared with fiscal 2003 to ¥178,720 million in fiscal 2004.

Cost of sales increased by ¥30,481 million, or 35.6%, compared to fiscal 2003 to ¥115,994 million in fiscal 2004. While this increase can be attributed to the increase in net sales from fiscal 2003 to fiscal 2004, such increase was offset by a decrease of ¥1,271 million in write-downs of inventories compared with fiscal 2003 as well as the improved sales cost ratio attained by product mix and revenue increase effect amidst the ongoing price pressure.

Research and development expenses increased by ¥4,643 million, or 21.5%, when compared to fiscal 2003, to ¥26,280 million in fiscal 2004. This increase in research and development was focused on the development of products for the future as well as to increased expenses for

research and development subcontractor.

Selling, general and administrative expenses increased by ¥338 million, or 0.9%, compared to fiscal 2003 to ¥36,446 million in fiscal 2004. This increase consists primarily of the increase of ¥1,227 million in accrued warranty expenses and the increase of ¥2,833 million in variable expenses. In addition, Advantest recognized

Table of Contents

expenses for stock options for fiscal 2004 in the amount of ¥2,290 million, and the expenses increased by ¥2,018 million due to expenses related to Advantest's 50th anniversary events. On the other hand, this increase in selling, general and administrative expenses was offset by various factors. First, Advantest did not recognize any impairment of long-lived assets in fiscal 2004, as it did in fiscal 2003 in the amount of ¥3,030 million. Second, due to improved collection activities, some allowance for doubtful accounts were reversed, resulting in a decrease of ¥1,682 million in bad debt expenses, compared to fiscal 2003. Third, Advantest accounted for ¥3,317 million as a decrease in its selling expenses due to the transfer of the substitutional portion of its Employee's Pension Fund plan to the Japanese government and the resulting transition by Advantest to its defined benefit plans.

Operating Income

Operating income increased by ¥29,759 million, compared to ¥30,960 million in fiscal 2003, to ¥60,719 million in fiscal 2004.

Other Income and Expenses

Interest and dividend income increase by ¥258 million, or 76.1%, compared with fiscal 2003 to ¥597 million in fiscal 2004. This increase was primarily due to the increase in the outstanding balance of deposits and the increase in interest income.

Interest expense decreased by ¥28 million, or 6.0% when compared to fiscal 2003, to ¥441 million in fiscal 2004. This decrease was primarily due to lower interest rate payments as a result of repayment of bonds in the amount of ¥4,500 million during fiscal 2004 and a lower average balance of total debt outstanding during fiscal 2004 compared to fiscal 2003.

Other income improved by ¥2,885 million, compared to fiscal 2003 to ¥933 million in fiscal 2004. Improvement in the non-operating income was mainly due to the impairment loss on securities decreasing by ¥1,307 million, compared to fiscal 2003, to ¥122 million in fiscal 2004, and the gains on the sales of investment securities increasing by ¥729 million over fiscal 2003 to ¥943 million in fiscal 2004. Foreign exchange gains and losses represent an improvement of ¥109 million to a loss of ¥77 million in fiscal 2004 compared to the loss of ¥186 million registered in fiscal 2003. This represents the difference between the value of foreign currency-denominated sales translated at prevailing exchange rates and either (i) the value of sales amounts settled during the year, including those settled using foreign exchange forward contracts, or (ii) the value of accounts receivable and payables outstanding remeasured at the exchange rate in effect at March 31, 2005. In fiscal 2004, foreign exchange gains and losses were negatively impacted due to strengthening of the yen against the U.S. dollar.

Income Taxes

Advantest's effective tax rate was 40.0% in fiscal 2003 and 38.4% in fiscal 2004. Advantest's statutory tax rate was 40.3% for fiscal 2004. The difference between the statutory tax rate of 40.3% in fiscal 2004 and the effective tax rate of 38.4% in fiscal 2004 was primarily due to earnings of foreign subsidiaries taxed at different rates from the statutory rate in Japan. For a more detailed discussion of income taxes of Advantest in fiscal 2004 and fiscal 2003, see note 14 to Advantest's consolidated financial statements.

Net Income

Advantest's net income increased by ¥20,749 million, or 119.7% compared to fiscal 2003, resulting in a net income of ¥38,078 million in fiscal 2004. The changes in net income for fiscal 2004 compared to fiscal 2003 reflect the factors discussed above.

Other Comprehensive Income (Loss)

Advantest's other comprehensive income improved by ¥7,189 million, compared to fiscal 2003 to ¥3,183 million in fiscal 2004. One of the reasons for this improvement was a ¥5,611 million increase in foreign currency

Table of Contents

translation adjustment from a loss of ¥3,976 million in fiscal 2003 to an income of ¥1,635 million in fiscal 2004 as the yen was weaker against euro. Furthermore, another reason was the ¥2,792 million decrease for additional minimum pensions liabilities because of the elimination of the unfunded accumulated benefit obligations in fiscal 2004. However, other comprehensive income was offset by decrease of an unrealized holding gain on investment of ¥1,214 million.

5.B LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities was ¥59,480 million in fiscal 2005, compared to ¥90,327 million in fiscal 2004. Net cash provided by operating activities increased in fiscal 2005 is primarily due to the increase in net income to ¥41,374 million, the increase in income taxes payable to ¥12,506 million, the increase in trade account payables to ¥7,627 million, and the increase in non-cash expenses, including depreciation and amortization of ¥8,275 million, partially offset by the increase in trade receivables by ¥11,072 million in fiscal 2005.

The increase in tax payable was mainly due to the increase in income before income taxes and the decrease in losses carried forward from prior years that are eligible for deduction. Outstanding trade account receivables increased as net sales increased from the second half of fiscal 2004 through the end of fiscal 2005. Accounts payable increased because the amount of procurement expenses estimated in the second half of fiscal 2005 based on the sales forecast for the first half of fiscal 2006 increased from the amount of procurement expenses estimated in the second half of fiscal 2004 based on the sales forecast for the first half of fiscal 2005.

Net cash used in investing activities was ¥8,542 million in fiscal 2005, compared to ¥8,250 million in fiscal 2004. This results from the significant increase in the purchases of securities from ¥0 in fiscal 2004 to ¥4,156 million in fiscal 2005, offset by the increase in proceeds from the sales of available-for-sales securities by ¥1,549 million to ¥2,977 million in fiscal 2005.

Advantest's main capital expenditures during fiscal 2005 consisted of its investment in equipment used in Advantest's test equipment leasing program, its investment in equipment used for research and development and its investment in manufacturing and maintenance facilities.

Advantest has budgeted ¥10.0 billion for capital expenditures in fiscal 2006. Advantest's expected capital expenditures in fiscal 2006 include:

¥3.0 billion allocated to equipment used in Advantest's test equipment leasing program; and

¥4.0 billion on equipment for research and development and manufacturing.

Advantest did not complete any large capital expenditures related to facilities and other infrastructure in fiscal 2005. For additional information about Advantest's capital expenditure projects, see "Information on the Company History and Development of the Company". Advantest currently does not have any plans for large capital expenditure projects in fiscal 2006 or 2007.

Net cash used in financing activities was ¥18,336 million in fiscal 2005, compared to ¥63,036 million in fiscal 2004. The significant decrease in net cash used in financing activities was primarily due to the decrease in payments made for Advantest's purchases of its own shares by ¥54,454 million, as compared with fiscal 2004, to ¥57 million in fiscal 2005.

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The outstanding amount of Advantest's total long-term debt (including current installments) decreased by ¥20,043 million, or 99.8% compared to March 31, 2005, to ¥40 million as of March 31, 2006. The current portion of long-term debt decreased by ¥20,013 million to ¥30 million as of March 31, 2006. This decrease is a result of repayment of principal of unsecured bonds in the amount of ¥20,000 million on December 14, 2005.

Table of Contents

Advantest has various retirement and severance plans for employees, including contributory defined benefit retirement and severance plans consisting primarily of the EPF plan. As mentioned in Note 17 to the consolidated financial statements, in the balance sheet as of March 31, 2006, the amount of ¥12,292 million has been recognized as a liability. In fiscal 2004, in relation to the substitutional portion of the EPF, Advantest accounted for the exemption from the obligations for future services and the exemption from the obligations from past services under the transfer of pension plan assets as a series of procedures in relation to liquidation transactions, and recognized a net gain of ¥3,317 million on these transactions. The net gain of ¥3,317 million was accounted for as a decrease in selling, general and administrative expenses. This amount is comprised of the difference of ¥6,116 million between the cumulative benefit obligation liquidated at the time of the transfer of benefit obligations for the past services and the payment in return to the substitutional portion to the national treasury, and the amount of ¥2,799 million recognized as unrecognized actuarial net loss. Advantest has contributed to the EPF plan in accordance with the funding requirements of applicable Japanese governmental regulations. Although there is presently no immediate or significant near-term increase expected in cash funding requirements, Advantest's cash funding requirements would be affected by any changes in interest rates, rate of returns on plan assets and government regulations. The contributions paid by Advantest under the EPF were ¥2,348 million in fiscal 2004 and ¥2,075 million in fiscal 2005. Advantest expects to contribute approximately ¥2,107 million to its domestic defined benefit plans in fiscal 2006.

Advantest's funding and treasury policy (including funding for capital expenditures), which is overseen and controlled by its Finance Department, has funded and is expected to continue to fund substantially all of its cash needs through cash from operating activities and cash and cash equivalents on hand. Advantest expects to fund its capital expenditures in fiscal 2006 from cash and cash equivalents on hand. In the event conditions in the semiconductor industry, and thus the semiconductor and component test system industry, experiences a downturn in the near to medium term, Advantest may need to fund future capital expenditures and other working capital needs through the incurrence of additional debt or dilutive issuances of equity securities.

Advantest's cash and cash equivalents balance increased by ¥36,939 million in fiscal 2005 to ¥157,925 million as of March 31, 2006. At March 31, 2006, 64.2% of Advantest's cash and cash equivalents were held in Japanese yen.

5.C RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES**Research and Development and Product Enhancement**

In order to support technology on the leading-edge, Advantest undertakes research and development initiatives to develop products which play a central role in the area of measuring technologies to support electronics, information and communications, and semiconductor manufacturing. Advantest's research and development focuses on the improvements of existing products. In particular, in the semiconductor and component test system segment, a large and ongoing investment in development is necessary in order to maintain market competitiveness and to provide many types of products that meet the various needs of the customers. Advantest also conducts research of basic technologies. Advantest's expenditures for research and development were approximately ¥21.6 billion in fiscal 2003, ¥26.3 billion in fiscal 2004 and ¥26.9 billion in fiscal 2005. Advantest employs over 1,000 engineers and other personnel in its research and development division.

The contents and achievements to date of Advantest's current research and development activities include:

Basic Technology

development of constituent technologies in the field of terahertz;

development of constituent technologies, including high speed, energy-saving micro switches and high speed samplers used in semiconductor and component test systems and millimeter wave measuring instruments;

Table of Contents

development of methods to detect timing jitters in high bit-rate signals; and

development of compound semiconductors devices, including less-distortion devices used for test systems for semiconductors and components.

Semiconductor and Component Test System Segment

development of semiconductor and component test systems that enables testing of super high speed memories at actual motion speed;

development of semiconductor and component test systems, that enhances the functionality of testing of DRAM semiconductors and flash memory semiconductors and requires less floor space;

development of semiconductor and component test systems that have the capacity to simultaneously test multiple complex SoC semiconductors with large pin counts and requires less floor space;

development of semiconductor and component test systems with specialized applications;

development of measurement modules for devices that operate at an extremely high frequencies and for networks that carry extremely high density transmissions; and

development of high speed transmission technologies for high speed large pin counts and high speed transmission signal contact technologies.

Mechatronics Systems Segment

development of test handlers for memory semiconductors enabling measuring of multiple semiconductors for high throughput testing; and

development of test handlers for SoC semiconductors that respond to diversified device types and packages.

Advantest has four research and development facilities in Japan, one in the U.S. and one in France.

In October 2005, Advantest established a new SoC test solution development division (US R&D Center) at its subsidiary in Santa Clara, California. At this US R&D Center, Advantest has been carrying out research and development for new modules which can be applied to open architecture platform.

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Advantest promotes joint development efforts between its various research facilities to capitalize on the capabilities of its researchers worldwide. Advantest's research and development team for semiconductor and component test systems in Japan works closely with Advantest engineers in Santa Clara, California in the development of open architecture platforms.

Advantest has been carrying out research and development activities for its burn-in system, concentrating its development resources on Japan Engineering Co., Ltd, a subsidiary of Advantest.

Advantest is currently engaged in the research and development of electron-beam, or e-beam, lithography technology used to draw circuit patterns on semiconductors. Due to their throughput limitations, e-beam lithography systems are currently only used in the production of high value-added semiconductors with limited production volumes and semiconductor prototypes. Advantest believes that further research and development will be necessary in order to attain high precision technologies for the leading design rule, in addition to the development of technologies for throughput responding to the demand for next generation equipment.

For a description of Advantest's patents, licenses and other intellectual property, see [Information on the Company Business Overview Licenses and Intellectual Property Rights](#).

Table of Contents

5.D TREND INFORMATION

For a discussion of the trends that affect Advantest's business and financial conditions and results of operations, see Information on the Company Business Overview, Operating and Financial Review and Prospects Operating Results and Operating and Financial Review and Prospects Liquidity and Capital Resources.

5.E OFF-BALANCE SHEET ARRANGEMENTS

As of March 31, 2006, Advantest provided financial guarantees to third parties related to lease obligations by Advantest's customers of ¥232 million. Advantest would be required to satisfy the lease obligation of its customers in the event of default. The guarantees are collateralized by the leased asset. The fair value of the obligation with respect to such guarantees was insignificant.

Advantest does not participate in transactions that derecognize assets or liabilities through unconsolidated entities, structured finance or special purpose entities that were created for the purpose of facilitating off-balance sheet arrangements or other limited purposes.

5.F TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

The following table reflects Advantest's current obligations and commitments to make future payments under contracts, contractual obligations and commercial commitments at March 31, 2006.

	<u>Payments due by Period</u>	
	<u>Total</u>	<u>Less than 1 year</u>
<u>Contractual Cash Obligation</u>	-	-