Notes to Consolidated Financial Statements

Tokyo Electron Limited and Subsidiaries
Years ended March 31, 2017 and 2016

1. Basis of Presentation of Consolidated Financial Statements

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

The Company uses financial statements prepared by foreign subsidiaries in accordance with International Financial Reporting Standards or U.S. generally accepted accounting principles for the preparation of the consolidated financial statements, together with adjustment for certain items which are required to be adjusted in the consolidation process.

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

The amounts in the consolidated financial statements and associated notes shown in millions of yen and in thousands of yen, U.S. dollars and shares, as of and for the year ended March 31, 2016 and prior periods are rounded. On the other hand, such amounts as of and for the year ended March 31, 2017 are rounded down and therefore the totals do not necessarily agree with the sum of the individual account balances for the corresponding period.

U.S. dollar amounts included herein are solely for the convenience of readers and are presented at the rate of ¥112.19 to $1.00, the approximate rate as of March 31, 2017. The translation should not be construed as a representation that the Japanese yen amounts shown could be converted into U.S. dollars at that or any other rate.

2. Summary of Significant Accounting Policies

(a) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its 35 and 37 subsidiaries as of March 31, 2017 and 2016, respectively. All significant inter-company accounts, transactions and unrealized profits or losses have been eliminated through consolidation procedures.

There are 8 affiliates accounted for using the equity method as of March 31, 2017.

The fiscal year-end of all entities is March 31, except for 3 consolidated foreign subsidiaries. Financial statements provisionally closed for the period ending March 31 are used for those subsidiaries.

(b) Foreign currency translation

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

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

The balance sheet accounts of foreign subsidiaries are translated into Japanese yen at the rates of exchange in effect at the balance sheet date, except for shareholders' equity accounts, which are translated at the historical rates. Revenue and expense accounts of foreign subsidiaries are translated at average rates of exchange in effect during the year. Resulting translation adjustments are presented in net assets as a component of accumulated other comprehensive income in the consolidated balance sheets.

(c) Cash equivalents

Tokyo Electron considers all highly-liquid instruments purchased with original maturities of three months or less to be cash equivalents.

(d) Short-term investments

Short-term investments consist of short term deposits and low-risk financial instruments with original maturities of more than three months.

(e) Investment securities

Tokyo Electron examines the intent of holding each security and classifies those securities as trading securities, held-to maturity debt securities or other securities. Tokyo Electron has no trading securities as of March 31, 2017 and 2016. Held-to-maturity debt securities are stated mainly at amortized cost. Other securities with market prices are valued at fair value at the balance sheet date. The differences between the book value and fair value of other securities, net of applicable income taxes, are presented in net assets as a component of accumulated other comprehensive income. Other securities without market prices are valued at cost using the weighted-average method.

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

(f) Inventories

Inventories other than raw materials are stated at the lower of cost, determined by principally the specific identification method, or net realizable value, which is defined as selling price less estimated additional manufacturing costs and estimated direct selling expenses. Raw materials are stated at the lower of cost, determined principally by the moving-average method, or replacement cost.

(g) Property, plant and equipment

Property, plant and equipment are stated at cost. Depreciation of buildings, machinery and equipment of the Company and its domestic subsidiaries is computed using the declining-balance method, except for buildings acquired since April 1, 1998 and facilities attached to buildings and structures acquired since April 1, 2016 which are depreciated using the straight-line method, based on the estimated useful lives of assets. Foreign subsidiaries mainly apply the straight-line method over the estimated useful lives of assets.

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

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

(h) Intangible assets (excluding goodwill)

Intangible assets are amortized by the straight-line method over their estimated useful lives.

(i) Goodwill

Goodwill is evaluated on an individual basis and amortized by the straight-line method over a period not exceeding 20 years.

(j) Impairment of fixed assets

Tokyo Electron evaluates the carrying value of fixed assets held for use in the business and idle assets.

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

(k) Allowance for doubtful accounts

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

(l) Employee benefits

The Company and its domestic subsidiaries provide defined benefit plans for their employees. Expected benefits are attributed to accounting periods by the benefit formula basis. Prior service costs are charged to earnings on a straight-line basis, beginning from the fiscal year in which they are incurred, over a fixed number of years (4 years) within the average remaining years of service of employees when the changes occur. Actuarial differences are charged to earnings on a straight-line basis, beginning from the following fiscal year after they are incurred, over a fixed number of years (4 years) within the average remaining years of service of employees when the differences occur.

The provision for accrued pension and severance costs for directors and audit & supervisory board members of the Company and its domestic subsidiaries is calculated in accordance with internal regulations.

The Company and certain domestic subsidiaries decided to discontinue the payment of severance pay for directors and audit & supervisory board members after April 1, 2005, and at the general shareholders' meeting in June 2005, it was resolved that the severance pay for directors and audit & supervisory board members until March 31, 2005 would be paid at the termination of their service and the decision regarding the payment amount for each director and audit & supervisory board member was delegated to the board of directors and audit & supervisory board members. The accruals for severance costs for directors and audit & supervisory board members are included in Net liability for defined benefits in the consolidated balance sheets.

(m) Accrued warranty expenses

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

(n) Derivatives and hedge accounting

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

Derivatives are carried at fair value in the consolidated balance sheet with changes in unrealized gain or loss charged or credited to earnings, except for those which meet the criteria for hedge accounting. Unrealized gains or losses on hedging instruments, net of taxes, are reported in net assets as a component of accumulated other comprehensive income. Receivables and payables hedged by qualified forward foreign exchange contracts are translated at the corresponding foreign exchange contract rates.

Notes to Consolidated Financial Statements

(o) Income taxes

Tokyo Electron records deferred tax assets and liabilities on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes and net operating loss carryforwards. Deferred tax assets and liabilities are measured using the enacted tax rates and laws which are expected to be in effect when net operating loss carryforwards and temporary differences are expected to be realized.

(p) Revenue recognition

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

(q) Per share information

Net income per share and net assets per share are computed based on the weighted-average number of shares of common stock outstanding during each year. Net income - diluted per share is computed based on the weighted-average number of shares of common stock outstanding during each year after incorporating the dilutive potential effect of shares of common stock to be issued upon the exercise of stock options.

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

The basis for the calculation of net income per share for the fiscal years ended March 31, 2017 and 2016 is as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2016	2017
Net income attributable to owners of parent	¥115,208	¥77,892	$1,026,908
Less components not pertaining to holders of common stock	—	—	—
Net income pertaining to holders of common stock	¥115,208	¥77,892	$1,026,908
Weighted-average number of shares of common stock outstanding (thousands)	164,054	168,924	

(r) Research and development expenses

Research and development expenses are charged to earnings as incurred and amounted to ¥83,800 million ($746,950 thousand) and ¥76,287 million for the years ended March 31, 2017 and 2016, respectively.

(s) Reclassifications

Certain reclassifications have been made to the prior year's consolidated financial statements to conform with the presentation used for the year ended March 31, 2017.

3. Change in Accounting Policies and Adoption of New Accounting Standards

Year ended March 31, 2017

In accordance with the revision to the Japanese Corporation Tax Act, the Company and its domestic subsidiaries adopted the "Practical Solution on a change in depreciation method due to Tax Reform 2016" (ASBJ Practical Issues Task Force No. 32, June 17, 2016) and changed the depreciation method for facilities attached to buildings and structures acquired since April 1, 2016 from the declining-balance method to the straight-line method, starting from the fiscal year ended March 31, 2017.

The effect of this change on the consolidated financial statements is immaterial.

Year ended March 31, 2016

The Company and its domestic subsidiaries adopted "Revised Accounting Standard for Business Combinations" (ASBJ Statement No.21, September 13, 2013 (hereinafter, "Statement No.21")), "Revised Accounting Standard for Consolidated Financial Statements" (ASBJ Statement No.22, September 13, 2013 (hereinafter, "Statement No.22")) and "Revised Accounting Standard for Business Divestitures" (ASBJ Statement No.7, September 13, 2013 (hereinafter, "Statement No.7")) (together, the "Business Combination Accounting Standards"), from the year ended March 31, 2016. As a result, the Company changed its accounting policies to recognize in capital surplus the differences arising from the changes in the Company's ownership interest of subsidiaries over which the Company continues to maintain control and to record acquisition related costs as expenses in the fiscal year in which the costs are incurred. In addition, the Company changed its accounting policy for the reallocation of acquisition costs due to the completion following provisional accounting to reflect such reallocation in the consolidated financial statements for the fiscal year in which the business combination took place. The Company also changed the presentation of net income and the term "non-controlling interests" is used instead of "minority interests". In the consolidated statement of cash flows, cash flows from acquisition or disposal of shares of subsidiaries with no changes in the scope of consolidation are included in "Cash flows from financing activities" and cash flows from acquisition related costs for shares of subsidiaries with changes in the scope of consolidation or costs related to acquisition or disposal of shares of subsidiaries with no changes in the scope of consolidation are included in "Cash flows from operating activities".

With regard to the application of the Business Combination Accounting Standards, the Company followed the provisional treatments in article 58-2 (4) of Statement No.21, article 44-5 (4) of Statement No.22 and article 57-4 (4) of Statement No.7 with application from the beginning of the year ended March 31, 2016 prospectively.

As a result of adoption of these standards, there is no effect on the consolidated financial statements for the year ended March 31, 2016.

4. Additional Information

The Company and its domestic subsidiaries adopted "Revised Implementation Guidance on Recoverability of Deferred Tax Assets" (ASBJ Guidance No. 26, March 28, 2016) from the year ended March 31, 2017.

5. Securities

Other securities as of March 31, 2017 and 2016 are as follows:

	Millions of yen	
2017:	Cost	Carrying value
Non-current		
Securities with market prices		
Equity securities	¥7,183	¥22,704
Securities without market prices		
Unlisted stock	1,381	1,399
Other	14	14
Total	¥8,580	¥24,119

	Millions of yen	
2016:	Cost	Carrying value
Non-current		
Securities with market prices		
Equity securities	¥7,204	¥18,580
Securities without market prices		
Unlisted stock	1,318	1,334
Total	¥8,522	¥19,914

	Thousands of U.S. dollars	
2017:	Cost	Carrying value
Non-current		
Securities with market prices		
Equity securities	$64,032	$202,378
Securities without market prices		
Unlisted stock	12,314	12,472
Other	133	133
Total	$76,480	$214,983

Held-to-maturity securities classified as current assets are ¥244,500 million ($2,179,338 thousand) and ¥160,999 million as of March 31, 2017 and 2016, respectively.

Reconciliation of held-to-maturity securities as of March 31, 2017 and 2016 to the amounts of short-term investments in the consolidated balance sheets are as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2016	2017
Held-to-maturity (current)	¥244,500	¥160,999	$2,179,338
Deposits and low-risk financial instruments with original maturities of three months or less	(93,500)	(45,000)	(833,407)
Deposits with original maturities of more than three months	—	25,036	—
Short-term investments	¥151,000	¥141,035	$1,345,931

Net loss on devaluation of investment securities was ¥105 million ($939 thousand) and ¥331 million for the years ended March 31, 2017 and 2016, respectively.

For the year ended March 31, 2017, the amount of gain and loss on sale of available-for-sale securities was immaterial.

For the year ended March 31, 2016, the Company sold available-for-sale securities and recognized the following gain and loss on sale:

	Millions of yen		
	Amount of sale	Gain on sale	Loss on sale
Equity securities	¥1,275	¥446	¥247
Total	¥1,275	¥446	¥247

6. Inventories

Inventories as of March 31, 2017 and 2016 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2016	2017
Finished products	¥152,629	¥130,479	$1,360,456
Work in process, raw materials and supplies	83,626	64,601	745,405
Total	¥236,256	¥195,080	$2,105,861

The amounts of change in inventory provision included in cost of sales in the consolidated statements of income for the years ended March 31, 2017 and 2016 were a decrease of ¥3,060 million ($27,283 thousand) and an increase of ¥758 million, respectively.

Notes to Consolidated Financial Statements

7. Other Income (Expenses)

Loss on disaster

Loss on disaster of ¥7,521 million ($67,039 thousand) for the year ended March 31, 2017 represents the actual and current estimated expenses relating to the recovery of buildings, production and development facilities as well as the disposal of inventories caused by the impact of the Kumamoto earthquake in 2016.

Loss on impairment of property, plant and equipment, goodwill and other assets

For the year ended March 31, 2016, the following loss on impairment was recognized:

(1) Goodwill and non-current assets of TEL FSI, Inc.

Location	Use	Type of Asset	Loss on impairment Millions of yen
Chaska, Minnesota, U.S.A.	Business assets	Goodwill	¥3,825
		Buildings	2,756
		Other intangible assets	2,880
		Total	¥9,461

Tokyo Electron performed an impairment test and recognized loss on impairment of assets of TEL FSI, Inc., a subsidiary manufacturing semiconductor production equipment, due to TEL FSI, Inc.'s reconsideration of its business plan. Tokyo Electron recognized the difference between the book value and the recoverable amount of goodwill, buildings, and other intangible assets as loss on impairment. The recoverable amount was measured as value in use, and was calculated by discounting future cash flows at a discount rate of 14.0-14.5%.

(2) Others

Loss on impairment of ¥266 million was recognized for other asset groups of Tokyo Electron.

Loss on business restructuring

Loss on business restructuring of ¥2,235 million for the year ended March 31, 2016 represents losses relating to the business restructuring in U.S. subsidiaries, which mainly consists of inventory disposal costs.

8. Pledged Assets

Tokyo Electron did not hold any assets pledged as collateral as of March 31, 2017 and 2016.

9. Short-term Borrowings

There are no short-term borrowings classified as current liabilities as of March 31, 2017 and 2016.

As of March 31, 2017 and 2016, Tokyo Electron had unused lines of credit amounting to ¥126,944 million ($1,131,512 thousand) and ¥114,960 million, respectively.

10. Employee Benefits

The Company and its domestic subsidiaries provide a cash balance plan and a non-contributory retirement and severance benefit plan as defined benefit plans for their employees. Further, certain consolidated overseas subsidiaries provide defined benefit plans for their employees.

Defined benefit plans

(1) Movement of defined benefit obligations

	Millions of yen 2017	2016	Thousands of U.S. dollars 2017
Balance at April 1, 2016 and 2015	¥116,228	¥112,272	$1,035,998
Service cost	6,080	5,677	54,198
Interest cost	772	1,273	6,882
Actuarial loss	(3,075)	9,690	(27,412)
Benefits paid	(2,708)	(7,748)	(24,141)
Increase by transfer	1,327	—	11,828
Effect of change in scope of consolidation	—	(4,548)	—
Foreign currency exchange rate changes	101	(475)	906
Other	(65)	87	(583)
Balance at March 31, 2017 and 2016	¥118,660	¥116,228	$1,057,677

(2) Movement of plan assets

	Millions of yen 2017	2016	Thousands of U.S. dollars 2017
Balance at April 1, 2016 and 2015	¥62,549	¥70,905	$557,534
Expected return on plan assets	1,266	1,271	11,286
Actuarial gain (loss)	540	(2,304)	4,818
Employer contributions	2,940	2,997	26,206
Benefits paid	(1,011)	(5,506)	(9,014)
Increase by transfer	1,289	—	11,495
Effect of change in scope of consolidation	—	(4,461)	—
Foreign currency exchange rate changes	84	(380)	754
Other	(6)	27	(56)
Balance at March 31, 2017 and 2016	¥67,653	¥62,549	$603,026

(3) Reconciliation from defined benefit obligations and plan assets to liability (asset) for defined benefits

	Millions of yen 2017	2016	Thousands of U.S. dollars 2017
Funded defined benefit obligations	¥63,761	¥62,003	$568,333
Plan assets	(67,653)	(62,549)	(603,026)
Funded status	(3,892)	(546)	(34,692)
Unfunded defined benefit obligations	54,899	54,225	489,343
Net liability for defined benefits at March 31, 2017 and 2016	¥51,007	¥53,679	$454,651
Net liability for defined benefits	55,825	55,302	497,600
Net asset for defined benefits	(4,818)	(1,623)	(42,949)
Net liability for defined benefits at March 31, 2017 and 2016	¥51,007	¥53,679	$454,651

Note: The provision for accrued pension and severance costs for directors and audit & supervisory board members of ¥374 million ($3,342 thousand) as of March 31, 2017 and 2016 is not included.

(4) Defined benefit costs

	Millions of yen 2017	2016	Thousands of U.S. dollars 2017
Service cost	¥6,080	¥5,677	$54,198
Interest cost	772	1,273	6,882
Expected return on plan assets	(1,266)	(1,271)	(11,286)
Net actuarial gain amortization	291	(2,268)	2,600
Other	290	243	2,590
Total defined benefit costs for the years ended March 31, 2017 and 2016	¥6,168	¥3,654	$54,985

(5) Remeasurements of defined benefit plants

	Millions of yen 2017	2016	Thousands of U.S. dollars 2017
Actuarial gain (loss)	¥3,869	¥(13,594)	$34,494

(6) Accumulated remeasurements of defined benefit plants

	Millions of yen 2017	2016	Thousands of U.S. dollars 2017
Net actuarial loss that is yet to be recognized (before tax)	¥(2,712)	¥(6,582)	$(24,180)

(7) Plan assets

1. Plan assets comprise:

	2017	2016
Bonds	39%	46%
Life insurance company general account	26	26
Equity securities	20	17
Cash and cash equivalents	3	2
Other	12	9
Total	100%	100%

2. Long-term expected rate of return

Current and target asset allocations, and historical and expected returns on the various categories of plan assets have been considered in determining the long-term expected rate of return.

(8) Actuarial assumptions

The principal actuarial assumptions at and for the years ended March 31, 2017 and 2016 are as follows:

	2017	2016
Discount rate	0.71%	0.59%
Long-term expected rate of return	2.00%	2.00%

The expected rates of salary increase for the years ended March 31, 2017 and 2016 are also considered as one of the actuarial assumptions, which are set based on the salary increase index by age group as of January 1, 2014.

Notes to Consolidated Financial Statements

11. Income Taxes

Significant components of the deferred tax assets and liabilities as of March 31, 2017 and 2016 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2016	2017
Deferred tax assets			
Elimination of unrealized profit in inventories	¥19,276	¥14,100	$171,817
Net liability for defined benefits	18,102	17,717	161,352
Net operating loss carryforwards	15,402	17,061	137,292
Accrued employees' bonuses	4,977	2,831	44,365
Devaluation of inventories	3,995	4,913	35,610
Loss on impairment of property, plant and equipment and other assets	2,765	3,037	24,652
Accrued warranty expenses	2,168	2,395	19,330
Other	11,350	12,366	101,169
Total gross deferred tax assets	78,038	74,420	695,591
Less valuation allowance	(9,808)	(11,995)	(87,429)
Total deferred tax assets	68,229	62,425	608,162
Deferred tax liabilities			
Undistributed earnings of subsidiaries	(5,197)	(5,383)	(46,323)
Net unrealized gains on investment securities	(4,757)	(3,487)	(42,408)
Intangible assets identified through business combination	(3,016)	(3,741)	(26,889)
Other	(4,310)	(3,146)	(38,420)
Total deferred tax liabilities	(17,282)	(15,757)	(154,042)
Net deferred tax assets	¥50,947	¥46,668	$454,119

Net deferred tax assets are included in the consolidated balance sheets as of March 31, 2017 and 2016 as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2016	2017
Current assets	¥36,892	¥31,204	$328,837
Investments and other assets	19,128	20,782	170,505
Other current liabilities	—	—	—
Other non-current liabilities	(5,073)	(5,318)	(45,222)

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

Based on the level of historical taxable income and future estimated taxable income over the periods which the temporary differences are deductible and net operating loss carry forwards are available to be utilized, management believes Tokyo Electron will realize the benefits of deferred tax assets, net of valuation allowance, as of March 31, 2017 and 2016.

The Company and its wholly-owned domestic subsidiaries apply a consolidated tax filing system for corporate tax purposes.

On March 31, 2016, amendments to the Japanese tax regulations were enacted into law. Based on the amendments, the statutory income tax rates utilized for the measurement of deferred tax assets and liabilities expected to be settled or realized from April 1, 2016 to March 31, 2018 and on or after April 1, 2018 were changed from 32.34% to 30.86% and 30.62%, respectively, as of March 31, 2016.

Due to these changes in statutory income tax rates, net deferred tax assets (after deducting the deferred tax liabilities) decreased by ¥1,781 million, and deferred income tax expense increased by ¥1,893 million for the fiscal year ended March 31, 2016.

Significant components of the difference between the statutory and effective tax rates for the years ended March 31, 2017 and 2016 are as follows:

	2017	2016
Statutory tax rate in Japan	30.86%	33.06%
Adjustments:		
Tax credits	(8.41)	(7.49)
Others, net	0.26	1.23
Effective tax rate	22.71%	26.80%

The Company received notification from the National Tax Agency, Japan (NTA) dated February 14, 2017, that agreement had been reached through the Mutual Agreement Procedure (MAP) between the NTA and U.S. income tax authorities concerning the transfer pricing adjustments assessed during prior historical periods relating to the transactions between the Company and its U.S. subsidiary. As a result, ¥405 million ($3,616 thousand) of tax benefit is included in current income tax expense as the difference between the current tax refunds and the estimated amount recorded in the prior year.

12. Net Assets

Net assets comprises four subsections, which are shareholders' equity, accumulated other comprehensive income, share subscription rights and non-controlling interests.

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

In cases where dividend distribution of surplus is made, the lesser of an amount equal to 10% of the dividend or the excess, if any, of 25% of common stock over the total of additional paid-in capital and legal reserve must be set aside as additional paid-in capital or legal reserve. Legal reserve is included in retained earnings in the accompanying consolidated balance sheets.

Both appropriations of legal reserve and additional paid-in capital used to eliminate or reduce a deficit generally require a resolution of the shareholders' meeting.

Additional paid-in capital and legal reserve may not be distributed as dividends. All additional paid-in capital and legal reserve may be transferred to other capital surplus and retained earnings, respectively, which are potentially available for dividends.

The Company is subject to restriction of dividends based on the Japanese Corporate Act, which restricts the amount of dividends to retained earnings on a consolidated basis.

The Company's articles allow for the distribution of earnings to shareholders on dates other than the mid-term and year-end, by a resolution of the board of directors in accordance with Japanese laws and regulations.

At the board of directors' meeting held on May 12, 2017, the distribution of cash dividends amounting to ¥36,752 million ($327,595 thousand) was resolved. Such appropriations have not been accrued in the consolidated financial statements as of March 31, 2017 since they are recognized in the period in which they are resolved at the board of directors' meeting.

13. Other Comprehensive Income

Other comprehensive income for the years ended March 31, 2017 and 2016 is as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2016	2017
Net unrealized gains on investment securities			
Net unrealized gains (losses) arising during the year	¥4,152	¥ (2,379)	$37,016
Reclassification adjustments	(6)	(201)	(56)
Sub-total, before tax	4,146	(2,580)	36,960
Tax expense	(1,271)	1,024	(11,331)
Sub-total, net of tax	2,875	(1,556)	25,629
Net deferred gains (losses) on hedging instruments			
Net deferred gains (losses) arising during the year	15	(168)	141
Reclassification adjustments	—	—	—
Sub-total, before tax	15	(168)	141
Tax expense	(4)	56	(43)
Sub-total, net of tax	10	(112)	97
Foreign currency translation adjustments			
Adjustments during the year	(933)	(5,705)	(8,317)
Reclassification adjustments	—	(1)	—
Sub-total, before tax	(933)	(5,706)	(8,317)
Tax expense	—	—	—
Sub-total, net of tax	(933)	(5,706)	(8,317)
Remeasurements of defined benefit plans			
Adjustments during the year	3,578	(11,326)	31,893
Reclassification adjustments	291	(2,268)	2,600
Sub-total, before tax	3,869	(13,594)	34,494
Tax expense	(1,187)	4,361	(10,582)
Sub-total, net of tax	2,682	(9,233)	23,911
Share of other comprehensive income of associates accounted for using the equity method			
Adjustments during the year	114	(345)	1,021
Total other comprehensive income	¥4,750	¥(16,952)	$42,342

Notes to Consolidated Financial Statements

14. Share Subscription Rights

Stock option plan

The Company's shareholders have approved annual stock option plans for directors and selected employees since the year ended March 31, 1999. The options under the plans vest immediately or over three-year period with restriction on exercise up to three years after the date of grant, and have an exercise period of seventeen years from the date on which the options become exercisable.

Options to purchase 194,400 shares of the Company were authorized and granted at an exercise price of ¥1 ($0.01) for the year ended March 31, 2017.

A summary of stock options outstanding and exercisable as of March 31, 2017 and 2016 is as follows:

	2017			2016	
	Number of shares	Weighted-average exercise price		Number of shares	Weighted-average exercise price
		Yen	U.S. dollars		Yen
Outstanding at the beginning of year	305,500	¥1	$0.01	378,200	¥1
Granted	194,400	1	0.01	135,700	1
Exercised	42,400	1	0.01	207,400	1
Expired (forfeited)	—	—	—	1,000	1
Outstanding at the end of year	457,500	1	0.01	305,500	1
Exercisable at the end of year	127,400	1	0.01	169,800	1

Amounts expensed related to stock options

The amounts expensed related to stock options for the years ended March 31, 2017 and 2016, are as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2016	2017
Selling, general and administrative expenses	¥1,141	¥967	$10,178

Valuation method of fair value per unit of stock options

Fair value as of the grant date for stock options granted for the year ended March 31, 2017 was ¥5,874 ($52.36) per unit, which was evaluated as follows:

(1) Valuation method used : Black-Scholes model

(2) Major underlying assumptions and estimates:

	12th Stock Acquisition Rights
Volatility (Note 1)	39.58%
Expected residual period (Note 2)	11.5 years
Expected dividends (Note 3)	190.0 ($1.69) per share
Risk-free interest rate (Note 4)	(0.1%)

Notes: 1. Calculated based on the stock price performance for 11.5 years (from December 2004 to June 2016).
2. Calculated on the assumption that the share subscription rights would be exercised at the mid-point of the exercise period.
3. Based on the dividends paid for the years ended March 31, 2016 and 2015.
4. Based on Japanese government bond yield corresponding to the expected residual period.

(3) Method of estimating the number of vested stock options

It is not necessary to estimate the number of vested stock options as the rights to exercise stock options are vested immediately when granted.

15. Leases

Future minimum lease payments on non-cancelable operating leases are as follows:

	Millions of yen		Thousands of U.S. dollars
	2017	2016	2017
Due within one year	¥3,554	¥2,397	$31,685
Due over one year	6,272	4,756	55,908
Total	¥9,827	¥7,153	$87,593

16. Fair Value of Financial Instruments

Policy for financial instruments

Tokyo Electron limits its fund management to short-term bank deposits and low-risk financial instruments.

Trade receivables, which consist of notes and accounts receivable, are exposed to credit risk in the event of non-performance by the counterparties. Execution and management of credit risk, maturity and receivable balance are conducted pursuant to the internal management rules for credit control. Credit risk of major customers is assessed on a regular basis.

Short-term investments consist of time deposits and low risk financial instruments and Tokyo Electron trade with highly-rated financial institutions to mitigate credit risks.

Investment securities consist of mainly equity interests in listed companies exposed to equity market risks. Conditions, including market prices, for these investment securities are monitored on a regular basis.

Trade payables, which consist of notes and accounts payable, mainly mature within one year. Trade payables are exposed to liquidity risks which are managed through activities such as implementing cash management plans.

See note 17 for detailed discussion on derivative financial instruments.

Fair value of financial instruments

Carrying amount and estimated fair value of financial instruments as of March 31, 2017 and 2016 are set out below. Fair value of financial instruments which is practically difficult to estimate are excluded (see note 5).

	Millions of yen	
2017:	Carrying amount	Estimated fair value[1]
Assets		
Cash and cash equivalents	¥164,366	¥164,366
Short-term investments	151,000	151,060
Trade notes and accounts receivable, net of allowance for doubtful accounts (¥63 million)	133,794	133,794
Investment securities	22,704	22,704
Liabilities		
Trade notes and accounts payable	79,217	79,217
Derivatives (see note 17)		
Hedge accounting not applied	(306)	(306)
Hedge accounting applied	49	49

	Millions of yen	
2016:	Carrying amount	Estimated fair value[1]
Assets		
Cash and cash equivalents	¥ 95,638	¥ 95,638
Short-term investments	141,035	140,785
Trade notes and accounts receivable, net of allowance for doubtful accounts (¥48 million)	116,455	116,455
Investment securities	18,580	18,580
Liabilities		
Trade notes and accounts payable	55,050	55,050
Derivatives (see note 17)		
Hedge accounting not applied	1,182	1,182
Hedge accounting applied	33	33

	Thousands of U.S. dollars	
2017:	Carrying amount	Estimated fair value[1]
Assets		
Cash and cash equivalents	$1,465,075	$1,465,075
Short-term investments	1,345,931	1,346,470
Trade notes and accounts receivable, net of allowance for doubtful accounts ($569 thousand))	1,192,569	1,192,569
Investment securities	202,378	202,378
Liabilities		
Trade notes and accounts payable	706,100	706,100
Derivatives (see note 17)		
Hedge accounting not applied	(2,729)	(2,729)
Hedge accounting applied	437	437

Notes: 1. Fair value calculation of financial instruments
Cash and cash equivalents, short-term investments, trade notes and accounts receivable and trade notes and accounts payable.
The carrying amounts approximate fair value because of the short maturity of these instruments.
Investment securities
The fair values of marketable securities are based on quoted market prices.
See note 5 for further information by classification of investment securities.
Derivatives
See note 17 for detailed discussion on derivative financial instruments.

2. The following unlisted equity securities are not included in the above as they do not have quoted market prices and therefore it is considered extremely difficult to measure their fair value.

	Millions of yen		Thousands of U.S. dollars
	2017	2016	2017
	Reported amount In balance sheet		
Unlisted stocks	¥1,399	¥1,334	$12,472
Other	14	—	133
Total	¥1,414	¥1,334	$12,605

3. Maturities of financial assets and securities are as follows:

	Millions of yen	
2017:	Within 1 year	After 1 through 5 years
Cash and cash equivalents	¥164,366	¥—
Short-term investments	151,000	—
Trade notes and accounts receivable	133,858	—

	Millions of yen	
2016:	Within 1 year	After 1 through 5 years
Cash and cash equivalents	¥ 95,638	¥—
Short-term investments	141,035	—
Trade notes and accounts receivable	116,503	—

	Thousands of U.S. dollars	
2017:	Within 1 year	After 1 through 5 years
Cash and cash equivalents	$1,465,075	$—
Short-term investments	1,345,931	—
Trade notes and accounts receivable	1,193,138	—

Notes to Consolidated Financial Statements

17. Derivative Financial Instruments

Tokyo Electron is subject to risk from adverse fluctuations in foreign currency exchange rates in its operating and financing activities. The Company and certain subsidiaries enter into forward foreign exchange contracts in order to hedge such risks, but do not enter into such transactions for speculative purposes. The Company implements a ratio analysis of the total cumulative cash flow fluctuations to assess effectiveness of hedging for all derivative transactions, except for transactions where the critical terms of the hedging instrument and hedged item match and the Company could conclude that changes in fair value or cash flows are expected to completely offset. Execution and management of all derivative transactions are conducted pursuant to the internal management rule.

The estimated fair values of the derivative financial instruments as of March 31, 2017 and 2016 are as follows:

1. Derivative financial instruments not designated as hedging instruments

	Millions of yen		
2017:	Contract amount	Fair value	Gains (losses)
Sell U.S. dollars	¥ 6,532	¥ 43	¥ 43
Sell Korean won	589	(353)	(353)
Sell Singapore dollars	55	(0)	(0)
Buy U.S. dollars	2,013	4	4
Buy Taiwan dollars	668	0	0
Buy Chinese yuan	404	(0)	(0)
Buy EURO	71	(0)	(0)
Buy Singapore dollars	42	(0)	(0)
Total	¥10,379	¥(306)	¥(306)

	Millions of yen		
2016:	Contract amount	Fair value	Gains (losses)
Sell U.S. dollars	¥51,173	¥1,773	¥1,773
Sell Korean won	1,068	(612)	(612)
Sell Singapore dollars	58	(0)	(0)
Buy Korean won	879	2	2
Buy U.S. dollars	834	(1)	(1)
Buy Taiwan dollars	431	10	10
Buy EURO	359	9	9
Buy Swiss francs	95	1	1
Buy Singapore dollars	33	(0)	(0)
Total	¥54,930	¥1,182	¥1,182

	Thousands of U.S. dollars		
2017:	Contract amount	Fair value	Gains (losses)
Sell U.S. dollars	$58,225	$ 388	$ 388
Sell Korean won	5,258	(3,151)	(3,151)
Sell Singapore dollars	496	(2)	(2)
Buy U.S. dollars	17,950	36	36
Buy Taiwan dollars	5,961	2	2
Buy Chinese yuan	3,605	(3)	(3)
Buy EURO	640	(0)	(0)
Buy Singapore dollars	379	(0)	(0)
Total	$92,517	$(2,729)	$(2,729)

Note: The fair values are based on the quoted forward foreign exchange rates.

2. Derivative financial instruments designated as hedging instruments

The contract amounts of forward foreign exchange contracts, entered into to hedge future transactions and receivables and payables denominated in foreign currencies that have been translated by the corresponding contracted rates, are as follows:

	Millions of yen		Thousands of U.S. dollars	
2017:	Contract amount	Fair value	Contract amount	Fair value
Future transactions denominated in a foreign currency				
Sell U.S. dollars	¥4,117	¥50	$36,700	$452
Sell Korean won	1	(0)	13	(7)
Buy U.S. dollars	340	(0)	3,034	(6)
Monetary assets and liabilities in foreign currency (Note)				
Sell U.S. dollars	130	—	1,163	—
Buy U.S. dollars	127	—	1,137	—
Total	¥4,717	¥49	$42,048	$437

	Millions of yen	
2016:	Contract amount	Fair value
Future transactions denominated in a foreign currency		
Sell U.S. dollars	¥1,371	¥63
Sell Korean won	33	(19)
Buy EURO	361	(8)
Buy GBP	19	(3)
Buy U.S. dollars	13	(0)
Monetary assets and liabilities in foreign currency (Note)		
Sell U.S. dollars	162	—
Buy U.S. dollars	200	—
Buy Singapore dollars	21	—
Buy EURO	12	—
Total	¥2,192	¥33

Note: The fair value of these derivative financial instruments, which is based on the quoted foreign exchange rates, is included in the carrying value of hedged assets and liabilities.

18. Segment Information

General information about reportable segments

A reportable segment is a component or an aggregated component of Tokyo Electron. For each of the components, discrete financial information is available and the operating result is regularly reviewed by management to make decisions about resources to be allocated to the segment and assess its performance.

The operation of Tokyo Electron consists of segments by products and services based on business units (BUs), and Tokyo Electron identifies as a reportable segment, "semiconductor production equipment (SPE)" and "flat panel display (FPD) production equipment".

Products of the SPE segment consist of coater/developers, plasma etch systems, thermal processing systems, single wafer deposition systems, cleaning systems used in wafer processing, wafer probers used in the wafer testing process and other semiconductor production equipment. The SPE segment principally develops, manufactures, sells and distributes such products.

Products of the FPD production equipment segment consist of coater/developers and etch/ash systems used in the manufacture of flat panel displays. The FPD production equipment segment principally develops, manufactures, sells and distributes such products.

Basis of measurement of reportable segment net sales, segment profit (loss), segment assets and other items

The accounting policies applied in each reportable segment are generally consistent with those applied for the preparation of the consolidated financial statements. Intersegment sales or transfers are determined based on current market prices. Assets in common use have not been allocated to each reportable segment, while costs associated with those assets have been allocated to reportable segments on a systematic basis.

Information about reportable segment net sales, segment profit (loss), segment assets and other items

Reportable segment information as of and for the years ended March 31, 2017 and 2016 is as follows:

	Millions of yen					
	Reportable Segment					
2017:	Semiconductor production equipment	FPD production equipment	Other	Total	Eliminations and Corporate	Consolidated
Net sales						
Sales to external customers	¥749,893	¥49,387	¥ 438	¥799,719	¥ —	¥799,719
Intersegment sales or transfers	—	—	14,372	14,372	(14,372)	—
Total	749,893	49,387	14,810	814,091	(14,372)	799,719
Segment profit	182,709	4,618	82	187,410	(38,294)	149,116
Segment assets	374,513	27,494	2,646	404,654	552,792	957,447
Depreciation and amortization	8,694	418	89	9,202	8,670	17,872
Amortization of goodwill	631	—	—	631	—	631
Loss on impairment	362	—	—	362	—	362
Capital expenditures, including intangible assets	10,881	562	472	11,917	10,347	22,264

Notes to Consolidated Financial Statements

Millions of yen

2016:	Reportable Segment: Semiconductor production equipment	Reportable Segment: FPD production equipment	Other	Total	Eliminations and Corporate	Consolidated
Net sales						
Sales to external customers	¥613,033	¥44,687	¥ 6,229	¥663,949	¥ —	¥663,949
Intersegment sales or transfers	—	—	11,592	11,592	(11,592)	—
Total	613,033	44,687	17,821	675,541	(11,592)	663,949
Segment profit	123,163	4,747	2,036	129,946	(23,479)	106,467
Segment assets	321,100	25,186	2,134	348,420	444,948	793,368
Depreciation and amortization	8,792	424	45	9,261	9,996	19,257
Amortization of goodwill	970	—	—	970	—	970
Loss on impairment	9,711	—	—	9,711	16	9,727
Capital expenditures, including intangible assets	8,500	285	13	8,798	5,952	14,750

Thousands of U.S. dollars

2017:	Reportable Segment: Semiconductor production equipment	Reportable Segment: FPD production equipment	Other	Total	Eliminations and Corporate	Consolidated
Net sales						
Sales to external customers	$6,684,140	$440,210	$ 3,910	$7,128,260	$ —	$7,128,260
Intersegment sales or transfers	—	—	128,105	128,105	(128,105)	—
Total	6,684,140	440,210	132,015	7,256,366	(128,105)	7,128,260
Segment profit	1,628,573	41,171	730	1,670,475	(341,336)	1,329,138
Segment assets	3,338,207	245,073	23,591	3,606,871	4,927,286	8,534,157
Depreciation and amortization	77,499	3,727	801	82,028	77,281	159,310
Amortization of goodwill	5,625	—	—	5,625	—	5,625
Loss on impairment	3,235	—	—	3,235	—	3,235
Capital expenditures, including intangible assets	96,995	5,015	4,212	106,222	92,232	198,455

Notes: 1. "Other" includes all other operating segments which are not included in the reportable segments, including Photovoltaic panel Production Equipment business, group-wide logistic services, facility maintenance and insurance.

2. (1) "Eliminations and Corporate" segment loss totaling ¥38,294 million ($341,336 thousand) and ¥23,479 million for the years ended March 31, 2017 and 2016, respectively, includes corporate expenses not allocated to any reportable segments. The corporate expenses consist of research and development costs of ¥17,830 million ($158,935 thousand) and ¥13,583 for the years ended March 31, 2017 and 2016, respectively, pertaining to fundamental research and element research, not allocated to any of the reportable segments, and the loss on disaster of ¥7,521 million ($67,039 thousand) for the year ended March 31, 2017.

(2) "Eliminations and Corporate" segment assets totaling ¥552,792 million ($4,927,286 thousand) and ¥444,948 million as of March 31, 2017 and 2016, respectively, consist mainly of cash and cash equivalents, short-term investments and buildings not allocated to any of the reportable segments.

(3) "Eliminations and Corporate" capital expenditures totaling ¥10,347 ($92,232 thousand) and ¥5,952 million for the years ended March 31, 2017 and 2016, respectively, consist mainly of capital expenditures for buildings, machinery and equipment not allocated to any of the reportable segments.

Other information

(1) Domestic and overseas net sales by destination for the years ended March 31, 2017 and 2016 are as follows:

Millions of yen

2017:	Japan	U.S.A.	Europe	South Korea	Taiwan	China	Other	Total
Net sales	¥101,122	¥101,566	¥59,998	¥145,216	¥233,754	¥115,126	¥42,935	¥799,719

Note: Sales are classified in countries or regions based on location of customers.

Millions of yen

2016:	Japan	U.S.A.	Europe	South Korea	Taiwan	China	Other	Total
Net sales	¥121,808	¥103,574	¥56,659	¥107,273	¥170,095	¥87,325	¥17,215	¥663,949

Note: Sales are classified in countries or regions based on location of customers.

Thousands of U.S. dollars

2017:	Japan	U.S.A.	Europe	South Korea	Taiwan	China	Other	Total
Net sales	$901,348	$905,310	$534,791	$1,294,379	$2,083,557	$1,026,173	$382,699	$7,128,260

(2) Net property, plant and equipment by location as of March 31, 2017 and 2016 are as follows:

Millions of yen

2017:	Japan	U.S.A.	Other	Total
Property, plant and equipment	¥77,407	¥11,228	¥11,805	¥100,441

Millions of yen

2016:	Japan	U.S.A.	Other	Total
Property, plant and equipment	¥75,580	¥9,724	¥11,013	¥96,317

Thousands of U.S. dollars

2017:	Japan	U.S.A.	Other	Total
Property, plant and equipment	$689,964	$100,088	$105,223	$895,277

(3) Major customer information

Net sales to external customers that represent 10 percent or more of net sales are as follows:

Name of customer	Related reportable segment	Millions of yen 2017	Thousands of U.S. dollars 2017
Intel Corporation	Semiconductor production equipment	¥143,488	$1,278,974
Taiwan Semiconductor Manufacturing Company Ltd.	Semiconductor production equipment	127,621	1,137,549
Samsung Electronics Co., Ltd.	Semiconductor production equipment and FPD production equipment	112,151	999,657
Micron Technology, Inc.	Semiconductor production equipment	84,111	749,722

Note: The amounts include sales to the customer and its subsidiaries.

Name of customer	Related reportable segment	Millions of yen 2016
Samsung Electronics Co., Ltd.	Semiconductor production equipment and FPD production equipment	¥100,672
Intel Corporation	Semiconductor production equipment	83,795
Taiwan Semiconductor Manufacturing Company Ltd.	Semiconductor production equipment	71,938

Note: The amounts include sales to the customer and its subsidiaries.

Notes to Consolidated Financial Statements

Information about reportable segment goodwill

Reportable segment information about amortization of goodwill for the years ended March 31, 2017 and 2016, and unamortized balances as of March 31, 2017 and 2016 are as follows:

	Millions of yen		
2017:	Semiconductor production equipment	FPD production equipment	Total
Amortization of goodwill	¥ 631	¥—	¥ 631
Goodwill	3,376	—	3,376

	Millions of yen		
2016:	Semiconductor production equipment	FPD production equipment	Total
Amortization of goodwill	¥ 970	¥—	¥ 970
Goodwill	4,095	—	4,095

	Thousands of U.S. dollars		
2017:	Semiconductor production equipment	FPD production equipment	Total
Amortization of goodwill	$ 5,625	$—	$ 5,625
Goodwill	30,100	—	30,100

Independent Auditor's Report

KPMG

Independent Auditor's Report

To the Board of Directors of Tokyo Electron Limited:

We have audited the accompanying consolidated financial statements of Tokyo Electron Limited and its consolidated subsidiaries, which comprise the consolidated balance sheets as at March 31, 2017 and 2016, and the consolidated statements of income, comprehensive income, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in Japan, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, while the objective of the financial statement audit is not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Tokyo Electron Limited and its consolidated subsidiaries as at March 31, 2017 and 2016, and their financial performance and cash flows for the years then ended in accordance with accounting principles generally accepted in Japan.

Convenience Translation

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2017 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 1 to the consolidated financial statements.

KPMG AZSA LLC
June 20, 2017
Tokyo, Japan