

MANAGEMENT INTERVIEW

Question & Answer

In this section, Chairman Higashi and President Sato are asked about market trends and Tokyo Electron's strategies and actions.

Question 1

In fiscal 2007, Tokyo Electron posted record results. How do you evaluate this performance?

Answer



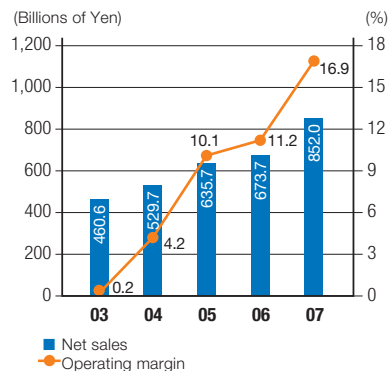
This reflects the benefits of our ongoing efforts to elevate profitability by the entire Tokyo Electron Group.

The figures at each level—net sales of ¥852.0 billion, operating income of ¥144.0 billion and net income of ¥91.3 billion—are record highs for the Company. Although we did benefit from favorable conditions in the business environment, we view these results as a reflection of the overall strength of the Tokyo Electron Group, and the success of our unified efforts to enhance profitability.

Two years ago, at a time when the Company's operating margin had only just recovered to 10%, we embarked on a medium-term business plan which set the goal of elevating operating profitability to 17% over the medium term. This would surpass the Company's previous record high of 16.7%. Raising the operating margin from around 10% to 17% seemed extremely ambitious, but considering the Company's underlying potential, we had confidence that it was an attainable goal. Sharing one goal, the entire group made all the necessary efforts in sales, marketing, services, development and production to execute strategy. As a result, the Company posted an operating margin for fiscal 2007 of 16.9%, and in the second half we recorded a margin of 18.6%. On a six-month basis, at least, we have already surpassed our goal.

Naturally, we were glad to have the opportunity to share this success with shareholders, by raising the annual dividend to a record high of ¥103 per share.

Net Sales and Operating Margin



Note: Effective from fiscal 2005, the Company made certain changes in accounting policies as discussed in the notes to consolidated financial highlights.

Question 2

Answer


Specifically, what steps has Tokyo Electron taken to increase profitability?

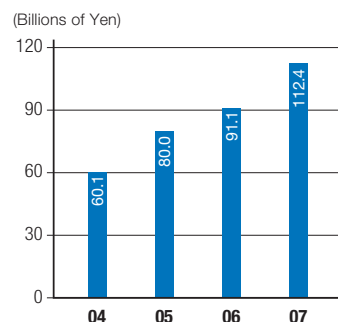
We implemented three specific strategies—creating new, high-value-added products, improving manufacturing efficiency, and expanding post-sales businesses. We have made steady progress in all three areas.

The Company's medium-term management plan, "Innovative Challenge 20," challenged employees and executives to pursue three strategies for improving profitability.

The first involved creating new, high-value-added products. As semiconductor production processes become more sophisticated, customer needs are diversifying. What is important in this context is to introduce models optimized for each market segment based on an understanding of customer markets. We have brought to market some 13 new types of production equipment born from this approach over the past 2 years. Significantly, these new models are now beginning to contribute to profitability.

The second strategy involved improving Tokyo Electron's manufacturing efficiency in order to reduce costs. The most essential feature of production facilities, in this business, is to raise quality. I have repeatedly stressed the importance of "quality enhancement" to our manufacturing team, as I believed that through this concept, design, procurement, and manufacturing technology would certainly improve and consequently cost reductions would follow. This has proven to be true.

The Company's third objective was to expand post-sales businesses. Sales in Tokyo Electron's equipment refurbishment business, in particular, have risen steadily, and as a result we have outperformed the 3-year goal of growing the post-sales businesses to ¥100.0 billion. This business generates good profits, so any sales growth makes a direct contribution to increasing the Company's operating margin.

Post-sales Business


Post-sales business: Refurbishment/Relocation, Contract service, Parts sales

Question 3

Could you tell us more about the Company's efforts to improve manufacturing capabilities? What changes have taken place?

Answer



By reforming product development and design and through activities for reducing wasteful processes, we have improved quality, shortened manufacturing lead times, cut costs and enhanced customer satisfaction.

By examining some quality problems that the Company experienced in the past, we learned that careful management and control of the product development and design processes from the initial stage were an extremely important factor in the manufacturing process. From the upstream processes of product development and design, Tokyo Electron now emphasizes not only a product's functions and performance, but also factors such as reliability, productivity and ease of maintenance. Furthermore, we have gone back to the basics, re-examining every stage of the manufacturing process to identify and quantify any elements of waste or inefficiency, and then looking for ways to eliminate such production losses. These comprehensive efforts, on the factory floor, to reform production processes have contributed to higher quality, shorter manufacturing lead times, reduced costs and high customer satisfaction. Nevertheless, Tokyo Electron is never satisfied with the status quo, and our task in the future is to identify ways to make further improvements to our operations.

Question 4

Once Tokyo Electron has surpassed the interim objectives laid out in the current medium-term management plan, what will you then set your sights on?

Answer



We will implement growth strategies that will allow the Company to become even more profitable when the next peak of the silicon cycle arrives.

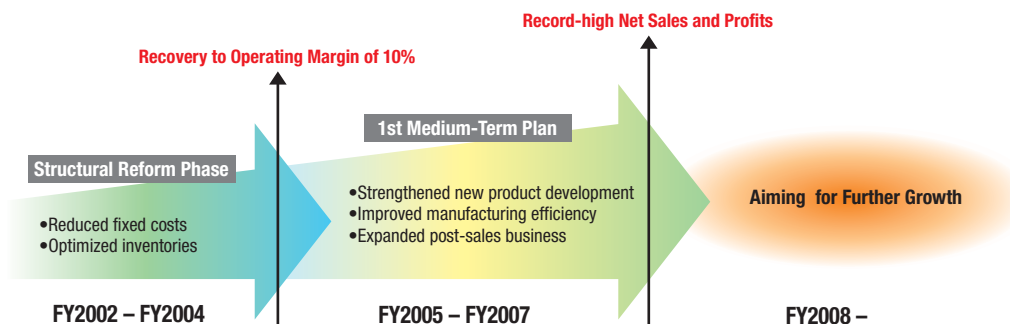
Achievement of a 17% operating margin is merely a signpost on the road to further success. Tokyo Electron wants to develop even greater earnings power and use the extra profits to strengthen products for customers. And of course, this would also mean that we will be able to return more value to shareholders, through strong earnings and higher dividends.

To reach those goals, we must first look for ways to elevate the earnings power of existing products even further. The new products that Tokyo Electron has introduced over the past two years are moving into a volume production phase this year. We must not only seek to reap the returns of our investments in these products, but also work on launching new products in a timely manner.

Second, we must make further improvements to manufacturing efficiency to boost the cost-competitiveness of Tokyo Electron products. Reform efforts over the past two years have yielded steady improvements. But going a step further, we are collaborating with business partners to improve the efficiency of our supply chain and logistics activities. We aim to establish ideal manufacturing sites that can shorten manufacturing lead times and cut costs.

A third theme is increasing profitability through new businesses. In order to further raise profitability, within 10 years we want to establish several new high-value-added businesses which can generate sales of as much as ¥100.0 billion. The business that is currently closest to achieving that sort of success is the production equipment that Tokyo Electron is developing using a Radial Line Slot Antenna (RLSA) plasma source. We are now speeding up efforts to build this business. In addition, last December Tokyo Electron acquired Epion Corporation, a U.S.-based company that is on the cutting edge of Gas Cluster Ion Beam technology. We plan to cultivate this as one of Tokyo Electron's core technologies for the future. In the growing market for Micro Electro-Mechanical Systems (MEMS), meanwhile, the Company has already launched MEMS testers and we are making rapid strides to build this business further.

In addition to the items described above, Tokyo Electron is stepping up environmental initiatives.



Question 5

Tokyo Electron has been working on environment-related technology in the past. What is the Company doing now to step up these efforts?

Answer



Developing environment-related technology is our mission and responsibility as the industry leader.

Early this year, I had the opportunity to participate in an environmental conference, and was able to sense the growing importance that people around the world are placing on issues such as global warming. This renewed my determination to help solve environmental issues through technological innovation.

First of all, by incorporating high-performance semiconductors and displays with high environmental efficiency in electronics products and automobiles, manufacturers can help reduce total energy

consumption. Tokyo Electron's production equipment allows manufacturers to produce these more efficient devices at a low cost, and this helps to encourage the trend towards energy efficiency. In other words, we make a contribution by providing customers with high-performance, highly productive equipment that allows them to make cost-efficient devices, while still making good profits. Furthermore, Tokyo Electron is actively supporting the efforts of companies that are developing power semiconductors and other products that save energy, as well as manufacturers of solar panels and other products that help reduce power consumption.

In addition, Tokyo Electron is improving the energy efficiency of its own semiconductor and FPD production equipment, and developing new products that are even more environmentally friendly. Considering the Company's large market share, our efforts have a very important impact on trends for the industry. In this sense, we bear a heavy responsibility; by taking the lead in efforts to improve environmental efficiency, we can exercise strong influence on the environmental impact of the entire industry.

Question 6

What are your expectations for the future growth of the semiconductor industry, and the semiconductor production equipment industry?

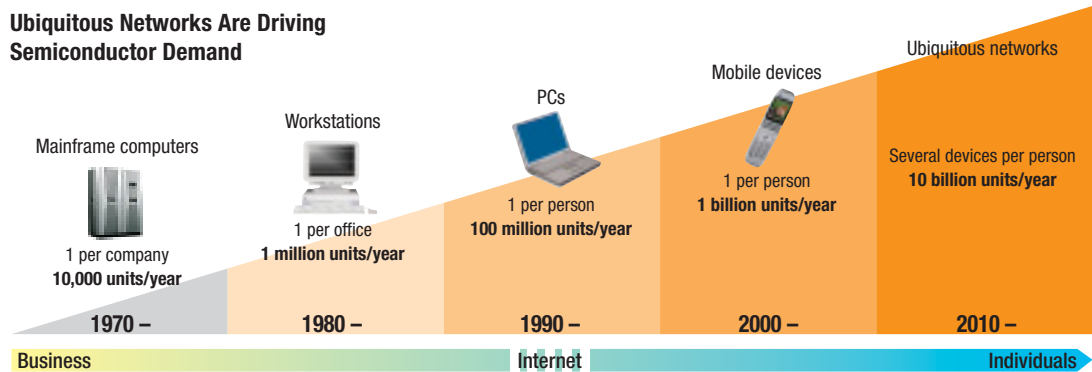
Answer



Semiconductors, and in particular, memory, have become a key component of many consumer products. Therefore, the possibilities for market growth are boundless.

At the moment, new trends are emerging in the semiconductor industry. For example, in the memory segment, where personal computers once solely drove market growth, today high-performance mobile devices and digital consumer products have emerged as another driver of the memory market. The PC is also evolving into a digital consumer product. Also, mobile functions and broadband networks that realize "anywhere, anytime access" are creating new markets for NAND flash memory and DRAM.

Ubiquitous Networks Are Driving Semiconductor Demand



Ubiquitous networks: Enabling access to the Internet and other information networks anytime, anywhere

Furthermore, these trends now mean that semiconductors are being adapted to new uses and services, such as remote health diagnosis, on-line educational programs, and remote security services. Meanwhile, as with developed countries, emerging markets like BRICs, Eastern Europe, Africa, the Middle East and South America are accelerating network building as an essential condition for national growth. With semiconductor demand expanding beyond borders, I believe that the semiconductor production equipment industry is poised for dynamic growth in the years to come.

Question 7

Shipments of production equipment for memory seem to be brisk, but do you have any concerns about a sudden market correction, as in the past, in the future?

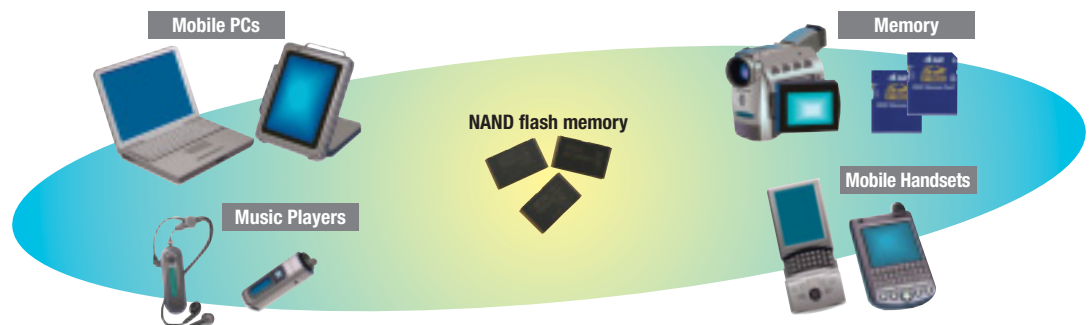
Answer



As semiconductors are finding wider applications, we think that the silicon cycle will grow shorter, and volatility will also become steadily smaller.

Certainly, we think that the current high level of capital investment in memory is partly a reflection of market expectations that Microsoft's launch of *Windows Vista* will increase demand for high-speed, large-capacity DRAM. However, our view is that the "Vista effect" is not the only reason why capital investment is currently very high. Supply factors also come into play. As manufacturers retire 200mm wafer processing equipment from DRAM manufacturing, customers need to acquire cost-effective 300mm processing equipment to partly make up for lost 200mm capacity. For that reason, we think there is little risk that the current surge in investment will create excess production capacity. The PC market, which is still a primary source of demand for DRAM, has not yet reached the market penetration levels that are enjoyed by other consumer products, such as radios and TVs. We think there is plenty of room for market expansion.

Expanding NAND Flash Memory Applications



Meanwhile, as NAND flash memory establishes itself as an ideal storage device for consumer electronics products, we think capital investment will continue to expand based on the large potential for growth in demand. The market for semiconductors continues to widen, and as this continues, the overall market impact of a sudden drop in demand for any one application will steadily become less severe. We expect the silicon cycle to become shorter, and the scale of fluctuation between peaks and valleys to become smaller.

Nevertheless, we cannot control the pace of capital investment by our customers. If sudden market corrections do occur, the stability of Company earnings will depend on how sound our underlying business foundation is. Therefore, we will continue to focus our efforts on building a sound earnings base.

Question 8

It is often said that semiconductor production equipment manufacturers are playing a greater role in semiconductor manufacturing. In what way is this role expanding?

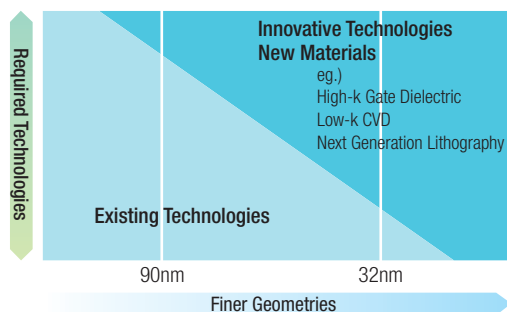
Answer



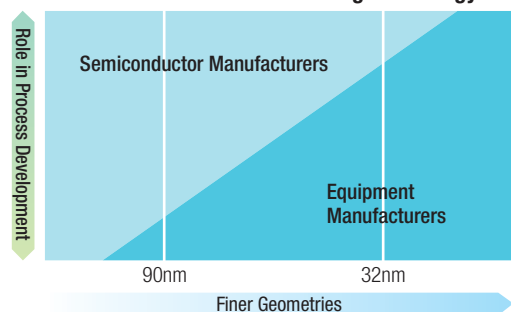
Equipment manufacturers are becoming deeply involved in efforts to develop semiconductor process technology. Although this is a real challenge for us, it also represents an excellent business opportunity.

The performance of semiconductors has been improved by reducing geometries and increasing the number of interconnect layers. Since the start of the millennium, however, the types of technology developments that had driven progress in the past reached their limits, and chip manufacturers face high barriers to further progress. In order to address their difficulties, new multilayer interconnect and etching technologies and new materials are being introduced, and equipment makers' involvement in the area of semiconductor process innovation holds the key to achieving new advances.

Existing Technology vs Innovative Technology



Growing Role of Equipment Manufacturers in Semiconductor Manufacturing Technology



Particularly since semiconductors came into use in consumer electronics, chipmakers have focused most of their development efforts on product planning, circuit design and software, and consequently they are now increasingly dependent on equipment manufacturers to make the advances in semiconductor process technology. The important thing here is first to fully comprehend the various technological needs expressed by customers, and then crystallize what the real technological needs are and provide solutions for them. Put another way, equipment manufacturers will be required to take the initiative more in proposing process technology. This will demand an even more scientific approach than in the past on the part of SPE manufacturers. But there are only a handful of companies in the world who possess these capabilities—and we are one of them.

As this discussion suggests, the role of a semiconductor production equipment manufacturer is becoming increasingly important. Although this presents us with a major challenge, we think that it also offers tremendous opportunities for future growth.

Question 9

What trends do you foresee in the FPD production equipment industry in coming years?

Answer



Capital investment is entering a cyclical lull in 2007. Over the medium and longer term, however, we expect rising demand for large-screen, flat-panel TVs to revive capital investment.

The market for FPD production equipment surpassed our expectations in 2006, expanding rapidly, but the trend is likely to reverse in 2007—the capital investment environment is expected to remain weak throughout the year. However, this is merely a short-term lull. We expect capital investment to rebound in 2008 and beyond.

Global demand for television sets is estimated at around 190 million units a year. LCD TVs are steadily expanding their share of this market, but last year total shipments amounted to just 45 million units. That suggests that there is still tremendous potential for market growth.

At present, countries around the world are shifting from analog to digital broadcasting technology and we expect that LCD TVs will be in strong demand as people upgrade to new digital TVs. Furthermore, whereas people used to have only one TV in the house, flatter screens have made it easier to put one in every room. Many people now have one in the living room, one in the den, one in the bedroom and one in the kitchen. The era of one TV for every family member is coming closer. Naturally, this trend will stimulate demand further.

We expect to see continued waves of demand for capital investment and ongoing growth, at least for the time being.

Question 10

Could you give us your thoughts on the return of profits to shareholders?

Answer



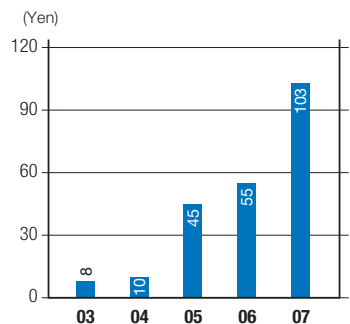
To make possible more attractive returns of profits to shareholders, we will continue to make investments for growth. We will also look at the appropriate allocation of capital through a balance sheet management approach.

Tokyo Electron's basic policy on shareholder returns is to continue linking dividends to consolidated net income. We are implementing a dividend policy that aims for a consolidated payout ratio of 20%. In fiscal 2007, the Company paid a dividend of ¥103 per share—the highest level in our history.

However, we are not content with that and hope to reward shareholders even more for their support.

Tokyo Electron has pursued cash flow management as an important theme in recent years. As a result, we have seen a marked improvement in our ability as a company to continuously generate cash. Because the markets where we are active are expected to experience considerable growth going forward, we intend to use this cash to make investments for the development of new technologies and in other ways to drive growth. There will therefore be no change in our policy of putting top priority on raising corporate value over the medium and long terms in this way. That said, we will think about how best to allocate the cash we generate. We think that it is important to adopt a flexible capital structure policy, one that balances three goals: investing for growth, strengthening our financial foundations and returning profits to shareholders. Together with these measures, we are determined that we will continuously work hard to provide more shareholder return in the future.

Cash Dividends per Share



Question 11

Is it true that the Company has adopted a unique compensation system to increase corporate value?

Answer



Yes, our compensation system—not only for directors and executive officers, but also for ordinary employees—links pay directly to the Company's earnings performance.

Tokyo Electron has adopted an earnings-linked dividend policy which rewards shareholders by paying dividends equal to 20% of consolidated net income. For people on the operations side, a similar system linked to earnings performance incentivizes them.

The “annual bonus” portion of compensation for the Company’s directors and executive officers is directly linked to earnings results. The upper limit on these bonuses is set at 3% of consolidated net income. About one-third of those bonuses are paid in the form of stock options (warrants with an exercise price of ¥1, and a restricted period of three years). Therefore, if the Company’s share price rises, executives receive higher compensation than if they received the bonuses in cash, but if the share price falls, their compensation is less than it would have been if the entire bonus was paid in cash. In other words, the Company’s executives bear the same risks—both positive and negative—as the shareholders. Tokyo Electron’s stock options are not based on job title, but rather, are solely a reflection of profit results.

In fiscal 2007, we also introduced a compensation system for employees which is directly linked to consolidated operating income. Employee bonuses are paid out based on earnings results (set at 15% of operating income, before bonuses). This means that all three of the Company’s major stakeholder groups—shareholders, executives and employees alike—have a common goal. All benefit from efforts to boost earnings and enhance corporate value.

Question 12

What kind of company does Tokyo Electron aim to become?

Answer



We want to create a company that is full of vision and energy, an organization in which all stakeholders can realize their goals through their involvement with Tokyo Electron.

Tokyo Electron wants to provide high value to all of its stakeholders. First of all, we are dedicated to developing new products and technologies that provide high value to customers, and also benefit society in general. The technical hurdles to meeting customer needs grow higher with each passing year, but by developing and manufacturing equipment that offers superior reliability and productivity, we are pursuing full customer satisfaction.

The most essential element in Tokyo Electron’s business success is people, our employees, and our basic personnel policy reflects this belief. In order to cultivate the abilities of employees, and maximize their contributions over the medium and long term, we have established TEL University. At TEL University we aim to foster employees who have ambition, are open-minded, and possess a risk-taking spirit that is not constrained by fear of failure. We believe that this initiative will help us to become the industry leader in growth potential and earnings capacity. By developing vision and energy within our company, we hope to offer shareholders, and all stakeholders globally, an opportunity to share in our success and realize their goals. This is the type of company we aim to be.