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### 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 = ¥120.20. This was the approximate exchange rate in Japan on March 31, 2003.

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 20, 2003 was \$1.00 = ¥118.39. 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 of period</u>	<u>Average (of month- end rates)</u>	<u>High</u>	<u>Low</u>
		(¥ per \$1.00)		
1999	¥ 118.43	¥ 128.10	¥147.14	¥108.83
2000	102.73	110.02	124.45	101.53
2001	125.54	111.65	125.54	104.19
2002	132.70	125.64	134.77	115.89
2003	118.07	121.10	133.40	115.71
2004 (through June 20, 2003)	118.39	118.99	120.55	115.94
<u>Month ended</u>	<u>High</u>	<u>Low</u>		
		(¥ per \$1.00)		
December 31, 2002	¥124.99	¥118.38		
January 31, 2003	120.18	117.80		
February 28, 2003	121.30	117.14		
March 31, 2003	121.42	116.47		
April 30, 2003	120.55	118.25		
May 31, 2003	119.50	115.94		

### 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

#### *Continuing weak demand in the cyclical market for semiconductors is adversely affecting Advantest's automated test equipment business*

Advantest's automated test equipment business and results of operations depend largely upon the capital expenditures of manufacturers of semiconductors, independent providers of semiconductor test services, or test houses, and independent semiconductor manufacturing service providers, or foundries. These manufacturers and 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, including investment in automated test equipment, during downturns in the semiconductor industry has typically been much greater than the percentage reduction in worldwide sales of semiconductors. The semiconductor industry

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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 test systems and other automated test equipment components, including those of Advantest. The market for memory semiconductors is especially cyclical as compared to non-memory semiconductors, including "system-on-a-chip", or SoC, semiconductors. In fiscal 2002, approximately 70% of Advantest's net sales from semiconductor test systems were derived from the sale of semiconductor test systems for memory semiconductors. Therefore, any cyclical downturns in the memory market will likely adversely affect Advantest more than its competitors.

The market for both memory and SoC semiconductors contracted significantly in the second half of 2000 and during 2001. Furthermore, despite an increase in demand generated by certain digital home electronics and high-end wireless handsets, the worldwide semiconductor market grew by only 1.3% in 2002 compared to 2001. 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. 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. Several factors have contributed to this continuing weak market for memory and SoC semiconductors, including:

- the global economic downturn, particularly in the United States;
- sluggish sales levels in the personal computer industry; and
- continued restraint in investment in communications infrastructure and, in particular, the effect on the high-end wireless handset market.

Amid this continuing downturn, Advantest's net sales from automated test equipment increased by 14.4% in fiscal 2002 compared to fiscal 2001, following a decrease of 69.3% in fiscal 2001 compared to fiscal 2000. Of the net sales of ¥84,910 million in fiscal 2002, ¥35,124 million was recorded in the first half of fiscal 2002 and ¥49,786 million was recorded in the second half of fiscal 2002. While it appears that the semiconductor market bottomed out in the second half of fiscal 2001 and has started to slowly improve, Advantest believes that the market price for semiconductors remains depressed. Advantest believes that there still exists a substantial lack of visibility regarding semiconductor demand that makes it very difficult to estimate the timing and extent of improvement in Advantest's automated test equipment business.

### ***Advantest's market position in non-memory semiconductor test systems creates challenges for Advantest to grow its business***

In 2002, Advantest had an approximately 9.3% market share in SoC semiconductor test systems, which is the largest segment of the non-memory semiconductor test system market. Advantest's smaller market share in non-memory semiconductor test systems creates challenges for Advantest to grow its non-memory semiconductor test system business. Customers typically purchase new automated test equipment from current equipment suppliers because they want to ensure that new equipment is compatible with their existing systems. In addition, the development of new semiconductor test systems is, in general, a cumulative process, which means established manufacturers enjoy competitive advantages based on technology and know-how already acquired. Advantest believes that increasing sales of non-memory semiconductor test systems, particularly SoC semiconductor test systems, is vital to growing its overall business. In recent years, the non-memory semiconductor test system market has been approximately two to three times as large as the memory semiconductor test system market. Advantest may need to reduce sales prices for its non-memory semiconductor test systems, particularly SoC semiconductor test systems and, therefore, reduce its margins from current levels in order to grow its non-memory semiconductor test system business.

### ***Advantest may not recoup its investment in, or otherwise benefit from the successful adoption of, OPENSTAR***

Advantest is currently expending time and resources to design and create, as well as promote the adoption of, OPENSTAR, an industry-wide, open architecture that seeks to address the rapidly changing testing requirements of SoC semiconductors. Advantest is leading the efforts in the design and creation and for the

adoption of OPENSTAR because it believes that OPENSTAR will provide an opportunity for late entrants to the SoC automated test equipment market, such as Advantest, to increase their market share. However, the development of OPENSTAR is not complete and there can be no assurance that OPENSTAR will ever develop into a viable architecture. In addition, the adoption of this standard depends on a number of factors, such as the active participation of other systems and module equipment manufacturers and the support of a substantial number of semiconductor manufacturers. Advantest believes that other automated test equipment companies are also in the process of developing new testing platforms of their own. There can be no assurance that the OPENSTAR standard will be adopted by the semiconductor industry or, if adopted, that this standard will be successful. If OPENSTAR is not adopted by the semiconductor industry, Advantest will not recoup its investment in this new open architecture.

Furthermore, even if OPENSTAR is broadly accepted by the semiconductor industry, the consequences of the adoption of OPENSTAR on Advantest's automated test equipment business are uncertain. OPENSTAR is an open architecture that allows all semiconductor industry participants to participate, therefore the adoption of the new standard could result in the increase of the number of market participants and in a loss of market share for Advantest. In addition, OPENSTAR is a new standard and, therefore, will require all automated test equipment 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 SoC automated test equipment business.

***Advantest is facing significant price pressure in both of its business segments***

Price pressure in Advantest's businesses is adversely affecting Advantest's operating margins. Advantest believes that price pressure with respect to automated test equipment is strongest during periods when demand, in terms of volume, for semiconductors is increasing, but there exists pressure on the market price for semiconductors. During these periods, semiconductor manufacturers and testing companies seek to increase their production capacities, while minimizing their capital expenditures at the same time. Advantest believes that, despite a general lack of visibility regarding the timing of a real recovery in the semiconductor market, it is in such a period. With respect to its measuring instruments segment, Advantest has continued to experience significant price pressure following the drop in capital investment levels in the communications industry and the downturn in the global economy beginning in the later part of 2000. A further increase in price pressure will adversely affect Advantest's future operating results and financial condition.

***Demand for Advantest's products, in particular its wireless and fiber optic measuring instruments, is being negatively affected by continued restraint on investments by the communications industry***

Advantest's measuring instrument business depends, in large part, on demand from wireless communications and fiber optic network equipment and components manufacturers and service providers. Of Advantest's net sales from measuring instruments, sales of measuring instruments to these manufacturers and service providers accounted for approximately 70% in fiscal 2001 and 50% in fiscal 2002, respectively. Capital expenditures by manufacturers and service providers in the communications industry grew significantly between 1995 and 2000. However, beginning in early 2001 several factors contributed to a significant decrease in capital expenditures by the communications sector, particularly in the fiber optic communications industry. These factors include:

- the global economic downturn, particularly in the United States;
- excess capacity of fiber optic communications networks due to the failure of demand for high-speed voice, data and video services to increase at the rate anticipated;
- the inability of some fiber optic and wireless communications companies, particularly in the United States, to service debt obligations incurred in connection with the roll-out of their networks, and the resulting deterioration in the financial condition and, in some cases, bankruptcy of these companies; and

- delays in the roll-out of third-generation wireless services worldwide, particularly in Europe and the United States.

The decrease in, and continued restraint on, capital spending adversely affected demand for Advantest's products. Consequently, Advantest's net sales from measuring instruments fell in fiscal 2002 by 39% compared to fiscal 2001 to ¥12,830 million, consisting of net sales of ¥5,989 million in the first half of fiscal 2002 and ¥6,841 million in the second half of fiscal 2002. The adverse conditions in the communications industry have also affected demand for semiconductors, in particular semiconductors incorporated in high-end wireless handsets, which, in turn, has affected Advantest's sales of automated test equipment. Advantest believes that investment levels in communications networks, particularly in fiber optic networks, will continue to be weak in fiscal 2003 and will adversely affect Advantest's sales and profits from measuring instruments and automated test equipment.

***The market for automated test equipment is highly concentrated, and Advantest may not be able to increase sales of its products because of the limited opportunities***

The market for automated test equipment, particularly for memory semiconductor test systems, 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 automated test equipment industry. Advantest believes that this state of the market 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. Advantest's largest customer accounted for approximately 18% of total net sales in fiscal 2000, 16% in fiscal 2001 and 12% in fiscal 2002. Sales to Advantest's five largest customers, all of which were automated test equipment customers, accounted for approximately 41% of total net sales in fiscal 2000, 37% in fiscal 2001 and 38% in fiscal 2002. The loss of one or more of these major customers could materially harm Advantest's business.

***The failure by Advantest to meet demand for its products upon a significant recovery in the automated test equipment market would likely adversely affect its future market share and financial results***

As part of its cost-cutting efforts during the last two fiscal years, Advantest has reduced the number of full-time employees from 4,805 at the end of fiscal 2000 to 3,519 at the end of fiscal 2002. If the market for automated test equipment were to experience an increase in demand similar to that experienced in 2000 when the automated test equipment market grew by approximately 63%, Advantest would require a significant increase in personnel in order to fully capitalize on such a recovery. The failure of Advantest to meet the 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 a 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.

***If Advantest does not introduce new products and services in a timely manner, its products and services will become obsolete, and its operating results will suffer***

Advantest sells its products in several industries that are characterized by rapid technological changes, frequent new product and service introductions and evolving industry standards. Advantest anticipates that future

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demand for its automated test equipment will be driven, in large part, by advances in semiconductor technology, which create new testing requirements that are not adequately addressed by currently installed semiconductor test systems. These advances include:

- the introduction of SoC semiconductors that incorporate more advanced memory, logic and analog circuits;
- investment by semiconductor manufacturers in facilities that use 300 millimeter wafers in the production of semiconductors; and
- the use of self-test technologies that employ circuit designs incorporated into the circuits of semiconductor chips to simplify the front-end testing functions performed by automated test equipment.

Advantest also believes demand for its automated test equipment, as well as its measuring instruments, will be strongly affected by the level of demand for high-speed wireless and wireline data services and digital consumer products. Advances in technologies used in those products and services frequently require new testing equipment and measuring instruments. Without the timely introduction of semiconductor test systems and measuring instruments capable of effectively testing and measuring equipment that use new technologies, Advantest's products and services will become technologically obsolete over time, in which case Advantest's business, financial condition and results of operations would suffer. In addition, advances in technology typically lead to declining average prices for testing equipment and measuring instruments based on older technologies or processes.

### ***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 automated test equipment 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 or measuring 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 particularly acute with respect to SoC semiconductor test systems because, in general, new SoC 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'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 semiconductor test systems. For example, Advantest has been outsourcing the insertion and interconnection of the numerous circuit boards in each semiconductor test system beginning in fiscal 2001. In addition, many of the components used in Advantest's semiconductor test 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 and high costs. In addition, Advantest depends on sole source, or a limited number of, suppliers for a portion of its components and 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 or 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.

***Advantest's operating results are subject to significant fluctuations, which could cause the market price of its American Depositary Shares, or ADSs, and shares to decline***

Advantest's operating results have varied significantly from period to period and will continue to vary in the future, due to a number of factors. For example, after recording record sales and profits in fiscal 2000, Advantest experienced approximately a 66% decrease in net sales in fiscal 2001, which contributed to Advantest recording a net loss of ¥23.9 billion in fiscal 2001. In fiscal 2002, Advantest recorded net sales of ¥97.7 billion, an increase of 2.6% compared to fiscal 2001, and decreased its net losses to ¥13.0 billion.

Fluctuations in sales of automated test equipment can be explained in large part by cyclical changes in production capacity and demand for semiconductors. Advantest's operating results can also be negatively affected by other factors, including:

- its inability to quickly adjust to unanticipated declines or shortfalls in projected demand and market prices for its products;
- the timing of investments in product development in anticipation of future orders;
- the rate of technological change that requires the introduction of new products;
- the long selling process involved in the sale of automated test equipment;
- the relatively small number of total units sold in the semiconductor test system market;
- order cancellations or delays by customers;
- the difficulty of forecasting revenues from large system sales;
- 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;
- changes in the timing of product orders due to, among other things:
  - unexpected delays in the introduction of new products by Advantest's customers;
  - reduced demand for products made by Advantest's customers;
  - lifecycles of its customers' products ending earlier than expected;
  - uncertain market acceptance of products developed by its customers; or
  - a decline in operating results of Advantest's customers; and
- changes in costs and availability of components, parts, equipment and labor.

Downward fluctuations in Advantest's operating results may result in decreases in the market price of its ADSs and shares.

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

Advantest faces substantial competition throughout the world in both of its operating segments. Advantest's primary competitors in the semiconductor test system market include Teradyne, Inc. and Agilent Technologies, Inc. In addition, Advantest competes in the semiconductor test systems market with several other smaller companies, particularly in the SoC semiconductor test system market. In measuring instruments, Advantest competes with a number of significant competitors in all of its major product categories and across its targeted industries. Agilent Technologies is the leading provider of measuring instruments in many of Advantest's product categories. 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 automated test equipment that reduces testing costs. Advantest must continue to enhance its business processes to lower the cost of its products, as well as introduce enhancements that otherwise lower overall testing costs, to compete successfully. 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 third-party distributors for its measuring instruments may fail to increase sales***

Advantest is dependent on its third-party distribution channels in its measuring instrument business. Sales through third-party distributors accounted for 40.0% of sales of measuring instruments in fiscal 2000, 48.7% in fiscal 2001 and 47.4% in fiscal 2002. Substantially all of Advantest's distribution agreements have one-year terms and are automatically renewed unless cancelled before the end of the term. Advantest may not be able to grow its measuring instrument business if its distribution channels fail to increase sales of Advantest products. Most of Advantest's agreements with its third-party distributors in Japan and other parts of Asia are nonexclusive, and many of these distributors have similar agreements with Advantest's competitors. An affiliate of Rohde & Schwarz GmbH & Co. KG is the sole distributor of Advantest's measuring instruments in Europe. Rohde & Schwarz also manufactures its own measuring instruments, some of which compete with Advantest's products. Rohde & Schwarz sells Advantest products in Europe in conjunction with sales efforts for its own products. There can be no assurance that these third-party distributors will not prioritize sales efforts relating to their own products or products of other competitors over Advantest's products.

***Advantest's commencement of direct sales of its measuring instruments in North America could adversely affect its future sales in North America***

Advantest commenced direct sales of its measuring instrument products in North America in July 2002. Between May 1993 and June 2002, Tektronix, Inc. was the sole distributor of Advantest's measuring instruments in North America. Advantest's annual sales of measuring instruments in North America were approximately ¥5.1 billion in fiscal 2000, ¥2.9 billion in fiscal 2001 and ¥0.7 billion in fiscal 2002. Advantest's sales of measuring instruments in North America in fiscal 2002 decreased as it started to establish its own distribution network. In addition, Advantest has commenced direct sales of its measuring instruments products in North America during a period when the overall communications industry market and demand for all measuring instruments is weak. There can be no assurance that Advantest will be able to establish a successful distribution network in North America or that it will, in any future period, match or exceed the revenue or profit levels for its measuring instruments achieved under the distribution arrangement with Tektronix.

***Advantest's failure to meet its customers' technical and cost requirements in a timely manner would adversely affect its current and future sales***

Many of Advantest's customers require semiconductor test systems and measuring instruments that are customized to meet specific technical and cost requirements. The failure of Advantest to meet its customers'

technical and cost requirements 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. Advantest's inability to provide a product that meets requested performance criteria at an acceptable cost when required by its customer would severely damage its reputation with that customer and could adversely affect future sales efforts with respect to that customer.

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

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 2002, 42.2% of Advantest's total net sales came from Asia (excluding Japan), a majority of which consists of sales in Taiwan and Korea, 8.9% from North America and 9.1% 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 manufacturing facilities and suppliers are located in the United States, Korea and Malaysia. 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 manufactures its products, 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;
- 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.

***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 60% of Advantest's fiscal 2002 net sales were from products sold to overseas customers. Most of Advantest's products are manufactured in Japan, but approximately 40.4% of Advantest's net sales in fiscal 2002 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 does business 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.

***Advantest's intellectual property rights may be inadequate to provide meaningful protection of its proprietary rights***

Advantest relies on a combination of patents, licenses, copyrights, trademarks, utility model rights, design rights and confidentiality provisions to establish and protect its proprietary rights. For instance, with respect to the device interface market, Advantest has taken legal actions based on its patent and utility model rights against small manufacturers that sell replicas of Advantest's products and, in some instances, have obtained injunctions against sales of replicas. However, in general, it is difficult for Advantest to gain access to, and investigate, the products with respect to which Advantest believes its intellectual property rights have been infringed. Therefore,



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Advantest cannot ensure that its patents and other intellectual property rights will provide meaningful protection of its proprietary rights. Nevertheless, Advantest is focused on protecting its intellectual property rights and will continue to monitor and police these rights.

***Third parties may claim Advantest is infringing their intellectual property, and Advantest could suffer significant liabilities, litigation costs or licensing expenses or be prevented from selling its products***

Advantest may be unknowingly infringing the intellectual property rights of others 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 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, obtain licenses, 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. Similarly, changing Advantest's products or processes to avoid infringing the rights of others may be costly or impractical.

***The current 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.

***Chemicals used by Advantest may become subject to more stringent regulations, and Advantest may incur significant expenses to comply with these regulations***

Advantest uses chemicals, 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 commence regulation of other chemicals used by Advantest. For instance, Advantest uses lead solder for mounting electronic parts and components for its products. Further, to cool its semiconductor test systems, Advantest uses a particular type of perfluorocarbon, or PFC, that is regulated under the laws of Japan and certain other jurisdictions. 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 expenditures 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.

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

Advantest's main research and development and production facilities for semiconductor test systems, as well as many of Advantest's smaller facilities that manufacture test handlers, device interfaces and measuring instruments, are located in Japan. Japan suffers from relatively frequent earthquake activity. If Advantest's facilities, particularly its semiconductor test system manufacturing plant, 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. Similar disruptions to Advantest's business may occur if the facilities of Advantest's subcontractors and suppliers were to experience a catastrophic loss. 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.

#### **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 depositary in Japanese yen and then converted by the depositary 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 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 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 United States. It may not be possible, therefore, for investors to effect service of process within the United States upon Advantest