Management's Discussion and Analysis

Overview

(Years ended February 29, 2012 and February 28, 2011)

Business Environment

In fiscal 2012, the year ended February 29, 2012, the U.S. economic recovery slowed and the European economies overall also lost momentum amid growing concerns for the fiscal and financial soundness of the eurozone countries. Meanwhile, Asia generally maintained strong rates of economic growth, despite the effects of tighter monetary policies in China. In Japan, there were signs the economy was recovering from a sustained but transitional period of severity that was brought on by the Great East Japan Earthquake. The yen's foreign exchange rate, meanwhile, remained strong against major currencies.

Net Sales

(Millions of yen)

2011	**2012**	Change (%)
¥35,718	**¥41,654**	16.6

Sales increased driven by strong business performance in the Machine Tools Segment.

Operating Income

(Millions of yen)

2011	**2012**	Change (%)
¥1,429	**¥3,953**	176.6

There was also a sizeable increase in operating income as a result of sales increasing.

Net Income

(Millions of yen)

2011	**2012**	Change (%)
¥161	**¥2,427**	

Net income rose substantially, despite an increase in expenses as a consequence of loss on disposition of foreign currency translation adjustments involved in the liquidation of a subsidiary, and damages incurred in the flooding in Thailand.

Cash Dividends per Share

(Yen)

2011	**2012**	Change (yen)
¥22	**¥26**	¥4

The cash dividends in the year under review increased ¥4 from the previous year to ¥26 per share.

Total Assets

(Millions of yen)

2011	**2012**	Change (%)
¥49,250	**¥51,925**	5.4

Total assets rose year on year. This was mainly due to an increase in inventories in relation to factors such as higher sales, and an increase in cash and cash equivalents.

Free Cash Flows

(Millions of yen)

2011	**2012**	Change (%)
¥2,002	**¥4,073**	103.4

This term saw a sharp increase in free cash flows year on year. This was due to cash provided by items such as income before income taxes and minority interests and depreciation and amortization expenses, which offset cash used for increasing items such as inventories, and trade notes and accounts payable.

Free cash flows = Operating cash flows + Investing cash flows

Capital Expenditures

(Millions of yen)

2011	**2012**	Change (%)
¥974	**¥2,040**	109.4

Capital expenditures increased, mainly due to the expansion and enhancement of manufacturing bases overseas.

Sales by Region

(Millions of yen)

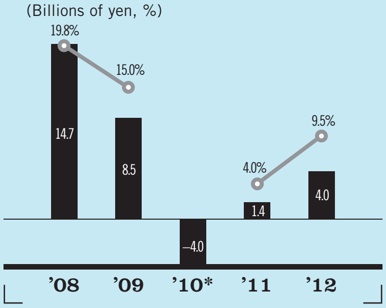
	2011	**2012**	Change (%)
Europe	¥9,979	**¥14,552**	45.8
America	8,516	**10,163**	19.3
Asia	9,589	**8,454**	(11.8)
Japan	7,634	**8,485**	11.1

Overseas sales grew in all regions apart from Asia, with sales strong once again in Europe and firming in the Americas.

Income Analysis

▶ **Profit and sales both increased, driven by strong business performance in the Machine Tools Segment.**

OPERATING INCOME (LOSS) AND OPERATING INCOME RATIO
(Billions of yen, %)



■ Operating Income (Loss)
-o- Operating Income Ratio*
* The operating income ratio was not calculated for fiscal 2010 because an operating loss was incurred.

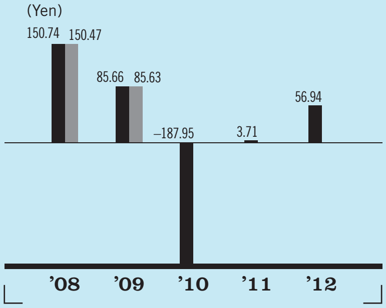
For fiscal 2012, the fiscal year under review, Star Micronics reported consolidated sales of ¥41,654 million (US$514,247 thousand), up 16.6%, or ¥5,936 million, year on year. This outcome reflected a sharp rise in revenue growth in our core Machine Tools business, mainly as a result of robust demand for capital investments in the European and North American markets. The cost of sales increased ¥2,488 million, or 10.7%, to ¥25,753 million (US$317,938 thousand). As a result of the above, gross profit increased ¥3,448 million, or 27.7%, year on year to ¥15,901 million (US$196,309 thousand). The gross profit margin increased 3.3 percentage points to 38.2%. This was due primarily to the high-margin Machine Tools Segment increasing its share of total sales by 10.0 percentage points to 64.0%, while sales held unchanged from the year before for POS printers in the Special Products Segment, and wristwatch components in the Precision Products Segment.

Selling, general and administrative (SG&A) expenses increased ¥924 million year on year, or 8.4%, to ¥11,948 million (US$147,507 thousand). This increase was due mainly to higher transportation and packaging costs, and an increase in direct costs, such as advertising and promotional costs, sales commissions, and other items increasing in line with rising sales.

As a result of the above, the Company saw operating income increase a sharp 176.6%, or ¥2,524 million, year on year to ¥3,953 million (US$48,802 thousand) this term.

▶ **Net income increased substantially, unhampered by setbacks from foreign exchange and natural disasters.**

NET INCOME (LOSS) PER SHARE
(Yen)



■ Basic Net Income (Loss)
■ Diluted Net Income

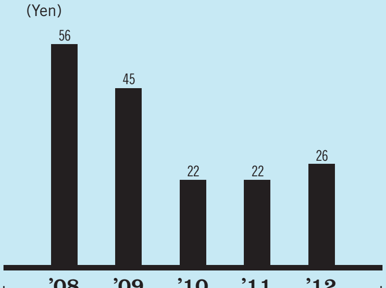
Other expenses—net narrowed to ¥724 million (US$8,938 thousand) this term compared to ¥1,069 million in the previous fiscal year. The major non-operating losses incurred in the year under review were ¥209 million (US$2,580 thousand) in foreign exchange loss—net, which declined in comparison to a net ¥456 million loss the year before; ¥439 million (US$5,420 thousand) in loss on disposition of foreign currency translation adjustments; and ¥438 million (US$5,407 thousand) in loss on disaster. The main offset was a ¥33 million, or 19.1%, increase year on year in interest and dividend income to ¥206 million (US$2,543 thousand).

As a result, the Company saw income before income taxes and minority interests increase ¥2,869 million year on year to ¥3,229 million (US$39,864 thousand). Total income taxes were ¥717 million (US$8,852 thousand). Net income after deducting minority interests was ¥2,427 million (US$29,963 thousand).

Basic net income per share was ¥56.94 (US$0.70).

▶ **Dividend increased ¥4 year on year to ¥26 per share.**

CASH DIVIDENDS PER SHARE
(Yen)

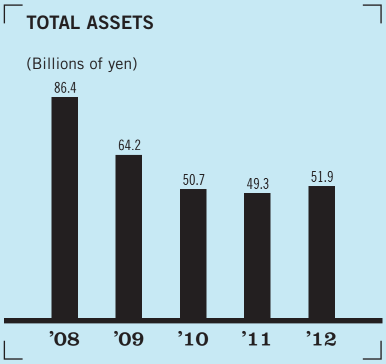


The Company increased the annual dividend ¥4 for the year under review to ¥26 (US$0.32) per share. Total dividends increased ¥148 million, or 15.4%, to ¥1,107 million (US$13,667 thousand). We plan to increase the annual dividend ¥4 in the fiscal year ending February 2013 to ¥30 per share.

Regarding future dividends, the Company is emphasizing shareholder returns and is therefore aiming for a total shareholder return ratio of at least 40%. Dividend on equity (DOE) will also be considered in setting future dividends. Planned use for internal reserves will include investment in future growth areas to achieve sustainable growth, with the goal of raising both corporate values and shareholder profits.

Financial Position and Liquidity

▶ **Total assets increased mainly due to an increase in inventories in line with higher sales and an accrual in cash and cash equivalents.**



Total current assets as of February 29, 2012 were ¥38,302 million (US$472,864 thousand), an increase of ¥3,466 million, or 9.9%, compared with the previous fiscal year-end. This increase chiefly reflected an increase in cash and cash equivalents of ¥1,519 million, or 11.5%, to ¥14,736 million (US$181,926 thousand), as well as an increase in inventories of ¥1,857 million, or 19.5%, to ¥11,379 million (US$140,481 thousand) as production levels rose.

Net property, plant and equipment decreased ¥260 million, or 2.5%, to ¥10,289 million (US$127,025 thousand). This downward trend, continuing from the previous fiscal year-end, was due to a decline in machinery and equipment of ¥658 million, or 2.8%, to ¥22,451 million (US$277,173 thousand). Total investments and other assets decreased ¥531 million, or 13.7%, to ¥3,334 million (US$41,160 thousand). This was due to a decrease of ¥265 million, or 11.7%, in investment securities to ¥2,009 million (US$24,803 thousand) and ¥215 million, or 41.6%, in deferred tax assets to ¥302 million (US$3,728 thousand).

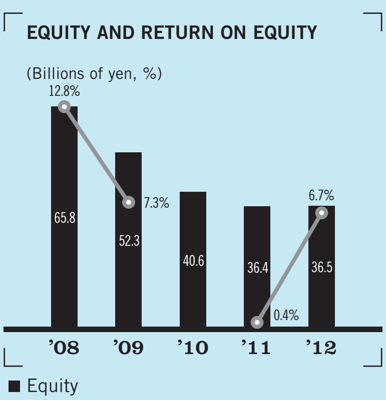
As result of the above, total assets increased ¥2,675 million, or 5.4%, year on year to ¥51,925 million (US$641,049 thousand).

▶ **Total liabilities rose, mainly due to an increase in trade notes and accounts payable.**

On the other side of the balance sheet, current liabilities increased ¥2,807 million, or 23.9%, to ¥14,538 million (US$179,481 thousand). This increase mainly reflected an increase in trade notes and accounts payable of ¥1,691 million, or 28.9%, to ¥7,552 million (US$93,235 thousand) as a result of higher sales, offset by a decrease in deferred tax liabilities of ¥261 million, or 49.7%, to ¥264 million (US$3,259 thousand).

Total long-term liabilities decreased ¥16 million, or 3.8%, to ¥407 million (US$5,025 thousand).

▶ **In equity, retained earnings fell due to the acquisition of treasury stock and the payment of dividends, despite an increase in net income in the year under review.**

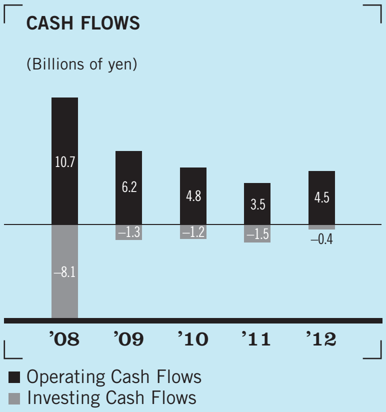


* ROE was not calculated for fiscal 2010 because a net loss was incurred.

Equity increased ¥76 million, or 0.2%, to ¥36,488 million (US$450,469 thousand) in contrast to the Company posting net income of ¥2,427 million. This was largely the result of a decline in retained earnings of ¥2,521 million, or 9.8% year on year, to ¥23,258 million (US$287,135 thousand) after paying dividends of ¥1,034 million (US$12,766 thousand) and other outlays, as well as a decline in foreign currency translation adjustments of ¥545 million, or 6.7%, to ¥8,692 million (US$107,309 thousand). Total equity including minority interests was ¥36,980 million (US$456,543 thousand). The equity ratio fell 3.7 percentage points to 70.2%, while equity per share increased ¥21.63 to ¥866.94 (US$10.70).

Cash Flows

▶ **Net cash provided by operating activities increased due largely to income before income taxes and minority interests, and depreciation and amortization expenses.**



Net cash provided by operating activities increased ¥946 million to ¥4,466 million (US$55,136 thousand). This was largely attributable to income before income taxes and minority interests of ¥3,229 million (US$39,864 thousand), reflecting a substantial recovery in operating results, and an adjustment for ¥1,607 million (US$19,840 thousand) in depreciation and amortization. On the other hand, net cash used for increases in trade receivables, inventories and trade payables was ¥1,424 million (US$17,581 thousand), due mainly to a sizeable increase in inventories.

Net cash used in investing activities was ¥393 million (US$4,852 thousand), a decrease of ¥1,125 million year on year. This chiefly reflected ¥1,267 million (US$15,642 thousand) in net cash used in the purchases of property, plant and equipment, which was partly offset by ¥498 million (US$6,148 thousand) in cash provided by proceeds from sales of investment securities.

Net cash used in financing activities was ¥2,092 million (US$25,827 thousand), an increase of ¥279 million from the previous fiscal year. This was mainly the result of ¥1,040 million (US$12,840 thousand) in dividends paid to shareholders, along with ¥760 million (US$9,382 thousand) in payments for purchase of treasury stock.

As a result of the above, after foreign currency translation adjustments on cash and cash equivalents of ¥462 million, cash and cash equivalents as of February 29, 2012 totaled ¥14,736 million (US$181,926 thousand), a net increase of ¥1,519 million from February 28, 2011.

Capital Expenditures and R&D Expenses

▶ **Capital expenditures increased year on year, apart from for the Components Segment.**

Capital expenditures in fiscal 2012 rose ¥1,066 million, or 109.4%, year on year to ¥2,040 million (US$25,185 thousand). In fiscal 2013, the Company is forecasting capital expenditures of ¥5,150 million.

Special Products

Expenditures in the Special Products Segment rose ¥159 million year on year to ¥215 million (US$2,654 thousand). In fiscal 2013, the Company is budgeting expenditures in this segment in the amount of ¥280 million, mainly for dyes used in manufacturing new models.

Components

Expenditures in the Components Segment fell ¥38 million year on year to ¥51 million (US$630 thousand).

Machine Tools

Expenditures in the Machine Tools Segment increased ¥289 million from the previous fiscal year to ¥754 million (US$9,309 thousand). In fiscal 2013, we anticipate that ¥2,915 million will be spent on investments such as the construction of a new production plant in Thailand.

Precision Products

Expenditures in the Precision Products Segment rose ¥545 million year on year to ¥735 million (US$9,074 thousand). In fiscal 2013, we expect to spend ¥1,721 million mainly on bolstering the capacity of production sites overseas.

▶ R&D expenses in fiscal 2012 were little changed from the previous year.

The research and development (R&D) framework for the whole Group comprises the Research and Development Department, which cultivates new businesses and works to comprehensively raise the technology level of all Group companies, and the development departments in each business in charge of the product and technology development directly linked to current products.

R&D expenses in fiscal 2012 were ¥1,807 million (US$22,309 thousand), an increase of ¥52 million, or 3.0%, from the previous year. This represented 4.3% of total sales, a decrease of 0.6 of a percentage point year on year.

Research and Development Department

The Research and Development Department took part in initiatives cultivating commercially viable businesses in new fields and providing technical support to all of the Company's segments.

In terms of cultivating new businesses, this department developed and unveiled a prototype exciter utilizing the Company's many years of expertise in miniature acoustics technologies, while initiating various other projects and collaborating with companies outside the Group. An exciter is a device that produces sound by utilizing the surfaces it contacts as a diaphragm. Simply attaching an exciter will convert a conference room table or white board, for example, into an audio speaker. The device can also be applied to an automobile dashboard or bumper to emit tones as a guide or warning signal. Going forward, the department will strive to develop the mass production of emitters, along with the commercialization of other R&D themes.

The Research and Development Department continues to provide other segments within the Company with technical support in the three areas of physico-chemical analysis, sophisticated computer aided engineering (CAE) and quality engineering. Along with the technical support it has provided the business segments in introducing and maintaining value engineering (VE) activities, the department has worked to raise the technology level of the whole Company. The department is also responsible for supporting the testing and evaluation of products for quality assurance, as well as intellectual property-related operations with an eye to strengthening competitive power of the entire Company.

Special Products

Product development in this segment is aimed at developing highly competitive products that meet customers' needs. The basis for this activity is development and design of products that contribute to lowering environmental impact while retaining high quality and reliability

In fiscal 2012, the Company strengthened the development of new POS printers and utility software for responding to the various local market needs globally. These included the *TSP-L* series of printers for markets in Europe and the Americas, and suitable for application in lottery and ticket vending machines, as well as a multi-function POS thermal printer equipped with a barcode ID scanner, IC card reader, magnetic reader and other functions for targeting kiosks and convenience stores in the North American market.

We also developed the *SM-S220* mobile printer, which we upgraded in compatibility with smartphones and tablets, for a major settlement system vendor in Japan.

In software development, we developed a software development kit for our Star I/O utility software, designed to improve the affinity of our existing product line of small printers with the latest operating software found in mobile terminals and devices. The kit was then provided to system integrators as an easy-to-use systems solution for establishing connectivity between smartphones and our printers.

Machine Tools

The Machine Tools Segment worked on development initiatives for expanding and improving the product line of Swiss-type automatic lathes. The new model we launched was the *SW-20* lathe for the high-speed machining of complicated parts, while the models we renewed were the *SR-20J type C*, *SR-20J type N*, *SR-32J* and *SR-32J type N* low-cost lathes for complex machining.

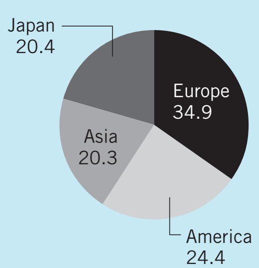
Development of machine tool software centered mainly on ongoing improvements in operability, functionality and safety features, always with a firm eye on market needs.

Moreover, as part of its environmental initiative, the Machine Tools Segment is working to improve the ratio of components it consumes that are RoHS compliant and to proactively promote the powder coating of sheet-metal parts. The segment has established its own Star Environmental Standards, and labels the automatic lathes satisfying these standards with an ECO mark for designation as Star Environmental Standards Conformity Models.

Sales Framework and Net Sales by Region

NET SALES BY REGION

(%)



A significant proportion of Star Micronics' products are sold in international markets. To provide customer support on a global scale, the Company operates an extensive network of overseas sites. (See table)

	U.K.	Germany	France	Switzerland
Special Products	Star Micronics Europe Ltd.			
Machine Tools	Star Micronics GB Ltd.	Star Micronics GmbH	Star Machine Tool France SAS	Star Micronics AG

	U.S.	Thailand	China
Special Products	Star Micronics America, Inc.	Star Micronics Southeast Asia Co., Ltd.	
Machine Tools	Star CNC Machine Tool Corporation	Star Micronics (Thailand) Co., Ltd.	Shanghai Xingang Machinery Co., Ltd.

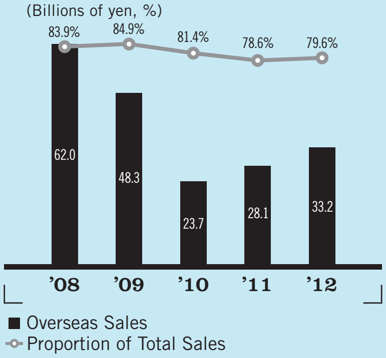
* Star Micronics America, Inc. markets components in addition to special products.

* In September 2011, the Special Products Segment established a new subsidiary named Star Micronics Southeast Asia Co., Ltd. in Bangkok, Thailand, as an independent sales base for covering regional sales activities in Southeast Asia. This sales base was split off from Star Micronics (Thailand) Co., Ltd., a local subsidiary of the Machine Tools Segment, where the Special Products Segment had housed its regional sales operations since September 2010.

▶ Overseas sales as a share of total sales up 1.0 percentage point to 79.6% on increased sales in Europe and the Americas.

OVERSEAS SALES AND PROPORTION OF TOTAL SALES

(Billions of yen, %)



In the fiscal year under review, overseas sales as a proportion of total sales increased 1.0 percentage point to 79.6%.

By region, in Europe, net sales increased ¥4,573 million to ¥14,552 million (US$179,654 thousand), representing 34.9% of total sales, a 7.0 percentage points increase from the previous fiscal year.

In the Americas, net sales increased ¥1,647 million to ¥10,163 million (US$125,469 thousand), representing 24.4% of total sales, up by 0.6 of a percentage point.

Net sales in Asia decreased ¥1,135 million to ¥8,454 million (US$104,370 thousand). Asia's share of total sales decreased 6.6 percentage points to 20.3%.

In Japan, net sales increased ¥851 million to ¥8,485 million (US$104,753 thousand), representing 20.4% of total sales, down by 1.0 percentage point.