# Milestone Breakthrough

**ANNUAL REPORT 2017 (PDF Version)**

For the year ended February 28, 2017

STAR MICRONICS CO., LTD.

# Profile

Since its establishment in 1950, Star Micronics Co., Ltd. has worked diligently to "generate the greatest impact from the least materials." In order to achieve its aspirations, the Company has continued to deliver a steady stream of high-added-value products based on its core technologies of small-scale precision processing and assembly. Currently, Star Micronics is engaged in three businesses: special products, mainly point-of-sale (POS) printers; machine tools, mainly CNC automatic lathes; and precision products, including wristwatch, automobile, and other related components.

From each of the sales and manufacturing perspectives, the Company is also actively engaged in global business development. Building on a current ratio of overseas sales to all sales of 83% and a ratio of overseas production to all production of 75%, Star Micronics will leverage its core technologies to further expand its business.

## Contents



**Forward-looking Statements**

Statements in this annual report with respect to Star Micronics' plans, strategies and beliefs as well as all other statements that are not historical facts are forward-looking statements involving risks and uncertainties. These forward-looking statements rely on a number of assumptions concerning future events. The important factors that could cause actual results to differ materially from such statements include, but are not limited to, general worldwide economic conditions, competitive pressure on sales and pricing, and movements of currency exchange rates.

# Medium-Term Management Plan

## Medium-Term Vision

As a global niche company, our goal is to enhance the prosperity and well-being of all stakeholders by distributing the added-value created through efforts aimed at combining the strengths of advanced software and precision processing technologies that help maximize customer satisfaction.

## Basic Policies

### 1. Reform Existing Businesses

- Pursue precision processing technologies that are vital to an IoT society
- Transition to a business entity that incorporates software technology
- Work toward a production system that maximizes added-value

### 2. Create and Nurture New Businesses

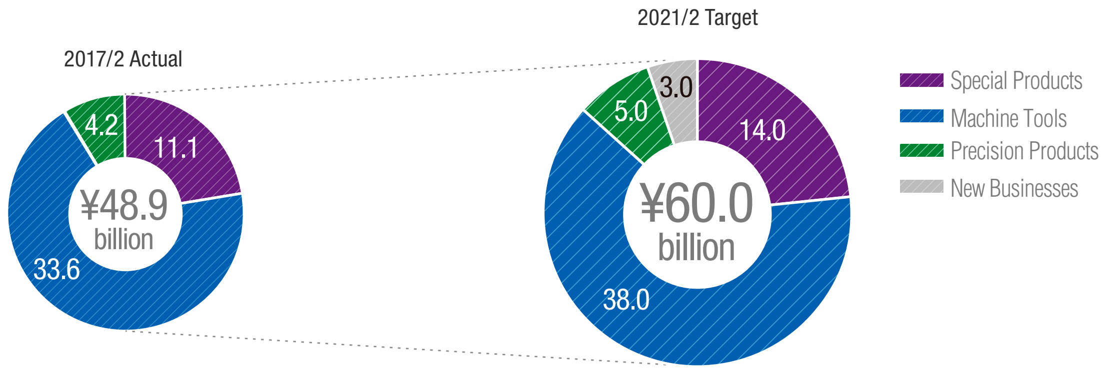
- Create a fourth major business pillar (through various initiatives including M&A and business alliances)
- Cultivate new businesses and products (Vibration Power Generators, Cloud Service Business, etc.)

### 3. Evolve into a Genuine Global Company

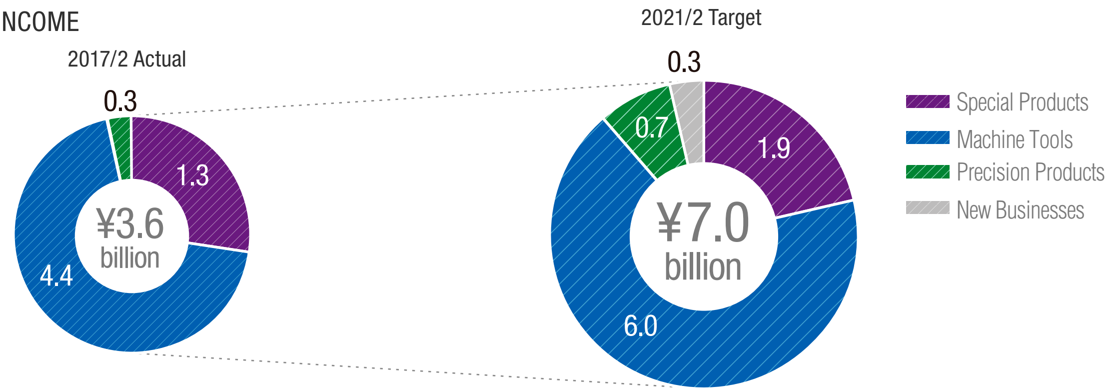
- Educate, train and assign global human resources
- Further strengthening of sales channels

## Performance Targets

NET SALES




OPERATING INCOME



| | | 2017/2 Actual | 2021/2 Plan |
|---|---|---|---|
| Exchange Rate | US$ | ¥108.87 | ¥110.00 |
| | EUR | ¥120.36 | ¥115.00 |

### Financial Target (2021/2 target)

| | |
|---|---|
| Net Sales | ¥60.0 billion |
| Operating Income | ¥7.0 billion |
| Operating Income Ratio | 11.7% |
| Return on Equity (ROE) | 12.0% or more |

### Returns to Shareholders (2021/2 target)

| | |
|---|---|
| Total Payout Ratio | 50.0% or more |
| DOE | 4.5% or more |
| Dividends per Share | ¥60 |

# Financial Highlights

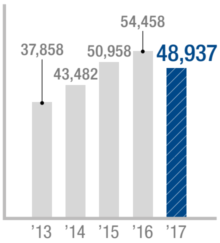
**Financial Highlights** | Related Information by Geographical Region

Star Micronics Co., Ltd. and Consolidated Subsidiaries
For the years ended February 2015, 2016 and 2017

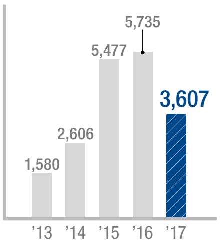
| | Millions of yen | | | Change (%) | Thousands of U.S. dollars |
|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | 2017/2016 | 2017 |
| **For the year :** | | | | | |
| **Net sales** | ¥50,958 | ¥54,458 | ¥48,937 | -10.1 | $436,938 |
| **Operating income** | 5,477 | 5,735 | 3,607 | -37.1 | 32,205 |
| **Net income attributable to owners of the parent** | 4,696 | 3,721 | 3,181 | -14.5 | 28,402 |
| **Return on sales** | 9.2% | 6.8% | 6.5% | | |
| **Capital expenditures** | 2,105 | 2,275 | 1,441 | -36.7 | 12,866 |
| **Depreciation and amortization** | 1,924 | 2,274 | 2,167 | -4.7 | 19,348 |
| **At year-end :** | | | | | |
| **Total assets** | 70,261 | 67,828 | 68,351 | 0.8 | 610,277 |
| **Total equity** | 51,903 | 50,200 | 43,755 | -12.8 | 390,670 |
| **Equity ratio** | 72.4% | 72.7% | 62.8% | | |
| | Yen | | | Change (%) | U.S. dollars |
| **Per share :** | | | | | |
| **Basic net income** | ¥111.36 | ¥87.98 | ¥81.77 | -7.1 | $0.73 |
| **Diluted net income** | 111.05 | 87.69 | 74.69 | -14.8 | 0.67 |
| **Cash dividends applicable to the year** | 44.00 | 46.00 | 48.00 | 4.3 | 0.43 |
| | | | | | |
| **Stock information :** | | | | | |
| **Common shares issued** | 47,033,234 | 47,033,234 | 47,033,234 | | |
| **Number of shareholders** | 11,123 | 10,097 | 8,730 | | |

Note : The rate of ¥112 to US$1, prevailing on February 28, 2017, has been used for translation into U.S. dollar amounts.

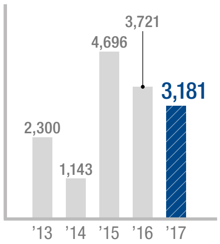
NET SALES
(Millions of yen)



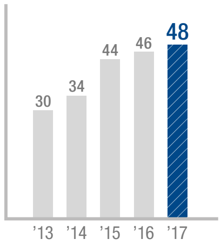

OPERATING INCOME
(Millions of yen)




NET INCOME ATTRIBUTABLE TO OWNERS OF THE PARENT
(Millions of yen)




CASH DIVIDENDS APPLICABLE TO THE YEAR
(Yen)



# Related Information by Geographical Region

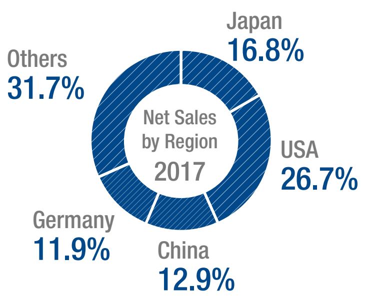


Star Micronics Co., Ltd. and Consolidated Subsidiaries
For the years ended February 2015, 2016 and 2017

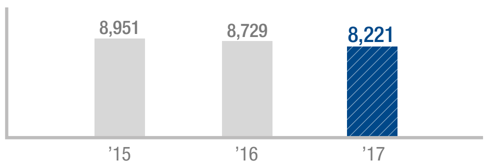
### Net Sales by Geographical Region

| | Millions of yen | | | Change (%) | Thousands of U.S. dollars |
|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | 2017/2016 | 2017 |
| **Japan** | ¥ 8,951 | ¥ 8,729 | ¥ 8,221 | -5.8 | $ 73,402 |
| **USA** | 12,123 | 12,566 | 13,084 | 4.1 | 116,822 |
| **China** | 5,320 | 6,543 | 6,317 | -3.5 | 56,402 |
| **Germany** | 6,629 | 7,339 | 5,836 | -20.5 | 52,107 |
| **Others** | 17,935 | 19,281 | 15,479 | -19.7 | 138,205 |
| **Total** | 50,958 | 54,458 | 48,937 | -10.1 | 436,938 |

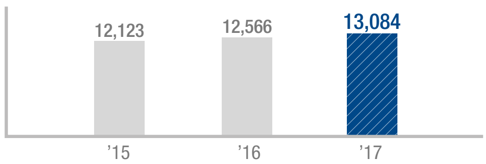
Note : The rate of ¥112 to US$1, prevailing on February 28, 2017, has been used for translation into U.S. dollar amounts.



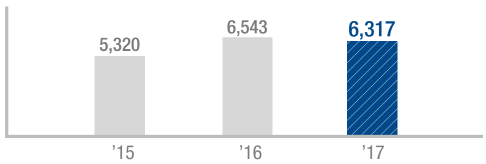

**Japan**
(Millions of yen)
down 5.8%



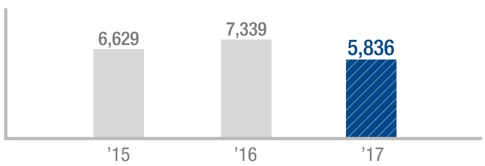

**USA**
(Millions of yen)
up 4.1%



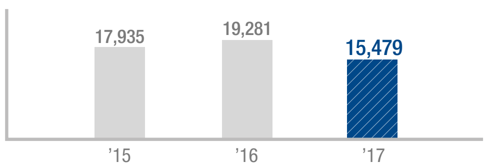

**China**
(Millions of yen)
down 3.5%




**Germany**
(Millions of yen)
down 20.5%




**Others**
(Millions of yen)
down 19.7%



# To Our Shareholders

**Hajime Sato**
Representative Director,
Chairman of the Board

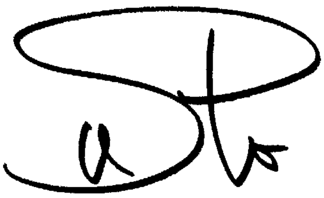
**Mamoru Sato**
Representative Director,
President and CEO

Taking into consideration a variety of factors, including the U.K.'s decision to withdraw from the European Union and the inauguration of a new administration in the U.S. during fiscal 2017, the year ended February 28, 2017, the global economy is shrouded in uncertainty. In the principal fields in which the Star Micronics Group operates, demand for POS-related products in the Special Products Segment is exhibiting signs of a recovery. In contrast, demand in the Machine Tools- and Precision Products-related markets has stalled. Under these circumstances, and with such additional factors as appreciation of the yen coupled with a downturn in sales of machine tools and other products, revenues and earnings declined in the fiscal year under review. Looking ahead, however, revenues and earnings are projected to increase in fiscal 2018, the year ending February 28, 2018, on the back of an upswing in sales across all business segments.

In a bid to further reinforce the Company's management structure and systems, Hajime Sato assumed the position of Chairman of the Board with Mamoru Sato taking his position as president and CEO. Under the stewardship of Hajime Sato, Star Micronics has taken positive steps to build a robust financial position over the past eight years. Despite this endeavor, the Company continues to witness considerable fluctuation in its operating environment. Due to a variety of factors including the emergence of an IoT society, we remain exposed to a sea of violent change. Under the guidance of a new management organization, and with the new president and CEO, Mamoru Sato, taking a leading role, we will focus on transforming existing business and generating new business opportunities while making the most of our accumulated technologies and business network that spans the globe.

As we work to achieve our goals and objectives, we kindly request the continued support and understanding of investors and shareholders.

May 2017



**Hajime Sato**
Representative Director,
Chairman of the Board

**Mamoru Sato**
Representative Director,
President and CEO


## Milestone Breakthrough

**As the Internet of Things (IoT) continues to play a more prominent role in society, Star Micronics is safeguarding the product development and precision processing technologies that it has accumulated since its founding. Every effort is also being made to generate new-added value and to maximize customer satisfaction by combining the strengths of advanced software and our capabilities.**

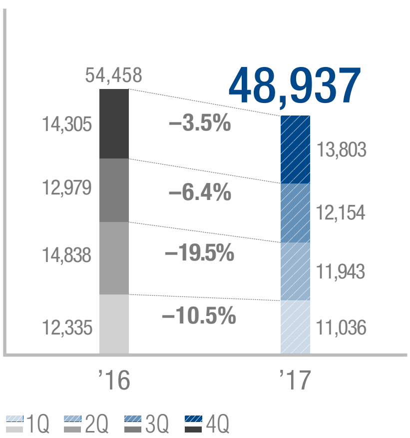
### Q1 What are your aspirations as you assume the position of Company president?

With the shift to an IoT society, each of the Star Micronics Group's three core businesses, Special Products, Machine Tools and Precision Products, is entering a period of considerable change.

As the automobile industry, a major sales destination of the Group's Machine Tools and Precision Products segments, increasingly utilizes IoT to boost productivity and competitiveness, we recognize that our ability to identify trends in such features as the configuration, precision and durability of essential parts, and how we apply this knowledge to our product planning process will hold the key to differentiating ourselves from the competition and the use of IoT-based software services amid the shift to smart factories.

NET SALES

(Millions of yen, %)




In the Special Products Segment, the use of electronic receipts is progressively becoming mainstream especially in the U.S. With these and other trends, we are seeing the urgent need to build a new business model rather than rely solely on hardware-based business activities.

Against this backdrop, and with the nature of product and service demand exhibiting signs of a major change, it is vital that we embrace a period of major transformation if we are to continue harnessing our traditional strengths focusing mainly on precision processing technologies amid fierce global competition going forward. At this critical juncture, I believe that my mission as president is to identify the position of each of the Group's three core business segments, our approach toward the creation of new businesses and our overall direction. With this in mind, my focus is on how to rebuild a business that is acutely aligned to the current era.

## Q2 Tell us about the Group's performance in the fiscal year ended February 28, 2017.

Net sales in the mainstay Machine Tools Segment declined 11.9% year on year. Despite robust trends in China throughout the fiscal year under review as well as the U.S. over the second half, this downturn was largely attributable to the impact of fluctuations in foreign currency exchange rates.

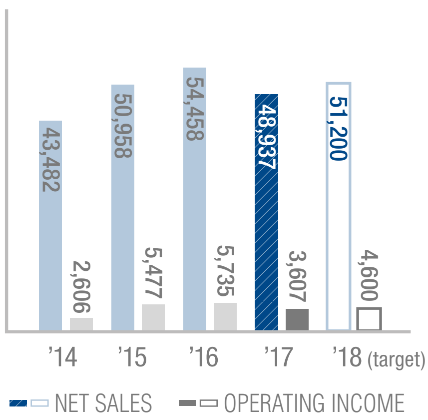
Net sales in the Special Products Segment also contracted 2.6%. While sales of mobile POS printers* (mPOS) in Japan were strong, the year-on-year drop in net sales again reflected movements in foreign currency exchange rates and the yen's appreciation in overseas markets.

In the Precision Products Segment, results for wristwatch components were impacted by production adjustments by wristwatch manufacturers. Non-wristwatch components also struggled due to the drop in demand for automotive and other parts as well as the negative flow-on effects of the strong yen. Accounting for these factors, net sales in this Segment declined 14.2% year on year.

Based on the aforementioned, total net sales decreased 10.1% compared with the previous fiscal year, to ¥48,937 million in fiscal 2017. From a profit perspective, operating income fell 37.1% year on year, to ¥3,607 million, while net income attributable to owners of the parent amounted to ¥3,181 million, down 14.5%.

* mPOS systems that employ tablet terminals and other mobile devices are distinguished by their easy, low-cost installation compared with conventional PC-based and other designated POS systems.

NET SALES AND OPERATING INCOME
(Millions of yen)




## Q3 What is your outlook for the fiscal year ending February 28, 2018?

Despite the uncertainty surrounding such factors as trends in the policies adopted by the new administration in the U.S., and the U.K.'s impending withdrawal from the European Union, we are projecting a modest recovery in global economic conditions generally in fiscal 2018, the fiscal year ending February 28, 2018.

Under these circumstances, and in the context of the Company's consolidated business performance for the coming fiscal year, we anticipate that in the mainstay Machine Tools Segment the Asian market will continue to experience robust trends in addition to the positive turnaround in Japan. As a result, sales are expected to increase. In the Special Products Segment, we are forecasting strong trends focusing largely on mPOS-related printers. Sales of mainly non-wristwatch components are also projected to grow in the Precision Products Segment.

As a result, the Group is forecasting net sales of ¥51,200 million, an increase of 4.6% year on year. On the earnings front, the Group forecasts operating income of ¥4,600 million, an increase of 27.5% year on year. Net income attributable to owners of the parent is projected to increase 16.3% year on year to ¥3,700 million. We are projecting sales and earnings to increase in fiscal 2018.

## Q4 Tell us about the Company's Medium-Term Management Plan.

In the leadup to the 70th anniversary of the Company's founding four years from now, Star Micronics has put in place the Medium-Term Management Plan that carries through to the fiscal year ending February 28, 2021. Under this plan, we have identified the Medium-Term Vision: as a global niche company, our goal is to enhance the prosperity and well-being of all stakeholders by distributing the added-value created through efforts aimed at combining the strengths of advanced software and precision processing technologies that help maximize customer satisfaction. Guided by this Vision, we have positioned efforts to reform existing businesses, create and nurture new businesses and evolve into a genuine global company as our three basic policies.

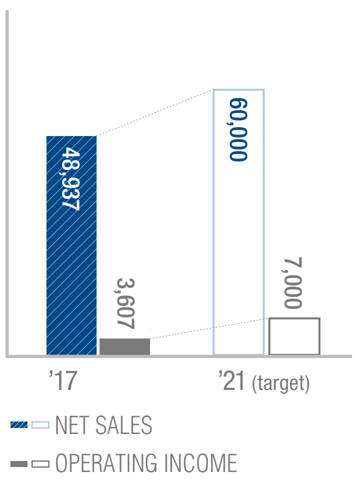
As a part of efforts to reform existing businesses, we will pursue precision processing technologies that are vital to an IoT society, transition to a business entity that incorporates software technology and work toward a production system that maximizes added-value.

On an individual business basis, we will endeavor to develop high-value-added products and reorganize sales bases in Europe in light of the U.K.'s impending withdrawal from the European Union in the Special Products Segment. Moreover, we will reduce costs by increasing supply chain efficiency.

In the Machine Tools Segment, we will release a series of fixed headstock automatic lathes and develop IoT-related software while shortening lead times and reducing inventories through modular design and production. From an overseas perspective, we will strengthen service systems in China, which continues to experience growth.

### MEDIUM-TERM TARGETS

(Millions of yen)




In the Precision Products Segment, we will cultivate new customers and markets by actively leveraging our network of five production bases spread across Japan and overseas. In addition to streamlining production and promoting full automation, we will increase operating rates through the use of IoT.

With a view to creating and nurturing new businesses, we will channel our energies toward IoT-related commercialization activities. Particular emphasis will be placed on vigorously considering a host of initiatives including M&As and business alliances in a bid to establish a fourth major business pillar. Over and above the education, training and assignment of human resources who can excel in global markets, we will make every effort to evolve into a genuine global company by further strengthening sales channels.

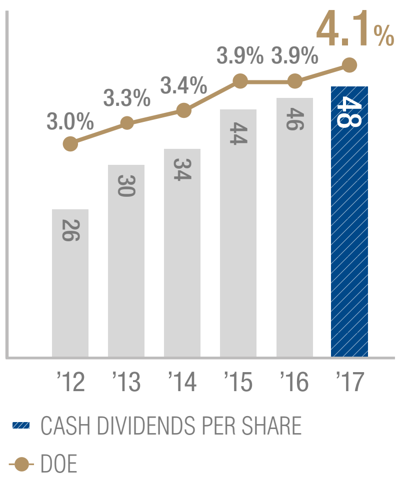
## Q5 Tell us about the Company's governance activities and your thoughts toward the return of profits to shareholders.

Star Micronics transitioned to a company with an audit and supervisory committee in May 2016 in order to further strengthen the supervisory function of the Board of Directors and reinforce corporate governance. At the same time, steps were also taken to ensure that a majority, or four, of the seven-member Board of Directors was comprised of outside directors. Looking ahead, we will continue to clarify the supervisory and executive functions of management and work diligently to lift the pace at which we carry out our business strategies.

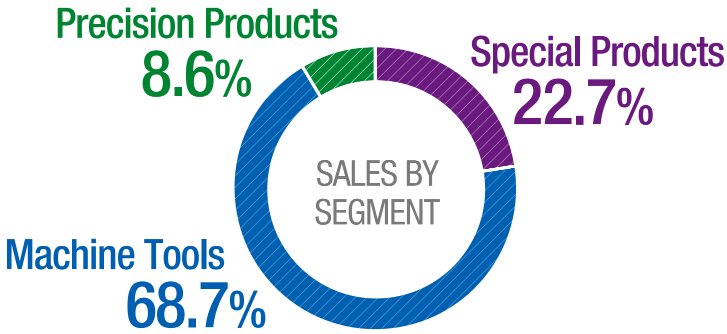
As far as the return of profits to shareholders is concerned, Star Micronics has continued to increase its dividend payment over the past six years. In this regard, the Company positions the return and distribution of profits to shareholders as an important management priority. In the fiscal year under review, the Company intends to implement the basic policy of a consolidated dividend payout ratio of at least 40% while taking into consideration dividend on equity (DOE). In an effort to further bolster the return and distribution of profits to shareholders, Star Micronics will again implement its basic policy while taking into consideration DOE and a total consolidated payout ratio of at least 50% that includes repurchase of the Company's own shares from the fiscal year ending February 28, 2018. Looking further ahead, we have set the medium-term DOE and ROE targets of at least 4.5% and at least 12%, respectively, four years hence, in the fiscal year ending February 28, 2021. Striving to achieve these goals, we will work in unison as a group to enhance our corporate value.

### CASH DIVIDENDS PER SHARE AND DOE

(Yen, %)



# At a Glance by Segment




## Special Products

NET SALES ¥11,082 million

Point-of-sale (POS) printers used to issue receipts and for other purposes at places such as department stores, supermarkets and restaurants are the main products in the Special Products Segment. The Company maintains a product lineup that harnesses the distinctive features of both thermal and dot matrix printers. In recent years, demand for mobile POS (mPOS) printers that are compatible with tablet terminals, smartphones, and other devices has experienced a steady increase.

▸ Special Products

## Machine Tools

NET SALES ¥33,629 million


In the Machine Tools Segment, Star Micronics' Swiss-Type CNC Automatic Lathes enjoy a high market share. Ideally suited for precision component processing with high accuracy, the Company's products in this segment are used in the processing of not only automotive parts, but also digital equipment and medical components. Star Micronics works tirelessly to satisfy customer needs by leveraging the latest technologies including its proprietary Star Motion Control System for optimizing machining operations.

▸ Machine Tools

## Precision Products

NET SALES ¥4,226 million

The Precision Products Segment is a foundation business of Star Micronics. Building on its strengths and the ability to address a full range of needs from machining to plating, the Company holds a leading share in the wristwatch component processing field in Japan. Currently, we are expanding our business activities into the non-wristwatch component field including automotive, air-conditioner and medical components.

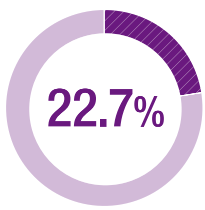
▸ Precision Products

# Special Products

**In the period under review, revenues declined in the Special Products Segment as a whole. In POS printers, sales in Japan increased substantially on the back of robust mPOS-related sales. This was more than offset, however, by the downturn in sales in the U.S., Europe and Asia due to the effects of the strong yen. Going forward, revenues and earnings are projected to increase in the fiscal year ending February 28, 2018. This mainly reflects growth in mPOS-related sales.**

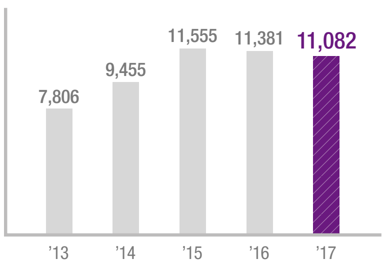
## SPECIAL PRODUCTS

SALES BY SEGMENT



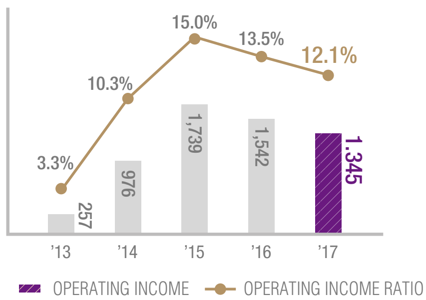

NET SALES

(Millions of yen)




OPERATING INCOME & OPERATING INCOME RATIO

(Millions of yen, %)



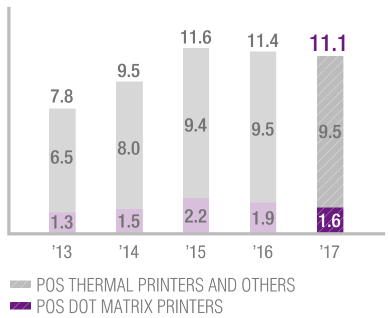

### Business Environment and Results in Fiscal 2017

In this segment, Star Micronics is engaged in the global sale of mainly POS printers. In addition to conventional products that communicate with POS terminals or PCs, demand for mPOS printers that utilize mobile devices including tablet terminals has enjoyed a steady increase in recent years.

In the period under review, demand for mPOS systems that connect to tablet terminals and smartphones has expanded in Japan. This in turn has triggered robust trends in mPOS printers with a substantial year-on-year upswing in sales. In the mainstay U.S. market, distributors continued to adjust inventories especially in the first half. These and other factors caused sales volumes to stall. Turning to the markets in Europe and Asia, trends were strong. Despite an increase in volume, however, sales declined due to the impact of the strong yen.

SALES IN THE SPECIAL PRODUCTS SEGMENT

(Billions of yen)




Accounting for each of these factors, sales in the Special Products Segment decreased 2.6% compared with the previous fiscal year to ¥11,082 million (US$98,947 thousand). Operating income also declined 12.8% year on year to ¥1,345 million (US$12,009 thousand).

## Outlook for Fiscal 2018 and Business Strategies

As independent software companies continue to turn to Star Micronics' mPOP series of mPOS-related products, an all-in-one package that combines both a printer and cash drawer in a single configuration, sales of this series are projected to spearhead revenues mainly in Japan. In countries in Europe including Russia, demand for printers for tax collection use is also anticipated to expand.

Based on the aforementioned forecasts, sales in the Special Products Segment are expected to reach ¥12,300 million, an increase of 11.0% compared with the fiscal year under review. Operating income is anticipated to come in at ¥1,620 million, up 20.4% year on year.

POS printer
TSP650 II

### Sales Volume of POS Printers by Region

(Thousands of units)

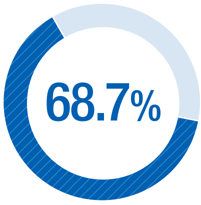
| | 2016 | 2017 | Change |
|---|---|---|---|
| The Americas | 262 | 257 | -1.9% |
| Europe | 131 | 147 | 12.2% |
| Asia | 84 | 129 | 53.6% |
| Japan | 44 | 64 | 45.5% |
| Total | 520 | 596 | 14.6% |

# Machine Tools


**Revenues in the Machine Tools Segment decreased in the fiscal year ended February 28, 2017. Despite robust trends in the U.S. as well as China, this decrease was largely attributable to the impact on results of the strong yen. In the fiscal year ending February 28, 2018, revenues and earnings are projected to increase. This is mainly due to a recovery in orders.**

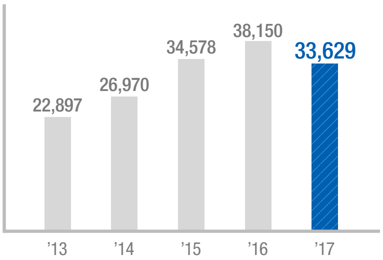
## MACHINE TOOLS

SALES BY SEGMENT



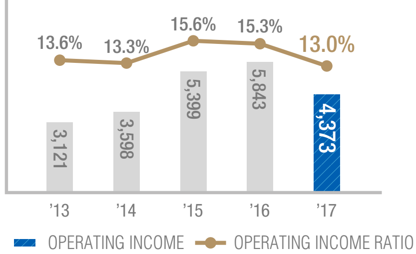

NET SALES

(Millions of yen)




OPERATING INCOME & OPERATING INCOME RATIO

(Millions of yen, %)

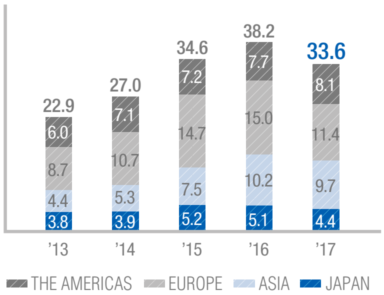



## Business Environment and Results in Fiscal 2017

Amid the effects of the strong yen on operations in the U.S. market, sales of the segment's key CNC automatic lathes increased during the period under review. This largely reflected firm trends in the mainstay medical equipment-related sector over the second half of the fiscal year. In Europe, results declined substantially owing to sluggish sales in such emerging markets as Eastern Europe as well as in major countries including Germany and the effect of the strong yen. Looking at the Asian market, sales declined. Despite steady trends in China, this decline was mainly due to the downturn in sales in other regions and the effect of the strong yen. On the domestic front, sales in Japan decreased. This largely reflected the cautious approach adopted by the market toward capital expenditures.

MACHINE TOOLS SEGMENT SALES BY GEOGRAPHICAL REGION

(Billions of yen)




Taking into account each of these factors, sales in the Machine Tools Segment fell 11.9% compared with the previous fiscal year to ¥33,629 million (US$300,259 thousand). Operating income also declined 25.2% year on year to ¥4,373 million (US$39,045 thousand).

## Outlook for Fiscal 2018 and Business Strategies

Sales in the Machine Tools Segment are expected to increase in the fiscal year ending February 28, 2018. In addition to anticipated recovery in the Japanese market, this increase is mainly due to the forecast of robust trends in Asia. Building on the Company's efforts to commence sales of products that employ a modular design production method in the period under review, we plan to roll out and expand the scope of our operations to other models throughout the fiscal year ending February 28, 2018 in a bid to shorten production development and production lead times.

As a result, sales in the Machine Tools Segment are projected to increase 2.3% in the current period to ¥34,400 million. Operating income is forecast to improve 9.8% year on year to ¥4,800 million.


CNC Swiss-Type
Automatic Lathe SV-20R

## Milestone Breakthrough

### Launch of New Products That Employ a Modular Design Production Method

Star Micronics released the SR-32JII as a new model Swiss-type automatic lathe in the SR series in April 2017. The SR-32JII is a renewed version of its predecessor, the SR-32J, which has continued to enjoy a favorable market reputation since its launch in 2005, that employs a modular design production method.

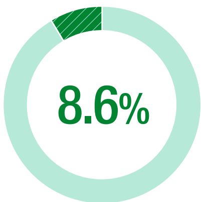
This modular design production method entails the design and standardization of parts that are already highly compatible. These parts are then combined and configured into a wide range of products. Compared with traditional methods that require the development and design of components for each individual model, the modular design production method helps to reduce the number of component parts while shortening production lead times. For these and other reasons, this method enables a more flexible response to changes in demand. In addition to cutbacks in costs and product inventories, this method can also be expected to boost production systems efficiency. Looking ahead, Star Micronics plans to progressively apply the modular method as it renews each of its models.

# Precision Products

Sales of both wristwatch and non-wristwatch components declined during the period under review mainly due to weak demand. In the fiscal year ending February 28, 2018, revenues and earnings are expected to increase largely on the back of a forecast upswing in demand for medical- and semiconductor-related components.

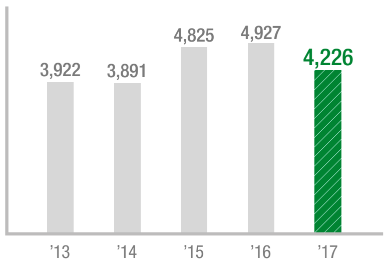
## PRECISION PRODUCTS

SALES BY SEGMENT



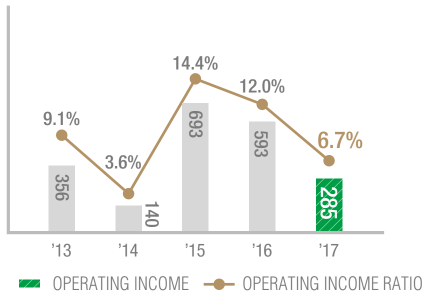

NET SALES

(Millions of yen)




OPERATING INCOME & OPERATING INCOME RATIO

(Millions of yen, %)



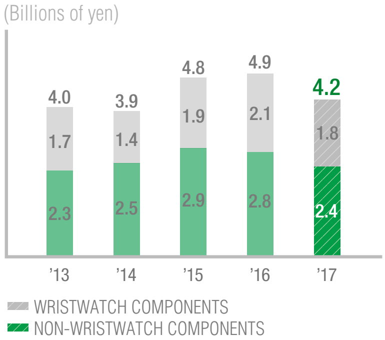

### Business Environment and Results in Fiscal 2017

The products in the Precision Products Segment are divided into two main areas: wristwatch components, a business that the Company has been involved in since it was founded, and other precision components (non-wristwatch components) such as automotive-, medical- and air-conditioner-related components.

Impacted by production adjustments by wristwatch makers, sales of wristwatch components declined 11.6% compared with the previous fiscal year to ¥1,837 million (US$16,402 thousand). Sales of non-wristwatch components also decreased 16.2% year on year to ¥2,388 million (US$21,321 thousand) owing mainly to the downturn in automotive components and the effect of the strong yen.

PRECISION PRODUCTS SEGMENT SALES

(Billions of yen)




Taking into account these factors, sales in the Precision Products Segment fell 14.2% compared with the previous fiscal year to ¥4,226 million (US$37,732 thousand). Operating income dropped 52.0% year on year to ¥285 million (US$2,544 thousand).

## Outlook for Fiscal 2018 and Business Strategies

In the fiscal year ending February 28, 2018, sales of wristwatch and non-wristwatch components are projected to increase. Looking ahead, every effort will be made to pursue growth by expanding activities in high-value-added components in non-wristwatch areas including automotive- and semiconductor-related fields.

Based on the aforementioned, Star Micronics is forecasting sales for the Precision Products Segment of ¥4,500 million, an increase of 6.5% compared with the period under review. Operating income is expected to surge 64.9% year on year to ¥470 million.

Automotive Components

# Corporate Governance

At Star Micronics, our basic approach to corporate governance is based on fulfilling our social responsibilities as a company. To this end, we strive for management that is both appropriate and efficient at sustainably raising corporate value, while distributing an appropriate amount of the resulting profits to our shareholders and other stakeholders.

Based on a resolution at the Company' s 91st General Meeting held on May 26, 2016, Star Micronics transitioned to a company with an audit and supervisory committee in order to further strengthen the supervisory function of its Board of Directors and to enhance its corporate governance capabilities.

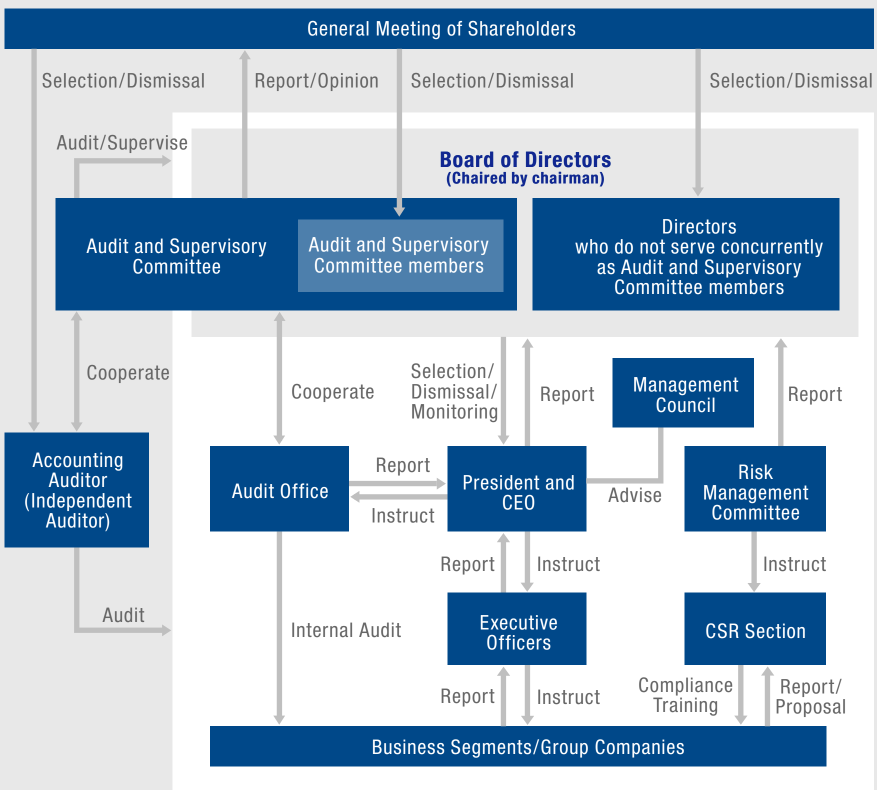
The Company has decided to set the number of internal directors including the president at three and to appoint four outside directors including directors who serve as Audit and Supervisory Committee members. In this manner, outside directors make up a majority of the Board of Directors. Based on each of the aforementioned, the Company has taken steps to further clarify the supervisory and executive roles of management. This initiative is aimed at increasing the speed at which business strategies are implemented.

Furthermore, an executive officer system was introduced to Star Micronics to speed up and raise the efficiency of business execution even further, and ensure that management as an organization is flexible and capable of prompt, rational decisions for executing business.

The Board of Directors is comprised of seven directors, four of whom are appointed from outside the Company. This ensures the independence, efficacy, and efficiency of the decision-making process while fortifying the supervisory function with respect to the execution of directors' duties.

The Audit and Supervisory Committee is comprised of three outside directors. In addition to auditing the activities of directors in the general conduct of their duties, the Audit and Supervisory Committee is responsible for auditing the Company's accounting statements and related documentation and preparing audit reports in accordance with audit policies and plans determined by the Audit and Supervisory Committee. Moreover, the Committee undertakes audits in conjunction with accounting auditors as well as internal audit and related departments.

**STAR MICRONICS' CORPORATE GOVERNANCE SYSTEM**



## Compensation of Directors and Audit & Supervisory Board Members

Members of the Board of Directors at Star Micronics are compensated in accordance with the Company's earnings performance. Their package consists of a basic compensation that is paid monthly, a yearly bonus and stock options provided as a medium- to long-term incentive. In view of the tasks that they are asked to perform, outside directors and directors who concurrently serve as Audit and Supervisory Committee members receive only the basic compensation.

The standard amount of basic compensation paid to directors (excluding directors who concurrently serve as Audit and Supervisory Committee members) is based on the Company's performance as well as the status and position of each director. Together with the bonus payment outlined below, the basic compensation paid to each director shall not exceed ¥300 million annually. Of this total, the amount paid to outside directors shall not exceed ¥20 million annually.

The amount of basic compensation paid to each director who concurrently serves as an Audit and Supervisory Committee member shall not exceed ¥30 million annually and is determined through deliberations by the Audit and Supervisory Committee.

The total amount of bonuses paid to directors is calculated by multiplying profit attributable to owners of the parent by a payment rate determined by the Company. The amount of each bonus paid to individual directors (excluding outside directors and directors who concurrently serve as Audit and Supervisory Committee members) shall be determined in line with the status and position of each director. The Company determined that the payment of directors' bonuses falls within the scope of profit-based compensation stipulated under Article 34, Paragraph 1.3 of Japan's Corporation Tax Act at a Board of Directors' meeting held on May 25, 2017.

Turning to the granting of stock options, the amount of allocation to each director (outside directors as well as directors who serve as Audit and Supervisory Committee members) shall not exceed ¥100 million annually. Stock options shall entail the issuance of two types of stock acquisition rights (SARs): ordinary stock options granted as a medium-term incentive and stock compensation-type stock options granted as a long-term incentive. SARs shall be allocated in line with the status and position of each director.

### Breakdown of Compensation of Directors and Audit & Supervisory Board Members

| Director rank | Total compensation, etc. (¥ million) | Total compensation by category (¥ million) | | | Headcount of those eligible |
|---|---|---|---|---|---|
| | | Basic compensation | Stock options | Bonus | |
| Directors (excluding outside directors) | 192 | 94 | 35 | 63 | 6 |
| Audit & Supervisory Committee members (excluding outside directors) | — | — | — | — | — |
| Audit & Supervisory Board members (excluding outside Audit & Supervisory Board members) | — | — | — | — | — |
| Outside directors and Audit & Supervisory Board members | 20 | 20 | — | — | 4 |

Notes:

1. The figures for "Stock options" and "Bonus" are the monetary amounts recorded as expenses in the fiscal year under review.
2. The aforementioned amount of director compensation does not include salaries paid to directors who are also employees of the Company.
3. Star Micronics is scheduled to pay ¥57 million in total to two directors of the Board upon their retirement. These payments are for severance of a retirement benefit allowance for directors that was discontinued pursuant to a resolution of the Ordinary General Shareholders' Meeting for the 82nd Period held on May 24, 2007.

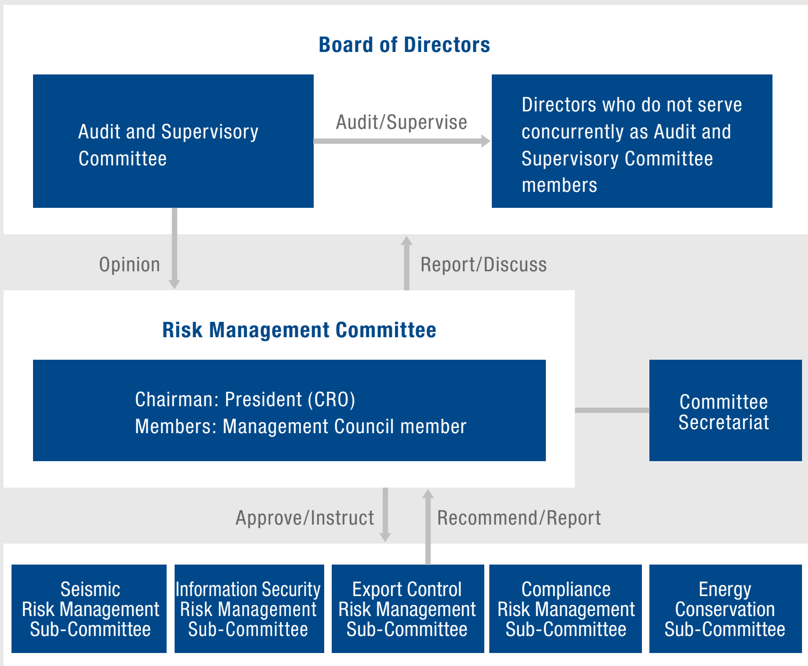
## Internal Control System

Star Micronics strives to maintain an internal control system that will enable proper and efficient management to drive a continuous increase in corporate value. To strengthen internal control, the Star Micronics Global Charter of Corporate Conduct was issued, setting out the Group's basic policies on compliance. Since then, the Star Micronics Global Code of Conduct was drawn up for employees to follow, and we have been working to establish rules and organizational structures to ensure compliance at every level of our activities. In addition, a department dedicated to corporate social responsibility (CSR) spearheads our compliance activities. This department plays a central role in providing reminders and education on compliance to the Group's directors, executives and employees, and is charged with holding periodic committee meetings and monitoring the status in regard to the Group's adherence with all relevant laws and regulations. Star Micronics also has an appropriate internal control and whistleblower system for ensuring the reliability of its financial reporting, as stipulated in the Financial Instruments and Exchange Law of Japan.

## Risk Management

Star Micronics approaches the management of material risks such as legal issues, natural disasters, environmental considerations and export management in an organized and systematic manner. Departments and individuals are assigned as needed to manage a specific risk, and take responsibility for establishing rules and manuals, and so forth, for managing the risks. They also implement programs to alert, educate and prepare the Group's directors, executives and employees against the risks. There is also a committee which meets periodically to monitor and manage risks for the Group.

STAR MICRONICS' RISK MANAGEMENT SYSTEM



# Consolidated Eleven-Year Summary

Star Micronics Co., Ltd. and Consolidated Subsidiaries
Eleven years ended the last day of February

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| **For the year:** | | | |
| Net sales | **¥48,937** | ¥54,458 | ¥50,958 |
| Cost of sales | **30,825** | 33,558 | 31,355 |
| Selling, general and administrative expenses | **14,505** | 15,165 | 14,126 |
| Operating income (loss) | **3,607** | 5,735 | 5,477 |
| Other income (expenses) – net | **224** | (383) | 605 |
| Income (loss) before income taxes | **3,831** | 5,352 | 6,082 |
| Income taxes | **572** | 1,530 | 1,285 |
| Net income attributable to noncontrolling interests | **78** | 101 | 101 |
| Net income (loss) attributable to owners of the parent | **3,181** | 3,721 | 4,696 |
| Net cash provided by operating activities | **5,338** | 3,107 | 4,326 |
| Net cash provided by (used in) investing activities | **813** | (1,074) | (2,501) |
| Free cash flows | **6,151** | 2,033 | 1,825 |
| Net cash provided by (used in) financing activities | **139** | (2,180) | (1,568) |
| **Per share:** | | | |
| Basic net income (loss) | **¥ 81.77** | ¥ 87.98 | ¥111.36 |
| Diluted net income | **74.69** | 87.69 | 111.05 |
| Cash dividends applicable to the year | **48.00** | 46.00 | 44.00 |
| **At year-end:** | | | |
| Current assets | **¥53,172** | ¥50,367 | ¥50,533 |
| Net property, plant and equipment | **12,926** | 14,360 | 15,309 |
| Total assets | **68,351** | 67,828 | 70,261 |
| Long-term liabilities | **9,935** | 2,021 | 617 |
| Total equity | **43,755** | 50,200 | 51,903 |
| **Stock exchange price per share of common stock:** | | | |
| Highest | **¥1,770** | ¥2,238 | ¥1,885 |
| Lowest | **1,023** | 1,125 | 1,115 |
| **Selected financial indicators:** | | | |
| Equity ratio (%) | **62.8** | 72.7 | 72.4 |
| Return on equity (%) | **6.9** | 7.4 | 9.8 |
| Dividend payout ratio (%) | **58.7** | 52.3 | 39.5 |
| Dividend on equity (%) | **4.1** | 3.9 | 3.9 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Millions of yen (Except for per share data) | | | | | | | |
| 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 |
| ¥43,482 | ¥37,858 | ¥41,654 | ¥35,718 | ¥ 29,181 | ¥56,953 | ¥73,884 | ¥62,670 |
| 28,047 | 24,683 | 25,753 | 23,265 | 22,326 | 33,535 | 42,207 | 37,004 |
| 12,829 | 11,595 | 11,948 | 11,024 | 10,840 | 14,873 | 17,025 | 15,222 |
| 2,606 | 1,580 | 3,953 | 1,429 | (3,985) | 8,545 | 14,652 | 10,444 |
| 40 | 2,140 | (724) | (1,069) | (2,665) | (984) | (271) | 410 |
| 2,646 | 3,720 | 3,229 | 360 | (6,650) | 7,561 | 14,381 | 10,854 |
| 1,400 | 1,330 | 717 | 107 | 1,800 | 3,147 | 6,190 | 3,719 |
| 103 | 90 | 85 | 92 | 105 | 76 | 111 | 122 |
| 1,143 | 2,300 | 2,427 | 161 | (8,555) | 4,338 | 8,080 | 7,013 |
| 2,597 | 483 | 4,466 | 3,520 | 4,769 | 6,152 | 10,666 | 10,711 |
| (2,455) | (1,908) | (393) | (1,518) | (1,194) | (1,314) | (8,072) | (3,169) |
| 142 | (1,425) | 4,073 | 2,002 | 3,575 | 4,838 | 2,594 | 7,542 |
| (1,394) | (1,202) | (2,092) | (1,813) | (3,977) | (9,077) | (2,152) | (1,331) |
| ¥ 27.17 | ¥ 54.66 | ¥ 56.94 | ¥ 3.71 | ¥(187.95) | ¥ 85.66 | ¥150.74 | ¥131.09 |
| 27.14 | | | | | 85.63 | 150.47 | 130.73 |
| 34.00 | 30.00 | 26.00 | 22.00 | 22.00 | 45.00 | 56.00 | 32.00 |
| ¥41,233 | ¥35,827 | ¥38,302 | ¥34,836 | ¥ 34,346 | ¥44,762 | ¥63,152 | ¥53,620 |
| 14,327 | 13,476 | 10,289 | 10,549 | 11,678 | 15,169 | 17,728 | 16,355 |
| 59,303 | 52,564 | 51,925 | 49,250 | 50,681 | 64,205 | 86,375 | 76,195 |
| 524 | 303 | 407 | 423 | 592 | 459 | 696 | 920 |
| 45,698 | 40,710 | 36,980 | 37,096 | 41,261 | 52,986 | 66,602 | 61,396 |
| Yen | | | | | | | |
| ¥1,422 | ¥988 | ¥958 | ¥1,182 | ¥1,020 | ¥2,175 | ¥3,740 | ¥2,710 |
| 857 | 647 | 657 | 702 | 595 | 773 | 1,506 | 1,691 |
| 75.5 | 76.1 | 70.2 | 73.9 | 80.1 | 81.5 | 76.2 | 79.9 |
| 2.7 | 6.0 | 6.7 | 0.4 | | 7.3 | 12.8 | 12.2 |
| 125.1 | 54.9 | 45.7 | 593.0 | | 52.5 | 37.2 | 24.4 |
| 3.4 | 3.3 | 3.0 | 2.5 | 2.2 | 3.8 | 4.7 | 3.0 |

# Management's Discussion and Analysis

## OVERVIEW (Years ended February 28, 2017 and February 29, 2016)

### Business Environment

Looking at economic conditions during the fiscal 2017, the year ended February 28, 2017, the U.S. economy exhibited signs of a recovery trend while Europe continued to experience a modest positive turnaround. In Asia, the Chinese economy continued to slow at a moderate pace. There were, however, signs of a positive turnaround in Southeast Asia. On the domestic front, the Japanese economy continued along a modest recovery path.

### Net Sales

(Millions of yen)

| | 2016 | 2017 | Change (%) |
|---|---|---|---|
| | ¥54,458 | **¥48,937** | (10.1) |

While impacted by movements in foreign currency exchange rates, the Special Products Segment witnessed a recovery in POS-related market demand. In contrast, demand was sluggish in each of the machine tools and precision products markets.

### Operating Income

(Millions of yen)

| | 2016 | 2017 | Change (%) |
|---|---|---|---|
| | ¥5,735 | **¥3,607** | (37.1) |

In addition to the impact of the strong yen, sales of machine tools and other products decreased. This in turn contributed to a downturn in operating income.

### Net Income Attributable to Owners of the Parent

(Millions of yen)

| | 2016 | 2017 | Change (%) |
|---|---|---|---|
| | ¥3,721 | **¥3,181** | (14.5) |

Despite a significant improvement in the foreign exchange loss, net income attributable to owners of the parent declined owing to such factors as the downturn in operating income.

### Cash Dividends per Share

(Yen)

| | 2016 | 2017 | Change (Yen) |
|---|---|---|---|
| | ¥46 | **¥48** | ¥2 |

The annual cash dividend in the fiscal year under review increased ¥2 per share from the previous fiscal year to ¥48 per share.

### Total Assets

(Millions of yen)

| | 2016 | 2017 | Change (%) |
|---|---|---|---|
| | ¥67,828 | **¥68,351** | 0.8 |

Total assets increased from the end of the previous fiscal year. Despite decreases in the balances of inventories, property, plant and equipment, and investment securities, this increase was mainly due to growth in the balance of cash and cash equivalents.

### Free Cash Flows

(Millions of yen)

| | 2016 | 2017 | Change (%) |
|---|---|---|---|
| | ¥2,033 | **¥6,151** | 202.6 |

Free cash flows increased substantially during the fiscal year under review. This was mainly comprised of cash provided by investing activities on the back of such factors as proceeds from sales of marketable and investment securities as well as the net decrease in short-term investments.

Free cash flows = Operating cash flows + Investing cash flows

### Capital Expenditures

(Millions of yen)

| | 2016 | 2017 | Change (%) |
|---|---|---|---|
| | ¥2,275 | **¥1,441** | (36.7) |

Capital expenditures decreased substantially year on year. This was mainly due to the absence of expenditures related to the introduction of production facilities in the Machine Tools segment and efforts to expand domestic plants in the Precision Products segment incurred during the previous fiscal year.

### Net Sales by Region

(Millions of yen)

| | 2016 | 2017 | Change (%) |
|---|---|---|---|
| Japan | ¥ 8,729 | **¥ 8,221** | (5.8) |
| USA | 12,566 | **13,084** | 4.1 |
| China | 6,543 | **6,317** | (3.5) |
| Germany | 7,339 | **5,836** | (20.5) |
| Others | 19,281 | **15,479** | (19.7) |

## INCOME ANALYSIS

### Decrease in revenue and earnings due to the substantial impact of the strong yen.

In fiscal 2017, the fiscal year under review, the Company reported consolidated sales of ¥48,937 million (US$436,938 thousand), down 10.1%, or ¥5,521 million year on year. Looking at movements in foreign currency exchange rates, the value of the yen appreciated against both the U.S. dollar and the euro compared with the previous fiscal year. Impacted by these movements, shipments in the Machine Tools Segment fell substantially in the first half, before recovering throughout the second half of the fiscal year under review. In the Special Products Segment, trends in POS-related markets were also mixed. On the one hand, shipment growth in the U.S. was limited. On the other hand, conditions were robust in Japan, Europe and Asia. Turning to precision product-related fields, demand for wristwatch and non-wristwatch components stalled.

The cost of sales decreased 8.1%, or ¥2,733 million, year on year, to ¥30,825 million (US$275,224 thousand). As a result, gross profit declined 13.3%, or ¥2,788 million, to ¥18,112 million (US$161,714 thousand). On this basis, the gross profit margin came in at 37.0%, down 1.4 percentage points compared with the previous fiscal year.

Selling, general and administrative (SG&A) expenses fell 4.4%, or ¥660 million, year on year, to ¥14,505 million (US$129,509 thousand). This downturn largely reflected the conversion of local currency expenses into Japanese yen.

Accounting for each of the aforementioned factors, operating income decreased substantially falling 37.1%, or ¥2,128 million, year on year, to ¥3,607 million (US$32,205 thousand). The operating income ratio declined 3.1 percentage points compared with the previous fiscal year, to 7.4%.

### Net income declined despite an improvement in other income.

In fiscal 2017, other income-net came to ¥224 million (US$2,000 thousand) compared with other expenses-net of ¥383 million in the previous fiscal year. This was mainly due to an improvement in the foreign exchange loss-net from ¥881 million in fiscal 2016 to ¥328 million (US$2,929 thousand) in the fiscal year under review.

Based on the aforementioned, income before income taxes and noncontrolling interests decreased 28.4%, or ¥1,521 million, year on year, to ¥3,831 million (US$34,205 thousand). Total income taxes were ¥572 million (US$5,107 thousand). Net income attributable to owners of the parent after deducting net income attributable to noncontrolling interests was ¥3,181 million (US$28,402 thousand), down 14.5%, or ¥540 million, compared with the previous fiscal year.

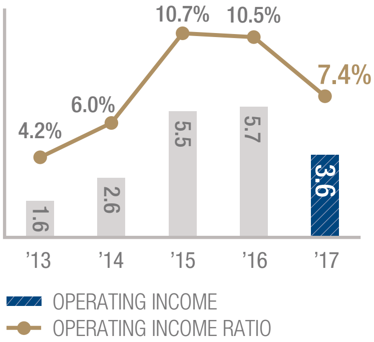
Basic net income per share came to ¥81.77 (US$0.73) and diluted net income per share was ¥74.69 (US$0.67).

### The annual cash dividend increased ¥2 per share year on year, to ¥48 per share.

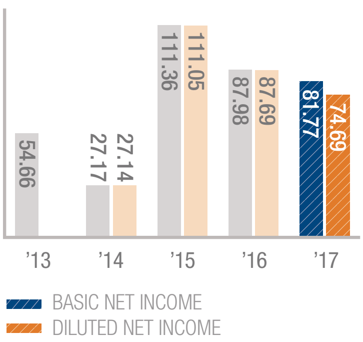
The Company increased its annual cash dividend ¥2 per share for the fiscal year under review to ¥48 (US$0.43) per share. The dividend on equity (DOE) came to 4.1%, up 0.2 of a percentage point compared with the previous fiscal year. Star Micronics plans to again increase its annual cash dividend ¥2 per share for the fiscal year ending February 28, 2018 to ¥50 per share.

As far as its policy toward the payment of future dividends is concerned, the Company is aiming for a total consolidated payout ratio of at least 50% that included the repurchase of its own shares while taking into consideration DOE. Turning to the Company's internal reserves, Star Micronics will allocate funds to a wide range of areas

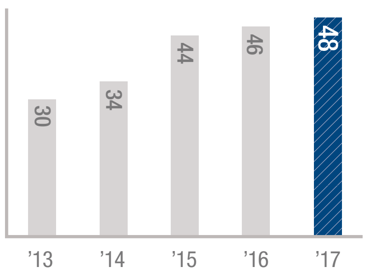
OPERATING INCOME AND OPERATING INCOME RATIO
(Billions of yen, %)




NET INCOME PER SHARE
(Yen)




CASH DIVIDENDS PER SHARE
(Yen)



including investment in growth businesses with the aim of ensuring sustainable growth. At the same time, the Company will work to enhance its corporate value and improve shareholder returns.

## FINANCIAL POSITION & LIQUIDITY

### Total assets increased on the back of a substantial upswing in cash.

Total current assets as of February 28, 2017 stood at ¥53,172 million (US$474,750 thousand), an increase of 5.6%, or ¥2,805 million, compared with the end of the previous fiscal year. Despite a year-on-year decrease in the balance of inventories, which fell 8.0%, or ¥1,433 million, to ¥16,412 million (US$146,536 thousand), this increase in current assets largely reflected higher balances of cash and cash equivalents, which climbed 37.7%, or ¥5,608 million, to ¥20,478 million (US$182,839 thousand).

Net property, plant and equipment decreased 10.0%, or ¥1,434 million, compared with the end of the previous fiscal year, to ¥12,926 million (US$115,411 thousand). This decrease was mainly due to further depreciation of various facilities. The balance of investments and other assets declined 27.3%, or ¥848 million, year on year, to ¥2,253 million (US$20,116 thousand). This largely reflected the substantial drop in investment securities following disposal of shares held for policy purposes.

Accounting for each of the aforementioned factors, total assets edged up 0.8%, or ¥523 million, compared with the end of the previous fiscal year, to ¥68,351 million (US$610,277 thousand).

### Total liabilities increased on the back of such factors as the issuance of bonds with stock acquisition rights.

Current liabilities decreased 6.1%, or ¥946 million, compared with the end of the previous fiscal year, to ¥14,661 million (US$130,902 thousand). This decrease was largely attributable to the drop of 6.8%, or ¥610 million, year on year, in payables, to ¥8,324 million (US$74,322 thousand).

Total long-term liabilities came to ¥9,935 million (US$88,705 thousand), a roughly fivefold increase, or ¥7,914 million, year on year. This dramatic jump was mainly due to the new issuance of bonds with stock acquisition rights during the fiscal year under review totaling ¥8,068 million (US$72,036 thousand) for the repurchase of own shares and business investment.

### The balance of equity declined as a result of the repurchase of own shares.

Total equity decreased 12.8%, or ¥6,445 million, compared with the previous fiscal year-end, to ¥43,755 million (US$390,670 thousand). While retained earnings grew 4.6%, or ¥1,291 million, to ¥29,096 million (US$259,786 thousand), this decrease mainly reflected the turnaround in foreign currency translation adjustments from a positive ¥1 million as of the end of the previous fiscal year to a negative ¥1,354 million (US$12,089 thousand), as of February 28, 2017 as well as the increase in the negative balance of treasury stock-at cost of ¥6,304 million year on year, to ¥10,783 million (US$96,277 thousand).

Owing to the increase in total assets and the decrease in total equity, the equity ratio came to 62.8%, down 9.9 percentage points compared with the end of the previous fiscal year. Equity per share as of February 28, 2017 decreased ¥13.07 year on year, to ¥1,151.40 (US$10.28).

## CASH FLOWS

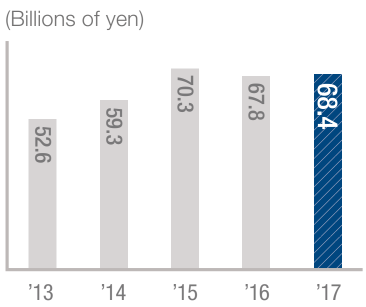
### Cash increased substantially from each of the Company's operating, investing and financing activities.

Net cash provided by operating activities came to ¥5,338 million (US$47,661 thousand), up ¥2,231 million compared with the previous fiscal year. Despite year-on-year decreases in income before income taxes to ¥3,831 million (US$34,205 thousand) as well as depreciation and amortization to ¥2,167 million (US$19,348 thousand), the substantial increase in operating cash flows was mainly due to the decrease in inventories totaling ¥946 million (US$8,447 thousand), increase in trade payable, which came to ¥384 million (US$3,429 thousand) and the year-on-year decrease in income taxes-paid, which amounted to ¥906 million (US$8,089 thousand).

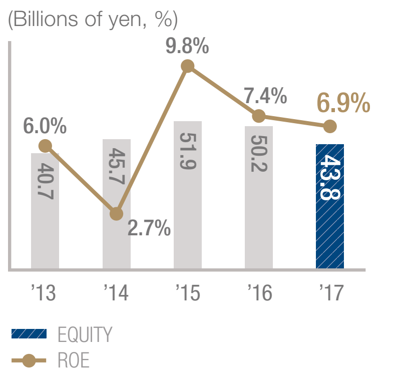
Net cash provided by investing activities totaled ¥813 million (US$7,259 thousand), a positive turnaround of ¥1,887 million compared with the previous fiscal year. This turnaround largely reflects the substantial year-on-year drop in purchases of property, plant and equipment to ¥984 million (US$8,786 thousand) coupled with proceeds from sales of marketable and investment securities of ¥1,783 million (US$15,920 thousand), which continued at the same high level as the previous fiscal year.

Net cash provided by financing activities amounted to ¥139 million (US$1,241 thousand), a positive turnaround

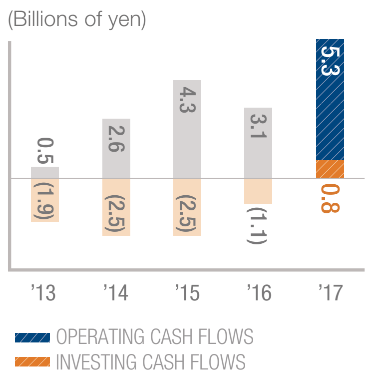
TOTAL ASSETS




EQUITY AND RETURN ON EQUITY




CASH FLOWS




of ¥2,319 million compared with the previous fiscal year. In the fiscal year under review, major cash inflows included proceeds from the issuance of bond with stock acquisition rights totaling ¥8,059 million (US$71,955 thousand). These cash inflows were used in part for the repurchase of own shares amounting to ¥6,389 million (US$57,045 thousand).

Taking into account each of the aforementioned activities in addition to foreign currency translation adjustments on cash and cash equivalents, which came to a negative ¥682 million (US$6,090 thousand), as well as the net increase in cash and cash equivalents of ¥5,608 million (US$50,071 thousand) for the fiscal year under review, cash and cash equivalents stood at ¥20,478 million (US$182,839 thousand) as of February 28, 2017.

## CAPITAL EXPENDITURES AND R&D EXPENSES

### Star Micronics plans to undertake large-scale investments to push forward a variety of initiatives including the construction of a new head office buildings and to help boost the Machine Tools Segment.

In the fiscal year under review, capital expenditures decreased 36.7%, or ¥834 million, compared with the previous fiscal year, to ¥1,441 million (US$12,866 thousand). In the fiscal year ending February 28, 2018, the Company plans to undertake capital expenditures totaling ¥5,226 million. Of this total, ¥2,574 million will be allocated as expenses for the construction of a new head office building.

***Special Products***–Expenditures in the Special Products Segment declined ¥120 million compared with the previous fiscal year, to ¥137 million (US$1,223 thousand). In fiscal 2018, the Company is budgeting expenditures of ¥287 million in this segment mostly for dyes used in the manufacture of new products.

***Machine Tools***–Expenditures in the Machine Tools Segment decreased ¥367 million compared with the previous fiscal year, to ¥766 million (US$6,840 thousand). In the fiscal year ending February 28, 2018, the Company is looking to undertake expenditures to the amount of ¥1,670 million. Expenses will cover such activities as the maintenance and renewal of facilities as well as jigs and tools for new models.

***Precision Products***–Expenditures in the Precision Products Segment came to ¥389 million (US$3,473 thousand), down ¥237 million compared with the previous fiscal year. In fiscal 2018, the Company expects to spend ¥695 million mostly for equipment and facilities for new processes, equipment and facilities to streamline operations and initiatives aimed at saving labor.

### Development of new products by the R&D Center and business divisions.

***R&D Activities***–The Star Micronics Group's research and development structure consists of the R&D Division, which develops products in new business fields, and the development departments of each business segment, which are in charge of developing products and technologies directly related to their current operations.

The main outcomes of R&D in the fiscal year under review are outlined below. R&D spending totaled ¥2,032 million (US$18,143 thousand).

***R&D Center***–In the second half of the fiscal year under review, the R&D Center was restructured into an organization specializing in the development and marketing of products with the aim of commercializing new business fields. With the intention of building business models that utilize energy harvesting, a field with strong growth potential, Star Micronics aims to develop high-value-added products that incorporate its extensive miniaturization and electromagnetic induction technologies, in addition to the application of circuit and software technologies.

During the fiscal year under review, progress was made on the development of battery-less beacons for security systems integrating sensors and wireless communications module with small vibration power generation units that convert imperceptible vibrations into electricity; IoT sensor units and battery-less switches for smart factories with IoT environments; as well as vibration power generation units aimed at decorative illumination applications. At the same time, Star Micronics ascertained customer requirements for commercialization, participated in exhibitions around the world to forge connections with new customers, and proactively performed verification tests for promising customers.

The R&D Center spent ¥486 million (US$4,339 thousand) on R&D during the fiscal year under review.

***Special Products Segment***–During the fiscal year under review, the Special Products Segment developed the TSP100IIIBI, a new 3-inch thermal printer for the mobile POS printer market, and the IFBD-HI01X intelligent interface. Software updates and modifications were also made.

The TSP100IIIBI features an enhanced ability to connect to mobile devices by incorporating functions with a Bluetooth interface, eliminating the need to change printer settings for printing from iPhones and other iOS devices or Android devices. With a maximum print speed of 250mm/sec, the TSP100IIIBI also features a de-curling function that prevents printed receipts from curling up, and a 5V USB port for recharging mobile devices such as tablets.

The IFBD-HI01X intelligent interface was developed for the Company's top-of-the-range series, such as the TSP650II. It has interfaces for wireless and wired LAN as well as for USB Type A and B for transmitting printer data, and it can connect to peripheral devices such as barcode readers. It is also compatible with CloudPRNT, a new solution being offered by Star Micronics. Instead of sending data directly to the printer, data for printing can be sent via cloud-based servers to internet-connected printers that have the IFBD-HI01X intelligent interface installed, enabling remote printing in a variety of situations.

In software development, the name for StarIO SDK, a software development kit for the Company's printers that is often used in mobile device operating systems, was changed to StarPRNT SDK and given new functions. The StarPRNT SDK now lets developers control printing in an emulation-free environment thanks to the creation of an API* for the function commands required for printing. Moreover, it is now compatible with the Swift programming language for iOS devices.

Star PassPRNT, which handles HTML layout designs as direct printer data, was upgraded to a new version that is compatible with Android devices in addition to iOS devices, and it can print PDF data as well. Star WebPRNT Browser, which enables printing by embedding JavaScript libraries in HTML files without regard to device, can now display data in the browser that was scanned by a barcode reader connected to the printer, making it possible to print more information on receipts.

R&D expenses totaled ¥771 million (US$6,884 thousand) in the Special Products Segment during the fiscal year under review.

* API: Application Programming Interface

***Machine Tools Segment***–In the fiscal year under review, the Company developed the SR-32JII as an updated version of the SR-32J, which has been praised by the market since its release in 2005 for its mechanical rigidity that enables continuous machining with high accuracy of extended time. The Company also developed software compatible with IoT. Development also advanced on fixed headstock automatic lathes in preparation for entering new fields.

The SR-32JII employs a modular design production method based on a modular design—a first for Star Micronics—with the aim of shortening product development and production lead times.

The model has two types. Type A features linear control of 5 axes by incorporating a six-axis unit for backworking, and Type B offers linear control of 6 axes by incorporating an eight-axis unit with Y2 axis control function. In addition, power tools on the gang-type tool post for front working include two types (5-axis type and 6-axis type) to offer the optimum tooling layout for customer needs.

The mechanical structure employs the Company's proprietary slanted slide guideway structure for the gang-type tool post to enhance mechanical rigidity and enable long-running, uninterrupted machining with reliable accuracy. In order to flexibly meet versatile machining needs, the model can switch between guide bush type and non-guide bush type, enabling processing at optimal specifications for machining parts. In addition, a flip-up door is incorporated to ensure sufficient work space inside the machine and a swing-type panel is used to enable the operator to operate the machine at the best position.

The NC unit is equipped with an alarm help function to check the alarm contents on the NC screen and many other help functions to improve operability and workability.

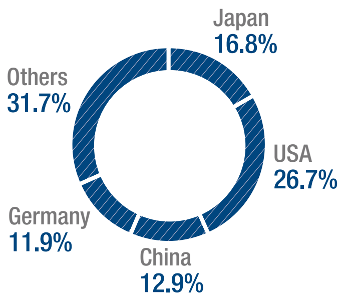
In software development, we developed software for monitoring machine operations as an IoT initiative, and exhibited the software at the 28th Japan International Machine Tool Fair (JIMTOF 2016). The software connects machine tools made by Star Micronics via LAN at plants, giving operators a view of machine operations and history via PC, tablets and smartphones. Star Micronics aims to commercialize the product based on customer feedback of functions during demonstrations.

In the Machine Tools Segment, R&D expenses amounted to ¥775 (US$6,920 thousand) million in the fiscal year under review.

## SALES FRAMEWORK AND NET SALES BY REGION

A significant proportion of the Company's products are sold in international markets. Details of the Group's principal bases are presented as follows.

NET SALES BY REGION




| | USA | U.K. | Germany | France | Switzerland | China | | Thailand |
|---|---|---|---|---|---|---|---|---|
| Special Products | Star Micronics America, Inc.<br>Star Cloud Services Inc. | Star Micronics Europe Ltd. | | | | Star Precisions Ltd. | | Star Micronics Southeast Asia Co., Ltd. |
| Machine Tools | Star CNC Machine Tool Corp. | Star Micronics GB Ltd. | Star Micronics GmbH | Star Machine Tool France SAS | Star Micronics AG | Shanghai Xingang Machinery Co., Ltd. | Star Micronics Manufacturing Dalian Co., Ltd. | Star Micronics (Thailand) Co., Ltd.<br>Star Micronics Manufacturing (Thailand) Co., Ltd. |
| Precision Products | | | | | | Shanghai S&E Precision Co., Ltd. | | Star Micronics Precision (Thailand) Co., Ltd. |

### The ratio of overseas sales to total sales increased slightly.

In the fiscal year under review, overseas sales as a proportion of total sales decreased 0.8 of a percentage point compared with the previous fiscal year, to 83.2%.

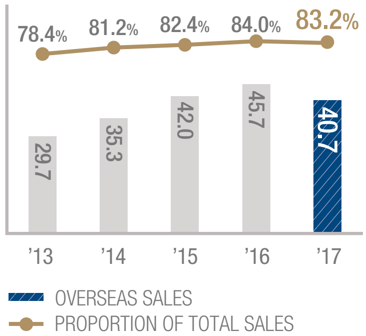
By region, net sales in the U.S. climbed 4.1%, or ¥518 million year on year, to ¥13,084 million (US$116,822 thousand).

Net sales in China declined 3.5%, or ¥226 million, to ¥6,317 million (US$56,402 thousand).

In Germany, net sales fell 20.5%, or ¥1,503 million, to ¥5,836 million (US$52,107 thousand).

In Japan, net sales decreased 5.8%, or ¥508 million, to ¥8,221 million (US$73,402 thousand).

OVERSEAS SALES AND PROPORTION OF TOTAL SALES
(Billions of yen, %)



# Consolidated Balance Sheet

Star Micronics Co., Ltd. and Consolidated Subsidiaries
February 28, 2017

| Assets | Millions of yen 2017 | Millions of yen 2016 | Thousands of U.S. dollars (Note 1) 2017 |
|---|---|---|---|
| **Current assets:** | | | |
| Cash and cash equivalents (Note 14) | ¥ 20,478 | ¥ 14,870 | $ 182,839 |
| Marketable securities (Notes 3 and 14) | | 301 | |
| Short-term investments (Notes 4 and 14) | 819 | 1,595 | 7,313 |
| Receivables (Note 14): | | | |
| Trade notes and accounts receivable | 13,592 | 13,743 | 121,357 |
| Unconsolidated subsidiaries and associated companies | 617 | 406 | 5,509 |
| Other | 726 | 936 | 6,482 |
| Allowance for doubtful receivables | (74) | (109) | (661) |
| Inventories (Note 5) | 16,412 | 17,845 | 146,536 |
| Deferred tax assets (Note 11) | 158 | 231 | 1,411 |
| Prepaid expenses and other | 444 | 549 | 3,964 |
| Total current assets | 53,172 | 50,367 | 474,750 |
| **Property, plant and equipment:** | | | |
| Land | 2,984 | 3,000 | 26,643 |
| Buildings and structures | 15,955 | 16,080 | 142,455 |
| Machinery and equipment | 23,649 | 23,826 | 211,152 |
| Lease assets (Note 13) | 114 | 121 | 1,018 |
| Construction in progress | 79 | 53 | 705 |
| Total | 42,781 | 43,080 | 381,973 |
| Accumulated depreciation | (29,855) | (28,720) | (266,562) |
| Net property, plant and equipment | 12,926 | 14,360 | 115,411 |
| **Investments and other assets:** | | | |
| Investment securities (Notes 3 and 14) | 429 | 1,599 | 3,830 |
| Investments in unconsolidated subsidiaries and associated companies | 407 | 416 | 3,634 |
| Deferred tax assets (Note 11) | 138 | 147 | 1,232 |
| Other assets | 1,279 | 939 | 11,420 |
| Total investments and other assets | 2,253 | 3,101 | 20,116 |
| Total | ¥ 68,351 | ¥ 67,828 | $ 610,277 |

See notes to consolidated financial statements.

| Liabilities and equity | Millions of yen 2017 | 2016 | Thousands of U.S. dollars (Note 1) 2017 |
|---|---|---|---|
| **Current liabilities:** | | | |
| Payables (Note 14): | | | |
| Trade notes and accounts payable | ¥ 6,824 | ¥ 7,316 | $ 60,929 |
| Unconsolidated subsidiaries and associated companies | 1 | 1 | 9 |
| Other | 1,499 | 1,617 | 13,384 |
| Short-term bank loans (Notes 7 and 14) | 2,500 | 2,000 | 22,321 |
| Current portion of long-term debt (Note 7) | 22 | 18 | 196 |
| Income taxes payable (Note 11) | 504 | 257 | 4,500 |
| Accrued expenses | 822 | 887 | 7,339 |
| Deferred tax liabilities (Note 11) | 102 | 602 | 911 |
| Other | 2,387 | 2,909 | 21,313 |
| Total current liabilities | 14,661 | 15,607 | 130,902 |
| **Long-term liabilities:** | | | |
| Convertible bonds (Notes 7 and 14) | 8,068 | | 72,036 |
| Long-term debt (Note 7) | 39 | 39 | 348 |
| Liability for retirement benefits (Note 8) | 1,613 | 1,726 | 14,402 |
| Deferred tax liabilities (Note 11) | 66 | 112 | 589 |
| Other | 149 | 144 | 1,330 |
| Total long-term liabilities | 9,935 | 2,021 | 88,705 |
| **Commitments and contingent liabilities** (Note 13) | | | |
| **Equity** (Notes 9, 10 and 20): | | | |
| Common stock – authorized, 158,000,000 shares; | | | |
| issued, 47,033,234 shares in 2017 and 2016 | 12,722 | 12,722 | 113,589 |
| Capital surplus | 13,939 | 13,923 | 124,455 |
| Stock acquisition rights (Note 10) | 210 | 152 | 1,875 |
| Retained earnings | 29,096 | 27,805 | 259,786 |
| Treasury stock – at cost, | | | |
| 9,741,728 shares in 2017 and 4,713,213 shares in 2016 | (10,783) | (4,479) | (96,277) |
| Accumulated other comprehensive income (loss): | | | |
| Unrealized gain on available-for-sale securities | 140 | 182 | 1,250 |
| Foreign currency translation adjustments | (1,354) | 1 | (12,089) |
| Defined retirement benefit plans | (822) | (874) | (7,339) |
| Total | 43,148 | 49,432 | 385,250 |
| Noncontrolling interests | 607 | 768 | 5,420 |
| Total equity | 43,755 | 50,200 | 390,670 |
| Total | ¥ 68,351 | ¥67,828 | $610,277 |

See notes to consolidated financial statements.

# Consolidated Statement of Income

Star Micronics Co., Ltd. and Consolidated Subsidiaries
Year Ended February 28, 2017

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2017 | 2016 | 2017 |
| **Net sales** | ¥48,937 | ¥54,458 | $436,938 |
| **Cost of sales** (Note 8) | 30,825 | 33,558 | 275,224 |
| Gross profit | 18,112 | 20,900 | 161,714 |
| **Selling, general and administrative expenses** (Notes 8 and 12) | 14,505 | 15,165 | 129,509 |
| Operating income | 3,607 | 5,735 | 32,205 |
| **Other income (expenses):** | | | |
| Interest and dividend income | 177 | 216 | 1,580 |
| Interest expense | (6) | (15) | (53) |
| Foreign exchange loss – net | (328) | (881) | (2,929) |
| Gain on sale of property, plant and equipment | 4 | 8 | 36 |
| Gain on sale of investment securities | 258 | 267 | 2,304 |
| Loss on disposal of property, plant and equipment | (15) | (31) | (134) |
| Loss on impairment of long-lived assets (Note 6) | | (98) | |
| Other – net | 134 | 151 | 1,196 |
| Other income (expenses) – net | 224 | (383) | 2,000 |
| **Income before income taxes** | 3,831 | 5,352 | 34,205 |
| **Income taxes** (Note 11): | | | |
| Current | 1,007 | 1,458 | 8,991 |
| Deferred | (435) | 72 | (3,884) |
| Total income taxes | 572 | 1,530 | 5,107 |
| **Net income** | 3,259 | 3,822 | 29,098 |
| **Net income attributable to noncontrolling interests** | 78 | 101 | 696 |
| **Net income attributable to owners of the parent** | 3,181 | 3,721 | 28,402 |
| | Yen | | U.S. dollars (Note 1) |
| **Per share of common stock** (Notes 2.s, 9 and 17): | | | |
| Basic net income | ¥81.77 | ¥87.98 | $0.73 |
| Diluted net income | 74.69 | 87.69 | 0.67 |
| Cash dividends applicable to the year | 48.00 | 46.00 | 0.43 |

See notes to consolidated financial statements.

# Consolidated Statement of Comprehensive Income

Star Micronics Co., Ltd. and Consolidated Subsidiaries
Year Ended February 28, 2017

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2017 | 2016 | 2017 |
| **Net income** | ¥ 3,259 | ¥3,822 | $ 29,098 |
| **Other comprehensive income** (Note 16): | | | |
| Unrealized loss on available-for-sale securities | (42) | (634) | (375) |
| Foreign currency translation adjustments | (1,394) | (735) | (12,446) |
| Defined retirement benefit plans | 52 | (585) | 464 |
| Share of other comprehensive income in an associate | (10) | | (89) |
| Total other comprehensive income | (1,394) | (1,954) | (12,446) |
| **Comprehensive income** | ¥ 1,865 | ¥ 1,868 | $ 16,652 |
| **Total comprehensive income attributable to** (Note 16): | | | |
| Owners of the parent | ¥ 1,836 | ¥ 1,811 | $ 16,393 |
| Noncontrolling interests | 29 | 57 | 259 |

See notes to consolidated financial statements.

# Consolidated Statement of Changes in Equity

Star Micronics Co., Ltd. and Consolidated Subsidiaries
Year Ended February 28, 2017

| | Thousands | Millions of yen | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Accumulated other comprehensive income (loss) | | | | | |
| | Outstanding number of shares of common stock | Common stock | Capital surplus | Stock acquisition rights | Retained earnings | Treasury stock–at cost | Unrealized gain on available-for-sale securities | Foreign currency translation adjustments | Defined retirement benefit plans | Total | Non-controlling interests | Total equity |
| **Balance, February 28, 2015** (March 1, 2015, as previously reported) | 42,227 | ¥12,722 | ¥13,902 | ¥ 86 | ¥27,536 | ¥ (4,567) | ¥ 816 | ¥ 693 | ¥(215) | ¥50,973 | ¥ 930 | ¥51,903 |
| Cumulative effect of accounting change | | | | | (1,423) | | | | (74) | (1,497) | | (1,497) |
| **Balance, March 1, 2015** (as restated) | 42,227 | ¥12,722 | ¥13,902 | ¥ 86 | ¥26,113 | ¥ (4,567) | ¥ 816 | ¥ 693 | ¥(289) | ¥49,476 | ¥ 930 | ¥50,406 |
| Net income attributable to owners of the parent | | | | | 3,721 | | | | | 3,721 | | 3,721 |
| Cash dividends, ¥46.0 per share | | | | | (2,029) | | | | | (2,029) | | (2,029) |
| Purchase of treasury stock | (1) | | | | | (2) | | | | (2) | | (2) |
| Disposal of treasury stock | 94 | | 21 | | | 90 | | | | 111 | | 111 |
| Net change in the year | | | | 66 | | | (634) | (692) | (585) | (1,845) | (162) | (2,007) |
| **Balance, February 29, 2016** | 42,320 | ¥12,722 | ¥13,923 | ¥152 | ¥27,805 | ¥ (4,479) | ¥ 182 | ¥ 1 | ¥(874) | ¥49,432 | ¥ 768 | ¥50,200 |
| Net income attributable to owners of the parent | | | | | **3,181** | | | | | **3,181** | | **3,181** |
| Cash dividends, ¥48.0 per share | | | | | **(1,890)** | | | | | **(1,890)** | | **(1,890)** |
| Purchase of treasury stock | **(5,090)** | | | | | **(6,373)** | | | | **(6,373)** | | **(6,373)** |
| Disposal of treasury stock | **62** | | **16** | | | **69** | | | | **85** | | **85** |
| Net change in the year | | | | **58** | | | **(42)** | **(1,355)** | **52** | **(1,287)** | **(161)** | **(1,448)** |
| **Balance, February 28, 2017** | **37,292** | **¥12,722** | **¥13,939** | **¥210** | **¥29,096** | **¥(10,783)** | **¥ 140** | **¥(1,354)** | **¥(822)** | **¥43,148** | **¥ 607** | **¥43,755** |

| | Thousands of U.S. dollars (Note 1) | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Accumulated other comprehensive income (loss) | | | | | |
| | Common stock | Capital surplus | Stock acquisition rights | Retained earnings | Treasury stock–at cost | Unrealized gain on available-for-sale securities | Foreign currency translation adjustments | Defined retirement benefit plans | Total | Non-controlling interests | Total equity |
| **Balance, February 29, 2016** | $113,589 | $124,312 | $1,357 | $248,259 | $(39,991) | $1,625 | $ 9 | $(7,803) | $441,357 | $ 6,857 | $448,214 |
| Net income attributable to owners of the parent | | | | **28,402** | | | | | **28,402** | | **28,402** |
| Cash dividends, $0.43 per share | | | | **(16,875)** | | | | | **(16,875)** | | **(16,875)** |
| Purchase of treasury stock | | | | | **(56,902)** | | | | **(56,902)** | | **(56,902)** |
| Disposal of treasury stock | | **143** | | | **616** | | | | **759** | | **759** |
| Net change in the year | | | **518** | | | **(375)** | **(12,098)** | **464** | **(11,491)** | **(1,437)** | **(12,928)** |
| **Balance, February 28, 2017** | **$113,589** | **$124,455** | **$1,875** | **$259,786** | **$(96,277)** | **$1,250** | **$(12,089)** | **$(7,339)** | **$385,250** | **$ 5,420** | **$390,670** |

See notes to consolidated financial statements.

# Consolidated Statement of Cash Flows

Star Micronics Co., Ltd. and Consolidated Subsidiaries
Year Ended February 28, 2017

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2017 | 2016 | 2017 |
| **Operating activities:** | | | |
| Income before income taxes | ¥ 3,831 | ¥ 5,352 | $ 34,205 |
| Adjustments for: | | | |
| Income taxes – paid | (906) | (1,927) | (8,089) |
| Depreciation and amortization | 2,167 | 2,274 | 19,348 |
| Loss on impairment of long-lived assets | | 98 | |
| Reversal of allowance for doubtful receivables | (26) | (9) | (232) |
| Loss on sale and disposal of property, plant and equipment | 10 | 23 | 89 |
| Changes in assets and liabilities: | | | |
| (Increase) decrease in trade receivables | (787) | 215 | (7,027) |
| Decrease (increase) in inventories | 946 | (1,652) | 8,447 |
| Increase (decrease) in trade payables | 384 | (1,296) | 3,429 |
| Decrease in liability for retirement benefits | (61) | (478) | (545) |
| Other – net | (220) | 507 | (1,964) |
| Total adjustments | 1,507 | (2,245) | 13,456 |
| Net cash provided by operating activities | 5,338 | 3,107 | 47,661 |
| **Investing activities:** | | | |
| Purchases of property, plant and equipment | (984) | (2,119) | (8,786) |
| Proceeds from sale of property, plant and equipment | 12 | 26 | 107 |
| Decrease in short-term investments | 589 | 580 | 5,259 |
| Purchases of marketable and investment securities | (131) | (633) | (1,170) |
| Proceeds from sale of marketable and investment securities | 1,783 | 1,639 | 15,920 |
| Other – net | (456) | (567) | (4,071) |
| Net cash provided by (used in) investing activities | 813 | (1,074) | 7,259 |
| **Financing activities:** | | | |
| Increase in short-term bank loans | 500 | | 4,464 |
| Proceeds from issuance of convertible bonds | 8,059 | | 71,955 |
| Dividends paid to shareholders | (1,889) | (2,025) | (16,866) |
| Dividends paid to noncontrolling shareholders of consolidated subsidiaries | (190) | (220) | (1,696) |
| Payments for purchase of treasury stock | (6,389) | (2) | (57,045) |
| Disposal of treasury stock | 72 | 89 | 643 |
| Other – net | (24) | (22) | (214) |
| Net cash provided by (used in) financing activities | 139 | (2,180) | 1,241 |
| Foreign currency translation adjustments on cash and cash equivalents | (682) | (297) | (6,090) |
| Net increase (decrease) in cash and cash equivalents | 5,608 | (444) | 50,071 |
| Cash and cash equivalents at beginning of year | 14,870 | 15,314 | 132,768 |
| Cash and cash equivalents at end of year | ¥20,478 | ¥14,870 | $182,839 |

See notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

Star Micronics Co., Ltd. and Consolidated Subsidiaries
Year Ended February 28, 2017

## 1. Basis of Presentation of Consolidated Financial Statements

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

In preparing these consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside of Japan.

In addition, certain reclassifications have been made in the 2016 consolidated financial statements to conform to the classifications used in 2017.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which Star Micronics Co., Ltd. (the "Company") is incorporated and operates. The translation of Japanese yen amounts into U.S. dollar amounts is included solely for the convenience of readers outside Japan and has been made at the rate of ¥112 to $1, the approximate rate of exchange at February 28, 2017.

Such translation should not be construed as a representation that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

## 2. Summary of Significant Accounting Policies

**a. Consolidation**

The consolidated financial statements as of February 28, 2017, include the accounts of the Company and its 19 (19 in 2016) significant subsidiaries (together, the "Group").

Under the control and influence concepts, those companies in which the Company, directly or indirectly, is able to exercise control over operations are fully consolidated, and those companies over which the Group has the ability to exercise significant influence are accounted for by the equity method.

Investment in one (one in 2016) associated company is accounted for by the equity method. Investments in the remaining associated companies are stated at cost. If the equity method of accounting had been applied to the investments in these companies, the effect on the accompanying consolidated financial statements would not be material.

The fiscal periods of consolidated subsidiaries in Japan end at the end of February, and those of consolidated subsidiaries outside of Japan end on December 31. In preparing these consolidated financial statements, financial statements as of December 31 are used to consolidate foreign subsidiaries. However, necessary adjustments are made in the consolidation process concerning significant transactions that occurred for the period from January 1 to the end of February.

All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized profit included in assets resulting from transactions within the Group is also eliminated.

**b. Unification of Accounting Policies Applied to Foreign Subsidiaries for the Consolidated Financial Statements**

In May 2006, the Accounting Standards Board of Japan (the "ASBJ") issued ASBJ Practical Issues Task Force ("PITF") No. 18, "Practical Solution on Unification of Accounting Policies Applied to Foreign Subsidiaries for the Consolidated Financial Statements," which was subsequently revised in February 2010 and March 2015 to reflect revisions of the relevant Japanese GAAP or accounting standards in other jurisdictions. PITF No. 18 prescribes that the accounting policies and procedures applied to a parent company and its subsidiaries for similar transactions and events under similar circumstances should in principle be unified for the preparation of the consolidated financial statements. However, financial statements prepared by foreign subsidiaries in accordance with either International Financial Reporting Standards or generally accepted accounting principles in the United States of America (Financial Accounting Standards Board Accounting Standards Codification–"FASB ASC") tentatively may be used for the consolidation process, except for the following items that should be adjusted in the consolidation process so that net income is accounted for in accordance with Japanese GAAP, unless they are not material: (a) amortization of goodwill; (b) scheduled amortization of actuarial gain or loss of pensions that has been recorded in equity through other comprehensive income; (c) expensing capitalized development costs of R&D; and (d) cancellation of the fair value model of accounting for property, plant, and equipment and investment properties and incorporation of the cost model of accounting.

**c. Business Combinations**

In October 2003, the Business Accounting Council (the "BAC") issued a Statement of Opinion, "Accounting for Business Combinations," and in December 2005, the ASBJ issued ASBJ Statement No. 7, "Accounting Standard for Business Divestitures," and ASBJ Guidance No. 10, "Guidance for Accounting Standard for Business Combinations and Business Divestitures."

In December 2008, the ASBJ issued a revised accounting standard for business combinations, ASBJ Statement No. 21, "Accounting Standard for Business Combinations." Major accounting changes under the revised accounting standard are as follows: (1) The revised standard requires accounting for business combinations only by the purchase method. As a result, the pooling of interests method of accounting is no longer allowed. (2) The previous accounting standard required research and development costs to be charged to income as incurred. Under the revised standard, in-process research and development costs (IPR&D) acquired in the business combination are capitalized as an intangible asset. (3) The previous accounting standard provided for a bargain purchase gain (negative goodwill) to be systematically amortized over a period not exceeding 20 years. Under the revised standard, the acquirer recognizes the bargain purchase gain in profit or loss immediately on the acquisition date after reassessing and confirming that all of the assets acquired and all of the liabilities assumed have been identified after a review of the procedures used in the purchase price allocation. The revised standard was applicable to business combinations undertaken on or after April 1, 2010.

In September 2013, the ASBJ issued revised ASBJ Statement No. 21, "Accounting Standard for Business Combinations," revised ASBJ Guidance No. 10, "Guidance on Accounting Standards for Business Combinations and Business Divestitures," and revised ASBJ Statement No. 22, "Accounting Standard for Consolidated Financial Statements." Major accounting changes are as follows:

*(a) Transactions with noncontrolling interest* – A parent's ownership interest in a subsidiary might change if the parent purchases or sells ownership interests in its subsidiary. The carrying amount of noncontrolling interest is adjusted to reflect the change in the parent's ownership interest in its subsidiary while the parent retains its controlling interest in its subsidiary. Under the previous accounting standard, any difference between the fair value of the consideration received or paid and the amount by which the noncontrolling interest is adjusted is accounted for as an adjustment of goodwill or as profit or loss in the consolidated statement of income. Under the revised accounting standard, such difference is accounted for as capital surplus as long as the parent retains control over its subsidiary.

*(b) Presentation of the consolidated balance sheet* – In the consolidated balance sheet, "minority interest" under the previous accounting standard is changed to "noncontrolling interest" under the revised accounting standard.

*(c) Presentation of the consolidated statement of income* – In the consolidated statement of income, "income before minority interest" under the previous accounting standard is changed to "net income" under the revised accounting standard, and "net income" under the previous accounting standard is changed to "net income attributable to owners of the parent" under the revised accounting standard.

*(d) Provisional accounting treatments for a business combination* – If the initial accounting for a business combination is incomplete by the end of the reporting period in which the business combination occurs, an acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. Under the previous accounting standard guidance, the impact of adjustments to provisional amounts recorded in a business combination on profit or loss is recognized as profit or loss in the year in which the measurement is completed. Under the revised accounting standard guidance, during the measurement period, which shall not exceed one year from the acquisition, the acquirer shall retrospectively adjust the provisional amounts recognized at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and that would have affected the measurement of the amounts recognized as of that date. Such adjustments shall be recognized as if the accounting for the business combination had been completed at the acquisition date.

*(e) Acquisition-related costs* – Acquisition-related costs are costs, such as advisory fees or professional fees, which an acquirer incurs to effect a business combination. Under the previous accounting standard, the acquirer accounts for acquisition-related costs by including them in the acquisition costs of the investment. Under the revised accounting standard, acquisition-related costs shall be accounted for as expenses in the periods in which the costs are incurred.

The above accounting standards and guidance for (a) transactions with noncontrolling interest, (b) presentation of the consolidated balance sheet, (c) presentation of the consolidated statement of income, and (e) acquisition-related costs are effective for the beginning of annual periods beginning on or after April 1, 2015.

Either retrospective or prospective application of the revised accounting standards and guidance for (a) transactions with noncontrolling interest and (e) acquisition-related costs is permitted. In retrospective application of the revised standards and guidance, the accumulated effects of retrospective adjustments for all (a) transactions with noncontrolling interest and (e) acquisition-related costs which occurred in the past shall be reflected as adjustments to the beginning balance of capital surplus and retained earnings for the year of the first-time application. In prospective application, the new standards and guidance shall be applied prospectively from the beginning of the year of the first-time application.

The revised accounting standards and guidance for (b) presentation of the consolidated balance sheet and (c) presentation of the consolidated statement of income shall be applied to all periods presented in financial statements containing the first-time application of the revised standards and guidance.

The revised standards and guidance for (d) provisional accounting treatments for a business combination are effective for a business combination which occurs on or after the beginning of annual periods beginning on or after April 1, 2015.

The Company applied the revised accounting standards and guidance for (a) transactions with noncontrolling interest, (b) presentation of the consolidated balance sheet, (c) presentation of the consolidated statement of income, and (e) acquisition-related costs above, effective March 1, 2016, and (d) provisional accounting treatments for a business combination above for a business combination which occurred on or after March 1, 2016. The revised accounting standards and guidance for (a) transactions with noncontrolling interest and (e) acquisition-related costs were applied prospectively.

With respect to (b) presentation of the consolidated balance sheet and (c) presentation of the consolidated statement of income, the applicable line items in the 2016 consolidated financial statements have been accordingly reclassified and presented in line with those in 2017.

There was no impact from these accounting changes.

### d. Cash Equivalents

Cash equivalents are short-term investments that are readily convertible into cash and that are exposed to insignificant risk of changes in value.

Cash equivalents include time deposits, certificates of deposit and investment trusts in bonds that represent short-term investments, all of which mature or become due within three months of the date of acquisition.

### e. Inventories

Inventories are stated at the lower of the cost (substantially determined by the average method for the Company and its consolidated subsidiaries in Japan, and by the first-in, first-out method for the consolidated subsidiaries outside of Japan) or net selling value.

### f. Marketable and Investment Securities

All investment securities are classified as available-for-sale securities.

Marketable available-for-sale securities are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of equity. The cost of securities sold is determined based on the moving-average method.

Nonmarketable available-for-sale securities are stated at cost determined by the moving-average method. For other-than-temporary declines in fair value, nonmarketable available-for-sale securities are reduced to net realizable value by a charge to income.

Investments in limited partnerships, which are considered securities under Article 2, Clause 2 of the Japanese Financial Instruments and Exchange Act, are recorded under the equity method and based on the latest consolidated financial statements available on the reportable date ruled by the partnership contracts.

### g. Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation of property, plant and equipment of the Company and its consolidated subsidiaries in Japan is computed substantially by the declining-balance method based on the estimated useful lives of the assets, while the straight-line method is applied to substantially all of the consolidated subsidiaries outside of Japan.

The range of useful lives is principally from 15 to 47 years for buildings and structures and from 2 to 15 years for machinery and equipment. The useful lives for lease assets are the terms of the respective leases.

(Change of Useful Life)

In December 2016, the Board of Directors resolved to construct a new head office building.

The Company shortened the estimated useful life of properties of the Company due to the reason that it is impossible to use such properties. Due to the change of the useful life, depreciation for the year ended February 28, 2017, increased by ¥82 million ($732 thousand), operating income and income before income taxes decreased by the same amount, respectively.

### h. Long-lived Assets

The Group reviews its long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset or asset group may not be recoverable. An impairment loss would be recognized if the carrying amount of an asset or asset group exceeds the sum of the undiscounted future cash flows expected to result from the continued use and eventual disposition of the asset or asset group. The impairment loss would be measured as the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of the discounted cash flows from the continued use and eventual disposition of the asset or the net selling price at disposition.

### i. Retirement and Pension Plans

The Company has a non-contributory funded pension plan covering substantially all of its employees. To provide for the payment of retirement benefits and pension plan payments to employees, the Company recorded a reserve equivalent to the amounts recognized as necessary at the end of the period under review based on the projected retirement benefits obligation and the fair value of the pension plan assets at the balance sheet date.

In May 2012, the ASBJ issued ASBJ Statement No. 26, "Accounting Standard for Retirement Benefits," and ASBJ Guidance No. 25, "Guidance on Accounting Standard for Retirement Benefits," which replaced the accounting standard for retirement benefits that had been issued by the Business Accounting Council in 1998 with an effective date of April 1, 2000, and the other related practical guidance, and were followed by partial amendments from time to time through 2009.

(a) Under the revised accounting standard and guidance, actuarial gains and losses and past service costs that are yet to be recognized in profit or loss are recognized within equity (accumulated other comprehensive income), after adjusting for tax effects, and any resulting deficit or surplus is recognized as a liability (liability for retirement benefits) or asset (asset for retirement benefits).

(b) The revised accounting standard and guidance does not change how to recognize actuarial gains and losses and past service costs in profit or loss. Those amounts are recognized in profit or loss over a certain period no longer than the expected average remaining service period of the employees. However, actuarial gains and losses and past service costs that arose in the current period and have not yet been recognized in profit or loss are included in other comprehensive income, and actuarial gains and losses and past service costs that were recognized in other comprehensive income in prior periods and then recognized in profit or loss in the current period, are treated as reclassification adjustments (see Note 16).

(c) The revised accounting standard and guidance also made certain amendments relating to the method of attributing expected benefit to periods, the discount rate, and expected future salary increases.

This accounting standard and the guidance for (a) and (b) above are effective for the end of annual periods beginning on or after April 1, 2013, and for (c) above are effective for the beginning of annual periods beginning on or after April 1, 2014, or for the beginning of annual periods beginning on or after April 1, 2015, subject to certain disclosure in March 2015, all with earlier application being permitted from the beginning of annual periods beginning on or after April 1, 2013. However, no retrospective application of this accounting standard to consolidated financial statements in prior periods is required.

The Company applied the revised accounting standard and guidance for retirement benefits for (a) and (b) above, effective February 28, 2015, and for (c) above, effective March 1, 2015.

With respect to (c) above, the Company changed the method of attributing the expected benefit to periods from a straight-line basis to a benefit formula basis and the method of determining the discount rate from using the period which approximates the expected average remaining service period to using a single weighted average discount rate reflecting the estimated timing and amount of benefit payment, and recorded the effect of (c) above as of March 1, 2015 in retained earnings. As a result, retained earnings as of March 1, 2015, decreased by ¥1,423 million.

Domestic consolidated subsidiaries have lump-sum retirement benefit plans, and certain foreign consolidated subsidiaries have lump-sum retirement benefit plans or defined contribution pension plans.

### j. Asset Retirement Obligations

In March 2008, the ASBJ issued ASBJ Statement No. 18 "Accounting Standard for Asset Retirement Obligations," and ASBJ Guidance No. 21 "Guidance on Accounting Standard for Asset Retirement Obligations." Under this accounting standard, an asset retirement obligation is defined as a legal obligation imposed either by law or contract that results from the acquisition, construction, development and the normal operation of a tangible fixed asset and is associated with the retirement of such tangible fixed asset. The asset retirement obligation is recognized as the sum of the discounted cash flows required for the future asset retirement and is recorded in the period in which the obligation is incurred if a reasonable estimate can be made. If a reasonable estimate of the asset retirement obligation cannot be made in the period the asset retirement obligation is incurred, the liability should be recognized when a reasonable estimate of the asset retirement obligation can be made. Upon initial recognition of a liability for an asset retirement obligation, an asset retirement cost is capitalized by increasing the carrying amount of the related fixed asset by the amount of the liability. The asset retirement cost is subsequently allocated to expense through depreciation over the remaining useful life of the asset. Over time, the liability is accreted to its present value each period. Any subsequent revisions to the timing or the amount of the original estimate of undiscounted cash flows are reflected as an adjustment to the carrying amount of the liability and the capitalized amount of the related asset retirement cost.

### k. Stock Options

ASBJ Statement No. 8, "Accounting Standard for Stock Options," and related guidance are applicable to stock options granted on and after May 1, 2006.

This standard requires companies to recognize compensation expense for employee stock options based on the fair value at the date of grant and over the vesting period as consideration for receiving goods or services. The standard also requires companies to account for stock options granted to non-employees based on the fair value of either the stock option or the goods or services received. In the balance sheet, the stock option is presented as a stock acquisition right as a separate component of equity until exercised.

**l. Bonuses to Directors and Audit and Supervisory Committee Members**

Bonuses to directors and Audit and Supervisory Committee Members are accrued at the year-end to which such bonuses are attributable.

**m. Leases**

In March 2007, the ASBJ issued ASBJ Statement No. 13, "Accounting Standard for Lease Transactions," which revised the previous accounting standard for lease transactions.

Under the previous accounting standard, finance leases that were deemed to transfer ownership of the leased property to the lessee were to be capitalized. However, other finance leases were permitted to be accounted for as operating lease transactions if certain "as-if-capitalized" information is disclosed in the note to the lessee's financial statements. The revised accounting standard requires that all finance lease transactions should be capitalized by recognizing lease assets and lease obligations in the balance sheet. In addition, the revised accounting standard permits leases that existed at the transition date and do not transfer ownership of the leased property to the lessee to continue to be accounted for as operating lease transactions with certain "as-if-capitalized" information disclosed in the notes to the lessee's financial statements.

All other leases are accounted for as operating leases.

**n. Research and Development Costs**

Research and development costs are charged to income as incurred.

**o. Income Taxes**

The provision for income taxes is computed based on the pretax income included in the consolidated statement of income. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred taxes are measured by applying currently enacted income tax rates to the temporary differences.

**p. Foreign Currency Transactions**

All short-term and long-term monetary receivables and payables denominated in foreign currencies are translated into Japanese yen at the exchange rates as of the balance sheet date. The foreign exchange gains and losses from translation are recognized in the consolidated statement of income to the extent that they are not hedged by forward exchange contracts.

**q. Foreign Currency Financial Statements**

The balance sheet accounts of the consolidated foreign subsidiaries are translated into Japanese yen at the current exchange rates as of the balance sheet date except for equity, which is translated at the historical rate.

Differences arising from such translation are shown as "Foreign currency translation adjustments" under accumulated other comprehensive income in a separate component of equity.

Revenue and expense accounts of consolidated foreign subsidiaries are translated into yen at the average exchange rate.

**r. Derivatives**

The Group uses derivative financial instruments to manage its exposures to fluctuations in foreign exchange. Foreign exchange forward contracts are utilized by the Group to reduce foreign currency exchange risks. The Group does not enter into derivatives for trading or speculative purposes.

All derivatives are recognized as either assets or liabilities and measured at fair value, and gains or losses on derivative transactions are recognized in the consolidated statement of income.

The foreign exchange forward contracts employed to hedge foreign exchange exposures for export sales are measured at fair value and the unrealized gains/losses are recognized in the consolidated statement of income.

**s. Per Share Information**

Basic net income per share is computed by dividing net income attributable to common shareholders by the weighted-average number of common shares outstanding for the period.

Diluted net income per share reflects the potential dilution that could occur if securities were exercised. Diluted net income per share of common stock assumes full conversion of the outstanding convertible bonds and stock acquisition rights at the beginning of the year (or at the time of issuance) with an applicable adjustment for related interest expense and net of tax.

Cash dividends per share presented in the accompanying consolidated statement of income are dividends applicable to the respective fiscal years, including dividends to be paid after the end of the year.

### t. Accounting Changes and Error Corrections

In December 2009, the ASBJ issued ASBJ Statement No. 24, "Accounting Standard for Accounting Changes and Error Corrections," and ASBJ Guidance No. 24, "Guidance on Accounting Standard for Accounting Changes and Error Corrections." Accounting treatments under this standard and guidance are as follows:

(1) Changes in Accounting Policies – When a new accounting policy is applied following revision of an accounting standard, the new policy is applied retrospectively unless the revised accounting standard includes specific transitional provisions, in which case the entity shall comply with the specific transitional provisions.
(2) Changes in Presentation – When the presentation of financial statements is changed, prior-period financial statements are reclassified in accordance with the new presentation.
(3) Changes in Accounting Estimates – A change in an accounting estimate is accounted for in the period of the change if the change affects that period only, and is accounted for prospectively if the change affects both the period of the change and future periods.
(4) Corrections of Prior-Period Errors – When an error in prior-period financial statements is discovered, those statements are restated.

### u. New Accounting Pronouncements

***Tax Effect Accounting***

On December 28, 2015, the ASBJ issued ASBJ Guidance No. 26, "Guidance on Recoverability of Deferred Tax Assets," which included certain revisions of the previous accounting and auditing guidance issued by JICPA. While the new guidance continues to follow the basic framework of the previous guidance, it provides new guidance for the application of judgment in assessing the recoverability of deferred tax assets.

The previous guidance provided a basic framework which included certain specific restrictions on recognizing deferred tax assets depending on the Company's classification in respect of its profitability, taxable profit and temporary differences, etc.

The new guidance does not change such basic framework but, in limited cases, allows companies to recognize deferred tax assets even for a deductible temporary difference for which it was specifically prohibited to recognize a deferred tax asset under the previous guidance, if the company can justify, with reasonable grounds, that it is probable that the deductible temporary difference will be utilized against future taxable profit in some future period.

The new guidance is effective for the beginning of annual periods beginning on or after April 1, 2016. Earlier application is permitted for annual periods ending on or after March 31, 2016. The new guidance shall not be applied retrospectively and any adjustments from the application of the new guidance at the beginning of the reporting period shall be reflected within retained earnings or accumulated other comprehensive income at the beginning of the reporting period.

The Company expects to apply the new guidance on recoverability of deferred tax assets effective March 1, 2017, and is in process of measuring the effects of applying the new guidance in future applicable periods.

## 3. Marketable and Investment Securities

Marketable and investment securities at February 28, 2017 and February 29, 2016, consisted of the following:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | **2017** | 2016 | **2017** |
| **Current:** | | | |
| Corporate and other bonds | | ¥ 301 | |
| Total | | ¥ 301 | |
| **Non-current:** | | | |
| Equity securities | **¥295** | ¥1,503 | **$2,634** |
| Trust fund investments and other | **134** | 96 | **1,196** |
| Total | **¥429** | ¥1,599 | **$3,830** |

The costs and aggregate fair values of securities classified as available-for-sale at February 28, 2017 and February 29, 2016, were as follows:

| | Millions of yen | | | |
|---|---|---|---|---|
| **2017** | Cost | Unrealized gains | Unrealized losses | Fair value |
| **Securities classified as:** | | | | |
| Available-for-sale | | | | |
| Marketable equity securities | **¥108** | **¥118** | | **¥226** |
| Trust fund investments and other | **29** | **33** | | **62** |

| | Millions of yen | | | |
|---|---|---|---|---|
| 2016 | Cost | Unrealized gains | Unrealized losses | Fair value |
| **Securities classified as:** | | | | |
| Available-for-sale | | | | |
| Marketable equity securities | ¥1,227 | ¥357 | ¥151 | ¥1,433 |
| Corporate and other bonds | 300 | 1 | | 301 |
| Trust fund investments and other | 29 | 22 | | 51 |

| | Thousands of U.S. dollars (Note 1) | | | |
|---|---|---|---|---|
| **2017** | Cost | Unrealized gains | Unrealized losses | Fair value |
| **Securities classified as:** | | | | |
| Available-for-sale | | | | |
| Marketable equity securities | **$964** | **$1,054** | | **$2,018** |
| Trust fund investments and other | **259** | **295** | | **554** |

Proceeds from sales of available-for-sale securities for the years ended February 28, 2017 and February 29, 2016, were ¥1,783 million ($15,920 thousand) and ¥1,639 million, respectively. Gross realized gains and losses on these sales, computed on the moving-average cost basis, for the year ended February 28, 2017, were ¥258 million ($2,304 thousand) and nil, respectively, and for the year ended February 29, 2016, were ¥271 million and nil, respectively.

## 4. Short-term Investments

Short-term investments at February 28, 2017 and February 29, 2016, consisted of the following:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | **2017** | 2016 | **2017** |
| Deposits over three-month period | **¥618** | ¥ 715 | **$5,518** |
| Other | **201** | 880 | **1,795** |
| Total | **¥819** | ¥1,595 | **$7,313** |

## 5. Inventories

Inventories at February 28, 2017 and February 29, 2016, consisted of the following:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | **2017** | 2016 | **2017** |
| Merchandise | **¥ 520** | ¥ 578 | **$ 4,643** |
| Finished products | **10,179** | 11,293 | **90,884** |
| Work in process | **3,611** | 3,773 | **32,241** |
| Raw materials and supplies | **2,102** | 2,201 | **18,768** |
| Total | **¥16,412** | ¥17,845 | **$146,536** |

## 6. Long-lived Assets

The Group reviewed its long-lived assets for impairment as of February 29, 2016, and recognized impairment losses of ¥98 million as other expenses for certain unutilized assets due to the planned demolition.

The carrying amounts of the related assets were written down to the memorandum value. No impairment loss was recognized in 2017.

## 7. Short-term Bank Loans and Long-term Debt

Short-term bank loans at February 28, 2017 and February 29, 2016, consisted of bank overdrafts. The annual interest rates applicable for the years ended February 28, 2017 and February 29, 2016, were 0.12% and 0.27%, respectively.

Long-term debt at February 28, 2017 and February 29, 2016, consisted of the following:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2017 | 2016 | 2017 |
| Zero-coupon convertible bonds due 2021 | ¥8,068 | | $72,036 |
| Lease obligations | 61 | ¥57 | 544 |
| Total | 8,129 | 57 | 72,580 |
| Less: current portion | 22 | 18 | 196 |
| Long-term debt, less current portion | ¥8,107 | ¥39 | $72,384 |

Annual maturities of long-term debt at February 28, 2017, were as follows:

| Years ending February 28 or 29 | Millions of yen | Thousands of U.S. dollars (Note 1) |
|---|---|---|
| 2018 | ¥ 22 | $ 196 |
| 2019 | 18 | 161 |
| 2020 | 12 | 107 |
| 2021 | 8 | 71 |
| 2022 | 8,001 | 71,438 |
| Total | ¥8,061 | $71,973 |

Under specific conditions, the convertible bonds outstanding at February 28, 2017, are convertible into 4,720 thousand shares of common stock of the Company from June 30, 2016 to June 2, 2021 at ¥1,695 ($15.13) per share. The conversion prices of the convertible bonds are subject to adjustments in certain circumstances.

## 8. Retirement and Pension Plans

The Company and certain consolidated subsidiaries have severance payment plans for employees. Under the pension plans, employees terminating their employment are, in most circumstances, entitled to pension payments.

Certain consolidated subsidiaries use a simplified method, which is permitted for small-sized companies in conformity with the Accounting Standard for Retirement Benefits for calculating liability for retirement benefits and retirement benefit expenses for their severance payment plans.

(1) The changes in defined benefit obligation for the years ended February 28, 2017 and February 29, 2016, were as follows:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2017 | 2016 | 2017 |
| Balance at beginning of year (as previously reported) | ¥9,762 | ¥8,313 | $87,161 |
| Cumulative effect of accounting change | | 1,497 | |
| Balance at beginning of year (as restated) | 9,762 | 9,810 | 87,161 |
| Current service cost | 169 | 137 | 1,509 |
| Interest cost | 104 | 105 | 929 |
| Actuarial gains and losses | 128 | 110 | 1,143 |
| Benefits paid | (286) | (400) | (2,554) |
| Balance at end of year | ¥9,877 | ¥9,762 | $88,188 |

(2) The changes in plan assets for the years ended February 28, 2017 and February 29, 2016, were as follows:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2017 | 2016 | 2017 |
| Balance at beginning of year | ¥8,036 | ¥8,192 | $71,750 |
| Expected return on plan assets | 201 | 204 | 1,795 |
| Actuarial gains and losses | 63 | (486) | 563 |
| Contributions from the employer | 250 | 526 | 2,232 |
| Benefits paid | (286) | (400) | (2,554) |
| Balance at end of year | ¥8,264 | ¥8,036 | $73,786 |

(3) Reconciliation between the liability recorded in the consolidated balance sheet and the balances of defined benefit obligation and plan assets as of February 28, 2017 and February 29, 2016, were as follows:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2017 | 2016 | 2017 |
| Funded defined benefit obligation | ¥ 9,822 | ¥ 9,717 | $ 87,697 |
| Plan assets | (8,264) | (8,036) | (73,786) |
| Total | 1,558 | 1,681 | 13,911 |
| Unfunded defined benefit obligation | 55 | 45 | 491 |
| Net liability arising from defined benefit obligation | ¥ 1,613 | ¥ 1,726 | $ 14,402 |

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2017 | 2016 | 2017 |
| Liability for retirement benefits | ¥1,613 | ¥1,726 | $14,402 |
| Net liability arising from defined benefit obligation | ¥1,613 | ¥1,726 | $14,402 |

(4) The components of net periodic benefit costs for the years ended February 28, 2017 and February 29, 2016, were as follows:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2017 | 2016 | 2017 |
| Service cost | ¥ 169 | ¥ 137 | $ 1,509 |
| Interest cost | 104 | 105 | 929 |
| Expected return on plan assets | (201) | (204) | (1,795) |
| Recognized net actuarial gains and losses | 123 | 46 | 1,098 |
| Amortization of prior-service cost | (6) | (36) | (53) |
| Net periodic benefit costs | ¥ 189 | ¥ 48 | $ 1,688 |

(5) Amounts recognized in other comprehensive income (before income tax effect) in respect of defined retirement benefit plans for the years ended February 28, 2017 and February 29, 2016, were as follows:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2017 | 2016 | 2017 |
| Prior-service cost | ¥ (6) | ¥ (35) | $ (54) |
| Actuarial gains and losses | 58 | (550) | 518 |
| Total | ¥52 | ¥(585) | $464 |

(6) Amounts recognized in accumulated other comprehensive income (before income tax effect) in respect of defined retirement benefit plans as of February 28, 2017 and February 29, 2016, were as follows:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2017 | 2016 | 2017 |
| Unrecognized prior-service cost | | ¥ (6) | |
| Unrecognized actuarial gains and losses | ¥822 | 880 | $7,339 |
| Total | ¥822 | ¥874 | $7,339 |

(7) Plan assets

***a. Components of plan assets***

Plan assets as of February 28, 2017 and February 29, 2016, consisted of the following:

| | 2017 | 2016 |
|---|---|---|
| Debt investments | 23% | 23% |
| Equity investments | 22 | 20 |
| General account | 35 | 35 |
| Others | 20 | 22 |
| Total | 100% | 100% |

***b. Method of determining the expected rate of return on plan assets***

The expected rate of return on plan assets is determined considering the long-term rates of return which are expected currently and in the future from the various components of the plan assets.

(8) Assumptions used for the years ended February 28, 2017 and February 29, 2016, are set forth as follows:

| | 2017 | 2016 |
|---|---|---|
| Discount rate | 1.1% | 1.1% |
| Expected rate of return on plan assets | 2.5% | 2.5% |
| Expected rate of salary increase | 3.0% | 3.0% |

(9) Defined contribution pension plan

The amounts of the required contribution to the defined contribution plans of the consolidated subsidiaries were ¥133 million ($1,188 thousand) and ¥139 million for the years ended February 28, 2017 and February 29, 2016, respectively.

## 9. Equity

Japanese companies are subject to the Companies Act of Japan (the "Companies Act"). The significant provisions in the Companies Act that affect financial and accounting matters are summarized below.

### (a) Dividends

Under the Companies Act, companies can pay dividends at any time during the fiscal year in addition to the year-end dividend upon resolution at the shareholders' meeting. Additionally, for companies that meet certain criteria including (1) having a Board of Directors, (2) having independent auditors, (3) having an Audit and Supervisory Board, and (4) the term of service of the directors being prescribed as one year rather than the normal two-year term by its articles of incorporation, the Board of Directors may declare dividends (except for dividends-in-kind) at any time during the fiscal year if the company has prescribed so in its articles of incorporation. With respect to the third condition above, the Board of Directors of companies with (a) board committees (namely, appointment committee, compensation committee and audit committee), or (b) an audit and supervisory committee (as implemented under the Companies Act effective May 1, 2015) may also declare dividends at any time because such companies, by their nature, meet the criteria under the Companies Act. The Company is organized as a company with an audit and supervisory committee, effective May 26, 2016. The Company meets all the above criteria, and accordingly, the Board of Directors may declare dividends (except for dividends-in-kind) at any time during the fiscal year.

The Companies Act permits companies to distribute dividends-in-kind (non-cash assets) to shareholders subject to certain limitations and additional requirements.

Semiannual interim dividends may also be paid once a year upon resolution by the Board of Directors if the articles of incorporation of the company so stipulate. The Companies Act provides certain limitations on the amounts available for dividends or the purchase of treasury stock. The limitation is defined as the amount available for distribution to the shareholders, but the amount of net assets after dividends must be maintained at no less than ¥3 million.

### (b) Increases/Decreases and Transfer of Common Stock, Reserve and Surplus

The Companies Act requires that an amount equal to 10% of dividends must be appropriated as a legal reserve (a component of retained earnings) or as additional paid-in capital (a component of capital surplus) depending on the equity account charged upon the payment of such dividends, until the total of the aggregate amount of legal reserve and additional paid-in capital equals 25% of the common stock. Under the Companies Act, the total amount of additional paid-in capital and legal reserve may be reversed without limitation of such threshold. The Companies Act also provides that common stock, legal reserve, additional paid-in capital, other capital surplus and retained earnings can be transferred among the accounts within equity under certain conditions upon resolution of the shareholders.

### (c) Treasury Stock and Treasury Stock Acquisition Rights

The Companies Act also provides for companies to purchase treasury stock and dispose of such treasury stock by resolution of the Board of Directors. The amount of treasury stock purchased cannot exceed the amount available for distribution to the shareholders which is determined by a specific formula.

Under the Companies Act, stock acquisition rights are presented as a separate component of equity.

The Companies Act also provides that companies can purchase both treasury stock acquisition rights and treasury stock. Such treasury stock acquisition rights are presented as a separate component of equity or deducted directly from stock acquisition rights.

## 10. Stock Options

The stock options outstanding as of February 28, 2017, were as follows:

| Stock Option | Persons Granted | Number of Options Granted | Date of Grant | Exercise Price | Exercise Period |
|---|---|---|---|---|---|
| 2011 Stock Option | 8 directors<br>13 employees | 126,000 shares | July 4, 2011 | ¥ 935 | From July 1, 2013<br>to June 30, 2017 |
| 2012 Stock Option | 6 directors<br>2 executive officers<br>14 employees | 113,000 shares | July 2, 2012 | ¥ 827 | From June 30, 2014<br>to June 29, 2018 |
| 2013 Stock Option | 6 directors<br>2 executive officers<br>12 employees<br>18 directors of subsidiaries | 192,000 shares | July 5, 2013 | ¥1,119 | From June 29, 2015<br>to June 28, 2019 |
| 2014 I Stock Option | 5 directors | 23,100 shares | June 9, 2014 | ¥ 1 | From June 9, 2014<br>to June 8, 2044 |
| 2014 II Stock Option | 5 directors<br>4 executive officers<br>18 employees<br>9 directors of subsidiaries | 183,000 shares | July 15, 2014 | ¥1,466 | From July 1, 2016<br>to June 30, 2020 |
| 2015 I Stock Option | 6 directors | 17,100 shares | June 15, 2015 | ¥ 1 | From June 15, 2015<br>to June 14, 2045 |
| 2015 II Stock Option | 5 directors<br>3 executive officers<br>16 employees<br>9 directors of subsidiaries | 154,000 shares | June 15, 2015 | ¥2,203 | From June 30, 2017<br>to June 29, 2021 |
| 2016 I Stock Option | 3 directors<br>3 executive officers | 36,200 shares | June 13, 2016 | ¥ 1 | From June 13, 2016<br>to June 12, 2046 |
| 2016 II Stock Option | 3 directors<br>6 executive officers<br>18 employees<br>9 directors of subsidiaries | 168,000 shares | June 13, 2016 | ¥1,289 | From June 29, 2018<br>to June 28, 2022 |

The stock option activity was as follows:

| | Shares | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2011 Stock Option | 2012 Stock Option | 2013 Stock Option | 2014 I Stock Option | 2014 II Stock Option | 2015 I Stock Option | 2015 II Stock Option | 2016 I Stock Option | 2016 II Stock Option |
| Year ended February 29, 2016 | | | | | | | | | |
| **Non-vested** | | | | | | | | | |
| February 28, 2015 – Outstanding | | | 190,000 | | 183,000 | | | | |
| Granted | | | | | | 17,100 | 154,000 | | |
| Canceled | | | | | 2,000 | | 2,000 | | |
| Vested | | | 190,000 | | | 17,100 | | | |
| February 29, 2016 – Outstanding | | | | | 181,000 | | 152,000 | | |
| **Vested** | | | | | | | | | |
| February 28, 2015 – Outstanding | 27,000 | 59,500 | | 23,100 | | | | | |
| Vested | | | 190,000 | | | 17,100 | | | |
| Exercised | 16,000 | 37,500 | 38,700 | 2,100 | | | | | |
| Canceled | | | | | | | | | |
| February 29, 2016 – Outstanding | 11,000 | 22,000 | 151,300 | 21,000 | | 17,100 | | | |

| | Shares | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2011 Stock Option | 2012 Stock Option | 2013 Stock Option | 2014 I Stock Option | 2014 II Stock Option | 2015 I Stock Option | 2015 II Stock Option | 2016 I Stock Option | 2016 II Stock Option |
| **Year ended February 28, 2017** | | | | | | | | | |
| **Non-vested** | | | | | | | | | |
| February 29, 2016 – Outstanding | | | | | 181,000 | | 152,000 | | |
| Granted | | | | | | | | 36,200 | 168,000 |
| Canceled | | | | | | | | | |
| Vested | | | | | 181,000 | | | 36,200 | |
| February 28, 2017 – Outstanding | | | | | | | 152,000 | | 168,000 |
| **Vested** | | | | | | | | | |
| February 29, 2016 – Outstanding | 11,000 | 22,000 | 151,300 | 21,000 | | 17,100 | | | |
| Vested | | | | | 181,000 | | | 36,200 | |
| Exercised | 7,000 | 2,000 | 40,100 | | 13,100 | | | | |
| Canceled | | | | 2,100 | | 4,200 | | | |
| February 28, 2017 – Outstanding | 4,000 | 20,000 | 111,200 | 18,900 | 167,900 | 12,900 | | 36,200 | |
| Exercise price | ¥ 935 | ¥ 827 | ¥1,119 | ¥ 1 | ¥1,466 | ¥ 1 | ¥2,203 | ¥ 1 | ¥1,289 |
| Average stock price at exercise | ¥1,698 | ¥1,650 | ¥1,619 | | ¥1,725 | | | | |
| Fair value price at grant date | ¥ 254 | ¥ 167 | ¥ 191 | ¥1,209 | ¥ 265 | ¥1,995 | ¥ 407 | ¥ 988 | ¥ 165 |

The assumptions used to measure fair value of the 2016 I Stock Options were as follows:

| | |
|---|---|
| Estimate method: | Black-Scholes option pricing model |
| Volatility of stock price: | 31.09% |
| Estimated remaining outstanding period: | 4.5 years |
| Estimated dividend: | ¥46.00 per share |
| Risk free interest rate: | (0.269)% |

The assumptions used to measure fair value of the 2016 II Stock Options were as follows:

| | |
|---|---|
| Estimate method: | Black-Scholes option pricing model |
| Volatility of stock price: | 32.01% |
| Estimated remaining outstanding period: | 4 years |
| Estimated dividend: | ¥46.00 per share |
| Risk free interest rate: | (0.270)% |

## 11. Income Taxes

The Company and its consolidated subsidiaries in Japan are subject to Japanese national and local income taxes which, in the aggregate, resulted in a normal effective statutory tax rate of approximately 32.3% and 34.8% for the years ended February 28, 2017 and February 29, 2016, respectively.

Consolidated subsidiaries outside of Japan are subject to income taxes of the countries in which they operate.

The tax effects of significant temporary differences and loss carryforwards which resulted in deferred tax assets and liabilities at February 28, 2017 and February 29, 2016, were as follows:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | **2017** | 2016 | **2017** |
| **Current:** | | | |
| **Deferred tax assets** | | | |
| Tax loss carryforwards | **¥ 290** | ¥ 338 | **$ 2,589** |
| Inventories | **220** | 219 | **1,964** |
| Unrealized profit on inventories | **220** | 138 | **1,964** |
| Accrued bonuses | **198** | 237 | **1,768** |
| Allowance for doubtful receivables | **17** | 19 | **152** |
| Other – net | **175** | 121 | **1,563** |
| Less valuation allowance | **(461)** | (427) | **(4,116)** |
| Total | **659** | 645 | **5,884** |
| **Deferred tax liabilities** | | | |
| Undistributed earnings of associated companies | **(489)** | (915) | **(4,366)** |
| Tax-deductible inventory losses | **(46)** | (45) | **(411)** |
| Other – net | **(68)** | (56) | **(607)** |
| Total | **(603)** | (1,016) | **(5,384)** |
| **Net deferred tax assets (liabilities)** | **¥ 56** | ¥ (371) | **$ 500** |
| | | | |
| **Non-current:** | | | |
| **Deferred tax assets** | | | |
| Tax loss carryforwards | **¥ 605** | ¥ 1,062 | **$ 5,402** |
| Liability for retirement benefits | **486** | 270 | **4,339** |
| Depreciation | **210** | 210 | **1,875** |
| Impairment loss | **45** | 51 | **402** |
| Write-down of investment securities | **45** | 117 | **402** |
| Other – net | **260** | 242 | **2,321** |
| Less valuation allowance | **(1,481)** | (1,798) | **(13,223)** |
| Total | **170** | 154 | **1,518** |
| **Deferred tax liabilities** | | | |
| Reserve for special depreciation | **(25)** | (31) | **(223)** |
| Property, plant and equipment | **(16)** | (17) | **(143)** |
| Unrealized gain on available-for-sale securities | **(13)** | (46) | **(116)** |
| Other – net | **(44)** | (25) | **(393)** |
| Total | **(98)** | (119) | **(875)** |
| **Net deferred tax assets (liabilities)** | **¥ 72** | ¥ 35 | **$ 643** |

A reconciliation between the normal effective statutory tax rate for the years ended February 28, 2017 and February 29, 2016, and the actual effective tax rate reflected in the accompanying consolidated statements of income was as follows:

| | **2017** | 2016 |
|---|---|---|
| Normal effective statutory tax rate | **32.3%** | 34.8% |
| Valuation allowance | **(7.9)** | (8.0) |
| Undistributed earnings of associated companies | **(5.9)** | 3.1 |
| Unrealized profit on inventories | **(4.9)** | (0.4) |
| Effect of foreign tax rate differences | **1.0** | (2.5) |
| Other – net | **0.3** | 1.6 |
| Actual effective tax rate | **14.9%** | 28.6% |

New tax reform laws enacted in 2016 in Japan changed the normal effective statutory tax rate from approximately 31.6% to 30.2% for the fiscal year beginning on or after April 1, 2016, and to 30.0% for the fiscal year beginning on or after April 1, 2017. The impact of this change is insignificant.

## 12. Research and Development Costs

Research and development costs charged to income were ¥2,032 million ($18,143 thousand) and ¥2,005 million for the years ended February 28, 2017 and February 29, 2016, respectively.

## 13. Leases

The Company and its consolidated subsidiaries lease certain machinery, computer equipment, office space and other assets.

Obligations under non-cancelable operating leases at February 28, 2017 and February 29, 2016, were as follows:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2017 | 2016 | 2017 |
| Due within one year | ¥ 81 | ¥ 84 | $ 723 |
| Due after one year | 189 | 259 | 1,688 |
| Total | ¥270 | ¥343 | $2,411 |

## 14. Financial Instruments and Related Disclosures

### (1) Group Policy for Financial Instruments

The Group invests cash surpluses in low-risk financial instruments and raises funds by bank loans and convertible bonds. Derivatives are used mainly to manage foreign exchange risks, not for speculative purposes.

### (2) Nature, Extent of Risks Arising from, and Risk Management for Financial Instruments

Trade receivables such as trade notes and accounts receivable are exposed to customer credit risk. The Group manages its credit risk from receivables on the basis of internal guidelines, which include monitoring of the payment term and balance of each customer. The Group also periodically checks the credit status of key customers.

Marketable securities and investment securities, which are mainly equity instruments, are exposed to market risk. The Group periodically monitors market values of these securities and reports them to the management.

Trade payables such as trade notes and accounts payable are mostly due within one year.

Loans and convertible bonds are used to finance operating activities, capital investment and purchase of treasury stock. Loans are exposed to risks of interest rate fluctuations, but all such loans are short-term borrowings.

The Group uses forward foreign exchange contracts to manage exchange risks arising from receivables and payables denominated in foreign currencies. Derivative transactions entered into by the Group have been made in accordance with internal policies which prescribe the authorization, and the result is reported to management. The Group also limits the counterparties of these derivatives to major international financial institutions to reduce credit risk.

With regard to trade payables, loans and convertible bonds, the Group is exposed to liquidity risk. The Group manages this risk through periodic financial planning by each Group company.

### (3) Fair Values of Financial Instruments

Fair values of financial instruments are based on their quoted market price, if available. If a quoted price is not available, other rational valuation techniques are used instead.

*(a) Fair Value of Financial Instruments*

| February 28, 2017 | Millions of yen Carrying amount | Fair value | Unrealized gain/loss | Thousands of U.S. dollars (Note 1) Carrying amount | Fair value | Unrealized gain/loss |
|---|---|---|---|---|---|---|
| Cash and cash equivalents | ¥20,478 | ¥20,478 | | $182,839 | $182,839 | |
| Marketable and investment securities | 288 | 288 | | 2,571 | 2,571 | |
| Short-term investments | 819 | 819 | | 7,313 | 7,313 | |
| Trade receivables | 14,209 | 14,209 | | 126,866 | 126,866 | |
| Total | ¥35,794 | ¥35,794 | | $319,589 | $319,589 | |
| Trade payables | ¥ 6,824 | ¥ 6,824 | | $ 60,929 | $ 60,929 | |
| Short-term bank loans | 2,500 | 2,500 | | 22,321 | 22,321 | |
| Convertible bonds | 8,068 | 9,072 | ¥1,004 | 72,036 | 81,000 | $8,964 |
| Total | ¥17,392 | ¥18,396 | ¥1,004 | $155,286 | $164,250 | $8,964 |
| Derivatives | ¥ (131) | ¥ (131) | | $ (1,170) | $ (1,170) | |

| February 29, 2016 | Millions of yen Carrying amount | Fair value | Unrealized gain/loss |
|---|---|---|---|
| Cash and cash equivalents | ¥14,870 | ¥14,870 | |
| Marketable and investment securities | 1,785 | 1,785 | |
| Short-term investments | 1,595 | 1,595 | |
| Trade receivables | 14,149 | 14,149 | |
| Total | ¥32,399 | ¥32,399 | |
| Trade payables | ¥ 7,317 | ¥ 7,317 | |
| Short-term bank loans | 2,000 | 2,000 | |
| Total | ¥ 9,317 | ¥ 9,317 | |
| Derivatives | ¥ 160 | ¥ 160 | |

***Cash and cash equivalents and short-term investments***

The carrying values of cash and cash equivalents and short-term investments approximate fair value because of their short maturities.

***Marketable and investment securities***

The fair values of marketable and investment securities are measured at the quoted market prices of the stock exchange for equity instruments, and at the quoted prices obtained from the financial institution for certain debt instruments. Fair value information for marketable and investment securities by classification is included in Note 3.

***Trade receivables***

The carrying values of receivables approximate fair value because of their short maturities. Further, the carrying values of receivables due in more than one year, arising from some overseas subsidiaries having installment sales, are measured in a rational manner, discounted at the Group's assumed corporate discount rate.

***Trade payables and short-term bank loans***

The carrying values of payables and short-term bank loans approximate fair value because of their short maturities.

***Convertible bonds***

The carrying values of convertible bonds are measured at the quoted price obtained from the financial institution.

***Derivatives***

Information on the fair value of derivatives is included in Note 15.

*(b) Carrying Amount of Financial Instruments Whose Fair Value Cannot be Reliably Determined*

| | Carrying amount | | |
|---|---|---|---|
| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
| | 2017 | 2016 | 2017 |
| Investments in equity instruments that do not have a quoted market price in an active market | ¥ 69 | ¥ 70 | $ 616 |
| Investments in unconsolidated subsidiaries and associated companies | 304 | 313 | 2,714 |
| Investments in limited partnerships | 72 | 45 | 643 |
| Total | ¥445 | ¥428 | $3,973 |

### (4) Maturity Analysis for Financial Assets and Securities with Contractual Maturities

| | Millions of yen | | | |
|---|---|---|---|---|
| February 28, 2017 | Due in one year or less | Due after one year through five years | Due after five years through ten years | Due after ten years |
| Cash and cash equivalents | ¥20,478 | | | |
| Marketable and investment securities | | ¥ 72 | | |
| Short-term investments | 819 | | | |
| Trade receivables | 13,202 | 1,004 | ¥3 | |
| Total | ¥34,499 | ¥1,076 | ¥3 | |

| | Millions of yen | | | |
|---|---|---|---|---|
| February 29, 2016 | Due in one year or less | Due after one year through five years | Due after five years through ten years | Due after ten years |
| Cash and cash equivalents | ¥14,870 | | | |
| Marketable and investment securities | 300 | ¥ 45 | | |
| Short-term investments | 1,595 | | | |
| Trade receivables | 13,214 | 935 | | |
| Total | ¥29,979 | ¥980 | | |

| | Thousands of U.S. dollars (Note 1) | | | |
|---|---|---|---|---|
| February 28, 2017 | Due in one year or less | Due after one year through five years | Due after five years through ten years | Due after ten years |
| Cash and cash equivalents | $182,839 | | | |
| Marketable and investment securities | | $ 643 | | |
| Short-term investments | 7,313 | | | |
| Trade receivables | 117,875 | 8,964 | $27 | |
| Total | $308,027 | $9,607 | $27 | |

## 15. Derivatives

*Derivative transactions to which hedge accounting is not applied*

| | Millions of yen | | | |
|---|---|---|---|---|
| At February 28, 2017 | Contracted amount | Contracted amount due after one year | Fair value | Unrealized gain/loss |
| **Foreign currency forward contracts:** | | | | |
| Selling | ¥3,410 | | ¥ 16 | ¥ 16 |
| Buying | 2,146 | | (147) | (147) |
| Total | ¥5,556 | | ¥(131) | ¥(131) |

| At February 29, 2016 | Millions of yen<br>Contracted amount | Contracted amount due after one year | Fair value | Unrealized gain/loss |
|---|---|---|---|---|
| **Foreign currency forward contracts:** | | | | |
| Selling | ¥3,911 | | ¥208 | ¥208 |
| Buying | 1,550 | | (48) | (48) |
| Total | ¥5,461 | | ¥160 | ¥160 |

| At February 28, 2017 | Thousands of U.S. dollars (Note 1)<br>Contracted amount | Contracted amount due after one year | Fair value | Unrealized gain/loss |
|---|---|---|---|---|
| **Foreign currency forward contracts:** | | | | |
| Selling | $30,446 | | $ 143 | $ 143 |
| Buying | 19,161 | | (1,313) | (1,313) |
| Total | $49,607 | | $(1,170) | $(1,170) |

## 16. Other Comprehensive Income

The components of other comprehensive income for the years ended February 28, 2017 and February 29, 2016, were as follows:

| | Millions of yen | | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|
| | 2017 | 2016 | 2017 |
| Unrealized loss on available-for-sale securities: | | | |
| Gains (losses) arising during the year | ¥ 185 | ¥ (563) | $ 1,652 |
| Reclassification adjustments to profit or loss | (260) | (267) | (2,322) |
| Amount before income tax effect | (75) | (830) | (670) |
| Income tax effect | 33 | 196 | 295 |
| Total | ¥ (42) | ¥ (634) | $ (375) |
| Foreign currency translation adjustments: | | | |
| Adjustments arising during the year | ¥(1,394) | ¥ (735) | $(12,446) |
| Total | ¥(1,394) | ¥ (735) | $(12,446) |
| Defined retirement benefit plans: | | | |
| Adjustments arising during the year | ¥ (65) | ¥ (596) | $ (580) |
| Reclassification adjustments to profit or loss | 117 | 11 | 1,044 |
| Total | ¥ 52 | ¥ (585) | $ 464 |
| Share of other comprehensive income in an associate: | | | |
| Losses arising during the year | ¥ (10) | | $ (89) |
| Total | ¥ (10) | | $ (89) |
| Total other comprehensive income | ¥(1,394) | ¥(1,954) | $(12,446) |

## 17. Net Income Per Share

Reconciliation of the differences between basic and diluted net income per share ("EPS") for the years ended February 28, 2017 and February 29, 2016, was as follows:

| | Millions of yen | Thousands of shares | Yen | U.S. dollars (Note 1) |
|---|---|---|---|---|
| | Net income attributable to owners of the parent | Weighted-average shares | EPS | |
| **Year ended February 28, 2017** | | | | |
| Basic EPS | | | | |
| Net income attributable to common shareholders | **¥3,181** | **38,908** | **¥81.77** | **$0.73** |
| Effect of dilutive securities | | | | |
| Convertible bonds | **(20)** | **3,336** | | |
| Stock acquisition rights | | **90** | | |
| Diluted EPS | | | | |
| Net income for computation | **¥3,161** | **42,334** | **¥74.69** | **$0.67** |
| Year ended February 29, 2016 | | | | |
| Basic EPS | | | | |
| Net income attributable to common shareholders | ¥3,721 | 42,290 | ¥87.98 | |
| Effect of dilutive securities | | | | |
| Stock acquisition rights | | 140 | | |
| Diluted EPS | | | | |
| Net income for computation | ¥3,721 | 42,430 | ¥87.69 | |

## 18. Segment Information

Under ASBJ Statement No. 17, "Accounting Standard for Segment Information Disclosures," and ASBJ Guidance No. 20, "Guidance on Accounting Standard for Segment Information Disclosures," an entity is required to report financial and descriptive information about its reportable segments. Reportable segments are operating segments or aggregations of operating segments that meet specified criteria. Operating segments are components of an entity about which separate financial information is available and such information is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Generally, segment information is required to be reported on the same basis as is used internally for evaluating operating segment performance and deciding how to allocate resources to operating segments.

1. Description of reportable segments

The Group's reportable segments are those for which separate financial information is available and regular evaluation by the Company's management is being performed in order to decide how resources are allocated among the Group. Therefore, the Group has three reportable segments: "Special Products," "Machine Tools," and "Precision Products."

"Special Products" produces and sells POS printers and others.

"Machine Tools" produces and sells CNC automatic lathes and others.

"Precision Products" produces and sells wristwatch parts, automotive parts, air conditioning parts, HDD parts, medical parts and others.

2. Methods of measurement for the amounts of sales, profit (loss), assets, liabilities and other items for each reportable segment

The accounting policies of each reportable segment are consistent with those disclosed in Note 2, "Summary of Significant Accounting Policies."

3. Information about sales, profit (loss), assets, liabilities and other items.

| 2017 | Millions of yen | | | | | |
|---|---|---|---|---|---|---|
| | Reportable Segment | | | | | |
| | Special Products | Machine Tools | Precision Products | Total | Reconcilia-tions | Consolidated |
| Sales to external customers | ¥11,082 | ¥33,629 | ¥4,226 | ¥48,937 | | ¥48,937 |
| Intersegment sales or transfers | | | | | | |
| Total | 11,082 | 33,629 | 4,226 | 48,937 | | 48,937 |
| Segment profit | ¥ 1,345 | ¥ 4,373 | ¥ 285 | ¥ 6,003 | ¥ (2,396) | ¥ 3,607 |
| Segment assets | ¥ 9,286 | ¥39,260 | ¥6,685 | ¥55,231 | ¥13,120 | ¥68,351 |
| Other items: | | | | | | |
| Depreciation | 209 | 1,138 | 585 | 1,932 | 235 | 2,167 |
| Investments in associates | 301 | | | 301 | | 301 |
| Increase in property, plant and equipment and intangible assets | 137 | 766 | 389 | 1,292 | 149 | 1,441 |

| 2016 | Millions of yen | | | | | |
|---|---|---|---|---|---|---|
| | Reportable Segment | | | | | |
| | Special Products | Machine Tools | Precision Products | Total | Reconcilia-tions | Consolidated |
| Sales to external customers | ¥11,381 | ¥38,150 | ¥4,927 | ¥54,458 | | ¥54,458 |
| Intersegment sales or transfers | | | | | | |
| Total | 11,381 | 38,150 | 4,927 | 54,458 | | 54,458 |
| Segment profit | ¥ 1,542 | ¥ 5,843 | ¥ 593 | ¥ 7,978 | ¥(2,243) | ¥ 5,735 |
| Segment assets | ¥ 9,515 | ¥42,540 | ¥7,492 | ¥59,547 | ¥ 8,281 | ¥67,828 |
| Other items: | | | | | | |
| Depreciation | 229 | 1,237 | 636 | 2,102 | 172 | 2,274 |
| Investments in associates | 309 | | | 309 | | 309 |
| Increase in property, plant and equipment and intangible assets | 257 | 1,133 | 626 | 2,016 | 259 | 2,275 |

| 2017 | Thousands of U.S. dollars (Note 1) | | | | | |
|---|---|---|---|---|---|---|
| | Reportable Segment | | | | | |
| | Special Products | Machine Tools | Precision Products | Total | Reconcilia-tions | Consolidated |
| Sales to external customers | $98,947 | $300,259 | $37,732 | $436,938 | | $436,938 |
| Intersegment sales or transfers | | | | | | |
| Total | 98,947 | 300,259 | 37,732 | 436,938 | | 436,938 |
| Segment profit | $12,009 | $ 39,045 | $ 2,544 | $ 53,598 | $ (21,393) | $ 32,205 |
| Segment assets | $82,911 | $350,536 | $59,687 | $493,134 | $117,143 | $610,277 |
| Other items: | | | | | | |
| Depreciation | 1,866 | 10,161 | 5,223 | 17,250 | 2,098 | 19,348 |
| Investments in associates | 2,688 | | | 2,688 | | 2,688 |
| Increase in property, plant and equipment and intangible assets | 1,223 | 6,840 | 3,473 | 11,536 | 1,330 | 12,866 |

Notes: 1. Reconciliations recorded for segment profit include corporate expenses that are not allocated to any reportable segment. Corporate expenses principally consist of general corporate expenses incurred by the Administration Headquarters of the Company.

2. Reconciliations recorded for segment assets include corporate assets that are not allocated to any reportable segment. Corporate assets principally consist of assets maintained by the Administration Headquarters of the Company and consist principally of excess funds under management (cash and cash equivalents) and long-term investments (investment securities).

3. Reconciliations recorded for depreciation include depreciation incurred by corporate assets that are not allocated to any reportable segment.

4. Reconciliations recorded for increase in property, plant and equipment and intangible assets are capital investments principally for corporate assets that are not allocated to any reportable segment.

5. Segment profit agrees with operating profit in the accompanying consolidated statement of income.

***Related Information***

1. Related information by geographical area at February 28, 2017 and February 29, 2016, consisted of the following:

(1) Net Sales

| | Millions of yen | | | | | |
|---|---|---|---|---|---|---|
| **2017** | Japan | USA | China | Germany | Others | Total |
| | **¥8,221** | **¥13,084** | **¥6,317** | **¥5,836** | **¥15,479** | **¥48,937** |

| | Millions of yen | | | | | |
|---|---|---|---|---|---|---|
| 2016 | Japan | USA | China | Germany | Others | Total |
| | ¥8,729 | ¥12,566 | ¥6,543 | ¥7,339 | ¥19,281 | ¥54,458 |

| | Thousands of U.S. dollars (Note 1) | | | | | |
|---|---|---|---|---|---|---|
| **2017** | Japan | USA | China | Germany | Others | Total |
| | **$73,402** | **$116,822** | **$56,402** | **$52,107** | **$138,205** | **$436,938** |

Note: Sales are classified by country or region based on the location of customers.

(2) Property, Plant and Equipment

| | Millions of yen | | | | |
|---|---|---|---|---|---|
| **2017** | Japan | Thailand | China | Others | Total |
| | **¥6,175** | **¥3,973** | **¥1,825** | **¥953** | **¥12,926** |

| | Millions of yen | | | | |
|---|---|---|---|---|---|
| 2016 | Japan | Thailand | China | Others | Total |
| | ¥6,680 | ¥4,457 | ¥2,196 | ¥1,027 | ¥14,360 |

| | Thousands of U.S. dollars (Note 1) | | | | |
|---|---|---|---|---|---|
| **2017** | Japan | Thailand | China | Others | Total |
| | **$55,134** | **$35,473** | **$16,295** | **$8,509** | **$115,411** |

2. Information for impairment loss of long-lived assets by reportable segments at February 28, 2017 and February 29, 2016, were as follows:

No impairment loss was recognized in 2017.

| | Millions of yen | | | | | |
|---|---|---|---|---|---|---|
| | Reportable Segment | | | | | |
| 2016 | Special Products | Machine Tools | Precision Products | Total | Eliminations or Corporate | Consolidated |
| | | ¥64 | ¥34 | ¥98 | | ¥98 |

## 19. Related Party Disclosures

Transactions of the Company with related parties for the years ended February 28, 2017 and February 29, 2016, were as follows:

### Year ended February 28, 2017

| Related party | Category | Description of transaction | Millions of yen | Thousands of U.S. dollars (Note 1) |
|---|---|---|---|---|
| Michael Hanson | Director of subsidiary | Exercise of stock options | **¥12** | **$107** |

Year ended February 29, 2016

| Related party | Category | Description of transaction | Millions of yen |
|---|---|---|---|
| Junichi Murakami | Director | Exercise of stock options | ¥12 |

## 20. Subsequent Event

The following appropriation of retained earnings at February 28, 2017, is to be approved at the Company's shareholders' meeting held on May 25, 2017:

| | Millions of yen | Thousands of U.S. dollars (Note 1) |
|---|---|---|
| Year-end cash dividends, ¥24 ($0.214) per share | **¥895** | **$7,991** |

Deloitte.

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## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of Star Micronics Co., Ltd.:

We have audited the accompanying consolidated balance sheet of Star Micronics Co., Ltd. and its consolidated subsidiaries as of February 28, 2017, and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, all expressed in Japanese yen.

### 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 audit. We conducted our audit in accordance with auditing standards generally accepted in Japan. Those standards require that we 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 the auditor's judgment, 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, the auditor considers 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, but 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 referred to above present fairly, in all material respects, the consolidated financial position of Star Micronics Co., Ltd. and its consolidated subsidiaries as of February 28, 2017, and the consolidated results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in Japan.

### Convenience Translation

Our audit also comprehended the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made in accordance with the basis stated in Note 1 to the consolidated financial statements. Such U.S. dollar amounts are presented solely for the convenience of readers outside Japan.

Deloitte Touche Tohmatsu LLC

May 25, 2017

Member of
Deloitte Touche Tohmatsu Limited

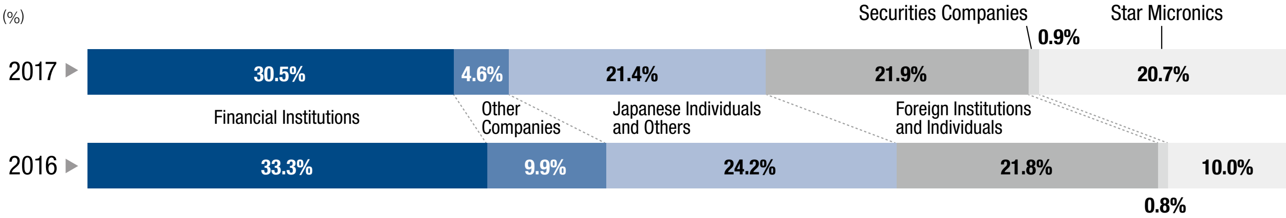
# Stock Information

as of February 28, 2017

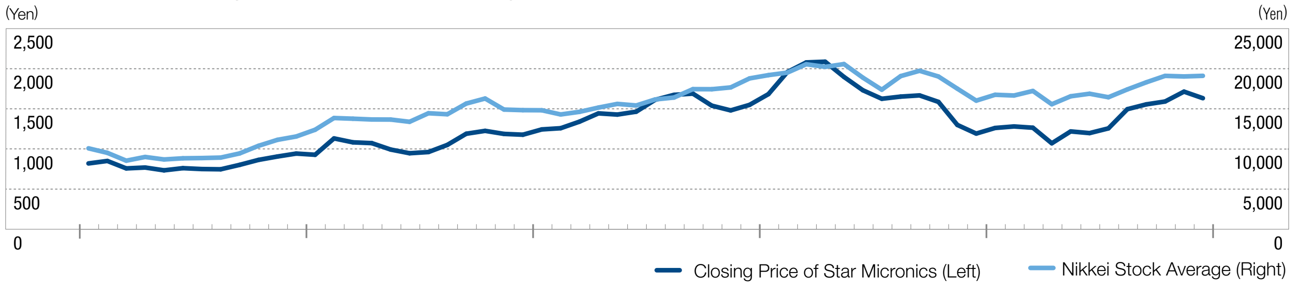
| | | |
|---|---|---|
| **Common Stock** | Authorized | 158,000,000 |
| | Issued | 47,033,234 |
| **Paid-in Capital** | | 12,721,939,515 yen |
| **Number of Shareholders** | | 8,730 |

| | |
|---|---|
| **Stock Listing** | First Section of the Tokyo Stock Exchange |
| **Transfer Agent** | Mitsubishi UFJ Trust and Banking Corporation<br>1-4-5 Marunouchi, Chiyoda,<br>Tokyo 100-8212 Japan |

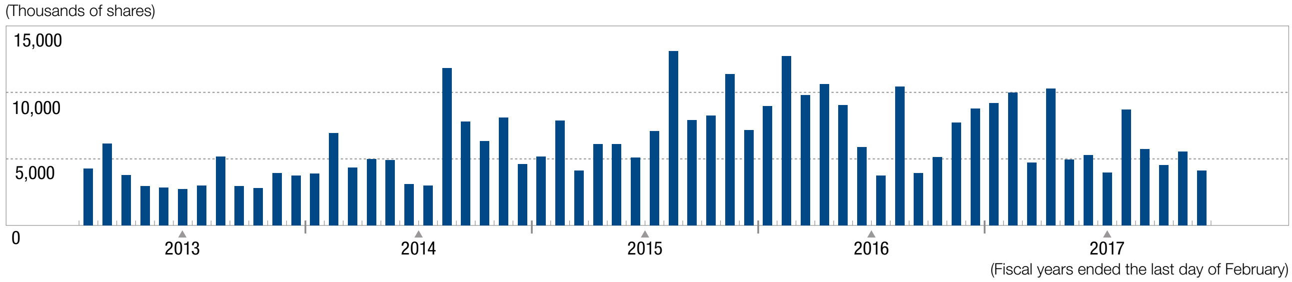
## COMPOSITION OF SHAREHOLDERS




## STOCK PRICE RANGE (TOKYO STOCK EXCHANGE)




## TRADING VOLUME




Notes: 1. This trading volume shows the monthly volume of trade on the Tokyo Stock Exchange. Each fiscal year starts in March and ends in February.
2. Stock prices of Star Micronics and the Nikkei Stock Average are based on a simple average of daily closing prices for each day of every month at the Tokyo Stock Exchange.

## STOCK PRICE

(Yen)

(Years ended February)

| Year | 2013 | 2014 | 2015 | 2016 | **2017** |
|---|---|---|---|---|---|
| At year-end | 943 | 1,178 | 1,550 | 1,192 | **1,633** |
| High | 988 | 1,422 | 1,885 | 2,238 | **1,770** |
| Low | 647 | 857 | 1,115 | 1,125 | **1,023** |

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