MANAGEMENT’S DISCUSSION AND ANALYSIS

OVERVIEW
(Years ended February 28, 2011 and 2010)

Business Environment
The fiscal year ending February 2011 saw a gradual recovery in
the U.S. economy while the European economies remained
steady overall despite growing concerns over the fiscal crisis in
the euro-zone. Meanwhile, the emerging economies continued
to see high growth led by China, and the Japanese economy
continued to stage a gradual recovery despite the ongoing
appreciation of the yen.

Net Sales
(Millions of yen)

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>Change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>¥29,181</td>
<td>¥35,718</td>
<td>22.4</td>
<td></td>
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</table>

Sales improved sharply as demand rebounded particularly in the
Machine Tools segment, and also in the Special Products and
Precision Products segments.

Operating Income (Loss)
(Millions of yen)

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>Change (%)</th>
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</thead>
<tbody>
<tr>
<td>¥(3,985)</td>
<td>¥1,429</td>
<td>–</td>
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</table>

Operating income saw a vast improvement thanks to the large
increase in sales and reductions in fixed costs.

Net Income (Loss)
(Millions of yen)

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>Change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>¥(8,555)</td>
<td>¥161</td>
<td>–</td>
<td></td>
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</table>

This term saw the Company return to profitability despite factors
including special severance payments for early retired
employees.

Cash Dividends per Share
(Yen)

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>Change (Yen)</th>
</tr>
</thead>
<tbody>
<tr>
<td>¥22.00</td>
<td>¥22.00</td>
<td>0</td>
<td></td>
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</tbody>
</table>

The cash dividends applicable to the year remained at ¥22,
unchanged from the previous fiscal year.

Total Assets
(Millions of yen)

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<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>Change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>¥50,681</td>
<td>¥49,250</td>
<td>(2.8)</td>
<td></td>
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</table>

Total assets were lower, largely due to the impact of foreign
exchange rates and reductions in fixed assets reflecting restrained
investment.

Free Cash Flows
(Millions of yen)

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>Change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>¥3,575</td>
<td>¥2,002</td>
<td>(44.0)</td>
<td></td>
</tr>
</tbody>
</table>

This term saw a sharp decline year-on-year. This was due to
factors that included severance payments for early retired
employees, and an increase in trade notes and accounts receiv-
able. Inventories, the subject of major reductions in the previous
term, saw an increase in fiscal 2011 to normal levels.

Free cash flows = Operating cash flows + Investing cash flows

Capital Expenditures
(Millions of yen)

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>Change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>¥1,586</td>
<td>¥974</td>
<td>(38.6)</td>
<td></td>
</tr>
</tbody>
</table>

Capital expenditure declined due to curbs on investment, mainly
in the Components Segment.

Sales by Region
(Millions of yen)

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>Change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Europe</td>
<td>¥ 7,357</td>
<td>¥9,979</td>
<td>35.6</td>
</tr>
<tr>
<td>America</td>
<td>6,054</td>
<td>8,516</td>
<td>40.7</td>
</tr>
<tr>
<td>Asia</td>
<td>10,333</td>
<td>9,589</td>
<td>(7.2)</td>
</tr>
<tr>
<td>Japan</td>
<td>5,437</td>
<td>7,634</td>
<td>40.4</td>
</tr>
</tbody>
</table>

Sales rebounded strongly in all regions except Asia. Sales were
brisk in Europe, Germany in particular, thanks to the weak euro.
Sales also showed steady growth in the American market, with
medical-related fields particularly strong.
INCOME ANALYSIS

Return to profitability on sharp sales increases in core businesses.

For fiscal 2011, the fiscal year under review, Star Micronics reported consolidated sales of ¥35,718 million (US$435,585 thousand), up 22.4%, or ¥6,537 million, year on year. This outcome reflected steady growth in Asian markets, as well as outstanding revenue growth in our core businesses, Machine Tools, Special Products, and Precision Products resulting from factors such as rebounding demand in North American and European capital investment markets. The cost of sales increased ¥939 million, or 4.2%, to ¥23,265 million (US$283,719 thousand). As a result of the above, gross profit increased ¥5,598 million, or 81.7%, year on year to ¥12,453 million (US$151,866 thousand). The gross profit margin increased 11.4 percentage points to 34.9%. This was due primarily to the high-margin Machine Tools Segment accounting for a 14.7 percentage point higher share of total sales, to 54.0%, a substantial recovery in sales of POS printers in the Special Products Segment, and increased sales of wristwatch components in the Precision Products Segment.

Selling, general and administrative (SG&A) expenses increased ¥184 million year on year, or 1.7%, to ¥11,024 million (US$134,439 thousand). This increase was due mainly to higher transportation and packaging costs, and an increase in direct costs, such as advertising and promotional costs, sales commissions, and other items increasing in line with rising sales.

As a result of the above, the Company recovered from last term’s operating loss of ¥3,985 million to post operating income of ¥1,429 million (US$17,427 thousand) this term. The return to profitability was unhampered by booking of loss items such as special severance payments for early retired employees.

Other expenses—net narrowed to ¥1,069 million (US$13,037 thousand) this term compared to ¥2,665 million in the previous fiscal year. This mostly reflected the fact that interest and dividend income decreased ¥54 million year on year, or 23.8%, to ¥173 million (US$2,110 thousand), as well as special severance payments for early retired employees of ¥957 million (US$11,671 thousand). The foreign exchange loss—net deteriorated by ¥119 million, or 35.3%, to ¥456 million (US$5,561 thousand).

As a result, the Company recorded income before income taxes and minority interests of ¥360 million (US$4,390 thousand). Total income taxes were ¥107 million (US$1,305 thousand). Net income after deducting minority interests was ¥161 million (US$1,963 thousand).

Basic net income per share was ¥3.71 (US$0.05).

The Company will institute shareholder returns in close consideration of dividend on equity (DOE), targeting a dividend payout ratio of at least 40%. The annual dividend for the year under review will remain unchanged from the previous term, at ¥22 (US$0.27). Total dividends decreased ¥42 million, or 4.2%, to ¥959 million (US$11,695 thousand).

Regarding future dividends, the Company is emphasizing shareholder returns and is therefore aiming for a total shareholder return ratio of at least 40%. Dividend on equity (DOE) will also be considered in setting future dividends. As a result, taking DOE into account in light of steadily improving profitability, we plan to pay an annual dividend of ¥26 per share for the fiscal year ending February 2012, up ¥4 from the previous fiscal year. This dividend is expected to consist of interim and year-end dividends of ¥13 per share, both ¥2 higher than a year ago.
Financial Position & Liquidity

Restrained investment and other factors resulted in lower fixed assets.

Total current assets as of February 28, 2011 were ¥34,836 million (US$424,829 thousand), an increase of ¥490 million, or 1.4%, compared with the previous fiscal year-end. This increase chiefly reflected an increase in short-term investments of ¥576 million, or 57.5%, to ¥1,578 million (US$19,244 thousand), as well as an increase in inventories of ¥502 million, or 5.6%, to ¥9,522 million (US$116,122 thousand) as production levels began to recover, offset by a decrease in cash and cash equivalents of ¥1,156 million, or 8.0%, to ¥13,217 million (US$161,183 thousand).

Net property, plant and equipment decreased ¥1,129 million, or 9.7%, to ¥10,549 million (US$128,647 thousand). This downward trend, continuing from the previous fiscal year-end, was due to a decline in machinery and equipment of ¥943 million, or 3.9%, to ¥23,109 million (US$281,817 thousand) owing to restrained investment. Total investments and other assets decreased ¥792 million, or 17.0%, to ¥3,865 million (US$47,134 thousand). This was due to a decrease in deferred tax assets of ¥165 million to ¥517 million (US$6,305 thousand).

As result of the above, total assets decreased ¥1,431 million, or 2.8%, year on year to ¥49,250 million (US$600,610 thousand).

Total liabilities increased due to increased trade notes and accounts payable as a result of an increase in purchases.

On the other side of the balance sheet, current liabilities increased ¥2,903 million, or 32.9%, to ¥11,731 million (US$143,061 thousand). This increase reflected an increase in trade notes and accounts payable of ¥3,045 million, or 108.1%, to ¥5,861 million (US$71,476 thousand) as a result of higher sales, offset by a decrease in deferred tax liabilities of ¥786 million, or 60.0%, to ¥525 million (US$6,402 thousand).

Total long-term liabilities decreased ¥169 million, or 28.5%, to ¥423 million (US$5,159 thousand).

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

Equity fell ¥4,198 million, or 10.3%, to ¥36,412 million (US$444,049 thousand) despite the Company posting net income of ¥161 million. This was largely the result of a decline in retained earnings of ¥808 million, or 3.0% year on year, to ¥25,779 million (US$314,378 thousand), as well as a decline in foreign currency translation adjustments of ¥2,546 million, or 45.5%, to ¥8,147 million (US$99,354 thousand). Total equity including minority interests was ¥37,096 million (US$452,390 thousand). The equity ratio fell 6.2 percentage points to 73.9%, while equity per share decreased ¥76.24 to ¥845.31 (US$10.31).
CASH FLOWS

Net cash provided by operating activities decreased yet still exceeded net cash used in investing activities. Net cash provided by operating activities decreased ¥1,249 million to ¥3,520 million (US$42,927 thousand). This outcome was largely attributable to income before income taxes and minority interests of ¥360 million (US$4,390 thousand) reflecting a substantial improvement in operating results. On the other hand, adjustments for depreciation and amortization decreased ¥1,122 million to ¥1,762 million (US$21,488 thousand), and trade receivables, inventories, and trade payables decreased ¥5,544 million to ¥1,595 million (US$19,451 thousand).

Net cash used in investing activities was ¥1,518 million (US$18,512 thousand), an increase of ¥324 million year on year. This chiefly reflected increases in net cash used in activities other than the purchase of property, plant and equipment which, conversely, fell ¥683 million to ¥981 million (US$11,963 thousand), due to efforts to curb capital investments.

Cash and cash equivalents decreased due to exchange rates and payments for purchase of treasury stock. Net cash used in financing activities was ¥1,813 million (US$22,110 thousand), an improvement of ¥2,164 million from the previous fiscal year. This was mainly the result of a decrease of ¥220 million in dividends paid to shareholders to ¥975 million (US$11,891 thousand), along with a decline in payments for purchase of treasury stock to ¥839 million (US$10,231 thousand).

As a result of the above, after foreign currency translation adjustments of ¥1,345 million (US$16,402 thousand), cash and cash equivalents as of February 28, 2011 totaled ¥13,217 million (US$161,183 thousand), representing a net decrease of ¥1,156 million year on year.

CAPITAL EXPENDITURES AND R&D EXPENSES

Capital expenditures declined year on year Capital expenditures in fiscal 2011 fell ¥612 million, or 38.6%, year on year to ¥974 million (US$11,878 thousand). In fiscal 2012, the Company is forecasting capital expenditures of ¥2,827 million.

Special Products  Expenditures in the Special Products Segment fell ¥72 million year on year to ¥56 million (US$683 thousand). In fiscal 2012, the Company is budgeting expenditures in this segment in the amount of ¥312 million, mainly for dyes for new models.

Components  Expenditures in the Components Segment fell ¥483 million year on year to ¥89 million (US$1,085 thousand). In fiscal 2012, the Company is budgeting expenditures in this segment in the amount of ¥157 million, mainly for dyes for new models.
**Machine Tools**
Expenditures in the Machine Tools Segment were unchanged from the previous fiscal year at ¥465 million (US$5,671 thousand). In fiscal 2012, we anticipate that ¥1,106 million will be spent on investments such as the construction of a new production plant in Thailand, equipment for making new products, and other items.

**Precision Products**
Expenditures in the Precision Products Segment fell ¥78 million year on year to ¥190 million (US$2,317 thousand). In fiscal 2012, we expect to spend ¥884 million mainly on the acquisition of land and buildings for production sites overseas, as well as on bolstering production capacity, namely through increased production equipment for automatic lathes at overseas production sites.

**Head Office and Others**
In fiscal 2012, we plan to invest ¥368 million for the upgrading of information systems, and other items.

> **R&D expenses declined year on year**
Research and development (R&D) expenses in fiscal 2011 were ¥1,755 million (US$21,402 thousand), a decrease of ¥195 million, or 10.0%, from the previous year. This represented 4.9% of total sales, a decrease of 1.8 percentage points year on year.

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

**Research and Development Department**
As a result of corporate reorganization enacted during fiscal 2011, this department is now responsible for cultivating commercially viable businesses in new fields, and stepping up activities to provide technical support to all of the Company’s segments. In terms of cultivating new businesses, the Company is considering entering into partnerships with companies outside the Group in order to expedite the launch of new ventures. Regarding technical support, the department worked to raise the technology level of the whole Company. Activities included promoting technology, mainly by conducting physico-chemical analysis, advanced computer-aided engineering (CAE), and quality engineering, as well as conducting quality control and patent operations.

**Special Products**
Product development in this segment is aimed at developing highly competitive products that meet customers’ needs. The basis for this activity is development and design of products that contribute to lowering environmental impact while retaining high quality and reliability. In fiscal 2011, the Company developed a range of new products, including utility software compatible with multiple printer products and local-language printers for Southeast Asian markets.

**Components**
New product development in this segment included a new dynamic speaker for the automotive market, the SAG-40 Series, with a rich sound, flat frequency response and high thermal shock resistance. In addition, there are a number of accessories under development with hearing aid and headphone applications using BA receivers in response to customer demand. These accessories draw on our micro audio technologies.
Four new products were developed in fiscal 2011: the Swiss-type high-performance multi-axis lathe ST-38, the low-cost automatic lathe series SB-20, the turning center SF-25 for small precision components and the fixed-headstock CNC automatic lathe SG-42 for machining large-diameter precision parts, all targeting new markets. Development in the software field centered mainly on ongoing improvements in operability, functionality and safety features, always with a firm eye on market needs.

SALES FRAMEWORK AND NET SALES BY REGION

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

<table>
<thead>
<tr>
<th>Region</th>
<th>U.K.</th>
<th>Germany</th>
<th>France</th>
<th>Switzerland</th>
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<tbody>
<tr>
<td>Special Products</td>
<td>Star Micronics Europe Ltd.</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>U.S.</td>
<td>Star Micronics America, Inc.</td>
<td>Star Micronics (Thailand) Co., Ltd.</td>
<td>Shanghai Xingang Machinery Co., Ltd.</td>
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* Star Micronics America, Inc. markets components in addition to special products.
* In the Special Products Segment, realignment in our China and Southeast Asia sales network for POS printers saw a sales base established in September 2010 at our Thailand site, Star Micronics (Thailand) Co., Ltd., to replace Star Micronics Asia Ltd., which ceased operations at the end of December 2010.

Overseas sales as a proportion of total sales fell 2.8 percentage points to 78.6% while sales increased in Europe, America and Japan.

In the fiscal year under review, overseas sales as a proportion of total sales decreased 2.8 percentage points to 78.6%.

By region, in Europe, net sales increased ¥2,622 million to ¥9,979 million (US$121,695 thousand), representing 27.9% of total sales, a 2.7 percentage points increase from the previous fiscal year.

In America, net sales increased ¥2,462 million to ¥8,516 million (US$103,854 thousand). The share of total sales in America rose 3.0 percentage points to 23.8%.

Net sales in Asia decreased ¥744 million to ¥9,589 million (US$116,939 thousand). The share of total sales in Asia decreased 8.5 percentage points to 26.9%.

In Japan, the main products are machine tools and precision products. Domestic sales increased ¥2,197 million to ¥7,634 million (US$93,097 thousand), representing 21.4% of total sales, up by 2.8 percentage points year on year.