

FY03/17 Consolidated Financial Results For Third Quarter Ended December 31, 2016 (Japan GAAP)

January 30, 2017

Company name: Digital Arts Inc. <Tokyo Stock Exchange- First Section>
 Code no.: 2326 URL <http://www.daj.jp>
 Representative: Toshio Dogu, President and Chief Executive Officer
 Contact Person: Hidenobu Akazawa, Director, Administration Department Tel. (03) 5220-6045
 Scheduled date of filing Shihanki-Hokokusho: February 10, 2017
 Scheduled date of payment of cash dividends: --
 Additional materials of the Financial Results for the Second Quarter: Yes
 Briefing session of the Financial Results for the Second Quarter: No

(Amounts less than one million yen are rounded)

1. Consolidated Financial Results for the Third Quarter Ended December 31, 2016 (April 1, 2016 through December 31, 2016)

<1> Consolidated operating results (cumulative)

(Percent indications show percentage of changes from corresponding figures for the previous period)

	Net sales		Operating income		Ordinary income		Net income attributable to owners of parent	
	Millions of yen	%	Millions of yen	%	Millions of yen	%	Millions of yen	%
FY03/2017 3rd Quarter	3,518	28.1	1,145	89.3	1,134	85.8	693	92.7
FY03/2016 3rd Quarter	2,747	18.1	604	29.6	610	18.2	360	18.9

(Note): Comprehensive income: 709 million yen for FY03/2017 3rd Quarter (95.7%); 362 million yen for FY03/2016 3rd Quarter (17.2%)

	Net income per share-basic	Net income per share-diluted
	Yen	Yen
FY03/2017 3rd Quarter	49.81	49.66
FY03/2016 3rd Quarter	25.91	25.82

<2> Consolidated financial position

	Total assets	Net assets	Equity ratio	Net asset per share
	Millions of yen	Millions of yen	%	Yen
FY03/2017 3rd Quarter	6,397	4,848	74.4	344.48
FY03/2016	6,133	4,642	74.7	329.03

(Reference): Total equity: 4,760 million yen as of December 31, 2016; 4,583 million yen as of March 31, 2016

2. Dividends

	Annual cash dividends per share				
	at 1st Quarter end	at 2nd Quarter end	at 3rd Quarter end	at fiscal year end	Total
	yen	yen	yen	yen	yen
FY03/2016	—	7.00	—	8.00	15.00
FY03/2017	—	10.00	—	—	—
FY03/2017 (forecast)	—	—	—	10.00	20.00

(Note): Changes in dividends forecast for FY03/2017 from the latest disclosure: No

3. Forecast of Consolidated Operating Results for Fiscal Year Ending March 2017 (April 1, 2016 through March 31, 2017)

(Percent indications show percentage of changes from corresponding figures for the previous period)

	Net sales		Operating income		Ordinary income		Net income attributable to owners of parent		Net income per share
	Millions of yen	%	Millions of yen	%	Millions of yen	%	Millions of yen	%	yen
FY03/2017	4,600	15.0	1,400	39.1	1,400	40.8	870	59.5	62.49

(Note): Changes in forecast of consolidating operating results for FY03/2017 from the latest disclosure: No

※Notes

<1> Significant changes in scope of consolidation: None

In : — (Company Name:)

Out : — (Company Name:)

<2> Adoption of specific accounting policies for quarterly consolidated financial statements: Applicable

<3> Changes in accounting policies, accounting estimation change and restatement

<3>-1 Changes in accounting policies due to the revision of the accounting standards: Yes

<3>-2 Changes in accounting policies except for those in <2>-1: None

<3>-3 Changes due to accounting estimation change: None

<3>-4 Restatement: None

<4> Number of shares issued

(shares)

<4>-1 Number of shares issued at the end of the period (including treasury shares)

<4>-2 Number of treasury shares at the end of the period

<4>-3 Average number of shares issued during the 3rd Quarter ended Dec 31, 2016

FY03/17 3Q	14,133,000	FY03/16	14,133,000
FY03/17 3Q	313,500	FY03/16	201,800
FY03/17 3Q	13,930,476	FY03/16 3Q	13,899,074

※Implementation status of quarterly review

This Financial Result report for the second quarter is exempt from quarterly review which is based on Financial Instruments and Exchange Law of Japan. As of the second quarter disclosing, quarterly review procedures for the quarterly financial statements is on-going.

※Explanation of Appropriate Use of Performance Projections and Other Special Items

(Forward Looking Statements)

Business forecasts contained in this report are based on information available to the Company and on a certain assumption the Company considers reasonable on the date of this report's announcement, and it does not constitute the Company's intention to promise the accomplishment of the forecasts. Due to unforeseen circumstances, actual results may differ significantly from such forecasts due to various risks and uncertainties which include, but are not limited to, global economic environment, intensified sales competition, fluctuations in exchange rate and interest rate.

Refer to "Qualitative Information on Consolidated Financial Results for the Third Quarter Ended December 31, 2016 (3) Earnings Forecast for Fiscal Year Ending March 31, 2017" of the attached material for more information on performance projection.

(Obtaining Supplemental Material for the Financial Results for the Third Quarter)

Materials are available on our official website.

1. Qualitative Information on Consolidated Financial Results for the Third Quarter Ended December 31, 2016

(1) Operation Results

In the current consolidated third quarter (April 1, 2016 through December 31, 2016), the Japanese economy continued to show moderate recovery with continuing upturn in employment as a result of the government's aggressive economic policies and corporate performance holding firm. On the other hand, prospects of the world economy remained unclear with concerns of economic downturn, mainly due to decelerating economy in emerging countries, Brexit, and the uncertainties of the new Trump administration policies.

In the security industry where the Digital Arts Group (the "Group") engages its primary business, growing concerns over security incidents, such as large-scale leakage of personal data as a result of targeted attacks aimed at specific corporations and organizations, led not only security admins, but also corporate managers to become more aware of the importance of strengthening information security. Additionally, local governments actively improves their security under the guideline of fundamental strengthening of local government data security issued by the Ministry of Internal Affairs and Communications.

In such circumstances, the Group strengthened domestic marketing activities for large corporations and organizations that need relatively advanced security. Specifically, it created a department specializing in large domestic companies and organizations. The Group also created a consulting business subsidiary, Digital Arts Consulting Inc., to assist with security implementation and to provide high value added proposals for clients looking to implement security on a large scale and use its products as global tools.

In the public sector, the Group dramatically increased sales by developing and offering solutions that satisfy the level of security demanded in the Ministry of internal Affairs and Communications' guidelines on strengthening local government security.

Overseas, US subsidiary FinalCode, Inc. and Asia-Pacific subsidiary FinalCode Asia Pacific Pte. Ltd. began to acquire contracts as a result of progress in partnerships with local sales partners and implementing concrete measures to drive sales. In Europe, FinalCode Europe Limited focused on hiring employees and developing partnerships with local sales partners.

For FY03/17 third quarter cumulative results, consolidated net sales were JPY 3,518,161 thousand (+28.1% YoY). Despite increased expenses from hiring employees in Japan, the following contributed to the overall increase in earnings: operating income was JPY 1,145,071 thousand (+89.3% YoY), ordinary income was JPY 1,134,473 thousand (+85.8% YoY) and net income attributable to parent company shareholders was JPY 693,815 thousand (+92.7% YoY).

Business performance by segment is as follows.

Enterprise Sector

Net sales to the enterprise sector were JPY 1,740,544 thousand (+17.3% YoY).

Sales were favorable for the company's main products in the enterprise sector, i-FILTER and FinalCode. Corporate managers became more aware of the importance of improving information security as targeted attacks on specific companies are causing increasingly more damage. In such environment, the Company saw continued implementation of its i-FILTER and i-FILTER Browser & Cloud products, which can deal with a variety of complex security risks. FinalCode Ver. 5, released in FY03/16, providing company-wide advanced file security, met the needs of corporations that handle large volumes of customer data and firmly increased sales of FinalCode. With increased awareness on data security measures, orders received by Digital Arts Consulting were also favorable, contributing to the Group's overall sales growth.

Public Sector

Net sales to the public sector were JPY 1,523,134 thousand (+50.1% YoY).

In accordance to a guideline issued by the Ministry of Internal Affairs and Communications on fundamental strengthening of local government data security, prefectures are consolidating their internet connections and strengthening surveillance (using cloud solutions for local government data security), while cities, wards, towns and

villages are actively improving security (using the model for improving local government data systems). The Company's solutions that incorporates "i-FILTER (or D-SPA) to centralize web access" and "m-FILTER to neutralize web email messages" captured the needs of clients seeking to respond to the above guidelines, and pushed up sales. Deployment of FinalCode Limited Edition for Local Government, an edition that responds to needs specific to prefectural, city and local municipality governments, has been favorable and contributed to the overall increase in sales.

Consumer Sector

Net sales in the consumer sector were JPY 254,483 thousand (+2.3% YoY).

In the consumer segment, the Company continued to enter tie-ups with mobile operators and other business partners in effort to expand sales and increase collaboration for the mobile device version of i-FILTER (Consumer) for Smartphones.

Sales were firm for the PC version of the i-FILTER (Consumer) due to OEM-driven sales, robust shipment of multi-year packaged products, and other positive factors, despite the continuous decline in the number of domestic consumer PC shipments. Sales also expanded thanks to robust direct sales of i-FILTER (Consumer) Multi-Device, which can be used on three operating systems (Windows, iOS, and Android) with a single serial ID.

(2) Financial Position

(Assets)

Current assets increased JPY 263,624 thousand to JPY 6,397,484 thousand compared to March 31, 2016. This was mainly attributable to increase in cash and deposits due to an increase in operating cash flow.

(Liabilities)

Current liabilities increased JPY 57,288 thousand to JPY 1,549,114 thousand compared to March 31, 2016. This was mainly due to increase in advance received for unearned maintenance sales.

(Net Assets)

Net assets increased JPY 206,336 thousand to JPY 4,848,370 thousand compared to March 31, 2016. This was mainly due to increase in retained earnings by accounting third quarter net income attributable to owners of parent.

(3) Earnings Forecast for Fiscal Year Ending March 31, 2017

The Company maintains its full-year forecast, however given the favorable environment that is projected to continue, the consolidated forecast for FY03/17 (April 1, 2016 through March 31, 2017) is currently under review and will make timely disclosures as necessary.

2. Quarterly Consolidated Financial Statements

(1) Quarterly Consolidated Balance Sheet

(thousands of yen)

	Preceding Fiscal Year (As of March 31, 2016)	Current Third Quarter (As of December 31, 2016)
Assets		
Current assets		
Cash and deposits	2,942,965	3,164,679
Accounts receivable – trade	1,081,626	1,137,002
Securities	100,909	–
Finished goods	413	884
Deferred tax assets	73,813	74,156
Other	62,884	75,689
Total current assets	4,262,613	4,452,413
Non-current assets		
Property, plant and equipment	127,257	123,310
Intangible assets		
Software	821,395	826,473
Other	174,131	275,490
Total intangible assets	995,526	1,101,964
Investments and other assets	748,462	719,796
Total non-current assets	1,871,246	1,945,071
Total assets	6,133,859	6,397,484
Liabilities		
Current liabilities		
Accounts payable – trade	5,844	24,373
Income taxes payable	283,949	213,523
Provision for bonuses	109,975	58,532
Advances received	721,033	852,192
Other	327,288	356,015
Total current liabilities	1,448,091	1,504,636
Non-current liabilities		
Asset retirement obligations	43,089	43,833
Other	645	645
Total non-current liabilities	43,734	44,478
Total liabilities	1,491,826	1,549,114
Net assets		
Shareholders' equity		
Capital stock	713,590	713,590
Capital surplus	766,234	776,393
Retained earnings	3,220,233	3,667,692
Treasury stock	(117,511)	(413,602)
Total shareholders' equity	4,582,547	4,744,073
Accumulated other comprehensive income		
Foreign currency translation adjustments	1,208	16,504
Total accumulated other comprehensive income	1,208	16,504
Subscription rights to shares	58,278	83,412
Non Controlling Interest	–	4,380
Total net assets	4,642,033	4,848,370
Total liabilities and net assets	6,133,859	6,397,484

(2) Quarterly Consolidated Statement of Income and Quarterly Consolidated Statement of Comprehensive Income

Quarterly Consolidated Statements of Income

(thousands of yen)

	Preceding Cumulative Third Quarter (From April 1, 2015 to December 31, 2015)	Current Cumulative Third Quarter (From April 1, 2016 to December 31, 2016)
Net sales	2,747,276	3,518,161
Cost of sales	661,254	741,862
Gross profit	2,086,021	2,776,299
Selling, general and administrative expenses	1,481,206	1,631,228
Operating income	604,815	1,145,071
Non-operating income		
Interest income	983	927
Commission fees	126	150
Foreign exchange gains	523	—
Gain on forfeiture of unclaimed dividends	3,367	1,178
Miscellaneous income	656	114
Total non-operating income	5,657	2,371
Non-operating expenses		
Foreign exchange losses	—	11,546
Miscellaneous expenses	—	1,422
Total non-operating expenses	—	12,969
Ordinary income	610,473	1,134,473
Extraordinary income		
Gain on reversal of subscription rights to shares	3,613	283
Gain on sales of noncurrent assets	2,638	—
Total extraordinary income	6,252	283
Extraordinary loss		
Loss on sales of fixed assets	347	1,466
Total extraordinary loss	347	1,466
Income before income taxes	616,377	1,133,290
Income taxes	256,308	440,094
Net income	360,068	693,195
Loss attributable to non-controlling interests	—	(619)
Net income attributable to owners of parent	360,068	693,815

Quarterly Consolidated Statements of Comprehensive Income (Cumulative)

(thousands of yen)

	Preceding Cumulative Third Quarter (From April 1, 2015 to December 31, 2015)	Current Cumulative Third Quarter (From April 1, 2016 to December 31, 2016)
Net income	360,068	693,195
Other comprehensive income		
Foreign currency translation adjustments	2,368	15,296
Total other comprehensive income	2,368	15,296
Comprehensive income	362,437	708,491
(Breakdown)		
Comprehensive income attributable to owners of parent	362,437	709,111
Comprehensive loss attributable to non-controlling interests	—	(619)

(3) Note on FY03/17 Consolidated Financial Results for Third Quarter Ended December 31, 2016

(Note regarding going concern assumptions)

None

(Material changes in shareholders' equity)

None