

## FY03/17 Consolidated Financial Results For First Quarter Ended June 30, 2016 (Japan GAAP)

July 28, 2016

Company name: Digital Arts Inc.

<Tokyo Stock Exchange, First Section>

Code no.: 2326

URL <http://www.daj.jp>

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Additional materials of the Financial Results for the First Quarter: Yes

Briefing session of the Financial Results for the First Quarter: No

(Amounts less than one million yen are rounded)

### 1. Consolidated Financial Results for the First Quarter Ended June 30, 2016 (April 1, 2016 through June 30, 2016)

#### <1> Consolidated operating results

(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 1st Quarter | 916             | 14.1 | 99               | 21.7  | 78              | -8.1  | 13  | -76.4 |
| FY03/2016 1st Quarter | 803             | 19.4 | 81               | 127.1 | 85              | 139.5 | 57  | 259.2 |

(Note): Comprehensive income: -10 million yen for FY03/2017 1st Quarter (--%); 65 million yen for FY03/2016 1st Quarter (305.6%)

|                       | Net income per share-basic | Net income per share-diluted |
|-----------------------|----------------------------|------------------------------|
|                       | Yen                        | Yen                          |
| FY03/2017 1st Quarter | 0.98                       | 0.97                         |
| FY03/2016 1st Quarter | 4.14                       | 4.13                         |

#### <2> Consolidated financial position

|                       | Total assets    | Net assets      | Equity ratio |
|-----------------------|-----------------|-----------------|--------------|
|                       | Millions of yen | Millions of yen | %            |
| FY03/2017 1st Quarter | 5,992           | 4,527           | 74.5         |
| FY03/2016             | 6,133           | 4,642           | 74.7         |

(Reference): Total equity: 4,466 million yen as of June 30, 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            | —                               | —                  | —                  | —                  | —     |
| FY03/2017 (forecast) | —                               | 10.00              | —                  | 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                  |
| 2nd Quarter (cumulative) | 2,222           | 14.8 | 608              | 22.5 | 608             | 21.9 | 363   | 15.5 | 26.08                |
| 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

<2>-1 Changes in accounting policies due to the revision of the accounting standards: Yes

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

<2>-3 Changes due to accounting estimation change: None

<2>-4 Restatement: None

<3> Number of shares issued

(shares)

<3>-1 Number of shares issued at the end of the period (including treasury stocks)

|            |            |            |            |
|------------|------------|------------|------------|
| FY03/17 1Q | 14,133,000 | FY03/16    | 14,133,000 |
| FY03/17 1Q | 199,800    | FY03/16    | 201,800    |
| FY03/17 1Q | 13,932,606 | FY03/16 1Q | 13,890,986 |

<3>-2 Number of treasury shares at the end of the period

<3>-3 Average number of shares issued during the first quarter ended June 30, 2016

※Implementation status of quarterly review

This Financial Result report for the first quarter is exempt from quarterly review which is based on Financial Instruments and Exchange Law of Japan. As of the first 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 First Quarter Ended June 30, 2016 (3) Earning Forecasts 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 First Quarter)

Materials are available on our official website.

## Qualitative Information on Consolidated Financial Results for the First Quarter Ended June 30, 2016

### (1) Operation Results

In the current consolidated first quarter (April 1, 2016 through June 30, 2016), the Japanese economy continued to show moderate recovery with continuing upturn in employment as the government carried out aggressive economic policies and corporate performance holding firm. On the other hand, prospects of the world economy remained unclear with heightened uncertainty in the global economy, notably in emerging countries, and the rapid appreciation of the yen as a result of Britain's decision to leave the EU.

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 improving information security. Additionally, local governments actively improve 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 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 promoted sales while looking to work with other companies in order to provide 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. created partnerships with other companies and used more specific marketing strategies in order for its concentration on branding activities in FY03/16 to produce concrete sales results. In the Asia-Pacific region, FinalCode Asia Pacific Pte. Ltd. gained more contracts and created a marketing network the same way FinalCode, Inc. did. In Europe, FinalCode Europe Limited focused on hiring employees and worked on its infrastructure to carry out more specific measures from Q2 onwards.

In Q1 FY03/17, consolidated sales were a record high JPY916,915 thousand (+14.1% YoY). Operating income was JPY99,340 thousand (+21.7% YoY) thanks to the boost of sales, despite increased expenses from hiring employees in Japan and from an increase in overseas locations. However, ordinary income was JPY78,953 thousand (-8.1% YoY) and net income attributable to parent company shareholders was JPY13,601 thousand (-76.4% YoY) due to forex losses (JPY20,061 thousand) from the rapid appreciation of the yen and an increased tax burden primarily caused by investments in overseas subsidiaries.

Business performance by segment is as follows.

#### Enterprise Sector

Net sales to the enterprise sector were JPY530,169 thousand (+15.9% 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. In an environment where leaks of large volumes of customer data occur often, FinalCode Ver. 5, released in FY03/16, provided company-wide advanced file security, meeting the needs of corporations that handle large volumes of customer data and firmly increasing sales of FinalCode.

#### Public Sector

Net sales to the public sector were JPY296,908 thousand (+15.8% YoY).

Sales in the public sector were firm for company's core products, i-FILTER, m-FILTER, and FinalCode. The company acquired large i-FILTER contracts primarily with large organizations looking to strengthen security the same way corporations are. Sales of FinalCode grew thanks to robust implementation of the limited edition local

government version of FinalCode, which simply provides the functions that public organizations want. Additionally, contracts soared as local governments allocated money for improving cybersecurity under the Ministry of Internal Affairs and Communications' guidelines on fundamental strengthening of local government data security. Cities, wards, towns and villages are actively improving their security (using the model for improving local government data systems), and prefectures are consolidating their internet connections and strengthening surveillance (using cloud solutions for local government data security).

In response to the above guidelines, the company proposed centralizing web access using i-FILTER (or D-SPA), providing email security with m-FILTER and combating individual data leak using FinalCode. In Q1, sales increased for m-FILTER. From Q1 onwards, the company plans to further increase its market share by steadily acquiring prospective contracts.

## Consumer Sector

Net sales in the consumer segment were JPY89,837 thousand (+0.2% YoY).

In the consumer segment, the Company entered tie-ups with mobile operators and their business partners in an effort to expand sales and increase collaboration for the mobile device version of i-FILTER for smartphones.

Sales were firm for the PC version of the company's products due to OEM-driven sales, robust shipment of multi-year packaged products, and other positive factors, despite a decline in the number of domestic consumer PC shipments. Sales also expanded thanks to robust direct sales of i-FILTER 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 declined JPY141,131 thousand to JPY5,992,728 thousand compared to March 31, 2016. This was mainly attributable to decrease in accounts receivable due to collecting proceeds from the end of the preceding fiscal year.

### (Liabilities)

Current liabilities declined JPY26,947 thousand to JPY1,464,878 thousand compared to March 31, 2016. This was mainly due to decrease in accrued income tax by making appropriate tax payment.

### (Net Assets)

Net assets declined JPY114,184 thousand to JPY4,527,849 thousand compared to March 31, 2016. This was mainly due to dividend payment, although net income for the first quarter was recorded as net income attributable to owners of parent.

## (3) Earning Forecasts for Fiscal Year Ending March 31, 2017

As consolidated first quarter showed robust performance, the Group's forecast remains unchanged for the full year as presented on May 11, 2016. Earnings forecast was based upon information currently available to the Group's management, however various factors could cause actual results to differ from those expressed in the forecast. Important updates, if applicable, will be appropriately disclosed.

## Quarterly Consolidated Financial Statements

### (1) Quarterly Consolidated Balance Sheet

(thousands of yen)

|   | Preceding Fiscal Year<br>(As of March 31, 2016) | Current First Quarter<br>(As of June 30, 2016) |
|---|---|--|
| <b>Assets</b>                                       |   |  |
| Current assets                                      |   |  |
| Cash and deposits                                   | 2,942,965                                       | 2,954,724                                      |
| Accounts receivable – trade                         | 1,081,626                                       | 884,814  |
| Securities  | 100,909   | 100,909  |
| Finished goods                                      | 413   | 1,119  |
| Deferred tax assets                                 | 73,813  | 73,944   |
| Other   | 62,884  | 82,396   |
| <b>Total current assets</b>                         | <b>4,262,613</b>                                | <b>4,097,908</b>                               |
| Non-current assets                                  |   |  |
| Property, plant and equipment                       | 127,257   | 122,942  |
| Intangible assets                                   |   |  |
| Software  | 821,395   | 766,723  |
| Other   | 174,131   | 249,949  |
| <b>Total intangible assets</b>                      | <b>995,526</b>                                  | <b>1,016,672</b>                               |
| Investments and other assets                        | 748,462   | 755,204  |
| <b>Total non-current assets</b>                     | <b>1,871,246</b>                                | <b>1,894,819</b>                               |
| <b>Total assets</b>                                 | <b>6,133,859</b>                                | <b>5,992,728</b>                               |
| <b>Liabilities</b>                                  |   |  |
| Current liabilities                                 |   |  |
| Accounts payable – trade                            | 5,844   | 11,240   |
| Income taxes payable                                | 283,949   | 62,628   |
| Provision for bonuses                               | 109,975   | 58,933   |
| Advances received                                   | 721,033   | 840,823  |
| Asset retirement obligations                        | —   | 1,127  |
| Other   | 327,288   | 447,409  |
| <b>Total current liabilities</b>                    | <b>1,448,091</b>                                | <b>1,422,162</b>                               |
| Non-current liabilities                             |   |  |
| Asset retirement obligations                        | 43,089  | 42,071   |
| Other   | 645   | 645  |
| <b>Total non-current liabilities</b>                | <b>43,734</b>                                   | <b>42,716</b>                                  |
| <b>Total liabilities</b>                            | <b>1,491,826</b>                                | <b>1,464,878</b>                               |
| <b>Net assets</b>                                   |   |  |
| Shareholders' equity                                |   |  |
| Capital stock                                       | 713,590   | 713,590  |
| Capital surplus                                     | 766,234   | 769,807  |
| Retained earnings                                   | 3,220,233                                       | 3,122,385                                      |
| Treasury stock                                      | (117,511)                                       | (116,347)                                      |
| <b>Total shareholders' equity</b>                   | <b>4,582,547</b>                                | <b>4,489,435</b>                               |
| Accumulated other comprehensive income              |   |  |
| Foreign currency translation adjustments            | 1,208   | (22,471)                                       |
| <b>Total accumulated other comprehensive income</b> | <b>1,208</b>                                    | <b>(22,471)</b>                                |
| Subscription rights to shares                       | 58,278  | 56,240   |
| Non Controlling Interest                            | —   | 4,645  |
| <b>Total net assets</b>                             | <b>4,642,033</b>                                | <b>4,527,849</b>                               |
| <b>Total liabilities and net assets</b>             | <b>6,133,859</b>                                | <b>5,992,728</b>                               |

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

Quarterly Consolidated Statements of Income

(thousands of yen)

|   | Preceding First Quarter<br>(From April 1, 2015<br>to June 30, 2015) | Current First Quarter<br>(From April 1, 2016<br>to June 30, 2016) |
|---|---|---|
| Net sales   | 803,529   | 916,915   |
| Cost of sales                                     | 211,388   | 240,819   |
| Gross profit                                      | 592,141   | 676,096   |
| Selling, general and administrative expenses      | 510,482   | 576,755   |
| Operating income                                  | 81,658  | 99,340  |
| Non-operating income                              |   |   |
| Interest income                                   | 299   | 268   |
| Commission fees                                   | 44  | 43  |
| Foreign exchange gains                            | 3,815   | —   |
| Miscellaneous income                              | 199   | 34  |
| Total non-operating income                        | 4,287   | 346   |
| Non-operating expenses                            |   |   |
| Foreign exchange losses                           | —   | 20,061  |
| Miscellaneous expenses                            | —   | 672   |
| Total non-operating expenses                      | —   | 20,733  |
| Ordinary income                                   | 85,946  | 78,953  |
| Extraordinary income                              |   |   |
| Gain on reversal of subscription rights to shares | 3,538   | 10  |
| Gain on sales of noncurrent assets                | 2,638   | —   |
| Total extraordinary income                        | 6,177   | 10  |
| Income before income taxes                        | 92,123  | 78,964  |
| Income taxes                                      | 34,553  | 65,717  |
| Net income  | 57,570  | 13,246  |
| Loss attributable to non-controlling interests    | —   | (354)   |
| Net income attributable to owners of parent       | 57,570  | 13,601  |

Quarterly Consolidated Statements of Comprehensive Income

(thousands of yen)

|  | Preceding First Quarter<br>(From April 1, 2015<br>to June 30, 2015) | Current First Quarter<br>(From April 1, 2016<br>to June 30, 2016) |
|--|---|---|
| Net income   | 57,570  | 13,246  |
| Other comprehensive income                                   |   |   |
| Foreign currency translation adjustments                     | 7,741   | (23,679)  |
| Total other comprehensive income                             | 7,741   | (23,679)  |
| Comprehensive income   | 65,311  | (10,433)  |
| (Breakdown)  |   |   |
| Comprehensive income attributable to owners of parent        | 65,311  | (10,078)  |
| Comprehensive loss attributable to non-controlling interests | —   | (354)   |