

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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Scheduled date of filing Shihanki-Hokokusho: August 10, 2016

Scheduled date of payment of cash dividends: —

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 (As of March 31, 2016)	Current First Quarter (As of June 30, 2016)
Assets		
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
Total current assets	4,262,613	4,097,908
Non-current assets		
Property, plant and equipment	127,257	122,942
Intangible assets		
Software	821,395	766,723
Other	174,131	249,949
Total intangible assets	995,526	1,016,672
Investments and other assets	748,462	755,204
Total non-current assets	1,871,246	1,894,819
Total assets	6,133,859	5,992,728
Liabilities		
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
Total current liabilities	1,448,091	1,422,162
Non-current liabilities		
Asset retirement obligations	43,089	42,071
Other	645	645
Total non-current liabilities	43,734	42,716
Total liabilities	1,491,826	1,464,878
Net assets		
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)
Total shareholders' equity	4,582,547	4,489,435
Accumulated other comprehensive income		
Foreign currency translation adjustments	1,208	(22,471)
Total accumulated other comprehensive income	1,208	(22,471)
Subscription rights to shares	58,278	56,240
Non Controlling Interest	—	4,645
Total net assets	4,642,033	4,527,849
Total liabilities and net assets	6,133,859	5,992,728

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

Quarterly Consolidated Statements of Income

(thousands of yen)

	Preceding First Quarter (From April 1, 2015 to June 30, 2015)	Current First Quarter (From April 1, 2016 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 (From April 1, 2015 to June 30, 2015)	Current First Quarter (From April 1, 2016 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)