

FY03/17 Consolidated Financial Results For Second Quarter Ended September 30, 2016 (Japan GAAP)

October 27, 2016

Company name: Digital Arts Inc. <Tokyo Stock Exchange- First Section>
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 Additional materials of the Financial Results for the Second Quarter: Yes
 Briefing session of the Financial Results for the Second Quarter: Yes (for institutional investors and analysts)

(Amounts less than one million yen are rounded)

1. Consolidated Financial Results for the Second Quarter Ended September 30, 2016 (April 1, 2016 through September 30, 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 2nd Quarter	2,420	25.0	789	58.9	767	53.6	454	44.5
FY03/2016 2nd Quarter	1,935	20.2	497	46.8	499	39.0	314	49.1

(Note): Comprehensive income: 423 million yen for FY03/2017 2nd Quarter (34.6%); 315 million yen for FY03/2016 2nd Quarter (47.1%)

	Net income per share-basic	Net income per share-diluted
	Yen	Yen
FY03/2017 2nd Quarter	32.62	32.53
FY03/2016 2nd Quarter	22.64	22.57

<2> Consolidated financial position

	Total assets	Net assets	Equity ratio	Net asset per share
	Millions of yen	Millions of yen	%	Yen
FY03/2017 2nd Quarter	6,624	4,970	74.2	352.48
FY03/2016	6,133	4,642	74.7	329.03

(Reference): Total equity: 4,912 million yen as of September 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	—	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

<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 shares)

FY03/17 2Q	14,133,000	FY03/16	14,133,000
FY03/17 2Q	196,400	FY03/16	201,800
FY03/17 2Q	13,934,131	FY03/16 2Q	13,890,986

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

<3>-3 Average number of shares issued during the 2nd quarter ended Sep 30, 2016

※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 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.

1. Qualitative Information on Consolidated Financial Results for the Second Quarter Ended September 30, 2016

(1) Operation Results

In the current consolidated second quarter (April 1, 2016 through September 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 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 driving concrete measures to drive sales. In Europe, FinalCode Europe Limited focused on hiring employees and developing partnerships with local sales partners.

For FY03/17 second quarter cumulative results, consolidated net sales were JPY 2,420,047 thousand (+25.0% YoY). Despite increased expenses from hiring employees in Japan and exchange loss due to the rapid appreciation of the yen, the following contributed to the overall increase in earnings: operating income was JPY 789,980 thousand (+58.9% YoY), ordinary income was JPY 767,285 thousand (+53.6% YoY) and net income attributable to parent company shareholders was JPY 454,595 thousand (+44.5% YoY).

Business performance by segment is as follows.

Enterprise Sector

Net sales to the enterprise sector were JPY 1,149,613 thousand (+13.8% 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 JPY 1,096,059 thousand (+45.2% YoY).

Sales in the public sector dramatically increased for the company's core products, i-FILTER, m-FILTER, and FinalCode. 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 offered solutions such as “centralizing web access with i-FILTER (or D-SPA)” and “neutralizing web email messages with m-FILTER”, which captured the needs of clients seeking to respond to the above guidelines, and pushed up sales. As for FinalCode, 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 174,375 thousand (+2.4% 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 a 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 490,829 thousand to JPY 6,624,689 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 162,766 thousand to JPY 1,654,592 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 328,063 thousand to JPY 4,970,097 thousand compared to March 31, 2016. This was mainly due to net income for the second quarter recorded as net income attributable to owners of parent.

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

The Company announces that its consolidated financial results for the second quarter ended September 30, 2016 differ from the consolidated financial forecasts for the relevant period (released on May 11, 2016). For more information, please refer to *Notice of Difference between FY03/17 Consolidated Financial Forecast and Results For Second Quarter Ended September 30, 2016 (Japan GAAP)* released today.

The Company expects favorable environment to continue mainly in the public-sector market. Consolidated forecast for FY03/17 (April 1, 2016 through March 31, 2017) is currently under review and will be released and announced accordingly.

2. Quarterly Consolidated Financial Statements

(1) Quarterly Consolidated Balance Sheet

(thousands of yen)

	Preceding Fiscal Year (As of March 31, 2016)	Current Second Quarter (As of September 30, 2016)
Assets		
Current assets		
Cash and deposits	2,942,965	3,258,941
Accounts receivable – trade	1,081,626	1,323,931
Securities	100,909	—
Finished goods	413	775
Deferred tax assets	73,813	73,986
Other	62,884	74,038
Total current assets	4,262,613	4,731,673
Non-current assets		
Property, plant and equipment	127,257	118,468
Intangible assets		
Software	821,395	783,289
Other	174,131	266,901
Total intangible assets	995,526	1,050,191
Investments and other assets	748,462	724,355
Total non-current assets	1,871,246	1,893,015
Total assets	6,133,859	6,624,689
Liabilities		
Current liabilities		
Accounts payable – trade	5,844	7,187
Income taxes payable	283,949	318,812
Provision for bonuses	109,975	123,843
Advances received	721,033	854,264
Asset retirement obligations	—	925
Other	327,288	306,737
Total current liabilities	1,448,091	1,611,771
Non-current liabilities		
Asset retirement obligations	43,089	42,175
Other	645	645
Total non-current liabilities	43,734	42,820
Total liabilities	1,491,826	1,654,592
Net assets		
Shareholders' equity		
Capital stock	713,590	713,590
Capital surplus	766,234	774,341
Retained earnings	3,220,233	3,567,832
Treasury stock	(117,511)	(114,367)
Total shareholders' equity	4,582,547	4,941,396
Accumulated other comprehensive income		
Foreign currency translation adjustments	1,208	(29,044)
Total accumulated other comprehensive income	1,208	(29,044)
Subscription rights to shares	58,278	53,198
Non Controlling Interest	—	4,546
Total net assets	4,642,033	4,970,097
Total liabilities and net assets	6,133,859	6,624,689

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

Quarterly Consolidated Statements of Income

(thousands of yen)

	Preceding Cumulative Second Quarter (From April 1, 2015 to September 30, 2015)	Current Cumulative Second Quarter (From April 1, 2016 to September 30, 2016)
Net sales	1,935,354	2,420,047
Cost of sales	439,043	497,303
Gross profit	1,496,311	1,922,743
Selling, general and administrative expenses	999,159	1,132,763
Operating income	497,151	789,980
Non-operating income		
Interest income	652	671
Commission fees	85	96
Foreign exchange gains	965	599
Miscellaneous income	612	46
Total non-operating income	2,316	1,414
Non-operating expenses		
Foreign exchange losses	43	23,436
Miscellaneous expenses	—	672
Total non-operating expenses	43	24,109
Ordinary income	499,424	767,285
Extraordinary income		
Loss on sales of noncurrent assets	3,538	283
Gain on sales of fixed assets	2,638	—
Total extraordinary income	6,177	283
Extraordinary loss		
Loss on sales of fixed assets	—	155
Total extraordinary loss	—	155
Income before income taxes	505,602	767,413
Income taxes	191,004	313,271
Net income	314,597	454,142
Loss attributable to non-controlling interests	—	(453)
Net income attributable to owners of parent	314,597	454,595

Quarterly Consolidated Statements of Comprehensive Income (Cumulative)

(thousands of yen)

	Preceding Cumulative Second Quarter (From April 1, 2015 to September 30, 2015)	Current Cumulative Second Quarter (From April 1, 2016 to September 30, 2016)
Quarterly net income	314,597	454,142
Other comprehensive income		
Foreign currency translation adjustments	435	(30,252)
Total other comprehensive income	435	(30,252)
Comprehensive income	315,033	423,889
(Breakdown)		
Comprehensive income attributable to owners of parent	315,033	424,342
Comprehensive loss attributable to non-controlling interests	—	(453)

(3) Quarterly Consolidated Statements of Cash Flows

Quarterly Consolidated Statements of Income (Cumulative)

(thousands of yen)

	Preceding Cumulative Second Quarter (From April 1, 2015 to September 30, 2015)	Current Cumulative Second Quarter (From April 1, 2016 to September 30, 2016)
Cash flows from operating activities		
Profit before income taxes	505,602	767,413
Depreciation	247,641	254,146
Increase (decrease) in provision for bonuses	25,430	13,867
Interests and dividend income	(652)	(671)
Gain (loss) on non-current assets	(2,638)	—
Loss on retirement of non-current assets	—	155
Foreign exchange losses (gains)	85	19,343
Gain on reversal of subscription rights to shares	(3,538)	(283)
Increase (decrease) in accounts receivable	73,620	(110,181)
Increase (decrease) in inventories	(938)	865
Increase in accounts payable	(324)	1,343
Increase (decrease) in accounts payable- other	(48,412)	(31,445)
Decrease (increase) in other current assets	10,610	(13,252)
Increase (decrease) in other current liabilities	(39,301)	20,831
Others	6,005	11,706
Subtotal	773,189	933,838
Interest and dividends received	305	856
Income taxes paid	(259,589)	(278,630)
Income taxes refund	27,328	—
Net cash provided by operating activities	541,234	656,065
Cash flows from investment activities		
Payments for acquisition of tangible fixed assets	(40,185)	(13,545)
Payments for acquisition of intangible fixed assets	(246,580)	(292,594)
Payments for purchases of investment securities	(104,796)	—
Payments of security deposit and guarantee deposit	(3,205)	(11,524)
Others	(10,800)	—
Net cash used by investment activities	(405,567)	(317,664)
Cash flows from financial activities		
Proceeds from treasury shares disposal	7,709	6,454
Proceeds from stock issuance from non-controlling interests	—	5,000
Cash dividends paid	(124,417)	(110,978)
Net cash used by financial activities	(116,707)	(99,523)
Effect of exchange rate changes on cash and cash equivalents	(3,826)	(51,294)
Increase (decrease) in cash and cash equivalents	15,131	187,582
Cash and cash equivalents at the beginning of the fiscal period	2,074,381	2,443,875
Increase (decrease) in cash and cash equivalents as a result of change of scope of consolidation	—	27,482
Cash and cash equivalents at the end of second quarter	2,089,512	2,658,941

(4) Note on FY03/17 Consolidated Financial Results for Second Quarter Ended September 30, 2016

(Note regarding going concern assumptions)

None

(Material changes in shareholders' equity)

None