

Friday, November 15, 2024

Financial Results for the First Six Months of the Fiscal Year Ending March 31, 2025:
Briefing for Institutional Investors and Analysts [Transcript]

Digital Arts Inc.

[Event Overview]

Company name: Digital Arts Inc.

Securities Code: 2326

Event Language: Japanese

Event Type: Briefing for Institutional Investors and Analysts

Event Name: Financial Results Briefing for the First Six Months of the Fiscal Year Ending March 31,
2025

Fiscal Period Under Review: First Six Months of the Fiscal Year Ending March 31, 2025

Schedule: Friday, November 1, 2024

Time: 4:00pm-5:00pm (JST)

Format: Streamed Online

Speakers: Toshio Dogu, Representative Director, President and CEO

Fumihiko Tanizaki, General Manager, Investor Relations Office

[Moderator]

Hello, everyone. We will now begin the Digital Arts Inc. financial results briefing for the first six months of the fiscal year ending March 31, 2025. Allow me to introduce the representatives in attendance today. We have Toshio Dogu, Representative Director, President and CEO. And Fumihiko Tanizaki, General Manager of the Investor Relations Office. Without further ado, CEO Dogu will start by providing a summary of Digital Arts' financial results.

[Dogu]

Thank you everyone for taking the time out of your busy schedules to join us here today. Today we received registrations up to the last minute, and we have an unusually large number of people watching compared with regular years. As around one third of you are taking part in a financial results briefing or IR coverage of Digital Arts for the first time, I would like to start by giving a brief but thorough introduction to the company. I hope this provides you with some insight.

Company Profile



Company Name	Digital Arts Inc.	Stock Market	Tokyo Stock Exchange Prime Market (Securities Code: 2326)
Date of Establishment	June 1995	Number of Employees	Consolidated: 292 (As of March 31, 2024)
Listed on	September 2002	Sales Offices	Hokkaido Sales Office/ Tohoku Sales Office / Chubu Sales Office/ Kansai Sales Office/ Chushikoku Sales Office/ Kyushu Sales Office
Service	Planning, Development and Sale of Internet Security Software		
Head Office	14F Otemachi First Square West Tower, 1-5-1 Otemachi, Chiyoda-ku, Tokyo		

*1: The number of users of i-FILTER Ver. 10, m-FILTER Ver. 5, i-FILTER@Cloud and m-FILTER@Cloud as of September 2024 (internal research)

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We are now in our 29th year of operation and are looking forward to reaching our 30th anniversary next year. We are listed in the Prime Market of the Tokyo Stock Exchange as a Japanese maker of security software.

Web		E-mail	
<p>Enabling users to securely connect to websites without security concerns</p> <p>i-FILTER. i-FILTER@Cloud.</p> <p>Endpoint Web Security Secure proxy appliance Malicious website-filtering software for home use</p> <p>i-FILTER. D-SPA. イフィルター.</p> <p>ブラウザ & クラウド</p>	<p>Enabling users to securely send and receive email without security concerns</p> <p>m-FILTER. m-FILTER@Cloud.</p> <p>Measures to provide pop-ups for email misdelivery NEW</p> <p>[For email software] m-FILTER. [For Microsoft365 software] MailAdviser</p>		
File		IDaaS NEW	
<p>File encryption solution</p> <p>Automatically protecting files from the moment of creation and allowing users to delete them after transfer</p> <p>FINALCODE FINALCODE@Cloud.</p>	<p>DLP / File transfer solution NEW</p> <p>Supporting secure file transfers without leaking critical information</p> <p>f-FILTER.</p>	<p>Equipped with multi-factor authentication to ensure the secure management of IDs for cloud services</p> <p>StartIn.</p>	

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One of our unique characteristics is our products and services in the area of web and email security. In particular we offer protection against web and email-based attacks from external sources, prevent the leakage of information files that are important to users, and since last year have also been operating IDaaS (individual certification service). This fiscal year we have developed software to strengthen firewalls and authentication in addition to our existing products, and have been working with the aim of becoming a fully-domestic comprehensive security software provider by enhancing our product lineup during this period.

Key Points



Excluding the impact of the transfer of the shares of a consolidated subsidiary at the end of the previous fiscal year, propelled by the growth of the enterprise sector market, **the Group achieved the planned growth** of net sales the first six months of the fiscal year ending March 31, 2025.

Operating profit decreased because the increase in the cost of sales was not offset by the increase in net sales.

Enterprise sector market

Net sales grew through major growth in i-FILTER, which captured needs for a variety of security measures. (Excluding DAC¹)

Public sector market

Net sales grew following the acquisition of Security Improvements for Local Governments projects, which remained in demand, and Next-Generation School Affairs DX projects, for which full-scale procurement began this year.

The exclusion of DAC from consolidation meant declines in the consolidated cost of sales and DAC personnel expenses.

Revenue

The cost of sales increased, reflecting a rise in data center communication expenses due to an increase in the number of cloud product users. Consequently, operating profit decreased because the increase in the cost of sales was not offset by the increase in net sales.

*1: DAC: Digital Arts Consulting (a consolidated subsidiary in which shares were transferred at the end of the previous fiscal year)

Now I would like to move on to our financial results for the first half of the fiscal year ending March 31, 2025.

In the first six months, sales fell in line with our expectations. Profit did not grow in line with sales, and declined year on year due to increased costs. i-FILTER achieved significant growth and boosted sales primarily in the enterprise sector market, while net sales also increased in the public sector market through security improvements for local governments and next-generation school affairs DX projects. On the other hand, the sale of Digital Arts Consulting (DAC) has led to a decline in the cost of sales. In addition, sales from cloud services accounted for a slightly higher percentage of total sales than forecast, leading to higher data center communications expenses. Although this was in line with plans, there was a rise in personnel and recruitment expenses. As a result, expenses grew in line with sales, leading to a decline in operating profit.

Consolidated Results Highlights



Contracts	<p>4,516 million yen</p> <p>– 460 million yen or – 9.2% YoY + 548 million yen or + 13.8% YoY *Excluding DAC</p>	<p>Enterprise sector market</p> <p>Public sector market</p>	<p>The i-FILTER business grew sharply, mainly due to the acquisition of projects related to the transition to cloud security products and projects related to customers switching products due to the end of support (EOS) of competitors' security products.</p> <p>Performance was steady with the acquisition of Security Improvements for Local Governments projects and Next-Generation School Affairs DX projects.</p>
Net Sales	<p>4,838 million yen</p> <p>– 725 million yen or – 13.0% YoY + 283 million yen or + 6.2% YoY *Excluding DAC</p>	<p>Enterprise sector market</p> <p>Public sector market</p>	<p>Sales saw robust growth, reflecting sales from strong orders for cloud service products and from license sales products.</p> <p>Sales were up following the posting of sales from Security Improvements for Local Governments projects and Next-Generation School Affairs DX projects, as well as from GIGA School Concept projects received in preceding fiscal years.</p>
Operating Profit	<p>2,052 million yen</p> <p>– 135 million yen or – 6.2% YoY</p>	<p>Cost of Sales</p> <p>SG & A expenses</p> <p>Overall</p>	<p>Data center communication expenses increased due to an increase in the number of cloud product users.</p> <p>Efforts were made to strengthen sales promotions with an eye toward the full-scale implementation of the GIGA School Concept program in the next fiscal year. Even so, the increase in SG&A expenses was within the projected range.</p> <p>Operating profit decreased because the increase in the cost of sales was not offset by the increase in net sales.</p>

Special Notes

The transfer of all shares in Digital Arts Consulting (DAC¹), a consolidated subsidiary, held by the Company at the end of the previous fiscal year has an impact of **lowering contracts and net sales by around 1,008 million yen** respectively for the current fiscal year.

*1: DAC: Digital Arts Consulting (a consolidated subsidiary in which shares were transferred at the end of the previous fiscal year)

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Looking at the highlights of our consolidated results, contracts amounted to 4,516 million yen, with net sales of 4,838 million yen and an operating profit of 2,052 million yen. The year-on-year figures shown on the left are inclusive of DAC, which was sold at the end of the previous fiscal year. The text shown in orange below these figures illustrates the year-on-year changes excluding DAC, indicating a 13.8% year-on-year increase in contracts, and a 6.2% year-on-year increase in net sales. Primarily for contracts, as stated on the right the first six months of the year saw notably high sale growth from i-FILTER. This reflects an expanded range of services associated with i-FILTER including optional products and feature enhancements. As a result, i-FILTER achieved strong growth alongside these expanded offerings. In addition, in connection with the end of support (EOS) of competing security products, where other companies announced they would fully migrate to cloud-based services and eliminate on-premise versions of their products, in the first half we continued to see a considerably large number of customers who wished to continue using on-premise versions of products switch from those providers to Digital Arts. This was one of the factors driving strong growth in sales of i-FILTER.

Operating profit fell 135 million yen year on year, as I will explain in greater detail in a moment. With data center communications expenses increasing and cloud service products accounting for a higher percentage of total sales, contracts achieved double-digit growth, but since a certain percentage of sales from cloud service products is deferred, net sales only rose 6.2%, which was insufficient to offset the 135 million yen decline in operating profit.

Consolidated Statement of Income



While the contract amount **increased more than planned** on the back of strong enterprise and public sector market conditions, the increase in net sales remained in line with the plan, reflecting slow progress in the posting of net sales attributable to the greater-than-planned growth of the percentage of sales that are cloud product sales (Excluding DAC¹). Operating profit decreased because the increase in data center communication expenses was not offset by the increase in net sales. The cloud product percentage being higher than expected was a factor in this.

(million yen)

	First 6 Months FY March 2024	First 6 Months FY March 2025	Change YoY	FY March 2025 Full-Year Forecast ²
Contracts	4,976 [3,968]	4,516	-9.2% [+13.8%]	-
<small>*The figure in square brackets [] represents the result excluding DAC.</small>				
Net sales	5,563 [4,554]	4,838	-13.0% [+6.2%]	10,720
<small>*The figure in square brackets [] represents the result excluding DAC.</small>				
Cost of sales	2,128	1,482	-30.3%	2,850
Gross profit	3,435	3,355	-2.3%	7,870
Selling, general and administrative expenses	1,246	1,302	+4.5%	2,730
Operating profit	2,188	2,052	-6.2%	5,140
Operating margin (%)	39.3%	42.4%	-	47.9%
Ordinary profit	2,201	2,053	-6.7%	5,140
Profit attributable to owners of parent	1,521	1,417	-6.8%	3,540
EBITDA³	2,670	2,559	-4.1%	-

¹1: DAC: Digital Arts Consulting (a consolidated subsidiary in which shares were transferred at the end of the previous fiscal year)

²2: Financial Forecast is the consolidated financial forecast announced on May 8, 2024.

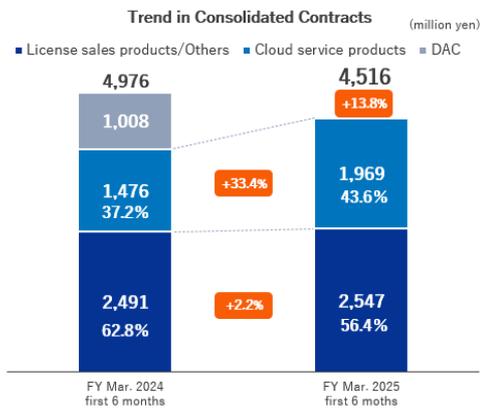
³3: EBITDA = Operating profit + Depreciation + Tax expenses included in operating expenses

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This is our consolidated statement of income, which I will talk about now.

Trend in Consolidated Contracts

Consolidated contracts totaled **4,516 million yen, up 13.8% year on year.** (Excluding DAC*1)



Cloud service products

- Sales of Cloud-based j-FILTER and m-FILTER remained strong to meet demand related to cloud security needs in the enterprise sector market.
- A greater-than-planned increase was recorded due to the acquisition of projects in the public sector market, including large projects with the goal of addressing needs related to the Next-Generation School Affairs DX program.

License service products/Others

- Projects were received by fulfilling needs related to a switch to the Company's on-premises products following the end of support (EOS) of competitors' security products in the enterprise sector market.
- In the public sector market, projects continued to be acquired in relation to Security Improvements for Local Governments projects.

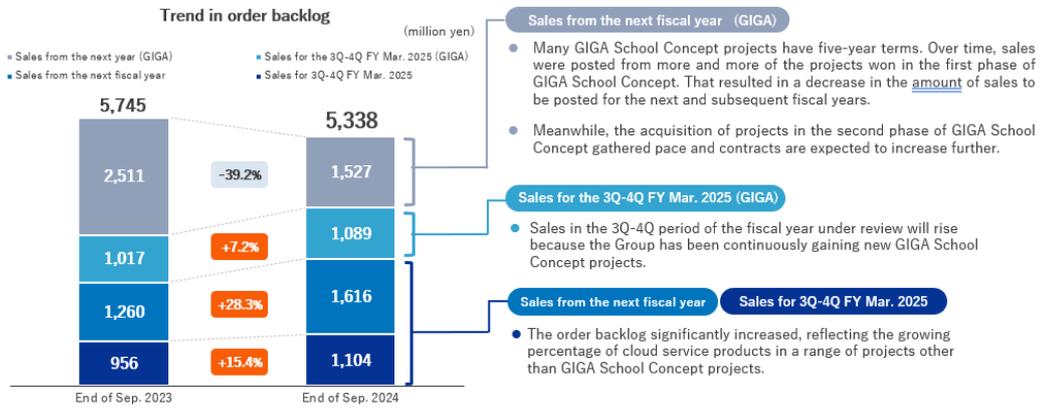
*1: DAC: Digital Arts Consulting (a consolidated subsidiary in which shares were transferred at the end of the previous fiscal year)

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This is the breakdown of consolidated contracts. Here we have the breakdown of license service products (on-premise) and cloud service products. In the first half, we saw a shift to cloud products particularly in the public sector market, which explains the percentage of cloud service products jumping 33% compared with the previous year.

Trend in Order Backlog

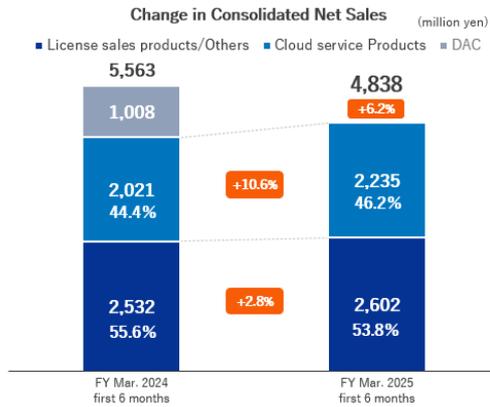
Excluding GIGA School Concept projects, sales from which will be posted for the next and subsequent fiscal years, **order backlog steadily increased**.



This slide shows the trend in the order backlog. While the full monetary amounts of contracts are recognized at the time of order receipt, sales are deferred depending on the contractual period, part of which is recorded as sales in the future. This slide shows how much of sales deferred in the past remain to be recorded as sales in the future. Each item is as stated. The gray part in particular relates to GIGA. GIGA School Concept projects were not recorded as sales at the time of order receipt, so the amounts to be recorded as sales from the next fiscal period and beyond are shown. The amount as of the end of the first half of this year has declined 39% compared with the amount as of the end of the first half of FY2023. However, starting this fiscal year the second phase of the GIGA School Concept has started, so the gray portion is expected to increase from this fiscal year onward, particularly in the next fiscal year.

Change in Consolidated Net Sales

Consolidated net sales **grew 6.2%** year on year, to **4,838 million yen**. (Excluding DAC*1)



Cloud service products

- Sales of cloud-based j-FILTER and m-FILTER remained strong in response to demand related to cloud security needs in the enterprise sector market.
- Sales were up following the posting of sales from Security Improvements for Local Governments projects and Next-Generation School Affairs DX projects, as well as from GIGA School Concept projects received in preceding fiscal years in the public sector market.

License sales products/Others

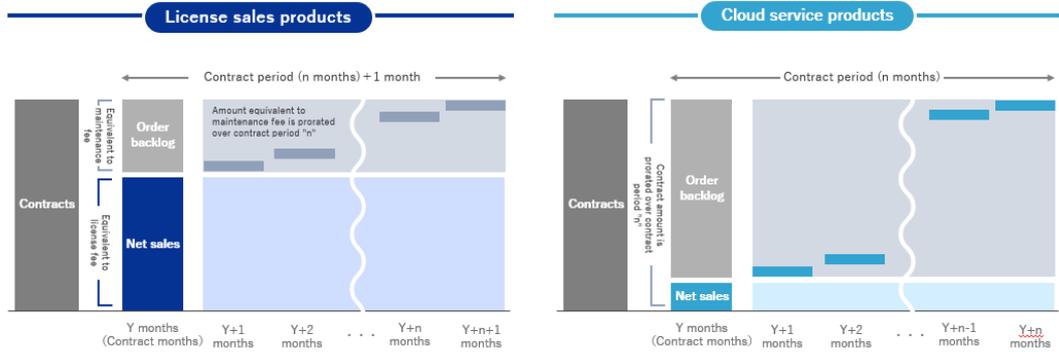
- Projects were received by fulfilling needs related to a switch to the Company's on-premises products following the EOS of competitors' security products in the enterprise sector market.
- Projects continued to be acquired in relation to Security Improvements for Local Governments projects in the public sector market.

*1: DAC: Digital Arts Consulting (a consolidated subsidiary in which shares were transferred at the end of the previous fiscal year)

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This slide shows consolidated net sales. As some parts of contracts for cloud service products are deferred, there are differences in the growth of contracts and net sales.

Supplement Method of recording sales by product

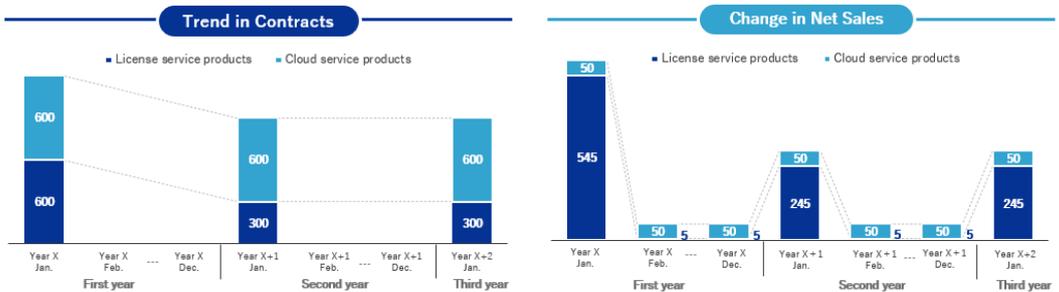


- License fees make up a large proportion of the contract amount. This portion is recorded in a lump sum as sales in the month when the contract is obtained.
- Amount equivalent to maintenance fee is recorded on a pro rata basis over the contract period.
- Contract amount is recorded as sales on a pro rata basis over the contract period (split into equal monthly amounts).
- As the contract amount of cloud service products rises, the contract amount that is deferred (order backlog) increases.

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Supplement Relationship between contract amount and sales by product (one-year contracts)

For example, the diagrams on the left show the relationships between the contract amount and net sales in license sales products and cloud service products with a one-year contract at the amount of 600 million yen.



For license sales products, contracts in the second and subsequent years are half of those of the first year. For cloud service products, contracts in the second and subsequent years are the same amounts as those in the first year. An increase in new contracts for cloud service products will result in a higher growth rate in coming fiscal years than for license sales products.

For license sales products, a high percentage of net sales is recorded at the time of the contract. For cloud service products, net sales are posted in monthly installments. For license sales products, net sales decrease because of a decline in contracts at the time of renewal. For cloud service products, net sales are constant.

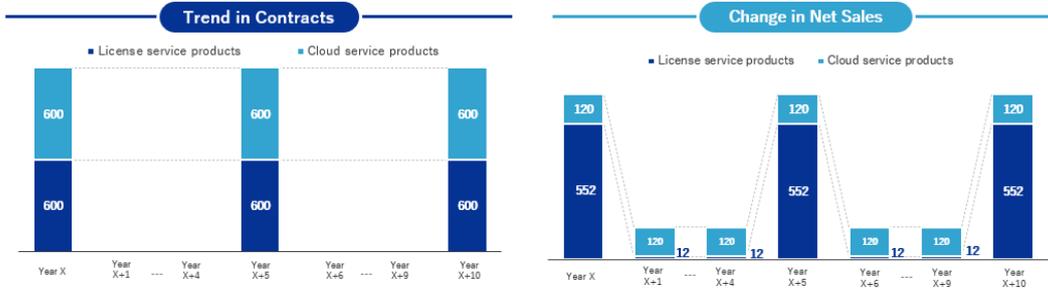
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Relationship between contract amount and sales by product (multi-year contracts)

Supplement

Many projects in the public sector market are multi-year contracts, such as five-year ones. They have longer periods until renewal.

For example, the diagrams on the left show the relationships between the contract amount and net sales in license sales products and cloud service products with a five-year contract of 600 million yen.



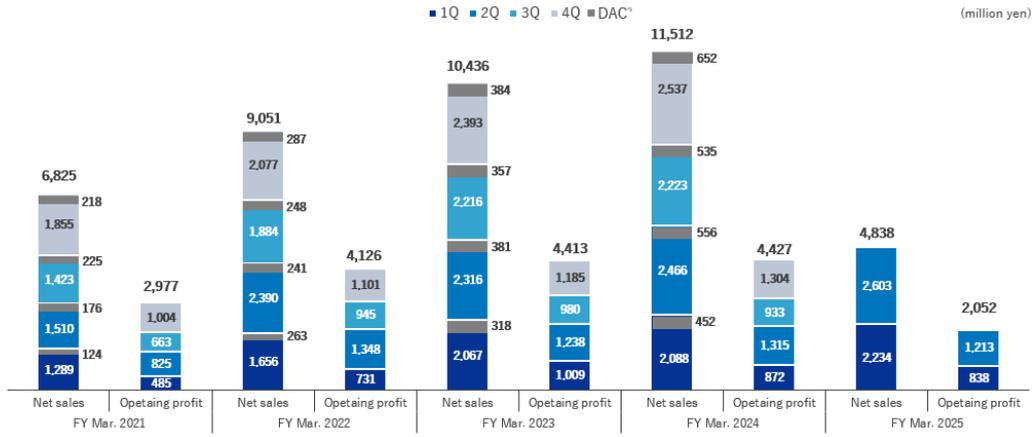
For both license sales products and cloud service products, contract amounts are unchanged at the time of renewal.

For license sales products, a high percentage of net sales is recorded at the time of the contract. For cloud service products, sales are recorded in monthly installments for a period of five years. This means a wider gap between the contract amount and net sales (order backlog).

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These three slides explain our approach to deferred sales, which significantly impacts the recording of sales for cloud service products in particular.

Trend in Consolidated Net sales, Operating profit



*1: DAC: Digital Arts Consulting (a consolidated subsidiary in which shares were transferred at the end of the previous fiscal year)

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This is the trend in consolidated net sales and operating profit.

01 Consolidated Cost of Sales and Selling, General and Administrative Expenses



While the consolidated cost of sales and DAC's¹ personnel expenses decreased, communication expenses increased at the data center due to the higher-than-planned growth of the percentage of cloud service products.

	First 6 Months FY March 2024	First 6 Months FY March 2025	Change YoY	Main Factors for Change
Cost of sales	2,128	1,482	- 645	
Labor	923	513	- 410	Increase due to the enhancement of DA's development workforce (+92M) Impact of exclusion of DAC from consolidated (Approx. -498M)
Depreciation	411	434	+22	
Communication expenses	602	755	+152	Data center communication expenses increased due to an increase in the number of cloud product users. (+151M) Note: Including an increase due to the effect of foreign exchange rates (+34M).
Others	651	365	- 285	Increase due to the development of new DA products (+15M) Impact of exclusion of DAC from consolidated (Approx. -300M)
Transfer to other accounts	- 461	- 586	- 125	
Selling, general and administrative expenses	1,246	1,302	+56	
Personnel expenses	614	610	- 4	Increase in DA's personnel expenses (+43M) Impact of exclusion of DAC from consolidated (Approx. -42M)
Advertising expenses	160	198	+38	Increased due to the implementation of sales promotions (+10M) and the provision of trial versions of cloud service products (+16M)
Others	471	493	+22	DA's Hiring expenses (+27M)

*1: DAC: Digital Arts Consulting (a consolidated subsidiary in which shares were transferred at the end of the previous fiscal year)

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This slide deals with costs. We have received questions over the past couple of days about why operating profit has not surpassed the previous year's level despite net sales having grown. I would like to explain this in a little detail. The cost of sales is mainly incurred during the development process. Digital Arts develops all of its products in-house. Those development expenses and the communications expenses for operating our cloud services are recorded as the cost of sales. Selling, general and administrative expenses are the expenses incurred by non-development departments including sales, marketing and administrative departments.

Labor expenses under the cost of sales refers to personnel costs for development. The 410 million yen year-on-year decline for labor is explained by the elimination of personnel costs for DAC compared with the previous fiscal year, resulting in a decline of around 500 million yen (498 million yen) in just the first six months. Looking only at Digital Arts, the difference over the first half of the year is an increase of 92 million yen.

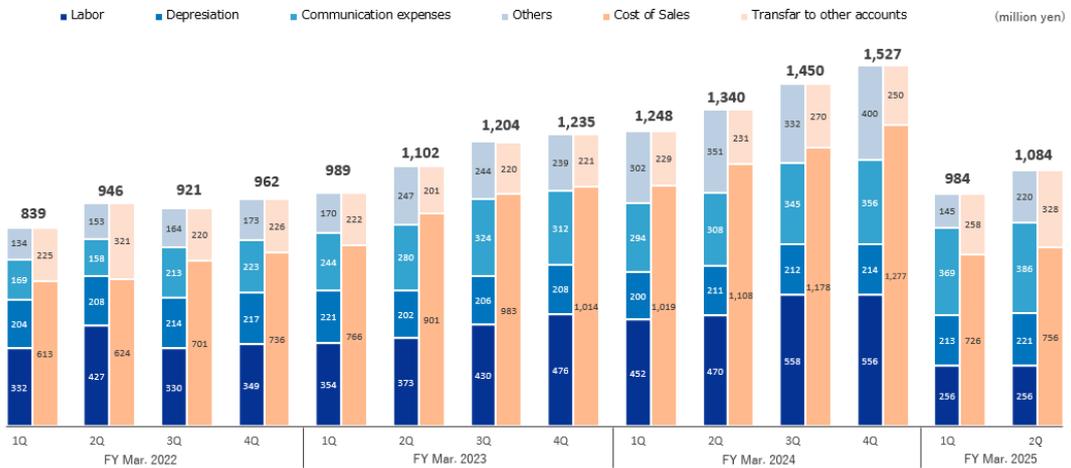
Another reason operating profit did not surpass the levels seen in the previous fiscal year was communication expenses. Costs under this category rose 152 million yen year on year. The effects of foreign exchange rates account for 34 million yen of this increase. In addition, in selling, general and administrative expenses, personnel expenses have decreased by 42 million yen due to the sale of DAC, but on a non-consolidated basis, personnel expenses at Digital Arts have increased by 43 million yen.

As a result, looking at the first half of the year overall, personnel expenses at Digital Arts on a non-consolidated basis increased by 135 million yen (with labor expenses increasing 92 million yen and

personnel expenses rising 43 million yen). In addition, with data center expenses increasing 151 million yen, the total increase is around 280 million yen, indicating that expenses have increased on a non-consolidated basis compared with the previous fiscal year. Of course, at the beginning of this fiscal year we announced our strategy of making strong investments in personnel alongside business investments, and if anything, we had expected to incur slightly higher costs, but these increases fall within our plans.

01

Quarterly Trend in Consolidated Cost of Sales

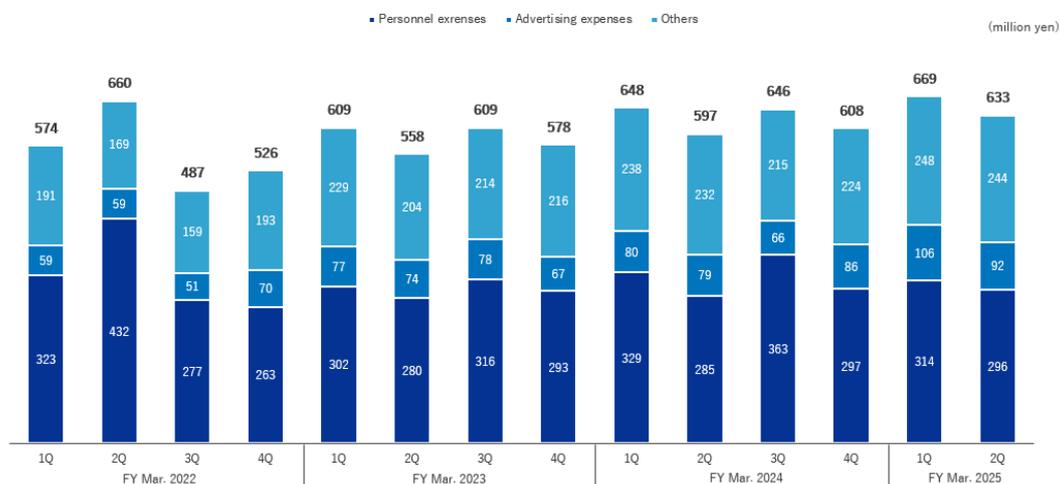


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This slide shows the quarterly trend in the consolidated cost of sales.

01 Quarterly Trend in Consolidated Selling, General and Administrative Expenses

DigitalArts



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This is the change in consolidated selling, general and administrative expenses.

01 Consolidated Balance Sheet

DigitalArts

The repurchase of our own stock that was announced on June 12, 2024 was completed as scheduled. (total acquisition price of 499 million yen). The equity ratio was up 3.3 percentage points from the end of the previous fiscal year, to 74.3%.

(million yen)

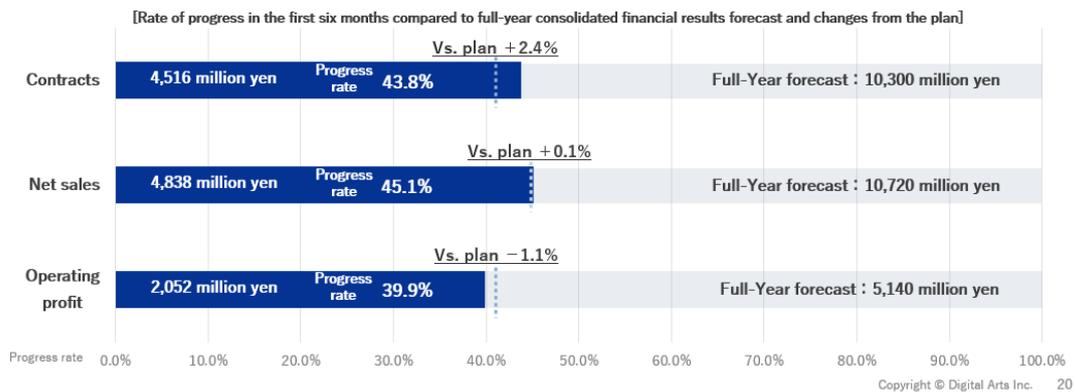
	As of end of 2Q FY March 2024	As of end of FY March 2024	As of end of 2Q FY March 2025	Change from end of FY March 2024	Main factors for changes
Current assets	18,637	20,183	19,567	-3.1%	Cash and deposits (-156M), accounts receivable (-343M)
(Cash and deposit)	16,259	18,339	18,183	-0.9%	Fund for treasury share purchases (-500M)
Non-current assets	2,259	2,334	2,449	+4.9%	
Total assets	20,896	22,518	22,016	-2.2%	
Current liabilities	6,582	6,467	5,594	-13.5%	Income taxes payable (-676M)
(Advanced received)	5,172	4,418	4,357	-1.4%	Decreased linked to the progress in the recording of sales.
Non-current liabilities	50	52	51	-0.5%	
Equity capital	14,229	15,986	16,358	+2.3%	Treasury share buy-back(-492M), Dividends paid (-550M), Profit(+1,417M), and others
Net assets	14,262	15,998	16,370	+2.3%	
Equity ratio	68.1%	71.0%	74.3%	-	
ROE	10.7%	29.1%	8.8%	-	
ROA	7.2%	20.1%	6.4%	-	

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This is the consolidated balance sheet. One item of news is the 500 million yen in repurchases of our own stock that we announced following the release of our first quarter financial results. We managed to make these purchases within the period as planned. As a result, the equity ratio has increased to 74.3%. There are no major developments affecting other items in particular.

Operating Profit Forecast

As of the end of the first six months, the rate of progress in contract amount and net sales exceeded the plan, but the rate of progress in operating profit fell short of the plan. Operating profit was lower planned due to a deviation in the timing of the posting of sales due to larger-than-expected orders for cloud service products. If the progress in the contract amount and net sales continues in line with the forecast in the second half, full-year consolidated operating profit is expected to be in line with the plan, partly reflecting the accumulation of sales of cloud products, for which orders were received in the first six months.



A question we fielded from many investors is what will happen in the second half of the year with data center expenses and the proportion of cloud-related business on the rise. This slide explains that. As stated here, as cloud service product sales increase as a proportion of total sales, net sales rise, because the prices we offer are higher for cloud editions (cloud service products) than for on-premise editions (license sales products). In particular, as sales will continue to grow at a fast pace, cloud service products will grow as a percentage of all products, and this is a positive in terms of net sales. However, data center expenses also increase alongside that sales growth. As I will explain in a moment, rather than data center expenses from the second half of the year increasing in proportion to customer growth, by exercising a little ingenuity on the development side we have worked to curb data center expenses to some extent. Therefore for the full year, data center expenses will not change, and instead remain in line with expectations.

Summary of Non-consolidated Results

While the contract amount increased more than planned due to the strong enterprise and public sector market conditions, the increase in net sales remained in line with the plan, reflecting slow progress in the posting of net sales which is attributable to the greater-than-planned growth of the percentage of sales that are cloud product sales. Operating profit decreased not offset by the increase in net sales because the cost of sales increased, reflecting a rise in data center communication expenses due to an increase in the number of cloud product users.

(million yen)

	First 6 months FY March 2024	First 6 Months FY March 2025	Change YoY	FY March 2025 Full-Year Forecast*
Contracts	3,962	4,511	+13.9%	-
Net sales	4,548	4,833	+6.2%	10,710
Cost of sales	1,244	1,481	+19.1%	2,850
Gross profit	3,304	3,351	+1.4%	7,860
Selling, general and administrative expenses	1,133	1,296	+14.4%	2,710
Operating profit	2,171	2,055	-5.3%	5,150
Operating margin	47.7%	42.5%	-	48.1%
Ordinary profit	2,183	2,057	-5.8%	5,150
Profit	1,512	1,421	-6.0%	3,550

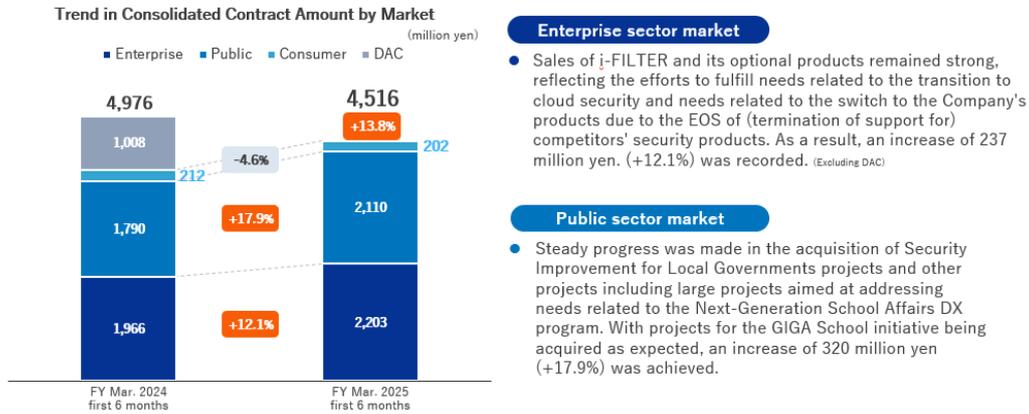
*1: Financial Forecast is the non-consolidated financial forecast announced on May 8, 2024.

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This is a summary of Digital Arts' non-consolidated results, and is essentially the same as what we have discussed from the perspective of excluding DAC.

Consolidated Contract Amount by Market

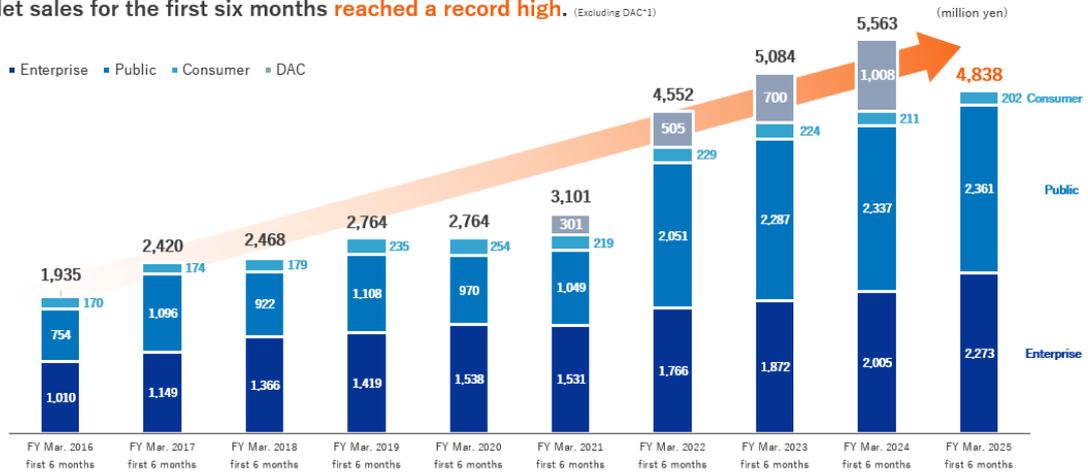
The positive growth of the contract amount was achieved in both the enterprise sector market and the public sector market. (Excluding DAC*1)



In this section we will look at results in each market. Consolidated contracts amounted to 4,516 million yen. Breaking down the 13.8% overall increase, we achieved a 12.1% increase in enterprise sales, and a 17.9% increase for the public sector. Particularly with regard to the enterprise sector market, we have received a great deal of feedback from you asking how we intend to grow this area. For our part, since last year we have been expanding our product lineup to better align what we offer with customer needs. Particularly in the first six months of this year, we will that we have been effectively aligning with those customer needs. In the second half of the year, we will fully utilizing the personnel that were added in the first half and further grow our business for the enterprise sector market. I also believe we have made progress laying those foundations in line with our plans. As a result, we will aim for a little higher growth in the second half of the year in an effort to achieve our planned performance. In the public sector market, GIGA school projects will fully roll out in the next fiscal year, and we have continued to enjoy strong performance in security improvements for local governments and next-generation school affairs DX projects. This gives us confidence in continued growth in the second half of the year.

Trend in Consolidated Net Sales by Market

Net sales for the first six months **reached a record high**. (Excluding DAC*1)

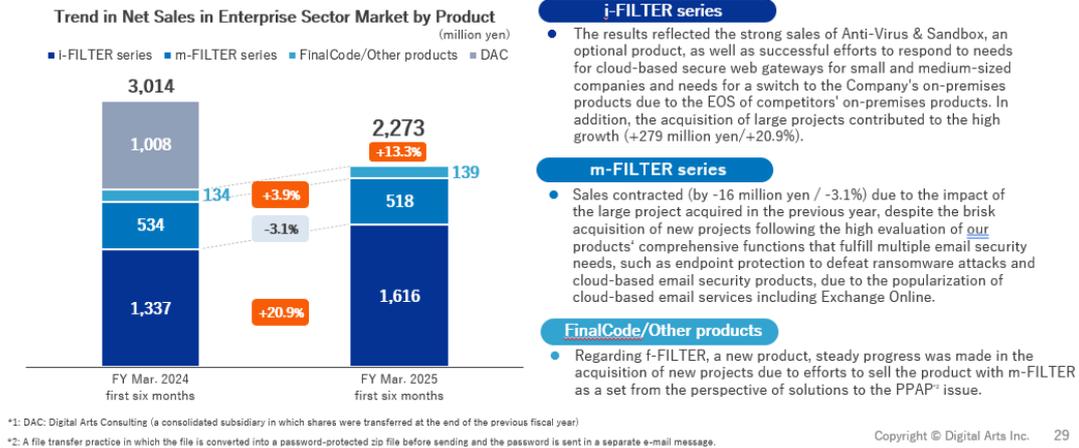


*1: DAC: Digital Arts Consulting (a consolidated subsidiary in which shares were transferred at the end of the previous fiscal year)

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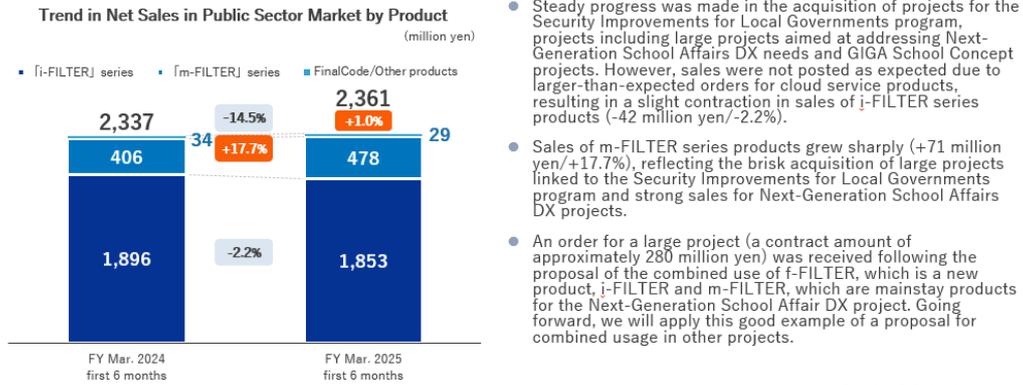
This is the trend in consolidated net sales for the first six months. For this fiscal year, the expression "excluding DAC" unavoidably appears often, but as you can see, when the grey portion is removed, net sales is at a record high.

Net sales achieved enormous growth, reflecting a major leap in the i-FILTER series following the acquisition of projects for shifting to cloud security and for shifting from competitors' products, as well as strong sales of options. (Excluding DAC^{*1})



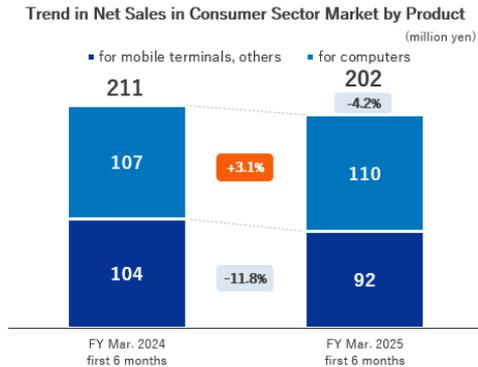
This shows sales by product for the enterprise sector market. As I mentioned at the beginning, i-FILTER achieved growth of 20%, mainly through sales to the enterprise sector market, and this drove an unprecedented expansion. One point is that we have achieved significant growth with Anti-Virus & Sandbox, which was released the year before last, which naturally drove growth with i-FILTER as well. Steady progress has been achieved in line with a strategy we have continued since last year. The part that corresponds to the m-FILTER series has declined slightly by 3.1%, but we had a major project last year and when that is included with the comparison, it results in a relative decline. As there has been an increasing demand for set sales that include m-FILTER, Anti-Virus & Sandbox and the f-FILTER optional product, the 3.1% decline is still solely based on a comparison that includes the major project that was undertaken in the previous fiscal year. We have also achieved steady growth with m-FILTER. f-FILTER, one of the products that falls under FinalCode and other products, has only just gone on sale, but we perceive a very strong demand for it, and we believe sales will increase a little more over the full year.

While the **contract amount increased significantly (+17.9%)** due to the acquisition of projects for the Security Improvements for Local Governments and Next-Generation School Affairs programs (see page 24), sales increase slightly due to slow progress in the recording of sales as a result of an increase in cloud service-related orders.



This shows sales by product for the public sector market. In terms of demand from the public sector in the first half of the year, security improvements for local governments and next-generation school affairs DX performed well and contracts increased 17.9%. However, as cloud service products accounted for a high percentage of total sales (involving a larger amount of deferred sales recognition), net sales only increased 1.0%. Additionally, we also received orders for major projects from the public sector, so although there are slight upward and downward movements in the figures year over year, this kind of special demand means we expect strong performance to continue.

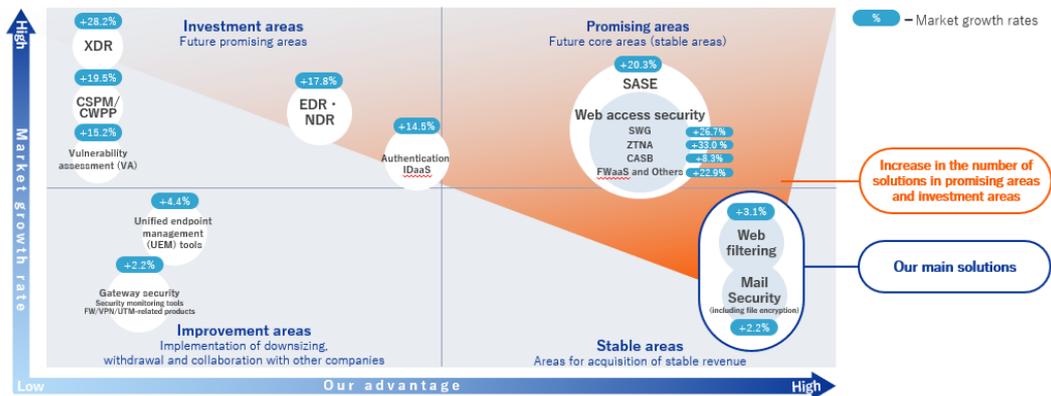
In the consumer sector market, net sales did not increase as expected due to the sense of plateauing with respect to demand for filtering measures. The Group will facilitate the strengthening of products and expand target customers, aiming to tap into new demand.



- Net sales of products for computers rose (by +3 million yen or +3.1%) as a result of advertising multiple-year package products and taking initiatives for products for Internet cafes.
- Net sales of products for mobile terminals and others declined (by -12 million yen or -11.8%), reflecting a slowdown in new contracts obtained.
- Regarding products for personal computers and mobile phones, given the sense of a plateauing of demand for filtering measures for children, the Group will strengthen its products, while also securing new revenue sources through the expansion of target customers.

Here we have products for the consumer sector market. One of the products for households with children is i-Filter, which can be purchased as a bundle for a mobile phone carrier, PC, and so on. Over the past few years we have not been able to focus much on the consumer sector, but we have been making progress in product development with the aim of strengthening our presence in this sector.

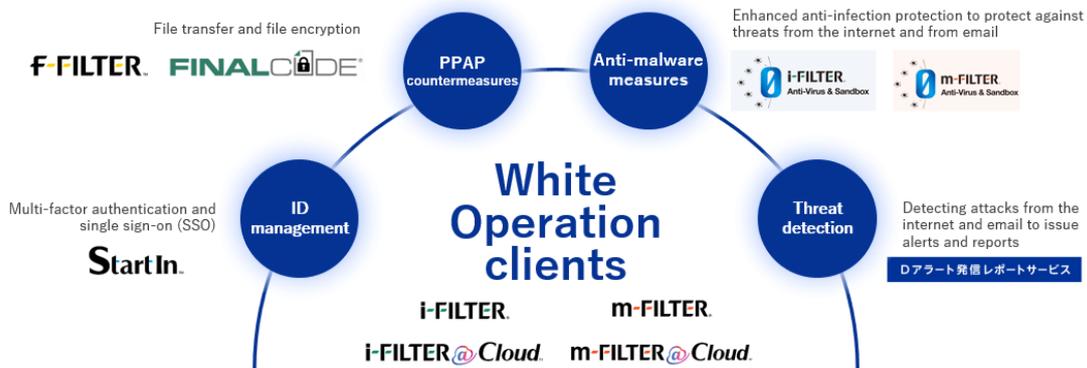
In view of the rate of growth of the product market and our advantages, we will increase solutions in promising areas and investment areas to maximize synergy with our mainstay solutions.



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There are no major changes to our strategies over the first six months of the year and this fiscal year in general. To date, we have focused on this web filtering and mail security area (bottom right of the diagram) as our main businesses. This is a stable area where we enjoy a market share of over 50% and have established name recognition and visibility, but looking to the future, growth is not particularly high. Moreover, as you can see from the security incidents that occur on a daily basis, the current situation in the world is that anyone could be victim to an attack at any time. Our goal is to not only cover this area of stability (bottom right), but to develop a slightly broader range of solutions in-house in the orange area, so that we can provide comprehensive and safe internet security independently. Since last year we have been pursuing development in areas that are particularly promising (top right of the diagram). As a result, personnel expenses have accounted for an increasing portion of the cost of sales. As I just mentioned, we have already completed some of the products in these promising areas, and we have improved business performance by selling them as a set with our main products. Therefore, if we manage to complete the development of the products in these promising areas within the current fiscal year, we believe that even greater growth will be possible in the next fiscal year.

We will promote cross-selling and upselling for White Operation customers.

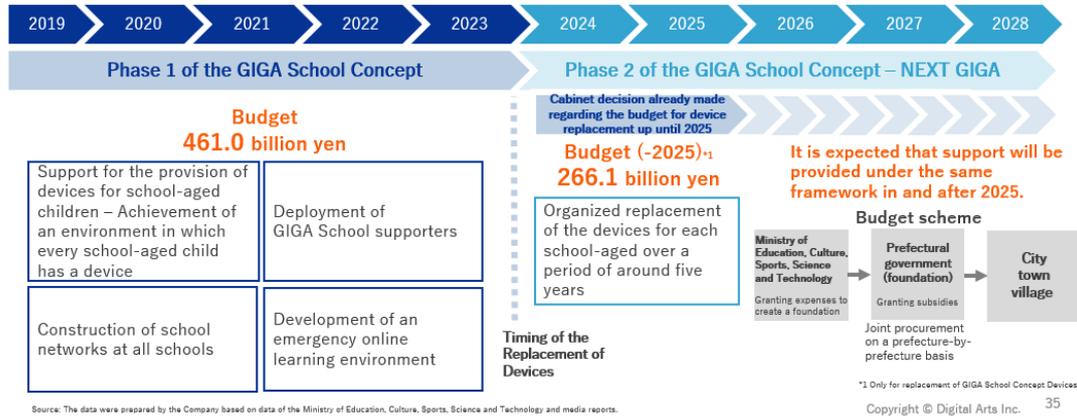


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"White Operation" is a characteristic of our products. White Operation refers to the environment provided by Digital Arts that has been verified to be safe for web and email use, within which customers can use the Internet in a secure way. The diagram on this slide is expressed as a dome-like structure. Other security providers, by contrast, work on a blacklist basis. Typical security measures involving someone falling victim to an attack, and security providers applying patches in response so that others who have not been affected can avoid it. We work on a different basis. We create an environment in which customers are only allowed to view websites or receive and view email messages that we assure are safe. The unique feature of this approach is that we have customers operate in a secure world that we have created where it doesn't matter what new attacks emerge externally, because whatever happens our customers are unaffected. Just the other day we placed an advertisement in the Nikkei Shimbun newspaper, where we highlighted the fact that when over 13.39 million users, we have maintained a record of 0 cases of malware incidents for seven straight years. If you think about it, it's only natural. As we do business within an environment that we have determined to be secure, creating a world that remains secure regardless of what occurs outside it. That is the unique quality that forms the basis for the products we provide.

The implementation of Phase 2 of the GIGA School Concept was planned for the five-year period starting in FY2024.

[GIGA School Concept operated by the Ministry of Education, Culture, Sports, Science and Technology]



I touched on this a little earlier, but a major topic in the public sector market is the GIGA School concept. Phase 1 of the GIGA School Concept began in 2019, and was a policy to put one device in the hands of every elementary and junior high school student at the expense of the national government. The budget from the national government allocated 461 billion yen up to 2023 for this effort. Over this period (phase 1 of the GIGA School Concept from 2019 to 2023), we did business worth more than 10 billion yen. Phase 2 of the GIGA School Concept started this fiscal year. Under Phase 2, PCs and devices are to be replaced once every five years in general, and this once-every-five-years cycle starts from this year. As a result, this fiscal year and the next, 266.1 billion yen has already been earmarked in the budget. When those who purchased devices under Phase 1 of the GIGA School Concept replace a device, the security, software used and OS will be reviewed. This is the GIGA School Concept.

We will work proactively to ensure the renewal of existing contracts as well as receive new contracts to increase our market share.

[Our share of the GIGA School Concept market]



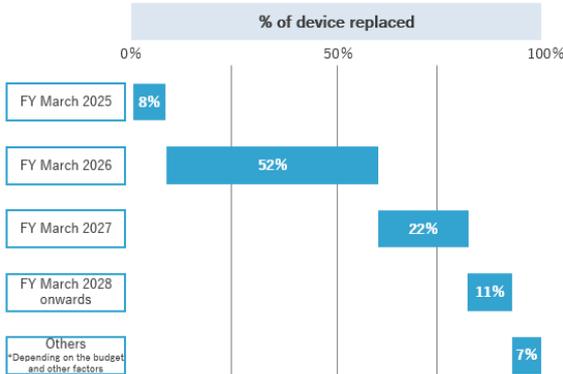
In Phase 1 of the GIGA School Concept, we maintained a 53% market share with i-FILTER. Naturally we are conducting activities to maintain this share and then gaining those who have not yet used our software as new customers.

Phase 2 of the GIGA School Concept

– Timing of the Replacement of GIGA School Concept Devices -

The GIGA School Concept device replacement will start in the fiscal year ending March 31, 2025 and will be fully implemented in the fiscal year ending March 31, 2026.

[GIGA device replacement timing]



POINT

- As for the date of replacing GIGA devices, **approx. 60% of the education boards** will be due for replacement **by the end of FY March 2026**.
- The guidelines for device procurement in phase 2 of the GIGA School Concept presented by the Ministry of Education, Culture, Sports, Science and Technology stipulate that the procured devices **must have a web filtering function**. It is anticipated that procurement of web filtering will be faster than in phase 1.

Source : The data were prepared by the Company based on data of the Ministry of Education, Culture, Sports, Science and Technology and media reports.

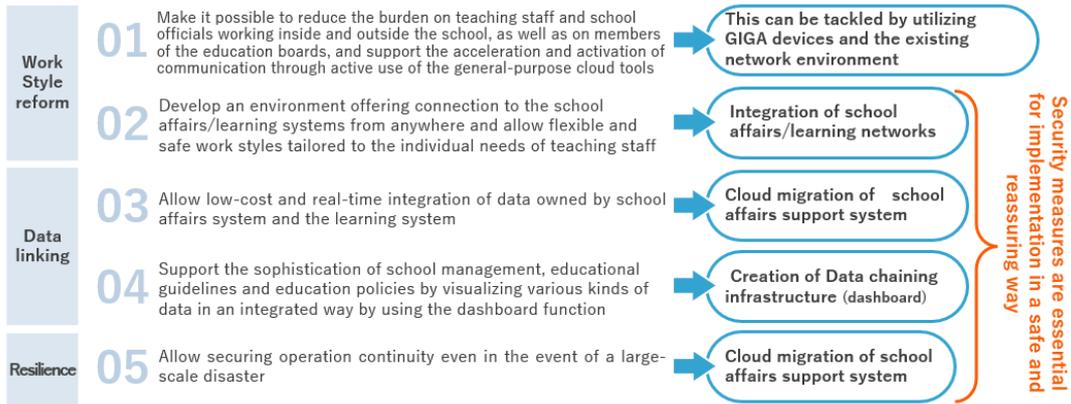
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This fiscal year 8% of all schools have entered Phase 2 of the GIGA School Concept, and we have made steady progress in earning their business. In the next fiscal year 52% of schools will replace their devices. We are already engaged in activities to get those already using i-FILTER to update it, and newly provide i-FILTER to the individuals and local governments still not using it. We are making steady progress in sales activities or providing quotations to boards of education, toward the goal of reaching 60% of boards of education for the device replacement by the next fiscal year.

Next-Generation School Affairs DX

The Ministry of Education, Culture, Sports, Science and Technology calls for the following implementation as the direction of the next-generation school affairs DX:

*As a regional fiscal measure, financial support of 180.5 billion yen on a single-year basis has always been provided for computerization of school affairs

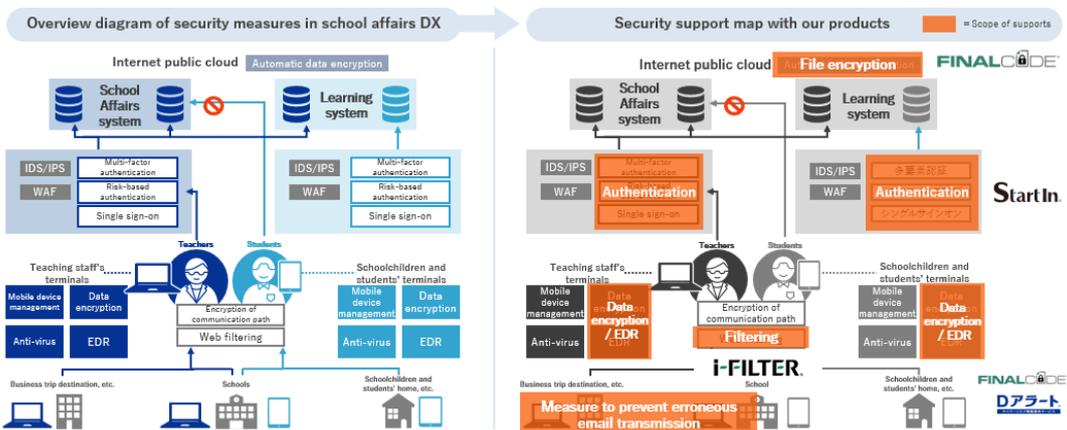


Source: Created by the Company based on https://www.mext.go.jp/lv/menu/shingi/chousa/shotou/175/mext_01385.html

School affairs DX is the effort to digitally transform schools. The Japanese government has also allocated 180 billion yen in funding in a single year for this.

Initiative for Next-Generation School Affairs DX

Our products are applicable in many different areas to ensure security. We will proactively advertise the value of our products.

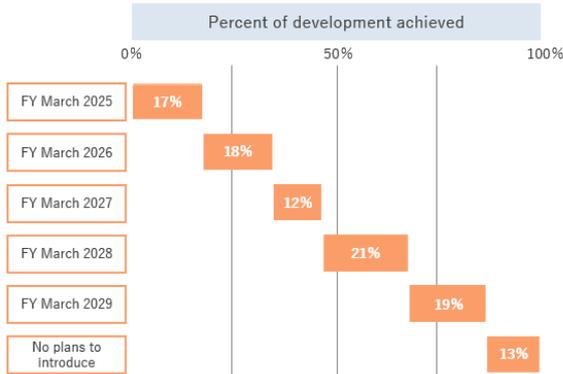


Since last year we have also developed various products to address these School affairs DX efforts. As a result, our products are able to cover a considerable range of school affairs DX activities.

Schedule for Development of Next-Generation School Affairs DX

Procurement of products is expected to start in the fiscal year ending March 31, 2025 with a view toward the operation of a school affairs support system.

[School Affairs DX development schedule]



Source : The data were prepared by the Company based on data of the Ministry of Education, Culture, Sports, Science and Technology and media reports.

POINT

- As a regional fiscal measure, financial support of **180.5 billion yen on a single-year** basis has always been provided for computerization of school affairs
- The Ministry of Education, Culture, Sports, Science and Technology's document, School Affairs DX under the GIGA School Concept, stresses the importance of security measures by presenting some case studies. For school affairs that involve the personal information of school-aged children, it is necessary to apply **stronger measures than the measures used for GIGA School Concept devices.**

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The budget for School affairs DX will be distributed over a five-year period.

New Functions released in July

Large-size storage / file storage period adjustment functions

Examples of requests for f-FILTER



Customer A

We hope that f-FILTER will **support large files of over 100 MB**, since they cannot be sent by e-mail.



Customer B

For security reasons, we want to limit the file access period to several days. (A period shorter than 30 days is desirable.)



Customer C

We hope that, for **audit purposes**, files can be stored for a longer period than 30 days, such as five to seven years.

Enhancement of features

The **uploadable file size is increased to 20 GB** and an option is provided that allows users to choose from different levels of storage capacity according to their needs.

The software is modified to provide a **standard function that allows users to set the file access period within a range from one day to 30 days**.

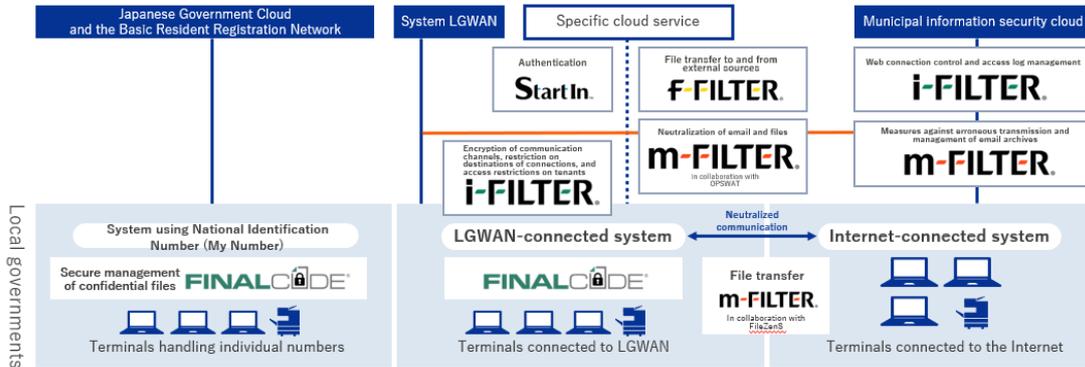
An **option is provided** that allows users to configure the file storage period to one year, three years, five years, seven years and others.

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This is the result of measures implemented in the first half of the year. f-FILTER is a product in much greater demand than we had anticipated. A particularly common request is for integration m-FILTER to address the PPAP issue and other difficulties when sending files over email, by instead transferring or sending files over the cloud. We have also improved the features offered through f-FILTER on a standalone basis, supporting the transfer of large files and also allowing them to be archived, in other words a file storage function. We have implemented measures to increase sales unique prices by having customers purchase f-FILTER as a standalone product equipped with a wide range of functionality rather than as an optional extra. We have improved its functionality to achieve this, and in the second half we will focus on generating customer demand for f-FILTER as a standalone product.

05 Toughening of Security for Local Government: Compliance with New Guidelines

The α model, defined as a method for connecting directly to cloud services from LGWAN-connected business devices, has been re-defined, as is, as the α' model. There are a number of points that can be dealt with using the Company's solutions, and acquisition of certification under the Information system Security Management and Assessment Program (ISMAP[®]) is significant for implementing the measures. It is likely that the situation will be advantageous to the Company.



*1: Security assessment system for government information systems

This slide describes the security improvements for local governments, the developments underway in the public sector market which I mentioned earlier.

Web Security	Mail Security
<p>Enabling users to securely connect to websites without security concerns</p> <p>i-FILTER.</p> <p>i-FILTER@Cloud. </p>	<p>Enabling users to securely send and receive email</p> <p>m-FILTER. m-FILTER@Cloud. </p> <hr/> <p>[Microsoft 365 supported Version] m-FILTER.  <i>MailAdviser</i></p>
File Encryption	Secure file transfer
<p>File encryption solution</p> <p>Automatically protecting files from the moment of creation and allowing users to delete them after transfer</p> <p>FINALCODE. FINALCODE@Cloud. </p>	<p>DLP / File transfer solution</p> <p>Supporting secure file transfers without leaking critical information</p> <p>F-FILTER. </p>
	IDaaS
	<p>Equipped with multi-factor authentication to ensure the secure management of IDs for cloud services</p> <p>StartIn. </p>
<p>*1: Security assessment system for government information systems</p> <p>Copyright © Digital Arts Inc. 44</p>	

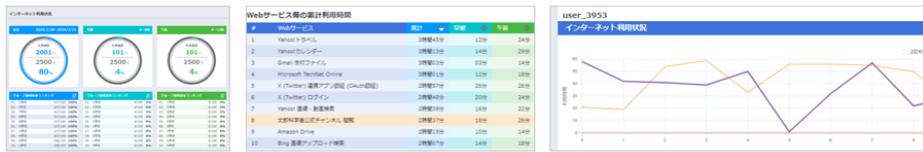
Half of our sales are from the public sector. Products used in the public sector, particularly cloud services used by the government, must meet the requirements of the ISMAP standard. Naturally i-FILTER and m-FILTER were among the very first in the industry to be registered when the ISMAP standards were introduced. We are looking to accelerate sales in the public sector market by acquiring ISMAP registration for products developed last year as well.

New functions released in April

Visualizing what websites schoolchildren and students view and how often



Meeting one of the conditions for subsidies for terminal replacement costs, **monitoring the state of operation of terminals** for fulfillment of the minimum standard for specifications.



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This slide describes the characteristics of the GIGA School Concept that will accelerate next year. New functions were added in the first half of the year.

A major update in April



It is a portal website that put together online learning videos.

It supports search by grade or by subject and indication of videos in the order of popularity. It can be used by schoolchildren and students for home learning and for educational materials in school classes.

POINT

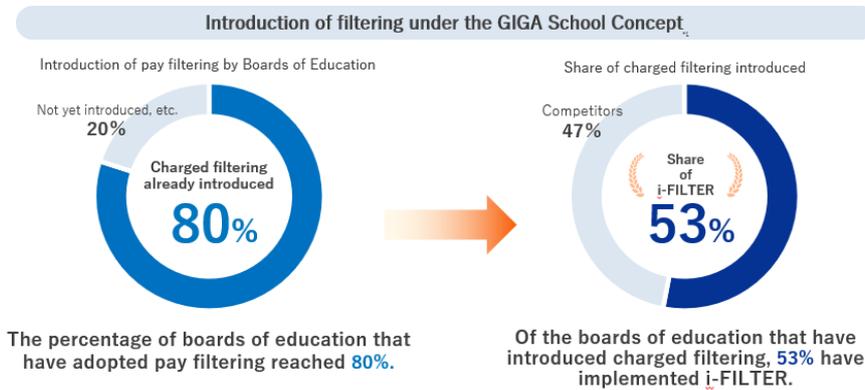
- **For previews and reviews of school classes**
What is learned at school can be previewed and reviewed at any time and anywhere!
- **For educational materials in school classes**
Videos can be used as education materials for a more intuitive understanding!



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This slide also explains about the GIGA School Concept.

Advertise the superiority of i-FILTER to boards of education that have yet to introduce filtering and those which have introduced competitors' products in order to hold an even larger market share



*1: According to our survey of 1,741 boards of education (Sep. 2024)

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Although we have grown our market share in the GIGA School Concept, but overall, 20% of board of education have yet to introduce filtering equipped with adequate functionality. 47% of the market share is held by competitors who comprise around 10 companies. We have ascertained the situation at each board of education, and plan to approach each board of education using a competitor's products or not using a filtering solution, with the aim of reaching 100% market share. We have already begun making approaches to these potential customers.

Forecasts for Fiscal Year Ending March 31, 2025 (Consolidated)



DAC's sales of 2.3 billion yen and expenses of 2.2 billion yen, which were included in the financial results of the previous fiscal year, are excluded from consolidated earnings forecasts for the current fiscal year. Therefore, DA's growth in sales is expected to result in significant improvements in the gross profit and operating profit margins. Meanwhile, profit attributable to owners of parent of the previous financial results included extraordinary income of approximately 1.9 billion yen due to the transfer of shares in DAC^{*1}.

(million yen)

	FY March 2024 Full-Year Results	FY March 2025 Full-Year Forecasts	Change	% Change	Main Factors for Change
Net sales	11,512	10,720	-792	-6.9%	DAC's sales, which were of 2.3 billion yen in the previous fiscal year, are excluded from consolidation, starting from the current fiscal year.
Cost of sales	4,583	2,850	-1,733	-37.8%	For the above reason, DAC's cost of sales, which was 1.9 billion yen in the previous fiscal year, is excluded from consolidation, starting from the current fiscal year.
Gross profit	6,928	7,870	+941	+13.6%	
Gross profit point	60.2%	73.4%	-	-	Improved significantly due to the deconsolidation of DAC whose cost of sales ratio is high.
SG & A	2,500	2,730	+229	+9.2%	For the above reason, DAC's selling, general and administrative expenses, which were 200 million yen in the previous fiscal year, are excluded from consolidation, starting from the current fiscal year. Approximately 330 million yen are expected to be invested in human resources.
Operating profit	4,427	5,140	+712	+16.1%	
Operating margin	38.5%	47.9%	-	-	Improved significantly due to the deconsolidation of DAC
Ordinary profit	4,443	5,140	+696	+15.7%	
Profit attributable to owners of parent	4,377	3,540	-837	-19.1%	The previous fiscal year's profit reflects extraordinary income of approximately 1.9 billion yen due to the transfer of shares in DAC.

*1: DAC: Digital Arts Consulting (a consolidated subsidiary in which shares were transferred at the end of the previous fiscal year)

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There are no changes to our full-year financial forecast. Explanations are given on the right for each of the cost items.

06 Consolidated Cost of Sales and Selling, General and Administrative Expenses



The cost of sales is expected to improve significantly because DAC's¹ cost of sales in the previous fiscal year is excluded from consolidation. Selling, general and administrative expenses are expected to rise mainly due to the increased investment in human resources.

(million yen)

	FY March 2024 Full-Year Results	FY March 2025 Full-Year Forecasts	Change	% Change
Cost of Sales	4,583	2,850	-37.8%	Impact of the deconsolidation of DAC
Labor	2,038	1,071	-47.4%	
Depreciation	839	852	+1.6%	
Communication expenses	1,304	1,390	+6.6%	An increase in cloud server expenses as a result of the expansion of sales of cloud service products and an increase in the number of licenses.
Others	1,384	642	-53.6%	
Transfer to other accounts	-982	-1,107	+12.7%	
SG & A	2,500	2,730	+9.2%	
Personnel expenses	1,275	1,457	+14.3%	Investments in human resources including the hiring of new graduates, strengthening of employment activities and incentive plans
Advertising expenses	313	320	+2.0%	
Others	911	952	+4.5%	

*1: DAC: Digital Arts Consulting (a consolidated subsidiary in which shares were transferred at the end of the previous fiscal year)

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Regarding communication expenses and the prospects for server charges, as I mentioned earlier, we are on track to achieve the figures in our full-year forecast. We expect to incur over 500 million yen more than previously in personnel recruitment expenses. Investors often express concern to us after reading the *Japan Company Handbook* about whether the salaries at Digital Arts are too low and whether our employees will quit. Naturally we have increased salaries compared with the previous fiscal year and are also increasing hiring to strengthen our workforce. Those activities have allowed us to pursue a number of initiatives, such as increasing the number of products we offer. As we are always told, when a company is growing, it should make investments in proportion to its scale, including in how it uses cash. This is something I realized during the first half of this year as a manager, and in the second half of the year we will continue to make investments that reflect that approach, while still remaining within the bounds of our established plans.

Return to Shareholders for the Fiscal Year Ending March 31, 2025

We are planning to **pay dividends** as follows to return a portion of our earnings to our shareholders.

- Target payout ratio for fiscal year ending March 31, 2025: 33.0%
- Annual dividends of surplus forecasted for fiscal year ending March 31, 2025: 85.00 yen per share.
- We expect to increase the annual dividend by 5.00 yen per share. **(planned to increase for 11 consecutive years)**

	Dividend (in yen) per share			Consolidated payout ratio
	2Q-end	Year-end	Annual	
FY March 2024	40.00	40.00	80.00	36.5% ^{*1}
FY March 2025	40.00			
FY March 2025 (forecast)		45.00	85.00	33.0%

Treasury shares will be purchased using a **flexible approach**, with a focus on returns to shareholders while taking into consideration trends in business performance and stock market movements.

■ Reference [Total payout ratio]

(million yen)

	Dividends paid	Amount of treasury stock acquired	Total return	Total payout ratio
FY March 2024 (results)	1,105	1,429	2,534	82.6% ^{*1}
FY March 2025 (forecast)	1,158	500[*]	1,658	46.9%

^{*1} Excluding 1,930 million yen as a gain on sale of the stock of consolidated subsidiary Digital Arts Consulting Inc.

^{*2} Announced on June 12, 2024

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On the topic of shareholder returns, we plan to increase dividends for the 11th straight fiscal period. In addition, we carried out one purchase of treasury shares in the first half of the year, we will take a flexible approach going forward while monitoring trends in the share price and other factors.

That concludes this presentation. Thank you for your time and attention.