

**3620**
**TSE 1st**
**DIGITAL Hearts Co., Ltd.**
**Summary of Q3 FY3/12 Financial Results**

On February 3, 2012, DIGITAL Hearts Co., Ltd., hereinafter DIGITAL Hearts or the Company, announced its 3<sup>rd</sup> quarter financial results for the fiscal year ending March 2012. Following that Trias Corporation took the opportunity to interview Director Kenichi Kawaguchi about the background to the striking recovery in the earnings trend. Below you can find a summary of our findings.

**Q3 FY3/12 Financial Results Summary**

The Q3 data, as you can see in table 1 below, shows that DIGITAL Hearts was able to achieve an all time historic high for both net sales and incomes. The operating income margin also recovered substantially rising from 13.6% to 18.1% versus the corresponding period last year. In particular, the main driver of this result was the strong performance of QA testing in the Consumer Games Business division. In addition, from this term DIGITAL Hearts has begun consolidating its earnings, in table 1 below we have prepared a comparison of last term's parent results versus the this term's consolidated.

**● [Table 1] Q3 FY3/12 Business Results Summary**

(¥ million)	Parent-Only Q3 FY3/11 (YTD)		Consolidated Q3 FY3/12 (YTD)		YoY Change	
	Actual	Weighting	Actual	Weighting	Amount	Ratio
<b>Net Sales</b>	<b>2,999</b>	<b>100.0%</b>	<b>4,171</b>	<b>100.0%</b>	<b>1,172</b>	<b>39.1%</b>
<b>QA Testing Business</b>	<b>2,999</b>	<b>100.0%</b>	<b>4,160</b>	<b>99.7%</b>	<b>1,161</b>	<b>38.7%</b>
Consumer Games	1,253	41.8%	2,184	52.4%	931	74.3%
Digital Solutions	650	21.7%	850	20.4%	200	30.8%
Arcade Games	1,095	36.5%	1,126	27.0%	31	2.8%
<b>Others (3D Content Production, Fuguai.com)</b>	<b>n.a.</b>	<b>n.a.</b>	<b>10</b>	<b>0.2%</b>	<b>10</b>	<b>n.a.</b>
<b>Operating Income</b>	<b>409</b>	<b>13.6%</b>	<b>757</b>	<b>18.1%</b>	<b>348</b>	<b>85.1%</b>
<b>Ordinary Income</b>	<b>408</b>	<b>13.6%</b>	<b>732</b>	<b>17.5%</b>	<b>324</b>	<b>79.4%</b>
<b>Net Income</b>	<b>226</b>	<b>7.5%</b>	<b>384</b>	<b>9.2%</b>	<b>158</b>	<b>69.9%</b>

Notes: Tables 1 & 2 prepared by Trias Corp. with the data disclosed by DIGITAL Hearts Co., Ltd.  
 Parent-only figures for Q3 FY3/11 (YTD)

Regarding trends in the Company's business divisions and the all-important QA testing business, net sales increased across the board in the Consumer Games, Digital Solutions and Arcade Games versus the corresponding period last year.

The above results are illustrated in the data in table 2.

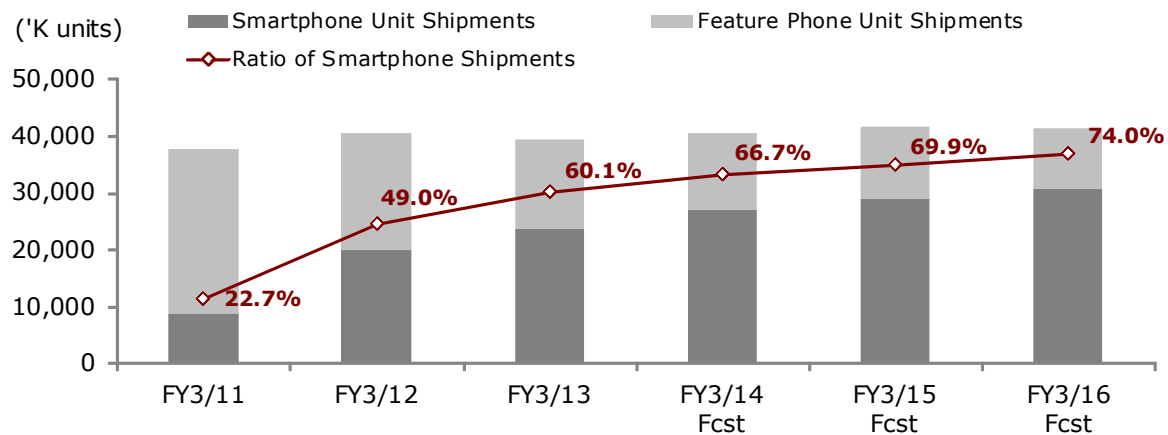
● **[Table 2] Q3 FY3/12 Key Measures of Business Performance**

Indicators	Unit	Q3 FY3/09	Q3 FY3/10	Q3 FY3/11	Q3 FY3/12
Net Sales	¥ million	2,535	2,559	2,999	4,171
No. of Clients	Companies	505	611	742	917
No. of Registered Testers	Persons	3,521	3,869	4,507	6,019
No. of Title Leaders	Persons	106	165	168	181
No. of Permanent Hires	Persons	132	158	151	163
No. of Bug Cases	Cases	390,000	430,000	540,000	630,000
YoY Change	Unit	Q3 FY3/09	Q3 FY3/10	Q3 FY3/11	Q3 FY3/12
Net Sales		48.4%	0.9%	17.2%	39.1%
No. of Clients		n.a.	21.0%	21.4%	23.6%
No. of Registered Testers		n.a.	9.9%	16.5%	33.5%
No. of Title Leaders	%	n.a.	55.7%	1.8%	7.7%
No. of Permanent Hires		n.a.	19.7%	-4.4%	7.9%
No. of Bug Cases		n.a.	10.3%	25.6%	16.7%

DIGITAL Heart views that the game software business, the QA testing's target, has bottomed out, as there is an increase in net sales of new game titles. Furthermore, the QA testing in the Consumer Games business that has experienced favourable business conditions in the second quarter has continued to strengthen and that its percentage of total net sale has risen from 41.8% in the corresponding period last year to 52.4%. The outsourcing of QA testing of both existing and new blockbuster game software is driving this trend. In addition, there have been largish projects from multiple clients that have also contributed to the strong results. The reason why the Company has been able to deal with the increase in orders without incurring any problems relates to the fact that during the past few years when the industry was suffering difficult business conditions it continued to nurture and developed its staff as a matter of policy and in turn create a strong business culture.

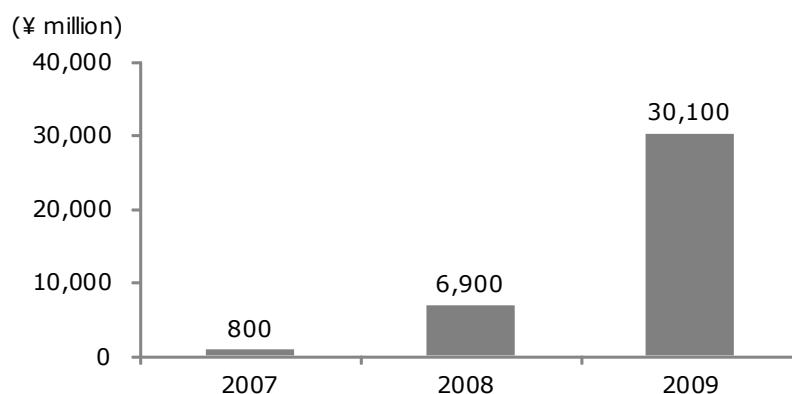
The Consumer Games, as shown in tables 3 and 4, is expected to expand in tandem with the rise in the penetration rate of Smartphones and accompanying growth in social network games. In line with this market trend, the world of QA testing is meeting the growing needs of social games for Smartphone and DIGITAL Hearts is well positioned to reap the benefits of this. The Company expects this trend to continue for the next one to two years. And it, without experiencing any opportunity cost, is well prepared to deal with orders that arise from the trend.

● **【Table3】 Domestic Unit Shipments of Smartphones and Mid Term Forecast**



NOTE: Prepared by Trias Corp. based on the data by MM Research Institute, Ltd. on the Smartphone market as of July 2011

● **【Table 4】 Domestic Social Game Size Trends**



NOTE: Sourced from the Digital Contents Associations White Paper 2010

DIGITAL Hearts has also started to receive orders for QA testing of business software systems, which is a new territory for its QA testing business. In addition, DIGITAL Hearts has begun a new proprietary system to respond to client needs along with a strengthening of its efforts to develop new clients that has led to success in increasing business.

## Initiatives for Future Growth

### Development of Overseas Businesses

In October last year, DIGITAL Hearts established a subsidiary in the USA and appointed a senior executive from a well-known game maker as president. Following that the U.S. operation has begun to actively develop its business, a number of large projects are currently under discussion and it is

expected that orders there will increase. Also under discussion is a plan to use the Thai subsidiary, established in December 2011, to deal with labour intensive functions and improve cost competitiveness.

### **Development of 3D Content Production Business**

As a result of the growth in the 3D content market DIGITAL Hearts is currently focused on the technology that enables 2D content to be converted into 3D and is planning to strengthen its overseas operations. Particularly to deal with the rotoscoping techniques (\*1), a handcrafted matting process, DIGITAL Hearts has started to hire and train local people in this skill in the Thai subsidiary. In addition, through its Korean subsidiary that has advanced technological knowhow in 3D conversion, it is creating a platform for clients and a track record in this business.

Table 5 shows revenue trends in the film and entertainment industry in North America, for the period from 2005 to 2009, it also shows the year-on-year growth of the 3D film market. It can be clearly seen that revenues and the number of titles from the 3D film and entertainment market is growing annually, along with this trend it can also be forecast that there will be a growing need to convert old films into 3D.

Furthermore in table 6, based on the data gathered by Trias Corp. from Box Office Mojo (\*2), you can see the trend of revenues for top 50 films in the USA from 2009 to 2011, with a breakdown showing the revenues from 3D films. This data shows that the U.S. film and entertainment industry experienced a decline in revenues from 2009 onwards. In the case of 3D films, however, revenues have been in an uptrend over the same period and making a remarkable contribution at the top of the film industry's rankings.

In addition, the International Television Expert Group (\*3) estimates the global penetration rate for 3D television by 2015 to be 20.6 million households, which would represent a diffusion rate of 45% in North America, 33% in Europe and 22% in Asia.

*\*1: Rotoscoping techniques are to convert an object into a 3D image by cutting it out from a 2D background image*

*\*2: Box Office Mojo, that was the film and entertainment industries main source of industry statistics and analysis until 2007, was acquired by Amazon in 2008 and merged into a division called Internet Movie Data Base*

*\*3: The International Television Expert Group was established as an independent industry association in 2007 in Berlin for the exchange of information and networking*

Based on this forecast, we can see that over the medium term 3D content production needs will continue to expand. This leads us to conclude that DIGITAL Hearts is well positioned to take advantage of these trends, through its experience and production know how in the 3D industry. Going forward we think one of the most important management decisions will be the expansion and development of the Thai and Korean subsidiaries.

● **【Table 5】 North American Film and Entertainment and 3D Film Revenue Trends**

(\$ million)	2005		2006		2007		2008		2009	
North American Film Revenues	8,820	100%	9,180	100%	9,630	100%	9,640	100%	10,610	100%
3D Film Revenues	40	0.45%	90	0.98%	130	1.35%	240	2.49%	1,140	10.74%

NOTE: Prepared by Trias Corp. based on the American Film Association 2010 data and the 3D films data sourced from JETRO (Japan External Trade Organization)

● **【Table 6】 USA Top 50 Film Revenue Trends with 3D Films Ratio**

(\$ million)	2009	2010	2011
All American Film Revenues for the Top 50 Titles	1,081	1,018	989
Revenues for Films also having a 3D Version	196	259	273
Revenues for 3D Films (2010 Actual 3D Ratio estimated as 58.4%)	114	151	159
3D Films Revenue Ratio	10.6%	14.9%	16.2%

NOTE: Prepared by Trias Corp. based on All American Film and Entertainment Data from Box Office Mojo

## FY3/12 Financial Forecast

On November 4, 2011, when DIGITAL Hearts announced its Q2 financial results, it also revised up its full year forecast for FY3/12, as seen in table 7 below. Furthermore, Q3 YTD results were so robust, including all items below the operating level, resulting in the Company exceeding its most recent full year upward revision. The decision to leave the full year forecast unchanged relates to the expansion of its investment in its overseas operations, in particular the 3D Content Production business ahead of next fiscal term. Just last year in December DIGITAL Hearts won an order to convert the animation film "INAZUMA ELEVEN" to 3D. Unfortunately at that time it did not have the capacity to complete the conversion for entire film. In order to avoid this type of situation occurring again the Company is working hard to ensure that it can complete 3D conversion for entire films by improving the speed of operations while still maintaining the quality. In order to successfully catch this wave of expanding business opportunity the Company is discussing further investment in this area.

However in the key QA Testing Business, business conditions continue to be buoyant, for example in the Consumer Games area the Company has been receiving an increase in projects for QA testing for new titles of PlayStation®Vita, and in the Digital Solutions area there are more business opportunities being created by the growth of the Smartphone market and the accompanying boom in social games.

● **【Table 7】 FY3/12 Financial Forecast**

(¥ million)	Parent-Only FY3/11		Consolidated FY3/12				YoY Change	
	Full-Year	Weighting	Q3 YTD	Weighting	FY Fcst	Weighting	Amount	Ratio
Net Sales	3,957	100.0%	4,171	100.0%	5,057	100.0%	1,100	27.8%
Operating Income	528	13.3%	757	18.1%	721	14.3%	193	36.6%
Ordinary Income	495	12.5%	732	17.5%	701	13.9%	206	41.6%
Net Income	278	7.0%	384	9.2%	357	7.1%	79	28.4%

Note: FY3/12 forecast announced on November 4, 2011

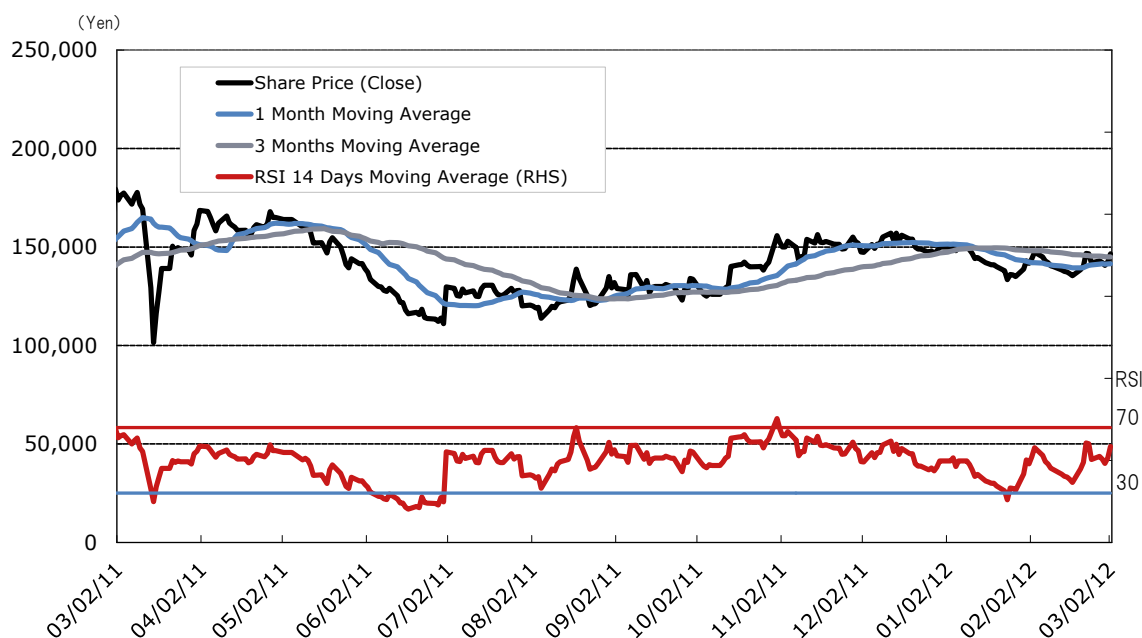


**Reference**
**● Key Financial Data and Business Results (Consolidated)**

No. of Shares Issued	Mar-11	57,885	Total Assets (¥ million)	Mar-11	2,343
No. of Treasury Stock	Mar-11	0	Shareholders' Equity (¥ million)	Mar-11	1,848
Market Value (¥ million)	2-Mar-12	8,486	Interest-Bearing Debt (¥ million)	Mar-11	12
BPS (¥)	Mar-11	31,929.1	Equity Ratio (%)	Mar-11	78.9
ROE (%)	Mar-11	15.0	Ratio of Interest-Bearing Debt (%)	Mar-11	0.6
ROA (%)	Mar-11	11.9	Free Cash Flows (¥ million)	Mar-11	215
PER (times)	FY3/12 fcst	23.7	ROE=Current Net Income÷Shareholders' Equity		
PCFR (times)	Mar-11	25.5	ROA=Current Net Income÷Total Assets		
PBR (times)	Mar-11	4.6	PCFR=Market Value÷(Current Net Income+Depreciation)		
Share Price (¥)	2-Mar-12	146,600	Ave. Daily Vol.=Ave. Daily Vol. for the last 12 months		
Unit Share (shares)	Mar-11	n.a.	Interest-Bearing Debts Ratio=I.B.D.÷Shareholders' Equity		
Average Daily Volume (share)	2-Mar-12	150	Free Cash Flows=Operating CF+Investment CF		

(¥ million)	Net Sales	Operating Income	Ordinary Income	Net Income	EPS (¥)	DPS (¥)
FY3/08	2,372	336	319	169	9,942.30	0.00
FY3/09	3,378	641	643	347	6,035.86	500.00
FY3/10	3,416	521	526	306	5,303.32	500.00
FY3/11	3,957	528	495	278	4,820.11	750.00
1H FY3/12 Actual	2,618	464	463	244	4,222.14	--
FY3/12 Fcst	5,057	721	701	357	6,176.26	500.00

Note: FY3/12 forecast announced on November 4, 2011.

**● Stock Price Charts and RSI**


Source: Prepared by Trias Corp. with Bloomberg data.

Note: RSI, Relative Strength Index, is the index representing the ratio of overbought or oversold share prices.

In general, over 70 in RSI shows overbought share price range, while below 30 shows oversold share price range.

$RSI = \frac{\text{averaged share price appreciation for N days}}{\text{averaged share price appreciation for N days} + \text{averaged share price decline for N days}} \times 100$

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