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November 14, 2024

Consolidated Financial Results for the Third Quarter of the Fiscal Year Ending December 31, 2024 (Under Japanese GAAP)

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Listing: Tokyo Stock Exchange
Securities code: 4011
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Scheduled date to commence dividend payments: -
Preparation of supplementary material on financial results: Yes
Holding of financial results briefing: None

(Yen amounts are rounded down to millions, unless otherwise noted.)

1. Consolidated financial results for the third quarter of the fiscal year ending December 31, 2024 (January 1, 2024 – September 30, 2024)

(1) Consolidated operating results

(Percentages indicate year-on-year changes.)

	Net sales		Operating profit		Ordinary profit		Profit attributable to owners of parent	
Nine months ended	Millions of yen	%	Millions of yen	%	Millions of yen	%	Millions of yen	%
September 30, 2024	2,087	16.9	216	156.8	218	155.1	145	171.2
September 30, 2023	1,786	67.4	84	247.7	85	331.7	53	353.1

Note: Comprehensive income For the nine months ended September 30, 2024: ¥147 million [up 172.3%]
For the nine months ended September 30, 2023: ¥54 million [up 355.3%]

	Basic earnings per share	Diluted earnings per share
Nine months ended	Yen	Yen
September 30, 2024	77.08	69.93
September 30, 2023	28.71	25.85

Note: Headwaters conducted a 2-for-1 common stock split on July 1, 2023. Basic earnings per share and diluted earnings per share have been calculated as if this stock split had taken place at the beginning of the fiscal year ended December 31, 2023.

(2) Consolidated financial position

	Total assets	Net assets	Equity-to-asset ratio
As of	Millions of yen	Millions of yen	%
September 30, 2024	1,571	1,127	71.4
December 31, 2023	1,294	961	74.1

Reference: Equity As of September 30, 2024: ¥1,122 million As of December 31, 2023: ¥958 million

2. Cash dividends

	Annual dividends per share				
	First quarter-end	Second quarter-end	Third quarter-end	Fiscal year-end	Total
	Yen	Yen	Yen	Yen	Yen
Fiscal year ended December 31, 2023	-	0.00	-	0.00	0.00
Fiscal year ending December 31, 2024	-	0.00	-		
Fiscal year ending December 31, 2024 (Forecast)				0.00	0.00

Note: Revisions to the most recently announced dividend forecast: None

3. Consolidated forecast for the fiscal year ending December 31, 2024 (January 1, 2024 – December 31, 2024)

(Percentages indicate year-on-year changes.)

	Net sales		Operating profit		Ordinary profit		Profit attributable to owners of parent		Basic earnings per share
	Millions of yen	%	Millions of yen	%	Millions of yen	%	Millions of yen	%	Yen
Full Year	2,928	26.5	293	209.7	297	203.0	206	191.6	108.83

Note: Revisions to the most recently announced consolidated forecast: Yes

*** Notes**

(1) Significant changes in the scope of consolidation during the period: None

Newly included: - Excluded: -

(2) Application of special accounting methods for presenting consolidated interim financial statements: None

(3) Changes in accounting policies, changes in accounting estimates, and restatement

(i) Changes in accounting policies due to revisions to accounting standards and other regulations: None

(ii) Changes in accounting policies due to other reasons: None

(iii) Changes in accounting estimates: None

(iv) Restatement: None

(4) Number of issued shares (common stock)

(i) Total number of issued shares at the end of the period (including treasury shares)

As of September 30, 2024	1,898,370 shares
As of December 31, 2023	1,881,298 shares

(ii) Number of treasury shares at the end of the period

As of September 30, 2024	42 shares
As of December 31, 2023	26 shares

(iii) Average number of shares outstanding during the period

Nine months ended September 30, 2024	1,892,533 shares
Nine months ended September 30, 2023	1,873,819 shares

Note: Headwaters conducted a 2-for-1 common stock split on July 1, 2023. The total number of issued shares at the end of the period, the number of treasury shares at the end of the period and the average number of shares outstanding during the period have been calculated as if this stock split had taken place at the beginning of the fiscal year ended December 31, 2023.

* Review of the attached quarterly consolidated financial statements by a certified public accountant or auditing firm: None

* Proper use of earnings forecasts, and other special matters

Forecasts and forward-looking statements in these materials are based on assumptions judged to be valid and information available to Headwaters at the time the materials were created. These materials are not promises by Headwaters regarding future performance. Actual performance may differ significantly from these forecasts for a number of reasons. Please refer to “1. Qualitative Information on Quarterly Consolidated Financial Performance (3) Explanation of Consolidated Earnings Forecasts and Other Forward-looking Statements” on page 4 of the attachments regarding preconditions or other related matters for the forecast shown above.

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1. Qualitative Information on Quarterly Consolidated Financial Performance

(1) Explanation of Results of Operations

During the first nine months of the fiscal year ending December 31, 2024 (January 1, 2024 to September 30, 2024), the Japanese economy achieved a certain degree of growth, driven by rising wages, economic stimulus measures and a recovery of domestic demand. Nonetheless, economic conditions remained unstable given a number of concerns such as Russia's prolonged invasion of Ukraine, instability in the Middle East, downside risks related to the economic conditions caused by the continuing high interest rates in Europe and the United States, and inflation.

In the IT industry in which the Headwaters Group operates, rapid growth is continuing because of many innovations, notably artificial intelligence (AI) and the digital transformation (DX). In particular, the emergence and evolution of generative AI has led to new ways to deal with Japan's falling working age population and other social issues. This technology has also made enormous contributions to creating new business models and promoting innovations. During the first nine months of 2024, generative AI technology continued to advance remarkably. The progress of multimodal AI processing (natural language/image/voice) is particularly notable. New generative AI-based services are being created one after another, with issues such as processing speed, accuracy and cost having been overcome due to technological innovation. That said, the Group believes that it should continue to address the issue of how to utilize the large amount of data possessed by companies while taking advantage of the convenience of generative AI.

In the first nine months of 2024, large projects were underway in two of our service categories: AI Integration Services and DX Services. The shift to loyal clients, which has been promoted in recent years, is contributing significantly to the increase in unit sales price. In the AI solutions business, demand has grown across a broad range of industries and multiple projects are being carried out in parallel.

The Headwaters Group divides the AI solutions business into the following three service categories.

AI Integration Services: Consulting and development services for generative AI, Copilot, edge AI and other fields and other activities

DX Services: Platform development, DX consulting, Azure cloud development, low-code development and other activities

Product Services: Headwaters services, sales agent operations including cloud utilization fees

* OPS Services has been discontinued from the first nine months of 2024 (Reasons for discontinuation are discussed below).

Year-on-year changes have been calculated by reclassifying the financial results for the first nine months of 2023 into the relevant three service categories.

AI Integration Services

In addition to IoT-based edge AI projects, the Group started to focus on promoting generative AI projects in the first nine months of 2024 by expanding its lineup of generative AI GPT services. Consequently, most of new orders were accounted for by those for generative AI.

Given the situation in which the use of chat-based generative AI became mainstream, the Group started to implement several large-scale data utilization projects in the first nine month of 2024. It is now possible to improve quality (the accuracy and speed of responses) to the point where the generative AI-powered services provided by clients are provided through a variety of user interfaces (online services, smartphone apps, etc.).

Moreover, in a situation where improving the accuracy of retrieval-augmented generation (RAG) is a significant challenge in the business use of generative AI, the Group has established a method for providing

solutions to these issues and expertise in this area leveraging its top-class project record in Japan. The AI agent, which automatically executes specific tasks using AI, is autonomous, adaptable and interactive, and it has problem-solving capabilities. It has been practically used as an effective solution to social issues such as the decrease in the working age population. The Group also uses it in its projects.

The large volume of business data possessed by clients allows advanced analysis and visualization through management on a data platform and linkage to generative AI. In conjunction with the use of generative AI, there is strong demand for data platforms from the perspective of utilization as an important technical element particularly among clients that possess their own corporate data. There are a limited number of companies that have the capacity to provide one-stop services including consulting such as planning and proposing generative AI and data utilization, the designing of an AI, and the development of the user interfaces that clients provide. On top of this, the Group has been promoting projects in a customer-centric way, including support for in-house production.

In the first nine months of 2024, sales from AI Integration Services increased 43.8% year on year to 1,041 million yen thanks to higher sales of generative AI projects.

DX Services

The Group's DX service projects include platform development for cloud services centered on Microsoft Azure, consultation for companies' DX initiatives, and low-code development to improve operational efficiency. We primarily provide services such as modernization, which entails updates and improvements to old systems using the latest technologies and methods, and support for the internalization of various processes using Microsoft Power Platform and other low-code tools. Companies' actions for DX have steadily continued from the first nine months of 2023.

In the first nine months of 2024, the Group increased the number of opportunities in which it received orders for multiple projects from a single client as a result of further progress in the development of new businesses for existing clients. However, DX Services sales decreased 3.5% year on year to 948 million yen due to the popularization of the use of generative AI in a range of services including DX services, making it essential to implement AI technologies.

Product Services

Product Services are operated based on two profit models that are not dependent on person-months.

In-house service model: initial setup fee plus monthly license fees for the SyncLect in-house service

Other companies' service model: cloud service utilization fees (collected monthly) and agency model for the purchase and sale of IoT equipment

In the first nine months of 2024, the Group engaged in the development of services with a focus on the SyndLect Generative AI platform using generative AI. As a result of cloud usage fees rising due to client referrals from Microsoft, mainly enterprise companies, and the implementation of development based on cloud services, Product Services sales increased 23.6% year on year to 97 million yen.

OPS Services

In the first nine months of 2024, the OPS category has been discontinued for the following reasons.

- As a measure to strengthen the revenue base, which is one of our growth strategies, we are working on initiatives to improve the sales unit price. We have shifted to a contracting and project management method based on DevOps (*) for the operation and maintenance phase, where the unit price tends to be set low.

- The shift to loyalty-based clients has led to a shift to time-and-materials contracts that combine development and operations, as DevOps development methods match the needs of clients who want to promote projects in a run-along fashion.

The projects that were recorded in the OPS category in the first nine months of 2023 have been allocated to the DX (approx. 80%), AI integration (approx. 15%), and Product (approx. 5%) service categories.

- * DevOps is a term coined by combining the words Development and Operations. Although there is no strict definition, DevOps represents a concept and mechanism for providing services quickly and flexibly by having development and operations teams work together.

As a result, net sales for the first nine months of 2024 increased 16.9% year on year to 2,087 million yen. Operating profit rose 156.8% to 216 million yen, and ordinary profit climbed 155.1% to 218 million yen. Profit attributable to owners of parent increased 171.2% to 145 million yen.

The Headwaters Group will continue to operate in a single business segment, AI Solutions, with the goal of using AI to provide an even larger lineup and higher level of services for clients.

(2) Explanation of Financial Position

Assets

Total assets at the end of the third quarter of 2024 stood at 1,571 million yen, an increase of 277 million yen from the end of 2023.

Current assets totaled 1,496 million yen at the end of the third quarter, an increase of 269 million yen from the end of 2023. This was mainly attributable to increases of 105 million yen in cash and deposits, 140 million yen in accounts receivable - trade and contract assets, and 32 million yen in prepaid expenses, despite a 6 million yen decrease in work in process. Non-current assets increased 7 million yen from the end of 2023, to 75 million yen. This was attributable principally to an increase of 9 million yen in property, plant and equipment, which more than offset a decrease of 2 million yen in intangible assets.

Liabilities

Total liabilities at the end of the third quarter stood at 444 million yen, an increase of 111 million yen from the end of 2023. This was mainly due to increases of 26 million yen in accounts payable - trade, 10 million yen in accrued expenses, 10 million yen in accrued consumption taxes, 39 million yen in income taxes payable, 7 million yen in contract liabilities, and 2 million yen in deposits received.

Net assets

Total net assets as of the end of the third quarter resulted in 1,127 million yen, which is an increase of 165 million yen from the end of 2023. This was mainly attributable to an increase in retained earnings of 145 million yen resulting from the posting of profit attributable to owners of parent.

(3) Explanation of Consolidated Earnings Forecasts and Other Forward-looking Statements

For the earnings forecasts for the fiscal year ending December 31, 2024, please see the notice regarding the revision of the full-year earnings forecasts announced on November 14, 2024.

2. Quarterly Consolidated Financial Statements and Notes

(1) Quarterly Consolidated Balance Sheet

	(Thousands of yen)	
	Fiscal Year 2023 (As of Dec. 31, 2023)	Third quarter of Fiscal Year 2024 (As of Sep. 30, 2024)
Assets		
Current assets		
Cash and deposits	897,899	1,003,548
Accounts receivable - trade and contract assets	292,365	432,535
Work in process	16,493	9,844
Prepaid expenses	16,840	49,593
Other	2,897	739
Total current assets	1,226,496	1,496,261
Non-current assets		
Property, plant and equipment	30,517	39,770
Intangible assets	13,710	10,964
Investments and other assets	23,515	24,703
Total non-current assets	67,742	75,437
Total assets	1,294,238	1,571,699
Liabilities		
Current liabilities		
Accounts payable - trade	144,705	171,488
Accounts payable - other	16,852	29,807
Accrued expenses	74,775	85,393
Accrued consumption taxes	46,975	57,550
Income taxes payable	22,531	61,787
Contract liabilities	4,141	12,048
Deposits received	22,247	25,154
Provision for loss on orders received	129	981
Total current liabilities	332,358	444,212
Non-current liabilities		
Deferred tax liabilities	220	-
Total non-current liabilities	220	-
Total liabilities	332,579	444,212
Net assets		
Shareholders' equity		
Share capital	369,023	378,338
Capital surplus	359,023	368,338
Retained earnings	230,844	376,728
Treasury shares	(227)	(227)
Total shareholders' equity	958,663	1,123,177
Accumulated other comprehensive income		
Foreign currency translation adjustment	(221)	(662)
Total accumulated other comprehensive income	(221)	(662)
Non-controlling interests	3,216	4,971
Total net assets	961,659	1,127,487
Total liabilities and net assets	1,294,238	1,571,699

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

Quarterly Consolidated Statement of Income

(For the Nine-month Period)

(Thousands of yen)

	First nine months of Fiscal Year 2023 (Jan. 1, 2023 – Sep. 30, 2023)	First nine months of Fiscal Year 2024 (Jan. 1, 2024 – Sep. 30, 2024)
Net sales	1,786,500	2,087,675
Cost of sales	1,136,725	1,187,890
Gross profit	649,775	899,784
Selling, general and administrative expenses	565,375	683,074
Operating profit	84,399	216,709
Non-operating income		
Interest income	8	98
Foreign exchange gains	80	1,560
Subsidy income	500	-
Subsidy income	573	-
Other	20	63
Total non-operating income	1,181	1,722
Non-operating expenses		
Other	0	125
Total non-operating expenses	0	125
Ordinary profit	85,581	218,306
Profit before income taxes	85,581	218,306
Income taxes - current	31,892	72,127
Income taxes - deferred	(2)	(1,465)
Total income taxes	31,890	70,661
Profit	53,691	147,645
Profit (loss) attributable to non-controlling interests	(110)	1,761
Profit attributable to owners of parent	53,801	145,884

Quarterly Consolidated Statement of Comprehensive Income
(For the Nine-month Period)

	(Thousands of yen)	
	First nine months of Fiscal Year 2023 (Jan. 1, 2023 – Sep. 30, 2023)	First nine months of Fiscal Year 2024 (Jan. 1, 2024 – Sep. 30, 2024)
Profit	53,691	147,645
Other comprehensive income		
Foreign currency translation adjustment	370	(447)
Total other comprehensive income	370	(447)
Comprehensive income	54,061	147,197
Comprehensive income attributable to		
Comprehensive income attributable to owners of parent	54,079	145,548
Comprehensive income attributable to non-controlling interests	(17)	1,649

(3) Notes to Quarterly Consolidated Financial Statements

Going Concern Assumption

Not applicable.

Significant Changes in Shareholders' Equity

Not applicable.

Segment Information

This information is omitted because AI Solutions are the only business of the Headwaters Group.

Consolidated Statement of Cash Flows

The quarterly consolidated statement of cash flows for the first nine months of the Fiscal Year 2024 is not prepared. Depreciation for each period is as follows.

	First nine months of Fiscal Year 2023 (Jan. 1, 2023 – Sep. 30, 2023)	First nine months of Fiscal Year 2024 (Jan. 1, 2024 – Sep. 30, 2024)
Depreciation	10,457 thousand yen	13,470 thousand yen