

Financial Supplementary Materials

for the Third Quarter of FY2024

Headwaters Co., Ltd.

November 14, 2024 Securities code: 4011

FY2024 1Q-3Q Consolidated Financial Results Overview

(Thousand yen)

(Thousand yen)

	FY2023 1Q-3Q Results		FY2024 1Q-3Q Results			
		Pct. to net sales (%)		Pct. to net sales (%)	YoY change (%)	Vs. annual plan (%)
Net sales	1,786,500	100.0	2,087,675	100.0	116.9	71.3
AI	723,987	40.5	1,041,187	49.9	143.8	69.6
DX	983,475	55.1	948,813	45.4	96.5	71.9
Product	79,037	4.4	97,675	4.7	123.6	86.0
Operating profit	84,399	4.7	216,709	10.4	256.8	95.9
Ordinary profit	85,581	4.7	218,306	10.5	255.1	95.3
Profit attributable to owners of parent	53,691	3.0	145,884	7.0	271.7	93.1
Net income per share	28.71 yen		77.08 yen			

* The OPS Services category was discontinued from FY2024 and the number of service categories were changed from four to three. In line with this change, FY2023 service category sales were reclassified into the three service categories to enable year-on-year comparisons to be made under the same conditions.



Financial Summary

FY2024 Key Performance Indicators

Sales, Operating Profit, Recruiting

Net Sales

- Sales increased 20.2% YoY for the Quarter and 16.9% YoY **to a new all-time high**.
 - ➔ Both unit prices per project and sales per employee increased as a result of steady orders for generative AI projects for which budgets were properly allocated.
 - ➔ Sales per client also increased, reflecting an increase in orders on several projects received from the same client as a result of efforts to develop new businesses with existing clients by increasing the number of loyal clients.

Operating Profit

- **Operating profit increased 74.1% YoY for the Quarter and 156.8% YoY.**
 - ➔ Progress was made in the recruitment of people with high levels of skills and the percentage of sales involving partner companies was kept below a certain level, which contributed to improving profitability.
 - ➔ Progress is being made in profit structure improvement as in 2Q, aided by higher unit sales prices, measures for unprofitable projects and the effects of reduced recruitment expenses.
 - ➔ Maintained quality by undertaking projects on a larger scale while simultaneously ensuring a gross profit margin of 40% or higher, and provided on-the-job training to mid-career hires.

Recruiting

- A net increase of 60 employees, which was the initial plan of 2024, was achieved in 3Q.
 - ➔ Progress in recruitment exceeded the target by 5%, **resulting in a net increase of 63 employees** (1Q: net increase of 9 employees / 2Q: net increase of 26 employees / 3Q: net increase of 28 employees)
 - ➔ The plan targeting the reduction of the turnover rate to 10% (16 employees/year) or below is in progress.

Remarks

- The OPS Services category has been discontinued from FY2024.
 - ➔ This is due to a decrease in the number of contracts for the operation and maintenance phase only, and an increase in time-and-materials contracts mainly for agile development.
 - ➔ Projects that were recorded in the OPS Services category have been allocated to the DX (approx. 80%), AI (approx. 15%), and Product (approx. 5%) service categories.
 - * In each graph on the following pages, figures relating to OPS projects for each quarter of the last two years have been allocated to the three other service categories.



Net Sales by Service Category

(Thousand yen)

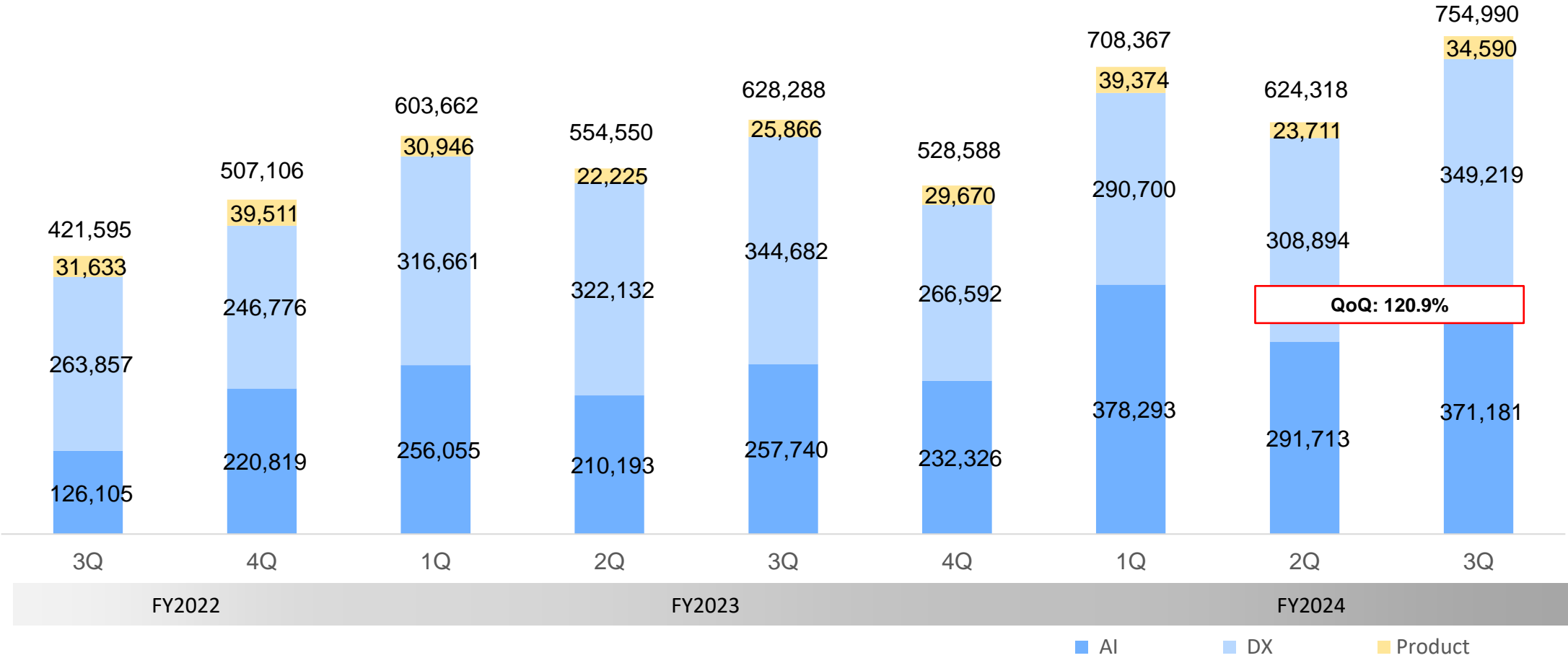
FY2022 Sales: 1,574,596

FY2023 Sales: 2,315,088

FY2024 1Q-3Q Sales: 2,087,675

YoY for the Quarter: 120.2% / YoY: 116.9%

QoQ: 120.9%



* Because the OPS Services category was discontinued from FY2024, FY2022 and FY2023 OPS sales have been allocated to the three other service categories.



Cost of Sales by Service Category

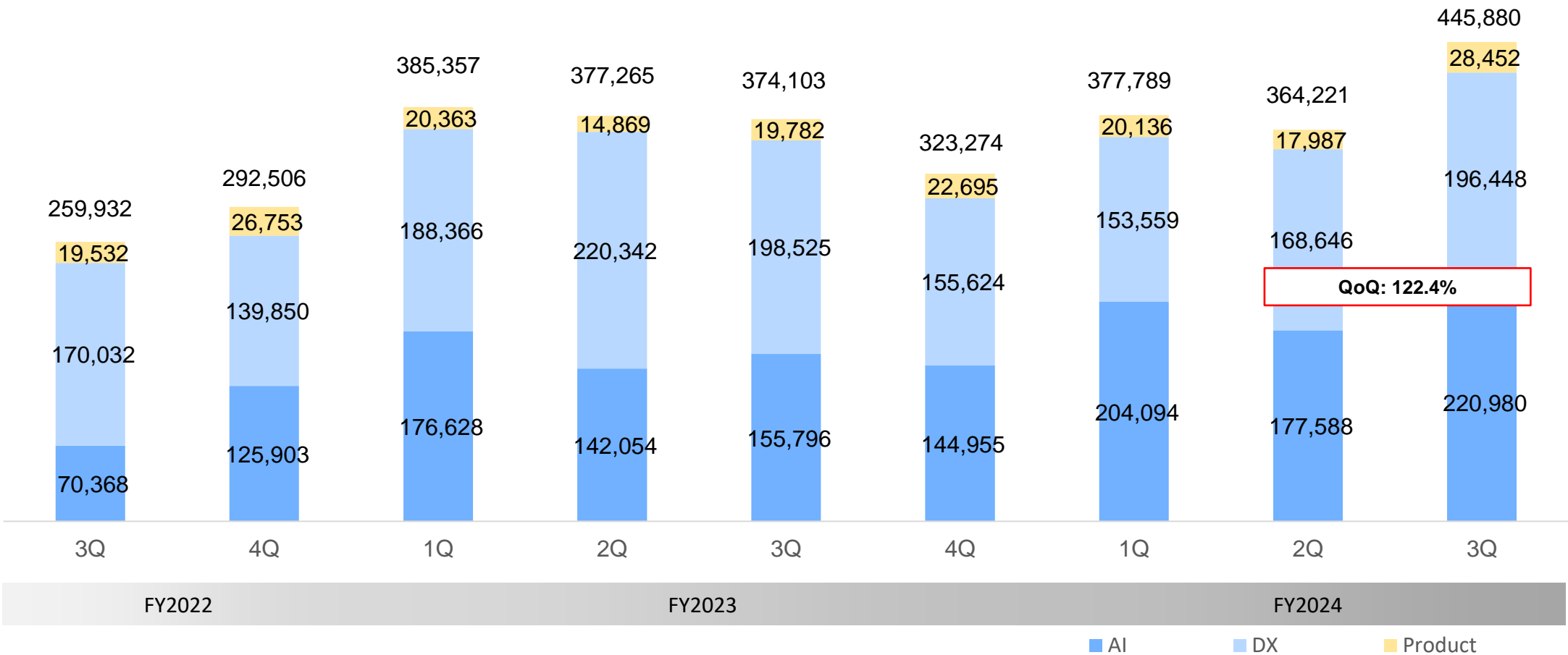
(Thousand yen)

FY2022 Cost of Sales: 929,060

FY2023 Cost of Sales: 1,459,999

FY2024 1Q-3Q Cost of Sales: 1,187,890

YoY for the Quarter: 119.2% / YoY: 104.5%



* Because the OPS Services category was discontinued from FY2024, FY2022 and FY2023 OPS sales have been allocated to the three other service categories.



Gross Profit by Service Category

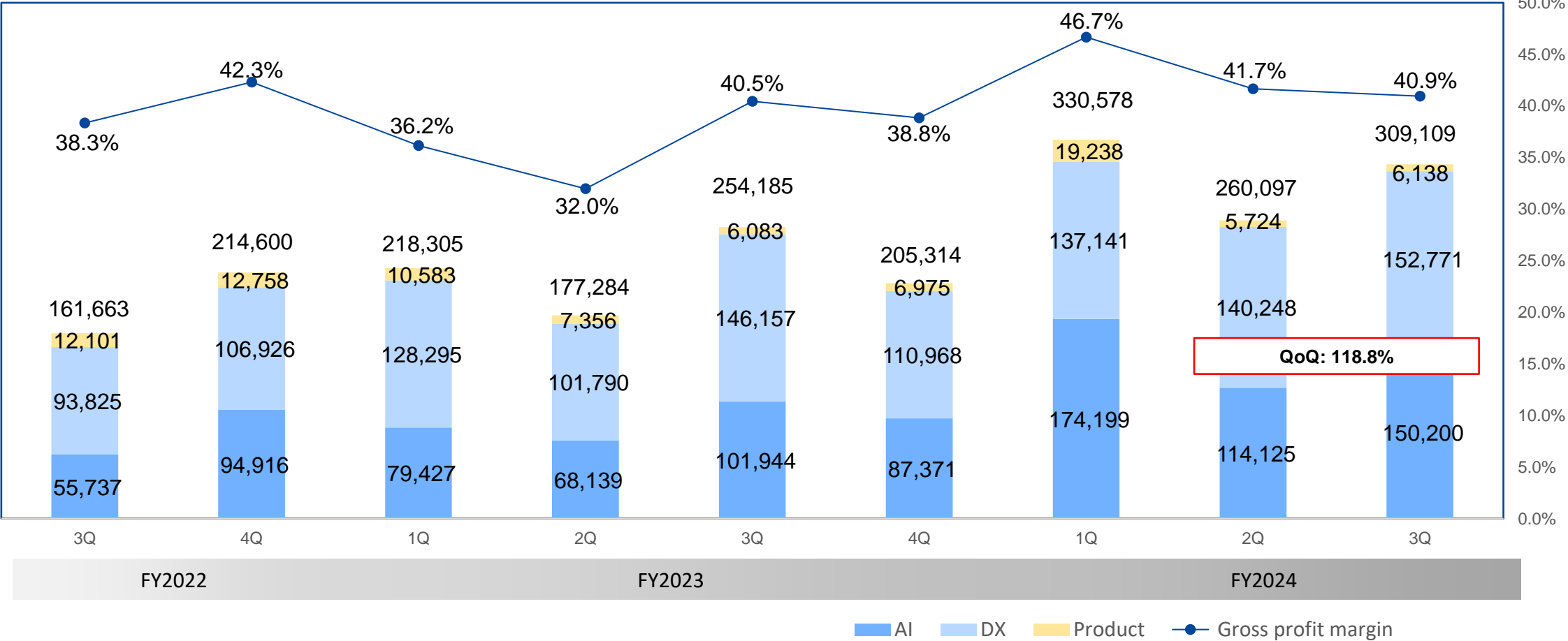
(Thousand yen)

FY2022 Gross Profit: 645,535

FY2023 Gross Profit: 855,088

FY2024 1Q-3Q Gross Profit: 899,784

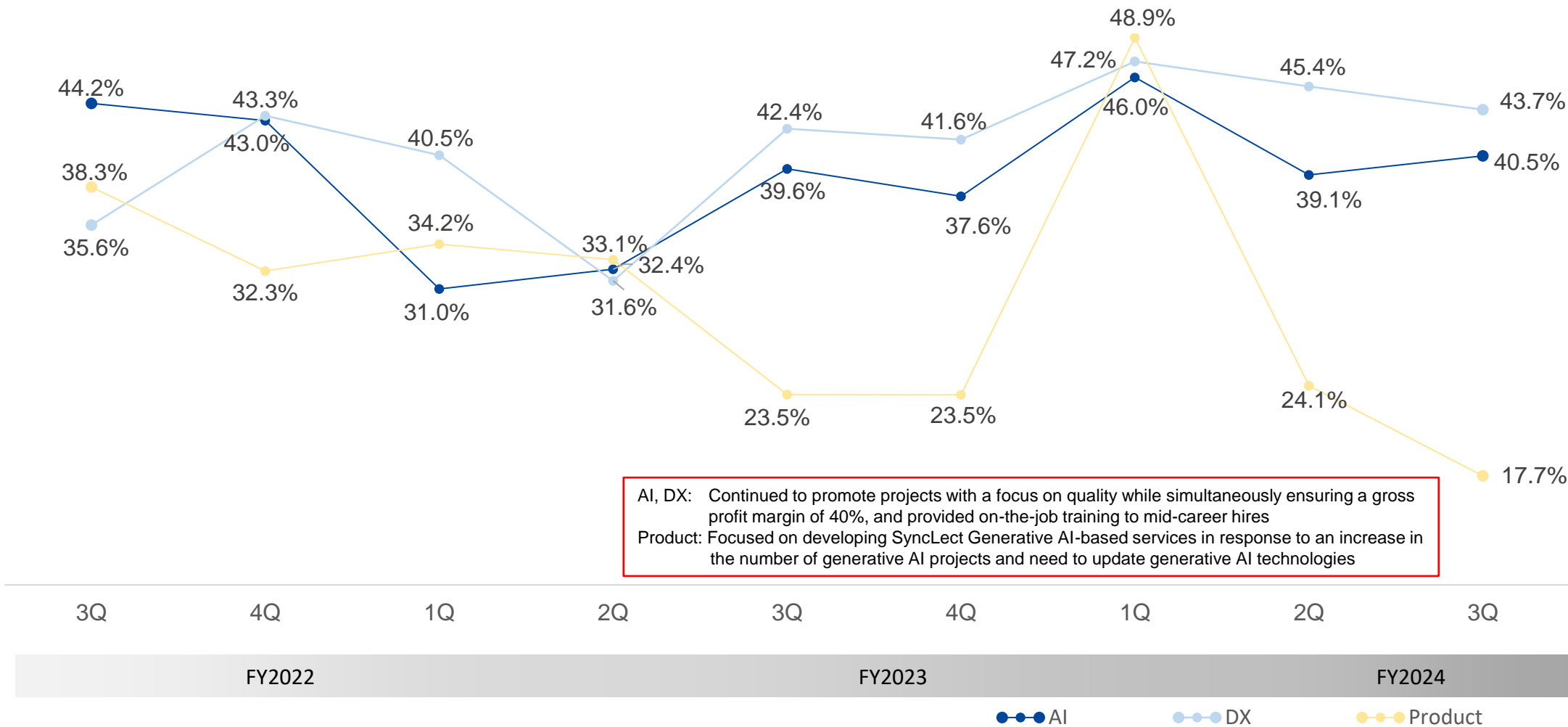
YoY for the Quarter: 121.6% / YoY: 138.5%



* Because the OPS Services category was discontinued from FY2024, FY2022 and FY2023 gross profit have been allocated to the three other service categories.



Gross Profit Margin by Service Category



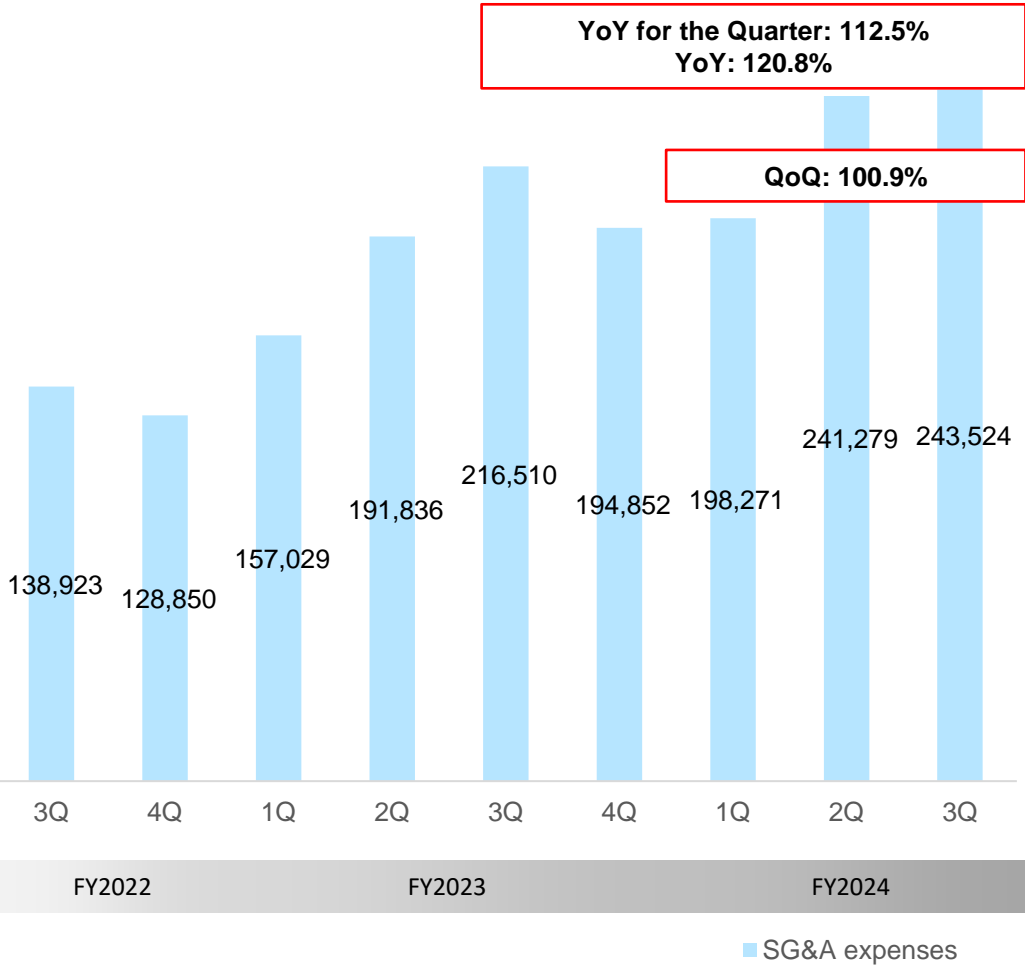
* Because the OPS Services category was discontinued from FY2024, FY2022 and FY2023 gross profit margin have been allocated to the three other service categories.



SG&A Expenses, Operating Profit / Operating Profit Margin

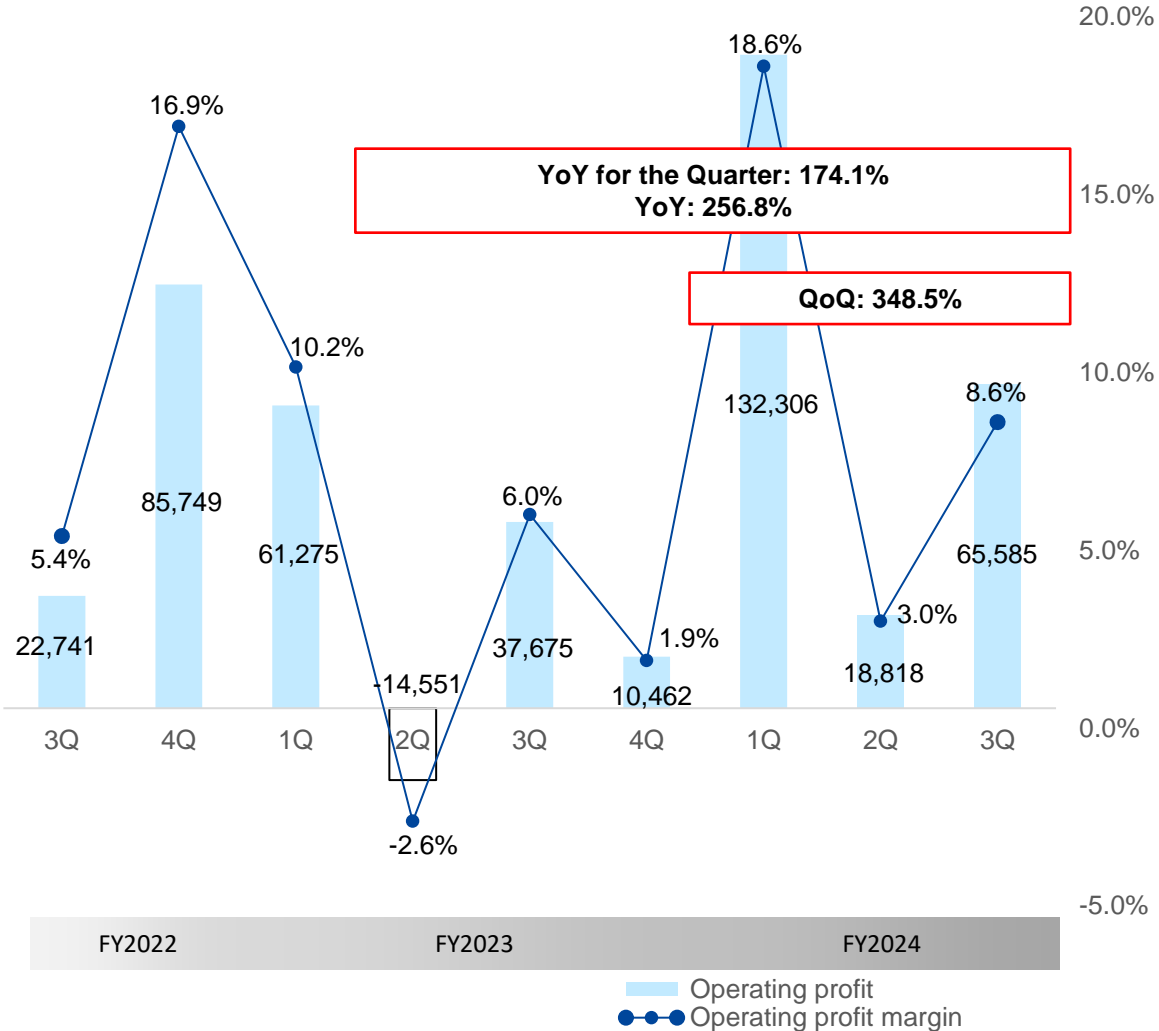
SG&A Expenses

(Thousand yen)



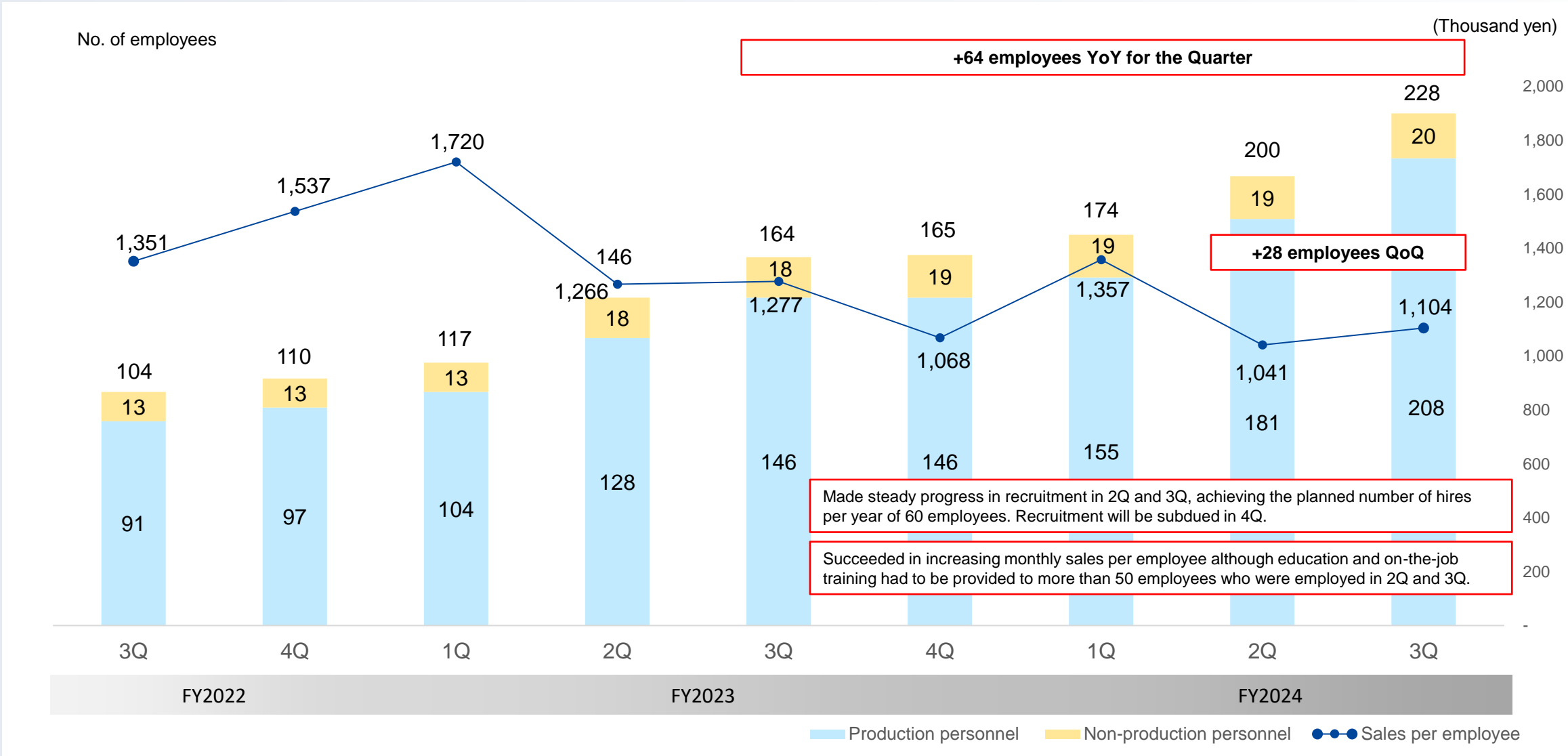
Operating Profit / Operating Profit Margin

(Thousand yen)





Employees, Monthly Sales Per Employee

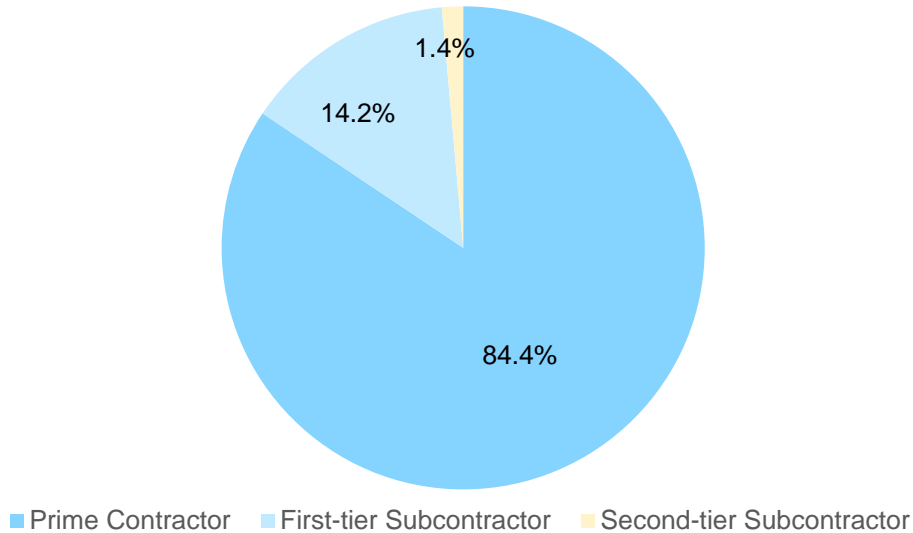


* Contract and part-time employees are not included beginning from FY2024 for the consistency with other disclosed materials.

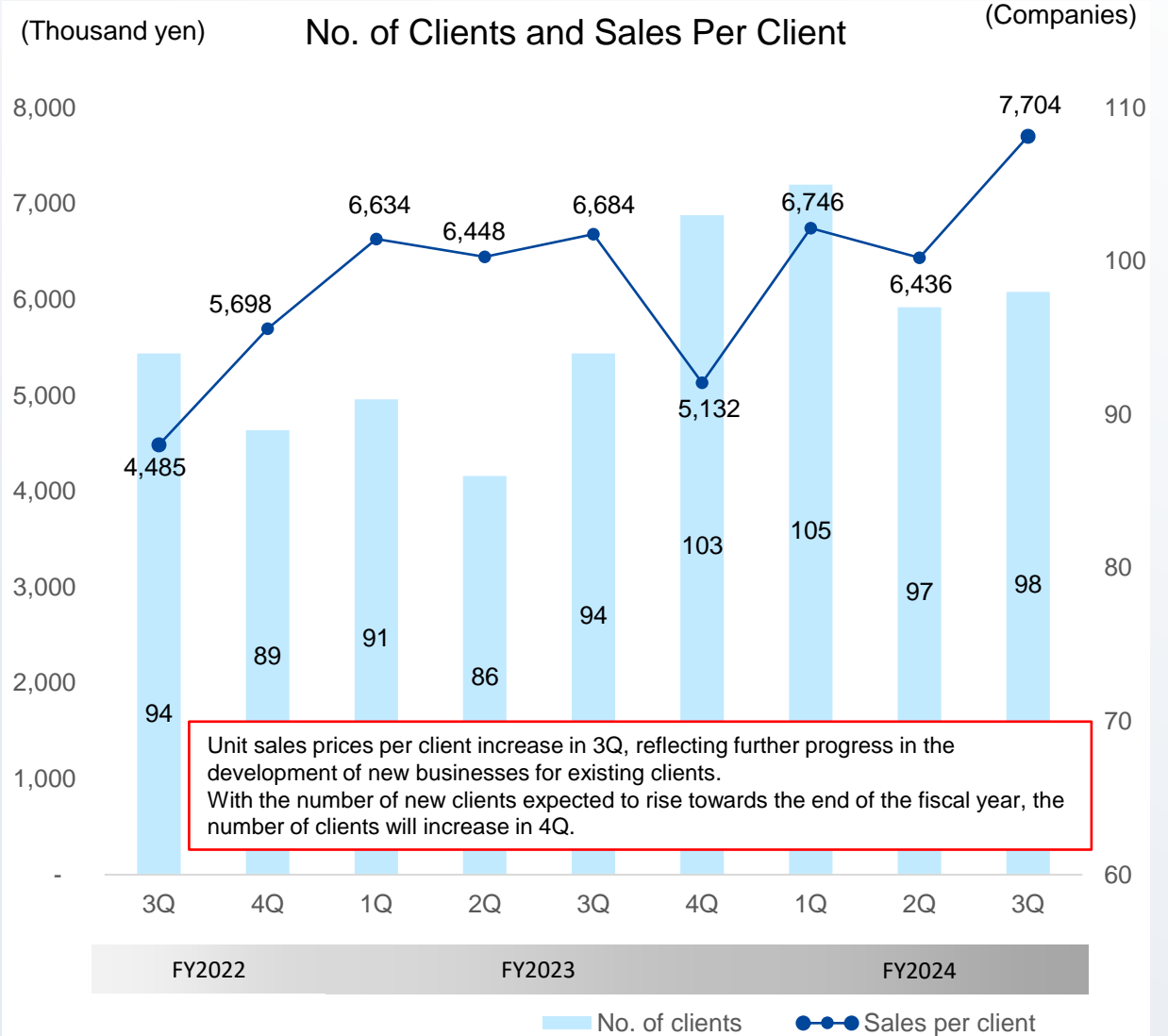


Unit Sales Price, Number of Projects and Contractual Chain Status by Service Category

Pct. of the Contractual Chain (FY2024 cumulative)



- Direct contracts with clients account for most of contracts.
- Even for the projects referred through alliance strategies, contracts are signed directly with the referred client.
- For enterprise companies, there may be a contract through a system subsidiary or a contract with a group company, in which case it is categorized as the first-tier subcontractor.

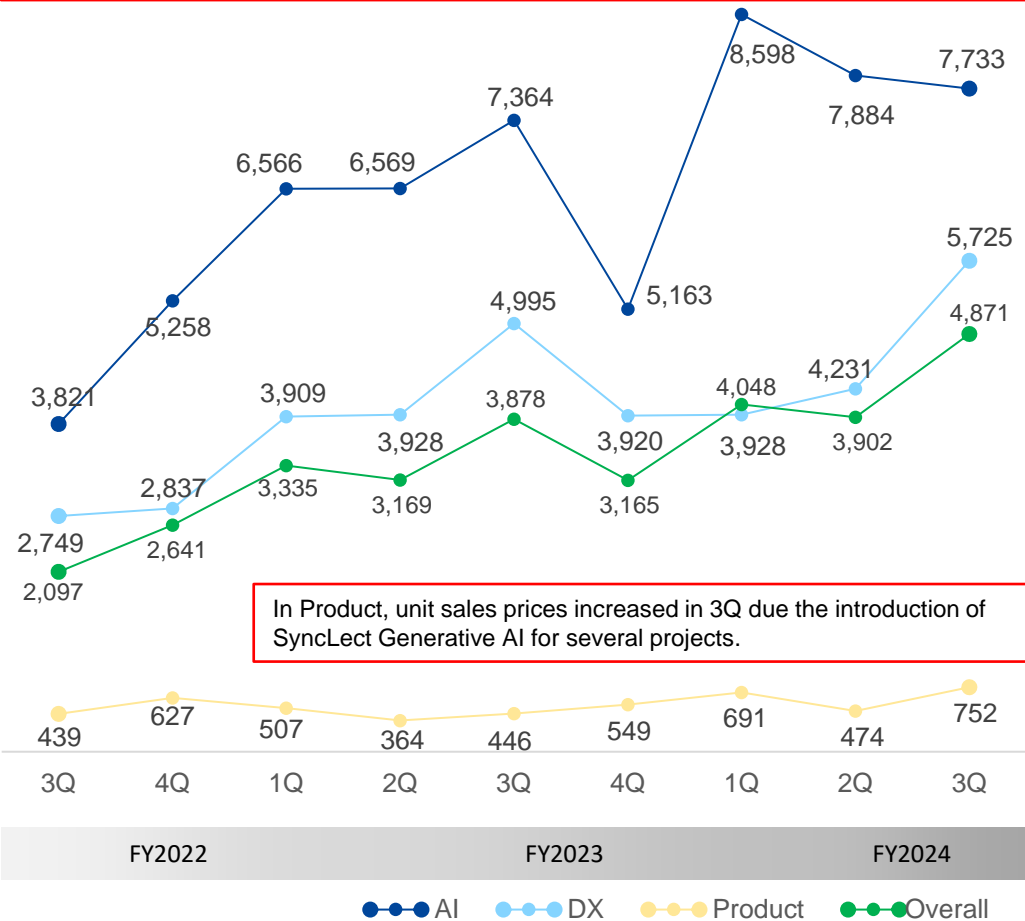




Unit Sales Price, Number of Projects and Contractual Chain Status by Service Category

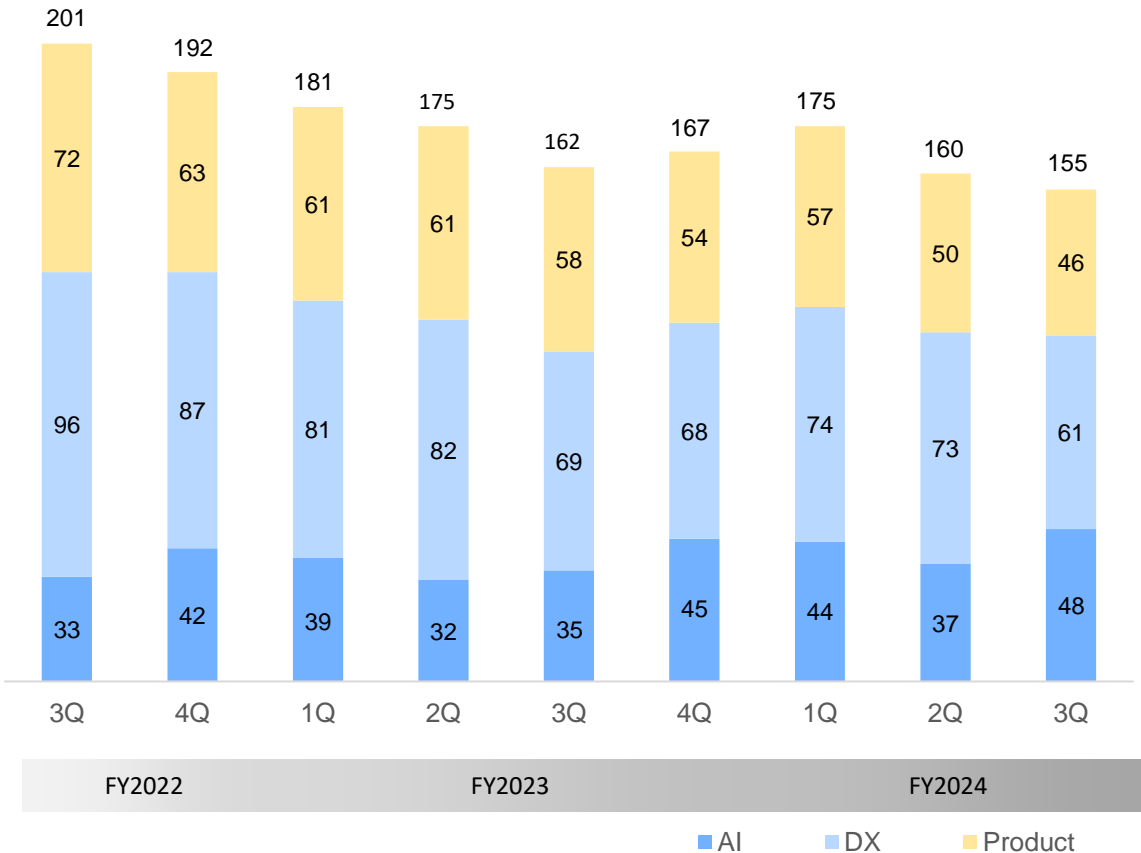
Unit Sales Price by Service Category (Thousand yen)

With medium- and large-scale projects launched as scheduled with respect to both AI and DX, efforts continued to be made to tap into projects while also developing new businesses for clients.



No. of Projects by Service Category

The number of projects decreased overall, reflecting an expansion in the size of each project as more customers became loyal. Even so, the number of AI projects rose due to an increase in the number of generative AI projects. Generative AI began to be used in projects that were undertaken as DX projects previously. Reflecting this, such projects are recategorized as AI projects instead of DX projects.



* Because the OPS Services category was discontinued from FY2024, the number of OPS projects in FY2022 and FY2023 has been allocated to the three other service categories.

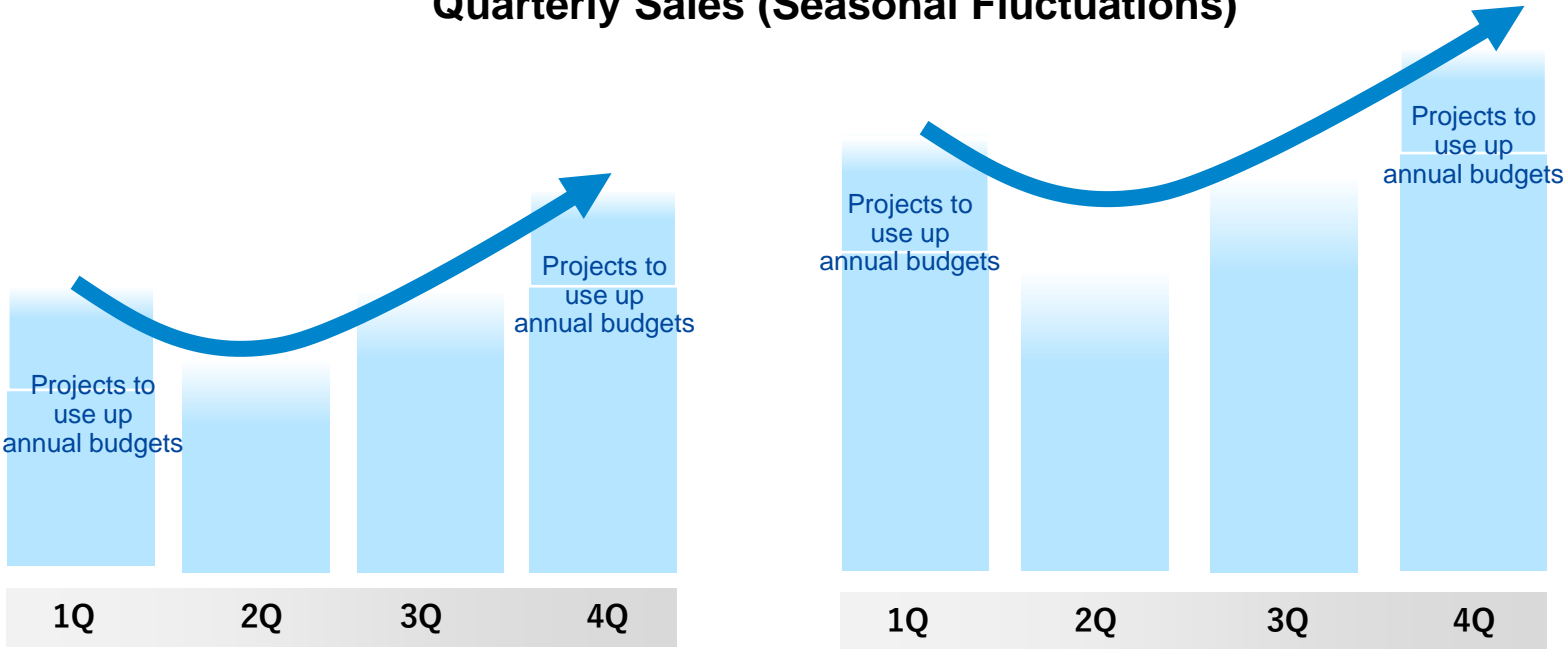


Seasonal Fluctuations in Net Sales

Headwaters' sales are budgeted in a quarterly budget plan that incorporates the following seasonal fluctuations.

	Net sales trend	SG&A expenses trend	Characteristics
1Q	Medium	Low	Sales are steady due to projects to use up annual budgets. Recruitment is slow, and SG&A expenses tend to be kept low.
2Q	Low	High	Sales are at their lowest point. SG&A expenses increase due to progress in recruitment and profit reaches its lowest point.
3Q	High	Very high	Sales are strong if recruitment is steady. It is expected that recruitment continues from 2Q and SG&A expenses rise steeply.
4Q	Very high	High	While sales are at their highest point and recruitment decreases, SG&A expenses remain high due to a steep increase in personnel expenses.

Quarterly Sales (Seasonal Fluctuations)





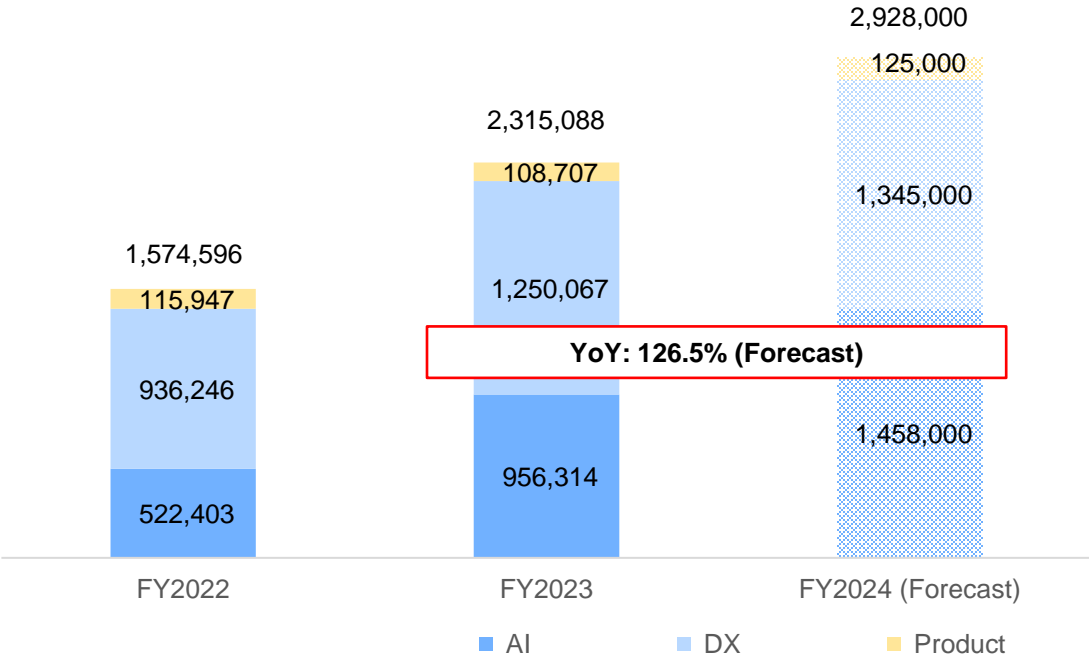
4Q Revenue Forecast

In 4Q, projects are expected to be launched from the perspective of consuming budgets by the last month of the fiscal year, namely, December or March, in addition to medium- and large-scale projects that began to be implemented in 3Q.

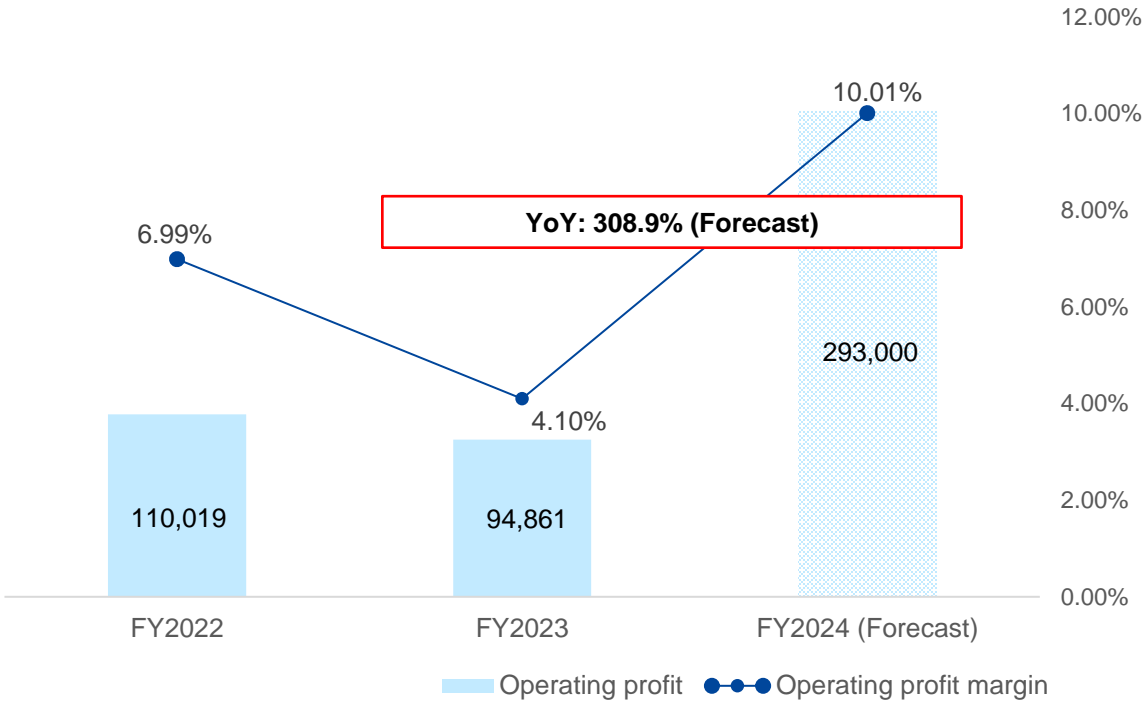
- Net sales: **Expected to be a record high** for the second consecutive fiscal year, reflecting steady progress in sales and recruitment.
- Gross profit margin: Forecast to remain around 40% due to an increase in the percentage of sales involving partner companies, although the number of projects is expected to increase.
- SG&A expenses: Expected to be kept under control because recruitment is being subdued, although personnel expenses are gradually rising in line with the increase in the number of employees.
- Operating profit: Forecast to be in the range of 70 million yen to 100 million yen, reflecting record sales and controlled SG&A expenses.

On a YoY basis, steady growth is expected as in 4Q, as shown in the following graphs.

Sales forecasts by service category (Thousand yen)



Operating profit and operating profit margin forecasts



* Forecast figures may change as they are as of the time of disclosure of these materials.



IR News Summary (July 2024 - September 2024)

IR News: <https://www.headwaters.co.jp/ir/news/>

■ AI technology innovations / Services

- ✓ Launched the customized SLM Fine-tuning service to improve the accuracy of generative AI-based responses by utilizing small scale language models such as Phi-3, Llama-3 and GPT-4o mini.
- ✓ Enhanced the lineup of multimodal AI services for enterprises with respect to the GPT-4o mini model of Azure OpenAI Service.
- ✓ Introduced an AI-based conversational digital human that utilizes the advanced technologies of NVIDIA and Siemens at Ryoyo Electro's exhibition booth in the Japan Robot Week 2024.
- ✓ Strengthened the development of services for Edge VLM, On-device SLM and Copilot PCs by taking advantage of ARM AI Partner certification.

■ Partnership enhancement / certification

- ✓ Headwaters was certified as a GitHub Technology partner.
- ✓ Acquired the AI and Machine Learning for Microsoft Azure specialization, a higher partner certification in Microsoft.
- ✓ Provided a generative AI-powered support service for the enhancement of corporate competitiveness in collaboration with Uchida Spectrum, Inc.

■ Achievements / Examples of implementation

- ✓ Launched a support service for the introduction of the AITRIOS-powered visual detection solution (Support for the implementation at 500 convenience stores).

■ Awards / Social contribution

- ✓ Headwaters and Headwaters Consulting were certified as work-life balance promotion companies by Shinjuku ward.
- ✓ The 2024 Microsoft Top Partner Engineer Award was provided to seven Headwaters engineers, the largest-ever number of receivers.
- ✓ Received the AI Innovation Partner of the Year Award, part of the Microsoft Japan partner of the year 2024 award program.



Notes on Forward-looking Statements

- This document contains outlooks, future plans and management goals related to Headwaters. Descriptions regarding these forward-looking statement are based on assumptions made at the current moment about future events and trends, and there is no guarantee that these assumptions are accurate. Various factors may cause actual performance to significantly differ from what is described in this document.
- The figures in this document represent consolidated figures for the entire group, including Headwaters Consulting, Headwaters Professionals and DATA IMPACT JOINT STOCK COMPANY.
- In this document, numerical comparisons are presented in the following three categories.
 - **QoQ:** A comparison between the figures of the previous quarter and the current quarter
 - Comparison between figures of 2Q FY2024 and 3Q FY2024
 - **YoY:** A comparison between the cumulative figures of the previous fiscal year and the current fiscal year
 - Comparison between figures of 1Q-3Q FY2023 and 1Q-3Q FY2024
 - **YoY for the Quarter:** A comparison between the figures of the corresponding quarter for the previous fiscal year and the current fiscal year
 - Comparison between figures of 3Q FY2023 and 3Q FY2024
- Unless otherwise specified, the financial information in this document is based on generally accepted accounting principles in Japan.
- Information regarding companies other than Headwaters is based on generally known information.