Financial Supplementary Materials
for the First Quarter of FY2025

Headwaters Co., Ltd.

May 15, 2025   **Securities code: 4011**

FY2024 Consolidated Financial Results Overview

(Thousand yen)   (Thousand yen)

	FY2024 1Q (Results)		FY2025 1Q (Results)			
		Pct. to net sales (%)		Pct. to net sales (%)	YoY change (%)	Full-year forecast achievement rate* (%)
Net sales	708,367	100.0	739,209	100.0	104.3	18.4
AI	378,293	53.4	435,920	58.9	115.2	19.8
DX	290,700	41.0	273,740	37.0	94.2	17.1
Product	39,374	5.6	29,548	3.9	75.0	14.2
Operating profit (loss)	132,306	18.6	(67,619)	-	-	-
Ordinary profit (loss)	131,605	18.5	(2,865)	-	-	-
Profit (loss) attributable to owners of parent	89,896	12.6	(20,619)	-	-	-
Net income (loss) per share	23.89 yen		(5.43) yen			

FY2025 Key Performance Indicators   Sales and Recruiting

Net Sales
- To address seasonal fluctuations, we allocated resources to acquire orders for medium- to large-scale projects starting in the second quarter. As a result, <u>net sales increased 4.3% YoY and declined 9.7% QoQ.</u>
- While new clients were added, a reduction in projects from top existing clients weighed on net sales, resulting in lower-than-expected growth.
  - ➡ AI: Inquiries for generative AI projects grew to 1.6 times what they were in the same period of FY2024.
        Net sales **hit a new record high** for the second consecutive quarter.
  - ➡ DX: Net sales were significantly impacted by a reduction in projects from existing clients.
         As the adoption of generative AI progressed, net sales gradually shifted from the DX segment to the AI segment.
  - ➡ Product: Prioritized the development of new services featuring AI agents.
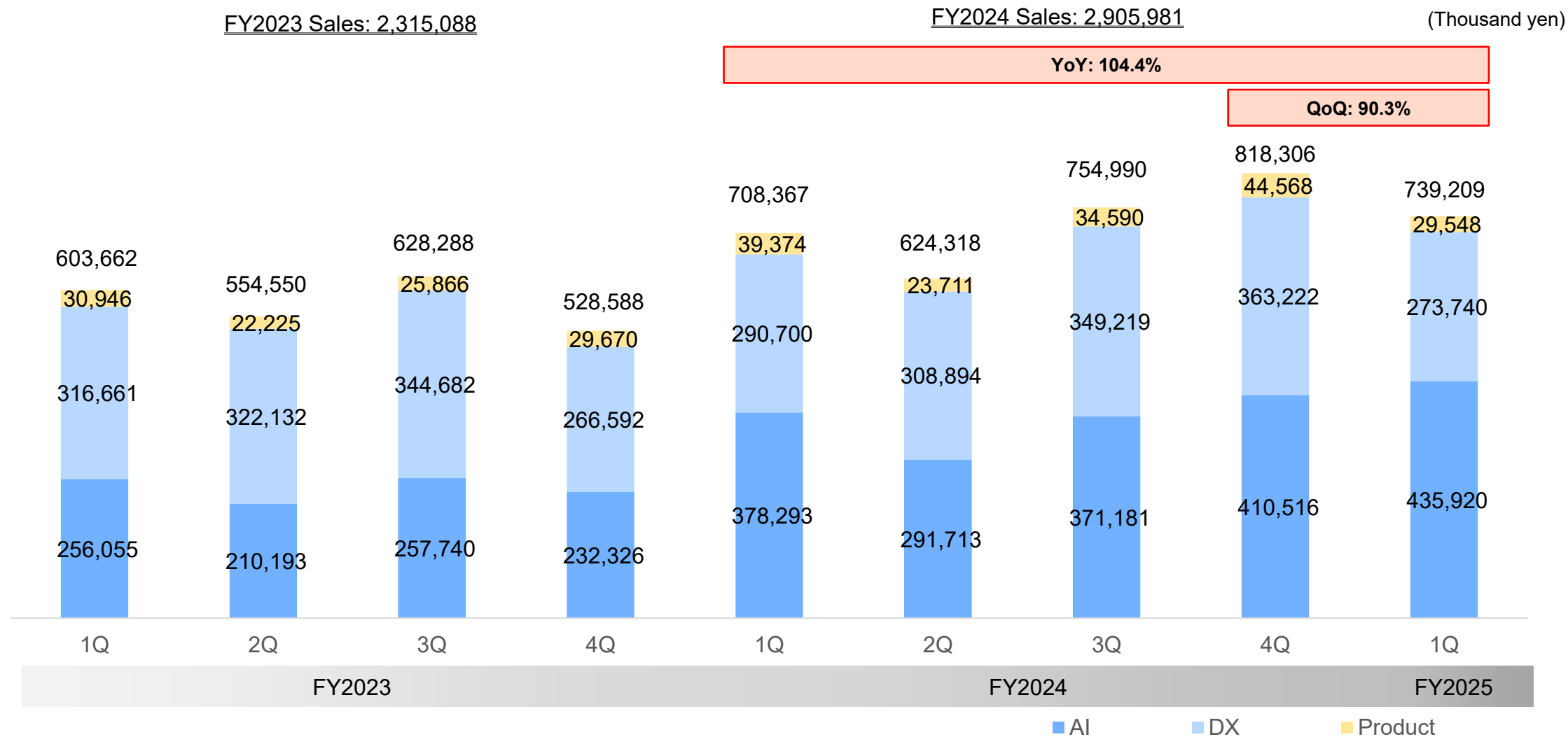
Operating Profit / Ordinary Profit
- Gross profit and margin: While sluggish sales directly impacted gross profit, the gross profit margin remained largely in line with the plan at 40.3%.
- SG&A expenses: Investments were strategically directed toward the following areas to support future sales expansion:
  - ➡ Outsourcing expenses: Increased the number of key partners by over 20% YoY and implemented quality improvement initiatives.
  - ➡ Research and development expenses: Front-loaded the annual budget in the first quarter to launch the SyncLect AI Agent service.
  - ➡ Advertising and promotion expenses: Participation in the Microsoft AI Tour raised awareness and increased inquiries for generative AI projects, contributing to order intake in and after the second quarter.
- Non-operating income: A gain on valuation of derivatives was recorded, as in FY2024.

Recruiting
- Net increase of 13 employees in the first quarter (compared to a net increase of 9 in the same period of FY2024).
- Strengthened back-office functions in line with the growth of businesses.
- The steady progress in the recruiting of middle- to high-level talent continued.
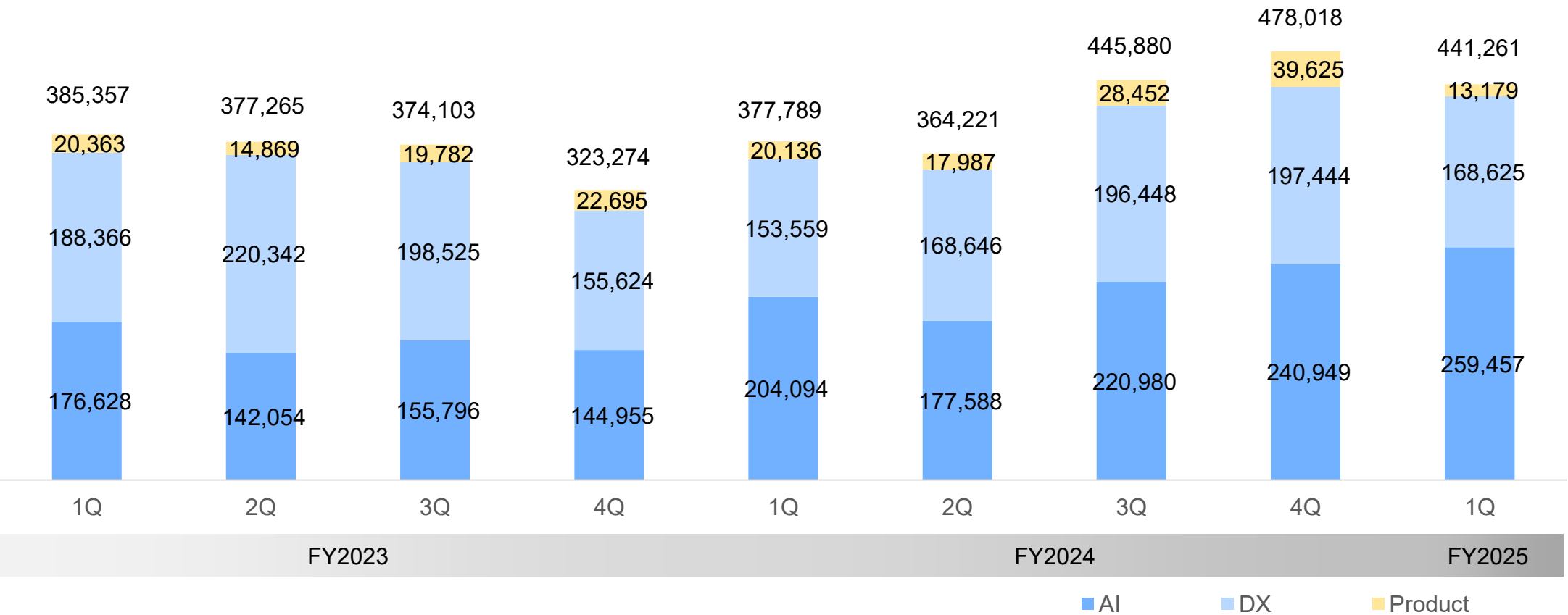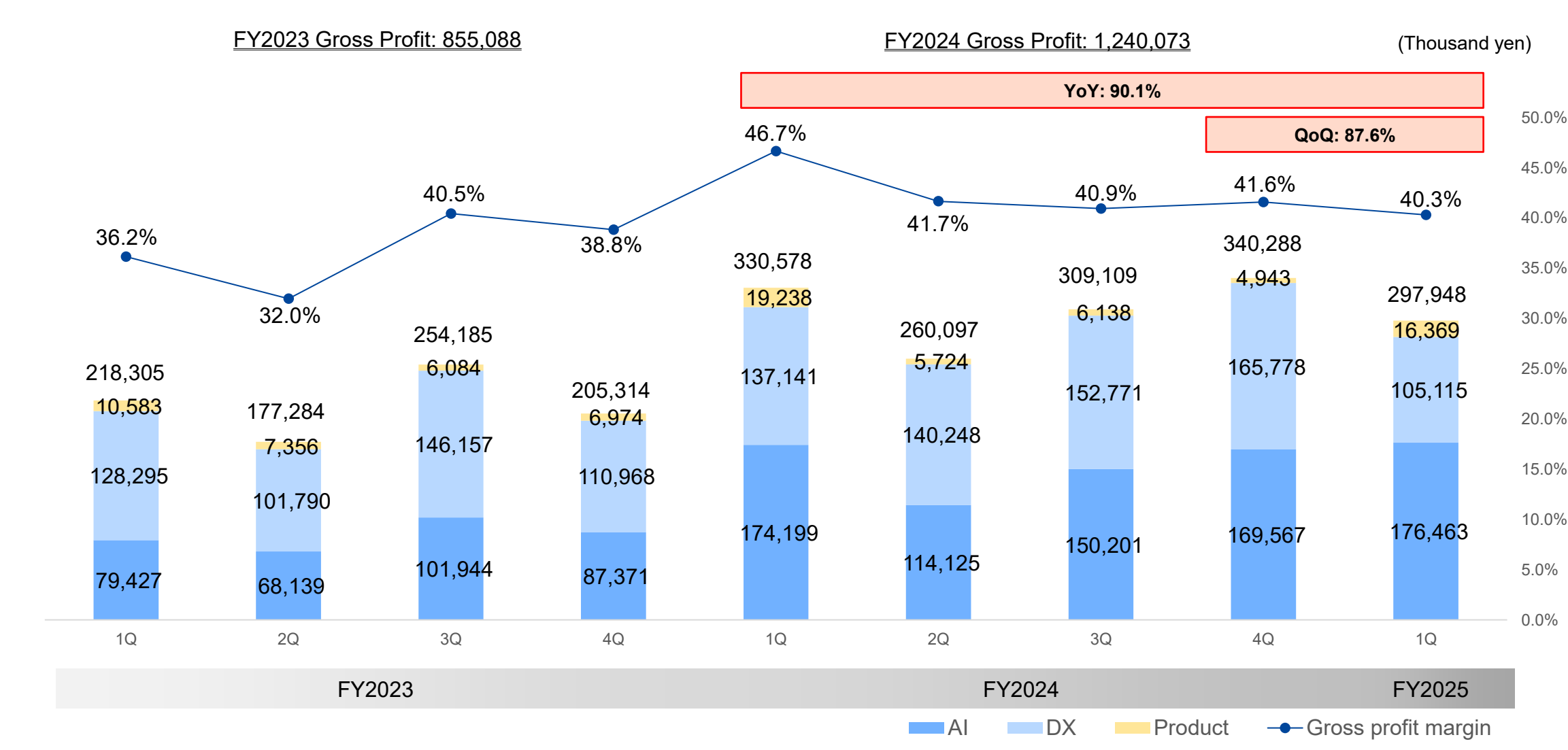
Gross Profit Margin by Service Category

AI: Promoted stable project operations while providing on-the-job training for AI engineers.
DX: The gross profit margin declined because of a reduction in projects from existing clients, which led to a mismatch between declining sales and engineering resource allocation.
Product: The gross profit margin improved due to the reduced cost of sales of existing services, following a shift in focus toward R&D for the SyncLect AI Agent service.

FY2023 — 1Q 40.5%, 2Q 33.1%/31.6%/32.4%, 3Q 42.4%/39.6%/23.5%, 4Q 41.6%/37.6%/23.5%
FY2024 — 1Q 48.9%/47.2%/46.0%, 2Q 45.4%/39.1%/24.1%, 3Q 43.7%/40.5%/17.7%, 4Q 45.6%/41.3%/11.1%
FY2025 — 1Q 55.4%/40.5%/38.4%

Legend: AI, DX, Product

SG&A Expenses, Operating Profit / Operating Profit Margin

SG&A Expenses (Thousand yen)

FY2023 SG&A expenses: 760,227
FY2024 SG&A expenses: 932,119

YoY: 184.4%

QoQ: 146.8%

157,029 / 191,836 / 216,510 / 194,852 / 198,271 / 241,279 / 243,524 / 249,045 / 365,568

1Q 2Q 3Q 4Q | 1Q 2Q 3Q 4Q | 1Q
FY2023 | FY2024 | FY2025

■ SG&A expenses

(Thousand yen) Operating Profit (Loss) / Operating Profit Margin

FY2023 Operating profit: 94,861
FY2024 Operating profit: 307,954

10.2% / (2.6)% / 6.0% / 1.9% / 18.6% / 3.0% / 8.6% / 11.1% / (9.1)%

61,275 / (14,551) / 37,675 / 10,462 / 132,306 / 18,818 / 65,585 / 91,245 / (67,619)

1Q 2Q 3Q 4Q | 1Q 2Q 3Q 4Q | 1Q
FY2023 | FY2024 | FY2025

■ Operating profit ●●● Operating profit margin

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Employees, Monthly Sales Per Employee
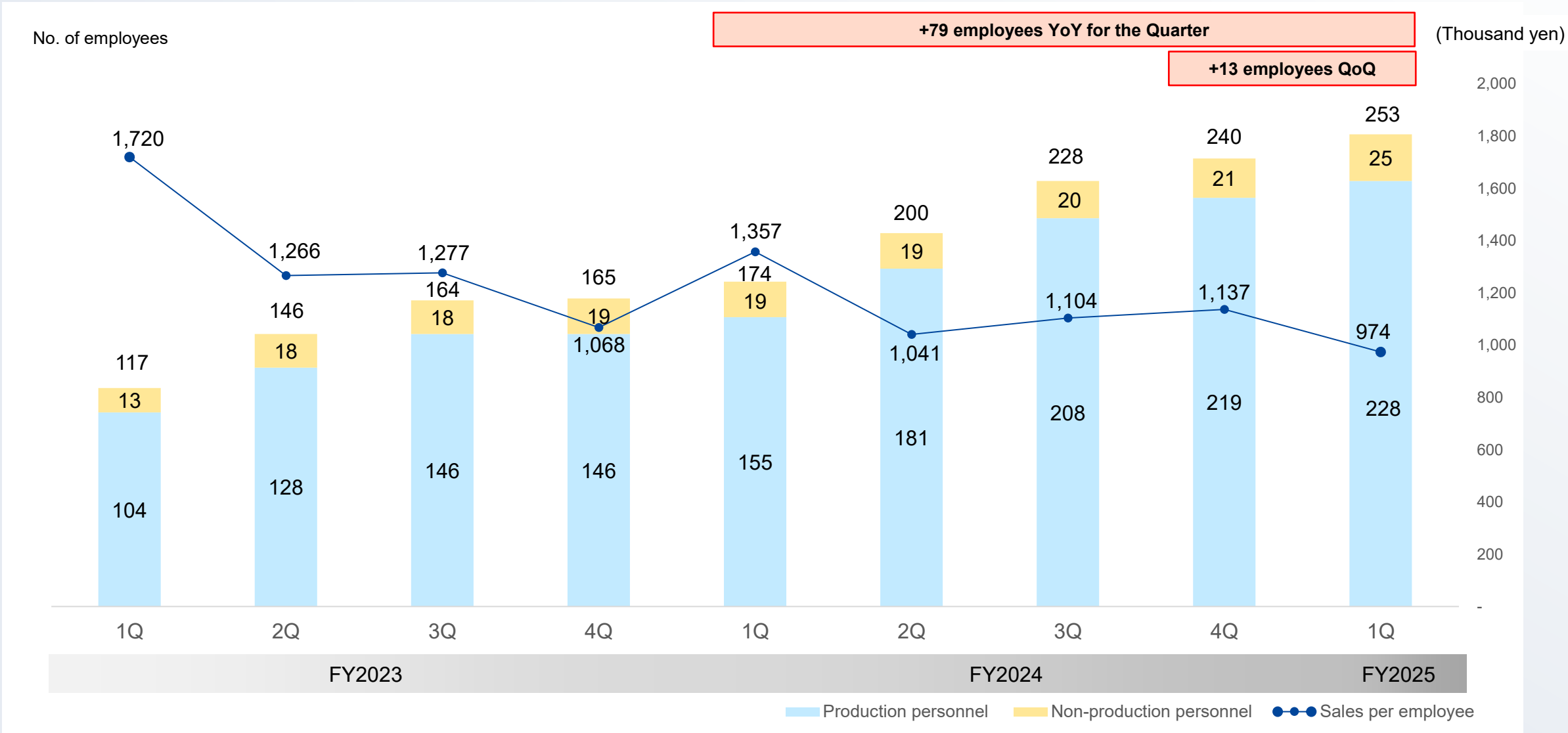
Unit Sales Price, Number of Projects and Contractual Chain Status by Service Category
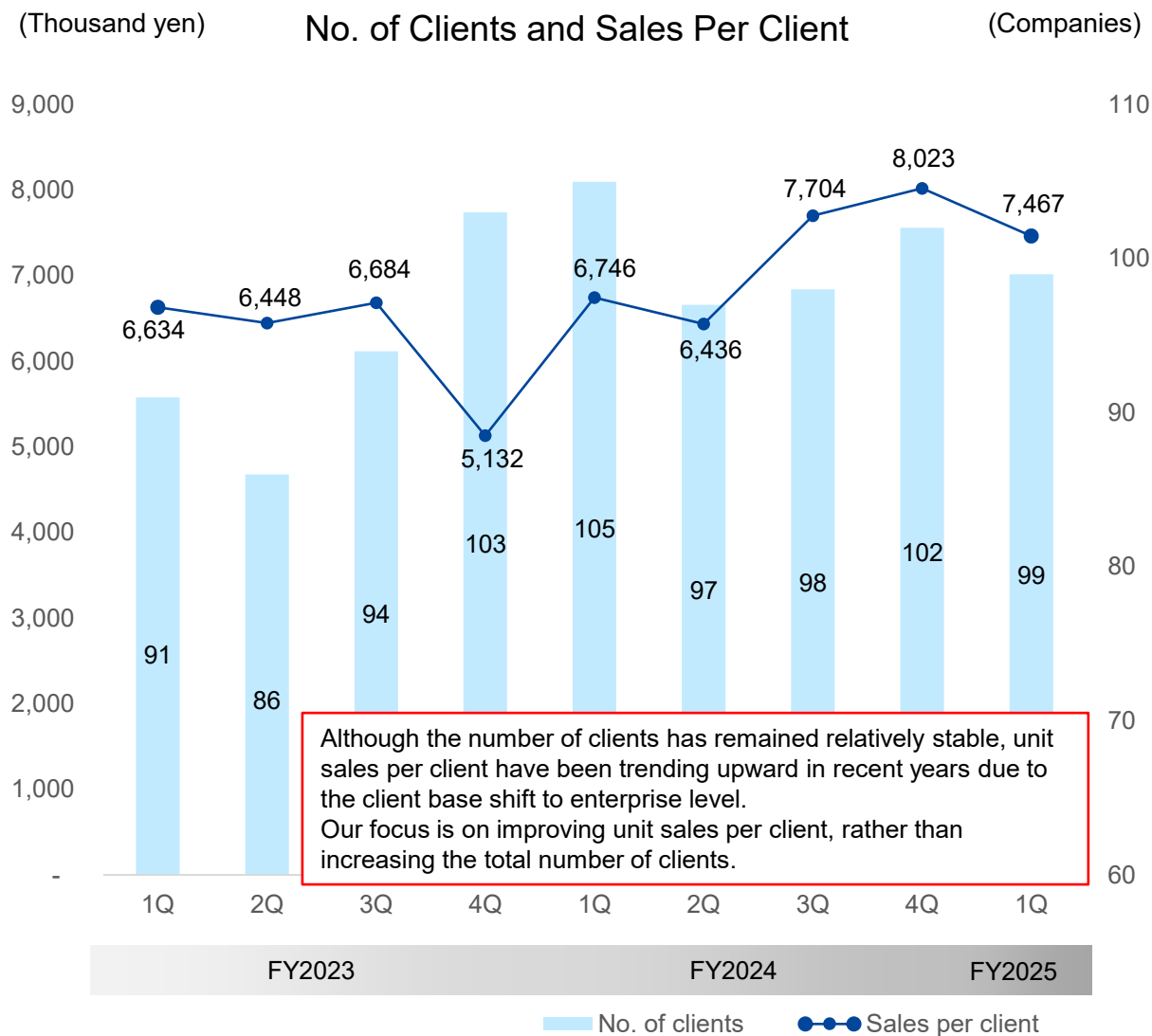
Headwaters

Pct. of the Contractual Chain (FY2025 cumulative)

- 19.2%
- 80.8%

Legend: ■ Prime contractor ■ First-tier Subcontractor ■ Second-tier Subcontractor
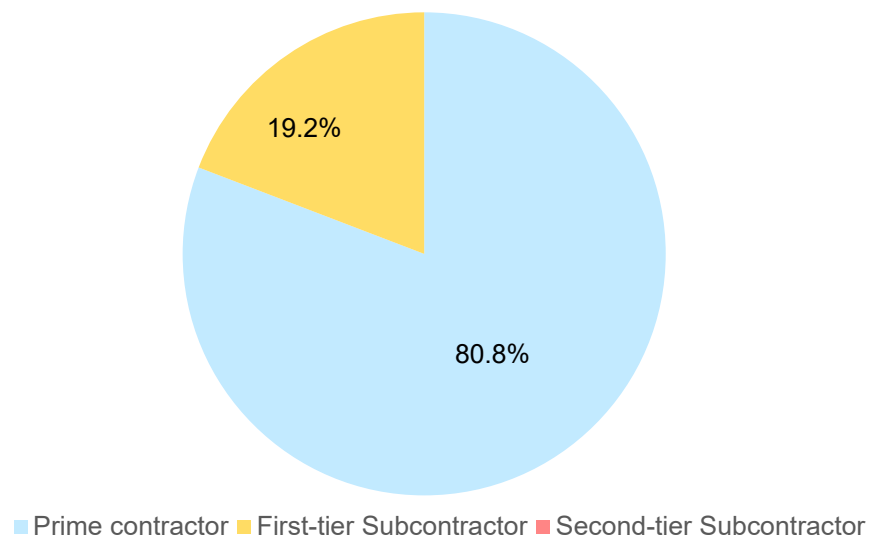
- Direct contracts with clients account for most of contracts.

- In the alliance strategy, there are several alliance patterns such as becoming first-tier contractors to strategically develop customers through collaboration with system integrators and consulting companies, in addition to concluding contracts directly with customers.

- 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.

No. of Clients and Sales Per Client

(Thousand yen) ... (Companies)

	FY2023				FY2024				FY2025
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q
Sales per client	6,634	6,448	6,684	5,132	6,746	6,436	7,704	8,023	7,467
No. of clients	91	86	94	103	105	97	98	102	99

Although the number of clients has remained relatively stable, unit sales per client have been trending upward in recent years due to the client base shift to enterprise level.
Our focus is on improving unit sales per client, rather than increasing the total number of clients.

Legend: ■ No. of clients ●—● Sales per client

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

Unit Sales Price by Service Category
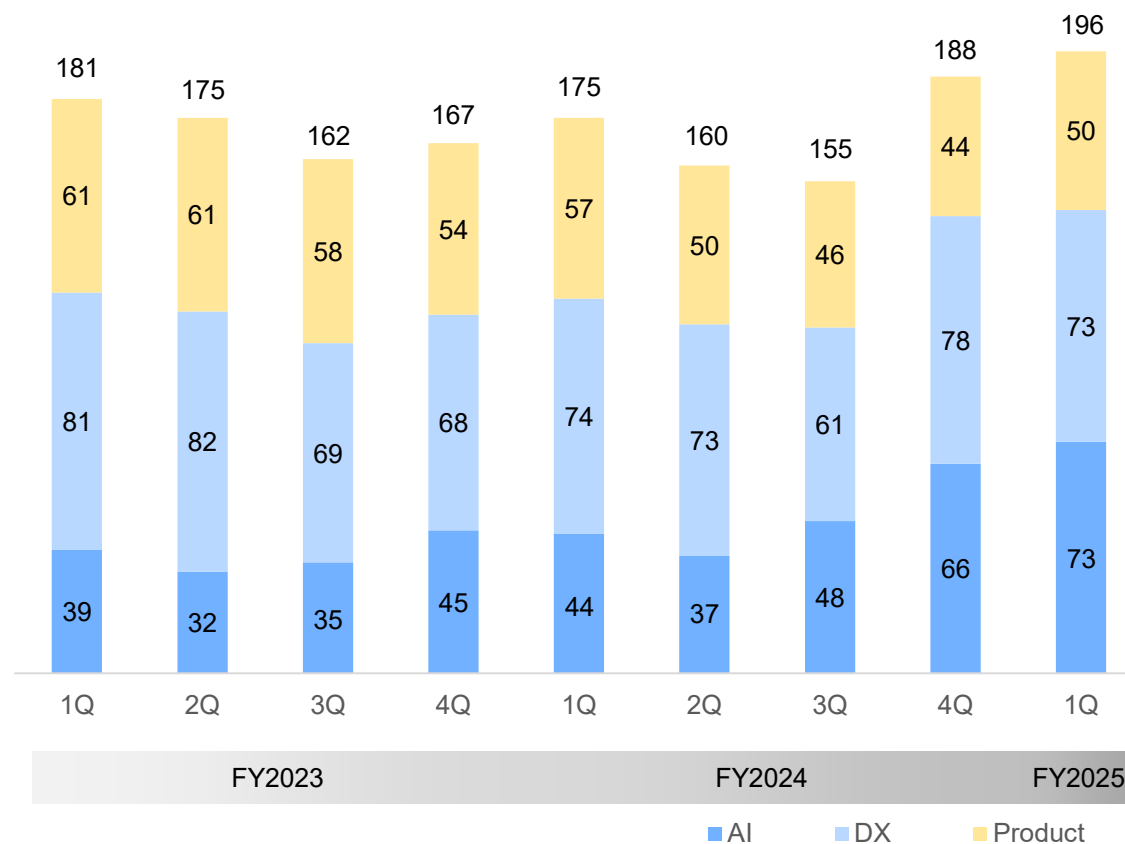(Thousand yen)

In the AI segment, hands-on generative AI projects increased.
In the DX segment, medium- to large-scale projects declined, leading to lower unit prices.
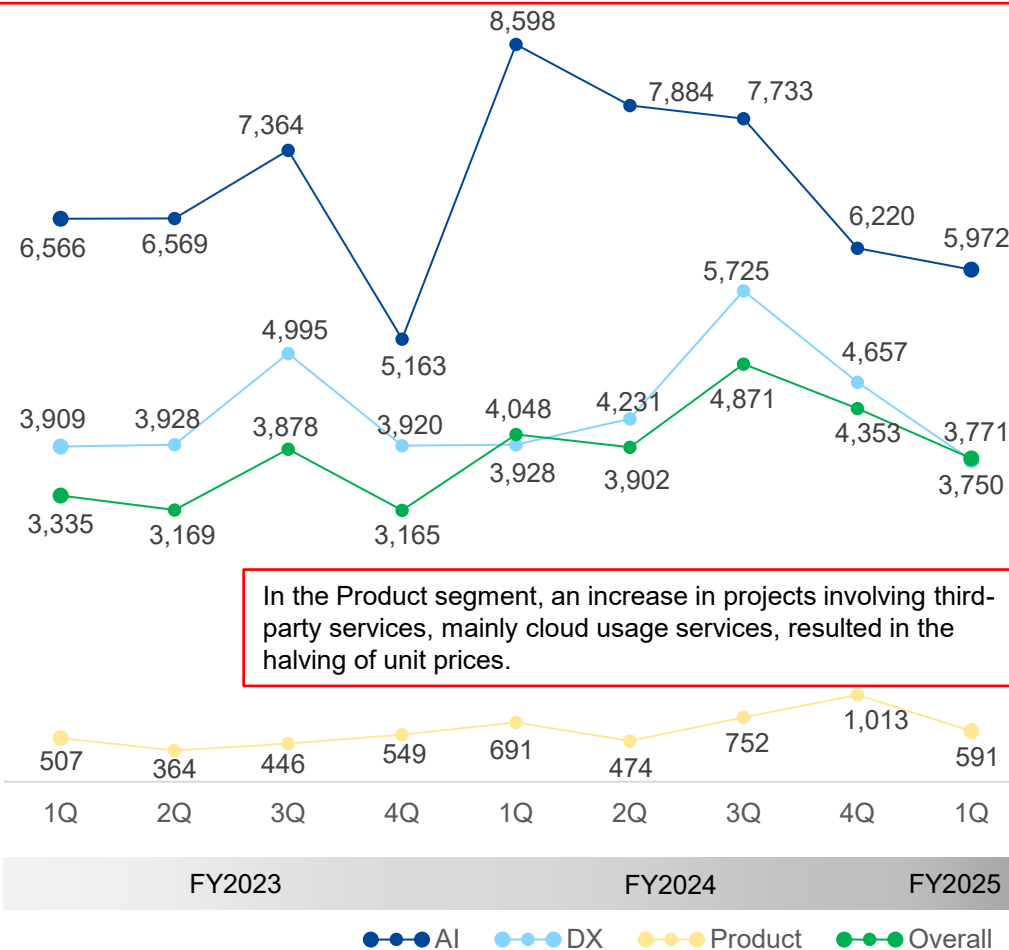
In the Product segment, an increase in projects involving third-party services, mainly cloud usage services, resulted in the halving of unit prices.

AI: 6,566 / 6,569 / 7,364 / 5,163 / 8,598 / 7,884 / 7,733 / 6,220 / 5,972
DX: 3,909 / 3,928 / 4,995 / 3,920 / 4,048 / 4,231 / 5,725 / 4,657 / 3,771
Overall: 3,335 / 3,169 / 3,878 / 3,165 / 3,928 / 3,902 / 4,871 / 4,353 / 3,750
Product: 507 / 364 / 446 / 549 / 691 / 474 / 752 / 1,013 / 591

1Q 2Q 3Q 4Q | 1Q 2Q 3Q 4Q | 1Q
FY2023 | FY2024 | FY2025

● AI ● DX ● Product ● Overall

No. of Projects by Service Category

While the number of clients remained relatively unchanged (see previous page), the number of projects steadily increased, driven by efforts to develop new businesses with existing clients.

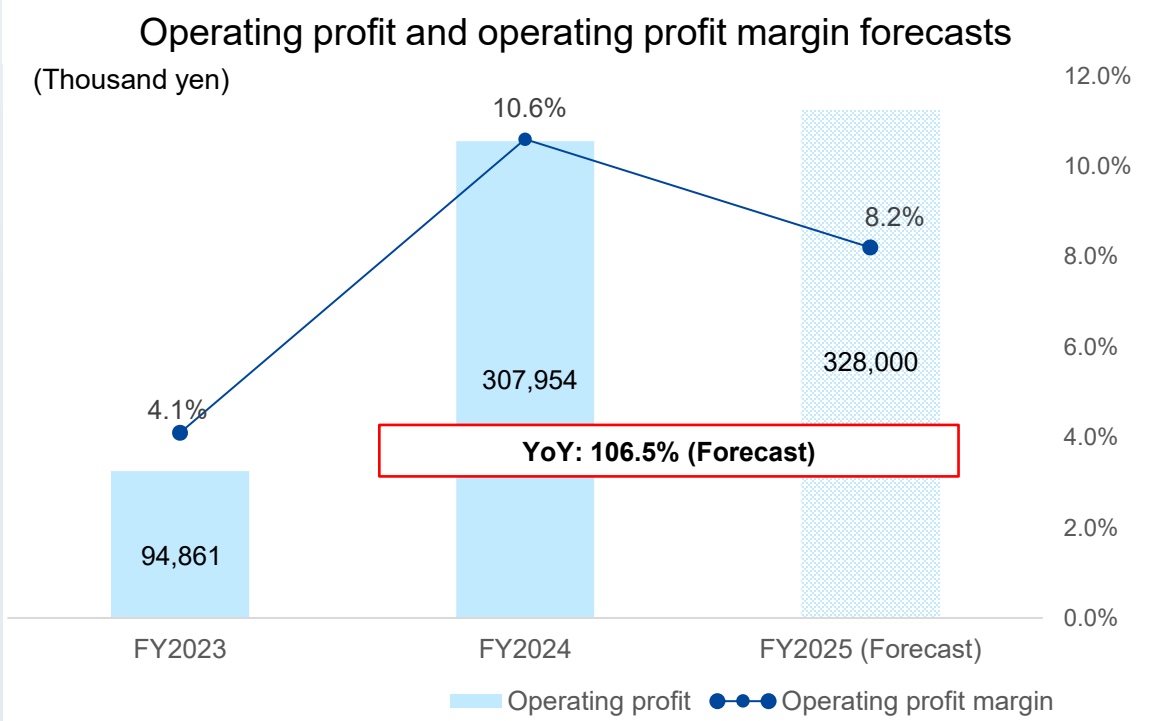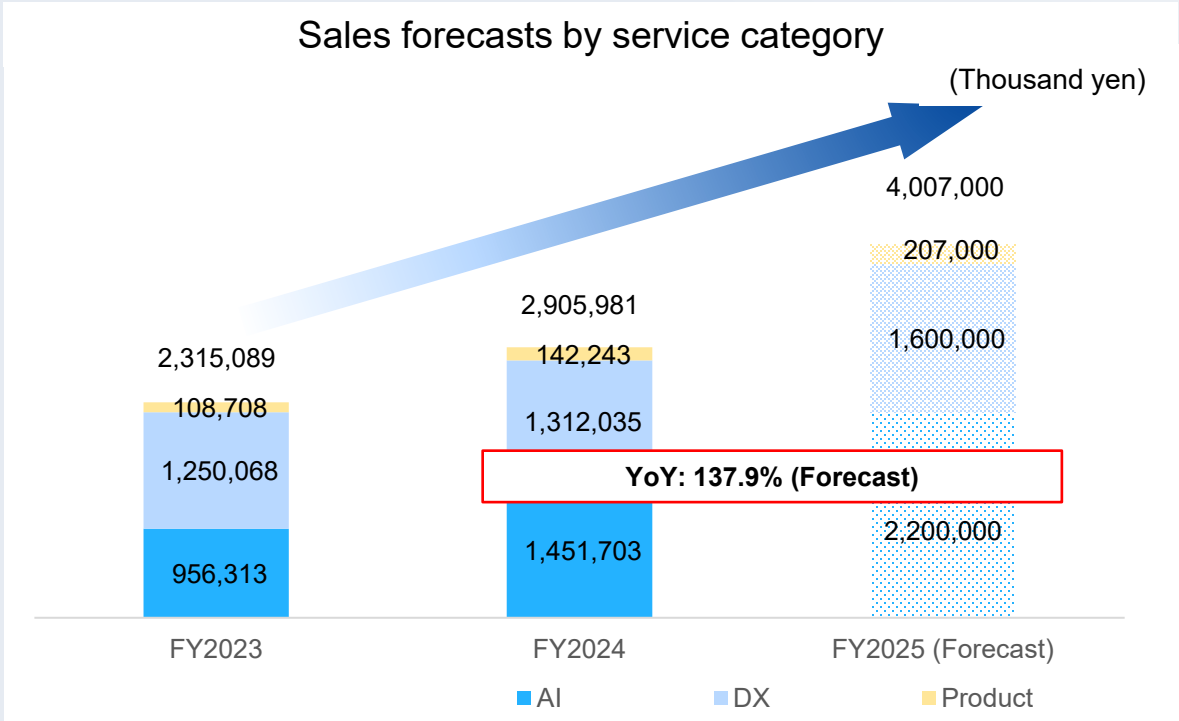|	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q
Total	181	175	162	167	175	160	155	188	196
Product	61	61	58	54	57	50	46	44	50
DX	81	82	69	68	74	73	61	78	73
AI	39	32	35	45	44	37	48	66	73

FY2023 | FY2024 | FY2025

■ AI ■ DX ■ Product

* 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.

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Headwaters

Headwaters believes that FY2025 is a breakthrough year for AI agents and a period in which the generative AI market will continue to expand. In response to this market environment, Headwaters has positioned this year as a year of investment, in which it aims to significantly increase the volume of sales to further accelerate the growth it has been recording.

- KPI: **Sales and recruiting**
- Net sales: **Sales target of 4.0 billion yen** with year-on-year growth of 37.9%, exceeding the growth rate for FY2024.
- Recruiting: Necessary investments will be made for **a net increase of 80 employees** and a turnover rate of 10% or less.
- Sales strategy: Resources will be allocated to acquire orders for large-scale projects and strengthen business teams, as well as to implement the alliance strategy and develop new businesses for existing clients.
- Operating profit: While investments will be prioritized with a view toward the expansion of the volume of sales, operating profit **is expected to rise 6.5%**.
- Ordinary profit: **Profit is expected to decrease** because a gain on valuation of derivatives, which temporarily occurred in FY2024, will not be factored in the plan for FY2025.

Sales forecasts by service category

(Thousand yen)

	FY2023	FY2024	FY2025 (Forecast)
Total	2,315,089	2,905,981	4,007,000
Product	108,708	142,243	207,000
DX	1,250,068	1,312,035	1,600,000
AI	956,313	1,451,703	2,200,000

YoY: 137.9% (Forecast)

■ AI ■ DX ■ Product

Operating profit and operating profit margin forecasts

(Thousand yen)

	FY2023	FY2024	FY2025 (Forecast)
Operating profit	94,861	307,954	328,000
Operating profit margin	4.1%	10.6%	8.2%

YoY: 106.5% (Forecast)

■ Operating profit ●━● Operating profit margin

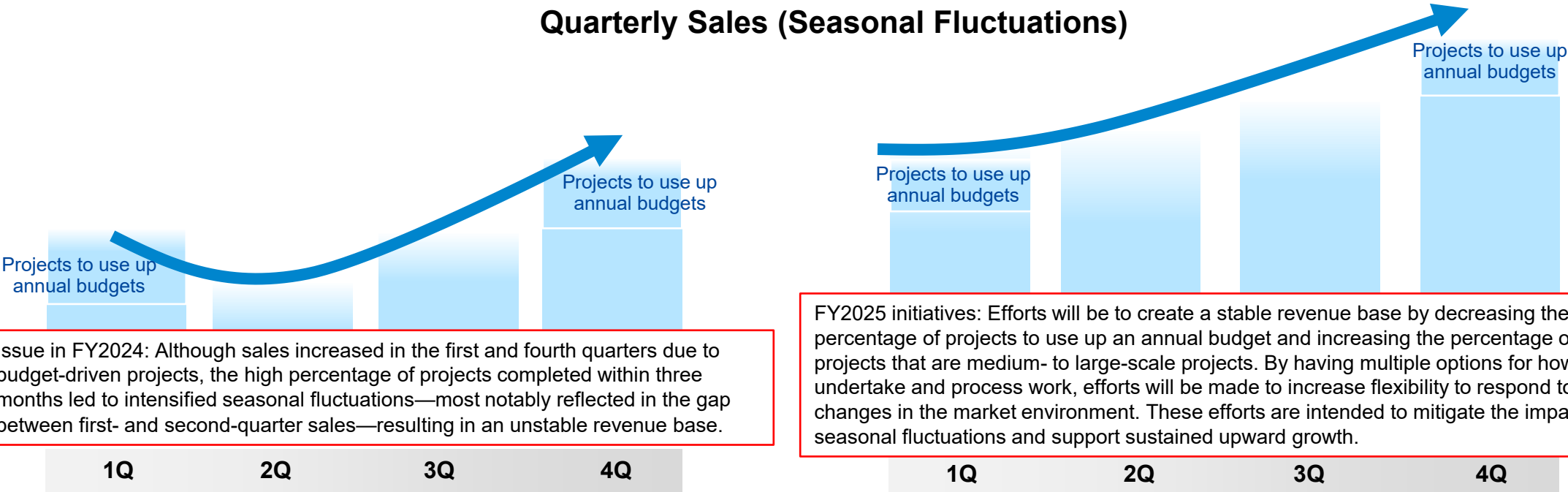* Forecast figures may change as they are as of the time of disclosure of these materials.

Seasonal Fluctuations in Net Sales

Headwaters' sales are forecast that usually incorporates seasonal fluctuations. Considering these fluctuations to be a management issue, Headwaters has prepared its FY2025 forecasts with an eye toward the creation of a stable revenue base.

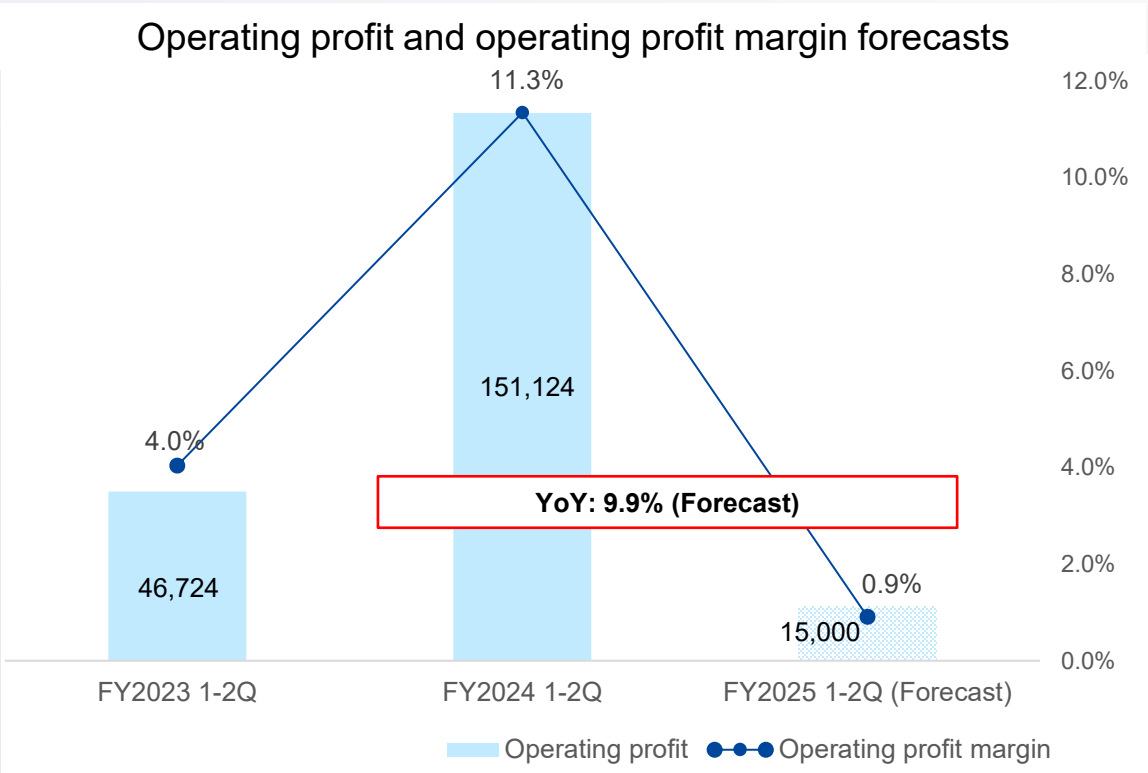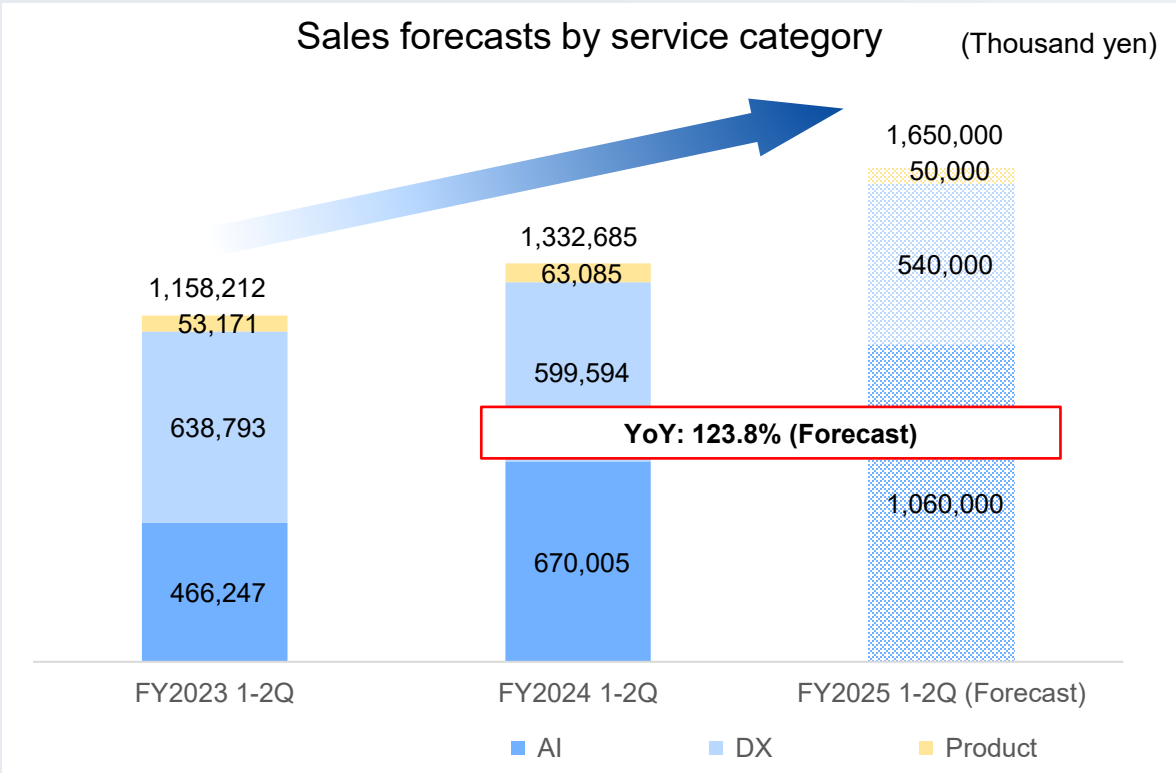|	Net sales trend	SG&A expenses trend	Characteristics
1Q	Low	Medium	As the period will be characterized by a flood of projects, efforts will be made to control seasonal fluctuations by shifting to the acquisition of orders with a focus on medium- to large-scale projects.
2Q	Medium	High	Sales will be stronger than the level of 1Q due to the launch of large-scale projects, and SG&A expenses will increase due to the impact of progress in recruitment.
3Q	High	Very high	Sales are strong if recruitment is steady in 3Q. It is expected that recruitment continues from 2Q and SG&A expenses rise steeply.
4Q	Very high	Medium	As sales are at their highest point and recruitment is decreasing, SG&A expenses will be a certain percentage of total expenses due to a steep increase in personnel expenses.

Quarterly Sales (Seasonal Fluctuations)

Projects to use up annual budgets

Projects to use up annual budgets

Projects to use up annual budgets

Projects to use up annual budgets

Issue in FY2024: Although sales increased in the first and fourth quarters due to budget-driven projects, the high percentage of projects completed within three months led to intensified seasonal fluctuations—most notably reflected in the gap between first- and second-quarter sales—resulting in an unstable revenue base.

FY2025 initiatives: Efforts will be to create a stable revenue base by decreasing the percentage of projects to use up an annual budget and increasing the percentage of projects that are medium- to large-scale projects. By having multiple options for how to undertake and process work, efforts will be made to increase flexibility to respond to drastic changes in the market environment. These efforts are intended to mitigate the impact of seasonal fluctuations and support sustained upward growth.

| 1Q | 2Q | 3Q | 4Q |

| 1Q | 2Q | 3Q | 4Q |

IR News Summary (January 2025 - March 2025)

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

- **Timely disclosure**
  - ✓ Consolidated Financial Results for the Fiscal Year Ended December 31, 2024 (Under Japanese GAAP)
  - ✓ Financial Supplementary Materials for FY2024
  - ✓ Notice of Difference Between Forecast and Actual Results, and Recording of Non-operating Expenses (Derivative Valuation Gain)
  - ✓ Approach and Policy regarding Reduction of Minimum Investment Unit
  - ✓ Notice Regarding Change of Certified Public Accountants
  - ✓ Extraordinary Report
  - ✓ Notice of Receipt of Notification Regarding Rejection of Registration of Accounting Auditor on the List of Auditors for Listed Companies, Etc.
  - ✓ Result of Operations for FY2024
  - ✓ Notice of the Annual General Meeting of Shareholders and Meeting Materials for FY2024
  - ✓ [Delayed] Financial Supplementary Materials for FY2024
  - ✓ [Delayed] Consolidated Financial Results for the Fiscal Year Ended December 31,2024 (Under Japanese GAAP)
  - ✓ [Delayed] Result of Operations for FY2024
  - ✓ Securities Report — 20th Fiscal Period (January 1, 2024-December 31, 2024)
  - ✓ Articles of Incorporation (as of January 1, 2025)
  - ✓ Matters Concerning Controlling Shareholders, Etc.
  - ✓ Business Plan and Growth Potential

IR News Summary (January 2025 - March 2025)

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

- ■ AI technology innovations / Services
  - ✓ Headwaters Launches AI Agent Solutions Utilizing NTT's tsuzumi LLM on Microsoft Azure
  - ✓ Launch of Next-Generation SyncLect AI Agent
  - ✓ Launch of Agentic RAG Service Enabling Autonomous AI Through the Integration of AI Agents and Business Data
  - ✓ Launch of Agentic Voice RAG, an AI Agent Service Powered by GPT-4o Realtime API

- ■ Achievements / Examples of implementation
  - ✓ Supported the Operation of Mobile App Contest 2024 Organized by the Tokyo Metropolitan Board of Education
  - ✓ Headwaters and Fujitsu Conduct PoC for Task-Specific On-Device Generative AI Solution to Streamline Report Creation by Japan Airlines Cabin Attendants

- ■ Business alliances / Strengthening of partnerships / Notices
  - ✓ Edge-AI-Based Cargo Handling Time Management Solution Co-Developed with Sony Semiconductor Solutions Exhibited at Smart Logistics EXPO
  - ✓ Headwaters and Databricks Established Databricks GenAI LAB to Strengthen Collaboration in Generative AI and Data Infrastructure
  - ✓ Strengthened Collaboration with Secure Inc. to Jointly Develop AI Agent–Based Surveillance Camera Solutions
  - ✓ Conducted Edge AI Validation Using SLM, Microsoft IoT Edge, and Fine-Tuning in Collaboration with Tokyo Electron Device

Notes on Forward-looking Statements

➢ This document contains outlooks, future plans and management goals related to Headwaters. Descriptions regarding these forward-looking statements 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 FY2024 4Q and FY2025 1Q

- **YoY:** A comparison between the cumulative figures of the previous fiscal year and the current fiscal year

  → Comparison between figures of FY2024 1Q and FY2025 1Q
    In the first quarter, the cumulative figures and quarterly figures are the same, and therefore the figures are the same as the "YoY for the Quarter" described below.

- **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 FY2024 1Q and FY2025 1Q

➢ 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.