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May 15, 2024

Consolidated Financial Results for the First 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 quarterly financial results: Yes
 Holding of quarterly financial results briefing: None

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

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

(1) Consolidated operating results

(Percentages indicate year-on-year changes.)

	Net sales		Operating profit		Ordinary profit		Profit attributable to owners of parent	
	Millions of yen	%	Millions of yen	%	Millions of yen	%	Millions of yen	%
Three months ended								
March 31, 2024	708	17.3	132	115.9	131	112.8	89	122.6
March 31, 2023	603	99.6	61	-	61	-	40	-

Note: Comprehensive income For the three months ended March 31, 2024: ¥91 million [up 127.1%]
 For the three months ended March 31, 2023: ¥40 million [-%]

	Basic earnings per share	Diluted earnings per share
	Yen	Yen
Three months ended		
March 31, 2024	47.78	43.09
March 31, 2023	21.57	19.70

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
	Millions of yen	Millions of yen	%
As of			
March 31, 2024	1,440	1,053	72.9
December 31, 2023	1,294	961	74.1

Reference: Equity As of March 31, 2024: ¥1,049 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
Fiscal year ended December 31, 2023	Yen -	Yen 0.00	Yen -	Yen 0.00	Yen 0.00
Fiscal year ending December 31, 2024	-				
Fiscal year ending December 31, 2024 (Forecast)		0.00	-	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	226	138.3	229	133.0	156	121.8	82.62

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

*** Notes**

(1) Changes in significant subsidiaries during the period (changes in specified subsidiaries resulting in the change in scope of consolidation): None

Newly included: - Excluded: -

(2) Application of special accounting methods for presenting quarterly consolidated 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 March 31, 2024	1,881,698 shares
As of December 31, 2023	1,881,298 shares

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

As of March 31, 2024	26 shares
As of December 31, 2023	26 shares

(iii) Average number of shares outstanding during the period

Three months ended March 31, 2024	1,881,360 shares
Three months ended March 31, 2023	1,872,400 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.

* Quarterly financial results reports are exempt from quarterly review conducted by certified public accountants or an audit corporation.

* Proper use of earnings forecasts, and other special matters

Cautionary statement with respect to forward-looking statements

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 quarter of fiscal year ending December 31, 2024 (January 1, 2024 to March 31, 2024), the Japanese economy achieved a degree of growth, driven by rising wages, economic stimulus measures, and a recovery in domestic demand. Nonetheless, the economic environment remained unstable given concerns such as the prolonged war in Russia and Ukraine, the significant depreciation of the yen linked to the strong US economy, and inflation.

In the IT industry in which the Headwaters Group operates, the pace of technological progress is rapid because of many innovations, notably artificial intelligence (AI) and the digital transformation (DX). In particular, the emergence and evolution of generative AI may lead to new ways to deal with Japan's falling working age population and other social issues. This technology may also create new business models and make enormous contributions to other types of innovations. At companies that use generative AI, there is increasing demand for prompt engineer, which is a technician who can use generative AI to obtain even more accurate and appropriate responses. However, the emergence of generative AI is creating numerous problems. One issue involves copyrights and privacy because there are still inadequate guidelines and rules for this new AI category. In addition to these legal problems, there are ethical issues and problems involving hallucinations, which are outputs that are nonsensical or inaccurate.

In the first quarter of 2024, as in 2023, large-scale projects are in progress in each of the AI and DX service categories. The shift to royalty clients, which has been promoted in recent years, is contributing significantly to the increase in unit sales price. Several AI solutions projects are now under way because demand for AI solutions is growing in a wide range of industries rather than in just a few sectors.

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

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 current fiscal year (Reasons for discontinuation are discussed below).

Figures for the OPS Services in the previous fiscal year are also reclassified into the three service categories of AI, DX and Product for the year-on-year comparison.

AI Integration Services

In addition to IoT-based edge AI projects, the Group has focused on promoting generative AI projects by expanding its GPT service lineup for generative AI since 2023. We have already conducted several development projects from the use of chat-based generative AI for client services and business use. The large volume of business data held by clients can be efficiently trained into a generative AI by handling it on a data platform. It is rare for a company to be able to perform both analysis and visualization of data on a data platform and development using generative AI. The Group promotes projects with clients, including support for in-house production.

In the first quarter, AI Integration Services sales increased 47.7% year on year to 378 million yen thanks to growth in generative AI projects and sales expansion in edge 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 efficiency. We also provide services such as modernization, which is updates and improvements to old systems by using the latest technologies and methods, and support for internalization of various processes by using Microsoft Power Platform and other low-code tools. The number of projects for the DX of companies and sales of these projects remain strong since 2023.

In the first quarter, DX Services sales decreased 8.2% year on year to 290 million yen, despite the start of another large-scale project as in AI Integration Services and cross-selling to existing clients. The reason for the year-on-year decrease is the size of large projects and the difference in the amount of acceptance inspection due to the difference in the period of project implementation.

Product Services

There are two major components of this category. One is a licensing business for SyncLect, Pocket Work Mate and other Headwaters services. The other is a sales agent business involving cloud utilization service fees and the sale of IoT equipment purchased from other companies.

During the first quarter, the Company expanded the service lineup of SyncLect Generative AI, a platform for use with generative AI. Many potential new customers, mainly enterprise companies using Microsoft 365, contacted Headwaters about the use of generative AI and there were stable orders from customers directed to Headwaters by Microsoft. As a result, sales of Product Services increased 27.2% year on year to 39 million yen.

OPS Services

Effective from the first quarter of 2024, the OPS category was 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 royalty-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 2023 have been allocated to the DX (approx. 80%), AI (approx. 15%), and Products (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 quarter increased 17.3% year on year to 708 million yen. Operating profit rose 115.9% to 132 million yen, and ordinary profit climbed 112.8% to 131 million yen. Profit attributable to owners of parent increased 122.6% to 89 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 first quarter of 2024 stood at 1,440 million yen, an increase of 146 million yen from the end of 2023.

Current assets totaled 1,375 million yen at the end of the first quarter, an increase of 148 million yen from the end of 2023. This was mainly attributable to increases of 104 million yen in cash and deposits, 47 million yen in accounts receivable - trade and contract assets, and 9 million yen in prepaid expenses, despite a 10 million yen decrease in work in process. Non-current assets dropped 2 million yen from the end of 2023, to 65 million yen. This is mainly attributable to decreases of 0.8 million yen in property, plant and equipment, 0.9 million yen in intangible assets and 0.9 million yen in investments and other assets.

Liabilities

Total liabilities at the end of the first quarter stood at 386 million yen, an increase of 54 million yen from the end of 2023. This was mainly due to a decrease of 2 million yen in contract liabilities, offset by increases of 19 million yen in accounts payable - trade, 14 million yen in accounts payable - other, 2 million yen in accrued expenses, and 18 million yen in income taxes payable.

Net assets

Total net assets as of the end of the first quarter resulted in 1,053 million yen, which is an increase of 91 million yen from the end of 2023. This was mainly attributable to an increase in retained earnings of 89 million yen resulting from the posting of profit attributable to owners of parent.

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

No change has been made to the earnings forecasts announced on February 14, 2024.

For the first quarter of 2024, each of the profit levels showed a high degree of progress against the consolidated earnings forecast for the full year. Based on the current progress, we recognize that we are in a situation to consider revising the consolidated earnings forecast. We will, however, maintain the consolidated earnings forecast announced on February 14, 2024, as we intend to invest aggressively in sales activities, recruitment, and training for more growth in the following fiscal year and beyond. If the earnings forecast requires any revision in light of changes in circumstances, it will be publicly announced as soon as possible.

2. Quarterly Consolidated Financial Statements and Notes

(1) Quarterly Consolidated Balance Sheet

	(Thousands of yen)	
	Fiscal Year 2023 (As of Dec. 31, 2023)	First quarter of Fiscal Year 2024 (As of Mar. 31, 2024)
Assets		
Current assets		
Cash and deposits	897,899	1,001,932
Accounts receivable - trade and contract assets	292,365	339,770
Work in process	16,493	6,137
Prepaid expenses	16,840	26,699
Other	2,897	726
Total current assets	1,226,496	1,375,266
Non-current assets		
Property, plant and equipment	30,517	29,716
Intangible assets	13,710	12,794
Investments and other assets	23,515	22,589
Total non-current assets	67,742	65,100
Total assets	1,294,238	1,440,366
Liabilities		
Current liabilities		
Accounts payable - trade	144,705	163,708
Accounts payable - other	16,852	31,192
Accrued expenses	74,775	77,195
Accrued consumption taxes	46,975	41,149
Income taxes payable	22,531	40,984
Contract liabilities	4,141	1,426
Deposits received	22,247	30,821
Provision for loss on orders received	129	258
Total current liabilities	332,358	386,736
Non-current liabilities		
Deferred tax liabilities	220	-
Total non-current liabilities	220	-
Total liabilities	332,579	386,736
Net assets		
Shareholders' equity		
Share capital	369,023	369,148
Capital surplus	359,023	359,148
Retained earnings	230,844	320,741
Treasury shares	(227)	(227)
Total shareholders' equity	958,663	1,048,810
Accumulated other comprehensive income		
Foreign currency translation adjustment	(221)	529
Total accumulated other comprehensive income	(221)	529
Non-controlling interests	3,216	4,289
Total net assets	961,659	1,053,630
Total liabilities and net assets	1,294,238	1,440,366

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

Quarterly Consolidated Statement of Income

(Thousands of yen)

	First three months of Fiscal Year 2023 (Jan. 1, 2023 – Mar. 31, 2023)	First three months of Fiscal Year 2024 (Jan. 1, 2024 – Mar. 31, 2024)
Net sales	603,662	708,367
Cost of sales	385,357	377,789
Gross profit	218,304	330,578
Selling, general and administrative expenses	157,029	198,271
Operating profit	61,275	132,306
Non-operating income		
Interest income	3	4
Foreign exchange gains	62	-
Subsidy income	500	-
Other	-	1
Total non-operating income	566	5
Non-operating expenses		
Foreign exchange losses	-	669
Other	-	36
Total non-operating expenses	-	706
Ordinary profit	61,841	131,605
Profit before income taxes	61,841	131,605
Income taxes - current	21,056	40,199
Income taxes - deferred	403	686
Total income taxes	21,460	40,885
Profit	40,380	90,719
Profit attributable to non-controlling interests	-	823
Profit attributable to owners of parent	40,380	89,896

Quarterly Consolidated Statement of Comprehensive Income

(Thousands of yen)

	First three months of Fiscal Year 2023 (Jan. 1, 2023 – Mar. 31, 2023)	First three months of Fiscal Year 2024 (Jan. 1, 2024 – Mar. 31, 2024)
Profit	40,380	90,719
Other comprehensive income		
Foreign currency translation adjustment	-	1,000
Total other comprehensive income	-	1,000
Comprehensive income	40,380	91,720
Comprehensive income attributable to		
Comprehensive income attributable to owners of parent	40,380	90,647
Comprehensive income attributable to non-controlling interests	-	1,073

(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.