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August 14, 2024

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

Company name: Headwaters Co., Ltd.
Listing: Tokyo Stock Exchange
Securities code: 4011
URL: <https://www.headwaters.co.jp/en/>
Representative: Yosuke Shinoda, Representative Director
Inquiries: Kazutaka Harashima, Executive Officer, Administrative Management Department
Manager
Telephone: +81-3-6258-0525
Scheduled date of filing of Semi-annual Report: August 14, 2024
Scheduled date to commence dividend payments: -
Preparation of supplementary material on financial results: Yes
Holding of financial results briefing: Yes (for institutional investors/analysts and individual investors)

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

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

(1) Consolidated operating results

(Percentages indicate year-on-year changes.)

Six months ended	Net sales		Operating profit		Ordinary profit		Profit attributable to owners of parent	
	Millions of yen	%	Millions of yen	%	Millions of yen	%	Millions of yen	%
June 30, 2024	1,332	15.1	151	223.4	150	214.4	100	234.7
June 30, 2023	1,158	79.3	46	-	47	-	30	-

Note: Comprehensive income For the six months ended June 30, 2024: ¥103 million [up 240.0%]
For the six months ended June 30, 2023: ¥30 million [-%]

Six months ended	Basic earnings per share	Diluted earnings per share
	Yen	Yen
June 30, 2024	53.44	48.39
June 30, 2023	16.11	14.64

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

As of	Total assets	Net assets	Equity-to-asset ratio
	Millions of yen	Millions of yen	%
June 30, 2024	1,516	1,083	71.2
December 31, 2023	1,294	961	74.1

Reference: Equity As of June 30, 2024: ¥1,079 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	226	138.3	229	133.0	156	121.8	82.78

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

*** 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 June 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 June 30, 2024	32 shares
As of December 31, 2023	26 shares

(iii) Average number of shares outstanding during the period

Six months ended June 30, 2024	1,889,601 shares
Six months ended June 30, 2023	1,872,648 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.

* The current financial report is not subject to quarterly (semi-annual) review by certified public accountants or auditing firms.

* 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 half of the fiscal year ending December 31, 2024 (January 1, 2024 to June 30, 2024), the Japanese economy achieved a degree of growth, driven by rising wages, economic stimulus measures and a recovery in domestic demand. Nonetheless, economic conditions remained unstable given a number of concerns such as the prolonged invasion of Ukraine by Russia, instability in the Middle East, the significant depreciation of the yen linked to the strong US economy, 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 half of 2024, generative AI technology has continued to advance remarkably, and the progress in natural language processing and image generation was particularly notable. While it is now possible to generate more advanced text and more realistic images, one of the challenges that is being faced is discovering how to effectively use the large volumes of data held by companies and the convenience of generative AI, as well as the accuracy and speed of generative AI's responses.

In the first half of 2024, large projects were underway in two of our service categories: AI Integration Services and DX Services. The shift to loyalty 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

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 half of 2024 (Reasons for discontinuation are discussed below).

Figures for the OPS Services in the first half of 2023 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 services for generative AI since the first half of 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 half of 2024, sales from AI Integration Services increased 43.7% year on year to 670 million yen thanks to the growth of generative AI projects and the expansion of sales of 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 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 half of 2023.

In the first half of 2024, new businesses were developed from business with existing customers and we experienced more opportunities enabling orders for multiple projects to be received from a single customer. However, DX Services sales decreased 6.1% year on year to 599 million yen due to differences in the sizes of ongoing large projects from the first half of 2023.

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 half of 2024, the Company developed services with a focus on the SyncLect Generative AI platform and steadily acquired new customers, largely enterprise companies, through customer referrals from Microsoft and inquiries regarding measures related to inbound tourism. As a result, net sales from Product Services increased 18.6% year on year to 63 million yen.

OPS Services

As of the first half 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 half of 2023 have been allocated to the DX (approx. 80%), AI (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 increased 15.1% year on year to 1,332 million yen, operating profit rose 223.4% year on year to 151 million yen and ordinary profit climbed 214.4% year on year to 150 million yen. Profit attributable to owners of parent increased 234.7% year on year to 100 million yen in the first half of 2024.

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

(i) Assets, liabilities and net assets

Assets

Total assets at the end of the first half of 2024 stood at 1,516 million yen, an increase of 222 million yen from the end of 2023.

Current assets totaled 1,444 million yen at the end of the first half, an increase of 218 million yen from the end of 2023. This was mainly due to increases of 203 million yen in cash and deposits, 3 million yen in accounts receivable - trade and contract assets, and 18 million yen in prepaid expenses. Non-current assets increased 3 million yen from the end of 2023, to 71 million yen. This was attributable principally to an increase of 4 million yen in property, plant and equipment, which more than offset a decrease of 1 million yen in intangible assets.

Liabilities

Total liabilities at the end of the first half of 2024 stood at 432 million yen, an increase of 100 million yen from the end of 2023. The factors contributing to this included increases of 17 million yen in accounts payable - trade, 17 million yen in accrued expenses, 31 million yen in income taxes payable and 18 million yen in contract liabilities.

Net assets

Total net assets as of the end of the first half of 2024 were 1,083 million yen, an increase of 121 million yen from the end of 2023. This was mainly attributable to an increase in retained earnings of 100 million yen resulting from the posting of profit attributable to owners of parent.

(ii) Cash flows

The balance of cash and cash equivalents (hereinafter, "cash") increased 203 million yen from the end of 2023 to a total of 1,100 million yen at the end of the first half of 2024.

The following is a summary of cash flows and major factors in the first half of 2024.

Cash flows from operating activities

Net cash provided by operating activities was 202 million yen (35 million yen provided in the first half of 2023). This was attributable in large part to 150 million yen in profit before income taxes, 7 million yen in depreciation, an increase of 17 million yen in trade payables, an increase of 18 million yen in contract liabilities, an increase of 14 million yen in accounts payable - other and an increase of 17 million yen in accrued expenses, which more than offset an increase of 3 million yen in trade receivables and contract assets and 15 million yen in income taxes paid.

Cash flows from investing activities

Net cash used in investing activities was 11 million yen (10 million yen used in the first half of 2023).

This was a result mainly of 11 million yen for the purchase of property, plant and equipment.

Cash flows from financing activities

Net cash provided by financing activities was 10 million yen (2 million yen provided in the first half of 2023). The major contributing factor was proceeds from issuance of shares of 10 million yen.

(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.

2. Consolidated Interim Financial Statements and Notes

(1) Consolidated Interim Balance Sheet

(Thousands of yen)

	Fiscal Year 2023 (As of Dec. 31, 2023)	Second quarter of Fiscal Year 2024 (As of Jun. 30, 2024)
Assets		
Current assets		
Cash and deposits	897,899	1,100,915
Accounts receivable - trade and contract assets	292,365	295,882
Work in process	16,493	11,712
Prepaid expenses	16,840	35,594
Other	2,897	800
Total current assets	1,226,496	1,444,906
Non-current assets		
Property, plant and equipment	30,517	35,182
Intangible assets	13,710	11,879
Investments and other assets	23,515	24,359
Total non-current assets	67,742	71,421
Total assets	1,294,238	1,516,327
Liabilities		
Current liabilities		
Accounts payable - trade	144,705	162,009
Accounts payable - other	16,852	30,401
Accrued expenses	74,775	92,394
Accrued consumption taxes	46,975	42,090
Income taxes payable	22,531	54,423
Contract liabilities	4,141	23,012
Deposits received	22,247	27,695
Provision for loss on orders received	129	959
Total current liabilities	332,358	432,986
Non-current liabilities		
Deferred tax liabilities	220	-
Total non-current liabilities	220	-
Total liabilities	332,579	432,986
Net assets		
Shareholders' equity		
Share capital	369,023	378,338
Capital surplus	359,023	368,338
Retained earnings	230,844	331,820
Treasury shares	(227)	(227)
Total shareholders' equity	958,663	1,078,270
Accumulated other comprehensive income		
Foreign currency translation adjustment	(221)	1,042
Total accumulated other comprehensive income	(221)	1,042
Non-controlling interests	3,216	4,028
Total net assets	961,659	1,083,341
Total liabilities and net assets	1,294,238	1,516,327

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

Consolidated Interim Statement of Income

(Thousands of yen)

	First six months of Fiscal Year 2023 (Jan. 1, 2023 – Jun. 30, 2023)	First six months of Fiscal Year 2024 (Jan. 1, 2024 – Jun. 30, 2024)
Net sales	1,158,212	1,332,685
Cost of sales	762,622	742,010
Gross profit	395,589	590,674
Selling, general and administrative expenses	348,865	439,550
Operating profit	46,724	151,124
Non-operating income		
Interest income	3	4
Foreign exchange gains	36	-
Subsidy income	500	-
Subsidy income	573	-
Other	20	47
Total non-operating income	1,132	52
Non-operating expenses		
Foreign exchange losses	-	660
Other	-	40
Total non-operating expenses	-	700
Ordinary profit	47,857	150,475
Profit before income taxes	47,857	150,475
Income taxes - current	18,065	50,332
Income taxes - deferred	(277)	(1,224)
Total income taxes	17,788	49,108
Profit	30,069	101,366
Profit (loss) attributable to non-controlling interests	(97)	390
Profit attributable to owners of parent	30,166	100,976

Consolidated Interim Statement of Comprehensive Income

(Thousands of yen)

	First six months of Fiscal Year 2023 (Jan. 1, 2023 – Jun. 30, 2023)	First six months of Fiscal Year 2024 (Jan. 1, 2024 – Jun. 30, 2024)
Profit	30,069	101,366
Other comprehensive income		
Foreign currency translation adjustment	239	1,685
Total other comprehensive income	239	1,685
Comprehensive income	30,309	103,052
Comprehensive income attributable to		
Comprehensive income attributable to owners of parent	30,346	102,240
Comprehensive income attributable to non-controlling interests	(37)	811

(3) Consolidated Interim Statement of Cash Flows

(Thousands of yen)

	First six months of Fiscal Year 2023 (Jan. 1, 2023 – Jun. 30, 2023)	First six months of Fiscal Year 2024 (Jan. 1, 2024 – Jun. 30, 2024)
Cash flows from operating activities		
Profit before income taxes	47,857	150,475
Depreciation	6,235	7,987
Increase (decrease) in provision for loss on orders received	-	829
Interest income	(3)	(4)
Decrease (increase) in trade receivables and contract assets	(61,665)	(3,516)
Decrease (increase) in inventories	(14,054)	4,781
Decrease (increase) in prepaid expenses	-	(10,367)
Increase (decrease) in trade payables	44,808	17,304
Increase (decrease) in contract liabilities	16,827	18,870
Increase (decrease) in accounts payable - other	3,660	14,098
Increase (decrease) in accrued expenses	6,034	17,618
Increase (decrease) in accrued consumption taxes	5,585	(4,885)
Subsidy income	(573)	-
Subsidy income	(500)	-
Increase (decrease) in other current liabilities	1,615	5,448
Decrease (increase) in other current assets	(1,647)	(511)
Other, net	796	(199)
Subtotal	54,977	217,929
Interest received	3	4
Subsidies received	573	-
Subsidies received	500	-
Income taxes paid	(20,764)	(15,480)
Net cash provided by (used in) operating activities	35,290	202,453
Cash flows from investing activities		
Purchase of property, plant and equipment	(10,749)	(11,372)
Net cash provided by (used in) investing activities	(10,749)	(11,372)
Cash flows from financing activities		
Proceeds from issuance of shares	-	10,250
Proceeds from share issuance to non-controlling shareholders	2,744	-
Net cash provided by (used in) financing activities	2,744	10,250
Effect of exchange rate change on cash and cash equivalents	191	1,685
Net increase (decrease) in cash and cash equivalents	27,477	203,016
Cash and cash equivalents at beginning of period	818,610	897,899
Cash and cash equivalents at end of period	846,087	1,100,915

(4) Notes to Consolidated Interim 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.