# Financial Supplementary Materials
## for the Second Quarter of FY2024

**Headwaters Co., Ltd.**

**August 14, 2024**        **Securities code: 4011**

# FY2024 1H Consolidated Financial Results Overview

**Headwaters**

(Thousand yen)　　　　　　　　　　　　　　　　　　　　　　　　　　(Thousand yen)

| | FY2023 1H Results | | FY2024 1H Results | | | |
| --- | --- | --- | --- | --- | --- | --- |
| | | Pct. to net sales (%) | | Pct. to net sales (%) | YoY change (%) | Vs. annual plan (%) |
| **Net sales** | 1,158,212 | 100.0 | 1,332,685 | 100.0 | 115.1 | 45.5 |
| **AI** | 466,247 | 40.3 | 670,005 | 50.3 | 143.7 | 44.8 |
| **DX** | 638,793 | 55.2 | 599,594 | 45.0 | 93.9 | 45.4 |
| **Product** | 53,171 | 4.6 | 63,085 | 4.7 | 118.6 | 55.5 |
| **Operating profit** | 46,724 | 4.0 | 151,124 | 11.3 | 323.4 | 66.9 |
| **Ordinary profit** | 47,857 | 4.1 | 150,475 | 11.3 | 314.4 | 65.7 |
| **Profit attributable to owners of parent** | 30,166 | 2.6 | 100,976 | 7.6 | 334.7 | 64.4 |
| **Net income per share** | 16.11 yen | | 53.44 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 12.6% YoY for the Quarter and 15.1% YoY.**
  ➡The shift to/focus on enterprise companies has led to significant seasonal fluctuations requiring time for project launches beginning in the new fiscal year.
  ➡ Developing new businesses with existing clients aiming to increase the LTV of loyal clients => growing as a stable revenue base
  ➡ The number of clients from which sales of more than 100 million yen per year can be expected doubled from the previous fiscal year.

## Operating Profit

- **Operating profit increased 223.4% YoY.**
  ➡ Improving profit structure by reducing the number of unprofitable projects, raising unit sales price, reducing recruitment expenses, etc.
  ➡ The gross profit margin and size of each project grew as a result of increasing the number of loyal clients and adopting new technologies such as generative AI.
  ➡ SG&A expenses were successfully reduced as planned by decreasing recruitment expenses.

## Recruiting

- There was a **net increase of 35 employees** in line with the initial plan (net increase of nine employees in 1Q of FY2024 + net increase of 26 employees in 2Q of FY2024).
  ➡ The recruitment target for FY2024 is a net increase of 60 employees (progress ratio: 58%).
  ➡The plan targeting the reduction of the turnover rate to 10% (16 employees/year) or below is steadily 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.
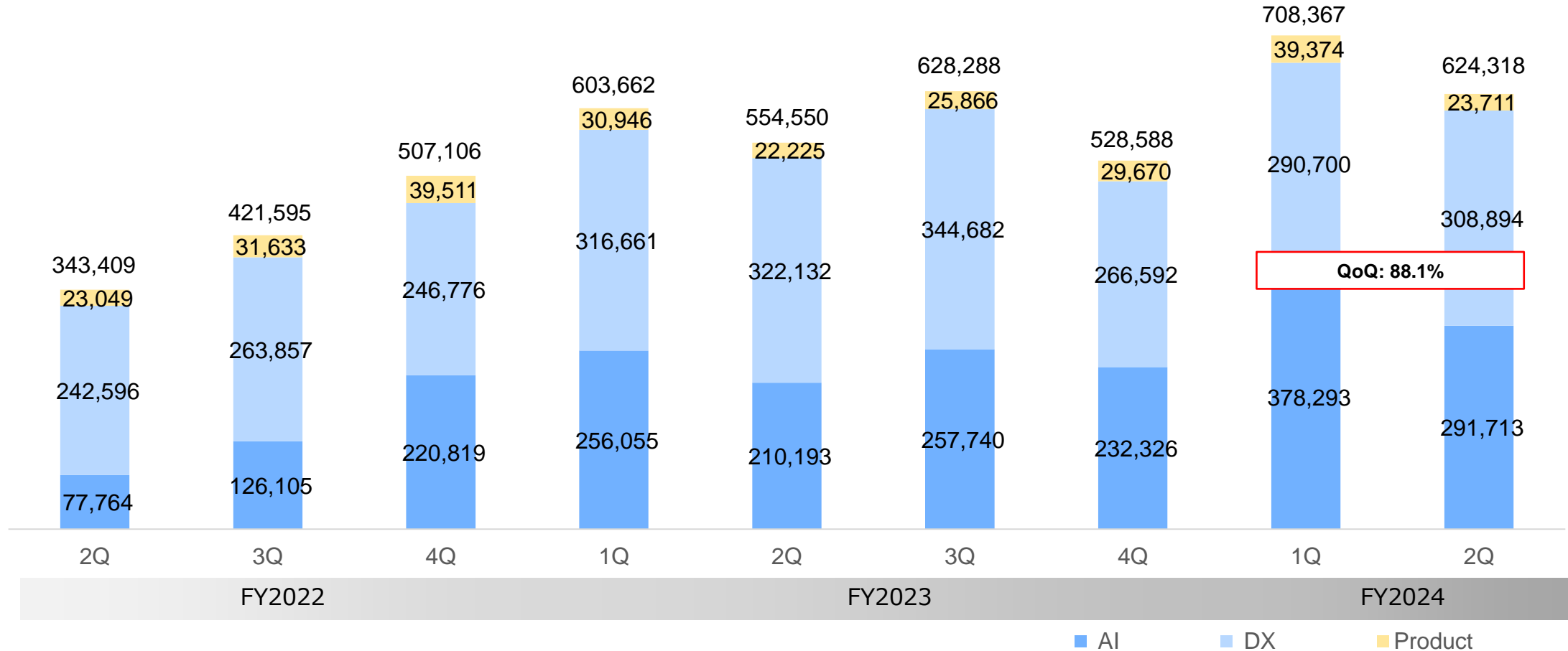
# Net Sales by Service Category



FY2022 Sales: 1,574,596    FY2023 Sales: 2,315,088    (Thousand yen)

YoY for the Quarter: 112.6% / YoY: 115.1%

QoQ: 88.1%

■ AI    ■ DX    ■ Product

* Because the OPS Services category was discontinued from FY2024, FY2022 and FY2023 OPS sales have been allocated to the three other service categories.
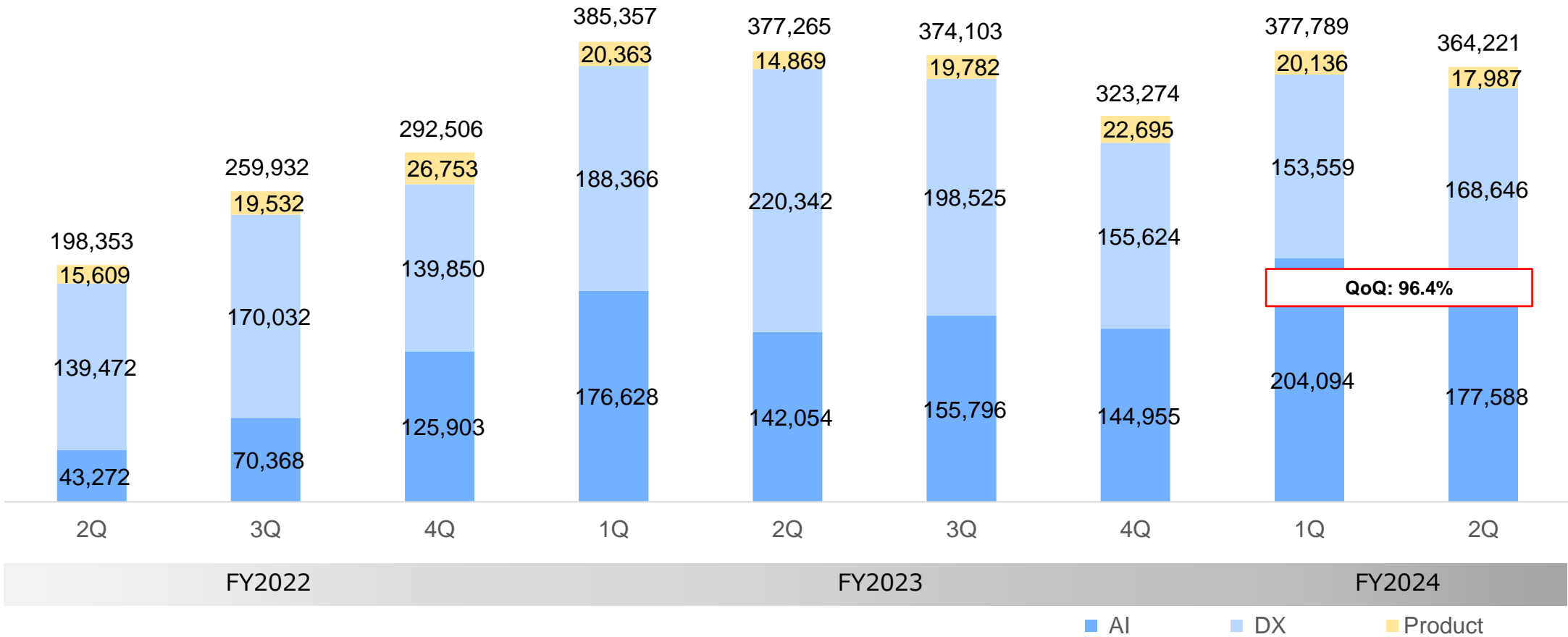
# Cost of Sales by Service Category



FY2022 Cost of Sales: 929,060

FY2023 Cost of Sales: 1,459,999

(Thousand yen)

**YoY for the Quarter: 96.5 % / YoY: 97.3%**

**QoQ: 96.4%**

| | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q |
|---|---|---|---|---|---|---|---|---|---|
| Total | 198,353 | 259,932 | 292,506 | 385,357 | 377,265 | 374,103 | 323,274 | 377,789 | 364,221 |
| Product | 15,609 | 19,532 | 26,753 | 20,363 | 14,869 | 19,782 | 22,695 | 20,136 | 17,987 |
| DX | 139,472 | 170,032 | 139,850 | 188,366 | 220,342 | 198,525 | 155,624 | 153,559 | 168,646 |
| AI | 43,272 | 70,368 | 125,903 | 176,628 | 142,054 | 155,796 | 144,955 | 204,094 | 177,588 |

FY2022     FY2023     FY2024

■ AI    ■ DX    ■ Product

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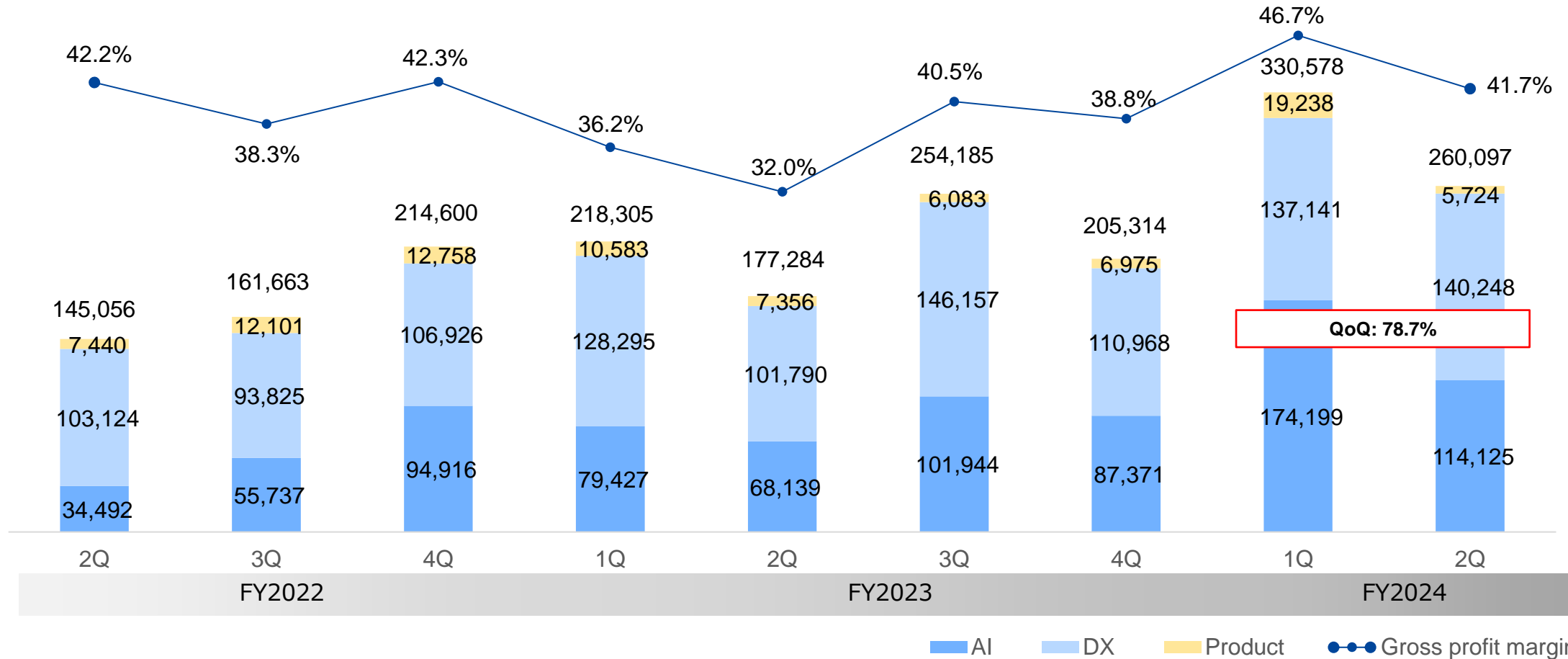
# Gross Profit by Service Category

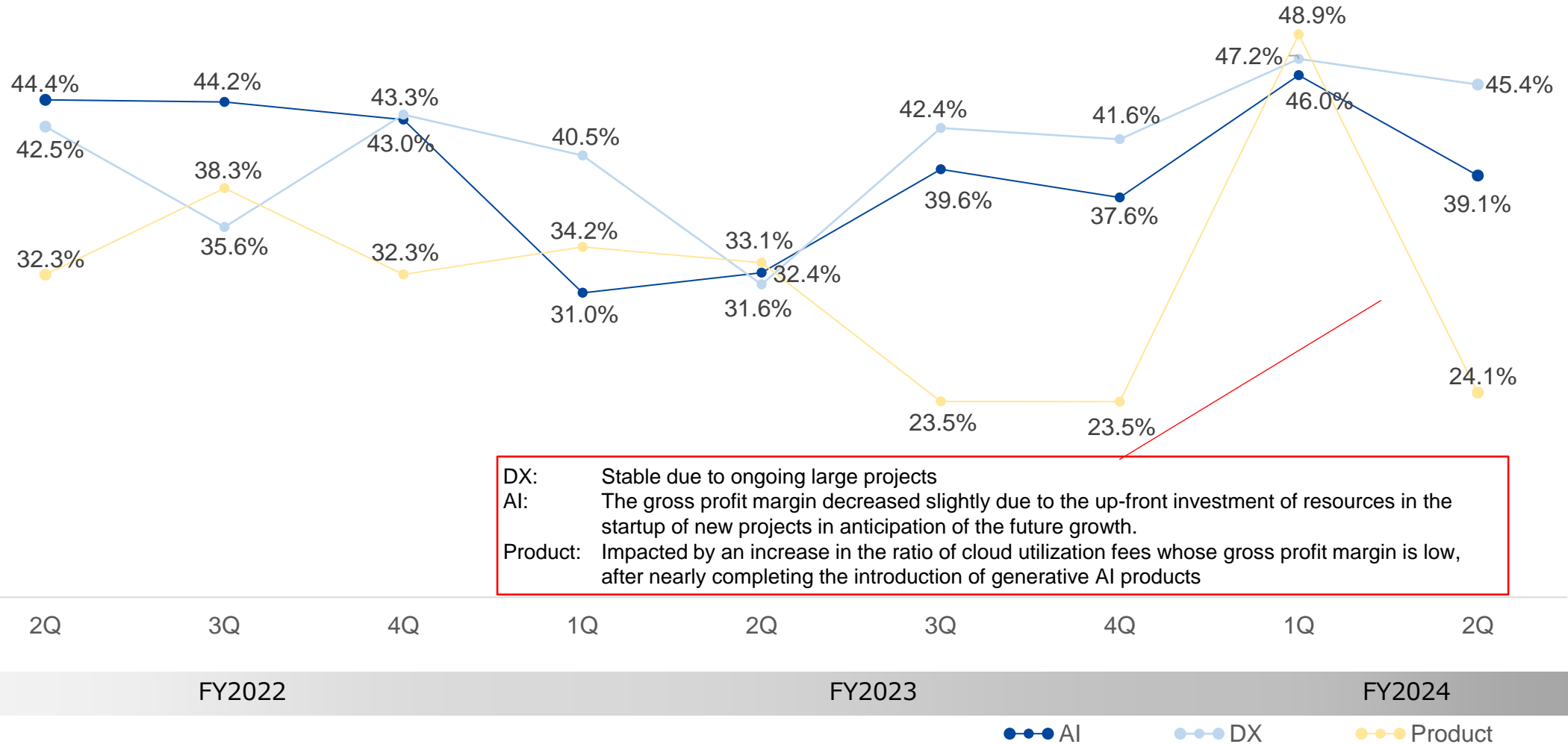FY2022 Gross Profit: 645,535 FY2023 Gross Profit: 855,088 (Thousand yen)

YoY for the Quarter: 146.7 % / YoY: 149.3%

QoQ: 78.7%

* Because the OPS Services category was discontinued from FY2024, FY2022 and FY2023 gross profit have been allocated to the three other service categories.
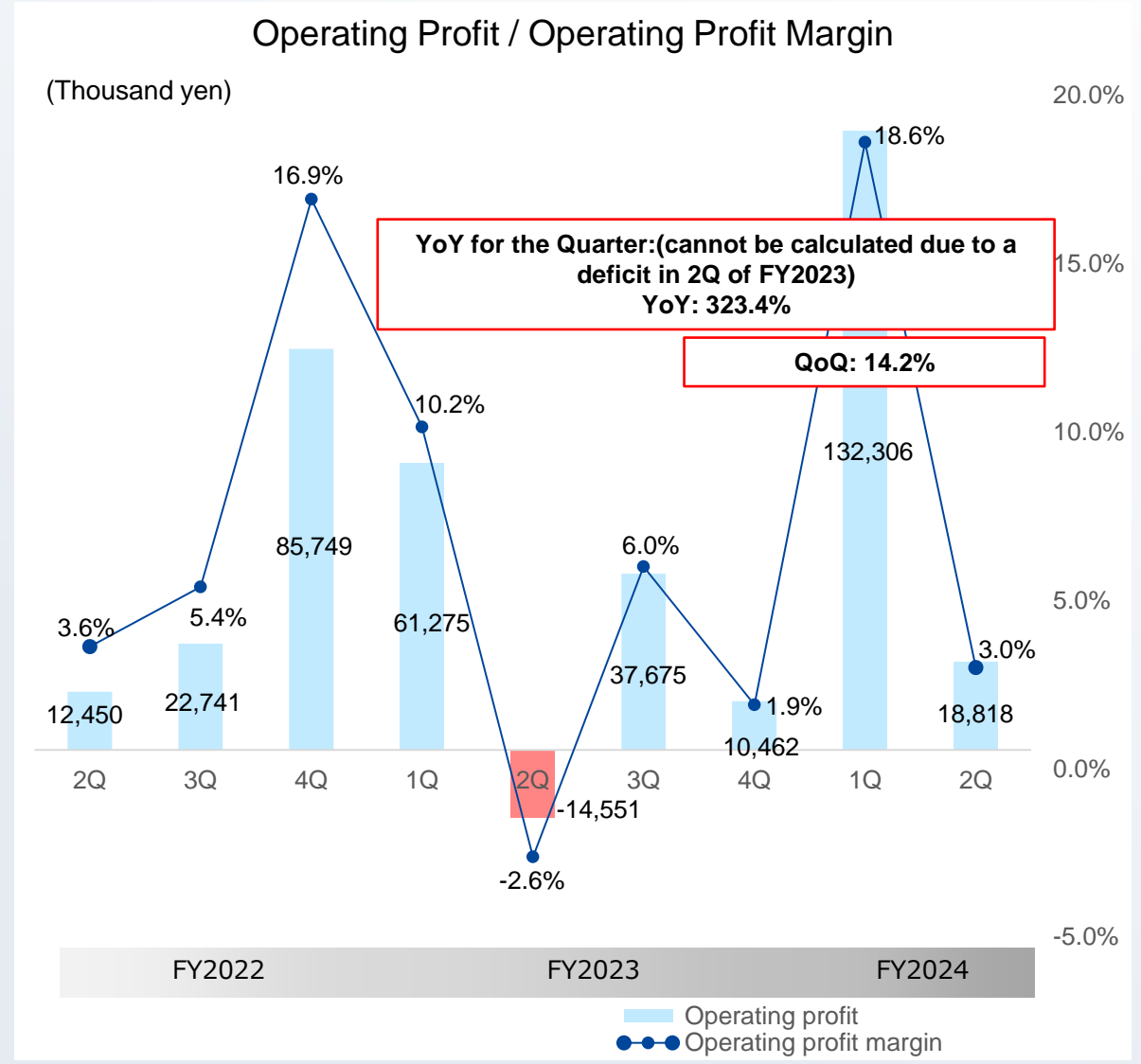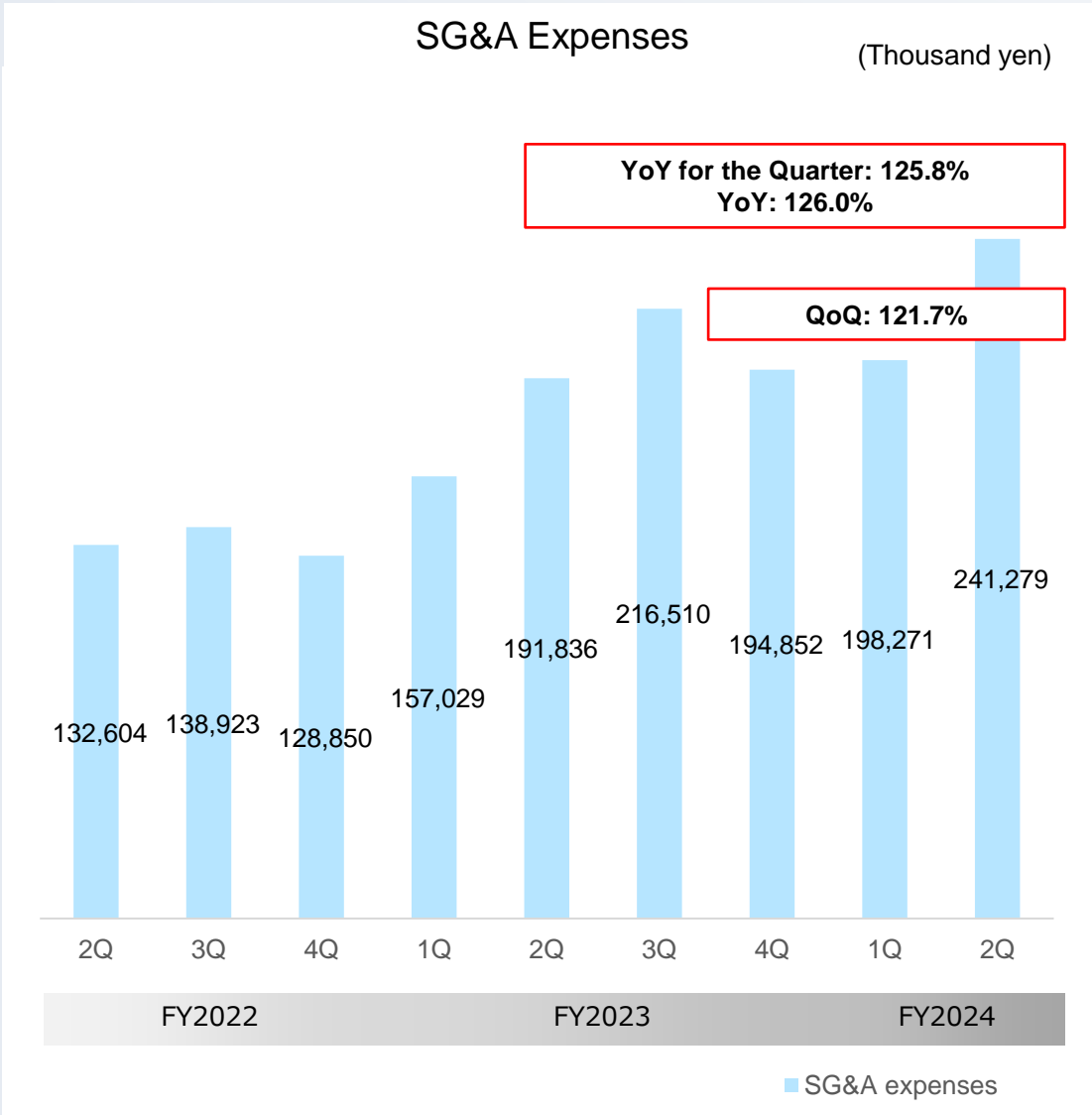
# Gross Profit Margin by Service Category



48.9%

47.2%

45.4%

44.4% 44.2%
43.3%
42.5% 43.0% 40.5% 42.4% 41.6% 46.0% 39.1%
38.3% 39.6% 37.6%
35.6% 34.2% 33.1%
32.3% 32.3% 31.6% 32.4% 24.1%
31.0%
23.5% 23.5%

DX: Stable due to ongoing large projects
AI: The gross profit margin decreased slightly due to the up-front investment of resources in the startup of new projects in anticipation of the future growth.
Product: Impacted by an increase in the ratio of cloud utilization fees whose gross profit margin is low, after nearly completing the introduction of generative AI products

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

FY2022            FY2023            FY2024

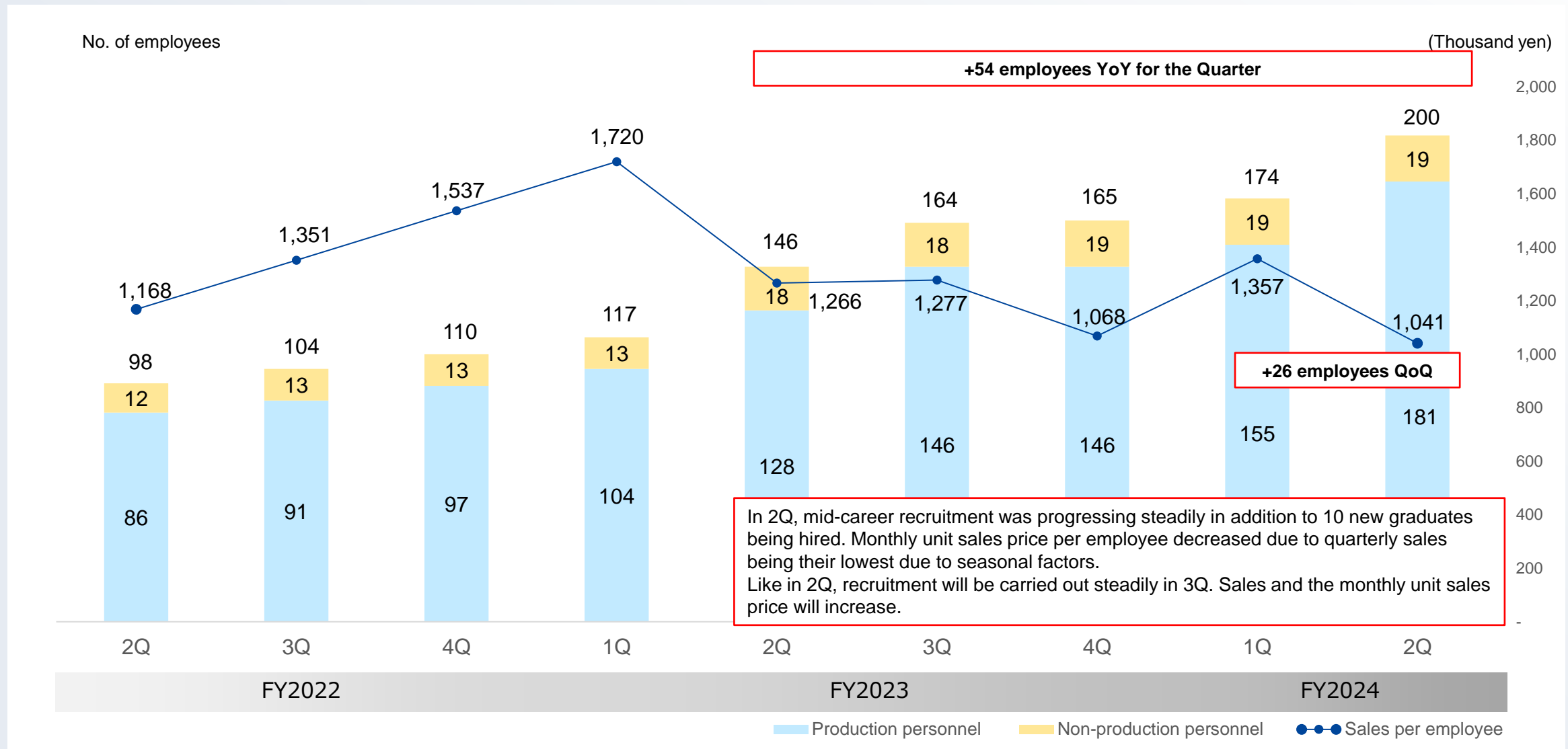●●● AI    ●●● DX    ●●● Product

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

# Employees, Monthly Sales Per Employee



No. of employees (Thousand yen)

**+54 employees YoY for the Quarter**

**+26 employees QoQ**

In 2Q, mid-career recruitment was progressing steadily in addition to 10 new graduates being hired. Monthly unit sales price per employee decreased due to quarterly sales being their lowest due to seasonal factors.
Like in 2Q, recruitment will be carried out steadily in 3Q. Sales and the monthly unit sales price will increase.

Production personnel | Non-production personnel | Sales per employee

| | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q |
|---|---|---|---|---|---|---|---|---|---|
| Total | 98 | 104 | 110 | 117 | 146 | 164 | 165 | 174 | 200 |
| Non-production | 12 | 13 | 13 | 13 | 18 | 18 | 19 | 19 | 19 |
| Production | 86 | 91 | 97 | 104 | 128 | 146 | 146 | 155 | 181 |
| Sales per employee | 1,168 | 1,351 | 1,537 | 1,720 | 1,266 | 1,277 | 1,068 | 1,357 | 1,041 |

FY2022 | FY2023 | FY2024

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

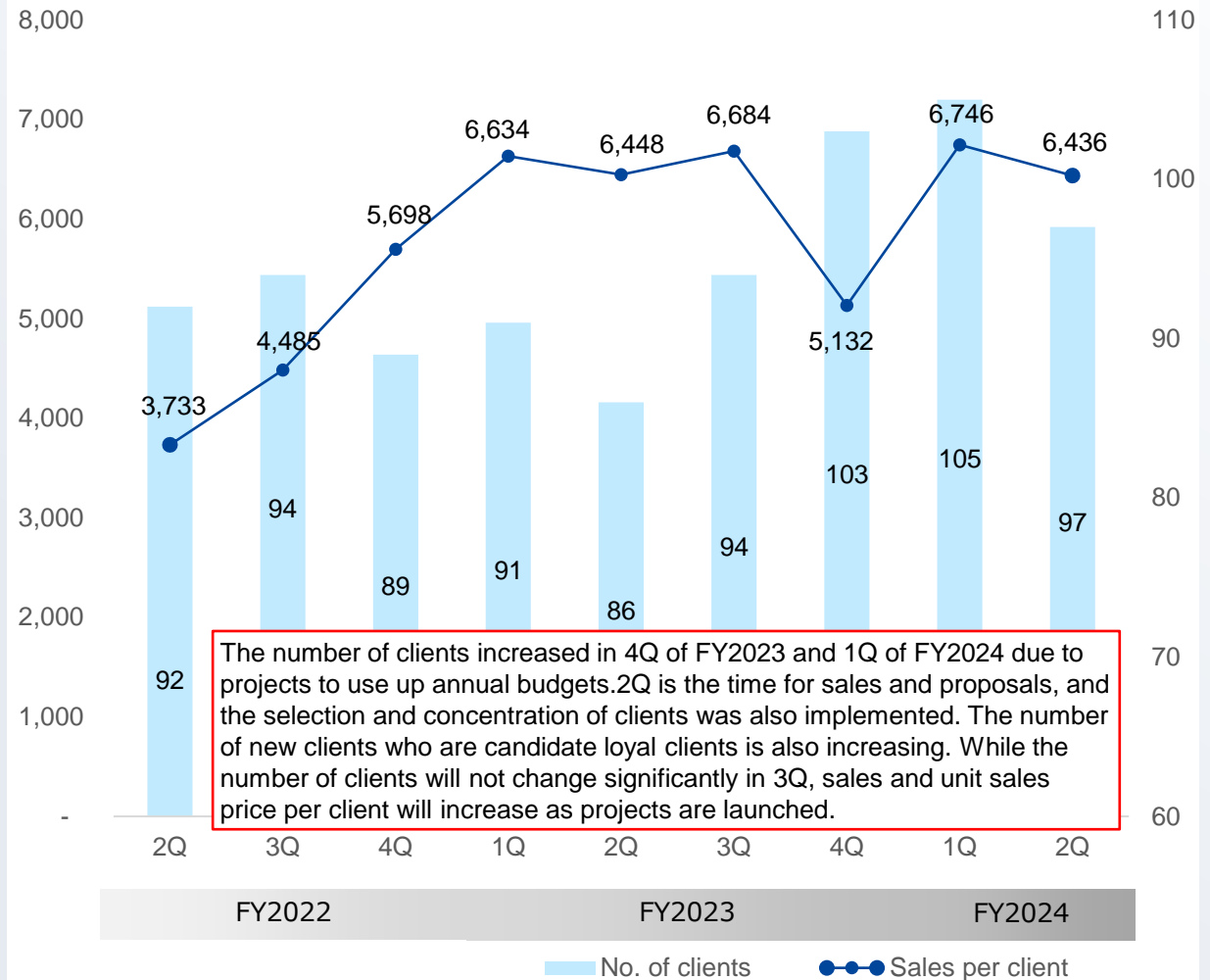# Unit Sales Price, Number of Projects and Contractual Chain Status by Service Category

## Unit Sales Price by Service Category (Thousand yen)

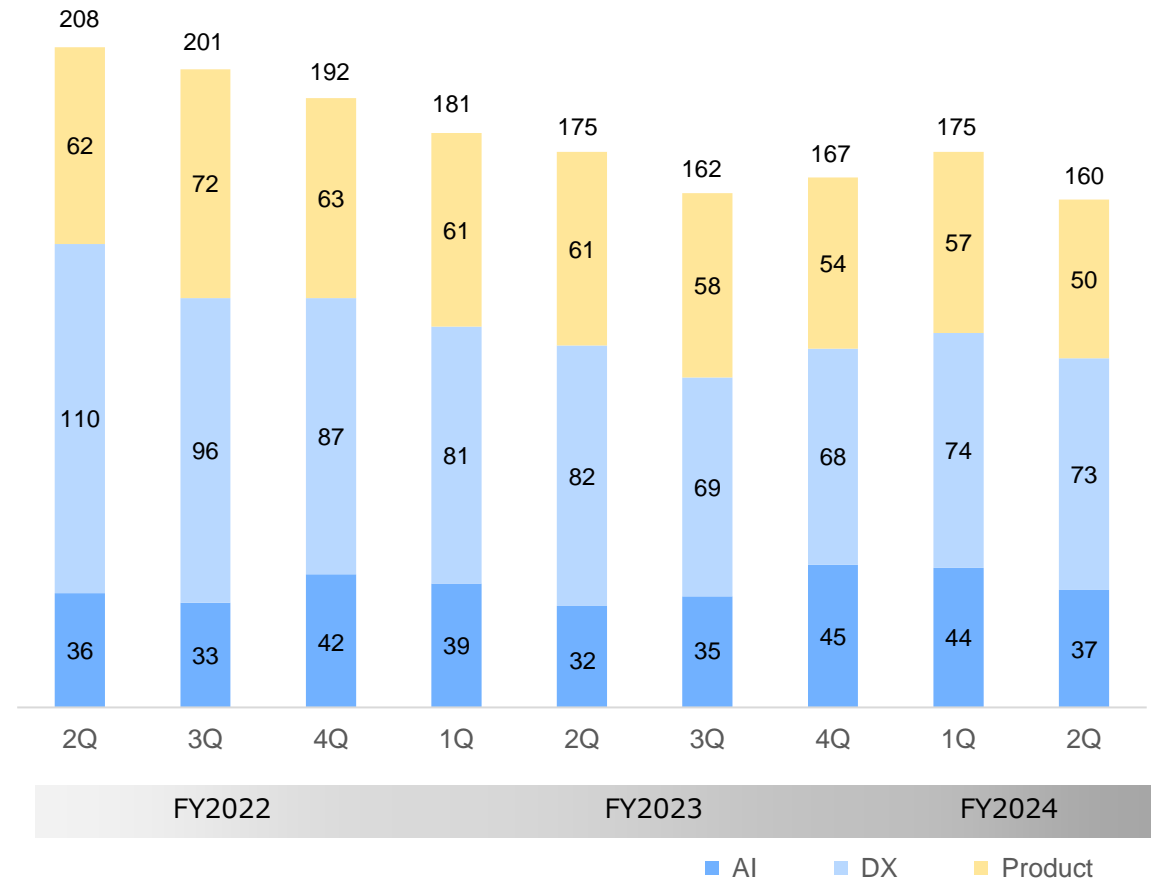The unit sales prices of both AI and DX have consistently increased from the prior periods, even in 2Q which is strongly affected by seasonal fluctuations. Looking at the data, there is a more pronounced increase in the AI category, which has many new clients.

In Product, unit prices cannot be easily raised due to it having a certain number of small agency sales models related to infrastructure.

AI values: 2,205 / 3,821 / 5,258 / 6,566 / 6,569 / 7,364 / 5,163 / 8,598 / 7,884

DX values: 2,160 / 2,749 / 2,837 / 3,909 / 3,928 / 4,995 / 3,920 / 3,928 / 4,231

Product values: 372 / 439 / 627 / 507 / 364 / 446 / 549 / 691 / 474

Periods: 2Q 3Q 4Q (FY2022) 1Q 2Q 3Q 4Q (FY2023) 1Q 2Q (FY2024)

Legend: ●AI  ●DX  ●Product

## No. of Projects by Service Category

More clients are becoming loyal, and the size of each project is growing. Keeping the number of projects to a certain level and ensuring quality will increase the LTV ratio, resulting in a stable revenue base.

| Period | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q |
|--------|----|----|----|----|----|----|----|----|----|
| Total | 208 | 201 | 192 | 181 | 175 | 162 | 167 | 175 | 160 |
| Product | 62 | 72 | 63 | 61 | 61 | 58 | 54 | 57 | 50 |
| DX | 110 | 96 | 87 | 81 | 82 | 69 | 68 | 74 | 73 |
| AI | 36 | 33 | 42 | 39 | 32 | 35 | 45 | 44 | 37 |

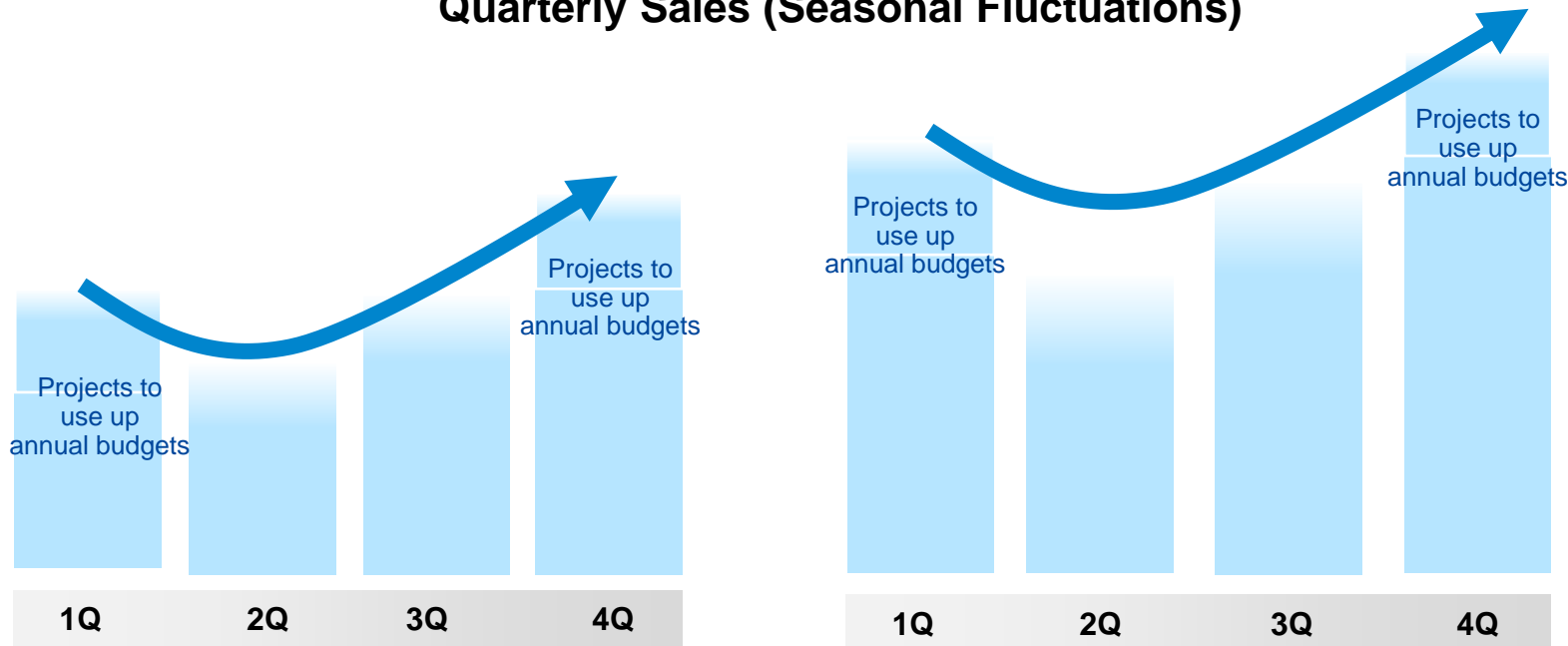FY2022 / FY2023 / FY2024

Legend: ■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.

# Seasonal Fluctuations in Net Sales

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

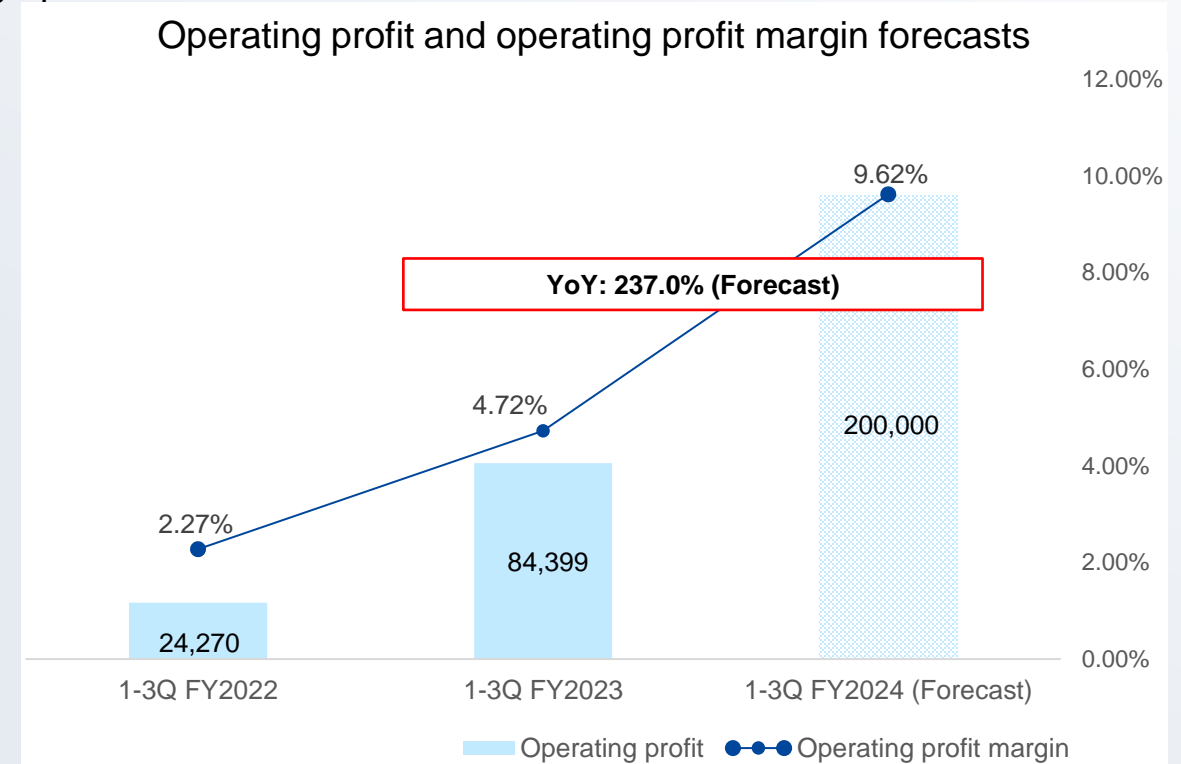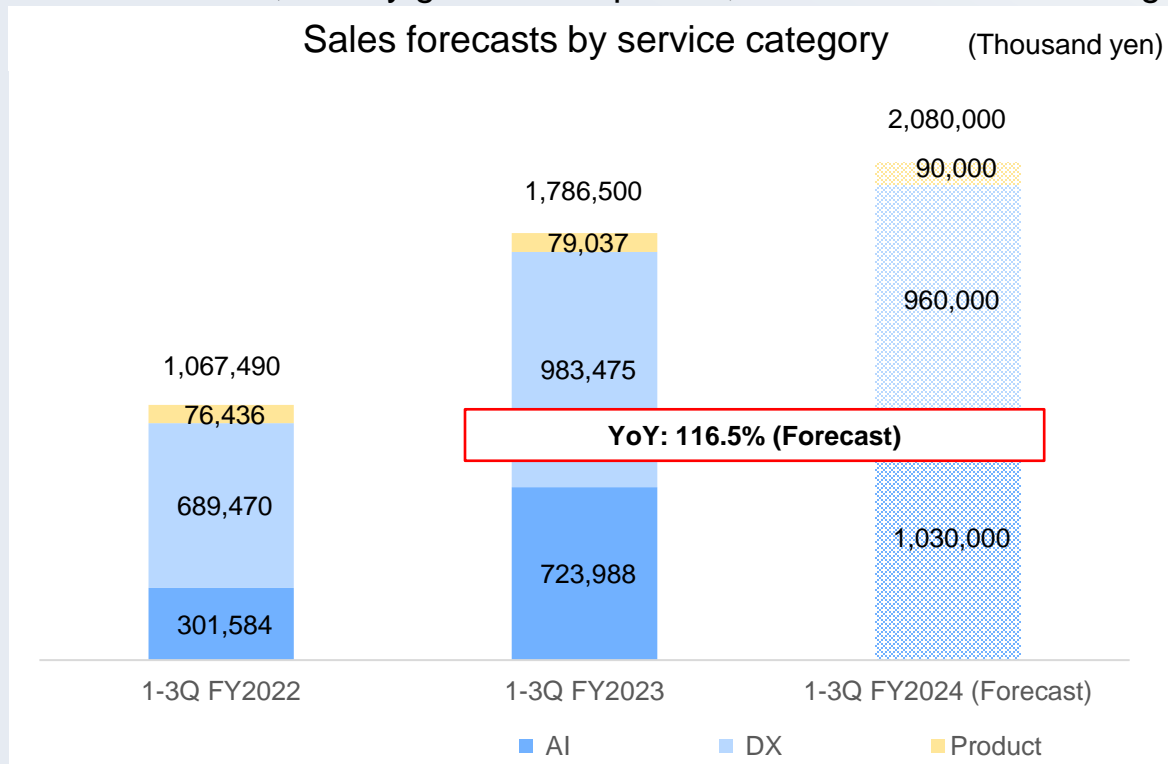| | Net sales trend | SG&A expenses trend | Characteristics |
|---|---|---|---|
| 1Q | Medium | Low | Sales are steady due to projects to use up annual budgets. Recruitment is slow, and SG&A expenses tend to be kept low. |
| 2Q | Low | High | Sales are at their lowest point. SG&A expenses increase due 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)

Projects to use up annual budgets

Projects to use up annual budgets

1Q 2Q 3Q 4Q

Projects to use up annual budgets

Projects to use up annual budgets

1Q 2Q 3Q 4Q

In addition to ongoing large projects, projects toward the end of December and the fiscal year-end in March start in 3Q.

- Net sales: Because human resources have been secured due to steady progress in recruitment up to 2Q, **sales are forecast to be a record high**, exceeding sales in 1Q (708 million yen).
- Gross profit margin: Expected to be higher than the gross margin in 2Q (41.7%) due to higher sales in the AI category, which has a high gross margin, than 2Q.
- SG&A expenses: Forecast to be a record high due to an increase in personnel expenses as a result of steady recruitment in 3Q continuing from 2Q and the posting of recruitment expenses.
- Operating profit: Both sales and SG&A expenses are forecast to be record highs, and operating profit is expected to be 50 to 80 million yen.

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

## Sales forecasts by service category (Thousand yen)

| | AI | DX | Product | Total |
|---|---|---|---|---|
| 1-3Q FY2022 | 301,584 | 689,470 | 76,436 | 1,067,490 |
| 1-3Q FY2023 | 723,988 | 983,475 | 79,037 | 1,786,500 |
| 1-3Q FY2024 (Forecast) | 1,030,000 | 960,000 | 90,000 | 2,080,000 |

**YoY: 116.5% (Forecast)**

## Operating profit and operating profit margin forecasts

| | Operating profit | Operating profit margin |
|---|---|---|
| 1-3Q FY2022 | 24,270 | 2.27% |
| 1-3Q FY2023 | 84,399 | 4.72% |
| 1-3Q FY2024 (Forecast) | 200,000 | 9.62% |

**YoY: 237.0% (Forecast)**

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

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

■ Collaborations/Services
- ✓ Advanced RAG service launched using Microsoft Fabric as a data platform for companies who have not been successful using RAG in generative AI operations.
- ✓ Industrial edge and generative AI solution LLaVA Edge Vision developed using Siemens and NVIDIA's advanced technologies: Introduced at Ryoyo Electro's 8th AI EXPO TOKYO Spring exhibition booth
- ✓ Announcement of More Collaborations with Information Strategy and Technology Co., Ltd.: Jointly providing in-house DX support services using generative AI for enterprise companies operating financial and IT businesses

■ Track record
- ✓ Provision of development support for JR West's Copilot for Ekiin generative AI assistant

■ In-house activities
- ✓ Introduced SkillDB, a service for visualizing the skills of DX and AI human resources to accelerate human capital strategies
- ✓ Headwaters, Headwaters Consulting, and Headwaters Professionals announced their Silver Certification for being healthy companies

■ Lectures and webinars
- ✓ Announcement of webinar on June 5: How ITOCHU Corporation and JR West start projects and expertise in the development of human resources with generative AI skills are introduced in Reforming Business Using the Power of Generative AI.
- ✓ Headwaters Consulting: Provided generative AI practice program for beginners during the New Techniques for Working in the Age of ChatGPT Nikkei Business School seminar.

# 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 1Q FY2024 and 2Q FY2024

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

  → Comparison between figures of 1H FY2023 and 1H 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 2Q FY2023 and 2Q 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.