

# Financial Supplementary Materials

for FY2023

Headwaters Co., Ltd.

February 14, 2024    Securities code: 4011



# FY2023 Consolidated Financial Results Overview

(Thousand yen)

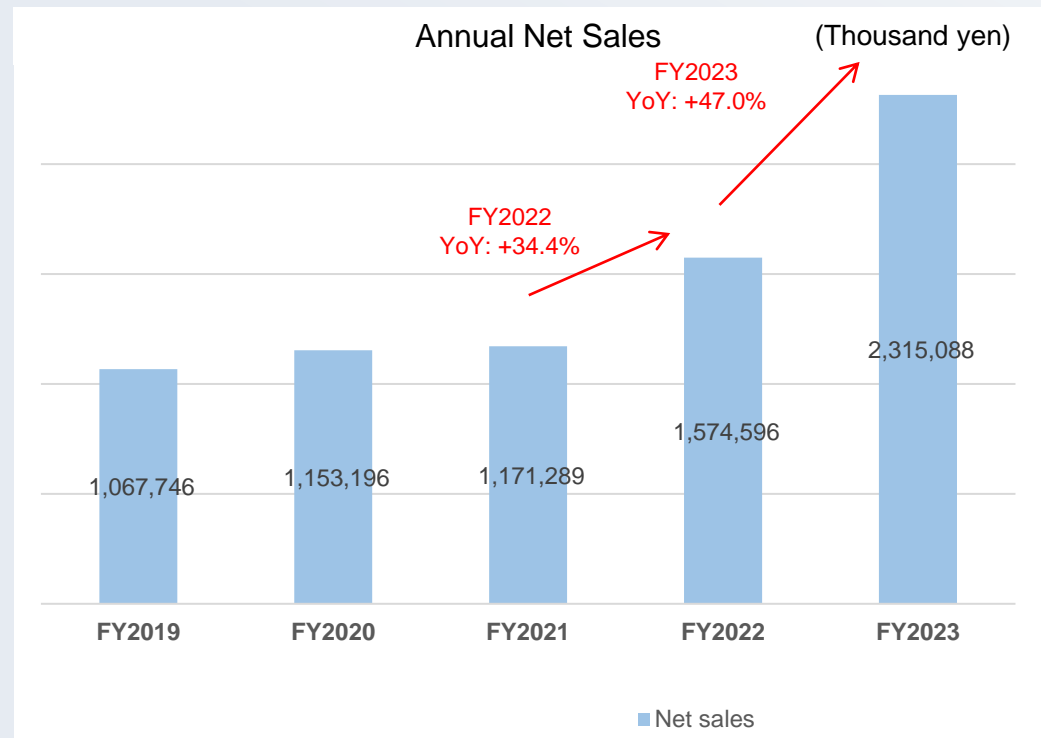
(Thousand yen)

	FY2022 Results		FY2023 Results			
		Pct. to net sales (%)		Pct. to net sales (%)	YoY change (%)	Vs. annual plan (%)
<b>Net sales</b>	<b>1,574,596</b>	<b>100.0</b>	<b>2,315,088</b>	<b>100.0</b>	<b>147.0</b>	<b>99.7</b>
<b>AI</b>	<b>506,359</b>	<b>32.1</b>	<b>950,620</b>	<b>41.1</b>	<b>187.7</b>	<b>101.6</b>
<b>DX</b>	<b>767,135</b>	<b>48.7</b>	<b>1,066,178</b>	<b>46.1</b>	<b>139.0</b>	<b>101.5</b>
<b>Product</b>	<b>115,947</b>	<b>7.3</b>	<b>108,707</b>	<b>4.7</b>	<b>93.8</b>	<b>91.2</b>
<b>OPS</b>	<b>185,153</b>	<b>11.7</b>	<b>189,581</b>	<b>8.2</b>	<b>102.4</b>	<b>87.5</b>
<b>Operating profit</b>	<b>110,019</b>	<b>6.9</b>	<b>94,861</b>	<b>4.1</b>	<b>86.2</b>	<b>78.8</b>
<b>Ordinary profit</b>	<b>106,916</b>	<b>6.7</b>	<b>98,300</b>	<b>4.2</b>	<b>91.9</b>	<b>78.6</b>
<b>Net profit</b>	<b>75,143</b>	<b>4.7</b>	<b>71,229</b>	<b>3.1</b>	<b>94.8</b>	<b>82.2</b>
<b>Profit attributable to owners of parent</b>	<b>-</b>	<b>-</b>	<b>70,683</b>	<b>3.1</b>	<b>-</b>	<b>-</b>
<b>Net income per share</b>	<b>40.13 yen</b>		<b>37.70 yen</b>			

## FY2023 Key Performance Indicators Sales, Recruiting

### Net Sales

- Sales, which is a key performance indicator, **increased 47.0% YoY in FY2023 to a new record high for the fifth consecutive year.**
  - Large AI and DX projects in the first three quarters were the primary sources of sales growth.
  - In the fourth quarter, there was an extremely large volume of interactions with customers regarding the demonstration trial phase for the use of generative AI in business operations.  
Large companies are establishing budgets to start using generative AI in 2024 or later. To serve these companies, Headwaters is placing priority on generative AI projects and assigning many people to this category.



# ▶ Financial Summary

## Operating Profit / Ordinary Profit

- Earnings decreased due to investments made in recruiting and training activities and the generative AI business, while Headwaters worked on recovering from a second quarter operating loss.

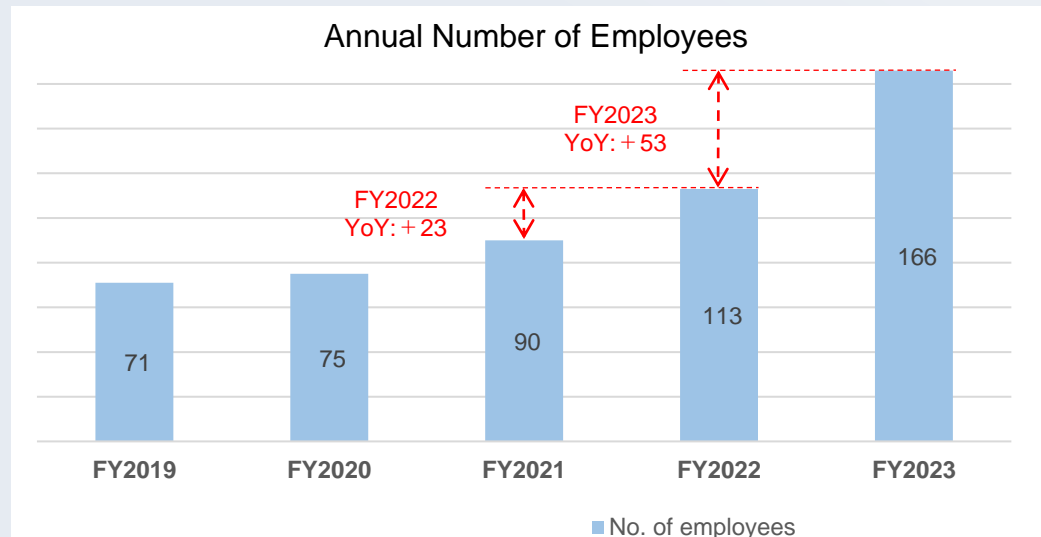
Operating profit: Down 13.8% YoY

Ordinary profit: Down 8.1% YoY

- Increased joint activities with partner companies due to sales growth
- Making new employees productive and controlling the pct. of work using partner companies are priorities because a higher pct. of sales involving partner companies lowers the gross profit margin.
- SG&A expenses increased 42.0% YoY and were 5.5% above the FY2023 plan. This was the net result of measures to hold down recruiting expenses by reexamining methods used and an increase in personnel expenses caused by workforce growth.

## Recruiting

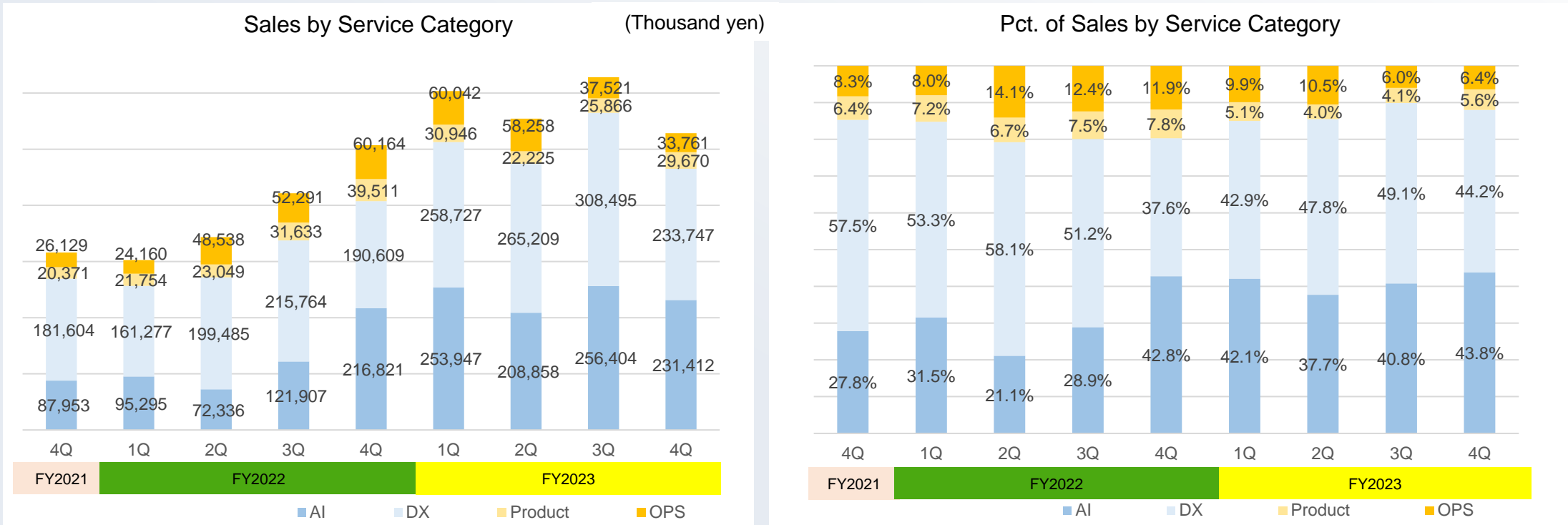
- Annual Recruitment Plan: Exceeded the target by **achieving a net increase of 53 employees** compared to the planned net increase of 43. (Net increase of 23 in FY2022)
- Number of employees as of the end of December 2023: 166, including 1 contract employee





# Net Sales

**Net sales increased 47.0% YoY in FY2023** in part due to large projects that contributed to consistent increase in sales. AI sales **increased 87.7%** because of the strong growth of orders for midsize projects, in addition to large projects.



**Recurring Revenue Business (Service Category: OPS, Product): Down 0.1% YoY; no change in a QoQ basis**

OPS: Up 2.4% YoY; No change in sales from FY2022 because of the termination of unprofitable projects starting in the third quarter.

Product: Down 6.2% YoY; Sales decreased because of the one-time contribution to FY2022 growth of sales of equipment for large projects.

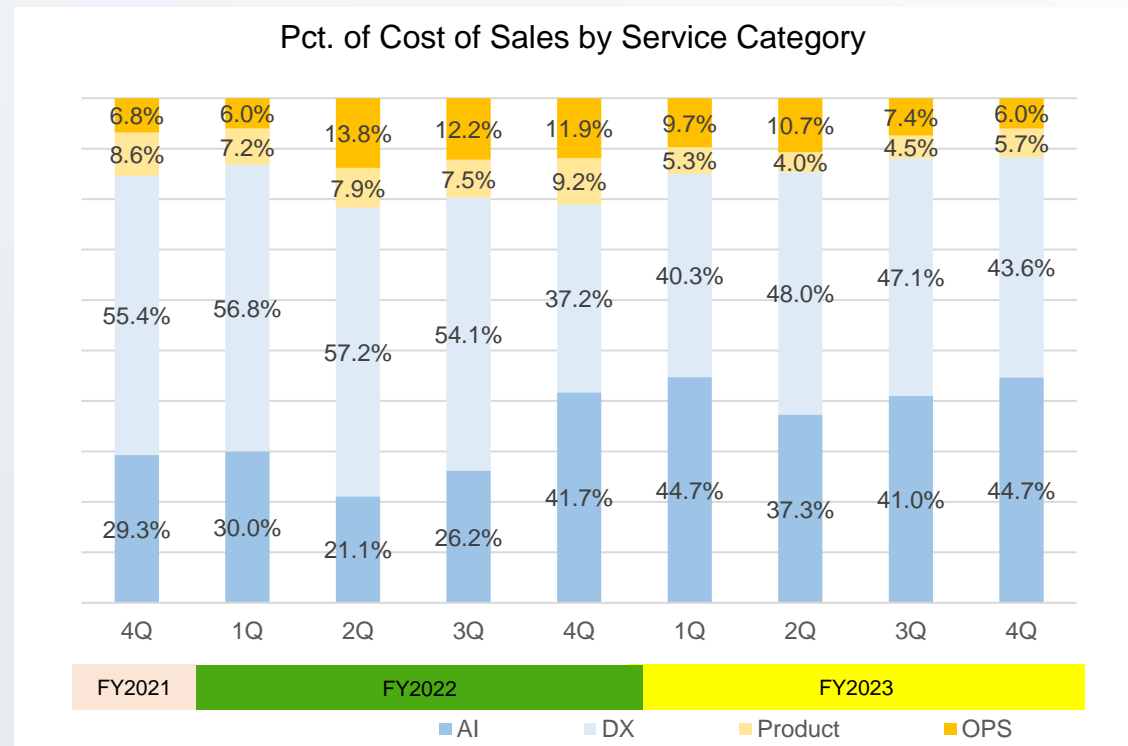
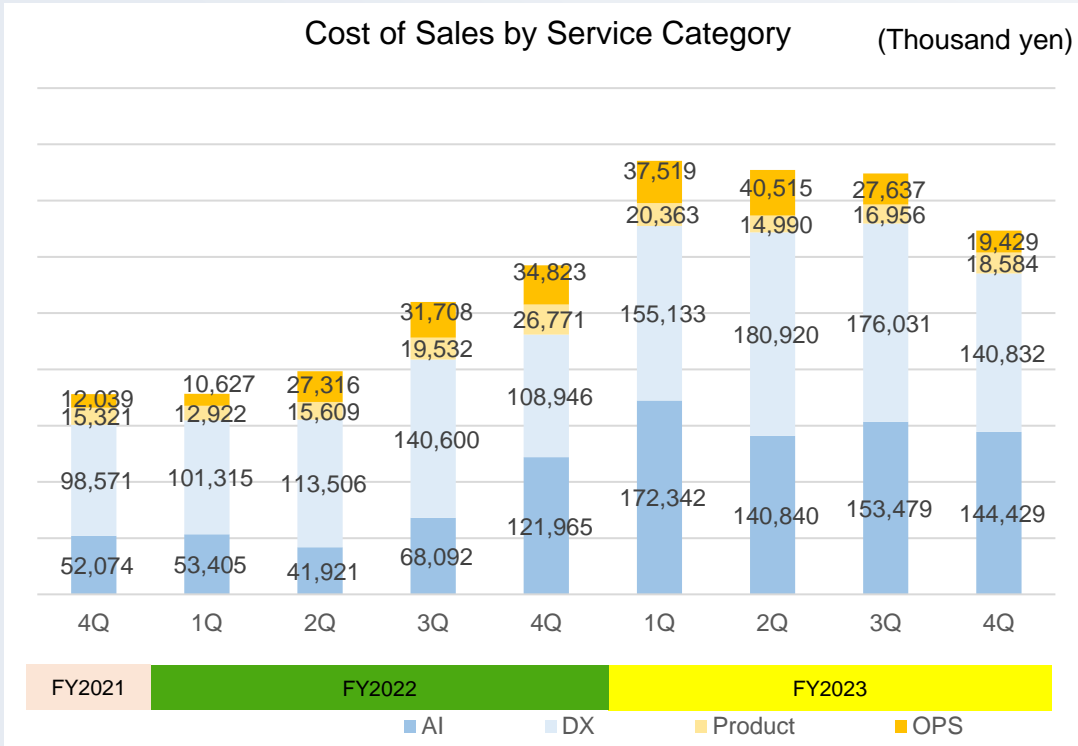
**Pay-Per-Service Business (Service Category: AI, DX): Up 58.3% YoY; Down 17.7% QoQ**

AI: Up 87.7% YoY; Following the third quarter end of large projects, shifting resources for emphasis on generative AI.

DX: Up 39.0% YoY; Only a small sales decline after the end of large projects because of many midsize Azure Cloud and DX consulting projects.

# ▶ Cost of Sales

The cost of sales increased 57.1% YoY due mainly to sales growth. Major components of the increase are higher rates for payments to partner companies, a higher pct. of sales involving partner companies, and numerous measures required to add skills for using new technologies.



## Recurring Revenue Business (Service Category: OPS, Product): Up 9.3% YoY; Down 14.8% QoQ

On a QoQ basis, numerous measures were able to hold down the cost of sales while maintaining sales in both the OPS and product categories.

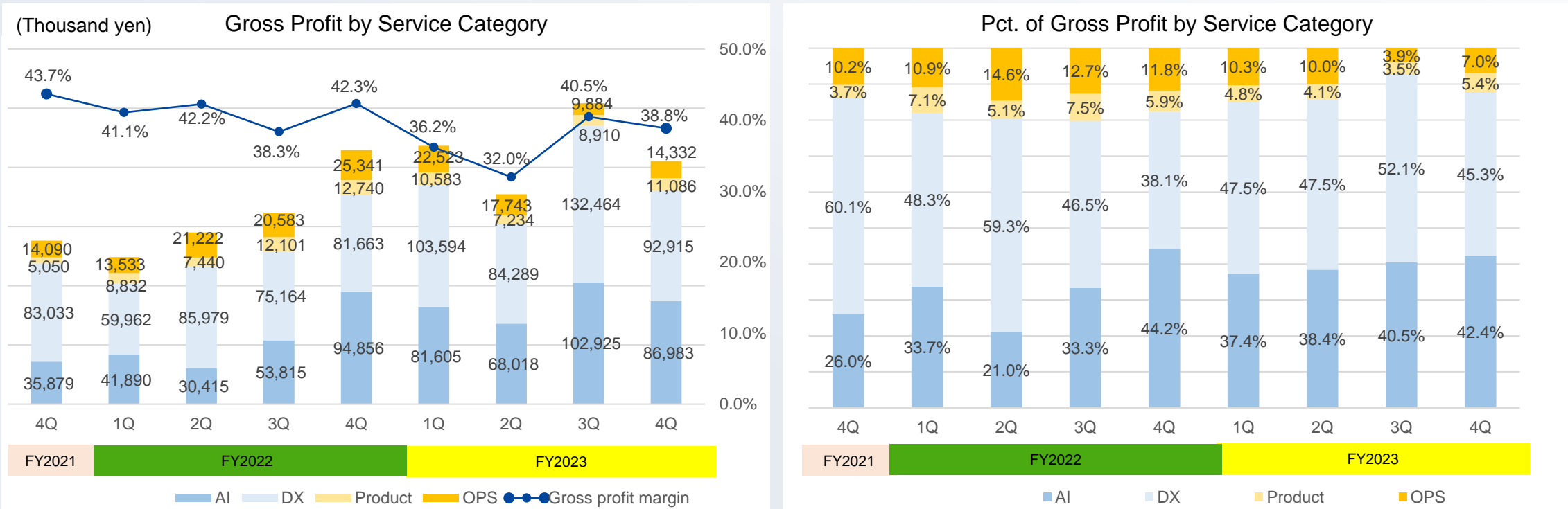
## Pay-Per-Service Business (Service Category: AI, DX): Up 68.5% YoY; Down 13.5% QoQ

At generative AI, DX and other projects that use new technologies, the cost of production increased because more people were assigned to ensure consistent progress during the start-up phase.

# Gross Profit

Gross profit increased **32.4% YoY in FY2023**.

In part due to emphasis on sales as a key performance indicator, the gross profit margin in FY2023 was 36.9% because of higher rates for payments to partner companies and a higher pct. of sales involving partner companies.



### Recurring Revenue Business (Service Category: OPS, Product): Down 16.1% YoY

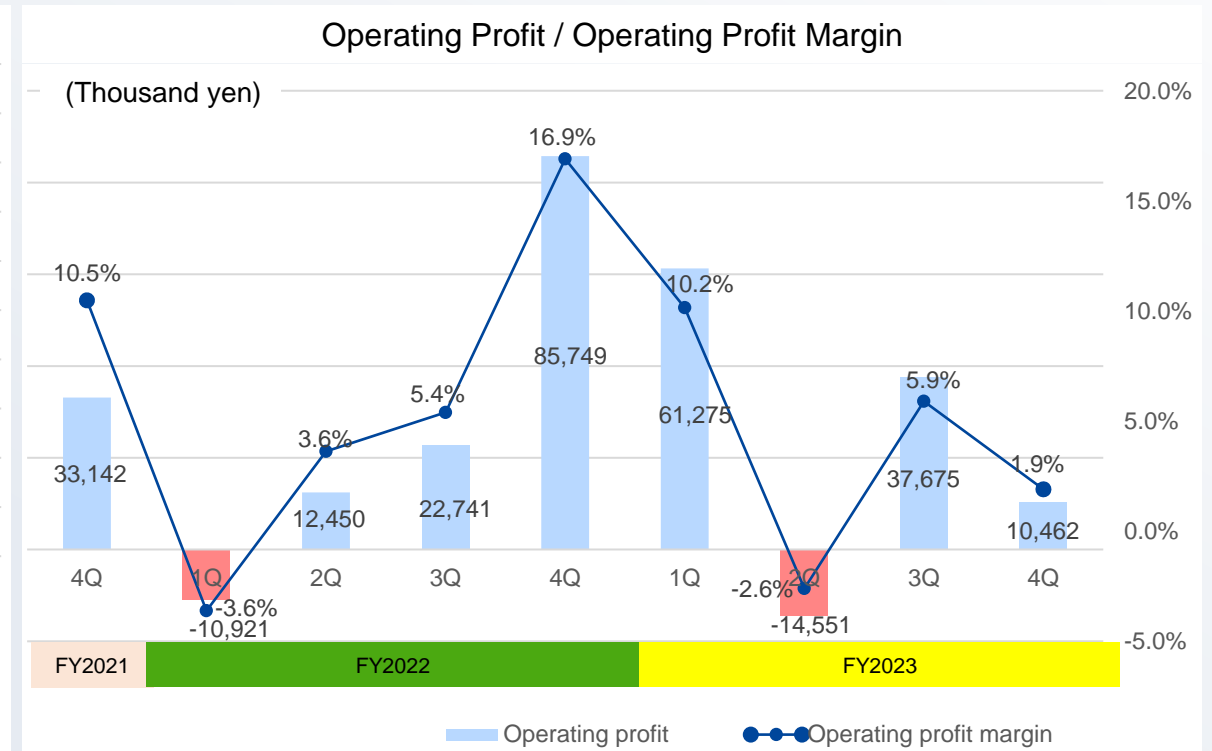
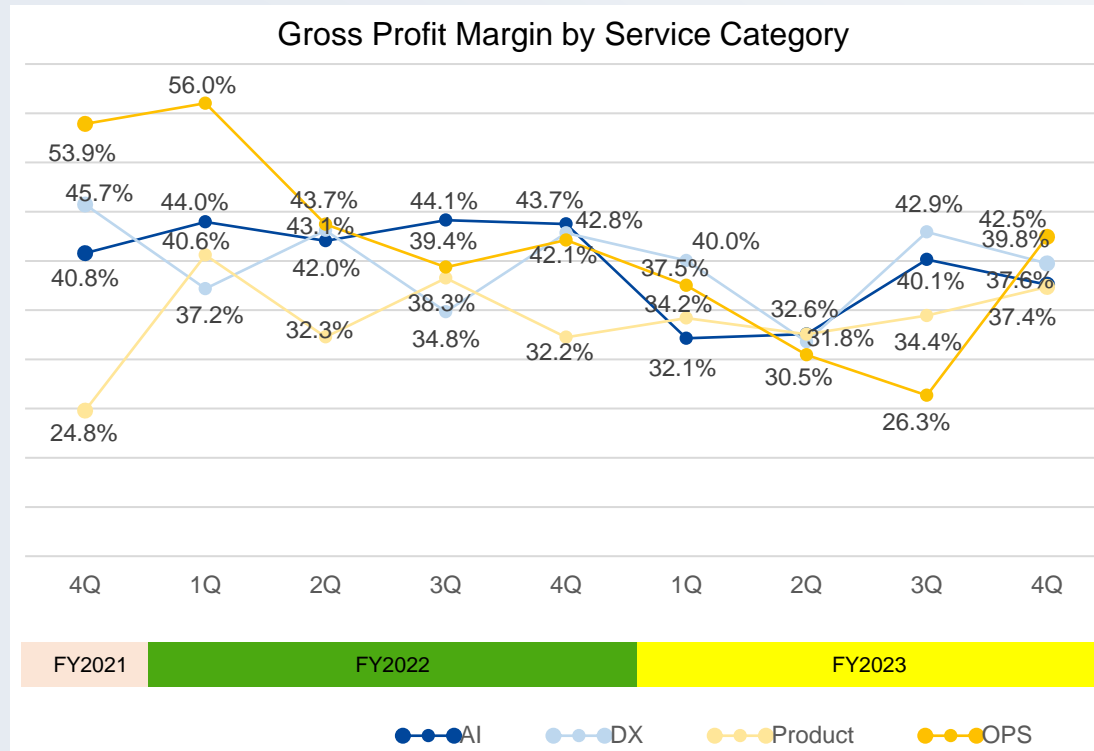
OPS: Decreased 20.1% YoY because of the termination of unprofitable projects starting in the third quarter but is now improving as shown by a 45% QoQ increase.  
 Product: An 8.1% decrease YoY in part due to large projects, but currently increasing (up 24.4% QoQ) because of SyncLect Generative AI orders that started in the third quarter.

### Pay-Per-Service Business (Service Category: AI, DX): Up 43.7% YoY

AI: Down 15.5% QoQ due to the end of a large project but up 53.6% YoY.  
 DX: Down 29.9% QoQ due to the end of a large project but up 36.4% YoY.

# Gross Profit Margin by Service Category / Operating Profit Margin

Operating profit in FY2023 was the result of a third quarter improvement following the second quarter loss and the growth of the number of contacts and orders for generative AI in the third and fourth quarters. There was a profit even as investments were made in the fourth quarter to establish a strong competitive position in the generative AI market in 2024 and afterward.



## Recurring Revenue Business (Service Category: OPS, Product)

The gross profit margin is recovering in the OPS and product categories because of the termination of unprofitable projects and higher sales of Headwaters services.

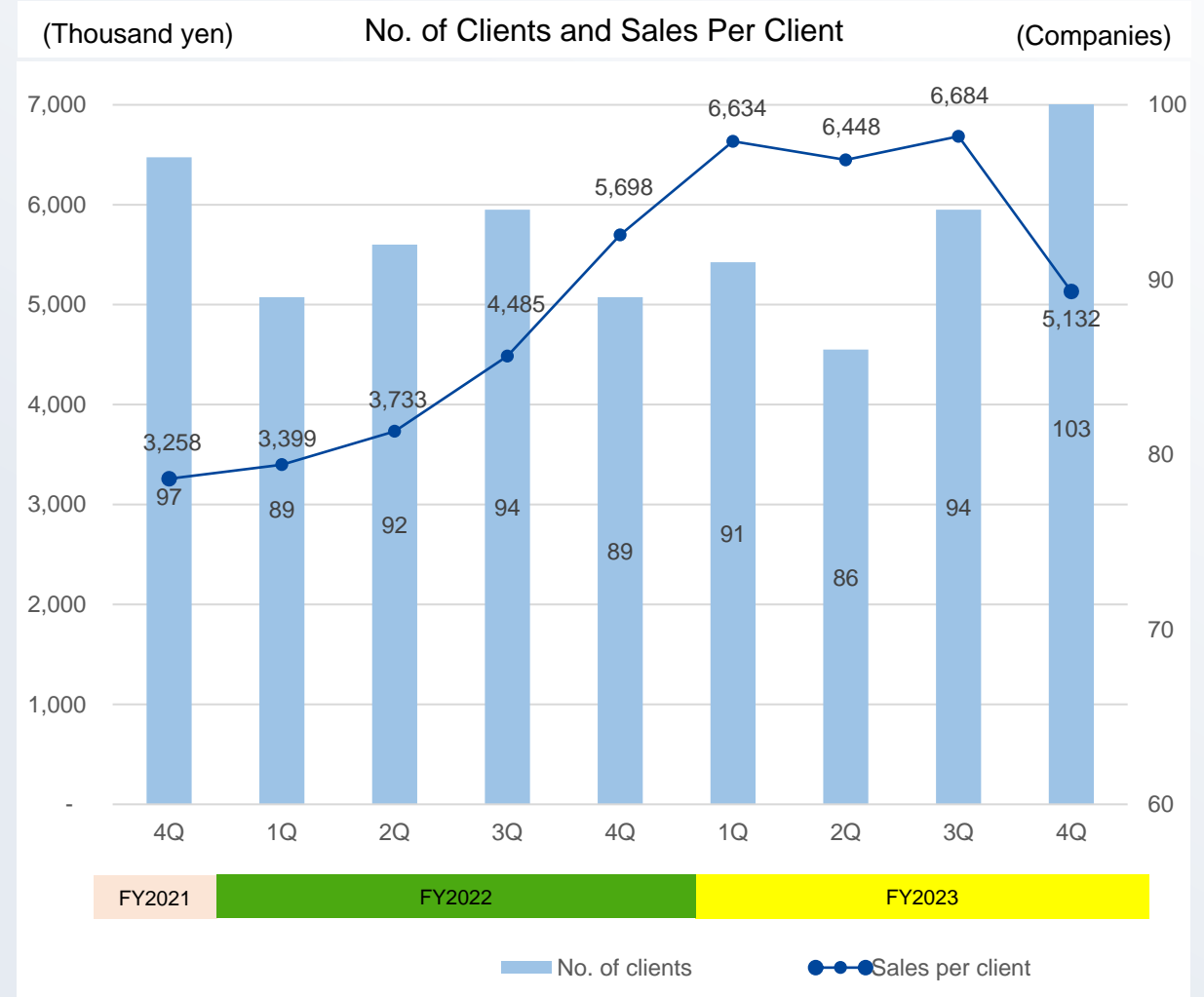
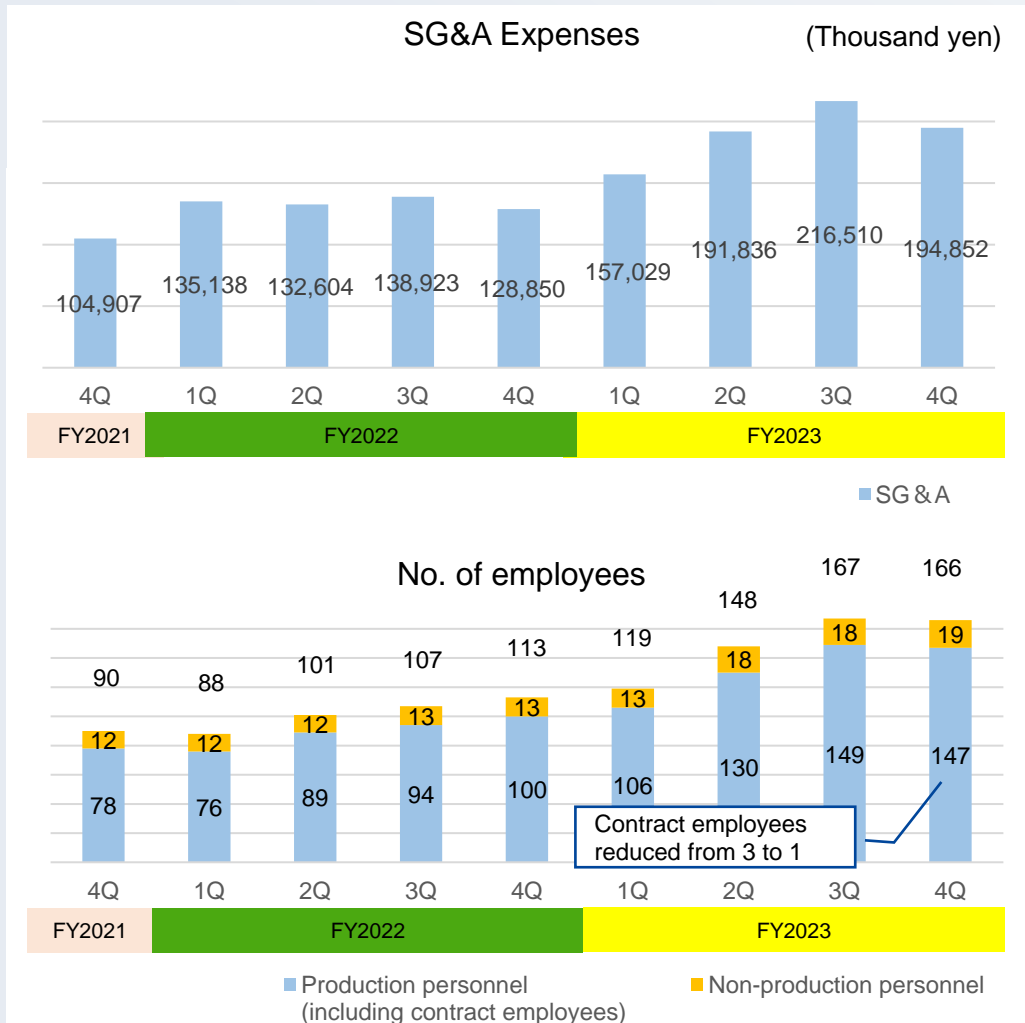
## Pay-Per-Service Business (Service Category: AI, DX)

A small decrease in the AI gross profit margin as more people were assigned to generative AI projects at an early stage. Also a small decrease in the DX gross profit margin, the result of a higher pct. of sales involving partner companies.



# ▶ SG&A Expenses, Employees, Clients and Sales Per Client

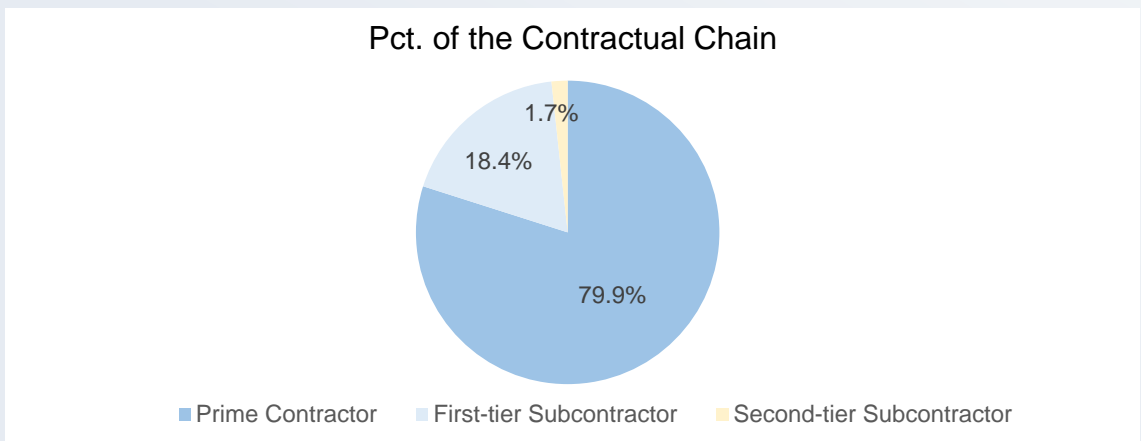
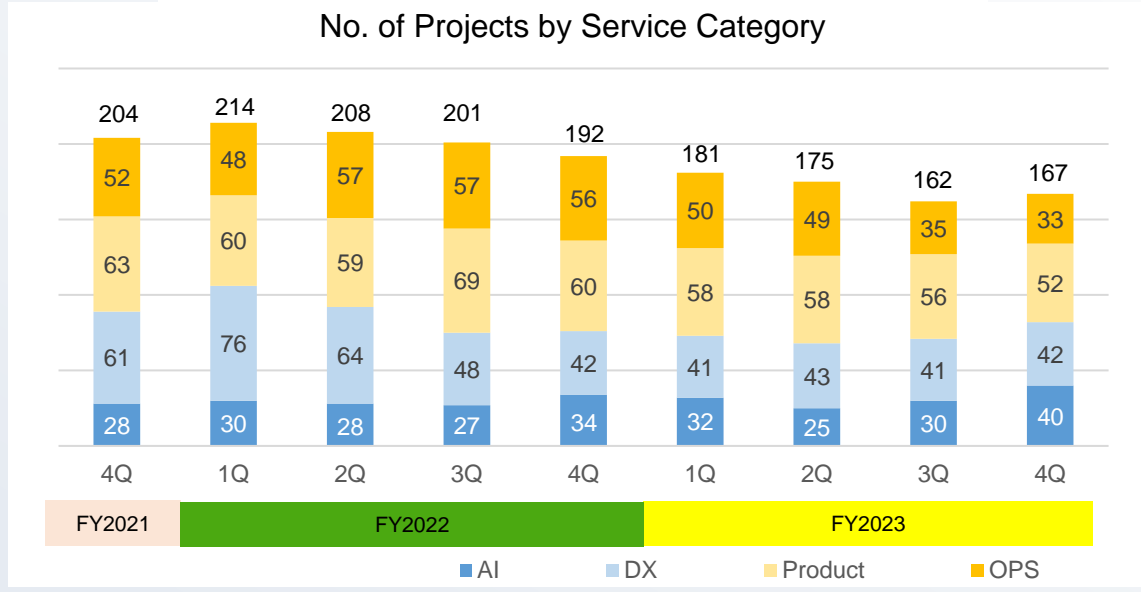
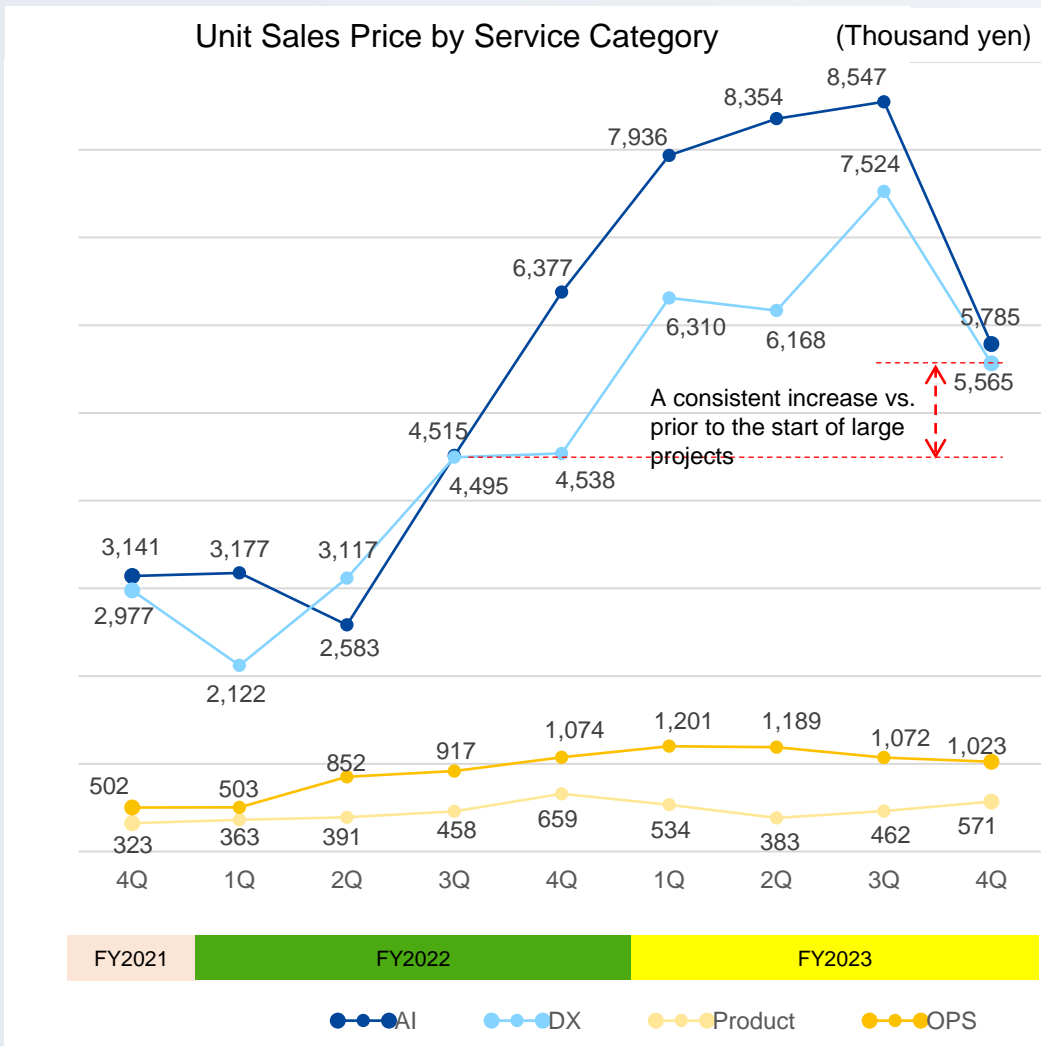
The number of clients decreased and sales per client increased as people were assigned to clients as selected by Headwaters, which was made possible by measures during the first half of FY2023 to increase the number of loyal clients. The number of clients increased with the growth in generative AI orders that started in the third quarter. Sales per client temporarily declined in FY2023 because major clients have not yet established large budgets for generative AI.





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

A contribution to higher unit sales prices of large AI and DX projects in the first three quarters. In the fourth quarter, the unit sales price decreased for AI due to more projects as the number of clients increased and for DX due to the end of large projects. There has been a steady increase since the third quarter of FY2022, which was prior to the start of the large projects.



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

## ■ Collaborations/Services

- ✓ Development of an Industrial Metaverse Utilization Support Solution by using advanced technologies of Siemens and NVIDIA
- ✓ Headwaters and rinna assist with Yamaha Motor's development of an AI robot
- ✓ Cooperation with AI development activities of SHIMIZU for assisting with structural examination tasks
- ✓ March-August 2023 demonstration test of edge AI for the DX of Lawson stores
- ✓ Industrial Metaverse Utilization Support Solution compatibility with the industrial high-performance PC of NVIDIA Omniverse and Siemens
- ✓ Support for the use of the Virtual Office generative AI of ITOCHU and the Microsoft Fabric and other data platforms
- ✓ Headwaters and Tokyo Metropolitan Board of Education held an app production workshop for students of Tokyo public schools

## ■ Others

- ✓ Disclosure of the English-language financial supplementary materials for the first half of FY2023 (Started disclosure of financial documents in English)
- ✓ Certified as an advanced partner for the support program of the Azure OpenAI Service Reference Architecture
- ✓ Certified as a Red Hat Ready Business Partner
- ✓ Started the Copilot Internalization Support Service to assist with the use in business operations of the Azure OpenAI service and Microsoft Copilot
- ✓ Notice of revisions to consolidated forecasts (upward revision of sales)



# 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 DATA IMPACT JOINT STOCK COMPANY established in June 2023.
- 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 3Q FY2023 and 4Q FY2023
  - **YoY:** A comparison between the cumulative figures of the previous fiscal year and the current fiscal year
    - Comparison between figures of FY2022 and those of FY2023
  - **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 4Q FY2022 and 4Q FY2023
- 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.
- As explained in Consolidated Financial Results for the Fiscal Year Ended December 31, 2023 (*kessan tanshin*), Headwaters has terminated OPS services, which is services for the operation and maintenance of IT systems. Therefore, Headwaters has three service categories in FY2024: AI Integration Services, DX Services and Product Services.