

Transcript of results briefing

Results of Operations for Fiscal Year Ended March 31, 2019, Business Strategies for Fiscal Year Ending March 31, 2020

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■ Introduction

Greetings, my name is Tooru Tanihara, and I am the president of SCSK Corporation. I would like to thank you for joining us today for this financial results briefing meeting.

■ Financial Result of FY2018 (slide1)

I first want to begin by explaining our full-year results of operations for fiscal year ended March 31, 2019. Our performance in the fiscal year under review was as follows:

Net sales: ¥358.6 billion (up 6.5% year on year)

Operating profit: ¥38.3 billion (up 10.9% year on year)

Operating margin: 10.7% (up 0.4 percentage point year on year)

Ordinary profit: ¥38.6 billion (up 6.5% year on year)

Net profit attributable to owners of parent: ¥27.8 billion (down 14.1% year on year)

Unfortunately, we failed to achieve the figure of ¥39.0 billion for operating profit that was announced as a revised forecast at the financial results briefing for the nine-month period ended December 31, 2018. Regardless though, we were able to post record-breaking figures for net sales and operating profit, both of which exceeded our initial forecasts, and the operating margin also hit a record high for a full-year margin.

Fukunaga will discuss our financial results in more detail later on. I, meanwhile, would like to explain the business trends in the fiscal year ended March 31, 2019, that lent to this performance.

In the fiscal year under review, the IT services market experienced robust system investment demand for the purposes of automation, labor saving, and productivity improvement to address labor shortfalls through means including the implementation of working style reforms. At the same time, an upward trend in strategic IT investment demand was sustained throughout the fiscal year for applications such as reinforcing strategic businesses and securing a competitive edge continued to rise among customer companies along with demand for transforming certain legacy systems into open systems and otherwise upgrading existing operational systems, which had been stagnant for quite some time.

Investment demand was driven by smart factory and other IoT-related investments by manufacturing industry customers and by distribution industry customer investments related to e-commerce and customer relationship management for the purposes of enhancing digital marketing initiatives.

This strong upward trend in IT investment demand remains firm even in the face of mounting uncertainty regarding the outlook for global political and economic conditions in light of trade friction between the United States and China and the issues surrounding the United Kingdom's withdrawal from the European Union.

Sluggish conditions were seen in certain sectors in reflection of a challenging operating environment arising from trends in IT investment among financial industry customers, among others.

Regardless, I do not see the current growth in IT investment demand as a passing trend. Rather, I believe that this growth will continue given our position in the medium- to long-term investment cycle.

The aforementioned business trends led to robust performance in the fourth quarter, as expected, and increases of more than 6% in net sales and over 10% in operating profit for the fiscal year ended March 31, 2019.

Our inability to achieve our revised full-year forecasts was mainly due to the early depreciation of automotive systems basic software and other business assets conducted at the end of the fiscal year under review in an amount of nearly ¥1.0 billion.

I will explain our future vision and other matters pertaining to the automotive software systems business later on.

With this, I conclude my overview of our full-year results of operations for fiscal year ended March 31, 2019.

■ Review of FY2018 (slide2)

Next, I would like to introduce some of the major management initiatives implemented in the fiscal year ended March 31, 2019.

In addition to our core strategies, which will be explained later on, we took steps to respond to the robust IT investment demand I just talked about. For example, we continued to utilize SmartEpisode Plus, our internal development standard, on a Companywide basis in order to improve production capabilities and productivity in conventional contract systems development services while also encouraging core partners to adopt this platform. In addition, we established a new base in Kumamoto Prefecture and otherwise worked to enhance our domestic nearshore development systems.

Furthermore, we implemented various management initiatives for laying the groundwork for future corporate growth in the fiscal year ending March 31, 2020, and beyond, although there were no direct contributions to performance in the fiscal year under review.

The first new core management initiative I would like to talk about is the establishment of SCSK's DX Center and its predecessor, the DX & Innovation Business Committee.

As I am sure you are aware, there has been a recent trend toward digital transformations in various industries as companies have come to recognize these transformations as prime opportunities for expanding their businesses. As digital transformations drive industry-wide ICT and borderless trends, we anticipate the advent of an era in which it will not be enough for companies to simply pursue digitization; they will need to become disruptors, transforming their businesses and business models to fundamentally alter their industries.

SCSK is committed to supporting customers in transforming their businesses in this manner. With our customer base of around 8,000 companies, we have accumulated extensive insight and a wealth of technologies related to customers' various business activities through our participation in the development of operational systems for numerous industrials and companies. Leveraging these assets, we will identify what customers will need for the transformation of their business model from a cross-industry perspective. In this undertaking, we will aspire to base our efforts on an understanding of the latest trends pertaining to cutting-edge technologies, solutions, and other innovations. The DX & Innovation Business Committee was established in November 2018 to aid in these efforts. Furthermore, we aim to create and commercialize new businesses in the digital transformation field as we work together with customers to support their transformations. This aspiration inspired us to

establish the DX Center in April 2019. SCSK's DX Center will step up direct coordination with the new DX Center of parent company Sumitomo Corporation to promote concrete digital transformation initiatives targeting the more than 900 affiliates of Sumitomo Corporation. At the same time, SCSK's DX Center will serve as a strategic organization for providing technological, research, and investigation support pertaining to cutting-edge technologies. This organization has already begun working toward the future commercialization of digital transformations.

I would now like to talk about the establishment of our DevOps Innovation Committee.

Established in November 2018, this committee is tasked with making the commercialization of digital transformations more feasible and creating new, distinctively SCSK services. Another duty of the DevOps Innovation Committee will be to develop services platforms for thoroughly entrenching high levels of quality and productivity in conventional systems of record operations.

We are committed to helping society overcome the so-called "2025 Digital Cliff" by working to realize development that does not entail as much effort, infrastructure that does not need a builder, and solutions application methods that do not require human hands.

In addition to these initiatives, we will seek to organically link the SCSK Group's management resources in order to better exercise the Group's overall capacities. To this end, we undertook tender offers to convert consolidated subsidiaries JIEC Co., Ltd., and VeriServe Corporation into wholly owned subsidiaries, as has been disclosed previously. The conversion of these two companies into wholly owned subsidiaries was completed on April 23, 2019. As indicated by these initiatives, the fiscal year ended March 31, 2019, was a year in which the SCSK Group banded together to go above and beyond in constructing foundations to support the exercise of its overall capacities.

As I have explained, in the fiscal year under review I led management initiatives eyeing the fiscal year ending March 31, 2020, with the goal of laying the groundwork for future business innovation while responding to the needs of the new era. These initiatives were advanced alongside steadfast efforts for bolstering production capabilities in existing businesses.

■ Shift to Service-Oriented Business (slide3)

Next, I would like to talk about the progress of our core strategies.

Let me begin by discussing the shift to service-oriented businesses, which is a major initiative for realizing earnings growth. Net sales from service-oriented businesses amounted to ¥74.0 billion in the fiscal year ended March 31, 2019, compared with ¥70.0 billion in the fiscal year ended March 31, 2018. We continued to feel the impacts of certain customers for business process outsourcing services reducing the scale of their large-scale contracts during the fiscal year ended March 31, 2018, and performance was also affected by the replacement of systems related to e-commerce outsourcing. These factors led to sales growth of less than 6% in service-oriented businesses. However, if the impacts of these factors are excluded, strong sales growth of 10% was witnessed in service-oriented businesses that provide SaaS-type core systems or that offer subscription-style services based on SCSK's intellectual properties. Looking ahead, the steady rise in demand from customers for labor-saving and other investments is anticipated to contribute to future business expansion and assured improvements in earnings capacity.

■ Mobility System Businesses (slide4)

In regard to our automotive software systems business, the development of advanced driver-assistance systems, automated driving, and other highly functional systems is progressing much faster than expected, as has been explained at previous results briefings. For this reason, the introduction of a standardized automotive software system development platform based on AUTOSAR will likely be

delayed by three to four years past our initial expectations.

In this manner, the current situation differs from our initial expectations, and management is therefore pressed with a need to navigate SCSK's business through difficult waters.

In other words, we must expect a sizable delay from our initial schedule for realizing profits from the development of scalable businesses.

Based on these business trends, we made the conservative management decision to perform the early depreciation of certain business assets at the end of the fiscal year under review, in an amount of nearly ¥1.0 billion.

As a result, the operating loss from the automotive software systems business amounted to more than ¥3.0 billion, exceeding our initial forecast of around ¥2.0 billion by the amount of said depreciation.

The performance of these businesses was regrettable, and, as has been stated, these businesses are not yet scalable. Still, we are seeing demand for company-specific development platforms, and we have been laying the foundations for our next step forward by supporting the creation of new development platforms for customers while utilizing SCSK's QINeS basic software product.

SCSK has won high praise from automobile manufacturers for the technological superiority of its basic software products and for the Company's overall technological prowess. For example, we have been called upon to provide technological support and basic software products for use in the core products of tier 1 manufacturers, such as in the next-generation brake system of ADVICS CO., LTD. Although it has required some time, occurrences such as this are signs indicating that SCSK will have a significant market position when it becomes capable of developing scalable business of a substantial size in the future.

I may be getting ahead of myself, but let me say that it will be difficult to achieve a position of profitability in the automotive software systems business in the fiscal year ending March 31, 2020, or within the next few years. Nevertheless, we have taken steps to build a strong business promotion system that integrates the automotive application development field (model-based development) and the platform field (QINeS) and to enhance business management by establishing the Mobility Systems Business Group as an independent organization effective April 1, 2019.

There have been no significant changes to our basic policy for developing this business to support the automotive industry with IT. As for our growth scenario for the AUTOSAR market, while the growth of this market may be lagging behind our anticipated timetable, the overall scale of the market is more or less in line with our projections. We are now looking to take our next step by executing the necessary business investments at the ideal timing.

This wraps up our discussion of business trends and management initiatives in the fiscal year ended March 31, 2019.

■ New Axis Business Strategy (slide5)

I would now like to discuss our full-year financial results forecast for the fiscal year ending March 31, 2020.

Before I detail our financial results forecasts, I want to talk about the management initiatives we have planned for the fiscal year ending March 31, 2020.

As I mentioned previously, in this era of rapid change, we are pressed to transform ourselves while working together with customers to transform their business models.

The fiscal year ending March 31, 2020, is the final year of the current medium-term management plan and is also the period leading up to the start of the next medium-term management plan. We are dedicated to completing the current medium-term management plan. At the same time, we aim to develop new businesses during the fiscal year ending March 31, 2020, grounded on the foundations we reinforced in the fiscal year ended March 31, 2019, in order to ensure we get off to a strong start in new businesses during the fiscal year ending March 31, 2021, which will mark the start of the next medium-term management plan. Simultaneously, we will work to build frameworks for accelerating the development of certain core businesses prior to the start of the fiscal year ending March 31, 2021.

I did not touch on this matter when explaining management initiatives, but we began participating in an accelerator program in the United States that is focused on IoT and FinTech in December 2018. In addition, we are investing in venture funds. These initiatives are part of our efforts to commercialize digital transformations and to create new businesses. Investments in new startup companies grants us access to both business opportunities and open innovation opportunities. We look to capitalize on these opportunities to develop new businesses.

SCSK is also undertaking new global business initiatives. In Asia, we have concluded a memorandum of understanding with FPT Corporation, Vietnam's largest ICT company, pertaining to a comprehensive partnership. In addition, we are preparing to set up local subsidiaries in Indonesia and Myanmar to serve as new bases in Asia. Please understand that we are currently readying ourselves to develop new digital transformation and business IT operations in the Asia-Pacific region.

We do not anticipate that these initiatives will immediately begin producing results in the fiscal year ending March 31, 2020. Nonetheless, we are committed to conducting the necessary business investments at the ideal timing in order to facilitate digital transformations in customers' businesses, develop new co-creation businesses together with customers, and explore possibilities for new businesses that link customers to foster inter-industry coordination.

Management initiatives in the fiscal year ending March 31, 2020, will, of course, include advancing the shift to service-oriented businesses and other core strategies. At the same time, we look to develop certain new core businesses ahead of schedule to prepare for the next medium-term management plan.

To this end, we will build new business investment frameworks and conduct the necessary investments to start developing new core businesses leading up to the next medium-term management plan. At the same time, we plan to take advantage of the IT investment trends seen among customers in conventional IT services businesses to ensure that we do not go astray in completing the current medium-term management plan.

■ Forecasts for FY2019 (slide6)

Our full-year financial results forecasts for the fiscal year ending March 31, 2020, are as follows:

Net sales: ¥380.0 billion (up 6.0% year on year)

Operating profit: ¥41.0 billion (up 6.8% year on year)

Net profit attributable to owners of parent: ¥28.0 billion (up 0.4% year on year)

These forecasts are based on the assumption that investments and expenses associated with the shift to service-oriented businesses, the early-stage development of the automotive software systems business, and the advancement of other core strategies in the fiscal year ending March 31, 2020, will be around the same level as in the fiscal year ended March 31, 2019. We also plan to conduct significant investments and incur substantial costs for new core management initiatives pertaining

primarily to digital transformations, global operations, and manufacturing innovations. These investments and expenses will offset the profit growth of around 10% anticipated in conventional systems development and systems maintenance and development operations. Operating profit will likely amount to between ¥43.0 billion and ¥44.0 billion when the increase in business investment-related expenses is excluded.

■ Business Performance Trends (slide7)

In closing, let me talk about shareholder returns. Out of consideration for the Company's financial position, anticipated improvements to earnings capacity, and our target dividend payout ratio of 40%, we plan to increase the full-year dividend by ¥10 year on year, to ¥110 per share, in order to enhance returns to shareholders.

Also, we will celebrate the 50th anniversary of SCSK's founding, when taking into account its predecessors, in the fiscal year ending March 31, 2020. In commemoration of this 50th anniversary, we plan to achieve by issuing an additional commemorative dividend of ¥20 per share, making for a total full-year dividend of ¥130 per share.

■ 50th Anniversary (slide8)

Looking back at our past, Computer Services Corporation, the predecessor of CSK Corporation, and Sumisho Computer Service Corporation, the predecessor of Sumisho Computer Systems Corporation, were established at approximately the same time, roughly 50 years ago, in Higashi-ku (now Kitahama, Chuo-ku), Osaka City. SCSK was born in 2011 through the union of these two companies and their long histories, after which we have proceeded to pursue true integration and create a new corporate culture.

Our people are our greatest asset. I believe that it is when our people are energized and motivated that we are able to help make people around the world happy and impressed with IT and to contribute to the realization of a safe and secure society.

All of our efforts, including our working style reforms, health and productivity management, and diversity initiatives, are linked to fostering such people.

■ External Recognition (slide9)

Furthermore, we were recently selected, for the fifth consecutive year, for inclusion in the Nadeshiko Brand selection sponsored by the Ministry of Economy, Trade and Industry. In addition, SCSK was one of the two companies chosen to be included in the Diversity Management Selection 100 Prime program, which recognizes companies selected for the New Diversity Management Selection 100 that have exhibited particular excellence. Driven by our aspirations and our pride for working at a leader in promoting diversity management, everyone at SCSK will unite under our corporate philosophy—"Create our Future of Dreams"—to respond to this rapidly changing era of spontaneous business transformations, which are being seen currently and will only accelerate in the future.

With this, I conclude my portion of today's presentation. I would like to ask for your ongoing support and understanding of the Company.

Thank you.