Transcript of results briefing

Consolidated Financial Results for Fiscal Year Ended March 2019 and Financial Forecasts for Fiscal Year Ending March 2020

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■ Introduction

Greetings, I am Tetsuya Fukunaga, director of SCSK Corporation.

■ Contents (slide1)

I would like to begin by discussing our performance in the fiscal year ended March 31, 2019, and our forecasts for the fiscal year ending March 31, 2020, based on the framework provided by the materials that have been distributed.

■ Consolidated Performance Highlight (slide2)

Please turn to slide 2. Here you will see highlights of our consolidated performance in the fiscal year under review.

As mentioned by President Tanihara, we were able to reach new record highs for net sales and operating profit with our seventh consecutive year increases in these items since the merger. We also set a new record for the operating margin of 10.7%.

This strong performance was a reflection of the favorable operating environment and of strong trends in IT investment by customers. Specifically, businesses catering to the manufacturing industry and the distribution industry continued to experience impressive performance that exceeded our initial expectations throughout the fiscal year ended March 31, 2019. Meanwhile, businesses targeting the financial industry, which were displaying lackluster performance due to the rebound from previously recorded large-scale projects, saw the commencement of projects for major customers. As a result, overall performance was in line with our revised forecasts for full-year performance.

The upward trend in IT investment demand continued throughout the fiscal year. In addition to strategic investment demand for boosting competitiveness, we saw the emergence of demand for investing in upgrades to various operational systems. Some of these investments were aimed at implementing labor-saving measures and addressing software and hardware that will be reaching the ends of their service periods in the next few years while others were for transforming legacy systems, primarily in the manufacturing and financial industries, into open systems.

We were also able to effectively capitalize on the robust IT investment demand by securing the

production capabilities needed to respond to the higher demand in systems development businesses through increased productivity and the use of subcontractors. Together with the expansion of service-oriented businesses, these efforts enabled us to achieve sales growth of 6.5%.
Operating profit failed to reach the higher forecast we had set for this item. A year-on-year increase in profit was achieved due to sales growth and the benefits of higher productivity and profitability. However, we fell short of the revised forecast as a result of the early depreciation of automotive systems basic software and other business assets conducted at the end of the fiscal year under review, which amounted to nearly ¥1.0 billion.

The operating margin was higher than anticipated with a year-on-year increase of 0.4 percentage point. This increase was attributable to the benefits of higher productivity and profitability stemming from enhanced internal development frameworks and more efficient use of subcontractors.

Despite uncertainty with regard to global political and economic trends, current business conditions remain strong centered on the manufacturing and distribution industries. As shown on this slide, consolidated order backlog was up 17.4% year on year.

■ Consolidated Statements of Income (slide3)
Turning now to slide 3, here is a summary of SCSK’s consolidated statements of income.

Here, we will be looking primarily at profit attributable to owners of parent, which was down 14.1% year on year. This decrease was a result of the large rebound from the gain on the transference of QUO CARD Co., Ltd., recorded in the fiscal year ended March 31, 2018, which amounted to ¥10.7 billion. If the impact of this factor is excluded, profit attributable to owners of parent saw strong growth of more than 30%.
This concludes my summary of our consolidated statements of income.

■ Sales Comparison by Sales Segment (slide4)
Moving on, I would now like to more closely examine earning figures for the fiscal year under review through our usual presentation materials. On slide 4, you will see a comparison of sales by segment.

Sales in the systems development segment grew 9.1% year on year. This outcome was a result of the previously mentioned robust IT investment demand from manufacturing industry and distribution industry customers. The benefits of this demand compensated for the impacts of the rebound from the conclusion of certain large-scale projects for financial institutions in the previous fiscal year.

Sales in the system maintenance and operation and services segment were up 3.9% year on year.

Factors contributing to this increase included the expansion of system maintenance operations fueled by impressive performance in systems development operations and steady growth in service-oriented businesses based on SCSK intellectual properties, such as the provision of SaaS services for core systems and core application maintenance services. However, overall sales growth was dampened by the heavy impact of sales declines in service-oriented businesses that are extensions of conventional businesses. These declines were the product of certain customers for business process outsourcing (BPO) services reducing the scale of their large-scale contracts during the fiscal year ended March 31, 2018, and the replacement of e-commerce outsourcing-related systems. The end result was a low overall sales growth rate.

System sales increased 10.7% year on year because of strong trends in sales of network IT equipment to certain communications industry customers and sales of hardware for leasing industry customers and for academic research institutions.

As the prepaid card business was sold in December 2017, the performance of this business is not included in the performance for the fiscal year ended March 31, 2019, and will not be included in performance going forward.

■ Incoming Orders and Backlog (slide5)

Looking at slide 5, I would like to discuss the order trends seen in each sales segment.

Incoming orders and order backlog showed double-digit growth on a consolidated basis on the back of strong growth in incoming orders and backlog for systems development, for system maintenance and operation and services, and for system sales.

The systems development segment posted double-digit growth in incoming orders and backlog following favorable business trends.

Strategic IT investment demand was strong among manufacturing industry and distribution industry customers, and particularly robust demand was seen in relation to operational system upgrades, most notably those pertaining to enterprise resource planning, production management, and customer relationship management in the manufacturing industry. As for financial industry customers, there was a solid flow of project for insurance and leasing industry customers. These factors contributed to an increase in order backlog of 33.5%.

In regard to maintenance and operation services, both incoming orders and order backlog showed substantial year-on-year increases. IT service demand from distribution industry customers aimed at enhancing digital marketing measures and from automakers for product and software verification services held firm throughout the fiscal year. There was thus a robust deal flow for service-oriented businesses and data center-related cloud services.

Double-digit growth was achieved in incoming orders and order backlog for systems sales. This outcome was in part a result of sales of network products to certain communications industry customers.

■ Sales Comparison by Customer Industry (slide6)

Turning to slide 6, I will now explain sales and other trends by customer industry.

Sales to manufacturers rose by 7.3%. Once again, sales to manufacturers were impacted by certain customers for BPO services reducing the scale of their previously large-scale contracts. However, an overall increase was achieved as a result of growth in conventional automotive embedded software development and other systems development demand and higher product verification service demand from automobile manufacturers as well as increased operational system upgrade demand among electronic components manufacturers and construction industry customers.

Sales to distributors increased 7.9% year on year. This increase was attributable to e-commerce and customer relationship management development and outsourcing projects aimed at enhancing digital marketing measures as well as ongoing growth in the number of orders from our parent company.

Sales to financial institutions were up 6.4% year on year. Sales in this category were heavily impacted by the conclusion of large-scale orders from banks and securities firms that had contributed to sales in the previous fiscal year. This factor, however, was outweighed by the benefits of the commencement of certain new projects and the increased scale of existing development projects for insurance industry customers as well as higher system upgrade demand from leasing industry customers.

Sales to the communications and transportation industries were up 9.9% year on year. Contributors to this increase included higher network product sales to certain communications industry customers as well as a solid flow of development and system sales orders from transportation industry customers.

Sales to power and gas providers rose 59.4% due to robust systems development demand in relation to facility upgrades, an area where demand has been limited since the Great East Japan Earthquake. This demand was primarily seen among major players in the power and gas sector.

■ External Sales and Segment Profit by Reportable Segment (slide7)

We will now move on to slide 7, which shows a breakdown of the performance I just discussed by reportable segment.

The trends in the performance of reportable segments mirrored the trends seen by customer industry. Specifically, beneficial business conditions contributed to strong growth in sales and profit in five of our seven reportable segments.

Today, I will only be explaining trends in those two remaining segments in which segment profit was down or unchanged year on year.

The Distribution / Media Systems Business Group posted an increase in sales following brisk orders from customers in various industries engaged in consumer businesses and higher system sales to certain media industry customers. However, profit was down due to a rise in business investment expenses and diminished profitability in systems sales.

Segment profit was relatively unchanged year on year in the Business Solutions Group due to the previously mentioned early depreciation of automotive systems basic software and other business assets.

With this, I would like to wrap up my explanation of performance by reportable segment.

■ Operating Profit Analysis (slide8)
Up until now, I have focused on net sales in our discussion of performance in the fiscal year ended March 31, 2019. Looking now at slide 8, I would like to offer a supplementary explanation of the factors that influenced operating profit. I mentioned some of the factors contributing to increased profit in the fiscal year under review at the beginning of this presentation. To reiterate, we owe our profit growth to higher sales on the back of favorable business trends together with the benefits of productivity and profitability improvements. I would now like to take this opportunity to elaborate on other factors that influenced operating profit.

First of all, let me talk about unprofitable projects. In the previous fiscal year, losses from unprofitable projects amounted to roughly ¥0.8 billion. The amount of losses from unprofitable projects recorded during the fiscal year ended March 31, 2019, was around ¥0.7 billion, making for a year-on-year decrease of ¥0.1 billion. This reduction in loss buoyed operating profit.

Next, I would like to talk about specific detractors from operating profit that have been explained previously. The change in the period for calculating bonuses that pushed up operating profit by approximately ¥1.0 billion in the fiscal year ended March 31, 2018, resulted in the recording of roughly ¥0.5 billion in bonus payments scheduled for the fourth quarter of this fiscal year being delayed until the fiscal year ended March 31, 2019. In addition, the rebound from the transference of QUO CARD reduced operating profit by around ¥0.2 billion while business investment-related expenses of approximately ¥0.5 billion were recorded.

In addition to these detractors, we applied an accounting treatment to perform the early depreciation of automotive systems basic software and other business assets, which amounted to nearly ¥1.0 billion, as explained earlier.

The net impact of all of the specific factors I just explained had the effect of decreasing operating profit by ¥3.1 billion.

Adding this amount to the increase of roughly ¥3.8 billion in operating profit, we will arrive at the figure of almost ¥7.0 billion, which represents operating profit excluding the aforementioned factors.

A trial calculation excluding those factors among the profit detractors I explained that were one-time occurrences produces a figure of ¥1.4 billion for the increase in operating profit that was attributable to improvements to overall business profitability. Accordingly, the remaining amount of roughly ¥5.5 billion in the operating profit increase can be accredited to higher sales.

The operating margin was influenced by the specific profit detractors I have explained as well as by higher profitability that was a product of our various efforts and the favorable operating environment. As a result, the operating margin rose 0.4 percentage point from 10.3% in the previous fiscal year to 10.7% in the fiscal year under review, as mentioned at the start of this presentation.
This ends my supplementary explanation of the factors that influenced operating profit.

■ Consolidated Balance Sheets (slide9)
Moving on from the consolidated statements of income, we will now discuss our consolidated

balance sheet. Please turn to slide 9.

In September 2018, the Company issued ¥10.0 billion worth of straight bonds with a maturity period of five years.

Meanwhile, operating cash flows showed a smooth increase in conjunction with operating profit growth. We were thus able to maintain sufficient cash to secure financial stability despite the outflow of ¥19.0 billion that occurred prior to March 31, 2019, in relation to tender offers for converting two listed subsidiaries into wholly owned subsidiaries.

Capital surplus decreased by ¥12.0 billion due to the acquisition of additional shares of stock in these subsidiaries. Nonetheless, we managed to maintain a sound financial position with an equity ratio of 61.4%.

■ Financial Forecast for FY2019 (slide10)

This ends my explanation of the consolidated performance in the fiscal year ended March 31, 2019. Looking at slide 10, I will now touch on our forecasts for performance in the fiscal year ending March 31, 2020.

It is difficult to form an accurate outlook for IT investment trends by customers in the fiscal year ending March 31, 2020. Factors behind this uncertainty include the rising sense of opaqueness surrounding global political and economic conditions, which itself stems from trade issues. Nevertheless, we continue to observe robust IT investment demand among manufacturing and distribution industry customers. In addition, a substantial increase in order backlogs was seen at the end of the fiscal year under review. Based on these factors, it could be said that a stronger start was cut in the fiscal year ending March 31, 2020, than in the fiscal year ended March 31, 2019.

In the fiscal year ending March 31, 2020, SCSK is committed to capturing the strong demand from customers and translating it into business earnings while continuing to invest in service-oriented businesses and the automotive software systems business. Through these investments, we aim to accomplish the core strategies of the medium-term management plan in its final year.

Also, as was explained by President Tanihara, we will implement new management initiatives aimed at ensuring corporate growth during the period of the new medium-term management plan, which will be a time of rapid change. These initiatives will include making substantial investments in reforming business structures pertaining to digital transformations, global operations, manufacturing innovations, and improved employee training programs. Combining these investments with those related to existing strategies will result in total investments of between ¥2.0 billion and ¥3.0 billion.

The forecast of ¥41.0 billion for operating profit is in the lower end of the strategic target for operating profit of between ¥40.0 billion and ¥45.0 billion set forth by the current medium-term management plan, as has been explained in the fiscal year under review. Regardless, we are devoted to advancing measures for the period after the current medium-term management plan ahead of schedule to the greatest degree possible in order to get SCK on the track toward rapid, ongoing growth as soon as we can. We will look to accomplish this objective by taking advantage of the beneficial business environment and developing new core businesses.

When excluding rise in business investment expenses associated with these efforts, we anticipate operating profit of between ¥43.0 billion and ¥44.0 billion. Accordingly, operating profit will grow by around 10% year on year from ¥39.3 billion in the fiscal year ended March 31, 2019, when excluding the impacts of the early depreciation of automotive systems basic software and other business assets.

This concludes my explanation of our full-year forecasts for consolidated performance.

■ Dividend Forecasts (slide11)

The last topic I would like to touch upon is SCSK's policies for shareholder returns, including the year-end dividend for the fiscal year ended March 31, 2019, and our dividend forecast for the fiscal year ending March 31, 2020.

Based on a comprehensive assessment of factors including business performance, our financial position, and the dividend payout ratio, we have chosen to adhere to our initial dividend forecast by issuing a full-year dividend of ¥100 per share in the fiscal year ended March 31, 2019. This amount represents an increase of ¥5 over the previous year's dividend of ¥95 per share.

As for the fiscal year ending March 31, 2020, we will target a dividend payout ratio of 40% of our earnings forecast in accordance with the basic policy for this ratio that has been explained as part of the Company's policies for capital measures and dividends. Taking into account this policy, we intend to issue a full-year dividend of ¥110 per share, a year-on-year increase of ¥10 per share.

Furthermore, we plan to issue a commemorative dividend of ¥20 per share to commemorate the 50th anniversary of SCSK's founding. Taking into account the Company's financial position and projected profitability for the fiscal year ending March 31, 2020, and considering the fact that we will celebrate the 50th anniversary of SCSK's founding in October 2019, we decided to issue this commemorative dividend to express our gratitude to our shareholders for their support thus far and to enhance shareholder returns.

Combined with the ordinary dividend, this will make for a total full-year dividend of ¥130 per share, an increase of ¥30 per share.

We aim to increase shareholder returns while fully utilizing the Company's continually growing operating cash flows to conduct business investments to support future growth. Accordingly, we plan to raise dividends in line with projected performance improvements.

With this, I would like to conclude my portion of today's presentation.

SCSK looks forward to your advice and encouragement going forward.

We greatly appreciate you taking the time to join us today.