Transcript of results briefing
Consolidated Financial Results for 1st Quarter of Fiscal Year Ending March 2022

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■ Contents (slide 1)

Greetings, my name is Yasuhiko Oka.
So now, let me start today's presentation along the agenda on page 1.

■ Summary of Financial Results (PL/Incoming Orders/Backlog) (slide 2)

Please look at slide 2, which displays consolidated performance highlights.

As shown on this slide, in the three-month period ended June 30, 2022, SCSK Corporation posted net sales of ¥104.4 billion, an increase of 5.2% year on year; operating profit of ¥9.9 billion, a decrease of 8.7%; and an operating profit margin of 9.5%, down 1.5 percentage points.
In this manner, profit was down, despite the increase in sales.
However, we did achieve a massive increase in orders, with incoming orders up 14.2%, to ¥99.7 billion, and order backlog rising 13.9%, to ¥172.3 billion.

The outlook for the Japanese economy going forward remains opaque, due to factors such as the high prices of materials and commodities stemming from rapid yen depreciation and the situation in the Ukraine as well as the persistence of the COVID-19 pandemic.

SCSK caters to the IT services industry, which is currently witnessing ongoing growth in IT investment among our customers. As if to underscore this fact, the software investment projections of the Bank of Japan were revised in its July 2022 *Short-Term Economic Survey of Enterprises in Japan.*

In terms of how this situation relates to SCSK, there has been no change to trends at the segment level explained at the financial results briefing for the fiscal year ended March 31, 2022, when talking about our performance forecasts for the fiscal year ending March 31, 2023. Accordingly, we maintain our outlook that performance will be steady going forward.

As I mentioned a moment ago, profit was down, despite the increase in sales, in the three-month period ended June 30, 2022. I would thus like to take this opportunity to discuss why profit was down on the Companywide level, before looking at factors affecting us at the segment level.

■ Operating Profit Analysis (slide 3)

Slide 3 shows factors affecting operating profit.

As you can see, the increase in net sales buoyed operating profit by ¥1.3 billion. Meanwhile, cost of sales and selling, general and administrative (SG&A) expenses reduced operating profit by more than ¥2.0 billion. The end result was a net decrease in operating profit of ¥0.9 billion.

Factors behind the fluctuation in the gross profit margin included cost factors incorporated into our initial forecasts, like depreciation and operating expenses on structures for newly built and completed data centers and amortization expenses on the proprietary ProActiveC4 enterprise resource planning (ERP) package released in the previous fiscal year. In addition, we incurred investment-related costs that were projected at the beginning of the fiscal year, including upfront costs equipment for the call center augmentation measures commenced in the previous fiscal year for the purpose of expanding our call center business. We also saw our electricity bill increase by ¥0.1 billion due to energy market trends. These factors detracted from gross profit and thus resulted in a reduced gross profit margin.

SG&A expenses, meanwhile, were up. One factor behind this rise was an increase of ¥0.5 billion associated with business investments conducted in line with the core strategies of our medium-term management plan. These included R&D investments and expenses of proof of concept for Commercialization of DX as well as human resource investments for recruitment and human resource development. We also incurred higher personnel costs, due to promotions and wage increases, as well as higher marketing expenses, which were primarily directed toward broadcasting commercials for improving SCSK's brand value. In addition, there was an increase in expenses for sales activities, which were resumed following a hiatus in response to the COVID-19 pandemic.

These factors caused the total for cost of sales and SG&A expenses to rise by more than ¥2.0 billion. However, if you exclude the jump in our electricity bill, then this increase in costs was in line with our initial projections. Accordingly, it could be said that the decline in operating profit was a result our inability to achieve the sales growth necessary for absorbing the rise in expenses, as would be expected amid the concentrated upfront investment costs in the three-month period ended June 30, 2022.

■ Net Sales and Backlog Analysis (slide 4)

Let us now turn to slide 4, which shows a breakdown of factors affecting net sales and order backlog by sales segment.

I just mentioned that the decrease in operating profit in the three-month period ended June 30, 2022, was a result of insufficient growth in net sales. I would like elaborate on this statement while looking at the net sales graph on the top half of this slide.

Net sales were up ¥5.2 billion year on year. More than 40% of this increase can be attributed to the Packaged Software / Hardware Sales segment. Conversely, it might seem as though the Systems Development segment posted weak sales growth in the three-month period ended June 30, 2022, with a rise of only ¥0.7 billion, or 1.8%. However, we feel that this outcome is less a result of lackluster performance and more because factors like the increasing size and length of projects and the timing of contracts are making it take longer after orders are received before the associated sales are recorded.

Conversely, year-on-year increases of more than ¥6.0 billion were seen in the order backlogs of all three sales segments, as shown in the order backlog graph on the bottom half of this slide.

In the Systems Development segment, the aforementioned delay in the timing of sales recording can be viewed in how order backlog was up by 19% in the three-month period ended June 30, 2022, compared with the increase of more than 10% in incoming orders. We are thus poised to benefit from a large backlog of orders going forward.

Accordingly, we expect massive improvements in net sales and operating profit in the second quarter, despite the decrease in profit seen regardless of higher sales in the first quarter. These improvements will be further supported by the solid operating environment.

■ Business Performance by Reportable Segment (slide 5)

I would next like to talk about performance by segment in the three-month period ended June 30, 2022, with slide 5.

On this slide, you will find two graphs detailing segment performance. The graph on the top shows net sales while the graph on the bottom provides information on operating profit and the operating profit margin.

We will begin by looking at the Industrial IT Business segment on the lefthand side of the slide, and then work to the right from there to discuss the factors affecting net sales and operating profit in all segments.

In the Industrial IT Business segment, net sales were up ¥2.3 billion, or 7.4%, year on year due to increased strategic investment demand from the automotive industry as well as growth in sales of systems redevelopment services for the distribution industry and of verification services. Operating profit, meanwhile, was down ¥0.1 billion, due in part to the absence of the highly profit projects that contributed to profit in the previous equivalent period. Other factors behind this decline included investment costs for Commercialization of DX, increased R&D expenses associated with verification services, and depreciation expenses incurred due to the replacement of some assets.

In the Financial IT Business segment, net sales were practically unchanged year on year. This outcome can be attributed to the absence of previously recorded large-scale projects, specifically development projects for the life and non-life insurance industries and large-scale licenses sales to the securities industries. These detractors counterbalanced the benefits of increases sales of systems development services utilizing international calculation system packages to the banking industry and of DevOps services to the credit and leasing industries. Operating profit in this segment was impacted by the same factors as net sales, but showed a slight decrease in the end as a result of upfront costs associated with the launch of new services.

The IT Business Solutions segments, which handles our ERP, contact center, and business process outsourcing businesses, posted an increase in net sales, but a decrease in operating income.

Net sales in this segment were up ¥0.4 billion, or 3.0%, year on year as increases in SAP core systems development and ProActive development projects for service and machinery industry customers outweighed the decreases from the contraction of e-commerce fulfillment center service orders.

The segment's operating profit, meanwhile, decreased ¥0.1 billion due to an increase in amortization expenses associated with ProActiveC4 and the upfront recording of expenses for the expansion our contact center business base network commenced in the previous fiscal year.

Moving on, the IT Platform Solutions segment conducts sales of hardware and software products while also supplying maintenance support.

This segment posted increases of ¥2.1 billion, or 11.5%, and ¥0.5 billion, or 21.1%, in net sales and operating profit, respectively. These increases were largely a product of strong trends in network equipment sales orders from the communications industry, a factor that offset the negative impacts of the absence of previously recorded hardware sales to academic research institutions.

Next, the IT Management Service segment develops our data center business while supplying cloud infrastructure and managed services.

Net sales in this segment were on par with the previous equivalent period as the decrease in sales of managed services to communications industry and financial industry customers were counteracted by the increase in data center business sales to the service industry. Conversely, operating profit was down ¥0.6 billion in this segment due to increased depreciation and operating expenses associated with a data center completed in April 2022, a rise electricity bills as a result of energy market conditions, and the absence of the highly profitable projects that buoyed performance in the three-month period ended June 30, 2021.

Lastly, the Others segment comprises SCSK Minori Solutions Corporation, Gran Manibus Co., LTD., and SCSK Nearshore Systems Corporation.

This segment posted net sales that were relatively unchanged year on year. Operating profit, meanwhile, was down ¥0.2 billion following increased costs for reinforcing the operating foundations of SCSK Minori Solutions and higher recruitment costs for bolstering the regional base network of SCSK Nearshore Systems.

■ Business Performance by Reportable Segment (slide 6)

Moving on to slide 6, we will look next at trends in incoming orders and order backlog by segment. The graph on the top half of the slide shows incoming orders while the slide on the bottom displays order backlog.

Looking first at the Industrial IT Business segment, this segment posted year-on-year increases of ¥5.8 billion and ¥7.4 billion in incoming orders and order backlog, respectively. These increases in orders were a result of growth in core systems development demand from the distribution industry, strategic investment demand from the automotive industry, systems development demand from the gas industry, and verification service orders.

Incoming orders in the Financial IT Business segment decreased ¥0.8 billion, despite the acquisition of large-scale hardware and software sales orders from the credit and leasing industries, due to the absence of large-scale disaster recovery projects received from securities industry customers in the three-month period from ended June 30, 2021. Order backlog, meanwhile, was up ¥2.9 billion year on year as a result of orders received in relation to the overseas branches of banks in the previous fiscal year, multiple international calculation system orders, and DevOps orders from the credit and leasing industries.

In the IT Business Solutions segment, incoming orders were up ¥0.2 billion year on year. The increase in orders for ERP and data management projects, which was supported by robust digital transformation demand from a wide range of industries, outweighed the impacts of detractors like contract service business contract cancelations and downsizing among certain customers. Order backlog in this segment rose ¥1.9 billion, despite the cancelation and downsizing of contracts by some customers in the contact center business, as a result of orders for ERP and data management projects.

The IT Platform Solutions saw incoming orders increase by ¥6.8 billion year on year due higher network equipment orders for the communications industry as well as large-scale hardware orders for the automotive and service industries. These same factors caused order backlog to increase by ¥7.6 billion in this segment.

Incoming orders in the IT Management Service segment decreased ¥0.2 billion due to a delay in the timing of contract conclusions following the receipt of advance orders at the end of the previous fiscal year for certain contracts that are renewed annually. Order backlog, meanwhile, increased ¥1.4 billion as a result of data center business orders received in the wake of cloud-related demand.

Looking last at the Others segment, incoming orders were up by approximately ¥0.5 billion year on year, as the renewal of certain recurring service contracts was delayed until the fiscal year ended March 31, 2022. Order backlog, meanwhile, was down ¥0.2 billion due to reductions in orders for hardware and software.

This concludes my explanation of segment performance.

■ Business Performance by Reportable Segment Analysis (slide 7 to 8)

Slides 7 and 8 offer a summary of the factors affecting segment performance that I just explained. I will not be offering any additional comments on these slides.

■ Topics (slide 9)

Having concluded our discussion on business performance, I would now like to talk about two recent business topics. Let us take a look at slide 9.

As you know, one of the core strategies of our medium-term management plan is Commercialization of DX. I would thus like to present two examples of efforts which commercialized in 2022.

First, we launched our Efukuri Asset Building Lounge platform service for building assets through one’s work in April 2022. A news release detailing this event was issued in February 2022, in Japanese only.

Amid the increased interest in social welfare programs as well as in saving for old age, there is a need for products and services that track customer circumstances and needs and can accommodate the life and financial plans of individuals.

Efukuri is a platform for supplying information, products, and services that respond to the needs of companies to support the asset building efforts of employees and otherwise provide welfare benefits that help employees live richer lives in addition to the needs of employees seeking to formulate their own life plans that include old age through precise financial simulations.

A major characteristic of this platform is that it distinguishes itself from standard personal finance simulation services by providing detailed simulations that reflect the human resource systems of specific companies. Efukuri is thereby able to provide information, products, and services that have a meaningful impact on the life events of specific employees. One such service is recommendations of external services based on user preferences as determined based on the past actions.

On the bottom-lefthand side of this slide, you will see a diagram indicating the revenue model of Efukuri. Rather than charging a subscription fee, Efukuri's primary revenue stream is anticipated to be the advertisement fees received from the companies that provide the various external services offered to employees through the platform.

As illustrated on the bottom-righthand side of this slide, Efukuri was developed through co-creation with Mitsui Sumitomo Insurance Co., Ltd., a partner with a similar commercialization concept. The operation of the platform itself will be performed by SCSK, while Mitsui Sumitomo Insurance will supply a similar platform under its own brand through an OEM-like scheme. Accordingly, sales through the platform will be grown through a two-pronged approach targeting the customers of both Mitsui Sumitomo Insurance and SCSK.

At the same time, we will look to coordinate Efukuri with SCSK's existing Japanese turnkey asset management platform (TAMP) business to go beyond simple simulations to provide sales of financial products. The government administration led by Prime Minister Fumio Kishida has announced a plan to double income from assets. This plan is expected to create a favorable environment for Efukuri, and we are committed to capitalizing on this opportunity to the grow this service.

■ Topics (slide 10)

We will now turn to slide 10.

Our next topic is much more recent; a news release on this topic was just issued on July 20, 2022. SCSK has concluded a business alliance agreement with FPT Software Company Limited regarding the overseas sales of its QINeS BSW AUTOSAR-compliant basic automotive software product.

FPT Software Company is a global technology and IT service provider headquartered in Vietnam. With operations in 26 countries, this company employees around 22,000 individuals and generates annual revenues in excess of U.S.$500 million. As a pioneer in the digital transformation field, FPT Software Company offers a lineup of world-leading services related to smart factories, digital platforms, robotic process automation, artificial intelligence, Internet of Things, cloud servers, augmented reality, virtual reality, and business process outsourcing.

Moreover, in October 2018, SCSK signed a memorandum with FPT Corporation, parent company of FPT Software Company, regarding a comprehensive partnership in the global IT services business.

SCSK began selling QINeS BSW in October 2015, at which point the primary customers for this product were domestic automobile and automotive part manufacturers. In recent years, there has been push for high-performance control in next-generation automobiles. This trend has been driving increased adoption of the AUTOSAR standard for automotive software around the world. FPT Software Company has a robust track record of dealing with AUTOSAR. Based on this track record, SCSK chose to conclude a business alliance agreement with FPT Software Company regarding overseas sales of QINeS BSW. Through this alliance, SCSK will supply QINeS BSW to FPT Software Company with the aim of growing sales of this product in unexplored overseas markets.

In conjunction with our business alliance with FPT Software Company, we look to strengthen our product lineup by incorporating input from overseas automobile and automotive part manufacturers regarding their desires for QINeS BSW and the related tools. We also hope to expand outside of the basic software field to cater to all types of automotive electronic control units, including those for vehicle operating systems.

Slides 11 and beyond constitute an appendix containing the information on net sales by sales segment and customer industry that we have provided at past financial results briefings. Please feel free to use this appendix as a reference.

This concludes my presentation. SCSK looks forward to your ongoing support and encouragement.

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