SCSK Corporation

Consolidated Financial Results for 2nd Quarter of Fiscal Year Ending March 2023

Q&A Session Summary

Date： October 31, 2022 3:30-4:30 PM

Speakers: Takaaki Touma, Representative Director President and Chief Operating Officer
Yasuhiko Oka, Managing Executive Officer

Q. Could you please offer a numerical figure for sales of ERP products?

A. Sales of ERP products rose from ¥12.1 billion in the six-month period ended September 30, 2021, to ¥14.8 billion in the six-month period ended September 30, 2022. We have been witnessing strong sales of ERP products against a backdrop of wide-ranging core system upgrade and introduction needs seen amid the shift toward cloud services and digital transformation with relation to customers’ ERP systems. This situation is creating a favorable environment for SCSK’s ProActive service package, and we have been receiving high levels of inquiries as well as multiple large-scale orders for this offering. In fact, we have already logged more than 50 orders for C4, the latest version of ProActive, in this fiscal year.

Q. SCSK’s rivals have been seeing strong growth in sales of ERP products from mid-scale companies and listed conglomerates. Could you please offer some details with regard to the competition affecting ProActive and the industry as a whole?

A. Competitors have also been achieving impressive performance. Nonetheless, SCSK has succeeded in receiving a substantial amount of inquiries following the launch of our system as a service (SaaS) and cloud options for ProActive through the new C4 version. Going forward, we will bolster the relative frameworks, including those pertaining to partners, and ramp up marketing to develop a business so that we can keep up with the competition.

Q. Incoming orders in the Systems Development segment were up 5% year on year in the six-month period ended September 30, 2022. This is a solid increase, but it feels like this segment should have seen a larger increase given the prior talk of the strength of its pipeline. Do you have any details that you can offer with regard to the outlook for orders in this segment in the second half of the fiscal year or its pipeline?

A. The order pipeline for the Systems Development segment was estimated to be nearly ¥60.0 billion on September 30, 2022, an increase from the figure of approximately ¥38.0 billion a year earlier. Around half of this pipeline is projects that are already underway. Accordingly, we anticipate increases in orders when these projects are in need of additional engineering or development services. The reason why incoming orders only grew by around 5% is that many of these projects, particularly large-scale ERP projects, are still in their initial or front-end phases. Some of these projects are expected to enter into subsequent phases in the third quarter, which should contribute to higher orders.

Q. To what extent did performance in the six-month period ended September 30, 2022, fall short of internal forecasts?
A. Performance in the six-month period ended September 30, 2022, was more or less within the scope projected by internal forecasts.

Q. The gross profit margin seems to have improved to a degree that is greater than expected in the second quarter. What type of level do you view to be appropriate for the second half of the fiscal year ending March 31, 2023?
A. In the second quarter, we achieved an improved sales mix due to massive growth in sales of high-margin systems development projects, and multiple projects finished the receiving inspection, further boosting profit margins. In the second half of the fiscal year, there is a need for us to secure a gross profit margin of 26.9%, the same as in the second quarter. Fortunately, we feel that it is possible to maintain such a margin given the current sales mix and order backlog. Selling, general and administrative (SG&A) expenses were initially expected to decline in the second quarter, when compared to the first quarter. However, we actually saw an increase of around ¥0.6 billion. If SG&A expenses continue to grow at this pace, they may surpass the disclosed forecast increase of ¥1.0 billion. Accordingly, limiting the increase in expenses will be a major target of management decision-making going forward.

Q. Given the current order backlog as well as the forecasts for incoming orders and sales, it would seem that strong progress is being made toward the full-year forecast for net sales of ¥450.0 billion. Is this assumption correct?
A. We have analyzed order backlog, inquiry trends, and the likelihoods of inquiries translating to sales based on reports of forecasts for the second half of the fiscal year from business groups and subsidiaries. This analysis has led us to believe that performance will be near the initially projected figure of ¥450.0 billion for net sales. It was for this reason that we chose not to revise our performance forecast. Going into a little more detail on our outlook with regard to specific sales segments, order backlog is down in the Packaged Software / Hardware Sales segment. However, this is because between ¥4.0 billion and ¥5.0 billion in orders expected to contribute to sales in the fiscal year ending March 31, 2023, was recorded ahead of schedule and thus included in the order backlog in the fiscal year ended March 31, 2022. Taking into account this situation, we do not view the order backlog in the Packaged Software / Hardware Sales segment as having actually decreased. The forecasts of business segments also suggest that sales of systems will be up year on year in the second half of the fiscal year. As for the Systems Development segment, we anticipate sales growth as the multiple large-scale ERP projects currently underway will be moving past the initial phase and into the development phase in the second half of the fiscal year and beyond.

Q. Why did SG&A expenses increase to a greater-than-expected degree? You spoke of plans to reduce SG&A expenses by ¥1.0 billion. Specifically, in what areas will you seek to curb costs?
A. One of the reasons behind the greater-than-expected increase in SG&A expenses was business investments. Specifically, progress in investments was faster than we had anticipated in the six-month period ended September 30, 2022, in comparison

to the initially anticipated increase in business investment expenses. The rise in recruitment costs also exceeded our projects. As far as plans to reduce SG&A expenses by ¥1.0 billion, although we have been proactive in our business investment activities, we will be practicing more austerity when making management decisions related to individual investments going forward. We thereby aim to make sure that these investments will be beneficial during the period of the next medium-term management plan. This will be primary way in which we will seek to limit costs.

Q. It was mentioned that revisions to prices would be necessary in order to improve the gross profit margin. Overall, what type of trends are being seen in orders? I have heard from other companies that sales cycles are growing longer, hurdle rates are rising, and these conditions are creating difficult conditions.

A. Yen depreciation is leading to a type of polarization among customers, but SCSK has been seeing favorable trends in orders from customers. For example, we expect to receive multiple large-scale orders in the second half of the fiscal year and in the year ending March 31, 2024. We would thus consider the order trends favorable if there are no occurrences such as the projects postponement. As for revisions to prices, initiatives by frontline organizations kicked off at the start of the fiscal year, and these efforts began creating results in the second quarter. Prices have long been stagnant in the IT services industry, and this is an issue that will need to be addressed on an industry-wide basis. Price revisions will continue to be an area of focus going forward. Please understand that we have been making headway in transferring costs to selling prices.

Q. You stated that selection and concentration would be one of the policies of the next medium-term management plan. Will the scale of businesses deemphasized through this selection and concentration process be particularly large?

A. Each business of SCSK employs thousands of people. A major focus of the next medium-term management plan will be increasing the market value of these businesses and of the engineers we employ. I mentioned our intent to carefully assess individual businesses to shift from a client-oriented approach toward a market-oriented approach. Our overarching policy for this process is to focus on industry-agnostic areas where we can leverage SCSK's intellectual properties. Concrete figures with this regard will be presented when we explain the next medium-term management plan.

Q. I understand that sales growth in the Systems Development segment was less than expected during the first quarter. Did sales in the second quarter compensate for this slow start?

A. Sales growth was slower than normal in the first quarter as a result of the longer lead times required for orders to be translated to sales. Although we were unable to fully compensate for this slow start in the second quarter, we were able to produce significant sales growth in the Systems Development segment by advancing large-scale and other projects. We expect sales from such projects to be recorded during this fiscal year.

Q. If the portion of net sales represented by Packaged Software/Hardware Sales were to rise in the second half of the fiscal year, it might create a sales mix that will make it difficult to increase both net sales and profit margins. Is this assessment correct?

A. While we expect that Packaged Software/Hardware Sales will increase in the second half of the fiscal year, this increase is anticipated to be outpaced by growth in systems development sales. We will need to be diligent if we hope to achieve these increases in sales, but I feel confident in our ability to achieve a second-half gross profit margin that is similar to the level of 26.9% seen in the second quarter.

Q. I understand that SG&A expenses and other investment costs are on the rise. Has SCSK adopted a more aggressive stance toward investing in future growth since Takaaki Touma took up the position of president? I suspect that a substantial amount of investment will be needed to achieve the target of net sales of ¥100.0 billion in the mobility business. What are your policies with regard to investment costs?

A. Our resources are limited. Accordingly, our basic policy will be to conduct ongoing investments in areas where we can anticipate monetization and business growth in line with our expectations. These investments will be carried out while carefully monitoring the relevant conditions. This basic policy also applies to the mobility business. Vigilance will be imperative in determining if our efforts in this business will be able to produce results and contribute to business growth. One such effort was the establishment of SCSK Automotive H&S Corporation, a development subsidiary for this business, on November 1, 2022. If the assessments we conduct indicate that net sales of ¥100.0 billion might be within reach in the mobility business in 2030, we intend to carry out the investments necessary to accomplish this target. The decision-making process going forward will emphasis a balance between business growth and investment. We do not plan to simply ramp up investments without thinking.

END

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