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

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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 from Apr. to Sep. (PL/Incoming Orders/Backlog) (slide 2)

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

As shown on this slide, in the six-month period ended September 30, 2022, SCSK Corporation posted net sales of ¥213.0 billion, an increase of 6.5% year on year; operating profit of ¥22.5 billion, a decrease of 0.3%; and profit attributable to owners of parent of ¥16.2 billion, an increase of 2.8%.

In addition, incoming orders were up 5.1%, to ¥204.8 billion, and order backlog rose 6.8%, to ¥168.8 billion.

Operating profit decreased as result of the economic and market conditions discussed by President Touma earlier. Nevertheless, we posted steady performance in the second quarter, and six-month performance almost fully recovered to the level of the previous equivalent period. I would like to talk about our performance in the second quarter of the fiscal year ending March 31, 2023, with the following slide.

■ Summary of Financial Results from Jul. to Sep. (PL/Incoming Orders/Backlog) (slide 3)

Please turn to slide 3.

In the second quarter of the fiscal year ending March 31, 2023, SCSK Corporation recorded net sales of ¥108.6 billion, an increase of 7.8% year on year; operating profit of ¥12.5 billion, an increase of 7.5%; and profit attributable to owners of parent of ¥9.2 billion, an increase of 14.1%. Operating profit declined by ¥0.9 billion in the first quarter, mainly as a result of upfront business investment costs and weak growth in systems development sales. In the second quarter, however, we were able to achieve higher sales while securing an increase in operating profit of nearly ¥0.9 billion by absorbing costs through sales growth and improved profit margins due to rises in relatively high-margin systems development sales.

The reason why the increase in second-quarter profit attributable to owners of parent was so large is that we recorded valuation gains on investment securities, resulting in financial revenues that surpassed those seen in the previous equivalent period.

Incoming orders were down 2.3%, or ¥2.4 billion, in the second quarter. This outcome is a result of a decrease of ¥7.1 billion in the Packaged Software / Hardware Sales segment as a result of the absence of network equipment orders from communications industry customers that were recorded ahead of schedule as single batch orders in the second quarter of the previous fiscal year. Orders were up in the Systems Development and System Maintenance and Operation / Services segments.

■ Net Sales Analysis (slide 4)

We will look next at slide 4.

This slide shows year-on-year growth rates in sales by sales segment on a quarterly basis. The graph on the top displays growth in the first quarter while the graph on the bottom details second-quarter sales growth.

On a by-segment basis, a particularly noteworthy increase was seen in the sales growth rate for the Systems Development segment, which rose from 1.8% in the first quarter to 7.3% in the second quarter. Sales growth in this segment was sluggish in the first quarter as a result of a concentration of several large-scale projects in their initial phases. The steady sales growth rate seen in the second quarter was thus a result of the backlog of such systems development orders accumulated in the first quarter being translated into sales as the associated development projects moved forward.

Performance in the System Maintenance and Operation / Services segment, meanwhile, does not fluctuate to any significant degree throughout the fiscal year. Accordingly, consistent sales growth was seen in the first and second quarters. The steady performance in this segment was founded on demand for data center and verification services.

The second quarter sales growth rate of the Packaged Software / Hardware Sales segment may appear a bit weak when compared to the double-digit growth rate seen in first quarter, but this does not change the fact that this segment is continuing to post steady growth rates, with year-on-year growth of 8.6% in the second quarter.

■ Operating Profit Analysis (slide 5)

Next, slide 5 shows factors affecting operating profit.

The boost to profit from higher sales is as displayed on this slide. Factors behind the fluctuation in the gross profit margin included cost factors continuing from the first quarter, like depreciation and operating expenses associated with data centers and other structures, as well as equipment augmentation expenses for expanding our contact center business, amortization expenses on our proprietary ProActive C4 ERP (enterprise resource planning) package, and other business investment expenses. Other factors included higher electricity bills stemming from energy market conditions and unprofitable projects occurring in the second quarter. These factors pushed down gross profit. Nevertheless, we secured a gross profit margin of 25.9% in the six-month period ended September 30, 2022, in line with the previous equivalent period, thanks to improvements witnessed in the second quarter as a result of increases to profitability centered on systems development and a more beneficial sales mix.

SG&A expenses, meanwhile, were up. One factor behind this rise was an increase in expenses associated with business investments conducted in line with the core strategies of our medium-term management plan. We also incurred higher personnel costs and recruiting expenses, 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.

As a result, second-quarter operating profit allowing us to achieve performance in line with the previous equivalent period on a six-month basis, despite having to recover from the decrease in profit from the first quarter.

■ Incoming Orders/Backlog Analysis (slide 6)

Let us now turn to slide 6, which shows a breakdown of factors affecting incoming orders and order backlog by sales segment in the six-month period ended September 30, 2022.

Incoming orders and order backlog both rose by approximately ¥10.0 billion year on year, showing respective increases of 5.1% and 6.8%. We believe that conditions are positive, especially the growth in order backlog going to contribute the performance in the second half of the fiscal year and beyond.

A particularly large increase of 16.0% was seen in the order backlog of the Systems Development segment, which accompanied by growth in incoming orders of 7.8%. Orders in this segment feature relatively high profit margins. Accordingly, the increase in this backlog, as well as in inquiries not yet reflected in order backlog, promise to contribute to performance in the second half of the fiscal year.

The System Maintenance and Operation / Services segment is not subject to large fluctuations in orders. Nevertheless, this segment continues to make contributions to steady sales with stable growth in incoming orders and order backlog as well as its large outstanding order backlog.

As for the Packaged Software / Hardware Sales segment, incoming orders only increased by 1.5% while order backlog was down ¥1.2 billion. These results might seem a bit negative, but this outcome was merely a result of the absence of network equipment orders from communications industry customers that were recorded ahead of schedule as single batch orders in the second quarter of the fiscal year ended March 31, 2022, that I touched upon during the performance overview. This factor is not expected to impact performance in the second half of the fiscal year.

■ Business Performance by Reportable Segment (Sales/Operating Profit/Operating Profit Margin) (slide 7)

I would next like to talk about performance by segment in the six-month period ended September 30, 2022, with slide 7.

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 ¥5.9 billion, or 9.3%, year on year due to increased strategic investment demand from automotive, electrical machinery, and other industries as well as growth in sales of core systems redevelopment services for the distribution industry, other development projects, and verification services. Operating profit rose ¥0.2 billion, or 2.2%, recovering from the decline seen in the first quarter as the aforementioned increase in net sales compensated for higher business investment costs, depreciation expenses associated with asset replacement, and losses from unprofitable projects.

In the Financial IT Business segment, net sales rose ¥0.9 billion, or 3.3%, year on year. This increase can be attributed to 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. These factors counterbalanced the absence of previously recorded large-scale development projects for the life and non-life insurance industries and licenses sales to the securities industries. Similar to the Industrial IT Business segment, operating profit in the Financial IT Business segment was up ¥0.3 billion, or 8.2%, as the higher sales outweighed the impacts of upfront costs for launching new businesses.

The IT Business Solutions segments posted increases in net sales and operating profit in the six-month period ended September 30, 2022, an improvement from the first quarter, when operating profit decreased despite a rise in net sales.

Net sales in this segment were up due to increases from the growth of our call center and business process outsourcing (BPO) businesses and our success in incorporating demand for developing core systems with ERP frameworks from service, distribution, manufacturing, and various other industries. This segment was thus able to grow sales despite the cancelation and reduction of e-commerce fulfillment center service orders. The segment’s operating profit rose following growth in high-margin ERP-related sales, which outset the increase in amortization expenses associated with ProActive C4 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 posted increases in net sales and operating profit. These increases were largely a product of steady trends in network equipment sales orders from the communications industry and network security product sales to the distribution industry, factors that offset the negative impacts of the absence of previously recorded hardware sales to academic research institutions.

Next, the IT Management Service segment. Net sales in this segment were on par with the previous equivalent period as the decreases in sales of managed services to communications industry and platform development orders from the distribution industry were counteracted by the increase in data center business sales. Conversely, operating profit was down 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 previous equivalent period.

Lastly, the Others segment posted net sales that were relatively unchanged year on year, decreasing just ¥0.1 billion. Operating profit, meanwhile, was down ¥0.4 billion because of 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 (Incoming Orders/Backlog) (slide 8)

Moving on to slide 8, 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 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 and systems investment demand in strategic fields from industries including the automotive industry, other manufacturing industries, the transportation industry, and the gas industry. Higher verification service orders were another factor behind these increases.

Incoming orders in the Financial IT Business segment were relatively unchanged year on year, despite the acquisition of platform upgrade orders from the banking industry and fraudulent transaction detection system 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 ended June 30, 2021. Order backlog, meanwhile, was up as a result of the fraudulent transaction detection system orders from the credit and leasing industries that also buoyed incoming orders as well as DevOps orders from the credit and leasing industries received in the third quarter of the fiscal year ended March 31, 2022.

In the IT Business Solutions segment, incoming orders and order backlog both increased attributable to growth in ERP-related orders against a backdrop of robust digital transformation demand in a myriad of industries. This factor offset the impacts of detractors like contract service business contract cancelations and reductions among certain customers.

The IT Platform Solutions saw incoming orders decreased because of the absence of network equipment orders from communications industry customers recorded ahead of schedule as single batch orders in the previous equivalent period outweighed the benefits of higher hardware sales orders from the service and manufacturing industries. Order backlog was affected by similar factors, declining as the backlog of ahead-of-schedule orders was converted to sales.

Incoming orders in the IT Management Service segment were relatively unchanged year on year. The increase in orders for managed services, data center services, and other recurring services was counterbalanced by the absence of previously recorded platform development orders for financial, service, and other industries. Order backlog, meanwhile, increased 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 year on year, as the renewal of certain recurring service contracts had been delayed until the period under review. Order backlog, meanwhile, was unchanged year on year.

This concludes my explanation of segment performance.

■ Business Performance by Reportable Segment Analysis (slide 9 to 10)

Slides 9 and 10 offer a summary of the factors affecting segment performance that I just explained. I will not be offering any additional comments on these slides.

■ Full-year Consolidated Financial Forecasts/ Dividends Forecasts (slide 11)

Lastly, I will explain SCSK's full-year performance and dividend forecasts. Now look at slide 11.

As I have stated, in the six-month period ended September 30, 2022, we fell only just a little short of posting a year-on-year increase in operating profit thanks to the recovery seen centered on high-margin systems development sales in the second quarter. Nevertheless, I feel that this performance puts us essentially where we had initially planned to be at this point.

In the second half of the fiscal year, we anticipate robust IT investment demand among customers. However, this will not change the need for significant effort on the part of SCSK. We have chosen not to revise our initial forecasts based on consideration of current business trends in light of the outstanding order backlog and inquiries we have been seeing centered on systems development. We also recognize the need for greater efforts to secure gross profit and limit selling, general and administrative expenses. Appropriate and timely action will thus be taken by management to accomplish these objectives.

Based on these considerations, our full-year performance forecasts remain generally unchanged.

Moreover, we intend to adhere to our initial plan of issuing an interim dividend of ¥26 per share, which will represent an increase of ¥2.67 from the previous fiscal year. There has currently been no change to our initial forecast for the year-end dividend.

This concludes my portion of today's presentation. SCSK looks forward to your ongoing support and encouragement.

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