SCSK Corporation

Consolidated Financial Results for 3rd Quarter of Fiscal Year Ending March 2023

Q&A Session Summary

Date: January 31, 2023 3:30-4:30 PM

Speakers: Yasuhiko Oka, Managing Executive Officer

Q. Loss-making projects were the major factors behind the deterioration in the gross margin due to the failure of the sales growth rate to reach 10% in the third quarter? Please provide details such as the factors behind loss-making projects and the timing of cutover.

A. In Q3, there were two loss-making projects, one in the Industrial IT Business segment and the other was in the Financial IT Business segment, with an impact of approximately ¥500 million. A common cause is a lack of integration of recognition in upstream processes. Since both projects will have a cut-over in the next fiscal year, we will continue its development work while working to improve quality. At the present time, the necessary accounting procedures have been completed, and we do not expect this to have any impact in the future.

The loss-making projects this time were difficult and complex. By resolving this project, we expect to further reinforce the development standard model and increase profitability for the future.

In Q3, sales increased 7.0% YoY, and although this was not a very bad figure, it was slightly downward from the assumption of a sales increase of nearly 10%. One of the factors behind this was the loss of opportunities as resources are devoted to dealing with this loss-making project. On the other hand, the gross profit margin for Q3 was 26.4%, but even including the impact of loss-making projects of about ¥500 million, the gross profit margin for Systems Development segment has improved YoY, and if the impact of loss-making projects is removed, the gross profit margin and productivity on a company-wide basis also steadily improved YoY.

Q. In the Q4 forecast, which is derived by subtracting the results from the revised earnings forecast through Q3, the gross profit margin will be at a record high level. What is the reason behind the improved results in Q4?

A. Looking at the results by sales category, in Systems Development segment, gross profit margin improved YoY, and we think the same improvement can be realized in Q4. In System Maintenance and Operation / Services segment, the gross profit margin declined in the first half of this fiscal year due to higher costs associated with the completion of data centers, depreciation costs for facilities in BPO business, and the inability to pass on higher electricity charges to prices. However, it can be expected that the gross profit margin will improve in the second half this fiscal year, particularly in Q4, in line with the accumulation of sales and the pass-through of costs. In Packaged Software / Hardware Sales segment, compared to Q3, the product mix that is scheduled to be booked in Q4 is an improvement factor in gross profit margin.

Q. Are the full-year forecasts set at the beginning of the fiscal year too strong as a factor behind the downward revision? What is different from the initial forecast? Also, while the operating profit forecast for Q4 is a very strong figure, I would like to know the background behind the preparation of the numerical plan.

A. The full-year plan announced at the beginning of the fiscal year stretches the order backlog at the end of the period at the beginning of the fiscal year, the trends in orders received in the pipeline, and the forecasts and plannings for each business division. Furthermore, based on the market conditions at the time, I do not think it was too strong. In this context, there are two reasons why the forecast for net sales was lowered by ¥5 billion this time. First, in Q1, Systems Development segment sales were sluggish at 1.8%, and even in Q2 and Q3 thereafter, the sluggishness in Q1 was not recovered. The second point was the opportunity loss due to the devaluation of loss-making projects. These two points are the factors behind the downward revision. As for Q4 forecasts, from the order backlog at the end of December, while verifying the contribution to sales, expected period of orders, and period sales, the company drafted the forecasts by interviewing each business division with its forecasts. In respect of SG&A expenses, while depreciable property tax for fixed assets will be generated in Q4, other than that, we think the effects of the reduction will be realized, and we will further strengthen management and thoroughly curtail it. Accordingly, please understand that these figures are estimates based on these assumptions.

Q. Is the worsening of business confidence a factor behind the revision of sales results?

A. In Q1, the slow start was made in the initial phase, but sales are steadily increasing in Q2 and Q3, and there is no sense of deterioration in business confidence. In Q3, sales did not increase by double digits due to the emergence of loss-making projects.

Q. I think there was an explanation that the full-year SG&A forecast, which was revised upward by ¥1 billion, will be kept down when the first half financial results are announced. Was there any change?

A. In the course of business execution, management of cost reduction is carried out, and the necessity of individual cost is judged carefully. On the other hand, we should not decide to forgo business investment and lose the opportunity for the business opportunity we hold.

Q. Please tell us about the factors behind the increase in SG&A expenses in cumulative Q3, such as business investment-related expenses.

A. Expenses related to business investment were expected to increase annually by ¥2 billion at the biggening of the year. In Q3, the expenses increased ¥1.6 billion, but they are expected to be within this category. Other than that, personnel expenses of 1.6 billion and CM and other operating expenses of 1.3 billion were the major factors behind this increase. Looking ahead to Q4, we do not plan to implement CM implemented through Q3 in Q4, and we will actively control operating expenses and other expenses as a whole.

Q. Please tell us about the status of ERP businesses.

A. Both SAP, Oracle, ProActive remained firm, and ERP totaled ¥22.6 billion in the current fiscal year, up from ¥18.5 billion in the previous fiscal year in cumulative Q3. Within ProActive, the portion of C4 sales accounted for by sales is limited due to the large portion of sales accounted for by the cloud version based on usage after its introduction, but the number of companies has grown significantly, and the introduction is proceeding smoothly.

Q. What is the situation regarding the impact of soaring electricity prices?

A. We are reviewing the portion that it was unable to pass on until the first half of the fiscal year to be burdened through negotiations with customers. Under the previous contract, we incurred an increase in the cost of electricity charges, but from the second half onward, we are reviewing the contract in a way that customers can bear the increase in electricity charges.

Q. What do you feel about the issues toward the medium-term management plan starting in the next fiscal year?

A. As the ideal way of future IT vendors, the image of sustainable growth was realized by realizing the solution of the social problem by IT technique, and the present Medium-Term Management Plan was decided. Meanwhile, over the past three years, COVID-19 has accelerated social change, and there have been major social changes. Digital technologies have become more inevitable, and the roles and positions of IT vendors have changed.

By shifting the value it provides and its business model to the next generation through the selection and concentration of businesses and customers, which the president Touma explained at the beginning of the fiscal year, and by implementing this strategy, we aim to achieve an operating income margin of 15% in the next medium-term management plan.

In the future, I would like to explain at the end of the fiscal year, taking into account ESG's response and initiatives to realize sustainability management.

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