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

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■ Contents (slide 1)

Greetings, my name is Yasuhiko Oka. Thank you for joining us today for our briefing on the performance of SCSK Corporation in the nine-month period ended December 31, 2022.

So now, let me start today's presentation along the agenda on page 1.

■ Summary of Financial Results from Apr. to Dec. (PL/Incoming Orders/Backlog) (slide 2)

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

As shown on this slide, in the nine-month period ended December 31, 2022, SCSK Corporation posted net sales of ¥323.0 billion, an increase of 6.7% year on year; operating profit of ¥35.1 billion, an increase of 1.2%; and profit attributable to owners of parent of ¥25.4 billion, an increase of 5.1%.

In addition, incoming orders were up 2.4%, to ¥305.1 billion, and order backlog rose 0.4%, to ¥159.2 billion.

Although the financial results for the third quarter of the fiscal year ending March 31, 2023 did not improve as much as those for the second quarter, from the first half of the fiscal year, which was a slight decline, the cumulative third quarter saw an increase in profits.

I would like to talk about our performance in the third 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 third quarter of the fiscal year ending March 31, 2023, SCSK Corporation recorded net sales of ¥109.9 billion, an increase of 7.0% year on year; operating profit of ¥12.6 billion, an increase of 3.9%; and profit attributable to owners of parent of ¥9.2 billion, an increase of 9.4%. The 3.9% increase in operating profit could be seen as a bit lacking in comparison to the 7.0% growth in net sales. However, this was due to the impact of loss-making projects in the Industrial IT Business segment and the Financial IT Business segment, as well as the product mix in the Packaged Software / Hardware Sales segment, resulting in an increase in operating profit in the first half of the single digits.

Conversely, we saw a large increase in profit attributable to owners of parent. The reason why this increase was so large is that we recorded gains on sales of and valuation gains on investment securities.

Incoming orders were down 2.8%, or ¥2.9 billion, in the third quarter. This outcome was a result of a decrease of ¥8.2 billion in orders in the Packaged Software / Hardware Sales segment due to the absence of previously recorded sales of large-scale storage equipment as well as the absence of network equipment orders from communications industry customers that were recorded ahead of schedule as single batch orders in the third quarter of the previous fiscal year. This decrease in orders outweighed the benefits of the continuously firm growth of orders for the Systems Development segment and the System Maintenance and Operation / Services segment as well as the increase in sales of network security equipment seen when excluding certain customers affected by one-time factors.

Order backlog, meanwhile, was up 0.4%, to ¥159.2 billion, due to the same factors that affected incoming orders. By sales segment, strong growth was seen in the backlog of the Systems Development segment and the System Maintenance and Operation / Services segment.

■ 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.

Beginning with the Systems Development segment, this segment posted a growth rate of more than 8% in the third quarter, supported by the recovery trend that emerged in the second quarter. The first quarter saw a concentration of multiple large-scale projects in their initial phases, but their prolonged lead times led to low sales growth in the first quarter. As these projects progressed, however, they eventually culminated in the recovery trend. The strong third-quarter sales growth rate can thus be seen as a reflection of the project progress being translated to sales growth.

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 third quarter. The strong performance in this segment was founded on demand for business process outsourcing (BPO) and verification services.

The sales growth rate of the Packaged Software / Hardware Sales segment in the third quarter was relatively unchanged from the previous equivalent period. This outcome was a result of the decrease in sales of network equipment to communications industry customers being counteracted by the increase in sales of network security equipment seen when excluding certain customers.

■ Operating Profit Analysis (slide 5)

Next, slide 5 shows factors affecting operating profit.

As I mentioned previously, we achieved an increase in operating profit in the nine-month period December 31, 2022.

As you can see on this slide, while we are steadily building up profits of ¥5.3 billion through higher sales, we have explained the impact of increased depreciation/amortization expenses due to the completion of our data center and the launch of ProActiveC4, as well as the steep rise in electricity charges since the beginning of the fiscal year. In the third quarter, the impact of loss-making projects resulted in a slight decrease of approximately ¥300 million in terms of fluctuations in the gross margin.

SG&A expenses, meanwhile, were up due to factors similar to those that increased expenses in the six-month period ended September 31, 2022. One such factor was an increase in expenses associated with strategic business investments conducted in line with the core strategies of our Medium-Term Management Plan. We also incurred higher personnel expenses related to personnel increases and promotions, and recruitment-related expenses to strengthen human resources. We also had 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, operating profit in the nine-month period ended December 31, 2022, grew 1.2%, to ¥35.1 billion.

■ 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 nine-month period ended December 31, 2022.

A particularly large increase of 15.0% was seen in the order backlog of the Systems Development segment, which was accompanied by growth in incoming orders of 7.7%. Orders in this segment feature relatively high profit margins. Accordingly, these increases are expected to contribute to performance in the fourth quarter.

The System Maintenance and Operation / Services segment, meanwhile, is anticipated to make strong contributions to sales through its stable growth in incoming orders and order backlog.

As for the Packaged Software / Hardware Sales segment, incoming orders decreased by 11.4% while order backlog was down 27.2%. These decreases can be attributed to the absence of previously recorded sales of large-scale storage equipment as well as of network equipment orders from communications industry customers that were recorded ahead of schedule as single batch orders in the third quarter of the previous fiscal year. Nevertheless, we expect a year-on-year increase in sales in the fourth quarter when considering that the backlog of orders for network security equipment is growing, when excluding certain customers impacted by one-time factors, and when looking at the present level of backlog, despite the current decrease resulted from the absence of prior orders.

■ 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 nine-month period ended December 31, 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.

Despite the first-quarter decline in profit, the Industrial IT Business segment posted double-digit growth in both net sales and operating profit in the third quarter, continuing the upward trend in profit that began in the second quarter. Net sales were up due to increased strategic investment demand from automotive, electrical machinery, and other manufacturing 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 as the increase in net sales compensated for higher business investment costs and losses from loss-making projects.

In the Financial IT Business segment, net sales rose due in part to the benefits of increased sales of systems development services utilizing international calculation system packages to the banking industry and of DevOps and fraud transaction detection systems development 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. Strong growth was seen in operating profit in the Financial IT Business segment as the amount of loss-making projects incurred in the third quarter, was less than the amount of underperforming and loss-making projects recorded in the previous equivalent period.

The IT Business Solutions segment achieved double-digit growth in net sales and operating profit after posting an increase in sales but a decrease in profit in the first quarter followed by increases in sales and profit beginning in the second quarter. Net sales in this segment were up due to increases from the growth of our call center and BPO businesses and our success in incorporating demand for developing core systems with enterprise resource planning (ERP) frameworks from the manufacturing and service industries. The segment's operating profit rose following growth in high-margin ERP-related sales, which outset the increase in amortization expenses associated with ProActiveC4.

Moving on, the IT Platform Solutions segment posted increases in net sales and operating profit in the nine-month period ended December 31, 2022. These increases were largely a product of strong trends in network equipment sales to 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. In the third quarter, operating profit was down due to sluggish sales growth coupled with the changes in the sales mix and the absence of sales of network equipment to the communications industry recorded in the previous equivalent period.

Next, the IT Management Service segment achieved an increase in net sales as the decreases in sales of management 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 due to increased depreciation and operating expenses associated with a data center completed in April 2022 along with a rise electricity bills. Earnings improved in the third quarter, as revisions to customers' contracts helped us transfer the impacts of the higher electricity bills to product selling prices.

Lastly, the Others segment posted net sales that were relatively unchanged year on year. Operating profit, meanwhile, was down because of costs for reinforcing the operating foundations of SCSK Minori Solutions Corporation and higher recruitment costs for bolstering the regional base network of SCSK Nearshore Systems Corporation.

■ 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 both incoming orders and order backlog. These increases in orders were a result of growth in core systems development demand from the distribution industry and systems investment demand from a wide range of industries including the automotive industry, other manufacturing industries, the communications industry, and the transportation industry. Higher verification service orders were another factor behind these increases.

Incoming orders in the Financial IT Business segment were down year on year, despite the acquisition of platform upgrade orders from the banking industry and fraud transaction detection system orders from the credit and leasing industries, due to the absence of large-scale disaster recovery projects from securities industry customers and large-scale systems development orders from life and non-life insurance companies received in the previous equivalent period. Order backlog, meanwhile, was up as a result of the receipt of fraud transaction detection system orders from the credit and leasing industries.

Incoming orders in IT Business Solutions segment increased due to the expansion of ERP construction projects against the backdrop of strong demand for DX in a wide range of industries, although there were downward factors such as cancellations and contraction of some customers in the contact center business. In terms of order backlog, while there was an increase in system development projects, there was also a decrease due to the impact of the cancellation and reduction of some customers in the contact center business and the timing of order contracts.

Despite the increase in network equipment orders from distribution industry customers, the IT Platform Solutions segment saw a massive decrease in incoming orders. This was because of the absence of network equipment orders from communications industry customers recorded ahead of schedule as single batch orders in the second and third quarters of the prior fiscal year and of previously recorded hardware sales orders from academic research institutions. Order backlog declined as the backlog of network equipment orders primarily from communications industry customers was converted to sales.

Incoming orders in the IT Management Service segment decreased year on year due to the absence of previously recorded platform development and upgrade orders from customers in financial, service, and other industries. Another factor behind this decrease was a change in the segment to which service orders from the distribution industry are attributed. Order backlog, meanwhile, increased following a rise in data center business orders stimulated by growth cloud-related demand.

Looking last at the Others segment, incoming orders rose as the renewal of certain recurring service contracts had been delayed until the period under review. In addition, we saw an increase in systems development orders from the service and financial industries. Except for the contract delays, order backlog was affected by the same factors as incoming orders, resulting in year-on-year growth in order backlog.

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)

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

Demand for investing in IT at client companies continues to grow due to an increase in large-scale projects, such as projects to rebuild core systems and demand for digitization and cloud computing, against the backdrop of customers' own DX strategies. We also believe that the business climate in the fourth quarter of this fiscal year is solid.

Accordingly, with regard to the outlook for the fourth quarter of the fiscal year under review, we expect to expand sales in the Industrial IT Business segment on the back of the steady backlog of orders for system development for various industries, particularly the manufacturing industry, including the automotive industry, and verification services. IT Business Solutions segment is expected to expand into ERP and BPO businesses. In addition, we expect to expand sales of systems mainly in IT Platform Solutions segment, including projects for which we have already concluded contracts, and overall we expect sales to increase by nearly double digits.

In terms of gross profit, in addition to an increase in profits from higher sales, profitability and productivity, including system development, are on an improving trend, and we expect a commensurate increase in profits due to the accumulation of gross profit through year-end settlements. In SG&A expenses, we will further promote cost management amid an upward trend, including a recovery in sales activities, soaring prices, and business investment.

However, even considering the cumulative results in the fourth quarter, we were unable to recover the impact of the delayed start-up due to factors such as the extension of lead times for large-scale system-development projects in the first quarter and the opportunity-loss effects resulting from the allocation of resources to unprofitable PRJ. In terms of costs, in addition to business expansion investments already factored in and strategic business investments in the Medium-Term Management Plan, we judged that it would be difficult to recover the forecasts we set at the beginning of the fiscal year considering factors such as the fact that the costs of investments in human resources and other investments in anticipation of future business growth exceeded our initial expectations. Accordingly, we lowered the full-year forecasts by ¥5 billion to ¥445 billion and revised downward the forecasts for operating profit by ¥2 billion to ¥52 billion.

Profit attributable to owners of parent was ¥37.5 billion, a downward revision of ¥500 million. This was due to the recording of gains on sales and valuation of investment securities held as a positive factor, and the amount of decrease was smaller than that of operating profit.

The dividend per share forecast has been left unchanged because of comprehensive consideration of our dividend policy of continuously strengthening shareholder returns considering this revised forecast.

■ Topics (slide 12)

Lastly, please look at slide 12.

With this I conclude my discussion of performance. Lastly, I would like to talk about a recent development related to our business.

We issued a news release on this subject in November 2022 and have begun developing the business as the "first domestic" I-REC platform operator.

An increasingly large number of companies are embracing renewable energy, whether by purchasing it or generating it in-house. In conjunction with this trend, renewable energy certificates are garnering attention as a way to utilize renewable energy and achieve zero emissions.

This global rise in decarbonization needs is stimulating growth in demand for authentic certifications that are unique and trackable.

SCSK is working to facilitate the distribution of renewable energy certificates in order to make greater contributions to the global environment. As part of this effort, we are preparing to start providing EneTrack, a tracking service compliant with the standards of the I-REC, via an online system. This system will allow for the tracking of the issuance, transference, and redemption of certificates that comply with the requirements of international initiatives.

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.