SCSK Corporation

Consolidated Financial Results for the 2nd Quarter of Fiscal Year Ending March 2024

Q&A Session Summary

Date: October 27, 2023 3:30-4:30 PM

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

Q. Impressive trends were seen in systems development orders in the first half of the fiscal year ending March 31, 2024. What sort of trends are projected in the second half of the fiscal year?

A. Trends in the second half of the fiscal year ending March 31, 2024, are expected to be similar to those seen in the first half of the fiscal year. Enterprise resource planning (ERP) and other orders have continued to show strong growth since the fourth quarter of the fiscal year ended March 31, 2023, and many of these were large-scale orders. We have thus been able to secure orders for each phase of these orders, which has been a significant factor behind the current upward trend in incoming orders. Meanwhile, certain orders peaked in the first half of the fiscal year. We aim to compensate for the absence of such orders by incorporating demand in other areas to achieve orders growth in the second half of the fiscal year.

Q. The gross profit margin was down year on year in the second quarter of the fiscal year ending March 31, 2024, even when excluding the impacts of a loss-making project. I suspect that the increase in base salaries was one factor behind this outcome. At the same time, however, we must recognize that there were improvements in the sales mix. What, then, were the reasons behind the decline in the gross profit margin? Also, what type of trends do you anticipate in the second half of the fiscal year?

A. The primary reasons behind the year-on-year decline in the gross profit margin in the second quarter of the fiscal year ending March 31, 2024, were a loss-making project as well as low-profitability projects in the Financial IT Business segment. We believe that it will be possible to achieve higher levels of productivity in the second half of the fiscal year and beyond by managing these factors. Meanwhile, we have been making progress in transferring the rises in base salaries and outsourcing prices to selling prices.

Q. Will performance continue to be impacted by low-profitability projects in the Financial IT Business segment in the second half of the fiscal year ending March 31, 2024?

A. A portion of the low-profitability projects in the Financial IT Business segment are those loss-making projects for which a provision was recorded on March 31, 2023. The Financial IT Business segment saw a large increase in orders centered on banks during the second quarter, and we therefore anticipate that performance will improve in the second half of the fiscal year and beyond.

Q. It was stated that SCSK has been able to absorb practically all of the impacts from the rise in outsourcing costs and the higher personnel expenses resulted from the increase in base salaries. It is safe to assume that efforts to transfer these costs to selling prices will continue in the second half of the fiscal year?

A. For new projects, we incorporate the impacts of the increase to base salaries when presenting initial price estimates. For existing subdivision operations, negotiations for transferring these costs to prices are conducted on an individual project basis, and we have been having success with this regard.

Q. What impact will the rise in outsourcing costs have on earnings in the future? For what processes has SCSK been successful in transferring costs increases to selling prices? Also, is there a risk that the rise in outsourcing costs will cause a decline in profit margins?

A. SCSK has implemented the Core Partner Program for subcontractors, and price negotiations are being advanced based on price ranges defined on an individual partner basis. For maintenance and operation services, price negotiations take place in April for many projects, and we have been able to transfer price increases to customers in a majority of projects. For new projects, we reflect cost increases in the initial price estimates we submit to customers, thereby incorporating the impact of the increase in outsourcing costs. In these manners, the rise in outsourcing costs has already begun to affect earnings.

Q. How was performance for ERP offerings in the six-month period ended September 30, 2023, and what sort of trends are anticipated in the second half of the fiscal year ending March 31, 2024, and beyond?

A. In the six-month period ended September 30, 2023, sales of ERP offerings came to ¥18.6 billion, an increase of ¥3.9 billion, from ¥14.7 billion in the previous equivalent period. Given the current order backlog, we anticipate that growth in the second half of the fiscal year will be seen centered on SAP offerings in a similar manner to the first half. We also project increases in ProActive orders. These factors should result in the continuation of the growth trend.

Q. Could you please offer some information on a loss-making project in the second quarter of the fiscal year ending March 31, 2024?

A. The loss-making project incurred in the second quarter, which was valuated at around ¥0.3 billion, is different from that seen in the first quarter. The cutover for this project is planned for mid-2024, and we have recorded provisions that cover the costs expected to be recorded at this point in time.

Q. Profit margins were high in the second half of the fiscal year ended March 31, 2023. Do you believe it will be possible to surpass this level in the second half of the fiscal year ending March 31, 2024?

A. Based on the outstanding order backlog on September 30, 2023, we anticipate increases in sales and profit in the third quarter that are of a similar level to those seen in the second quarter. However, we are currently unsure of whether we will be able to surpass the incredibly impressive level of performance seen in the fourth quarter of the fiscal year ended March 31, 2023, and we are thus taking a conservate approach toward our projections for the fourth quarter of the fiscal year ending March 31, 2024.

Q. If we compare the projected sales growth rate for the second half of the fiscal year ending March 31, 2024, with that seen in the six-month period ended September 30, 2023, the projection seems to call for a slowdown in sales growth. What are the factors behind this outlook?

A. Large-scale SAP projects for the distribution industry reached a peak in the fourth quarter of the fiscal year ended March 31, 2023, and this level is expected to continue until the third quarter of the fiscal year ending March 31, 2024. We do anticipate the start of other large-scale projects, and these projects will be in the upstream phases in the third and fourth quarters and will thus enter in to the volume zone in the fiscal year ending March 31, 2025.

Q. Does SCSK have the capacity needed to fill the influx of orders associated with the high IT demand?

A. We have been incredibly efficient in our efforts to fill large-scale ERP orders, and our staff has been shifting toward ERP approach. Meanwhile, we do see a need to utilize generative AI and to ramp up recruitment of mid-career individuals. It will also be important to foster highly talented project managers and other human resources. We are planning a transformation to our organizational frameworks for this purpose, and we will be implementing a variety of measures to address personnel shortages.

Q. Given the upward revision to performance forecasts, will there by any change in the pace at which the Company achieves the operating profit target of ¥65.0 billion presented in the Medium-Term Management Plan?

A. We have no intention of slowing our pace as we work to achieve operating profit of ¥65.0 billion or more. We have only just finished the first six months of the new Medium-Term Management Plan, but we will examine the possibility of revising our target based on order trends projected in the fiscal year ending March 31, 2025, while discussing the matter with business groups.

Q. When do you expect to be able to use generative AI in actual coding development?
A. Certain SCSK products already feature low-code, no-code development functions. We are currently in the process of verifying methods of using generative AI, and we expect to be able to commence partial utilization of generative AI next year. A little more time will likely be required before generative AI can be used for large-scale automatic coding tasks.

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