SCSK Corporation

Consolidated Financial Results for the 3rd Quarter of Fiscal Year Ending March 2024

Transcript of results briefing

Date: January 31, 2024 3:30-4:30 PM

Speaker: Yasuhiko Oka, Managing Executive Officer

■ Contents (slide 1)

Greetings, my name is Yasuhiko Oka, and I am a managing executive officer of SCSK Corporation.

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

Turning first to slide 2, let us look at performance in the nine-month period ended December 31, 2023.

As shown on this slide, in the nine-month period ended December 31, 2023, we posted net sales of ¥351.3 billion, up 8.8% year on year; operating profit of ¥40.9 billion, up 16.5%; and profit attributable to owners of parent of ¥28.3 billion, up 11.1%.

These figures include the impacts of the absence of the valuation gains on investment securities recorded in the previous equivalent period as well as the impacts of the valuation losses on investment securities recorded in the nine-month period ended December 31, 2023.

In this manner, we achieved higher sales and profit in the nine-month period ended December 31, 2023, continuing the trend from the six-month period ended September 30, 2023, by setting new record highs for net sales and operating profit thanks to consistently strong demand for IT investment among customers.

In addition, incoming orders were up 8.2% year on year, to ¥330.2 billion, and order backlog rose 1.8%, to ¥162.0 billion. I will offer more details on order trends a little later. For now, let me state that there was no significant change in IT investment trends from the six-month period ended September 30, 2023.

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

Let us now look at slide 3.

In the third quarter of the fiscal year ending March 31, 2024, net sales amounted to ¥120.1 billion, up 9.3% year on year; operating profit was ¥14.0 billion, up 11.0%; and profit attributable to owners of parent came to ¥9.8 billion, up 6.5%.

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Meanwhile, incoming orders rose 6.0% year on year in third quarter, to ¥106.3 billion.

■ Net Sales Analysis (slide 4)

Please turn to slide 4.
This slide shows year-on-year changes in sales by sales segment.

In the third quarter, the Systems Development segment posted double-digit growth in net sales for the third consecutive quarter. This growth was a result of increases in sales of core systems to the distribution industry, development services to the manufacturing industry, and anti-money laundering systems to the financial industry.

The System Maintenance and Operation / Services segment was impacted by changes to accounting standards in the data center business, which decreased sales. Nevertheless, this segment saw third-quarter net sales rise by 7.5% year on year as a result of the higher sales of managed services and the strong performance of verification services.

In the third-quarter, the decline in net sales in the Packaged Software / Hardware Sales segment was not quite as pronounced as that seen in the six-month period ended September 30, 2023. This outcome was in part a result of the deceleration of decreases in sales of network equipment to certain communications industries customers. Another factor was sales of hardware and software to the manufacturing and distribution industries as well as to academic research institutions.

■ Operating Profit Analysis (slide 5)

Next, slide 5 shows factors affecting operating profit.

As you can see on this slide, higher net sales buoyed operating profit by ¥7.3 billion.

In terms of factors affecting the gross profit margin, the increase instituted to base salaries heightened costs by ¥1.0 billion while loss-making projects detracted from operating profit. However, we were able to counteract such detractors by proposing appropriate prices for our services to transfer costs to customers and by improving productivity. The resulting increase in profitability boosted profit by around ¥3.1 billion. This compensated for the higher costs and pushed overall operating profit up by ¥1.1 billion.

Selling, general and administrative (SG&A) expenses were up as a result higher personnel and recruitment expenses following the increase to base salaries and the hiring of new employees. Other factors included rises in expenses for sales activities and the addition of expenses attributable to new consolidated subsidiaries.

As a result, operating profit in the nine-month period ended December 31, 2023, grew 16.5%, to ¥40.9 billion, and the operating profit margin rose 0.8%, to 11.7%.

■ Incoming Orders/Backlog Analysis (slide 6)

Let us know turn to slide 6, which shows a breakdown of factors affecting incoming orders and backlog by sales segment in the nine-month period ended December 31, 2023.

The Systems Development segment saw increases in incoming orders and order backlog of 10.5% and 4.7%, respectively. These increases were a result of growth in orders for core system development services, orders for development services from financial industry customers, and orders from manufacturing industry customers. Looking at the third quarter specifically, incoming orders only rose by 0.1%, small in comparison to the 15.9% increase seen in the six-month period ended September 30, 2023. This was a result of the absence of multiple large-scale orders recorded in the previous equivalent period. However, we believe that this low growth was merely due to the timing of orders with respect to each quarter, especially when considering the consistently robust investment demand we are seeing at the moment.

Incoming orders in the System Maintenance and Operation / Services segment were up 7.1% following increases in orders for management services as well as strong performance for verification services. Meanwhile, order backlog was down 1.7% primarily as a result of changes to accounting method in the data center business and certain large-scale customers curtailing their orders for business process outsourcing (BPO) services.
In the Packaged Software / Hardware Sales segment, meanwhile, incoming orders increased 5.1% and order backlog was up 8.4%. The degree of decreases in orders for network equipment from certain communications industry customers in the second and third quarters was less than that seen in the first quarter. Large-scale hardware sales orders also contributed to higher orders in the third quarter.

■ Business Performance by Reportable Segment (Net 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, 2023, with slide 7.

We will begin by looking at the Industrial IT Business segment, which once again posted increases in sales and profit. Factors behind these increases included growth in core system redevelopment orders for distribution industry customers and higher sales of systems development and verification services for the automotive industry. As a result, overall performance improved, despite the fact that the increases in third quarter were not as pronounced as those seen in the six-month period ended September 30, 2023, an outcome that can be partially attributed to loss-making projects.

In the Financial IT Business segment, net sales rose due to growth in anti-money laundering services for the banking, credit, and leasing industries as well as in systems development orders for securities companies. Meanwhile, the rate of decline in operating profit in the nine-month period ended December 31, 2023, was lower than in the six-month period ended September 30, 2023, as a result of a rise in third-quarter operating profit. The rise in third-quarter operating profit was thanks to increased orders for anti-money laundering services from the banking industry, a factor that counteracted the impacts of the rebound from previously recorded international calculation systems sales.

The IT Business Solutions segment posted higher net sales, which can be attributed to core systems development demand from manufacturing and distribution industry customers and significant success in the acquisition of orders for ProActive. In addition, sales were up for BPO services thanks to the benefits of the consolidation of newly acquired companies, which offset the impacts of the absence of previously received orders from public institutions. Operating profit, however, was down, despite the increase in sales, as a result of expenses for reskilling employees in preparation for the expansion of digital supply chain businesses as well as for advertising ProActive. Another factor was the deterioration of the supply–demand balance for BPO services.

Moving on, the IT Platform Solutions segment saw decreases in rates of decline in sales and profit in the third quarter in comparison to the six-month period ended September 30, 2023. Demand for network security products remained strong, and the impacts of the decline in sales of network equipment to certain communications industry customers, which reduced sales in first quarter, were less in the second and third quarters. This segment also benefited from the sales of hardware to manufacturing industry customers and to academic research institutions recorded in the third quarter.

Next, the IT Management Service segment achieved an increase in net sales thanks to the ongoing demand associated with transitioning to cloud systems and redeveloping existing systems to use cloud infrastructure seen centered on management services as well as consistent demand for management services. In addition, a massive increase was seen in operating profit due to higher inter-segment sales following rises in platform development projects for customers of the Industrial IT Business and Financial IT Business segments. Another factor behind the massive increase in operating profit was the absence of the impacts of higher electricity bills, which had not been fully transferred to customers in the six-month period ended September 30, 2022.

■ 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 backlog by segment.

Beginning with the Industrial IT Business segment, this segment posted a year-on-year increase in incoming orders of ¥8.2 billion. This increase in orders was a result of the receipt of orders for later phases of core system redevelopment projects from the distribution industry. In addition, the segment was able to capitalize on verification service demand and on development demand from manufacturers of items such as automobiles. Conversely, order backlog decreased ¥2.3 billion year on year, despite the increase in incoming orders, as large-scale orders were translated to sales.

In the Financial IT Business segment, incoming orders were up ¥5.6 billion year on year while order backlog rose ¥3.8 billion. These increases can be attributed to orders for anti-money laundering services and for online banking services from the banking industry as well as orders associated with accommodating new systems from the securities and life and non-life insurance industries. Despite these trends, the rate of increase in incoming orders in the third quarter was lower than that of the six-month period ended September 30, 2023, as a result of the absence of previously recorded orders from the banking and securities industries.

Incoming orders in the IT Business Solutions segment in the nine-month period ended December 31, 2023, were up ¥4.4 billion due to growth in enterprise resource planning development projects, a result of brisk demand for core systems. Incoming orders in the third quarter, however, showed a significant decline due to certain major customers curtailing their BPO service contracts. Meanwhile, order backlog increased ¥1.2 billion as a result of the same factors that affected incoming orders.

The IT Platform Solutions segment posted increases of ¥2.0 billion in incoming orders and ¥2.5 billion in order backlog. This outcome was a result of the fact that the declines in network equipment orders from certain communications industry customers seen in the first quarter were lower in the second and third quarters. Another factor was large-scale hardware sales orders.

In the IT Management Service segment, incoming orders were up year on year due to the solid trends in orders in relation to management and other services. Order backlog, however, decreased substantially as a result of the impacts of changes in accounting method associated with the data center business.

■ 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 would like to explain SCSK'S full-year performance and dividend forecasts. Please look at slide 11.

There has been no change to the forecasts for full-year performance in the fiscal year ending March 31, 2024, that were announced together with financial results for the six-month period ended September 30, 2023.

We have, however, revised our forecast for dividend payments, increasing the forecast amount from the previously announced year-end dividend payment forecast by ¥2, to ¥30 per share. This, when combined with the interim dividend, will make for annual dividend payments of ¥58 per share, which should equate to a dividend payout ratio of 45.9% based on the revised performance forecasts.

■ Key Points of Financial Results (slide 12)

This slide is summary of the key points of the third quarter financial results that were explained today, so I will omit the explanation.

■ Topics (slide 13)

Please turn to slide 13.
This concludes our look at performance. Next, I would like to touch on a development that pertains to our medium-term management plan.

Under Core Strategy 2, which has been positioned as a growth driver in our medium-term management plan, we are currently advancing a number of initiatives in the respective business areas.

This slide displays five such initiatives. Today, I would like to talk about one: the NebulaShift service for promoting cloud native computing at companies.

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■ Topics (slide 14)

Please turn to slide 14.

NebulaShift is a new service launched together with Red Hat, Inc., and Hewlett Packard Japan, G.K. that helps customers promote cloud native computing.

The name "NebulaShift" is meant to evoke the image of a nebula as a higher level of cloud and imply a shift or transition to this new higher-level cloud.

This service is aimed at helping customers promote cloud native computing through means such as entrenching agile development approaches and modernizing applications. This is accomplished via the provision of comprehensive bundles packaging the design, development, product support, and fully managed services needed for cloud native applications with agile development consulting, technical support, and coaching services.

By helping customers implement digital transformation and improve their business agility, we look to cultivate businesses related to NebulaShift to the point that they are generating annual net sales of around ¥10.0 billion by 2026.

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.

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