

Transcript of results briefing

Results of Operations for Fiscal Year Ended March 31, 2018, Business Strategies for Fiscal Year Ending March 31, 2019

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■ Introduction

Greetings, my name is Tooru Tanihara, and I am the president of SCSK Corporation. I would like to thank you for joining us today for this financial results briefing meeting.

■ Business Strategy (slide1)

The fiscal year ended March 31, 2018, was a year that tested the Company. We managed to secure increases in both sales and profits, although this was a bit of struggle, but our performance still fell below our initial forecasts. This was the first time we failed to achieve our initial forecasts since the establishment of the Company. I apologize for the concern this has caused to our shareholders and other investors.

My view on management is that numbers do not lie. From this perspective, it might seem prudent for us to begin this briefing with an explanation of our performance in the fiscal year under review. However, I rather think it would be better for me to start our review of this year by taking this opportunity to once again explain the course we have set for the Company and our management strategies.

As has been stated, the three core strategies of our current medium-term management plan are shift to service-oriented businesses, promote strategic businesses that capture the changing times, and enter into the second stage of global business expansion.

The shift to service-oriented businesses, in particular, furthers our efforts to break away from the prior labor-intensive business models utilized in regard to certain aspects of our business portfolio. The aims of these efforts include higher growth potential and increased profitability.

However, our true goal goes beyond simply enhancing our business portfolio.

The underlying principles of service-oriented businesses are to lend an earnest ear to the voices of customers in order to develop an accurate understanding of their needs. Based on this understanding, we aim to pursue and provide the value customers truly seek by mustering the comprehensive strength of the SCSK Group to supply customers with our diverse range of IT services.

Recently, the term “digital transformation” has been generating a bit of a buzz, a trend that has pressed us with the urgent task of transforming our business model through the use of technological innovations, such as those pertaining to artificial intelligence, or AI; robotic process automation, or RPA; the Internet of Things, or IoT; and FinTech. However, I believe that rapid technological process has caused customers to feel concern regarding the disparities between the benefits promised by new technologies and reality. It is for this reason that we at SCSK seek to make proposals that are more than just a list of the latest technologies and tools, specifically by providing proposals that help improve the value of customers’ businesses. Accordingly, it is crucial for us to call upon our insight and deliver IT services that create the kind of value that customers truly desire.

The core strategies of the medium-term management plan function as a roadmap for transforming the Company into an organization that is better able to supply the IT services and value customers truly desire in any era.

SCSK is an IT service company that primarily serves Japanese companies as its clientele. These companies are responsible for driving the Japanese economy and are therefore spurred toward strategic IT investment for the purpose of strengthening their businesses. At the same time, these companies are in need of IT services to improve business efficiency and reduce labor requirements. By responding to these needs, SCSK strives to help such companies build a better future for the Japanese economy and to become itself a leader in developing the Japanese economy.

Our goals include working together with customers to create our future of dreams by providing the power of the IT services that we have developed to date. At the same time, we look to utilize our comprehensive strengths to supply IT technologies and services that offer truly meaningful value to the customers that might find themselves overwhelmed by recent buzzwords, such as AI, RPA, IoT, and FinTech. In the fiscal year ending March 31, 2019, and beyond, we will endeavor to manage the Company while remaining mindful of this point of departure for our operations.

■ Financial Results for FY2017 (slide2)

I would now like to discuss our financial results in the fiscal year ended March 31, 2018.

As shown, net sales were ¥336.6 billion, operating profit were ¥34.6 billion, and profit attributable to owners of parent were ¥32.4 billion.

Although full-year sales and profits were up year on year, prior to this, we had chosen to institute a downward revision to our full-year performance forecasts during the third quarter. This decision was based on the judgment that we would be unable to accomplish our initial earnings forecasts in existing systems

development businesses targeting financial industry customers as well as consideration for the increase in upfront expenses recorded during the first half of the fiscal year as part of the shift to service-oriented businesses.

In the fiscal year under review, progress was effectively halted in our business structure reforms, which include the shift to service-oriented businesses. Meanwhile, although we had initially assumed that the strong flow of large-scale deals seen at the outset of the fiscal year would continue in businesses serving the financial industry, we found ourselves unable to accurately evaluate current conditions. As such, the fiscal year under review proved to be a year in which we were reminded of the importance of turning a keen eye to the needs of customers.

During the second half of the fiscal year, however, we saw a gradual recovery in business growth following the commencement of certain large-scale projects for financial industry customers and greater-than-anticipated progress in systems development businesses targeting the manufacturing industry. As a result, fourth-quarter operating profit grew by more than 20% year on year, reaching a new record high. This strong performance coupled with the increase of 7.4% in systems development order backlog leads me to believe that we have established a firm foundation on which to begin the fiscal year ending March 31, 2019.

■ Forecasts for the FY2018 (slide3)

Moving on, I would now like to discuss the current conditions we are seeing in the fiscal year ending March 31, 2019, and our full-year performance forecasts for this year.

Looking at current conditions, business trends suggest conditions that are more favorable than those seen in the fiscal year under review. For example, the strong increase in the deal flow from the manufacturing industry that began in the second half of the fiscal year under review is continuing and we are witnessing positive trends in orders in systems development businesses targeting the financial industry.

In addition, we do not expect upfront expenses for business structure reforms to increase to the degree seen in the fiscal year under review. This outlook is based on the aforementioned trends in existing businesses as well as our anticipation that we will be able to commence certain service-oriented businesses, although others will remain in the preparation phase. CFO Fukunaga will be discussing these matters a little later on.

Based on this outlook, our performance forecasts for the fiscal year ending March 31, 2019, call for us to partially make up last year's moderate earnings growth which we should have done better, with net sales of ¥345 billion, operating profit of ¥37 billion, and profit attributable to owners of parent of ¥25 billion.

The emerging global trend toward protectionism is making for an opaque outlook for the earnings of SCSK's customers. Nevertheless, we are committed to increasing our earnings by achieving growth in existing business, most notably systems development businesses, as well as in new service-oriented businesses.

■ Mid-Term Management Plan (slide4)

As I stated at the beginning of this presentation, our goal is to create the value desired by customers, and thereby help drive the growth of the Japanese economy, with the power of our IT services.

To accomplish this goal, we will cultivate talented human resources capable of further evolving the ICT that leads social progress through means such as promoting contributions from senior and female employees. These human resources will form the driving force behind the growth of the Japanese economy.

At the same time, we will take steps to prevent our customers and ourselves from being led astray by such ambitious goals or by the buzzword of digital transformation. Accordingly, we will take a well-grounded approach toward developing new IT service businesses, which will include the utilization and application of AI, IoT, and other new technologies.

SCSK's medium-term management plan has set the target for the strategic indicator of operating profit at the lofty level of ¥50.0 billion. Of this figure of ¥50.0 billion, between ¥40.0 billion and ¥45.0 billion will come from the continuation of the efforts to grow our business and reform our portfolio that we implemented to date. In other words, these profits will be generated through the growth of our existing operations and the shift to service-oriented businesses.

The final year of the current medium-term management plan will be the fiscal year ending March 31, 2020, and this year is approaching rapidly. However, the amount of between ¥40.0 billion and ¥45.0 billion is within the scope of the previously mentioned forecasts for performance in the fiscal year ending March 31, 2019.

As for the remaining ¥5.0 billion to ¥10.0 billion of the medium-term management plan's operating profit target, we are diligently working toward this amount by starting up new strategic businesses and conducting M&A activities. In regard to M&A activities, these activities are dependent on the presence of acquisition targets, and I unfortunately have nothing to report on this front today. We will talk about the trends in specific strategic businesses later. Right now, let me say that we have not yet reached a point at which we can look forward to earnings contributions from the automotive software systems business or from other strategic businesses.

As the leader of SCSK, I will continue working in my fullest to develop new strategic businesses and advance M&A activities with the aim of closing the gap between our actual performance and the medium-term management plan's operating profit target of ¥50.0 billion. At the moment, however, management's outlook is that we will be able to generate operating profit of between ¥40.0 billion and ¥45.0 billion in the fiscal year ending March 31, 2020, through the growth of existing businesses and the shift to service-oriented businesses.

■ Shift to Service-Oriented Businesses (slide5)

There are only two more topics I would like to touch on in today's presentation. First, I will discuss the investments being made in service-oriented businesses and the earnings these businesses are generating.

As previously disclosed, sales from service-oriented businesses amounted to ¥40.0 billion in the fiscal year ended March 31, 2015; ¥44.0 billion in the fiscal year ended March 31, 2016; and ¥50.0 billion in the fiscal year ended March 31, 2017.

In the fiscal year under review, we revised the definitions of certain service-oriented businesses to better reflect customers' needs for SCSK's IT services. We thus adopted broader definitions for our service-oriented businesses, which include various non-cloud solutions, and pursued substantive performance improvements accordingly. Under the new definitions, service-oriented businesses generated sales of ¥705 billion in the fiscal year ended March 31, 2018. When calculated using the new standards, sales from service-oriented businesses in the fiscal year ended March 31, 2017, amounted to ¥640 billion, meaning that sales from these businesses effectively showed a year-on-year increase of 10% in the fiscal year under review.

In the fiscal year ending March 31, 2019, we project that sales from service-oriented businesses will increase by more than 10% year on year.

■ Promotion of Strategic Businesses: Automotive Software (slide6)

I would next like to discuss our automotive software systems business.

The QINeS-BSW business, a new extension of our automotive software systems business, attempts to apply the standardization that is a given in the IT service industry to automotive software systems development in a manner that is in step with the software standards being developed in the automotive industry. This drive for standardization is embodied by the AUTOSAR standard, which is becoming more widely used in Europe and other regions, as you are surely aware.

I would like take this opportunity to talk about the trends toward AUTOSAR compatibility in Japan. Our initial business plan assumed that this standard would spread throughout various automotive software systems development fields.

However, the actual situation ended up being different from what we had envisioned. Progress in developing highly functional automotive systems, such as advanced driver-assistance systems and self-driving cars, is moving forward much quicker than we had anticipated. As a result, there is now a need to quickly develop such functions for the fiscal years ending March 31, 2020 and 2021. Accordingly, the creation of functions for automobiles to be released in these model years will need to be conducted using legacy systems development techniques prior to the adoption of AUTOSAR.

At the same time, the development of self-driving cars, electric vehicles, and other highly functional automobiles is a pressing task. The majority of original equipment manufacturers and tier 1 parts manufacturers are currently examining the possibility of adopting the AUTOSAR standard or even preparing for or promoting compatibility as part of the push to rollout highly functional automotive software systems in the 2022 and 2023 model years.

In this manner, the current operating environment for our automotive software systems businesses differs from our projections, which is impacting our business plans.

Certain advanced functions developed for the 2019 and 2020 model years are expected to be reengineered as AUTOSAR compatible functions for use in automobiles released in the 2022 model year or beyond.

Against this backdrop, a large number of automotive companies began working to achieve AUTOSAR compatibility in their development of highly functional automotive software systems during the second half of the fiscal year ended March 31, 2018. These companies were not limited to industry leaders. As a result, the number of potential deals to be made is greatly exceeding our initial forecasts.

This situation is, of course, favorable to SCSK. However, deal project teams are being forced to address the numerous specific development requirements of individual companies, and customer demands are proving to be incredible diverse. For this reason, the Company currently lacks the resources necessary to pursue all potential deals, making it difficult to upscale our business in response to the increased demand.

At the same time, the scope of AUTOSAR application itself is evolving. The technologies associated with this standard are expected to advance steadily in the future, moving past the level of controlling individual automotive parts, to control entire vehicles and eventually transcend the boundaries of vehicles themselves through the advent of connected cars. This evolution will result in AUTOSAR being applied in a wide range of areas. We therefore believe that it will be important for SCSK to continue conducting substantial investments in technologies going forward.

Against this backdrop, we judged that delays in our initial schedule for earnings contributions from our automotive software systems business would be unavoidable. At the moment, we do not see the goal of realizing earnings contributions by the fiscal year ending March 31, 2020, as being feasible.

Looking ahead, SCSK will conduct business development investments in accordance with its initial plans as the Company seeks to protect its firstcomer position as a developer of cutting-edge technologies in this field.

At the same time, we are committed to recovering the upfront investments made in these operations as quickly as possible, although this recovery will be delayed slightly from our initial plans. We will be implementing various business initiatives to accomplish this objective.

As for specific details about our progress on this front, in the fiscal year ended March 31, 2018, we received basic software-related orders with an eye to future development of mass-produced automobiles from three parts manufacturers, one of which was Sanden Automotive Components Corporation, as was disclosed in a news release. These deals will generate sales in the area of a few hundred million yen.

Also, please let me add that our automotive software systems businesses, based on a broad definition including conventional model-based development, are advancing at an increasingly fast clip and are thus contributing to the growth of SCSK's earnings.

Going forward, we will work to swiftly achieve profitability in our automotive software systems businesses. These efforts will be based on SCSK's three pillars of strength, namely its technology development capabilities pertaining to the advanced QINeS-BSW AUTOSAR compliant software product and related technologies, its technological prowess in model-based development, and the system development capacities the Company has honed over its long history of supplying IT services to corporate clients.

■ In Closing

This wraps up my explanation of performance, business trends, and the progress of business strategies.

As you are no doubt aware, we instituted reforms to human resource and other organizations effective April 1, 2018, with the aim of accelerating business growth going forward. There is just one element of these reforms that I would like to talk about right now.

Effective April 1, 2018, we established SCSK's first dedicated, Companywide sales organization. At the beginning of this presentation, I stated that we aim to accurately understand the value sought by customers

and to comprehensively utilize Companywide services and resources to supply this value. The new sales organization was created to facilitate this undertaking. Of course, we intend to promote coordination between this sales organization and existing business divisions while also managing our business in a manner that allows for operations to be developed through a united effort encompassing corporate divisions as well as the rest of the Company. The goal of this approach will be to address customers' needs in the truest sense.

With this, I conclude my portion of today's presentation. In closing, I would like to ask for your ongoing support and understanding of the Company.

Thank you.