Transcript of results briefing
Consolidated Results for Fiscal Year Ended March 2018

Tetsuya Fukunaga
CFO, SCSK Corporation

■ Introduction

Greetings, I am Tetsuya Fukunaga, CFO of SCSK Corporation.

Today, we will be discussing our performance in the fiscal year ended March 31, 2018, and our performance forecasts for the fiscal year ending March 31, 2019, based on the framework provided by the materials that have been distributed to you.

■ Highlights for FY2017（Slide2）

First, I would like to talk about our performance in the fiscal year ended March 31, 2018. Please look at the summary of consolidated performance on slide 2. Our performance in the fiscal year under review was as shown on this slide. As stated by President Tanihara, this is the first year since SCSK was born out of the merger in which we have failed to achieve our initial, disclosed forecasts. Nevertheless, we set new records for fourth-quarter net sales and operating] profit and succeeded in achieving higher full-year sales and profit for the sixth consecutive year following the merger.

To elaborate, performance was impacted by increases in expenses, particularly those incurred during the first half of the fiscal year, that exceeded our initial forecasts. Examples of such higher expenses included expenses related to efforts to advance core strategies, such as the shift toward service-oriented businesses and the development of strategic businesses; upfront business investment expenses, depreciation and amortization, and R&D expenses for reinforcing existing operations; and marketing expenses. Also, systems development businesses targeting financial industry customers saw struggling performance due to delays and cancellations of large-scale projects. These factors caused performance in the nine-month period ended December 31, 2017, to fall below our initial forecasts and thus forced us to institute downward revisions to our full-year forecasts in January 2018.

Conversely, IT service businesses targeting the distribution industry performed well during the second half of the fiscal year, and performance in systems development businesses serving the manufacturing industry exceeded our initial forecasts during the fourth quarter. Also, we were able to effectively manage selling, general and administrative, or SG&A, expenses and other expenses to an appropriate degree, despite the delayed starts of large-scale projects for customers in the financial industry. As a result, a massive year-on-year increase was seen in fourth-quarter operating profit, an accomplishment that helped us secure higher sales and profits on a full-year basis. Although performance was lower than initially anticipated, we still managed to set new records for full-year net sales and operating profit.

In addition, overall order backlog increased 0.6% year on year, to ¥117.0 billion.

I will explain order trends by segment a little later on. For now, let me say that, despite the decrease in system sales, we were able to achieve an increase in orders of 7.4% year on year in systems development businesses. Accordingly, as stated by President Tanihara, we believe that the Company was able to establish a firm foundation on which to begin the fiscal year ending March 31, 2019.

The operating margin showed a slight increase from the fiscal year ended March 31, 2017, coming to 10.3% on a full-year basis regardless of the burden of higher upfront business investment-related expenses.

■ Consolidated Statements of Income（Slide3）

Moving on to slide 3, I would like to offer a summary of SCSK's consolidated statements of income for the fiscal year ended March 31, 2018.

As mentioned previously, sales were up while profit was down in the nine-month period ended December 31, 2017. Looking at the fourth quarter on a standalone basis, we achieved a massive increase of 26.0% in operating profit following an improvement in the gross profit margin and a reduction in SG&A expenses, which was partially a reflection of delays in incurring certain expenses. As a result of these factors, performance fell in line with the revised performance forecasts.

As the final component of this summary of SCSK's consolidated statements of income, I would like to discuss profit attributable to owners of parent, which was actually higher than our initial forecasts.

As you are no doubt aware, wholly owned subsidiary QUO CARD Co., Ltd., was sold in the third quarter of the fiscal year under review, leading the Company to record extraordinary income of ¥10.7 billion in the form of gain on sales of investment securities.

Meanwhile, extraordinary losses were recorded following the strategic revision of various business investment assets. For example, impairment losses were incurred as a result of consolidating data centers, some of which are to be used as offices, in an effort to streamline our data center business. In addition, lump-sum amortization treatments were applied to certain software associated with service-oriented businesses in conjunction with a change in strategic targets.

Profit attributable to owners of parent rose by 14.2% year on year after reflecting these unexpected extraordinary factors.

With this, I conclude this overview of our consolidated statements of income.

■ Sales Comparison by Segment（Slide4）

Moving on, I would now like to more closely examine earning figures for the fiscal year under review through our usual presentation materials.

On slide 4, you will see a comparison of sales by segment. In the systems development segment, overall sales showed a slight increase of 1.1% year on year. Continuing throughout the entirety of the fiscal year under review, there was a strong trend in systems development demand from distribution industry customers looking to invest in omni-channel retailing and digital marketing as well as from certain major communications carriers and other communications industry customers. In addition, the second half the fiscal year, particularly the third quarter, brought with it upturns in demand that exceeded our initial anticipations. Specifically, these upturns were seen in demand for strategic IT investment among automobile, machinery, and other manufacturers and in system upgrade demand, which rose on the back of strong earnings among customers. Conversely, we felt the impacts of the initially expected rebound from a large-scale development project for a specific customer recorded in systems development businesses targeting the financial industry during the fiscal year ended March 31, 2017. There were also delays and cancellations of several large-scale projects in these businesses, which weighed heavily on performance.

Looking ahead, we project that conditions in the fiscal year ending March 31, 2019, will be more favorable than in the fiscal year under review. This outlook is based on the solid systems development demand seen among manufacturing industry customers as well as gradual commencement of projects for financial industry customers.

Sales were up 2.6% year on year in the system maintenance and operation and services segment. This segment benefited from firm performance in system operation service businesses catering to the communications and transportation industries as well as in IT service businesses supplying digital marketing enhancement services for the distribution industry. In addition, the performance of cloud and other service oriented-businesses improved in line with our forecasts with sales growth of more than 10.0%. The benefits of these positive developments counteracted the impacts of certain manufacturing industry customers for conventional business process outsourcing, or BPO, services concluding their large-scale contracts or reducing the scale of their contracts, a trend we touched on when discussing the performance for the six-month period ended September 30, 2017.

The system sales segment posted 4.2% increase in sales. Factors contributing to this increase included higher sales of IT products to the communications industry and nearly all other customer industries.

■ Incoming Orders and Backlog（Slide5）

Looking at slide 5, I would like to discuss the order trends seen in each sales segment. In addition to full-year order trends, this slide contains information on fourth-quarter order trends. This information is also available in the supplementary information materials.

Incoming systems development orders were up 3.0% on a consolidated basis. Although performance was heavily impacted by the absence of orders from major financial industry customers recorded in the previous fiscal year, overall orders increased centered on the manufacturing industry.

Order backlog similarly grew 7.4% due to a rise in orders from almost all industries supported by a strong deal flow.

Strategic IT investment demand was strong overall, which contributed to increases in both incoming orders and order backlog. Another contributing factor was the enterprise resource planning system and other system upgrade demand that emerged primarily among manufacturing industry customers during the second half of the fiscal year. As has been stated, orders from financial industry customers are currently on the rise, and I thus feel confident in saying that the fiscal year ending March 31, 2019, began amid strong order trends.

In regard to maintenance and operation services, both incoming orders and order backlog decreased slightly year on year. These decreases were mainly a result of certain manufacturing industry customers for our conventional BPO services reducing the scale of their previously large-scale contracts.

Nonetheless, we anticipate an increase in order backlog to occur near the end of the first half of the fiscal year ending March 31, 2019. This increase will be an extension of the upswing in orders that began during the fourth quarter of the fiscal year under review in conjunction with our expansion of service-oriented businesses.

Incoming orders and order backlog for systems sales decreased 1.6% and 8.3%, respectively, due to the impacts of reduced network product orders from certain communications industry customers, among other factors.

■ Sales Comparison by Customer Industry（Slide6）

Turning to slide 6, I will now explain sales and other trends by customer industry, although I can only touch on the major trends.

Overall sales to manufacturers rose by a slight 1.7%. Impressive growth in conventional automotive embedded software development sales was seen with an increase of over 15.0%. Systems development sales, which include automotive embedded software development sales, were up by more than 5.0% due to strong performance supported by increase in systems development demand from automotive manufacturers and in systems upgrade demand from machinery manufacturers for efficiency improvement purposes. However, the increase in sales to manufacturers was limited due to lower orders for product verification services from certain manufacturing industry customers as well as reductions in the size of large-scale BPO service contracts.

Sales to distributors increased 7.2% year on year. This increase was attributable to the ongoing rise in digital marketing-related development and outsourcing projects.

Sales to financial institutions decreased 1.8% year on year due to the heavy impacts of the rebound from large-scale orders from banks that were recorded in the previous fiscal year, a factor we have spoken of since the beginning for the fiscal year under review and also mentioned previously today, as well as to the cancellations and delays of several large-scale projects initially scheduled to take place during the fiscal year under review.

Sales to the communications and transportation industries were up 7.3% year on year. Strong performance was seen in systems development and system maintenance and operation services for major communications carriers and cable TV providers as well as in system sales operations.

This concludes my explanation of sales by customer industry.

■ External Sales and Segment Profit by Reportable Segment（Slide7）

We will now move on to slide 7, which shows a breakdown of performance by reportable segment.
As has been explained, particularly strong trends were seen in businesses serving the manufacturing, communications, and distribution industries, resulting in higher sales in all segments, with the exception of the Financial Systems Business Group. In addition, higher operating profit was achieved in the Manufacturing Systems Business Group, the Telecommunication Systems Business Group, the Distribution Systems Business Group, the Business Solutions Group, and the IT Platform Solutions Group.

The Financial Systems Business Group was heavily affected by the aforementioned rebound from previously recorded large-scale orders and delays in the commencement of several projects, which resulted in a year-on-year decrease in sales. Segment profit was down due to the lower sales as well as the impacts of unprofitable projects.

In the Business Services Group, sales were up year on year. Conversely, profit declined due in part to an increase in business investment expenses associated with the development of new e-commerce services to reinforce business operations and the opening of a service center for providing BPO services. Another detractor was higher marketing-related expenses.

With this, I would like to wrap up my explanation of performance by reportable segment.

■ Operating Profit Analysis（Slide8）

Up until now, I have focused on net sales in our discussion of full-year performance for the fiscal year ended March 31, 2018.

Looking now at slide 8, I would next like to elaborate on the factors that influenced operating profit. Specifically, I will talk about the expenses incurred during the fiscal year under review.

As explained previously, the combined increase in cost of sales and SG&A expenses in the nine-month period ended December 31, 2017, amounted to more than ¥3.2 billion, which mainly consisted of business investment-related expenses. However, we were able reduce SG&A expenses by nearly ¥0.5 billion during the fourth quarter through effective cost management. These efforts, together with the impact of expenses that were carried over to the next fiscal year, resulted in an increase in expenses of approximately ¥2.0 billion on a full-year basis.

As for the automotive software systems business, an area garnering strong interest, there was an increase in expenses of approximately ¥0.9 billion that was accounted for in our initial forecasts. As a result, the business posted a loss of roughly ¥2.0 billion in the fiscal year ended March 31, 2018.

Total losses from unprofitable projects were relatively unchanged year on year at ¥0.8 billion as such losses in the fourth quarter was only just above ¥10.0 million. Accordingly, these losses were lower than the amount of ¥1.0 billion we budget for each year.

As we have explained in the past, SCSK endeavored to conduct the necessary business investments in line with its budgets while working to manage expenses. Through these efforts, we were able to limit the full-year increase in expenses to approximately ¥2.0 billion, which was more or less in line with our initial forecasts.

With this, I conclude my explanation of how expenses influenced operating profit.

■ Consolidated Balance Sheets（Slide9）

Moving on from the consolidated statements of income, we will now discuss our consolidated balance sheet. Please turn to slide 9.

As explained during the briefing on performance for the nine-month period ended December 31, 2017, all assets and liabilities associated with former subsidiary QUO CARD, which amounted to over ¥100.0 billion, were excluded from the scope of consolidation following the transference of this company's stock on December 1, 2017.

Together with performance in the fiscal year under review, the transference of QUO CARD's stock led to a substantial improvement in various indicators. Notably, the equity ratio rose from 42.8% on March 31, 2017, to 62.3% on March 31, 2018.

■ Financial Forecasts for FY2018（Slide10）

This ends my explanation of the consolidated performance in the fiscal year ended March 31, 2018. Looking at slide 10, I will now touch on our forecasts for performance in the fiscal year ending March 31, 2019.

We currently view the fiscal year ending March 31, 2019, as being characterized by a persistent sense of opaqueness in terms of IT investment trends among customers, a characteristic that comes against a backdrop of political and economic uncertainty around the world. Conversely, recent trends in SCSK's business environment include the continuation of the solid trend in IT investment demand seen among manufacturing industry customers during the second half of the fiscal year ended March 31, 2018, as well as the commencement of certain systems development projects for financial industry customers, an area in which the Company struggled last year. Accordingly, as stated by President Tanihara, we have judged that overall business trends in the fiscal year ending March 31, 2019, are proving more favorable than in the fiscal year ended March 31, 2018.

Our focuses in the fiscal year ending March 31, 2019, will include tying the solid order trends to business earnings and promoting service-oriented businesses. We anticipate that these efforts will lead to respectable increases in both sales and profit, despite the fact that we will continue incurring upfront expenses in relation to business investments.

An increase of more than ¥2.0 billion in expenses, primarily upfront business investment expenses, was incorporated into our initial forecasts for the fiscal year ended March 31, 2018. However, we anticipate that the increase in such upfront expenses will amount to just more than ¥1.0 billion in the fiscal year ending March 31, 2019. These expenses will be associated with new strategic businesses, among others.

Moreover, our forecasts call for a year-on-year decrease in profit attributable to owners of parent in the fiscal year ending March 31, 2019. This decrease will be the result of the absence of the extraordinary income recorded in relation to the transference of QUO CARD's stock during the fiscal year ended March 31, 2018.

This concludes my explanation of our full-year forecasts for consolidated performance.

■ Dividend Forecasts for FY2018（Slide11）

The last topic I would like to touch upon is SCSK's policies for shareholder returns, including the year-end dividend for the fiscal year ended March 31, 2018, and our dividend forecast for the fiscal year ended March 31, 2019.

Although profit attributable to owners of parent exceeded our initial forecast in the fiscal year ended March 31, 2018, this outcome was largely due to the one-time recording of extraordinary income following the transference of QUO CARD's stock in the third quarter. Given this fact, we have chosen to adhere to our initial dividend forecast by issuing a year-end dividend of ¥47.5 per share, which will make for a full-year dividend of ¥95, an increase of ¥5 over the previous year's dividend of ¥90 per share.

As for the fiscal year ending March 31, 2019, we will target a dividend payout ratio of 40.0% of our earnings forecast in accordance with the basic policy for this ratio that has been explained as part of the Company's policies for capital measures and dividends. Taking into account this policy as well as our financial position and projected improvements to earnings capacity, we intend to issue a full-year dividend of ¥100 per share, an increase of ¥5 per share, in order to better return profits to shareholders.

We aim to increase shareholder returns while fully utilizing the Company's continually growing cash flows to invest in the service-oriented businesses and strategic businesses that will support future growth. Accordingly, we plan to raise dividends in line with projected performance improvements.
With this, I would like to conclude my portion of today's presentation.

We are committed to making steady progress on the path toward growth, supported in these efforts by our shareholders and investors. SCSK looks forward to your advice and encouragement going forward.

We greatly appreciate you taking the time to join us today.