Transcript of results briefing

Results of Operations for Six-Month Period Ended September 30, 2018

Tooru Tanihara
Representative Director
President and Chief Operating Officer,
SCSK Corporation

■ Results of Operations for Six-Month Period Ended September 30, 2018 (slide1)

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.

I will now begin my explanation of our financial results in the six-month period ended September 30, 2018, and our full-year forecasts for the fiscal year ending March 31, 2019.

In the six-month period ended September 30, 2018, performance exceeded our initial forecasts. The impressive consolidated performance was supported by strong performance in almost every segment, which itself was driven by systems development businesses amidst growth in IT investment demand seen among all customers in all industries.

Specifically,

・Net sales: ¥167.4 billion (up 2.4% year on year)

・Operating profit: ¥16.0 billion (up 20.6% year on year)

・*Operating margin: 9.6% (up 1.4 percentage points)*

・Ordinary profit: ¥16.3 billion (up 14.6% year on year)

・Profit attributable to owners of parent: ¥10.8 billion (down 10.0% year on year)

The decrease in profit attributable to owners of parent was a result of the transference of QUO Card, which was conducted in the previous fiscal year.

CFO Fukunaga will provide more details on this performance later in today's presentation. For now, let me say that we were able to set new six-month records for net sales, operating profit, and the operating margin.

Moving on, I would like to discuss the environments and trends in each industry that supported this performance.

Systems development businesses catering to the manufacturing industry enjoyed strong performance in the second half of the previous fiscal year, particularly the fourth quarter. This trend has been continuing in the current fiscal year, with increases in order numbers, net sales, and incoming orders that exceeded our initial forecasts. Accordingly, this trend has been a major driver behind the favorable Companywide performance posted in the six-month period ended September 30, 2018.

Based on past experience and as you may be aware, IT investment trends in the manufacturing industry are highly dependent on customer earnings trends. For this reason, we believe that the current trend toward proactive IT investment, which began in the second half of the previous fiscal year, has been supported by the robust performance and operating cash flows among customers that have continued since the previous fiscal year.

The IT investment trends currently seen in the manufacturing industry encompass a wide range of investment fields. In addition to higher IT investment linked to performance, we have been seeing investments aimed at labor saving to address labor shortfalls through working style reforms and other means. Furthermore, customers have been investing in upgrades to existing operational systems, an area in which investment has not be anywhere near brisk since the 2008 financial crisis. There has also been a trend toward strategic investment, such as smart factory and other IoT-related investments and investment in automotive software systems, which have been becoming increasingly more functional, as indicated by the rise of automated driving and electric vehicles.

Based on these trends, I believe that the increase in IT demand in the manufacturing industry is not a temporary trend but rather an ongoing trend representative of our current position in the medium- to long-term investment cycle.

The trends seen in the previous fiscal year are continuing in the distribution and service industries as well. By these trends, I refer to the IT system investment and service demand centered on customers in consumer businesses for strengthening aspects of operations such as digital marketing and customer relationship management.

As for the financial industry, a considerable number of customers, including major banks, limited their total investment expenditures given the downward pressure placed on earnings by Japan's negative interest rate policy. Nonetheless, there has been an ongoing growth trend in strategic IT investment by financial industry customers looking to ensure ongoing competitiveness. Among these investments have been IT investments aimed at applications including enhancing online services through means such as utilizing FinTech, artificial intelligence, and other new IT technologies.

As I mentioned at the beginning of this presentation, SCSK's performance grew centered on systems development businesses amidst the robust IT investment demand seen among such customers, which are among our primary targets. We were thereby able to achieve six-month performance that exceeded our initial forecasts.

With this, I conclude my overview of our performance in the six-month period ended September 30, 2018. As for our forecasts for performance in the fiscal year ending March 31, 2019, the manufacturing and other industries are expected to face an uncertain outlook for global political and economic conditions as we advance into the second half of the fiscal year. This outlook is predicated on the instability of financial and capital markets arising from trade friction between the United States and China and the interest rate hike in the United States.

Looking ahead, future business trends will be more or less consistent with the trends seen thus far, which have been manifesting in favorable order backlogs. Also, to reiterate, I am certain that the upward trend in IT investment demand will continue over the medium to long term.

■ Full-Year Forecasts for Fiscal Year Ending March 31, 2019 (slide2)

Assessing the fiscal year ending March 31, 2019, on a full-year basis, however, it is clear that we cannot ignore the impacts of short-term changes in the global economy going forward, and it is incredibly difficult to formulate an outlook for IT services businesses catering to the manufacturing industry that includes factors such as short-term fluctuations in IT investment demand. As for businesses serving the financial industry, although our full-year performance forecasts account for the commencement of a significant number of large-scale and other projects, we cannot guarantee that all of the projects scheduled will actually come to fruition.

Accordingly, we have chosen not to revise our previous forecasts for full-year performance in the fiscal year ending March 31, 2019, which project net sales of ¥345.0 billion, operating profit of ¥37.0 billion, and profit attributable to owners of parent of ¥25.0 billion. As we progress through this fiscal year, we will forge ahead with business investments, as has been stated previously, and we continue efforts to ensure the accomplishment of our performance forecasts.

Having said this, I would like to wrap up this overview of our financial results in the six-month period ended September 30, 2018, and our full-year forecasts for the fiscal year ending March 31, 2019.

■ Shift to Service-Oriented Businesses (slide3)

The shift to service-oriented businesses is one of our core strategies. Next, I would like to discuss the progress of this shift.

In the six-month period ended September 30, 2018, net sales from service-oriented businesses amounted to ¥36.0 billion, a year-on-year increase of 6% from the figure of ¥34.0 billion posted in the previous equivalent period. This growth fell short of our target for sales growth for this year of 10% or more. This outcome was a result of the conclusion of a long-term contract for a large-scale business process outsourcing project. In service-oriented businesses, such as the pay-per-usage, cloud service, and SaaS service businesses we recently created based on existing intellectual properties, we have sustained sales growth of nearly 10%. Management is not satisfied with this result, but we do believe it is within the acceptable range of progress toward our full-year forecasts.

Through our Companywide efforts to date, we have achieved a smooth increase in the numbers of services we offer while also conducting ongoing business investments.

Looking ahead, we will conduct comprehensive marketing activities and proactively propose projects to major customers through the Sales Coordination Group established in the fiscal year ending March 31, 2019. We thereby aim to achieve the sales growth target of 10% or more put forth at the beginning of the fiscal year.

■ Strategic Businesses 1—Automotive Software Systems Business (slide4)

Moving on, I would like to explain our progress in strategic businesses during the fiscal year ending March 31, 2019. I will begin with the high-interest topic of the automotive software systems business.

The operating environment for the automotive software systems business is changing constantly.

As has been stated previously, our initial business plan had originally projected that AUTOSAR, a software standard for the automotive industry, would spread to all areas of automotive software systems development. However, as you know, the development of advanced driver-assistance systems, automated driving, and other highly functional systems is progressing much faster than expected, and companies from other industries are entering into the automotive market. As a result, people have come to expect value from automobiles that exceeds the idea of driving or a means of transportation. If automobiles can be linked to other parts of society and endowed with automated driving capabilities, they can become mobile offices. Meanwhile, electric vehicles have the potential to double as household batteries. In this manner, services are being created that betray the prior concept of the automotive industry.

Going forward, it will be important to keep a keen eye on the rapidly changing operating environment and industry trends as SCSK refines and implements its business strategies. SCSK's management is thus at the threshold of turbulent seas.

At the results briefing for the fiscal year ended March 31, 2018, we were forced to inform you that the timing at which the automotive software systems business is projected to become profitable will likely be later than planned. Regardless, there will be no fundamental changes to the course we have set for this business. We will, however, need to weather these turbulent seas by conducting the necessary investments at the required timing based on an accurate understanding of industry trends.

Current conditions in this business are essentially the same as those described back in April of this year. What has changed is that QINeS-BSW has been adopted for use in the development of next-generation automobile models in the fiscal year ending March 31, 2019, adding to those that employed this basic software during the previous fiscal year, and we have received orders from new customers seeking the assistance of SCSK as a partner in development.

Our QINeS operations generated sales in the area of ¥0.2 billion during the six-month period ended September 30, 2018. While this figure is significantly lower than our original target, it still represents steady progress in the growth of this business and the recovery of our investment therein.

For your reference, the automotive software systems business based on a broad definition, including model-based development, continues to enjoy brisk performance, with sales growth of more than 20% year on year.

■ Strategic Businesses 2—Commercialization of Digital Transformations (DX) (slide5)

Next, I would like to talk about our efforts to commercialize digital transformations. This initiative is one of our focuses among the new initiatives we are advancing as part of our promotion of strategic businesses to explore new markets, not only in the automotive software systems business but also in other fields over the medium to long term.

As you know, digital transformations are spreading across all industries, and the ICT and borderless trends are advancing at a rapid clip. Is this era, simply embracing digital technologies will not be enough; customers will need to identify the aspects of their operations requiring transformation and then to disrupt and rebuild their own operations and business model.

SCSK is committed to supporting customers in transforming their businesses in this manner. With our broad customer base of around 8,000 companies, we have accumulated extensive insight and a wealth of technologies related to customers' various business trials through our participation in the development of operational systems for numerous industrials and companies. Leveraging these assets, we will identify what customers will need for the transformation of their business model from a cross-industry perspective. In this undertaking, we will aspire to base our efforts on an understanding of the latest trends pertaining to cutting-edge technologies, solutions, and other innovations.

Furthermore, we aim to create and commercialize new businesses in the digital transformation field as we work together with customers to support their digital transformations.

To facilitate these efforts, we have resolved to establish the DX & Innovation Business Committee effective November 1, 2018. This cross-Company organization will be tasked with consolidating information regarding the wide-ranging needs of customers in relation to the digital transformations expected to become common place in all industries and supporting the creation and commercialization of new business models, both together with customers and exclusively by SCSK.

This committee will thus be responsible for promoting the digital transformations of customers and for commercializing digital transformations as services to be offered by SCSK through combinations of its various technologies and frameworks. By means of these initiatives, we will identify and develop technologies and intellectual assets that will be advantageous to the commercialization of digital transformations while also recruiting and cultivating human resources that are similarly beneficial. We thereby aim to heighten SCSK's ability to promote digital transformations.

In the medium-term management plan it launched in the fiscal year ending March 31, 2019, parent company Sumitomo Corporation has defined its intent to pursue revolution in business models and upgrading of business by the acceleration of digital transformation. SCSK has roles to play that is strategically important to Sumitomo Corporation's business in this field. We have been involved in the DX Center, which was set up by Sumitomo Corporation to facilitate the creation of next-generation businesses, since its inception, and we are working together with this company to promote digital transformations throughout the Sumitomo Corporation Group.

The experience and insight gained through coordination and collaboration with Sumitomo Corporation will be fully utilized as we increasingly partner with other companies boasting new technologies and business models that relate to digital transformations. Through this approach, we hope to contribute, as a partner, to the transformation of the business models of a wide range of customers while also commercializing various digital transformation-related services.

■ In Closing

This wraps up my explanation of performance, business trends, the progress of business strategies, and our efforts to commercialize digital transformations.

In closing, let me say that SCSK is devoted to tackling digital transformations head on and to commercializing these transformations. Nevertheless, we recognize that "digital transformation" is a buzzword with the potential to mislead customers and SCSK itself. Faced with a massive paradigm shift, we must be careful to avoid being misled by buzzwords in order to guide business transformations appropriately, to guarantee sustainable improvements in corporate value. And, above all else, we must help improve the value of customers' businesses in a manner that contributes to the growth of our own business.

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

Thank you.