Transcript of results briefing

Consolidated Results of Operations for 2nd Quarter of Fiscal Year Ending March 2020

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■ Greeting

Greetings, my name is Yasuhiko Oka, and I am a senior executive officer of SCSK Corporation. I would like to start by thanking you all for taking time out of your busy schedules to join us for this presentation during which we will discuss the performance of SCSK Corporation during the six-month period ended September 30, 2019.

■ Contents (slide1)

Today, I will be discussing our performance in the six-month period ended September 30, 2019, based on the materials that have been distributed.

The agenda for today's presentation can be seen in the contents section on slide 1. In accordance with this agenda, I will begin by providing an overview of our performance in the six-month period ended September 30, 2019, and then move on to discuss specific performance items.
This presentation is scheduled to take around 15 minutes.

■ Consolidated Performance Highlight (slide2)

Please look at slide 2, which displays consolidated performance highlights for the six-month period ended September 30, 2019.

As mentioned by President Tanihara, net sales in the period under review were up 11.9% year on year, to ¥187.3 billion, while operating profit rose 23.7%, to ¥19.8 billion, making for record breaking six-month performance.
In addition, order backlog was up 9.4%, to ¥130.4 billion.

As explained at the financial results presentation for the three-month period ended June 30, 2019, operating environment and market trends have remained strong since the beginning of the fiscal year. Particularly noteworthy has been the recent and ongoing trend toward robust growth in IT investment demand among customers in the manufacturing industry.

In addition to demand for strategic IT investment for improving competitiveness, we have seen firm demand for operational system upgrade investment for implementing labor-saving measures in response to labor shortfalls and for converting certain legacy systems into open systems. Furthermore, businesses catering to the financial industry benefited from the continuously strong appetite for investment in a diverse spectrum of business augmentation measures.

These conditions led to the performance that I will be discussing next.
Please turn to the overview of performance on slide 3.

■ Summary of Financial Results（PL/Incoming Orders/Backlog）(slide3)

Net sales increased ¥10.8 billion, or 13.5%, year on year, to ¥90.9 billion. Large contributors to this increase included growth in systems development projects for automobile manufacturers and analytical server and other equipment introduction projects for the manufacturing industry as well as higher network equipment sales to the communications industry.

I will explain the factors that influenced operating profit in more detail later on. As for the gross profit margin, a decrease of 0.1 percentage point was seen year on year primarily due to a sharp rise in relatively low-margin system sales. However, excluding one-time factors, overall business profitability continues to increase.

Meanwhile, selling, general and administrative (SG&A) expenses rose ¥0.9 billion. The majority of these expenses are business investment expenses and other anticipated expenses. Regardless, the ratio of SG&A expenses to net sales was actually down year on year, and the operating profit is improving.

As a result, operating profit was up ¥1.5 billion, or 23.7%, year on year, to ¥7.8 billion, making for an operating profit margin of 8.6%.

In addition, both incoming orders and order backlog were up year on year.

■ By Sales Segment（Sales/Incoming Orders/Backlog）(slide4)
Moving on, please look at slide 4, which displays a sales comparison by sales segment.

Year-on-year increases in net sales, incoming orders, and order backlog were seen in all segments. On the following slides, I would like to explain the performance in each sales segment in a little more detail.

■ Systems Development（Sales/Incoming Orders/Backlog）(slide5)
Please turn to slide 5.

Systems development sales were up 14.2% year on year, to ¥75.7 billion. Sales in this segment were brisk as a result of strong demand for strategic investments, redevelopment of enterprise resource planning and customer relationship management systems, and operational efficiency improvement and streamlining amid the continuation of robust IT investment demand among customers in the manufacturing and distribution industries. Other factors included a rise in system upgrade demand from the financial industry as well as investment demand for improving operating efficiency and enhancing customer services from the power and gas industry.

Incoming orders in this segment were up 6.2% year on year in the six-month period ended September 31, 2019, due to a 10.7% increase seen in the second quarter, despite the impacts of the rebound from large-scale orders from communications and distribution industry customers recorded in the previous equivalent period. There is no change to the favorable trend in inquiries stimulated by the beneficial business environment, and impressive performance continued as a result.

Order backlog, meanwhile, showed double-digit growth following the acquisition of orders from customers in manufacturing, financial, and various other industries combined with the substantial amount of orders that had been logged as of March 31, 2019.

■ System Maintenance and Operation/Services（Sales/Incoming Orders/Backlog）(slide6)
Next, please take a look at slide 6.

Sales in the system maintenance and operation / services segment were up 7.1%, to ¥69.8 billon. In regard to total e-commerce outsourcing-related systems, business catering to the distribution industry felt certain impacts from decreased sales of fulfillment services. Conversely, growth was seen in systems maintenance businesses, in reflection of the favorable systems development trends, and in verification services for pre-market products. Service-oriented businesses are also growing steadily. This growth is apparent in the robust performance of cloud-based core system services and business process outsourcing (BPO) services related to products and services.

Year-on-year growth was posted in incoming orders and order backlog as a result of the favorable trends that contributed to net sales, namely the accumulation of orders for BPO projects, and the fact that the order backlog on March 31, 2019, buoyed order backlog on September 30, 2019. These factors outweighed the impacts of reductions in order periods and sizes from certain customers in comparison to the previous equivalent period.

■ Packaged Software/Hardware Sales（Sales/Incoming Orders/Backlog）(slide7)

Turning to slide 7, we will see performance in the packaged software/ hardware sales segment. Inheriting the order backlog accumulated prior to March 31, 2019, and enjoying impressive order trends in the period under review, packaged software/ hardware sales in the six-month period ended September 30, 2019, were strong in terms of network equipment sales to the communications industry and hardware sales to the manufacturing industry, and overall system sales increased 16.4% year on year, to ¥41.7 billion.

Double-digit growth was seen in both incoming orders and order backlog thanks to the continuation of the solid trend in orders for network equipment from the communications industry that began in the previous fiscal year as well as to the accumulation of orders for hardware from academic research institutions.

With this, I conclude this explanation of performance by sales segment.

■ Sales Comparison by Customer Industry (slide8)

We will next look at sales by customer industry. Sales to all customer industries, as defined by SCSK, were up in the six-month period ended September 30, 2019. I will therefore only be explaining industries for which sales increases were particularly pronounced.
Please turn to slide 8. You also might want to refer to page 2 of the supplementary information data book.

Overall sales to manufacturers rose ¥5.2 billion year on year.
This sales growth was a result of higher sales in the manufacturing industry related to systems development projects from automobile manufacturers as well as to analytical server and other sales. The increased sales of verification services for pre-market products and BPO services related to products and services was also a factor. In addition, contributions came from operational system upgrade demand from the construction industry.

Sales to financial institutions were up ¥4.4 billion year on year. Factors behind this increase included our ability to incorporate system upgrade demand from certain banks coupled with the large scale of systems development projects for the leasing industry, which remained high throughout the period under review.

Sales to the communications and transportation industries were up ¥5.9 billion year on year. Network equipment sales to communications industry customers grew, and we continued to take part in the core system upgrade projects for the transportation industry that began emerging during the previous fiscal year.

■ Business Performance by Reportable Segment (slide9)
On slide 9, you will see this performance reorganized based on the Company's reportable segments. Performance by reportable segment in the six-month period ended September 30, 2019, mirrors the performance by sales segment and customer industry that I just explained. Due to these strong business trends, higher sales and profit were seen in all of our reportable segments.

As was explained at the financial results presentation for the three-month period ended June 30, 2019, the performance of the Mobility Systems segment includes the performance of the automotive application development field and platform field operations of the automotive software systems business as well as the performance of VeriServe, a company with rapidly growing automotive operations.

We once again anticipate a loss in the platform area operations of the automotive software systems business. Performance in the six-month period ended September 30, 2019, was within the scope of our forecasts.

Overall, however, the Mobility Systems segment posted year-on-year growth in both sales and profit, with operating profit in this segment coming to ¥0.6 billion.

■ Operating Profit Analysis (slide10)
Looking now at slide 10, I would like to offer an explanation of the factors that influenced operating profit.
In the six-month period ended September 30, 2019, losses from unprofitable projects were just over ¥0.5 billion. Losses from such projects in the six-month period ended September 30, 2018, amounted ¥0.3 billion, and losses in the period under review therefore decreased operating profit by more than ¥0.2 billion year on year.

SG&A expenses increased ¥1.8 billion year on year in the period under review. Factors behind this increase in expenses included the performance-linked bonuses payments explained at the financial results presentation for the three-month period ended June 30, 2019, and a rise in expenses associated with events commemorating the 50th anniversary of the Company's founding. Another factor was higher SG&A expenses associated with the extension of training periods for new employees that began in the fiscal year ending March 31, 2020. In addition, business investment-related expenses, which are projected to amount to between ¥2.0 billion and ¥3.0 billion on a full-year basis, came to ¥1.1 billion in the six-month period ended September 30, 2019, nearly ¥0.6 billion of which was recorded as SG&A expenses.

These detractors were compensated for by the profit growth stemming from higher sales driven by solid business trends as well as by the improved profitability seen in systems development and in system maintenance and operation / services. As a result, operating profit was up ¥3.8 billion year on year, to ¥19.8 billion.

■ Consolidated Balance Sheets (slide11)
We will now discuss our consolidated balance sheet. Please turn to slide 11.

On September 30, 2019, total assets amounted to ¥317.1 billion, net assets were ¥201.0 billion, and the equity ratio stood at 63.3% while net assets per share was ¥1,932.

■ Consolidated Financial Forecasts / Interim Dividends (slide12)

Next, please turn to slide 12.
SCSK's performance in the six-month period ended September 30, 2019, was as I have explained thus far as a result of the strong operating environment and market trends continuing on from the previous fiscal year.

At this point in time, we have chosen not to revise the forecasts for the fiscal year ending March 31, 2020, that were announced on April 26, 2019. This decision was based on the need to carefully discern various IT investment trends, as was mentioned by President Tanihara.
As shown on this slide, we have decided to raise the interim dividend for the fiscal year ending March 31, 2020, by ¥5 from ¥50 in the previous fiscal year, on top of which a special dividend of ¥10 commemorating the 50th anniversary of the Company's founding will be added, making for a total interim dividend payment of ¥65 per share. This amount is in line with our initial plan.

This concludes my presentation. SCSK looks forward to your support and encouragement going forward.
We greatly appreciate you taking the time to join us today.