Transcript of results briefing

Consolidated Financial Results for Fiscal Year Ended March 2021 and Financial Forecasts for Fiscal Year Ending March 2022

Yasuhiko Oka

Managing Executive Officer, SCSK Corporation

■ Greeting

Greetings, my name is Yasuhiko Oka, and I am a Managing Executive Officer of SCSK Corporation.

■ Contents (slide 1)

The agenda for today's presentation can be seen in the contents section on slide 1. I will be discussing the Company's consolidated financial results in the fiscal year ended March 31, 2021, and our forecasts for consolidated financial results in the fiscal year ending March 31, 2022.

■ Summary of Financial Results (PL/ Incoming Orders/ Backlog) (slide 2)

Please look at slide 2, which displays consolidated performance highlights for the fiscal year ended March 31, 2021.

In the fiscal under review, net sales were ¥396.8 billion, up 3.0% YoY.
Operating profit was ¥45.8 billion, up 14.6% YoY.
The operating profit margin was 11.6%, up 1.2 percentage points YoY.
Profit attributable to owners of parent was ¥33.4 billion, up 16.2% YoY.

We were thus able to achieve our ninth consecutive year of net sales and operating profit growth since the merger, despite the challenging operating conditions created by the COVID-19 pandemic.

We will be looking at sales by sales segment later on. For now, let me begin by talking about consolidated net sales, which rose 3.0%, to ¥11.5 billion. This increase can be attributed to higher Systems Development, and System Maintenance and Operation/ Service sales, which offset the initially anticipated decrease in Packaged Software/ Hardware Sales.

Gross profit was up 5.9%, or ¥5.7 billion, due to the higher net sales as well as the benefits of our ongoing efforts to prevent the occurrence of unprofitable projects and to quickly address downturns in profitability through the use of SCSK's proprietary development standard. Meanwhile, the gross profit margin increased by 0.7 percentage point, to 25.9%, due to changes in the sales mix of Packaged Software/ Hardware Sales.

Selling, general and administrative (SG&A) expenses were relatively unchanged year on year. Personnel expenses rose following the influx of new graduate and mid-career hires and the introduction of new human resource systems in July 2020. However, these higher expenses were counterbalanced by reductions in business trip and other expenses stemming from the COVID-19 pandemic, special support payments made on a one-time basis to employees in 2020 in response to the pandemic, and the fact that software amortization and other one-time expenses were almost nonexistent.

As a result of these factors, operating profit showed a year-on-year increase of 14.6%, or approximately ¥5.8 billion, to ¥45.8 billion, and the operating profit margin rose 1.2 percentage points.

Profit attributable to owners of parent amounted to ¥33.4 billion, an increase of ¥4.6 billion, or 16.2%, thanks to a decrease in income taxes associated with tax exemptions for wage increases.

Incoming orders rose 5.6%, or ¥21.9 billion, year on year, to ¥412.9 billion, and order backlog grew 11.0%, or ¥ 16.1 billion, to ¥163.2 billion. Increases in these two items were seen in all sales segments as a result of recovery witnessed despite the persistently challenging operating environment.

Also, as explained at the financial results briefing for the nine-month period ended December 31, 2020, Minori Solutions Co., Ltd., which was converted to a consolidated subsidiary in December 2019, contributed ¥11.3 billion to net sales, ¥0.7 billion to operating profit, and ¥9.6 billion to incoming orders in the nine-month period.

■ Summary of Financial Results from Jan. to Mar. 2021 (PL/ Incoming Orders/ Backlog) (slide 3)

Moving on to slide 3, this slide provides an overview of performance in the fourth quarter of the fiscal year ending March 31, 2021.

Net sales were ¥105.9 billion, up 1.5% year on year.
Operating profit was ¥11.8 billion, up 39.6%.
The operating profit margin was 11.2%, an increase of 3.1 percentage points.

In this manner, the upward trend in sales and profit seen in the third quarter of the fiscal year continued on into the fourth quarter.

The 1.5% increase in net sales was a result of the strong trends in Systems Development, and System Maintenance and Operation/Services that were particularly pronounced in the second half of the fiscal year, the benefits of which outweighed the decrease in Packaged Software/ Hardware Sales from the absence of previously recorded large-scale hardware sales.

Fourth-quarter operating profit showed a massive year-on-year increase of ¥3.3 billion, or 39.6%. Factors behind this increase included net sales growth; higher gross profit, a product of fewer unprofitable projects and improvements to the gross profit margin driven by sales mix changes; and the aforementioned absence of the one-time expenses accounted for under SG&A expenses that detracted from profit in the previous fiscal year.

In addition, fourth-quarter incoming orders and order backlog rose in all sales segments.

In Packaged Software/ Hardware Sales, fourth-quarter net sales decreased year on year while fourth-quarter incoming orders rose as orders for next-generation network equipment were received from the communications industry during the fourth quarter.

■ Comparison by Sales Segment (Sales/ Incoming Orders/ Backlog) (slide 4)

Moving on, slides 4, 5, and 6 detail performance by sales segment.

Looking first at the Systems Development segment, the graph on this slide shows full-year and fourth-quarter performance in net sales and incoming orders, with the numbers on the top of each row representing full-year performance and the numbers on the bottom showing fourth-quarter performance.

Net sales in the Systems Development segment rose 4.4%, to ¥163.0 billion. In the nine-month period ended December 31, 2020, we saw the contraction of projects from the securities, transportation, real estate, and utilities industries while Minori Solutions buoyed sales by ¥8.1 billion. Overall, sales growth was achieved thanks to IT investment demand for customer contact point strengthening from communications industry clients, core system redevelopment demand from distribution industry clients, next-generation systems development demand from food product manufacturers, and demand for strategic business investment from automobile manufacturers. These factors led to a particularly large increase of ¥1.9 billion in fourth-quarter net sales.

Incoming orders were up 5.7%, or ¥8.8 billion, year on year, to ¥163.9 billion. Although large-scale orders from life insurance and gas companies shrunk, overall orders rose because of investment demand from clients in the communications, distribution, and food product industries as well as system upgrade demand from banking industry clients.

Order backlog similarly rose 2.2%, or ¥0.8 billion, year on year, to ¥37.1 billion.

■ Comparison by Sales Segment (Sales/ Incoming Orders/ Backlog) (slide 5)

Next, we will look at the System Maintenance and Operation / Services segment.

Net sales in this segment showed strong growth, rising 6.4%, or ¥9.1 billion, year on year, to ¥152.5 billion. Net sales increased in the manufacturing and banking industries, despite a decrease in verification services. In addition, against the backdrop of efforts to strengthen non-face-to-face client contact and to reform operations through digitization, the BPO business through contact centers and EC-related businesses remained firm.

Incoming orders were up 8.1%, or ¥12.0 billion, year on year, to ¥159.9 billion. Similar to net sales, incoming orders increased in the data center business, while verification services decreased. In addition, against the backdrop of efforts to strengthen non-face-to-face client contact and to reform operations through digitalization, BPO businesses from contact centers and EC-related companies accumulated.

Order backlog benefited from the same trends as incoming orders, rising 8.0%, or ¥7.4 billion, to ¥100.5 billion.

■ Comparison by Sales Segment (Sales/ Incoming Orders/ Backlog) (slide 6)

We will look next at the Packaged Software / Hardware Sales segment on slide 6.

Net sales in this segment decreased ¥4.4 billion year on year. This decrease was a result of the rebound from previously recorded sales of servers, storage, and other hardware to automobile manufacturers as well as sales reductions stemming from delays in the development of next-generation network equipment for communications industry clients. These detractors outweighed the benefits of higher sales of enterprise resource planning system and other licenses, the growth in demand for network and security products prompted by the COVID-19 pandemic, and the rise in sales of network equipment to the communications industry.

Incoming orders were up ¥1.0 billion year on year, despite the rebound from previously recorded orders for servers, storage, and other hardware experienced amid the COVID-19 pandemic, as the growth in demand for network and security products and batch orders for network equipment from communications industry clients that contributed to net sales also boosted incoming orders.

Order backlog rose ¥7.9 billion due in part to batch orders for network equipment from communications industry clients.

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

■ Sales Comparison by Customer Industry (slide7)

We will next look at sales by customer industry.

Sales to the manufacturing industry rose ¥4.5 billion year on year. This increase can be attributed to demand for next-generation systems development from food product manufacturers, systems upgrade demand from electrical machinery manufacturers, and IT investment demand from precision equipment manufacturers. Sales to automobile manufacturers decreased roughly ¥2.1 billion, but this decrease was a result of several large-scale orders for Packaged Software / Hardware Sales such as servers or storage which being recorded in the previous fiscal year. Systems development sales catering to strategic IT investment demand remained strong.

Sales to the distribution industry were up ¥3.8 billion as Packaged Software/ Hardware Sales grew due to the higher demand for network and security products seen in response to the COVID-19 pandemic and to the recording of orders for large-scale core system redevelopment projects.

Sales to financial institutions grew ¥3.7 billion as a result of rises in the sales in System Maintenance and Operation/ Services following growth in demand for managed services as well as increases in large-scale systems development projects for the banking industry.

As for the communications and transportation industries, Systems Development sales increased by approximately ¥1.4 billion. Conversely, a decrease in sales of roughly ¥5.0 billion was seen as a result of the rebound from network equipment sales to communication industry clients recorded in the previous fiscal year.

Sales to the utilities industry were down ¥0.5 billion following the contraction of Systems Development projects.

Sales to the service industry and other clients were up ¥4.3 billion due to large-scale hardware sales to academic research institutions and increased sales in data center and e-commerce-related businesses.

■ Business Performance by Reportable Segment (slide 8)

Next, I would like to discuss performance by reportable segment.

Today, I will be focusing specifically on the Industrial IT Business segment, the Financial IT Business segment, and the IT Platform Solutions segment.

Despite lower verification service sales and the contraction of projects for the transportation, real estate, and utilities industries, net sales increased in the Industrial IT Business segment as a result of growth in Systems Development sales to manufacturing industry clients, such as automobile and food product manufacturers, and to communications industry clients. Segment profit increased due to the higher sales coupled with the reduction of losses associated with unprofitable projects.

In the Financial IT Business segment, net sales were down ¥1.0 billion in the nine-month period ended December 31, 2020, as projects for the securities industry declined after having peaked. However, growth in Systems Development projects for the banking industry resulted in full-year net sales being relatively unchanged year on year. Segment profit rose due to the absence of the losses on unprofitable projects recorded in the previous fiscal year.

Sales were down in the IT Platform Solutions segment as a result of lower hardware sales to the manufacturing industry as well as delays in the development of next-generation network equipment for communications industry clients. However, profit was up following increased demand for relatively high-margin network and security products.

■ Operating Profit Analysis (slide 9)

Looking now at slide 9, I would like to offer an explanation of the factors that influenced operating profit.

Overall, operating profit was up ¥5.8 billion year on year. The rise in net sales boosted operating profit by ¥2.9 billion while the improved gross profit margin, which incorporated a ¥1.6 billion reduction in losses from unprofitable projects, raised operating profit by ¥2.9 billion.

SG&A expenses were relatively unchanged year on year primarily due to the factors detailed on this slide.

The combined impact of these factors was a year-on-year increase of approximately ¥5.8 billion in operating profit, which came to ¥45.8 billion, and a rise in the operating profit margin from 10.4% to 11.6%.

■ Consolidated Financial Forecasts/ Dividend Forecast (slide 10)

Next, I would like to talk about our financial forecasts and dividend forecasts for the fiscal year ending March 31, 2022.

The sense of uncertainty surrounding the COVID-19 pandemic persists. At the same time, however, we anticipate that IT investment demand will recover as the economy picks up due to the accelerated digitization trend seen in response to the change associated with the new normal emerging in the midst of the pandemic.

Given this outlook, our consolidated financial forecasts for the fiscal year ending March 31, 2022, are as follows: net sales of ¥420.0 billion, up 5.8%; operating profit of ¥48.0 billion, up 4.6%; and profit attributable to owners of parent of ¥34.0 billion, up 1.7%.

Net sales are forecast to increase 5.8% because current order and inquiry trends have led us to judge that the strong system investment demand will continue. Another factor considered in this forecast is the outlook that consistent demand for maintenance and operation services will continue on from the fiscal year ended March 31, 2021.

In regard to operating profit, we will continue previous measures for improving profitability while conducting aggressive strategic investments in line with the core strategies of the Medium-Term Management Plan in order to accelerate the plan in its second year.

Therefore, in anticipation of profit growth through the maintenance and improvement of sales and productivity, we plan to increase operating profit by approximately ¥2.1 billion, or 4.6%, year on year, by absorbing cost increase factors, such as strategic investment costs and operating-related expenses that anticipate the end of the spread of COVID-19 pandemic.

As for dividends, as stated by President Tanihara, we plan to raise dividend payments by ¥5 per share, to ¥140 per share, in the fiscal year ending March 31, 2022, which will once again make for a dividend payout ratio that exceeds 40%.

This concludes my presentation. SCSK looks forward to your ongoing support and encouragement.

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