

Transcript of results briefing Business Results Summary for the 2nd Quarter of Fiscal Year Ending March 2024 and Progress of Medium-Term Management Plan

Takaaki Touma
Representative director, and President of SCSK Corporation

■ Introduction

Greetings, my name is Takaaki Touma, and I am representative director, president of SCSK Corporation.

I would like to thank you for taking time out of your busy schedules to join us to today for this briefing on the financial results of SCSK Corporation in the six-month period ended September 30, 2023.

Today, in addition to offering an overview of SCSK's six-month performance, I would also like to discuss the progress of the Medium-Term Management plan that we launched in April 2023.

We will look first at performance in the six-month period ended September 30, 2023.

Let us turn to slide 3.

■ Financial Results for the Q2 of FY2023 (Summary) (slide 3)

SCSK's operating environment is characterized by a consistently growing appetite for IT investment among customers. This trend is contributing to a strong deal flow for core systems redevelopment and other services.

Meanwhile, there is a significant shortage of the sophisticated digitally proficient human resources and IT engineers needed to respond to the growing demand for IT services, and our peers are currently directing their attention toward augmenting their production capabilities.

At SCSK, we are utilizing low-code, no-code development methodologies to heighten productivity in development. In addition, we are embracing generative AI, which I will get into a little later, while maintaining our focus on expanding our nearshore development capacity and bolstering relationships with partners based on our Core Partner Program in order to heighten our production capacity.

Alongside such efforts, we moved forward with Company-wide initiatives based on the core strategies of the Medium-Term Management plan and shifted toward businesses promising higher growth potential and profitability. As a result of these initiatives, SCSK posted net sales of ¥231.1 billion in the six-month period ended September 30, 2023, an increase of 8.5% year on year; gross profit of ¥61.2 billion, an increase of 10.9%; and operating profit of ¥26.9 billion, an increase of 19.6%.

Managing Executive Officer Yasuhiko Oka will providing a more detailed explanation on our performance a little later on in today's presentation.

We will now turn to the next slide.

■ Financial Results for the Q2 of FY2023 (Backlog) (slide 4)

With this slide, I would like to explain the order backlog that will support performance in the second half of the fiscal year.

On a consolidated basis, order backlog was up 4.2% year on year. The Systems Development segment, specifically, showed a 17.7% year-on-year increase in order backlog.

We expect orders for core systems re-construction projects from distribution industry customers to peak and start to decline in the second half of the fiscal year. Nevertheless, we still anticipate sales growth in the second half of the fiscal year as a result of progress in large-scale projects for several other customers as well as the acquisition of new orders.

In the six-month period ended September 30, 2023, System Maintenance and Operation / Services segment showed weak growth in order backlog while order backlog was down year on year in the System Maintenance and Operation / Services segment. Both of these outcomes were as initially expected and were a result of factors that we have explained previously, namely changes to accounting standards in the data center business and the absence of large sales of systems to certain communications industry customers recorded in the previous equivalent period.

I would now like to move on to the next slide.

■ Consolidated Financial Forecasts for FY2023 (slide 5)

We have chosen to institute an upward revision to the forecasts for consolidated performance announced on April 28, 2023, as shown on this slide. This decision was made based on the six-month performance and order trends we have discussed thus far as well as on the fact that figures for net sales, operating profit, and profit attributable to owners of parent are now anticipated to surpass the initially forecast level.

As shown on this slide, the forecast for net sales has been raised by ¥5.0 billion from the initial forecast, to ¥475.0 billion; the forecast for operating profit has been increased by ¥2.5 billion, to ¥56.5 billion; and the forecast for profit attributable to owners of parent has been upped by ¥1.5 billion, to ¥39.5 billion.

Managing Executive Officer Yasuhiko Oka will be offering more details on our performance a little later on.

We will now turn to the next slide.

■ 2. Progress of Medium-Term Management Plan (slide 6)

I would now like to talk about the progress of the Medium-Term Management plan. Let us move on to the next slide.

■ Medium-Term Management Plan SCSK Group's Core Strategies (slide 7)

This slide shows the core strategies of the Medium-Term Management plan.

With the following slides, we will be discussing the progress of the Medium-Term Management plan with a focus on specific points primarily related to core strategy 1 and core strategy 2.

Let us look at the next slide.

■ Progress of the Medium-Term Management Plan (Core Strategy I) (slide 8)

Core strategy 1 calls on us to undertake three decisive business shifts that target all of our existing businesses in order to improve growth potential and profitability in these businesses. These shifts are designed to generate the surplus investment funds and resources that will be necessary to the implementation of other two core strategies.

The shift toward high-potential business areas, displayed on the lefthand side of this slide, has entered the phase of undertaking actual business shifts as we have already identified the businesses that will be subject to the selection process. We intend to shift toward growth areas by substantially narrowing the scope of our businesses on the division level, to withdraw from product sales businesses for which we cannot chart a course toward future growth, and to advance other reorganizations based on clearly defined plans.

We are also examining the possibility of Companywide staff reallocations in accordance with core strategy 2. For example, resources are being concentrated on businesses related to digital supply chains for the manufacturing industry as well as to mobility and security services. In regard to digital supply chains, specifically, a shift of more than 100 personnel to this area has been completed, and a large number of people have finished the necessary reskilling and begun taking part in actual business activities.

In regard to the shift toward high-value-added areas shown on the center of this slide, we are involved in a shift toward upstream processes in the systems development field. A prime example of this shift can be seen in the strategic partnership with Honda Motor Co., Ltd., announced in July 2023. At the same time, we were dedicating effort to securing consulting and other sophisticated human resources.

Since becoming president, I have continued to act with a strong sense of commitment toward adjusting IT service prices to more appropriately reflect the market value of IT human resources. This undertaking is something to be expected given the current operating environment. Through such efforts, we have succeeded in achieving more appropriate price levels for new projects while also redefining prices at the time of contract renewals for existing maintenance and operation service businesses. These revisions are expected to lead to improvements in performance in the fiscal year ending March 31, 2024, that will be sufficient to absorb the majority of the impacts from the increases to base salaries instituted in July 2023 and from the rise in outsourcing costs at partner companies.

Meanwhile, the shift toward high-productivity business models, seen on the righthand side of this slide, is being advanced through assessment of the potential of applying generative AI to the improvement of productivity in development businesses. I will go into these efforts in a little more detail later on.

Please look at the next slide.

■ Progress of Medium-Term Management Plan (Core Strategy II) (slide 9)

Turning to core strategy 2, this strategy will be the driver behind the growth of the SCSK Group during the period of the Medium-Term Management plan and will entail building a business portfolio that will allow us to exercise our strengths in the era of cloud and digital technologies.

On righthand side of this slide, you will see the year-on-year changes in sales by service area in the six-month period ended September 30, 2023.

The largest increase in sales was seen with regard to the modernization services. This increase was in part a result of growth in digital supply chain businesses, which itself can be attributed to strong demand for medium- to large-scale SAP projects. Other contributing factors include

favorable performance in anti-money laundering service businesses catering to financial institutions and a rise in projects for accommodating Japan's newly instituted invoice system in businesses serving medium-sized companies and supporting data-driven management.

As for innovation services, we witnessed strong growth in systems development orders from original equipment manufacturers in the mobility business. Meanwhile, demand for security products remained brisk with regard to integration services. These factors led to the results indicated on this slide.

Let us move on to the next slide.

■ Progress of Medium-Term Management Plan (Topics) (slide 10)

I would now like to talk about a couple of topics that pertain to the progress of the Medium-Term Management plan.

As shown on this slide, we kicked off a number of initiatives related to core strategy 2 during the fiscal year ending March 31, 2024. Among these, I would like to highlight the company split announced on October 27, 2023, and the establishment of a new dedicated cybersecurity company announced on September 29, 2023.

I will also be touching on our establishment of an AI center of excellence and our initiatives for utilizing generative AI as part of our efforts to incorporate AI into our business in order to strengthen management foundations.

We will now move on to the next slide.

■ Progress of the Medium-Term Management Plan (Topics) (slide 11)

In regard to anti-money laundering businesses, SCSK has been providing proprietary anti-money laundering solutions centered on its BankSavior brand of offerings since 2004. These solutions have been embraced by more than 80 customers in banks, credit card companies, securities firms, insurance companies, and a wide range of other industries.

The BankSavior brand has been evolved through the regular exchanges of information with users and financial institutions that we have been holding since 2010. This process has enabled us to shape the consensus among users when it comes to the latest anti-money laundering trends and to enhance our offerings together with users.

No doubt due in part to this ongoing diligence, in March 2023 SCSK became the only private company selected for the Financial Services Agency subsidy program for businesses developing sophisticated anti-money laundering measures. Furthermore, we established SCSK RegTech Edge Corporation as a preparatory company as part of the process of developing a dedicated anti-money laundering service organization in June 2023, and it was resolved to transfer a portion of the Company's operations to this subsidiary at a meeting of the Board of Directors held on October 27, 2023.

By capitalizing on the financial crime prevention insight and experience we have amassed over

the years, we are committed to evolving SCSK RegTech Edge Corporation as a leading anti-money laundering service company and thereby developing a business that contributes to the safety and security of society.

Let us turn to the next slide.

■ **Progress of the Medium-Term Management Plan (Topics) (slide 12)**

Next, I want to talk about the establishment of a new dedicated cybersecurity company. The new company, SCSK Security Corporation, is tasked with delivering the high-level cybersecurity services customers expect by combining product businesses, in which we utilize the advanced technologies of SCSK's product vendors and service vendors, with service businesses, where we capitalize on our robust track record in systems assessment, analysis, development, operation, and security consulting.

Positioning SCSK Security as a dedicated cybersecurity company and a central component of our cybersecurity business, we will seek to bolster our staff of white hackers and other human resources with specialized expertise while also offering compensation that matches the skills of such individuals. On a Groupwide basis, our cybersecurity business generates net sales of around ¥20.0 billion. By further growth these sales, we aim to raise recognition of SCSK and build its brand image in the cybersecurity market.

In this manner, SCSK Security will offer an environment in which such employees are able to fully utilize their skills while tackling the cybersecurity issues faced by customers and society head on. I am also sure that this environment will contribute to better employee well-being by allowing employees to receive compensation and career development opportunities commensurate to their skills.

We will now turn to the next slide.

■ **Progress of the Medium-Term Management Plan (Topics) (slide 13)**

Lastly, I would like to discuss our efforts to further utilize AI.

We have established an AI center of excellence along with SCSK AI Integration Lab to accelerate our efforts to apply AI to our business and to support customers in adopting AI.

The AI center of excellence is staffed by internal AI expertise and has been assigned the role of using generative AI to achieve improvements in the productivity and quality of our systems development and operation activities.

Moreover, we created SCSK Generative AI as our internal AI infrastructure, and all employees began using this infrastructure in May 2023. In addition, we have been arranging what we call "Idea Kitchen" as internal workshops for cooking up ideas on how to utilize generative AI. More than 3,000 promising ideas have been produced by Idea Kitchen to date, and those deemed to be particularly feasible have been put to proof of concept testing at the AI center of excellence.

Please take a look at the next slide.

■ **Progress of the Medium-Term Management Plan (Topics) (slide 14)**

This slide compiles information on the process of verifying ideas for applying generative AI to systems development.

We are, of course, looking to utilize generative AI to achieve massive improvements in productivity in system development through automated generation of source codes and test codes. At the same time, we aim to apply generative AI to conditions definition and project management processes in order to heighten quality in systems development.

Specific generative AI applications being examined include preparing requirement proposals and requirement definition documents as well as reviewing requirement definition documents as to prevent failures to implement requirements. We are also advancing verification of ways generative AI can help support project management and related organizations in efforts to identify signs of potential project delays based on outputs and project management materials.

By utilizing generative AI, we aim to improve the quality of increasingly large and complex systems development services as well as their outputs. At the same time, we seek to enhance the skills of human resources in order to enable a greater range of SCSK IT engineers to supply IT services in sophisticated areas. In manner, we are targeting high levels of productivity and profitability that could not be achieved merely by continuing our existing business activities.

I hope to be able to provide you with some information on the findings of our verification testing at the full-year financial results briefing for the fiscal year ending March 31, 2024.

With this, I conclude my portion of today's presentation. I hope you will continue to offer your support and understanding to SCSK.

END