SCSK Corporation

Consolidated Financial Results for the First Quarter of Fiscal Year Ending March 2025

Q&A Session Summary

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Speaker: Yasuhiko Oka, Managing Executive Officer

Q. How did performance in the three-month period ended June 30, 2024, compare with internal forecasts? Also, was the ¥0.6 billion in gains on sales of real estate included in these forecasts?

A. Performance in the three-month period ended June 30, 2024, was almost exactly as projected by internal forecasts. The gains on sales of real estate were also in line with forecasts.

Q. Was the decline in the gross profit margin within the projected scope?
What were some of the factors behind this decline? Also, can we anticipate improvements with this regard going forward?

A. There were three main factors behind the decline in the gross profit margin. The first factor was a sales mix that featured a lower ratio of systems development sales in comparison to the three-month period ended June 30, 2023.
The second factor was the decline resulted from low-margin system sales projects. This factor was only temporary.
The third factor was costs incurred in relation to the integration of our ProActive operations and investments in business process outsourcing (BPO) operations. We expect an increase in the portion of our sales mix represented by systems development sales in the second quarter of the fiscal year while the margins on system sales projects should return to normal levels.
These factors are expected to result in the second-quarter gross profit margin improving in comparison to the first quarter. However, costs for investments in ProActive and BPO operations will continue to be incurred in the second quarter.

Q. What is the outlook for sales of hardware to certain communications industry customers?
As these are large-scale orders, I expect that their margins may be a bit low. Will the product mix to be seen going forward have any impact on profit margins?

A. It is difficult to judge the timings at which we will record sales as orders are placed based on the circumstances at customers. Also, not all sales of hardware to certain communications industry customers have low margins.
Rather, the margins vary on a product-by-product basis. Accordingly, it is not as though an increase in such sales will necessarily lead to lower profit margins.

Q. BPO operations have been cited as a factor behind the decline in the gross profit margin. Could you please offer some details regarding BPO contract cancelations and the costs of transitioning to business process modernization services?

A. BPO contract cancelations pertain to orders, and will therefore have no impact on sales. The decrease in sales, rather, was a result of a decline in public-sector projects associated with the COVID-19 pandemic.
This is a trend that is impacting the entire industry. We have received multiple inquiries regarding BPO services that may help counteract this decline, but any contributions to sales from these inquiries will likely not be seen until the second half of the fiscal year.
As for business process modernization services, we have bolstered our service centers. We also recognize the need to invest in enhancing sales and other frameworks to support the transition away from conventional BPO services.
Costs will be incurred for this purpose in the second quarter, but a portion of these costs will be temporary.

Q. What sort of costs and full-year impacts are projected with regard to the enhancement of ProActive's functionality?

A. In the first quarter, we recorded costs in the scale of a couple of hundred million yen in association with the ProActive business integration, and a similar amount of costs is expected to be incurred in the second quarter of the fiscal year.
Investments should be completed in the six-month period ending September 30, 2024, and performance in the second half of the fiscal year is anticipated to be in line with the previous equivalent period as a result.
Meanwhile, we plan to begin recovering our investment in the fiscal year ending March 31, 2026, as our focus in the fiscal year ending March 31, 2025, will be installing frameworks and infrastructure after having completed development.

Q. Could you please provide a breakdown of the increase of ¥2.1 billion in selling, general and administrative (SG&A) expenses seen in the three-month period ended June 30, 2024? Also, what is the forecast for SG&A expenses throughout the remainder of the fiscal year?

A. When explaining our full-year guidance figures, we mentioned three principal sources of SG&A expenses in the fiscal year ending March 31, 2025, namely personnel expenses, expenses for addressing aging internal systems, and office renovation and business investment expenses.
Expenses in the three-month period ended June 30, 2024, were more or less as expected with regard to these sources. Of the ¥2.1 billion increase, ¥0.7 billion was associated with personnel expenses, ¥0.4 billion was for addressing aging internal information systems, and ¥0.7 billion was office renovation and business investment expenses.
The remaining ¥0.3 billion was for sales activities. We also incurred ¥0.3 billion in SG&A expenses that was unexpected as we had anticipated that said expenses would be treated as part of cost of sales. These expenses ended up needing to be recorded under SG&A expenses for accounting purposes.
The ¥2.1 billion increase also included ¥0.4 billion in one-time costs recorded during the three-month period ended June 30, 2024. Second-quarter expenses for addressing aging information systems and renovating offices will be around the same level as those recorded in the first quarter.

Q. What topline growth drivers and cost factors will be seen in second quarter and throughout the remainder of the fiscal year? Also, how does the year-on-year increase of ¥2.1 billion SG&A expenses compare with forecasts?

A. Topline growth drivers will include increased mobility projects as well as core systems development projects for distribution, communications, and banking industry customers in the Systems Development segment.
Meanwhile, we anticipate that upstream processes for multiple SAP-related projects will continue until the second quarter, meaning that sales contributions will be more concentrated in the second half of the fiscal year and later as these projects advance on to subsequent phases.
In the System Maintenance and Operation / Services segment, meanwhile, steady growth is anticipated in relation to verification and management services.
As for costs, considering that a portion of SG&A expenses was represented by expenses expected to be included in cost of sales, it could be said that SG&A expenses only rose by about ¥1.4 billion to ¥1.5 billion when excluding these expenses, which is around what we had anticipated.
However, it is possible that SG&A expenses may continue to increase throughout the fiscal year due to such accounting classification issues.

Q. What is the outlook for performance in the IT Business Solutions segment? This segment recorded a loss in the first quarter of the fiscal year ending March 31, 2025. Will a lose also be recorded in the second quarter?

A. One factor behind the first-quarter loss was the transference of SAP-related operations to the Industrial IT Business segment. The IT Business Solutions segment is currently comprised primarily of ProActive and BPO operations, and the ¥0.1 billion loss recorded in the first quarter was a result of these two areas of operation.
Performance in the second quarter is expected to be around the same level as in the first quarter.
However, performance in the second half of the fiscal year should improve in comparison to the first half as we plan to have completed business reinforcement measures to a certain degree during first half of the year.

Q. What is the full-year forecast for ProActive sales?

A. We cannot disclose a specific figure with this regard, but we can say that we expect to see a certain level of growth in full-year sales due in part to the projects involving prior versions of ProActive.

Q. It was stated that incoming orders in the Systems Development segment have significantly surpassed the previous equivalent period. Could you please provide a breakdown of these orders? Will the resulting order backlog be gradually converted to sales beginning in the second quarter, or will the pace be accelerated?
It was stated that an increase in SAP sales of ¥0.3 billion was seen in the first quarter, and that this increase was a result of us being in a period of transitioning to new systems for the distribution industry and of projects in the condition definition phase being concentrated in the first quarter.
Does this mean that sales growth will speed up in the second half of the fiscal year?

A. Orders in the first quarter were in line with the trends explained at the financial results briefing for the fiscal year ended March 31, 2024.
Specifically, orders were driven by strong performance in the SAP-related projects that at the core of our mobility and digital supply chain businesses as well as by the start of development projects targeting principal industries, such as the distribution, communications, and banking industries. Second-quarter SAP sales are expected to be relatively unchanged from the first quarter as a number of projects will remain in the condition definition phase throughout the second quarter.
It is difficult to predict performance with regard to SAP sales in the second half of the fiscal year, but we anticipate that sales growth will accelerate as projects move on to subsequent phases. Meanwhile, year-on-year growth is anticipated for the SAP order backlog.

Q. What amount of orders are in SCSK's pipeline?

A. As of June 30, 2024, our pipeline included orders totaling ¥69.0 billion, an increase of ¥3.0 billion year on year.

Q. Is the trend in collaboration among major automobile manufacturers a positive development for SCSK's mobility business?
As these companies seek to create development platforms, is there any chance that they may adopt SCSK's QINeS platform?

A. While we cannot offer a definitive answer on matters dependent on trends among customers, we can say that SCSK views this trend as a positive development. The QINeS platform will not be the sole driver of the growth of our mobility business.
SCSK has insight pertaining to both application development and platforms. This has enabled to grow our mobility business through participation in upstream processes and other development support activities. Our partnership agreement with Honda Motor Co., Ltd., has been one venue for this growth.

Q. What type of trends are being seen in regard to enterprise resource planning (ERP) sales?

A. In the three-month period ended June 30, 2024, enterprise resource planning (ERP) sales amounted to ¥9.5 billion, down ¥0.1 billion from ¥9.6 billion in the previous equivalent period. The reason for this decline was a decrease of ¥0.2 billion in sales of ProActive as a result of the dissipation of demand for projects associated with Japan's new invoicing system.