

Samsung SDS Q2 2024 Earnings Conference Call

Good afternoon, this is Won Seo, Team Leader of Investor Relations at Samsung SDS. We will now commence Samsung SDS's second quarter fiscal year 2024 earnings conference call.

With us today are Executive Vice President Jeongheon Lee, Office Leader of Strategic Marketing;

Executive Vice President Scott HJ Koo, Division Leader of Cloud Service Business;

Executive Vice President Haegoo Song, Division Leader of Solution Business;

and Executive Vice President Kooil O, Division Leader of Logistics Business.

Today's conference call will proceed with a presentation on our Q2 2024 earnings, followed by a detailed explanation of each business division's performance and future strategies.

Please note that this call contains forward-looking statements based on current expectations and assumptions, which may differ materially from the actual results.

Now, let us review the Q2 earnings. Please refer to the first page of the earnings presentation slides.

In Q2, our revenue was KRW 3.37 trillion, a 3.7% increase from the previous quarter and a 2.4% increase year-over-year.

Looking at the profit, the gross profit was KRW 500 billion, a 1.9% increase from the previous quarter and a 12.7% improvement year-over-year. The gross profit margin was 14.8%, a 0.3 percentage point decrease from the previous quarter but a 1.3 percentage point improvement year-over-year.

Next is the operating profit for Q2. Operating profit was KRW 221 billion, a 2% decrease from the previous quarter but a 7% increase year-over-year. The operating profit margin was 6.6%, a 0.4 percentage point decrease from the previous quarter but a 0.3 percentage point increase year-over-year.

Net profit was KRW 190 billion, a 12.2% decrease from the previous quarter but an 11.8% increase year-over-year.

Next, let's review the performance by business division on page 2.

First, Q2 IT services revenue was KRW 1.59 trillion, a 2.1% increase from the previous quarter and a 5% increase year-over-year. The cloud business contributed significantly to this growth, with revenue of KRW 556 billion, a 4.8% increase from the previous quarter and a 25% increase year-over-year. The logistics business revenue was KRW 1.78 trillion, a 5.3% increase from the previous quarter, maintaining the same level as the previous year.

The operating profit for IT services in Q2 was KRW 198 billion, an approximate 17% increase from both the previous quarter and the same period last year. The operating profit margin was 12.5%, a 1.6 percentage point increase from the previous quarter and a 1.3 percentage point improvement year-over-year.

The logistics business recorded an operating profit of KRW 23 billion with an operating profit margin of 1.3%. The decline in logistics operating profit margin in Q2 is due to significant one-time gains in Q1 and reduced profitability from decreased air transport revenue in Q2.

This concludes the brief overview of Q2 performance.

Additionally, regarding Samsung SDS's ESG, we published and distributed the 2023 Samsung SDS Sustainability Report on our website on June 30, explaining our ESG performance. Please refer to this newly published report to understand our ESG management performance and strategies.

Now, let me open the floor for division leaders to explain the performance of Q2 and outline any upcoming plans.

[Strategic Marketing Office]

Good afternoon, I am Jeongheon Lee, Executive Vice President of the Strategic Marketing Office. I will explain the Q2 performance and the outlook for the second half of the year for the IT services division.

In Q2, we secured major projects in the financial sector and expanded our ERP business to various industries. Additionally, we achieved significant results in the generative AI business, strengthening our market recognition and establishing a foundation for continuous growth.

In the financial business, we continuously explored and actively participated in non-captive business opportunities, securing core banking systems projects for large banks and data/information systems projects for the insurance companies.

For the ERP business, we expanded our operations to various industries such as electronics, heavy industry, and consumer goods, based on preliminary consulting projects carried out in Q1 and industry-specific strategies.

In the enterprise generative AI business, we launched the FabriX, Brity Copilot in April, securing various business cases and actively promoting our business.

We secured consecutive orders for AI platform projects from banks and new technology-based reference projects from public institutions, solidifying our position as a leading player in the generative AI market. Furthermore, we have completed the application of FabriX to 11 Samsung affiliates in the first half and are sequentially proceeding with contracts for the remaining affiliates.

Next, I will discuss the IT business outlook for the second half.

The domestic economy is expected to experience delayed recovery in the second half. However, industries showing performance improvement thanks to increased exports such as semiconductors and automobiles are anticipated to see an increase in IT investments. The financial and public sectors are expected to improve business conditions, with continuously promoting cloud transformation and generative AI businesses.

In the financial business, we will intensively pursue next-generation information systems for insurance and expand core business projects for large insurance companies, while securing additional reference projects from banks.

In the public business, we will continue promoting cloud transformation while expanding our business scope to new technology areas such as data analytics based on generative AI. Additionally, we plan to expand our public business by focusing on integrated platform projects for the Digital Platform Government of Korea.

We aim to secure visible achievements centered on the financial and public sectors in the rapidly growing generative AI market in the second half and expand to various industries.

Thank you for your attention.

[Cloud Service Business Division]

Good afternoon, I am Hyungjoon Koo, Vice President of the Cloud Service Business Division. I will present the Q2 performance and second-half plans for the cloud business.

Please refer to slide 4.

Cloud revenue was KRW 556 billion, a 25% increase year-over-year.

CSP sales were KRW 209.5 billion, a 49% increase year-on-year. The sales have steadily increased thanks to a growing demand for HPC servers and the significant increase in demand for GPUs for generative AI services.

MSP sales were KRW 248.1 billion, an 11% increase year-on-year but a slight decrease from the previous quarter. With the continued orders for cloud transformation projects and generative AI projects, we expect a significant sales increase in the next quarter.

With the generative AI platform FabriX launched in April, we have achieved the results of receiving orders for generative AI business and data platform business in the financial sector.

By leveraging our generative AI technologies and experience in large-scale projects, SDS won large commercial bank projects, solidifying our position as a leading company in generative AI.

In the second half, we will accelerate cloud and generative AI businesses, focusing on the financial and public sectors.

In the financial sector, we will actively participate in AI platform implementation projects using use cases and order references, while expanding cloud transformation projects for banks and insurance companies.

In the public sector, we plan to open the Daegu data center, selected in the first half as a public-private partnership cloud data center, will provide official services in the second half. We will enhance pre-sales efforts targeting public customers demanding high security level and collaborate with public partners to expand our business.

Additionally, we are preparing products and offerings necessary for the business, aiming to complete additional development of FabriX products in Q3 and diversify customized SCP offerings such as Oracle services and cloud DR to support various projects.

We will leverage FabriX as a key differentiating factor for our MSP and CSP businesses and introduce our cloud business to all industries.

We will strive to achieve favorable results in the cloud business in the second half.

This concludes the cloud business presentation.

Thank you.

[Solution Business Division]

Good afternoon, I am Haegoo Song, Vice President of the Solution Business Division. I will present the Q2 2024 performance and second-half outlook for the solution sector.

First, please refer to slide 3. The ERP business grew by 15% compared to the previous quarter through the advancement projects of next-generation ERP systems for Samsung affiliates and follow-up projects discovered through preliminary consulting projects in industries such as consumer goods and heavy industry.

In the second half, the ERP business is expected to continue to expand through follow-up projects of ongoing consulting projects and expansion projects to overseas branches and affiliates of existing customers.

The smart factory business is continuously carrying out MES implementation and expansion projects for affiliates. In the first half, we completed the introduction of next-generation MES for 3 out of 6 existing plants of a battery manufacturer. In the second half, we plan to complete the introduction for the remaining 3 existing plants and new overseas plants.

On slide 4, you will see that the global SaaS business, one of the pillars of MSP, experienced significant growth thanks to the acceleration of SaaS adoption in SCM, CRM, HCM, and other core business areas. As mentioned in the previous quarter, we are carrying out the next-generation SCM implementation project for Samsung Electronics, and additionally secured the first phase SCM data platform implementation project. In HCM, we secured integrated HR system implementation projects in manufacturing and service sectors and expect to expand non-captive business using Workday reseller partnership.

Our SaaS business also grew through the increase in subscription and license sales of solutions such as cloud EMM and Brity Automation.

The enterprise collaboration solution Brity Works continues to generate stable revenue. Following the launch of Brity Copilot for generative AI-based automation in April, we have been enhancing services of integrated search/summary linked with internal and external knowledge and MS office add-in features. The service enhancement is expected to drive sales growth in the second half.

Our work automation solution, Brity Automation secured the top market share in Korea with growing license sales through securing large financial customers beating global solutions. We plan to expand the generative AI business in the second half based on successful business cases in the bio industry.

We are working together with Emro for the SRM SaaS solution business to enter the global market. We named the SRM SaaS solution as Caidentia and participated in the Gartner Supply Chain Symposium held in North America, identifying leads and initiating full-scale sales activities in the North American market. We are promoting the business through follow-up meetings with the leads that are in need for the solution and will strive to win orders in overseas market in the second half.

Thank you for your attention.

[Logistics Business Division]

Good afternoon, I am Kooil O, Executive Vice President of the Logistics Division at Samsung SDS. I will explain the major achievements of the logistics business in Q2, market outlook and our business strategy for the second half.

In Q2, logistics business revenue was KRW 1.78 trillion, a 5.3% increase from the previous quarter. By logistics segment, ocean transport revenue increased in Q2 compared to last quarter due to the early peak season caused by major country tariff policies and the Red Sea issue as well as rising freight rate. However, air transport revenue decreased in Q2 due to the completion of new product transportation for major customers in Q1. Inland transport and warehouse logistics revenue increased compared to the previous quarter due to increased cargo volume in North America.

Cello Square revenue in Q2 was KRW 285 billion, a 12% increase from the previous quarter. Overseas revenue is expanding in regions such as China, North America, and Europe as well. The number of registered customers increased by 2,000 from the previous quarter to 14,800, and the cumulative number of shipment customers also increased by 15%.

We continuously improve competitiveness of customer services and operational productivity using generative AI. To minimize the impact of global supply chain risks on customers' global operations, we collect 60,000 news items daily and analyze their relevance to logistics so that we can detect logistics-related risks at an early stage and establish response plans. We analyze importance and estimate cargo volume using generative AI to minimize the impact on customers' businesses.

Next, I will discuss the market outlook and business strategy for the second half.

Ocean freight rates have been surging due to increased external uncertainties such as tight capacity on major routes, ongoing conflicts, tariff policy changes, and strikes. These conditions are anticipated to persist in the second half. Congestion at major Asian ports like Shanghai and Singapore also contributes to increasing operational risks.

Air transport rates are expected to remain strong in the second half due to increased e-commerce cargo from China and continued demand shifts from ocean caused by the Red Sea situation. Despite the high external uncertainty, SDS will proactively secure stable capacity and competitive rate through long-term partnerships with shipping and airline companies to minimize customers' logistics burden.

Next is the business direction for the second half. In the second half, we will focus on differentiating our services by providing information services that meet growing customer needs, such as global logistics control services and carbon emissions dashboards, to identify strategic global customers.

Additionally, with the increase in companies relocating production bases from China to Southeast Asia and Mexico due to recent U.S. tariff policies, SDS has strengths in providing logistics services in both regions. We plan to provide end-to-end logistics services which cover from consulting to equipment relocation, materials procurement, and finished product export logistics for customers adjusting their global supply chain networks.

This concludes the presentation on the logistics business. Thank you.

[Q&A Session]

Q: Hoyoon Jung from Korea Investment & Securities

Can you briefly explain the business performance since the launch of FabriX and the business plans for the second half of the year?

A: Scott HJ Koo, EVP and Cloud Service Business Division Leader

We launched FabriX, our enterprise generative AI platform, to support the full spectrum of GenAI service development and use. Since April, we've been actively involved in various internal and external business activities.

We began by rolling out the service to Samsung affiliates and have been actively pursuing external opportunities. As a result, we've won several contracts for generative AI implementation projects from the banking sector.

Our generative AI technology has shown its superiority through advanced features like high-performance AI knowledge search, powerful development tools, and optimized learning. Winning these contracts has been a key milestone in solidifying our leadership in the market.

In the public sector, we were chosen as a private investment project contractor in the first half of the year. We're now gearing up for pilot projects with ten different institutions, setting ourselves up to achieve significant results in the public market as well.

Regarding the plan for securing FabriX products in the second half, we plan to release three additional products to stay ahead in the fast-evolving generative AI landscape. Our plan is to expand built-in plug-in functions such as Code Interpreter and develop use case-specific RAG models.

We'll leverage the contracts and use cases gained from various PoCs in finance and the public sector to further drive our focus on cloud and generative AI projects.

We will strive to achieve good results as we are one step ahead of our competitors in terms of technology and orders.

Q: Junho Lee from Hana Securities

Firstly, you mentioned plans to focus on cloud transformation projects in the financial sector during the second half of the year. Can you provide more details on the current

market situation of the financial sector and SDS's approach to these business opportunities? Also, is there a possibility of lower profit margins if orders occur in the financial and public sectors? Secondly, regarding the recent CrowdStrike incident, do you expect a slight slowdown in CSP business, or do you expect to benefit from the expansion of multi-cloud?

A1: Jeongheon Lee, EVP and Strategic Marketing Office Leader

In the financial sector, the easing of regulations is accelerating the transformation to cloud-based systems. After major banks, insurance companies and other second-tier financial institutions are now beginning to implement next-generation cloud systems. Also, interest in applying new technologies such as generative AI is also increasing.

The financial IT business is largely composed of core system, information system, and channel system. The core system is the unique business system of financial institutions, such as loans and deposits. The information system is the system for storing and analyzing data related to customers and operations, and the channel system is the system used directly by customers, such as internet banking and mobile banking. In Q2, our financial business secured core system implementation projects for large banks such as KDB Bank and information system projects for the insurance industry such as ABL Life Insurance. We also secured generative AI platform implementation projects in two large commercial banks.

In the second half, we plan to focus on core system implementation projects in the insurance industry and information system projects using generative AI technology for data analysis and real-time marketing in the second-tier financial sector.

We do not expect the profit margin to be significantly affected by the business we are promoting. We're set to lead the market by providing unique value-added services that distinguish SDS, driven by our expertise in cloud and generative AI technologies.

A2: Scott HJ Koo, EVP and Cloud Service Business Division Leader

The CrowdStrike incident is related to security solutions rather than CSP issues. As security solutions are necessary for all companies, it can be an opportunity for CSPs that can manage them well. MSP providers with well-organized procedures and problem-solving capabilities will be highly sought after.

Q: Soojin Kim from Mirae Asset Securities

Regarding Brity Copilot, a generative AI product, can you explain the current business status and future prospects?

A: Haegoo Song, EVP and Solution Business Division Leader

To support the implementation of hyper-automation in corporate work, we launched Brity Copilot, a solution integrating generative AI into common work solutions such as mail, messenger, meetings, and document management in Brity Works in April. We are promoting the expansion of the service to Samsung affiliates and external markets after applying it internally in SDS. As of July, about 90,000 employees from Samsung affiliates such as Electronics and C&T are using this service.

In the second half, we plan to expand it sequentially to all affiliates, including overseas subsidiaries. For external business, a Vietnamese IT company adopted Brity Works and Copilot, and multiple customers in manufacturing and service industries are expected to adopt it soon. We are also conducting PoCs with 14 customers in industries such as petrochemicals, automotive, and food and beverage, and expect to secure more customers in the second half. Additionally, we plan to expand the business targeting large corporations, finance, and public sectors with high security needs through private cloud offerings.

Regarding the product improvement plans for the second half, we are preparing for enabling the use of Brity Copilot in office programs such as Microsoft Word, PowerPoint, and Outlook.

Meeting Copilot currently supports real-time captions in Korean and English and plans to support 10 languages including Vietnamese and Japanese, and provide offline meeting mode that can distinguish speakers in the same place. This service enhancement will help us secure more use cases, so we expect to drive sales growth in the second half.

We are also developing plug-in functions to integrate corporate work systems with Copilot. We will provide optimized Copilot services for enterprises by linking with major global solutions widely used in companies, such as Workday and Confluence. Thank you.

Q: Donghwan Oh from Samsung Securities

First, you mentioned that Cello Square overseas sales have increased. Can you provide more details on the global sales status of Cello Square? Secondly, what is the revenue forecast from AI-related businesses this year and next year?

A1: Kooil O, EVP and Logistics Business Division

Quarterly Cello Square business sales recorded KRW 285 billion, with domestic sales accounting for 20% and overseas sales for 80%. By region, sales from export-oriented countries, China and Southeast Asia where we opened the services in 2022, have accounted for 43% of the total Cello Square sales, and sales from the Americas and Europe, where we opened the services last year, accounted for 30%.

SDS is now capable of conducting logistics operations in 30 countries globally through Cello Square.

With the capability, we will expand the business by providing services that analyze and optimize customer end-to-end logistics from export countries' factories to import countries' final destinations based on data. We will also strengthen inland transport and warehouse operation services in major destinations, continuously expanding the import logistics business in large consumer markets.

A2: Won Seo, IR Team Leader

The revenue from generative AI is expected to come from FabriX in the form of PaaS, MSP revenue from implementation, SaaS revenue from Brity Copilot, and GPU server sales. In the first half, the revenue was not significant, but it is expected to be generated mainly in the second half. So we expect the annual revenue to reach the mid-KRW 100 billion range.

Q: Seokjin Jang from Kyobo AXA Asset Management

First, will the increase in Cello Square sales structurally improve the logistics operating profit margin in the future? Secondly, when can we expect overseas SaaS sales to become visible? Thirdly, can you share the company's plans for shareholder returns from our cash holdings?

A1: Kooil O, EVP and Logistics Business Division Leader

One of our goals when we first set up the Cello Square business model and entered the market was to enhance customer service to increase the value that customers perceive and automate operational tasks to improve productivity.

Therefore, by continuously pursuing operational automation, we can reduce operating costs, which is expected to contribute to the increase in operating profit in the long term, although there may not be significant changes in the short term.

A2: Haegoo Song, EVP and Solution Business Division Leader

The overseas SaaS business includes the cloud EMM business and the newly launched SRM SaaS business.

The cloud EMM business is continuously expanding, with additional service offerings developed recently, and is expected to continue growing in the second half and next year.

The SRM SaaS business started this year and is in its early stages. Enterprise SaaS solutions have an absolute sales lead time. Therefore, we expect visible results to appear in the second half of this year and be in full swing next year.

We are actively engaging in sales activities with many customers and overseas potential customers and have made significant progress with some, but we expect tangible results appearing from the second half of this year or the first half of next year, considering the sales lead time.

A3: Won Seo, IR Team Leader

Our cash holdings continue to increase, but growth-oriented CAPEX, R&D, and M&A are priorities. We have been considering enhancing shareholder value even before the Corporate Value-up program was announced.

We are considering expanding and sustaining shareholder policies in line with the announced program, but we have no confirmed details to share at this time.

Q: Joonsop Kim from KB Securities

First, the high growth of CSP is impressive. Can you provide guidelines on how to view the future of the CSP business? Also, regarding the core business of CSP, HPC services, can you provide updates on additional large-scale investments or customer discovery?

The second one is the smart factory. I know that there has been a trend that various new business companies have jumped into the recent smart factory market, but I am curious about the prospect of the market and what countermeasures Samsung SDS will take.

A1: Scott HJ Koo, EVP and Cloud Service Business Division Leader

In Q2, CSP sales grew by 49% year-on-year. The main drivers were the steady performance of HPC and the significant increase in demand for GPUs for generative

AI, as well as the diversification of new services added last year, such as cloud networks. In addition, increased SCP sales have driven growth of CSP business. We plan to continue expanding CSP focusing on SCP business. To this end, we will invest in services such as Oracle DRCC service, cloud DR, and AI specialized products, securing service competitiveness.

We are also opening the Daegu Center in October and starting AI cloud services for administrative public institutions, reinforcing our capabilities in the public cloud market.

A2: Haegoo Song, Vice President of Solution Business Division

The smart factory business is broadly divided into traditional MES business and digital twin business using new technologies.

In the traditional MES business, some new cloud MES companies are emerging in the global market, but the nature of MES, which requires high stability, means that on-premise MES business is still dominant. Therefore, we do not see a significant market change domestically, and we continue to support the MES business of Samsung affiliates, primarily focusing on overseas factory expansion. We are actively supporting Samsung affiliates' overseas business expansion across various industries, and there would be no significant change to this approach.

The digital twin business is not yet prominent in large-scale projects, but some companies are trying new approaches. Our company is conducting technical verification projects to establish digital twin roadmaps for operational automation in key facilities such as semiconductor manufacturing plants, implementing digital twins using 3D data, identifying optimal production conditions through simulation linkage, as well as providing an environment where the results can be verified on the digital twin platform.

We plan to expand the application scope of digital twins to areas such as remote setup pre-verification for reducing lead times of new factory setup and layout changes, but

we do not yet expect significant growth in this area and consider it a field where various new technologies are being pilot-tested across different domains.

We will update our business plans based on the progress of these technology verifications and market outlook.

[Conclusion]

Finally, I would like to make some announcements and conclude the conference call.

The IR team provides real-time streaming services and a replay function on the Samsung SDS website for the earnings announcement conference call.

Starting with this earnings announcement, we are now able to provide scripts in Korean and English using our generative AI technology.

Especially since this is the first time we provide English scripts including Q&A for the conference call, it will greatly help foreign investors understand the earnings announcement content.

We will actively apply generative AI to various IR activities to enhance communication with investors and analysts.

This concludes the 2024 Q2 earnings announcement conference call of Samsung SDS.

Thank you for attending today's conference call.