(July 29, 2021, Tokyo)

Nomura Research Institute, Ltd.

The First Quarter of FY March 2022 Financial Results Briefings Q&A Session

First inquirer (analyst)

Q1: My understanding is that two large clients were the driving force behind your strong performance in industrial IT last year. During the first quarter, were there any new movements or changes in the trend for large clients to drive performance with business in DX?

A1: Like last year, business remains strong in logistics and telecom. Furthermore, we are expanding into other industries. For example, it seems that the breadth of DX projects has grown to include trading companies and retail.

Q2: As for trading companies, are you referring to the collaborative effort with Marubeni announced last year? And as for retail, are there clients other than Seven & i?

A2: We cannot disclose the identity of the clients, but the trading companies are other than Marubeni. In retail, we have increasingly more clients besides Seven & i.

Q3: Will the broadening range of clients be an ongoing trend?

A3: DX-related business remains strong in industrial IT. Additionally, financial IT is also in the realm of DX 1.0, but we are seeing more modernization projects there. We anticipate the trend of integrating management with IT to continue.

Q4: Your profit is growing significantly. Is this growth in line with your plan?

A4: Our profits recovered in the fourth quarter of the previous year, and that trend has continued. Our normal operating profit margin is around 15%, but we have reached an even higher level of over 16% in the first quarter even excluding gain from the sale of assets. This also reflects the effect of productivity improvement initiatives, and I would say it is consistent with our intended direction as a company.

Q5: Are there any special factors behind this profitability other than the sale of trust beneficiary rights for the Yokohama Nomura Building?
A5: The sale of trust beneficiary rights had been factored into our plan. There are no special factors other than that.

Q6: Regarding share buybacks, will the policy to retire treasury shares which you announced in March also apply now? And have your cash reserves been strained by complying with requests from Nomura Holdings?
A6: Our policy is still to retire treasury shares which we do not anticipate using, but this upcoming share buyback will take place between now and December 2021, and I am not at liberty to comment on retirement of shares at this time. Also, we consult with Nomura Holdings for the repurchase of shares, according to our financial strategy to maintain ROE of around 20%.

Q7: How are you raising the 60 billion yen in funds for the share buyback?
A7: Our fund raising includes borrowing funds. Last fiscal year we tried to keep cash reserves of three to four months' worth of sales due to the COVID-19 pandemic, but this year we have reverted to our previous policy of two to three months' worth. Since we conduct share buybacks according to our financial strategy, we have no concerns about liquidity shortages in our cash reserves.

Second inquirer (analyst)

Q1: My guess is that your profit increased in financial IT by an amount roughly corresponding to unprofitable projects last year. Can you actually say your performance is particularly strong?
A1: Last year we reported unprofitable projects of over 1 billion yen, so our increase in operating profit might not appear terribly large when taking that into consideration, but our order backlog is at a high level and business is proceeding without any issues.

Q2: Are any factors negatively affecting your profit margin?
A2: Not particularly.

Q3: How much of a consolidation effect did the two companies in Australia have on your order volume?

A3: The two companies totaled roughly 11 billion yen in order volume during the first quarter. They were consolidated in May, but their order backlog at the time of consolidation was also reflected in addition to orders actually received in May and June.

Q4: Was the decrease in domestic order volume in financial IT an effect of the peak out in THE STAR migrations for major securities brokerages?

A4: Half of the decrease resulted from orders that missed the cutoff to be recorded, and the remainder was reversion from large projects for securities and banking.

Third inquirer (analyst)

Q1: Regarding the breakdown of order volume in financial IT into securities, insurance, banking, and other financial, could you provide additional information about the actual status of inquiries? Additionally, order volume in consulting decreased, but I believe that may be a reversion from orders that were moved forward to the fourth quarter of last year. Could you also let us know the status heading into the second quarter of this year?

A1: In consulting, just over 1 billion yen of orders for public sector projects was moved forward. If we add these to the first quarter figures, you could even say there was a slight increase. Looking by industry type in financial IT, our plan in securities calls for a slight increase in sales after reversion from large projects the previous year, and sales are proceeding in line with the plan. Insurance is proceeding in line with the 4% increase in the plan, with robust order sales in areas such as the public sector and mutual insurance. In banking, orders have not progressed according to our initial forecast, but robust orders for mobile services projects in other financial business have compensated for the decrease in banking.

Q2: Considering the strong demand for consulting throughout the world, and the fact that the year-on-year comparison is against the down year caused by the COVID-19 pandemic last year, your numbers for consulting seem a bit weak. Is it an issue of order timing and are inquiries actually robust, or are you insufficiently staffed to take on any significant increase in orders?

A2: It is an issue of order timing. We are not understaffed.

Q3: You had roughly 5.2 billion yen in overseas sales, but what was the actual result after excluding the M&A effect of around 3 billion yen and exchange rate impact? Also, your profit margin in Australia had recovered to around 10% as of the fourth quarter of last year, but what was the figure for the first quarter alone?

A3: Revenues at ASG increased even on a local currency basis, but exchange rate impact had a major role in the increase. Overall, profit margin for ASG was around 10%. Profit margin was just under 10% for all three companies in Australia including the two that were acquired, but we will have to observe the post-merger integration to know whether this trend will continue.

Fourth inquirer (analyst)

Q1: Your profitability is trending upward even excluding the sale of assets. How much progress did you make relative to your plan for the first quarter, and what is causing this upward trend?

A1: Our profit margin of over 16% excluding the effect of asset sales exceeded our initial plan. In addition to the productivity improvements that I mentioned before, this upward trend can also be attributed to projects in which labor costs are more broadly specified through quasi-mandate contracts, which give us greater ability to generate stable profit by limiting the variability of profits.

Q2: The upward trend in sales is rather small, so can we assume that will allow the trend to continue into the second quarter and beyond?

A2: The same trend is likely to continue in the second quarter.

Q3: Other IT services companies are having problems with contractors in China accessing personal information, and some clients are now sensitive about outsourcing to China. What is the state of NRI's offshore development in China? What is your perception of the risk, and what is the likelihood that additional costs could arise there in the future?

A3: Contracting to China seems to be a topic of business discussions throughout the world. At NRI we have not received any specific requests from our clients, but we will continue exercising tight control in order to provide safe, secure conditions to our clients. At the same time, we will take another look at the issues regarding access to personal information which has become a problem at other companies, while also enforcing strict rules based on the planned revision to the Personal Information Protection Law in order to continue providing both safety and security. Regarding China, we will keep a close eye on developments there, and maintain a clear understanding of the circumstances. We also likely need to establish a combination of contractors here in Japan plus another country other than China (expand our overseas contracting to more countries).

Q4: Supply and demand seem to be tight in Japan, but what are the current circumstances with overseas contractors in countries other than China such as Vietnam?

A4: Since the scale of operations in other countries is not as large as in China, it will take some time for full-scale initiatives to get off the ground. We are tackling this with awareness that it is of critical importance.

Fifth inquirer (analyst)

Q1: Gain from the sale of trust beneficiary rights was a factor behind your profit increase in the first quarter. Do you also plan to sell more company-owned buildings in the future? What is your policy going forward?

A1: Our policy is to not hold company-owned buildings. The only one remaining is the Yokohama Nomura Building for which we hold trust beneficiary rights. As already disclosed, we will divide the sales of these rights between this year and next. As a result of this policy, the only real estate that we hold will be data centers. Furthermore, we expect an in-office work ratio of around 50% even after COVID-19 is contained, so our policy is to sell off surplus office space that we are renting.

Q2: Do you believe that NRI should own data centers? They are not quite the same as offices.

A2: Data centers are mechanisms that provide both safety and security. We believe that NRI should own them.

Q3: DX-related sales growth rate had previously been below 10%, but in the first quarter it increased to 16.8%. Was there some change on the part of your clients? Could this level of profitability continue into the second quarter and even possibly next year?

A3: We expect the positive trend in DX projects to continue. However, we also have legacy projects with certain clients. The combination of growth in DX projects and legacy projects might indicate different trends depending on the year, but in this first quarter sales for DX-related projects have increased.

Sixth inquirer (analyst)

Q1: Could you explain the background behind your high profit margin in the first quarter? In terms of productivity improvement, what costs did you reduce? Also, in terms of individual segments it looks like sales in consulting were indeed strong, but positive gross profit rate from the mix of segments also likely had an effect, along with higher operating capacity rate of NRI employees due to a lower outsourcing ratio.

A1: In industrial IT, we are breaking down components for applications such as e-commerce and route optimization. These components can be applied in an increasing number of cases, which is contributing to profit. In systems integration, there are many cases in which maintenance operations continue for a while after system architecture has been completed, and no development projects arise until the next major replacement. However, new initiatives are repeatedly incorporated into the system in DX, which offers higher efficiency because people can be regularly assigned. Growth in DX-related projects such as these has driven the increase in profit margin. We have also maintained the reduction in sales, general and administrative expenses resulting from the COVID-19 pandemic.

Q2: What are the circumstances of your main clients? Your sales to Seven & i have not been disclosed, but I understand that they are not as robust as before. You have also explained that sales to Nomura Holdings have not significantly declined relative to last year, but could you please provide more details?

A2: Since Nomura Holdings has migrated to THE STAR, our sales to them are mainly comprised of THE STAR usage fees and systems integration. THE STAR usage fees will be maintained as long as there is a certain level of stock trading volume.

Last year, the special circumstances of an office move also drove an increase in sales. Excluding special circumstances, the roughly 15.2 billion yen in sales to Nomura Holdings in the first quarter of this year is in line with sales levels up to now.

With Seven & i, we do not have any large projects for convenience stores, but business remains strong as new projects with major supermarkets such as systems overhauls are increasing. There are no major changes in our business with them overall.

Seventh inquirer (analyst)

Q1: I understand that increased operating capacity rate contributed to your profit margin. Could you share your forecast for orders going forward? Can we assume that projects with limited profit variation due to quasi-mandate contracts will continue to increase, and that orders will continue to level out? Or could there be fluctuations in industrial IT orders from the second quarter onward since not everything is on quasi-mandate contracts?

A1: Not all of the projects are on quasi-mandate contracts, but DX projects are increasing. At the same time, systems integration projects will not disappear. Legacy systems overhaul projects are still on the same subcontractor agreements as before. We currently have a mix of both subcontractor agreements with wide variation in profitability and quasi-mandate agreements with narrow variation in profitability, so I believe that our management of resources will be important.

Q2: Will robust orders in the industrial IT segment continue in the second quarter and onward? What do you foresee?

A2: I cannot exactly say how much we expect DX projects to increase, but we do expect the relatively favorable conditions to continue.

Eighth inquirer (analyst)

Q1: Your first quarter financial results outline describes impact on the business performance of each company that you acquired through M&A, but this differed from the operating profit margin of roughly 10% alluded to in your presentation. Can you explain the difference?

A1: The profit described in the outline is on what we call a net profit basis, which is not the same as the operating profit reported in the presentation.

Q2: Was there a special profit that arose in the first quarter which caused net profit to exceed operating profit?

A2: After acquiring new companies and implementing PPA (Purchase Price Allocation), we began amortizing their intangible assets in the first quarter which had a negative effect. The numbers in the financial results outline are the sales and profits of non-consolidated subsidiaries and do not include amortization of intangible assets arising from M&A.