

(October 27, 2021, Tokyo)

## **Nomura Research Institute, Ltd.**

### **The Second Quarter of FY March 2022 Financial Results**

#### **Briefings Q&A Session**

##### **First inquirer (analyst)**

Q1: In the upward revision to your earnings forecast, sales increased significantly in industrial IT. Performance was also strong in industrial IT last year, but is there any change in where the strength lies this year? For example, could it be an increase in large first-mover clients, or have you brought in a wider scope of new clients? And what is your outlook heading into next year?

A1: In our financial results presentation for last year, we explained that Tier 1 major clients are the first movers, and Tier 2 clients will take action following them. This year, clients in distribution, logistics, and telecom are highly motivated to invest, and we are also expanding our client base all around. I believe the situation will remain this way for a while. Additionally, we seem to be handling a wider range of themes. For example, in addition to projects about building new business models in e-commerce, we are also starting to see a broader range of needs such as operational reform projects that apply AI algorithms to business processes.

Q2: You are on track to achieve the targets in your Medium-Term Plan ahead of schedule. What are the key points in each segment leading up to next year?

A2: The financial targets in our Medium-Term Plan are part of that discussion. At NRI we are using balanced scorecard (BSC) strategy maps to visualize the strategies in our Medium-Term Plan. We set KPIs for each strategic target and execute PDCA cycles. There is no need to change our strategy map (strategy scenarios) leading up to next year. However, we do need to revise our budget projections for next year. Projections will be discussed later, but we are currently reviewing our forecast for this year along with the investment plans

of our clients. We expect our momentum this year to carry over into next year, and I believe that our projections for next year will be aggressive. Beyond that, we are discussing major changes in future trends that could arise looking ahead to the year 2030, and how we will position ourselves for these. We are preparing to be able explain the foundational parts of our strategy leading up to 2030 at the time of our financial results presentation next April.

Q3: I understand there will be gain from the sale of assets again next year. Has there been any progress there?

A3: Since the same assets are being sold in two steps, there will be gain from the sale of assets again next year. Approximately 60% of the gain was recorded this year and around 40% will be recorded next year.

Q4: In industrial IT, there was concern that demand from Tier 1 clients who are driving expansion could dissipate and growth might stop. However, I understand that you received orders from new clients and growth will continue into next year. In financial IT, will you be able to acquire new projects for development resources that are freed up when large projects transition into operation, and what is your forecast for that?

A4: THE STAR migration projects with major clients in securities are proceeding smoothly according to the agreed schedule. Aside from those, we have THE STAR migration projects and related systems integration projects with second-tier clients which will continue into next year. From next year onward, we also expect contributions from the front-office platform we are currently putting together. Therefore, projects will not peak out this year. Business in securities will remain brisk into next year. We will be taking on large projects in rapid-fire succession, so project management will be important. In insurance, there is a trend among non-life insurers to move away from the use of hosts (modernization). We also have projects in mutual insurance, and next year looks promising. In banking, the core system for a major online bank is nearing release and other projects are peaking out, so we will be thinking about how to utilize the resources that will be freed up next year. I do not think there is any concern about a sudden slowdown in the finance segment overall.

## **Second inquirer (analyst)**

Q1: Why does order volume in the second quarter appear weak in domestic financial IT and industrial IT?

A1: In financial IT, this is a reversion from systems integration projects that accompanied THE STAR migration for major clients. In industrial IT, large projects have peaked out, but business remains strong aside from that. Order backlog is piling up overall, and capacity utilization is also high. It also bears mentioning that there had been a reversion in the second quarter of last year when orders jumped after slumping in the first quarter when COVID-19 broke out. We take a positive outlook on our order volume in the second quarter being at about the same level as the second quarter of last year when orders rebounded significantly.

Q2: Will there be a decrease in order volume during the second half as a reversion from large projects?

A2: In the second quarter of last year, our Kansai Regional Headquarters had large projects in the food industry. Order volume did not increase at a high rate in the second quarter due to reversion from these two projects. Inquiries are currently robust, and business remains brisk overall. We are not concerned about the second half and beyond.

Q3: Regarding your plans to expand Planit from Australia into Japan and other parts of Asia, I assume that there is increasing demand for the outsourcing of testing processes. How is this developing in Japan? You can probably receive many orders through consulting as a starting point with non-finance clients, but can you acquire a new client base through services for post-processes?

A3: We first intend to utilize Planit within NRI and are not thinking about acquiring new clients right away. At NRI we are also devoting large numbers of personnel to testing processes, so we want to experiment with Planit at improving our own productivity and learn what points must be considered for utilization in Japan. Outside sales would be the next step.

Q4: Would two or three years from now be the approximate timeline for outside sales of Planit solutions in Japan?

A4: Preparations such as localization into Japanese must also be done, so that is

indeed the approximate timeline that we anticipate for outside sales. Outsourcing of testing processes is normal in Europe and North America since clients there are developing their systems in-house, but in Japan the systems integrator handles everything including testing in many cases. We will need to investigate roughly how much demand there is for automation of testing processes in the area of in-house systems. This is not written in the briefing materials, but we believe the services of Planit are ideally suited to the North American market.

### **Third inquirer (analyst)**

Q1: How conservative is your upwardly revised plan for this year? You have only added one billion yen in operating profit to the previous plan.

A1: The upward revision might seem small compared to our performance in the first half, but we might make an additional upward revision in our third quarter financial results presentation if the conditions in this strong second quarter continue. However, we cannot say that with certainty at this time.

Q2: Is the revised operating profit large relative to revised sales due to operating margin contributions from DX?

A2: There are complex factors behind this, but we are operating in a stable manner through agile development mainly in industrial IT. Utilization of digital IP is also likely contributing to the upswing in profits. Gain from the sale of trust beneficiary rights was already factored into our initial forecast at the beginning of the year, and thus has no direct connection with the upward revision.

Q3: About how much business are you currently doing in carbon neutrality? And how large of a market do you expect for it in the future?

A3: Carbon neutrality is a topic that we had not dealt with until now, and it is something we just started working on in the first half of this year. Therefore, it is not a very large area of business for us. Currently we have many carbon neutrality consulting projects in the public sector. The figures will need to be confirmed, but I believe these comprise around 10% of our public sector consulting projects. Going forward, I think we can also expect demand from

the private sector. For example, we get inquiries from financial institutions for monitoring and assessing recipients of their loans for Scope 3 reporting. We also expect to see new business themes based on systemizing carbon offset transactions.

Q4: How large do you think this market will be in the future? Around what proportion of your consulting do you think it will comprise?

A4: The regional decarbonization roadmap adopted by the Cabinet Office in June 2021 will be designating 100 areas as decarbonization model areas. There is demand for advisory services for local governments that want to apply for designation, so we expect a market to arise among local government offices in addition to the central government. Subsidies are also involved, so we expect these projects to reach at least a certain size. There will likely also be demand from regional financial institutions to support the monitoring and assessment of their loan recipients with high CO2 emissions for the purpose of Scope 3 reporting. Additionally, there might be projects in manufacturing with large amounts of exports directly linked to business performance. In addition to compliance with regulations, we also see potential to support industry-government collaborative initiatives for determining how to address systems such as the EU taxonomy. Carbon neutrality is a topic that has only recently come about, and it is currently hard to gauge how large the market will eventually be.

#### **Fourth inquirer (analyst)**

Q1: Normally, I get the impression that even when business performance in the first half is strong, you do not revise earnings forecasts for the second half because orders must be secured in advance when consultants and systems engineers are operating at high capacity. Can we assume you have made an upward revision this time because productivity has improved more than sales, consultants and systems engineers are not overburdened, and so you are reflecting the strong performance produced in the first half as-is?

A1: Capacity utilization is high because orders are extremely robust. Profit is surging significantly past the break-even point, and we see no sign of this slowing down in the second half. It was simply a decision to make the

appropriate upward revision to our forecast.

Q2: Your productivity improvement appears to be structural. Can we therefore assume that profitability will not decline in the second half? Also, why did you lower your forecasted sales, general and administrative expenses in the second half?

A2: Productivity is determined by a variety of elements, one of which is the balance of supply and demand. In situations like we have now, the seller has strong demand. Since capacity utilization is also high, this productivity improvement can also be seen as driving up the added value per employee. For example, in e-commerce there are a lot of functions that are similar for every client. Breaking these down into components can eliminate the need to create from scratch. Also, recently in industrial we have been using AWS in many cases, so man-hours can be reduced by breaking down infrastructure into components. It may be gradual, but costs have fallen by billions of yen since we have engaged in increasing numbers of activities such as these. Productivity has thus been improving up to now. Sales, general and administrative expenses have been set to reflect actual circumstances through the second quarter. There is no particular reason beyond that.

Q3: There had previously been discussion about cases of man-hours being significantly reduced through agile development and breaking down into components. Do you think that productivity can constantly continue to improve?

A3: Since we are breaking down components, I believe productivity will keep improving. Using clients in distribution as an example, we can come up with a number of algorithm patterns as we establish a track record of improving operational efficiency in their stores. Now when we get a request from a new client, we can create an algorithm efficiently by matching up the right pattern and fine tuning it without having to start from scratch. We are putting complex things together such as this.

Q4: Since capacity utilization is so extraordinarily high, do you think it might decrease in your plan for next year?

A4: Basically, our policy is to simply judge what we think will occur.

## **Fifth inquirer (analyst)**

Q1: How much progress are you making in self-initiated productivity improvement efforts?

A1: Productivity improvement is an everlasting theme. To enhance the sophistication of development processes, we standardize development frameworks and use those. We have been doing that and will continue doing it. For maintenance tasks we have the people who handle maintenance operate at higher capacity by working in organizations of a certain size rather than in scattered small teams. This is also what we have been doing and will continue doing. Enhancing sophistication of development processes is an activity that we never intend to stop.

As for optimizing our work environments, remote work has become quite established over the past year. Even now, only around 40% of our employees commute to work. They can utilize time more efficiently by telecommuting. For example, over 8,000 people participated in our DX human resources development program +DX last year. We will continue to use telecommuting since it also helps to fulfill the purpose of training programs such as these. However, employees have less communication outside of their work-related tasks when they telecommute. This leads to problems in areas such as organizational unity, which must be overcome. To that end, we are continuously pushing forward with improvement-related activities for employees to feel organizational unity and maintain a high level of motivation in their work while at the same time raising productivity. We have come a long way, but there are still quite a few things that must be done.

For the development and deployment of digital IP, there are currently around 10 themes that have entered the process of breaking down components. We believe that we can still increase our digital IP, and we still have a long way to go.

Q2: I understand that you have put together a basic lineup of services in Australia. Could you let us know the likelihood of additional M&A during this Medium-Term Plan?

A2: We had been planning M&A of a relatively large company in order to further boost our capabilities in the areas of IT consulting and development in Australia, but after some consideration we decided against it. Currently we

have run out of options for large-scale M&A. We might acquire companies that are not large or that complement our regional coverage, but we are shifting gears toward a policy to pursue organic growth going forward. We will begin discussing unification of our brands, or possibly integrating companies to exist as a different entity.

At the same time, we will continue exploring market entry opportunities in North America. We would like to execute M&A if the opportunity arises, while continuously reworking our pipeline. If the right opportunity materializes, we hope to seize it.

### **Sixth inquirer (analyst)**

Q1: In the consulting market overall, do you think the current DX strategy planning bubble is likely to peak sometime next year, or will it continue for a while longer? Please share your outlook.

A1: The planning of strategies themselves is likely to peak out before long. The companies working on DX are starting to shift from Tier 1 to Tier 2, but since there are lots of companies in Tier 2, this work will likely continue for the time being. Going forward, we will likely shift toward work processes to operate the online business models launched together with our clients and develop them while fine tuning their business. We must thoroughly prepare the type of services that penetrate the operations between strategic consulting and systems consulting and fine-tune the businesses of the clients. This year we established a team focused on CX (customer experience). This business is likely to endure for a long time. It will probably not be the type of business that peaks out in a year or two, after which the market shrinks.

Q2: Are there any non-recurring expenses factored into your forecast for the second half?

A2: As of now, our forecast for this year does not factor in any special expenses.

Q3: Within this positive forecast, are there any risks that you can anticipate? If there are any elements that are not outside of what you can control such as business sentiment, what are they?

A3: COVID-19 has had a significant impact over the past year. Many companies



had been thinking that business model transformations incorporating digital would occur, but the legacy model of in-person business had a strong presence and there was some hesitation to shift the core of their operations to new online models. However, the world changed significantly over this past year. When you talk to managers now, there is no longer any hesitation. This is true in both finance and industrial. The fear of changing business models has vanished. For example, we gained experience seeing that telecommuting can be done reasonably well and have some positive impacts on productivity just by giving it a try. The pandemic changed the world, taking what had previously been limited to particular clients or business operators and making it widespread among a broad range of industry types. Companies other than us in the IT sector feel the same. Since we also have consulting, we have the particular advantage of being right there next to our clients. Speaking to our clients' managers from this position, we can see that things are clearly different from two to three years ago.

As far as risks are concerned, I do not see any significant risks at this point in time. However, while carbon neutrality might be an opportunity for Japan, it could also potentially evolve into a major risk. This requires close attention over the long term, and we at NRI are thinking about what we can contribute to this issue.

Q4: I believe that NRI has achieved differentiation in terms of human resources, but what is your outlook on the acquisition and development of human resources?

A4: One example would be large modernization projects. There are cases where other companies simply fail to deliver quality after the upstream consulting process when entering the development process, so their clients change course and call us. This is not only at the level of apps used on smartphones; the core systems themselves can also be overhauled by changing the front office systems. Overhauling these systems while also using new technologies on the cloud requires particularly high-quality personnel with considerable technical abilities. Ultimately some things are decided by the quality of the people.