(October 25, 2019, Tokyo)

Nomura Research Institute, Ltd.

The Second Quarter of FY March 2020 Financial Results

Briefings Q&A Session

First inquirer (analyst, attendee)

Q1 : These results are quite good overall, but my one concern is that domestic orders are not increasing in industrial IT solutions. This may be due to resources having been allocated toward production-related activities throughout the first half and not as many new orders as a result, but when do you expect orders to start picking up again? Will the current situation continue into the third quarter?

A1 : We will no longer have the special demand that we had in distribution over the first half of the year leading up to the consumption tax increase, but there is robust demand for DX-related investment including digital marketing related to e-commerce, and this is an area where we can expect to continue winning orders while leveraging NRI's strengths. In areas such as manufacturing and services, one of the SAP-related systems development projects we had forecasted in the first half for a client in manufacturing was postponed. However, aside from that we had hardly any deviations from our forecast, and we are not worried about the business climate in the immediate future. While we may be off to a slower start in these areas than in distribution, there are definitely more clients in manufacturing and services who are thinking about business transformation through DX investment in D2C and IoT, and we have plenty of project inquiries. We also made tremendous progress at improving profitability during the first half. Excluding numbers form overseas, our operating margin in domestic industrial IT was approximately 14%, which was higher than in financial IT. This shows that we are structured in a way that ensures profitability even amidst harsh competition, and at the very least we will not be experiencing any sudden downturns in the second half of the year.

Q2: Your performance was strong throughout the first half in insurance, yet your plan for the year is unchanged. Do you see any specific signs of weakness or other potential downturns in the second half? For example, could there be any downturn in projects with major life insurance companies?

A2: While there are no tangible changes such as development projects being cancelled at this current time, we are maintaining a relatively conservative outlook for the second half. On the other hand, with the future potential of DX investments for data utilization by non-life insurers and other promising possibilities, we have no reason to expect any sudden overall drop in projects for insurance. Our business with insurance has maintained strong growth over the past few years. Even if the speed of that growth were to slow a bit now, there would still not be any problems.

Q3: Please tell us if there are any developments in your approach to shareholder returns, such as the non-recurring gain that was recorded when you sold shares of stock in Recruit Holdings.

A3: In terms of our dividend, we generally intend to maintain steady increases in line with profit growth in our main business, without any impact from non-recurring profits. However, while our current dividend of 15 yen (on a half-year basis) per share may be a desirable level from the perspective of long-term profit growth, there is still room to consider future changes. In the first half of the year, we executed a large acquisition of treasury shares, and believing that we have established high shareholder return from an overall return perspective, we have not revised the amount of our dividend.

Second inquirer (analyst, attendee)

Q1: Please tell us whether you have made progress acquiring resources that can be directed toward activities to acquire more orders in industrial IT domestically, and whether your hiring of talent is proceeding according to plan.

A1: In the first half alone, we have already brought aboard as many mid-career hires (about 100) as we did for throughout all of last year, and we plan to hire at an even greater pace going forward. However, it will take time for the people we hired to be ready to deploy toward activities to secure orders. There will be a time lag in that regard.

Q2: Without the special demand ahead of the consumption tax increase which you had in the first half, how do you plan to boost second half sales and profits in industrial IT where orders aren't increasing?

A2: While we had special demand in distribution ahead of the sales tax increase, it was not large-scale. Therefore, the absence of this demand will have only a limited impact on our second half performance. There is robust demand for DX-related investment, mainly related to e-commerce, and we expect this positive trend to continue. In areas such as manufacturing and services, one of the SAP-related systems development projects we had forecasted in the first half for a client in manufacturing was postponed, causing a minor deviation from our forecast. However, more clients in manufacturing and services are thinking about business transformation through DX investment, and we have plenty of DX-related project inquiries in the second half, so we believe we'll be able to increase orders and sales in the second half as planned. For profitability in particular, we are now seeing results from our ongoing efforts to improve productivity, so there is definitely reason to believe we can achieve our plan.

Q3: Please tell us the status of The STAR projects for securities.

A3: We have launched a The STAR implementation project for a major securities brokerage, and we can expect revenue effects over the next few years from systems development accompanying the migration. Even after migration to The STAR is complete, we expect increased profit from operations. Transaction volume is strong for The STAR as a whole, and we expect stable performance in securities overall.

Q4: In Australia, if we look only at the second quarter it seems orders are not increasing even on a local currency basis. What is the background behind this? Also please tell us the profit and loss status of your business there.

A4: In Australia we secured a major government-related project in July, and if we look at the first half as a whole our orders are increasing on a local currency basis. The business climate there is turning positive overall. In terms of profit and loss, our operating profit margin in Australia was around 8% before goodwill amortization, and break-even after goodwill amortization.

Third inquirer (analyst, attendee)

Q1: These results are quite strong overall. It seems you are leveraging your strengths in shared online services and China offshore development in financial IT, particularly for securities brokerages. Your performance also remains strong in industrial IT, with continuously high capacity utilization. At the same time, I doubt you can achieve the Medium-Term Plan 2022 Targets simply through a continuation of your current business operations unless you can engineer some new forms of business.

It seems to me that we are now in an age where you'll have to change the structure of your business if you want to add any additional growth, but what do you think?

A1: Our IT solutions business has differentiated itself from other companies with around 100 billion yen in annual sales in shared online services. At the same time, competition for project order-based business is fierce. Amongst that business, differentiation is hard to achieve for package implementation projects such as SAP, where revenue can only be forecasted for the implementation phase. We can leverage our strengths in the type of business where we develop IT from scratch alongside business transformation. It is relatively easy to establish shared online services in financial IT which is regulated by business law, but not so easy in industrial IT. For that reason, we have been launching businesses together with clients and sharing the profits with them, while charting new territory by establishing a number of joint venture companies with clients.

I believe this Medium-Term Plan can be achieved through the continuation of our current three main pillars of business (consulting, shared online services, advanced systems development), but beyond that I think we will need a fourth pillar. Profit sharing business is one possibility.

Q2: If NRI only invests capital and simply applies it toward governance in Australia, that wouldn't seem to lead toward any future business growth, would it? Shouldn't now be the time to become the NRI that integrates personnel exchange and management with operations?

A2: NRI does not yet have the capability there to integrate management with operations. Still, when considering our medium to long-term growth, IT services is a domestic demand-driven industry, so we need to bring it into markets with growing populations. Among developed countries in the world right now, the ones with growing populations are the US and Australia.

In Australia we are currently only active in industrial IT, but with plenty of pension assets and other business potential in the Australian market we have opportunities there to expand financial IT services, which is our strength. Also, there was a limit to what ASG could accomplish after we acquired it two years ago, as its founding CEO remained in charge of management and we sought to create synergies under his management. Their new CEO took over in July of this year and their management policy has changed, so we are currently working out ways to harness synergies such as adding NRI security business onto ASG's managed services to deliver more added value.

Fourth inquirer (analyst, attendee)

Q1: At around 14%, your operating profit margin in domestic industrial IT is at a higher level than financial IT. Will you be able to raise operating profit margin even further in the future?

A1: The growth areas in industrial IT are e-commerce architecture and supply chain management (SCM) related to that architecture. These require not only package implementation but also consulting to reform business processes, which are areas in which we can leverage NRI's strengths. We are currently working on putting together components to IT solutions that can be used in e-commerce architecture, which is why our immediate operating profit margin is increasing. Going forward, I believe we can also put together groups of components the same way in SCM and improve productivity even more. At the same time, in financial IT it's important to operate managed services with shared online services in combination with the accompanying business process outsourcing (BPO). For insurance in particular, we are considering whether we can offer IT solutions for multiple non-life insurers in the form of new shared online services.

Q2: Concerning your overseas business, please tell us your forecast for the Australian IT services market, and for business in North America.

A2: The IT market in Australia is not in bad shape at all. However, roughly half of ASG's main clientele is government-affiliated, and revenues have been delayed due to the postponement of a large government-related project order (Main Roads Project: AUS $75M, five-year project), possibly due to impact from the Australian general election last year. For that reason, ASG faced a harsh business climate in 1Q, then rebounded in 2Q, and we believe it will show a resurgence over the second half of the year.

In North America, competition has intensified in the market for loyalty marketing where Brierley+Partners operates, with the entry of one major competitor after another. We recorded an impairment loss there in March 2019 as a result, but right now there is a new product in development with scheduled launch in January 2021. We have high expectations in North America from next year onward.

Q3: Roughly how much of your DX-related sales is comprised by DX 2.0? And what is your future outlook in that regard?

A3: DX 2.0 comprises roughly a few percent of our overall sales. When we consider it to be our fourth growth strategy, we think additional investments will be needed such as establishing joint ventures on a much larger scale.

Fifth inquirer (analyst, telephone attendee)

Q1: SG&A costs have decreased since last year, but why? Also, why are you forecasting SG&A cost to increase in your second half plan?

A1: This is due to multiple factors. Last fiscal year we impaired the entire amount of goodwill on the books at Brierley+Partners, labor cost was recorded as sales cost rather than SG&A due to high capacity utilization in production, and the reduction in rental cost through last year's aggregation of real estate assets. We also do not expect any major SG&A cost increases in the second half compared to the first.

Q2: In distribution, special demand leading up to the consumption tax increase produced projects in the hundreds of millions of yen, but if you add up to total from multiple projects what was the total amount?

A2: In terms of the projects we handled in the lead-up to the consumption tax increase, hundreds of millions of yen for a single client would be considered quite a big project. Normally these were smaller projects, and I think they totaled less than 1 billion yen.

Q3: Looking at the progress made over the first half of the year, it seems unlikely that you will reach your target for the year of 61 billion yen in overseas sales. Do you plan to revise this target? And if you are unable to achieve this target, do you expect domestic business to make up the difference?

A3: Our target of 61 billion yen in overseas sales includes planned external growth. There are external growth projects that we currently have under consideration, but since these have not materialized as of the end of October they may have only a limited contribution in terms of performance this fiscal year. Therefore, we are lowering forecasted second half sales in manufacturing and services by 6 billion yen, the majority of which applies to overseas sales.

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