(October 28, 2020, Tokyo)

Nomura Research Institute, Ltd.

The Second Quarter of FY March 2021 Financial Results

Briefings Q&A Session

First inquirer (analyst, telephone attendee)

Q1: What kind of projects are you getting as a result of increased demand for DX due to the paradigm shift?

A1: One type involves moving existing business processes online, including sales activities conducted online rather than in person. Another type is to move the business models themselves to the online medium. The latter type of project is increasing in the industrial IT segment in particular. For example, in e-commerce-related projects it is difficult to build systems with complex e-commerce mechanisms in packages, so we have to develop them from scratch. In addition to the consulting skills to be able to revise business models, this also requires the skills of systems engineers to develop systems from scratch, so we are in a good position to capture this demand. In the financial IT segment there is currently strong demand for switching to shared online services such as THE STAR in order to modernize existing legacy systems. Going forward, there will also be lots of potential in moving business processes online. To strike the optimal balance between in-person and remote sales, we will build digital platforms and then sequentially add various tools and features to them. We will take the time to make improvements to them. There is demand for this in every sector in finance, from securities to insurance and banking. Projects like these require skill sets in both consulting and systems development, so they cannot be handled simply by package implementation. We are receiving relatively less of the bulk orders for large conventional waterfall model development projects we had previously handled. Now, there are more quasi-mandate type projects where we receive orders for work little by little.

In consulting, many large companies are looking toward long-term trends such as ESG and beginning to consider transformations in their corporate management, including dynamic reshuffling of their business portfolios. Many different types of these projects are ongoing. Our clients seem to have stronger determination to revamp their existing lines of business and be unwavering in the face of the COVID-19 pandemic.

Q2: Is there any difference in profitability between conventional DX projects and the projects that are increasing right now?

A2: As you can see on page 16 of the presentation materials, a few years ago we began working on rapid agile development type projects together with clients. At first we were unable to smoothly handle sudden changes in the requirements and other issues that caused these projects to be less profitable for us. However, agile development is now becoming a normal part of our day-to-day operations, and we have made these projects sufficiently profitable.

Q3: Why did you have such a high rate of year-on-year increase in your SG&A expenses during 2Q? And what is your forecast for SG&A expenses in the second half?

A3: The increase in SG&A expenses during 2Q was largely attributable to greater labor costs from increased new graduate and mid-career hiring. There were no temporary cost increase factors in 2Q. We anticipate around the same level of SG&A expenses in the second half as we had in the first. We believe that as sales increase, our ratio of SG&A expenses will decline.

Second inquirer (analyst, telephone attendee)

Q1: What is the sector-by-sector breakdown of your DX projects in the industrial IT segment? Can we assume that multiple large projects will continue for a few years?

A1: In terms of sectors, we have more projects related to telecommunications, logistics, and retail. These companies have spare investment capacity despite the effects of the COVID-19 pandemic. Business is brisk with multiple clients whose top leadership had been attempting to move forward with large-scale DX for a number of years, and we are allocating large concentrations of company resources to them. These projects are correlated with increases in orders and sales in the industrial IT segment.

Q2: Implementing IFRS will likely translate goodwill amortization costs into higher profits, but what other effects do you expect this to have?

A2: We expect IFRS implementation to have both positive and negative effects on our business performance figures. Our reviews are in the final stages and I am not at liberty to share any of the details at this time. Please allow me to explain this in greater detail when announcing our performance forecast for next fiscal year.

Third inquirer (analyst, telephone attendee)

Q1: Although current growth in orders is relatively high, your anticipated sales growth in the second half seems a bit too low. What is the basis for your expected second half sales in each segment?

A1: In consulting, our second half sales forecast is lower than the previous year. Compared to the first half we are forecasting sales growth to be high enough to form a V-shaped recovery. In the financial IT segment, the nature of projects at one particular subsidiary caused large amounts of sales to be recorded in the first half, resulting in a sales decrease forecast in the second half which has a significant impact on the overall second half sales forecast. In the industrial IT segment, we cannot forecast any second half recovery in overseas sales, but we do expect orders and sales to increase domestically.

Q2: What initiatives and measures are you implementing to ensure profitability in DX?

A2: One thing is digital IP as commonly usable components in DX systems development. For example, when we build e-commerce system platforms for use on the cloud, we have already built digital IP that we can use with significantly lower development costs than before. In terms of our personnel, we are improving their agile developing skills. As opposed to development in the waterfall model, profitability worsens if you do not micromanage to handle problems as soon as they arise. However, through our past experience in agile development we have made big strides in acquiring the skills necessary for project management.

Q3: Can other companies mimic that strength? Does NRI have an advantage there?

A3: It is difficult to compare us with other companies in this regard, but we believe our human resources are highly capable of acquiring new skills. We have spent a few years working on developing the skills needed for agile. Now this capability is becoming firmly established and we have achieved profit margins of 14 to 15%.

Q4: Will advertising and marketing companies turn into competitors?

A4: Our subsidiary NRI digital is reviewing business possibilities utilizing advanced digital technologies, and they also have interest in advertising business. Rather than entering existing advertising businesses and competing with other companies, we would prefer to pioneer new business fields.

Fourth inquirer (analyst, telephone attendee)

Q1: Domestically, what type of clients have strong appetite for investment? Existing clients or new clients?

A1: NRI has clients who have suffered a severe negative impact from COVID-19, and also clients whose businesses are gaining momentum and are actively looking to invest. These two types are increasingly polarizing. We are pooling our company resources to provide total support from planning to executing business model transformation for those clients who are actively looking to invest. For example, there are now cases where we have expanded our relationships with clients to whom we had previously only provided consulting, and we are now doing much larger transactions with them including solution development. It is important for us to aggressively approach the needs of clients who are actively looking to invest and see whether we can do more business with them.

Q2: In what sectors are orders increasing in the financial IT and industrial IT segments during 2Q?

A2: The largest contributor to orders in the financial IT segment was insurance. Next was securities. In the industrial IT segment, orders from the service industry are increasing significantly.

Q3: What is the current state of your overseas business in each region? And what are your respective forecasts for them next fiscal year?

A3: While it depends on how the COVID-19 situation plays out, we forecast the business climate in Australia to gradually improve, and their federal government has indicated that they will not be reducing their IT budget. We also currently have inquiries for projects in Australia, and we can expect business to pick up there leading up to next fiscal year. Brierley+Partners in North America is generally breaking even. However, their clients are in many of the sectors that have been severely impacted by COVID-19, and some clients are handling their systems in-house during the economic slump. As a result, we have not reached a point where we could forecast any business recovery in North America next year. After the New Year they will need to release new products and develop new clients. In overseas consulting, business is mostly returning to normal in North America and China, but the business climate is harsh in Thailand and India and we cannot predict what the future holds in these places.

Fifth inquirer (analyst, telephone attendee)

Q1: Your order volume in the industrial IT segment increased significantly in 2Q. Was this attributable to any specific large projects, or was it the result of an accumulation of multiple projects?

A1: During 2Q this increase was largely attributable to comparatively large-scale telecommunications-related projects. We also had multiple reasonably-sized projects in service-related sectors, which led to the increase in order volume.

Q2: Do you expect order volume to increase or decrease in the second half?

A2: Considering the inquiries that we have right now, we don’t have any reason to predict that order volume would significantly decrease in the second half. We expect that order volume in the second half will likely maintain its positive momentum.

Sixth inquirer (analyst, telephone attendee)

Q1: You said that companies’ IT investment appetites are becoming polarized. Is it reasonably possible that you will be able to achieve sales growth only by taking on the DX projects of companies with strong appetite to invest?

A1: Looking at software investments over time in the Ministry of Finance’s Corporate Statistics, we can see that investments have fallen sharply this year, and that the business climate is completely different from what it had been up to last year. This year has been quite harsh in terms of demand for IT investment overall, but in these circumstances we are seeing two extremes emerge. Ultimately, we have to resolutely approach those companies which are using the change in consumer behavior in the COVID-19 pandemic as an opportunity to immediately transform their business models. In this situation, we know that communication with client reps at the actual business sites will be important, but success is not possible without trust and communication between senior management on both sides. In our case, we believe that our current approach is a good one.

Q2: Do you believe that with NRI's strength in DX, you are taking business away from other companies and increasing your market share?

A2: It would be difficult to simply take the work that other companies had been doing, the way they had been doing it. It works to NRI's disadvantage when other companies are more familiar with the clients' business operations that are behind their systems, so we cannot simply take those projects away unless we lower our price considerably or push ourselves some other way. We are better off selling projects mainly in new domains where we can more easily leverage NRI's strengths, such as moving e-commerce-related business processes online.

Seventh inquirer (analyst, telephone attendee)

Q1: Based on the current state of your business inquiries, what is your order forecast for the second half?

A1: In the financial IT segment we have multiple THE STAR implementation projects for new clients in securities. We can also expect a steady stream of orders going forward. For insurance, we will have to conduct sales in person mainly with individual system integrators, or else our sales will be impacted. Our first half sales reflected projects that we had sold the previous fiscal year, and we believe the impact of being unable to conduct sales in person during the first half due to the state of emergency declaration will show in second half sales. However, projects with major life insurers which we had not anticipated at the beginning of the fiscal year are making a comeback. In insurance, we would like the results of our sales activities going forward to be reflected next fiscal year rather than in the second half. In banking, projects to overhaul the systems of online banks have already peaked out, and we anticipate that growth in orders will slow in the second half. At the same time, some new projects are materializing, and if we can thoroughly address newly-arising needs then I think we can maintain our momentum with new orders. In the industrial IT segment there are multiple clients who are pursuing large transformations, and we believe that orders will remain at a high level in the second half. In the consulting segment we cannot make any progress unless we conduct sales activities, so we were significantly impacted in the first half by the state of emergency declaration. Our sales activities have now returned to normal, and we are not worried about orders in the second half.

Q2: Will the application of IFRS have any impact on target operating profit in your Medium-Term Management Plan?

A2: We are not considering any changes to the target itself as a result of the change in accounting standards.

Q3: Considering the current market climate and the state of target companies, what is your outlook on M&A? And what are your plans for the joint venture with Nomura Securities in India?

A3: Our current overseas sales are short of 50 billion yen, but we have no intention of changing our FY 2022 target of 100 billion yen in overseas sales. We would like to create around 70 to 80 billion yen of business in Australia through large-scale M&A, and our activities to accomplish this are ongoing. We are considering what domains are necessary for NRI’s business in Australia next fiscal year and the year after.

As for the joint venture with Nomura Securities, they have undergone a change in management and are in the process of revealing their new management direction. We are considering our future policy for the joint venture based on that, but there might be some change of direction.

End