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Nomura Research Institute, Ltd.

Q & A from Small Meeting for sell-side analysts

1st

- In order to make it easier to understand, the contents of the question and answer are partially revised and modified.

(Questioner No.1)

Q: The state of emergency declaration has been lifted, but how do you think demand will recover? And how does that compare to the way things looked at the time of your financial results briefing?

A: The recovery seems to be happening faster than the preconditions we foresaw at the time of our financial results briefing one month ago. As of the end of April, clients were diverging into the two extremes of companies whose performance had suffered significantly due to the coronavirus, and those who were attempting to use this as an opportunity to reform their business models and increase investment.

There has not been much impact on the sales environment in finance. In industrial there are both positive and negative sides but overall the impact seems to have been neutral. Currently around 70% of our production staff are working via telecommuting. Since our partner companies in Japan did not have environments in place for telecommuting NRI took on some of our partners' work in April, which caused a decline in productivity. Making corrections at a feverish pace, our partners had telecommuting environments in place after the end of the Golden Week holiday.

Q: Does that mean that overall you are headed in a positive direction faster than you expected?

A: Right now that is how it seems. Nobody knows whether there will be a second or third wave of the coronavirus so of course I cannot make any declaration, but it does seem that IT investment is returning faster than previously expected.

Q: What is the analysis of NRI consultants on the current coronavirus situation, and

what are they saying about its socioeconomic impact?

A: In consulting we are communicating weekly emergency recommendations on our website, consisting of a variety of informed opinions. My own personal feeling is that there are two main trends. One is the paradigm shift toward new workstyles, and the other is the shift from face-to-face to non-face-to-face. I think that both of these trends will proceed rapidly.

The trend toward new workstyles involves more than just telecommuting. In the past, the source of Japanese companies' competitiveness was the "obeya" all-hands-on-deck control room approach, which brought managers together to pool their knowledge and build tacit knowledge. The new workstyles that are gaining traction now might go in a direction that refutes the very fundamentals of the industrial and corporate success stories we have known to this point. I think the big challenge facing Japanese companies now is how they will be able to balance the introduction of new workstyles with the sources of their corporate DNA and strengths, without these being damaged. The HR systems and organizational structures for these new workstyles are completely different. Managers need to identify the major problems surrounding these new workstyles amidst the overall scope of their work and take the appropriate action. Addressing this issue only partially can have unintended side effects, causing problems of significant magnitude. I think we also need to develop a more in-depth approach to this at NRI as well.

Another issue is the accelerating shift from face-to-face to non-face-to-face in particular, even in existing DX. Until now, many manufacturers had refrained from creating their own direct consumer channels out of consideration for distributors and other intermediaries. However, this crisis has eliminated the circumstances in which consideration is given to distributors, and now these manufacturers can invest without holding back.

In insurance, many salespeople had been conducting their sales face-to-face, and there was backlash against the shift to non-face-to-face. Conversely, now that salespeople are unable to interact with their customers directly they are saying that they cannot do business without non-face-to-face tools.

Various obstructions have all at once been lifted due to the coronavirus, and now the circumstances allow for a new type of all-out investment. Managers who have noticed this are not waiting for suggestions to come from the bottom up. They are enacting their own reforms hands-on in order to speed things up. For example, cross-organizational teams headed by the company president are

being formed. I don't think you can keep pace with the current paradigm shift using a bottom-up approach. Going forward, more companies will probably be driven by their presidents' direct commitments to major business model changes. We see this as an upcoming opportunity for NRI's services.

(Questioner No.2)

Q: As the post-coronavirus market environment diverges into two extremes, what tendencies do you see among clients who aim to use this as an opportunity for change?

A: The increase in companies whose managers are acting on their own to dramatically change business models is unrelated to the divergence in the market. I think managers at many different companies are feeling the need for change. Airlines, the travel industry, and global manufacturing are all really struggling with business performance right now, and uncertainty is pervasive. Various conceptual discussions may be taking place, but it is likely hard for them to actually pull the trigger on new IT investments.

At the same time, e-commerce in logistics is being stretched thin and the existing core systems are nowhere near capable of handling it, so we are getting consultations about overhauling core systems to deal with new demand, as well as consultations about building secondary cores. Consumer goods manufacturers are also taking this as an opportunity to consider all-out investment in e-commerce since physical channels such as mass retail outlets are struggling. Telecom traffic is also increasing, which means more investment is needed to update existing communications infrastructure.

We are also seeing a trend to use the current situation as an opportunity to launch a variety of new services outside of telecom, and this has been further accelerated by the effects of the coronavirus. We have both of these types of clients in our Industrial IT segment, so things appear to be evening out to neutral overall.

Q: While orders in financial IT have not been impacted by the coronavirus, insurers and other such companies are slightly changing their approach to sales. Are there any new trends or other changes in finance as a whole?

A: In the securities industry, the migration process to THE STAR at Mizuho Securities is proceeding on schedule with no major changes. There are also more securities clients who want to change their own IT to THE STAR due to the

escalating service charges expected in the future.

In insurance, new sales have stopped at the life insurer which is our largest client, and how they change their approach will also depend on when they can restart. We are getting consultations from clients about what to do after their sales efforts restart, but investment seems to be a bit restrained. Over the past few years we have had large projects in core systems overhauls for direct non-life insurers, and last year was the peak so our sales grew significantly. Those numbers will fall back a notch this year, and we have forecasted a year-on-year drop in sales in our performance forecast.

Our business in insurance involves sequentially developing individual systems, so our problem is that we are unable to bring in new projects if we cannot conduct sales. Right now our worksites have existing projects to work on, but we need to arrange projects to work on in the second half and next year. Overall it is taking a while to close sales conducted in April and May because our clients are also telecommuting. There is also a certain level of sluggishness as clients are tending to put off serious discussions until later. In banking, we have core systems projects under way for large online banks, and these are stable. Companies from other industries are also entering the banking sector, and we are beginning to take on related projects. To summarize, our forecast is a bit unclear in insurance but stable in other sectors.

These are the trends in our core businesses, but we also have a variety of other new tech-related projects that we are working on. However, it will be a while until these projects contribute to sales and profit.

Q: You made some personnel cutbacks overseas, but how do you think demand might change overseas after the coronavirus?

A: Currently, circumstances are harsher overseas than they are in Japan. For example, Brierley+Partners in North America is a loyalty marketing company whose main customers are airline, rental car, and other companies in the services industry as well as companies such as department stores in the distribution industry. Current circumstances in these lines of business are too harsh to make any type of future forecast. Since we do not yet know when their customers' performance will recover, we plan to minimize staff numbers and operate with a balanced budget.

In Australia the number of infections is low, but the nationwide lockdown will continue until the end of June. ASG acquired SMS two years ago and absorbed

the upstream functions of their consulting and application businesses, but new projects have been halted by the coronavirus. In response, we laid off over 100 staff at the end of March and are now operating there with a balanced budget while waiting to see when a recovery might happen. Australia is different from North America in that our main business there is managed services (IT infrastructure outsourcing) which are not impacted much by economic fluctuations. We have suffered less damage there than in North America, but we will not be able to envision a long-term growth strategy without waiting a little longer to see when demand will recover.

Q: About when do you think you will be able to make a future forecast for your overseas business?

A: At this time I do not know. Right now our policy is to operate with the absolute minimum level of resources and try to push through the adversity. We are managing business with mainly a defensive approach in order to not overextend ourselves and produce any losses.

(Questioner No.3)

Q: What is the situation with outsourcing in China and Nvantage in India? And have you made any changes to future overseas business plans due to the coronavirus?

A: We are regularly using about 5,000 man-hours in China offshoring. Since we do not have any bases in Wuhan we did not suffer any critical setbacks, but the situation was rough from the end of January until the beginning of February when engineers were unable to go to work. Recovery began in mid-February, and by the end of the month we were operating at 100% capacity there again. Currently we have no problems in our utilization of offshoring. Nvantage in Mumbai is engaged in back office operations for securities. Their employees are going to work and carrying out their tasks as normal. With a small staff numbering less than 100, they are currently not having any problems. We expect to see various changes in North America due to the coronavirus. There were many cases of good companies with extremely high valuations that were not ultimately worth the effort. North America has quite a few companies that own a variety of new cloud-native technologies. These are appealing in that they can be implemented for business here in Japan. We intend to continue looking out for investment opportunities in North America.

As for business growth going forward, our overseas sales are currently around 50 billion yen, but our plan calls for 100 billion yen in 2022. However, rather than chasing a sales target I would prefer that we pay more attention than before to global growth strategies that entail profit growth. The effects of the coronavirus will probably linger for the next two to three years, so I don't want us to overextend ourselves.

In that context, I would like us to properly develop our business in Australia. As we announced in the financial results briefing, NRI has agreed to acquire AUSIEX, a division handling back-office IT and operations services functions to be split off from a securities subsidiary of the megabank Commonwealth Bank of Australia (CBA). We will establish a new company over the next year or so. AUSIEX handles back office and some front office in wealth management, and Australia's personal pension market is larger than Japan's, with a population that is also growing, making it a highly appealing market. This relationship we now have with megabank CBA is an extremely advantageous springboard to enter Australia's IT and operations markets in finance.

AUSIEX is using old back office technology, so we are thinking to deploy NRI's services there. We might also join them in working on platforms for finance fields other than wealth management. We would like to significantly grow our finance in Australia over the next few years. AUSIEX alone will not give us enough functions to achieve this, so we need to build up our capabilities by acquiring other small and specialized companies.

Q: Speaking of Nvantage, I remember there was a plan for that company to move on to its next stage sometime this summer. Can we assume that plan has not changed?

A: Nothing has been set in stone yet. Senior management at Nomura Securities has changed, and now they are discussing future policies. At this time I cannot provide any specific information beyond that.

(Questioner No.4)

Q: If there is a second wave of coronavirus this winter, can you build up your operations so that your supply systems will not suffer much impact?

A: In consulting it is difficult to do everything in sales and production-related activities via telecommuting. If a second or even third wave were to occur between now and winter, and Japan were forced to take extreme measures

such as enforcing a lockdown, consulting would probably suffer considerably more damage than IT services would. Currently we do not foresee such a scenario. It is not a risk that you can completely hedge.

Q: My understanding is that you are preparing for an increase this winter in the scale of your proposal activities ahead of the paradigm shift. Is that correct? And what is the progress of your new projects?

A: Previously I mentioned two trends, new workstyles and the shift from face-to-face to non-face-to-face, but in terms of the large demand for NRI's consulting and the subsequent connection to our IT services in particular, I think we need to thoroughly track the shift from face-to-face to non-face-to-face. Even amongst the clients we work with, several companies now have cross-organizational review teams and task forces created top-down by the company president, which then create hurried investment plans. This covers everything from the conceptual phase to the planning phase, and I think the time lag until the start of actual development and investment is faster than before.

They want to operate top-down to emphasize speed, so rather than carefully putting together a detailed investment plan there are now cases where they start first with one billion yen that requires particular urgency out of an overall 5 to 6 billion yen to invest. They start working on what they can do right away, without spending much time in the planning phase. I think this type of demand will appear rather quickly not only in consulting, but in IT services as well.

Q: What do you think about the risks of business turning unprofitable due to price wars with competitors, creating hurried plans and executing them too soon, or things of that nature? And how do you think you can address these risks?

A: We intend to maintain workstyles that assume employees will be telecommuting, with around 50% of work being done from the office. This poses project-related risks due to lower quality of communication, so we intend to monitor projects more thoroughly than before. We also must prevent unprofitable business that arises after accepting orders at too low of a price when failing to incorporate the actual risks in the order stage.

For projects in which we work together with clients starting from the conceptual phase, it is very likely that we can keep risks down in some cases by understanding clients well enough that we march to the same beat with them, and know what they really want to achieve with their investments, what they

need to keep, and what could possibly be scrapped. However, if we are not involved from the conceptual phase and we accept orders and begin development starting from the RFP, we will not understand the inherent risks well enough and will not be able discern what costs we could cut by negotiating with the client. I think it is very dangerous to accept orders in such circumstances. I am always saying that I don't want us to overextend ourselves by accepting orders such as these. From the management perspective this is something that we need to be very concerned about.

(Questioner No.5)

Q: You say that the paradigm shift will only be happening at some companies, and that major changes might not be happening in Japan overall. Do you think there will be any overall changes in Japan?

A: I think there are some managers in Japan who want things to go back to the way they were. The results of the survey that NRI conducted in early May showed that around 40% of all employees in Japan were telecommuting, and that 60% of employees who work for large companies with at least 1,000 employees are telecommuting. When we asked respondents whether they would like to switch to a workstyle that incorporates telecommuting in the future, 90% of them said yes.

On the other hand, around 60% of those who are telecommuting also said that telecommuting is causing problems in their work. The number of respondents who said it presents problems has increased compared to the results of the survey conducted in March. In other words, they have tried telecommuting, and as time has passed various problems have arisen. Some managers that tried telecommuting but saw problems arise such as declining productivity and couldn't eliminate these problems might think the only solution is to go back to the way things were before.

On the other hand, if 90% of employees who telecommuted desire that workstyle, I think there are some managers who think they need to switch to a workstyle that incorporates telecommuting going forward while eliminating as many of the problems as possible. The biggest reason employees want workstyles that incorporate telecommuting is work-life balance. I think there are lots of managers who see declining productivity arise but want to try various ways to fix it and help their employees achieve work-life balance. Right now, Japan might have a once-in-a-lifetime opportunity to find an equilibrium

between work-life balance and productivity. If we can overcome this problem, we might be able to create a society that achieves both of these objectives. I hope we can go in that direction.

(Questioner No.6)

Q: Are you solving the problem with telecommuting in outsourcing?

A: Business partner companies in Japan did not have environments in place for telecommuting, so we enabled them to also use the AWS-based remote development environment called Aslead Remote which we had been using internally to that point. As of the end of the Golden Week holiday we had enabled connections for around 5,000 people, and partners have been gradually utilizing it since then. Some partners did not have computers to use when telecommuting, so we have been working with them to supply devices from NRI and enable them to be as productive as possible via telecommuting. We struggled in April, but now it seems those problems have subsided.

Q: What is your situation with projects in the telecom industry? With 5G services having launched in March, how much have the expected values of the future market risen?

A: Rather than in 5G, we are bustling with inquiries in telecom for projects in areas of non-communications services unrelated to 5G such as the switch to non-face-to-face business for conventional stores, overhauling inundated call centers, and launches of new business geared toward rising expectations for non-face-to-face financial services. I think 5G will come later. We have relationships with several points of contact, but we are taking a step beyond those points of contact and toward investing going forward.

Q: You mentioned investment in communications infrastructure at companies. Is that for mobile communication?

A: It is about telecommuting environments at companies. Big companies can have problems such as insufficient VPN connections, networks that are too vulnerable, no virtual desktop infrastructure, and no external access via thin client computers. It means there is rising demand for urgent investments to address these problems.

(Questioner No.7)

Q: You said that HR systems must change for work from home to continue, but what consultations has NRI fielded for this? What do you think will happen in Japan?

A: Role-oriented refers to each individual having a role and several individuals forming teams to complete individual jobs, which is similar to Japan's conventional work format. On the other hand, task-oriented and job-oriented are when the work each person does is clearly defined, they work independently, and organizational goals will be achieved if they each do their job well.

Fundamentally, telecommuting must be task-oriented or job-oriented in order to function. Telecommuting while staying role-oriented means co-mingling tasks and marching to the same beat online only, which increases the amount of time needed to maintain the same level of communication. As such, if Japanese companies simply transition to telecommuting, their productivity will fall. We end up with the paradox of spending an additional 20% to 30% more time unnecessarily, only to maintain the same output as before.

I think one effective tactic to solve this problem, even if you are not going to significantly change HR systems is to switch to work processes that are as close to job and task-oriented as possible. Going into even more depth, some people might imagine that a network-type organizational structure where individuals relate to each other horizontally as opposed to hierarchically is more agile and flexible. Japan also develops personnel through on-the-job training, which is not effective in a telecommuting environment. We probably need to think of ways other than on-the-job training to develop personnel. I think there are various challenges involved in transitioning to new workstyles and effectively raising productivity.

Going forward, I think this type of topic will be subject to widespread discussion. Demand for virtual offices will likely arise out of such discussions in the future. Work-at-home environments are quite flimsy, so I think there will be demand for services such as virtual office-type environments on the cloud, which also have virtual desktop infrastructure and security that is tightly managed. Upgrades for work environments in households might be needed.

End