(Tokyo - 27th November, 2020)

Nomura Research Institute, Ltd.
Q&A from Small Meeting for Institutional Investors

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

(Questioner No.1)

Q: With some companies decreasing and some companies increasing IT investment due to COVID-19, I do not think it is easy to ascertain companies increasing investment and flexibly shift the allocation of resources. Why was NRI able to do this?

A: As it turned out, orders have increased, but I think our customer portfolio has had a positive effect overall. COVID-19 has had little impact on the financial industry, which is NRI's largest customer segment, and with a base of proceeding on schedule at the start of the fiscal year, we have not had a large downturn. There are many service systems in industrial IT, but travel and transportation have been subject to considerable damage. Our customers are also struggling in terms of performance. Meanwhile, retail and telecommunications are actively investing in non-face-to-face sales and e-commerce. We have also concentrated resources and proposed projects because NRI's major customers have also made such moves, and things clicked.
We were monitoring the situation in 1Q, but I think the stance on investment became clear in 2Q.

Q: Was the reason (for strong performance in 2Q) mainly attributable to coincidental elements? Isn't it better to think that things may not necessarily go smoothly if the same thing happens again?

A: Although there were connections between top management and long relationships in consulting, customers that had not progressed with solution proposals came in with inquiries about wanting to hurry forward. Letting them use NRI as an additional resource has led to numerous projects. I think it is possible that the use of services, solutions and personnel base on a little suggestion could lead to future projects due to the relationships of trust between top management. Such moves are difficult for each site to take, but I believe having long relationships is a positive in emergencies where it is necessary to take top-down action.

Q: How much effect did orders concentrated on certain customers have on 2Q performance

A: The movements of customers who made big moves were big. We made greater

allowances for places making big moves because we are unable to deal with everyone evenly due to the limitations on NRI's resources.

(Questioner No.2)

Q: I would like you to explain the current evaluation of DX-related sales specified in the medium-term plan. Do you think domestic DX-related sales will accumulate to target levels due to COVID-19?

A: I think DX sales are progressing well. There has not been a sudden increase since COVID-19 because there had been a trend of DX projects for some time. In particular, DX is involved in some way in all new projects, and thanks to COVID-19, we have been able to maintain better levels than initially planned, or more accurately, things have become more focused on DX. This is why I don't think there will be a sudden uptick.

Q: Starting in FY2018, it can be inferred that DX accounts for 60% of 500 billion yen in sales, and shared online services and other DX excluding overseas is around 250 billion yen. As a result, it has been estimated that these will be almost double in FY2022, but is it correct to believe that you are on track with such an image?

A: I don't think the trend of DX will regress. We have a broad perception of DX sales and have determined the use of the cloud to be DX. Now, on-premises projects are being phased out, and I think we will go with DX for new projects. Maintenance on old systems is included in the old type of sales and I think this will decrease in future. As a result, digitalization will progress and replacement will progress.

Q: Existing business other than domestic DX is anticipated to have decreased revenue over the next four years, but is your impression that it is progressing as expected?

A: This may have been somewhat affected by COVID-19. I have also heard that ordinary maintenance projects have also been restricted. I think they have been declining somewhat.

(Questioner No.3)

Q: It is believed that transformation projects will increase in other companies and industries. What kind of projects are anticipated? In the event there are many similar projects, can you efficiently roll out accumulated expertise? I would like you to describe the outlook for the future of transformation projects.

A: I think it is possible that we will be able to use know-how and algorithms accumulated in the process of conducting DX projects. However, I think this is largely dependent on the business lines of individual customers. We are making algorithms for things like optimal

delivery in logistics, but we do not think these apply to all logistics customers. Know-how is accumulated on how algorithms are made according to the type of data collected and how it is analyzed. I think such areas can also be used in other companies. In anticipation of this, I think it is possible that parts that can be shared will remain as assets.

I think things used in non-face-to-face sales by BtoC customers could also be used by a variety of customers.

Q: What sort of things do you require in non-face-to-face sales? Please provide examples.

A: In general, I think we have developed on-site sales tools, data input into devices and things viewed by customers.

There is also discussion of customers with brick-and-mortar stores planning and designing tools enabling customer contact without them coming to stores.

(Questioner No.4)

Q: What is your approach to the lifetime value of the DX business you are currently engaged in? I would like you to explain what NRI aims to do in terms of the image of revenue at the time of cut-over and following that such as simply selling systems, operation and recurring business.

A: There is a variety of patterns, but in the shared online services for financial customers, we receive recurring revenue.

In new projects that have increased recently, it is common to build moving forward. Therefore, the image is not one of ending once something has been made, but rather expanding the scope by constantly adding improvements and modifications in the process of making and using, followed by using and fixing. The current image is closer to having customers use people than having them use software. This is a method called agile development, and it is a style that involves staying by the user's side and constantly making improvements.

Q: Will the top line target for FY2022 be linearly increased per head, or will you flexibly use or further increase outsourcing to be able to dynamically respond to a degree? What is your view on how the scale of the company and application of resources will change?

A: Considering the period covered by the current medium-term plan, we do not anticipate NRI's business model will change significantly. Basically, until around 2022, this will involve a style where a platform of shared online services is used by consultants and engineers to create new software assets, develop the digital transformation of the businesses of new customers, expand the number of business domains and customers, dig deeper on a single project and direct resources toward obtaining more projects.

Q: Has there been a relearning of skills by NRI's own engineers being more focused on consulting business? Will this happen in the future?

A: Although NRI's personnel may be engineers, they listen to customers to perform computerization, and regardless of whether this is a waterfall or agile approach, I do not think there are any differences in their core skills. I think we can use training to cover any differences in the tools and languages used. NRI has highly absorbent personnel, and I think we have been able to change from old ways to skills matching the current times without much time lag. Talking about business in front of customers and implementing this in software can be performed using existing skills.

Q: What is your view of the current situation concerning the possibility that vendors of infrastructure such as the cloud strengthening ties with customers cutting out system integrators?

A: I think there is a tendency to think that customers are able to produce systems internally. However, an internal system is not completed using a single vendor. There are old and new systems, and it may not be possible to properly design systems because data cannot be properly linked and nobody knows how to link them despite the necessity to do so. As a result, customers are faced with the problem of a system not being completed by infrastructure vendors alone. This should not be much of a concern because NRI has always been able to handle such problems by taking a position of organizing multiple vendors. In Europe and the United States, customer companies have had many IT engineers with various skills for internal production, leaving little room for the work of system integrators. I feel that it will take some time for such conditions to reach Japan's shores.

Q: In Japan, it appears that competition with other system integrators will dissipate and that competition will mainly be with companies focused on consulting, but do you have this impression?

A: Recently, we often encounter consulting firms at a variety of customers in the upstream consulting area. We frequently have competitions with companies trying to enter from upstream. However, even when starting with consulting, this is not completed by simply connecting cloud vendor services and in many cases it is necessary to build something oneself and take care of the customer until the end. We do not encounter many rivals that deal with the client that far.

Q: As trading company affiliated IT vendors issue policies leveraging their connections with

trading company groups, is it possible that trading company groups will rise in the industry?

A: I think trading companies will view growth of the IT sector as a strategy. I think it is natural for them to adopt a strategy leveraging and expanding their IT companies. However, I do not think they will grow simply by having IT services. Trading companies do not seem to have a lineup of services enabling them to handle everything from top to endpoint of user companies. I think they will probably move to widely sell certain processes, products and services.

(Questioner No.5)

Q: What kind of impact will using agile development to implement DX projects have on the profit margin?

A: I think there are concerns that the profit margin may decline with agile development in DX in non-financial clients, but we have been taking steps to increase productivity since last year, and these are bearing fruit. We have secured a profit margin of around 14% in domestic industrial IT and it is on a level on par with for finance, so we are not very concerned.

Q: I thought the profit margin would be increased by raising the unit price and having common components, but is this expecting too much?

A: It is necessary to make up-front investment and some trial and error parts always remain. The areas we cover will not expand without this. There are parts where we are not seeking just efficiency. We are maintaining a balance of securing a certain profit margin while also supporting growth by also facing challenges to a certain degree.

Q: Six months ago, you said that although the brakes may be pumped due to COVID-19, DX would not be reached without modernizing legacy systems, but what is your view of inquiries from clients six months later?

A: Many clients view modernizing legacy systems to be a problem, and even some existing clients refuse to accept proposals unless they are in that direction. I think the current condition is that customers are feeling pressure.

Q: Is this a trend of properly allocating a budget to perform modernization rather than postponing it because of the weak economy?

A: Many clients are concerned that they will be left far behind once they realize it if they do not go ahead with modernization. In particular, I think places where top management has this view move quickly and powerfully.

(Questioner No.6)

Q: I would like you to tell me about the risk and potential of promoting DX in the public sector.

A: NRI has done very little work on IT solution projects in the public sector. It is difficult to get into the public sector, and we have not reached the point of allocating resources because the difficulty of projects is also high. Until now, we have been involved in projects and made proposals at a variety of government ministries and agencies in consulting. We cannot suddenly make an entry with solutions due to problems with the accumulation of strength and know-how. In particular, I do not think it would be easy to enter existing areas because leading domestic vendors are already working in these areas. However, I think NRI may have opportunities in areas where the government uses services in the private sector through new initiatives starting with DX. For example, in relation to My Number, the certification service called e-NINSHO provided by NRI could also be used by the government, and I think it is something that could be evaluated based on our track record in financial institutions.

(Questioner No.7)

Q: I would like you to explain the specifics of how consultants and engineers cooperate in agile development.

A: In the past, consultants have first proposed solutions and passed the direction onto engineers who develop systems in a relay format. With the relay format, there are some cases where systems are not built according to consultants' proposals, and course corrections are later required. In the case of the agile format, consultants and engineers discuss together and make corrections on the spot, enabling them to propose feasible solutions. For example, there are some cases taken as far as system architecture and coding in around one week from the proposal.

In the actual workplace, consultants and engineers working on agile development are in the same room and discuss issues to address on the spot while posting Post-it Notes on a board. This enables viable solutions to be quickly provided to clients, which differs from the past relay format. We have already been conducting agile development for more than five years, and it is currently expanding after accumulating know-how.

Q: DX projects using agile development have an image of being labor intensive. Is it possible to increase profit margins?

A: Agile development itself does not provide much leverage. However, projects can be expanded for some time even with the current approach. Measures to increase efficiency

will be something we consider once things have taken shape.

(Questioner No.8)

Q: Will DX lead to further expansion of the market in the Japanese IT industry as a whole, or will it lead to fighting over the pie with the existing IT market?

A: The amount of investment required will decrease if on-premises system development that had been carried out with existing IT budgets is simply modernized. It can be expanded if new services are created through DX, such as marketing divisions being able to form budgets in new areas. Proposing the tools required by clients on site and increasing DX investment from different areas other than IT budgets in the past will lead to expansion of the IT market as a whole.

Q: Will it be possible to quickly take share from rivals if you propose a set of modernization of core systems using existing on-premises development and new DX business?

A: It is theoretically possible, but is difficult to inject that many resources in a short period of time. It is possible that competition will intensify and we will be unable to secure profitability. It is easier to implement a new separate core system for new business. It is possible that we will use new business as an entry point and take time to gradually work on the main target of core systems.

Q: What stage is the provision of services utilizing data in Japanese companies and will this progress?

A: It varies substantially depending on the industry. There are strong needs for real-time systems in retail, etc., and a trend of investment is continuing. We will use agile development to handle things processed by core systems and enable the utilization of data. For example, if we are able to track the status of inventory in brick-and-mortar stores under the same conditions as online, it will be possible to prevent lost business opportunities. Meanwhile, retaining past data is an important mission for financial institutions, for example, and significantly changing systems for the purpose of data utilization is relatively difficult.

Q: Will you increase hiring with the aim of securing personnel for meeting burgeoning DX demand? What kind of personnel shortages will be a bottleneck?

A: In our Medium-Term Management Plan, we plan to increase personnel to match the 6-7% annual growth rate in net sales. Rapidly increasing the number presents the risk of lowering quality and is not a good idea. It is necessary to carefully select the personnel to recruit. Understanding of client needs and quality of system design have a greater

impact on final quality than skills such as coding, and it is important to secure and develop personnel able to contribute to such operations.

(Questioner No.9)

Q: What is the most important mission of NRI's corporate division?

A: Strengthening of Group governance for the independent business operation of subsidiaries such as joint ventures established with clients and overseas subsidiaries is an important issue. Based on this, we would like to secure a diverse range of human resources and link this to long-term growth of the Group as a whole by raising the quality of human resources.

Q: Will you assign human resources from NRI itself to subsidiaries?

A: In order to conduct management utilizing the characteristics of each subsidiary, we generally will not send people from NRI, and would like to create a system enabling each subsidiary to hire, develop and grow personnel. Balance is important in determining how much control is required and how much discretion is allowed concerning the governance systems for achieving this. At present, the centrifugal force of NRI itself is too strong, so we would like to apply more centripetal force to the Group as a whole to refine the shape of the Group.

(Questioner No.10)

Q: In order to aim for the overseas sales target of 100 billion yen mentioned n the Medium Term Management Plan, what elements are required in the Australian business?

A: The Australian subsidiary ASG does not cover the entire country, so we will expand the areas covered through M&A of local companies. Furthermore, as already announced, we will move forward with procedures to purchase AUSIEX shares, and build a business base for finance. In addition, I think we could also have another pillar of business in Australia.

Q: It appears that the cash conversion cycle is getting longer. Are you consciously controlling this? What KPIs are you emphasizing?

A: The cash conversion cycle is not a KPI we are particularly conscious of. We plan to make the transition to IFRS from next fiscal year, and operating profit and operating profit margin are also important in IFRS. In addition, we will also emphasize EBITDA and ROE. Also, the policy for equally allocating cash to shareholder returns, investment in existing business and investment in growth should be maintained after the transition to IFRS.

(Questioner No.11)

Q: Are there any businesses that you anticipate to change with the establishment of the Digital Agency?

A: The establishment of the Digital Agency itself will not generally have a large impact on NRI business. We will continue to invest in business related to My Number, which is the cornerstone of digital government, because it is expected to grow. We already provide public certification services (e-NINSHO and e-Post Office Box) in relation to My Number. It is anticipated that linkage of financial institution accounts and contracts with My Number will progress in future, and we would like to naturally expand business through the use of certification services.

Q: For example, could you consider initiatives such as embedding data analysis functions into THE STAR?

A: We could consider it if there are such analysis needs in securities firms. For example, a variety of possibilities can be considered, such as NRI proposing the data analysis method and building systems for data analysis if needs are revealed, or providing support for the execution of analysis.

(Questioner No.12)

Q: Do you have a policy on mobile application efforts in DX within the area of marketing?

A: We do not have any special plans for applications alone such as making and rolling out original applications. Our policy is just to meet the needs of clients.

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