Nomura Research Institute, Ltd.

Q & A from Small Meeting for sell-side analysts

Part 2

- In order to make it easier to understand, the contents of the question and answer are partially revised and modified.
- Glossary:
  - DX: An abbreviation meaning Digital Transformation, which refers to initiatives that utilize digital technologies to reform business models and processes

(Questioner No.1)

Q: Your implementation of THE STAR at Mizuho Securities was covered in a news release, but please tell us the background behind this implementation and how you expect the related business to develop going forward.

A: I believe this project came about due to the desire of our securities clients to reduce IT-related costs in non-competitive areas as the business climate in their industry becomes harsher. Mizuho Securities has been a client of ours for over 20 years and their strategy is a good match for the services that THE STAR performs, so they decided to go forward on this project with us. The implementation project is currently in progress, and we expect it to take roughly two years.

Q: Is the implementation at Mizuho Securities on a smaller scale compared to what you are doing at Nomura Securities? And while the implementation at Nomura Securities may have involved enhancing a considerable number of general features, how much of that does this project involve?

A: The Mizuho Securities project is on the scale of a major securities brokerage and has quite a few original features, so we have to accommodate these.

Q: While I believe you are recording sales for development in the implementation phase and from service usage fees in the operation phase, about how much sales is being recorded?

A: While I cannot share the specific numbers, the implementation period typically
contributes a lot in terms of sales, but contribution to profit is larger when we enter the operation phase.

(Questioner No.2)
Q: I believe the implementation of THE STAR at Mizuho Securities is comprised of a consulting project and a systems integration development project, but what is the profit margin for each project? Could you also please tell us the profit margin for service usage fees after the implementation?
A: I cannot share the specific profit margin numbers. This implementation is comprised of many development and migration projects. Also, the profit margin for service usage fees after implementation will be higher than the development and migration projects during implementation.

Q: What are the service usage fees for THE STAR implemented at Nomura Securities?
A: We do not disclose THE STAR service usage fees for individual companies. Out of around 60 billion yen in sales to Nomura Holdings, around 70% is sales to Nomura Securities including usage fees for THE STAR.

(Questioner No.3)
Q: Over the last few years I believe you have been shifting resources from financial IT toward industrial IT, but will you now be bringing resources back to financial IT for the implementation of THE STAR at Mizuho Securities?
A: Our resources currently in financial IT are sufficient, so we will not be bringing any back. At the same time, our offshore partners in China have a system that can flexibly increase or decrease resources according to project demand.

(Questioner No.4)
Q: The acquisition of Mizuho Securities subsidiary Nippon Securities Technology (NSTec) has brought a few hundred engineers on board. Will NSTec employees be involved in projects for THE STAR implementation at Mizuho Securities, and then be involved in financial IT business once implementation is complete?
A: That is correct. During the implementation phase the systems currently in operation need to be managed and maintained, and we are planning to push forward with projects for Mizuho Securities once implementation is finished. This
will also require cooperation from NSTec employees, so we are discussing with our client as we move ahead.

Q: Are NSTec employees involved in projects for the Mizuho Financial Group other than for Mizuho Securities?
A: They are generally handling projects for Mizuho Securities. After implementation of THE STAR is complete, we would like to move forward with projects for the wholesale business.

Q: This acquisition of NSTec has brought a few hundred finance-oriented system engineers on board. Do you see this as a positive amidst the shortage of human resources?
A: Precisely. While there are management personnel in our headquarters organization, nearly everyone else there is a system engineer.

Q: Will performance contributions from NSTec be part of consolidated numbers starting in 4Q of this year? And about how much sales are they doing?
A: If the procedures go through without any delays, NSTec figures will be subject to consolidation starting in 4Q of this year. As for the sales figures, we plan to provide an explanation once the official decision has been made. These numbers will be consolidated into the financial IT segment.

Q: Can we assume that NSTec is currently only handling projects for Mizuho Securities, and that they are not producing much profit? And about how much amortization of goodwill will be absorbed from this acquisition?
A: Since they are not currently under our affiliation, I cannot state their performance figures.

(Questioner No.5)
Q: How much future expansion potential is there for THE STAR?
A: Fundamentally, it could be expanded to all securities brokerages that do not compete with Nomura Securities.

(Questioner No.6)
Q: It would seem challenging to be able to implement THE STAR at other major
A: We will not immediately be implementing THE STAR at any other major securities brokerages, but I believe it does have growth potential for midsize securities brokerages.

(Questioner No.7)
Q: What is the state of your global business with Nomura Holdings?
A: Business is proceeding well at NVANTAGE our joint venture established in India. Next year we plan to investigate whether its services can be expanded to multiple clients, which was the goal of its establishment. However, Nomura Holdings has also announced a change to its management structure, so we will see how their new management handles business before moving forward.

(Questioner No.8)
Q: How will the change in management structure at Nomura Holdings impact NRI?
A: It was only announced the other day, so we still do not know whether it will impact us.

(Questioner No.9)
Q: Is your IT solutions development unit for global business geared toward Nomura Holdings located in London?
A: Our development resources are mostly located in India. Some of them are also in London.

Q: Will any of the global IT assets owned by Nomura Holdings be transferred to NRI?
A: That relates to their strategy, and NRI is unable to provide any particular comment on the matter.

Q: Is the development unit in India technically capable of handling IT solutions for wholesale?
A: Fundamentally, Nomura Holdings manages its own global IT assets. We are only in charge of managing some of them, and we are handling IT solutions for wholesale within that scope.
Q: Would NRI be capable of single handedly undertaking all the global IT assets of Nomura Holdings?
A: We have not reached such a juncture.

(Questioner No.10)
Q: Please tell us the status of your DX 2.0 initiatives to co-create business with clients.
A: Our companies that handle DX 2.0 have only been established recently, and we are working to launch and stably maintain their business operations. We do not expect any major contributions to performance from these immediately, but we believe that we can expect such contributions in the future.

(Questioner No.11)
Q: At about what point do these companies normally stabilize and begin contributing to performance?
A: Typically, we want to get a new company’s business off the ground within about a year after establishment, but each of these companies also has its own circumstances so we cannot describe them with one blanket statement.

Q: I believe each company is experiencing cost overruns as they get their businesses off the ground. How much of an impact will that have on your performance this year and next?
A: These companies have positive and negative circumstances both this year and next, but we do not expect them to have any big impact on our performance.

(Questioner No.12)
Q: What type of projects had you expected in the first fiscal year of operations for KDDI Digital Design? And what do you forecast going forward?
A: The plan was for roughly two-thirds of all projects to be for the main entity of KDDI itself, and the rest to work with KKDI for their corporate-aimed business to provide IT solutions to new clients. Going forward, we would like to offer new IT solutions such as those that utilize 5G and IoT.

(Questioner No.13)
Q: Taking initiative seems to be more complicated with a profit-sharing joint venture compared to a conventional outsourcing joint venture. Is that because it takes time to establish stable business operations?
A: From our perspective it is not the way the venture does business, but rather a matter of time perception such as taking longer to do things than planned.

(Questioner No.14)
Q: Other joint ventures get their businesses off the ground very quickly. On the other hand, KDDI Digital Design is struggling to get its business started. Why is that?
A: This is because time was spent narrowing down the potential clients to whom services could be provided. I can’t summarize the way things are for other companies, but typically I think when a company is selling its own products the business can be started up quickly.

Q: Who are the target clients for KDDI Digital Design?
A: I am unable to go into specifics about that.

Q: Why did you form a joint venture with KDDI in the telecom field?
A: KDDI has been a client of ours for some time, and we believed we could mutually leverage the strengths of KKDI’s telecom infrastructure along with NRI’s IT solutions.

Q: Is growth for KDDI Digital Design factored into your current Medium-Term Management Plan?
A: Yes, it is.

(Questioner No.15)
Q: In terms of the scale of your consulting business operations, what is the ratio of your strategy consulting compared to systems consulting?
A: In terms of sales, the ratio is about 2:1. We have less employees than this ratio in strategy consulting since it is a higher value-added field.

Q: Does the strategy consulting division handle the consulting process in DX projects, or does the systems consulting division handle it?
A: For business model transformation you have to work with CEOs of clients, so the strategy consulting division often handles these. The systems consulting division gets involved when considerations for IT solutions are taking place. We have various points of contact with clients depending on the project. Some projects start with management consulting, while others start with systems consulting.

Q: From the client’s perspective when NRI handles everything from consulting to IT solutions, do they get the impression of being locked in with NRI?
A: Hardly any companies are capable of handling everything from strategy formulation to IT solutions on their own. There are cases where, for example, a company formulates its own strategy while contracting vendors for IT solutions and it doesn’t go well, and cases where the strategy by a contracted consulting company is too broad and no solutions can be achieved. From this perspective, there are no companies other than NRI that can formulate strategies, incorporate them into IT solutions, and handle architecture and operations in a streamlined fashion.

(Questioner No.16)
Q: How many strategy consultants and systems consultants do you have?
A: We have around 500 strategy consultants. Our systems consultants are fewer in number than our strategy consultants. Our IT solutions division also has systems consultants who can handle upstream processes.

(Questioner No.17)
Q: Do employees who join NRI as IT engineers gain experience and become strategy consultants?
A: That is not the case. From the time of hiring, the strategy consulting division and IT solutions division are separate.

Q: Order volume in industrial IT decreased during 2Q, and in the financial results briefing it was explained that this was due to constraints on orders resulting from insufficient human resources. The shortage of manpower will likely continue, so what are you expecting in terms of orders?
A: We want to book more medium to long-term projects. Rather than increasing immediate projects and letting profit slide, we are selecting projects that can
ensure profit. We also have an increasing number of short-term, small-scale projects which tend to keep order volume from rising.

Q: Does this mean you are putting effort into securing more projects that are longer in duration?
A: Projects that have no risk of eroding profits but lead to increasing our client base are important, not the length of the project duration.

Q: Do you think your profit margin is low in projects for new clients?
A: In terms of profit margin, our business portfolio is comprised of 20% high-earnings projects, 60% normal earnings projects, and 20% strategic projects with low earnings. We can develop new clients through strategic low-earnings projects on the assumption that we also have other projects that bring in earnings.

Q: Can we assume that order volume has decreased because the business climate is favorable, and you are selectively taking on projects that can ensure earnings?
A: That is correct.

Q: I understand that NRI is not contracted for 7pay, but are you getting consultations for additional requirements such as for service deployment?
A: We have provided support for system failures. As for future strategy, we are not making any considerations or providing support.

Q: Please tell us the story of how you will achieve the target 100 billion yen in operating profit called for in your Mid-Term Plan 2022.
A: We believe that we will improve our profit margin in financial IT. Currently our profit margin in industrial IT is also improving even more than we anticipated. This year we set a challenging target, but in addition to achieving it we think we can also achieve next year’s target a year ahead of schedule. We planned a high growth rate for the second two years of our current four-year Medium-Term Management Plan, so we believe that achieving progress one year ahead of schedule makes our target even more achievable.

Q: What enabled you to get one year ahead of schedule in progress toward your target operating profit?
A: We accepted orders selectively without taking more orders than we could handle in industrial IT, and our profit margin improved.

Q: What is the approximate profit margin for new projects at KDDI Digital Design?
A: It is at about the same level as our other projects.

Q: Between either industrial IT or financial IT, which will be the growth driver toward achieving the target of 100 billion yen in operating profit?
A: Our business in financial IT is on a much larger scale, so it will be our growth driver and it will be important to improve productivity.

Q: Does overseas business contribute to achieving your target for operating profit?
A: In our current Medium-Term Management Plan we do not forecast a significant contribution to operating profit from overseas business.

Q: About when will you implement IFRS?
A: We are making positive progress in our reviews geared toward implementing IFRS during the current Medium-Term Management Plan as originally planned.

(Questioner No.18)
Q: Are any of the joint ventures established for DX 2.0 going to expand business externally?
A: Companies such as KDDI Digital Design and Technium will.

Q: You established NDIAS as a joint venture with Denso, but why did you make this a joint venture?
A: We were aiming for business expansion in the automotive industry.

(Questioner No.19)
Q: It seems that all your joint ventures up to now have been established top-down. Are there any cases in which you develop such a business starting from on-site collaboration? I think there are lots of cases in which other companies have taken collaborations and grown them into joint ventures.
A: NDIAS and JAL Digital Experience are cases in which we grew on-site collaborations into joint ventures.
(Questioner No.20)
Q: Was the goal of establishing NDIAS to accumulate knowledge about the automotive industry, or to expand business into the automotive industry?
A: The latter. We aimed to expand our client base.

Q: In the past, the automotive industry was inclined toward self-sufficiency and doing things in-house. Do you think that mentality has changed?
A: Yes, we believe it has.

(Questioner No.21)
Q: If the ratio of your sales that is DX-related increases, will it put downward pressure on your overall profit margin?
A: DX projects do not diminish profitability. We sometimes strategically accept orders for low-profit projects to bring in new clients. This does diminish profitability, and strategic projects such as these comprise around 20% of our projects overall.

(Questioner No.22)
Q: Do you strategically accept low-profit projects, then see an upside profit-wise if the project goes better than expected?
A: Precisely.

(Questioner No.23)
Q: Please tell us your forecast for the business climate next year.
A: The macro environment was sluggish this year. We expect the market growth rate to remain about the same next year, and for the macro environment to improve after that. As for global manufacturing, IT investment was rather sluggish this year, but we think it will rise next year.

Q: Do you think your profit margin in industrial IT will also continue to improve?
A: Growth is possible if we secure and prepare resources and then make good proposals to our clients. Our profit margin will subsequently improve.

(Questioner No.24)
Q: There is concern over the second half performance of insurance companies that each had to pay out large amounts in claims from typhoon damage, but is this having any effect on IT investment?
A: It is not having any effect.