

(Tokyo - 27th November, 2019)

## 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.
- Glossary:
  - DX: An abbreviation meaning Digital Transformation, which refers to initiatives that utilize digital technologies to reform business models and processes
  - D2C: An abbreviation for Direct to Consumer, which refers to a mechanism that bypasses distributors and sells company's products and services directly to consumers
  - Con-solution: A business model in which consulting and IT solutions run side-by-side with clients from the planning and concept stages, creating business while repeating the process of hypothesis testing

#### (Questioner No.1)

Q: Please tell us your future forecast for the life insurer that is one of your major clients.

A: We are providing information and offering various other forms of support to normalize business operations at the client, but major IT investments that had been scheduled for the second half have been put on hold. For example, efforts to put together a new product development project that was originally scheduled have stalled. As a result, we expect to fall short of our original second half plan in life insurance. At the same time, demand for IT investments remains strong in non-life insurance, particularly in direct non-life insurance, and we expect this strong business climate to continue.

#### (Questioner No.2)

Q: Your outsourcing costs increased in the first half. Although this would likely be due to cost increases, it appears that this has not damaged your operating profit. Why is that?

A: We can utilize outsourcing (increase outsourcing costs) to reduce overall cost when working on systems development. Our employees team up with domestic and offshore partners. Unit costs are lower for domestic partners than for our employees, and lower for offshore partners than for domestic partners. We were able to record sales with greater leverage effects by improving our outsourcing cost ratio, and our operating profit margin improved.

Q: Do you see a rising trend in outsourcing unit cost, including for offshore partners in China, over the medium- to long-term in the next three to five years?

A: Labor unit cost is increasing in China's metropolitan areas, so it will be difficult to continue sourcing labor in only these areas at reasonable cost. NRI's partners in China have been working with us for a long time, and taking our needs into consideration, they are sourcing labor in more inland areas and other places where unit cost is lower. We are working together and engaging in mutual discussion to keep average unit cost from increasing.

Q: Are you also utilizing outsourcing such as through partners in China to handle systems development for DX projects?

A: Our partner companies are working with us on DX projects while also transferring skills to us. Special skills are needed in DX projects for upstream processes in sales by senior management and systems development, and other such areas. However, many areas of system architecture other than these are hardly different from normal non-DX projects, so we can handle them with the same organizational structures that handle regular projects.

**(Questioner No.3)**

Q: Please tell us your numbers for DX-related sales in the first half of last year. I would also like to hear the breakdown of these figures for DX 1.0 and DX 2.0 respectively.

A: We are disclosing DX-related sales starting this fiscal year, so unfortunately we don't have these figures for the first half of last year. We are also not producing a breakdown between DX 1.0 and DX 2.0, but at the moment the numbers are weighted heavily toward DX 1.0.

Q: What is your definition of projects that are classified as DX 2.0?

A: The simplest example is when we establish a joint venture with a client and launch a new business. Cases such as these do not occur all that frequently.

Q: IDC Japan defines their DX according to what type of IT platform is used. Compared to that, NRI seems to have a rather narrow definition of DX 2.0. Can we assume that most projects will fall under DX 1.0?

A: That is correct.

Q: Other companies in the same industry are establishing DX subsidiaries and employing large numbers of consultants. Is this causing NRI to feel a pinch in terms of supply and demand for human resources? Also, it seems that other companies in the industry are saying that they must renew or terminate past systems agreements and enter into

separate consulting agreements with subsidiaries. Is this not happening at NRI?

A: While there has been some turnover in human resources, the effect has not been substantial overall. We have also long been operating as a single company on the levels of management consulting, IT consulting, and IT solutions. We expect to maintain this structure going forward and we will not be affected by the movements of other companies in this regard.

Q: Amendments of the civil code are expected to place stricter conditions for defect liability deadlines on vendors. Will this have any effect on NRI?

A: Legal revisions will not make conditions stricter across the board, and we will decide on the terms and conditions of agreements through individual discussions with clients.

**(Questioner No.4)**

Q: What is your strategy for shifting from DX projects to ASP and subscription-based? And how much progress has been made so far in this regard?

A: We are approaching clients with various proposals aimed at shifting toward subscription-based. However, in some cases this requires major transformations in the business of the client, so it will take a considerable amount of time until these come to fruition. At the same time, client mindsets are changing, and they are becoming more open-minded.

Q: Please tell us specifically what is involved in the breakdown of DX business into parts.

A: As an investment operation for NRI, we have begun creating parts that can be used in system architecture in several different fields, and we aim to offer them in combinations catered to each client. For example, we want to put together a full lineup of parts for the functions required in D2C and be able to quickly propose them to clients with needs.

Q: Does this mean that your profit margin will improve by creating and combining parts?

A: We expect that being able to share parts between systems will help contain overall development costs and have the effect of improving profit margin. We can also significantly increase our speed by having parts lined up in advance, as many of our clients require speed to meet their delivery deadlines.

Q: What is your strategy for expanding your finance business in Australia?

A: In addition to the government and industrial fields that are the focus of our Australian subsidiary ASG, we also want to achieve expansion in the field of finance where NRI has an advantage within Japan.

Q: You will likely be utilizing offshore in increasing proportions, but will your policy remain the same going forward? For example, are you planning any new initiatives such as building a global delivery center?

A: We are not planning any major changes to how we utilize offshore, but we do need to keep working on improvement initiatives. For example, while our offshore partners in China see the improving trend in Japan-China relations as a good thing in continuing their Japan-aimed business, the scale of their business aimed at their domestic market in China is becoming overwhelmingly larger, and thus increasingly likely to take engineers away from Japan-aimed efforts. We have to continuously engage in conversations with these partners to have them secure resources for Japan.

Q: Do you still intend to mainly utilize offshore partners in China going forward?

A: Since we believe that we will need to source manpower in the hundreds, and even thousands, China is the most realistic option. India has the numbers, but operations there are proportionally more challenging.

**(Questioner No.5)**

Q: In the financial results briefing we heard that around 20% of your 1,000 some-odd consulting projects are linked to IT solutions. What exactly do you mean by linked?

A: Until now we have approached clients from different angles, even when approaching the same client. For consulting we would approach the CEO, and for IT solutions we would approach the CIO. Linking these makes it possible to, for example, propose IT solutions to the CEO. We can approach clients more effectively. We have increasing numbers of projects such as these which involve internal interconnection.

Q: Has the increased number of projects linking consulting with IT solutions expanded your range of potential clients?

A: We now have actual cases in which sharing client lists that had previously been managed separately in consulting and in IT solutions, and mutual introductions, have led to new business deals. One example of this is when IT solutions gains the ability to make proposals to clients who, from their perspective, are new.

Q: To what degree has linking led to orders for systems projects? Can you express the effects quantitatively?

A: It would be difficult to directly express the degree to which this has led to orders for systems projects, but we currently have linking in about 20% of our orders for consulting projects, and this number is trending upwards.

Q: Your global strategy is one of the pillars of your growth strategy in the Medium-Term Plan, but it wasn't mentioned in the financial results briefing materials for the first half. What is the current situation with this strategy?

A: The first aim of our global strategy is to expand business in all regions of Australia. The IT market in Australia is growing, potential M&A target companies there have more affordable valuations than in the US, and we would also like to expand our finance-related business there. In the US we are narrowing down our M&A considerations to companies that possess IP that is highly appealing to NRI, and we are continuing to explore DX-related companies and other similar options. We will also be providing consulting services and IT solutions to Japanese companies entering overseas markets as we always have. These are the three pillars on which our global expansion will be based.

Q: Are you achieving any such effects from companies you have thus far acquired with the intent of owning their IP?

A: We are utilizing the marketing and CRM IP owned by US company Brierley+Partners in the form of solutions that we provide to our domestic clients. Additionally, asset management consulting firm Cutter Associates is working first to establish solid business growth so that we can effectively utilize its IP in the future.

**(Questioner No.6)**

Q: When you acquired Cutter, we heard that you would pursue synergies by mutually utilizing each other's client bases and introducing clients to one another. Has that produced any effects to this point?

A: We have not yet reached the level of harnessing any tangible synergies there. The first task immediately at hand is to support the growth of Cutter itself. Also, both Cutter and ASG changed CEOs in the first half of the year, and at NRI we were focusing our efforts on strengthening governance. We are structurally enhancing the organization for future growth.

Q: Unprofitable projects have been conspicuous amongst the first half financial results announcements at other companies, but is there any sign that risks of unprofitability could increase at NRI? Also, apparel companies have been experiencing multiple system failures recently, but why is that? Is there more chance they could change their IT vendors, leading to business opportunities for NRI?

A: At NRI we have had less unprofitable projects than in previous years. We have been pushing forward with initiatives to cut down on unforeseen unprofitable projects for a

number of years now, and these efforts have produced results. Specifically, it is critical to discern the possibility that a project could turn unprofitable at the point of proposing it, and we have been enhancing our review systems and processes to that effect. The need for steady action is the very cornerstone of risk management at NRI.

As for system failures at other companies, we do not know the individual reasons why each of these occurred. These could possibly lead to business opportunities for NRI, but there is no conclusive evidence of what can be done to prevent such failures from occurring, or anything else of that nature, so it would not be easy to just swoop in and take these projects.

**(Questioner No.7)**

Q: About your policy to increase hiring, what is the current status of your hiring efforts considering the continued tight market for IT personnel?

A: We have been increasing our hiring as planned. We had previously been hiring around 300 new graduates per year, but we now have offers out to nearly 400 of them for positions starting next fiscal year. We are relatively popular among students, so we think our policy for hiring new graduates is proceeding steadily overall. Also, in addition to new graduates we are also dedicating efforts to mid-career hiring, to bring aboard talent that can produce more immediate results than new graduates. We brought aboard around 100 mid-career hires last year, but this year we plan to hire around 200. We have already approved around 150 to 160 of these hires so far, and progress is ongoing.

Q: I hear that other foreign-owned companies in the same industry are hiring as many as around 1,000 new graduates. Would NRI think about increasing its hiring to that level?

A: At NRI our fundamental approach is to reliably hire and develop a certain number of new graduates. Just as it has been, our policy is to steadily increase staff numbers in line with the expansion of our business, and we are not considering any sudden, drastic increase in hiring.

**(Questioner No.8)**

Q: Although your 2Q financial results briefing mentioned that revenues are down in all regions in your overseas business, there was no explanation of the details. Aside from exchange rate effects, please tell us what caused these revenue decreases in the first half, and what you are forecasting for the second half in each region.

A: In Australia some employees resigned during the post-merger integration after ASG acquired SMS, which cost us relationships with multiple small-scale clients. The resulting loss in project orders is reflected in decreased revenues from 3Q of last year until 2Q of

this year. On the other hand, new management took over in May 2019, strategies aimed mostly at large-scale projects were revised to also include smaller projects, while employee resignations also stopped, and the success rate for receiving orders improved. Order backlog is currently at around the same level as a year before. It looks like the worst part may be over, and there will be a shift toward recovery in the second half.

Q: How much appetite for IT investment are you seeing among clients in Australia, including government agencies?

A: In the first half Australia had an election but the incumbent party won, so there is no change in our approach to government-affiliated clients. While there were some who put things off until the election results came out in the first half, which caused some orders to be delayed, there has been no change in demand for IT investment.

Q: Is the Con-solution business model yielding any differentiation from other companies? New projects in Con-solution are increasing, but is there any change in contract unit prices, profitability, or any other indicators?

A: Our Con-solution efforts are company-wide, with consulting and IT solutions working together. We achieve differentiation by combining the consulting knowledge that NRI has accumulated helping clients increase their sales over the years, with the practical ability to leverage this knowledge in the form of IT solutions, and we are confident in the competitive edge that this differentiation gives us. By linking consulting which has contact with CEOs, to IT solutions which interacts with CIOs, we are also able to gain deeper penetration with clients from both approaches. Our approach is not to look at things only in terms of contract unit price and profitability for NRI, but also to provide solutions that help clients boost their sales and receive a share of the earnings we help generate.

Q: What differentiates NRI from foreign-based vendors such as Accenture?

A: Though they may be able to make proposals for upstream processes, foreign-based consulting firms do not have strength in providing integrated services that include IT solution architecture and operations. NRI achieves differentiation by being able to work with clients in an integrated manner, from upstream processes in consulting to building and providing IT solutions.

**(Questioner No.9)**

Q: Can we assume that the 2Q earnings decline in the consulting segment was a reversion after high-profitability management consulting projects occurring in 2Q the previous year, and that the current business climate remains favorable?

A: Yes, that would be accurate.

Q: Can we assume that the lower order backlog in the consulting segment is due to the timing of when projects end and the projects themselves being short, resulting in a lower figure as of the end of September; and that despite this, the current business climate remains favorable?

A: Yes, that would be accurate. Order backlog may be lower, but the business climate remains strong.

Q: Sales in consulting seem to be trending upwards, but it looks like the rate of increase is slowing. Is this because consulting is not a business that can utilize outsourcing for leverage the way IT solutions can?

A: Just as you have pointed out, consulting cannot apply as much leverage as IT solutions. However, Con-solution links consulting projects for low sales revenues with IT solutions which does large-scale sales, so consulting thus has a high level of contribution overall. However, these efforts are not reflected in disclosures of sales for the consulting segment, so it is hard to see the leverage effects.

Q: I think the business climate in the IT services industry was extraordinarily favorable this first half of the year thanks to demand for purchasing new computers, responses to the consumption tax increase, and other factors. Could there possibly be a reversion next year from the special demand we are seeing this year?

A: The scale of Windows update projects and responses to the consumption tax increase was not large enough to have any reversion next year. Some software sales to financial institutions will have a reversion despite the sales being small-scale.

**(Questioner No.10)**

Q: What involvement do outside directors have in NRI's growth strategy?

A: Our Board of Directors has a monitoring function to scrutinize the business strategy formulation process of the executive side. Therefore, while outside directors are not directly involved in the formulation of business strategy, their extensive knowledge and experience is communicated to the executive side from a governance standpoint.

Q: Do you think the presence of Outside Director Miwako Doi has any influence on NRI's DX strategy?

A: While she is not directly involved in formulating our DX strategy, she does monitor our creation of company culture that spurs innovation, and the technological side of our



human resources development.

Q: What is the future direction of your BPO business?

A: The NRI Group has a number of subsidiaries that provide BPO services. They operate independently since they are in different business fields, but in the future, we might try to make them more efficient, strengthen their business structure, and bolster their services to outside companies.

Q: What are the trends in demand for BPO business?

A: Demand has bottomed out, but it is stable. Securities clients in particular are cost-sensitive, and I think there is some business potential if we can provide relatively high-quality, low-cost services in combination with shared online services.

**(Questioner No.11)**

Q: Japan Post Insurance is looking into introducing a policy conversion system next fiscal year, so should we expect them to deal with new products in FY 2022 once they are finished with the conversion system?

A: At the briefing session by Japan Post Insurance they discussed introducing a policy conversion system in fiscal years 2020 and 2021, but as of now nothing has been decided yet in terms of how systems will be handled.

Q: What is the status of Nvantage, the joint venture with Nomura Holdings?

A: It is providing stable services to the extent that was set out in the original plan. Going forward, it will follow the global strategy of Nomura Holdings.

Q: Are there any movements to expand business at Nvantage, such as increasing its capital amount?

A: Currently there are no such discussions.

**(Questioner No.12)**

Q: Orders in industrial IT (for 2Q) decreased, but you mentioned that mid-career hiring is progressing ahead of plan. Can we assume that you have increased mid-career hiring because orders in industrial IT are trending in a positive direction?

A: It is an in-between season for projects in industrial IT. In the first half we focused on production activities, and not enough on preparation activities. Human resources who were hired mid-career were focused on production activities, and we are shifting our existing personnel toward sales activities, but I think it will take time for this to produce

any results. Perhaps not even in the second half, but rather in the next fiscal year.

**(Questioner No.13)**

Q: Are you looking into expanding overseas with the shared online services you offer in Japan? Or will you be expanding out the mechanisms you have in place for your overseas business?

A: We are not considering expansion of our shared online services for retail in Japan. We believe there is sufficient potential to internationally expand our shared online services for wholesale.

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