Q: Medium-Term Management Plan 2022 calls for DX-related sales to increase, but first off how exactly do you define DX? Also, how much growth potential do you think there is for DX-related projects?

A: At NRI we define DX with two different classifications, DX 1.0 and DX 2.0. DX 1.0 is business process transformation to make business models more sophisticated, which we classify as either Digital Front Office which digitalizes contact points with customers, or Digital Back Office which digitalizes the internal operations of client companies.

DX 2.0 is referred to as business model transformation, which is classified as creating business models that do not yet exist in the world such as “As a Service.” Within DX 1.0 there is also “Infrastructure Transformation” which means supporting migrations from on-premises environments to the cloud, and managed services to provide assets that have been migrated to the cloud as services.

We also have security-related business which refers to our new initiative in security called DevSecOps that installs security ahead of time on cloud-native applications. DX-related sales were roughly 60% of sales in FY March 2019, and we expect them to...
These materials were prepared for the sole purpose of providing information to use as reference in making investment decisions, and are not intended as a solicitation for investment.

Copyright (C) Nomura Research Institute, Ltd. All rights reserved.

reach approximately 75% of sales in FY March 2023.

(Questioner No.2)
Q: Are any companies losing market share as existing security vendors? Since a hardware security vendor just announced a rapid boost in business performance the other day, it would seem that competitors would have lost market share to them.
A: The security market is expanding overall, and demand is currently exceeding supply, so I do not feel there are any changes in market share. As opposed to existing security business, this might be due to the growth of new security business as we are seeing in DX 1.0 infrastructure transformation. Last year NRI established the joint venture company NDIAS together with Denso. In the future we also expect demand for new security to expand along with the spread of connected cars in which cars are linked to a variety of devices, and we believe this is an area where we can leverage our NRI expertise.

(Questioner No.3)
Q: About how much growth do you think is possible in DX 2.0 business model transformation over the four years of Medium-Term Plan 2022?
A: Over the three years of Medium-Term Plan 2018 we engaged in a total of seven different initiatives including the establishment of joint ventures. Over the four years of Medium-Term Plan 2022 we would like to establish an even greater number of joint ventures and increase the scale of our business even more. As far as the scale of business each company does on an individual basis, we believe that aside from KDDI Digital Design they all have sales in the hundreds of millions, and billions of yen.

(Questioner No.4)
Q: Please give us a profit breakdown for DX-related sales. In particular, about how much do you think profitability will improve for DX-related sales other than overseas and for business platforms?
A: The size of DX-related projects and their development methods are different from those of traditional CiT projects. At the time that we created Medium-Term Plan 2018, those projects had low profitability. However, over the last three years we have been accumulating expertise, and our proficiency has grown. As a result, the profit margin of the Industrial IT Solutions segment which is mostly DX projects has eclipsed that of the Financial IT Solutions segment after excluding the amortization of goodwill. We also expect even more profitability improvements if we can further elevate our proficiency and improve productivity over the four years of Medium-Term Plan 2022. However, we have
no intentions to seek profit improvements by reducing strategic projects that produce little profit but are investments in the future. These projects comprise around 20% of our overall business portfolio.

Q: If revenue sharing-type business classified as DX 2.0 expands, will its profitability improve?
A: Profitability will increase as a result of elevating our proficiency in cloud-native development methods and improving productivity, not by relying on business models. And even if we increase our numbers of human resources as planned, we will not be able to achieve our target of at least 670 billion yen in sales in Medium-Term Plan 2022 if we do not improve productivity.

Q: How should we conceptualize the breakdown of 100 billion yen in operating profit in Medium-Term Plan 2022?
A: The majority of the 100 billion yen is comprised of high profitability business which is roughly 20% of the total, and business that conforms to our standard profit margin which is roughly 60% of the total. We also expect positive profitability overseas before amortization of goodwill.

(Questioner No.5)
Q: Why does NRI do well in DX projects despite the fact that other companies in the industry are struggling with them?
A: The main type of project that we see in DX is business process transformation which we classify as DX 1.0. Amongst those projects, Digital Front Office is a strategic domain that differentiates us from other companies, as it requires not only package installation but also transformation of our clients’ business operations and systematization of their requirements. NRI has both the consulting and systems integration capabilities to be able to accomplish this.
We also have Digital Back Office, for which we are getting more projects in non-manufacturing businesses in particular due to labor shortages. Business analysis is necessary for our clients because of their need to replace people with IT. This is where NRI can leverage its strength in consulting.
In IT structural reforms for legacy assets—which are being referred to as the “2025 Digital Cliff,” we also believe we will start to see IT investments for shifting to APIs to connect with core systems, and for shifting core systems to microservices, in order to flexibly accommodate business models. This is a domain that NRI can handle, but so can our
competitors, so we anticipate tough competition ahead.

Q: What companies are your competitors for DX projects?
A: We compete with Accenture in upstream processes such as consulting and defining requirements. In systems development processes we compete with domestic system integrators.

Q: If Accenture, with its strength in upstream processes such as consulting, were to join forces with a domestic system integrator that has strength in systems development processes, would they then compete with NRI?
A: I hear that this is actually occurring. However, there are areas where NRI is a step ahead of the competition. Having the expertise to build e-commerce sites that integrate real and digital in Industrial IT Solutions is one example. NRI is also accumulating more expertise, and we intend to utilize it to outdo our competitors.

(Questioner No.6)
Q: Please tell us about what level of sales you expect in DX 1.0 and DX 2.0 respectively in Medium-Term Plan 2022.
A: First, the business platform for DX 1.0 is shared online services in the Financial IT Solutions segment, and we believe we can forecast new client acquisitions over the next four years. Second, we have seen extremely vigorous IT investment over the last three years in Digital Front Office, mainly in DX 1.0 Industrial IT Solutions, which is particularly due to the Amazon effect in direct-to-consumer. In addition to this, over the next four years we expect that IT investment will also begin in direct-to-business (D2B) which is classified as DX 2.0 business model transformation, such as the joint venture that NRI has established with DMG Mori. Finally, business process automation through software such as RPA may have garnered attention at first, but it is not actually doing well because maintenance and upkeep are challenging. However, NRI has its sights set on in-store business process automation such as Amazon Go, and we believe that IT investment will move forward in this area.

Q: Does DX 1.0 infrastructure transformation comprise a large proportion of sales volume?
A: While some projects only involve infrastructure transformation, many are incidentally accompanied by infrastructure transformation—such as process transformation in conjunction with migration to the cloud. We make business happen while creating combinations within DX 1.0.
Q: This question is about proficiency effects in DX projects. There will probably be various new technologies that emerge over the four years of Medium-Term Plan 2022. Will you still be able to easily gain proficiency in these as well?

A: I believe that proficiency effects depend on volume of experiences in projects. For example, three years ago there were a number of projects where we struggled with Agile software development. We were struggling because we had no expertise in that type of development, but in order to gain proficiency in something you have to actually try doing it. It also takes time to do the things to establish the proficiencies, such as sharing the expertise from what you did internally, and then utilizing it in large numbers of projects. Of course, catching up with new technologies is a never-ending process, but we feel good about the proficiency effects we have shown in our DX projects over the past three years.

Q: Can we expect proficiency effects such as higher revenues and profits to emerge in DX projects over the next four years?

A: Our level of proficiency is much higher now than it was three years ago when we first started hearing about “DX” and “digital,” and we expect to improve even more.

Q: What are the business categories and industries that NRI expects to focus on with DX projects over the next four years?

A: In the last three years the focus has been on projects that integrate real and digital in B2C, such as in distribution, the apparel industries, and high-volume retail stores. In the next four years we also intend to focus our energy on DX projects in B2B where there are still many legacy assets, as our joint venture with DMG Mori “Technium” does.

(Questioner No.7)

Q: Your target for ROE in Medium-Term Plan 2022 is 14%, and your target for operating profit margin is at least 14%. In light of this, please tell us your approach to your ROE target.

A: We believe that we can generate between 360 and 370 billion yen of cash in the next four years. As far as how to use the cash, we envision one-third going to shareholder returns, one-third going to normal investment, and one-third going to growth investments such as M&A and DX-related investments. From this, we expect operating profit at the end of Medium-Term Plan 2022 to be 100 billion yen, and we expect equity to grow from 410 billion yen in FY March 2019 to 530 billion yen. Dividing net income at the end of Medium-Term Plan 2022 by net equity results in ROE of 14%.
Q: Your target for operating profit margin in Medium-Term Plan 2022 is “at least” 14%, but considering that operating profit margin is around 14% right now, how much do you expect to be able to raise it when you say “at least”?

A: Our highest profitability business is shared online services. Over the next four years we would like to boost profitability through efforts such as taking the bits and pieces (pre-trained models) we have developed through e-commerce systems architecture in Industrial IT Solutions, making them common, and rolling them out into other industries.

Q: Which is the higher priority between the two targets of 14% ROE and over 20% EBITDA margin in Medium-Term Plan 2022?

A: There is no higher or lower priority at the current time. Over the next four years we will have to compete with global companies, and to compare ourselves against them we selected target values for not only operating profit margin but for EBITDA margin as well.

Q: Your target for operating profit margin in Medium-Term Plan 2022 is “at least” 14%, but considering that operating profit margin is around 14% right now, how much do you expect to be able to raise it when you say “at least”?

A: Our highest profitability business is shared online services. Over the next four years we would like to boost profitability through efforts such as taking the bits and pieces (pre-trained models) we have developed through e-commerce systems architecture in Industrial IT Solutions, making them common, and rolling them out into other industries.

Q: Which is the higher priority between the two targets of 14% ROE and over 20% EBITDA margin in Medium-Term Plan 2022?

A: There is no higher or lower priority at the current time. Over the next four years we will have to compete with global companies, and to compare ourselves against them we selected target values for not only operating profit margin but for EBITDA margin as well.

Q: This question is about the Medium-Term Plan 2022 target of 100 billion yen in overseas sales. After acquiring overseas companies, there are risks of impairments and other things that could be detrimental to operating profit. How attainable do you consider this target to be?

A: When acquiring an overseas company, management of the acquired company works for a three- to four-year compensation plan. After that, you need to bring aboard new management. Structures and mechanisms have to be made that are appropriate for this, and in April 2019 we built the structure for our global headquarters. We are hiring personnel who have global experience, and we hope to put a system in place over the course of one year this year.

(Questioner No.8)

Q: Competitors are taking on full contracted outsourcing of systems for the apparel industry and taking aim at shared online services, but it seems that they are struggling to accommodate the requests of individual companies. Are the IT solutions that NRI provides for the apparel industry cloud services, or do you provide on-promises environments for individual companies?

A: Our basic approach is to build systems on the cloud that improve agility at low-cost. At the same time, e-commerce websites are strategic areas for every company, and it is hard to provide them as shared online services. Still, we believe that we could make the application parts (pre-trained models) common and provide those to individual companies.
(Questioner No.9)
Q: Please tell us about your recruitment plans for bringing about the personnel needed to do the work for DX projects, such as those capable of Agile development.
A: You have to dissociate the content of DX projects from the methods for system development. NRI enjoys brand recognition in new graduate recruitment and we are not struggling in this regard, but since we have an image as being more of a consulting company we are bolstering our efforts to appeal to students who want to be engineers. With the pace of our mid-career hiring until now, we are creating a plan to hire around 100 more employees per year in the next four years than we do now. We are conducting mid-career hiring more actively than we did last year, and we are acquiring good talent.

(Questioner No.10)
Q: Looking at what has happened in the past, large-scale unprofitable projects have been arising a few years after increases in outsourcing costs. For now, NRI’s outsourcing costs are not rising much relative to increases in sales, but these costs are increasing significantly for some of your competitors. Please tell us about NRI’s business partner strategy.
A: The risk of unprofitable projects can only increase when you make getting orders the priority and then outsource to unreliable partners. When we outsource, we do so while looking at the contracting capability of our partners with whom we have built trusting relationships.