Business Briefing (North America, EMEA & LATAM)

Q1

In North America, the sales have increased through M&A at a good rate, but I wonder whether your clients are shifting toward in-house development. I would like to know the background and whether such situation will last for a while. Please tell me your initiatives and countermeasures.

A1

We can clearly see the shift toward in-house development. Each client has a different view, and some clients want to internally develop systems related to their core competencies, instead of outsourcing all IT, in this digitalization world. There is a clear dividing line between what is insourced and what is outsourced.

It depends on a client's way of thinking, but I think that insourcing will increase more. The breadth of our business area may be narrowed, but I am sure that all IT area will not be in-housed, and some area will continue to be outsourced. Also, a client may be satisfied with in-house development at first, but the client may feel that there is a lack of ideas and knowledge that external parties can provide. Then, the client may ask, "What can NTT DATA do?" and seek a proposal. We may lose sales due to insourcing, but the client may want to have our talents dispatched for the in-house development. For the dispatch, we need to promote a plan in cooperation with the client. Even in this case, as we imagine that the client would face difficulties caused by the shift toward full in-house development one or two years later, we are sure that our relationship with the client will continue.

If a client has all IT area in-housed only by its employees, they will face increased costs and be forced to outsource some area. Vendors will compete fiercely for the outsourced processes, which will result in a price war. In this case, a company that has a lot of staff in India will be in an advantageous position because it can develop solutions at cheaper costs. The probability of NTT DATA failing to win a contract will be higher, but if we have a chance, we will strive to win a contract. There is no doubt about fiercer competition.

Q2

Why are EBITA margins without goodwill and PPA amortization, etc. in EMEA and Latin America much lower than those in North America? Will you prioritize expanding the size or need to review the cost structure? Please tell me about the strategy to improve profit margins.

A2

In EMEA and Latin America, three units, itelligence, everis, and NTT DATA EMEA, are the key players. NTT DATA EMEA mainly consists of a former BMW's information system subsidiary in Germany, an Italian company, and a U.K. company we acquired. Each unit has different characteristics. everis, which used to be a Spanish company, is very strong in regions including Latin America, Spain, and Portugal, and its profit margin (EBITA margin) is 5-6%. We direct everis to focus on enhancing business in Latin America rather than improving the profit margin, and the sales have increased by 30%. We put emphasis on the Latin American business because the market is growing at a higher rate and we expect our business to grow faster than the one in APAC.

Previously, we focused on sales growth, but now that the size has increased, we have begun to focus on profitable growth. We adopt an approach of increasing sales and raising profit margin at the same time, and not one of improving profit margin through cost reduction. Compared to the profit margin of NTT DATA EMEA, which is the lowest, the profit margin of everis in Spain is high because it tries to grow by having more human resources in Latin America in consideration of costs, such as by using a BPO center in Argentina for a project for a Spanish client. It is difficult for a client in a non-English-speaking country to carry out offshore operations in India, etc. because of the language barrier.

We utilize Romania as a near-shore center. We place orders with Indian companies via companies in East Europe. We are willing to utilize India to reduce cost percentages. The U.S. unit has utilized India and accumulated know-how. I think that cost percentages can be reduced if we build a model to deliver services in a flexible manner.

Another element we really need to tackle is G&A. As I said before, there are three key units in EMEA, and G&A can be naturally reduced if these units are integrated into one big unit. For now, however, we are focusing more on enhancing each unit's business and maintaining enough back office functions to respond to the growth. As we need to address issues of company names, etc., integration is a possibility at some point, but if we integrate these units now, the administrative and support structure would be insufficient for a new M&A deal, which would result in problems.

We will make efforts to raise the EBITA margin steadily and cut indirect personnel in a timely manner. Our experience tells us that if indirect personnel are cut first, rumors circulate about impending restructuring, which would prohibit us from going in a positive direction. Now, top priority needs to be given to creating a sense of togetherness. However, I think that we will have to cut down G&A sometime in the future.

Q3

I think that the global delivery model favorable to India may change in the next 5-10 years. Other companies' strategies seem to have shifted toward cloud computing and digital areas. Under such circumstances, how will NTT DATA's position change in the global competition? In the global competition environment where more existing solutions are internally developed, which triggers a price war, how will you gain market share? I would like to hear your vision, especially for the U.S. market.

A3

I think that we cannot compete against IBM and Accenture that have 100,000–200,000 personnel in India. However, having only 20,000 personnel in India can be our advantage. I believe that the model in which all solutions are developed in India will disappear in the next 5-10 years, and the industry will need to respond to robotics. In the U.S., while more clients shift to insourcing, they will outsource some of the processes too. In this case, we cannot provide outsourcing services at cheaper costs only by using Indian units. I think that our technological capabilities cultivated through R&D will be tested. Until then, it is necessary to continue utilizing India.

In the U.S., NTT DATA is facing big challenges. We now have a real sense of being ranked higher, and if we compare it to the soccer World Cup, the previous competition was like a game in the preliminaries and the current competition is like a game in the finals. We are happy that NTT DATA's brand awareness has increased due to the acquisition of the former Dell Services, but we will be forced to directly compete against companies like Accenture. I think that we have to enjoy the very tough conditions in the U.S. If we can enjoy it, we will be able to become a real global winner. But we have still a long way to go; it is like discussing which will happen first—NTT DATA achieving a successful outcome in the global market or Japan winning the World Cup by defeating Brazil and Germany. In the finals, you cannot maintain the same winning rate as the one recorded in the preliminaries. We have to create real advantages.

Q4

The whole NTT group has promoted cross-selling and made achievements in numerous fields and areas. In what area and field will NTT group's capabilities be utilized? What change can you see, especially in profitability?

A4

Previously, our clients placed orders separately for the application layer as IT services, network, and data center. If insourcing and digital outsourcing become popular and outsourced processes on the

infrastructure layer are commoditized, NTT DATA will be the contracting party for more contracts and asked to provide services related to networks and data centers. We are willing to strengthen synergy with NTT Com and Dimension Data as much as possible, but if NTT DATA remains weak, no client will make an offer to them. Currently, there are few cases where we are asked to make a proposal to a client of these companies who has a requirement for networks and data centers.

The more clients who generate sales revenue of 50 million dollars or more we gain, the more opportunities we have. When this happens, we will make a proposal involving utilizing the resources of NTT Com and Dimension Data to such clients, which can be our advantage.

Q5

I heard that the NTT group would strengthen global business. Will you benefit from working with the NTT group? When will you see synergy effect, if any?

A5

We will have a lot of benefits in the future, especially from NTT's strong R&D capabilities. No one can predict the situation five years later, but the NTT group makes investments of 200 billion yen or more in total every year and shifts the investments toward AI and IoT. hitoe is an example of such an investment. If the group becomes more capable of consulting in a step-by-step fashion, it can create different value for each client, which can be an advantage.

In my view, the former Dell Services decided to join the NTT DATA group because it evaluated NTT DATA as a stable company that promoted global business, had various delivery methods and R&D capabilities as tools, which would remain unchanged five years later. If a company wants to raise profit margin temporarily, it should cut jobs in unprofitable units. Then, the sales will decrease, but EBITA margin will improve.

Business performance in Germany and Italy, which was poor, has improved. We started to utilize resources in Romania as well as in Naples and Cosenza, southern cities of Italy, where there is a gap of development capabilities between the North and the South. We aim to utilize countries that have an affinity in terms of culture and language, improve cost percentages in a step-by-step fashion, reduce G&A, and apply R&D results to practice.

Our clients often tell us, "Accenture visited us with MIT (Massachusetts Institute of Technology) and Tata with IIT (Indian Institute of Technology). Who will accompany NTT DATA?" We answer that NTT R&D center will do so and explain that the NTT DATA and NTT R&D center are group

companies of NTT, which have a good channel of communication, while the above mentioned companies partner with different organizations. Collaboration with other group companies of NTT will give us confidence. While competition is fierce, we are prepared to have several success cases.

Q6

In the U.S., before the acquisition, NTT DATA, Inc. carried a margin of about 9% and the former Dell Services carried a margin of about 7%, according to past data. The current margin seems to be lower than the weighted average value, at about 8%. Will the margin increase to the weighted average value in the second half of the next fiscal year when the consolidation will be completed?

A6

As the former Dell Services are larger than NTT DATA, Inc. before the acquisition, the EBITA margin will be 8% or less. We will make great efforts to defeat competitors in the fiercely competitive environment of the U.S.