(January 30, 2023, Tokyo)

Nomura Research Institute, Ltd.

The Third Quarter of FY March 2023 Financial Results Briefings Q&A Session

First inquirer (analyst)

Q1: Continuing from the second quarter, order volume in consulting domestically was down again year-on-year. Was this a result of quarterly fluctuations or was it an issue with business sentiment? The overseas portion of your order volume was also down significantly year-on-year, but was there some sort of technical cause? And what is your expectation going forward?

A1: Although order volume is down, order backlog is accumulating. This appears in different shades according to the industry type as polarization grows between the bearish sentiment in industries impacted by inflation, and industries with growth such as trading companies and healthcare. Business is strong in DX-related social issue solution topics, and we do not see any concern there. Overseas, the third quarter of last year was when the order backlog of Core BTS was incorporated, which included an effect of 13 billion yen. This year, their order volume for the quarter is around 6 billion yen, and the difference of around 7 billion yen is attributable to negative technical factors. Orders remain strong in Australia.

Q2: Do you have any expectation that worsening economic sentiment could also cause a bleaker outlook in industrial IT?

A2: The large projects that we mentioned being in the pipeline at the first quarter financial results briefing turned into orders in the second quarter, resulting in a large increase. The breadth of the year-on-year decrease in the third quarter is minimal, and we believe it is not a particularly bad situation. Core systems overhaul projects are also increasing, and we are not concerned about the outlook going forward.

Q3: Quantitatively, what was your operating profit by region overseas? And what sort of recovery do you anticipate going forward?

A3: In the third quarter, operating profit in industrial IT (overseas) was down 1.4 billion yen, much of which was attributable to Core BTS (higher depreciation cost, stagnation in the cloud business, costs for restructuring the sales organization, etc.). On the other hand, operating profit in Australia was mostly unchanged year-on-year. As a result of structural reforms implemented by AUSIEX in the second quarter, their bottom line turned positive in the third quarter. ASG is maintaining an operating margin of around 10%. As for the pace of recovery going forward, we intend to provide an explanation at the financial results briefing in April.

Q4: I would like to ask again about your approach to M&A and shareholder returns as means for the use of cash.

A4: Our ongoing approach to allocate one-third to existing investments, one-third to growth investments including M&A, and one-third to shareholder returns has not changed. We are not conducting share buybacks every year, but we have been buying back one-third overall during the term of the current Medium-Term Plan. As for dividends, we are targeting a dividend payout ratio of 35% and have now raised our dividend forecast to approach that level.

Our most recent share buyback was conducted to offset the dilution of shares resulting from the (exercising of greenshoe options for the) over-allotment in the secondary offering. Shareholder returns should not be considered the main purpose.

Second inquirer (analyst)

Q1: What is the reasoning behind the one-yen increase in your dividend forecast?

A1: This dividend increase reflects our expectations to achieve our performance forecast. The one-yen amount is with a dividend payout ratio of 35% in mind.

Q2: Why was a dividend payout ratio close to 35% not specified in the initial plan?

A2: (In the initial plan) It was not necessarily 35%; we make decisions to alter the ratio as necessary according to the progress of our business performance.

Q3: Does that mean the dividend increase is a result of your forecast exceeding the net profit specified in the original plan?

A3: Our sales forecast was upwardly revised in the second quarter, but profit was not revised. The dividend increase this time was because it became apparent that we would achieve our goal.

Q4: What was the breakdown of the 1.4 billion yen decrease in overseas operating profit year-on-year?

A4: Of the 1.4 billion yen, around 700 million was attributable to lower profit due to PPA depreciation and amortization cost. The other 700 million was attributable to downturns on the business side, primarily for Core BTS. It should be noted that the costs for restructuring the sales organization of Core BTS's cloud business were around 200 million yen.

Q5: Are the structural reforms in North America which you explained in the second quarter completed?

A5: The new head of sales was hired and efforts toward structural reforms to grow the cloud business were carried out through the end of the year, which includes building a sales organization specialized in cloud business. As a result, we are planning to lead the business toward recovery. Also, in addition to business growth, we are also factoring a gradual decrease in depreciation and amortization cost of PPA assets into our plan going forward. In FY March 2025, we plan for these costs to be around 1.0 billion yen less (than now).

Third inquirer (analyst)

Q1: At the second quarter financial results briefings, you explained that NRI Shanghai suffered a downturn in consulting due to the effects of lockdowns. How much of an impact was there in the third quarter?

A1: China is still unsettled and circumstances there have yet to improve. However, sales at NRI Shanghai are relatively small in scale, so this does not have a major impact overall.

Q2: Is my understanding correct that you have finished implementing all of your stated measures overseas, and that no additional costs will arise?

A2: We have done all that we needed to do at this time.

Q3: Eliminating the difficulties in materials procurement seems to be one factor toward improving profitability, but is there a structural reason why Core BTS is slow to recover?

A3: They are resolving the problems in materials procurement while their order backlog accumulates, and sales are also increasing. However, they have been waiting on the procurement of Cisco devices, and that situation is largely unchanged. We expect the situation to significantly improve around the summer of 2023.

Q4: Were they able to procure devices last year?

A4: It is difficult to accurately compare since they were not one of our consolidated subsidiaries in the third quarter of last year. It will be possible to compare starting in the fourth quarter.

Q5: The situation with difficulties in materials procurement is ongoing, but trending toward improvement relative to plan. Is that correct?

A5: That is correct. Order backlog is accumulating, and we believe that procurement will gain momentum.

Fourth inquirer (analyst)

Q1: You explained the impact of yen depreciation in the second quarter. Around how much did this impact increase in the third quarter?

A1: Expenses such as electric power remain high. Unit prices for offshoring in China have also increased by around 8%, but our domestic profit has increased year-on-year which is compensating for these costs. Since we will be passing on cost increases, we expect to see an improvement.

Q2: Do you think the impact of yen depreciation bottomed out in the third quarter?

A2: We have mostly compensated for that impact in the second and third quarters. Going forward, we believe that we can find ways to further increase profitability, including by passing on cost increases.

Q3: In domestic consulting and industrial IT, should we consider the different shades you are seeing in each industry type to be attributable to macroeconomic factors?

A3: In consulting, we may be seeing different shades by industry type, but that effect is not large on a company-wide scale. In industrial IT, sales did not pick up during the first quarter, but we received orders for large-scale projects in the second quarter and there are gradually leading toward development in the third and fourth quarters. Therefore, we consider the business overall to be within our anticipated range.

Q4: In consulting, can we assume that you have inquiries that seem promising in terms of turning order volume positive from the fourth quarter onward?

A4: Order volume is lower compared to last year and the year before when demand for DX projects was high due to the COVID-19 pandemic, but we do not believe it has significantly declined.

Fifth inquirer (analyst)

Q1: You assessed your order volume of 25.3 billion yen in domestic industrial IT during the third quarter was not bad. What was the reason for that assessment?

A1: There are some peaks and valleys from one quarter to the next. While the current order volume might not be as high as the third quarter of last year when it was at a high level, we assessed that it was not at a low level either.

Q2: While that order volume does not seem low, if demand is solid and you have a pipeline, it should grow.

A2: Currently, our priority is to handle the order backlog that has accumulated.

Q3: In Revenue Forecasts by Service for FY March 2023 on page 38 of the briefing materials, System Management & Operation Services is decreasing. In Forecasts for FY March 2023 <Consolidated Earnings Model> on page 40, personnel and subcontracting costs are decreasing. On the other hand, gross margin is slightly improving. Could you explain these? Is it attributable to exchange rate impacts on sales, and thus not something to be particularly concerned about?

A3: Our overseas business and the related exchange rate impact now have a heavier weight. These pages that you are referencing do not show domestic trends excluding overseas portions, so they might not offer a clear picture.

Q4: The fourth quarter operating profit shown on page 12 of the briefing materials is 2.5 billion yen more than in the third quarter. Could you explain this?

A4: Operating profit was in line with the plan through the second quarter but a little short in the third, which we are balancing out in the fourth quarter. As I explained earlier, we believe the effects of the large order backlog, the contribution from financial IT, and shoring up our overseas business will result in 2.5 billion yen more operating profit in the fourth quarter than in the third.

Q5: You recorded some one-time expenses in the fourth quarter of last year, but do you expect any in the fourth quarter this year?

A5: We are not expecting any special factors in the fourth quarter of this year. While there were one-time expenses in the IT platforms segment in the fourth quarter of last year, we expect no such expenses this year.

Sixth inquirer (analyst)

Q1: Is the domestic consulting market strong?

A1: Yes it is, in areas including social issue solution-related topics.

Q2: You are also engaged in consulting overseas, but how is that going?

A2: Upstream processes for systems are the focus of our overseas consulting services. For example, the market is robust for ASG in Australia, and they are performing well.

Q3: Around how much of your order volume overseas is attributable to organic growth?

A3: Looking at the third quarter, our order volume of 22.8 billion yen last year included roughly 13 billion yen of order backlog from Core BTS, and this year they recorded 6 billion yen from three months of order volume. In other words, the portion from Core BTS has a negative impact of about 7 billion yen due to when it was consolidated.

Q4: How would you evaluate your third quarter performance overall?
A4: Domestically, I would say that we boosted our profit margin and are doing good work. Overseas, we are spending money to shore up Core BTS.

Q5: Is it correct to say that you shored up AUSIEX in the second quarter and their business recovered in the third quarter? And you shored up Core BTS in the third quarter, but will there be any additional expenses beyond that?
A5: As a result of structural reforms, AUSIEX broke even in the third quarter. As for the results of efforts at Core BTS, we anticipate a recovery going forward.

Q6: Were there any unprofitable projects in the third quarter?
A6: We have disclosed upwards of 1 billion yen in unprofitable projects, but there were no such (large-scale) projects in the third quarter.

Seventh inquirer (analyst)

Q1: In terms of monetary value, about how far short was your third quarter operating profit relative to the plan? And you are expecting a 2.5 billion yen profit increase in the fourth quarter relative to the third, but how many billion yen of that is contributions from business overseas?
A1: Honestly, we did intend to increase our profit a little more in the third quarter. In the fourth quarter, we are expecting just under 1 billion yen in profit contribution (relative to the third quarter) from business overseas.

Q2: Around how much are you forecasting in sales to Nomura Holdings for the year? And how much demand do you anticipate in financial IT looking toward next year?
A2: Our sales to Nomura Holdings are normally around 63 billion yen annually. Since multiple projects peaked in the third quarter this year, we are outperforming (the normal level). As for our outlook in financial IT, we are receiving orders for large core systems projects from banks and insurance companies, and we believe that trend will continue.

Q3: The M&A market environment is changing, and exchange rates have shifted back toward yen appreciation. What is the state of your M&A pipeline and stance toward acquisitions in North America?

A3: Valuations were high due to the weakened yen, but we have not scrapped our M&A plan. We intend to make decisions as we assess the situation.

Eighth inquirer (analyst)

Q1: Please help me reaffirm my understanding of your approach to overseas M&A. The exchange rate has gotten close to where it was at the start of the year. Going forward, will you be accelerating your M&A efforts? Or will you wait and observe for a little longer since the environment is uncertain?

A1: When we announced our new vision V2030 (framework) in April 2022, we needed M&A to reach overseas sales upwards of 250 billion yen, and it takes time for the companies we acquire to contribute toward profit. Therefore, our approach to firmly push forward with M&A in the first half of the new vision is unchanged from what we announced then.

Q2: Have valuations declined?

A2: That depends on the target company, but it seems that valuations are generally trending downward.

Ninth inquirer (analyst)

Q1: Please help me reaffirm my understanding of your domestic order volume in the third quarter. Order volume is decreasing in consulting and industrial IT. This appears weak compared to the figures from last year, but is something preventing you from securing orders?

A1: The situation differs by industry type and topic. Orders in social issue solution-related topics are exceeding our plan. As for our personnel, capacity utilization is high and we are capably handling inquiries. We are not experiencing any problems such as being unable to pass cost prices on to clients.