

(Tokyo – 16th June, 2023)

Nomura Research Institute, Ltd.

Q&A from Small Meeting for sell-side analysts

Part 1

(Questioner No.1)

Q1: How do you feel about what has happened in your North American business thus far?

A1: We sold off Brierley+Partners in March. The business environment in North America changes rapidly. Even if times are good, a few years later the competitive environment undergoes drastic change and you can even end up losing your competitive edge. We consider it an appealing market, but also a risky one. Therefore, rather than taking on the risk of executing large-scale M&A, our policy is to acquire companies with EBITDA multiples of around 10 to 20 and revenue multiples of about two, then take the time to grow them into competitive companies through supplemental M&A. Core BTS is also a mid-sized IT services company in North America, and it is natural to be concerned about how they can go about growing their business in its present form. One reason we are glad to have acquired this company is that it is run by an outstanding management team. The company had previously been owned by a private equity fund, and the management team they installed has stayed on board. Their original CEO is now the chairperson, and the original CFO is now the CEO. As opposed to replacing, they have promoted internally. Batons are being passed to younger people without changing their general framework as a management team. No discontinuous changes are taking place. They had acquired four companies before we acquired them, but the sales operations of the companies had not been integrated. We shored them up, and the new organizational structure was in place starting in January. We believe we have done what needed to be done. All we can do now is watch the results. We had an update on our latest pipeline at the Board meeting a few weeks ago. The market environment is not headed toward any swift rebound. Our clients anticipate a recession going forward and are restricting their IT investment, thus we were able to verify that the pipeline will not make a V-shaped recovery. At the financial results briefing in April 2023, we explained that April through June will be harsh and that recovery will begin from July to September and onward, so improvement should be expected in the second half. Unfortunately, that situation has not changed. We will also be thoroughly monitoring on the Tokyo side in order to produce results this second half. However, when looking at it long-term, we lack the functions to

conduct business competitively in North America. We are looking into conducting small-scale M&A if we can find a company that can supplement upstream consulting. Also, we would like to gradually expand our regional coverage. Although we think the network business has hardly any potential for future growth, there are synergies with the Japan side in application development for cloud business, so we would like to make additional acquisitions if we can find companies with expertise in that area. However, we have verified with the local management team that the priority is to turn around the existing business. We have not yet reached the point where we can describe a forward-looking growth story in detail.

Q2: Who are the major clients of Core BTS?

A2: One example is a major retailer client (Kroger). Japanese companies that operate locally are also clients. However, a number of these companies are on the scale of around \$10-20 million in annual sales. Clients that have ample variety in the single-digit millions per company are long tail. There are large and small sized clients, but companies that offer work in single-digit millions per year are in the thousands of employees in terms of size.

(Questioner No.2)

Q1: Around what level of profitability can Core BTS's business model seek in terms of the duration of the Medium-Term Plan? What is the time line, and what operating margin are you targeting?

A1: Their amortization of intangible assets will drop significantly in the second half of the Medium-Term Plan. Around the year 2025, we would like them to have an operating margin in the high single-digits after depreciation and amortization.

Q2: Is that something they can achieve if costs decline naturally?

A2: They will not reach that level the way things are now. Core BTS would need to increase its profit by around 4 to 5 billion yen compared to the current level, around half of which can be achieved with factors such as reduced depreciation and amortization. However, they would need to grow their business on an organic basis for the other half.

Q3: Will you be growing their cloud business?

A3: Yes we will.

Q4: Do you believe that generative AI can contribute to sales as a solution in addition to using it as a tool to improve productivity during development?

A4: We have created an internal task force and are discussing that matter in three subcommittees.

First is to improve productivity at development worksites. There are large amounts of back office tasks at worksites that perform systems development, such as creating review materials and reports for internal meetings. These take up the engineers' time. If we can replace some of that work with generative AI or something to that effect, we could likely expect the tasks incidental to systems development to become more efficient. Second is to use generative AI on the business side. We are receiving large numbers of inquiries from clients and are working on making specific proposals. For example, in consulting we are working on a project in which a particular educational institution is dedicating considerable time to academic affairs, so we are looking into whether they can reduce labor costs by switching to ChatGPT. Consulting business covers a broad range of clients, so we believe there are considerable business opportunities for replacing some of their operations with ChatGPT. Aside from that, there is an idea to apply generative AI to helpdesk in finance, but the degree to which we can assure 100% results in switching client operations to AI is an issue, so we must proceed with caution. In industrial, we are getting more inquiries about whether work to provide expert advice from head office to the retail side about products and services can be replaced with ChatGPT. As for the effects in terms of upside, while it may not be in the multiple tens of billions of yen, we do believe there could be effects in the single-digit billions or just upwards of 10 billion yen.

Third is to utilize it for making corporate operations within NRI more efficient. We believe that generative AI can be used to a certain degree for internal helpdesk operations.

It is a technology that looks to have considerable potential for us in these three areas.

Q5: There are discussions about copyright issues. Can these effects be expected even after such issues are resolved?

A5: When operating services using ChatGPT, currently the only option is to use OpenAI services in Microsoft Azure. In some cases ChatGPT can also be used as-is, but that is mostly in combination with some other application. In those cases, the task-related search engine is created on the outside, then those search results are imported into ChatGPT and we use the resulting output. In other words, the way that the search engine positioned outside of ChatGPT is created determines whether it can be used to perform actual tasks. The data imported into the search engine also probably cannot be

produced in-house. Copyrights and non-disclosure agreements are on the search engine side. They are not built into ChatGPT itself. Copyrights are an issue since ChatGPT acquires large volumes of information from the web. Thus, when we are providing services, we use what is protected in the search engine. If we use OpenAI services, we can configure the settings to not relearn. When it is used in the business applications that we provide, usage is on the assumption of no risks in terms of copyrights or information leakage.

(Questioner No.3)

Q1: Around when is M&A in North America likely to happen? And in what order do you think of layers and regions? Please share your current sentiment, including about the market circumstances for M&A.

A1: Movement in the current M&A market is slow, so we do not expect to mobilize on any M&A transactions right away. There are some possible cases that we anticipate, but no actual plans have been made. We are not thinking of acquiring any unanticipated companies. We must first dedicate our energy to stabilizing Core BTS's business infrastructure. Possibilities for additional M&A could arise after that starts to take shape, but we are not considering any large-scale M&A during the current Medium-Term Plan unless the conditions align.

Q2: Is the M&A market the reason why you are not proactive about M&A?

A2: That is one factor, but solidifying Core BTS's business infrastructure takes priority, and our position is that we cannot acquire new companies while working on that.

Q3: Is your thought process that M&A will take shape once you can see the results of the recovery in the second quarter?

A3: Even if we conduct smaller M&A, it will be in the second half and onward.

(Questioner No.4)

Q1: In North America, what were the events surrounding the change of senior management and changes to the sales organization? How have you been involved as the parent company, and to what degree have you delegated authority to those on-site? Also, what KPIs would show the progress? Please share more details about how governance is being handled.

A1: Sales locally had been in a state of chaos since around summer in 2022. One reason was that post-merger integration (PMI) did not proceed well. The head of sales at the time was handling both network and cloud business, but their methods for proposing applications in cloud business and lack of experience in client relations were fundamental problems. The report that sales was not sufficiently functional was raised from the worksites to the local board of directors. In response, the head of sales was replaced, for which we entrusted the selection process to the CEO at the time. We consulted the new head of sales on an ongoing basis from October until the end of the year, and he then joined Core BTS in January. Concurrently, we assigned an officer on the Tokyo side from the summer until the end of the year in 2022 to make plans hands-on. Authority has been delegated to the new head of sales since January, and we have changed to a position of monitoring what he does.

The KPI to verify progress would be how much the order pipeline recovers year-on-year. There is still momentum from last year's post-pandemic IT investment, and the pipeline had been robust. Since it has now bottomed out after a subsequent decline, we believe that we will be able to ascertain the level of recovery going forward.

(Questioner No.5)

Q1: How has the year started for your domestic business?

A1: Our performance forecast outlook for the year is conservative because it was hard to imagine positive circumstances continuing throughout the year when we originally made the plan, due to circumstances such as the changing environment in financial IT caused by the changing of the Bank of Japan chief, and the impact on industrial IT from market downturns in the US and Europe. However, order backlog was at a high level as of the end of March 2023, and the situation in the first quarter is actually not bad. For example, core systems are aging, so we are getting projects to overhaul core systems by combining them with newly-built front-end systems. If this continues, business might not be as bad as we had originally forecast.

Q2: Have consulting projects also increased in scale?

A2: Business last year was strong in public sector projects but not so much in private sector projects, resulting in a lower profit margin. Since public spending is also strong this year, there are still large numbers of public sector projects supporting that. The private sector is also off to a fairly good start, as we have increasing numbers of inquiries related to new business such as EVs.

Q3: Regarding labor costs, do you foresee the need to raise base salaries next year?

A3: For employee compensation, first we use a HR system that defines job classifications according to roles handled for manager positions. For non-manager positions we have not been giving base salary raises in recent years, but our average annual salary has ticked up by 6-7% when including promotions. Since our salary levels are sufficiently higher than our competitors to begin with, we do not see the need to accelerate pay increases going forward.

(Questioner No.6)

Q1: As labor costs in the IT industry rise, have there been any changes in the ease of price negotiations with clients? And have you made any changes to the way you utilize human resources, such as changing your outsourcing methods?

A1: We requested a uniform price increase from our clients to cover increased data center costs resulting from surging energy prices, but it seems like there is greater social tolerance for price increases now. When asking to utilize domestic partners due to economic security issues, our clients have been accepting of price increases. We have been able to negotiate smoothly as long as we can provide a logical explanation. In competitions for projects, there are still intense price wars, but we do not match other companies' discounts. In order to avoid price competition, our business style is to get involved starting upstream and enter into discretionary contracts. We would like to continue doing that as much as possible.

Q2: Around how long will it take for price increases to have a positive impact on performance?

A2: In data centers, we have already offset the rises in costs and the situation will remain neutral for a while as we do not expect other factors putting upward pressure on costs. As for labor costs, profits have continued to grow and productivity improvements and other positives have outstripped cost increases thus far. We believe that we can continue operating that way going forward.

Q3: Has the spring labor bargaining caused any change in the tides of price negotiations?

A3: I do not think that has been a factor. We have not used increased labor costs as a reason to raise prices in negotiations, and we have absorbed rises in costs with productivity improvements up to this point. This should still be possible going forward considering the current pace of pay increases, and we intend to keep doing business without getting engulfed in price wars. We do not consider the issue of pay increases that began this

past spring to have any major impact on our business itself.

(Questioner No.7)

Q1: Compared to the past, clients are also now more inclined to use IT after recognizing its value. It seems likely that if you can increase the value you deliver through IT, you should also be able to aggressively increase your prices. As a result, even if the entire industry experiences an inflation trend, it could actually be a good thing for the industry, but what do you think from that perspective?

A1: We make proposals after setting the appropriate profit margin including value added, and our clients have been comfortable with that.

(Questioner No.8)

Q1: What is a specific example of DX 3.0 business? And where do you achieve differentiation from other companies?

A1: DX 3.0 is something that produces results over the long haul. There are lots of needs, but many of these are not worth consideration in terms of earning the profitability we expect. Currently we are working on just under 30 different topics, from which we hope to produce some success stories. We are working on business to link My Number to the e-Shishobako (PO Box) platform from the private sector and make it more efficient. For example, if life insurance companies can join this platform, My Number can then be used to automatically check the lifetime information of policy holders. My Number-related platform business that we refer to as Social DX now appears likely to fall within the range of profitability that we expect, so we aim to expand it going forward. Aside from that, Japan's emissions trading system will launch in 2026. Evaluations by outside agencies for carbon emissions will be required, and NRI-CTS (Carbon Tracing System) is a framework which contributes to that. We have received an order for a project at the Ministry of Economy, Trade and Industry, and if we can make NRI-CTS into a platform, it might become our second pillar of Social DX. However, we are not currently certain how this will go. While there are topics other than these, many are small in scale, so we want to take the time and eventually turn them into a more coherent block of business at some point.

Q2: Business with DX 3.0 seems to involve a longer path than with DX 1.0 or 2.0; is that correct?

A2: Precisely.