

(Tokyo – 18th May, 2022)

## Nomura Research Institute, Ltd.

### Q & A from Small Meeting for Institutional Investors

#### Part 2

##### (Questioner No.1)

Q1: Digital social capital created by DX 3.0 was mentioned in the framework of Group Vision 2030 (“V2030”) announced at the financial results presentation. In Vision 2022 (“V2022”) you set out to generate synergies between consulting and systems and successfully seized on momentum in DX. What do you consider particularly important in your experience seizing this momentum and in allocating management resources?

A1: This is the final year of V2022, for which considerations began in 2015. At the time, we used the phrase “business IT” in our discussions, not the word “DX.” We also did not anticipate there would be such robust demand for DX as there is now. Since around the time that the 2008 financial crisis subsided in 2010, consulting projects to utilize IT for transforming business models instead of just back office have been increasing. For example, in a project for a cosmetics manufacturer, we explored using e-commerce in addition to the traditional physical sales channels. We had a feeling that projects like that would lead to future IT investment. In preparation for the wave of investment in IT that transforms business, we established teams in which consultants and systems engineers work together. I believe that having a consulting division helped keep us ahead of the times. There are cases in which the future of DX 3.0 is taking root, and we want to capture business opportunities by investing ahead of other companies.

Q2: The stock market has not reacted positively since 2022 began. As the president and CEO, what is your take on the situation?

A2: I do not think our results for FY March 2022 were bad at all, but our stock price ended up somewhat lower than analysts’ consensus. We also estimated our FY March 2023 business forecast conservatively due to uncertainties such as global supply chain problems and the conflict in Ukraine. For a time, the P/E ratio of

NRI stock was around 40, and I believe this has been the result of complex factors such as the decline in growth technology stocks similar to what happened with stocks in the US, as well as the effect on supply and demand caused by Nomura Holdings selling off 15 million shares of NRI stock in March.

**(Questioner No.2)**

Q1: What kind of impact will cloud strategies such as migration to Oracle Cloud Infrastructure (“OCI”) have on your business performance going forward? How much impact will there be, and when?

A1: The finance industry is reluctant to use public cloud in core systems. OCI is an outstanding service that builds dedicated clouds, which are cloud environments within high-security NRI data centers that can utilize cloud-native modules. Compared to on-premises, infrastructure costs can be reduced by migrating THE STAR in financial IT to OCI, which means that profit margin can be increased. We also have inquiries for migrating clients’ on-premises environments to OCI, so this shows promise as a new business. In industrial IT we fundamentally use public cloud. To leverage the advantages of the cloud, we provide services that not only migrate infrastructure but also modernize toward cloud environments where various libraries can be utilized.

Q2: How much will that change profitability, and when?

A2: We predict that migrating all of NRI Cloud to OCI could reduce costs by the single-digit billions of yen. Since IT infrastructure engineers can then be utilized in other areas, it will also help improve productivity. Nearly all industrial IT projects are for cloud, and it would be difficult to specifically express the bottom-line effects of cloud.

Q3: You have been particularly successful in your overseas strategy in Australia. What are you mindful of in terms of governance? Judging from the case examples of other companies in the past, succeeding at overseas M&A must be challenging in certain ways.

A3: Comparing us with other companies is difficult, but NRI’s business size in Australia is around 70 billion yen, and we have conducted eight M&A transactions there over six years. Rather than acquiring a single large company,

we plotted out NRI's target market segments and started by acquiring companies that can be the foundation for our business infrastructure. We then added supplemental features and functions through additional acquisitions. What we can control ourselves are probably the factors that can limit risk. We communicate expectations on the Tokyo side to the management of the companies we acquire and share opinions and ideas with them.

Q4: There are many cases of delegating authority to local management even outside of the IT industry, but what areas of governance does NRI control more tightly?

A4: We delegate authority for local operations, but the Tokyo side commits to business planning, including strategies and numerical targets.

### **(Questioner No.3)**

Q1: This question refers to the short term, but supply chain problems are likely a reason why your business forecast for this year appears conservative. Have these problems already had an impact? What do you predict in terms of procurement costs and other supply chain factors?

A1: Supply chain problems are impacting our client companies more than NRI. This is mainly because the unpredictable earnings environment impacts IT investment, particularly due to supply chain problems in global manufacturing. We anticipate the risk of IT investments getting postponed starting in the second half. NRI is not experiencing any problems with procurement. We are utilizing offshore partners in China, but they have remote work environments in place, so the lockdowns have no effect on them.

Q2: The framework of V2030 calls for sales of over a trillion yen. Around how much does the current 390 billion yen in DX-related sales become when DX 1.0, 2.0, and 3.0 are added in? Also, how do you see the breakdown between Tier 1 (first mover) and Tier 2 (follower) companies and factors such as profitability?

A2: In terms of orders, there are many projects for non-face-to-face and contactless front-end in areas such as cloud-related and e-commerce. Going forward, we believe demand will arise for overhauling core systems to match business models that have been transformed by DX. This corresponds to DX 1.0, but we

expect this demand to increase over the next few years. An example of DX 2.0 is Earthbrain which we are working on with Komatsu. There will probably be a second or third initiative but that is hard to predict, so DX 2.0 is not highly factored into the plan. We are currently in the topic exploration stage. DX 3.0 is for addressing social issues. Services that utilize the “My Number” cards (Japan’s relatively new social security card-type numerical ID system) are highly deliverable in the near future. NRI has experience getting “My Number” into use in securities. Going forward, at banks we plan to link “My Number” to accounts used for receiving public funds. This is an opportunity to utilize the NRI service called e-Shishobako (PO Box), which can also be used for year-end tax adjustments that have insurance premium deductions. We aim for “My Number” individual number-related services to be a business in the tens of billions of yen in around 2030.

Q3: Will your unit prices also increase if you expand the scope of your DX 1.0 business with existing clients? Could your margins also increase if the content of the projects evolves?

A3: On the path toward an operating margin of at least 20% as set out in the framework of V2030, we would like to achieve 30% of the profit increase through productivity improvements. It is important to increase the unit prices in our proposals, but it is even more important to improve our productivity internally. Specifically, we will raise productivity through the combined effects of efforts such as reducing man-hours in development by shifting to components and modules, utilizing SaaS in modernizing business applications, slimming down processes by automating test processes, and increasing utilization of our business partners.

Q4: What is your biggest obstacle to improving productivity?

A4: Efforts to improve productivity cannot achieve success within one or two years. The key is to set KPIs and manage how many of them you achieve every year. We use the balanced scorecard for business management, and productivity improvements are specified as strategic goals for every division.

#### **(Questioner No.4)**

Q1: In your overseas business, what benefits are there for NRI to operate in North America? Can NRI do things in North America that other companies cannot? Also, are you adding anything or making any adjustments to apply your successes in Australia to North America?

A1: North America is an attractive market with a high rate of growth, but the competitive environment there is fierce. If we take on the major IT vendors head-on, we have no chance, so the key is to find market segments where NRI does well. Larger clients in North America typically handle systems engineering in-house and procure any manpower they lack from IT vendors and others. NRI does not operate any business to staff large amounts of personnel. NRI's strength is the ability to provide end-to-end services from consulting to development and operation. Midsized companies are the target market where NRI can leverage its strength in North America. The IT at midsized companies often consists of on-premises legacy systems, so we anticipate doing business in migrations to the cloud.

Specifically, we will work on migrating office automation (OA) systems to Office 365 and changing business applications to cloud-native, with network infrastructure as the starting point. There will be opportunities to utilize external DX partners since midsized companies lack the capabilities to handle the work in-house. There are no M&A candidate companies of an acquirable size that can deliver the business that we envision, so we will establish business infrastructure through additional acquisitions with Core BTS as the foundation. Core BTS operates network and cloud businesses, but they lack business application and consulting functions. We want to conduct additional M&A, with the next three to four years as the anticipated timeline. We also conducted additional M&A for early acquisitions of companies that became our foundation in Australia, so this is the same approach.

Q2: Around what size do you consider midsized companies to be? Are you targeting any specific industry types or segments?

A2: These are companies with roughly a few thousand employees. For Core BTS's network business, we are targeting a broad variety of industry types without leaning heavily toward any industries in particular. When also seeking targets for business applications, the industry types must be narrowed down to some degree.

Q3: In Japan, you have a strength in being able to make proposals directly to clients' management. Can you also provide similar services to mid-sized companies in North America? Do you have the resources?

A3: Core BTS started its business with migrations of legacy network infrastructure, and they can upsell from there. Proposals to management are necessary for projects that modernize IT assets in their entirety, including business applications, so we will need to add a consulting function.

Q4: Is this a situation in which you are building a new business model, and there are no companies that can be used as a benchmark for the future vision of your North American business?

A4: That is correct.

Q5: Do you have room to expand your domestic capacity and utilization of external partners, including offshore partners?

A5: There is room to expand. We expect productivity improvements from shifting to components and modules to have a positive effect in the single-digit billions of yen. This corresponds to over 1,000 man-months (MM) of extra development capacity. We are working to both utilize external partners and improve in-house productivity.

Q6: Is your use of external partners nearshoring in Japan?

A6: We utilize both domestic and overseas partners. However, we believe it is important to not depend only on the resources of external partners, but to balance our usage of their services with productivity improvements in-house.

#### **(Questioner No.5)**

Q1: This might relate to migrating financial IT infrastructure to the cloud, but what level of ROE are you aiming for? Your target for V2022 was 14% but now it stands at around 20%. What will happen to your target ROE level when the way you hold assets changes due to OCI migration? Please share the extent of what you know at this point in time.

A1: We announced the V2030 framework one year earlier than planned, but the

official announcement of V2030 will come in April 2023. We plan to disclose the numerical targets including ROE in April 2023. NRI operates asset-light to begin with, so there is hardly any likelihood of a regression from the 20% level.

Q2: Please share your thoughts on what business will be like 10 years from now. OCI is one example. Could it involve generating revenue from software assets while accumulating software IP?

A2: There are some competitors who do not own assets, but NRI has data centers, which are tangible assets. We are moving forward in cloud utilization, but economic security or other factors could possibly cause a reversion to on-premises. In any event, generating earnings from software assets will not change, even in 2030.

#### **(Questioner No.6)**

Q1: You explained that the wave of DX demand will shift from front-end to core systems overhauls. Does that mean you will be competing with major IT vendors in on-premises and legacy systems?

A1: One aspect of simple, large-scale migrations such as migrating away from host systems is that they are trials of strength. There are many competitors in our industry who specialize in this. Rather than areas where NRI does not have the strength to compete such as simple migrations, we aim for more sophisticated projects such as reconstructing business applications. Projects in the systems implementation phase that other companies in our industry cannot handle can also be a target. For projects too large for one company to handle alone, we work together with other companies in our industry.

Q2: Improving productivity is a major topic, but increasing personnel is also important. With the harsh hiring environment throughout the industry as a whole, will you be able to increase personnel?

A2: We are increasing our hiring head count to NRI payroll (including group company employees hired by the main body of NRI) as indicated on page 56 of the presentation materials of FY March 2022 Financial Results Briefings. We aim to add around 100 employees while at the same time maintaining the quality of the people we hire. Also, we have a human resources development team of

around 100 working on upskilling as well as learning and development, and we are improving our training programs. We are confident that our human resources development is top class in our industry.

**(Questioner No.7)**

Q1: This is from a short-term perspective, but is order volume in industrial IT remaining flat because you are selectively accepting orders according to the profitability of the projects?

A1: The consulting category in our fourth quarter revenue by service includes upstream processes in systems. The fourth quarter numbers also include effects from M&A, but projects in upstream processes are robust and some of them will transition to the systems development phase within one year. As you pointed out, order volume in industrial IT has been unchanged for three consecutive quarters, but projects in upstream processes such as consulting are abundant, and we have established a pipeline. At the same time, the numbers also reflect the harsh second-half business circumstances of our clients to a certain degree.

Q2: Two years ago, your order volume in industrial IT increased by 20 to 30%. What is different about it now?

A2: DX demand rose suddenly from 2019 to 2020. Investments in front-end are continuing, but now we have inquiries for overhauling core systems that have gotten left behind. Core systems projects are large, but it takes time to receive the orders.

Q3: How profitable are core systems overhaul projects?

A3: We are enhancing added value and increasing profitability by incorporating elements such as delivery route optimization and credit automation which had never been available in core systems before.

**(Questioner No.8)**

Q1: There seems to be strong demand for carbon neutrality in DX 3.0. Is NRI in a position to provide these services?



A1: As indicated on page 58 of the presentation materials, we have launched a service for financial institutions to analyze their CO<sub>2</sub> emissions according to calculation standards. As opposed to simple carbon tracking, which has already become a red ocean, this produces added value in areas that are complex and time-consuming such as finance.

Q2: Is that too much of a niche area to become a large-scale business?

A2: We believe that we can cross-sell consulting projects with accompanying CO<sub>2</sub> emissions analysis services.