(Tokyo – 21th May, 2021)

Nomura Research Institute, Ltd.

Q＆A from Small Meeting for Institutional Investors

Part 1

- In order to make it easier to understand, the contents of the question and answer are partially revised and modified.

（Questioner No.1）

Q: Looking back on last year as a whole, what is your overall assessment? And what is your position on the new year ahead?

A: This time about a year ago, we were in quite a nervous situation. While there was no major impact on financial IT, that April we discussed the possibilities of significant impacts on orders in consulting and industrial IT. In consulting, we had a harsh first quarter due to restrictions on sales activities, but there was very strong demand for business model transformations. Sales decreased for the segment overall due to effects from business overseas, but domestic sales in the segment were up. Since there were lots of high profit margin projects, operating profit also increased.

In industrial IT, airlines and travel agencies were very severely impacted and therefore cut back on their IT investments. However, this was significantly overshadowed by increased IT investment for business model transformations sparked by COVID-19, including growth in e-commerce due to the surge in demand for at-home consumption. As a result, sales increased considerably.

Overseas, Australia and North America were heavily impacted by lockdowns, but in Australia the outbreak was controlled, and business returned to normal starting around the third quarter. The positive effects of COVID-19 are continuing into this year, and large-scale IT investments such as in e-commerce are driving growth in industrial IT. Consulting has also been operating at high capacity, maintaining strong performance into the beginning of the fiscal year. We believe there is good reason to be optimistic this year.

(Questioner No.2)

Q: What are you hearing about clients' assessments of their returns on DX investment?

A: Companies are becoming polarized into those that are accelerating their DX initiatives top-down, and those that are struggling to figure out the balance with returns. The first mover companies are dealing with higher volumes which their current core systems are inadequate to handle. However, since e-commerce players are entering the market, they cannot gain something without sacrificing something else. With so many things to do, they are accelerating investment with an emphasis on speed.

Business is growing in industrial IT by catering to clients who are investing in IT to beat the competition by dynamically transforming their business models top-down. There are also some clients who need to take on DX, but are doing proof of concept (POC) while thinking very carefully about the relationship with returns. We are working with clients like these by attentively discussing their business models through consulting.

Q: Generally, what is your ratio of first mover to follower clients?

A: Currently we have a large number of projects being implemented dynamically top-down, and we are allocating our resources to these. Therefore, our ratio of first mover clients is high.

Q: Is there a risk that DX investment could slow down in the near future?

A: For conventional projects, we had cyclical demand in which we would perform rebuilds once every few years when hardware maintenance periods ended, then perform maintenance, and then do another rebuild. DX is fundamentally different from conventional IT in that once you start operating, from that day forward business requirements constantly change, and the built-in software must be continuously updated. Even after release, demand continues to arise on a regular basis. I believe the situation in which we are intensively supporting the first movers will continue for a while. The follower companies currently have old core systems. Business IT also requires investment in DX, and to-do lists are long. Since investment cannot be done all at once, I think it will work out to where we set priorities and support clients in investing according to their capabilities through consulting activities. We believe that DX investment will remain high for the time being.

（Questioner No.3）

Q: What are your high profit margin projects in consulting?

A: We have been doing more work for consulting companies who we have longstanding relationships with, who know our company well and want us to start on something right away. In price negotiations with clients, the balance of supply and demand has also been deteriorating throughout the industry as a whole, and it seems we have continuously been able to negotiate on favorable terms. Rather than any major change to the work involved in projects, I think that demand is robust, and that clients have a strong preference to order from someone they already trust.

Q: What is the status of your capacity utilization in business consulting?

A: Currently we are near full capacity. Normally in consulting, projects finish around the end of the fiscal year, and there is some idle time in April and May. This year we were already operating at high capacity in April, as our high order backlog would indicate. In the first half, I believe we will be at higher capacity utilization than we were last year.

Q: How much do you plan to increase your consulting staff for the year?

A: We are not disclosing headcount for consulting alone, but this year we are expecting around a 10% increase in revenue. In the past, around 10% was cruising velocity. We do not have HR policies to hire large numbers when there is demand or downsize when demand disappears. Neither do we have any policies to dramatically increase headcount of consultants on our payroll. Our approach is to stably increase personnel with double-digit new graduate and mid-career hires.

Q: Your plan for a roughly 10% increase in sales revenue gives the impression of being different in substance from 10% increases in the past. Can we assume even with the end of last fiscal year just behind us, that you will be able to secure enough personnel to achieve a 10% increase?

A: Even in the current climate, I think we will be able to hire as needed for a 10% increase. We rarely have any issues hiring consultants. The tendencies differ between those who join foreign companies from the beginning and those who come to NRI, so it seems unlikely that recruiting battles could suddenly get out of hand and prevent us from hiring who we need.

(Questioner No.4)

Q: Have you improved on the situation of being unable to devote manpower to future-oriented initiatives due to booming activity in projects?

A: We do not consider ourselves to be significantly diminishing the scope of our future-oriented initiatives. In financial IT, we will still be working mainly as an ASP, which yields a high profit margin. The business scheme is about to change significantly, which includes adding in non-face-to-face with face-to-face in our approach to the affluent segment, and the emergence of intermediary-style business. Until now our work has been focused on middle and back office, but it seems there is now demand for platforms in front office to accommodate changes in sales styles and lines of business, and we began making investments to that end last year. From this year on, we intend to launch services in phases and develop them over a three-year period. We have split up organizations to work separately on these investments in next-generation platforms, and these activities are not being downsized.

In industrial IT, e-commerce-related demand is strong. Breaking down functions into components and using those components for systems integration improves productivity. We have also established separate organizations to work on these components. The new work we are getting in industrial IT solutions is based on the premise of cloud usage, and we have been working over the past few years to prepare tools that can automate infrastructure-building as much as possible when using cloud. We have specialized organizations creating component groups that seek higher productivity rather than novelty. We believe that we have made the necessary preparations for the future, and we do not have any feeling of lagging behind at new initiatives.

(Questioner No.5)

Q: When you acquire overseas companies and share a single way of thinking globally, it could possibly lead to human rights issues or other sustainability-related challenges. Which of these issues are you currently aware of, and how do you intend to overcome them?

A: Australia is stricter than Japan at monitoring human rights in areas such as procurement. If we are not much more sensitive to this than in Japan, it would pose significant risk. We have established the controlling company NRI-AU in Australia, and two years ago the company locally disclosed its stance on human rights issues. We want to expand our global business even more, so in addition to head office in Japan, we think it will be necessary for the boards of directors at local affiliates and the controlling companies above them to conduct thorough monitoring as well. Otherwise, there could be significant risk. We intend to continue working on this.

Q: As the industrial IT industry structure changes throughout the world due to COVID-19, is there anything that you need to change over a long time span, such as exposure, or the way you do business?

A: At least over the next five years or so, even within the same industry and business type we will see clear polarization in the industrial sector between clients who change their business dynamically under the leadership of their management and clients who do not. This gap was not very large before COVID-19, but a shakeup has begun between those companies that have the capability to adapt to the new post-COVID-19 environment, and those that do not.

We need to thoroughly meet the demands of our clients. In addition to establishing trust with their worksites, we also need to understand the degree to which management of those clients aims to transform their companies' business models, understand their level of urgency, and allocate resources accordingly. Rather than making proposals to all kinds of clients, I believe it will be important over the next four or five years in industrial IT to narrow our focus to only certain clients and contribute as much to them as possible.

It will be important to determine where to focus our efforts for our next generation of clients, and I am also involved in these discussions. We will dedicate consulting resources to these clients and as management we will strive to also establish solid relationships with their management. The paradigm of how business is created has changed since before the COVID-19 pandemic. While consulting companies from overseas might be stronger in terms material resources, they only offer solutions in packages with maybe something extra added. They cannot put complex systems together from scratch. From the standpoint of leveraging the advantage of our balance between consulting and solutions, I think that growing our business in industrial IT under the approach I have just mentioned makes good use of our unique characteristics at NRI.

As for exposure, our finance ratio is 50%, while the finance ratios of other systems integrators are clustered around 20%, so I think we could lower our finance ratio a little.

Q: What type of people are joining NRI as mid-career hires? What are their characteristics?

A: The people who come to NRI seem to have a long-term desire for self-fulfillment. I think these are people who want to leverage their personal strengths and build on their expertise in a focused manner. We have many types of people joining us, so it would be difficult to describe a stereotype.

(Questioner No.6)

Q: I get the impression that your profit margin is somewhat disappointing relative to the strong demand and top line momentum. What is your take on that, and how do you think it will change going forward?

A: Excluding overseas factors, our profit margin in industrial IT last year was in the 13% range. When looking at domestic figures only, there is hardly any difference anymore between our profit margins in financial and industrial IT. In the fourth quarter we had a client in industrial IT that really wanted to implement a new technology, and we were unable to achieve the productivity we had planned. It was not a large project, but it turned out unprofitable. Our profit margin was in the 13% range for the year even including that, so I think our profit margin in industrial IT is in quite a different realm than it was before. There are two reasons. One is that we are receiving work that cannot be done by anyone other than NRI. The other is that our rate of capacity utilization is rising due to a high level of activity.

Domestically, we do not think our profit margin in industrial IT is low. In Australia, we believe our profit margin will recover significantly this year. We expect that our profit margin this year in industrial IT will be indicative of our true capability.

Q: I recall that there was amortization for software in the fourth quarter.

A: The largest reason for decreased profitability was unprofitable projects driving profit margin downward. However, our profit margin in the fourth quarter was indeed low, due to factors including the amortization you mentioned. I believe many of the factors were temporary.

Q: Can we assume you are able to maintain high profitability excluding temporary factors?

A: Every year we have to impair software assets that accumulate when software created in investment projects does not sell as expected. The impairment in the fourth quarter was a small one that we recorded with an optimistic outlook.

Q: Should we see the financial strategy you have specified with ROE at around 20% as having raised your outlook?

A: At the very least, we do not have the option to go back to ROE of 14%. The intention is to get close to the level of 20% at least once. We have not decided how much to buy back in treasury shares this year and next, but I think we will consider these according to the circumstances when the time comes to decide.

(Questioner No.7)

Q: Do you have any symbolic projects in which you have assembled parts through acquisitions in Australia to be able to offer a complete function?

A: Our first acquisition in Australia was ASG, which is the largest system management solutions company in the country. We have been working at infusing our strengths to leverage ASG. Four years have passed since the acquisition, and I believe a sense of unity with NRI has taken hold.

Starting in May of this year, AUSIEX and Planit will both become consolidated subsidiaries. AUSIEX is a subsidiary of CBA* and provides middle and back-office services focused on wealth management. Capital markets in Australia are bustling and have shown strong performance. We have an ASP called I-STAR/GV which is an overseas version of THE STAR, and it has already been installed at one firm in Australia. We will further accelerate this initiative at AUSIEX and expand sales of this ASP to other Australian financial institutions, executing the same business model as THE STAR in Japan together with AUSIEX. We will infuse the strengths of NRI and leverage them.

Planit is the largest testing company in Australia. In-house production is common overseas, so they hire third parties for the testing process. This is different from Japan, where testing companies have little presence since the testing process is included in the work of systems integrators. We not only handle the testing process but also give feedback from testing to the development process that precedes it, and we have a framework for even more advanced development called DevOps which includes operations. We also have technology for development called DevSecOps which incorporates security elements. We will infuse these into Planit to drive their business.

We believe that we can introduce NRI's resources to these acquired companies to drive their businesses over the next several years, and once this produces something tangible, we can collaborate with each other to acquire new clients. I think the first step is to focus on increasing the value of each of these companies while getting them to use what NRI has. When this business foundation solidifies to a certain degree, the next stage might be about synergies between the acquired companies. The main storyline is achieving the objectives we had at the time we acquired these companies by generating earnings in the present.

*CBA: Commonwealth Bank of Australia Limited

Q: Australia is set to rebound this year, but am I correct in understanding that we could expect increases in the degree of this rebound through deployment of NRI expertise this year and onward?

A: As you can see in the order backlog at the end of March, business in Australia is growing. The market will return to normal this year, so we are optimistic about this year and beyond.

(Questioner No.8)

Q: About how much profit margin are you expecting in Australia in the medium to long-term?

A: In Australia we believe that 10% is within range. After that, we want profit margin there to rise to a level that rivals NRI. ASG is close to maturity. AUSIEX will expand its platform as an ASP. I believe that Planit will strengthen its upstream business, add the security function to its services, and increase its profit margin. There is still some post-merger integration cost to be determined, but we believe the capacity is in place to earn 10% profitability.

Q: Industries are expanding in Australia, but what do you think about the possibility of M&A in other regions?

A: In North America we have candidates for M&A, mainly in the US, so we are always considering these. However, the valuations are currently high, so we are thinking more carefully about them. If we go out to get more exposure, I think it will be in North America.

(Questioner No.9)

Q: What is the overwhelming difference between existing DX and DX 3.0?

A: Existing DX inevitably applies to the company, such as transforming the business model of the client company, and creating new business models together with them. On the other hand, DX 3.0 applies to society. This might mean communities or local government agencies. Carbon neutrality might apply to the energy industry. One example could be improving well-being in the community by providing the community with a digital platform.

It is difficult to convert this into financial value, but the social surplus it generates could possibly be monetized by local government agencies in the form of tax revenues. If we create platforms related to generating social surplus, monetizing them is more complicated than when dealing with companies. Over the coming year, we intend to consider what these platforms could address, and what platforms to create that could paint a picture of monetizing them. Our consulting related to this is increasing, and we are getting work from local governments, central government agencies, and companies conducting business in the public good.

I would like to form a hypothesis about what we could do through consulting that would lead to business in solutions. At about this time next year, I hope to be able to say what we are thinking about investing in. That is what the time scale looks like right now.