(Tokyo – 1st June, 2022)

Nomura Research Institute, Ltd.

Q & A from Small Meeting for sell-side analysts

Part 1

(Questioner No.1)

Q1: In the framework of Group Vision 2030 (“V2030”) explained at the financial results presentation, you mentioned the topics of social DX, value chain DX, and infrastructure DX as digital social capital. Which of these topics do you expect to contribute to business performance?

A1: There are currently around 30 topics under consideration. We are separating out the topics into those in the planning stage, PoC (Proof of Concept) stage, and business planning stage to manage their progress. Among those 30 topics, the one we expect to grow into the tens of billions of yen by around 2030 is shifting government services to digital. NRI has been working on “My Number” individual number-related services from the beginning. For example, e-Shishobako (PO Box) is a private-public collaborative cloud service that links “My Number” portals on the government side with the services of private companies. There are companies working on similar services, but NRI has a large share of the market and we are considering further utilization and deployment of these services. NRI has a proven track record in linking securities brokerage accounts with “My Number” individual numbers and was commissioned for a project by the Deposit Insurance Corporation of Japan which is working on linking savings accounts to “My Number” for receiving public funds. Insurance companies are also using e-Shishobako (PO Box) for deduction certificates issued for year-end tax adjustments. In DX 3.0 we cannot earn sufficient income from individual systems integrations, so we are focusing on platform-based business.

Q2: Is this a business model where usage fees are paid to NRI when individual users conduct transactions?

A2: Transaction fees when individuals use e-Shishobako (PO Box) are paid to NRI through legal entities such as financial institutions or government agencies.

Q3: In "My Number" individual number-related business, are your revenues from financial institutions recorded in the financial IT segment and revenues from government agencies in the industrial IT segment?

A3: Currently, we are recording all revenues from "My Number" individual number-related business in the financial IT segment. It will be this way for the time being, but by around the year 2030 we expect this business to grow enough to comprise its own division.

Q4: Nomura Holdings sold off NRI stock two times in FY March 2022. NRI conducted a share buyback at the time of the first sale, but not for the second. What was the background behind that, and what is your policy and your approach going forward?

A4: When large amounts of NRI stock are released onto the market, fundamentally our policy is to conduct share buybacks after considering whether to purchase all or part of those shares. When the second sale of NRI shares occurred, we decided against a buyback out of consideration for our balance of cash to be invested in M&A and shareholder returns. Our policy is to allocate roughly one-third of our cash flow to shareholder returns, but we had actually allocated more than one-third. We conducted significant M&A in FY March 2022, and we are taking overall balance into consideration.

(Questioner No.2)

Q1: Regarding the over one trillion yen in sales called for in the framework of V2030, it seems you are aiming for an even higher growth rate in your domestic business than the growth rate of the IT market. For example, you have a large share of the market for shared online services in financial IT and it seems unlikely that you will be able to exceed the growth rate of the market as a whole, but what factors are driving top-line growth? Also, I understand you are working on migrations to Oracle Cloud Infrastructure (OCI) to improve profit margin, but what is the timeline for that and what effects will there be?

A1: Shared online services in financial IT make an important contribution to profit, and we will continue sales activities aimed at usage of THE STAR at securities brokerages, including major ones. As for top-line growth factors, in financial IT, projects among major non-life insurers to migrate away from host systems toward open architecture are starting to appear, and we expect these to be large long-term projects lasting five to six years. We are getting consultations for this starting in upstream processes, but since these are highly advanced projects, only a limited number of vendors can actually implement them.

In platforms for “My Number” individual number-related services, we aim for the tens of billions of yen. In industrial IT, many projects until now have been for front-end. Rather than just infrastructure updates, we expect to see core systems overhaul projects utilizing new technologies such as AI with clients whose core systems are unchanged since before DX. NRI aims to obtain large projects from major clients as prime accounts in our long-term plans, and we are setting milestones for up to four or five years from now. Migrations to OCI have the effect of reducing infrastructure costs at NRI, so we are migrating finance platforms to OCI one after another. Migration to OCI was completed for some services around the summer of 2021, and we plan to migrate more of them sequentially until around 2024 or 2025. The contributions to income will take hold from 2025 onward.

Q2: There is likely a large market for core systems overhauls in industrial IT, but the difficulty is not the same as for front-end. Can NRI get new orders for core systems overhauls from new clients?

A2: Core systems overhauls going forward will not be the same business as the simple infrastructure updates we had worked on in the past. Experience reforming business operations primarily in front-end will be an advantage. NRI’s policy is to focus on our targeted clients, and we are at the stage of proposing core systems overhauls to clients with whom we already do business.

Q3: Soaring labor costs are putting a short-term squeeze on the profits of global IT vendors. Are soaring labor costs a problem for NRI’s businesses in Australia and North America? If so, how are you dealing with it?

A3: This year we are aiming for around 70 billion yen in Australia. Labor costs are soaring in Australia, but unlike Japan, it is easier to pass on the costs in sales prices there. ASG has been able to pass on increased labor costs in their sales prices. Planit has been managing costs by offshoring to the Philippines and receiving staff transfers from the Philippines, but staff transfers are currently suspended due to COVID-19. Rather than costs, a bigger problem is that supply is not catching up to demand. Looking at our business in Australia overall, our profits there are strong. In North America, we just acquired Core BTS in December 2021, and we will be scaling up going forward. Rising labor costs are not impacting the execution of our business plans. However, in the network business, our procurement of Cisco devices is falling behind due to the semiconductor shortage, which is impacting business performance.

Q4: Is my understanding correct that in Australia, there is no concern that your profit margin will decline even over the short term?

A4: Yes, that is correct.

(Questioner No.3)

Q1: This question is about the topic of DX demand shifting from front-end to core systems overhauls. The DX report by the Ministry of Economy, Trade and Industry gives the impression that efforts to modernize existing systems are in preparation for DX investment. This is not the same as the order of starting with front-end and continuing with core systems overhauls. Does the way demand emerges differ by client? What type of investment patterns does NRI anticipate?

A1: Investments in front-end have been weighted toward non-face-to-face and contactless in the last two years which were impacted by COVID-19, and core systems overhauls became a lower priority. For example, one topic is core systems overhauls that are not the conventional simple infrastructure updates. These include utilizing AI in ordering processes at convenience stores. In logistics, the use of delivery route optimization algorithms is a topic. Among large clients, many companies have likely completed modernizations to migrate their HR and accounting systems to ERP.

Aside from these, new demand is arising for core systems overhauls to accommodate reforms of business processes for order placement, order receiving, and supply chain. Core systems overhauls are larger in scale than front-end. We expect DX investments in core systems overhauls to increase over the next three to four years. Additionally, our efforts in digital twins as a new business with Earthbrain have begun to take flight. We have high expectations for future growth.

Q2: Some investments in DX to accommodate non-face-to-face and contactless became necessary due to COVID-19. Have there been any changes in clients' attitudes to ROI of their DX investments based on the experience they now have investing in DX?

A2: In finance-related DX there is DX to grow the top line and DX to improve clients' services, but much of the DX is aimed at cost reductions such as eliminating and consolidating stores. Awareness of ROI increases when the purpose of DX is to reduce costs, so we need to present materials to use as evidence. In industrial DX, rather than cost reduction there is more focus on DX that grows the top line and improves clients' services. Management is taking risks by making decisions on investments aimed at differentiation while keeping ROI in mind. For example, in a logistics project, a client invested in functions to offer re-delivery procedures in real-time using smartphones in order to enhance their CX and differentiate themselves from the client's competitors such as Amazon.

(Questioner No.4)

Q1: One could infer that NRI is developing in-house tools such as AI. It is concerning that IT vendors could be first movers for technologies, but those on the client side might not be able to master the new technologies enough to use them. Is there any gap between NRI's engineers and those in charge of clients' IT?

A1: Our AI utilization is more than just some simple theory. We optimize algorithms through verification, such as conducting PoCs for certain tasks. For example, we are working collaboratively with our clients via efforts such as adjusting algorithms through practical application by comparing and verifying marketers' hypotheses and determinations made by AI, and incorporating these into the production environment.

Q2: My question was out of concern for risks of unprofitability, such as challenging projects.

A2: Costs can increase due to rework when user departments add requirements afterward to the requirements agreed to beforehand with the person handling the client's IT. To mitigate cases such as these, NRI supports the person handling the client's IT at communicating smoothly with user departments.

Q3: My impression was that there is a higher risk of unprofitable work due to gaps arising between the IT vendor and the client side when the vendor adopts new technologies.

A3: We are controlling the risk of unprofitable work by upscaling after verifying with PoCs that target certain tasks.

(Questioner No.5)

Q1: I understand that DX demand in industrial IT is shifting from front-end to core systems overhauls. This is from a short-term perspective, but your order volume in the fourth quarter of FY March 2022 was unchanged year-on-year. Industrial IT is likely to grow over the medium to long-term, but where are the fluctuations happening over the short term?

A1: We had large numbers of inquiries in FY March 2022, but we had to carefully consider whether we could handle them with the personnel we have, or whether we should utilize our partners more extensively. There are also projects for orders that previously had been for lump-sum contracts of 4 to 5 billion yen, but recently with agile development are for 1 to 2 billion yen on a continuing basis. Changes in contract formats could be impacting orders. For NRI, the pipeline is important. Our order volume by quarter may fluctuate depending on the timing of contracts, but our pipeline in industrial IT is robust. It may appear that our order volume in the fourth quarter of last year was unchanged, but once we receive the orders for projects in the pipeline, they will be recorded in the order volume of the first quarter and onward this fiscal year. However, that has not yet been finalized at this point in time.

Q2: I understand there is no lull in DX demand in industrial IT, and that business is strong.

A2: Inquiries are robust.

Q3: This question is about medium to long-term risk, particularly pertaining to personnel and resources. If I remember correctly, your personnel were stretched thin in 2019, but is there any sense of personnel being stretched thin now, compared to then? How do you see your human resources strategy for the next three to five years, such as for increasing headcount?

A3: In systems integration, increases in resources are directly linked to sales increases, so we will steadily bolster our resources. We are currently hiring a head count of around 600 (400 new graduates, 200 mid-career), and that number will increase going forward. We will not reach 1,000 hires per year like some other companies, but we aim to increase our hiring headcount by around 100. We are also working on improving productivity. In financial IT, migrations to OCI are freeing up engineer resources involved with IT infrastructure. Industrial IT uses the public cloud and therefore cannot be like financial IT, but we are making progress in shifting to components that can be used in systems integration processes. We will utilize components to reduce overall man-hours in development.

As a medium-term topic, we will work on automating test processes such as those conducted by Planit in Australia. We will also increase the proportion of our partner usage. Through the combination of these initiatives, we will improve our overall productivity. We are considering scenarios for resource increases and productivity improvements in which we achieve more than one trillion yen in sales and an operating margin of at least 20% in 2030.

Q4: So, the tight supply and demand situation will likely continue, but resources will not be a limitation to sales growth, and you will achieve growth through a mix of personnel increases and productivity improvements. Is that correct?

A4: Thanks to NRI's strong brand image in hiring, we believe that we can increase our hiring headcount by 100 without any decline in the quality of our hires.

(Questioner No.6)

Q1: Are the joint venture you established with clients in industrial IT starting to produce results? And outside of the joint ventures, are you receiving orders for systems projects from the main business entities of these clients?

A1: Among our joint ventures, KDDI Digital Design is the largest in scale and its sales have grown to more than 10 billion yen. Orders from KDDI are also growing. Technium is epoch-making in the early going for digital twins, but sales in the machine tools market are small-scale. NDIAS and Boostry are also small-scale in terms of sales. Earthbrain is building IT platforms with investment from NRI in addition to capital injections. The model is for increasing returns, with earnings rising through increases in transactions. The next four or five years will be the startup phase, and we expect revenues to expand after that. The business model for Earthbrain and Technium is to visualize physically real situations using digital twins, consider the optimum solution, and share profits earned by improving physically real operations. We are currently exploring domains where this model can be applied. For example, we are discussing the transport industry.

(Questioner No.7)

Q1: You talked about the semiconductor shortage in North America. Do you forecast sales this year to recover from that or improve?

A1: The P&L of Core BTS was consolidated starting in the fourth quarter of FY March 2022. Due to post-merger integration there was no contribution to consolidated profit, but sales ended up matching our forecast. The situation of being unable to reliably procure devices will continue this year as well. Roughly half of Core BTS's sales is network business and roughly half is cloud business that uses Microsoft Azure. Their cloud business is steadily expanding. In that business, they are upselling core systems modernizations after migration to Office 365. However, there is competition from other companies, so not all of these efforts are leading to orders. This year, Core BTS will not contribute to consolidated profit, but we are in discussions with their local management team about growth over the next two to three years.

Q2: What is your strategy in North America from now until 2030, and what was the intention behind the acquisition of Core BTS?

A2: Large clients in North America fundamentally handle their IT in-house. When performing large-scale systems updates, they procure whatever resources they lack from major consultancies and India-based IT vendors. We would need to have large numbers of engineers at our disposal in North America to be able to enter that business, but we do not operate any such business in Japan. In North America, midsized companies with single-digit thousands of employees have limited in-house resources, so there is a market for their usage of outside resources when performing system updates. We are focusing attention on this as a similar market to Japan.

Rather than large clients, Core BTS targets midsized companies. Network infrastructure at midsized companies is on-premises and legacy infrastructure, so they have needs for cloud migration. After migrating to Microsoft Azure, Core BTS implements Office 365 as an office automation (OA) environment and modernizes business applications using cloud libraries. This is similar to the DX business model that NRI operates in Japan.

Focusing on this market segment, we acquired Core BTS as the company to form the foundation. We will need to upgrade their capabilities in business applications and consulting to make them the same as NRI in Japan. For managed services, we will give them a system management solutions function similar to ASG in Australia. In other words, this means bolstering their lineup of services. Additionally, they currently operate mainly in the Midwest and on the East Coast, but we will expand their operations nationwide. Our policy at this point in time is to conduct additional M&A targeting business functions and geographical coverage.

Q3: Are you also aiming for an operating margin of 20% in North America leading up to 2030?

A3: Currently, our operating margin in Australia is just under 10%. Through reorganization and other efforts, we are aiming for 14% to 15% there going forward. In North America, we are aiming for an operating margin of around 10% leading up to 2030.