(Tokyo – 1st June, 2022)

Nomura Research Institute, Ltd.

Q & A from Small Meeting for sell-side analysts

Part 2

(Questioner No.1)

Q1: You mentioned that you will engage in full-scale M&A originating from Core BTS which you acquired, but how do you handle management locally when you expand in North America? Will you have Core BTS manage the companies they acquire themselves, or will you send over staff from Japan?

A1: The Core BTS management team consists of their CEO, CFO, business head and sales head. The senior executive managing director at NRI in control of overseas business assumes the role of full-time chairperson of Core BTS, and these five handle the management. Core BTS has a very highly skilled management team, which was actually one of the reasons we acquired them. They devote significant effort to retention, including compensation design. We will be in discussions with them as we conduct future M&A. Core BTS wants to greatly expand the size of their cloud business, but their capabilities in developing business applications after cloud migration are currently weak, so we will need to supplement that through additional M&A.

Their operations are also heavily clustered in the Northeast, so we will acquire companies that own similar business infrastructure in order to expand throughout America. Therefore, M&A must be conducted for both functionality and geographical coverage. We are starting by sending one staff member from Japan on assignment to the head office of Core BTS's management organization to work with their CFO on grasping the full picture, including pipeline management and cash flow management. We could possibly assign additional staff from Japan once our business in North America expands. We intend to manage our business there jointly with Core BTS. If the acquired companies increase in number, one possibility could be to expand the control functions of NRI Holdings America.

Q2: Does the CEO of Core BTS also leverage his own capabilities for M&A? Does he have connections such as at unlisted companies, and does he bring in projects?

A2: Yes, he does. The CFO is also excellent at management through numbers. For post-merger integration after M&A, the CFO will likely play the central role.

Q3: Will you be conducting M&A in North America at a quick pace?
A3: We have already compiled a long list of candidates. There might even be a transaction this year.

Q4: Your acquisitions will be in applications development, but will you generally be acquiring local companies as opposed to tie-ups with Japan?
A4: Production is done differently there than in Japan, so we want to acquire companies locally that handle DX production. Core BTS has already acquired two or three smaller companies, but we are considering companies capable of application development for core systems.

Q5: If your local expansion targets distributors, would that not involve large investments?
A5: Companies with high valuations in North America are software and SaaS companies. Core BTS targets midsized companies with single-digit thousands of employees, which in many cases do not have strong in-house capabilities and are still using legacy systems. For companies such as these, Core BTS starts with migration to the cloud, then transitions to working on core systems. This is the same business model that we operate in Japan. I think the right approach is to gain a foothold through infrastructure business where company valuations are not high, clients are locked in and there is little escape risk.

Q6: In North America, do the client companies have CIOs, and is it customer-driven?
A6: Larger companies have CIOs and in-house IT organizations. For whatever they lack when handling large projects, they utilize IT services companies to create the systems. The market segment we are focusing on is companies with single-digit thousands of employees. Since these companies do not have in-house IT organizations, they contract out the work to IT services companies that are capable of production. This is how we aim for markets similar to Japan. Consulting is our entry point for approaching client companies, but the consulting function of Core BTS is currently weak, so we need to supplement it.

We and their local management share a two-pronged approach to business expansion, through functional additions and geographical coverage.

(Questioner No.2)

Q1: In the enterprise market, roughly how large is your target market for midsized companies with no in-house IT in North America?

A1: It is far larger than in Japan. I believe that we will be able to explain this with accurate data at our business briefing session at the end of June.

Q2: Are Core BTS's competitors local or global IT services companies?

A2: The mainstream IT services companies in North America are accounting-related or India-based, but I have not heard about any of those companies being competitors to Core BTS. The competitors are actually community-based vendors. To prevail against that competition, they will need to upsize to a certain degree. Core BTS has received a Microsoft Partner of the Year award in the category of Microsoft Azure. The challenge going forward will be to make them stronger in applications.

Q3: NRI seems to have successfully seized on the DX movement in Japan. There is apparently increasing awareness about DX on the client side, but it is unclear how much it has actually increased. How do you feel things are changing on the client side?

A3: Investment in non-face-to-face and contactless has been inevitable over the last two years due to COVID-19. Every company is adding elements such as e-commerce to their current business models, but rather than true DX, they only go far enough to meet their immediate needs. There are many clients like this. In a large project we worked on last year with a major logistics company, we differentiated their CX from other companies by dramatically changing their core system. This involves investment on a completely different scale than simply creating an e-commerce site. Only managers are capable of making such decisions, and very few managers have done their decision-making early on. We need to make the value of our presence felt by getting involved from the early stages with clients who have big plans and supporting them consistently from business to IT. We support our clients' business transformations as a partner, not as a vendor. Our ability to provide consistent support puts us in an advantageous position, which we will leverage. We will continue to steadily lengthen our list of major clients by seeking them out, building trust, and never letting up in our efforts.

Q4: In Japan, is your approach still to aim for profit growth while combining increased revenue effects with productivity improvements?

A4: Increased revenue effects will account for 40% of our planned profit growth and productivity improvements will account for 30%, but we consider productivity improvements to be more important. Productivity improvements include efforts to make components out of IP, automate testing processes, slim down other processes, and reduce maintenance costs by revising source code. Since we have already established similar efforts in the current Medium-Term Plan for the 40% from increased revenue effects, we will now need to generate the 30% from productivity improvements, and we will need to follow through on it.

Q5: It seems like a positive cycle, that projects working on front-end DX are expanding to core systems overhauls that had not happened before. What kind of projects were these?

A5: Investments in response to the COVID-19 pandemic were mostly for front-end services. Since core systems that were in place before DX are still in operation, we have recently been starting to receive inquiries for core systems overhauls and similar work. For example, call centers become more important when front-end goes online due to an e-commerce site being built. We will be changing the operations of call centers with technologies such as AI and natural language processing.

Also, in many cases in supply chains the front-end is a hybrid of e-commerce and physical, but inventory control is still done physically and inventory needs to be centrally managed both online and offline. In other words, they need supply chain transformation. One example would be to build AI into the ordering function of core systems. There are also topics for projects in front-end, but we are getting projects for topics in core systems overhauls and these are promising in terms of size.

Q6: Is it a strength having both core systems and front-end capabilities?

A6: NRI handles front-end, so while we might not also automatically receive orders for core systems, handling front-end gives us an in-depth understanding of how the client's business will change, which puts us in an advantageous position to proceed with defining requirements.

(Questioner No.3)

Q1: The macro environment is changing. How are your post-financial results presentation discussions with top management of the companies changing? Are demand trends changing? In particular, are there any changes in consulting projects which could be leading indicators?

A1: The conflict in Ukraine is prominent in the news, but I do not believe there are any cases where our clients' performance has been significantly impacted by it. Many more of our clients are concerned about lock downs and zero-Covid policies in China, particularly in Shanghai. We have many clients with a high level of exposure to China and their performance tends to be impacted quite easily, including by supply chain problems.

In consulting, we also currently do not hear anything about geopolitical risks changing the direction of projects in climate change or carbon neutrality. There are more projects on the topic of EVs in consulting recently, which is connected to the high likelihood of an accelerated shift to renewable energy due to the continued high prices of fossil fuels. There are also discussions about future forecasts and initiatives that trace all the way back to auto parts and even materials in addition to just cars themselves. It feels like the shift to EVs could even happen earlier as a result of geopolitical risk.

Q2: When can we expect contributions to business performance from North America? Also, what are the issues and the risks?

A2: We believe that around 20% of our profit growth in 2030 will be overseas. For instance, assume that we have just under 10 billion yen in profit overseas this year, and in 2030 we are able to exceed one trillion yen in sales with an operating margin of 20% or higher. If 20% of the profit increase comes from overseas, that would calculate out to an increase of 20 billion yen, for a total of 30 billion yen earned in profit overseas. If we are targeting 250 billion yen in overseas sales, I think we would aim for a profit margin in the low teens. Our profit margin in Australia last year was 8-9%, and we will be taking measures on the cost side, including reorganization. In Australia, we are aiming for a profit margin of 15%. In North America, we are targeting a profit margin on the high end of single digits. We will need to give tangible form to our M&A in North America over the next four or five years in order to achieve our profit goal for 2030.

As for risk, I believe we can control risk if we are thoroughly careful not to make any overambitious acquisitions in North America. The biggest risk is likely the retention of managers. I think it will be key that we fully engage in the retention of management teams, including compensation design, and control the risk of losing valuable people among management.

Q3: What kind of incentive schemes are you thinking about for retention?

A3: Although these are not stock incentives, we are combining short-term incentive compensation (STI) with medium to long-term incentive compensation (LTI). LTI is a framework with leveraged incentives depending on how much the business plan created with them is exceeded. In addition to monetary rewards, we will also be discussing position-related incentives for promotions either to management or to head office executive roles for our overall North America operation once our business is bigger there.

(Questioner No.4)

Q1: When becoming a global company, you must also think globally about sustainability assessments. Value co-creation is instilled domestically, but how will you go about instilling value co-creation and your shared mission globally?

A1: This year we are putting the finishing touches on our next long-term vision, but Australia is getting involved in these activities starting this year. We are also sharing the framework of Group Vision 2030 conceived by the Japan side with the management team in Australia, and whatever matches the 2030 Vision will be created in Australia as well. We will have them position value co-creation as a core concept. In Australia, we want to carry out initiatives that share our values, with NRI Australia playing the central role. When we announce Group Vision 2030 in April 2023, I believe we will also be able to explain this about our business in Australia.

Q2: I am interested to know how deeply you will instill your social initiatives. It seems that sustainability cannot improve without a mission declaring why the NRI Group is essential. As President on the Japan side, what ideas are you coming up with?

A2: We would like to incorporate Australia in the process of creating the vision. Next month we plan to hold a town hall meeting with the three companies in Australia. There, we will also be able to understand their approaches and ideas while we thoroughly communicate what we are thinking on the Japan side. If those in charge at the local business sites do not continue communicating the meaning of working in the NRI Group, we will not be able to retain employees there. This is not something that will just suddenly happen one day, so we will start by sharing the vision.

Q3: Sustainability initiatives at NRI do not seem inferior to global standards. I hope that you will make efforts toward better disclosures regarding your overseas activities, such as visualizing key metrics.

A3: Understood.

Q4: Among your overall management, what initiatives are you considering that will lead to improving asset efficiency, such as revising data center operations?

A4: We are increasing the proportion of renewable energy used at our data centers, and we expect to achieve our target earlier than planned. The ratio of renewable energy used at our three largest data centers already reached 100% during FY March 2022. Additionally, we have moved forward our target year for achieving carbon neutrality, from 2050 to 2030. Between now and 2030, we will continue working on the areas where we have not completed the shift to renewable energy in Scope 1.

We have also engaged in multiple discussions about related initiatives, including in supply chains. Since the primary focus going forward will be Scope 3, we are discussing together with group companies, partners, and others, rather than just within NRI. In January 2022 we organized an occasion to explain NRI’s ESG approach to our partners, and we asked them to consider environmental goals to set. We will be monitoring this going forward. For human rights due diligence, we plan to move forward with efforts both domestically and internationally. We are reconsidering goals which had previously been focused only on non-consolidated NRI, and now we are also involving our group companies and partners. I hope to also be able to provide an explanation for this in our next Medium-Term Plan.

（Questioner No.5）

Q1: How do you perceive the current state of your hiring capabilities and positioning overseas? Has there been any recent factor that has led to success in hiring?

A1: In Australia, labor costs are rising and the possibilities for retention are limited, so there is some degree of personnel turnover taking place. The brand of the NRI Group is probably not the reason, but ASG is not having any problems with hiring. Rising costs have been passed on to clients to a certain degree, and there have been no major impacts on income. Planit is utilizing offshoring for resources. They have bolstered their resources by establishing an offshoring center in the Philippines and receiving staff transfers from the Philippines. Acceptance of staff transfers have most recently been suspended due to COVID-19, but they are currently bolstering resources at a rapid clip. Getting back to what the situation was before the pandemic will probably still take a little more time. Our business expansion in North America has only just begun, so any issues or problems arising there will be discussed in the future.

Q2: In Australia you have been able to pass on spiking labor costs in the prices charged to clients, but from a macro standpoint, how long do you think this will continue? Is there any risk that you could enter a phase of being unable to pass on costs in the form of prices?

A2: Labor costs are rising significantly in Australia. We are controlling these costs by tolerating a certain degree of personnel turnover while bringing aboard new personnel from the outside, and at the same time focusing effort on human resources development. The rising labor costs are not currently damaging ASG's profit margin. Labor costs will likely continue to rise for a while, and we will find ways to improve operations while tolerating a certain degree of turnover.

(Questioner No.6)

Q1: Do you plan to expand anywhere other than North America between now and 2030? And will you establish new locations or expand through M&A?

A1: Developed countries are our target markets because our services aim for high added-value areas. IT services is a business tied to domestic demand, and our targets are North America and Australia because these are developed countries where the population is expected to grow. We are not considering any indiscriminate expansion.