

(October 26, 2023, Tokyo)

**Nomura Research Institute, Ltd.**

**The Second Quarter of FY March 2024 Financial Results**

**Briefings Q&A Session**

**First inquirer (analyst)**

Q1: For your fiscal year forecast, how would the 3 billion yen upward revision in operating profit break down between domestic and overseas business?

A1: We are upwardly revising our forecast by around 10 billion yen domestically, and downwardly revising overseas by around 7 billion yen. We anticipate breaking even for the year in terms of operating profit and loss overseas.

Q2: Your second quarter operating profit and loss improved by around 1.7 billion yen compared to the first quarter. Excluding the earn-out expense of approximately 1 billion yen arising in the first quarter, how would the approximately 700 million yen remaining break down between Australia, Core BTS, and others?

A2: More than 1 billion yen is improvement in Australia including the earn-out, improvement at Core BTS accounts for a few hundred million yen, and other improvements account for another few hundred million yen.

Q3: How are you looking at profit and loss in the third quarter for your overseas business overall?

A3: In Australia, the third quarter will improve on the second, and the fourth quarter will improve on the third. We expect a larger improvement in the fourth quarter. Operating profit and loss at Core BTS will likely decline starting in the second quarter since we have a few hundred million yen in short-term incentive (STI) payments scheduled in the third quarter and the Christmas break also means less operating days, but we are forecasting an improvement in the fourth quarter.

Q4: Will operating profit and loss at Core BTS be around the same level in the third quarter as in the first?

A4: We believe it will be around the same level.

Q5: Are you expecting another incremental workforce downsizing at Core BTS through its de-facto integration with NRI-ITSA?

A5: We are currently in discussions with the local management, including about whether to downsize workforce. These considerations are proceeding as we scrutinize factors such as when orders will return, and what proportion of orders from NRI-ITSA clients we can redirect to Core BTS. Synergy effects from the integration with NRI-ITSA are not reflected in the performance forecast revision. Core BTS is currently formulating their business plan for the fiscal year ending December 2024. They will finish it by this December, so we expect to be able to explain the synergies portion in the next financial results presentation.

Q6: This question is about changing trends in domestic orders. Orders are about the same as the previous year in consulting and financial IT solutions. Is that due to the difficulty of repeating last year's numbers, or is it within the scope of quarterly fluctuations?

A6: In financial IT solutions, we had just under 10 billion yen in orders accompanying the launch of THE STAR at major securities brokerages last year. Orders this year were strong enough to compensate for that and reach about the same total. In consulting, there is an element of projects coming together as orders at uneven timing. Order volume through the end of the first half is at a high level, and order backlog is also building up, so we currently have no reason to be concerned.

## **Second inquirer (analyst)**

Q1: Since performance has been slumping at Core BTS, why are you paying out hundreds of million yen in STIs?

A1: The objective is to retain talented management. We have been anticipating these payments from the beginning.

Q2: Management at Core BTS may be talented, but their performance has deviated from the original forecast. Will you need to revise your strategy for business expansion in North America?

A2: For core systems, package-based IT services are the focus in the North American IT services market, and companies such as Accenture, Deloitte, Infosys, and Tata have large numbers of personnel to mobilize. NRI is not focused on that type of model. Our interest is in projects conducting agile development on DX for user departments to improve their customer experience. We aim to conduct business with strength in designing upstream processes. Our medium to long-term policy to that end will not change. Currently, companies are screening out IT investments due to rising interest

rates. Typically, core systems have an End-of-Service-Life (EOSL) and in most cases that is handled on schedule, but front-end DX projects are impacted by investments being put off until next year. Circumstances are also harsh for Perficient and Slalom, which have similar business models. The situation is more attributable to the impact of a slumping IT services market as opposed to any expectations for management to be able to exercise their own abilities to improve performance. Another round of workforce downsizing could also be considered depending on when demand starts to return. As a short-term measure, we believe that integration with NRI-ITSA will enable Core BTS to boost its capacity utilization which has been declining.

Q3: My impression is that Core BTS has few human resources capable of designing upstream processes such as UX and DX.

A3: As I explained earlier, we have a shared vision for what we aim to achieve in the medium- to long-term. We had also planned additional acquisitions of companies capable of designing upstream processes in North America as we had done in Australia, but we have set those plans aside for now. NRI's office in New York has around 60 consultants on staff. The business operations-oriented consultants among them have already begun working together with Core BTS engineers. That is how we are attempting to supplement our design capabilities in upstream processes.

Q4: Is your momentum in domestic orders trending upward or downward in the second half?

A4: During the three years of the pandemic, progress was accelerated in front-end DX and business model transformation in particular. On the other hand, old middle and back-end systems have been left alone, and demand for reconstructing core systems to accommodate business model transformation began to appear last year. The transition into the development phase is starting this year, and we believe this trend will continue into next year.

### **Third inquirer (analyst)**

Q1: You explained that there will be a recovery in overseas business leading up to the fourth quarter, but there cannot be any discussion about recovery if restrained IT investment due to rising interest rates is a driving factor. Will the recovery be the result of Core BTS having been reorganized? And is there a different factor at work in Australia? If there are any factors other than interest rates, please share them.

A1: In Australia, we do not think the market environment will dramatically recover, but as a result of the workforce downsizing and other actions taken through the first half, we should now be able to turn profit even without significant top-line growth. By around the end of this year, we will need to consider whether to implement another round of workforce downsizing at Core BTS. We do not foresee a dramatic recovery in the North American market environment, either. The new sales organization at Core BTS began functioning sometime around June of this year, and they are working on developing new clients. We also expect NRI-ITSA to supply them with projects. Measures are currently being implemented for their performance in the fourth quarter to exceed the second and third quarters.

Q2: It seems that increases with existing clients and contributions from Baas/Core are major components of your business performance domestically. Where are you developing new clients and in what business fields are you having success that will lead to future growth?

A2: Our strength in financial IT solutions is platforms. Two BaaS/Core projects for banking that we received orders for last year have entered the development phase and are contributing to performance. We can expect orders in the single-digit billions of yen from projects for newly-operating online banks. Nomura Securities is also connecting us to regional banks through financial intermediation. BESTWAY which NRI provides for regional banks has been producing a loss, but we expect to recover that by performance for THE STAR turning positive. The Financial Services Agency's Progress Report for Enhancing Asset Management Business, points out the problem of double-check calculation to calculate net asset values of investment trusts, and this is a negative factor for the performance of T-STAR. However, processing fees will turn positive if asset management picks up as a result of the new NISA scheme. For industrial IT solutions, new client development is a key topic in the Medium-Term Management Plan. NRI is making proposals to clients who appreciate the quality of our information systems, and to new clients who are primarily infrastructure-related companies in terms of industry type. Over the next few years, we expect that we can achieve sufficient growth by handling projects from existing clients.

#### **Fourth inquirer (analyst)**

Q1: At this current point in time, what impact are ChatGPT initiatives having on your organizational systems, sales, and balance sheet?

A1: In consulting, we already have around 1 billion yen in orders. These are relatively simple projects, but they have already grown to this scale in a matter of months and are already producing profits in consulting. For projects to build and utilize dedicated in-house large language models (LLMs), the accuracy of output by the generator cannot increase without increasing the performance of the search engine. For example, 90% accuracy is insufficient when used in call centers of financial institutions with high requirements for quality. With our current technology, we are challenged to figure out how to make the quality improvement for that last 10% to reach 100%. We are conducting many different proofs of concept (PoCs), but it will take some time before any of these are incorporated into actual systems. For high-difficulty projects, we anticipate the monetary amounts will grow one digit larger. It might be next year or the year after, but we believe that high-difficulty projects are within range. We also need to begin preparing now for projects to build and utilize new architecture. Since generative AI is a field that is evolving with each passing day, we cannot really determine what level of performance goals to set. We will not likely be able to predict how large the business will grow, and when, until the technology is a little more mature. At some point, implementations will also probably happen all at once for in-house manufacturing use, but we cannot yet predict exactly when that will be.

Q2: Although your plan for research and development expenses is not changing, you mentioned that you might also create your own engine for generative AI. Around how much would you invest?

A2: We would probably invest in the single-digit billions of yen. In a corner of our new data center, we are purchasing GPUs and making preparations to create our own LLMs. Single-digit billions of yen will likely be enough for the hardware investments. Also, Oracle has a field of specialization, where various forms of data can be handled in closed networks without going through the internet. Since financial institutions tend to feel averse toward their in-house data being handled on the internet, we are making preparations for use of LLMs in closed space owned by NRI. Including consultants, we have several hundred employees who specialize in AI. Counting our business partners, we have around 9,000 people on board who are familiar with ChatGPT. Many have experienced how they can use generative AI in their daily work.

Q3: This question is about your business performance next year. How certain are you that you can engineer a recovery overseas? Do you have a plan for structural reforms?

Domestically, demand will probably remain robust, but do you feel any uncertainty about corporate clients' earnings?

A3: That would be hard to say since we are still formulating our plan for next year, but we have disclosed targets for 2025 in the Medium-Term Plan. Overseas, we envision 150 billion yen in revenue, and a profit margin in the high single digits. However, that much of a recovery might not be realistic based on the current situation. The issue will be how much we can compensate domestically for the profit we cannot achieve overseas. If our current domestic momentum continues, we will be sufficiently able to compensate for the slump overseas. For that reason, we do not consider it necessary to change the numbers in the Medium-Term Plan. The same applies to our targets for fiscal 2024. We do not anticipate that the slump in overseas earnings will have any major impact on our plan for the company as a whole.

#### **Fifth inquirer (analyst)**

Q1: Your operating margins domestically and in financial IT improved significantly in the second quarter. What were the factors behind that?

A1: Our capacity utilization is increasing overall. We are engaged in measures to scale down the bloated source code in STAR and reduce maintenance costs. We refer to this as "decluttering" in production innovations, which is the main theme of our Medium-Term Plan. Currently, we are using different platforms for STAR and T-STAR, but we are proceeding with efforts to unify these platforms. Once that happens, we will be able to use our development resources more efficiently. These efforts are making big progress this year, and we should see the results next year and the year after. In the second quarter of this year, usage fees increased as financial markets were brisk, and we also improved our capacity utilization in projects for banking, leading to an increase in profit margin.

Q2: What is your thinking about a successor? You have now been serving for longer than previous CEOs. Is it time to think about passing on the mantle?

A2: We have an arbitrary Nomination Committee for appointment and removal of the CEO, and they have been engaged in ongoing discussions for the past few years. According to research findings analyzed by NRI consultants based on many years' worth of data, we found that in many cases it becomes more difficult to groom a successor when one good CEO serves for a long period of time, which ends up harming the company's value roughly two CEOs down the line. I also feel the need to carefully determine the

right time to pass the baton to the next generation. One characteristic of NRI's succession plan is the approach we call "next cabinet member." As opposed to just succeeding the CEO, this is an approach for changing out each "cabinet member" (member of management). Since around last year, a new generation has been emerging among our officer class. If the time were to come for us to replace the CEO, we would choose a leader from among the new cabinet members through this mechanism. It is not a matter of whether or not I will be replaced, but rather that we have made succession preparations for the next generation of management. After that, we discuss with members of the Nomination Committee and hear various opinions from them about when the successions should take place while passing resolutions in the Board of Directors.

Q3: The stock market has had strong confidence in NRI's strategies and business execution since you assumed the role of CEO. The market is watching over the change of CEO with great interest.

A3: We have a system prepared for replacing each cabinet member. Please be reassured that this is not reliant solely on the individual capabilities of the CEO.

### **Sixth inquirer (analyst)**

Q1: Your domestic and IT platform services orders increased at a high rate in the second quarter. Could you break down the factors and give any clues as to how that will proceed going forward? I would imagine your security business is a strength, but have you also been effective in passing on cost increases from data centers? And for how long do you think these circumstances will continue?

A1: The majority of the order increase in IT platform services has been in information security. In addition to conventional orders, we have also established a lineup of services for generative AI, and orders are increasing. Demand will remain strong for a while. On the other hand, since the situation with insufficient supply to meet demand will continue, we are in the process of bolstering our supply capacity by assigning employees from financial IT solutions to NRI SecureTechnologies (NRI Secure) and taking other similar actions starting this year. As opposed to only being able to handle information security-related business within NRI Secure, this will enable the solutions teams at the main body of NRI to get involved.

Q2: Do you have a strong forecast because you have valuable clients in industrial IT solutions? Or are circumstances favorable because you have broadened your client base to include more smaller-scale clients?

A2: Since NRI also has higher costs compared to other companies, we work with clients who highly appreciate the quality of our information systems. This is the same now as it was in the past. One example is clients such as convenience stores, who operate 24 hours a day 365 days a year, and who would significantly impact society if their operations were to stop. These clients invest more than others in information systems. Recently, we created a joint venture with KDDI to offer systems that handle payments. Payments by mobile phone are also a part of social infrastructure that would cause major problems if shut down, so the level of investment is considerable. I think the approach to focus on clients who have extremely high recognition for the value of IT investment is the reason for our robust orders.