

(April 25, 2024, Tokyo)

Nomura Research Institute, Ltd.
FY March 2024 Financial Results
Briefings Q&A Session

First inquirer (Analyst)

Q1: In the fourth quarter of FY March 2024, you had a loss in valuation of software assets in industrial IT. Is that the reason why profit margin in industrial IT declined during the same quarter?

A1: As you pointed out, profit declined year-on-year in industrial IT as a result of expenses that arose due to the approximately 1 billion yen revaluation we conducted on software assets that were produced in-house.

Q2: What exactly are your industrial IT software assets? Could you give some examples?

A2: Digital IP is one of the larger assets. These are algorithms and logic from software, broken down into components. They improve productivity by applying them in various types of projects. Some of them have produced effects, while others have been misfires with narrow applicable scope.

Q3: You had explained that overseas business accounts for 40% or around 4 to 5 billion yen of the 11.5 billion yen year-on-year profit increase in your forecast for FY March 2025. What kind of factors are attributable to this increase in profitability? Also, what are the drivers of your business performance domestically? Will the revenue increase in industrial IT in the second half mainly be overseas? Will financial IT drive business domestically this year? I recall that last year the telecom industry drove industrial IT, and the year before that it was logistics, but what will drive industrial IT this year?

A3: The factors behind increasing profit are improved profitability both at Core BTS and in Australia. Core BTS had produced a loss in FY March 2024, but we hope to bring it back to breaking even in FY March 2025. That is the largest factor. Due to the reversion from the earn-out expenses that occurred the previous year in Australia, we plan to bring operating margin (after depreciation) there back to somewhere near 5%. That is the second-largest factor. Domestically, we plan to increase revenue across all segments, and we will grow industrial IT even more robustly than financial IT. Industrial IT also has a relatively higher contribution to operating profit.

Q4: You explained that overseas revenue in industrial IT will rebound in the second half of FY March 2025. Is my understanding correct that much of the revenue increase in the industrial IT segment will come from overseas business in the second half? Will domestic industrial IT be a growth driver this year?

A4: We plan to grow our domestic industrial IT this year. The contribution from overseas is larger in the second half than in the first, but domestically (in industrial IT) there is no significant deviation between the level of increased revenue in the first and second halves.

Q5: You have announced a treasury stock acquisition, and your shareholder returns and improved capital efficiency have made a strong impression. What is your policy for investment and finance going forward? Is it a policy to leverage more debt for investment, or is it more cautious? People have various opinions regarding overseas investment, particularly about the United States. Personally, I think investing actively is fine, but as management you should probably be more committed to operations. Around how much will you invest overseas, and in what?

A5: We had explained that we will not conduct any large M&A through the duration of Medium-Term Plan 2025, and there is no change to that policy. Last week I traveled to the US to see the latest situation for myself and the market environment there is not good, so it appears that recovery will still take more time. At the same time, the fact also remains that there are no good targets with high multiples. For the time being, turning around business performance at Core BTS is the highest priority. We intend to raise our commitment level from the Tokyo side while exercising thorough management. For shareholder returns, we will also continue making our utmost effort.

Second inquirer (Analyst)

Q1: Regarding your domestic profitability, your operating margin in the fourth quarter of FY March 2024 seems to have decreased year-on-year, even with the reversion from the 1 billion yen software revaluation. While there may be quarterly fluctuations, if 60% of the profit increase in FY March 2025 is domestic, your operating margin would remain flat year-on-year. Are you expecting your margin to stop improving or to worsen? Please share the details.

A1: We recorded around 1 billion yen in office reorganization expenses in the fourth quarter of FY March 2024, which we allocated proportionally to each segment. Data center-related expenses also arose in IT platforms. Profit margin declined due to this

combination of factors. Domestically, our industrial IT is around half the scale of our financial IT, so the profitability improvement in industrial IT in FY March 2025 might appear lackluster.

Q2: Although profitability will recover in industrial IT which has a relatively lower margin than financial IT, are you expecting profit margin to remain flat because of a worsening mix?

A2: As opposed to the mix worsening, we see it as a difference in scale. If profit margin grows by the same one percentage point (from both financial IT & industrial IT), industrial IT with its smaller size will have less impact.

Q3: Will your overall improvements in domestic profitability level off for the time being?

A3: That is our plan for FY March 2025.

Q4: Overseas, you are forecasting a profit increase of 4.5 to 4.6 billion yen in FY March 2025, but how does that balance out between the first and second halves? Profit increased overseas in the fourth quarter of FY March 2024, but it seems that declining profit actually continued when excluding factors such as reversion from loss on the sale of subsidiaries. Circumstances are quite harsh for your revenue in North America. Is your perspective that profit will actually continue to decrease in the first half of FY March 2025, then make up for that in the second half? Your PPA depreciation and amortization expenses have likely decreased, but what is your balance between year-on-year profit and loss in the first and second halves?

A4: On a real basis excluding the effects of temporary expenses, we are planning for recovery in our overseas P&L in both the first and second halves of FY March 2025. The first half represents cost improvements achieved through structural reforms implemented in FY March 2024. We cannot call it a powerful recovery. In the second half, we are forecasting top-line recovery in addition to ongoing effects of structural reforms, which will likely be a more robust recovery than in the first half.

Q5: Did the structural reforms you implemented in FY March 2024 reduce fixed costs by reorganizing personnel in North America?

A5: Mainly in North America, but we also implemented these reforms in Australia.

Q6: This question is about generative AI. I understand that you are still in the trial phases of utilizing it in-house, such as for testing processes, and that it is not factored into your performance forecast for FY March 2025. Around what level of benefits such as

productivity improvements do you anticipate in FY March 2026? For example, what is your quantitative vision such as gross margin improvement, and what is the medium-term timeline of the impact of your in-house usage?

A6: Since we are working on efforts such as streamlining superfluous business operations while using AI at the same time, it would be difficult to pick out what AI usage will achieve and express that quantitatively. In areas where AI is deployed on an individual basis, if we achieve an 85% profitability improvement for a specific process among testing processes, which comprise a portion of the program as a whole (such as 20%), we would only improve part of the whole. We are improving productivity with certainty through an accumulation of multiple efforts, but we need to make AI applicable to more projects to reach the hundreds of millions of yen. It might be difficult to see how individually-applied AI usage has improved our gross margin over these past few years. I think you will start to see the effects when our daily production innovation efforts come together with AI usage. At the same time, I think we can expect significant impact from the area of company-wide implementation. We plan to work on this in projects scheduled for FY 2025-2026, and we expect effects from these.

Third inquirer (Analyst)

Q1: This question is about your business performance in North America. Your revenue in North America fell 25% year-on-year in the fourth quarter of FY March 2024, a significant drop. What happened? How does the forecast look for the first half of FY March 2025? And how large was the loss in FY March 2024?

A1: There were no special negative factors in the fourth quarter of FY March 2024 that were not previously explained, and we are not expecting any major improvement to this level in the first half of FY March 2025. Since orders that had accumulated in the network business were recorded as sales in the second and third quarters of FY March 2024, sales decreased when looking at the numbers through four quarters, while restraint on investments by large clients was also a negative factor. Looking at the year as a whole, the loss at Core BTS was roughly 3.5 billion yen including temporary expenses, but that did not fall short of our expectation at the time of the third quarter financial results announcement.

Q2: Are you projecting a double-digit revenue decline to continue into the first half of FY March 2025, followed by a significant recovery in the second half? Your revenue in North America in the second quarter of last year was around 9.9 billion yen. Wouldn't that be

quite difficult if the level of around 7 billion yen in the most recent quarter were to continue?

A2: The second quarter is as you mentioned, but we do not expect that much of a drop in the first quarter.

Q3: Even if revenues slump, will improvement in terms of P&L continue due to structural reforms?

A3: That is correct.

Q4: What will drive improvements in revenue in the second half of FY March 2025?

A4: I will explain this separately for the network and cloud businesses. Order backlog that had accumulated in the network business was recorded as sales up until the third quarter of last year, and the situation returned to normal in the fourth quarter. Network devices have an update cycle, and this performance represents that cycle. While special demand also arises, stable growth is expected in this business from a medium- to long-term perspective. On the other hand, we are working on various measures in the cloud business, and we are engaging in project introductions and joint sales together with vendors. Forecasters are expressing that they expect the external business environment to improve starting in the second half of FY March 2025. We formulated this plan factoring in expectations for top-line growth according to improvements in demand.

Q5: This question is about generative AI. From what you have announced in this presentation, there is no doubt that you offer top quality among Japan's IT services. NRI's competitors in Japan are most likely foreign-owned firms that are active in Japan such as Accenture. Will investments of around 10 billion yen be sufficient? In generative AI, models such as OpenAI's ChatGPT and Google's Gemini are available. What is your approach for choosing these platforms?

A5: Since there are optimal platforms for clients' needs, business operations, and systems, we want to choose from a neutral position while working closely with various platform providers. As shown on p. 24 of the financial results presentation materials, we are also establishing peripheral solutions including information security, operations, and environments. In the previous financial results briefing we explained that we are installing GPUs in our data centers and establishing environments for operating private LLMs. Our strength is that we can offer all-inclusive services incorporating peripheral solutions, which includes providing safe, secure environments with strengthened information security to clients.

We will need to see the results to know whether 10 billion yen is an appropriate scope of investment. However, we intend to turn 10 billion yen of investments into business by considering overall balance of personnel and other resources according to clients' needs while researching the latest trends in technology.

Q6: Around how much of your 10 billion yen in AI-related investments correlates with expenses? And roughly how much of this year's P&L is related to AI projects?

A6: Including expenses such as labor costs, roughly two-thirds correlate with expenses. Roughly one-third is investments in software involved with GPUs, peripheral equipment, and production innovation. We do not think it will have a major impact on this year's P&L.

Q7: Can we thus expect revenue corresponding with the expenses that arise?

A7: That is correct.

Fourth inquirer (Analyst)

Q1: You explained that orders arose at uneven timing in consulting. Can we consider the amount of change in order volume on p.49 of the financial results presentation materials to be the numbers corresponding to uneven timing? And can we also assume that this will be recorded in the first quarter of FY March 2025?

A1: That is correct. There are projects for public institutions that we also expect to receive orders for this year as we did last year. The orders were received around March one year ago, but this year we plan to receive the orders in the first quarter. While I cannot accurately state the size of the projects, they are enough to turn the decrease from last year (3.8 billion yen) positive.

Fifth inquirer (Analyst)

Q1; You had mentioned that you plan to increase acquisitions of new large clients for V2030. At the business briefing in March 2024 you defined your policy to scale up smaller-scale clients in domestic industrial IT. Is that the same as what you are saying today? Or are you engaging in activities to acquire new clients?

A1: In a larger sense, these mean the same thing. When we refer to "new clients," that does not necessarily mean we have no existing business with them. In a broader sense, it also includes those with whom we have consulting business, or even those with whom we have begun small-scale business in solutions. Over these past few years, we are

starting to see results from efforts to further scale up certain sizes of clients. Even as these efforts continue, we will channel resources with a focus on the area of new client acquisitions while working in lockstep between the consulting and solutions segments.

Q2: You provided a specific explanation about approaching transformation leaders and similar efforts, but do you have a large pipeline?

A2: We have already begun doing business with a number of clients. It is not something that is completely behind the scenes.

Q3: European and North American hyperscalers are bolstering their investments in data centers in Japan. How should we view the impact that has on NRI?

A3: We have a close relationship with Oracle. The fact that they are investing big in Japan is not at all bad for NRI. In terms of meeting the demands of clients who want to use public cloud and those who want to use Oracle Cloud Infrastructure (OCI), it is a good thing that eyes are turning to Japan. We are optimistic that we can do more together with them going forward.

Q4: As opposed to competing, is it more like finding ways to be differentiated, while working together in infrastructure?

A4: That is correct.