(Tokyo – 26th May, 2023)

Nomura Research Institute, Ltd.

Q＆A from Small Meeting for Institutional Investors

Part 1

(Questioner No.1)

Q1: Generative AI has become a topic of conversation. You explained its usage in development processes at the financial results briefing. What is your perspective on aspects such as business opportunities utilizing AI, the potential for it to replace the work of engineers, and its impact on your business partners?

A1: Transformers emerged in 2017, and ChatGPT has been capturing attention more recently, but it is still a technology that is under development. It will not have any major impact within the three-year span of our Medium-Term Management Plan. As for using ChatGPT in programming, it is currently difficult to put together complex operations in systems. We have requests to develop "entry point" services such as search engines within contact points with clients and the interactions in initial contact made with clients. These are currently in the proof of concept (PoC) stage and we are exploring the possibilities. For example, we are working on experiments using ChatGPT in the online websites of travel agencies. The certainty and accuracy of the responses provided by ChatGPT must still be verified, so this will probably take some time before it reflects in our earnings.

(Questioner No.2)

Q1: This question is about the productivity improvements that were explained in your Medium-Term Management Plan. What is the difference compared to past productivity improvements, and what about them is different? Low-code and no-code have been around since before. If there are any additional effects, please share them. Also, what is the impact on your subcontract expenses?

A1: We aim for the effects of productivity improvements to contribute around one-fourth (approximately 10 billion yen) of the profit increase in the Medium-Term Management Plan. In addition to AI usage, we are also working to modernize our existing IT resources, and on shrinking maintenance costs by "decluttering" vast amounts of source code - which is to say, reducing development volume. We are using Oracle APEX (Application

Express) at NRI, but it has not yet reached the point of generating any major effects at this point in time. As for establishing development processes that utilize AI (on p.19 of the Medium-Term Management Plan explanatory materials), we have completed Step 1 and the productivity improvement effects are likely to materialize in the next Medium-Term Management Plan.

Q2: Will your subcontract expenses not be decreasing in the current Medium-Term Management Plan?

A2: They will decrease after we achieve deployment of AI in Step 3.

(Questioner No.3)

Q1: You explained that your use of ChatGPT is limited in business development to clients, but Microsoft is making efforts to conduct in-house training on ChatGPT and get their clients to use it. Consultations for AI usage are increasing at North American and European IT consulting companies. Is there a difference in the level of enthusiasm toward AI in Japan and elsewhere?

A1: For financial institutions, we have consultations for using AI in company-specialized local databases, as opposed to open AI. We expect consultations such as these to continue going forward. However, work will be needed to verify the accuracy of ChatGPT's responses. It will take time until ChatGPT can be used in mission-critical operations. We have large numbers of inquiries such as the aforementioned example of travel agencies, but they are still in the PoC stage. We will conduct many trials on the utilization of AI in the current Medium-Term Management Plan. Although we do receive consulting fees, this will not make a significant contribution to profitability until much later. Evolution is happening quickly, so the situation could change next year or the year after.

(Questioner No.4)

Q1: You are planning to invest around 20 billion yen in productivity improvements during the Medium-Term Management Plan, but how much did you invest over the past three years?

A1: The figure of approximately 20 billion yen (not limited to capital expenditures) also includes labor costs. Every year, we are constantly holding meetings on production innovation and engaging in productivity improvement activities that involve our business partners, and these comprise a significant portion of those numbers. We are also investing resources in reducing the volume of development for financial ASPs (Application Service Providers). An apples-to-apples comparison of the past three years is not really possible, but the level of investment has increased by around 30%.

Q2: The reduced development volume for financial ASP has likely been recorded in assets, but will it apply to the P&L statement or balance sheet?

A2: This will likely be applied to P&L without much of a change from the past.

Q3: In your core areas which are pillars of the growth strategy in the Medium-Term Management Plan, you show the amounts of revenue increases by segment, but are there differences in risk and difficulty level between the segments? Which segment has higher potential?

A3: In the three years of the Medium-Term Management Plan we do not anticipate any major problems arising in financial IT, but we were severely impacted when financial crises occurred in the past and that risk will not go away. Demand is robust in industrial IT. That is also the case in consulting and IT platform services. While we cannot easily predict what will happen in three years, there are not many destabilizing factors domestically. As for our business overseas, there is a strong possibility of an economic recession this year in both Australia and North America. Last year there were internal problems at our subsidiaries and they underwent restructuring and organizational overhauls. We do not foresee any major improvements from July to September this year, so the improvements should happen from the second half onward. Overseas, we are not forecasting any large revenue increases in our plans.

Q4: It seems that subcontract expenses increased and capacity utilization declined since projects for the public sector increased in the consulting segment in FY March 2023. What do you think the balance between private and public sector will be going forward?

A4: Budgetary measures are also being taken this year, and public sector business is strong in the consulting segment. Last year our resources were weighted toward public sector projects. Since we were late to address that, we are focusing attention on our allocation of resources this year. Next year and the year after may still be unclear, but Japan's current administration is taking a proactive stance toward government spending, so public sector business will likely be strong. NRI received a large GX-related order. GX is a topic that will continue through 2026, and demand is likely to remain robust.

Q5: Hopefully, the profitability of public sector projects will improve. I have heard that other companies have earned high margins with public sector projects that are heavily funded, including reserve funds. Is the same possible for NRI?

A5: The prices of our proposals are higher in the private sector, but the volatility is also higher. We can get contracts with broad commitments for lengths of a year in the public sector, but not earning the same profit margin as in the private sector. We will carefully monitor our mix of these and secure an operating margin of around 30%. Although I am uncertain about reserve funds, it seems unlikely that we could earn the same profit margins as in the private sector.

Q6: Was last year a bottoming-out for your operating margin in consulting, and are you aiming for FY March 2022 levels this year?

A6: That is correct.

(Questioner No.5)

Q1: Regarding Core BTS, what is their progress in cloud-readiness? Layoffs are increasing at other companies in their industry. Does that mean the hiring climate could turn more favorable? My question is more about whether the environment will be more conducive to hiring high-level talent than about hiring people who have been laid off. Also, will there be a recovery in procurement of Cisco devices in the second half? In the financial results reported by Nvidia, it was commented that demand for network devices seems likely to increase. Could that be an indicator that favorable conditions are ahead?

A1: Of course it is important to devote effort to hiring, but we are currently monitoring trends in demand. We are also hearing that decisions on projects that seem ready to be green-lighted are being postponed. There is an emerging trend of controlling IT costs, such as cases where unofficial per-year contract amounts have been set, but when placing the order the contracts get broken down into segments. Rather than hiring people who have become available in the labor market, we are currently focused on sales to our immediate clients. However, the period from April to June will be the harshest. We have also received guidance from Cisco that procurement of network devices will pick back up from July to September. GPUs, for which demand is expected to increase, are for AI servers. Since Core BTS is targeting one network layer below that, it will be a favorable environment if data center demand arises going forward.

(Questioner No.6)

Q1: If needs for the use of AI increase, does NRI have the human resources to capture that demand? Will you need to assemble more human resources?

A1: We have the human resources. Our young engineers are working on various things, and the situation now is that they need knowledge sharing to consolidate and organize what they are working on. We may also need someone in a position of command such as a chief AI officer.

Q2: If new needs emerge, will NRI leverage its advantage of having high-level human resources?

A2: (To leverage our advantage) We will need to work on the issue of knowledge sharing to organize what our young high-level engineers are working on.

Q3: What in the Medium-Term Management Plan are you most insistent on? What absolutely must get done?

A3: What we are all most concerned about is our business overseas. The earnings of our current overseas subsidiaries will take a hit if the market environment worsens. We need to have the maneuverability to not only understand what is happening on-location overseas, but to also regroup together with them if anything happens. This essentially means making efforts to avert downturns, or in broader terms, governance. Hopefully we can get to the point of securing tangible results from these efforts this fiscal year. Next is growth in financial IT. Profit growth in financial IT is strong, but our client financial institutions are struggling in terms of earnings. In addition to providing high-quality support for finance operations, we also want to engage in activities that deliver top-line growth. We have 60 to 70 specialists in the Financial Technology Solution Division, and we want to work together with clients to create new services that utilize IT. In industrial IT, where demand is robust, we have worked on some areas where productivity had been lagging compared to financial IT. We are working on digital IP (breaking down components) since there are no ASPs in industrial IT, but this is also a major challenge. Since there is demand, we recognize productivity improvement as an issue to address.

Q4: My understanding is that overseas, you will consider a case if a good one comes along, but your thinking does not start with M&A. Is that correct?

A4: There could be small- to medium-scale M&A since we lack some services and functions, but we do not anticipate any large-scale M&A during the three years of the Medium-Term Management Plan.

Q5: What effects have there been from the governance of your outside directors? You fell short of your performance forecast for FY March 2023, and you are in a tough position relative to other companies in your industry.

A5: In FY March 2023, our domestic business performed according to forecast, but our overseas business had unexpected developments. Three of our outside directors are managers of leading global companies, and they reported on and discussed the state of business overseas, monitoring of the moves that were made, and PDCA management. In doing so, they have given us advice. One example was that we should allocate more resources to taking control of the companies we have acquired.

Q6: Have you implemented governance and monitoring based on this advice?

A6: Based on discussions in the Board of Directors, we expanded the structure of our global headquarters organization starting in April 2023.

(Questioner No.7)

Q1: Your overseas operating profit fell to 3.3 billion yen in FY March 2023. What is your expectation for this year and the year after?

A1: We have not disclosed a forecast for overseas operating profit, but we would quickly like to get back to FY March 2022 levels. Our expectation is for overseas business to contribute roughly half of the 5.1 billion yen profit increase in our forecast for FY March 2024.

Q2: You made structural reforms in Australia. Could you provide some details about the road to recovery there? Will there be any additional structural reforms?

A2: Structural reforms at AUSIEX in Australia were completed in the first half of FY March 2023. Currently, they are switching to I-STAR for the engine part of the core systems. It will take about another year to complete, but this will expand our lineup of services. We have also slimmed down the organizational structure compared to the previous year, and a recovery in performance for AUSIEX seems likely this year. However, they are amortizing intangible assets for a period of roughly five years after acquisition, and we still expect operating profit there to be negative this year after amortization. On the other hand, Planit is performing smoothly. Contracted testing operations are labor-intensive, and rising labor costs were having an impact. They are passing on rising labor costs in their prices, and although their profits were impacted by hiring not proceeding as expected, they still anticipate a return to FY March 2022 levels this year. NRI Australia (previously called ASG) is also performing smoothly. Australia's government also changed, and projects for government slumped. Projects for government account for around 30% of sales (for our Australia business overall). Business with the private sector might not grow much due to an economic slowdown there, but we expect higher profits there this year compared to last year. For Australia overall, we are aiming for higher profit levels than last year.

Q3: Is Core BTS's M&A oriented toward regional expansion?

A3: Core BTS has an organizational structure in place for deliveries but their sales organization was weak, so we reinforced their sales organization last year. If the sales organization functions, they should be able to expand the lineup they deliver in the areas of upstream consulting and cybersecurity this year. For this, we anticipate small-scale M&A. Regional expansion is another consideration, but this has become a relatively lower priority since the target companies have high valuations.

(Questioner No.8)

Q1: Core BTS overhauled both its management and sales organizations. Your explanation expressed confidence in a recovery going forward, but the results will not appear right away after bringing in new people. How were you able to feel confident about this?

A1: Employees who changed jobs from competitor companies to Core BTS are unable to access the clients of their previous companies during the period between April and June. Because of this downtime, we expect effects to begin appearing from July to September. At the time of the financial results briefing, we traveled to the US in April and directly discussed with key people at Core BTS. Based on the results of these discussions, we expressed our feeling that we have considerable reason to be optimistic. We will see the outcome in business performance from summer onward.

Q2: At approximately 8 billion yen, profitability improvements overseas account for one-fourth of your overall operating profit growth. Half of that could be explained by restructuring and other organizational changes. It would seem there is more growth potential than that. Is it a harsh or challenging situation?

A2: Overseas, we anticipate a profit increase of around 8 to 9 billion yen. Decreased amortization of intangible assets and the sale of loss-producing Brierley+Partners are also positive factors. This forecast factors in hardly any real growth, so it can be considered conservative.

Q3: You have increased your hiring. What response has there been from increasing your hiring headcount, including mid-career hires? Will you increase mid-career hiring going forward?

A3: We can likely increase our mid-career hiring even more. In our mid-career hiring, we are carefully selecting people with business knowledge and experience that proper-hire new graduate employees do not possess. In other words, we are narrowing our focus to those with a high likelihood of being immediate contributors.

(Questioner No.9)

Q1: In what way do you utilize domestic M&A? If you combine dividends with the treasury share buyback in response to the sell-off by a major shareholder, you had approximately 400 billion yen in shareholder returns in the previous Medium-Term Management Plan. NRI is positioned in a growth industry, but are you lacking sufficient investments in growth?

A1: That likely depends on what business model NRI aims for. Rather than competing in terms of scale, our policy is to beat the competition with the high added-value we can offer. We would like to consider M&A of companies whose policies are consistent with this, but like-minded companies are hard to find. Last year, we acquired an approximately 20% stake in Cube System Inc. NRI's added value on a non-consolidated basis increases by transferring a portion of NRI's operations to them and focusing on operations where our added value is higher. Capital and business alliances such as this are possible. We can likely produce synergy effects if we join forces with systems integrators with around 300-400 billion yen in sales whose clients do not overlap with ours. However, those companies have large shareholders, which makes M&A unrealistic.

Q2: Some people might complain about shareholder returns in cases like Core BTS where results do not come right away, but I hope that you continue making growth investments.

A2: Thank you very much.

(Questioner No.10)

Q1: The financial policy and financial discipline of this Medium-Term Management Plan appear to factor in the accommodation of supply and demand risk such as what happened last year (in the stock market), with a certain level of consideration for your corporate bond rating. Is that accurate?

A1: We do not want to take on supply and demand risk. S&P has also given us a single-A rating, and although we do not want this rating to fall, we have factored in a modest level of risk in terms of financial discipline.