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Nomura Research Institute, Ltd.
Q&A from Small Meeting
for Domestic Institutional Investors
Part 1

Speakers: · Kaga Yanagisawa
President & CEO
· Hidenori Anzai
Senior Executive Managing Director
Member of the Board, Representative Director
· Masaaki Yamazaki
Senior Corporate Managing Director

(Questioner No. 1)

Q1: Ms. Yanagisawa, I understand that you were involved as a core member in the formulation of the Medium-Term Plan and that the fundamental policy will not change, but are there any areas that you personally want to change or emphasize from your position as president?

A1: I was also involved as part of the team that formulated the long-term management vision for 2030 and Medium-Term Management Plan for 2025, so there will not be any big changes to management policy. However, generative AI is one change that happened, something that was not around when we were considering these. Since the second half of 2023 we have been considering how to use AI technologies released after the Medium-Term Plan was formulated, and also the related strategies. We positioned the first two years of the Medium-Term Plan as preparation years, but we are considering whether another layer of preparations should be made leading up to 2030. Eventually, I expect we will be able to tell you about these.

(Questioner No. 2)

Q1: From a global perspective and in the context of Japan's IT sector, what is NRI's standing and how much knowledge difference is there in terms of knowledge in AI? And how

much do you consider that difference to be a threat? Do you have the brand power to compensate for that difference with M&A and by bringing in overseas personnel? Please describe NRI's strengths and the differences with the rest of the world in AI.

A1: AI has had lots of momentum since around last summer. Including management, we have been travelling out to the West Coast of North America where the information originates to gather information and exchange views ourselves. My analysis of the results is that the gap between them and us seems large. Research and investments are also happening in Japan, but the West Coast of North America changes significantly every few months. For example, technologies to circumvent the struggles involved in LLM fine-tuning arise in a matter of months. It seems that we are constantly having to catch up. We are not considering hiring overseas personnel at our Japan headquarters at this point in time. Since this spring, we have assigned around 10 knowledgeable people to our base on the West Coast, NRI Pacific. These people have in-depth knowledge of technology plus capability at linking technology with business. They are working to get into inner circles and gain access to information on technology. We have also signed an advisory services agreement with professors at tech-savvy Stanford University, who give us advice on a need basis. With clients, we had nearly 100 projects in progress in the second half of last fiscal year. Our AI for finance business platforms is in the process of trial and error but has not yet reached the point of a go-live. In both financial and industrial IT, we are carrying out technology initiatives while engaging in interactions with clients. Production innovation is something that will impact the bottom line. This is an initiative to use generative AI for improving productivity in the system development process. Effects were also seen from this last year. This year, we are planning an even larger-scale effort.

(Questioner No. 3)

Q1: My understanding is that your earnings improvements in the US are somewhat lagging due to the bad business environment. What kind of measures will you take if you fall even further behind? It seems to be weighing on your stock valuation without showing any signs of bottoming out.

A1: I will discuss Australia and the US separately. Economic sentiment is poor and demand is slumping in both. In Australia, we have conducted M&A repeatedly since 2016 and generally put in place the necessary capabilities. Since we had an operating margin of around 10% pre-COVID, we believe that we have the capabilities to be able to earn an operating margin in the double digits. We reduced workforce in line with shrinking

demand to protect the bottom line, and we believe that our business slump in Australia has bottomed out. It will probably not get any worse, as long as there are no more major changes in the external environment. Government agencies and financial institutions comprise a large proportion of our business in Australia, and I think the risk of relying on them has now become apparent. For that reason, we are also engaging in sales that intensively increase client demographics that fall under the category of industrial IT in Japan. In the US, economic sentiment is the same as in Australia, but one difference is that we have held off on additional M&A to build up capabilities because demand slumped immediately after we acquired Core BTS in 2021. We made a loss there last fiscal year, but looking at the changes in monthly order backlog, we believe there was a bottoming-out in December 2023. Having also made some structural reforms including layoffs, the situation has been gradually improving since January 2024. It will not likely get any worse, and we are working to bolster sales. Specifically, we are jointly organizing seminars and events with Microsoft, and they are supplying us with leads. The leads are increasing, and clients have had positive responses to those that have turned into projects, so it feels like we are earning Microsoft's trust. Initially, the plan was also to cross-sell cloud business to clients in the network business. Personnel who were accustomed to product sales were not accustomed to consulting sales, but we are shrinking the sales organization while simultaneously increasing the numbers of human resources familiar with consulting sales. Their volume of activity is increasing, but there are problems with contracts being shorter in length and decision-making taking a long time. For the areas where we cannot supplement capabilities through M&A, we also launched collaborations with NRI's organic enterprises (NRI-ITSA, NRI America) in November 2023. Effects are starting to show from these, including two promising leads in consulting introduced to Core BTS by NRI America. We are testing whether we can modify our capabilities in both consulting and solutions development to accommodate the North American style.

Q2: Can we be confident that Core BTS can fully protect its bottom line? I hope they fully achieve the plan.

A2: We believe they can hold firm.

(Questioner No. 4)

Q1: NRI has a strong reputation in the domestic IT industry. Which companies are your benchmarks in business and the stock market?

A1: We have not found any company that makes a perfect benchmark for our business model and capabilities, but we are conscious of Accenture. Their possession of a large-scale BPO base in India differs from us, which makes the comparison difficult. Other differences are that they mainly use packages as opposed to systems integration from scratch, and that NRI has finance business platforms. Domestically, they are often compared at the same coverage level as large system integrators. Although they are conducting research, their consulting function is not as strong as NRI's, among other differences. We are keeping our eyes on various companies here and there while thinking about what we can do to boost our own standing and our presence in the stock market.

Q2: (This is my own personal opinion, but) Although it was great to hear detailed numbers in the financial results presentation, the presentation and appendix seem to be mixed together. The details about topics such as AI were easy to follow and quite interesting. As for the numbers, it would give investors more confidence if your growth trajectory could be depicted a little more illustratively. I think that would get through to a lot more people.

A2: We will take that into consideration.

(Questioner No. 5)

Q1: What is your outlook on what type of conditions must fall into place for you to consider M&A in North America?

A1: The main prerequisite is for Core BTS's business to reach the point of being able to autonomously grow. Another condition is that we get a feel for how the advantage of possessing the two existing capabilities of consulting and solutions actually works there. If those cannot be done, we will be forced to change the plan we had initially considered to grow while making additional acquisitions to Core BTS. In any case, I think the first point we need to focus on is whether the measures we are currently implementing lead to top-line growth once demand returns.

Q2: What is your definition of autonomous growth?

A2: Fundamentally, this means achieving the forecast. They will need to produce an operating margin of at least 5%, or more realistically, 7-8%.

Q3: Will they be more likely to achieve autonomy from next year onward as opposed to this

year?

A3: What we are declaring is that we will not conduct large-scale M&A during the current Medium-Term Plan. Small-scale M&A could be possible, although we do not have any plan. The first thing is to establish the business fundamentals and get them on a growth trajectory.

Q4: What kind of discussions are you having internally about goodwill impairment risk?

A4: We are regularly consulting with accountants and both investigating and verifying forecasts for recovery in business performance. Although we are maintaining a sense of urgency, those types of conversations are not currently arising.

(Questioner No. 6)

Q1: I would like to ask about your investment strategy for when you eventually resume M&A in North America. What capabilities is Core BTS lacking? And what areas will you be targeting in M&A?

A1: Core BTS was originally founded for sales of network devices. Before being acquired by NRI, they had themselves acquired four companies in application development, data analysis, and consulting. However, these capabilities are still insufficient. They cannot reach the status we had originally envisioned without further bolstering their application development and consulting capabilities.

Q2: Are you considering small-scale or large-scale acquisitions for those?

A2: We are constantly discussing what sized companies we can acquire to enable business growth. Smaller companies lack muscle, while management and post-merger integration are a struggle with larger companies. We are researching various companies that meet our envisioned criteria and considering the appropriate size. It is important for us to always have our eyes on the market, and we plan to continue these considerations going forward.

(Questioner No. 7)

Q1: Suspending M&A has increased your free cash flow. How do you plan to use it? Also, what do you feel is your threshold for treasury share buybacks?

A1: For cash allocations, we generally try to allocate one-third to existing business, one-third to new business, and one-third to shareholder returns. Our overseas M&A might

currently be frozen, but we do not have a zero-sum approach that there must be a corresponding increase somewhere else. We comprehensively consider our cash position, stock price level, and ROE of at least 20% in deciding on treasury share buybacks.

Q2: Your capital investments are temporarily larger due to factors such as investment in GPUs. What level of capital investment do you envision in the future, and what do you plan to invest in?

A2: We have been investing more in intangible assets than in fixed assets for a while. Over these past few years, we have been investing more in finance business platforms. We have been working these past few years on projects to migrate platforms such as THE STAR to the cloud while modernizing them. Thus, the amounts that we invest have been increasing. For AI, we are also making capital investments in air conditioning, power connections, and other facilities involved in deploying H100 GPUs at data centers, but not nearly as much as our investments in software.

(Questioner No. 8)

Q1: In previous explanations, NRI has emphasized DX 1.0, 2.0, and 3.0 as growth fields. What should we be looking out for, and what will be the growth drivers in your domestic business going forward? In what fields will you be expanding clientele in order to grow new clients?

A1: There are a number of growth drivers. DX remains a five to 10 year trend. Japan's level of IT investment is insufficient compared to North America. DX is also essential to maintaining service levels in Japan where the working population is decreasing. Investment in DX also triggers investment in core systems. Since new needs arise while investments are being made in core systems, we believe the DX trend will continue for the time being. Additionally, AI is also intertwined in this. Another growth driver is that there are abundant needs in modernizing legacy systems, primarily in finance. We are working on modernization projects with major insurance companies, but other companies are closely watching the trends among the first movers. Currently we are having conversations with clients about the timing of their system upgrades and modernizations. That will be a driver for large projects spanning multiple years.

Our existing business with various companies in Japanese society is now maturing. The trend of transforming business models is gaining momentum, including non-finance companies who enter the financial services business as they expand their business

coverage areas through point usage. The strategy of “client co-creation” explained in the financial results presentation is achieved by working together with clients who are strongly committed to transformation, all the way from consulting to IT solutions. From our perspective, this is also a driver. We think about clients who have strong commitment to transformation and want business models that leverage our strengths such as the complex systems that are our specialty. It may be difficult to explain by industry type, but our self-analysis is that we are well suited to clients who have systems and businesses that are similar in nature to social infrastructure and require a high level of quality. Finance is a prime example, but even in non-finance, we similarly seek out clients with high affinity for our strategy.

(Questioner No. 9)

Q1: You likely aim to raise NRI's stock price during your term as president, but the stock price will not rise simply by proceeding with the Medium-Term Plan. You probably have to do something to make it rise. Even if your overseas business recovers, we could hardly call it good quality business with profit margins of 7 to 10%. Why are you even doing business in the US and Australia at all? Only when there is a change in presidents can you decide on things like changing course on overseas business. It seems to me that your stock price will not rise if there are no changes such as showing that you not only want to maintain ROE but raise it a little each year. What are your thoughts on that?

A1: Your point is taken. Our stock price is undoubtedly being weighed down by our overseas business, despite the fact that it comprises a relatively smaller portion of the whole. When we thought about why we should do business overseas from a long-term perspective, the idea rose out of the desire to avoid the risk of being entirely dependent on one country, Japan, while also building the foundations to enable future growth. Some of our shareholders might not understand, but we believe it will take time to establish our overseas operations. Establishing our business infrastructure in Australia also took around six years. Ups and downs due to economic sentiment come with the territory. On the other hand, we are committed to numerical targets in order to meet our shareholders' expectations, and we are aware of what changes must also be made to those numerical targets, so I would like to take some time to think about what you have pointed out. It seems like what we have in place now will not be enough for what we want to achieve by 2030. We will need to challenge ourselves at another level of possibilities and take on new business models.

Q2: I understand that you need exposure in countries other than Japan such as Australia and the US, and I'm not against it, but you also have the option to sell off the companies you own and restart your acquisitions from scratch. I'm hearing that you will be working hard based on how things have been done to this point. Has management discussed going back to the drawing board and starting over?

A2: There are always options. Since the composition of the management team also changed, we are taking inventory and reflecting on what has happened to this point and reviewing those developments from a neutral standpoint.

(Questioner No.10)

Q1: Have you leveled up your expertise in conducting overseas business, such as how to handle post-merger integration and selecting projects to take on?

A1: We believe that we are at full speed. We are flexibly changing the way management is involved as we observe the situation. Initially, we managed in a way that allowed discretion to be exercised locally, via the board of directors. However, since last year we have been sending people there to manage. Our plan is to send over a few more personnel. As we get a clear view of our capabilities there, we will evaluate accordingly. While it has not always been smooth sailing, we have reflected on our efforts thus far and are putting those reflections to use.

Q2: Have there been any lessons to reflect on from Core BTS aside from the business environment?

A2: It feels like we had room to be more hands-on. Unlike manufacturing, needs and business practices differ by region in IT services. For that reason, we leave things up to the locals to a certain extent, but the issue is to what extent exactly. The level of quality required may not be the same, but we still should have sent personnel over from Japan in development. Sales being locally-led is fine, but Japan should have gotten more involved in the planning from an earlier stage. I think we should have considered proposals to send in people from Japan, comprehended the situation, reworked the strategy, and been able to make things work with the existing capabilities.

Q3: NRI gives the impression of having mostly Japanese board members and senior managing directors. Do you have the option of bringing in local human resources who have experience in IT services?

A3: We are constantly discussing the optimal staff structure. It is not simply a matter of plugging in overseas personnel. I think it is important to see a person's character. We have not ruled it out as an option. Our current outside directors have abundant global experience, and we are moving forward while holding discussions when necessary.

(Questioner No.11)

Q1: What are you emphasizing in management? Stock price is said to be an evaluation of management, but what is your take on that?

A1: All metrics are important, but I prefer to narrow my focus to profit growth. The strength and virtue of our business lies in providing high added-value solutions to our clients. I think it is important that they are satisfied and do business with us even though our prices are higher, and that we hire and develop highly-capable employees. ROE also starts with profit, and we would rather compete on quality than quantity.

Q2: You target an operating margin of 20% or higher in V2030, but if you focus on profit, is there potential for that to get even higher?

A2: Although I cannot mention any specific figures at this time, we would like to focus on raising it. It will be a balance with how much we can allocate to new efforts and new business that also leads to growth from 2030 onward. I want us to raise it as best we can. As for stock price, we do not go through short-term emotion swings over it. If the stock price is higher at the end of my tenure as president, I will take that as a positive evaluation.

Q3: Did Chairman Konomoto hand over any noteworthy matters (changes that have needed to happen but haven't yet) on his way out? Is your overseas business the current priority issue?

A3: Regarding changes, there was nothing specific. He said to do things my own way. In our strategizing to grow overseas business, I remember his comment that he regretted handing over the North American business in its current state.

(Questioner No.12)

Q1: How do you feel about the sense of scale and profitability of generative AI utilization projects that impact the top line?

A1: We have many PoCs that we are figuring out where and how to apply. Their profitability

is in line with normal consulting projects, but each is small in scale individually. When these get to core systems, we enter the phase of remaking the core systems. That is the stage when the scale increases. We expect some of these to move into such a phase within the next year or two.

Q2: You start from consulting, and then move toward systems integration. Is that the idea?

A2: That is correct.