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Nomura Research Institute, Ltd.
Q&A from Small Meeting
for Domestic Institutional Investors
Part 2

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 a change that happened, which 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 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: What do you consider the issues at the time you assumed your role in management, and what is your future vision?

A1: I was in charge of HR for four years before being appointed president. Personnel are critical to our core functions of consulting and IT services. We aim to work in business cycles of hiring highly capable human resources, giving them growth opportunities, through which we provide high added-value services to clients and grow our profits. That will likely lead to higher business value and shareholder returns. No part of that cycle can be removed. It is a positive cycle which we hope to maintain. Business has its ups and downs from one year to the next, but human resources is something that we want to stay consistently committed to.

Q2: Is there anything that you want to change having assumed the role of president, such as hiring methods, training and development methods, or the way services are provided?

A2: When I was in charge of human resources, I made the first change to the human resources system in 20 years. I implemented a system that enables each individual to challenge themselves, and increases their roles according to those challenges. We are also consciously transferring employees between organizations and assigning them to different projects to broaden their experience. Investing in human resources is a point of emphasis.

(Questioner No. 3)

Q1: During the financial results briefing, you mentioned the use of AI in overhauling business platforms. If this is successful, will you define a direction while the Medium-Term Plan is in progress? And is it also expandable? Could it readily be deployed across other departments and regions?

A1: Over the past few years, we have been working on cloud migrations and modernizations for finance business platforms, and making platforms common-use. This year we are accelerating the schedule for some of the system overhaul projects we had planned for next year, and utilizing AI abundantly in the development process. In some cases we have even achieved major effects applying it to small processes, but these only represent a small part of the whole. AI also cannot be applied to everything. However, application to all development processes in finance business platforms will lead to transformation of the development framework. Projects to modernize legacy systems are also currently in progress, but there will still be demand for these over the next 10 years or so, and we will likely be able to heavily utilize AI in some of them. In small-scale development such as for smartphone apps, productivity can be improved by applying tools. However, you cannot produce effects in large-scale systems just by applying tools.

That is where the significance of our efforts lies.

Q2: My understanding is that the significance of establishing locations in North America was to be positioned to absorb advanced technologies that originate in North America into NRI. Is that still the aim?

A2: In addition to the significance you mentioned, the other significance is our awareness of the problem that relying only on Japan with its declining population could hinder our continued growth from a long-term perspective.

In addition to that, I think we also need to import technologies such as AI. Input on topics such as technological trends comes from our base on the West Coast, NRI Pacific. We assigned human resources from worksites to handle practical business and increased our headcount by around 10. They are getting involved in the inner circles of West Coast startups and of Stanford University, and they also provide reports to the Japan side. We also have NRI Pacific structured to work on issues faced in R&D happening in Japan and in client projects. As they do business with both Japan and the US, they are accumulating experience in how new technologies can be applied to business and how business models can be made to fit them, and in how the needs differ between Japan and the US. At Core BTS in particular, we are strengthening our relationship with Microsoft as part of an effort to turn around business performance. Little by little they are receiving project leads from Microsoft and using AI in performing the implementations. We are importing information on efforts such as these while verifying what we learn.

(Questioner No. 4)

Q1: Could you explain the balance between your ROE, M&A, and treasury share buybacks?

A1: We consider an ROE of 20% to be a commitment to our shareholders. As for cash allocation, over the long term we operate under a policy of dedicating one-third to investments in existing business, one-third to new business, and one-third to shareholder returns. This has not been changed. In Australia, we put capabilities in place while acquiring small- to medium-sized companies. We look to proceed the same way in the US. However, the competitive environment has also changed since the pandemic, so we are currently conducting our market research all over again. As for acquisitions, we would like to make the final decision after confirming whether there are any actual targets once business recovers.

Q2: Are you thinking about increasing your domestic investments?

A2: That is probably a highly viable option. As when we invested in Cube System Inc. in 2022, we could potentially invest in establishing good relationships with partners who have talented personnel, with the goal of securing the human resources who can meet our clients' expectations. I understand that industry realignment does not readily occur in Japan's IT services industry since the parent companies are reluctant to let go of their shareholdings. However, since it is not entirely impossible, we are keeping our eyes on the situation as a potential option.

(Questioner No. 5)

Q1: What sort of discussions did you have before making decisions on investments in AI? And what response are you getting now?

A1: AI is a field that has rapidly been generating interest since around the spring of 2023. We also established a task force for it last year. At our worksites, we have a culture of freedom to try new things. Our engineers have also voluntarily conducted research on AI. We emphasize efforts such as these that originate in the workplace while also driving them forward by having the task force share expertise and other knowledge and establish rules including for preventing information leakage. We had many discussions among management while observing the situation last year, and in addition to overall information sharing and consolidating resources, we also updated the task force while deciding on the frameworks for AI utilization as explained during the financial results presentation. We also assigned a corporate officer in charge of AI and are revising our strategies as needed while observing changing technology trends, client needs, and the results of our productivity improvements.

We are still at the stage of information gathering and consulting, which includes figuring out where our clients use AI, the advantages and disadvantages, and the points of concern. The current situation is located on the left side of Phase 2 (p. 25 of the financial results briefing materials for FY March 2024), focusing on the PoC utilizing AI for front-end. We had as many as 100 consulting projects in the second half of last year, but there were exponentially more inquiries than that. Interest levels are high among clients. The profitability of these projects is about average for consulting, but each is small in scale individually. The scale will grow once we reach the right side of Phase 2. Implementing AI in front-end will make it necessary to connect data from core systems and back-end, and will also increase transaction frequency. Legacy systems will then

need to shift to the cloud and be reconstructed. We believe that similar trends as when DX arose could happen with AI. There have not been any projects that move to the right side yet, but discussions have begun about changes such as how data is kept and moving to the cloud through the use of AI. We expect some movements to occur over the next year or two. Another area is productivity improvements internally. We will continue applying AI tools in individual processes as we have been, but we will also accelerate the schedule of investments in finance business platforms which we had planned for next year and thoroughly utilize AI in them. This year, we will spend the year verifying how much productivity will be improved in areas such as development frameworks and document creation. If successful, we expect it to have a major impact on profitability. While there will also be short-term benefits such as reduced man-hours in projects to update finance business platforms, we additionally believe it could potentially be applied in future modernization projects.

Q2: Could you explain your approach to investment discipline and return on investment?

A2: One-third of the 10 billion yen in investments that we just announced will be capital investments. This includes installing GPUs at data centers and equipping the power sources and air conditioners to accompany them, as well as intangible assets for software development. The remaining two-thirds is for R&D. The scale will likely grow, but since technology changes quickly, we will think about it as we go. The results of our productivity improvement efforts will start to show around December of this year or January of next year. We will consider subsequent new efforts based on the results we see from these. How we increase the investments going forward will depend on those results.

(Questioner No. 6)

Q1: If productivity improves through the use of AI, in what forms will it appear? Will we see shifts in personnel assignments, or reductions in outsourcing?

A1: That also depends on the process. We advocate the ideal of “prospering together with our clients,” but we aim to share the benefits achieved with various stakeholders. When successful at improving productivity in coding and test processes, we want to focus on cooperating with our business partners to turn that into further growth rather than ordering less from them. Currently, we are determining the extent of our productivity improvements from now until 2030 by performing new simulations on whether partner man-hours are still needed when hiring certain numbers of employees. We have

increased our hiring numbers over these past few years, but as student numbers decline over the next five to 10 years, we are uneasy about whether we can secure superior talent. This will continue to be an issue. Since we might not need to increase hiring as much as planned when formulating V2030, we are running simulations. Since we will be shifting or rotating the assignments of our current human resources, due to productivity improvements, our current level of human resources will not likely become excessive.

Q2: I understand that decarbonization movements are accelerating. While there is probably demand in consulting, which of NRI's distinctive services can you offer for decarbonization movements in IT solutions?

A2: We are not seeing large development projects for decarbonization. Systems such as emissions trading are currently taking shape under the guidance of the national government. METI is administering the GX League, but NRI received the orders for the office and system to establish the emissions trading market and is building them. The first stage will be to establish the infrastructure. Our main involvement is in consulting for individual companies, but once emissions trading reaches the point of flourishing, we believe that back office business platforms such as THE STAR could become necessary at some point just like in trading financial instruments. We are considering where we can establish business while thinking about trading volume and demand for emissions rights, the market players, and the timing of demand in the market overall in combination. Work will likely come our way as the market picks up momentum.

(Questioner No. 7)

Q1: You mentioned not needing to continuously increase staff numbers if attaining a certain level of productivity improvements. Will that occur closer to 2030 as opposed to right away? When that happens, you will probably allocate financial resources to AI and capital investments, but could there be any change to your cash allocations?

A1: It will not happen right away. Our cash allocations could potentially change, but we are not a company that procures large volumes of GPUs like other companies. Various market players are involved with AI, but we select the appropriate LLMs according to client needs rather than building our own. Some clients are fine with LLMs on the public cloud, while others prefer a private environment. Since we are partnering with Oracle to build private clouds within data centers, we can satisfy demand to also add GPUs for clients that want them. We will keep a close watch on clients' demand and technological trends as we proceed. No dramatic changes are likely to arise.

Q2: My understanding is that the majority of NRI's clients are doing business domestically. Will client companies and local government agencies that produce their budgets in Japanese yen be negatively impacted if the weakening of the yen continues? And how is NRI dealing with that?

A2: There is hardly any impact at this point in time. Some clients are impacted by the weakening yen, but they are also facing issues such as staff shortages that they need to resolve, so we believe they will continue investing in IT in some form. On the other hand, we are also considering using Japan for offshoring from North America as an idea to turn the tables and take advantage of the weak yen. We believe that offshoring could be one of the keys as we work to revitalize our business in North America. Our understanding of business models and quality levels in North America can grow by making Japan an offshoring destination. We are also eager to take on projects ordered overseas in Japan and to tackle them together with our business partners in Japan.

(Questioner No. 8)

Q1: Will the final fiscal year of the Medium-Term Plan be the time to reap the fruits of your efforts? Based on the state of your preparations, what fruits do you think can be reaped in 2025? Since your stock price is also stagnating, I hope to hear some news of excitement in the stock market.

A1: Our preparations are coming along nicely. In addition to AI, our efforts to downsize systems by modernizing finance business platforms and to reduce maintenance man-hours by making platforms common-use are proceeding ahead of schedule. We expect these to result in productivity improvements. As for our stock price, our self-analysis indicates that our overseas business primarily in North America is weighing on our stock price despite not comprising a particularly large proportion of overall sales and profits. Thoroughly turning our overseas business around and leading it toward recovery by FY2025 will be key. We are considering what surprise elements might exist.

Q2: Are you saying the fruits to be reaped from your preparations are productivity improvements, and these will appear in FY2025?

A2: That is correct. In addition to that, we are constantly working on preparations to acquire new clients and efforts to scale-up our existing clients. We are working on preparations for R&D and sales, and we expect the results of those efforts to appear by FY2025.

(Questioner No.9)

Q1: What message do you have as the new president? Many companies simply have the new president take over for their predecessor, but it would be good for the new president to take on a new hue. Your valuation might rise if NRI takes on the complexion of a leading company in AI. How about painting it that way?

A1: I understand what you are thinking. I would like to communicate some form of message. Right now, interest in AI is running high. There had often been news stories about various ways to use it, but recently those seem less frequent. Instead, infrastructure-related news stories about things like LLMs and semiconductors have increased. Efforts with clients utilizing AI and also in production innovation are moving forward, and I hope to be able to reveal the fruits of those efforts soon.

Q2: NRI seems to excel as a think tank that communicates things like the impact of AI on society. Are you conscious of making recommendations to society at large in addition to just businesses?

A2: We are highly active in fields that are intimately connected to research and business. Beyond that, it may resemble a science fiction-like future, but we are advancing research on changes to social structures and other possibilities, which has already produced a number of publications. I hope to be able to make these available to our shareholders.

(Questioner No.10)

Q1: How have clients' approaches to IT investment changed? And how do you feel that your place has changed?

A1: There are changes that did not feel big when they happened, but actually were big once you look back on them. For example, research as a think tank was our main business in consulting 30 years ago. That shifted to desk research with the spread of the internet, and we transitioned to a higher value-added consulting business around the year 2000. There were concerns and doubts about those changes, but our management at the time indicated a firm direction. Our consulting has also transitioned from business consulting to implementation support and assistance in internal consensus-building. There were things that went unnoticed at the time but were actually big changes when looking back on them. I think the key is whether you can absorb the various changes occurring with Con-Solution, DX, and AI, while structurally figuring out how to incorporate them into strategies and whether you can present a clear direction.

(Questioner No.11)

Q1: What are the medium-term concerns and opportunities in your overseas business?

A1: We have some points of concern over the short term but none over the medium- to long-term. In North America we are currently working on a turnaround, but we do not have enough capabilities in place. At the initial time of acquisition we had planned to secure capabilities through additional acquisitions, but we have frozen additional M&A while economic sentiment is weak. As for restarting M&A, we are debating internally about whether to change our strategy based on changes in the market post-COVID. In the medium- to long-term, we believe the opportunities will be greater if business there can grow autonomously. North America is the market where IT began, and new technologies and business models originate there. We will absorb these and bolster our competitive strength domestically. Domestic IT demand is currently strong, but we consider it risky to rely only on Japan where the population is declining. If we think about whether we can fulfill our responsibilities to our employees and business partners, we cannot feel secure over the long term. We see our overseas business as a future growth engine and believe it will offer great opportunities.

(Questioner No.12)

Q1: Consulting plays a central role in AI, but which industry types have strong interest?

A1: After consulting, we expect to transition to utilizing AI in front-end while incorporating AI into back-end core systems. There is interest in all kinds of industry types. We shared examples of B-to-C, retail, and distribution in the financial results briefing, but interest is also strong in the logistics and parcel deliveries businesses. In 2022 we announced our initiative to automate ordering systems at convenience stores with machine learning AI. Since interfaces improve with generative AI, there is potential to utilize it across all industry types to optimize internal processes and make customer contact points more advanced, among other benefits. However, financial institutions have somewhat conservative tendencies. At call centers, they have also been working on operator support since early on, but they are more conservative than non-finance in automating through AI implementation in customer contact points. In any case, labor shortages are affecting various industries, and needs for differentiation are robust. Generally, there is a lot of enthusiasm.