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Nomura Research Institute, Ltd.
Q&A from Small Meeting for Analysts
Part 1

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(Questioner No.1)

Q1: We can see movements happening in the restructuring of industries, but I would like to know whether NRI has some functions that are insufficient with business partners alone. If there are, what is your current approach to address them? Could they be supplemented organically, or through acquisitions?

A1: Since NRI already possesses a full lineup of capabilities, we are not talking about adding capabilities. We also have NRI Secure which specializes in security and possesses a full lineup in IT infrastructure, so we do not feel that we lack anything functionally. For that reason, we are not discussing acquisitions of Japanese companies to add functions. However, when thinking about our business portfolio, I do think we discuss entering business areas we are not currently in from the perspective of clients' growth into new industry types.

(Questioner No.2)

Q1: You do not seem to have any successful launches in DX 2.0 or DX 3.0 which you have been advocating for a while now. It would be good to have something uniquely NRI that other companies do not have. You likely have the concepts, why has nothing been launched yet?

A1: In DX 2.0 where we work together with companies to launch new businesses, we did successfully launch Earthbrain together with Komatsu. However, the number of launches is indeed small. In DX 3.0 which seeks to transform society, we have produced results in social DX and My Number-related efforts, but it will take time to achieve greater breadth. As a think tank function, we are also engaged in lobbying and rule-making.

Please keep in mind that it will take time before we see the results.

Q2: Since NRI is also growing in size and the amount of growth at a 10% rate is different now than 10% a decade ago, growing only under your own power would seem challenging. Would you need to apply leverage to keep it from being a struggle?

A2: While we are not lacking any functions, we will probably need to think about M&A to supplement the industry types where clients are lacking. Domestically, we are launching companies such as NRI System Techno together with Ajinomoto and KDDI Digital Design with KDDI as we also have the option of working together with clients as opposed to acquisitions. We must always be thinking about expanding our client base.

(Questioner No.3)

Q1: Over half a year has passed since the new executive management team took over. Have there been any visible changes, or any changes that you can identify from your vantage point on the inside?

A1: Our succession planning is handled through appointments from within the team. Since our current corporate officer class is comprised of the members who also discussed the medium-term plan together, it feels like discussions in the Senior Management Committee have become more lively. Ms. Yanagisawa also has experience in charge of HR, so our human capital-related measures such as changing and establishing systems and promoting women's participation and advancement seem to have increased in number.

Q2: Do these enlivened discussions include anything epoch-making?

A2: AI is a major topic for us, which cannot be encompassed within a single segment. The other day, we also shared the direction of our AI usage between segments and strengthened horizontal connections. Working in silos had been prevalent before, but AI has been a catalyst for more horizontal collaboration. Movements between industries are also increasing, such as industrial clients entering finance, and growth of business coverage areas within finance. Thus, there are increasingly more projects that require horizontal collaboration.

Q3: Does it seem likely that companies entering finance from any industries will produce any results?

A3: We have a number of projects for non-finance clients entering finance. These are

currently in the conceptual phase, but some of them are likely to grow large in scale, so we are interested to move those forward.

(Questioner No.4)

Q1: What kind of financial institutions are the targets for NRI's financial AI platform? And are the needs strong? Also, can we expect it to contribute to earnings in the first half?

A1: At financial institutions, the efficiency of how they deal with retail clients is important. AI's effects can be harnessed for that. For example, if AI can be applied at call centers and with sales staff, its use in the finance industry will likely advance. The data is accumulating, so I think the key is how to utilize it.

(Questioner No.5)

Q1: You mentioned that you are not lacking functions, but are you considering domestic M&A from the standpoint of securing resources?

A1: We are not considering any M&A solely for the purpose of securing resources. We could consider domestic M&A if we need to expand into other industry types, or something along those lines. For personnel shortages, we have no issues in hiring, and our relationships with our business partners are also strong. We believe that we could devise actions pertaining to resources such as utilizing AI together with business partners.

Q2: Overseas, you gave your businesses a boost last year and the balance sheet recovered, but the top line is not in good shape. It seems unlikely that the macro factors will recover in the second half, so what are your current thoughts on giving an additional boost or revising your overseas strategy?

A2: We are doing various things such as restructuring and integrating corporate functions, which are producing cost reduction effects. Capacity utilization is also increasing, and as a result we have passed the break even point and are now making a profit after PPA depreciation and amortization. As for revenue, we had anticipated that interest rates would also fall and clients' investments would return in the second half, but that is taking longer to happen. As opposed to simply waiting for a recovery, NRI as a whole is working to address this by developing Japanese-owned and local clients while collaborating with NRI-ITSA and NRI-A, making use of Core BTS's production capacity, and similar efforts. However, the results will probably not show up right away.

Q3: Although you are apparently not expecting a recovery in the second half, are you foreseeing it happening in the first half of next fiscal year? Including the top line, around when will growth return?

A3: We consider the third quarter of last year to have been the bottom. From there, we brought about a balance sheet recovery through cost reduction effects. Capacity utilization is also rising, so we don't expect any further downturn.

(Questioner No.6)

Q1: You should sell your Australia business right away. Consider it a learning experience for the US market which is much bigger. You should go all-out in North America. Australia is meaningless. The business you have in Australia is really just a side job. Hasn't that stage ended? Entering North America means going global. If you consider NRI's financial capacity and management resources, you should really narrow down your global expansion targets a little. If you do business in the US, you probably cannot also do business in other regions. In other words, figure out your priorities. Purchasing a run-of-the-mill company like Core BTS was a product of your financial capacity. The money you have sitting idle there in Australia is a waste. It seems like you are approaching decision time.

You are now in the phase of fully focusing your overseas business on North America, are you not?

A1: We have acquired five companies over a six year span in Australia, and have a position of around 10th there. The Australian market is not large. Conducting our first overseas M&A in Australia produced a certain level of effects. We consider ourselves to have accumulated expertise in overseas business. Although we entered North America, the market size is indeed different from Australia. We do not consider the decision to acquire Core BTS to be a mistake, but we made the purchase after doing due diligence on information available externally. What we learned from our entry into North America is that instead of acquiring companies that are up for sale, we need to work together with business partners and consider acquisitions after understanding the target company's capabilities and ideas to make better subsequent acquisitions.

(Questioner No.7)

Q1: I also hear about other companies using AI in testing processes for system development. NRI is working on fundamentally recreating development processes to include

generative AI. As of April earlier this year, you were supposed to have something tangible to discuss within a year to a year and a half. Now that the first half has ended, is there any change to that timeline?

A1: Other companies will also engage in defense-oriented AI usage such as in test processes and development processes, so we will do the same. We do not see significant value in the coding and testing that can be done with simple tools. Our outlook is to apply the usage of high added-value AI to all processes. Since generative AI is also a language-generating tool, it is ideal for processes to turn requirements definition into creation of programming language. We want to make it possible to offer what other companies cannot comprehensively handle. Trying these things out on clients' systems is unrealistic, but since we own shared online services platforms, we can try them out as we wish. The trial for "Step 3" overall application for the next business platform update is scheduled to be completed by December. Once we figure out what we can accomplish there, we will apply it in business platform systems updates from April of next year onward. Although we need to adjust the timing of when we share the information with you, there is no change to the schedule.

Q2: Have you been able to see any bottlenecks thus far?

A2: There are no bottlenecks, but collaboration with business partners is something we should work on. Going forward, I believe we will need to strengthen collaboration with business partners who are actively working on AI. In the IT industry, heavy emphasis will need to be placed on what type of partners to work with in utilizing new technologies.

Q3: Do the overseas subsidiaries you acquired understand AI, or are you training them in AI?

A3: Our intention is to export our expertise to the companies we acquire. For the aforementioned business partners, we anticipate these will be outside contractors involved in our domestic business.

(Questioner No.8)

Q1: You mentioned (in the financial results briefing materials) "80% generation accuracy or higher" for the use of AI in production innovation. What does this mean? And how much room for improvement is there?

A1: This means that if a program written perfectly by humans is 100, the part of programs generated by AI that humans need to check and revise at the end amounts to around 20%. However, if divided into classifications, I feel the accuracy could go even higher.

The only question is how high it can be raised by the synergy effects between engineers' skills and evolution of AI. While some of it depends on the evolution of technology, there are some things that we can contribute ourselves.

Q2: Is 80% accuracy a usable level?

A2: If you have 80%, it is a usable level. Being able to have AI generate 80% of what humans have taken time to code until now is a tremendous productivity improvement. We now know that generative AI can be used to generate code, but the same can also be said for testing processes. We are also working on upstream processes, as we hope to establish competitive advantages in a variety of processes.

(Questioner No.9)

Q1: Around how much synergy is there between Core BTS and NRI in terms of clients, or technologically?

A1: Core BTS is partnering with production base NRI-ITSA and consulting base NRI-A, while starting off by approaching Japanese-owned clients and working to ascertain their needs. After that, they will take on local companies as clients. Currently the projects are in trials so they are small in scale and not large enough to contribute to business results for Core BTS. Although Core BTS has the two business areas of network and cloud, we would like to create cloud business going forward. The problem is that they have been excessively reliant on two large clients until now, and have thus been unable to secure diversification in their business portfolio. We hope to gain a better understanding of how IT is used and the need for it in the North American market in order to expand their client base. Currently it is still in the trial and error phase.

Q2: You are reducing workforce in North America, but are you making any changes to the sales organization to grow revenue?

A2: Regarding the sales organization, the head of the organization changed again in October of this year. The new head is a person who is capable of logically analyzing approaches to clients and is working on account plans for 30 companies. We hope to see what this person is capable of.

Q3: When your overseas business recovers well enough and you consider additional M&A, it seems like you could harness synergies with your domestic strength if you target companies that specialize in finance. What are you considering?

A3: NRI is strong in finance domestically. However, since the industry laws in finance differ by country, systems cannot be horizontally deployed from Japan. In the US, there are lots of companies in manufacturing and services, so we believe these clients will be the main focus. We are not keeping our thoughts limited specifically to finance.

(Questioner No.10)

Q1: Banking systems are undergoing major changes, mainly at regional banks. Is this a business opportunity for NRI?

A1: In banking, our BESTWAY over-the-counter system for mutual funds has a high market share. We do not own full bank systems, nor do we aim to. Since regional banks which have storefronts are full banks, we do not have functions for them. We do have a shared online service called BaaS/Core based on BANKSTAR which we created jointly with BIPROGY, and we want to focus on providing it to neobanks.

Q2: Can you share any comments on the topic of GMO Payment and KDDI?

A2: Payments are another element of business coverage areas. We have had a business relationship with KDDI for a long time. The movement to add IT functions with the idea of covering a larger business area has strong momentum, and we want to be heavily involved.

(Questioner No.11)

Q1: NRI is likely able to talk about the positioning of IT in companywide strategies in industries such as services, retail, and distribution. On the other hand, in manufacturing where your relationships are not as deep, what kind of opportunities are there when discussions turn to how they can position financial services in light of overall strategies?

A1: In manufacturing, it is hard to think about expanding into financial services directly. Since there is strong demand to enter finance among companies that sell things and that provide services, we want to focus on them.

Q2: If your new clients in the future are fundamentally consumer-oriented companies who want to enter financial services, will it be easy to leverage NRI's unique abilities?

A2: We are a B-to-B company, but beyond the B is a C. Since the clients have to think about how to increase the loyalty of the C's and get them to spend more money, growth in business coverage areas will likely be significant.

Q3: When launching small-scale financial services, other companies that are cheaper than NRI might also capture more business. Are you concerned about anything in the competitive environment?

A3: When large numbers of banks that have no physical storefronts enter the picture, large system integrators might also think of making existing systems lighter and become competitors.

(Questioner No.12)

Q1: NRI's domestic industrial IT is running counter to global trends. From what I gather, it may appear that investments by main clients are in a transitional period, but structurally you might actually not be able to acquire new clients. Or it could be that investments by existing clients are not cyclical, but rather in a situation of structurally being unable to recover.

A1: Industrial IT grew due to demand for non-face-to-face and contactless during the pandemic, and then in areas such as connectivity to core systems afterward. In preparation for this type of demand to run its course, we need to work on new client acquisitions and create a portfolio as we announced this past April. We were supposed to have our portfolio in place to compensate when performance downturns by larger clients occur, but the timing was off. However, we currently also have cases where we have received RFPs and made proposals. We now have a number of projects in the mid-single digit billions of yen. Preparations are ongoing and we have multiple projects in the pipeline, so even in harsh circumstances we will capture the business for what we proposed.

Q2: Results from ERP are also starting to show in manufacturing, but does your pipeline contain many projects outside of manufacturing?

A2: Manufacturing companies also have e-commerce sites but have not focused efforts on them yet. We are seeing projects in which manufacturing-related companies are handling e-commerce as suppliers. Aside from that, IT in real estate has fallen behind, so there is demand to catch up. There are also projects in transport, energy-related, and other areas. In more cases, we are getting involved through consulting with clients with whom we had no previous system architecture relationships and then getting opportunities to make proposals to them. Thus, I believe our preparation efforts are producing some results.

Q3: Do you envision industrial IT solutions projects that originated in consulting getting into full swing around next fiscal year?

A3: Since the upstream processes are small in scale, the contribution this year will be small. However, there are also some projects with total value in the mid- to high-single digit billions of yen. We will do our best to strengthen our portfolio from here.

Q4: In your past efforts focusing on industrial IT, you used to have projects with low profitability in the beginning, and some that were unprofitable due to lack of familiarity. What is your outlook on profitability going forward?

A4: Around 2015, our profit margin in industrial IT was in the high single digits. At the time, we had large numbers of long tail clients, and inefficiency was an issue. Then, we worked on increasing the scale of our clients and raising capacity utilization, and we achieved that over these past ten years. As a result, the profit margin has risen to a level on par with financial IT. Profit margin may decline somewhat at the outset of the fiscal year, but we intend to engage in company-wide account management activities and strategically set our sights on clients with high potential to grow in scale.

(Questioner No.13)

Q1: The size of your revenue from Seven & i Holdings seems to be unchanged. How does your current work with them differ from before? Why have their investments stopped?

A1: One main topic in retail is how much you can sell without relying on labor. At Seven Eleven, automated ordering through AI has been rolled out to all of their stores. Demand for projects like this will continue to grow going forward. As it also becomes harder to secure employees, systems that contribute to saving labor will be in demand. We want to make every effort to propose projects, primarily in the field of daily operations.

Q2: There is talk that they will sell off the supermarkets segment. What will NRI do in that case?

A2: In addition to the convenience stores, we also work with their group's supermarkets. Since the systems must be kept running, even if a company is spun off, I doubt there will be any sudden switch to another vendor or in-house production. Still, without assuming anything, we will continue making high added-value proposals so there is no switch to another company.

Q3: Is the proportion of supermarkets high?

A3: Supermarkets are an industry where there is constant shuffling. It depends on the client, but even if they are spun off, we want to accompany them.

Q4: Generally speaking, unit prices seem to be lowest in retail. Do clients in retail ever leave NRI due to high unit prices? And are you being forced into offering any special accommodations?

A4: To this point, we have been repeatedly getting further from and closer to our clients depending on the approach of the people leading their IT departments. Even if the relationship is good now, we cannot know what will happen when the shape of their company changes. All we can do is think about how to keep it going and how to go about adding good services.

(Questioner No.14)

Q1: Your business in transport seems to be struggling in many places. In industrial IT, are there any signs that your momentum might be slowing outside of retail and manufacturing?

A1: As our clients work to address various challenges, we are regularly providing them consultations. We want to contribute whatever we can.

Q2: Do you anticipate there could eventually be reluctance to invest?

A2: Companies that continue to curtail investment will fall into decline. IT is essential to raising the top line, and we aim to play a role in that.

(Questioner No.15)

Q1: Consulting seems to be an effective entry point for sales. Has that changed at all recently?

A1: In the past, consulting mainly involved writing reports. Now, IT has become necessary for delivering solutions to management issues such as growing the top line and reducing costs. Compared to before, it has become increasingly inevitable that consulting and systems work together. In systems, there used to be many back office frameworks to replace work that people had been doing manually, but that is changing due to DX. Now, I think consultants often listen to managers' problems and solve them with systems.