

(Tokyo-20<sup>th</sup> December, 2023)

## **Nomura Research Institute, Ltd.**

### **Q&A from Small Meeting for Analysts**

#### **Part 1**

##### **(Questioner No. 1)**

Q1: Please share some details about the background of your new president.

A1: Ms. Yanagisawa joined NRI in 1991 and worked as a systems engineer in the IT Solutions Department for five years. Then she transferred to the Consulting Department where she gained experience in fields such as telecommunications, consumer goods and services, and management consulting. In the last five years she has been a corporate officer, serving as deputy head of HR and human resources development. In FY2023 she has been managing company-wide business strategy, IR, and corporate communications as the division manager of the Center for Corporate Planning. From her experience in our Human Resources Department, one of her characteristics is her extensive familiarity with our personnel.

Q2: What are your new president's strengths?

A2: Our consultants have penned a report asserting that companies can achieve continuous growth by changing presidents in cycles of around six to eight years. Approaching just such a time frame ourselves, we have been engaged in discussions about our next president over the past three years, with involvement also from the Nomination Committee. In April, we initiated a rejuvenation by appointing our "next cabinet members" as the officers heading up our divisions. It was Ms. Yanagisawa who exercised the most leadership in the discussions among these cabinet members to determine our subsequent vision and Medium-Term Plan. The Nomination Committee decided that she was the optimal choice from a leadership perspective, after which she was appointed by the Board of Directors.

Q3: As president, Mr. Konomoto has been increasing value by combining existing strengths with new technologies. As you grow by leveraging existing strengths while adding technologies and other elements, will it be the technology side that you'll need to bolster

to make NRI stronger? Or will it be the HR side in which Ms. Yanagisawa has her more recent background?

A3: Since our business departments are functioning well, we have high execution capabilities at our worksites. While it will take time for Ms. Yanagisawa to reach Mr. Konomoto's level of proficiency as president, her consultant background alone gives her the ability to see toward the future. Going forward, Mr. Konomoto will no longer have representative rights and will be Chairman of the Board of Directors. He is also highly determined himself to work toward making the Board of Directors more dynamic. Execution will be handled under Ms. Yanagisawa. For higher level strategies, the Board of Directors will hold discussions and consolidate opinions, including about company operations. The Board of Directors will likely cover whatever is missing.

## **(Questioner No. 2)**

Q1: Around when will the new president's agenda be announced? Is there anything you can share now about what will change and what will stay the same?

A1: We are planning for the financial results briefing in April to be Ms. Yanagisawa's first time speaking in front of you. She was also involved in formulating the Medium-Term Plan and vision, so there will be no changes to our management policy. As Ms. Yanagisawa has also expressed in a video message to all of our employees, she has strong feelings about how to raise the level of our human capital. Our people are valuable assets to us, so I believe that our new president's biggest focus is on how they will thrive, and on dedicating effort to creating opportunities for them to thrive.

Q2: Business is good domestically, but you are struggling overseas. What approach are you using to turn things around in North America?

A2: In November, we initiated measures to bolster collaboration with NRI-ITSA in Dallas, Texas. NRI-ITSA supports Japanese-owned companies locally, and through this collaboration they will utilize Core BTS as development capacity. This also requires close communication with management at Core BTS. We have also been able to manage collaborative efforts with ITSA through a high level of communication. Since Ms. Yanagisawa can communicate directly with local management in English, it will be easier to push forward with management. Please listen to her presentation at the financial results briefing in April.

Q3: What is the current situation with Core BTS? Please also share your future outlook.

A3: Honestly, it is not good. In April we commented that there would be a recovery toward the end of the fiscal year, but it probably seems that the projection for this recovery is gradually getting pushed further into the future. We overhauled their sales organization and advanced their collaboration with NRI-ITSA, but clients remain reluctant to invest due to high interest rates. The rule of thumb for IT in North America is to mainly produce in-house and utilize outside resources for whatever is lacking, so when investment is restrained, outside resources are the first to be reduced. For that reason, we also had a decrease in work orders from two major clients. Business sentiment remains gloomy.

Q4: Looking at the situation in November and December, what is your outlook on (future) structural reforms?

A4: Originally, our objective had been to cross-sell between the network and cloud businesses while working on cloud implementations for network business clients. However, we realized it was difficult for sales personnel in the network business to sell cloud services, so we shuffled the sales organization to include more members with strength in cloud. The organization is generally in place, but the business climate remains unfavorable. We are in a situation of being prepared for when the business climate clears up.

### **(Questioner No. 3)**

Q1: You had originally informed that Senior Executive Managing Director Hidenori Anzai and Senior Corporate Managing Director Kaga Yanagisawa would be here in attendance.

A1: That information was communicated before the announcement of our new president. The first time they speak in front of you will be at the financial results briefing in April.

Q2: This question is about the measures to be implemented by your new president. Enhancing human capital was mentioned at the press conference for her appointment, but what will you specifically be doing to that effect?

A2: As deputy head of HR and human resources development, Ms. Yanagisawa updated our human resources system which had previously placed heavy weight on seniority and had not been updated for over a decade. In the updated system called Mission Grade, conditions are offered according to job responsibilities. Promotions and demotions are more drastic, but it is a framework that rewards those who produce results. The most

important thing will be to operate this new human resources system in a sound manner. In addition, we will also need to improve the business knowledge of our IT solutions personnel. We have an in-house certification system for personnel who create business, namely business analysts and business developers. However, we will need to bolster our numbers of personnel who handle more sophisticated DX such as DX 2.0 and 3.0. Additionally, we will need to expand our ranks of global personnel and AI engineers.

Q3: Will you achieve such an expansion through supplementary mid-career hiring, or will it be through internal reassignments and upskilling?

A3: Our employees are highly motivated on their own to learn new things without forcibly reskilling them. Many are already getting acquainted with AI. Supplementing our skills is one objective of our mid-career hiring, but we are hiring personnel who have potential and want to learn various things as they grow. The ratios of our managers hired mid-career and those who were originally hired as new graduates are actually about the same as that ratio among our general employees.

#### **(Questioner No. 4)**

Q1: Your new president Ms. Yanagisawa has followed a career path as a systems engineer and also as a consultant, but is it typical to have a career that shifts between multiple paths?

A1: Hers is a rare case. Since we entered the age of DX and began pursuing “Con-Solution,” consultants and systems engineers have frequently been working together cooperatively, so we have been exchanging personnel in a trainee-type format. As opposed to transferring personnel, our emphasis is on accumulating cooperative experience.

Q2: You have been proactive in mid-career hiring for a few years now. Have any negative aspects arisen from more employees having joined mid-career, such as the company culture being diluted?

A2: We have increased our mid-career hiring in line with our business growth. Desire to join a company full-time has declined among new graduates, so we are conducting mid-career hiring with a sense of compensating for that. We hold onboarding training for those hired mid-career to keep them from feeling like outsiders. Our president’s own explanations of our businesses also include efforts to communicate about our culture. Aside from that, we also involve them in value co-creation dialogues to consider

connections between business and society. Thus, I believe that our mid-career hires have no feelings of alienation. There was a period of time coinciding with COVID when it was taking longer for them to get acclimated, but our ratio of working in-office has increased, so I believe we've been able to catch up.

Q3: There has been talk that retention of new graduate hires is low. Is it markedly worse?

A3: It is not sharply declining. Last year, our turnover rate of those leaving us voluntarily (company-wide) was 3.1%, though that may increase somewhat this year. It seems natural that more people are interested not only in compensation levels, but also in taking on various challenges. We are also implementing various measures and making concerted efforts to bolster retention. This includes offering opportunities to change career paths via transfers through internal recruitment twice per year and interviews with the Human Resources Department about transfer requests.

Q4: What progress has been made with NRI-CTS? Do you expect it to contribute to performance in 2024?

A4: Is it not yet a completed solution. Although we can figure out our own Scope 1 and 2 emissions, the issue is that we need to know the CO2 emissions related to products purchased from other companies for Scope 3. This involves compiling and managing data measured by each individual company, and we are still in the building stage.

#### **(Questioner No. 5)**

Q1: This question is about your cash allocation. What is your order of priorities for capital investments in data centers, M&A, and shareholder returns?

A1: In data centers, we are eliminating facilities that are aging. Currently we own three data centers, in Tokyo, Yokohama, and Osaka. We constructed the second building of our Osaka data center the year before last, which expanded our capacity. Since we are making progress in public cloud usage for industrial, we are mainly using data centers in financial, where the physical location of the data must be made known. We still have some free space which we are thinking about how to utilize most efficiently, and we do not anticipate large investments in data centers for the time being. Since data centers are thought to age in 30-year cycles, we are limiting our investments to changes in equipment.

Regarding M&A, there have been no significant changes to the policy we have

previously explained. Although Australia is back on track, Core BTS has still not recovered. Therefore, we will not have any large new M&A transactions in North America during this current Medium-Term Plan. There are some pieces that are missing, so we will plug in a consulting function once the turnaround is complete and business growth can be forecasted, but that will likely happen in the next Medium-Term Plan.

Thus, our approach to cash allocation is generally one-third for updating existing facilities, equipment, and systems, one-third for M&A, and one-third for shareholder returns. We think in time frames of Medium-Term Plans and visions rather than year by year. Therefore, we are constantly thinking about when to take measures such as treasury share buybacks. This year, we are buying back 50 billion yen in treasury shares and also increasing our dividend as we strive to boost shareholder returns.

Q2: I understand that you acquired Core BTS as a platform for conducting M&A. What problems have prevented you from actually using it for that purpose?

A2: We acquired loyalty marketing service provider Brierley+Partners in North America a few years ago, but changes came quickly and services rapidly became obsolete. We determined that we would not likely achieve growth through them because it would not be possible to keep up with changes in the market without being a large company, and we withdrew. On the other hand, Core BTS is a company that creates systems and is not a service provider, so their company can change forms along with the times. In that sense, they are very similar to NRI. Our policy to cross-sell cloud business in the network business is not misguided in my opinion, but their sales capabilities were low, so we are bolstering their organization.

### **(Questioner No. 6)**

Q1: This question is about the potential of transitioning to platforms in industrial IT. Is there any possibility that modularization could be accelerated by having an increasing number of areas that could be automated, including by generative AI?

A1: It is difficult to build the same type of platform-based systems in industrial IT as there are in financial IT. Since systems for financial institutions only need to function as specified by business law, they end up the same no matter who builds them. On the other hand, there are no such regulations in industrial where IT itself is the basis of competitive advantage, which makes it difficult to consider shared usage. However, there are (also in industrial IT) many common elements. For example, the parameters when using

public cloud can be formulated as rules to a certain extent, so we are dedicating efforts to developing IP components such as infrastructure-related IP and breaking down front-end screens into components. Also, I think that AI is infrastructure that can be used in both financial and industrial. It might be used in different ways. Some potential uses could include incorporating it into recommendations, using it on interfaces in industrial, and utilization for call centers in financial. However, AI also has the problem of hallucinations, so a stage of careful assessment will likely be needed before offering it directly to consumers.

Q2: Is your usage of AI more geared toward providing services to expand business than it is about improving productivity?

A2: We use AI for two types of activities, one is for providing services to clients, and the other is for improving our own productivity. For improving productivity, we are prioritizing its application in test processes, after which we are considering using it to automatically generate source code, and finally to provide support with platforms that incorporate AI into all systems development processes. We can achieve major productivity improvements if we make good use of it, so we are currently in the phase of figuring out which areas to apply it.

Q3: There are several different ways to work on human resources retention, such as providing opportunities to thrive, high salaries, and high-quality training. Which do you consider most important?

A3: The compensation that we offer is higher than other companies. Most important is that we have a framework for employee returns from achievements in business growth by reflecting these achievements in their bonuses. This framework enables us to hire talented personnel. They also cannot grow as professionals without having challenging work, so it is important to provide opportunities. We consider it important to operate in cycles of hiring, providing opportunities, training, and compensation, without placing higher priority on any one of these.

### **(Questioner No. 7)**

Q1: Domestically, unit prices seem to have risen throughout the industry as a whole this year. You probably have room to raise prices even further from next fiscal year onward with clients who recognize your value and added value as being commensurate with the

rising unit prices. I think there will be a convergence between your prices and the commensurate value next fiscal year. How do you see that? What is your policy on revising unit prices for orders?

A1: First off, we will not get caught up in price wars. There is no added value to something that anyone anywhere can build. Our strength lies in our technical capabilities, including consultation. What we pursue are complex, high-transaction volume, and mission critical frameworks. The overarching idea is to thoroughly take on the work that others cannot do, for which there is no competition.

During the pandemic we had large numbers of front-end projects in areas such as e-commerce, non-face-to-face, and contactless. Since then, we have also had many core systems overhaul projects, including for aging core systems and for poor front-end connectivity. Projects to overhaul old core systems are more difficult than front-end. Few vendors can handle them. We believe this trend will continue for the time being. Companies are also currently thinking about saving labor in their business operations due to manpower shortages and spiking labor costs, as computerization becomes inevitable. Japan's computerization is still lagging behind Europe and North America. The pandemic drew attention to that, which I think was a big change.

Q2: Are you still able to promote the value of integrating both front-end and core systems to understanding clients?

A2: Our vision is to sell 10 billion yen each to 10 companies in order to raise sales by 100 billion yen (we do not envision selling 1 billion yen each to 100 client companies). We build relationships with clients who can potentially reach these numbers and earn their trust by delivering undeniable results which lead to subsequent work. We believe that we have established relationships with clients who have retrospective value to capture, and we must do so.

Q3: Good people likely gravitate toward companies that have taken the lead in that direction.

A3: It leads to good opportunities and chances to gain experience. Large projects are beneficial to project managers, and engineers are also intrigued by the prospect of using new technologies. We should meet the sophisticated needs of our clients, and this is also part of the growth cycles we employ for our human resources.



### **(Questioner No. 8)**

Q1: While I hear about overseas companies having established revenue streams with AI, I do not really hear that about Japanese companies. What is the difference? And how will the new president Ms. Yanagisawa's experience as head of the AI Working Group be utilized in NRI's AI initiatives?

A1: Since Ms. Yanagisawa is not an engineer herself, she is coordinating the AI efforts necessary for the direction of our business. She serves the role of coordinating how to utilize AI in each business segment and corporate department from a wider overall perspective as opposed to the finer details.

As for business being done overseas with generative AI alone, my reaction is to question whether that is actually possible. Rather than generating earnings solely with AI, we want to incorporate AI into core and front-end systems and leverage it adeptly while using it as an ingredient to make our own business more sophisticated. We will gain in sophistication, but I think that creating dedicated LLMs that match operating models will make the systems that we provide more sophisticated.

Q2: My impression is that generative AI is something that other companies are able to produce in-house. Will they become competitors to NRI in those cases?

A2: This is a topic for the future, but AI-oriented architecture is when AI is used throughout an entire system. The back-end frameworks for that are considerably difficult, and that will be a field of high added value. Since it involves complex, high-traffic framework, few companies can create it on a large scale. We have strength in that area, and I believe we can go forward building architecture that combines our technological capabilities with AI.

Q3: If system architecture becomes more complex due to AI, the systems that companies build in-house in the US would seem less feasible. Are you thinking about deploying this type of technology in the US?

A3: Usage of packages is quite common overseas, including in North America. AI is actively being incorporated into packages. In Japan, companies rely on systems integrators since the country has strong insistence on its own particular aspects of systems on the user side and IT personnel also cannot be mobilized. Only a limited number of vendors can provide such systems. We want to provide them to clients who can pursue added value retrospectively.

**(Questioner No. 9)**

Q1: What do you see as your domestic risks?

A1: We are always conscious of unprofitable projects arising in systems development, which we are striving to prevent. Looking at our results over the years, the times when we suffered falling revenues and profits were all when financial crises occurred. Having reflected on that, we grew the size of our business portfolio in industrial IT. Financial IT previously comprised 70% of our business, but that number is now less than 50%. Although we have evolved into a more resilient business portfolio, roughly half of it is still financial IT. Thus, we will not be as impacted as before if another financial crisis were to occur, but we would suffer some impact. However, we do not consider that a major risk at this point in time.

Q2: Roughly 60% of your sales is from ongoing business. Do you expect to increase this number going forward?

A2: We will be more stable if we scale up our ongoing business, but that increase would reduce our work in new systems development and upstream consulting, both of which we absolutely must do. The result is that our business relationships continue long-term. I think that being able to maintain that 60% is the product of our past efforts.