Mitsubishi Research Institute, Inc. （MRI）

Small Meeting with Institutional Investors（December 4th, 2023）

Summary of Q&A session

※Some contents have been added or modified for better understanding

【Investor 1】

Q. The capital policy in the Medium-term Management Plan 2026（MP2026）includes an explanation of cash allocation. Could you provide a breakdown of the investable amount as free cash flow and give a more proactive direction?

A. The investable funds comprise the funds available for investment after deducting working capital from the consolidated cash balance, as well as the accumulated operating cash flow over the three-year period of the plan, combined with the investment in human resources and R&D.

Around 15% of the investable funds, with a target dividend payout ratio of 40%, will be allocated for shareholder return, while the remaining funds will be allocated for growth investments. I believe that our group has significant growth potential and I aim to expand our business in areas such as Carbon Neutrality (CN), the challenges of an aging population and social security system, and productivity improvement in healthcare. We will extend the value chain in IT services based on the strength of MRI's policy challenge-oriented approach.

"Capital expenditure" refers to investments made to support the current business in a stable and sustainable manner. "Growth investments" encompass investments in human resources, research and development (R&D), and new business development, aiming for organic growth. We plan to allocate around 2% of revenues continuously to R&D. "Strategic investments" will be made from the investable funds for non-organic growth, including the establishment of joint ventures (JVs), capital investments, and M&A activities.

Q. What are your thoughts on the cash balance and the equity holdings on the balance sheet in the MP2026 or a slightly longer time frame?

A. In MP2026 and beyond, I aim to continuously increase the return on equity (ROE) towards 2030. In the previous mid-term plan 2023 (MP2023), we positioned achieving a 10% ROE as a milestone and almost succeeded. For MP2026, we aim to target a 12% ROE.

By 2030, we want to become a company with a scale of 200 billion yen. While increasing ROE and expanding our business, we need to operate with a focus on investment returns and ROE for new investments and equity holdings as equity method investments. This is being raised as an issue in the board of directors, including outside directors.

【Investor 2】

Q. I appreciate the fact that you have set social value goals in your integrated report. Could you explain the discussions that led to the establishment of these KPIs? And how do you plan to incorporate these KPIs into your business?

A. On our 50th anniversary, we redefined our management philosophy. We aim to be a company that solves societal issues while balancing the provision of social value and the growth of our own group. In doing so, we set non-financial goals and social value goals in addition to financial goals. We categorized societal issues based on their importance and the potential value contribution of our group, and set social value goals based on the perspective of what would lead changes in society.

We are also progressing discussions on how to visualize how our group's business ultimately contributes to solving societal issues, using a logical tree-like approach.

【Investor 3】

Q. What is the top priority among the KPIs you have established? If there is a priority order, please let me know.

A. We prioritize operating profit margin.

Q. Although only revenue is disclosed for 2030, does that mean that revenue is not the most important factor?

A. The revenue for 2030 represents a minimum threshold for business scale as a kind of entry ticket to be recognized as a company group with a certain level of social influence from customers, society, investors, and employees.

Q. Capital allocation has the potential to fluctuate in either direction. What happens if things don't go as planned?

A. The extent to which cash flow accumulates will determine how we adjust our capital allocation. "Strategic investments" can serve as a means of adjustment. I aim to maintain the scale of capital expenditure and growth investments to the best of our ability.

Share buybacks are an option for shareholder returns, but fundamentally I believe in the potential for growth in our business. Therefore, we want to base shareholder returns on dividends and stock price appreciation. Share buybacks should be considered based on our company's earnings, funding needs, market conditions, and other factors.

Q. What are the specific targets for M&A? In terms of talent acquisition, expanding capabilities in adjacent areas, and attracting customers, what options are available? Will the focus be on domestic or international areas? What are the considerations for selecting M&A targets?

A. We have two main targets. Firstly, talent is a critical area. There is a strong demand for talent in both Think Tank & Consulting services and IT services. If there are promising opportunities, capital participation or acquisitions could be potential options, considering the need for skilled individuals.

Secondly, to broaden our business scope, we are looking for partnerships, joint ventures, or acquisitions with companies that possess capabilities that our group currently lacks. We want to strengthen the IT consulting functions between MRI's management consulting and DCS's IT implementation, in order to activate the value chain. Additionally, as we aim to transition away from manpower-dependent businesses, we are targeting companies with products or as prime vendors. The business alliance with Technos Japan Inc. is part of this effort as well.

Although the focus is primarily on the domestic market, we are not closed off to opportunities in international areas.

Q. How to achieve an increase in staff numbers? Is there a way to maintain quality while doing so? What do we want to do about new graduates, mid-career hires, and staff turnover? What are you currently working on?

A. The planned increase of 500 staff members by 2026 corresponds to an annual average increase of 150-160 over three years, which is quantitatively feasible. We aim to secure both new graduates and mid-career hires while maintaining a lower staff turnover rate compared to other IT companies. The ratio of MRI to DCS will be proportional to the current employee base.

On the other hand, to further enhance quality, we will establish academies for talent development in both MRI and DCS and prepare training programs. On-the-job training will continue, but areas where intensive training is possible will be addressed through the academies. Additionally, we will provide opportunities for reskilling. While learning IT skills is necessary for MRI, we will leverage the programs of DCS to increase manpower and acquire new skills without compromising the quality of talent.

Q. Staff turnover has stopped decreasing since the second half of the previous MP2023. Did this result from any proactive efforts?

A. There are some signs from the potential turnover candidates. We have actively listened to their preferences and increased internal mobility of talent through transfers between departments. Additionally, we have responded attentively to the skill and career path aspirations of our young to mid-level employees. There are companies that offer higher wage levels, and we must be prepared for a certain level of turnover. However, if there are areas where our offerings do not align with the employee's preferences other than wage levels, we want to continue providing attentive support. Our recent staff turnover rate is lower compared to other IT companies, and instead of aiming for further decrease, we want to evaluate our recruitment efforts and increase the pace of net staff growth to ensure we remain competitive in hiring.

【Investor 4】

Q. In the current business environment where the consideration of capital costs and stock prices is important, how do you view the equity ratio? There is a trend of reducing cross-shareholdings, which suggests future stock releases from shareholder companies. Regarding share buybacks, some companies mention it in their securities reports or else, but it is not explicitly stated by MRI. How much flexibility do you have in this regard?

A. It is difficult to provide a specific answer regarding the level of flexibility. Our basic approach is to balance business expansion with providing value to society in the medium to long term. While it is important to deliver short-term returns to our shareholders, we also request their support for medium to long-term, stable holdings. When considering the sale of shares, we need to be mindful of the potential impact on market supply and demand. Share buybacks can be considered as part of that mix. Additionally, depending on the situation, we may consider holding shares that can be used for future M&A or partnerships.

Q. You hold shares of equity-method affiliates. If you were to invest a certain amount of capital here, what would be the appropriate equity ratio in the medium to long term? When it comes to working capital, would it be acceptable to take risks, such as using interest-bearing debt?

A. Improving capital efficiency through the use of debt in the future is certainly an option. We have not yet finalized our policy on the appropriate level of equity ratio or the debt-to-equity ratio. However, our first consideration will be strategic investments and risk allocation.

Q. Regarding Ines and JBS, there doesn't seem to be significant business synergy. What are your respective future plans?

A. JBS has strong sales capabilities and a network centering around Microsoft Azure. We plan to incorporate generative AI into Azure, and our group has accumulated years of research in generative AI, which we want to leverage in transforming our own business processes. We are already offering it to customers as "Robolisa" and "LalaSuppo" (LArge LAnguage model SUPPOrt). We consider this area a key focus for reinforcement in our MP2026, and there are significant opportunities for synergy.

As for Ines, it primarily focuses on local governments. We aim to strengthen our collaboration in the IT business for local governments. Furthermore, we want to enhance collaboration among MRI, Ines, and DCS to generate fruitful outcomes. We will be mindful of the timeline and respond accordingly.

Q. I feel that the competitive environment is different between the upstream consulting part and the downstream SIer part when it comes to personnel recruitment. Can you compete solely based on the attractiveness of your company orientation in terms of salary and benefits? Who are the individuals that you are currently able to recruit?

A. At MRI, we attract individuals who resonate with our principles. People with specialized expertise, particularly in the field of scientific and technological advancements, including AI, and who are motivated to enhance their expertise and contribute value to society.

DCS has a strong presence of stable, reliable, and diligent professionals. Recently, we have been able to recruit young talent who have relatively high abilities and technical expertise. These young professionals have started cross-departmental projects utilizing research and development budgets, some of which have already begun selling to customers.

Q. While I recognize your company's social value, unfortunately, I haven't seen any shareholder returns or capital gains over the past 10 years. How do you plan to increase profit margins? How do you plan to connect the value chain? Is there any catalyst or something to look forward to?

A. It is difficult to improve without changing the nature and portfolio of our business with leveraging and strengthening our strengths. Both MRI and DCS operate in manpower-dependent businesses, which have their limitations. We have established stable and positive relationships with key clients such as government agencies and major financial groups, contributing to important business areas and brand value. While maintaining this, it is necessary to expand our business portfolio beyond manpower-dependent businesses and venture into the general private sector market.

There are emerging opportunities in this direction. For example, MPX, a spin-out from our company in the energy sector, has the potential to become a significant business given the developments in the energy industry in Europe and the United States. We have other similar examples, and we expect to nurture a certain portfolio of non-manpower-dependent businesses within MRI if we can develop them successfully.

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