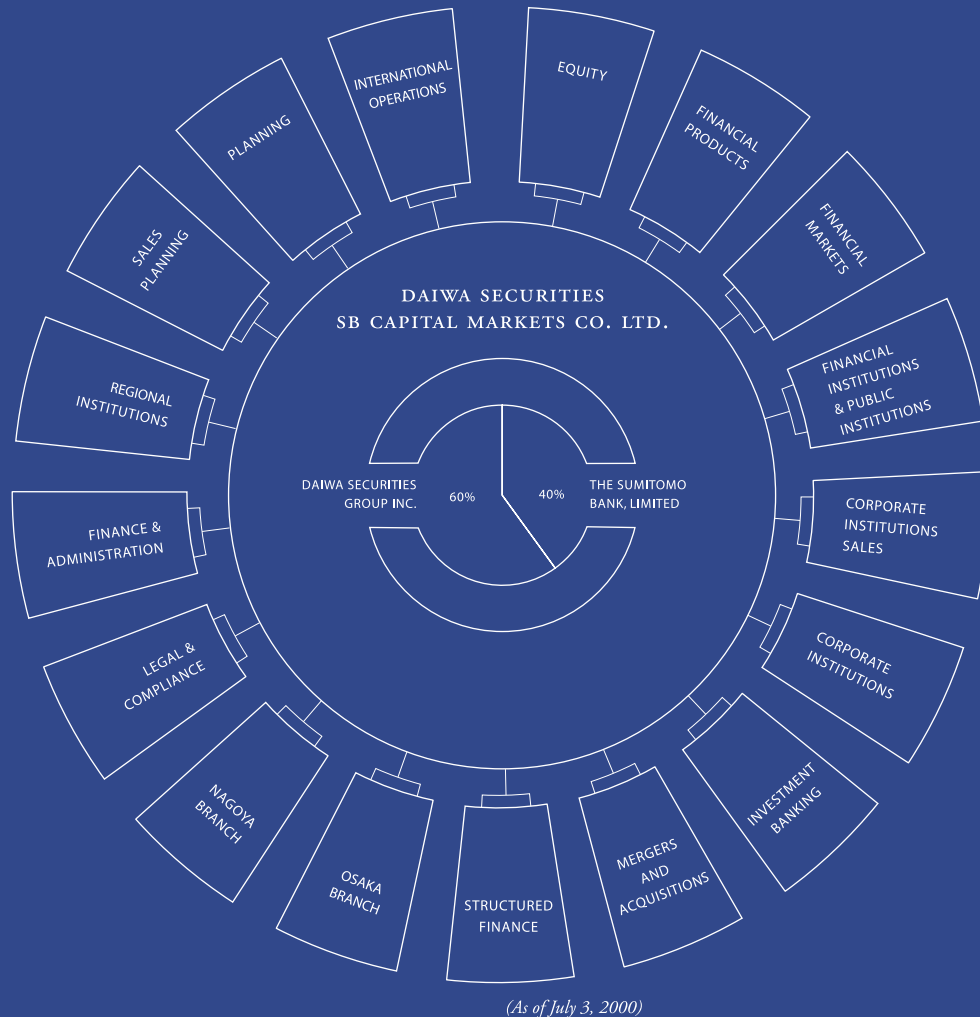


W H O L E S A L E   C O M P A N Y  
daiwa securities sb capital markets co. ltd.



(As of July 3, 2000)

**Directors:**

Akira Kiyota, *President* · Kensuke Uchida, *Deputy President* · Kenji Ebihara, *Deputy President* · Masahide Morimoto, *Senior Managing Director*  
Yoshiyuki Takemoto, *Senior Managing Director* · Michihito Higuchi, *Senior Managing Director* · Shoichi Oshima, *Managing Director*  
Yoichiro Inoue, *Managing Director* · Nobuaki Ohmura, *Managing Director* · Sumio Fukushima, *Director*

**Executive Officers:**

Mitsugi Kishimoto, *Senior Executive Officer* · Nagayoshi Miyata · Toshiro Ishibashi · Yasuo Nakamura · Kenji Hayashibe · Mamoru Ohtani · Kanichiro Hirata  
Hideo Shimada · Hidehiro Fujii · Kiyoshi Matsuba · Yutaka Murakami · Jun Kiseki · Tatsuro Inoue · Hideo Watanabe · Kazuo Ariake

**Corporate Auditors:**

Masayuki Kano · Toshihiko Akuta · Yoshiaki Senoo · Takayoshi Kobayashi



## FOCUSED

### Services

*The wholesale securities company also had a very good year. It established itself as a market leader in trading and in institutional sales of both equities and bonds. In addition, the new business operations — derivatives, structured finance, and mergers & acquisitions — increased their contribution to revenue. Meanwhile, the relationship with Sumitomo Bank is starting to bear fruit.*

Interview with

**AKIRA KIYOTA**

President of

Daiwa Securities SB Capital  
Markets

Could you please give us a brief overview of the year to March 2000 as you see it? Since we will be covering the individual operations of Daiwa Securities SB Capital Markets (Daiwa SBCM) in more detail later on, we would be grateful if you could concentrate on matters of strategic importance.

I suppose that I should start by pointing out that we started the year publicly stating our goal of achieving ordinary income of 60 billion yen and a return on equity of 15% within three years. In the event, our operating income during FY 1999 emerged at 73.0 billion yen.

Of course, we are not oblivious to the fact that the strong stock market was a major contributor to these profits. However, there were several major developments during the year that may not be obvious at first glance but which are nonetheless extremely important.

The first was increasing evidence of the benefits accruing to this company stemming from its close relationship with The Sumitomo Bank, Limited (Sumitomo Bank). Moreover, these benefits were such that I believe they will increase with the passage of time.

The second was the degree of success we have enjoyed in our equity trading operations since the final deregulation of commissions in October 1999. The two securities companies (Daiwa Securities and Daiwa SBCM) combined claimed the top slot for equity trading revenue during the third quarter. Our strong position in this area is attributable to thorough preparation and the establishment of sufficient technology support through our PowerTrade II and ATRAS systems which support the equity front office.

Finally, I would like to mention the three new business areas on which we place much emphasis. These are our derivatives, structured finance and M&A operations. These operations have gotten off to a very good start with their contribution to profits already at record highs. They also have the added benefit of diversifying our revenue sources.

You mentioned evidence of synergy with Sumitomo Bank. Could you elaborate?

We have benefited from utilizing Sumitomo Bank's business network. For example, in our derivatives operations, we made great strides by combining a securities company's expertise in equity with a bank's expertise in interest and foreign exchange. In M&A, although due to the confidential nature of the business I cannot name specific projects, we have succeeded in winning significant business together with Sumitomo Bank with still more in the pipeline. In our securitization activities we have completed several large scale projects, of which I can mention securitization of the NEC Head Office Building, securitization of the Omori Plant of Asahi Breweries and securitization of the Sumitomo Real Estate Building in Shinjuku.

Our bond underwriting business also benefited greatly from our joint venture status with a major city bank. Our market share for FY 1999 as lead manager for public straight bond



Our  
**ABILITY TO RESPOND**  
to changing market conditions and  
**ABILITY TO INNOVATE**  
has been  
**VASTLY IMPROVED**

issues is larger than that of the former Daiwa Securities and Sumitomo Capital Securities combined in FY 1998. The Sumitomo Bank issue, lead managed by Daiwa SBCM, was the first straight bond issue from a bank after restrictions were lifted in October 1999. This bond, for which we are committed to market making, is considered the benchmark for all bank bond issues, and is highly regarded in the industry. Actually, there are many more examples where joint efforts have borne fruit.

[Were there any parts of the business that you would like to improve on?](#)

Our equity underwriting and IPO operations did not distinguish themselves during the last financial year. This was mainly due to the fact that the other two major securities companies each managed to obtain large privatization mandates. We fully acknowledge that we need to work with Sumitomo Bank and cultivate our expanded client base. The IPO and equity underwriting market is dominated by the major Japanese securities companies, of which we are one. We are lead underwriters to over 600 publicly listed corporations which sets us apart from certain competitors such as foreign securities companies. Unfortunately, both of our major rivals have historically been stronger than us in this segment. In a sense, since this business has long lead times and substantial barriers to market entry, the situation during 1999 was a natural result of this historical background. For example, 60% of new equity issues were from companies which had undergone an IPO during the last 5 years and a full 80% of issues from companies which had listed within the last 10 years. Moreover, many IPOs during the year were parented by companies which had themselves gone through an IPO in recent memory. This sort of situation tended to mean that those securities companies with established relationships continued to reap the rewards with little chance of a major shift in market power occurring. However, since this sector is strategically important to us, improving our relative competitive position is a matter of priority.

So now, after one year, what would you rate as the strategic strengths and weaknesses of Daiwa SBCM?

I have already alluded to the strength of our two parents, the Daiwa Securities Group and Sumitomo Bank. Mostly, we are talking here about access to clients. In this respect, although details are yet to be worked out, I think that the Sumitomo Sakura Bank merger which will integrate the client bases of four banks — Sumitomo, Mitsui, Taiyo and Kobe — will be exceptionally positive for us.

I also rate our status as a stand-alone wholesale securities company as a very significant competitive strength. I would urge you not to underestimate the competitive power of being able to focus on the professional securities markets. For example, in the days before the formation of this company, the ability of the former Daiwa Securities to formulate personnel policies appropriate to the retention of highly qualified staff was limited. To be brutally frank, there have been times in the past when I felt we were running a training academy for the benefit of foreign securities houses and headhunters. Since the corporate restructuring this situation has changed completely. We have established a remuneration system that better reflects performance. This will open the door to hiring talented market specialists. There is now even a flow of qualified staff back to Daiwa SBCM from those very companies to whom we had earlier lost them.

On the product side, I would point to our equity trading capability as a core strength of this company. For example, in basket trading with institutions we rank among the top houses and command around one fourth of the market. We intend to strengthen our equity underwriting capabilities by utilizing this position in the secondary market.

In the bond market we also rank among the top houses for corporate bonds and in the JGB market in terms of providing liquidity. In addition, it is a point of some pride for us that according to an independent survey of institutional investors, we rank number one overall taking into account quality of information, underwriting and trading prowess.



Our status as a  
**STAND-ALONE**  
 Wholesale Securities Company  
 is a significant competitive  
**STRENGTH**

Of course, I have already alluded to the strong start we have made in business sectors such as derivatives, structured finance and M&A. These are areas which have sprung into being as a consequence of the Big Bang reforms and where we have been able to exploit our new-found corporate agility to establish an early lead.

Finally, I would like to allude to our strong IT backbone. Indeed the importance of technology in our business is so pervasive that neither quality service for customers nor competitive advantage can be achieved without it. Daiwa made significant investments in this area a long time before Daiwa SBCM was positioned as a joint venture. This is because qualities such as speed, accuracy, efficiency, capacity and convenience for customers as well as ultimately the performance of the company, are directly linked to the quality of the systems infrastructure. A great deal of the leadership we enjoy in such areas as equity trading can be directly attributed to the strong systems we have in place, including our PowerTrade II and ATRAS systems in the equity area and our Total Bond Analysis (TBA) system in bonds. One area in which we are making great strides is in the application of Internet technology to the professional securities markets. For example, in April 2000, this company became the first company in Japan to manage the underwriting procedure for a corporate bond, in our case for Sumitomo Bank, entirely over the Internet. In future, we will continue to streamline the flow from order to settlement and strengthen our risk management systems drawing on our past experience.

In the interests of balance, I should also point out our areas of weakness. This includes primarily the lack of relative strength in equity underwriting that I referred to above. Our first priority here is to greatly enhance our IPO operations since these represent the motherload from which other business opportunities eventually follow.

Secondly, as a challenge to be faced, I would point out that the status of our overseas network is under review now that we have completed the restructuring phase. To clarify responsibilities, we have implemented a functional reporting system where the head of each product line monitors profitability and risk control.

I would like to note here that our overseas equity operations remain intact and are adequately structured to support the Group's ambitions going forward. We have a strong sales and trading capability, adequate placing power for global offerings of Japanese issues, and are the market leader in Japanese placement of global equity offerings by overseas issuers. The placement of Deutsche Telecom shares in Japan is a good example of our position as the industry leader in this field. In the bond area, we are investigating expanding the operations of our London subsidiary to boost its presence in the Euromarkets.

## WHOLESALE Company

Daiwa Securities SB Capital Markets Co. Ltd. (Daiwa SBCM) was established through an alliance between the wholesale division of the former Daiwa Securities Co. Ltd. and The Sumitomo Bank, Limited (Sumitomo Bank). This 60% Daiwa-owned consolidated subsidiary started operations on April 5, 1999.

During the financial year that ended on March 31, 2000, Daiwa SBCM recorded revenues of 172.0 billion yen, operating income of 72.5 billion yen and ordinary income of 73.0 billion yen. To strengthen the quality of its balance sheet, the company took an extraordinary loss of 219.3 billion yen accounted for almost entirely by writing off the goodwill acquired on commencement of operations and by expenses relating to the company's creation as well as a provision related to a multi-employer pension plan. The company recorded a pretax loss of 146.3 billion yen which, under applicable tax-deferred accounting, became a net loss of 85.0 billion yen.

Daiwa SBCM's sales and trading activities cover a full range of both equities and fixed-income securities. The company's investment banking activities include mergers and acquisitions (M&A), structured finance, derivatives, IPOs and underwriting. Several of these businesses are traditional strengths of the Daiwa Securities Group. Others such as derivatives, structured finance and M&A are new strategic businesses addressing markets emerging in response to regulatory and market change.

Major market transformations forecast by Daiwa SBCM over the next several years are as follows:

- 1) The reform of Japan's legal and tax framework and the growing trend to direct financing as well as measures geared to corporate reorganization such as mergers, divestitures, and new incorporations will drive substantial growth in the capital markets.
- 2) Major revisions to Japanese accounting standards and practices will force a paradigm shift in asset liability management (ALM). Foremost among the changes anticipated are consolidated accounting, mark-to-market standards for assessing the value of financial products, and retirement benefit accounting.
- 3) Amendments to the Special Purpose Company Law and the Investment Trust Law will lead to increasing securitization of assets. Of special interest are developments relating to the securitization of real estate assets.
- 4) Pension system reform will add impetus to increased interest in alternative asset classes offering superior long-term returns.

Given these trends, it is certain that the next several years will see major changes in wholesale securities markets in Japan. While direct comparison with overseas markets is at best a rough guide, trends in already deregulated markets point to the following changes in Japanese financial markets:

## TIMETABLE OF REGULATORY CHANGES

	1997	1998	1999	2000	2001
<b>ASSET MANAGEMENT BUSINESS</b>					
Introduce various types of investment trusts <i>Introducing mutual funds, private funds, and lifting of OTC derivatives rules</i>		○			
<b>CORPORATE FINANCE</b>					
Change rules of issuing MTN and ABS <i>1997: MTN, 1998: ABS</i>	○	○			
Facilitate IPO process <i>Introduction of book-building method for IPO pricing</i>	○				
Reinforce functions of OTC equity market <i>Introduction of stock lending</i>	○				
Lift restrictions on handling private equity <i>Securities firms to handle private equity</i>	○				
<b>BROKERAGE</b>					
Abolish restrictions on dual operations <i>Introduction of general securities accounts and wrap accounts permitted in 1997 &amp; 1998 respectively. Securities firms permitted to operate as investment advisors.</i>	○	○			
Introduction of Private Trading System (PTS) <i>Securities firms are permitted to establish and manage PTS</i>		○			
Liberalisation of equity brokerage commissions <i>Full liberalization of stock brokerage commissions</i>		○	○		
Abolish regulation regarding entry and exit of securities firms <i>Move from licensing to registration system</i>		○			
Business entry between banking and securities business <i>Abolish restrictions regarding operations of banking, and securities affiliates: Restrictions on operations excluding equity-related products in 1997. Full liberalization in 1999.</i>	○		○		
Holding company structure <i>Approval of two laws regarding holding company structure</i>	○				
<b>EFFICIENT MARKET SYSTEM</b>					
Abolish rules on concentrating securities transactions to exchanges <i>Promote competition among markets</i>		○			
Improve securities transactions and settlement methods <i>JGB, corporate bonds and equity to move to T+1 settlement by FY2002</i>	○	○	○	○	○
<b>FAIR AND TRANSPARENT TRANSACTIONS</b>					
Expand scope of definition for securities <i>Covered warrants and DR (Depository Receipt) added</i>		○			
Emphasis on consolidated-basis accounting <i>Introduction of consolidation based on control, and consolidated financial statements</i>		○	○	○	
Introduction of accounting standards for financial products <i>Mark-to market accounting and hedge accounting</i>				○	○
Introduction of accounting method for retirement benefits <i>Accrual basis accounting. Pension to be shown on balance sheet</i>				○	
<b>RULES FOR BROKERS - SOUNDNESS AND LIQUIDITY</b>					
Expansion of securities firms disclosure and enforcement of segregation of client assets <i>Disclosure of capital adequacy ratio of securities firms. Establishment of protection trust fund for investors</i>		○			

- 1) Despite the increase in activity for the wholesale securities industry, consolidation will lead to a concentration of market share, with the emergence of a limited number of dominant players.
- 2) There will be a major shift in revenue structure away from sales-oriented commissions towards trading and investment banking.
- 3) Increasing deal size will drive expanded need for capital.
- 4) As new product development increases in importance, information technology (IT) will play an ever more vital role in sharpening the leaders' edge.

Given these market transformations, key leadership factors will include management flexibility in responding to new opportunities and threats; enhanced product development capabilities; breadth and depth of reach in all client categories, both domestic and foreign; and the power to procure and allocate capital efficiently.

### **Competitive Advantages**

In its first year of operation, Daiwa SBCM has both decisively demonstrated a number of competitive advantages and identified the competitive challenges that must now be overcome to achieve its corporate goals.

Advantage number one is Daiwa SBCM's solid relationships with its two shareholders: the Daiwa Securities Group Inc. and Sumitomo Bank, one of Japan's strongest commercial banks. The company's dual parentage vastly increases access to clients, particularly corporate clients, as well as a wide range of synergies drawing on the complementary strengths of the two companies.

Advantage number two is the business model, which is clearly focused on wholesale securities markets. This enables swifter and more accurate management response to market developments, and improved ability to tailor human resources and other policies to the specific needs of the company. In this way, Daiwa SBCM can take full advantage of new opportunities as the pace of change in Japanese wholesale securities markets accelerates.

### **Market Leadership**

As a member of one of a handful of fully integrated securities groups in Japan, Daiwa SBCM benefits not only from immense domestic reach but also important synergies with the retail and other Group companies.

Daiwa SBCM enjoys an especially strong position in equity and fixed income trading where it has been able to achieve an outstanding performance due to support from institutional investors. Building on these fundamental strengths, the company has moved quickly to establish a lead among major Japanese securities houses in derivatives and asset securitiza-

tion. In addition, Daiwa SBCM is consolidating resources and forming alliances to establish a leadership position in other areas of investment banking.

There are, however, areas — equity underwriting, IPOs and, in a different form, M&A, for example — where the company trails the market leaders. Effective use of the greater reach provided by the company's relationship with Sumitomo Bank and agility in responding to shifts in the underlying structure of markets are the keys to closing these gaps.

Daiwa SBCM's short-term goals are those set out in the Daiwa Securities Group's group strategy, i.e., to establish a clear leadership position in domestic securities markets, to improve the quality of earnings, and to strengthen the group balance sheet. For example, overseas branches of the former Daiwa Securities Co. Ltd, which sustained major losses in FY 1998, have been scaled back and restructured. Since October 1999, with limited exceptions, they operate along functional reporting lines as subsidiaries of Daiwa SBCM. The immediate results of strategically concentrating management resources on Japan-related businesses include a striking improvement in financial performance. However, the globalization of the Japanese economy calls for Daiwa SBCM to reconstitute its presence in the global capital markets. Rebuilding the overseas network in support of this new paradigm is a top-priority objective for the coming financial year.

### Equities Division

Daiwa SBCM's Equities Division is one of the leading players in equity trading in Japan, with a strong base in principal trading and IT intensive services. Daiwa SBCM has firmly established its position, with an approximately one-fourth market share in the non-auction markets (off-market and out-of-trading-hour transactions). These transactions consist mainly of basket trading and large lot transactions with institutional investors. During Daiwa SBCM's first year of operation, the Equities Division recorded brokerage commissions of 31.9 billion yen and trading gains of 33.2 billion yen, accounting for over one-third of the company's total revenues.

Equity brokerage commission revenues for the year to March 2000 declined following the total liberalization of commission rates in October. The main reason for this decline lies in the fact that most institutional investors shifted to transactions conducted on a net commission basis (transactions where commissions are included in the quoted price). Due to the rise in volumes, the liberalization of commissions had a minimal net impact on the total of commission and trading revenues considered together.

Sophisticated support systems have been developed to take full advantage of the talents and experience of Daiwa SBCM's traders and sales personnel. An example is ATRAS, an order system which allows for speedy execution of complicated transactions. PowerTrade II monitors the market, supports position control and provides traders and salespeople with an advanced End-User Computing (EUC) environment. Combined these functions enable strict real time position control and quick and accurate pricing. By utilizing these systems,

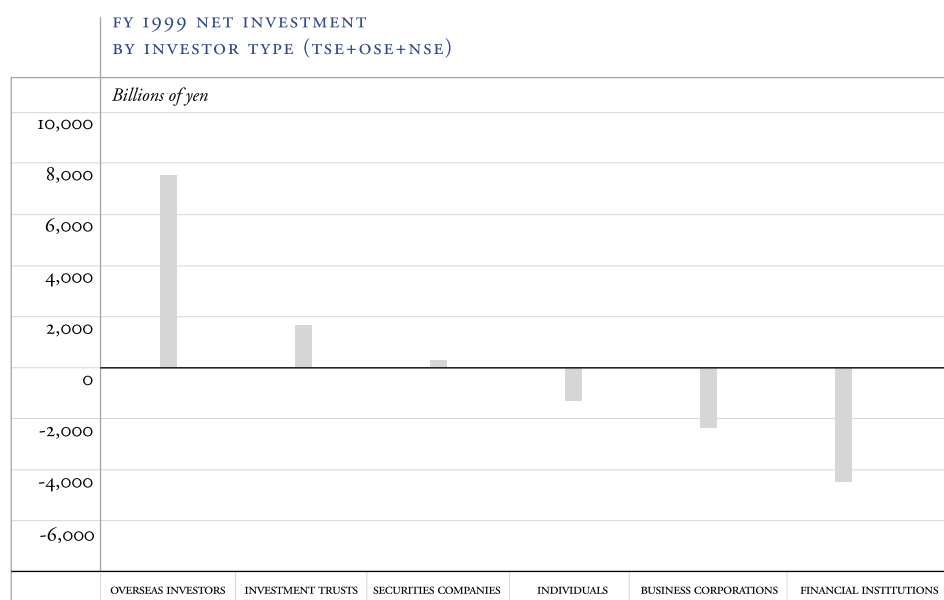
the division has been able to provide competitive execution services to institutional investors.

The Equities Division actively pursues opportunities arising from changes in the share ownership of Japanese corporations. The need to unwind corporate cross-shareholdings is facilitated through block trading and placement of shares with institutional investors. These methods enable corporations to unwind shareholdings with limited negative impact on market prices. Daiwa SBCM's global product line, which provides access to both the domestic and overseas networks, is key to its competitive advantage in this business.

The division is also Japan's front runner in electronic trading. The Daiwa Integrated Order (DIO) system utilizes the Financial Information Exchange (FIX) Protocol, the standard for electronic execution of stock transactions by institutional investors, and provides overseas institutional investors with the ability to place orders directly with stock exchanges in Japan. Furthermore the ATRAS Management System provides domestic investors with access to back office facilities. Daiwa SBCM has been able to apply its accumulated technological know-how to differentiate itself in this area.

The division works closely with Daiwa Institute of Research analysts to provide clients with corporate research and other information on a timely basis. Steps are being taken to enhance advisory functions extended to corporate investors in respect of the effects introduction of mark-to-market accounting may have on their portfolios.

The Equities Division is already providing the retail securities company with Volume Weighted Average Pricing (VWAP) transaction facilities and will continue to utilize its capability and knowledge of equity trading for the benefit of other Group companies. The



division will continue its development efforts and investments to maintain its leading position in the area of IT. Furthermore the division regards it as important to utilize its technological resources for the development of promising markets such as TSE Mothers, Nasdaq-Japan of the Osaka Securities Exchange and JASDAQ, and to provide higher levels of service to clients as well as in its trading operations.

Reporting lines for all aspects of the Equity Division's business are now functional, run from Tokyo, and global in scope. Japanese equity sales and trading conducted at the overseas offices are closely linked to Tokyo's equity positions. This enables Daiwa SBCM to service clients globally on a 24-hours basis.

### **Financial Markets Division**

The main business of the Financial Markets Division of Daiwa SBCM is to facilitate the bond trading needs of institutional investors. FY 1999 saw vigorous trading by investors in corporate and emerging market bonds as interest rates globally fell from the highs reached during 1997 and 1998. Moreover, as the Bank of Japan (BOJ) adhered to its zero interest rate policy, investors purchased large quantities of structured notes in an attempt to achieve higher yields. The Financial Markets Division was able to respond flexibly and swiftly to accommodate these trends with beneficial results for the bottom line.

Mark-to-market accounting for financial instruments became applicable in April 2000, while real-time gross settlement (RTGS) for government bonds is scheduled for introduction from December or later. In addition to the rapidly changing regulatory landscape, the bond market itself is also rapidly evolving, especially as competition increases and online trading gains ground. Business trends which historically would have been spread over the course of several years are now compressed into a single year or even into a timescale measurable in months. Innovation, building on strength in traditional bond markets and the strength of the Daiwa Securities Group, is the core competitive requirement for the Financial Markets Division.

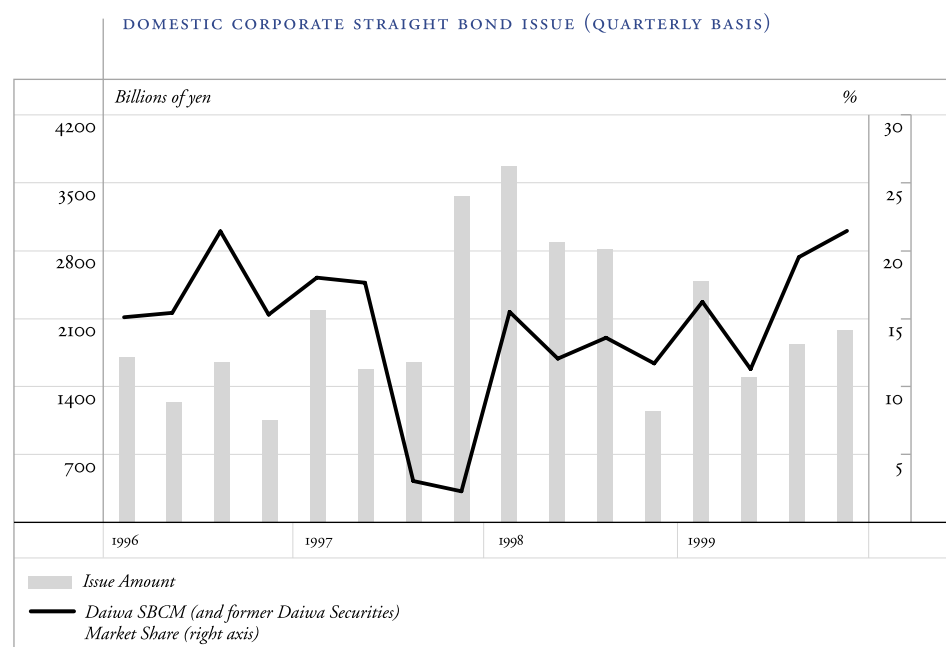
The division has, for example, established a dedicated team to assist customers in making a smooth transition in the application of mark-to-market accounting. The division already offers its proprietary Total Bond Analysis (TBA) system allowing customers to analyze their own portfolios independently. Work is in progress to enhance the system and improve its operability with a keen eye to the rapidly approaching age of the Internet. Daiwa SBCM is convinced that completion of this new TBA (named TBA Online or TOL) should dramatically benefit clients as it enables them to perform online, market value-based portfolio evaluations. Because the changes planned for government bond settlement requirements will require a huge investment to build new systems and infrastructure, decisions made in this area will be important to the long-term outlook of the division. In this area, too, the division has formed a project team to assist its customers in successfully shifting to the new system.

The Internet is a vital tool for the Financial Markets Division. It has been aggressive in promoting the usage of this technology in areas such as underwriting and syndication. Furthermore, Daiwa SBCM has taken an equity stake in asiabondportal.com, Inc. together with other major international investment banks to provide information and market making facilities for Asian bonds.

Against this background, the Financial Markets Division will continue to place emphasis on analysis of the bond market and individual bonds encompassing research, strategy assessment, credit evaluation, and quantitative analysis. As a consequence of low interest rates, institutional investors, particularly financial institutions, are now more conscious than ever of portfolio performance. Consequently, the demand for research and analysis can only increase. Investors now demand ever more sophisticated investment methods and techniques. The Financial Markets Division is committed to meeting the needs of such investors by assigning the correct human resources and implementing systems to reflect customer feedback in service provision.

The division prides itself on its ability to satisfy client needs across a wide spectrum. This was reflected in the high marks received in a survey of investors conducted by a prominent American consulting house. It listed Daiwa SBCM's Financial Markets Division as ranking top in terms of customer satisfaction in the handling of domestic bonds.

The most vital near-term objective for the division is to increase its reach among overseas investors to match the success it enjoys domestically, as the weight international investors occupy in the division's target markets naturally increases. Consequently, it intends to reinforce its services and infrastructure overseas, especially in Europe and Asia.



## Investment Banking and Corporate Institutions Division

### *Bonds*

Driven down by falling capital expenditures and balance sheet rationalization, the volume of straight bonds issued in Japan fell by around 26% to 7.8 trillion yen during the year to March 2000. While some of Japan's traditional securities companies lost market share to securities companies affiliated with banks, Daiwa SBCM performed well during the year, not only losing no market share, but actually seeing its share of the overall market increase. The improvement was mainly due to an increase in the underwriting of issues sourced from Sumitomo Bank's client networks.

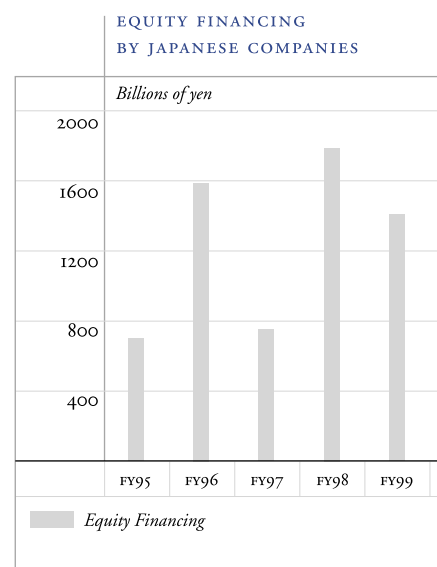
### *Equities*

In Japan, the equity IPO and underwriting business is dominated by the three major Japanese securities firms due to the necessity of having a strong retail network in order to compete effectively in this business.

During the year to March 2000, equity underwriting and distribution revenues for Daiwa SBCM were 23.4 billion yen. This figure is 68% above the 14.0 billion yen recorded by the former Daiwa Securities Co. Ltd. during the previous year.

Improving its position in this business is a top-priority goal for Daiwa SBCM. It is seen as especially important since primary business including IPOs are the starting point for many other kinds of business.

The company currently has a team of relationship managers, responsible for major companies in the cities in which their offices are located, split between offices in Tokyo, Osaka



and Nagoya. Daiwa Securities, the retail securities company, is responsible for relationship management for companies outside of, or on the fringes of, the major metropolitan areas. Prior to a reorganization in February 2000, relationship management responsibilities for non-public and public companies were managed by separate divisions. Following the reorganization, responsibilities have been allocated functionally and divided into relationship management and deal execution. In this way, clients will maintain contact with the same division even after going public. Furthermore, to strengthen the marketing and investigation functions, professional staff such as accountants and tax accountants have been hired externally.

In order to build relationships with potential IPO candidates, Daiwa SBCM is supplementing the efforts of its own sales force by working closely with NIF Ventures, the Group's venture capital arm, and Sumitomo Bank as well as by utilizing information collected from accounting firms, life insurance companies, and other venture capital companies.

Daiwa SBCM has, for some time now, emphasized growth sectors with better than average prospects, with top priority given to IT. Further out, it has also targeted the environmental, biotechnology, nursing care, and e-business sectors. Daiwa SBCM will continue to strengthen its capacity to introduce companies with high growth potential to traditional markets as well as to newer markets such as TSE Mothers and Nasdaq - Japan of the Osaka Securities Exchange.

Daiwa SBCM is convinced that its current strategy is a viable long-term approach to achieving market leadership.

### **Financial Products Division**

The Financial Products Division enjoyed an excellent year. Derivative revenues approximately doubled compared to the previous year's combined results for the former Daiwa Securities and Sumitomo Bank. Derivatives are one of the three pillars of growth (comprising derivatives, structured finance and M&A) identified by Daiwa SBCM.

The division is active in all segments of the derivatives markets but has staked an especially strong position in equity derivatives, which were greatly liberalized following legislative changes in December 1998. According to statistics regarding "Trading of Derivatives on the Securities OTC Market" released by the Japan Securities Dealers Association covering the period from October 1999 to March 2000, Daiwa SBCM ranked top in terms of trading value, volume outstanding and in number of transactions of equity derivative products. Equity derivatives carry higher profit margins than other products and are expected to continue to be a major contributor to revenues. Other revenue sources included interest rate/currency derivatives, structured bonds, and credit derivatives. Demand for interest rate and currency derivatives decreased due to limited needs for hedging by investors owing to

the BOJ's zero interest policy. However, taking into consideration the implementation of mark-to-market accounting and the recovery of the Japanese economy, demand for interest rate derivatives will most likely recover and contribute to revenues to a degree comparable to that of equity derivatives.

In the institutional market, Daiwa SBCM's success was due to its capacity to provide solutions, which in turn was made possible by an enhanced risk management ability and the strength of the trading departments. Keys to these abilities include an extremely strong middle office, with quantitative analysis skills far superior to the industry norm. In addition, sales traders are in constant touch with major institutions to ensure the highest possible level of client service and support. Moreover, the division is the first in Daiwa SBCM to implement a remuneration system based on merit and market norms. This has enabled the division to hire high-quality professionals as well as leading to an increase in productivity.

The advent of mark-to-market accounting for equity cross-holdings, which is scheduled to become mandatory in Japan for results to be announced after March 2002, will increase demand for derivatives. Strategic hedging of portfolios to minimize price risk will also require use of derivative products. To address these opportunities, the division is adding expert accountants to its current staff to deal with market-to-market issues raised by clients.

Derivative products placed through retail channels include stock-linked deposits through Sumitomo Bank as well as equity-linked bonds and covered warrants distributed through Daiwa Securities. To diversify revenue sources, the Financial Products Division will continue to develop products customized for the retail channel in the current low interest rate environment.

Compliance plays an important role in trading with both institutional and individual investors. In the institutional sector, the division concentrates on economically rational business opportunities and on building long-term relationships with clients by acting as a risk management solution provider. Although one current focus is on opportunities created by the introduction of mark-to-market accounting, high-risk, non-transparent transactions involving derivatives are avoided. In the retail sector, improvements in customer education and sales force training are laying the groundwork for future growth.

Together with a strong middle office and superior skills in quantitative analysis, providing customers with information to raise their level of product understanding lies at the heart of the division's activities. From the beginning it has been the Financial Products Division's policy to contribute to the healthy development of the derivatives markets by providing educational programs to market participants. The division has been the industry leader in providing both financial and human resources for this purpose.

Regularly published client guides, recent examples being the publication of guides related to integrated risk management techniques and derivative disclosure requirements, have been well received by customers. In addition, both large-scale and client-specific presentations are regularly held. For example, a seminar on mark-to-market accounting early in 2000 drew 1,500 attendees.

### Structured Finance Division

Structured Finance Division staff include qualified attorneys and real estate appraisers, together with accountants and other specialists to handle securitization and principal finance businesses.

The Division has rapidly established itself as the market leader in the Asset Backed Securities (ABS) market. Securitization was initially limited to leases and credit receivables, but has recently been applied to an increasingly diversified range of assets. In FY 1999, the securitization of real estate commenced and has since grown to become one of the main businesses.

One measure of the recognition this division has achieved in the market came when Daiwa SBCM was named the ABS House of the Year for 1999 by Thomson Dealwatch, a well-known industry monitoring service. The division has received high marks from the market due to its commitment to asset securitization and to developing new methods and structures.

Some of the main securitization transactions in FY 1999 were:

- 1) Shopping credit receivables by Orient Corporation (publicly issued securities backed by revolving shopping credit receivables)

ABS ISSUES DURING 1999			
DEALS CLOSED IN FY99			
Sumitomo Real Estate <i>Office building</i>	Nissan Credit <i>Auto loan</i>	Nippon Life <i>Office building</i>	
Asahigin Leasing <i>Lease</i>	Daiei OMC <i>Card shopping</i>	NEC <i>Headquarters building</i>	
Asahi Breweries <i>Factory site</i>	QUOQ <i>Reform loan</i>	NEC Leasing <i>Lease</i>	
Orient Corporation <i>Shopping credit</i>	Sumitomo Bank <i>Branch offices</i>	Hotel New Hankyu <i>Hotel</i>	

- 2) House improvement loans by QUOOQ (Japan's first pass-through type ABS)
- 3) Lease assets by NEC Leasing (Japan's first soft-bullet type ABS backed by lease assets)
- 4) Securitization of 20 branches of Sumitomo Bank (Japan's first public ABS issue backed by real estate)
- 5) Securitization of an office building for Sumitomo Real Estate (Japan's first securitization of an office building)
- 6) Securitization of Asahi Breweries' Omori Plant (a highly complex deal involving an operating plant)
- 7) Securitization of the head office of NEC Corporation (Japan's largest securitization of a headquarters building)

Daiwa SBCM has also entered the aircraft financing market and is actively considering opportunities for further expansion in this sector, particularly in Europe and Asia. Aircraft financing is a potential growth area due to the relatively stable secondary market for aircraft and the presence of a huge lease market. Expansion into this market will further diversify the range of products Daiwa SBCM can offer its investors.

As the examples mentioned above demonstrate, Daiwa SBCM has moved quickly to position itself as a leader in securitization, expected to become a one trillion yen plus market. To meet originator and investor needs, the asset financing business will be further enhanced to cover a wider range of underlying assets including financial assets, real estate related assets such as residential loans, and real estate held by the national and regional governments, as well as aircraft and intellectual property. Business development based on already powerful structuring capabilities, the Company's relationships with the Daiwa Securities Group and Sumitomo Bank and the ability to market to a wide range of clients in Japan, are central components in efforts to widen an already well-established lead.

Principal finance activities consist of making investments in instruments that are non-traditional for a securities company, falling outside of traditional areas such as publicly traded equity, bonds and investment trusts. Although the main assets used to date have been financial assets held by financial institutions, expansion into areas such as private equity is presently under consideration.

### ***Establishment of a Real Estate Investment Fund***

Daiwa SBCM believes that Japanese real estate investment trusts (REITs) will experience similar market expansion to that seen in the US subject to the passage of relevant legislation, the introduction of an accurate real estate valuation process, and the establishment of a liquid secondary market. The need for a more diversified product range under the current low interest rate environment is also a supportive factor.

In preparation for deregulation measures allowing establishment of REITs, Daiwa SBCM established a 50:50 real estate investment fund with Mori Trust Co., Ltd. (Mori Trust), a major Japanese real estate firm, in February 2000. This company was the first to be established with a focus on creating and managing REITs based on the amended Investment Trust Law expected to be enforced after the fall of 2000.

This alliance is based on the recognition by both companies that the promotion of real estate securitization and the liquidity of the real estate market are important social issues. Mori Trust is one of Japan's leading companies in real estate investment and management and is an owner of prime office buildings in the metropolitan area. Thus the alliance with Mori Trust represents a competitive advantage for Daiwa SBCM in this field.

The first real estate fund is expected to be listed as early as the current fiscal year. Daiwa SBCM aims to become a market leader in REITs.

### **Mergers and Acquisitions Division**

Corporate restructuring, including mergers and acquisitions (M&A), is rapidly moving to center stage in Japan. This has, in turn, given rise to strong demand from corporations for advisors that can introduce a wide range of global counterparties, provide fair valuations, a variety of solutions, and appropriate tax planning advice. In such transactions, it has become increasingly important for corporations to choose an advisor with the correct credentials including track record, knowledge, and access to quality information. Moreover, with the legal system being amended to accommodate transactions utilizing stock transfers and stock exchanges, the increase in M&A activity will be accompanied by a trend to larger and more complex transactions.

Daiwa SBCM's parentage gives the company a strong market position in domestic M&A transactions. Combining a strong domestic image with close ties to the information networks of both the Daiwa Securities Group and Sumitomo Bank, Daiwa SBCM is now in a good position to source new transactions.

While the Mergers and Acquisitions Division operates across all sectors, it assigns strategic priority to the automobile-related industries, pharmaceuticals, IT, telecommunications, distribution, and the food industry. This focus reflects both current market trends and also the traditional strengths of Daiwa SBCM.

#### *Alliance with Lazard*

To date, large cross-border M&A transactions for Japanese corporations have been dominated by well-placed foreign banks. The signing of a non-exclusive memorandum of understanding with the US-based M&A specialist Lazard has significantly strengthened Daiwa SBCM's market position. The relationship is a natural one, since Lazard, the Daiwa Securities Group and Sumitomo Bank have long worked closely together. Lazard with offices in New York, Paris and London has a track record in Europe and the US while Daiwa SBCM boasts a strong domestic client base. The alliance allows the partners to significantly strengthen their M&A activities in Asia, Europe and the US.

The Lazard relationship has greatly enhanced the company's ability to contribute to Japanese companies' restructuring efforts by providing access to overseas investors and corporations and will expand Daiwa SBCM's potential deal stream for the foreseeable future.

#### *Joint Venture with GE Capital*

Daiwa SBCM has also signed a memorandum of understanding with GE Capital, a wholly owned subsidiary of the US-based General Electric Company, to form the "Japan Equity Capital Fund" (Fund), a new private equity investment fund in Japan. Owned 50% by GE Capital and the balance by the Daiwa Securities Group, Sumitomo Bank and Sumitomo Corporation, the Fund will be jointly managed and operate independently of the partners' existing businesses. The initial investment cap was set at 20 billion yen. Due, however, to strong demand, the Fund may be increased to up to 100 billion yen.

The Fund is designed to address opportunities thrown up by the wave of corporate restructuring now prevailing in Japan, as larger corporations spin off non-core operations and medium-sized companies become more willing to accept equity capital in the course of restructuring of operations. Demand for this sort of fund is expected to increase.

Investment opportunities are concentrated in IT related and mature industries, The Fund has an investment horizon of between five and seven years with a goal of exiting via an IPO or acquisition.

#### **Overseas Operations**

Major changes were made to the structure and management of the overseas operations of the Daiwa Securities Group during FY 1999.

On October 1, 1999 the following overseas securities subsidiaries of the Daiwa Securities Group, Inc. were transferred to Daiwa SBCM.

#### *Europe and Middle East*

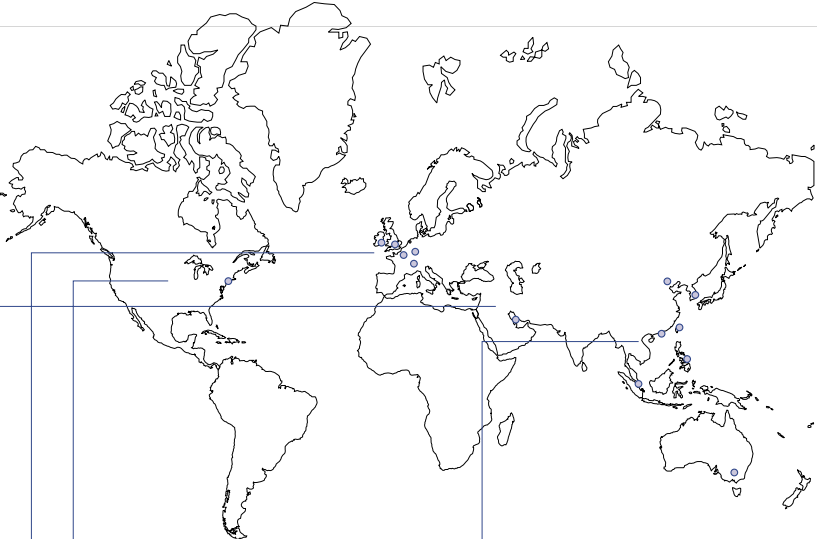
Daiwa Securities SB Capital Markets Europe Limited (including branches in Paris, Frankfurt, Geneva, and Bahrain)

### *Asia and Oceania*

Subsidiaries in Hong Kong, Singapore, Australia, Taiwan and the Philippines (a joint venture company)

For managerial purposes, these subsidiaries are now organized along functional rather than geographic lines. Reporting lines, applied globally, are now to the heads of the Equity, Financial Markets, Investment Banking, Finance & Administration and Legal & Compliance functions as appropriate.

The overseas equity operations of Daiwa SBCM remain fully capable of supporting the Daiwa Securities Group's equity trading and sales activities. The Group supported by Daiwa SBCM's investment banking capabilities has adequate placing power to support global Japanese equity offerings. Moreover, in certain segments of the overseas equity markets, for example in selling US equity products to Japanese retail and institutional investors,

OVERSEAS BRANCHES	
	
U.S.A	Daiwa Securities America Inc. Daiwa Securities Trust Company
EUROPE	Daiwa Securities SB Capital Markets Europe Limited Paris Branch Frankfurt Branch Geneva Branch Daiwa Securities Trust and Banking (Europe) plc Dublin Branch
MIDDLE EAST	Daiwa Securities SB Capital Markets Europe Limited Middle East Branch
ASIA	Daiwa Securities SB Capital Markets Hong Kong Limited Daiwa Securities SB Capital Markets Singapore Limited Daiwa Securities SB Capital Markets Australia Limited DBP - Daiwa Securities SB Capital Markets Philippines Inc. Daiwa Global Securities Co. Ltd. Daiwa Securities SB Capital Markets Co. Ltd. Seoul Branch Beijing Office Shanghai Office

the company ranks as a significant force. In addition, as the lead manager in Japan for global offerings during FY 1999 for Deutsche Telecom, Societe Generale and Australia-based Telstra, Daiwa SBCM has already established itself as a leader in primary offerings of overseas equity into the Japanese market. The overseas fixed income business, with an emphasis on yen-denominated products, is presently under review with a view to further establishing its position as a major player in the global bond business. Expansion into other areas will also be considered as financial, technological and human resources become available.

Daiwa SBCM is giving active consideration to increasing the value of its overseas operations through expansion of business lines related to Japanese securities markets, particularly in its primary markets activities.

### **Risk Management**

Daiwa SBCM and its affiliated overseas securities operations handle all aspects of the Group's involvement in the wholesale securities business. Their activities include the trading and underwriting of securities and trading of derivatives.

The main authority for risk management within Daiwa SBCM lies with the Risk Management Committee, the members of which include the president, deputy presidents, and executives of relevant departments. This committee meets quarterly to decide risk management policy and to set acceptable levels of credit, market, and liquidity risk as part of an integrated risk management process. Specific issues concerning risk management are considered at monthly meetings of the Risk Management Committee-General Managers Meeting.

Risk measurement and management basically starts with position management and hedging at the front office level in each product area. A two-stage monitoring mechanism has been established. Firstly, each product category has a specialist middle office department that operates independently of the front office and manages all aspects of market risk, credit risk and liquidity risk. Secondly, the Risk Management Department, which is independent from the product and sales departments, monitors market risk and credit risk in cooperation with the middle office departments and reports to management. Management of liquidity risk is the responsibility of the Treasury Department.

The Treasury Department also operates independently of the marketing and trading operations, and has responsibility for ensuring availability of adequate funding and management of potential liquidity risk.

Overseas securities offices have their own internal independent risk management systems and are subject to supervision by the authorities in each country. Reporting lines have been restructured so that risk management reports are sent to the Risk Management and Treasury Departments.

Market risk is managed through the assignment of risk limits. The Risk Management Department uses the Value at Risk indicator, stress tests and scenario analysis to set risk limits that reflect the characteristics of each type of product. The product departments are obliged to conduct trading and other activities within the risk limits set for each product. Clear internal rules govern the procedures for setting and reviewing these limits.

Counterparty risk management is based on the type of transaction involved, including swaps, repos, and foreign exchange, using an in-house developed rating system. The system is used to assess the credit risk for clients involved in these transactions and was developed by the Risk Management Department in 1993. This rating system, which has been updated a number of times, covers approximately 4,200 Japanese corporations including all listed and OTC-traded companies, as well as all banks, life and non-life insurance companies, and regional financial institutions. Before undertaking transactions, sales and product departments and overseas offices are required to obtain credit limits from the Risk Management Department. These credit limits are based on credit exposure, which consists of current exposure (restructuring costs) and potential exposure.

DAIWA SECURITIES SB CAPITAL MARKETS CO. LTD  
Income Statement fiscal 1999 (apr.1, 1999 - mar.31, 2000)

	Amount Millions of yen
<b>Operating revenues</b>	172,069
Commissions	92,471
Net gain on trading securities	70,679
Net gain on other commodities trading	340
Interest and dividend income	8,578
<b>Operating expenses</b>	99,488
Selling, general and administrative expenses	93,816
Commission and other expenses	37,518
Employees' compensation and benefits	22,834
Real estate expenses	9,832
Data processing and office supplies	16,364
Depreciation expenses	4,115
Taxes other than income taxes	1,913
Others	1,237
Interest expenses	5,671
<b>Operating income</b>	72,581
Non-operating income	579
Non-operating expenses	150
<b>Ordinary income</b>	73,010
Extraordinary gains	-
Extraordinary losses	219,392
<b>Income before income taxes</b>	-146,382
Income taxes	17,358
Income taxes-deferred	-78,659
<b>Net income</b>	-85,080
Unappropriated retained earnings-carryforward	-8
<b>Unappropriated retained earnings</b>	-85,088

DAIWA SECURITIES SB CAPITAL MARKETS CO. LTD.  
Statement of deficit

	Fiscal year 1999 Millions of yen
Undisposed deficit for the period	85,088
Surplus from reduction of additional paid-in capital	85,088
<b>Total</b>	0
Disposal of deficit	517
Reserve for special depreciation	517
Deficit of carryover	517
<i>(Note) Reserve for special depreciation is provided by regulation of "The Notifications on the Special Taxation Measures Law".</i>	

**DAIWA SECURITIES SB CAPITAL MARKETS CO. LTD.**  
**Balance sheet (assets)**

	As of March 31, 2000 Amount millions of yen
<b>Current assets:</b>	<b>5,545,267</b>
Cash and time deposits	118,356
Cash segregated as deposits related to securities transactions	785
Receivables	5,942
Advance payments on securities subscribed	199
Short-term loans	31,835
Accrued income	4,863
Trading assets:	2,592,120
Trading securities and others	2,470,177
Option transactions	12,343
Derivative valuation accounts	109,599
Receivables related to margin transactions:	85,418
Loans receivable from customers for margin transactions	315
Cash deposits as collateral for securities borrowed from securities finance companies	85,103
Receivables related to gensaki transactions	24,099
Cash deposits as collateral for securities borrowed	1,004,175
Securities in custody	1,659,021
Short-term guarantee money deposited	9,547
Deferred income tax assets-current	4,387
Other current assets	4,583
Less: Allowance for doubtful accounts	-70
<b>Non-current assets:</b>	<b>141,385</b>
Tangible fixed assets	5,333
Building and structures	18
Equipment and others	5,314
Intangible fixed assets	11,543
Software	11,528
Telephone subscription rights	15
Investments and others:	124,508
Investment securities	590
Investment in subsidiaries	34,928
Long-term loans	35
Long-term guarantee deposits	8,336
Deferred income tax assets-non-current	74,272
Other investments	6,344
Less: Allowance for doubtful accounts	- 0
<b>Total assets</b>	<b>5,686,652</b>

**DAIWA SECURITIES SB CAPITAL MARKETS CO. LTD.**  
**Balance sheet (liabilities)**

	As of March 31, 2000 Amount millions of yen
<b>Current liabilities:</b>	<b>5,257,012</b>
Short-term borrowings	230,200
Commercial paper	145,600
Deposits received	10,763
Trade date accrual	125,262
Advance receipts on securities subscribed	6,574
Accrued expenses	4,853
Trading liabilities:	1,078,232
Trading securities and others	962,454
Option transactions	12,806
Derivative valuation accounts	102,971
Payables related to margin transactions:	34,198
Loans from securities finance companies for margin transactions	168
Proceeds of securities sold for margin transactions	34,030
Payables related to gensaki transactions	1,123,837
Cash deposits as collateral for securities loaned	803,975
Short-term securities borrowed	1,451,897
Cash deposits received from customers	12,737
Securities deposited by customers as collateral	207,124
Accrued income taxes	16,878
Accrued bonuses	3,300
Other current liabilities	1,576
<b>Non-current liabilities:</b>	<b>105,974</b>
Long-term borrowings	100,000
Accrued retirement benefits	1,029
Multiemployers' pension plan	4,232
Other non-current liabilities	712
<b>Statutory reserves:</b>	<b>744</b>
Reserve for securities transaction liabilities	744
Reserve for financial futures transaction liabilities	0
<b>Total liabilities</b>	<b>5,363,731</b>
<b>Stockholders' equity</b>	
Common stock	205,600
Legal reserve:	202,410
Additional paid-in capital	202,410
Deficit	85,088
Undisposed deficit for the period	85,088
(Net loss for the current year)	85,080
<b>Total stockholders' equity</b>	<b>322,921</b>
<b>Total liabilities and stockholders' equity</b>	<b>5,686,652</b>

## Basis of financial statements for the fiscal year 1999

### 1) Valuation of specified trading account

Securities, assets and derivative transactions in specified transaction account are recorded on a trade date basis at market value.

### 2) Valuation of non-trading securities and commodities other than securities

Listed securities are valued on settlement basis at the lower of cost-or-market, cost being determined by the moving average method. Unlisted securities and commodities other than securities are valued on a settlement date basis at cost determined by the moving average method.

### 3) Depreciation of assets

#### a) Tangible fixed assets

Declining-balance method is applied in accordance with the Corporate Tax Law.

Properties (except appendix) acquired after April 1, 1998 are computed under straight-line method in accordance with 1998 amendment of the Corporate Tax Law.

#### b) Intangible fixed assets and investments

The Goodwill is written-off as an extraordinary loss. Intangible fixed assets other than goodwill are computed under straight-line method in accordance with the Corporate Tax Law.

### 4) Amortization of deferred assets

Stock issue expenses and development expenses are amortized in a lump sum when disbursed.

### 5) Accounting for certain lease transactions

Finance leases in which ownership is not transferred to a lessee are accounted for in the same manner as operating leases.

### 6) Accounting for consumption taxes

Consumption taxes are separately recorded. Non-deductible consumption tax in connection with assets is expensed when incurred.

### 7) Accounting policies for various provisions

#### a) Provision for doubtful accounts

Allowance is provided, based on the specific assessment and the historical deterioration rate stipulated by the Corporate Tax Law.

#### b) Accrued employees' bonuses

Estimated amount of employees' bonuses are accrued based on company regulations.

#### c) Accrued retirement benefits

Retirement benefits for employees and directors are accrued based on the company regulations.

#### d) Multiemployers' pension plan

The company is a member of a multiemployers' pension plan that is an industry-wide multi-employer contributory welfare pension plan administered by the Securities Companies' Welfare Pension Fund. The funded pension plan has faced the problems arising from the decreasing members and continuing low interest rates. The company's liability is calculated, based on the difference between its projected benefit obligation and its fair value of the plan assets.

## Notes to balance sheet

- 1) Accumulated depreciation of tangible fixed assets 2,016 million yen
- 2) Intangible fixed assets  
Software included in "Other investments" until the previous year is reclassified as "Intangible fixed assets" in accordance with amendment (Ministry of Finance, Ministerial Order number 135,1998) of "Regulation on Terminology, Forms, and Preparation Methods of Financial Statements" (Ministry of Finance, Ministerial Order No. 59, 1963).
- 3) Subordinated borrowings  
Long-term borrowings are the subordinated borrowings stipulated under "Article 2 of the Ministerial Ordinance on the Capital Adequacy Rule for Securities Companies" (the Prime Minister's Office Ordinance and Ministry of Finance Ordinance No. 28, 1999).

## Notes to income statement

- 1) Details of extraordinary losses

	Millions of yen
Write-off of goodwill	208,000
Non-deductible consumption tax and others regarding goodwill	4,359
Provision for multiemployers' pension plan	4,232
Expenses for foundation	2,056
Provision for reserve for securities transaction liabilities	7449
Provision for financial futures transaction liabilities	0

- 2) Write-off of goodwill  
The goodwill acquired on commencing operations was written-off in a lump sum as an extraordinary loss.
- 3) Expenses for foundation  
Expenses for foundation were posted as an extraordinary loss as the company amortized the development costs and new share issue costs on its commencing operations in a lump sum.