

Daiwa Securities Group

2001-2002-2003  
OUR FIRST HUNDRED YEARS  
Annual Report

**OUR  
FIRST  
HUNDRED  
YEARS**

---

## Contents

---

Letter to Shareholders	2
History 1902-2002	4
Roundtable with Management	8
Daiwa Securities Group Inc.	16
Daiwa Securities Co. Ltd.	30
Daiwa Securities SMBC Co. Ltd.	42
Other Domestic Main Group Companies	66
The Daiwa Securities Group	76
Leadership	78
Overseas Directory	80
Consolidated Financial Statements	81
Corporate Data	116

---

This annual report may contain forward-looking statements about the Daiwa Securities Group. You can identify these statements by the fact that they do not relate strictly to historic or current facts. These statements discuss future expectations, identify strategies, contain projections of results of operations or of financial condition or state other “forward-looking” information. These statements are based on currently available information and represent the beliefs of the management of the Daiwa Securities Group. These statements are subject to numerous risks and uncertainties that could cause the Daiwa Securities Group’s actual results, performance, achievements or financial condition to differ materially from those described or implied in the forward-looking statements. The Daiwa Securities Group undertakes no obligation to publicly update any forward-looking statements after the date of issuance of this annual report. These potential risks and uncertainties include, but are not limited to: competition within the financial services industries in Japan and overseas, our ability to adjust our business focus and to maintain profitable strategic alliances, volatile and sudden movements in the international securities markets, foreign exchange and global economic situations affecting the Daiwa Securities Group.

---

## Letter to Shareholders

---



2002 is the centennial of the founding of the Daiwa Securities Group. The first hundred years of our existence have certainly been eventful ones. The emergence of mass production and mass consumption and the triumph of liberal democracy as the dominant political system are the two trends for which I personally believe the twentieth century will be remembered. Neither of these would have been possible without functioning financial systems and securities markets, which allow capital to be readily redirected to the most promising areas. Daiwa Securities Group is proud to have been able to play a role in the development of global securities markets

during our first hundred years and proud also that we helped make possible creation of wealth on a scale which would have been unimaginable at the time of our foundation.

On the other hand, today, standing at the dawn of our second century of existence we find ourselves facing unprecedented pressure for change. The structures that have underpinned the Japanese economic system over the last fifty years are rapidly changing or disappearing altogether. In particular, as financing shifts from indirect to direct forms, a market based system with an emphasis on shareholder value is emerging. Securities

---

investment is, albeit slowly, becoming more widespread among ordinary Japanese while a declining level of cross ownership among Japanese corporations is changing the face of corporate governance. Meanwhile, deregulation of securities markets has changed the fundamental ground rules under which we compete.

In such a period of upheaval there will be winners and there will be losers. In our view, winners will be those companies that correctly identify opportunities and dare to reinvent themselves in a form capable of addressing the needs of the markets. The Daiwa Securities Group is not afraid of embracing change. The story of our evolution over the last three years has been the story of a company reinventing itself with a view to prospering in the securities markets of the twenty-first century. This process started when we became the first listed company in Japan to adopt a holding company structure and to form a joint venture with one of Japan's leading city banks to address the possibilities offered by the wholesale securities markets. It continued into the current year with a wide-ranging reorganization of our retail securities unit to allow us to garner demand from new classes of retail investors coming fresh to the securities markets. Along the way, it has embraced a wide-ranging branding initiative and a host of other innovations.

Perhaps the most significant development during FY 2001 was our decision to dispose of certain properties that were being held for purposes unrelated to Group business and were being held on our balance sheet at historical valuations substantially above current market value. Due to our decision to dispose of the properties in question, we marked these properties to current market value under Japanese GAAP (which does not

yet recognize impaired asset accounting). Although this generated an exceptional loss of 127.4 billion yen for the year, it concludes a series of measures we have taken over the last several years to improve the quality of our balance sheet.

I would like to thank each and every one of our shareholders for their support during the last financial year. I look forward to enjoying your support again as we enter our second century of existence. In my opinion, in spite of the dislocations caused by the poor economy and subdued nature of Japanese securities markets, the Daiwa Securities Group has shown real progress towards achieving its goals. This annual report is, as always, intended to give our readers, particularly our shareholders, a chance to make up their own minds on this point based on the evidence to date. It has been compiled with the aid of exhaustive interviews with the most senior of our Group directors and executive officers who have given generously of their time to support this project and to whom I would like to extend my thanks.

July 1, 2002



YOSHINARI HARA

**President and CEO, Daiwa Securities Group Inc.**

---

## History 1902-2002

# 1902

**1902**

Commenced operations as Fujimoto Bill Broker in Osaka.

**1949**

Became a member of the Tokyo Stock Exchange and eight other stock exchanges.

**1954**

Commenced Japan's first savings investment business.

**1961**

Listed on the Second Division of the Tokyo Stock Exchange, the Osaka Securities Exchange and the Nagoya Stock Exchange.

**1968**

Granted license from the Ministry of Finance to operate as a general securities firm.



Established Daiwa Securities Co. Ltd. (merger of Fujimoto Securities (previously Fujimoto Bill Broker) and The Japan Trust Bank, Ltd.).

**1943**

Commenced sales of Japan's first open-ended investment trust.

**1952**

Established New York office (predecessor of Daiwa Securities America Inc.).

Established Daiwa Asset Management Co. Ltd.

**1959**

Established London office (predecessor of Daiwa Securities SMBC Europe Limited).

**1964**

<b>1970</b> Listed on the First Section of the Tokyo Stock Exchange, the Osaka Securities Exchange and the Nagoya Stock Exchange.  Established The Daiwa Securities International (H.K.) Ltd. (predecessor of Daiwa Securities SMBC Hong Kong Limited).	<b>1972</b> Established DBS-DAIWA Securities International Ltd. (predecessor of Daiwa Securities SMBC Singapore Limited).  Established Daiwa Health Foundation (predecessor of Daiwa Securities Health Foundation).	<b>1975</b> Established Daiwa Computer Services Co. Ltd. (predecessor of Daiwa Institute of Research Ltd.).	<b>1980</b> Launched Medium-Term Government Bond Fund.	<b>1982</b> Established Daiwa Securities Research Institute Ltd. (predecessor of Daiwa Institute of Research Ltd.).  Established Nippon Investment Finance Ltd. (predecessor of NIF Ventures Co., Ltd.).
--	--	--	---	---



Lead manager for first Asian Dollar Bond (Development Bank of Singapore). <b>1971</b>	Established Daiwa International Capital Management Co., Ltd. (predecessor of Daiwa SB Investments Ltd.). <b>1973</b>	Lead underwriter of first Euro-yen bond (European Investment Bank). <b>1977</b>	Commenced sales of "New JGB fund," the first in Japan using the accumulation method. <b>1981</b>
--	---	--	---

<b>1984</b> Commenced Japan's first Medium-Term Government Bond Fund Money Sending (Sweep) System.	<b>1986</b> Commenced the Home Trade Service, the first personal computer-based service of its kind in Japan.	<b>1989</b> Established Daiwa Institute of Research Ltd. — Issued the securities industry's first Euro-yen CP.	<b>1991</b> Commenced "Daiwa Satellite" via satellite broadcast. — Launched third-generation online system.	<b>1993</b> Commenced offering of accumulative stock investments.
---	--	---	--	--



Lead underwriter of the first yen denominated bond issue on the U.S. market. <b>1985</b>	Established Daiwa Business Service Ltd. (predecessor of Daiwa Securities Business Center Co., Ltd.). — Established the Daiwa Anglo-Japanese Foundation. <b>1988</b>	Listed simultaneously on 7 European stock markets. <b>1990</b>	1992 Commenced sale of "Daiwa MMF." <b>1992</b>
---	--	---	--



**1994**  
Established Daiwa Securities Foundation.

**1996**  
Launched Japan's first Internet-based stock trading.

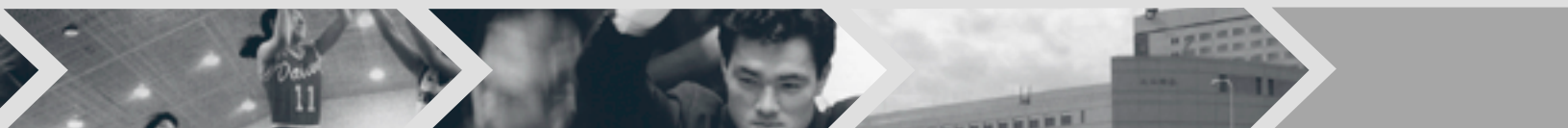
**1998**  
Securities business moves from a licensing to a registration system.

**2000**  
Launched new sales channel, the "three-service package."

**2002**  
Celebrated the 100th anniversary of establishment.

NIF Ventures Co., Ltd. listed on JASDAQ.

# 2002



Launched "Mini stock investments."

**1995**

Introduced the finance industry's first stock option plan.

Commenced "Daiwa CMP service."

Commenced automatic operations service through "Daiwa MRF."

**1997**

Established Daiwa Securities Group Inc., the first holding company listed on the stock market.

Re-established retail operations as Daiwa Securities Co. Ltd. and wholesale operations as Daiwa Securities SB Capital Markets Co. Ltd. (currently Daiwa Securities SMBC Co. Ltd.).

Established Daiwa SB Investments Ltd.

Launched Japan's first stock trading service via i-Mode.

**1999**

Announced the Daiwa Securities Group's Brand Statement.

Daiwa Securities SB Capital Markets Co. Ltd. re-named as Daiwa Securities SMBC Co. Ltd.

**2001**

# Roundtable with Management

## Roundtable Participants

**Yoshinari Hara**, President and CEO, Daiwa Securities Group Inc.

**Akira Kiyota**, President, Daiwa Securities SMBC

**Teruwo Hatano**, President, Daiwa Asset Management

**Tatsuhiko Kawakami**, President, Daiwa Institute of Research

Gentlemen, I would like to start off by thanking you for making the time to talk with us this morning. In this session, we would like to concentrate on matters of strategic interest for the Group as a whole and for its individual companies.

I would like to start with a general question, therefore. Looking back at the financial year just ended, what would you regard as the most significant events? Perhaps I could ask President Hara to start off.



### Hara

Our principle management policy was to establish the Daiwa Securities Brand. I would like to discuss this in more detail later. Other than this, strategic decision making last year involved revisions made to our medium-term management plan and the exceptional write-downs we elected to take on our real estate holdings.

Our medium-term management plan was produced at the beginning of FY 2000 and covers the three years to March 2003. Under the original plan, we set ourselves three targets—to achieve a sustainable return on equity of 15% or more by the end of the plan period, to achieve a credit rating of single-A or better with major credit-rating agencies, and to achieve a doubling in the level of retail client assets under custody to 28.3 trillion yen. During FY 2001, we recorded a loss due to the above-mentioned real estate write-offs; endured a credit-rating downgrade; and although Daiwa alone of all the big three brokers managed to increase retail assets under custody, the balance fell woefully short of initial targets due to the effect of declining valuations. Consequently, it is perhaps an understatement to say that we failed to make progress in meeting our financial goals.

However, the only one of the three targets we changed was the one pertaining to retail client assets under custody. The other two, relating to return on equity and to credit rating, remain unchanged. The reason that we changed the target relating to client assets is that the original target has proved to be too much a reflection of the direction of the general securities markets and too little a reflection of the results of our own efforts.

For the final year of our three-year management plan, we have decided to introduce a more appropriate measure of our ability to attract retail client assets. Our revised target is to attract new retail client assets under custody of 2.9 trillion yen unadjusted for valuation effects during FY 2002.

As for the real estate valuation write-downs, these were incurred due to our decision to dispose of these holdings in order to concentrate managerial and financial resources to our securities-related businesses. We also wanted to be ahead of the curve, especially in light of our upcoming listing on the NYSE, which requires us to use impaired value accounting, and to avoid having too wide a gap between our Japanese and U.S. GAAP figures. Under Japanese GAAP, impaired asset accounting is scheduled to be fully implemented from the fiscal year ending March 2006. This write-down thus represents the final act in a series of steps we have taken over the last several years to improve the quality of the Group's balance sheet.

**You say that it remains your goal to achieve a 15% return on equity and a single A or better rating from the credit rating agencies by March 2003. How realistic are these goals, especially the achievement of a single A credit rating?**



#### Hara

That is a good question. It seems that the major credit rating agencies are quick to downgrade but slow to raise ratings. Consequently, it will not be such an easy target to achieve. Perhaps the best way to state the goal is to achieve a corporate structure worthy of a single A

rating by the end of the year since we have little control over how and when our actual situation will be reflected in the views of the agencies. This is not to say, however, that a two-point upgrade is out of the question. Our internal forecasts call for a "V-shaped" economic recovery during the current financial year. If these prove to be correct, we could well experience a sharp recovery in profitability, in which case a sizable upgrade might be achievable.

**Playing devil's advocate, what would happen if you were wrong and there was no recovery this year? What is the chance of another downgrade in the credit rating for the Group as a whole and for Daiwa Securities SMBC? What would be the effect of such a downgrade if it occurred? I would like to address this question jointly to President Hara and to President Kiyota.**



#### Hara

From a Group point of view, the biggest contributor to the ratings downgrade was the low level of profitability in the retail securities company. Our wholesale securities company, headed by President Kiyota, still turned in a reasonable profit, albeit well down from FY 2000. Last year was among the worst years ever for our retail securities operation. Nevertheless, we have now reduced SG&A costs in that company to the point where we could break even in a similar market while still remaining fully prepared to take advantage of any upturn. As a result, I see little need for a further decline in our rating. Indeed, I see cautious grounds for optimism.



#### Kiyota

As President Hara has noted, a further downgrade is unlikely. However, were there some further deterioration I do not think that it would affect our short-term trading operations. On the other hand, there could well be some impact on our operations dealing with longer-term instruments, for example derivatives.

It has now been three years since the former Daiwa Securities moved to a holding-company structure and formed a close relationship with the former Sumitomo Bank, currently the Sumitomo Mitsui Banking Corporation. Looking back, I wonder if I might ask President Hara and President Kiyota to comment on developments over the last three years.



#### Hara

In general terms, I think I would point to two main developments that I believe have gone well for the Group.

The first is the clear pickup in efficiency that has been made possible by adopting a holding-company structure. The benefits of separating the retail and

wholesale securities companies have become increasingly evident as each company has been able to focus on its own area of specialization.

The second element of our strategy with which I am well pleased is the evolution of our corporate branding project. I should stress that the focus of the project is inward-looking rather than outward-looking. We wish to establish a common corporate culture across the Group, with the customer at the very center. Although this will be a lifelong quest for improvement, initial indications are that we have at least laid the foundations for a strong corporate culture.



#### Kiyota

I would point to synergies with the Sumitomo Mitsui Banking Corporation. While such synergies have maybe not lived up to the most aggressive of our initial expectations, we have, in fact, since inception of Daiwa Securities SMBC, managed to build on the depth and breadth of corporate relationships and available skill sets with visible result. For instance, during FY 2001 we were the clear leader in straight bond underwriting for the first time ever. The same benefit is evident in our new business operations - structured finance, derivatives, and mergers and acquisitions. I would also point to the huge success our Derivatives and Structured Financial Products Department has had with its innovative Enman-Sai structured bond as an example. It is even true in our IPO operations, where we ranked number one last year on the three markets for emerging companies, although second overall. Mandates awarded due to referrals through the SMBC network, for example,

have doubled over the last year. Our relationship with the bank has had a beneficial effect in many different areas of our business, therefore. The one area in which we have yet to see results is the area of equity underwriting, where we hoped that access to the networks of the merged bank would open up opportunities for us. This has not happened to date and is the single biggest disappointment we have.

Turning now to the retail securities company, Daiwa Securities Co. Ltd., I would now like to ask President Hara, in your capacity as president of this company, to comment on the role of the branch network in Daiwa's retail marketing strategy. After all, with one of Japan's most successful call centers and Internet brokerages in the Group, why does Daiwa need such a widespread physical presence? Would it not make more sense to scale back the branch network to cover the major metropolitan centers only and to rely on the call center and the Internet for the rest? Would this not represent a major cost saving?



#### Hara

Actually, if anything, we believe that our current network of 126 branches is about the minimum size we need to function effectively. The reason is that in addition to servicing retail clients, the branches also have the duty to service local companies, foundations, and financial institutions. Since these are attractive targets for us, in light of the upcoming end to blanket bank deposit insurance and a subsequent shift of funds into securities markets, the branch network clearly has

an important role to play. In addition, while there clearly is demand in the market for price-driven, low-cost, speculation-oriented brokerage services, those are not the areas we wish to emphasize or find most attractive. Rather, our Daiwa Call and Daiwa Net packages are intended to promote responsible accumulation of risk assets for economically sound reasons. For this sort of approach, the branch-office network is indispensable and offers all customers a physical point of access. The Saturday openings we started last October has made it easier for people to stop by our branch offices. We hope to expand our client base by fully utilizing our physical presence.

In fact, we have just started to introduce a wide-ranging restructuring of the branch network to concentrate on what we term "area marketing." For some time we have recognized that there are substantial differences between different geographical localities in terms of client type and demand for products. We have now grouped our branch network into semiautonomous "areas" and devolved far more responsibility for intra-area marketing to these areas. All areas will come under the control of a "mother branch," which will act as the local headquarters for area-oriented activities. Reporting to the mother branch may be 3 or even 10 other branches and sales offices. For example, in Tokyo 10 out of 50 branch offices will become mother branches, while in Osaka 2 out of 11 will be so appointed. Henceforth, the "area" will be the minimum geographical area with which the head office will be concerned. This will have a number of beneficial effects. For example, it will increase the critical mass of the local organization and allow them to take responsibility for a wider range of initiatives in marketing products and services in preparation for the complete lifting of blanket guarantees on bank deposits.

Again on the retail securities company, Daiwa Securities managed to squeeze its SG&A expenses relatively hard during FY 2001. Even so, there is some speculation that you could have done more. Would you care to comment?



#### Hara

We cut our SG&A expenses as hard as we sensibly could. For the year they fell by 10%. This was achieved without resorting to widespread layoffs in the retail company, which we regard as counterproductive. We could have cut more. I believe that certain of our competitors actually did so. However, our view is that the damage done to internal morale, the loss of institutional memory, and the necessity of ensuring adequate access to resources into a market upturn more than outweighed any potential short-term gain to our bottom line.

In summary, what are the major issues for the retail securities company during FY 2002?



#### Hara

As I have already mentioned, we would expect some flow of funds out of bank deposits into securities markets as historically safe bank deposits lose their guaranteed status. In addition, we need to cast our marketing net wider than in the past. On the product front, investment trusts continue to be the most important product as MMFs still offer a comfortable alternative to bank deposits, having much of the convenience and safety of bank deposits while providing exposure to the superior returns available in securities markets. In this respect, I should mention that Daiwa Asset Management bought for its own books eight issues of bonds with a face value totaling 143.6 billion yen from our MMF portfolio in February. While this has tied up shareholder's equity and increased investment securities on the balance sheet, it is intended to ensure the long-term credibility of Daiwa's MMF operations. This decision was made after careful consideration of the implications of this action. In addition to MMFs, we will emphasize foreign-currency denominated bonds and investment trusts investing in foreign bonds in light of the superior yields available in overseas markets. We must develop a range of medium-risk, medium return products that meet customer's asset management needs. Finally, of course, we will continue to rely on Daiwa Asset Management to achieve superior performance during the current year.



At this point, I would like to ask Mr. Hatano, President of Daiwa Asset Management, to comment on the challenges and issues you see for FY 2002.



#### Hatano

We completely restructured our operations in February 2002 to meet three major goals. In addition to the initiatives mentioned by President Hara, we embraced the following goals:

Firstly, we aim to enhance our core competency of fund management by integrating our investment management and research functions and bringing them into a common management framework.

Secondly, we will better articulate product strategies geared to the needs of the customer.

Finally, we need to improve the level of service extended to customers including a general improvement in the level of after sales support, the provision of help-desk functions, and so on.

Top priority in FY 2002 will be given to improving fund management performance, improving our research capability, developing an in-depth risk-management capability, and providing a high level of disclosure.

Turning now to the wholesale securities company, I would like to ask President Kiyota to comment on the major issues for your company as you see them.



#### Kiyota

I mentioned the positive developments earlier. However, clearly, the last financial year was also marked by a sharp downturn in our equity trading revenues. There is no doubt that the environment for the equity business was tough, but our poor performance is in reality the result of our failure to take advantage of the opportunities presented by companies unwinding their cross-shareholding positions.

Despite the disappointing revenue, our market share in the equity market remains high and our presence has by no means declined. To reflect this in profitability we have taken steps to coordinate more closely with our analysts at the Daiwa Institute of Research. We believe that the investor rating of our analysts will contribute to improving our bottom line.

Furthermore we have established a new division that cuts through the three product divisions Equity, Fixed Income and Derivatives, to better address our clients' needs. We are also considering an expansion in the number of staff to upgrade our trading capabilities.

We are working to take advantage of opportunities in the fixed income area provided by the lifting of blanket guarantees on bank deposits. Despite the aversion to credit risk during the second half of FY

2001, we have seen institutional investors shift funds from bank deposits to the securities markets.

Elsewhere, the background is much more supportive. We became the leading underwriter of straight bonds for the first time, as noted earlier. We maintained our position of strength in structured products and derivatives and improved our market position in mergers and acquisitions. Our position in the equity IPO market also improved, as I noted earlier. I even have good news concerning our equity underwriting operations. Since the end of the last term, we have been appointed lead underwriter for the privatization of Japan Tobacco. As you may know, equity underwriting, particularly for large privatization-related issues, has recently been an area where we were relatively weak. Landing this issue has been a major cause for celebration, therefore. We are now in a position to aggressively pursue these deals.

Going forward, we seem to have all of the pieces in place to enable us once again to report acceptable levels of sales and earnings. The key will be to quickly restore the health of our equity sales and trading operations. Pretty much everything else is already headed in the right direction.

Incidentally, at this point I would like to mention that we at Daiwa Securities SMBC are exceptionally pleased that the analysts at the Daiwa Institute of Research have managed to improve their market standing so dramatically. As you may know, DIR's research strength has usually not been reflected in external perceptions. For example, in FY 2000 the company ranked only eighth in Japan according to the widely followed Nikkei Financial Daily rankings. I am pleased to say that in FY 2001 DIR ranked number three, a five-place improvement over the previous year. We hold high hopes that this success will feed through into our investment banking operations, where perceptions of analytical strength can be vitally important.

At this point, therefore, I would like to ask Mr. Kawakami, President of the Daiwa Institute of Research, to comment on this improvement in the analyst ranking. In addition, I would like to ask you to comment on any other developments of note.



#### Kawakami

The improvement in external perceptions of analyst strength came not so much from any change in our actual research apparatus. There were, in fact, surprisingly few changes to the type of research we produce or in our internal staffing. We did not change our research style, nor did we aggressively go out into the market and hire so-called star analysts. Rather, the improvement recorded is the result of our having adopted a more disciplined approach to research dissemination. In particular, analysts are now far more actively involved in discussing their work directly with end-consumers of our research such as portfolio managers. The indications are that such personal contact is highly valued and accounts for the major portion of the improvement recorded.

Apart from continuing the improvement in our research ranking, the major challenge I face as president of Daiwa Institute of Research, is to cope with ever-expanding demands on our systems development resources while maintaining a tight control on costs. One core strategy we have adopted in this respect is to outsource an increasing proportion of our systems development to China.



President Hara, I wonder if you could wrap up this roundtable for us by summarizing the outlook for FY 2002 and beyond for the Group as a whole?



#### Hara

Firstly, we want to lead the industry in developing and offering products and services. We understand that progress is not made by standing still and will require continual improvement in our internal processes. In this we are fortunate that the Daiwa Securities Group has always been innovative and treasured its pioneer spirit. Taking advantage of these skills, the Group will lead the industry in launching new products and services, thereby increasing the scope of its businesses and creating new opportunities.

Secondly, we will work to enhance synergies among Group companies. Maximizing Group corporate value is the ultimate goal of everything we do. Consequently, the Group will endeavor to increase competitiveness by enhancing synergies among companies and by promoting efficient operation.

By adhering to the above principles, we hope to provide enhanced long-term returns to shareholders.

As for the current financial year, clearly much depends on the state of Japanese securities markets. However, we are not simply waiting passively for an upturn to come. I feel very confident that the initiatives we have taken over the last several years, ever since the formation of the holding company and which we have discussed earlier, will eventually bear fruit. In the

wholesale securities company, we have staked out market-leading positions in a number of promising business areas. Restoring the health of our equities operations there is clearly a challenge but one I think we will rise to. Meanwhile, the retail securities company has been restructured to garner maximum advantage from the changes we foresee happening in Japanese securities markets. We should be able to capture a large proportion of increased retail interest in securities once the markets turn. Overall, our operations are considerably more efficient than they were only a few years ago. Consequently, I think it is fair to say that we feel confident we will benefit in full from any upturn in our end markets. Recent indications are that the Japanese economy is in a mild upswing. At the very least, this should mean that the worst is behind us and, if projections for a “V-shaped” recovery do indeed turn out to be correct, there is every chance of a more pronounced improvement in our business.

Lastly, I would like to note that we aim to achieve an NYSE listing during the current year. With a foreign shareholding of around 30%, we must now consider ourselves a global issue, more than ever subject to global standards of excellence, especially as regards corporate governance and disclosure. Of course, all of these achievements will support the establishment of the Daiwa Securities Brand. This year is the one hundredth anniversary of the founding of Daiwa Securities. As a group we are resolved to take steps to achieve continuous growth during our second hundred years.



Our First Hundred Years: Fujimoto Bill Broker - c. 1902

## Consolidated Income Statement Summary

(Millions of Yen)

	FY 2001	FY 2000	% change yoy	FY 2001			
				4Q (1-3)	3Q (10-12)	2Q (7-9)	1Q (4-6)
<b>Operating revenues</b>	<b>488,044</b>	<b>714,909</b>	<b>-31.7%</b>	<b>119,174</b>	<b>112,491</b>	<b>117,209</b>	<b>139,168</b>
Commissions	171,869	254,704	-32.5%	41,453	39,662	40,651	50,101
Net gain on trading securities	63,392	165,637	-61.7%	24,779	14,290	9,487	14,834
Net gain on operational investment securities	3,855	3,853	+0.1%	902	1,791	-942	2,104
Interest and dividend income	195,934	220,788	-11.3%	30,755	46,304	57,931	60,943
Other revenues	52,992	69,909	-24.2%	21,283	10,443	10,080	11,184
<b>Interest expenses</b>	<b>164,505</b>	<b>195,522</b>	<b>-15.9%</b>	<b>21,351</b>	<b>37,276</b>	<b>52,514</b>	<b>53,362</b>
<b>Cost of sales</b>	<b>38,606</b>	<b>55,330</b>	<b>-30.2%</b>	<b>15,085</b>	<b>7,740</b>	<b>7,154</b>	<b>8,625</b>
<b>Net operating revenues</b>	<b>284,932</b>	<b>464,056</b>	<b>-38.6%</b>	<b>82,737</b>	<b>67,474</b>	<b>57,539</b>	<b>77,180</b>
SG&A	262,163	286,948	-8.6%	64,799	62,988	66,835	67,539
<b>Ordinary income</b>	<b>25,849</b>	<b>177,795</b>	<b>-85.5%</b>	<b>19,500</b>	<b>5,173</b>	<b>-9,377</b>	<b>10,553</b>
<b>Net income</b>	<b>-130,547</b>	<b>64,550</b>	<b>-</b>	<b>12,798</b>	<b>-11,769</b>	<b>-136,618</b>	<b>5,041</b>

## Daiwa Securities Group Inc.

Daiwa Securities Group Inc., the successor to the former Daiwa Securities Co. Ltd., came into being on April 26, 1999 as a pure holding company. At that time, the retail securities operations of the company were incorporated as Daiwa Securities Co. Ltd., while the wholesale securities operations were separated into a joint venture with The Sumitomo Bank Limited, and named Daiwa Securities SB Capital Markets Co. Ltd. In April 2001, The Sumitomo Bank merged with The Sakura Bank Limited to form the Sumitomo Mitsui Banking Corporation. At this time, Daiwa Securities SB Capital Markets acquired the assets of Sakura Securities, a securities subsidiary of Sakura Bank, and was subsequently renamed Daiwa Securities SMBC Co. Ltd.

In addition to the Holding Company and the two securities subsidiaries, the main companies within the Daiwa Securities Group are Daiwa Asset Management and Daiwa SB Investments (asset management business), Daiwa Institute of Research (research, systems development and consulting operations), Daiwa Securities Business Center (securities back-office operations), Daiwa Real Estate (branch management operations) and NIF Ventures (venture capital business).

The Group's compliance and corporate governance activities embrace the way in which the Holding Company maintains oversight of the Group's activities as a whole. Activities subject to oversight by the Holding Company include those related to the strategic management of the Group; legal and ethical matters including disclosure; matters related to the Group's branding activities; and matters related to the recruiting and training of Group personnel, including the formation of a cadre of senior managers equipped to operate at board or executive director level.

Additionally, it is the Holding Company's responsibility to ensure that the Group makes adequate investments in IT to construct a sufficient business infrastructure.

### Group Medium-Term Management Plan

The primary management target is to maximize shareholder value by becoming Japan's strongest securities group. The medium-term management plan was established in March 2000 to achieve this target and was revised at the beginning of FY 2002, the final year of the current plan. The plan, as revised, sets the following goals for the Group to be achieved by March 2003.

### Consolidated Return on Equity

The principal measure of financial success adopted by the Group is consolidated return on shareholders' equity. The plan calls for the Group as a whole to achieve a sustainable return on shareholders' equity of 15% by the end of the current financial year. In order to achieve this result, every major company in the Group has also been allocated a target return on equity.

Allocation of equity capital among Group companies on formation of the Daiwa Securities Group was made according to the needs of the business and the potential risks and return expected. In June 2002, in order to optimally redistribute resources, Daiwa Asset Management transferred 60 billion yen to the Holding Company as a dividend.

During FY 2001, the Daiwa Securities Group Inc. recorded a net loss and a negative return on equity.

## Credit Rating

The Group wishes to achieve a credit rating of single-A or better for each of the two securities companies (Daiwa Securities Co. Ltd. and Daiwa Securities SMBC Co. Ltd.) by March 2003. The rationale for adopting this measure was to complement measures of profitability, such as return on equity, with a measure of the quality of earnings of the Group as a whole. In addition, certain businesses of interest to the Group are sensitive to credit standing. Daiwa Securities Group Inc. believes that achieving a rating of single-A in the securities subsidiaries would give it sufficient standing to compete effectively in all market segments of interest.

Daiwa Securities, the retail securities company, underwent a series of rating downgrades by a number of rating agencies during the last financial year. In October 2001, the domestic rating agency JCR downgraded Daiwa Securities from A+ to A. This was followed in February by a downgrade from Baa1 to Baa2 by Moody's and, in March, from BBB to BBB- by Standard & Poors'. Meanwhile, the wholesale securities company, Daiwa Securities SMBC, was downgraded from A- to BBB+ by the rating agency Fitch in November 2001 and from BBB+ to BBB by Standard & Poors' in March 2002. Reasons given for the downgrade of Daiwa Securities included pressure on profitability and a slower than expected flow of retail funds into securities markets. For Daiwa Securities SMBC, reasons included delays in diversification and stabilization of the income stream and a decline in the credit standing of the Sumitomo Mitsui Banking Corporation.

## Retail Client Assets under Custody

The initial plan, announced during FY 2000, called for the Group to achieve retail client assets under custody of 28.3 trillion yen by March 2003. Unfortunately, the targets have been badly affected by falling valuations as well as dislocation to securities markets caused by the September 11 terrorist attacks and such other developments as the crisis of confidence in MMFs following the bankruptcy of Enron. Consequently, the targets were amended in March 2002 to achieving an increase of 2.9 trillion yen to 16.1 trillion yen during FY 2002, excluding fluctuations due to changes in market valuation. Retail client assets under custody are representative of the Group's overall capabilities. Although each company is contributing to this effort, as of end-March 2002, retail client assets under custody amounted to 13.2 trillion yen compared with 14.7 trillion yen at the start of the plan in March 2000.

## Corporate Governance

### Managerial Oversight of Group Management

The Daiwa Securities Group was the first Japanese listed company to adopt a holding company structure in April 1999. Under this structure, day-to-day decision-making has been delegated to the individual operating companies within the Group subject to oversight by the Holding Company. The Holding Company also takes responsibility for deciding strategic matters affecting the Group as a whole.

#### Board of Directors

As the main decision-making organ, the Board of Directors takes responsibility for important management issues such as efficient utilization of group resources and strategic policy-making.

#### Board of Statutory Auditors

The Board of Statutory Auditors oversees the legality of the Board's execution as well as ensuring substantial and adequate disclosure in financial statements to improve accountability to shareholders and creditors of the Holding Company.

### Executive Oversight of Group Management

#### Management Committee

The Management Committee considers crucial management matters such as the formulation of annual and medium-term management plans, budgets and personnel. Matters discussed here will proceed for deliberation at the Board of Directors' Meeting.

#### Executive Committee

##### (Former Group Management Meeting)

The Executive Committee consists of executive officers of the Holding Company and Group executive officers from other Group companies. Its brief is to maintain wide-ranging strategic oversight of the Group and all Group companies.

#### Advisory

##### Advisory Board

The Advisory Board's members, who are drawn from people with a well-established reputation, provide opinions and suggestions to the CEO drawing on their accumulated experience and expertise regarding managerial issues.

##### Compensation Committee

This committee consists of members from outside the Group and the CEO. Its purpose is to promote transparency in the setting of compensation and to ensure appropriate compensation for directors and executive officers.

#### Compliance and Ethical Oversight

While, in principle, each Group company is expected to maintain oversight of its own activities to ensure compliance with legal and ethical norms, the Holding Company monitors and supports these activities in the following ways.

##### Internal Monitoring

The Group has stepped up its self-monitoring procedures. These include regular review of its contractual obligations with suppliers to ensure fair treatment (supplier contracts have so far been reviewed three times in total) and regular inspections to check compliance with Group ethical policies.

Inspections involve the Group Ethics Promotion Department and the Legal Department, and focus on areas where payment of money and/or expenses are involved. The goal of such inspections is to insure that there is no flow of funds to anti-social groups. During FY 2001 inspections were restricted to the Holding Company. However, discussions aimed at promoting inspections throughout the Group are currently in progress.

In the past, inspections were only intended to check for compliance with the Securities and Exchange Laws. Recently, the Holding Company has extended the scope of such monitoring and now conducts more intrusive inspections with the aim of isolating the Group as a whole from undesirable elements.

---

## Developments in Corporate Governance

---

During FY 2002 Daiwa Securities Group will implement a number of measures intended to promote the emergence of a “shareholder culture” within the Group. These will consist of a sequence of initiatives aiming at promotion of shareholder value.

### External Directors

---

At the June 2002 General Shareholders' Meeting, the Company appointed an external director to its board - Mr. Tetsuro Kawakami, Counsel of Sumitomo Electric Industries. The Company believes that appointment of external directors having no executive responsibilities within the Group is a key measure needed to promote long-term corporate governance.

### Expansion of Executive Committee

---

The former Group Management Meeting consisted of the directors of the Holding Company together with the Presidents of the main Group companies. Reflecting the policy to concentrate management resources on securities-related businesses and to realize an executive body with a firm footing in the securities business, the composition of this decision-making body has been expanded so as to also include the deputy-president, director in charge of sales and director in charge of products from the two main securities subsidiaries.

### Change in Directors' Terms

---

From June 2002, all directors and executive officers will be appointed (or re-appointed as necessary) for a term of one year only.

## Review of the Group-Wide Risk Management System

In preparation for the Company's listing on the New York Stock Exchange, the Group's risk management system is in the process of being expanded in scope so as to ensure compliance with applicable US regulations. This involves establishing a risk management system covering legal, system, disclosure, as well as operational risk.

## Changes to the Commercial Code and the Basic Structure of Corporate Governance

Under revisions to the Commercial Code promulgated in May 2002, Japanese companies will be given a choice of continuing with the present basic system of governance embodied in the Commercial Code or of electing to implement a new system based on an executive officer system. Under the current Japanese system, responsibility for executive oversight of the corporation rests with the Board of Directors and the auditors. The executive officer system allows the division of management and executive functions in addition to the appointment of outside directors and executive officers. Under this system, a corporation must set up three standing committees (Nominating, Compensation and Auditing). This also requires the board to appoint external directors so that such directors make up a majority on each of these committees. The executive officers may also concurrently serve as directors.

As can be seen from the above, The Daiwa Securities Group is implementing a number of reforms, which lay the foundation for maximizing shareholder value.

## Personnel and Training

### Basic Personnel Policy

The Daiwa Securities Group has significantly revamped its general personnel policies since formation of the Group in April 1999. In general, the Group has abandoned seniority-based remuneration and promotion. Today, the company links remuneration and promotion, including allowances payable on retirement, with performance.

### Training and Development of Managerial Ability

Over the last two years the Group has also invested heavily in training programs, directed primarily at the Group's senior managers, with a view to promoting a cadre of officers able to serve at a Group level.

#### Daiwa Management Academy

Senior Group managers are chosen to attend the Daiwa Management Academy on recommendation from the President of the respective Group company.

The courses last for five months. In order to graduate, all students must on conclusion of the course present a business plan directly to President Hara who is closely involved with the process. To date, 74 managers have graduated from this course.

#### Daiwa Management Academy - Curriculum

Basic Knowledge (2 weeks)  
Main Program (6 weeks)  
Business Plan (2 weeks)



Basic knowledge consists of accounting and financial theory, which is taught because of the wide range of academic backgrounds possessed by attendees.

The main program is based around the Harvard case methodology and involves case studies and discussions and debates rather than formal lectures. The only prerequisite is the basic knowledge course. The main focus is human resources management, management theory and organization. Over 6 weeks, students complete 17 such courses given by both Daiwa Institute of Research staff and by invited academics and other specialists.

#### Daiwa Leadership Program

This program has been introduced for staff of deputy general manager level, one rank below those entitled to attend the Daiwa Management Academy. The basic goal of the course is to promote mindset adjustment and broadening the vision of attendees to a global level as well as promotion of logical thinking and analytical skills.

The course is held on weekends over a period of about 10 weeks.

## Disclosure

The Daiwa Securities Group maintains a policy of full and fair disclosure regarding the current situation and outlook for the Daiwa Securities Group.

The Holding Company's Investor Relations Section within the Corporate Communications Department is tasked with ensuring full disclosure of corporate information and with widespread information dissemination. This department undertakes a program of meetings and telephone conferences in order to ensure that investors are sufficiently well informed to arrive at an informed understanding of the Group's management strategy and business prospects.

The Group also exploits such new channels of communication as the Internet in its investor-relations activities to ensure the widest possible disclosure. The Holding Company maintains a state-of-the-art website (<http://www.ir.daiwa.co.jp/>), specifically dedicated to investor-relations activities and includes a number of interactive features designed to promote two-way communication with investors. In addition to posting press releases, earnings announcements and presentations, the Holding Company has heavily promoted the Internet as a means of communicating with investors in other ways by, for example, making available streaming video covering important company events such as investor relations meetings.



## Branding and Corporate Culture

The Daiwa Securities Group believes that establishing a corporate culture is a key success factor for survival in the financial markets of the twenty-first century. In the highly regulated Japanese securities markets of the late twentieth century, competition between companies and innovation were stunted. In March 2001, in an effort to mark a clean break with the past and to set the company on the road to prosperity in the new century, the Daiwa Securities Group distilled its core values into a brand statement.

The initial focus of the Group's branding initiative is its own employees, with the clear aim of instilling a set of shared values, laid out in the Brand Statement, throughout the Group.

The branding initiative has also been widely publicized outside of the Company through an extensive series of print and television advertisements and through the branding homepage (<http://www.branding.daiwa.co.jp/>).

The Group is currently preparing a "Sustainability Report" to report on the Group's activities with regard to social and environmental issues. This report, expected to be published in October this year, is part of the Group's branding initiatives targeting stakeholders such as customers, shareholders and employees.

### Daiwa Securities Group Brand Statement

We, the Daiwa Securities Group, are committed to acting as our clients' best partner and promoting their financial well-being. In order to achieve this, we shall redefine currently accepted best practice, drawing on the following three core values.

#### **We Shall Provide Products and Services that Exceed Expectations**

It is important that we apply detailed knowledge of customer needs, innovation in our internal processes, and a strong customer focus to provide solutions that routinely exceed customer expectations.

#### **We Shall Bring the Full Strength of the Group to Bear**

Cooperation among Group companies, sweeping aside traditional corporate barriers, a flexible approach to business, and swift decision making will enable us to offer comprehensive financial services precisely geared to meeting our customers' financial goals.

#### **We Shall Continually Challenge the Limits of Financial Best Practice**

Exploitation of our substantial store of professional knowledge and a proactive approach to team building will enable us to remain pioneers in our marketplace.

## Stimulation of Securities and Finance Markets through Cooperation between Business and Academia

The Daiwa Securities Group is currently cooperating with various universities for the purpose of contributing to the revitalization of the Japanese economy. In pursuit of this aim, the company is working to educate the public in the fundamentals of securities by sponsoring courses in this field. It is also involved in joint research with universities to further the expansion of financial and capital markets and to develop personnel with a high level of professional skills.

As examples, the Daiwa Securities Group has formed alliances with Hitotsubashi University's graduate school, Department of International Corporate Strategic Research (MBA course) in finance and business administration and with Kyoto University's graduate school, Department of Economic Research in Financial Science. The Department of International Corporate Strategic Research of Hitotsubashi University has appointed Michael Porter, a professor at Harvard University and the leading figure in corporate strategy theory, to serve as an advisor of the Porter Award, which was created to honor companies with a history of excellence in corporate strategy. Daiwa Institute of Research is fully backing this award. In addition, the Daiwa Securities Group offers programs at numerous universities and graduate schools including Keio University and Tohoku Fukushi University, sending directors and employees of the Daiwa Securities Group to serve as lecturers for the purpose of promoting securities-related knowledge.

## Finance

The Holding Company oversees the financial management of the Daiwa Securities Group including the setting of financial yardsticks and goals and allocation of capital and other financial resources to Group companies. It also takes overall responsibility for monitoring and controlling the risks occurring in pursuit of its business objectives.

### Group Cash Management System (Group CMS)

In addition to the allocation of equity capital among Group companies and the setting of financial and operational targets, the Group has also implemented a Group cash management system (CMS) to monitor the Group's liquidity situation. The two securities subsidiaries and NIF Ventures, the venture capital arm of the Group, are responsible for their own cash management, reflecting needs for flexible funding and the companies' capacity to manage risk, but remain subject to oversight from the Holding Company. Other companies within the group make use of the Group cash management system. Under this system, all external liabilities are held as loans from the Holding Company, which has assumed sole responsibility for external financing with a view to optimally managing the Group's net external liabilities.

Between March 2000 and March 2002, the Group was able to reduce cash balances and debt from 916 billion yen to 596 billion yen as a result of the CMS. This equates to savings of roughly 6.5 billion yen in interest payments per annum in addition to a major reduction in liquidity risk.

Originally, the Group was expecting to record a further reduction in debt during the year to March 2003 to 500 billion yen. However, in the wake of the Enron debacle and the industry wide turbulence in bond investment trusts, particularly the crucially important money management funds (MMF), Daiwa Asset Management, the asset management arm of the group, elected to transfer certain investments held in its bond investment trusts to its own account, reflecting the spirit of the revised guidelines. This has generated a need for additional funds over those foreseen in the plan of approximately 150 billion yen.

## Risk Management

### Responsibility for Risk Management

Risk management is primarily monitored by each individual company according to its business characteristics, while the Holding Company monitors and is responsible for the Group's overall risk management. Within the Holding Company, risk management is the responsibility of the Chief Executive Officer (CEO), as well as the directors and executives in charge of financial affairs. Matters requiring resolutions of the Board of Directors of each company include large borrowings, loans and the acquisition or disposal of assets.

Relevant financial matters including each company's risk management rules and matters which will affect the whole group are reported and deliberated by the Executive Committee.

The Daiwa Securities Group concentrates on domestic and cross-border securities operations and related activities in which it can achieve a competitive advantage. This also includes competitive advantage in terms of its ability to cope with risk arising in the course of business activities. The growth of Group activities will inevitably be accompanied by increased

IT investment and the expansion of trading positions in securities and venture capital holdings. To accommodate such expansion of the core business, and to avoid unnecessary risks, asset and liquidity risk has been minimized through the reduction of assets and liabilities outside of these areas.

The Holding Company measures risk factors relating to the scale and liquidity of assets held by each Group company on the basis of those companies' business plans, and the risks associated with the business activities in which they are engaged. It has provided each company with sufficient capital to bear liquidity risk and loss risk. This is, presently, the main risk countermeasure for Group companies other than the securities subsidiaries and NIF Ventures, which require additional risk management measures based on laws and regulations that govern these businesses. However, as has been discussed, the Company is currently working towards enhancing its oversight in this respect.

### Risk Management for the Securities Subsidiaries

Broker-dealer companies which are the heart of the Group's activities and the largest source of risk, are required to have self-contained risk management systems in accordance with the Securities and Exchange Law or equivalent rules in most jurisdictions. Because Daiwa Securities SMBC and its affiliated overseas operations are involved primarily in the trading and underwriting of securities and the trading of derivatives, there is a concentration of risk factors, such as market risk, credit risk and liquidity risk. Because of its importance, the risk management structure that has been adopted in respect of this company will be described separately within this annual report.

Daiwa Securities, the retail securities company, has also developed a risk management system in compliance with regulations. However, because it is mainly engaged in retail securities operations, especially brokerage, its exposure to market risk and credit risk is minimal. On the other hand, management of compliance in relation to solicitation activities, and the management of liquidity in relation to margin lending are important considerations.

### Risk Management for Other Main Group Companies

NIF Ventures invests on behalf of investment partnerships as well as directly. For this reason, it is exposed to credit and liquidity risk. As a listed company, NIF conducts its own risk management although this is monitored by the Holding Company.

All companies are exposed to operating risk and system risk. Key areas include research, systems development and consultation by the Daiwa Institute of Research, and the securities-related back office operations of the Daiwa Securities Business Center.

The risk exposure from the asset management activities of Daiwa Asset Management and Daiwa SB Investments is normally minimal, since these companies do not apply their own assets. They do have a fiduciary duty to properly manage assets on behalf of beneficiaries and trustees, however. There is some slight exposure to settlement risk arising from a mismatch between settlement terms on their investing activities and those applying to their own funds, particularly MMFs. This is normally not significant as a factor but was significant during FY 2001 due to a transitory but massive outflow of funds from MMFs during the period of instability in that market triggered by the collapse of the U.S. company Enron. During this period, actions were taken based on the funding capacities of Daiwa Asset Management as well as Daiwa Securities and Daiwa Securities SMBC.

Consequent to the events above, the Investment Trust Association of Japan set down rules to prevent further incidents that may lead to mass redemptions. In February 2002, Daiwa Asset Management acquired for its own portfolio bonds from its MMF, mainly subordinate bonds issued by City Banks, having a face value of approximately 140 billion yen, in response to this new rule.

This decision was exceptional and was based on a careful review of the Group's capacity to incur credit and liquidity risks as well as Daiwa Asset Management's reputation as an asset management company.

Through its involvement in real estate activities, including branch management, Daiwa Real Estate is exposed to liquidity risk as well as risks arising on real estate held. During the year, the company announced its intention to dispose of certain non-core portions of its real estate portfolio and consequently revalued these assets to market value under applicable regulations, thereby generating significant losses.

### Commitment Facilities

Through the diversification of funding sources and the maturity structure, the creditworthiness of the Holding Company has been used to establish commitment facilities that cover the short-term liquidity risk of the Group as a whole. As of March 2002, the Group has access to commitment facilities in the sum of 190 billion yen (Daiwa Securities Group Inc.: 120 billion yen, Daiwa Securities SMBC: 70 billion yen).

## Information Technology

In many areas of the securities markets information technology is a key determinant of future success and competitive advantage. The importance of IT has greatly increased as Japan's securities markets have become progressively more deregulated. Historically, entry into new business areas was regulated and subject to specific licensing requirements. With the move to administration based on registration rather than licensing, Daiwa Securities Group has gained more control over its own development activities.

The Daiwa Institute of Research is the Group's main organ responsible for systems development within the Group and continues to be responsible for the majority of investment in core systems. However, over recent years, the Group as a whole has increased the amount of business given to technology partners and third-party contractors. Starting in late 2001, however, the number of such contractors and partners has started being reduced as a number of major projects reach completion and the Company attempts to reduce costs in this area.

### Group IT Spending

FY 2000	37.4 billion yen
FY 2001	39.6 billion yen
FY 2002	31.6 billion yen (est.)

The Group's medium-term management plan initially called for spending between 130 billion yen and 150 billion yen over the three-year period started April 2000. Actual spending during FY 2001 was approximately 39.6 billion yen, somewhat below initial projections. After reviewing the initial plan from a cost-cutting point of view at the start of FY 2002, total spending for the three years to March 2003

is now projected at 110 billion yen with 31.6 billion yen scheduled for FY 2002. During the first two years of the medium-term management plan, the Group invested heavily in the ATRAS equity trading system, which underlies the Company's competitive advantage in equity trading, and an online version of its Total Bond Analysis system into the wholesale securities company, introduction of customer relationship management systems into the retail securities company and systems to prepare for the introduction of defined contribution pension plans into several Group companies. One priority for FY 2002 will be an upgrade for the BT97 bond trading system, introduced five years ago and currently in need of a makeover. Other priorities include continuing upgrades to the ATRAS systems and investment with an eye to the introduction of T+1 settlement systems.

---

## Social Activities

---

The Holding Company bears ultimate responsibility for the Group's engagement in the communities in which it operates. It aims to foster awareness of social contribution and organize activities designed to contribute to the development of a healthy civil society. The Corporate Community Affairs Department of the Holding Company has created a framework for group-level social contribution activities, as well as an organized support structure for voluntary activities by directors and employees. In addition to its own social contribution activities, the Daiwa Securities Group also works through the Daiwa Securities Health Foundation, the Daiwa Foundation and the Daiwa Anglo-Japanese Foundation. These organizations also engage in social activities that meet Group goals.

The principal social contribution activities of the Daiwa Securities Group are described below.

### Regional Community Action Programs

---

The global business activities developed by the Daiwa Securities Group through its nationwide branch network and overseas offices rely on the support of regional communities and the many people engaged in them. The Group aims to be a good corporate citizen by fostering a relationship of trust with communities, and by basing its corporate activities on the ideal of growth in partnership with society. This approach is based on the belief that healthy and dynamic communities are the foundation stones for business success. The Daiwa Securities Group puts considerable importance on communications with local communities and flexible support in response to specific needs, as part of its efforts to contribute to the

development and maintenance of a truly prosperous and dynamic society.

### Ecological Programs

---

Environmental problems are closely linked to people's values and lifestyles. Efforts to enhance understanding of ecological issues will be necessary to solve these problems. It will also be necessary to modify existing social and economic systems to create structures that can support sustainable development. The Daiwa Securities Group is helping to build this environmentally aware society. For example, all new hires into Group companies undertake a week of intensive induction into the Group before being dispatched to their ultimate destinations. This induction happens at the Group's main training center located in the Tama area near Tokyo. The last day of this induction consists of cleaning local parks to indicate support and respect for the local community and its ecology. These measures are supplemented by a range of voluntary activities, usually conducted at weekends with the cooperation of local authorities.

### Support for Employee Participation in Voluntary Activities

---

In addition to their contribution to society, those who participate in voluntary activities themselves gain certain tangible and intangible benefits, including the discovery of new worlds, as well as lifestyle diversity. To achieve these benefits, it is necessary to provide initial support to promote the development of such voluntary activities. The Daiwa Securities Group regards voluntary activities as a way to enhance the value of people, and it offers a variety of guidance and support to encourage participation by as many of its employees as possible. One example of this support is the arrangement of seminars to promote better understanding of the needs of people with low vision.

### The Daiwa Securities Health Foundation

This foundation was created in 1972 to commemorate the 30th anniversary of the establishment of the former Daiwa Securities. Its purpose is to fund research into the prevention and treatment of lifestyle-related diseases, and to disseminate information about the maintenance and promotion of health in adulthood. The Foundation also contributes to public welfare by supporting health-care and welfare programs for the aged. Activities are funded using investment income from the basic endowment, which in the year ended March 31, 2002 amounted to 135 million yen, together with donations from the Daiwa Securities Group. During FY 2001, assistance to the value of 30 million yen was made to 30 projects. The funds are used mainly for grants for research into health-care, medical treatment and welfare for the middle-aged and elderly.

### The Daiwa Foundation

The Daiwa Foundation was established in 1994 to mark the 50th anniversary of the founding of the former Daiwa Securities. Its role is to contribute to the good of society and create an environment in which all people can participate in voluntary activities, by providing grants to support voluntary activities in such areas as welfare and medical care, and by promoting the volunteer spirit.

Funding for the Foundation's activities includes investment income from its basic endowment, which amounted to 1.95 billion yen as of March 31, 2002, and donations from the Daiwa Securities Group. Grants are provided principally for voluntary activities in the areas of home care for the aged, support for children and adults with disabilities, and children's

issues. The Foundation also provides grants for research in such areas as welfare, medical care and public health. Donations of 50.4 million yen to fund 206 projects and a grant of 500 thousand yen to 1 project were provided in FY 2001.

### The Daiwa Anglo-Japanese Foundation

This Foundation was created in 1988 to commemorate the 25th anniversary of the establishment of the London operation of the former Daiwa Securities. It was established in the United Kingdom with an endowment of approximately 5 billion yen from the former Daiwa Securities. Its mission is to contribute to mutual understanding and goodwill between Japan and the United Kingdom through international exchange between the two countries.

As of March 31, 2002, the Foundation's endowment amounted to approximately 35 million pounds (approximately 6.8 billion yen). It uses its investment income to award grants and fund the Daiwa Scholar Program and the Daiwa Japan House. Under the Daiwa Scholar Program, young British people are invited to Japan to learn the Japanese language and participate in other study programs.

To date 81 scholars have participated in the program. Total grants provided amount to approximately 3.3 million pounds (approximately 640 million yen).

The Foundation also provides grants for activities in the United Kingdom and Japan that contribute to the growth of international exchange between the two countries in such areas as education, science and the arts. Some 1,400 grants totaling approximately 7 million pounds (approximately 1.5 billion yen) have been provided.



Our First Hundred Years: **Former Daiwa Securities** - c. 1972

## Income Statement Summary

(Millions of Yen)

	FY 2001	FY 2000	% change yoy	FY 2001			
				4Q (1-3)	3Q (10-12)	2Q (7-9)	1Q (4-6)
<b>Operating revenues</b>	<b>127,541</b>	<b>178,959</b>	<b>-28.7%</b>	<b>33,031</b>	<b>29,294</b>	<b>28,501</b>	<b>36,713</b>
<b>Commissions</b>	<b>103,774</b>	<b>157,918</b>	<b>-34.3%</b>	<b>25,027</b>	<b>22,475</b>	<b>23,936</b>	<b>32,335</b>
Brokerage (Stock and others)	43,234	65,747	-34.2%	10,130	8,944	9,262	14,897
Brokerage (Bond and others)	3	14	-77.9%	0	0	0	2
Distribution	26,100	52,312	-50.1%	5,954	5,747	5,884	8,513
(Investment trust)	14,047	35,783	-60.7%	2,734	3,351	2,205	5,755
Other commission	34,207	39,841	-14.1%	8,863	7,740	8,681	8,921
(Investment trust)	22,097	29,939	-26.2%	4,708	5,160	5,760	6,467
<b>Net gain on trading securities</b>	<b>21,897</b>	<b>17,021</b>	<b>+28.6%</b>	<b>7,620</b>	<b>6,418</b>	<b>4,015</b>	<b>3,842</b>
Stock and others	64	203	-68.3%	162	184	-398	115
Bond, forex and others	21,832	16,818	+29.8%	7,457	6,233	4,414	3,727
<b>Net gain on other commodities trading</b>	<b>-</b>	<b>13</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Interest and dividend income</b>	<b>1,869</b>	<b>4,006</b>	<b>-53.3%</b>	<b>383</b>	<b>400</b>	<b>549</b>	<b>535</b>
<b>Interest expenses</b>	<b>828</b>	<b>1,326</b>	<b>-37.6%</b>	<b>203</b>	<b>198</b>	<b>227</b>	<b>198</b>
<b>Net operating revenues</b>	<b>126,713</b>	<b>177,633</b>	<b>-28.7%</b>	<b>32,827</b>	<b>29,096</b>	<b>28,273</b>	<b>36,515</b>
<b>SG&amp;A</b>	<b>137,966</b>	<b>153,638</b>	<b>-10.2%</b>	<b>32,968</b>	<b>32,446</b>	<b>36,199</b>	<b>36,351</b>
<b>Ordinary income (loss)</b>	<b>-11,028</b>	<b>24,355</b>	<b>-</b>	<b>116</b>	<b>-3,483</b>	<b>-7,822</b>	<b>161</b>
<b>Net income (loss)</b>	<b>-3,641</b>	<b>13,396</b>	<b>-</b>	<b>-566</b>	<b>-2,198</b>	<b>-893</b>	<b>16</b>
<b>Capital Adequacy Ratio</b>	<b>328.0%</b>	<b>251.3%</b>	<b>-</b>	<b>328.0%</b>	<b>323.8%</b>	<b>318.5%</b>	<b>298.4%</b>

Note: FY 2000 figures have been restated based on the new Japanese uniform accounting standards of securities companies.



# Daiwa Securities Co. Ltd.

## At a Glance

### Business

Retail securities company, 100% owned by Daiwa Securities Group Inc. Operates through three distinct channels – a nationwide network of 126 branch offices, a call center and via the Internet. The branch offices also take responsibility for servicing institutional clients outside of the major commercial centers covered by Daiwa Securities SMBC. Daiwa Securities has embraced a unique segmentation of its service offerings, allowing access to different levels of service at different pricing levels. CRM systems implemented to all branch offices and sales people during FY 2001. Preparing to reorganize the branch network to concentrate on area marketing.

### Review

In addition to steady deterioration in the equities market for much of the year, the collapse of the U.S. company Enron caused considerable dislocation in Japanese MMFs (Money Management Funds), an area of strategic importance to Daiwa Securities. Both brokerage commission and investment trust-related revenues declined sharply due to poor business environments.

Although SG&A expenses also declined due to implementation of various measures to reduce costs, both ordinary income and net income were negative.

Retail assets under custody, however, increased 440 billion yen to 13.1 trillion yen.

### Outlook

Phasing out of blanket deposit insurance on bank accounts seems likely to lead to a flow of retail funds into securities markets during FY 2002. Against this background, Daiwa Securities intends to garner 2.9 trillion yen in additional retail assets under custody, unadjusted for changes in valuation, mainly from high-net-worth individuals and non-profit organizations.

Daiwa Securities Co. Ltd. is the retail securities brokerage within the Daiwa Securities Group. It has based its growth strategy on the premise that individual securities investment in Japan is under-developed compared to other major economies. Consequently, while continuing to maintain service to its existing customer base, the company has sought to attract new investors by drawing on its highly developed distribution network and strong product development capabilities.

---

## Distribution

---

Daiwa Securities, in addition to operating a nationwide network of branch offices, ranks among Japan's largest online brokerages as well as being the most established, having commenced operations in 1996. Daiwa has brought to its retail distribution activities innovations such as a large, technically superior call center, expanded use of technology throughout the branch system and the introduction of sales offices or "mini-branches."

As of the end of March 2002, Daiwa Securities maintained approximately 2.7 million customer accounts, with 15.7 trillion yen in assets under custody.

### Branch Network

---

Daiwa Securities operates a network of 126 branches throughout Japan, with at least one branch in each of the 47 prefectures. In addition to serving as the nerve centers of the Daiwa Securities Group's retail securities operations, the branches have a very important responsibility to service smaller institutions and corporations, particularly those located outside the major commercial centers and not covered by Daiwa Securities SMBC.

At the same time, Daiwa Securities is experimenting with the introduction of smaller sales offices, sometimes referred to as mini-branches. These mini-branches are being located near stations with the aim of attracting new customers. As of March 2002, Daiwa Securities had opened 5 sales offices around Japan. Plans for a more aggressive opening schedule have been scaled back due to the harsh operating environment.

### Systems

During FY 2001, in preparation for a major shift in the organization of the branch network, Daiwa Securities introduced an advanced Customer Relationship Management (CRM) system from the American CRM specialist, Siebel Systems, into every branch in the network.

### Daiwa Direct

---

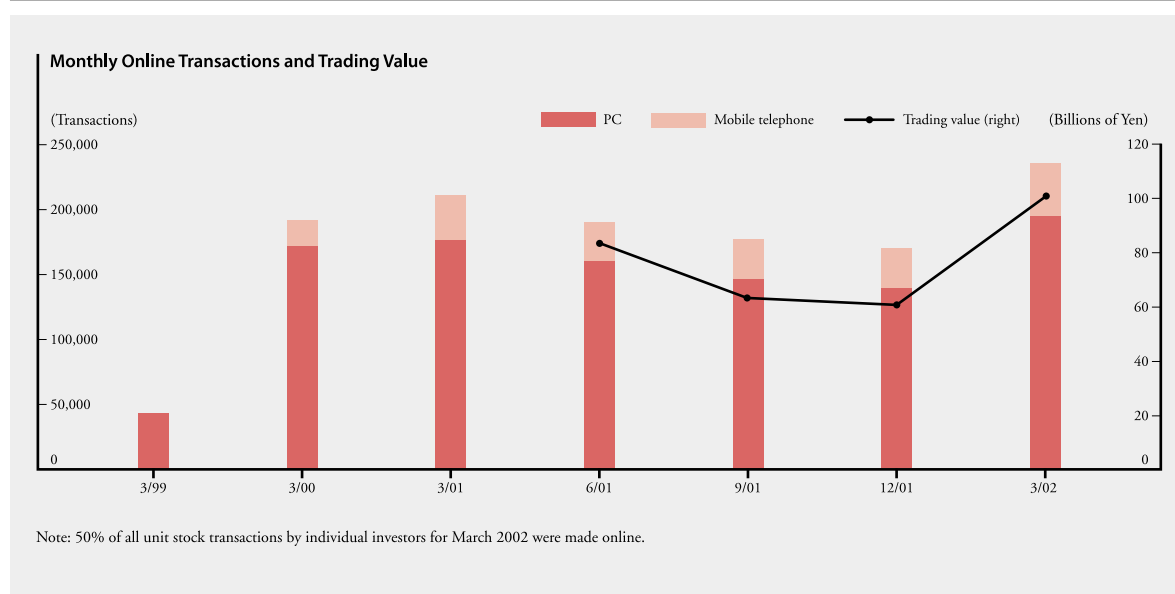
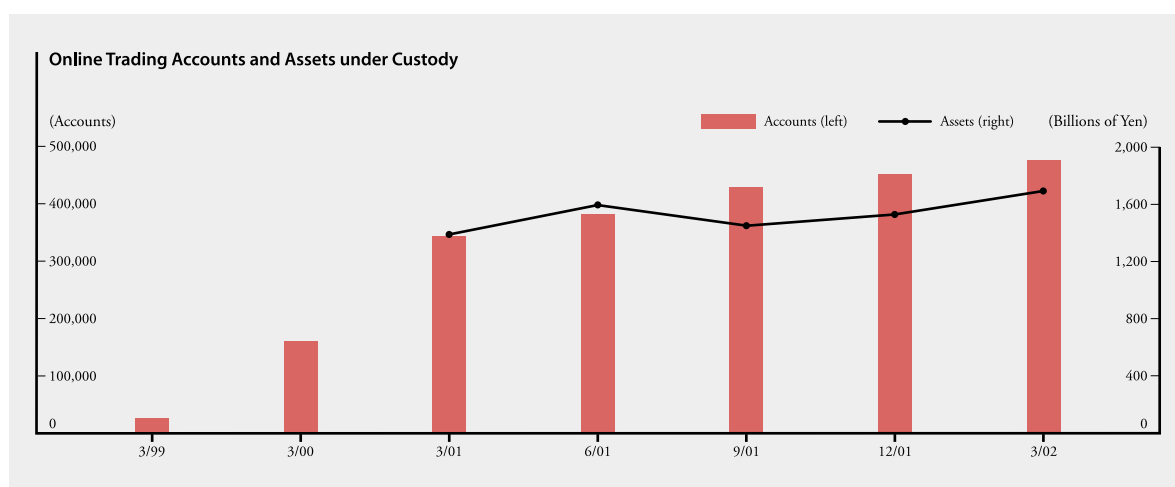
#### Internet

Daiwa Direct provides online brokerage services within Daiwa Securities. Daiwa Direct started operations in April 1996, making Daiwa Securities the first company in Japan to offer such services. The proportion of transactions conducted through the Internet has dramatically increased since equity brokerage was liberalized in October 1999. In March 2002, about 50% of transactions and about 17% of commissions on unit shares were derived from the Internet. Daiwa Direct also offers services via mobile telephones, utilizing the data communications capability of cellular telephones offered by NTT DoCoMo, AU and J-Sky. As of March 2002, mobile terminals accounted for approximately 17% of transactions conducted over the Internet.

At the time of the final deregulation of brokerage commissions in 1999, Daiwa Direct led the industry in terms of client accounts. Since then, the online brokerage industry in Japan has seen the advent of deep discounters—many lacking an existing client base—that have attempted to generate market share at the expense of profitability. Daiwa Securities has stayed aloof of this trend, being confident that its own business model, which regards the Internet as an integral part of its overall distribution strategy, is superior. Consequently, commissions charged by

Daiwa Direct are significantly higher than the average, being several times that of the lowest available commission level. Although Daiwa Securities, in common with other traditional brokerages, has lost market share to certain pure online brokers that focus on trading-oriented individual investors, it nevertheless remains one of Japan's leading online brokerages.

Much of Daiwa Direct's success can be ascribed to positive brand image and high client satisfaction. Independent surveys show that trust in the Daiwa Securities Brand is high and that confidence and after-sales support are major factors in customer satisfaction. Daiwa Securities believes that promotion of customer confidence is a crucial success factor. This has been achieved by maintaining the stability of the online system and by utilizing the Daiwa Securities call center and branch network for support.



### Call Center

Daiwa was the first securities company in Japan to establish a full-fledged call center in July 2000. It was launched in April 1999 with 25 seats as a help desk for Daiwa Direct customers. Today the call center has approximately 200 seats and employs 200 telephone service representatives (TSRs). The Center fills the distribution and service gap between the full-service branches and online trading, and it now provides services to call center accounts as well as maintaining its function as a help desk for online customers. Located in Tokyo, the call center has access to a large pool of qualified people.

To enhance flexibility, Daiwa Securities maintains a high level of training and has also installed various support systems, including automatic referrals and voice-response programs.

Building on its success in establishing strong representation in each of the major distribution channels, Daiwa also introduced its three-channel strategy as outlined below.

### Three Service Packages

In July 2000, Daiwa Securities divided its product offerings into three distinct service packages, as follows:

#### Daiwa Consulting

This channel provides a full range of services drawing on Daiwa Securities' extensive branch network and access to trained personnel capable of offering expert advice and support.

#### Daiwa Call

This channel is geared to customers who choose to make transactions over the telephone. People who prefer to conduct transactions online, but who require advice, and people who have difficulty using the Internet or find it difficult to get to a branch are the potential customer base.

#### Daiwa Net

This channel is geared to investors who appreciate the benefits of Net trading and do not require investment advice. The range of products offered through Daiwa Net is somewhat more restricted than those available through either of the other packages.

ATM services at branches and transactions via the Internet are available to all Daiwa Securities customers regardless of channel selected. However, counter service is available only to Daiwa Consulting customers. A 25% discount applies to Daiwa Consulting customers for online transactions. In addition, brokerage commissions for Daiwa Call customers for trades placed with the call center or via the Internet are set at 70% of the full commission rate applicable to Daiwa Consulting customers. This discount rises to 50% on orders placed over the Internet by Daiwa Net customers. Customers of all channels may receive discounts of up to 15% if they take advantage of a special fee-discount service offered to subscribers of the Daiwa Cash Management Program.

The goal of this three-channel strategy, which is unique in Japan, is to offer customized services while enabling seamless migration between channels.

Furthermore, Daiwa Securities will benefit by having customers utilize the call center and the Internet as it will allow maximum utilization of human resources at the branch offices.

## Private Banking

The Private Banking Department within Daiwa Securities is responsible for addressing the asset management and other financial needs of high-net-worth individuals in Japan. As of March 31, 2002 the department consisted of members with expertise in

taxation and legal matters and asset allocation. The majority of these staff are stationed in Tokyo although the department does maintain a direct presence both in Osaka and in Nagoya. The department is responsible for assets under management of approximately one trillion yen.

The majority of assets consist of the equity assets of business owners, particularly those whose businesses have undergone an IPO lead managed by Daiwa Securities SMBC. This department thus works closely with the IPO Department of the wholesale securities company. It also offers advice on such matters as inheritance and business succession planning jointly with the Corporate Finance Departments of Daiwa Securities SMBC. Furthermore, the department has been successful in increasing its customer base by providing individually tailored advice concerning recent tax reforms.

### Innovation in Retail Brokerage 1999-2002

#### FY 1999

Daiwa Securities is incorporated as the retail securities company within the Daiwa Securities Group. Retail assets under custody replaces brokerage commission as the main measure of marketing excellence within Daiwa Securities.

#### FY 2000

The call center becomes fully operational. Daiwa Securities introduces three distinct distribution channels catering to different segments of the retail securities market. The re-organization of the branch network also begins. Sales offices (mini-branches) are introduced.

#### FY 2001

Advanced customer relationship management (CRM) systems are rolled out to all branches. A Groupwide branding campaign seeks to develop a common corporate culture.

#### FY 2002

Daiwa Securities builds on previous innovations and radically changes the organization of the branch network to a satellite branch system. Simultaneously, the company introduces a more disciplined approach to institutionalize marketing best practice throughout the branch network.

### Reform of the Retail Distribution Network

At the beginning of FY 2002, Daiwa Securities announced a major multifaceted reform of its distribution network. This reform seeks to maximize the utility of Daiwa's established branch network while also making use of recent innovations such as the introduction of CRM systems into all branches during FY 2001.

The reforms have two main thrusts. The first is the reorganization of the branch network into a satellite branch structure in which branches around Tokyo and Osaka will be grouped into semi-autonomous units, based on locale, under the leadership of a "mother branch." Henceforth, such units or "areas" will be treated as a whole in forming marketing strategies.

The second is the adoption of a more focused and disciplined approach to sales management than has been attempted previously. This new approach builds

on the capabilities of the new CRM systems. It will involve focused application of sales effort in an attempt to build effective marketing channels for targeted customers and to promote the development of continuing relationships and repeat business.

### Satellite Branch System

To date, each branch has operated under the control of the head office, with all branches engaging in the same business activities. Starting in FY 2002, this situation will change radically. Branches in the same geographical area will be grouped into one unit under the leadership of a mother branch. This will reduce the head office's administrative overhead while allowing the branch network to continue responding to diverse customer needs.

### New Marketing Paradigm

As mentioned previously, the introduction of CRM systems to all branches and offices of Daiwa Securities was completed in FY 2001. These systems enable information on customers' preferences and attributes to be fully institutionalized within Daiwa Securities. Prior to the introduction of these systems, most customer information was stored in the form of personalized lists and databases maintained by each sales staff member. This in turn meant that such information was lost when staff were transferred or retired and had to be laboriously re-constructed. Introduction of the CRM system will ensure that this information is made permanently available to all sales

staff, thereby ensuring that individually-tailored proposals can be extended to customers as appropriate. The customer database compiled through the CRM system will also be utilized for other marketing efforts.

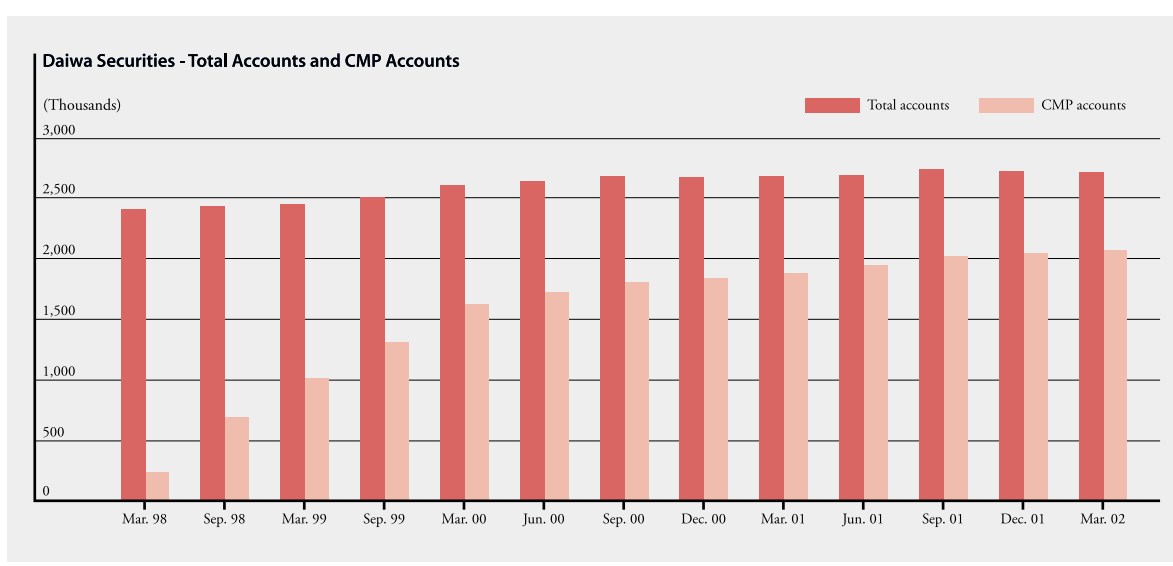
The Daiwa Securities Group has already actively embraced branding as a key component of its business activities. However it is expected that the introduction of the CRM systems will contribute to enhancing the value of the Group's brand. Utilization of these systems will also promote the consulting business – an activity that is strongly rooted in customer trust – which, it is hoped, will in turn lead to a larger customer base and a further increase in brand value.

- Utilization of the CRM system will enable Daiwa Securities to work towards set goals and further develop marketing activities. High net-worth individuals, regional public corporations and various foundations will form the target group for FY 2002 in light of the end of blanket government insurance on bank deposits and the possibility of a shift of a proportion of these deposits into the securities markets.
- Through the incorporation of best marketing practices, founded on the tenets of the Group brand, into a manual, Daiwa Securities will accumulate a wealth of knowledge accessible to all staff of the company.

## Review of FY 2001

Daiwa Securities operated in an extremely challenging environment during FY 2001. The equity market trended lower for most of the year, with only initial enthusiasm for the Koizumi administration's reform efforts and a brief year-end rally breaking the gloom. In addition, risk-averse investors were shaken by several defaults among issues previously assumed safe. In particular, the sudden bankruptcy of the U.S. energy trader Enron caused problems for several MMF funds in Japan that had substantial exposure to that company's debt. In some cases, valuations were reduced to below par value. This, in turn, triggered a massive outflow of funds from MMFs industrywide. Although MMFs managed by Daiwa Asset Management did not have exposure to Enron debt, Daiwa suffered from an indiscriminate withdrawal of funds that affected all MMFs. Because of Daiwa's

strong market position, with a market share of over 50%, and because Daiwa has positioned MMFs at the center of its strategy to capture flows of funds into securities markets from first-time investors, the events of FY 2001 were unwelcome. Initial indications in FY 2002, however, are that investors are indeed starting to move funds from bank accounts to securities markets, including MMFs, in anticipation of the end of blanket government insurance of bank accounts. The company saw active retail interest in its range of medium-term government bond funds during FY 2001. In addition, retail interest in foreign-currency denominated bonds reached high levels in light of the substantial yield pickup over that available domestically and the trend to a weaker yen. Consequently, Daiwa Securities experienced a net inflow of new funds totaling some 950 billion yen. Total retail funds under custody on the other hand, showed only a modest increase from 12.7 trillion yen to 13.2 trillion yen due to valuation losses in line with the depressed equity market.



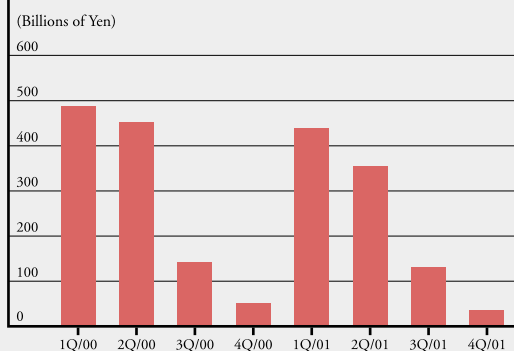
In addition to the above, Daiwa Securities lost market share in the retail securities sector, primarily to the plethora of price-driven Internet brokerages that have an active client base. Daiwa Securities' share of trading on the TSE (Tokyo Stock Exchange) fell from 1.9% at the end of FY 2000 to 1.3% as of end-FY 2001 in terms of value of shares traded.

In light of all of the above, operating revenues fell by 29% to 127.5 billion yen. Daiwa Securities recorded a loss at the ordinary income level of 11.0 billion yen and a net loss of 3.6 billion yen. Almost all areas of business contributed to the decline. Brokerage commissions fell 34% year-on-year, to 43.4 billion yen; distribution income fell by 50% to 26.1 billion yen, primarily due to an abrupt fall in income related to investment trusts; and for the same reason, other commissions fell by 14% to 34.2 billion yen. This was somewhat offset by a small rise in trading gains to 21.9 billion yen from 17.0 billion yen during the previous year related to active domestic demand for foreign currency denominated bonds.

Daiwa Securities was able to significantly squeeze SG&A expenses during the year. For FY 2001, SG&A expenses were 137.9 billion yen, down 10% over the preceding year. The improvement can be attributed to

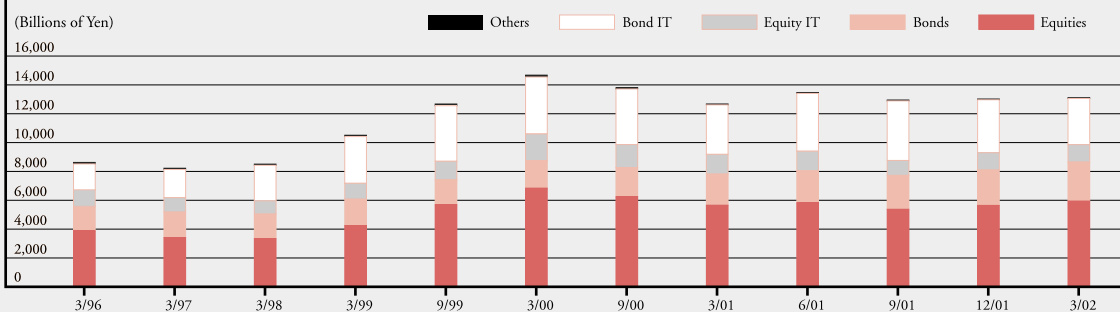
a decline in commissions paid to the stock exchange and other expenses, in turn a reflection of subdued trading activity during the year, as was a drop in personnel expenses linked to commissions earned and real estate expenses. On the other hand, depreciation increased due to a steep increase in IT investments. It should be noted that this reduction was achieved without drastic reductions in employee numbers. Daiwa Securities continues to resist making drastic cuts in this area due to the need to protect institutional memory and the need to secure access to adequate resources into an eventual market upturn.

**Daiwa Securities - Inflow of Individual Assets**



Note: 1. Figures are for individuals (institutions are not included).  
2. Inflow = net inflow / outflow of money + net deposit / withdrawal of securities for the quarter

**Trend in Daiwa Securities' Retail Assets under Custody**





## Other Highlights

Other highlights of FY 2001 include the following:

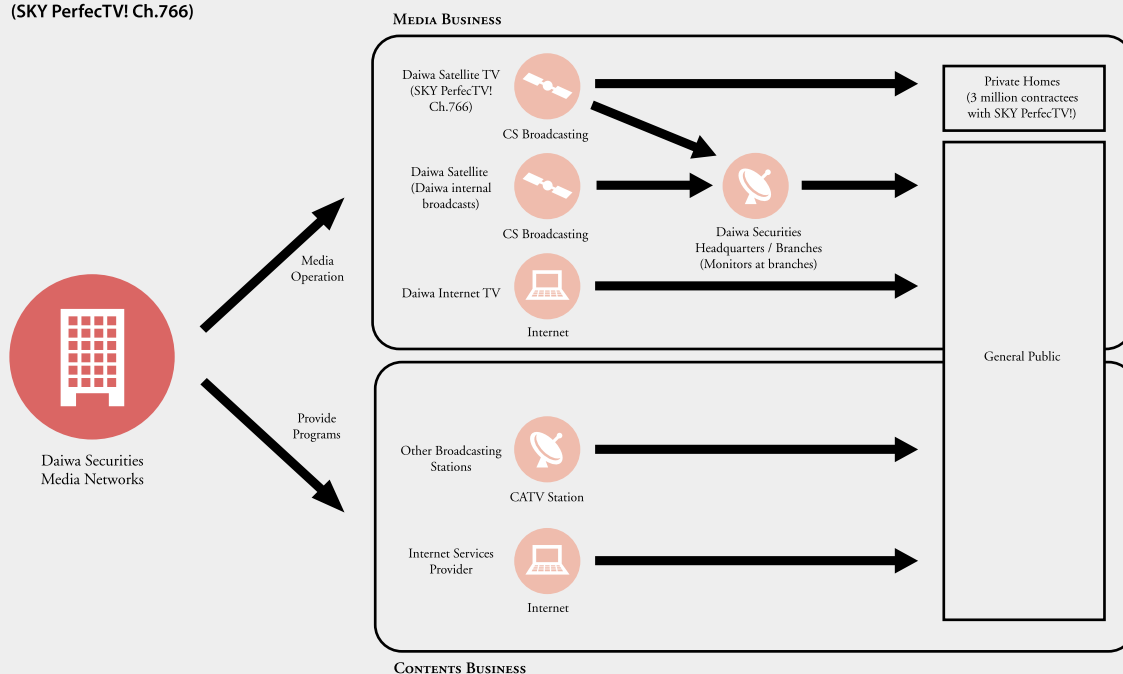
- Daiwa Securities introduced a customer support hotline to improve customer satisfaction. Customer awareness of this service is steadily increasing.
  - Daiwa Securities has started to open branches on Saturdays. All branches except sales offices (mini-branches) have opened each Saturday since October 2001. Sales offices open only on the first and third Saturdays of the month. Initial customer feedback has been very positive.
  - Daiwa Securities implemented “cashless” operations in all branches from April 2002 to enable branches to dedicate themselves to customer consultations, with the aim of freeing up as much time as possible for customer consultations.
  - Daiwa Securities started providing variable annuity products in November 2001. Currently, these products include 2 variable rate annuities products, “Pension Plus” (provided by T&D Financial Life Insurance) and “Good Stage” (provided by Scandia Life Insurance), and a variable interest rate annuity, “EXT” (provided by Sumitomo Life Insurance).
- In the unstable economic climate brought about by the low birth-rate and aging society and unsustainable structure of public pension plans, the need for funds to allow individuals to support themselves in old-age is expected to continue to grow even further. As a result, Daiwa Securities has given top priority to its pension and insurance products and is strengthening its consulting facilities to concentrate on customers’ mid-term financial needs.
- On 5 November, 2001, Daiwa Securities introduced margin trading, with a minimum deposit requirement of 3 million yen, as a component of the Daiwa Call and Daiwa Net packages. Daiwa has introduced margin accounts to facilitate the needs of Daiwa Securities customers with legitimate trading needs. The minimum deposit requirement was reduced to 1 million yen from 23 July, 2002.
  - Daiwa believes that investor education is vital to the healthy development of capital markets. Consequently, Daiwa Securities provides CS broadcasts via Daiwa Securities Media Networks, supports the establishment of investment clubs and sponsors lectures at a number of universities such as the Tohoku Fukushi University.

### Daiwa Securities Media Networks

Daiwa Securities Media Networks is a media strategy company within the Daiwa Securities Group. It started operation on 1 October, 2001 and commenced broadcasts of “Daiwa Satellite TV” on channel 776 of CS Broadcast’s “SKY PerfecTV!” on 1 December of the same year. As the only true broadcasting operator in the finance industry, Daiwa Securities Media Networks is hoping to develop this into a

business and economics channel offering a full variety of high quality finance- and securities-related information. In the future, the Group would like to gradually expand its product offerings to a much wider range of related transmissions of worthwhile information, including provision of programs to local broadcast stations and distribution of programs over the Internet.

Commenced Broadcast in December 2001  
(SKY PerfecTV! Ch.766)



---

## Outlook

---

In April 2002, blanket deposit insurance for time deposits was eliminated in Japan. Henceforth, the insurance program will cover only 10 million yen per depositor per bank. From April 2003, this will also apply to ordinary savings deposits. Indications are that this might well stimulate a flow of funds out of bank deposits and into securities markets, particularly the bond markets. For FY 2002, Daiwa Securities believes that the most promising strategic targets in this respect are high-net-worth individuals, regional governmental organizations, and government-related companies and foundations. A key source of competitive advantage in seeking to attract these clients is the newly installed CRM system and the reorganized branch network described earlier.

On the product-development front, Daiwa will continue to stress its wide range of investment trust products, particularly public bonds and structured bonds to corporations, and variable annuities, investment trusts and foreign bond funds to individuals.

As of January 2003, equity capital gains will be subject to taxation separately from earned income. Instead of being subject to withholding tax, there will be a special system allowing investors to easily calculate and make allowance for tax due. In addition, a variety of preferential tax measures applicable to securities taxation were introduced at the end of 2001. In light of this, Daiwa strengthened its consulting services related to these tax systems to be able to deal effectively with customer needs arising.

As noted before, the key management goal laid down for the retail securities operation during FY 2002 is to achieve an increase in retail client assets under custody of 2.9 trillion yen, excluding valuation effects.



Our First Hundred Years: Fujimoto Bill Broker, Taisho Era

## Income Statement Summary

(Millions of Yen)

	fy 2001	FY 2000	% change yoy	fy 2001			
				4Q (1-3)	3Q (10-12)	2Q (7-9)	1Q (4-6)
<b>Operating revenues</b>	<b>109,481</b>	<b>230,735</b>	<b>-52.6%</b>	<b>34,075</b>	<b>27,482</b>	<b>20,965</b>	<b>26,957</b>
Commissions	54,724	73,643	-25.7%	14,112	13,030	14,475	13,104
Brokerage (stock and others)	10,517	13,531	-22.3%	2,649	2,489	2,630	2,748
Brokerage (bond and others)	190	182	+4.8%	69	38	51	30
Underwriting commission (stock and others)	15,716	29,381	-46.5%	3,680	3,228	5,228	3,579
Underwriting commission (bond and others)	8,973	7,914	+13.4%	1,989	1,727	2,647	2,609
Distribution	1,709	3,384	-49.5%	528	479	522	179
Other commission	15,980	19,247	-17.0%	5,188	3,444	3,389	3,958
Net gain on trading securities	26,089	128,934	-79.8%	13,993	3,031	2,449	6,614
Stock and others	14,753	115,403	-87.2%	7,422	5,048	-1,995	4,278
Bond, forex and others	11,335	13,531	-16.2%	6,571	-2,017	4,445	2,336
Net gain on other commodities trading	-	2	-	-	-	-	-
Interest and dividend income	28,667	28,155	+1.8%	5,968	11,419	4,040	7,238
Interest expenses	6,810	12,258	-44.4%	1,528	1,531	1,755	1,995
Net operating revenues	102,670	218,477	-53.0%	32,546	25,951	19,209	24,962
SG&A	90,288	94,993	-5.0%	22,522	20,975	23,950	22,840
Ordinary income (loss)	13,231	123,640	-89.3%	10,209	5,492	-4,834	2,363
Net income (loss)	5,426	70,802	-92.3%	5,266	3,217	-1,759	-1,297
Capital Adequacy Ratio	500.3%	364.7%	-	500.3%	415.8%	469.4%	450.9%

Note: FY 2000 figures have been restated based on the new Japanese uniform accounting standards of securities companies.

# Daiwa Securities SMBC

## At a Glance

### Business

60%-owned joint venture between the Daiwa Securities Group Inc. and the Sumitomo Mitsui Banking Corporation operating in wholesale securities markets in Japan and overseas.

### Market Position

Strong in equity trading and bond trading with institutions, bond underwriting and IPOs. Ranks first for IPO listings on 3 emerging equity markets. Market leader in structured finance and derivatives. Growing presence in principal finance and mergers and acquisitions (M&A). First-tier player in equity underwriting.

### FY 2001 Results

52% decline in revenues due to severe conditions pertaining in Japanese equity markets. Continued to make progress in other areas including fixed income, structured products, derivatives and M&A.

Daiwa Securities SMBC was originally incorporated as Daiwa Securities SB Capital Markets in April 1999 as a joint venture between the Daiwa Securities Group Inc. and the former Sumitomo Bank, with a brief to participate in Japanese wholesale securities markets. As part of the reorganization of the Daiwa Securities Group, in October 1999 the majority of the overseas subsidiaries were transferred to the new company with the sole exception of the US subsidiary. In April 2001, Sumitomo Bank merged with Sakura Bank to form the Sumitomo Mitsui Banking Corporation. Associated with this merger, Daiwa Securities SB Capital Markets acquired the assets of Sakura

Securities, a subsidiary of Sakura Bank as well as some areas of the investment banking business, including M&A, from Sakura Bank, and was subsequently renamed.

FY 2001 was an extremely difficult year for Daiwa Securities SMBC due primarily to severe conditions applying in Japanese equity markets. Operating revenues fell by more than half to 109.4 billion yen. This was principally due to a sharp downturn in equity trading, which had been the principal driver of Daiwa Securities SMBC's earnings growth during the previous year. Equity trading revenue fell by 87% to 14.7 billion yen in FY 2001. This was compounded by a 47% fall in revenues from equity underwriting to 15.7 billion yen, again due to the poor conditions appertaining during the year, and a 22% fall in equity brokerage commissions to 10.5 billion yen. Improvement in Daiwa Securities SMBC's fixed income operations and in newer businesses such as M&A were insufficient to offset the negative impact of this shortfall.

SG&A expenses also fell by 5% due to a fall in trading expenses and a cut in personnel expenses. But due to the fall in operating revenues, ordinary income was 13.2 billion yen, while net income for the term emerged at 5.4 billion yen.

During the year, Daiwa Securities SMBC was subject to a ratings downgrade by Standard & Poor's, which downgraded its long-term debt from BBB+ to BBB and by Fitch, which downgraded it from A- to BBB+, citing continuing revenue weakness and a deterioration in Daiwa Securities SMBC's profitability. These downgrades did not have much impact on Daiwa Securities SMBC.

## Equities

### At a Glance

#### Business

Equity sales and trading with institutional investors.

#### Market Position

One of the major players in sales and trading of Japanese equities. Together with the retail company, market share on the Tokyo Stock Exchange is close to 10%. Especially strong in large-value off-market and off-exchange transactions drawing on advanced systems support.

#### Outlook

The need to unwind cross-shareholdings remains, providing opportunities for large-lot transactions.

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.

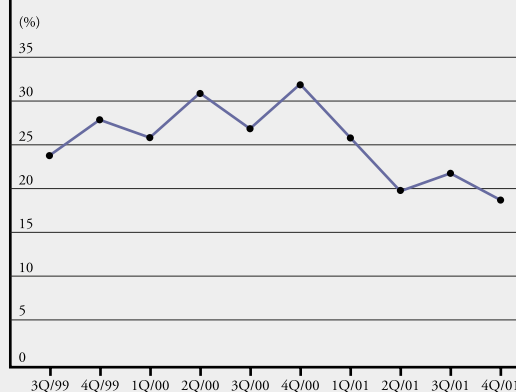
The Equities Division actively pursues opportunities arising from changes in the share ownership of Japanese corporations. The need to unwind corporate cross-shareholdings is facilitated through block trading and placement of shares with institutional investors. These methods enable corporations to unwind shareholdings with limited negative impact on market prices. Daiwa Securities SMBC's global product line, which provides access to both the domestic and overseas networks, is the key to its competitive advantage in this business. The division is also Japan's front-runner in electronic trading. Daiwa Securities SMBC's system utilizes the Financial Information Exchange (FIX) Protocol, the standard for electronic execution of stock transactions by institutional

## Background

Daiwa Securities SMBC'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 Securities SMBC has firmly established its position, ranking among the leading players in non-auction markets (off-market and off-exchange transactions) as well as trading on the stock exchange. These transactions consist mainly of basket trading and large-lot transactions with institutional investors.

Sophisticated support systems have been developed to take full advantage of the talents and experience of Daiwa Securities SMBC's traders and sales personnel. The order system, which allows for speedy execution of complicated transactions, monitors the market,

**Market Share:**  
Off-exchange and off-floor transactions  
(TSE, OSE, NSE)



Source: Daiwa Securities SMBC

investors, and provides overseas institutional investors with the ability to place orders directly with stock exchanges in Japan. Furthermore, transaction reports can be issued through the front office system.

## Review

During FY 2001, equity brokerage commission and equity trading gains amounted to 25.2 billion yen, an 80% fall from the previous year's 128.9 billion yen.

The principal reasons for the fall were as follows.

- (1) FY 2000 results were heavily influenced by massive activity by financial institutions and others unwinding cross-shareholdings ahead of the introduction of mark-to-market accounting from April 2001. This activity was particularly pronounced in the fourth quarter of FY 2000 when the Nikkei Average was trading at around 13,000 and when most financial institutions still had
- (2) Although Daiwa Securities SMBC maintained its strong position in basket trading with institutional investors, spreads came under pressure during the year, leading to a fall in profitability.

Market Size (Daily average)			
	Market-wide <sup>(*)</sup>	Sessions of the 3 major exchanges	(Billions of Yen) Non auction <sup>(**)</sup>
FY 2000	1,119.7	831.6	253.7
1Q	1,300.1	954.2	294.4
2Q	1,136.5	823.9	278.3
3Q	935.7	733.9	177.9
4Q	1,105.4	813.5	264.1
FY 2001 (comparison with previous term)	1,001.6 (-10.5%)	768.4 (-7.6%)	211.6 (-16.6%)
1Q	1,108.6	870.0	218.7
2Q	916.3	696.6	203.0
3Q	950.8	721.5	203.7
4Q	1,034.3	787.7	221.8

\*1: Whole market = The 3 major exchanges + off-exchange + the OTC market  
 \*2: Non auction = Off-floor for the 3 major exchanges + off-exchange  
 Source: Daiwa Securities SMBC



## Outlook

Demand from clients for services related to unwinding of cross-shareholdings seem likely to remain at high levels. Daiwa Securities SMBC will take advantage of its competitiveness in basket transactions to provide clients with the best solutions to meet their needs, including block transactions. To facilitate this, Daiwa Securities SMBC has implemented a number of organizational changes.

- In November 2001, it established a product headquarters that embraces the bond, equity and derivatives divisions with the aim of improving communication concerning customer needs and the ability to provide hybrid products.
- In February 2002, Institutional Sales Departments 1 (domestic) and 2 (international) were merged to share information about investor order flows.
- In April 2002, the product headquarters established a planning section to allow further integration between products.

## Initial Public Offerings

### At a Glance

#### Business

Prepares private companies for IPO, arranges the offering and provides post-offering support.

#### Market Position

The Japanese IPO market is an oligopoly dominated by the big three brokers Daiwa Securities SMBC, Nikko Salomon Smith Barney and Nomura. The market was lackluster in FY 2001, falling 43% in terms of value from the previous year. Daiwa Securities SMBC maintained its number two ranking on the back of large IPOs conducted for McDonald's Company (Japan) and usen Corp.

#### Outlook

Although the number of issues is expected to remain constant during FY 2002, a further fall in value terms seems likely. Nevertheless, the business environment for the IPO market is expected to be stable in the long term.

## Background

Daiwa Securities SMBC and Nomura, followed by Nikko Salomon Smith Barney, heavily dominate the Japanese market for initial public offerings (IPO) due primarily to their dominance in the retail securities markets. All three market participants identify candidates by having promising, privately-held companies suitable for an IPO referred from a variety of sources including banks, accounting firms, venture capital firms and others. The sponsoring broker provides a variety of legal, accounting, consulting and

other services for an extended period with a view to preparing the candidate for listing. Close relationships formed during this period form the basis for subsequent business as the company grows and makes further equity financing. Historically, Nomura Securities has been the leading company in the IPO market. Over recent years, Daiwa Securities SMBC has been increasing market share and has firmly established itself in second place.

During FY 2001, the number of IPOs remained roughly unchanged from the previous financial year, falling from 201 to 187 issues. However, poor market conditions meant that several previously expected, larger issues were put on hold, leading to a 43% fall in overall market value to 780.4 billion yen. During the year, information technology issues did not enjoy the cachet evident in recent years following the bursting of the dot com bubble and global malaise in that sector. However, successful companies in other sectors could still achieve successful listings as evidenced by the listing of McDonald's Company (Japan) and usen Corp. which were lead-managed by Daiwa Securities SMBC. Other large issues during the year included Nomura Research Institute and Dentsu.

## Review

During FY 2001 Daiwa Securities SMBC acted as lead manager in 36 IPOs, with a market value of approximately 260 billion yen, including those for usen Corp. and McDonald's Company (Japan), to achieve number two ranking in both value and volume terms.

## Outlook

It seems likely that the Japanese market for initial public offerings will remain roughly unchanged at perhaps 150 to 200 issues while market size continues to fall. As an IPO is the result of long-term preparation, short-term results are difficult to achieve. Furthermore, despite the present situation, the business environment in the long-term is expected to be stable. To date, the relationship with the Sumitomo Mitsui Banking Corporation has lead to Daiwa Securities SMBC obtaining increased participation in issues lead-managed by its competitors. It is expected that the competition with Nomura for the No. 1 spot will continue.

### League Table of IPO Underwriters

(Listed date basis)

Ranking	Securities firm	Amount (Billions of Yen)	Share	Number
1	Nomura	308.1	39.5%	45
2	Daiwa Securities SMBC	267.8	34.3%	36
3	NSSB	80.2	10.3%	32

Source: Daiwa Securities SMBC

## Equity Capital Markets

### At a Glance

#### Business

Underwriting of issues and offering of equity.

#### Market Position

Reasonably strong in small- and mid-sized issues into the domestic market. However, lags both Nomura Securities and Nikko Salomon Smith Barney due to recent weakness in obtaining mandates for privatization issues. Recently appointed lead manager for Japan Tobacco offering.

#### Outlook

New equity issuance is expected to remain weak in spite of some recovery in the secondary market. Next major issues expected are related to various privatizations. Actively seeking privatization-related issues while also pursuing leads provided by access to the networks of the Sumitomo Mitsui Banking Corporation.

### Background

Equity capital markets in Japan are largely dominated by Daiwa Securities SMBC, Nomura and Nikko Salomon Smith Barney and a limited number of foreign securities houses.

Recently, Japanese equity capital markets have been weak due to the malaise in the underlying Japanese securities markets and a tendency to balance sheet restructuring on the part of Japanese corporations. This has been partially offset by the advent of large global offerings, mainly related to privatizations, and

by a boom in demand for IT-related issues. However, both of these offsetting factors were absent in FY 2001 causing the market to contract abruptly.

While Daiwa Securities SMBC retains a strong position in the local market for equity underwriting it nonetheless lags both Nomura and Nikko Salomon Smith Barney in larger global issues. During FY 2002 large privatization offerings for Japan Tobacco (JT), JR East and JR West are planned or have been offered to date. Of these offerings, Daiwa Securities SMBC has been mandated lead manager for the 333,000 government-held share offering of JT.

### Review

During FY 2001 the volume of new equity and equity-linked issues by Japanese issuers shrank from 3.5 trillion yen to 0.7 trillion yen. Whereas FY 1999 had seen active issuance from information technology companies and FY 2000 had seen a number of landmark large-scale issues such as NTT DoCoMo and Oracle Japan, FY 2001 was devoid of these supporting factors.

Against this background, Daiwa Securities SMBC managed to obtain a mandate for the 23 billion yen U.S. debut of Nidec Corporation. Furthermore, the simultaneous issuance of convertible bonds and preferred trust securities on behalf of NEC was highly evaluated in the market. The Nidec Corporation deal was voted deal of the year by Thomson DealWatch. Reflecting the above, Daiwa Securities SMBC saw its market share in this area improve somewhat compared with the preceding year. There was no conspicuous increase in business that could be attributed to the parent bank, principally due to the subdued nature of the markets. However, Daiwa Securities SMBC will continue to work closely with the Sumitomo Mitsui Banking Corporation to take full advantage of its expanded client base.

## Japanese Corporations' Financing Activities

(Billions of Yen)

		Number	Amount
Equity	FY 2001	79	725.8
	FY 2000	107	3,580.8
	FY 1999	215	4,603.9
Straight bonds	FY 2001	327	8,078.5
	FY 2000	362	7,573.5
	FY 1999	431	7,554.5
IPO	FY 2001	187	780.4
	FY 2000	201	1,442.0
	FY 1999	126	658.1

Source: Daiwa Securities SMBC

## League Table of Arrangers of Equity Offerings in FY 2001

(Covering deals whose terms were finalized in the year)

Ranking	Securities firm	Amount (Billions of Yen)	Share	Number
1	Nomura	244.8	33.7%	27
2	NSSB	163.0	22.5%	15
3	Merrill Lynch	107.0	14.7%	2
4	Daiwa Securities SMBC	94.1	13.0%	23
5	UBS Warburg	51.2	7.1%	2
6	Morgan Stanley	25.6	3.5%	1
7	Kokusai	14.2	2.0%	1
8	Deutsche	9.0	1.2%	2
9	Mizuho	5.4	0.8%	3
10	Shinko	4.3	0.6%	5

Note: FY 2001 excludes tracking stock, preferred trust securities and REITs.

Source: Daiwa Securities SMBC

## Outlook

Although the Daiwa Securities Group anticipates some recovery in the wider equity markets during FY 2002, it does not expect significant issues of new equity as corporations continue with efforts to rationalize their balance sheets and to raise return on equity to competitive levels. During FY 2002, transactions expected or which have been completed are related to privatization and include listings for the various Japan Railway member companies and for Japan Tobacco. As previously mentioned Daiwa Securities SMBC has been appointed lead manager for the JT offering. Further out, Daiwa Securities SMBC sees significant potential demand from the governmental and quasi-governmental sectors. Daiwa Securities SMBC has formed a dedicated task force to address these business opportunities.

In addition, the division's consultancy business in such areas as debt-equity swaps is increasing as corporations continue efforts to restructure their balance sheets.

## Fixed Income

### At a Glance

#### Business

Facilitates the bond trading needs of institutional investors. Underwrites debt issued by corporations and government entities.

#### Market Position

Top in domestic SB issuance. Well established as number one in terms of customer satisfaction. Benefits from strong systems capability.

#### Outlook

Demand in the secondary markets is expected to grow as new classes of investors enter the bond markets for the first time. Issuance may continue to be subdued due to lack of need for funds among Japanese corporations.

## Background

According to a reputable industry survey by a well-respected U.S. consultancy, Daiwa Securities SMBC has ranked first in client satisfaction for the past three years.

Since the formation of Daiwa Securities SMBC as a joint venture between Daiwa Securities Group and the Sumitomo Mitsui Banking Corporation, this company has been able to improve its standing in domestic straight bond (SB) issuance, to the point where it currently ranks as the market leader. During FY 2001, it also ranked top in SB issuance for the retail securities market.

In its bond market operations, Daiwa Securities SMBC benefits greatly from strong systems support. In particular, Daiwa Securities SMBC is one of only

two companies able to provide real-time online portfolio valuation services via its TOL (Total Bond Analysis Online) system.

#### League Table of Underwriters of Domestic SBs in FY 2001

(Covering deals whose terms were finalized in the year)

Ranking	Securities firm	Amount (Billions of Yen)	Share	Number
1	Daiwa Securities SMBC	1,893.2	23.4%	92
2	Nomura	1,658.0	20.5%	75
3	NSSB	1,096.0	13.6%	53
4	Tokyo Mitsubishi	966.0	12.0%	46
5	Mizuho	933.8	11.6%	54
6	UFJ	554.1	6.9%	25
7	Goldman Sachs	296.5	3.7%	14
8	Morgan Stanley	158.8	2.0%	12
9	Shinko	151.5	1.9%	15
10	Merrill Lynch	82.0	1.0%	5

Source: Daiwa Securities SMBC

#### League Table of Underwriters of Domestic SBs for Sale to Individual Investors in FY 2001

(Covering deals whose terms were finalized in the year)

Ranking	Securities firm	Amount (Billions of Yen)	Share	Number
1	Daiwa Securities SMBC	400.8	33.3%	21
2	Nomura	397.2	33.0%	21
3	NSSB	276.0	22.9%	10
4	Shinko	53.0	4.4%	5
5	Kokusai	30.0	2.5%	3
6	UFJ	20.0	1.7%	2
7	Tokyo Mitsubishi	10.0	0.8%	1
8	Tokai Tokyo	10.0	0.8%	1
9	Mizuho	4.0	0.3%	1
10	Mizuho International	3.0	0.2%	1

Source: Daiwa Securities SMBC

Japanese bond markets have been affected by a number of changes over the last several years. Mark-to-market accounting for financial instruments was introduced in April 2000, while real-time gross settlements for government bonds was introduced in January 2001. From April 2002, blanket deposit insurance on bank time deposits ended, with similar deposit insurance on cash deposits to follow in April 2003. This has caused a number of types of investors, normally averse to investing in risk assets, to reconsider their attitude. The market is also seeing Zaito agencies starting to tap bond markets for the first time.

## Review

### Distribution & Trading

During the year under consideration, major market influences included a succession of 11 straight US rate cuts, the Argentinean debt crisis and the bankruptcies of Enron and Mycal, a large supermarket chain in Japan. This in turn led to a great deal of risk-aversion among investors, with companies having lower ratings finding it increasingly difficult to issue new debt. Furthermore, with expectations for economic recovery under the Koizumi Cabinet running low, investors have become even more conscious of taking credit risk.

Against this background, bond and forex trading revenue fell by 16% to 11.3 billion yen.

In advance of the ending of blanket deposit insurance on bank accounts, there were signs of a major increase in interest in fund allocation among many investor groups. Individuals invested actively in foreign currency bonds. Meanwhile, local authorities started to divert funds from banks to the bond markets. Other classes of risk-averse investors including schools, religious organizations, foundations and similar organizations are following the same path.

On top of this, there was continued strength in demand for structured bonds in light of the low interest rate environment. Conversely, straight bond issuance was subdued, particularly for issuers rated lower than BBB, as investors sought refuge in credit quality.

### Bond Underwriting

Underwriting commissions on bonds increased by 13% to 8.9 billion yen, comfortably outpacing the flat performance recorded by the market as a whole, as Daiwa Securities SMBC was able to increase its market presence with the help of the Sumitomo Mitsui Banking Corporation. Access to clients through the networks of the former Sakura Bank was one reason for the increase in market share.

Other major developments during the year included the commencement of SB issues by the Zaito agencies. Daiwa Securities SMBC managed to secure a major position in the issuance of Zaito bonds, handling 105 billion yen as lead manager out of a total of 580 billion yen issued during the year. In addition, there was a trend among some companies to appeal to the retail market in order to diversify the investor base and as a vehicle to promote investor relations.

Underwriting commission rates continued to fall during the year, especially for sought-after AAA-rated issues and, for these issues, have now fallen to rates applicable on the Euro markets. In Daiwa Securities SMBC's opinion further falls are unlikely during FY 2002.

### Outlook

Daiwa Securities SMBC expects the end of blanket deposit insurance for bank deposits to have a major knock-on effect on Japanese bond markets. Already, certain classes of investors such as local municipalities are starting to diversify their risk exposure by shifting



funds from deposits to government bonds and highly rated straight bonds. Daiwa Securities SMBC expects this trend to spread to other investors such as local public organizations, schools, foundations and religious organizations. In addressing demand from this source, exploitation of Daiwa's nationwide branch network will be a source of competitive advantage as will cooperation with the networks of the Sumitomo Mitsui Banking Corporation.

Given that the low interest rate environment is likely to continue through FY 2002, Daiwa Securities SMBC confidently foresees continuing growth in demand for structured bonds. Links between the Fixed Income and Derivatives & Structured Financial Products Departments will be strengthened to maximize Daiwa Securities SMBC's ability to offer market-leading solutions and further expand its market lead in this area.

In its underwriting activities, Daiwa Securities SMBC expects demand to remain at around current levels. However, the actual level of demand likely to be seen is somewhat dependent on the market's appetite for risk during the year since electric power, trading, consumer finance and steel companies each have major debt redemption scheduled for FY 2002. Continuing high levels of risk-aversion might well push issuers to seek alternative methods of financing.

Finally, Daiwa Securities SMBC will continue to place much emphasis on foreign currency bonds for the retail channel, a trend which started in FY 2001, in expectation of demand from that channel for higher-yielding instruments and currency diversification.

## Derivatives

### At a Glance

#### Business

Creation and distribution of interest rate, currency, and equity derivatives and alternative investment products.

#### Market Position

Market leader in Japanese derivatives markets. Integrated equity, interest rate, and currency derivative operations provide a significant competitive edge. Strong systems capability underpins advanced product creation. Innovative Enman-Sai bonds a blockbuster hit in FY 2001.

#### Outlook

Although business outlook is to some degree dependent upon movement in underlying securities markets, another year of brisk growth seems likely, due to the continuing low interest rate environment and the lifting of blanket guarantees on bank deposits.

## Background

The Derivatives & Structured Financial Products Department of Daiwa Securities SMBC ranks as a leading player in Japanese derivative securities markets. In particular, for several years it has been voted number one in terms of customer satisfaction in several crucially important areas of the market, according to a respected U.S.-based consultancy.

## Review

Department revenue recovered swiftly from year-earlier levels, which had been depressed due to a poor performance from equity derivative trading.

### Interest Rate Derivatives

Revenues from interest rate derivatives fell by more than 38% compared with the previous year due to limited needs to hedge outstanding positions in the low interest rate environment and difficulty predicting interest rate trends.

### Currency Derivatives

Because of low returns available on domestic fixed-income products, there was great interest during the year in foreign-currency bonds. Consequently, the market for currency derivatives was active. Much of this demand came from banks, traditionally competitors of Daiwa Securities SMBC in this area, due to its superior structuring capability for the requisite advanced exotic products. Revenues grew 76% year-on-year.

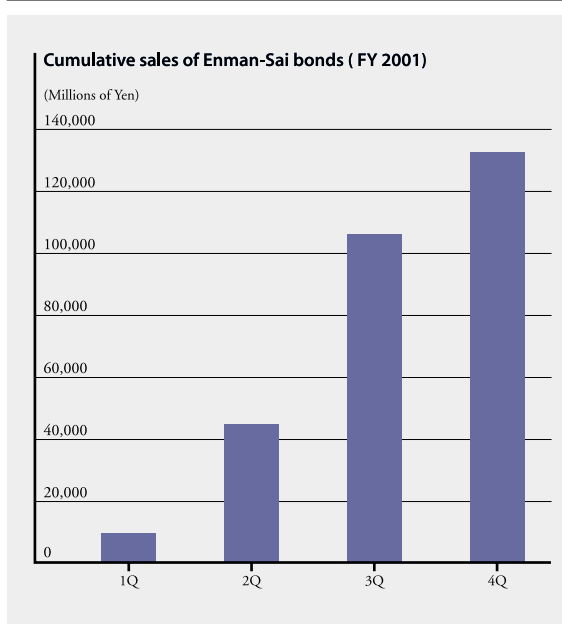
### Equity Derivatives

During the year, the department developed the so-called Enman-Sai bond. This is a structure including guaranteed principal but allowing the holder to participate in any rise in the Japanese equity markets in the form of enhanced coupon payout. This product was targeted at institutions such as regional banks, where it was well received. It has also proved extremely popular with corporations and with certain segments of the retail securities market. During the year, Daiwa Securities SMBC issued Enman-Sai bonds with a face value of 130 billion yen. Due to the hybrid rates-equity nature of the product and the technology needed to hedge such structures, Daiwa Securities SMBC was able to maintain exclusivity on the product for more than six months compared with the near

instantaneous replication by competitors usually exhibited in Japanese derivative markets. Due to the success of Enman-Sai bonds, the department's equity derivative revenues rose more than 657% compared with the depressed revenues seen during the previous year.

### Structured Bonds

Similarly, revenues from structured bonds, historically a mainstay of the operation, rose more than 14% due to the success of Enman-Sai bonds.



### Alternative Investments

After a period of careful preparation, the department started to promote alternative assets from July 2001. Sales in FY 2001 came to 12 billion yen, including private investment trusts and fund of funds-linked products guaranteeing principal and incorporating fund-of-funds managed by a leading U.S.-based asset manager. Daiwa Securities SMBC is convinced that this business has substantial long-term potential outpacing that of structured bonds over the next two to three years.

In February 2002, the department underwent an extensive systems upgrade, with the introduction of a new system for equities derivatives. The new system is destined to play a central role in further enhancing Daiwa Securities SMBC's strength in this area.

## Outlook

Business opportunities for equity derivatives expanded due to the depressed equity market and the increase in volatility. On the assumption that Japanese equity markets continue to show a modest recovery into FY 2002, equity derivative markets should show continuing strength, especially should financial institutions continue to unwind their cross-shareholding positions.

Further strength in structured bonds can also be confidently predicted due to a lack of alternatives in the current low interest rate environment. The termination of blanket deposit insurance coverage on bank accounts will also have a stimulative effect here. Finally, the department believes that continuing interest in foreign currency bonds will lead to increasing demand for currency derivatives.

## Structured Finance

### At a Glance

#### Business

Structuring and marketing of structured products, including those related to real estate and financial claims.

#### Market Position

Strong in asset-backed securities (ABS), ranking second to Mizuho Securities. Noted for its innovative product development capabilities, with a long line of industry firsts to its credit, backed by strong nationwide distribution. Especially strong in securitization of financial claims and real estate.

#### Outlook

Continued long-term growth building on an application of securitization to a wider range of asset classes.

## Background

The Japanese market for structured financial products was largely promoted by legislative changes happening as a part of Japan's "Big Bang" deregulation in the closing years of the last decade. Since that time, securitization markets have deepened and widened, embracing an ever-increasing pool of asset types. Daiwa Securities SMBC has been a leader in this market since its inception and has contributed to its development. Daiwa Securities SMBC ranks second in the ABS market behind Mizuho Securities in terms of total amount lead managed, according to a survey conducted by Thomson DealWatch, drawing on its

competencies in the area of advanced structuring and depth of distribution reaching every corner of Japan.

Although authoritative statistics on this market are not available because of the large number of private placements, Daiwa Securities SMBC estimates that total market size expanded from approximately 2,500 billion yen in FY 2000 to 3,000 billion yen in FY 2001. During FY 2001, securitization of financial claims made especially strong progress, driven by the securitization of assets owned by failed life insurance companies, while consumer finance companies started to take advantage of recent regulatory changes to more actively use securitization in their funding strategies. Real estate-related securitization also made progress, particularly in the area of RMBS (Retail Mortgage-Backed Securities), as the Housing Loan Corporation started active securitization and as the Resolution and Collection Corporation (RCC) started to use securitization as way to deal with bad debt. In the area of CMBS (Commercial Mortgage-Backed Securities), assets subject to securitization expanded from the historic mainstay of office buildings to other property classes including hotels, malls and other types, with Daiwa Securities SMBC introducing a number of innovative structures.

FY 2001 was also notable as the year in which the REIT (Real Estate Investment Trust) market was inaugurated in Japan. Three large-scale issues were made during the year. Market reaction to these deals was tepid, causing a number of pending transactions to be postponed. However, a modest market recovery could allow the available market to climb to 500 billion yen in as little as one or two years. Daiwa Securities SMBC expects the REIT market to show further expansion in the long term as it becomes an important financing tool for real estate developers.

## Review

Against this background, Daiwa Securities SMBC completed 11 transactions involving financial assets, worth some 238.6 billion yen, during the financial year. Highlights of these were as follows.

- In June 2001, Daiwa Securities SMBC arranged the issue of 50 billion yen in securitized receivables for the consumer finance company QUOQ, of which 10 billion yen was placed with individuals, a first in Japan.
- During FY 2001 Daiwa Securities SMBC arranged the first ever securitization of maintenance lease assets for NEC Leasing.
- In February 2002, Daiwa Securities SMBC raised 30 billion yen for QUOQ using the master trust program. Issued with a maturity of 10 years, these notes have the longest maturity ever achieved for credit receivables in Japanese securitization history.
- Daiwa Securities SMBC was bookrunner for the first issuance of residential mortgage-backed securities issued by the government Housing Loan Corporation, raising 50 billion yen in the first half of FY 2001.
- In FY 2000 Daiwa Securities SMBC securitized “kikin” funds for the Nippon Life Insurance Company, an industry first. During FY 2001, Daiwa Securities SMBC consolidated its lead in this area by securitizing such funds for Fukoku Life Insurance and Yasuda Life Insurance.

Daiwa Securities SMBC was also active in real estate securitization, completing a total of 5 transactions, worth 429.6 billion yen during the year. Highlights in this category include the following.

- The RCC started to use securitization as a way of disposing of real estate held. Daiwa Securities SMBC was lead manager for the first issue.
- Daiwa Securities SMBC securitized an office building owned by KDDI in a 190 billion yen issue, the largest real estate-related securitization ever in Japan.
- Daiwa Securities SMBC securitized the first building still under construction (on behalf of Recruit Cosmos).
- Daiwa Securities SMBC lead managed Orix JREIT, Inc., listed in June 2002.

### Outlook

Daiwa Securities SMBC expects stable growth in this area over the next several years as an increasing range of assets become subject to securitization. Daiwa Securities SMBC will continue to hone its advanced structuring skills and strong distribution to maintain a position of market leadership in this area.

#### Japanese ABS Market

	FY 2001		FY 2000	
	Amount (Billions of Yen)		Amount (Billions of Yen)	
Lease	396.4	15.0%	265.1	15.1%
Credit Card	361.5	13.7%	393.4	22.4%
Consumer Finance Loans	540.7	20.5%	46.6	2.7%
Residential Loans	322.4	12.2%	223.6	12.7%
Collateralized Debt Obligation (CDO)	277.0	10.5%	128.0	7.3%
Real Estate	643.4	24.4%	458.3	26.1%
Other	96.5	3.7%	243.9	13.9%
Total	2,637.8	100.0%	1,758.8	100.0%

Source: Daiwa Securities SMBC

#### FY 2001 League Table of Combined ABS Bookrunners

Ranking	Securities company	Amount (Billions of Yen)	Share	Number
1	Mizuho Securities	604.2	22.9%	21
2	Daiwa Securities SMBC	502.2	19.0%	18
3	Morgan Stanley	381.5	14.5%	5
4	UFJ Capital Markets	272.7	10.3%	5
5	Nomura Securities	229.4	8.7%	6

Source: Thomson DealWatch

## Principal Finance

### At a Glance

#### Business

Takes principal positions in assets that are non-standard for a Japanese securities company, such as financial claims and, more recently, real estate and private equity (alternative assets).

#### Market Position

Although independent comparative information does not exist, has ranked among the top few companies in this market sector since starting business in 1997, initially by acquiring non-performing assets in bulk transactions from financial institutions such as regional banks. Separated from Structured Finance Department in FY 2000 due to expansion in business. Formed Daiwa Securities SMBC Principal Investments Ltd. as a separate company to formally enter real estate-related and private equity business. Expanding scope of business by forming alliances. Established fund management company with GE Capital and Sumitomo Corporation in the field of MBOs and private equity while operating a fund with Wilbur Ross in corporate rehabilitation.

#### Outlook

Business should grow as Japanese financial institutions dispose of distressed assets and corporations accelerate restructuring efforts.

currently expanding amid the major reforms being instituted in Japan's corporate and financial sectors, such as the rationalization of balance sheets and restructuring, which has led to an expansion of disposals of real estate and other assets amid the revitalization of company operations. In the field of private equity investment, typified by MBO/LBO, numerous funds targeting Japan are being created.

During this period of reform encompassing the corporate and financial sectors of Japan, the needs of companies to sell off corporate assets and operations will probably continue to increase. Consequently, the importance of establishing alternative asset investment operations to provide risk financing for these needs will also increase. For this reason, the Daiwa Securities Group intends to expand operations in this field through Daiwa Securities SMBC Principal Investments.

### Review

This operation has hitherto targeted financial claims, including non-performing loans. In FY 2001, the range of assets targeted was expanded to include such activities as direct investment in real estate and corporate turnaround situations.

To advance these operations, Daiwa Securities SMBC Principal Investments, a wholly-owned subsidiary of Daiwa Securities SMBC, was established with an investment limit of 50 billion yen, and commenced operations in October 2001. In addition, the asset portfolio managed by Daiwa Securities SMBC was repatriated from the Cayman Islands to Tokyo and the Cayman subsidiary was closed.

### Background

These operations were originally initiated to meet the needs of financial institutions to quickly address the problem of non-performing loans. Activities are

As the first project in the area of corporate revitalization, Daiwa Securities SMBC acquired, in December 2001, a capital interest in the bankrupt Nikko Electric Company (an autoparts company, formerly listed on the second sector of the TSE) in a

joint operation with Wilber Ross of the U.S. The department has also expanded activity in such areas as advisory operations for revitalizing private-sector firms, and provided DIP (Debtor in Possession) financing (provision of funds to rebuild the operations of companies under legal liquidation) to Mycal.

In other operations, Daiwa Securities SMBC has conducted direct investment in various types of real estate totaling about 60 properties through purchases of real estate portfolios from sellers including financial institutions. Daiwa Securities SMBC also plans to resell real estate investments to retail investors and to increase the value of real estate by acquiring tenants and investing in equipment. Another planned activity involves providing finance by means of non-recourse loans and securitization.

Continuing to expand its operations in the bulk sale of non-performing loans, Daiwa Securities SMBC conducted more than 90 transactions with financial institutions and other firms in FY 2001. Daiwa Securities SMBC now ranks in the top echelon of firms in this area, completing more than 300 such transactions and conducting business with a majority of banks including regional and second-tier banks.

## Outlook

Daiwa Securities SMBC believes that the revitalization of debt-burdened companies will be the major focus of attention in FY 2002. It also believes that businesses relating to company revitalization, such as purchases of loans of nearly bankrupt companies, debt-equity swaps, company revitalization funds and DIP finance will expand substantially.

Daiwa Securities SMBC also believes that with the shift toward mark-to-market accounting, the need to dispose of real estate and other assets will increase, and that MBO/LBO and other private equity investments

relating to corporate reorganization will expand.

Amid this environment, Daiwa Securities SMBC plans to invest aggressively in a variety of assets and companies, with both its own funds and funds raised from others.

## M&A

### At a Glance

#### Business

Provides business support and advisory services related to mergers and acquisitions in Japan and overseas.

#### Market Position

Ranked number four (based on transactions closed) in the industry in 2001 on the strength of involvement in merger of Sumitomo Bank and Sakura Bank. Stable growth in domestic small-sized transactions, due to introductions from the Sumitomo Mitsui Banking Corporation. Attempting to improve its position in large-scale, cross-border M&A through a strategic alliance.

#### Outlook

Continuing steady long-term growth stemming from reorganization of corporates and the disposal of non-performing assets by the banking sector.

## Background

Historically, the banking sector has acted as custodian of corporate governance in Japan using leverage acquired as a result of its lending activities and privileged access to client information to promote managerial or financial reform at client companies on an as-needed basis. As reorganization of the banking



sector has progressed in the teeth of deflation and mounting bad debts, banks have lost both the will and the capacity to internalize this process and have sought assistance from external parties. The result has been a sharp increase in activity in the Japanese market over the last several years.

According to a survey by Thomson Financial, M&A activity in the Japanese market during FY 2001 fell by 43% compared with 115.4 billion dollars recorded the previous year, to 65.9 billion U.S. dollars (approximately 8.6 trillion yen), the lowest level since the survey started. Large-scale M&A activity in the financial and communications sectors appears to have run its course. However, traditional sectors such as iron and steel and pharmaceuticals picked up some of the slack, as evidenced by the formation of JFE Holdings through the merger of NKK and Kawasaki Steel, and the merger of Chugai Pharmaceutical with Roche of Switzerland.

Weak M&A activity was also evident on a global level. The worldwide total of publicized M&A deals dropped by almost one half from 3.4 trillion dollars (approximately 450 trillion yen) to 1.7 trillion dollars (approximately 226 trillion yen), with Japanese M&A accounting for 3.8% of this total.

Another feature of note during FY 2001 was increasing signs of maturity in the M&A market, with corporate management increasingly considering M&A earlier in the restructuring process. In addition, the use of legal proceedings in respect of failed companies is growing in popularity. Nevertheless, Japanese markets still lag those of the United States by many years in this respect.

## Review

Against this background, the department closed 56 transactions, or approximately 2.8 trillion yen, during FY 2001. Due to the concentration of deals closed at the end of March 2001, the beginning of FY 2001 was mostly dedicated to marketing. Although the M&A

### Ranking of M&A Advisors (Calendar Year 2001)

Ranking	Advisor	Amount (Millions of Dollars)	No. of deals
1	Goldman Sachs	94,010	22
2	Nomura	57,713	61
3	JP Morgan	56,618	21
4	Daiwa Securities SMBC	48,482	34
5	Merrill Lynch	32,464	11
6	Salomon Smith Barney	28,739	29
7	Morgan Stanley	25,675	15
8	Mizuho	21,742	82
9	CSFB	17,485	9
10	Lehman Brothers	17,130	7

Source: Thomson Financial

team from the former Sakura Bank contributed to these efforts, revenues for the first half declined year-on-year. However, the department was able to shake off the severe environment to come back in the second half.

Approximately 60% of deals were sourced from the networks of the Sumitomo Mitsui Banking Corporation. A further 15% were sourced from the networks of the Daiwa Securities Group, while the balance was self-generated.

The department was strengthened by the inclusion of a number of qualified staff from the M&A team at the former Sakura Bank. This group brought in a number of complementary skills, especially experience in dealing with bankrupted transactions, an area in which Daiwa Securities SMBC has historically been under-represented. Inclusion of these new resources brought the number of staff employed in the department to 67.

Daiwa Securities SMBC signed a nonexclusive memorandum of understanding with the U.S.-based M&A specialist Lazard Freres in FY 1999. This memorandum gives Daiwa Securities SMBC access to the global reach and industry expertise of its partner while allowing Lazard access to a strong Japanese partner to complement its solid position in the U.S. and Europe. During FY 2001, earnings from this quarter were minimal, largely due to the fact that a large number of deals were completed at the end of the previous financial year and to the fact that business in cross-border M&A was quiet during FY 2001, especially after the events of September 11th.

## Outlook

Japanese corporations are likely to accelerate movement to corporate reform making use of divestitures and acquisitions driven forward by the process of bad debt disposal by the banking sector. In

the face of declining opportunities in large-scale transactions, most market participants, including European and American banks, are shifting the focus of their operations to medium-sized deals. For the current year, Daiwa Securities SMBC will try to compete by making maximum use of its own networks and increased cooperation with the relationship management division and the other departments in the investment banking division, as well as those of the Sumitomo Mitsui Banking Corporation and Lazard.

## Overseas Network

### At a Glance

#### Business

The Daiwa Securities Group operates from a network of 19 locations in Europe and Asia. With the exception of the North American subsidiary and operations unrelated to securities, all overseas operations are structured as subsidiaries of Daiwa Securities SMBC.

#### Market Position

Daiwa Securities Group's overseas network is smaller than those of its closest rivals although equipped to support the Group's goals going forward.

#### Outlook

Expected domestic demand for foreign-currency denominated bonds in FY 2002 will highlight the value of the overseas operations. For the immediate future, the Group will continue to stress careful augmentation of its overseas presence in support of the management paradigm. Longer term, the Group looks to China for new growth opportunities.

## Background

The Daiwa Securities Group has established a strategy of careful and incremental building of its overseas capabilities to strengthen the Group's core competencies in Japanese securities. During FY 2000, the re-opening of the Madrid and Milan branch offices, primarily to support Daiwa Securities SMBC's equity operations, and a rebuilding of the fixed income origination and syndication operations based in London, were evidence of this. During FY 2001, there were no significant changes, although headcount again expanded.

## Review

During FY 2001, assets acquired through the bulk sale business by the group's Cayman subsidiary were transferred to Daiwa Securities SMBC Principal Investments, established in October 2001. Reflecting this situation, Daiwa Securities SMBC recorded a 55% fall in ordinary income to 7.8 billion yen in its overseas operations, including subsidiaries of the Holding Company, during FY 2001. In other areas, Asia slipped into loss due to its reliance on Japanese equity business, while the European operations saw an increase due to domestic demand for foreign-currency denominated bonds.

## Outlook

Daiwa Securities SMBC believes that the overseas operations are fully capable of meeting demands made

on them, mainly involving cross-border businesses involving Japanese securities or in satisfying domestic demand for foreign securities. Consequently, it will continue to make incremental improvements to the overseas operations to support the current management paradigm, taking into account an expected increase in domestic demand for overseas securities during FY 2002.

Further out, Daiwa Securities SMBC is committed to participating in the potential of the rapidly-evolving securities market in China. Daiwa Securities SMBC believes that such events as China's accession to the WTO and the upcoming Beijing Olympics in 2008 will prove to be seminal events in China's emergence as a world financial center.

To this end, the Daiwa Securities Group has signed a memorandum of understanding regarding business collaboration with the Shanghai International Group Corporation Limited ("SIG"). It is the intention of both parties to commence a study on business cooperation to establish a close relationship between the Daiwa Securities Group and the SIG Group with regards to securities-related businesses.

SIG, located in Shanghai, is a holding company of several financial and securities companies, with capital participation by the Shanghai Municipal People's Government. Daiwa Securities SMBC, together with Daiwa Institute of Research and SIG have reached a common understanding to speedily establish a

### Overseas Ordinary Income

(Millions of Yen)

	America	Europe	Asia	Total
FY 2001	2,508	5,507	-173	7,842
FY 2000	11,254	5,233	810	17,297

cooperative relationship and to promote mutual development with respect to Chinese capital markets. During the initial stage, the companies will collaborate through exchange of information, including market research. In the future, ways will be investigated to extend the scope of business cooperation.

## Risk Management in Daiwa Securities SMBC

### At a Glance

#### Business

Manages risks associated with Daiwa Securities SMBC's participation in securities markets.

#### Market Position

Has been able to draw upon the knowhow of each of its parent companies, Daiwa Securities Group and the Sumitomo Mitsui Banking Corporation to construct an advanced risk-management framework.

#### Outlook

During FY 2002, measurement and control of operational risk will be enhanced.

The ultimate authority for risk management within Daiwa Securities SMBC lies with the Risk Management Committee, the members of which include the president, deputy presidents and directors of related departments. The committee meets on a quarterly basis to decide basic risk management policy and to set acceptable levels of credit, market and liquidity risk as part of an integrated risk management process.

A subcommittee of the Risk Management Committee meets monthly to consider details related to the implementation of stated policy and to consider the current profile of credit, market and liquidity risk. The members of this subcommittee are the general managers in charge of each product, marketing and administration activity of Daiwa Securities SMBC.

Day-to-day operations are handled by the Risk Management Department within Daiwa Securities SMBC, which bears responsibility for implementing policies related to market and credit risk. Liquidity risk is the responsibility of the Treasury Department. Market risk and liquidity risk are measured and reported daily to management by the Risk Management Department and the Treasury Department. Credit risk is reported to the director of the Risk Management Department on a weekly basis. Risk management is also taken up by the Executive Officer Meeting held weekly, with reports submitted to the Holding Company.

## Background

### General Organization

Daiwa Securities SMBC, together with its affiliated overseas operations, are responsible for the Group's business in wholesale securities markets. These activities are intrinsically risk-bearing and include, as discussed before, the trading of equities, bonds and derivatives and principal investment in non-traditional asset classes. Risk management is thus a matter of importance for both Daiwa Securities SMBC and the Group as a whole.

Since the formation of the Daiwa Securities Group in 1999, the risk management functions in Daiwa Securities SMBC have been significantly strengthened in a number of ways. In particular, marketing and trading departments now have independent middle offices responsible for risk management and which operate independently of the front offices.

The Risk Management Department, which is independent of the marketing and trading divisions

and has a separate reporting line, is responsible for overall control and monitoring of credit and market risk as well as settlement risk. It manages these risks in consultation with the middle offices mentioned earlier.

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

### Risk Measurement and Containment

Risk limits are set by category using the most appropriate measures for each asset class. These measures are supplemented by integrative measures centered on value at risk (VaR) which is used for measuring both market and credit risk.

These measures are supplemented by stress-testing, assuming sudden and serious dislocation to markets, which might call the validity of historical statistically derived measures into question. Specific scenarios used include those derived from historical experience, including dislocations seen during the time of the U.S. hedge fund crisis and Japan Premium as well as theoretical dislocations, including disruption to domestic repo markets.

The one area of Daiwa Securities SMBC's business that is not subject to the above management procedures is Daiwa Securities SMBC's own principal investment in non-traditional asset classes through Daiwa Securities SMBC Principal Investments. Investments in this category are difficult, if not impossible, to hedge adequately. However, the total position limit for this department has been set based on the requirement that Daiwa Securities SMBC be able to survive even if all such assets acquired become simultaneously worthless. In addition, the department exercises caution in pricing assets and practices active diversification of the portfolio as described earlier.

Consequently, Daiwa Securities SMBC believes the risk profile in this area to be acceptable.

Finally, Daiwa Securities SMBC has imposed measures to monitor and control market liquidity risk separately from market risk. This involves the imposition of restrictions on positions according to the size of the position and liquidity of the underlying instrument. These restrictions were imposed during FY 2001.

### Contingency Plans

In addition to the above, Daiwa Securities SMBC has in place procedures to implement a phased reduction in position limits in response to a decline in its ability to access funds. In the most extreme case, positions would be reduced to within the limits of Daiwa Securities SMBC's long-term available funds and access to funds, such as commitment facilities granted by banks. Adjustments in allowable position were made following the recent credit rating downgrade experienced by Daiwa Securities SMBC.

### Review

The influx of qualified staff from the Sumitomo Mitsui Banking Corporation, who have brought with them a great deal of advanced risk management knowledge, has reinforced risk management at Daiwa Securities SMBC.

In contrast to FY 2000, during FY 2001 Daiwa Securities SMBC's risk management profile was very benign. In fact, on a month-end VaR basis, total measured risk was confined to only a third of of the previous year. This partly reflects the poor state of the underlying markets during the year and partly stricter guidelines in respect of market liquidity risk imposed during the year.

Reflecting Daiwa Securities SMBC's commitment to continuous improvement in risk management, the number of staff employed rose from 30 at the beginning of the year to 38 in April 2002. These included a number of staff joining the department from the former Sakura Securities.

## Outlook

The last several years have been devoted to the measurement and control of credit, market and similar risks. During FY 2002, Daiwa Securities SMBC will expend much effort in the identification and control of operational risk, including event risk where possible. In this, Daiwa Securities SMBC has benefited strongly from access to the risk management operations of the Sumitomo Mitsui Banking Corporation.

Value at Risk							(Billions of Yen)
(Confidence level 99%; holding period 1 day)							
(Month-end)	3/2000	9/2000	3/2001	6/2001	9/2001	12/2001	3/2002
Equity	6.37	3.42	2.68	1.08	2.01	1.13	1.06
Interest	0.21	0.60	0.88	0.49	0.65	0.61	0.19
Currency	0.02	0.01	0.02	0.04	0.02	0.04	0.02
Total	6.60	4.03	3.58	1.61	2.68	1.77	1.27
Diversification benefit	-0.20	-0.51	-0.57	-0.40	-0.53	-0.38	-0.19
VaR	6.40	3.52	3.01	1.21	2.15	1.39	1.08



Our First Hundred Years: **Former Daiwa Securities Staff Members - c. 1964**

#### Other Domestic Main Group Companies - Summary Data

(Millions of Yen)

	Daiwa Asset Management	Daiwa Institute of Research	Daiwa SB Investments	Daiwa Securities Business Center	Daiwa Real Estate	NIF Ventures
Operating Revenues	42,476	71,809	6,904	9,635	31,187	8,845
SG&A	38,150	11,391	4,058	8,176	1,554	4,222
Operating Income	4,326	5,794	610	1,458	7,602	3,289
Ordinary Income	5,156	5,542	672	1,490	4,822	3,336
Group Holdings (as of March 2002)	100.0%	96.4%	44.0%	100.0%	92.1%	79.2%

## Other Domestic Main Group Companies

### Daiwa Asset Management

#### At a Glance

##### Business

Daiwa Asset Management (DAM) is one of the main asset management companies within the Daiwa Securities Group and acts as the Group's development arm for investment trusts. The retail and wholesale securities companies within the Group distribute the majority of funds issued by DAM. Other distribution routes include banks and defined contribution pension schemes.

##### Market Position

DAM is the second-largest Japanese asset manager, with a particularly strong position in money management funds (MMFs). DAM has consistently recorded a positive net inflow of funds. However, due to valuation losses there has been a decline in assets under management. Due to its high exposure to MMFs the company was affected by an abrupt outflow of funds brought about by a drop in value below par of other companies' MMFs as a result of the "Enron Shock" in fy 2001.

##### Outlook

Ending of blanket deposit insurance on bank deposits will open up new opportunities. DAM will actively develop funds matched to investor needs and promote bank sales of investment trusts, as well as products geared to the emergent 401(k) defined contribution pension market.

#### Background

Daiwa Asset Management is the second largest asset management company in Japan with a balance of net investment trust assets under management of 8.2 trillion yen as of March 31, 2002. Utilizing a consistent investment process and risk management system, DAM invests on a medium-term view, using both fundamental and technical analysis to identify undervalued investments.

DAM relies on the Daiwa Securities Group, including both the retail and wholesale companies for distribution of approximately 70% of its products. The balance is distributed through various securities companies and financial institutions such as banks, as well as defined contribution pension systems. Daiwa Asset Management also utilizes direct marketing through the Internet and the call center. (<http://www.daiwa-am.co.jp/>)

DAM boasts a particularly high market share in fixed income investment trusts, particularly MMFs (Money Management Funds), where it has a market share of approximately 50%. The Daiwa Securities Group hopes to wean retail investors away from bank deposits and into securities markets through products such as its fixed income investment trusts and high yielding foreign bond investment trusts.

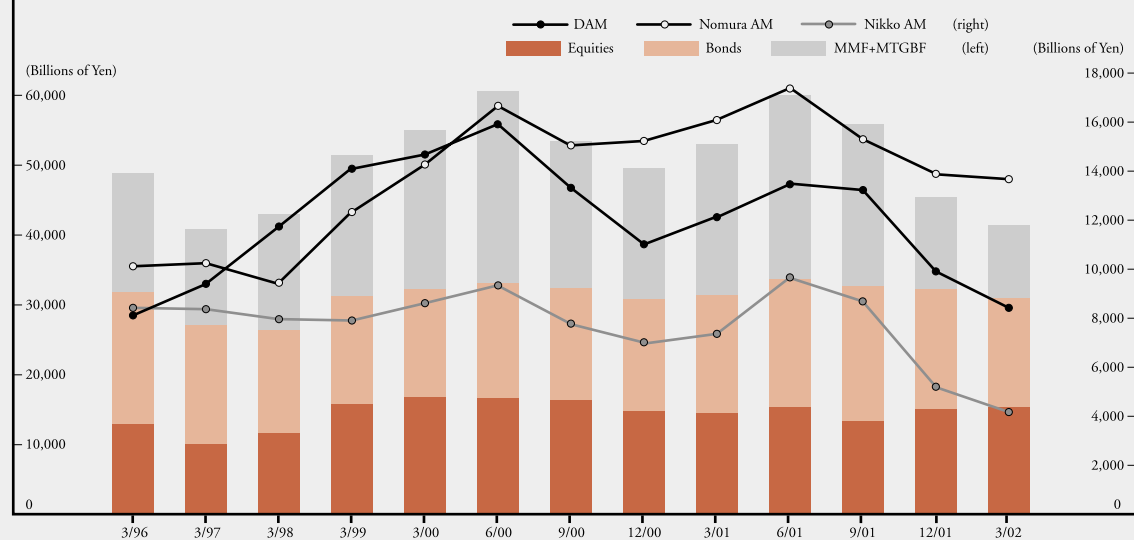


## Review

Ordinary income for fy 2001 fell by 50% to 5.1 billion yen on sales down 37% to 42.4 billion yen due to the poor conditions pertaining in Japanese stock markets during the year. A decline in asset

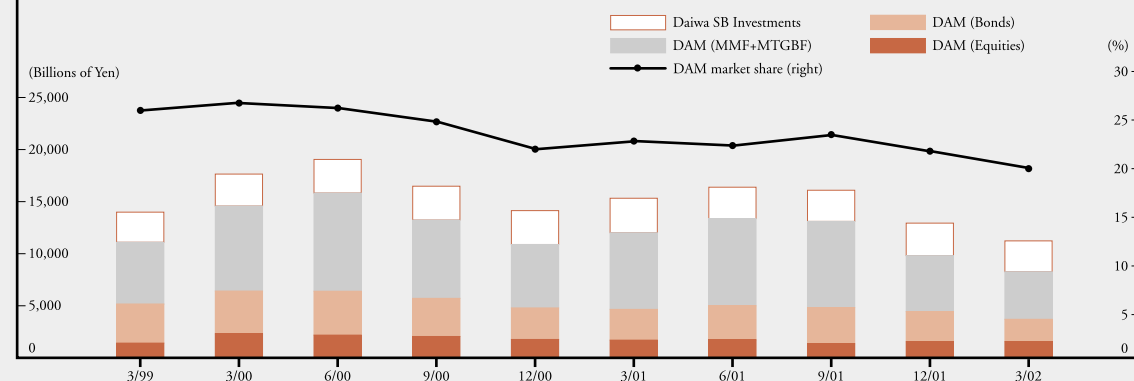
management fees due to poor market conditions and a fall in asset management rates for bond investment trusts due to the continuing low interest-rate regime, caused operating income to fall by more than half.

Investment Trust Market in Japan



Source: The Investment Trusts Association, Japan

Funds under Management (Daiwa Asset Management, Daiwa SB Investment)



---

The year was marked by the sudden and unexpected bankruptcy of the U.S. energy giant Enron. Certain investment managers in Japan, although not Daiwa Asset Management, owned significant quantities of Enron bonds in their MMFs, to the degree that certain of these funds dropped in value below par. Although DAM was unaffected by this debacle, as the leading player in MMFs in Japan, it too saw massive redemptions. Although the MMF balance had dropped to approximately 2,970 billion yen at the end of the year under consideration, it had recovered to 3,350 billion yen as at end-June 2002.

Elsewhere, despite a drop in assets under management due to poor market conditions, Daiwa Asset Management saw a continued inflow of equity funds. Unfortunately, valuation losses once again affected the balance of equity investment trust assets under management which fell roughly 15%, from approximately 1,700 billion yen to 1,440 billion yen(excluding ETFs) during the year. Reflecting the above, total assets under management fell from around 12.0 trillion yen to approximately 8.2 trillion yen.

In February 2002, DAM purchased subordinated debt and some other bonds intended to be held to maturity with a face value of 143.6 billion yen from its MMF portfolio in response to new rules regarding the management of MMFs, issued by the Investment Trust Association of Japan. These bonds are held on DAM's books.

## Outlook

---

During fy 2002, DAM will concentrate on promoting investment trust products through each of the 3 sales channels to address investor needs and opportunities opened by the ending of blanket deposit insurance.

Further, with regard to bank sales, the company intends to promote funds which match the particular characteristics of each bank, as well as improve its line-up of defined contribution pension-related products.

## Daiwa SB Investments

This company was formed on April 1, 1999, through the merger of Daiwa International Capital Management Co., Ltd., SB Investment Management Co., Ltd., and SBIM Investment Trust Management Co., Ltd. In addition, at its inception, an alliance with the U.S. investment management firm T. Rowe Price was formed, with the goal of providing investment trust products supported by international expertise for customers of the company in Japan. Daiwa SB Investments Ltd. is included in the Daiwa Securities Group's consolidated accounts as an equity method affiliate, the Group owning approximately 44% of the company. As a center for asset management businesses for both the Daiwa Securities Group and Sumitomo Mitsui Banking Corporation, Daiwa SB Investments has moved quickly to establish itself as Japan's leading investment advisory firm for pension assets. As of March 2002, Daiwa SB Investments provided investment advice for pension and other assets amounting to approximately 2.9 trillion yen. Of this amount, 2.6 trillion yen consisted of pension assets.

According to a survey conducted by R&I and announced in November 2001, Daiwa SB Investments ranked first in overall fund management capabilities among pension funds.

## Daiwa Institute of Research

### At a Glance

#### Business

Provides research, systems development and consulting services to the Daiwa Securities Group and external clients.

#### Market Position

Rapidly improving reputation for its research, as evidenced by sharp improvement in ranking in the most recent Nikkei Financial Daily survey of research excellence. Now ranks number three. Revenues for systems development ranked 11 in the domestic information service industry. Consultancy operations with depth in certain niches, especially related to public policy and pensions consulting. De-emphasizing work for external clients in favor of projects for the Daiwa Securities Group.

#### Outlook

Due to cost cutting measures of Group companies, both operating revenues and ordinary income are expected to fall in fy 2002. Key goals going forward are to maintain the improving momentum in its research operations and to improve the cost-competitiveness of the systems operations through outsourcing and other measures.

## Background

The Daiwa Institute of Research Ltd. (DIR) serves as the Group's systems developer and think tank. DIR supports the various companies in the Daiwa Securities Group by taking responsibility for research, systems development and consulting. It also provides services to non-Group companies by drawing on its accumulated know-how.

Since implementation of the Group's medium-term management plan in March 2000, the company has reoriented its operations to focus on increasing the enterprise value of the Daiwa Securities Group as a whole. Consequently, in line with the plan, each of the main divisions—research, systems development and consulting—has undertaken a wide-ranging review of its current operations. DIR is gradually reviewing its business with entities outside of the Daiwa Securities Group with the goal of maximizing the efficiency of its resource deployment and profitability.

In its research operations, DIR employs approximately 260 staff domestically and 60 overseas. In numerical terms this makes DIR one of the largest research organizations in Japan and ranks it as one of the most eminent think tanks for economic and capital market analysis.

The systems operations form the core of the planning, development and operation of each Group company's information systems. They are engaged in the development of various financial and securities systems, particularly preparation for T+1 trading in accordance with the Group's IT investment strategy. As of March 2002, these operations employed approximately 1,050 staff directly, in addition to a wide network of approximately 1,500 programmers employed by external subcontractors. According to an FY 2000 survey, the company ranked number 11

within its industry in terms of sales volume. In addition to external sales of systems for front- and back-office use in the financial industry, the company also provides wide-ranging solutions including planning, development, operating and implementation for public organizations and private companies.

DIR's consulting operations, are focused on areas of strategic importance to the Daiwa Securities Group. Areas of particular concern include the provision of consulting services to clients of Daiwa Securities SMBC, the 401(k) pensions business, where DIR works closely with other members of the Group, and internal education, where DIR is responsible for the curriculum and training of the Daiwa Management Academy considered earlier in this report.

Daiwa Institute of Research sponsors the Porter Prize established by the Graduate School of International Corporate Strategy (ICS) at Hitotsubashi University. The name of the award is derived from Professor Michael E. Porter of Harvard University, a leading authority on strategy. The prize will bestow recognition on Japanese companies that have achieved and maintained superior profitability in a particular industry by implementing unique strategies based on innovation in products, processes, and ways of managing. By making their practices known on a broad scale, it is DIR's intention that this prize will enable the theory and practice of competitive strategy to take root more widely among Japanese companies.

Two companies and two company divisions were awarded the first Porter Prize in December 2001.

## Review

For fy 2001, DIR reported ordinary income of 5.5 billion yen on sales of 71.8 billion yen. Of the sales amount, around 45% was derived from external clients.

During fy 2001, in its research activities, DIR pursued a policy of promoting direct contact with institutional investors through co-operation with Daiwa Securities SMBC. Surveys have shown that such contact is highly prized. This was most clearly shown by the fact that DIR's research was ranked number three overall (after Nomura and Morgan Stanley) in the most recent Nikkei Financial Daily ranking of research excellence, rising from eighth position the previous year.

The systems operations made headway during the year in increasing the amount of work outsourced to partner companies. In particular, DIR was able to significantly reduce costs by increasing the amount of work outsourced to China. Another major innovation during the year was the implementation of a disciplined design methodology in the development process for software design. This has boosted efficiency of development and quality of the software. Meanwhile DIR has started to prepare for the full-scale introduction of CMM (Capability Maturity Model) based procedures.

## Outlook

During fy 2002, DIR will continue to pursue further improvement in the external perceptions of its research capability, building on the excellent start made in fy 2001. In the systems operations, DIR will concentrate on fulfilling its role as internal systems provider of choice, particularly regarding ongoing T+1 settlement systems. This will be accomplished against a background of strict cost control by adopting a disciplined development paradigm and increasing the level of work outsourced to China and partner companies in other locations.

## NIF Ventures

### At a Glance

#### Business

NIF Ventures (NIF) invests both its own capital and that of investment partnerships in domestic and overseas private equity companies in such growth areas as IT and biotechnology. NIF Ventures was listed on the JASDAQ market on March 12, 2002.

#### Market Position

Ranks as one of Japan's largest venture capital companies. Recent results have been depressed by the downbeat state of global IPO markets, although the number of IPOs on Japan's three emerging exchanges remains relatively stable.

#### Outlook

Although the slump in equity markets is causing a fall in the number of companies going public, it also provides opportunities to make investments at depressed prices for the venture capital industry. NIF will promote investments into high growth areas such as IT, biotechnology and nanotechnology. NIF expects to increase the scope of its investment partnerships.

## Background

NIF Ventures (NIF) is the venture capital arm of the Daiwa Securities Group and is one of the leading venture capital firms in Japan with an accumulated investment of 253.8 billion yen in 1,413 companies in Japan and overseas.

Domestically, NIF identifies suitable candidates for investment, drawing both on its own networks and those of the Daiwa Securities Group. NIF also maintains an active direct presence in local VC markets in the United States, Europe and Asia via wholly-owned subsidiaries, joint ventures with local companies and through alliances with local venture capital firms.

Over the last several years, NIF Ventures has established core areas of expertise in various areas of the information technology sector which it is now moving to augment with expertise in other sectors having high growth potential, including biosciences and nanotechnology. A key element of competitive advantage in these areas is access to a network of specialist advisors eminent in their fields and capable of adequately evaluating new technologies in fast-evolving markets. For this reason, NIF established the technical advisory system in 1998.

NIF invests both its own funds directly and also through investment partnerships established with funds gathered from outside investors. Such partnerships have expected lifetimes of between 7 and 10 years. To date, no investment partnership has been redeemed below par value.

Over recent years, emerging markets such as MOTHERS, NASDAQ-Japan and JASDAQ, catering to venture investments, have led NIF, in common with the whole industry, to shift its focus to earlier-stage investments. This has involved a change in operational

style, with NIF becoming increasingly involved in the day-to-day operations of its investments.

## Review

The operating environment in which venture capital investors such as NIF operated during fy 2001 was severe, due to the slowdown in IT-related industries, the slowing U.S. economy and after-effects of the terrorist attacks, and continuing economic malaise in Japan. IPO markets slumped, particularly in the United States.

Nevertheless, in spite of the severity of the environment, NIF was able to report creditable results. A total of 24 companies backed by NIF successfully listed on the stock market during the year (16 in Japan and 8 overseas), compared with 43 (27 domestic and 16 overseas) during fy 2000.

During the year, NIF managed to establish five new investment partnerships with investment funds totaling 22.5 billion yen, the same level as recorded during the previous year. The amount invested during the year, however, fell to 16.2 billion yen, significantly below the previous year, as a consequence both of a cautious investment attitude by NIF and of a lower overall cost of acquisition in a troubled market.

For fy 2001, NIF recorded sales of 17.2 billion yen, down 16%, operating income of 3.3 billion yen, down 33% and ordinary income of 3.4 billion yen, down 32%. By contrast, net profit for the year actually rose by 22% to 3.2 billion yen due to a sharp reduction in losses on provision for doubtful accounts. Although investment management fees and operating earnings arising on investment partnerships actually increased 9% on the previous term to 2.5 billion yen, a fall in revenue resulted, mainly due to a decrease of 96% (84 million yen) in success fees.

NIF Ventures was listed on the JASDAQ market on March 12, 2002.

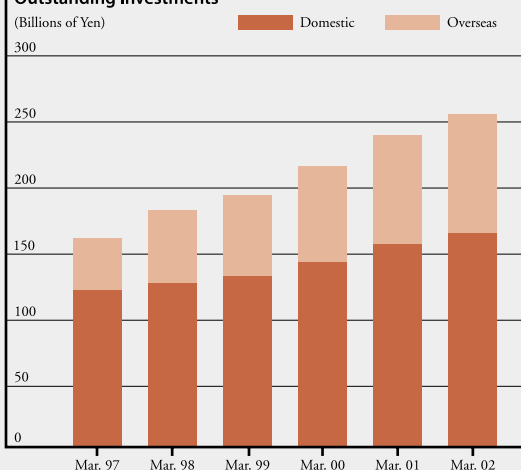
## Outlook

The near-term outlook for NIF Ventures is clouded by uncertainty over the direction of the overall global equity markets. Longer term, by improving the number and pricing of available investment targets, poor market conditions work to NIF's advantage. NIF will seek to improve its relative competitive position by concentrating on areas in which it is competitive, including information technology, bioscience and nanotechnology, as noted earlier. It will also work to improve its ability to add value to its investments through the provision of hands-on managerial services and will actively recruit high-caliber staff for this and other purposes. Other priorities include marketing investment partnerships more widely to broaden the base of institutional involvement in the market. Furthermore, NIF will diversify its exit strategies to include trading of non-listed equity and M&A.

## Daiwa Securities Business Center

Daiwa Securities Business Center Co., Ltd. (DSC) is a wholly owned subsidiary of the Daiwa Securities Group Inc. DSC provides securities back-office support to the Daiwa Securities Group and also provides temporary staff for securities-related businesses. This company became the first securities back-office service provider to be certified under the internationally recognized ISO 9001 standard in FY 2000 and will continue to make efforts to streamline and increase efficiencies in the back-office support activities.

**NIF Ventures  
Outstanding Investments**  
(Billions of Yen)



---

## Daiwa Real Estate

---

The Daiwa Real Estate Co., Ltd. is mainly involved with the holding and renting of the Daiwa Securities Group's office premises, housing, dormitories and other properties. During FY 2001, the Group took a decision to liquidate non-core properties managed and leased out to non-Group companies by Daiwa Real Estate generating an extraordinary loss of 127.4 billion yen.

Additional capital of approximately 119.5 billion yen fully subscribed by Daiwa Securities Group Inc. was injected to The Daiwa Real Estate Co., Ltd. during FY 2001. After this capital injection, The Daiwa Real Estate Co., Ltd. transferred its business unit which engages in the management of properties used for the Daiwa Securities Group's core business into a fully owned subsidiary, The Daiwa Building Management Co., Ltd. After completion of sales of its remaining assets, The Daiwa Real Estate Co., Ltd. is to be liquidated.



# Leadership

## Holding Company

**Daiwa Securities Group Inc.** (As of June 26, 2002)

### Directors:

**Yoshinari Hara**, President and CEO  
**Yoshiyuki Takemoto**, Deputy President and Executive Officer  
**Kenji Hayashibe**, Director and Executive Officer  
**Naoaki Takahashi**, Director and CIO  
**Junichiro Wakimizu**, Director and Executive Officer  
**Junji Takasaki**, Director and Executive Officer  
**Tetsuro Kawakami**, Director  
 (Counsel of Sumitomo Electric Industries, Ltd.)

### Corporate Auditors:

**Hiroyasu Kawaguchi**  
**Mitsugi Kishimoto**  
**Masahiro Yoshiike**, President, The Taiyo Mutual Life Insurance Co.  
**Isao Takemura**

### Executive Officers:

**Ikuo Mori**, Executive Officer  
**Akira Kiyota**, Group Executive Officer  
**Teruo Hatano**, Group Executive Officer  
**Tatsuhiko Kawakami**, Group Executive Officer  
**Shinichi Yamamura**, Group Executive Officer  
**Tetsuo Mae**, Group Executive Officer  
**Tatsuei Saito**, Group Executive Officer  
**Michihito Higuchi**, Group Executive Officer  
**Shigeharu Suzuki**, Group Executive Officer

### Advisory Board:

**Kazuo Inamori**, Founder and Chairman Emeritus, Kyocera Corporation  
**Jiro Ushio**, Chairman and CEO, USHIO INC.  
**Glen S. Fukushima**, President and CEO, Cadence Design Systems, (Japan) B.V.  
**Hirotaka Takeuchi**, Dean, Hitotsubashi University Graduate School of International Corporate Strategy

### Remuneration Committee:

**Koichi Uno**, CPA, Tax Accountant  
**Ichiro Kawamoto**, Attorney-at-Law, Senior Partner, Kawamoto & Miura  
**Yukio Yanagida**, Attorney-at-Law, Senior Partner, Yanagida & Nomura  
**Yoshinari Hara**, President and CEO, Daiwa Securities Group Inc.

## Retail Securities Company

Daiwa Securities Co. Ltd. (As of June 26, 2002)

### Directors:

**Yoshinari Hara**, President  
**Shinichi Yamamura**, Deputy President  
**Tetsuo Mae**, Senior Managing Director  
**Tatsuei Saito**, Senior Managing Director  
**Akira Hasegawa**, Managing Director  
**Akira Sakiyama**, Managing Director  
**Hiroshi Ota**, Director

### Corporate Auditors:

**Isao Tada**  
**Susumu Ueda**  
**Mitsugi Kishimoto**

### Executive Officers:

**Yoshihide Shimamura**  
**Tetsuya Ikeda**  
**Taro Tanaka**  
**Yoshimi Murakami**  
**Hiroshi Takeuchi**  
**Tokuzo Takagi**  
**Takashi Fukai**

## Wholesale Securities Company

Daiwa Securities SMBC Co. Ltd. (As of June 26, 2002)

### Directors:

**Akira Kiyota**, President  
**Kensuke Uchida**, Deputy President  
**Michihito Higuchi**, Senior Managing Director  
**Shigeharu Suzuki**, Senior Managing Director  
**Mitsutoshi Koyama**, Senior Managing Director  
**Masaki Hirabayashi**, Senior Managing Director  
**Yoichiro Inoue**, Managing Director  
**Nobuaki Ohmura**, Managing Director  
**Masayasu Ohi**, Managing Director  
**Yasuo Nakamura**, Managing Director  
**Sumio Fukushima**, Director  
**Taro Sumitani**, Director

### Corporate Auditors:

**Isao Takemura**  
**Ryuji Yamazaki**  
**Yoshiaki Senoo**  
**Fuminori Yoshitake**

### Executive Officers:

**Daisuke Saji**, Managing Director and Executive Officer  
**Toshiro Ishibashi**, Executive Officer  
**Mamoru Ohtani**, Executive Officer  
**Hiroshi Fujioka**, Executive Officer  
**Kiyoshi Matsuba**, Executive Officer  
**Yutaka Murakami**, Executive Officer  
**Hideo Watanabe**, Executive Officer  
**Kazuo Ariake**, Executive Officer  
**Akira Tanabe**, Executive Officer  
**Shinji Sunouchi**, Executive Officer  
**Shin Yoshidome**, Executive Officer  
**Yoshio Miyatake**, Executive Officer  
**Kazuhiko Akamatsu**, Executive Officer  
**Takashi Hibino**, Executive Officer

## Overseas

### Daiwa Securities SMBC Europe Limited

#### Head Office

5 King William Street  
London EC4N 7AX, U.K.  
Tel: 44-20-7597-8000

#### Frankfurt Branch

Trianon Building  
Mainzer Landstrasse 16  
60325 Frankfurt am Main  
Federal Republic of Germany  
Tel: 49-69-717080

#### Paris Branch

112 Avenue Kléber  
75116 Paris, France  
Tel: 33-1-56-26-22-00

#### Geneva Branch

50 Rue du Rhône  
P.O. Box 3198  
1211 Geneva 3, Switzerland  
Tel: 41-22-818-74-00

#### Milan Branch

Via Senato 14/16,  
20121 Milan, Italy  
Tel: 39-02-763271

#### Spain Branch

7th Floor,  
Jose Ortega y Gasset 20,  
Madrid 28006, Spain  
Tel: 34-91-529-9800

#### Middle East Branch

7th Floor, The Tower,  
Bahrain Commercial Complex,  
P.O. Box 30069  
Manama, Bahrain  
Tel: 973-534452

### Daiwa Securities SMBC Hong Kong Limited

Level 26, One Pacific Place  
88 Queensway, Hong Kong  
Tel: 852-2525-0121

### Daiwa Securities SMBC Singapore Limited

6 Shenton Way #26-08  
DBS Building Tower Two  
Singapore 068809  
Republic of Singapore  
Tel: 65-6-220-3666

### Daiwa Securities SMBC Australia Limited

Level 34, Rialto North Tower  
525 Collins Street, Melbourne  
Victoria 3000, Australia  
Tel: 61-3-9916-1300

### Daiwa Securities SMBC - Cathay Co., Ltd.

14th Floor,  
200 Keelung Road  
Sec. 1  
Taipei, Taiwan R.O.C.  
Tel: 886-2-2723-9698

### DBP-Daiwa Securities SMBC Philippines, Inc.

18th Floor, Citibank Tower  
8741 Paseo de Roxas  
Salcedo Village, Makati City  
Republic of the Philippines  
Tel: 632-813-7344

### Daiwa Securities SMBC Co., Ltd.

#### Seoul Branch

6th Floor, DITC Building  
#27-3, Youido-dong  
Yongdungpo-gu, Seoul  
Republic of Korea  
Tel: 82-2-787-9100

#### Beijing Office

International Building 2103  
Jianguo Menwai Dajie 19  
Beijing, People's Republic of  
China  
Tel: 86-10-6500-6688

#### Shanghai Office

38th Floor, HSBC Tower  
101 Yin Cheng East Road  
Pudong New Area  
Shanghai, People's Republic of  
China  
Tel: 86-21-6841-3333

### Daiwa Securities Trust & Banking (Europe) plc

#### Head Office

5 King William Street  
London EC4N 7JB, U.K.  
Tel: 44-20-7320-8000

#### Dublin Branch

Level 3, Block 5  
Harcourt Centre  
Harcourt Road  
Dublin 2, Ireland  
Tel: 353-1-478-3700

### Daiwa Securities America Inc.

Financial Square, 32 Old Slip  
New York, NY 10005, U.S.A.  
Tel: 1-212-612-7000

### Daiwa Securities Trust Company

One Evertrust Plaza  
Jersey City, NJ 07302, U.S.A.  
Tel: 1-201-333-7300

---

# Consolidated Financial Statements

---

---

Five-Year Financial Summary	83
Management's Discussion and Analysis	85
Consolidated Balance Sheets	88
Consolidated Statements of Operations	90
Consolidated Statements of Shareholders' Equity	91
Consolidated Statements of Cash Flows	92
Notes to Consolidated Financial Statements	94
Report of Independent Public Accountants	114
Corporate Data	116

---



# FIVE-YEAR FINANCIAL SUMMARY

Daiwa Securities Group Inc. & Consolidated Subsidiaries (years ended March 31, 1998 through 2002)\*

	Millions of yen					Thousands of U.S. dollars
	2002	2001	2000	1999	1998	2002
<b>Operating Results:</b>						
Operating revenues:						
Commissions . . . . .	¥ 171,869	¥ 254,704	¥ 364,116	¥ 185,450	¥ 198,118	\$ 1,292,248
Net gain (loss) on trading . . . . .	67,249	169,506	126,170	(20,708)	39,385	505,631
Interest and dividend income . . . . .	195,934	220,790	100,530	188,410	284,393	1,473,188
Service fees and other sales . . . . .	52,992	69,909	60,482	–	–	398,436
Total . . . . .	488,044	714,909	651,298	353,152	521,896	3,669,503
Net operating revenues . . . . .	284,932	464,057	512,276	180,710	267,430	2,142,345
Operating income (loss) . . . . .	22,769	177,109	224,778	(90,375)	(16,169)	171,195
Income (loss) before income taxes and minority interests . . . . .	(119,968)	166,615	135,173	(208,538)	(83,936)	(902,016)
Net income (loss) . . . . .	(130,547)	64,549	105,376	(127,890)	(83,657)	(981,558)

## Financial Position:

Total assets . . . . .	¥ 7,827,306	¥ 7,694,051	¥ 6,693,308	¥ 4,951,269	¥ 8,360,541	\$ 58,851,924
Total shareholders' equity . . . . .	570,839	716,816	666,072	639,859	774,699	4,292,023

## Per Share Amounts:

	Yen					U.S. dollars
Net income (loss) . . . . .	¥ (98.27)	¥ 48.62	¥ 79.43	¥ (96.00)	¥ (62.35)	\$ (0.74)
Cash dividends applicable to the year . . . . .	6.00	13.00	13.00	5.00	6.00	0.05
Shareholders' equity . . . . .	429.68	539.72	502.05	480.47	580.08	3.23

	Percent				
<b>Financial Ratios:</b>					
Pretax profit margin . . . . .	–%	23.2%	20.6%	–%	–%
(Income before income taxes and minority interests to total revenues)					
Net profit margin . . . . .	–	9.0	16.1	–	–
(Net income to total revenues)					
Return on average shareholders' equity. .	–	9.3	16.1	–	–
(Net income to average shareholders' equity)**					
Equity ratio . . . . .	7.3	9.3	10.0	12.9	9.3
(Shareholders' equity to total assets)					

## Other Data:

Number of employees*** . . . . .	11,483	11,114	11,415	8,855	10,006
----------------------------------	--------	--------	--------	-------	--------

Notes 1. Unless indicated otherwise, all dollar figures herein refer to US currency. Dollar amounts represent translations at the rate of ¥133 = US\$1, the rate prevailing on March 31, 2002

2. Net income and shareholders' equity per share are computed based on the average number of shares outstanding during the year

\* As of April 26, 1999 the former Daiwa Securities Co. Ltd. was reorganized and officially renamed Daiwa Securities Group Inc.

\*\* ROE is computed based on the average Shareholders' equity at the beginning and end of the fiscal year

\*\*\* Figures are the sum of the Holding Company and its consolidated subsidiaries



## MANAGEMENT'S DISCUSSION AND ANALYSIS

### OPERATING RESULTS

#### Business Environment

Japan's economy has suffered a period of prolonged weakness that started in the early 1990s. Although Japan's real GDP increased by 1.7% for the year ended March 31, 2001, it contracted by 1.3% for the year ended March 31, 2002. Severe economic conditions have been compounded by persistent deflationary pressures as evidenced by a continuous decline in the consumer price index since 1999. Meanwhile, the country's unemployment rate has risen to over 5%, far above historical norms. The effect of a number of expansionary fiscal recovery programs and other measures taken by the government has not yet put the economy on the path to sustainable recovery.

Japanese corporate earnings showed a limited recovery in the year ended March 31, 2001. This was mainly due to strong conditions in global information technology markets which led to strong growth in the electronic and precision instruments sectors. Following the collapse of the global IT boom, however, earnings deteriorated rapidly in most manufacturing sectors with the exception of the auto sector. The Daiwa Institute of Research estimates that, on average, a representative sample of 310 major corporations listed on the first section of the Tokyo Stock Exchange saw current earnings decline by 65.2% for the year ended March 31, 2002 compared with the previous year.

On the foreign exchange market, the value of the Yen has steadily depreciated during these past 2 years. During the year ended March 31, 2001 the value of the dollar decreased from approximately 105 yen to 121 yen. During the year ended March 31, 2002, it depreciated further to approximately 131 yen.

Japanese stock markets reacted to the worsening macroeconomic climate by declining steadily for most of the year. By March 31, 2002, the TOPIX stock index had declined by 17.0% from the level of 1277.27 as of March 31, 2001 to stand at 1060.19.

Overseas, the U.S. economy showed the first signs of a slowdown during the summer following almost a decade of unbroken growth and took a significant downturn following the terrorist attacks of September 11, 2001. The Federal Reserve, reacting to signs of this slowdown reduced the discount rate to 1.25% in March 2002. By the end of the period indications were that this aggressive easing had produced the desired effect as evidenced by stabilizing industrial production. During the year ended March 31, 2002, the Dow Jones Industrial Average increased by 5.3% from 9878.78 as of March 31 2001 to 10403.94 one year later, although the information technology sector continued under pressure as evidenced by a flat performance from the technology-heavy NASDAQ index.

Unlike the U.S. economy, the major European economies, which had started to slow during the summer of 2000, continued to remain sluggish during the period under consideration. The Governing Council of the European Central Bank made a series of reductions in the minimum bid rate on the main refinancing operations. European equities markets were flat to down during the period.

Outside of Japan, the Asian economies showed varying degrees of recovery from the global economic slowdown. Although certain countries, such as Singapore, seemed by the end of the period to be sliding back into recession, others, particularly China, showed impressive growth.



## **Consolidated Operating Results for the Year Ended March 31, 2002**

Consolidated operating revenues declined 31.7% to ¥488,044 million (\$3,669,503 thousand), mainly due to a decrease in brokerage commission and trading gains. Consolidated net operating revenues amounted to ¥284,932 million (\$2,142,345 thousand). Consequently, consolidated operating income decreased 87.1% to ¥22,769 million (\$171,195 thousand). A consolidated net loss of ¥130,547 million (\$981,558 thousand) was posted, mainly due to expenses for real estate business reorganization and write-off of securities as other expenses.

### **Commissions**

#### **(i) Brokerage commission**

Brokerage commission declined 27.9% to ¥59,753 million (\$449,271 thousand) with the average daily volume for the TSE also down 6.9% on the previous year, due to the continued depressed market conditions.

#### **(ii) Underwriting commission**

Underwriting commission fell 28.4% to ¥27,818 million (\$209,158 thousand), as the future of the market became increasingly uncertain.

#### **(iii) Distribution commission**

Distribution commission dropped 60.6% to ¥15,610 million (\$117,368 thousand), as the depressed stock market reduced commission on sale of equity-related beneficiary certificates.

#### **(iv) Other commission**

In the asset management division, Other commission from investment trusts decreased 34.1% to ¥46,424 million (\$349,053 thousand), due to a decline in trust fee rates and in the net asset value of equity-related beneficiary certificates. Other commission decreased 26.4% in total to ¥68,688 million (\$516,451 thousand).

### **Net trading gains/losses**

Total net trading gains plunged 60.3% to ¥67,249 million (\$505,631 thousand), mainly due to lackluster trading by clients, increasing pressure on margins in basket trading, an activity in which the Company holds a competitive edge and some loss of market share in block trading, one of the most profitable activities. However, gains on bond and exchange trading increased.

### Financial income

Net financial income amounted to ¥31,428 million (\$236,301 thousand), with interest and dividend income of ¥195,934 million (\$1,473,188 thousand) and interest expenses of ¥164,506 million (\$1,236,887 thousand), primarily due to expanded repurchase agreement transactions in overseas subsidiaries.

### Selling, general & administrative expenses

Commission and other expenses and bonuses included in Employees' compensation and benefits were curtailed in line with a decrease in revenues, while depreciation expenses on information technology-related investment increased. On balance, Selling, General & Administrative expenses decreased 8.6% to ¥262,163 million (\$1,971,150 thousand).

### Other income (expenses)

Net other expenses totaled ¥141,780 million (\$1,066,015 thousand), including expenses for real estate business reorganization of ¥127,401 million (\$957,902 thousand) and write-off of securities of ¥26,615 million (\$200,113 thousand), and other income in reversal of multi-employer pension plan of ¥13,692 million (\$102,946 thousand).

### Cash flow

Net cash used in operating activities was ¥865,151 million (\$6,504,893 thousand) during FY 2001, due to an increase in receivables on collateralized securities transactions, in spite of a decrease in trading assets. Loan assets from guaranteed stock transactions also increased. Net cash used in investing activities was ¥117,152 million (\$880,843 thousand) for the year ended March 31, 2002, due to increase in intangible fixed assets related to information technology-related investment and acquisition of subordinated bonds to meet new rules applicable to MMF. Net cash provided by financing activities was ¥1,119,245 million (\$8,415,376 thousand) for the year ended March 31, 2002, mainly due to an increase in short-term borrowings. Cash at end of year after the effect of exchange rate fluctuation increased by ¥140,495 million (\$1,056,354 thousand) to ¥454,559 million (\$3,417,737 thousand) for the year ended March 31, 2002.

# CONSOLIDATED BALANCE SHEETS (march 31, 2002 and 2001)

	Millions of yen		Thousands of U.S. dollars (note 1)
Assets	2002	2001	2002
<b>Cash and cash deposits:</b>			
Cash and time deposits (note 9) . . . . .	¥ 454,559	¥ 314,064	\$ 3,417,737
Cash segregated as deposits related to securities transactions . . . . .	108,610	94,475	816,617
	563,169	408,539	4,234,354
 <b>Receivables:</b>			
Loan receivables from customers . . . . .	23,686	30,602	178,090
Loan receivables from other than customers . . . . .	80,354	379,668	604,165
Receivables related to margin transactions (note 3) . . . . .	125,272	228,292	941,895
Other . . . . .	141,649	85,575	1,065,030
Less allowance for doubtful accounts . . . . .	(2,960)	(8,163)	(22,256)
	368,001	715,974	2,766,924
 <b>Collateralized short-term financing agreements (note 4) . . . . .</b>	3,493,652	2,729,721	26,268,060
<b>Trading assets (notes 5 and 9) . . . . .</b>	2,426,317	2,829,023	18,242,985
<b>Deferred income taxes (note 15) . . . . .</b>	89,563	92,200	673,406
 <b>Other assets:</b>			
Property and equipment, at cost (note 9) . . . . .	289,169	405,911	2,174,203
Less accumulated depreciation . . . . .	(100,717)	(92,005)	(757,271)
	188,452	313,906	1,416,932
 Lease deposits . . . . .	31,519	32,488	236,985
Investment securities (notes 6 and 9) . . . . .	394,650	374,364	2,967,293
Long-term loan receivables (note 10) . . . . .	14,746	14,968	110,872
Other (note 9) . . . . .	274,764	197,259	2,065,895
Less allowance for doubtful accounts . . . . .	(17,527)	(14,391)	(131,782)
	886,604	918,594	6,666,195
	<u>¥ 7,827,306</u>	<u>¥ 7,694,051</u>	<u>\$ 58,851,924</u>

see accompanying notes.

Liabilities and shareholders' equity	Millions of yen		Thousands of U.S. dollars (note 1)
	2002	2001	2002
<b>Loans:</b>			
Short-term borrowings (notes 9, 10 and 13) . . . . .	¥ 1,742,389	¥ 600,028	\$ 13,100,669
Commercial paper . . . . .	442,100	516,300	3,324,060
Long-term debt (notes 9, 10 and 13) . . . . .	682,844	598,839	5,134,165
	2,867,333	1,715,167	21,558,894
<b>Payables:</b>			
Payables to customers (note 12) . . . . .	246,899	188,570	1,856,383
Time deposits received . . . . .	15,064	13,573	113,263
Payables from brokers, dealers and customers . . . . .	169,347	13,814	1,273,286
Payables related to margin transactions (note 3) . . . . .	42,433	29,772	319,045
Other . . . . .	21,074	20,178	158,451
	494,817	265,907	3,720,428
<b>Collateralized short-term financing agreements (note 4) . . . . .</b>	<b>2,467,714</b>	<b>3,251,220</b>	<b>18,554,241</b>
<b>Trading liabilities (note 5) . . . . .</b>	<b>1,187,846</b>	<b>1,412,370</b>	<b>8,931,173</b>
<b>Accrued and other liabilities:</b>			
Income taxes payable . . . . .	2,786	30,344	20,947
Deferred income taxes (note 15) . . . . .	10,494	15,071	78,902
Accrued bonuses . . . . .	14,582	18,748	109,639
Multiemployers' pension plan (note 14) . . . . .	–	28,443	–
Retirement benefits (note 14) . . . . .	12,850	9,413	96,617
Provision for real estate business reorganization (notes 2 and 23) . . . . .	10,076	–	75,759
Other . . . . .	32,333	50,470	243,106
	83,121	152,489	624,970
<b>Statutory reserves (note 16) . . . . .</b>	<b>2,932</b>	<b>1,975</b>	<b>22,045</b>
<b>Minority interests . . . . .</b>	<b>152,704</b>	<b>178,107</b>	<b>1,148,150</b>
<b>Contingent liabilities and commitments (note 17)</b>			
<b>Shareholders' equity (notes 18 and 19):</b>			
Common stock, no par value;			
Authorized - 4,000,000 thousand shares			
Issued - 1,331,735 thousand shares . . . . .	138,432	138,432	1,040,842
Additional paid-in capital . . . . .	117,786	117,786	885,609
Retained earnings . . . . .	311,719	459,994	2,343,752
Net unrealized gain on securities, net of tax effect . . . . .	12,696	18,984	95,459
Translation adjustments . . . . .	(7,511)	(15,807)	(56,474)
Treasury stock, at cost. . . . .	(2,283)	(2,573)	(17,165)
Total shareholders' equity . . . . .	570,839	716,816	4,292,023
	¥ 7,827,306	¥ 7,694,051	\$ 58,851,924

# CONSOLIDATED STATEMENTS OF OPERATIONS (years ended march 31, 2002, 2001 and 2000)

	Millions of yen			Thousands of U.S. dollars (note 1)
	2002	2001	2000	2002
<b>Operating revenues:</b>				
Commissions (note 21) .....	¥ 171,869	¥ 254,704	¥ 364,116	\$ 1,292,248
Net gain on trading .....	67,249	169,506	126,170	505,631
Interest and dividend income (note 10) .....	195,934	220,790	100,530	1,473,188
Service fees and other sales .....	52,992	69,909	60,482	398,436
	488,044	714,909	651,298	3,669,503
<b>Interest expense (note 10) .....</b>	<b>164,506</b>	<b>195,522</b>	<b>89,324</b>	<b>1,236,887</b>
<b>Cost of service fees and other sales .....</b>	<b>38,606</b>	<b>55,330</b>	<b>49,698</b>	<b>290,271</b>
<b>Net operating revenues (note 20) .....</b>	<b>284,932</b>	<b>464,057</b>	<b>512,276</b>	<b>2,142,345</b>
Selling, general and administrative expenses (notes 14 and 22) .....	262,163	286,948	287,498	1,971,150
<b>Operating income (note 20) .....</b>	<b>22,769</b>	<b>177,109</b>	<b>224,778</b>	<b>171,195</b>
<b>Other income (expenses):</b>				
Reversal of statutory reserves, net (note 16) .....	(957)	(994)	(197)	(7,196)
Other, net (note 23) .....	(141,780)	(9,500)	(89,408)	(1,066,015)
	(142,737)	(10,494)	(89,605)	(1,073,211)
<b>Income (loss) before income taxes and minority interests .....</b>	<b>(119,968)</b>	<b>166,615</b>	<b>135,173</b>	<b>(902,016)</b>
<b>Income taxes (note 15):</b>				
Current .....	2,613	48,019	77,643	19,647
Deferred .....	2,990	21,830	(15,273)	22,481
	5,603	69,849	62,370	42,128
<b>Minority interests .....</b>	<b>(4,976)</b>	<b>(32,217)</b>	<b>32,573</b>	<b>(37,414)</b>
<b>Net income (loss) .....</b>	<b>¥ (130,547)</b>	<b>¥ 64,549</b>	<b>¥ 105,376</b>	<b>\$ (981,558)</b>
<b>Per share amounts:</b>				
	Yen			U.S. dollars (Note 1)
Net income (loss) .....	¥ (98.27)	¥ 48.62	¥ 79.43	\$ (0.74)
Diluted net income .....	—	46.26	76.19	—
Cash dividends applicable to the year .....	6.00	13.00	13.00	0.05

see accompanying notes.

# CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(years ended march 31, 2002, 2001 and 2000)

	Millions of yen						
	Number of shares of common stock (thousands)	Common stock	Additional paid-in capital	Retained earnings	Net unrealized gain on securities, net of tax effect	Translation adjustments	Treasury stock, at cost
<b>Balance at March 31, 1999</b> .....	1,331,722	¥ 138,425	¥ 117,779	¥ 383,672	¥ –	¥ –	¥ (17)
Net income .....				105,376			
Revisions in accounting for subsidiaries and affiliated companies (note 2) ....				(68,913)			
Cash dividends paid .....				(6,658)			
Bonuses to directors .....				(8)			
Shares issued upon conversion of bonds ..	11	6	6				
Change in treasury stock, net .....							(3,596)
<b>Balance at March 31, 2000</b> .....	1,331,733	138,431	117,785	413,469	–	–	(3,613)
Net income .....				64,549			
Change in stake in subsidiaries .....				(498)			
Cash dividends paid .....				(17,246)			
Bonuses to directors .....				(280)			
Shares issued upon conversion of bonds ..	2	1	1				
Net unrealized gain on securities, net of tax effect .....					18,984		
Translation adjustments .....						(15,807)	
Change in treasury stock, net .....							1,040
<b>Balance at March 31, 2001</b> .....	1,331,735	138,432	117,786	459,994	18,984	(15,807)	(2,573)
Net loss .....				(130,547)			
Cash dividends paid .....				(17,266)			
Bonuses to directors .....				(462)			
Net unrealized gain on securities, net of tax effect .....					(6,288)		
Translation adjustments .....						8,296	
Change in treasury stock, net .....							290
<b>Balance at March 31, 2002</b> .....	1,331,735	¥ 138,432	¥ 117,786	¥ 311,719	¥ 12,696	¥ (7,511)	¥ (2,283)

	Thousands of U.S. dollars (Note 1)					
	Common stock	Additional paid-in capital	Retained earnings	Net unrealized gain on securities, net of tax effect	Translation adjustments	Treasury stock, at cost
Balance at March 31, 2001. ....	\$ 1,040,842	\$ 885,609	\$ 3,458,602	\$ 142,737	\$ (118,850)	\$ (19,346)
Net loss. ....			(981,558)			
Cash dividends paid ....			(129,818)			
Bonuses to directors ....			(3,474)			
Net unrealized gain on securities, net of tax effect ....				(47,278)		
Translation adjustments ....					62,376	
Change in treasury stock, net ....						2,181
Balance at March 31, 2002 ....	\$ 1,040,842	\$ 885,609	\$ 2,343,752	\$ 95,459	\$ (56,474)	\$ (17,165)

see accompanying notes.

# CONSOLIDATED STATEMENTS OF CASH FLOWS (years ended march 31, 2002, 2001 and 2000)

	Millions of yen			Thousands of U.S. dollars (note 1)
	2002	2001	2000	2002
<b>Cash flows from operating activities:</b>				
Net income (loss) . . . . .	¥ (130,547)	¥ 64,549	¥ 105,376	\$ (981,558)
Adjustments to reconcile net income (loss) to net cash used in operating activities:				
Depreciation . . . . .	18,775	15,495	14,780	141,165
Provision for doubtful accounts, net . . . . .	4,962	4,345	33,959	37,308
Provision for retirement benefits, net (note 14) . . . . .	3,432	4,253	(2,584)	25,805
Reversal of statutory reserves, net (note 16) . . . . .	957	994	197	7,196
Losses (gains) related to investment securities (note 23) . . . . .	18,444	1,665	(10,992)	138,677
Losses related to fixed assets (note 23) . . . . .	2,238	2,978	9,182	16,827
Expenses for reorganization of related companies (note 23) . . . . .	–	–	10,552	–
Provision for (reversal of) multiemployers’ pension plan (notes 14 and 23) . . . . .	(13,692)	–	28,443	(102,946)
Payment for multiemployers’ pension plan . . . . .	(15,253)	–	–	(114,684)
Expenses for real estate business reorganization (note 23) . . . . .	127,401	–	–	957,902
Write-off of goodwill (note 23) . . . . .	5,000	–	8,000	37,594
Deferred income taxes . . . . .	2,990	21,830	(15,273)	22,481
Minority interest in income . . . . .	4,976	32,217	(32,573)	37,414
(Increase) decrease in receivables and increase (decrease) in payables . .	352,319	(152,635)	400,786	2,649,015
(Increase) decrease in trading assets and increase (decrease) in trading liabilities . . . . .	338,229	177,783	(818,888)	2,543,075
(Increase) decrease in receivables and increase (decrease) in payables related to margin transactions . . . . .	115,681	141,490	(263,189)	869,782
(Increase) decrease in collateralized short-term financing agreements . .	(1,549,168)	(510,205)	62,112	(11,647,880)
(Increase) decrease in other assets . . . . .	(152,983)	(45,159)	21,216	(1,150,248)
Other, net. . . . .	1,088	1,825	(5,175)	8,182
Total adjustments . . . . .	(734,604)	(303,124)	(559,447)	(5,523,335)
Net cash used in operating activities . . . . .	¥ (865,151)	¥ (238,575)	¥ (454,071)	\$ (6,504,893)

	Millions of yen			Thousands of U.S. dollars (note 1)
	2002	2001	2000	2002
<b>Cash flows from investing activities:</b>				
Payments for purchases of property and equipment . . . . .	¥ (11,754)	¥ (10,408)	¥ (14,681)	\$ (88,376)
Proceeds from sales of property and equipment . . . . .	8,857	6,297	9,755	66,594
Payments for purchases of investment securities . . . . .	(124,061)	(22,059)	(88,326)	(932,790)
Proceeds from sales of investment securities . . . . .	58,472	43,758	205,783	439,639
Decrease in long-term loan receivables . . . . .	176	7,391	28,945	1,323
Other, net . . . . .	(48,842)	(20,010)	(673)	(367,233)
Net cash provided by (used in) investing activities . . . . .	(117,152)	4,969	140,803	(880,843)
<b>Cash flows from financing activities:</b>				
Increase in short-term loans . . . . .	1,152,333	59,441	121,138	8,664,158
Decrease in long-term debt . . . . .	(117,205)	(126,904)	(9,970)	(881,241)
Proceeds from issuance of notes by subsidiaries . . . . .	161,904	192,109	80,000	1,217,323
Payments for redemption of bonds and notes . . . . .	(46,835)	(67,707)	(39,409)	(352,143)
Proceeds from issuance of stocks to minor shareholders . . . . .	6,580	2,145	162,000	49,474
Payments of cash dividends . . . . .	(17,265)	(17,246)	(6,658)	(129,812)
Payments of cash dividends to minor shareholders . . . . .	(20,579)	(29)	(233)	(154,729)
Other . . . . .	312	990	–	2,346
Net cash provided by financing activities . . . . .	1,119,245	42,799	306,868	8,415,376
Effect of exchange rate changes on cash . . . . .	3,553	7,696	8,839	26,714
Net increase (decrease) in cash . . . . .	140,495	(183,111)	2,439	1,056,354
Cash at beginning of year . . . . .	314,064	497,175	474,865	2,361,383
Increase in cash due to change in scope of consolidation . . . . .	–	–	19,871	–
Cash at end of year . . . . .	¥ 454,559	¥ 314,064	¥ 497,175	\$ 3,417,737
<b>Supplemental information on cash flows:</b>				
Cash paid during the year for:				
Interest . . . . .	¥ 174,980	¥ 205,945	¥ 93,939	\$ 1,315,639
Income taxes . . . . .	31,397	90,673	10,937	236,068
<b>Noncash investing and financing activities:</b>				
Conversion of convertible bonds into common stock and additional paid-in capital . . . . .	–	2	12	–

see accompanying notes.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (three years ended March 31, 2002)

### 1. Basis of financial statements

Daiwa Securities Group Inc. (the “Company”) changed its name from Daiwa Securities Co. Ltd. and transformed into a holding company on April 26, 1999, after transferring its wholesale business divisions and retail business divisions as mentioned below.

On April 5, 1999, the Company transferred its wholesale business divisions to Daiwa Securities SB Capital Markets Co. Ltd. (“Daiwa Securities SBCM”), a 60% owned subsidiary, in accordance with the agreement with The Sumitomo Bank, Limited dated on December 18, 1998 and the approval regarding the transfer in the extraordinary meeting of shareholders held on February 5, 1999. On April 1, 2001, The Sumitomo Bank and The Sakura Bank merged to form The Sumitomo Mitsui Banking Corporation. Associated with this merger, Sakura Securities Co., Ltd., a securities subsidiary of The Sakura Bank, was integrated into Daiwa Securities SBCM, which was subsequently renamed to Daiwa Securities SMBC Co. Ltd. (“Daiwa Securities SMBC”).

On April 26, 1999, the Company transferred its retail business divisions to Daiwa Securities Preparation Co. Ltd., in accordance with the approval regarding the transfer in the extraordinary meeting mentioned above. This company changed its corporate name to (new) Daiwa Securities Co. Ltd. on the same date.

The Company and its consolidated domestic subsidiaries maintain their official accounting records in yen and in accordance with the provisions set forth in the Japanese Commercial Code and accounting principles and practices generally accepted in Japan (“Japanese GAAP”). The accounts of overseas subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles and practices prevailing in the respective countries of domicile. Certain accounting principles and practices generally accepted in Japan are different from International Accounting Standards and standards in other countries in certain respects as to application and disclosure requirements. Accordingly, the accompanying financial statements are intended for use by those who are informed about Japanese accounting principles and practices.

The accompanying financial statements have been restructured and translated into English (with some expanded descriptions and the inclusion of statements of shareholders’ equity) from the consolidated financial statements of the Company prepared in accordance with Japanese GAAP and filed with the appropriate Local Finance Bureau of the Ministry of Finance as required by the Securities and Exchange Law. Some supplementary information included in the statutory Japanese language consolidated financial statements but not required for fair presentation is not presented in the accompanying financial statements.

The consolidated financial statements of the Company for the year ended March 31, 2002 are prepared in accordance with the amended “Uniform Accounting Standards of Securities Companies” (set by the board of directors of the Japan Securities Dealers’ Association, September 28, 2001). The balance sheet at March 31, 2001 and the operating results for the years ended March 31, 2001 and 2000 are reclassified to conform to the presentation for 2002.

The translations of the yen amounts into U.S. dollars are included solely for the convenience of the reader, using the prevailing exchange rate at March 31, 2002, which was ¥133 to U.S. \$1. The convenience translations should not be construed as representations that the yen amounts have been, could have been, or could in the future be, converted into U.S. dollars at this or any other rate of exchange.

## 2. Significant accounting policies

**Consolidation** - The Company prepared the consolidated financial statements in accordance with the revised Accounting Principles for Consolidated Financial Statements (the “Revised Accounting Principles”) effective for the year ended March 31, 2000. The consolidated financial statements include the accounts of the Company and significant companies which are controlled by the Company through substantial ownership of more than 50% of the voting rights or through ownership of high percentage of the voting rights and the existence of certain conditions evidencing control by the Company of the decision-making body of such companies.

Under the Revised Accounting Principles, in addition to 20% to 50% owned companies, certain companies of which the Company has at least 15% and less than 20% of the voting rights in the case where the Company has the ability to exercise significant influence over operating and financial policies of the investees are accounted for using the equity method.

Previously, only majority-owned companies were consolidated and only investments in companies of which the Company owns 20% to 50% of the voting rights and has the ability to significantly influence financial, operational or business policies were accounted for using the equity method. Due to the revision, eight subsidiaries and three affiliates were newly consolidated or accounted for on the equity method in the accompanying consolidated financial statements for 2000.

Significant intercompany balances, transactions and profits have been eliminated in consolidation.

**Statements of cash flows** - For purposes of reporting cash flows, cash includes “cash and time deposits” with maturities of not exceeding one year in the accompanying consolidated statements of cash flows, which is referred to the corresponding account balance in the accompanying consolidated balance sheets. Cash and time deposits as of March 31, 2002, 2001, and 2000 included time deposits more than three months in the amount of ¥14,578 million (\$109,609 thousand), ¥10,665 million, and ¥8,310, respectively.

**Trading assets and liabilities** - Trading assets and liabilities, including securities and financial derivatives for trading purposes held by the securities subsidiaries are recorded on a trade date basis in the consolidated balance sheets at either market value or fair value. Revenues and expenses related to trading securities transactions are recorded on a trade date basis. Changes in the market values or fair values are reflected in “net gain on trading” in the accompanying consolidated statements of operations. Gains and losses generated from derivatives held or issued for trading purposes are also reported as “net gain on trading” in the accompanying consolidated statements of operations, which includes realized gains and losses as well as changes in the market values or fair values of such instruments. Securities owned for non-trading purpose, shown in the accompanying consolidated balance sheets as “Investment securities”, are discussed below.

**Investment securities** - The Company and its consolidated subsidiaries examined the intent of holding each security and classified those securities as (a) debt securities intended to be held to maturity (“held-to-maturity debt securities”), (b) equity securities issued by subsidiaries and affiliated companies, and (c) for all other securities not classified in any of the above categories (“available-for-sale securities”).

Held-to-maturity debt securities are stated at amortized cost. Equity securities issued by subsidiaries and affiliated companies are stated at moving-average cost. Available-for-sale securities with market value are stated at market value, based on quoted market prices. Realized gains and losses on sale of such securities are computed using the moving-average cost. Unrealized gains and losses on these securities are reported, net of applicable income taxes, as a separate component of the shareholders’ equity.

Debt securities that do not have market value are stated at the amortized cost, net of the amount considered not collectible.

Other securities that do not have fair value are stated at the moving-average cost.

If the market value of held-to-maturity debt securities, equity securities issued by subsidiaries and affiliated companies, and available-for-sale securities declines significantly, such securities are stated at market value and the difference between market value and the carrying amount is recognized as loss in the period of the decline. If the market value of equity securities issued by subsidiaries and affiliated companies is not readily available, such securities should be written down to net asset value in the event net asset value is significantly declines. Unrealized losses on these securities are reported in the consolidated statements of operations.

**Hedging transactions** - The Company and its consolidated subsidiaries state derivative financial instruments at fair value and to recognize changes in the fair value as gains or losses unless derivative financial instruments are used for hedging purposes. Valuation gains or losses on hedging instruments are mainly deferred as assets or liabilities until the gains or losses on underlying hedged instruments are realized. Interests received or paid on interest swap for hedging are accrued without mark-to-market, and premium or discount on forward foreign exchange contract for hedging is allocated to each fiscal term without mark-to-market.

**Collateralized short-term financing agreements** - Collateralized short-term financing agreements consist of securities purchased under agreements to resell ("Resell transactions") or securities sold under agreements to repurchase ("Repurchase transactions"), securities borrowed or loaned, and Buy or Sell Gensaki which have been accounted for as financing transactions. Resell and Repurchase transactions are traded in overseas subsidiaries and carried at their contractual amounts. Securities borrowed or loaned are recorded at the amount of cash collateral advanced or received. Buy or Sell Gensaki represents a form of securities purchased under resale agreements or securities sold under repurchase agreements originated in Japan. Gensaki transactions have been accounted for in the same manner as financing transactions in accordance with the amendment of the "Uniform Accounting Standards of Securities Companies".

**Provision for doubtful accounts** - Provision for doubtful accounts of domestic consolidated subsidiaries is provided on the estimated historical deterioration rate for normal loans, and the allowance specifically assessed for doubtful and failed loans. Overseas consolidated subsidiaries provide specifically assessed amounts.

**Property and equipment** - Property and equipment are stated at cost. In the Company and its domestic consolidated subsidiaries, depreciation is computed principally by the declining-balance method over estimated useful lives as stipulated by corporate tax regulations. Depreciation for buildings purchased in Japan after April 1, 1998 is computed by the straight-line method. In its overseas subsidiaries, depreciation is computed by the straight-line method.

**Bonuses** - The Company and its domestic consolidated subsidiaries follow the Japanese practice of paying bonuses to employees in June and December. Accrued employees' bonuses represent liabilities estimated as of the balance sheet date. Bonuses to directors, which are subject to approval at the shareholders' meeting, are accounted for as an appropriation of retained earnings.

**Retirement benefits for employees** - Effective April 1, 2000, the Company and most of its domestic consolidated subsidiaries adopted the new accounting standard, "Opinion on Setting Accounting Standard for Employees' Severance and Pension Benefits" (the "Standard for Employees' Severance and Pension Benefits"), issued by the Business Accounting Deliberation Council on June 16, 1998.

As a result of the adoption of the Standard for Employees' Severance and Pension Benefits, in the year ended March 31, 2001, severance and pension benefit expense increased by ¥213 million, operating income and income before income taxes and minority interests decreased by ¥213 million compared with what would have been recorded under the previous accounting standard.

The Company and most of its domestic consolidated subsidiaries contributed an unfunded benefit pension plan to their employees in return for services rendered each year. The amount to be contributed to the individual employees' account is defined rather than the amount of pension benefits the employee is to receive. Under this unfunded benefit pension plans, pension benefits are accumulated on an annual basis by contribution of the Company and most of its domestic consolidated subsidiaries. The employees receive guaranteed hypothetical return at the rate of which the Company and most of its domestic consolidated subsidiaries predetermines each year. Certain consolidated subsidiaries provide allowance for employees' retirement benefits, based on estimated amounts of projected benefit obligations.

The Company and almost all of its domestic consolidated subsidiaries introduced defined contribution pension plan in December 2001. Some overseas consolidated subsidiaries adopt defined contribution pension plan.

Also the Company and its certain domestic subsidiaries were members of an industry-wide non-contributory welfare pension plan administered by Securities Companies' Welfare Pension Fund, in conjunction with the contributory governmental welfare pension plan. On September 29, 2001, the Company and its certain domestic subsidiaries withdrew from this non-contributory welfare pension plan (See Note 14).

***Provision for real estate business reorganization*** - The Company decided to withdraw from real estate business engaged by its certain domestic consolidated subsidiaries. Book values of the related properties were written down to estimated net realizable value. On October 26, 2001, the Company's Board of Directors resolved to reorganize such real estate business and to initiate working on how to provide financial assistance to those subsidiaries including capital injection, aiming at improving the Group's financial condition. Provision for real estate reorganization is based on anticipated financial assistance as of March 31, 2002 (See Note 23).

***Income taxes*** - Deferred tax assets and liabilities are recorded for the expected future tax consequences of temporary differences between the financial reporting and the tax bases of the assets and liabilities based upon enacted tax laws and rates. The Company recognizes deferred tax assets to the extent they are expected to be realized. Deferred tax assets and liabilities are reported as "deferred income taxes" in the accompanying consolidated balance sheets. Deferred tax expenses or benefits are recognized in the consolidated statements of operations for the changes in deferred tax assets or liabilities between years.

***Translation of foreign currencies*** - The Company and its domestic consolidated subsidiaries translate assets and liabilities in foreign currencies into yen at year-end exchange rate.

***Translation of foreign currency financial statements*** - Financial statements of foreign subsidiaries are translated into yen on the basis of the year-end rates for assets and liabilities except that retained earnings are translated at historical rates. Income and expenses are translated at the average rates for the years. The resulting differences are reported as translation adjustment in shareholders' equity.

***Net income (loss) per share*** - Net income (loss) per share of common stock is based on the average number of common shares outstanding during the period.

Diluted net income per share is computed based on the average number of common shares outstanding for the year plus the number of shares of common stock that would have been issued had the outstanding convertible bonds and warrants been converted as of March 31, 2002.

### 3. Margin transactions

Margin transactions at March 31, 2002 and 2001 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2002	2001	2002
<b>Assets:</b>			
Loan receivables from customers. . . . .	¥ 49,227	¥ 88,171	\$ 370,128
Cash deposits as collateral for securities borrowed from securities finance companies . . . . .	76,045	140,121	571,767
	¥ 125,272	¥ 228,292	\$ 941,895
<b>Liabilities:</b>			
Loans from securities finance companies. . . . .	¥ 3,591	¥ 14,453	\$ 27,000
Proceeds of securities sold for customers' accounts . . . . .	38,842	15,319	292,045
	¥ 42,433	¥ 29,772	\$ 319,045

Loan receivables from customers are stated at amounts equal to the purchase prices of the relevant securities and are collateralized by customers' securities and customers' deposits of cash or securities. Proceeds of securities sold for customers' accounts are stated at the sales prices of the relevant securities on the respective transaction dates.

### 4. Collateralized short-term financing agreements

Collateralized short-term financing agreements at March 31, 2002 and 2001 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2002	2001	2002
<b>Assets:</b>			
Securities purchased under agreements to resell. . . . .	¥ 1,527,560	¥ 1,629,394	\$ 11,485,413
Securities borrowed. . . . .	1,828,370	882,876	13,747,143
Buy Gensaki . . . . .	137,722	217,451	1,035,504
	¥ 3,493,652	¥ 2,729,721	\$ 26,268,060
<b>Liabilities:</b>			
Securities sold under agreements to repurchase . . . . .	¥ 1,869,469	¥ 1,716,006	\$ 14,056,158
Securities loaned . . . . .	520,148	793,276	3,910,887
Sell Gensaki . . . . .	78,097	741,938	587,196
	¥ 2,467,714	¥ 3,251,220	\$ 18,554,241

## 5. Trading assets and trading liabilities

Trading assets and trading liabilities at March 31, 2002 and 2001 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2002	2001	2002
<b>Trading assets:</b>			
Equity securities . . . . .	¥ 202,109	¥ 347,285	\$ 1,519,617
Government, corporate and other bonds . . . . .	1,740,980	2,102,608	13,090,075
Beneficiary certificates . . . . .	84,460	2,231	635,037
Commercial paper, certificates of deposits and others . . . . .	53,683	60,956	403,632
Option transactions . . . . .	22,566	43,022	169,669
Futures and forward transactions . . . . .	12,262	8,826	92,195
Swap agreements . . . . .	311,358	265,054	2,341,038
Other derivatives . . . . .	116	29	872
Credit reserves . . . . .	(1,217)	(988)	(9,150)
	<u>¥ 2,426,317</u>	<u>¥ 2,829,023</u>	<u>\$ 18,242,985</u>
<b>Trading liabilities:</b>			
Equity securities . . . . .	¥ 45,093	¥ 93,339	\$ 339,045
Government, corporate and other bonds . . . . .	823,270	1,016,189	6,190,000
Beneficiary certificates . . . . .	12,605	—	94,774
Option transactions . . . . .	29,642	40,049	222,872
Futures and forward transactions . . . . .	4,067	8,329	30,579
Swap agreements . . . . .	273,159	254,455	2,053,828
Other derivatives . . . . .	10	9	75
	<u>¥ 1,187,846</u>	<u>¥ 1,412,370</u>	<u>\$ 8,931,173</u>

## 6. Investment securities

Cost/amortized cost and market value of held-to-maturity debt securities as of March 31, 2002 and 2001 consisted of the following:

	Millions of yen		
	Cost/amortized cost	Market value	Difference
Government bonds, local government bonds, etc. at March 31, 2002 . . . . .	¥ 523	¥ 520	¥ (3)
Government bonds, local government bonds, etc. at March 31, 2001 . . . . .	¥ 2,020	¥ 2,031	¥ 11
	Thousands of U.S. dollars		
	Cost/amortized cost	Market value	Difference
Government bonds, local government bonds, etc. at March 31, 2002 . . . . .	\$ 3,932	\$ 3,910	\$ (22)

Cost and market value of available-for-sale securities as of March 31, 2002 and 2001 consisted of the following:

	Millions of yen		
	Cost	Market value	Difference
<b>March 31, 2002:</b>			
Equity securities . . . . .	¥ 91,861	¥ 116,202	¥ 24,341
Government, corporate and other bonds . . . . .	143,692	141,242	(2,450)
Other . . . . .	8,363	8,463	100
	¥ 243,916	¥ 265,907	¥ 21,991
<b>March 31, 2001:</b>			
Equity securities . . . . .	¥ 134,821	¥ 173,333	¥ 38,512
Government, corporate and other bonds . . . . .	366	378	12
Other . . . . .	22,782	18,925	(3,857)
	¥ 157,969	¥ 192,636	¥ 34,667
	Thousands of U.S. dollars		
	Cost	Market value	Difference
<b>March 31, 2002:</b>			
Equity securities . . . . .	\$ 690,684	\$ 873,701	\$ 183,017
Government, corporate and other bonds . . . . .	1,080,393	1,061,970	(18,423)
Other . . . . .	62,875	63,630	755
	\$ 1,833,952	\$ 1,999,301	\$ 165,349

Securities that do not have market value as of March 31, 2002 and 2001 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2002	2001	2002
Equity securities . . . . .	¥ 52,654	¥ 43,453	\$ 395,895
Government, corporate and other bonds . . . . .	10,580	8,974	79,549
Other . . . . .	38,862	99,879	292,195
	¥ 102,096	¥ 152,306	\$ 767,639

In addition to above, securities of non-consolidated and affiliated companies amounting to ¥26,124 million (\$196,421 thousand) at March 31, 2002 and ¥27,402 million at March 31, 2001 are included in investment securities.

## 7. Derivatives for non-trading purposes

Net unrealized gains (losses) of derivatives for non-trading purposes at March 31, 2002 and 2001 (excluding hedging transactions) consisted of the following:

	Millions of yen		
	Contract amount	Market value	Unrealized gains (losses)
<b>March 31, 2002:</b>			
Interest rate swap .....	¥ 4,204	¥ (16)	¥ (15)
Currency swap .....	279	(0)	(0)
<b>March 31, 2001:</b>			
Interest rate swap .....	¥ 86	¥ (1)	¥ (1)
Currency swap .....	342	0	0

	Thousands of U.S. dollars		
	Contract amount	Market value	Unrealized gains (losses)
<b>March 31, 2002:</b>			
Interest rate swap .....	\$ 31,609	\$ (120)	\$ (113)
Currency swap .....	2,098	(0)	(0)

## 8. Risk management information

The two domestic securities subsidiaries, Daiwa Securities Co. Ltd. and Daiwa Securities SMBC ("Securities subsidiaries"), enter into transactions involving trading assets and liabilities to meet customer needs, and for their proprietary trading activities, as a broker and an end-user. These trading assets and liabilities include (1) cash securities such as stocks and bonds, (2) financial derivatives traded on exchanges such as futures and options based on stock price indices, bonds and interest rates, and (3) financial derivatives traded over the counter such as currency and interest rate swaps, foreign exchange forward contracts, bonds with options, currency options, forward rate agreements and OTC equity derivatives.

The principal risks inherent in trading in these markets are market risk and credit risk. Market risk represents the potential for loss from changes in the value of financial instruments due to price and interest rate fluctuations in the markets. As to market risk, Daiwa Securities SMBC determines the balance of risk and profit or loss on each instrument and use a value-at-risk method to manage this risk. Credit risk represents the potential for loss arising from the failure of the counterparty in a transaction to fulfill its terms and conditions. Securities subsidiaries assess the credit risk of their counterparties applying internal credit rating and monitor their exposure by measuring notional principal and credit exposure.

Daiwa Securities SMBC has established five risk management principles: Active management participation, system of internal supervision, sound management by risk limit setting, risk management assuming emergency, and transparency in risk management process. By ensuring these five principles, Daiwa Securities SMBC expects that risks associated with trading activities are well controlled within a range that the management is willing to assume.



## 9. Pledged assets

At March 31, 2002, short-term borrowings amounting to ¥1,191,850 million (\$8,961,278 thousand), securities borrowed amounting to ¥3,591 million (\$26,998 thousand) and long-term borrowings amounting to ¥9,110 million (\$68,496 thousand) were secured by the following assets:

	Millions of yen	Thousands of U.S. dollars
Cash and time deposits . . . . .	¥ 16,200	\$ 121,805
Trading assets . . . . .	860,250	6,468,047
Property and equipment . . . . .	22,414	168,526
Investment Securities . . . . .	5,004	37,627
Other . . . . .	4,875	36,654
	¥ 908,743	\$ 6,832,659

In addition to above, securities borrowed amounting to ¥911,237 million (\$6,851,406 thousand) were deposited as guarantee at March 31, 2002.

Total fair value of the securities deposited as collateral at March 31, 2002 consisted of the following:

	Millions of yen	Thousands of U.S. dollars
Securities loaned . . . . .	¥ 6,420,612	\$ 48,275,278
Sell Gensaki transaction . . . . .	78,094	587,173
Other . . . . .	309,999	2,330,820
	¥ 6,808,705	\$ 51,193,271

Total fair value of the securities received as collateral at March 31, 2002 consisted of the following:

	Millions of yen	Thousands of U.S. dollars
Securities borrowed . . . . .	¥ 8,219,309	\$ 61,799,316
Buy Gensaki transaction . . . . .	138,149	1,038,714
Other . . . . .	97,228	731,038
	¥ 8,454,686	\$ 63,569,068

## 10. The Company's transactions with related parties

A statutory auditor of the Company is the president of the Taiyo Mutual Life Insurance Co. The significant account balances with the Taiyo Mutual Life Insurance Co. at March 31, 2002 were long-term loan receivables amounting to ¥5,000 million (\$37,594 thousand), short-term borrowings amounting to ¥5,000 million (\$37,594 thousand), and long-term borrowings amounting to ¥20,000 million (\$150,376 thousand). The Company paid ¥490 million (\$3,684 thousand) as interest expenses and received ¥177 million (\$1,331 thousand) as interest income. Interest payables and interest receivables at March 31, 2002 were ¥118 million (\$887 thousand) and ¥53 million (\$398 thousand), respectively. In addition, the Company purchased 10,000 shares of Daiwa Institute of Research Ltd., a domestic consolidated subsidiary of the Company, at ¥85 million (\$639 thousand) from this company.

## 11. Lease transactions

Financial leases that do not transfer ownership to lessees (“non-capitalized finance leases”) are not capitalized and are accounted for in the same manner as operating leases. Certain information at March 31, 2002 and 2001 is summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2002	2001	2002
Total assets under non-capitalized finance leases . . . . .	¥ 18,451	¥ 21,906	\$ 138,729
Accumulated depreciation . . . . .	10,873	12,886	81,752
Future lease payments of non-capitalized leases . . . . .	7,713	9,335	57,992
Due within one year . . . . .	3,420	4,011	25,714
Future lease payments of operating leases . . . . .	15,839	14,941	119,090
Due within one year . . . . .	2,065	2,018	15,526

## 12. Payables to customers

Payables to customers at March 31, 2002 and 2001 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2002	2001	2002
Cash received for customers' accounts on trading . . . . .	¥ 83,039	¥ 88,721	\$ 624,353
Cash deposits received from customers mainly for margin and futures transactions . . . . .	43,899	89,283	330,068
Other . . . . .	119,961	10,566	901,962
	¥ 246,899	¥ 188,570	\$ 1,856,383

### 13. Bank borrowings and long-term debt

As is customary in Japan, in the case of unsecured bank borrowings, security must be given under certain conditions if requested by a lending bank, and such bank has the right to offset cash deposited with it against any debt or obligation that becomes due and, in the case of default and certain other specified events, against all debts payable to the bank. No such request has been made and no such right has been exercised.

Long-term debt at March 31, 2002 and 2001, consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2002	2001	2002
Bond payable in yen: 1.4% due 2005 .....	¥ 100,000	¥ 100,000	\$ 751,880
Convertible bond payable in yen, convertible into common stock at ¥3,035.90 per share 1.5% due 2002 .....	19,440	19,440	146,165
Convertible bond payable in yen, convertible into common stock at ¥2,367.00 per share 1.4% due 2003 .....	36,269	36,269	272,699
Convertible bond payable in yen, convertible into common stock at ¥1,094.00 per share 0.5% due 2006 .....	79,986	79,986	601,398
Bond with warrants: 1.37% due 2004 .....	8,400	8,400	63,158
Notes payable in yen issued by subsidiaries:			
Series of notes with various rates and maturities due 2002 .....	—	2,978	—
5.0% subordinated due 2005 .....	1,005	993	7,556
2.0% Euro-yen bond due 2002 .....	80,000	80,000	601,504
Medium-term notes in yen issued by subsidiaries with various rates and maturities through 2022 .....	205,404	77,600	1,544,391
Euro medium-term notes (authorized \$5,000 million) issued by subsidiaries with various rates and maturities through 2008 .....	24,322	34,574	182,872
Yen subordinated loan due 2004 .....	40,000	40,000	300,752
Borrowings from financial institutions .....	87,862	118,300	660,617
Other .....	156	299	1,173
	<u>¥ 682,844</u>	<u>¥ 598,839</u>	<u>\$ 5,134,165</u>

The conversion prices shown above are subject to adjustment in certain circumstances.

At March 31, 2002, the number of shares of common stock issuable upon full conversion of outstanding convertible bonds and exercise of warrants were 101,055 thousand shares in aggregate.

The aggregate annual maturities of long-term debt as of March 31, 2002 are as follows:

Year ending March 31	Millions of yen	Thousands of U.S. dollars
2003 .....	¥ 117,458	\$ 883,143
2004 .....	108,998	819,534
2005 .....	54,944	413,113
2006 .....	112,314	844,466
2007 .....	85,994	646,571
2008 and thereafter .....	203,136	1,527,338
	<u>¥ 682,844</u>	<u>\$ 5,134,165</u>

The Company and its consolidated subsidiaries have unused committed bank facilities amounting to ¥190,055 million (\$1,428,985 thousand) under agreements with several banks at March 31, 2002.

#### 14. Retirement benefits

On March 31, 2000, certain domestic consolidated subsidiaries canceled all their employees' retirement benefit plans, both unfunded and funded, and liquidated their plan assets in order to pay retirement benefit to entitled employees in the amount which would be required if they involuntarily terminated their employment as of the dates when the plan assets had been liquidated. Those subsidiaries recorded liquidation losses of employees' pension plans of ¥3,171 million for the year then ended (Note 23).

As explained in Note 2, effective April 1, 2000, the Company and most of its domestic consolidated subsidiaries adopted the Standard for Employees' Severance and Pension Benefits, under which allowance and expenses for severance and pension benefits are determined based on the amounts obtained by actuarial calculations.

Retirement benefits as of March 31, 2002 and 2001 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2002	2001	2002
Projected benefit obligation .....	¥ 19,696	¥ 16,635	\$ 148,091
Less: pension assets .....	(6,945)	(8,273)	(52,218)
Less: unrecognized actuarial differences .....	(1,494)	(838)	(11,233)
Retirement benefits .....	<u>¥ 11,257</u>	<u>¥ 7,524</u>	<u>\$ 84,640</u>

Included in the consolidated statements of operations for the years ended March 31, 2002 and 2001 are severance and pension benefit expense comprising of the following:

	Millions of yen		Thousands of U.S. dollars
	2002	2001	2002
Service costs . . . . .	¥ 4,018	¥ 5,099	\$ 30,211
Contribution to multiemployers' pension plan . . . . .	—	2,080	—
Interest cost on projected benefit obligation . . . . .	264	289	1,985
Expected return on plan assets . . . . .	(122)	(285)	(917)
Amortization of actuarial differences . . . . .	425	209	3,195
Other . . . . .	1,827	—	13,737
Net expenses for severance and pension benefits . . . . .	¥ 6,412	¥ 7,392	\$ 48,211

The discount rate and the rate of expected return on plan assets used by the Company for the year ended March 31, 2002 are 1.5-1.75% and 1.5-1.75%, respectively, and for the year ended March 31, 2001 are 1.5-3.0% and 1.5-3.0%, respectively. The estimated amount of all retirement benefits to be paid at the future retirement date is allocated equally to each service year using the estimated number of total service years. Actuarial differences are recognized as expenses using the straight-line method over 5 years from the current year.

**Directors** - Directors' retirement benefits of ¥1,593 million (\$11,977 thousand) and ¥1,889 million are included in "Retirement benefits" in the accompanying consolidated balance sheets as of March 31, 2002 and 2001, respectively.

**Multiemployers' pension plan** - The Company and its certain domestic consolidated subsidiaries were members of an industry-wide non-contributory welfare pension plan administered by the Securities Companies' Welfare Pension Fund, in conjunction with the contributory governmental welfare pension plan. The plan's fund had experienced a low rate of performance due to adverse conditions in Japan's fund management environment, including low interest rates and declining stock prices in the Japanese market. Management estimated, based on analysis of currently available information, the Company and its consolidated subsidiaries' portion of the difference between the projected future benefit obligation and the fair value of the plan assets had become material. Provision for the multiemployers' pension plan was charged to income for the year ended March 31, 2000.

On September 29, 2001, the Company and its certain domestic consolidated subsidiaries withdrew from this non-contributory welfare pension plan. The reversal of the multiemployers' pension plan, which is a deduction of actual obligation on withdrawal from the Securities Companies' Welfare Pension Fund from the provision for the multiemployers' pension plan, was reported in the consolidated statement of operations for the year ended March 31, 2002 (Note 23).

## 15. Income taxes

The normal effective statutory income tax rate in Japan arising out of the aggregation of corporate, enterprise and inhabitants taxes was approximately 42% for 2002, 2001 and 2000. Foreign subsidiaries are subject to income taxes of the countries in which they operate.

Details of deferred tax assets and liabilities at March 31, 2002 and 2001 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2002	2001	2002
<b>Deferred tax assets:</b>			
Net operating losses carry-forward . . . . .	¥ 128,942	¥ 71,909	\$ 969,489
Expenses for real estate business reorganization . . . . .	40,831	—	307,000
Write-off of goodwill . . . . .	36,775	52,585	276,504
Provision for the multiemployers' pension plan . . . . .	—	12,127	—
Other . . . . .	43,671	36,228	328,353
Gross deferred tax assets . . . . .	250,219	172,849	1,881,346
Less: Valuation allowance . . . . .	(158,698)	(78,840)	(1,193,218)
Total deferred tax assets . . . . .	91,521	94,009	688,128
<b>Deferred tax liabilities.</b> . . . .	12,452	16,880	93,624
<b>Net deferred tax assets</b> . . . . .	¥ 79,069	¥ 77,129	\$ 594,504

The Company and certain subsidiaries recorded a valuation allowance to reflect the estimated amount of deferred tax assets that will not be realized.

Reconciliation of the difference between the normal effective statutory income tax rate and the effective income tax rate for the year ended March 31, 2002 is not presented, since the net loss is reported in the consolidated statement of operations.

For the year ended March 31, 2001, there was no significant difference between the normal effective statutory tax rate and the effective income tax rate reflected in the accompanying consolidated statement of operations.

A reconciliation of the difference between the normal effective statutory tax rate and the effective income tax rate reflected in the accompanying consolidated statement of operations for the year ended March 31, 2000 was as follows:

	2000
Normal effective statutory tax rate . . . . .	42.0%
Valuation allowance for deferred income tax assets. . . . .	11.5
Lower tax rate applicable to income of foreign subsidiaries. . . . .	(2.0)
Other, net . . . . .	(5.4)
Effective income tax rate . . . . .	46.1%

## 16. Statutory reserves

The Securities and Exchange Law of Japan requires a securities company to set aside a reserve in proportion to its securities transactions and other related trading to cover possible customer losses incurred by default of the securities company on securities transactions.

Statutory reserves mainly represented a reserve for securities and financial futures transaction liabilities amounting to ¥2,932 million (\$22,045 thousand) and ¥1,975 million at March 31, 2002 and 2001 respectively.

## 17. Contingent liabilities and commitments

At March 31, 2002, the Company and its consolidated subsidiaries were contingently liable as guarantors of loans and lease deposits amounting to ¥4,914 million (\$36,947 thousand).

Undrawn amount of contractual commitments to extend credits made by the Company's subsidiary is ¥760 million (\$5,714 thousand) at March 31, 2002.

Additionally, the Company's subsidiary engaged in the business of credit card loan has commitments to extend credit for consumer loans in the amount of ¥9,768 million (\$73,444 thousand) at March 31, 2002. Commitments to extend credit arise from agreements to extend to customers' unused lines of credit on certain credit cards.

## 18. Shareholders' equity

The shareholders of the Company approved a stock incentive plan on June 25, 1998. The plan provides for the issuance of up to 6,000 thousand shares in the form of options to directors and key employees. On March 30, 1999, options were awarded to those who were with Daiwa Securities Co. Ltd. listed as the grantees at the time of the shareholders' meeting, and at the time of grants were either (1) Directors or (2) General Managers, Deputy General Managers or Assistant General Managers under the plan. The options may be exercised during the period from July 1, 2000 until June 20, 2003, and the exercise price is ¥667 (\$5).

The Company was authorized to issue 4,000,000 thousand shares of common stock and 100,000 thousand shares of preferred stock on approval of the shareholders' meeting held on June 25, 1998.

On June 26, 2002, the shareholders' meeting of the Company approved a change in the articles of incorporation to issue 4,000,000 thousand shares of common stock.

On the same day, the shareholders of the Company approved to repurchase its common stocks up to 50,000 thousand shares or ¥40,000 million (\$300,752 thousand) in order to implement flexible capital strategies according to business environment.

## 19. Capital adequacy requirements

In Japan, a securities company is subject to risk-based capital adequacy rules established and administered by the Financial Services Agency. Securities subsidiaries report their capital adequacy ratio as defined pursuant to these rules. The authorities will take certain administrative measures if such ratio declines below 140%. Capital adequacy ratios of Daiwa Securities Co. Ltd. were 328.0% (unaudited) and 251.3% (unaudited) for 2002 and 2001, respectively, and those of Daiwa Securities SMBC were 500.3% (unaudited) and 364.7% (unaudited) for 2002 and 2001, respectively.

## 20. Segment information

The Company and its consolidated subsidiaries operate predominantly in a single industry segment. The Company and its consolidated subsidiaries' primary business activities include (1) trading in securities, (2) brokerage of securities, (3) underwriting and distribution of securities and (4) other business related to securities transactions.

A summary of revenues by geographic area for the three years ended March 31, 2002 and a summary of total assets by geographic area at March 31, 2002 and 2001 were as follows:

	Millions of yen					
	Japan	America	Europe	Asia & Oceania	Elimination or unallocated	Consolidated
<b>Year ended March 31, 2002:</b>						
Net operating revenues:						
Outside customer . . . . .	¥ 240,542	¥ 16,434	¥ 23,023	¥ 4,933	¥ –	¥ 284,932
Inter-area . . . . .	9,724	648	1,530	763	(12,665)	–
Total . . . . .	250,266	17,082	24,553	5,696	(12,665)	284,932
Selling, general and administrative expenses . . . . .	226,435	15,109	19,502	6,267	(5,150)	262,163
Operating income (loss) . . . . .	¥ 23,831	¥ 1,973	¥ 5,051	¥ (571)	¥ (7,515)	¥ 22,769
<b>At March 31, 2002:</b>						
Total assets by geographic area . . . . .	¥ 5,560,406	¥ 1,757,738	¥ 661,297	¥ 72,098	¥ (224,233)	¥ 7,827,306
<b>Year ended March 31, 2001:</b>						
Net operating revenues:						
Outside customer . . . . .	¥ 409,546	¥ 26,653	¥ 21,054	¥ 6,804	¥ –	¥ 464,057
Inter-area . . . . .	15,411	(1,756)	(89)	(69)	(13,497)	–
Total . . . . .	424,957	24,897	20,965	6,735	(13,497)	464,057
Selling, general and administrative expenses . . . . .	254,172	13,741	16,173	5,670	(2,808)	286,948
Operating income . . . . .	¥ 170,785	¥ 11,156	¥ 4,792	¥ 1,065	¥ (10,689)	¥ 177,109
<b>At March 31, 2001:</b>						
Total assets by geographic area . . . . .	¥ 5,542,775	¥ 1,817,112	¥ 572,244	¥ 76,507	¥ (314,587)	¥ 7,694,051
<b>Year ended March 31, 2000:</b>						
Net operating revenues:						
Outside customer . . . . .	¥ 455,409	¥ 20,534	¥ 28,682	¥ 7,651	¥ –	¥ 512,276
Inter-area . . . . .	17,668	(2,198)	(2,162)	(656)	(12,652)	–
Total . . . . .	473,077	18,336	26,520	6,995	(12,652)	512,276
Selling, general and administrative expenses . . . . .	254,876	15,798	20,389	5,444	(9,009)	287,498
Operating income . . . . .	¥ 218,201	¥ 2,538	¥ 6,131	¥ 1,551	¥ (3,643)	¥ 224,778



## Thousands of U.S. dollars

**Year ended March 31, 2002:**

## Net operating revenues:

	Japan	America	Europe	Asia & Oceania	Elimination or unallocated	Consolidated
Outside customer .....	\$ 1,808,586	\$ 123,564	\$ 173,105	\$ 37,090	\$ –	\$ 2,142,345
Inter-area .....	73,113	4,872	11,504	5,737	(95,226)	–
Total .....	1,881,699	128,436	184,609	42,827	(95,226)	2,142,345
Selling, general and administrative expenses .....	1,702,519	113,601	146,632	47,120	(38,722)	1,971,150
Operating income (loss) .....	\$ 179,180	\$ 14,835	\$ 37,977	\$ (4,293)	\$ (56,504)	\$ 171,195

**At March 31, 2002:**

Total assets by geographic area .....	\$ 41,807,563	\$ 13,216,075	\$ 4,972,158	\$ 542,090	\$ (1,685,962)	\$ 58,851,924
---------------------------------------	---------------	---------------	--------------	------------	----------------	---------------

Geographic overseas revenues for the three years ended March 31, 2002 were as follows:

## Millions of yen

**Year ended March 31, 2002:**

	America	Europe	Asia & Oceania	Total
Overseas revenue .....	¥ 20,389	¥ 21,195	¥ 7,358	¥ 48,942
Total revenue .....				284,932
% of total revenue .....	7.2%	7.4%	2.6%	17.2%

**Year ended March 31, 2001:**

Overseas revenue .....	¥ 17,087	¥ 19,456	¥ 6,785	¥ 43,328
Total revenue .....				464,057
% of total revenue .....	3.7%	4.2%	1.4%	9.3%

**Year ended March 31, 2000:**

Overseas revenue .....	¥ 14,691	¥ 20,382	¥ 8,948	¥ 44,021
Total revenue .....				512,276
% of total revenue .....	2.9%	4.0%	1.7%	8.6%

## Thousands of U.S. dollars

**Year ended March 31, 2002:**

	America	Europe	Asia & Oceania	Total
Overseas revenue .....	\$ 153,304	\$ 159,360	\$ 55,325	\$ 367,989
Total revenue .....				2,142,345
% of total revenue .....	7.2%	7.4%	2.6%	17.2%

## 21. Commissions

Commissions derived from each department for the three years ended March 31, 2002 were as follows:

Millions of yen						
	Equity	Fixed Income (Bond)	Asset Management	Investment Banking	Others	Total
<b>Year ended March 31, 2002:</b>						
Brokerage . . . . .	¥ 58,280	¥ 1,229	¥ 244	¥ –	¥ –	¥ 59,753
Underwriting . . . . .	–	–	–	27,818	–	27,818
Distribution . . . . .	–	–	14,734	876	–	15,610
Other . . . . .	2,387	3,442	46,425	7,619	8,815	68,688
	¥ 60,667	¥ 4,671	¥ 61,403	¥ 36,313	¥ 8,815	¥ 171,869

<b>Year ended March 31, 2001:</b>						
Brokerage . . . . .	¥ 82,231	¥ 642	¥ 8	¥ –	¥ –	¥ 82,881
Underwriting . . . . .	–	–	–	38,859	–	38,859
Distribution . . . . .	–	–	37,510	2,099	–	39,609
Other . . . . .	2,620	3,084	70,421	7,137	10,093	93,355
	¥ 84,851	¥ 3,726	¥ 107,939	¥ 48,095	¥ 10,093	¥ 254,704

<b>Year ended March 31, 2000:</b>						
Brokerage . . . . .	¥ 145,968	¥ 1,488	¥ 7	¥ –	¥ 13	¥ 147,476
Underwriting . . . . .	–	–	–	34,887	–	34,887
Distribution . . . . .	–	–	86,764	1,439	–	88,203
Other . . . . .	2,876	3,395	70,431	7,218	9,630	93,550
	¥ 148,844	¥ 4,883	¥ 157,202	¥ 43,544	¥ 9,643	¥ 364,116

Thousands of U.S. dollars						
	Equity	Fixed Income (Bond)	Asset Management	Investment Banking	Others	Total
<b>Year ended March 31, 2002:</b>						
Brokerage . . . . .	\$ 438,195	\$ 9,241	\$ 1,835	\$ –	\$ –	\$ 449,271
Underwriting . . . . .	–	–	–	209,158	–	209,158
Distribution . . . . .	–	–	110,782	6,586	–	117,368
Other . . . . .	17,947	25,880	349,060	57,286	66,278	516,451
	\$ 456,142	\$ 35,121	\$ 461,677	\$ 273,030	\$ 66,278	\$ 1,292,248

## 22. Selling, general and administrative expenses

Major elements of selling, general and administrative expenses for the three years ended March 31, 2002 were summarized as follows:

	Millions of yen			Thousands of U.S. dollars
	2002	2001	2000	2002
Employees' compensation and benefits . . . . .	¥ 129,972	¥ 140,426	¥ 140,648	\$ 977,233
Commissions and brokerage . . . . .	16,176	20,785	9,816	121,624
Communications . . . . .	18,518	12,926	15,896	139,233
Occupancy and rental . . . . .	35,090	38,663	40,787	263,835
Data processing and office supplies . . . . .	16,474	17,367	20,874	123,865
Taxes other than income taxes . . . . .	5,328	7,554	7,312	40,060
Depreciation . . . . .	18,775	15,495	14,780	141,165
Other . . . . .	21,830	33,732	37,385	164,135
	¥ 262,163	¥ 286,948	¥ 287,498	\$ 1,971,150

## 23. Other income (expenses)

Details of "Other, net" in the consolidated statements of operations for the three years ended March 31, 2002 were as follows:

	Millions of yen			Thousands of U.S. dollars
	2002	2001	2000	2002
Gains on sales of investment securities . . . . .	¥ 4,103	¥ 2,004	¥ 16,755	\$ 30,850
Write-off of securities . . . . .	(26,615)	(4,750)	(4,104)	(200,113)
Valuation losses of investment securities . . . . .	–	–	(1,659)	–
Gains on change in stake in subsidiary . . . . .	4,068	–	–	30,586
Valuation losses related to fixed assets . . . . .	(247)	(227)	(2,489)	(1,857)
Losses on disposal and sale of fixed assets . . . . .	(1,991)	(2,751)	(6,693)	(14,970)
Losses on sale of loan receivables . . . . .	(128)	(1,519)	–	(962)
Expenses for liquidation of related companies . . . . .	–	–	(12,418)	–
Losses related to foundation of domestic subsidiaries . . . . .	–	–	(15,493)	–
Liquidation losses of employees' retirement plans (note 14) . . . . .	–	–	(3,171)	–
Reversal of (provision for) multiemployers' pension plans (note 14) . . . . .	13,692	–	(28,443)	102,946
Provision for doubtful accounts . . . . .	(4,517)	(2,942)	(30,603)	(33,962)
Expenses for real estate business reorganization . . . . .	(127,401)	–	–	(957,902)
Early retirement benefits . . . . .	(731)	–	–	(5,496)
Write-off of goodwill . . . . .	(5,000)	–	–	(37,594)
Equity in earnings (losses) of affiliated companies . . . . .	963	761	(551)	7,241
Other . . . . .	2,024	(76)	(539)	15,218
	¥ (141,780)	¥ (9,500)	¥ (89,408)	\$ (1,066,015)

Valuation losses related to fixed assets for 2002, 2001 and 2000 were derived from appraisal of the golf club membership certificates.

Losses related to foundation of domestic subsidiaries for 2000 consisted of write-off of goodwill of ¥8,000 million, non-deductible consumption taxes derived from goodwill of ¥4,359 million and expenses for starting costs of ¥3,134 million.

## 24. Subsequent events

***Appropriation of retained earnings*** - Under the Commercial Code of Japan, a plan for appropriation of retained earnings proposed by the Board of Directors must be approved at a shareholders' meeting to be held within three months after the end of the fiscal year. Cash dividends (¥6 (\$0.05) per share) amounting to ¥7,971 million (\$59,933 thousand) were approved by the shareholders' meeting held on June 26, 2002, as the appropriation of retained earnings for the year ended March 31, 2002.

## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

### To the Shareholders and the Board of Directors of Daiwa Securities Group Inc.:

We have audited the accompanying consolidated balance sheets of Daiwa Securities Group Inc. (formerly “Daiwa Securities Co. Ltd.”, a Japanese corporation) and subsidiaries as of March 31, 2002 and 2001, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended March 31, 2002, expressed in yen. Our audits were made in accordance with generally accepted auditing standards in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the consolidated financial position of Daiwa Securities Group Inc. and subsidiaries as of March 31, 2002 and 2001, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2002 in conformity with accounting principles generally accepted in Japan (Note1) applied on a consistent basis during the periods.

Also, in our opinion, the U.S. dollar amounts in the accompanying consolidated financial statements have been translated from yen on the basis set forth in Note 1.

*Asahi & Co.*

Tokyo, Japan

June 27, 2002



---

# Corporate Data

---

Daiwa Securities Group Inc.

## Head Office

6-4 Otemachi 2-chome  
Chiyoda-ku, Tokyo 100-8101  
Japan  
Tel: 81-3-3243-2100  
Telex: J22411

## Internet Home Page Address

<http://www.ir.daiwa.co.jp/>

## Commencement of Operations

May 1, 1902

## Date of Founding

December 27, 1943

## Shares of Common Stock

Authorized  
4,000,000 thousand shares  
Issued and Outstanding  
1,331,735 thousand shares (as of March 31, 2002)

## Number of Shareholders

96,931 (as of March 31, 2002)

## Independent Public Accountants

Asahi & Co.

## Stock Exchange Listings

Tokyo, Osaka, Nagoya, London, Paris, Frankfurt, Brussels

## Transfer Agent and Registrar

The Sumitomo Trust and Banking Company, Limited  
Stock Transfer Agency Department  
4-4 Marunouchi 1-chome  
Chiyoda-ku, Tokyo  
100-8233, Japan

For further information, please contact:

## Daiwa Securities Group Inc.

Investor Relations  
Tel: 81-3-3243-3841  
Fax: 81-3-3242-0955  
Email: [ir-section@dsgi.daiwa.co.jp](mailto:ir-section@dsgi.daiwa.co.jp)

This annual report has been printed on recycled paper

**OUR  
FIRST  
HUNDRED  
YEARS**



**OUR  
FIRST  
HUNDRED  
YEARS**

**Daiwa Securities Group**

[www.ir.daiwa.co.jp](http://www.ir.daiwa.co.jp)