CEO Letter:

To Our Shareholders, Customers, Employees and All Other Stakeholders

My Uncompromising Commitment to Continued Reform

-Yoshinari Hara, CEO

During the past few years, we at the Daiwa Securities Group have steadily strengthened our business foundations and management base by diversifying our revenue streams, reining in costs to lower our breakeven point, reducing non-current assets, and implementing broad-based groupwide reforms in conjunction with our medium-term management plan ended March 31, 2003. However, we are far from satisfied with our current level of earnings, and this dissatisfaction is spurring us onward to the next phase of reforms. Now is the time to shift our focus from quantitative expansion to quality-oriented growth. We will continue striving to establish the Daiwa Securities Group brand and realize sustainable growth by providing our customers with differentiated services, building investor confidence in the stability of our operations, and creating an outstanding company for which our employees will be proud to work. As CEO, I am committed to making the Group indispensable to all stakeholders.

What Reforms Are We Pursuing?

Reforms Must Be Drastic and Timely

To date, the Daiwa Securities Group has aggressively implemented a number of business and management reforms well ahead of other firms in the Japanese securities industry. These include the introduction of the country's first online trading (1996), the implementation of a stock option system (1997), and becoming the first holding company listed on the stock exchange (1999).

Efforts to Eliminate the Weakness Inherent in the Securities Business

There are several reasons behind our urgent implementation of sweeping reforms. For one, we are anxious to minimize the weakness inherent in the securities business, shifting instead to a focus on steady and sustainable growth. This weakness is the earnings instability that results from economic fluctuations. While there is some variation according to company and country, the earnings of all brokerage houses are subject to a veritable rollercoaster ride determined by trends in the stock and bond markets, which mirror economic trends. The leading U.S. brokers are no exception. Sustainable growth—which had become a virtual given—began to falter as the outlook for the U.S. economy grew increasingly uncertain, triggering the first stock market downturn in more than a decade. This quickly forced brokers to implement staff cuts, scale back operations, and even pull out of the market altogether.

Volatility Won't Inspire Confidence or a Sense of Wellbeing

Why is high volatility a negative? The answer is simple. A volatile entity lacks reliability and stability. No one is interested in dealing with a company that cannot inspire confidence and convey a sense of wellbeing. Investors cannot view such a company as a stable long-term investment, and will thus relegate it to a simple trading buy. Customers can hardly be expected to turn over their assets to a company whose earnings are unstable. Employees cannot be expected to give their all to a company whose performance and pay scales are in a constant state of flux. Conditions such as these can cause a company's most talented personnel to seek employment elsewhere, creating a negative cycle that further weakens the company. The Daiwa Securities Group is seeking to eliminate this weakness and attain stable and sustainable growth.

A Turtle's Pace Can Threaten a Company's Very Survival

Another reason we are rushing to implement major reforms is the accelerating pace of change. The economic cycle of the past has disintegrated and is being replaced by a new, unknown paradigm in which past experiences no longer apply. This evolution can be attributed to several factors, one of which is political instability. For better or for worse, the Cold War did offer a certain stability and restrict the pace of change. Equality between two superpowers created stability, and their sheer size made for a slowness in the pace of change that made the changes relatively easy to anticipate. Today, however, circumstances have altered significantly. As evidenced by 9.11, a growing number of events are sudden and unanticipated, and political instability is mounting. Internationalization and the IT revolution are also accelerating the pace of change. Since the Big Bang, the securities industry has been called upon to make sweeping changes in its business model in order to seize business opportunities created by Japan's recent move towards direct financing in both corporate restructuring and the shift of individual financial assets from bank deposits into risk financial products.

In an era such as this, rigid adherence to past customs, businesses, and regional characteristics would be an egregious error. It is also futile to hope that past cycles will repeat themselves. Despite its inherent weaknesses, the securities industry has continued to exist thanks to the repetition of the economic cycle. It now looks likely that the current economic downtrend will last longer than ever before. Without change aimed at improving corporate quality, we can no longer be sure that any company will continue to exist. Herein lies our greatest motivation for pursuing rapid and wide-ranging reform.

Assessing Past Reforms

Results Have Been Mixed

In this section, we take an objective look at the reforms we have implemented based on the philosophy and strong convictions outlined above. Concerning our latest medium-term management plan, which covered the three years to FY 2002, I can say that we took successful steps toward our goal of achieving sustainable growth. However, we were unable to realize our targets in absolute terms.

Expansion of the Investment Banking Business to Stabilize Earnings Was Successful

One successful effort to attain sustainable growth was the expansion of our investment banking business. "New businesses" aimed at diversifying our revenue streams experienced particularly strong growth. These new businesses can be grouped into four categories: M&A, structured finance, derivatives, and principal finance. In FY 2002, the percentage of consolidated net operating revenues derived from these new businesses jumped to more than 9% from just 3.5% in FY 1999. Operating revenues from M&A activities have seen particularly robust growth, expanding 3.5-fold over the three years to FY 2002.

In other areas as well, the Daiwa Securities Group has seen a steady increase in its presence in the investment banking business. In the FY 2002 lead manager league tables (rankings based on pricing dates), we ranked No. 1 in three categories: domestic corporate straight bonds, initial public offerings (IPOs), and domestic public ABS (bookrunner). We also took the No. 2 position in public equity offerings and Samurai bonds (yen-denominated bonds issued by non-Japanese issuers). In these two categories, our market share has increased markedly compared with three years earlier. Specifically, our share of equity offerings rose to 16.4% from 6.9%, while our share of Samurai bonds jumped to 16.4% from 2.6%. We attribute this success to the fact that in 1999, we became the first company in the industry to move to a holding company structure while spinning off our wholesale securities business to form a joint-venture with the Sumitomo Mitsui Financial Group. This strategy is now bearing fruit.

Making Progress in Our Efforts to Revamp the Cost Structure; Non-current Assets Steadily Shrinking

In FY 2002, our consolidated SG&A expenses shrank to ¥246.7 billion from ¥287.4 billion in FY 1999, declining 14% over the three-year period. We accomplished this by reducing personnel costs, overhead, and other expenses and/or converting them to variable costs, and by restricting increases in depreciation expenses by streamlining investment in computer systems. We attribute these results to our efforts to lower our breakeven point by revamping our cost structure and to move away from an inherently weak business structure. In short, while the macroeconomic environment turned out to be significantly worse than we expected, we were able to handle this by altering our course.

We have also been able to boost financial efficiency by reducing non-current assets. Most notably, we have slashed real estate and other tangible fixed assets by 50% over the three-year period and cut investment securities including cross-shareholdings by 2%. The reduction in tangible fixed assets resulted mainly due to our decision to withdraw from the non-group real estate leasing business. The reduction in investment securities may appear small; however, this was due to the fact that changes in the rules regarding the management of money management funds

(MMF) issued by The Investment Trusts Association, Japan prompted Daiwa Asset Management Co. Ltd. (DAM), one of the Group's main companies, to purchase bank subordinated debt of approximately ¥140 billion from its MMF portfolio. Excluding this impact, the balance of investment securities shrank some 34%.

We are Making Progress but Still Have a Long Way to Go

The previous Group medium-term management plan, which was formulated in March 2000, set three targets to be reached by FY 2002: (1) achieve a consolidated ROE of 15%; (2) double retail client assets under custody (to ¥28.3 trillion); and (3) achieve a credit rating of single-A or better from the leading domestic and foreign credit rating agencies (for our two securities subsidiaries). As will be discussed in detail in Special Feature I (from page 15) of this annual report, we fell considerably short of all three of these goals. We attribute this to several factors. For example, the macroeconomic environment was far weaker than we anticipated. Specifically, we assumed that real GDP would grow an average of 2.5% per annum, while it actually grew only 1.2%. We also assumed that the TOPIX index would rise an average of 13% per annum; instead, it declined 14%.

However, we do not blame our inability to reach these goals on the macroeconomic environment alone; indeed, we believe much of the responsibility lies in our own inadequate efforts. We think there was considerable room for improvement in our marketing and product development efforts. In FY 2002, our trading gains jumped 48% to ¥93.9 billion, a sharp improvement over FY 2001. However, this figure was still well below the more than ¥165.6 billion in trading gains recorded in FY 2000. In addition to further increasing our trading gains, we must also work to (1) revitalize our languishing asset management operations, (2) redouble our efforts to develop a customer base of mid-sized corporations and individual investors with high net worth; and (3) enhance the post-sale follow up for retail customers.

Assessment of the FY 2002 Results

In FY 2002, we managed to hold the decline in consolidated net operating revenues to 5% despite an approximately 10% drop in the average daily trading value on the Tokyo Stock Exchange. Moreover, we achieved a 13% increase in ordinary income. The Group's mainstay securities business staged a dramatic rebound, as evidenced by the fact that Daiwa Securities Co. Ltd. (retail subsidiary) and Daiwa Securities SMBC Co. Ltd. (wholesale subsidiary) attained a 5.3-fold jump in ordinary income. (Note: The results of Daiwa Securities SMBC include the performance of its subsidiary Daiwa Securities SMBC Principal Investments.) This performance indicates that we are making steady progress with our efforts to strengthen our earnings foundation through reforms, particularly given that in FY 1997, when consolidated net operating income was roughly the same as in FY 2002, we incurred a consolidated ordinary loss of more than ¥13.1 billion. Nevertheless, the current level of earnings is still extremely low, and we are by no means satisfied with this result.

In FY 2002, we incurred a ¥6.3 billion net loss despite achieving consolidated ordinary income of ¥29.2 billion. This was primarily due to (1) a ¥4.1 billion addition to the account for doubtful debts made to increase the balance sheet transparency of our venture capital business, and (2) a ¥19.7 billion write-down of investment securities resulting from the stock market slump.

Future Reforms

Difficult Circumstances Offer Opportunities for Growth

The Daiwa Securities Group will continue to forge ahead in the coming years, stepping up the pace of change as we strive to stay in step with the rapidly evolving business climate. For the time being, at least, we expect Japan's economic growth to remain sluggish while deflationary pressures continues to intensify. However, we anticipate that even this difficult environment will offer unique opportunities for growth. If interest rates remain low, we have every expectation that both individual and corporate asset management needs for risk products will certainly rise, as evidenced by the fact that our sales of foreign currency-denominated bonds nearly doubled in FY 2002.

Japan's individual financial assets, which amount to slightly less than ¥1,400 trillion, have remained in ultra-low interest risk free products, rather than flowing into risk financial products, largely because (1) products and services lack sufficient appeal and (2) there is inadequate transparency with respect to business management and financial situation of securities companies. In short, we believe that individual financial assets remain stalled in ultra-low return financial products primarily due to our own inadequate efforts to offer attractive alternatives. The prolonged slump in the Japanese stock market has finally convinced the government to take steps to revive the market through deregulation. The protracted economic downturn has left the banks no choice but to accelerate writing-off of their bad debts. In the corporate world as well, the need for reorganization can only increase. These circumstances will inevitably create new business opportunities for the securities industry, and it is essential that we implement reforms rapidly and effectively if we hope to become a winner in this new business arena.

Call for Stepped-Up Efforts to Establish the Daiwa Securities Group Brand: Quality and Productivity Are Essential

As customer needs continue to diversify and competition intensifies, it is essential that we become a company that is chosen by those customers. In order for this to happen, we must develop products and services that set us apart from the competition. Moreover, in order for our customers to deal with us confidently, we must improve corporate governance and practice timely disclosure . In essence, it is crucial that we strengthen the Daiwa Securities Group "Brand." To this end, we have established a new medium-term management plan that reflects the hard lessons we learned through our previous plan. Dubbed "Best Brand Daiwa 2005," the new medium-term management plan spans the three years from FY2003 to FY2005 and focuses on two main goals: (1) to achieve superlative quality in every area of our operations and (2) to attain an equally high level of productivity. We believe that quality is at the heart of our ability to differentiate ourselves from our competitors and will thus become the identifying feature of the Daiwa Securities Group brand. Furthermore, the severity of the prevailing business environment means that we must provide high-quality products and services in a timely manner with limited human resources. For this reason, we must also strive to achieve top-notch productivity.

Learning from Past Lessons while Progressing Our Policies and Philosophy

Our new medium-term management plan has five key goals: (1) to strengthen the marketing structure for our retail business, (2) to supply high-value-added products and services that will enable us to boost trading gains, (3) to increase our presence

in businesses stemming from corporate restructuring in Japan, (4) to revamp our personnel management system, and (5) to enhance corporate governance. The first two of these goals are directed at resolving inadequacies that prevented us from realizing the goals laid out in our previous medium-term management plan. The third goal, on the other hand, builds on successes achieved through the previous management plan. The fourth and fifth goals will help further our long-standing commitment to value human resources and improving business transparency. We believe that all five of these goals are an essential part of our efforts to differentiate ourselves by establishing the Daiwa Securities Group brand.

In Special Feature II (from page 23), we outline the action plan that we have devised to realize these goals. The plan consists of a three-pronged approach focusing on (1) framework improvements (marketing and management frameworks), (2) evaluation improvements (personnel evaluations), and (3) the strengthening of intra-group relationships. Although we have not included it in the action plan's primary goals, we will naturally be improving cost management with an eye to changes in the macro environment. In addition, we will continue our efforts to lower our breakeven point by promoting a shift to variable costs, particularly in our retail business. In sum, over the next three years, the Daiwa Securities Group aims to implement a new strategy focusing on qualitative rather than quantitative growth.

To All Our Stakeholders

Impetus for Growth Must Come from Within

We aim to achieve sustainable growth by carrying out reforms that will strengthen the growth factors that lie within our control. Specifically, this will include efforts to further diversify revenue streams, enhance competitiveness by differentiating products and services, implement structural reforms and strengthen internal control in order to improve our credibility.

Our Goal Is to Achieve Growth by Building Credibility and Increasing Attractiveness

In the years to come, we will strive to achieve these goals, abandoning past practices and business models in favor of a new value system of our own creation. Our ultimate goal is to make the Daiwa Securities Group an indispensable presence to all of our stakeholders.

(1) To Our Shareholders and Investors

In order to inspire confidence in our company as a long-term investment, the Daiwa Securities Group will promote earnings stability and sustainable growth. We aim to stay one step ahead of the competition by enhancing the transparency of our operations and taking a proactive and timely approach to disclosure.

We will return the fruits of our success, taking into consideration the best combination of (1) dividend payout and (2) retained earnings and investments that promise long-term growth.

(2) To Our Customers

The Daiwa Securities Group aims to rapidly grasp customer needs and develop unique and profitable products and services in areas such as asset management and corporate restructuring. To enable customers to entrust their assets to us with confidence, we will take the lead in strengthening our management organization and undertaking timely disclosure.

Rather than continuing to emphasize our traditional focus, which was simply selling products, we plan to add value to our business through product design and post-sales follow up.

(3) To Our Employees

The Daiwa Securities Group will strive to create a company environment that enables employees to maximize their abilities by stabilizing operations and refining and clarifying our employee evaluation system. “Number one in quality” also refers to our desire to become a company that our employees can be proud to be a part of.

Under the new personnel evaluation system, our employees will be able to concentrate their energies on improving quality, as laid out in the medium-term management plan. If achieving these targets does not serve to improve our performance, the strategy, not the employees, will be at fault, and management stands ready to take final responsibility.

In sum, the Daiwa Securities Group will endeavor to achieve sustainable growth by winning the confidence of and providing a sense of wellbeing to all its stakeholders.

July 2003

Y. Hara

Yoshinari Hara

President and CEO
Daiwa Securities Group Inc.