Management's Discussion & Analysis

Analysis of FY 2002 Earnings

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The Management's Discussion & Analysis is based on information from the Groups' Securities Report submitted to the Japanese authorities

Summary

- Economic conditions remained difficult in Japan and overseas in FY 2002, contributing to lackluster results for the Daiwa Securities Group. However, investment banking businesses as well as sales of foreign currency-denominated bonds and pension insurance products grew strongly.
- As a result of tighter cost controls, ordinary income rose 13% from FY 2001.
- Due to extraordinary losses including the write-down of investment securities, the Group posted a consolidated net loss of ¥6.3 billion. However, this was substantially smaller than the ¥130.5 billion net loss posted in FY 2001 stemming from the cost of restructuring real estate operations.
- The Group's financial strategy is bearing some fruit. During the term, non-current assets were reduced by ¥130.0 billion, mainly by trimming real estate and subordinated bank debt, while external debt was reduced by ¥55.0 billion.

Macroeconomic Conditions

1. Japan

Strong Deflationary Pressures Persist

Real GDP growth in Japan turned positive in FY 2002 (ended March 31, 2003), improving from -1.2% in FY 2001 to an annualized growth of 1.5%. However, despite continued monetary easing by the Bank of Japan, there has been no letup in deflationary pressures, and growth in nominal GDP, which is closely tied to business sentiment, failed to turn positive and declined 0.7% from the previous fiscal year. In summary, economic conditions during FY 2002 were still a long way from recovery.

Weak Domestic Demand

Domestic demand remained sluggish in FY 2002. With priority being given to fiscal recovery programs, public spending continued to decline, falling 6.2% from FY 2001. Two areas of private sector demand that were expected to replace public spending as a driver of growth, namely capital investments and consumer spending, posted only modest growth.

The slow pace of structural reform and deregulation is one reason why we are not seeing a domestic demand-led economic recovery.

Sole Driver of Growth Heads South

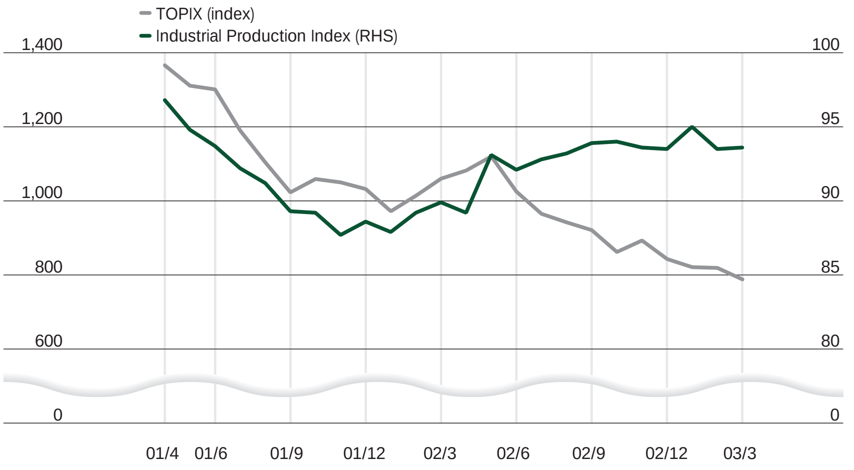
In the first half of FY 2002, industrial production continued to gain momentum, driven by export demand. Although exports to Asia remained strong, conditions changed in the second half of the year as economic growth in the United States slowed. As a result, industrial production in Japan turned to quarter-on-quarter declines from the third quarter.

Share Prices Continue to Decline Despite an Upturn in Corporate Earnings

On an all-industry basis, corporate recurring profits have been growing more than 20% over the previous year since the second quarter of FY 2002. This represents a marked recovery in business performance. The major factors behind this recovery, however, are restructuring and cost cutting measures, and growth in sales remains modest. Reacting to the uncertain outlook, share prices have declined steadily from the second quarter of FY 2002 and the TOPIX average over the fiscal year dropped 18% from FY 2001.

Despite active cross-transactions in the October-December quarter of 2002 ahead of securities tax changes, the average daily trading value on the 1st section of the Tokyo Stock Exchange (TSE) fell 10% year over year.

Industrial Production and the TOPIX index



2. Overseas

United States: Uncertainty Lingers

While the U.S. economy showed annualized real GDP growth of 4% in the July-September quarter of 2002, this has slowed to the 1% level after the third quarter. Personal consumption was underpinned by the Fed's aggressive reduction of interest rates, but business sentiment in the manufacturing sector turned downward.

Geopolitical risk has eased somewhat with the conclusion of the war in Iraq, but there are still no signs of a recovery in business sentiment. If companies are forced to continue carrying out production cuts and restructuring over a long period, there is the danger that consumption, which accounts for a large portion of GDP, could fall and this could lead to even more precarious conditions for the economy. Amid this uncertain outlook, the Dow Jones Industrial Average fell 14% and the NASDAQ index dropped 26% compared with FY 2001.

Europe: Clear Economic Downtrend

Europe saw a marked economic slowdown in FY 2002. With the strength of the euro causing exports to soften and employment continuing to deteriorate in the eurozone, growth in real GDP fell to zero from the October-December quarter of 2002. Germany's Ifo index of business sentiment has deteriorated sharply and real GDP growth turned negative in the October-December quarter of 2002. The United Kingdom's FTSE 100 index fell 22% from FY 2001, while Germany's DAX was down 35%.

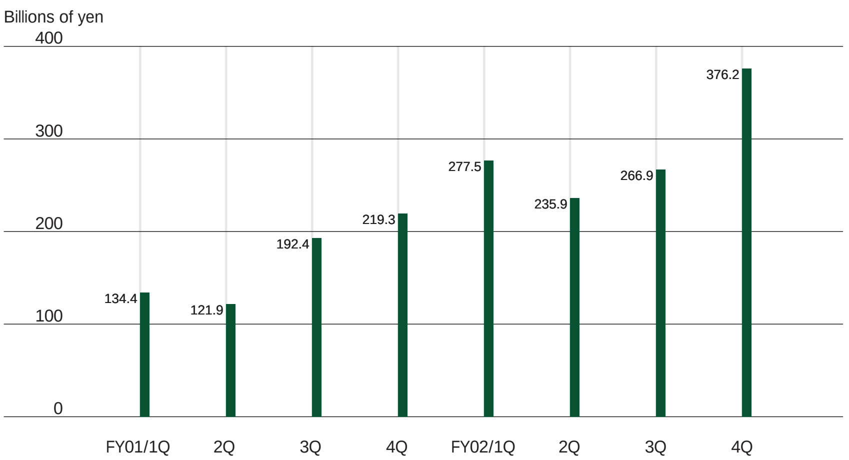
Asia: Still Strong, but Dark Clouds Loom Ahead

The economies of Asia continued to enjoy firm overall growth in FY 2002. However, because these countries are even more dependent on exports than Japan, the economic outlook there could worsen depending upon economic conditions in North America and Europe. In Korea, slowdown in personal consumption became evident in the second half of the year, leading to the government easing monetary policy in May 2003.

Breakdown of Commission Income

	Millions of yen						
	FY2002	FY2001	% YoY	FY2002/1Q	2Q	3Q	4Q
Equity	47,242	60,667	-22%	15,808	10,906	12,394	8,134
Bond	4,585	4,671	-2%	871	1,092	867	1,755
Investment trust	40,870	61,403	-33%	12,249	10,932	8,810	8,879
Investment banking	39,638	36,313	9%	7,425	10,814	9,459	11,940
Others	11,948	8,815	36%	2,637	3,763	2,950	2,598
Total	144,283	171,869	-16%	38,990	37,507	34,480	33,306

Foreign Currency-denominated Bond Sales at Daiwa Securities



Commissions

The average daily trading value on the TSE decreased 10% from FY 2001 and the Daiwa Securities Group posted a 5% decline in consolidated net operating revenues. Looking at commissions by businesses, equities were down 22%, while investment trust was down 33%. Declines in these commissions were due to the impact of lower share prices and the protracted period of near-zero interest rates. Fixed income commissions fared better, registering just a 2% decline, while investment banking commissions grew 9%. Other commissions, including those on pension insurance product sales, soared 36%.

Significant Decline in Assets under Management and Strong Sales of Foreign Currency-denominated Bonds

The sharp declines in equity and investment trust commissions can be attributed largely to external factors, including the protracted slump in the stock market and an extended period of near-zero interest rates. In the asset management businesses, lower sales commission income was accompanied by a sharp decrease in investment trust fees, which resulted from declines in assets under management and lower management fee rates. At the end of FY 2002, assets under management at Daiwa Asset Management Co., Ltd. (DAM) were down 20% from the previous fiscal year. Amid this environment, the Daiwa Securities Group increased sales of foreign currency-denominated bonds for which high yields could be expected. As a result, Daiwa Securities Co., Ltd. (Daiwa Securities), the retail entity of the Group, saw a 73% increase in sales of foreign currency-denominated bonds.

M&A and Other New Investment Banking Businesses Grow

Growth in investment banking commission income was driven by M&A and other new businesses targeted under the

Daiwa Securities Group's strategy to diversify and expand its revenue stream. Of total investment banking commissions, other commissions, which came mainly from new businesses, surged 45% from the previous fiscal year. Of this, M&A-related commissions at Daiwa Securities SMBC Co., Ltd. (Daiwa Securities SMBC) jumped from ¥3.3 billion in FY 2001 to ¥6.9 billion in FY 2002. Although not as high as growth in other commissions, underwriting commissions related to equities and bonds increased nearly 5% from the previous fiscal year. Despite continued stagnation in the market for initial public offerings (IPOs) throughout the fiscal year, Daiwa Securities SMBC successfully raised its market share. In addition, Daiwa Securities SMBC's aggressive approach in the equity capital market, as well as an increase in bond underwriting, also contributed to the expansion of underwriting commissions.

Strong Growth in Pension Insurance Commissions

Other commissions increased 36% to ¥11.9 billion as sales of Pension insurance products, which were started in FY 2001, rose significantly.

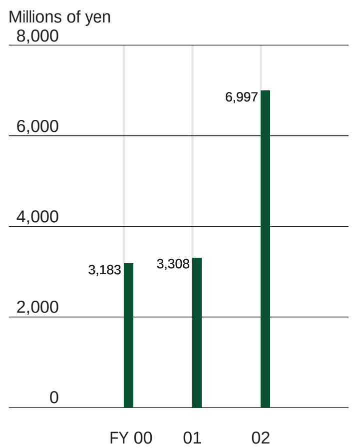
Improvement in Net Trading Gains/Losses

Total net trading gains rose 48% from FY 2001. On a quarterly basis, gains were consistently in the range of ¥18.0 billion to ¥25.0 billion each quarter. This was a dramatic improvement from FY 2001 in terms of stability. A loss of nearly ¥10.0 billion was made on stock trading in the fourth quarter, but gains on bond and forex trading amounted to more than ¥35.0 billion. The main reason for this situation was technical in nature. Due to swap and hedging transactions carried out in the creation of structured bonds, ¥8 billion "losses" were booked as equity trading losses and and the same amount of "gains" were

Breakdown of Investment Banking Commissions

	Millions of yen		
	FY2002	FY2001	% YoY
Underwriting commission (Equity)	18,093	17,112	6%
Underwriting commission (Bond)	9,523	9,070	5%
Distribution commission	608	876	-31%
Others (M&A commissions etc)	11,084	7,619	45%
Total	39,638	36,313	9%

M&A-related Revenues



Daiwa Securities SMBC's Performance in Lead Manager League Tables

	Corporate SB	IPOs	Primary and secondary equity offerings	Samurai bonds	Domestic Public ABS
1	Daiwa Securities SMBC 22.7%	Daiwa Securities SMBC 50.2%	Nomura 58.4%	NSSB 31.8%	Daiwa Securities SMBC 19.6%
2	Nomura 22.0%	Nomura 13.3%	Daiwa Securities SMBC 16.4%	Daiwa Securities SMBC 16.4%	Mizuho 19.4%
3	Mitsubishi 13.6%	NSSB 8.1%	NSSB 9.0%	Mitsubishi =Morgan Stanley 16.3%	Nomura 15.4%

NSSB is now Nikko Citigroup

Source : Daiwa Securities SMBC, THOMSON DealWatch for ABS table (bookrunner)
Nikkei Bonds & Financial Weekly (April 7, 2003) for corporate SB

Note : Issues with pricing dates between 4/02 and 3/03 booked as fixed income and forex trading gains. Even excluding this effect, however, bond and forex trading gains showed a significant growth thanks to strong sales of foreign currency-denominated bonds and structured bonds.

Proactive Cost Cutting

Selling, general and administrative (SG&A) expenses decreased ¥15.5 billion, or 6%, from the previous fiscal year. Of this ¥15.5 billion, ¥6.0 billion each can be attributed to declines in commission and other expenses and personnel costs.

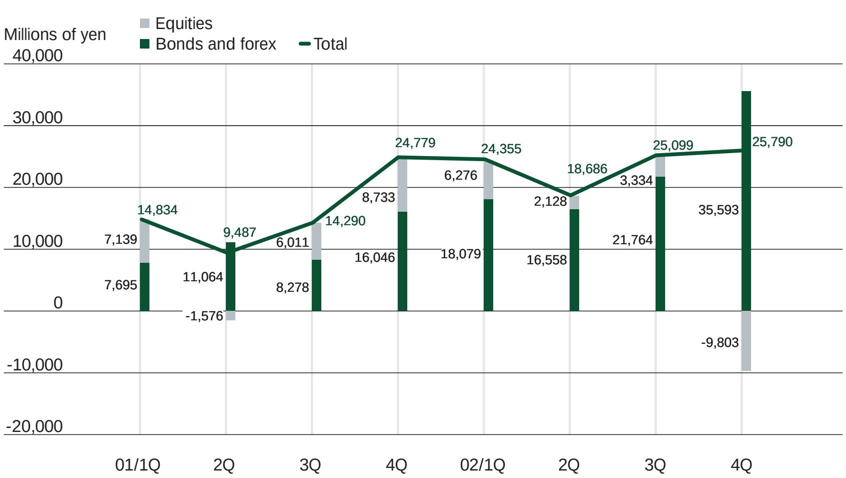
The reduction in SG&A expenses stemmed from the following two factors: First, we cut expenses in response to the unfavorable operating conditions. Second, over the past few years we have made efforts to convert fixed costs into variable costs to increase sensitivity of our expenses to revenue. As a result, fixed costs fell from nearly ¥40.0 billion in the first quarter of FY 2001 to approximately ¥36.0 billion in the fourth quarter of FY 2002. Over the same period, variable costs decreased from approximately ¥24.0 billion to ¥19.0 billion.

Ordinary Income Up 13%, but the Group Posted a Net Loss on Falling Stock Prices and Restructuring Costs

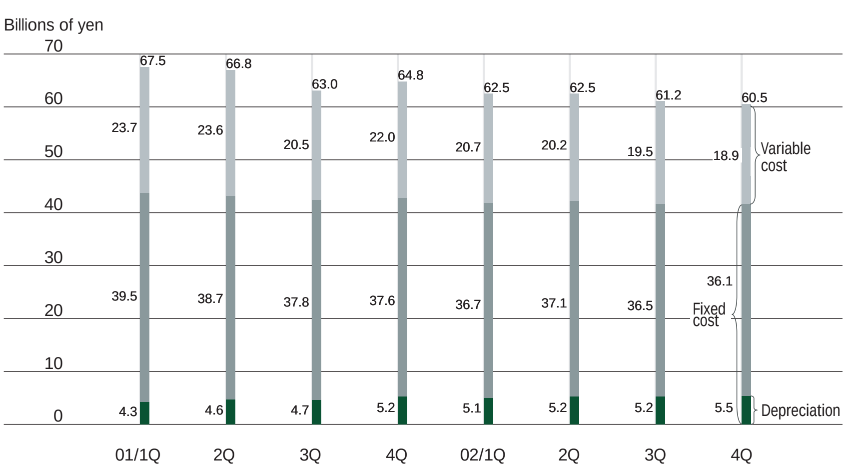
In FY 2002, operating income rose 6% to ¥24.1 billion and ordinary income increased 13% to ¥29.2 billion. At the bottom line, however, the Daiwa Securities Group posted another net loss totaling ¥6.3 billion. Continuing disposals of leased real estate and the unwinding of cross-shareholdings led to extraordinary gains of ¥15.5 billion. On the other hand, extraordinary losses of ¥32.9 billion were recorded owing chiefly to the following three factors: First, we wrote down ¥19.7 billion of securities. Of this amount, ¥12.0 billion came from banking sector stocks. Second, ¥4.5 billion in losses were recorded from the sale or disposal of fixed assets. Third, we provisioned ¥4.1 billion for doubtful accounts.

The FY 2002 results also included the ¥3.2 billion negative impact from factors including ¥2.2 billion from an increase in adjustments to corporate taxes in connection with the introduction of Pro Forma Standard Taxation and ¥1.0 billion from a rise in SG&A expenses resulting from changes in the social insurance system.

Net Trading Gains/Losses



SG&A Expenses by Fixed and Variable Costs



<Variable cost> Commission and other expenses, personnel costs such as bonuses and costs for hiring part time workers.

<Fixed cost> Personnel costs such as wages and fringe benefits, real estate expenses, depreciation, tax other than income taxes

Overseas Performance Deteriorated Significantly

By region, operating income in Japan rose slightly while Asia and Oceania turned from a ¥0.5 billion loss in FY 2001 to a slight profit. In the U.S., however, operating income turned from a gain of ¥1.9 billion last year to a ¥3.4 billion loss in FY 2002, while operating income in Europe fell from ¥5.0 billion last year to ¥3.3 billion. The net result was a significant deterioration in the overall performance of our overseas operations. As mentioned in the discussion of macroeconomic conditions above, the decline in operating income in Europe was chiefly attributable to the decline in net interest income and a worsening business sentiment. In the U.S., the declines are mainly technical in that the principal finance operations were transferred from the U.S. to Japan with the establishment of Daiwa Securities SMBC Principal Investments in October 2001.

Geographical Segment Information (FY 2001 and FY 2002)

	Millions of yen					
	Japan	America	Europe	Asia & Oceania	Elimination or unallocated	Consolidated
FY 2001						
Net operating revenues	250,266	17,082	24,553	5,696	-12,665	284,932
Operating income (loss)	23,831	1,973	5,051	(571)	-7,515	22,769
FY 2002						
Net operating revenues	239,719	7,677	23,331	5,862	-5,779	270,810
Operating income (loss)	24,054	(3,404)	3,386	67	6	24,109

Balance Sheet and Cash Flow Analysis

Balance Sheet

Total assets rose ¥1.67 trillion from FY 2001 to ¥9.50 trillion. Current assets increased ¥1.80 trillion from the previous year while non-current assets decreased by ¥129.7 billion, or 17%. Most of the increase in current assets stemmed from growth in trading assets, while the decrease in fixed assets was mainly attributable to declines in tangible fixed assets and investment securities. In connection with the decision to withdraw from real estate leasing for non-group companies made in FY 2001, the Group continued to sell real estate properties related to this business. The cumulative amount of real estate disposed by the end of FY 2002 was approximately ¥32.0 billion. Thus approximately 90% of intended disposals has been completed. Investment securities decreased ¥95.8 billion due mainly to disposals of subordinated bank debt totaling ¥70.0 billion (face value), disposal of cross-shareholding positions securities, and the write-down of investment securities.

On the liability side, external debt decreased ¥55.0 billion while payables on collateralized financing transactions increased ¥1.89 trillion. Total stockholders' equity decreased ¥29.1 billion to ¥541.7 billion, partly as a result of the net loss for the year. The stockholders' equity ratio fell to 5.7% from 7.3% in FY 2001.

Cash Flow

Cash flow from operating activities turned to an inflow of ¥369.7 billion from an outflow of ¥865.1 billion in FY 2001. The Group posted a net loss of ¥6.3 billion, but the reasons for the loss included items for which there was no physical cash outflow, such as write-down of investment securities, and a net increase in trading assets. Factors on the liabilities side include the increase in payables on collateralized financing transactions. Cash flows from investing activities turned to an inflow of ¥67.9 billion from an outflow of ¥117.1 billion in FY 2001. This was largely due to decreases in tangible fixed assets in connection with the restructuring of real estate operations and the sale of investment securities. As a result of the above, free cash flow totaled ¥437.7 billion. There was a net outflow of cash from financing activities of ¥447.3 billion as a result of reducing external debt.

Risk Management

Market conditions in FY 2002 were marked by weakness in the stock market and a continuing of low interest rates. As a result, there were few opportunities to take aggressive risk, and even for Daiwa Securities SMBC, which due to its operations bears the bulk of the risks inherent in the Group, value at risk (VAR) remained at a low level as shown below.

Value at Risk for Daiwa Securities SMBC

＜Range and assumption of VaR＞

● Confidence level: 99% ● Holding period: 1 day ● Adjusted for price correlation between products

(month end)	Billions of yen								
	2001/3	2001/6	2001/9	2001/12	2002/3	2002/6	2002/9	2002/12	2003/3
Equity	2.68	1.08	2.01	1.13	1.06	1.23	0.74	0.42	0.63
Interest	0.88	0.49	0.65	0.61	0.19	0.46	0.36	0.30	0.58
Currency	0.02	0.04	0.02	0.04	0.02	0.04	0.03	0.02	0.02
Total	3.58	1.61	2.68	1.77	1.27	1.73	1.13	0.74	1.23
Diversification benefit	-0.57	-0.40	-0.53	-0.38	-0.19	-0.36	-0.29	-0.19	-0.46
VaR	3.01	1.21	2.15	1.39	1.08	1.37	0.84	0.55	0.77

・FY 2001 high: ¥3.38 billion, low: ¥0.59 billion, average: ¥1.49 billion.

・FY 2002 high: ¥1.70 billion, low: ¥0.51 billion, average: ¥0.96 billion