Management's Discussion and Analysis

Analysis of FY 2003 Earnings

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Macroeconomic Conditions

1. Japan

Hints of domestic economic recovery, which first became apparent in FY 2002, evolved into dramatic progress in FY 2003. Growth in domestic GDP —both in real and nominal terms—accelerated amid partial easing of deflationary pressures. Despite the yen's appreciation against the U.S. dollar relative to FY 2002, exports remained firm in the current economic recovery phase, supported by healthy economic performances in Asia. Moreover, domestic demand, which had long been languishing, showed clear signs of a turnaround, representing a major highlight of the year. Private-sector capital investments posted double-digit growth in the latter half of the period, leading to a revival in domestic plant construction. In the fourth quarter of FY 2003, all these factors finally made a positive impact on personal consumption, which has a big influence on GDP. Stock markets also recovered strongly, with the Nikkei Average up 47% year-on-year, and the average daily trading value on the First Section of the Tokyo Stock Exchange up 57%.

2. Overseas

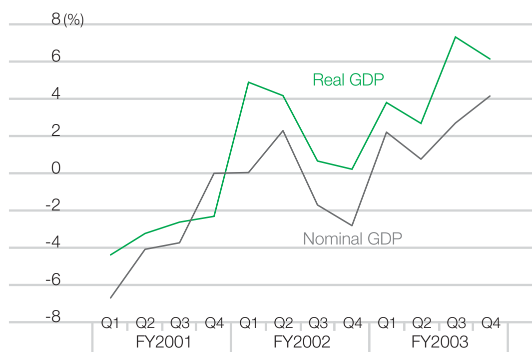
The United States:

Despite uncertainty caused by terrorism and an expanding fiscal deficit, the U.S. economy continued to gather momentum, with real GDP growing 0.5% in calendar 2001, 2.2% in 2002, and 3.1% in 2003. Tax cuts helped spur housing investments and underpin personal consumption. For FY 2003, the Dow Jones Industrial Average rose 30%, and the NASDAQ index jumped 49%.

Europe:

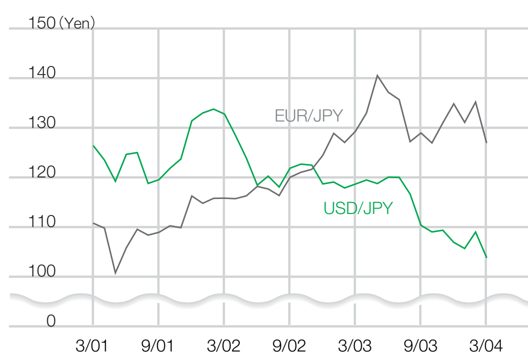
Although the European economy is also in a recovery phase, the pace of recovery has been slow compared with the United States, Japan, and the rest of Asia. Personal consumption continued to languish against the backdrop of corporate restructuring, especially in Germany. In short, the current European economy continued showing little consistency, due partially to the Euro's appreci-

GDP (Annualized Quarter-on-quarter Changes)



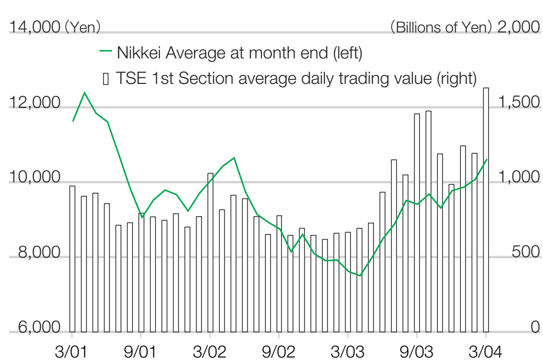
Source: Cabinet Office, Government of Japan

Foreign Exchange Rates



Source: Bloomberg

Nikkei Average and Trading Value



Source: Bloomberg, Tokyo Stock Exchange

ation, although few are predicting that the economy will slip into recession.

Asia:
In Hong Kong, Taiwan, and South Korea, GDP grew more than 3% in 2003, while China expanded an impressive 9.1%. The IT sector was stimulated by economic recovery in Europe and North America, while the boost in demand in China, spurred by the upcoming Olympics, reverberated positively throughout the region.

Consolidated Operating Results

(1) Net Operating Revenues

Consolidated net operating revenues in FY 2003 amounted to ¥352.4 billion, up 30% from FY 2002. Of this total, commissions jumped 35%, to ¥194.1 billion. In addition to the equity market recovery, we attribute this result to our strategies of continuously upgrading sales channels and enhancing products and services. By pursuing these strategies the Daiwa Securities Group was able to meet the diversified, fund-raising, and asset management needs of corporations and investors.

Net trading gains rose 28% from FY 2002, to ¥120.1 billion. Net trading gains, traditionally a major influencing factor of the Group's financial performance, have been growing steadily, from ¥63.4 billion in FY 2001 to ¥93.9 billion in FY 2002 and ¥120.1 billion in FY 2003. This growth is the result of a stronger customer base, improved trading capabilities, and strict profit management.

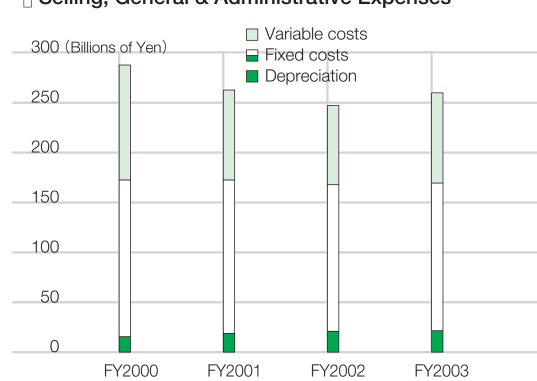
Breakdown of Net Operating Revenues (Millions of Yen)

				FY2003			
	FY2002	FY2003	yoy	Q1	Q2	Q3	Q4
Commissions	144,283	194,163	34.6%	31,547	49,441	52,960	60,213
Net gain on trading	93,932	120,195	28.0%	43,679	24,958	23,221	28,336
Net financial income	24,113	25,892	7.4%	6,531	8,171	6,362	4,827
Others	8,481	12,183	43.6%	2,822	2,904	3,128	3,331
Total	270,810	352,435	30.1%	84,579	85,475	85,672	96,708

(2) Selling, General, and Administrative (SG&A) Expenses

Despite the strong rise in revenues, the year-on-year increase in SG&A expenses was limited to 5%, to a total of ¥259.9 billion. The major reason for this ¥13.2 billion rise was due to an increase in variable costs, such as performance-linked bonuses. Within SG&A expenses, personnel costs went up 11%, to ¥136.9 billion, while real estate expenses declined 2%, to ¥32.5 billion.

Selling, General & Administrative Expenses



(3) Ordinary Income and Net Income

Ordinary income for the year totaled ¥96.1 billion, approximately 3.3 times the previous year's figure. In the year under review, we adopted accounting for impairment of fixed-assets—two years before becoming mandatory—resulting in a ¥12.7 billion impairment loss, a major part of our total extraordinary losses of ¥19.2 billion. As a result of our decision to move to a consolidated tax system in FY 2004, Daiwa Securities Group Inc. posted ¥17.1 billion in tax benefits. This is because the future profitability of all Group companies, including Daiwa Securities Co. Ltd. (Daiwa Securities) and Daiwa Institute of Research Ltd., will be recognized under the consolidated tax system. As a result of all these factors, net income amounted to ¥42.6 billion in FY 2003, a significant improvement from FY 2002 when we recorded a net loss of ¥6.3 billion.

Ordinary Income and Net Income (Millions of Yen)

				FY2003			
	FY2002	FY2003	yoy	Q1	Q2	Q3	Q4
Ordinary income	29,200	96,130	229.2%	23,682	21,401	22,442	28,603
Net income (loss)	(6,323)	42,637	—	11,028	8,263	9,100	14,244

Trends by Business, Group Company, and Geographical Region

(1) Breakdown of Commission Revenues

Equity commissions surged 69% year-on-year, to ¥80.0 billion, owing to the stock market recovery and the success of our strategies to meet diversifying customer needs. Fixed income (bond) commissions rose 14%, to ¥5.2 billion, and investment trust commissions were up 5%, to ¥43.0 billion. This was due to increased sales of equity investment trusts and the growing balance of assets under management, which compensated for the decline in revenues from bond investment trusts amid the continuing trend of ultra-low interest rates. Investment banking commissions jumped 41%, to ¥55.8 billion, due to an increase in primary and secondary offerings by listed companies in the second half of the fiscal year, as well as our success in securing the lead-manager role in numerous large-scale issues, including initial public offerings (IPOs).

Breakdown of Commission Revenues (Millions of Yen)

				FY2003			
	FY2002	FY2003	yoy	Q1	Q2	Q3	Q4
Equity	47,242	80,061	69.5%	13,058	22,086	20,808	24,107
Fixed income (Bond)	4,585	5,219	13.8%	1,004	1,550	1,352	1,311
Investment trust	40,870	43,046	5.3%	9,783	10,560	10,005	12,695
Investment banking	39,638	55,805	40.8%	5,130	12,796	18,064	19,813
Others	11,948	10,032	-16.0%	2,570	2,448	2,728	2,285
Total	144,283	194,163	34.6%	31,547	49,441	52,960	60,213

(2) Performances of Major Group Companies

Daiwa Securities, the Group's retail securities subsidiary, reported operating revenues of ¥171.6 billion, up 32%, and ordinary income of ¥35.2 billion, a 10-fold jump from the previous year. Revenue gains stemmed from an increase in sales of equity related products and foreign currency-denominated bonds, while the rise in SG&A expenses was limited to 8%.

Daiwa Securities SMBC Co. Ltd. (Daiwa Securities SMBC), the Group's wholesale securities subsidiary, posted a 37% year-on-year increase in operating revenues, to ¥161.6 billion, and a 2.5-fold surge in ordinary income, to ¥41.8 billion. Contributing factors include a dramatic gain in underwriting commissions in line with growing demand for capital among corporations, as well as a substantial jump in net trading gains.

In the asset management business, Daiwa Asset Management Co. Ltd. (DAM) reported ordinary income of ¥772 million, down 50% from FY 2002. The continuing decline in bond investment trust management fees, due to prolonged ultra-low interest rates, offset the company's efforts to reduce SG&A expenses. Daiwa SB Investments Ltd. (Daiwa SB Investments), an equity-method subsidiary of Daiwa Securities Group Inc., posted a 4% decline in ordinary income, to ¥523 million. Despite difficult operating conditions, the balance of pension funds under Daiwa SB Investments' management continued to expand. In FY 2003, the company successfully launched "China Ton-Fei" (China Equity Open), the largest Chinese equity fund launched in Japan to date.

Performances of Major Group Companies

(Millions of Yen)

	Daiwa Securities		Daiwa Securities SMBC		Daiwa Asset Management		Daiwa Institute of Research	
	FY2002	FY2003	FY2002	FY2003	FY2002	FY2003	FY2002	FY2003
Operating revenues . . .	129,817	171,605	118,300	161,681	22,865	16,638	61,675	65,388
Ordinary income	3,531	35,219	16,565	41,873	1,556	772	3,444	5,529
Net income (loss)	1,047	19,272	6,357	23,227	(138)	221	1,043	835

	Daiwa SB Investments*		Daiwa Securities Business Center		Daiwa Property		NIF Ventures	
	FY2002	FY2003	FY2002	FY2003	FY2002	FY2003	FY2002	FY2003
Operating revenues . . .	6,765	7,336	8,472	8,558	11,571	17,402	1,340	5,207
Ordinary income (loss) .	542	523	627	448	2,035	4,019	(2,850)	465
Net income (loss)	(49)	114	350	209	1,797	(54,137)	(9,319)	555

*Equity-method subsidiary

(3) Overseas Performance

The overseas performance of the Group showed steady expansion, reflecting the worldwide uptrend of share prices. In North America, we returned to profitability, with an ordinary income of ¥1.2 billion. In Europe, ordinary income more than doubled from FY 2002, to ¥7.5 billion. In Asia and Oceania, ordinary income was ¥1.9 billion, just under nine times the previous year's figure. Total ordinary income from overseas operations, therefore, was ¥10.7 billion, nearly 12 times the FY 2002 results.

Ordinary Income, by Geographical Region

(Millions of Yen)

	FY2002	FY2003
America	(2,836)	1,270
Europe	3,528	7,538
Asia & Oceania	220	1,977
Total	912	10,786

Balance Sheet and Cash Flows

(1) Assets

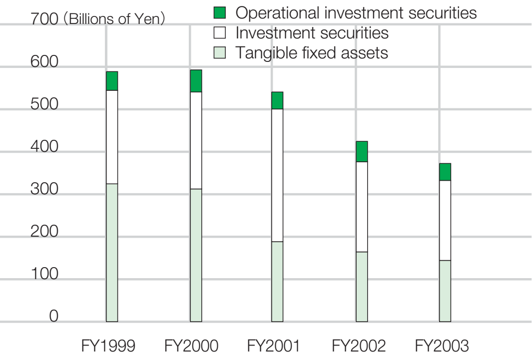
At the end of FY 2003, total assets of the Group stood at ¥10,765.6 billion, up ¥1,262.8 billion from a year earlier. Within that amount, total current assets grew ¥1,346.1 billion, to ¥10,210.0 billion, and non-current assets fell ¥83.2 billion, to ¥555.6 billion. Among current assets, trading assets were down ¥497.4 billion due largely to a decline in JGB positions, but receivables related to margin transactions rose ¥128.6 billion owing to an increase in such transactions amid a vibrant share market. Receivables on collateralized securities transactions, mostly associated with bond lending to corporate customers, surged ¥1,126.6 billion. Among non-current assets, tangible fixed assets fell ¥19.2 billion and investment securities declined ¥26.9 billion due to DAM's disposal of subordinate debt issued by banks. Non-current deferred income tax assets dropped ¥25.3 billion.

(2) Liabilities and Shareholders' Equity

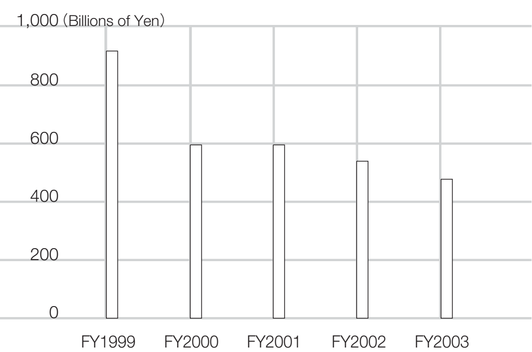
At fiscal year-end, total liabilities stood at ¥9,995.8 billion, up ¥1,188.7 billion from a year earlier. Current liabilities rose ¥907.1 billion, to ¥9,122.1 billion, and non-current liabilities grew ¥280.3 billion, to ¥868.5 billion. Among current liabilities, payables on collateralized securities transactions were down ¥263.2 billion, while trading liabilities soared ¥1,393.7 billion. Among non-current liabilities, bonds grew ¥231.1 billion due mainly to a ¥120.0 billion corporate bond issue by Daiwa Securities Group Inc.

Total shareholders' equity increased ¥62.4 billion, to ¥604.1 billion. In addition to posting profits, a major contributing factor was a ¥25.4 billion rise in net unrealized gain on securities, stemming from the stock market recovery.

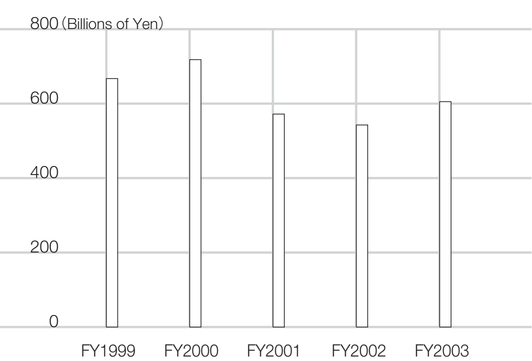
Composition of Major Risk Assets



External Debt



Shareholders' Equity



(3) Cash Flows

Cash flow from operating activities posted a net outflow of ¥111.2 billion, compared with a ¥369.7 billion net inflow in the previous fiscal year. The change stemmed mainly from an increase in receivables on collateralized securities transactions and a decline in payables on collateralized securities transactions. Cash flow from investing activities showed a net inflow of ¥50.1 billion, compared with ¥67.9 billion in FY 2002. Contributing factors included proceeds from sales of investment securities. Cash flow from financing activities turned to a net inflow of ¥114.4 billion, owing largely to proceeds from issuance of corporate bonds. This compares with a net outflow of ¥447.3 billion in the preceding year. Cash and cash equivalents (after deducting exchange rate changes on cash) at fiscal year-end stood at ¥486.9 billion, up ¥48.6 billion from a year earlier.

Cash Flows (Millions of Yen)	FY2002	FY2003
Cash flows from operating activities	369,749	-111,242
Cash flows from investing activities	67,967	50,143
Cash flows from financing activities	-447,392	114,407

Capital Investments

The Daiwa Securities Group's capital investment activities are based on several objectives, including building a foundation for reinforcing competitiveness and enhancing convenience for customers. In FY 2003, the Group made a total of ¥29.6 billion in IT-related expenditures, including investments to upgrade core administrative systems at Daiwa Securities and core administrative systems and trading systems at Daiwa Securities SMBC. In addition, the Group made investments to upgrade its branch office network.

Risk Management

Recognition of Risk

At the Daiwa Securities Group, various risks emerge in the course of its business activities. The main risks are market risk, credit risk, liquidity risk, operational risk, system risk, legal risk, and reputation risk. In addition to managing the risks related to its fixed assets, the Group is aware that, in order to maintain a healthy financial and earnings structure, identifying and evaluating the various types of risks that are generated from its business activities and managing them appropriately is an important factor.

Risk Management System

The primary responsibility for controlling the aforementioned risks rests with each subsidiary of the Daiwa Securities Group. Each subsidiary has established its own system for managing the various types of risks according to the characteristics and risk profiles of the business. Daiwa Securities Group Inc. in turn controls the risks by monitoring the subsidiaries' risk management systems and risk management processes.

The major risks that the Group is exposed to are market risk and credit risk. As the Group is in securities business, the market and credit risks stemming from trading are especially important. Thus, it is indispensable that the Group manages these risks effectively to ensure its financial health.

Most of the trading within the Daiwa Securities Group is carried out by Daiwa Securities SMBC and its wholly owned subsidiary Daiwa Securities SMBC Europe Limited (Daiwa Securities SMBC Europe), as well as Daiwa America Corporation (including its subsidiaries such as Daiwa Securities

America Inc.), a wholly owned subsidiary of Daiwa Securities Group Inc. At Daiwa Securities, the amount of securities trading conducted is minimized as a matter of policy, and transactions with customers are backed by sufficient collateral. Thus, the market risk and credit risk generated from trading activities is small.

Daiwa Securities SMBC is responsible for risk management of itself and its subsidiaries. The main authority related to risk management rests with the Risk Management Committee. The Risk Management Committee determines the risk management policy, procedures, and risk frameworks for trading positions at Daiwa Securities SMBC and its subsidiaries. Moreover, a system has been set up to monitor whether the risk frameworks that have been assigned to the trading departments are being observed and for making reports to management. Daily and monthly reports regarding market risk and credit risk related to trading positions are made to the management team. Comprehensive quarterly reports that include other risk information are submitted to the Risk Management Committee.

In addition, Daiwa Securities SMBC Europe has built an independent risk management system based on local laws. Reports on the market risk and credit risk related to trading positions are regularly made to the local management team, as well as to Daiwa Securities SMBC's Risk Management Department.

A similar risk management system has been put in place at Daiwa America Corporation. Here as well, reports regarding the risk situation are made to the local management team and Daiwa Securities Group Inc.

Management receives daily risk reports on trading positions at the aforementioned subsidiaries through the department in charge of risk management at Daiwa Securities Group Inc. By means of these reports, the Group's management team can obtain a good grasp of the risk profiles related to its trading positions.

In addition to the reports on market and credit risks related to trading positions, comprehensive and exhaustive quarterly reports are made to the Internal Control Committee, a subcommittee of the Executive Committee, regarding the market and credit risk for financial assets other than trading positions.

Based on these daily, monthly, and quarterly reports, Daiwa Securities Group Inc. monitors whether its subsidiaries' capital, which is the Group's invested capital, is being exposed to any excessive risk.

Measures for Dealing with Major Risks

(1) Market Risk

Market risk is the risk of incurring losses resulting from fluctuations in the value of financial assets or liabilities due to changes in stock prices, interest rates, exchange rates, and related derivatives. The Group's trading positions are mainly exposed to this type of risk.

The Group employs Value at Risk (VaR), a commonly used statistical management method, as an index for measuring and monitoring the market risk of its trading positions. VaR provides an estimate of losses that will be incurred from a trading position over a certain period and at a certain confidence level. The Group uses holding periods of one day and a confidence level of 99%.

(2) Market Risks Unrelated to Trading Positions

Investment securities, such as listed stocks we hold from a long-term perspective for business relationship purposes, are also exposed to market risk. A system has been set up for deciding the limit to the holding amount of these listed stocks, measuring its VaR, and making quarterly reports to the Internal Control Committee. These quarterly reports also include the balance of holdings of unlisted stocks and venture funds, for which VaR is not applicable to estimate market risk.

(3) Credit Risk

Credit risk is the risk of losses sustained as a result of a client being unable to fulfill a contract for a transaction. In the Group's wholesale securities business, credit limits are set for each client to restrain the amount of credit risk we are exposed to. In addition, we assign clients our own internal ratings similar to those given by external rating agencies. These internal ratings serve as a standard for judging whether or not to execute transactions. The usage of these credit limits is monitored regularly.

Furthermore, the Group manages the credit risk associated with the wholesale securities business by regularly reviewing the clients' financial situations, having clients sign comprehensive netting contracts, providing collateral, and limiting the periods of transactions.

(4) Liquidity Risk

Liquidity risk is the risk that the Group will run into difficulty procuring funds, or that the costs for attempting to do so will rise extremely higher than normal levels as a result of changes in the market environment or a deterioration in our balance sheet.

The Group carries out its business activities using many assets and liabilities. The majority of its assets are highly liquid, but it is important to maintain and manage liquidity in order to strike the appropriate balance with liabilities. To ensure that business activities are not interrupted even in the event of a credit crunch stemming from sharp fluctuations in the market environment, it is essential to maintain a liquid portfolio that will allow the Group to handle its demand for funds over a period of about one year, without relying on new uncollateralized fund procurement. Moreover, the Group has arranged commitment facilities that will enable it to procure funds in the case of an emergency.

Group Cash Management System

The extent to which the Group can be assured of procuring the necessary amount of funds and its costs are affected by the market environment and the Group's credit rating. To minimize liquidity risk in the event of a deterioration in the market environment and to lower procurement costs, the Group has introduced a group cash management system (group CMS). Under this system, procurement and management of funds needed for business activities are concentrated at Daiwa Securities Group Inc. However, Daiwa Securities, Daiwa Securities SMBC, and NIF Ventures Co., Ltd. carry out their own fund procurement and management because fund procurement is a part of a securities company's business activities and because listed subsidiaries are required to procure funds independently from the parent company.

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

	Billions of Yen								
(Month end)	3/02	6/02	9/02	12/02	3/03	6/03	9/03	12/03	3/04
Equity	1.06	1.23	0.74	0.42	0.63	0.39	1.11	0.78	0.52
Interest	0.19	0.46	0.36	0.30	0.58	0.68	0.85	0.51	0.54
Currency	0.02	0.04	0.03	0.02	0.02	0.05	0.04	0.10	0.05
Total	1.27	1.73	1.13	0.74	1.23	1.12	2.00	1.39	1.11
Diversification effect	-0.19	-0.36	-0.29	-0.19	-0.46	-0.18	-0.26	-0.45	-0.36
VaR	1.08	1.37	0.84	0.55	0.77	0.94	1.74	0.94	0.75

・FY 2002 high: ¥1.70 billion, low: ¥0.51 billion, average: ¥0.96 billion
・FY 2003 high: ¥1.99 billion, low: ¥0.46 billion, average: ¥0.96 billion

(5) Operational Risk and Computer System Risk

Operational risk is the risk of sustaining losses when internal processes, personnel, or computer systems are not appropriate or breakdown due to internal or external reasons. Various risks have risen due to the growing complexity and diversification of businesses and the use of computer systems. Every year, it is becoming increasingly important to manage operational risk.

The Group is working to reduce the operational risks of each business line by establishing necessary measures, such as setting rigid rules concerning authority, automation of manual clerical work to reduce human error, and reexamining of its business manuals.

System risk, which is a type of operational risk, refers to the risk of incurring losses from computer system problems, such as system breakdowns or malfunctions, or losses from the improper use of computer systems.

To reduce this type of risk, the Group has formulated an information security policy that forms the basis of its computer system risk management. At the same time, the Group has prepared information security-related regulations (security standards) that embody this policy, and is working to educate its employees and executives to observe the regulations. Furthermore, for its core systems, the Group has established a framework for constantly observing the operational conditions of those systems, minimizing the occurrence of computer problems, and responding quickly at times when a problem occurs.

(6) Legal Risk

Legal risk is the risk of sustaining losses as a result of the failure to abide by laws, regulations, and/or corporate ethics, or as a result of inappropriate contracts concluded with third parties. The Daiwa Securities Group pursues group management with the securities-related business as its core business. In conducting business in Japan and overseas, there are laws and regulations we must comply with to execute securities transactions. In addition, each Group company engaging in various businesses is required to observe various regulations pertaining to the general conduct of its businesses. To ensure that there is no infringement on the aforementioned practices, the Group has set up sections in charge of compliance at each company, and will discuss compliance issues at committees consisting of directors from the Management Committee, etc. At Daiwa Securities and Daiwa Securities SMBC, which are particularly important securities subsidiaries, the Group has established special compliance departments and a Legal Affairs & Compliance Committee chaired by the presidents of the respective subsidiaries.

Furthermore, the Group has established agreements with law offices in Japan and overseas to respond to cases in which a high level of specialization is required in determining the legality or legal propriety of securities-related transactions and the signing of other contracts with third parties.

(7) Reputation Risk

Reputation risk is the risk of losing clients and profits as a result of rumors or the loss of reputation. This risk arises due to various situations such as when improprieties are committed by employees or when we announce sluggish earnings. Thus, a variety of methods are used for controlling this risk. The Group has issued a Disclosure Policy, which lays out the Group’s policy for control and disclosure of corporate information. The Group has also established internal regulations based on this Disclosure Policy and has set up a Disclosure Committee, which is a subcommittee of the Executive Committee.