

Message from the CEO

Gaining a strong advantage by highlighting our two key attributes: quality and productivity—this strategy is now bringing tangible results.

Building on these results, the Daiwa Securities Group is poised to enter a stage of accelerated growth, propelled by “power” and “scale.”



FY 2004 Performance Highlights

— Sustained growth, despite lack of external support

It was another tough year...

The Japanese economy, which had been recovering strongly until FY 2003, began to lose momentum in FY 2004. One major reason was the slowdown in exports, especially of high-tech products, due to the effects of inventory adjustments by IT-related companies worldwide. Also, the second half of the year saw several major natural disasters, including typhoons and earthquakes, as well as historically high crude oil and other raw materials prices. These factors may have had a negative impact on the macro economy, as reflected in the equity market. While trading activity reached high levels amid expectations of medium- to long-term economic growth, the Nikkei Average remained in a narrow range around the ¥11,500 level. Interest rates also showed minimal volatility. In short, life was certainly not easy for the securities industry.

A healthy improvement in performance

Despite this challenging environment, the Daiwa Securities Group posted a steady improvement in earnings, as it did in the previous year. Consolidated net operating revenues reached ¥390.4 billion, up 11% from FY 2003. Ordinary income climbed 25%, to ¥120.4 billion, and net income grew 24%, to ¥52.6 billion. Consolidated return on equity (ROE) further improved from 7.4% in FY 2003 to 8.4% in FY 2004—the highest among the three major securities companies.

Three-Year Reflection (FY 2001 – FY 2004)

— Progress in improving “quality” and “productivity”

Improvement in financial results

Rather than focusing on single-year increments, let us look back over the longer term. Our financial performance is a good indication of how much the Daiwa Securities Group has changed. Between FY 2001 and FY 2004, consolidated net operating revenues grew 1.4-fold. Over the same period, ordinary income surged 4.7-fold, from ¥25.8 billion to ¥120.4 billion.

Enhanced competitiveness, reflected in facts and figures

Comparing FY 2004 to FY 2001, the average daily trading value on the Tokyo Stock Exchange (TSE) grew approximately 70% while the Nikkei Average remained at the same level. It is evident that this played a major part in our recovery. However, I would like to emphasize that, while major securities companies have historically tended to move in tandem due to the similar structure of their businesses, the Daiwa Securities Group has undergone a dramatic transformation by building its own unique business portfolio. As a result, we have steadily sharpened our competitive edge. One key indicator of this change is top-line growth. Over the past three years, the Group's net operating revenues increased 37%. Another noteworthy indicator is profitability. In FY 2004, our ROE rose to 8.4%.

With improved specialist expertise and skills, as well as a dominating position in quality and productivity, we now have what it takes to win the competition.

Driving revenue growth: Qualitative enhancement with priority on customers

In my opinion, our improved competitiveness was not the result of pursuing quantitative expansion. Instead, it came from the Group's focus on "qualitative enhancement." Under our medium-term management plan, which began in FY 2003, we have been targeting the No. 1 position in terms of "quality" and "productivity" rather than quantitative results. To this end, we must first further improve our professional skills in areas such as specialist expertise and productivity, so that our customers can become confident that our products and services are truly distinctive.

The results of our approach have evolved slowly, but surely. For example, Daiwa Securities SMBC has reached the top of the lead manager league tables in terms of equity offerings and corporate bond issues. Also, Daiwa Institute of Research (DIR) has received the No. 1 Analyst Ranking by the Nikkei Financial Daily for two consecutive years. Regarding our online services, we have received high acclaim for the information content of our online trading website, earning the Gomez Award.

These strategies for qualitative enhancement have consequently brought various quantifiable results. Over the past three years, the number of online accounts has grown 2.6-fold, and revenues from the investment banking business have doubled.

Further progress in profitability and stability

Supported by a business foundation distinguished by specialist expertise and productivity, the Group has shifted its emphasis to generating high-value-added services. At the same time, we have worked to strengthen the stability of our financial position, including our balance sheet. These actions have led to a significant increase in ROE. As an example of higher productivity, our SG&A expense ratio* was above 90% in FY 2001. Over the past three years, however, we have reduced this to 70.6%. In terms of our improving stability, we have reduced external debt by 25% in the past three years and dramatically lowered our fixed ratio from 134.7% in FY 2001 to 68.3% in FY 2004.

* SG&A expense ratio = SG&A / net operating revenues

As a result, we will accelerate the growth of our corporate value. This is my mission as CEO. Success in these areas will enable the Daiwa Securities Group to deliver its distinctive products and services to an increasing number of customers, thereby contributing to expanding their assets and to the growth of the Japanese economy.

Qualifications alone are inadequate. Outclassing our rivals with “power” and “scale” is vital.

Strategies Going Forward

— Power and scale

Power and scale:

Essential factors for winning the competition

The Daiwa Securities Group has made substantial progress in creating a distinguished business foundation. Going forward, our strategy is to relentlessly pursue “top-line growth.”

Of course, we can raise top-line growth to a certain extent simply by continuing the initiatives we have taken so far. However, we must keep in mind that we operate in the intensely competitive financial services sector. To be a winner, we must achieve an overwhelming competitive position by augmenting our business foundation with “power” and “scale.”

Expanding risk allowance in the wholesale business

In the wholesale area, the Group will cautiously, but also boldly increase risk assets. Here, we will engage in equity trading, where we can utilize the Group’s specialist expertise, and also actively invest in private equities. In the area of principal finance, finding investment targets from the non-performing loan field is becoming difficult as prices are already rising. However, there are considerable opportunities in private equities linked to corporate restructuring that provide the possibility of high returns.

Expanding our retail customer base and sales channels

In the retail sector, we will take steps to further broaden our customer base and sales channels. First, we must concentrate on expanding the balance of net assets under management, excluding fluctuations in market prices. To achieve this, we need to further enhance the capabilities of our salespeople for attracting new customers and providing meticulous consulting services. This will necessitate an increase in the current capacity of our salespeople, which is why the backbone of our retail strategy is to reinforce businesses that do not require a sales force. Through this strategy, we are simultaneously pursuing both higher profitability and productivity.

We are focusing particular attention on online trading, separately managed accounts (SMAs), and the securities intermediation business as the three main pillars of our retail business that need to be strengthened. Our first focus is online trading, where we have already differentiated ourselves with investment information and product lineup that a dedicated online brokerage company will find difficult to follow. To further broaden this differentiation, we introduced a flat-fee system for margin transactions in May 2005 and for cash transactions in July 2005. In addition, we have considerably enhanced convenience for our customers through measures such as over-the-counter account opening for margin transactions on a same-day basis and implementation of “loop trading.”

The goal of our second main focus, the SMA service, is to expand our base of high-net-worth customers. Since launching our pioneering Daiwa SMA

service in September 2004, we have diversified our management style and improved performance. We plan to increase our total SMA assets under management to ¥500 billion by March 2008.

Our third focus is the securities intermediation business, through which we will expand sales channels outside of the Daiwa Securities Group. Our plan is to set up “win-win” alliances, capitalizing on Group capabilities that the other party does not have. These include capability in product structuring, development and supply; specialist expertise in risk products; and enhanced research function. As of March 31, 2005, we had agreed alliances in the securities intermediation business with Sumitomo Trust & Banking Corporation and approximately 30 regional banks.

Further Upgrading Our Management Structure — Seeking to ensure sustainable growth

A system that directly rewards performance

The ability to achieve sustainable growth largely depends on the quality of human resources. We will continue enhancing our educational and training programs, but we must also focus on raising motivation to realize the maximum potential of our employees. To this end, we have been working to establish an evaluation system that more closely links remuneration with performance. Furthermore, I have introduced the President’s Award, which provides an incentive in addition to salaries and bonuses. The President’s Award, which previously covered only Daiwa Securities and Daiwa Securities SMBC, is now open to employees groupwide.

Maximizing our corporate value

I believe I have two key responsibilities as CEO. The first is to steadily implement our business strategies, and thus achieve sustainable growth in corporate value. The other responsibility, which is sometimes neglected, is to ensure that our true corporate value is reflected in our stock price. This means relentlessly monitoring the situation and, if our value is on a discount, taking steps to raise that value to a fair level.

To carry out the latter responsibility, we will constantly reassess our profit sharing policy with due consideration of our profit level and capital efficiency. We will also review our capital allocation strategies and business portfolio to determine which businesses should receive higher capital allocations in order to raise capital efficiency and ROE. In addition, we will set up an effective information disclosure system to ensure that our corporate value is accurately conveyed to the market. We will consider all possibilities in an effort to ensure that our corporate value is always fairly evaluated.

Achieving sustainable increase in corporate value through effective growth strategies and making constant efforts to ensure full recognition of corporate value
— these are the true responsibilities of corporate management.

Conclusion

— Results, the benchmark of true professionals

Establishing a “strong” Daiwa Securities Group

The Daiwa Securities Group is engaging in the relentless pursuit of higher corporate value. Having a long-term perspective, we have made steady progress in quality, productivity, and specialist expertise. However, that alone does not lead to an increase of corporate value, unless our customers benefit from our products and services. Moreover, we cannot meet the expectations of our shareholders if we fail to win the competition.

At the end of the day, results are the proof of professionalism. With “power” and “scale,” we will do our utmost to achieve tangible results. My mission as CEO is to ensure that we do whatever it takes to establish a Daiwa Securities Group “strong” in every regard.

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Shigeharu Suzuki
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