



**Special Feature**

**Power and Scale**

**Our Roadmap to Ultimate Victory**

**Products and services, no matter how superior, are useless if not effectively delivered to customers.**

**A strong business foundation, no matter how solid, is worthless unless used to improve corporate value.**

**As professionals, we must win the competition. With power and scale, we will expedite our quest to establish a “strong” Daiwa Securities Group.**



## Revisiting Progress Made to Date

As outlined in the “Message from the CEO” section of this report, the Daiwa Securities Group has made an earnings recovery since bottoming out in FY 2001. More importantly, we have established a strong position vis-à-vis the rest of the industry in three key areas: growth potential, profitability, and stability. In this section, we will provide some background to our recovery by citing specific factors to demonstrate how, and the extent to which, the Group has enhanced its strengths and overcome various challenges.

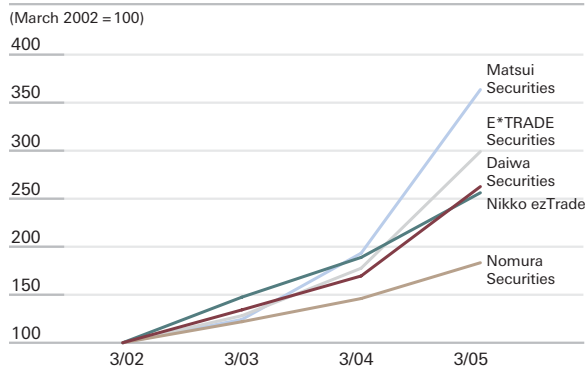
## Progress in Enhancing Our Strengths

### 1. Retail: Expansion of Online Business

One of the strengths of the Daiwa Securities Group is its online business. In the past three years, the number of our online accounts has grown 2.6-fold, from 480,000 at the end of FY 2001 to 1.25 million at the end of FY 2004. While this rate of growth is lower compared to some leading online brokers, Daiwa Securities took an overwhelming lead in terms of the number of new accounts.

Also, the number of new accounts in the Daiwa Direct course, our non-face-to-face channel, grew approximately 110,000 year-on-year to 430,000 at the end of FY 2004. This elevated Daiwa Securities to second place among online brokers, after E\*TRADE Securities. This growth is testimony to progress made in several areas. These include the high quality of investment information available via analyst reports produced by Daiwa Institute of Research Ltd. (DIR), reinforcement of our products and services to include IPOs and investment trusts, and sales of foreign stocks and bonds via our call center.

### Growth in Online Accounts



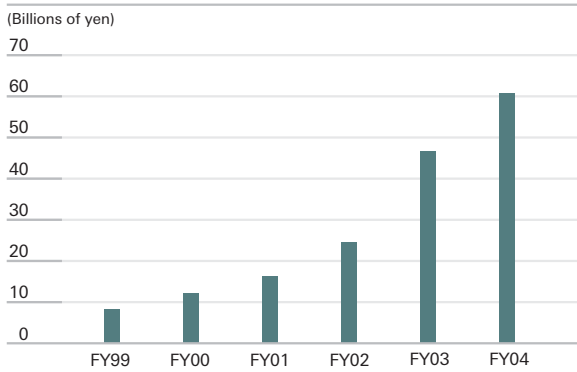
## 2. Wholesale: Expansion of Investment Banking Activities

Of Japan’s three major securities companies, the Daiwa Securities Group is the only one engaged in investment banking services through a full-fledged alliance with a “megabank,” utilizing the strong combined customer base of both groups. Daiwa Securities SMBC is our joint venture with the Sumitomo Mitsui Financial Group (SMFG), a prominent domestic megabank. If we simply relied on our partner bank to introduce customers and projects, however, we could not fully capitalize on the benefits of our collaboration. With this in mind, we have further enhanced our strengths by polishing our skills and experience in direct financial services, while developing more sophisticated consulting capabilities.

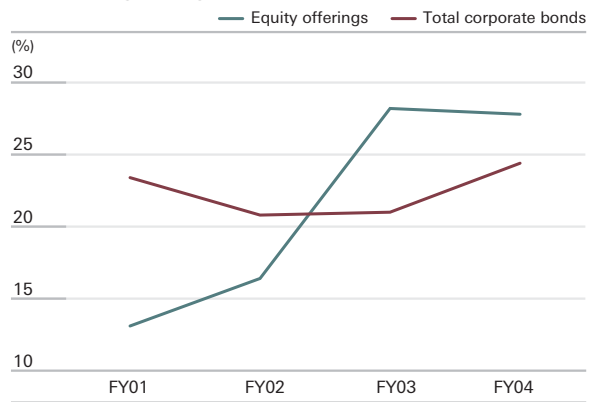
For example, thanks to the collaboration between Daiwa Securities SMBC and DIR, we have stepped up our market research and analytical capabilities, which are keys to providing consulting services. As a result of such efforts, the Group’s revenues generated from its

collaboration with Sumitomo Mitsui Banking Corporation (SMBC) has grown from ¥8 billion in FY 1999 to ¥60 billion in FY 2004. It has also steadily raised its position in the lead manager league tables over the past three years. In equity offerings, Daiwa Securities SMBC has moved from No. 4 (13.1% market share) in FY 2001 to No. 1 (27.8%) in FY 2004. In addition, it has achieved the No. 1 ranking in total corporate bonds for two consecutive years, also improving its market share.

**Revenues Generated from Collaboration with SMBC**



**Lead Manager League Tables: Market Share**



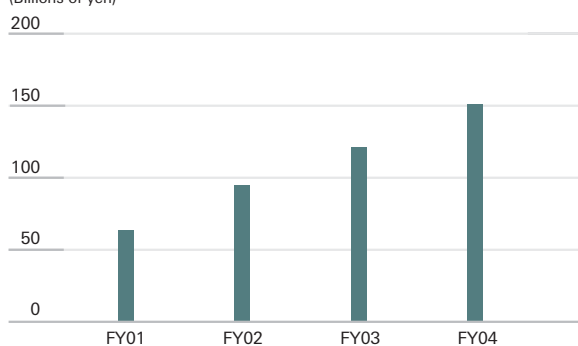
## Overcoming Challenges

### 1. Trading Revenues

Improvement in trading revenues was one of the challenges that the Daiwa Securities Group had to overcome in the pursuit of higher profitability. We responded by taking steps in a number of areas. For example, we upgraded our lineup of high value-added products including structured bonds, while acquiring order flows such as block trades, and adopting more diversified and sophisticated trading techniques. As a result, net gain on trading has increased steadily, from ¥63.0 billion in FY 2001 to ¥93.9 billion in FY 2002, ¥120.2 billion in FY 2003, and ¥151.1 billion in FY 2004.

**Gain on Trading (Consolidated)**

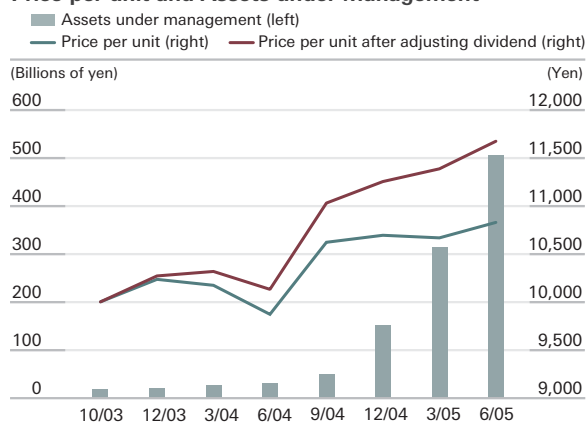
(Billions of yen)



### 2. Product Development and Management Capabilities

Product development, in actual fact, is not a major concern to us. The Group has long led the industry in developing unique products. These include “Million” and “MMF”, which we have offered for many years, and more recently, “Enmansai” structured bonds and “China Ton-Fei”, a Chinese equity fund. However, in this age, when customer focus is more important than ever, we recognize that priority should be placed on diversifying distribution channels, improving fund management performance, and otherwise comprehensively raising the appeal of products, rather than merely developing new ones. For this reason, we have worked to strengthen ties among Group members and extensively revamp our remuneration system. As a result, we achieved a major hit with the Daiwa Global Bond Fund, which ended FY 2004 with a balance of more than ¥300 billion under management (net assets having grown 12-fold during the year) and ¥500 billion in June 2005. We also diversified our products by launching an alternative product, the Daiwa Commodity Index Fund.

**Daiwa Global Bond Fund: Price per unit and Assets under Management**



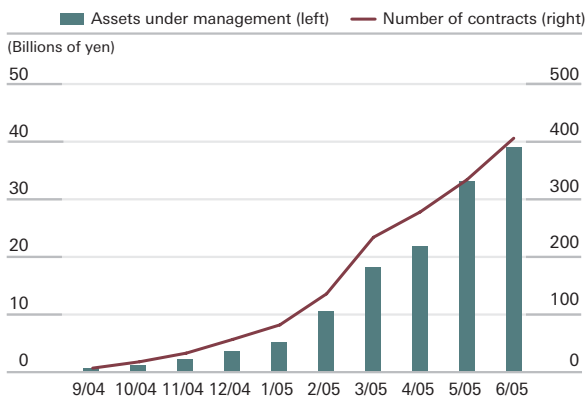
### 3. Client Base of High-net-worth Individuals

We have been making great efforts to expand our client base of high-net-worth individuals. As we reinforced our online trading capabilities in accordance with growing Internet-based transactions, we have also freed up the capacity of our branch salespeople, allowing them to invest their time and energy in expanding our high-net-worth customer base and providing in-depth consulting services. The quality and productivity of our consulting sales have improved as a result.

Separately managed accounts (SMAs), which Daiwa Securities launched in September 2004, represent a powerful tool in our consulting field for the wealthy segment of the market. Dedicated SMA consultants provide consulting services directly to customers, and specialist in-house asset managers are in charge of managing their assets. In this way, we can provide a comprehensive service package, ranging from initial advice to asset management and follow-up. For our SMA services, we have adopted a performance-based fee structure measured by absolute returns. These competitive advantages

have earned increasing support from high-net-worth customers, boosting the total assets under management of our SMAs to more than ¥40 billion, and the total number of contracts to over 400, in only ten months since the inception of this service.

**Daiwa SMA:  
Number of Contracts and Assets under Management**



## Future Strategies

**We believe that leveraging our strong business foundation with “power” and “scale” is crucial to the growth of the Daiwa Securities Group. We will exercise power and scale to expand the businesses of our own group and take initiative in strategic alliances in the industry and industry reorganizations.**

## Power and Scale for Business Expansion

### 1. Focus on Equities

The capability to handle risk is a key expertise required of participants in the capital markets. As economic conditions improve, it is clear that high-risk capital, centering on equities, will attract more attention from both asset management and fundraising. As deregulation progresses, the number of players handling securities, such as banks selling investment trusts and companies involved in securities intermediation, are growing sharply. Equities, however, are the risk products that represent the core domain of securities companies. Moreover, a look at Japanese securities companies reveals that only a few, including the Daiwa Securities Group, have capabilities across the full spectrum, encompassing product lineup, wealth of information, fund-

raising consulting skills, and underwriting capacity. In other words, equities represent the source of our strength, and demonstrating our power and scale in equities will help improve the corporate value of the Group. We will focus on areas where specialized expertise in equities is essential. In the retail securities business, these include equity investment consulting, centering on stocks and equity investment trusts. In the wholesale securities business, they encompass trading and underwriting, as well as M&As and private equities.

### 2. Risk-Taking

We provide income-producing opportunities for customers by using our skills and experience related to our own risk products. We also use these skills to take risks and generate income for ourselves. To do this, we first have to establish firm business and financial foundations. Now that we have made good progress in building such foundations, we will utilize these to expand businesses in areas such as principal finance and venture investments, which will enable us to assume our own risks and increase income opportunities accordingly.

For example, Daiwa Securities SMBC Principal Investments, a subsidiary of Daiwa Securities SMBC, raised its maximum investment limit from ¥100 billion to approximately ¥200 billion in June 2005. In FY 2004, Daiwa Securities SMBC reinforced its capital base through subordinated loans of ¥110 billion, thus strengthening its financial foundation to facilitate ongoing business expansion. Going forward, we will strive to identify opportunities for further growth through risk-taking initiatives while carefully monitoring market conditions.

### 3. Expansion of Customer Base

#### [1] Online Customers

Internet-based transactions will obviously become more and more prevalent in the future. We believe that enhancement of our online business will prove effective, as it will enable us to improve the quality and productivity of our consulting services in the retail sector and broaden our sales channels via the securities intermediation business. Increasing top-line revenue is the most effective way to improve profitability, as fixed costs are relatively high in our retail business, compared with the online business.

As stated earlier, we have significantly distinguished our online services in terms of information content for investment and product lineup. To further enhance convenience and sharpen our competitive advantage, we have extensively revamped our fee structure and upgraded our services for Internet transactions under the Daiwa Direct course. Specifically, we were the first major securities company to introduce a flat-fee system, which became effective for margin transactions in May 2005 and for cash transactions in July 2005. We also enabled customers to open margin transaction accounts on a same-day basis at our branches nationwide. In these ways, we have raised convenience to levels where online brokers cannot compete. The number of online margin transaction accounts rose 1.6 times by the end of June 2005, only less than two months after revamping our services in May.

#### [2] High-net-worth Customers

With respect to Daiwa SMA, the service we provide specifically to high-net-worth customers, our goal is to raise assets under management to ¥100 billion by the end of FY 2005 and to ¥500 billion by the end of FY 2007. Here, we will broaden our asset management

styles to further reflect customer needs, while also hiring top-level asset managers and improving the quality of our SMA consultants. In this way, we will upgrade our service system to provide comprehensive support as a strength of Daiwa SMA, ranging from consulting to asset management and follow-up services. After launching the Daiwa SMA service in September 2004, the number of accounts grew to approximately 400 by the end of June 2005, with total assets under management of approximately ¥40 billion.

#### [3] Potential Customers

As we move from saving to investing, people in Japan are increasingly taking risks in pursuit of higher returns, rather than adhering to capital-guaranteed but low-return investments. For this reason, more and more banking customers who have never made contact with securities companies are showing interest in securities investments. The potential for such people to initiate transactions with a securities company is growing significantly as a result.

To tap this base of potential customers, the Daiwa Securities Group has formed a comprehensive alliance with Sumitomo Trust & Banking Corporation (STB) covering three areas: securities intermediation, real estate, and trust agency businesses. Under this mutually beneficial alliance, STB acts as a securities intermediary to deliver our products and services to their clients. At the same time, the Daiwa Securities Group act as a trust agent and real estate intermediary, making STB's services in those areas available to our own customers.

In addition, Daiwa Securities has agreed with approximately 30 regional banks to cooperate in the securities intermediation business. We anticipate rapid expansion of our sales channels targeting retail customers in

regional areas, where we have a limited number of branch offices. To ensure smooth operation of the securities intermediation business, it is important that we strengthen our support system for our allied partners, providing them with experience and know-how gained through our long involvement in the securities business. In this way, we can indirectly deliver further services to customers through those channels.

## Exercising Power and Scale to Pursue Alliances and Reorganizations

### 1. Basic Stance for Tie-up Strategy

In February 2005, there were reports that the Daiwa Securities Group and the Sumitomo Mitsui Financial Group (SMFG) were in talks about a possible merger. At present, however, there are no such talks. Nevertheless, we have not changed our basic stance of continuing to explore potential alliances with SMBC in all business areas.

Our unwavering quest is to contribute to the development of the Japanese economy in our role as financial services professionals. In addition to targeting progress in quality and productivity through increased specialist expertise and speed, this will require acceleration of our own growth through power and scale. We will pursue all possibilities to raise our corporate value—even alliances that will remodel the industry—and study various scenarios in a forward-looking approach. However, we will only consider schemes in which we can take the lead in boosting value for shareholders, by fully utilizing the business foundation we have built to date and demonstrating our power and scale.

### 2. Corporate Reorganization through Functional Alliances

Corporate reorganizations based on mergers that target scale expansion alone are fading rapidly. Amid the wave of reorganizations in the financial services industry, the ultimate winners will be those who seek alliances that bring mutual reinforcement so that they can become solid organizations with fewer weaknesses.

To date, the Daiwa Securities Group has actively pursued functional alliances with SMFG in order to maximize synergy effects. Synergies generated by these alliances are the source of sustainable growth for the Group.

To further expedite growth in the future, we will continue seeking business fields in which alliances may generate new synergies. We will take full advantage of such synergies in order to establish a “strong” Daiwa Securities Group that will prevail in the competitive environment.

#### The Daiwa Securities Group and SMFG: History of Functional Alliances

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- 1999 Established joint venture companies in the asset management and wholesale businesses
- 2004 Integrated the two groups' credit businesses
- 2005 Formed alliances in the private equity business