Financial Section

Management's Discussion and Analysis

Macroeconomic Conditions

Japan

During FY 2006, the Japanese economy continued to expand despite a temporary slump in consumer spending through summer, due to stagnant wage conditions and inclement weather, as strong export demand took over as the engine of economic growth. According to the Cabinet Office's Monthly Economic Report, the economy has been expanding steadily since hitting bottom in January 2002; in November 2006, the current upturn became the longest economic expansion of the postwar era, surpassing the 57-month growth phase commonly referred to as the "Izanagi Boom" (November 1965 to July 1970). Real GDP has been expanding at an annual rate of around 2% since FY 2003, and preliminary data suggests that the growth rate for FY 2006 will also exceed 2%, for the fourth consecutive year. Fluctuations in the economic cycle appear to be moderating, and as a result, the current period of economic growth has been characterized by continuous expansion over a long period, with no signs of overheating.

The Japanese economy also shows signs of finally escaping from deflationary pressures. Since March 2001, when the Bank of Japan (BoJ) introduced a quantitative-based monetary easing policy, it has kept the unsecured overnight call rate at essentially 0%. However, in early 2006 consumer prices began to edge steadily upward, and in response the BoJ lifted its quantitative monetary easing policy in March 2006. In July 2006, the BoJ raised the unsecured overnight call rate to 0.25%, and it hiked rates a further 25 basis points in February 2007. The BoJ is not yet able to confirm that the economy has escaped from deflationary pressures. However, the decision to lift its zero interest rate policy, after a period of five years and four months, would suggest that the Japanese economy is moving back to normal.

This past year also brought clear indications of a change in the direction of land prices, which had fallen for many years. The nationwide average land price for both residential and commercial land published by the Ministry of Land, Infrastructure and Transport showed an increase for the first time in 16 years, as of January 1, 2007. Rising demand for condominiums and offices and a boom in real estate investment, particularly in the major metropolitan areas of Tokyo, Nagoya and Osaka, brought rising land prices in these areas. This was the main factor elevating nationwide prices. There are also indications that the decline in regional land prices is moderating.

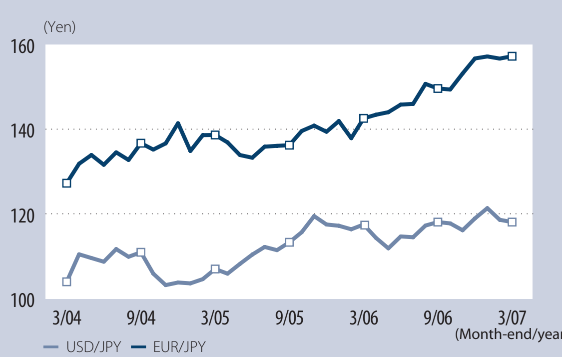
Under these healthy economic conditions, corporate earnings have been rising steadily. Large corporations, in particular, continued to report both sales and profit growth. Despite the positive trends, the Nikkei 225 Average was unable to find solid footing at the 17,000 level, and in mid-2006 slipped temporarily to the mid-15,000s. A subsequent recovery, however, saw the average top 18,000 in late February 2007. Thereafter, a global correction in stock prices led the Nikkei 225 Average lower, but by the end of the fiscal year it had recovered to ¥17,287.65, a 1.3% rise from ¥17,059.66 at the close of the previous fiscal year.

Considering the recent buoyancy of global stock markets, there is a sense that stock prices in Japan are lagging behind. One feature of Japan's current economic expansion is that, despite brisk external demand, the upturn has been slow to trigger a corresponding rise in domestic demand. The increasingly intense competition that global corporations face has caused labor's share of corporate added value to decline internationally. In Japan, this has meant that healthy corporate earnings are not being passed on to the household sector, in the form of higher wages, and thus the household sector has been slow to recover. As a result, Japan's economy is having trouble

GDP (Annualized Quarter-on-quarter Changes)

Source: Cabinet Office, Government of Japan

Foreign Exchange Rates



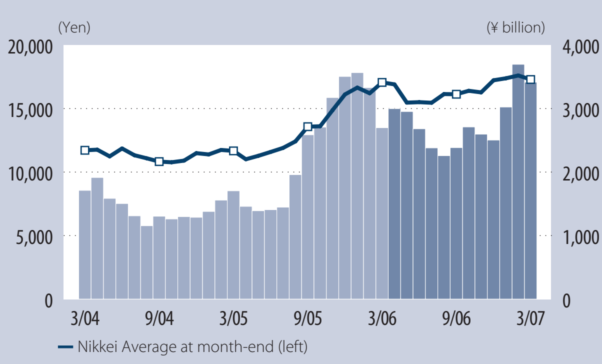
Source: Daiwa Institute of Research

making the transition to a self-sustaining expansion led by domestic demand, principally consumer spending. Nevertheless, domestic corporations have completed their restructuring, and are once again investing heavily in new plant and equipment. Meanwhile, economic growth in newly emerging economies has stimulated global trade, and the abundant liquidity in international markets is boosting asset prices. These factors are creating a fertile environment for continued economic growth in Japan.

Overseas

Recent trends in the global economy have been generally favorable for Japan. In the US, a slump in the housing market has restrained economic growth, and in response, the Federal Reserve Board (FRB) has kept interest rates unchanged since the last rate hike in June 2006. On the other hand, in the Euro zone, an economic revival in Germany is supporting the region's overall growth, and the European Central Bank (ECB) has been raising interest rates steadily. In China, which plays an increasingly important role in the global economy, the real economic growth rate remains high, at over 10% per annum. As new economic players such as China and India expand, their role in the global economy is shifting. No longer are they simply supply bases for the rest of the world. On the contrary, their domestic economies are now vibrant enough to lead international trends. These countries are establishing themselves as new engines for the global economy. Thus, even as the US economy began to lose momentum, global trade remained brisk and Japanese exports continued to expand. Furthermore, interest rate and inflation differentials between other countries and Japan have conspired to keep the yen weak. This has boosted the earnings of exporters.

Nikkei Average and Trading Value



Source: Tokyo Stock Exchange, Daiwa Institute of Research

Consolidated Operating Results

Overview

A sluggish equities market and a drop in individual stock trading created a tough business environment for Japanese securities companies in FY 2006. On the other hand, the favorable long-term trend of individuals shifting their assets from savings to investment accelerated the flow of funds into investment trusts. Against this backdrop, earnings at the Daiwa Securities Group were bolstered by the success of efforts to diversify the revenue base, but this was not enough to offset the full impact of market conditions. As a result, both revenues and profits declined year on year. Nevertheless, profitability remained high, with consolidated ROE at 10.8%; the Daiwa Securities Group was the only one of Japan's three major securities groups to achieve a return on equity of over 10%. The Company's dividend for the year was ¥28 per share, representing a dividend payout ratio of 41.2%, well above the 30% guideline adopted by the Group as a basic dividend policy.

Net Operating Revenues

Net operating revenues for the period declined 9.1% year on year, to ¥526.7 billion. Revenues from commissions were down 0.8% from last fiscal year, to ¥306.7 billion. This reflected both a decline in individual stock trading, which depressed equity commissions, and a smaller number of large-scale underwriting deals, which had elevated investment banking commissions in FY 2005. Assets under management of equity investment trusts increased year on year, driving a large increase in revenues from the asset management business. Gains from trading activities declined 30% year on year, to

¥157.3 billion. Most of this decline was attributable to reduced profits from the Structured Principal Solution (SPS) program, operated by Daiwa Securities SMBC. On the other hand, net gains from private equity and other securities held by Daiwa Securities SMBC Principal Investments and NIF SMBC Ventures increased sharply, as they realized gains from some investments in private equities.

Breakdown of Net Operating Revenues

(Millions of yen)

				FY2006			
	FY2005	FY2006	yoy	Q1	Q2	Q3	Q4
Commissions	¥309,189	¥306,736	–0.8%	¥ 67,858	¥ 67,110	¥ 90,278	¥ 81,489
Net gain on trading	224,912	157,333	–30.0%	35,234	37,833	37,219	47,044
Net gain on private equity and other securities	21,539	32,818	52.4%	11,602	7,058	6,159	7,997
Net financial income	13,638	19,207	40.8%	5,233	4,491	5,597	3,884
Others	10,079	10,669	5.9%	2,161	2,758	2,663	3,085
Net operating revenues	¥579,359	¥526,764	–9.1%	¥122,090	¥119,252	¥141,919	¥143,501

Note: Quarterly figures have not been audited by an independent auditor.

Breakdown of Commissions by Business Sector

Breaking down commissions by the source of the revenue, equity commissions totaled ¥98.9 billion, down 17.7% year on year. Although average daily trading value on the Tokyo Stock Exchange set a new record high for the second consecutive year, both the percentage of total activity accounted for by individual investors and Daiwa Securities' average brokerage commission rate declined. As a result, Daiwa Securities recorded a decline in equity brokerage commissions.

Commissions from asset management increased rapidly for the second consecutive year, by 29.7% year on year, to ¥106.9 billion. While distribution commissions declined due to a year-on-year drop in sales of equity investment trusts, growth in assets under management produced an increase in management fees. Total assets in publicly offered equity investment trusts managed by Daiwa Asset Management increased from ¥4.2 trillion at the end of March 2006, to ¥6.4 trillion at the end of March 2007.

Investment banking commissions declined 9.4% year on year, to ¥74.9 billion. Although the company landed several large-scale underwriting deals for initial public offerings (IPOs), the total number of large primary and secondary equity offerings underwritten declined sharply from the previous year. On the other hand, commissions from the M&A business continued to rise. In the major league tables, Daiwa Securities SMBC held the number 1 position in IPOs for the second consecutive year.

Breakdown of Commissions

(Millions of yen)

				FY2006			
	FY2005	FY2006	yoy	Q1	Q2	Q3	Q4
Equity	¥120,217	¥98,987	–17.7%	¥26,863	¥19,658	¥23,895	¥28,569
Fixed income	3,202	2,667	–16.7%	744	756	504	660
Asset management	82,404	106,906	29.7%	24,766	23,703	26,430	32,006
Investment banking	82,735	74,986	–9.4%	9,440	17,351	33,711	14,481
Others	20,631	23,190	12.4%	6,042	5,640	5,736	5,771
Total commissions	¥309,189	¥306,736	–0.8%	¥67,858	¥67,110	¥90,278	¥81,489

Note: Quarterly figures have not been audited by an independent auditor.

Selling, General and Administrative (SG&A) Expenses

SG&A expenses rose by 4.7% year on year, to ¥340.3 billion. The main factors contributing to this increase were an 11.8% year-on-year rise in fees and commissions paid, including agency commissions paid for investment trusts sold through sales channels outside the Group, and an 18.9% year-on-year increase in real estate expenses related to the refurbishing of Daiwa Securities branch offices. Office expenses also increased 33.3% year on year, mainly due to the outsourcing of systems development work. SG&A expenses increased as a percentage of net operating revenues, to 64.6% compared with a 56.1% ratio in FY 2005.

Ordinary Income and Net Income

Ordinary income declined by 25.0% year on year in FY 2006, to ¥195.4 billion. The net of extraordinary items amounted to a loss of ¥9.4 billion. Major extraordinary losses included a ¥2.9 billion loss on impaired fixed assets and a ¥4.6 billion expense associated with the relocation of the head office. As a result, net income for the period declined 33.7% year on year, to ¥92.7 billion.

Ordinary Income and Net Income

(Millions of yen)

				FY2006			
	FY2005	FY2006	yoy	Q1	Q2	Q3	Q4
Ordinary income	¥260,651	¥195,415	–25.0%	¥45,416	¥41,034	¥55,929	¥53,034
Net income	139,948	92,725	–33.7%	23,118	17,008	26,754	25,842

Note: Quarterly figures have not been audited by an independent auditor.

Performance of Major Group Companies

The Group's retail securities arm, Daiwa Securities, recorded a 10.9% year-on-year decline in operating revenues, to ¥230.6 billion, while ordinary income decreased 26.3%, to ¥74.4 billion. A lull in stock trading by individual investors, and a drop in the number of large-scale underwriting deals, compared with FY 2005, caused brokerage and distribution commissions to decline sharply. On the other hand, customer assets under custody of equity investment trusts grew steadily, from ¥3.6 trillion as of March 2006 to ¥4.7 trillion at the end of March 2007. Agency commissions grew dramatically as a result. The net inflow of retail assets rose to ¥2.4 trillion, far surpassing the ¥1.9 trillion inflow in FY 2005. In particular, the net inflow of securities assets soared, to ¥1.7 trillion from ¥500 billion in the previous year. This reflected changes in the book-entry transfer system for corporate bonds, which increased the volume of transfers from registered bonds. In addition, since the share certificate system is expected to be revised by 2009, making stock certificates completely electronic and paperless, deposits of "*tansu-kabu*" (stock certificates physically held by investors) accelerated. The net inflow of cash fell to ¥800 billion, compared with ¥1.4 trillion in FY 2005. As a result, total client assets held by Daiwa Securities as of March 2007 stood at ¥32.3 trillion. The balance of margin positions outstanding in the online trading business also increased, and contract assets under management in "Daiwa SMA"—the company's wrap account service for high-net-worth customers—rose to ¥223.4 billion as of March 2007.

Consolidated earnings at Daiwa Securities SMBC, the Group's wholesale securities arm, include contributions from consolidated overseas subsidiaries as well as Daiwa Securities SMBC Principal Investments, a domestic subsidiary which oversees the Group's investment business. Operating revenues for FY 2006 declined 9.6% year on year, to ¥317.1 billion, and ordinary income decreased by 34.4%, to ¥92.8 billion. Revenues from investment banking operations were bolstered by increased M&A advisory fees and other commissions. However, equity underwriting commissions fell sharply due to a drop in the number of large-scale underwriting deals. Daiwa Securities SMBC also posted a substantial decline in net gains on equity trading. On the other hand, net gains from private equity and other securities held by Daiwa Securities SMBC Principal Investments increased steadily. At the end of FY 2006, the total investment amount was approximately ¥356.0 billion, an increase of ¥46.0 billion year on year.

Daiwa Asset Management, the Group's asset management arm, increased its sales of equity investment trusts through Daiwa Securities and bank channels, resulting in a substantial increase in assets under management. Equity investment trust assets at the end of March 2007 stood at ¥6.4 trillion, an increase of approximately 50% year on year. As a result, management fees increased sharply, and ordinary income soared almost threefold, to a record high of ¥13.0 billion. Meanwhile, ordinary income at Daiwa SB Investments, an equity-method affiliate, declined by 4.5% year on year, to ¥4.4 billion.

Performance of Major Group Companies

(Millions of yen)

	Daiwa Securities		Daiwa Securities SMBC (consolidated)		Daiwa Asset Management	
	FY2005	**FY2006**	FY2005	**FY2006**	FY2005	**FY2006**
Operating revenues	¥258,943	**¥230,649**	¥350,818	**¥317,118**	¥31,374	**¥58,933**
Ordinary income	101,057	**74,477**	141,582	**92,866**	4,435	**13,015**
Net income	58,174	**43,468**	91,883	**51,945**	3,051	**8,659**

(Millions of yen)

	Daiwa Institute of Research		Daiwa SB Investments		NIF SMBC Ventures	
	FY2005	**FY2006**	FY2005	**FY2006**	FY2005	**FY2006**
Ordinary income	¥7,325	**¥9,744**	¥4,613	**¥4,407**	¥4,800	**¥4,233**

Overseas Performance

Regarding consolidated earnings contributions from overseas, revenues from the Americas and Europe declined, particularly in investment banking-related activities. However, in Asia and Oceania strong trading volume of stocks listed in Japan and Hong Kong supported earnings growth. Total operating income from overseas operations declined 14.0% year on year, to ¥13.8 billion.

Breakdown of Operating Income by Geographic Region

(Millions of yen)

	FY 2005	**FY 2006**
The Americas	¥ 2,366	**¥ 1,605**
Europe	10,079	**8,341**
Asia & Oceania	3,626	**3,878**
Total	¥16,071	**¥13,824**

Assets

As of the end of March 2007, total assets of the Daiwa Securities Group stood at ¥14,411.2 billion, ¥487.4 billion less than the balance at the end of March 2006. Of this total, current assets accounted for ¥13,891.1 billion (down ¥501.2 billion) and fixed assets ¥520.1 billion (up ¥13.6 billion year on year). The BoJ lifted its "zero interest rate" monetary policy during the period, and the associated rise in interest rates caused both assets and liabilities from derivatives trading, particularly at Daiwa Securities SMBC, to decline. As a result, trading assets were reduced by ¥1,080.0 billion year on year. On the other hand, receivables from collateralized securities loan increased by ¥540.1 billion.

Liabilities and Net Assets

Total liabilities stood at ¥13,188.0 billion at the end of March 2007, a decline of ¥681.8 billion year on year. Current liabilities showed a balance of ¥11,939.9 billion (down ¥872.9 billion year on year) and long-term liabilities totaled ¥1,240.2 billion (up ¥190.2 billion). The decline in current liabilities included a ¥773.8 billion drop in trading liabilities and a ¥150.9 billion decline in short-term borrowings but payables on collateralized securities loans increased by ¥415.0 billion year on year. Convertible bonds payable within one year declined by ¥79.1 billion, following conversion of the Series 16 unsecured convertible bond to stocks. On the other hand, the Group issued new straight bonds, which added ¥190.2 billion to long-term liabilities.

Total net assets stood at ¥1,223.2 billion at the end of March 2007. The Group made bookkeeping changes in FY 2006 to comply with the "Accounting Standard for Presentation of Net Assets in the Balance Sheet." Conversion of CBs during FY 2006 added ¥39.4 billion to common stock and ¥39.3 billion to the capital surplus. Retained earnings increased by ¥44.2 billion with the booking of net income and after payment of cash dividends.

Cash Flows

Cash flow from operating activities showed a net outflow of ¥14.4 billion, compared with ¥368.7 billion inflow in FY 2005. Cash flow from investing activities showed a net outflow of ¥73.2 billion (versus a ¥0.9 billion outflow in FY 2005), due mainly to the purchase of investment securities and intangible fixed assets. Cash flow from financing activities recorded an inflow of ¥43.1 billion versus a ¥322.9 billion outflow in FY 2005, due mainly to the new issue of straight bonds. Including the impact of foreign exchange conversion, the year-end balance of cash and cash equivalents stood at ¥352.7 billion.

Cash Flows

(Millions of yen)

	FY2005	FY2006
Cash flow from operating activities	¥ 368,790	¥ (14,470)
Cash flow from investing activities	(952)	(73,288)
Cash flow from financing activities	(322,945)	43,163
Cash and cash equivalents at end of term	¥ 392,350	¥352,779

Capital Investments

The goals of Daiwa Securities Group's capital investment activities include the determination to build a solid business foundation that will enhance competitiveness and improve customer convenience. In FY 2006, the Group made ¥49.1 billion in total IT-related investments, to upgrade the online trading systems at Daiwa Securities and improve trading systems at Daiwa Securities SMBC, as well as to replace core operating systems with state-of-the-art technology. In addition, the Group opened new Daiwa Securities branch offices in Aobadai (Kanagawa Prefecture) and Sakai (Osaka Prefecture), and actively invested in the transfer, refurbishing, and expansion of existing branches.

Risk Management

(1) Risk Management System

The Daiwa Securities Group faces various risks in the course of its business activities. The Group is aware that it is important to identify, evaluate, and properly manage these risks in order to maintain healthy financial and earnings structures. Most of these risks, particularly market risk, credit risk, liquidity risk, operational risk, system risk, legal risk, and reputation risk, are managed primarily by the subsidiaries of the Daiwa Securities Group. All subsidiaries have established their own systems for managing each type of risk according to the characteristics and risk profiles of their respective businesses. Daiwa Securities Group Inc., in turn, manages overall risk for the Group, by monitoring the risk management systems and processes of its subsidiaries.

Business plans for the Group, including consolidated budgets, are determined by the Board of Directors of Daiwa Securities Group Inc., which also establishes regulations concerning risk management and other organizational matters. Based on the progress of basic policies set by the Board and the business plans of each division, the Executive Committee decides how to allocate capital and other managerial resources. Details of the Group's risk exposure are reported to and discussed by the Internal Control Committee. This information is important to the Executive Committee in determining resource allocation.

Of the many risks which the Group faces, market and credit risk stemming from trading activities are especially important, since securities-related operations are central to the Group's business activities. It is imperative that the Group manage these risks effectively, in order to ensure financial health.

Daiwa Securities SMBC, Daiwa Securities SMBC Europe, and Daiwa Securities America conduct most of the trading within the Daiwa Securities Group. Daiwa Securities takes relatively small trading positions in situations where market risk exposure exists. Moreover, because transactions with its customers are backed by sufficient collateral, market risk and credit risk emanating from this trading are limited.

Daiwa Securities SMBC is responsible for its own risk management and that of its subsidiaries. The main authority related to risk management rests with the Risk Management Committee, which determines risk management policy, procedures, and risk frameworks for the trading positions of Daiwa Securities SMBC and its subsidiaries. A system has been set up to monitor measured risk and ensure that it does not exceed the upper limit established for the trading departments, and report to management. Daily and monthly reports are submitted to management, detailing market risk and credit risk related to trading positions. In addition, comprehensive quarterly reports, which include other risk information, are submitted to the Risk Management Committee.

Daiwa Securities SMBC Europe has built an independent risk management system based on local laws and regulations. Reports on market risk and credit risk related to trading positions are made regularly to the local management, as well as to the department in charge of risk management at Daiwa Securities SMBC. A similar risk management system has been put in place at Daiwa America Corporation. It reports on risk conditions to the local management and to Daiwa Securities Group Inc. The management of Daiwa Securities Group Inc. receives daily risk reports on trading positions at the aforementioned subsidiaries via its department in charge of risk management. These reports give the Group's management team an accurate grasp of the risk profile of its trading positions.

In addition, comprehensive and exhaustive quarterly reports are made to the Internal Control Committee regarding market and credit risks related to financial assets other than trading positions. Based on these daily, monthly, and quarterly reports, Daiwa Securities Group Inc. monitors risk conditions, and determines whether the capital of subsidiaries—capital invested by the Daiwa Securities Group Inc.—is being exposed to excessive risk.

(2) Major Risks and Methods of Management

[Market Risk]

Market risk is the risk of incurring losses due to fluctuations in the value of financial assets or liabilities due to changes in stock prices, interest rates, exchange rates, and value of commodities. Most of the Group's trading positions are exposed to market risk, and it is therefore of paramount importance to quantify the impact that market fluctuations have on the value of financial assets or liabilities, to gain a more objective understanding.

The Group employs Value at Risk (VaR) as an index for measuring the impact on the Group as a whole, using a holding period of one day and a confidence level of 99%. This enables the Group to gauge the estimated impact based on historical data related to market fluctuations. Moreover, the Group compensates for the limitations of the VaR method by monitoring a number of additional indicators, including market sensitivity, as well as taking a multi-faceted approach to setting credit limits, allowing it to control overall risk levels. In addition, the Group deals with the risk of sharp market fluctuations that exceed its statistical assumptions by regularly verifying the soundness of the Group's trading positions as a whole, through such methods as stress testing and scenario analysis.

Value at Risk

[Range and Assumption of VaR]

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

Daiwa Securities SMBC (Non-consolidated)

(Billions of yen)

(Month-end)	6/05	9/05	12/05	3/06	6/06	9/06	12/06	3/07
Equity	0.71	1.03	0.50	1.87	0.86	1.38	1.42	0.93
Interest	0.31	1.15	0.57	0.80	1.55	1.01	0.74	0.62
Currency	0.08	0.08	0.24	0.11	0.18	0.78	0.62	1.63
Commodities	–	–	–	–	–	–	0.03	0.12
Total	1.10	2.26	1.31	2.78	2.59	3.17	2.81	3.30
Diversification effect	–0.33	–0.58	–0.39	–0.96	–0.84	–1.16	–1.21	–1.35
VaR	0.77	1.68	0.92	1.82	1.75	2.01	1.60	1.95
Quarterly								
High	2.19	1.87	1.69	2.68	3.36	2.21	2.69	2.96
Low	0.77	0.66	0.92	0.84	1.28	1.17	1.09	0.91
Average	1.47	0.96	1.31	1.35	2.15	1.76	1.80	1.93

The Daiwa Securities Group (Consolidated)

(Billions of yen)

(Month-end)	6/05	9/05	12/05	3/06	6/06	9/06	12/06	3/07
Equity	0.77	1.09	0.53	1.93	1.05	1.48	1.48	0.98
Interest	0.48	1.29	0.78	0.92	1.71	1.09	0.88	0.80
Currency	0.08	0.08	0.24	0.11	0.18	0.78	0.62	1.63
Commodities	–	–	–	–	–	–	0.03	0.12
Total	1.33	2.46	1.55	2.96	2.94	3.35	3.01	3.53
Diversification effect	–0.38	–0.60	–0.40	–0.98	–0.88	–1.18	–1.22	–1.35
VaR	0.95	1.86	1.15	1.98	2.06	2.17	1.79	2.18
Quarterly								
High	2.39	2.30	1.95	3.07	3.69	2.42	2.86	3.55
Low	0.95	0.81	1.15	0.99	1.49	1.42	1.33	1.14
Average	1.66	1.19	1.55	1.56	2.42	1.99	2.02	2.13

[Credit Risk]
Credit risk is the risk of losses sustained due to the failure of clients to meet their liabilities, including repayment of debt. In the wholesale securities business, among others, the Group assigns credit limits for each transaction partner based on credit evaluation standards. These standards are derived by combining quantitative rating evaluation models with qualitative judgments. In addition, the Group assesses the probability of payment by regularly monitoring the performance of each transaction partner, taking into account the transaction period, availability of collateral, the validity of associated contracts and other conditions related to the transaction. In addition, the Group has imposed restrictions to ensure that the overall value of its risk portfolio is commensurate with the Group's financial strength.

[Market Risks and Credit Risks Unrelated to Trading Positions]
The Group also owns investment securities unrelated to its trading positions that are held from a long-term perspective for the purpose of maintaining business relationships, as well as private equity and other securities related to the venture capital and principal investment businesses. Since market- and credit-related risks associated with these investment assets vary in nature, the Group employs indicators appropriate to the particular type of risk—such as VaR, or a classification of holdings by credit rating, as an alternative to straightforward quantification of the balances held. These indicators, in combination with regular monitoring, enable the Group to manage credit limits appropriately.

[Liquidity Risk]
Liquidity risk is the risk that the Group will encounter difficulty procuring funds, or that the cost of capital will rise significantly higher than normal, due to changes in the market environment or a deterioration in the balance sheet. The Group employs a variety of assets in its business activities, the majority of which are highly liquid. As for liabilities, the Group strives to employ diversified methods of capital procurement, and multiple maturity periods, to minimize the risks associated with refinancing. In addition to straight bonds and medium-term note programs, the Group procures funds mainly by borrowing from financial institutions, via commercial paper, call money, repurchase agreements and other transactions.

The amount and cost of funds raised depend on market conditions and the Group's credit rating. The Group believes that it is important to have an appropriate asset-liability balance and to maintain and manage liquidity.

To ensure that business activities are not interrupted, even in the event of a credit crunch stemming from large fluctuations in financial markets, the Group thinks it is important to maintain sufficient liquidity to allow it to meet its funding needs for about one year, without relying on new, uncollateralized fund procurement. As of March 31, 2007, the Group had a liquid portfolio totaling ¥1,570.3 billion, consisting mainly of cash and deposits, government bonds, and other highly liquid instruments.

To manage liquidity, minimize liquidity risk in the event of deteriorating market conditions and lower procurement costs, the Group has introduced a group cash management system (group CMS). Daiwa Securities Group Inc. procures and manages funds centrally for the entire Group, including funds needed to cover the business activities of the holding company and its subsidiaries. However, some subsidiaries conduct their own fund procurement and management activities. This applies to securities companies, because procurement is a part of the securities business, and to listed subsidiaries (NIF SMBC Ventures), which are required to procure funds independently from the parent company. Daiwa Securities Group Inc. continuously monitors the fund-raising plans and activities of these subsidiaries. Other subsidiaries integrate their fund procurement with that of the parent company under the group CMS.

[Operational Risk]
Operational risk is the risk of incurring losses due to inappropriate or malfunctioning internal processes, personnel, or computer systems, or due to adverse external events. As the Group's business becomes more sophisticated, diversified, and systemized, the accompanying risks become more varied, and the need to manage such operational risk grows each year.

Specialized sections have been set up in each company to address operational risk, and conferences are held to consider the necessary issues. Due to the diversifying nature of its business, the Group sets rigid rules concerning authority, automates office work processes to reduce human error, prepares business manuals, and takes other necessary measures. Each Group company strives to reduce operational risk according to the nature of its own business.

[System Risk]
One form of operational risk is system risk, which refers to the potential for incurring losses due to a computer breakdown or malfunction or other systems-related problems. It also covers the risk of losses caused by the inappropriate release of information or improper use of computers.

The Group has established an information security policy, centering on system risk management, aimed at mitigating these types of risk. The Group has set security standards (regulations related to information security) and works to ensure that executives and employees understand, and fully comply with those standards.

In addition, the Group constantly monitors the operating status of its core systems to keep disorder to an absolute minimum. Even if problems do occur, the Group has procedures in place to respond to them swiftly.

[Legal Risk]
Legal risk refers to the potential for incurring losses due to non-compliance with legal and other regulations, lawsuits, invalid contracts with third parties, or violations of corporate ethics rules. The Group is engaged primarily in securities-related activities, and employs group management. It must observe the associated laws and regulations when executing securities transactions, and comply with various regulations in general operations outside of the securities business. To ensure that these regulations are observed, the Group has set up compliance sections at each company, and established committees to discuss and resolve compliance issues and matters related to corporate ethics.

Securities transactions and other third-party agreements often require high levels of specialization to determine the legality of contracts and suitability of processes. In response to such cases, the Group has consulting agreements with law firms, including overseas firms, to obtain legal advice.

[Reputation Risk]
Reputation risk refers to the possibility of the Group sustaining unforeseen losses due to deterioration of its reputation, caused by the spread of rumors or erroneous economic information. There are no uniform procedures for managing reputation risk, because it can emanate from a variety of sources.

The Group has established various regulations under its Disclosure Policy, with particular emphasis on the management and provision of information. It has also set up the Disclosure Committee within Daiwa Securities Group Inc.

Each group company is charged with the task of reporting information on reputation risk to the Disclosure Committee. Information is obtained and centrally managed at Daiwa Securities Group Inc., which disseminates it in a prompt and accurate manner according to resolutions of the Disclosure Committee.

The Group works hard to keep abreast of problems and occurrences that may affect its reputation, so that if and when such problems do occur, their impact on the Group can be minimized. It also acts to ensure that erroneous and inaccurate information is properly corrected, and responds appropriately to libel and other issues. The Group has public relations and investor relations systems in place to prevent and minimize risks to its reputation.

The Daiwa Securities Group's Credit Ratings

(As of July 26, 2007)

	Daiwa Securities Group Inc.		Daiwa Securities		Daiwa Securities SMBC	
	Long-term	Short-term	Long-term	Short-term	Long-term	Short-term
Moody's	Baa1	—	Baa1	P-2	A2	P-1
Standard & Poor's	BBB$^+$	A-2	BBB$^+$	A-2	A	A-1
Rating and Investment Information (R&I)	A	a-1	A	a-1	A	a-1
Japan Credit Rating Agency (JCR)	A$^+$	—	A$^+$	—	—	—

CONSOLIDATED BALANCE SHEETS

DAIWA SECURITIES GROUP INC.
March 31, 2007 and 2006

ASSETS	Millions of yen 2007	Millions of yen 2006	Thousands of U.S. dollars (Note 1) 2007
Cash and cash deposits:			
Cash and cash equivalents (Note 6)	¥ 352,779	¥ 392,350	$ 2,989,653
Cash segregated as deposits for regulatory purposes	256,435	297,878	2,173,178
Other deposits (Note 9)	21,031	15,540	178,228
	630,245	705,768	5,341,059
Receivables:			
Loans receivable from customers	1,925	3,113	16,314
Loans receivable from other than customers (Note 9)	143,467	56,886	1,215,822
Receivables related to margin transactions (Note 3)	575,457	563,538	4,876,754
Other (Note 9)	122,029	157,690	1,034,144
Less: Allowance for doubtful accounts	(141)	(294)	(1,195)
	842,737	780,933	7,141,839
Collateralized short-term financing agreements (Note 4)	6,814,612	6,274,506	57,750,949
Trading assets (Notes 5 and 9)	5,082,219	6,162,243	43,069,653
Private equity and other securities (Notes 6 and 9)	440,178	382,421	3,730,322
Deferred tax assets (Note 15)	25,680	29,488	217,627
Property and equipment, at cost	245,590	232,284	2,081,271
Less: Accumulated depreciation	(111,054)	(105,753)	(941,135)
	134,536	126,531	1,140,136
Other assets:			
Intangible fixed assets	81,315	68,813	689,110
Lease deposits	23,729	23,538	201,093
Investment securities (Notes 6 and 9)	269,805	269,854	2,286,483
Long-term loans receivable	11,492	11,865	97,390
Other	56,316	64,583	477,254
Less: Allowance for doubtful accounts	(1,599)	(1,851)	(13,551)
	441,058	436,802	3,737,779
	¥14,411,265	¥14,898,692	$122,129,364

See accompanying notes.

LIABILITIES AND NET ASSETS	Millions of yen 2007	2006	Thousands of U.S. dollars (Note 1) 2007
Borrowings:			
Short-term borrowings (Notes 9 and 12)	¥ 1,644,417	¥ 1,795,321	$ 13,935,737
Commercial paper	302,392	234,210	2,562,644
Long-term debt (Notes 9 and 12)	1,212,681	1,146,912	10,276,958
	3,159,490	3,176,443	26,775,339
Payables:			
Payables to customers and counterparties (Note 11)	233,164	250,765	1,975,966
Trading payables, net	67,771	302,573	574,331
Payables related to margin transactions (Notes 3 and 9)	233,353	197,483	1,977,568
Other	33,279	43,300	282,025
	567,567	794,121	4,809,890
Collateralized short-term financing agreements (Note 4)	5,159,100	4,744,007	43,721,186
Trading liabilities (Note 5)	4,105,362	4,879,189	34,791,203
Accrued and other liabilities:			
Income taxes payable	12,551	73,779	106,364
Deferred tax liabilities (Note 15)	33,290	41,907	282,119
Accrued bonuses	31,200	41,714	264,407
Retirement benefits (Note 13)	23,181	20,295	196,449
Provision for relocation costs of headquarter office	3,757	–	31,839
Provision for litigation losses	623	–	5,280
Other	84,021	91,411	712,042
	188,623	269,106	1,598,500
Statutory reserves (Note 16)	7,897	7,025	66,924
Total liabilities	13,188,039	13,869,891	111,763,042
Contingent liabilities (Note 17)			
Net assets (Notes 18 and 19):			
Owners' equity:			
Common stock, no par value;			
Authorized—4,000,000 thousand shares			
Issued—1,404,665 thousand shares as of March 31, 2007	178,324	138,828	1,511,220
Capital surplus	157,679	118,339	1,336,263
Retained earnings	520,474	476,216	4,410,797
Treasury stock at cost	(11,628)	(14,660)	(98,542)
Paid-in money for treasury stock	5	–	42
	844,854	718,723	7,159,780
Valuation and translation adjustments:			
Net unrealized gain (loss) on securities, net of tax effect	75,658	72,694	641,169
Deferred gain (loss) on hedges	468	(199)	3,966
Translation adjustment	8,546	864	72,424
	84,672	73,359	717,559
Stock subscription rights (Note 14)	611	–	5,178
Minority interests	293,089	236,719	2,483,805
Total net assets	1,223,226	1,028,801	10,366,322
	¥14,411,265	¥14,898,692	$122,129,364

CONSOLIDATED STATEMENTS OF OPERATIONS

DAIWA SECURITIES GROUP INC.
Years ended March 31, 2007, 2006 and 2005

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2007	2006	2005	2007
Operating revenues:				
Commissions (Note 21)	¥306,736	¥309,189	¥216,387	$2,599,458
Net gain on trading (Note 22)	157,333	224,912	151,118	1,333,331
Net gain on private equity and other securities	32,818	21,539	12,763	278,119
Interest and dividend income	373,453	245,211	105,428	3,164,856
Service fees and other revenues	46,968	44,809	33,641	398,033
	917,308	845,660	519,337	7,773,797
Interest expense	354,245	231,572	103,677	3,002,076
Cost of service fees and other revenues	36,299	34,729	25,228	307,619
Net operating revenues (Note 20)	526,764	579,359	390,432	4,464,102
Selling, general and administrative expenses (Notes 20 and 23)	340,373	325,199	275,544	2,884,517
Operating income (Note 20)	186,391	254,160	114,888	1,579,585
Other income (expenses):				
Provision for statutory reserves, net (Note 16)	(566)	(1,374)	(518)	(4,797)
Other, net (Note 24)	98	5,570	(1,767)	831
	(468)	4,196	(2,285)	(3,966)
Income before income taxes and minority interests	185,923	258,356	112,603	1,575,619
Income taxes (Note 15):				
Current	65,794	77,676	11,933	557,576
Deferred	3,657	392	28,234	30,992
	69,451	78,068	40,167	588,568
Minority interests	(23,747)	(40,340)	(19,771)	(201,246)
Net income	¥ 92,725	¥139,948	¥ 52,665	$ 785,805

	Yen			U.S. dollars (Note 1)
Per share amounts:				
Net income	¥67.90	¥103.90	¥39.03	$0.58
Diluted net income	66.07	98.61	37.36	0.56
Cash dividends applicable to the year	28.00	34.00	13.00	0.24

See accompanying notes.

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS

DAIWA SECURITIES GROUP INC.
Years ended March 31, 2007, 2006 and 2005

Millions of yen

		Owners' equity					Valuation and translation adjustments				
	Number of shares of common stock (thousands)	Common stock	Capital surplus	Retained earnings	Treasury stock at cost	Paid-in money for treasury stock	Net unrealized gain (loss) on securities net of tax effect	Deferred gain (loss) on hedges	Translation adjustments	Stock subscription rights	Minority interests
Balance at March 31, 2004	1,331,735	¥ 138,432	¥ 117,940	¥ 330,780	¥ (690)	¥ –	¥ 27,298	¥ –	¥ (9,590)	¥ –	¥ 165,664
Net income				52,665							
Cash dividends paid				(19,960)							
Conversion of convertible bonds	1	0	1								
Bonuses to directors				(536)							
Change in treasury stock, net					(97)						
Net changes of items other than owners' equity							8,376		3,713		23,530
Balance at March 31, 2005	1,331,736	138,432	117,941	362,949	(787)	–	35,674	–	(5,877)	–	189,194
Net income				139,948							
Increase in retained earnings due to merger of a consolidated subsidiary				608							
Cash dividends paid				(26,612)							
Conversion of convertible bonds	724	396	396								
Bonuses to directors				(677)							
Change in treasury stock, net			2		(13,873)						
Net changes of items other than owners' equity							37,020		6,741		47,525
Balance at March 31, 2006	1,332,460	138,828	118,339	476,216	(14,660)	–	72,694	(199)	864	–	236,719
Issuance of new shares	72,205	39,496	39,496								
Net income				92,725							
Increase in retained earnings due to merger of a consolidated subsidiary				406							
Cash dividends paid				(45,806)							
Bonuses to directors and executive officers				(1,828)							
Change in treasury stock, net			(156)	(1,239)	3,032						
Other						5					
Net changes of items other than owners' equity							2,964	667	7,682	611	56,370
Balance at March 31, 2007	1,404,665	¥ 178,324	¥ 157,679	¥ 520,474	¥ (11,628)	¥ 5	¥ 75,658	¥ 468	¥ 8,546	¥ 611	¥ 293,089

Thousands of U.S. dollars (Note 1)

	Owners' equity					Valuation and translation adjustments				
	Common stock	Capital surplus	Retained earnings	Treasury stock at cost	Paid-in money for treasury stock	Net unrealized gain (loss) on securities net of tax effect	Deferred gain (loss) on hedges	Translation adjustments	Stock subscription rights	Minority interests
Balance at March 31, 2006	$ 1,176,508	$ 1,002,873	$ 4,035,729	$(124,237)	$ –	$ 616,051	$(1,686)	$ 7,322	$ –	$ 2,006,093
Issuance of new shares	334,712	334,712								
Net income			785,805							
Increase in retained earnings due to merger of a consolidated subsidiary			3,441							
Cash dividends paid			(388,186)							
Bonuses to directors and executive officers			(15,492)							
Change in treasury stock, net		(1,322)	(10,500)	25,695						
Other					42					
Net changes of items other than owners' equity						25,118	5,652	65,102	5,178	477,712
Balance at March 31, 2007	$1,511,220	$1,336,263	$4,410,797	$ (98,542)	$42	$641,169	$3,966	$72,424	$5,178	$2,483,805

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

DAIWA SECURITIES GROUP INC.
Years ended March 31, 2007, 2006 and 2005

			Millions of yen	Thousands of U.S. dollars (Note 1)
	2007	2006	2005	2007
Cash flows from operating activities:				
Net income	¥ 92,725	¥ 139,948	¥ 52,665	$ 785,805
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Depreciation and amortization	23,117	22,641	22,129	195,907
Allowance for doubtful accounts, net	317	226	2,289	2,686
Provision for retirement benefits, net	1,234	23	1,402	10,458
Stock subscription rights	611	–	–	5,178
Statutory reserves, net	567	1,374	518	4,805
Losses (gains) related to investment securities	(3,926)	(11,060)	(2,687)	(33,271)
Losses (gains) related to fixed assets	5,880	11,838	(351)	49,831
Gain on change in stake in subsidiary	–	(4,725)	–	–
Provision for litigation losses	551	–	–	4,669
Provision for relocation costs of headquarter office	4,681	–	–	39,669
Deferred income taxes	3,657	392	28,234	30,992
Minority interests	23,747	40,340	19,771	201,246
Changes in operating assets and liabilities:				
Receivables and payables related to margin transactions	27,247	(195,882)	(28,087)	230,907
Other receivables and other payables	(113,773)	(29,270)	77,878	(964,178)
Private equity and other securities	(45,410)	(192,645)	(44,197)	(384,831)
Trading assets and liabilities	79,204	615,610	111,198	671,220
Collateralized short-term financing agreements	(150,764)	(63,704)	(1,183,394)	(1,277,661)
Other, net	35,865	33,684	(76,044)	303,941
Total adjustments	(107,195)	228,842	(1,071,341)	(908,432)
Net cash flows provided by (used in) operating activities	(14,470)	368,790	(1,018,676)	(122,627)
Cash flows from investing activities:				
Increase in time deposits	(36,290)	(10,685)	(53,041)	(307,542)
Decrease in time deposits	30,995	55,201	–	262,669
Payments for purchases of property and equipment	(18,439)	(12,526)	(7,786)	(156,263)
Proceeds from sales of property and equipment	539	719	5,315	4,568
Payments for purchases of intangible fixed assets	(34,648)	(24,312)	–	(293,627)
Payments for purchases of investment securities	(47,527)	(51,554)	(35,693)	(402,771)
Proceeds from sales of investment securities	36,553	43,604	99,469	309,771
Purchase of subsidiary's stock due to change in scope of consolidation	1,357	–	–	11,500
Decrease (increase) in long-term loans receivable	(876)	358	149	(7,424)
Other, net	(4,952)	(1,757)	(18,689)	(41,966)
Net cash flows provided by (used in) investing activities	(73,288)	(952)	(10,276)	(621,085)

	Millions of yen			Thousands of U.S. dollars (Note 1)
	2007	2006	2005	2007
Cash flows from financing activities:				
Increase (decrease) in short-term borrowings	¥ (97,430)	¥(446,190)	¥ 759,982	$ (825,678)
Increase (decrease) in long-term debt	10,360	58,496	14,788	87,797
Proceeds from issuance of notes	509,087	505,358	225,875	4,314,297
Payments for redemption of bonds and notes	(362,305)	(401,374)	(97,102)	(3,070,381)
Proceeds from issuance of stocks to minority shareholders	40,080	10,000	–	339,661
Payments of cash dividends	(45,806)	(26,612)	(19,960)	(388,186)
Payments of cash dividends to minority shareholders	(12,039)	(9,177)	(168)	(102,025)
Other, net	1,216	(13,446)	454	10,303
Net cash flows provided by (used in) financing activities	43,163	(322,945)	883,869	365,788
Effect of exchange rate changes on cash and cash equivalents	4,788	7,429	3,819	40,577
Net increase (decrease) in cash and cash equivalents	(39,807)	52,322	(141,264)	(337,347)
Cash and cash equivalents at beginning of year	392,350	338,697	480,123	3,325,000
Increase in cash and cash equivalents due to merger of a consolidated subsidiary	236	1,331	–	2,000
Decrease in cash equivalents due to exclusion of a consolidated subsidiary	–	–	(162)	–
Cash and cash equivalents at end of year	¥ 352,779	¥ 392,350	¥ 338,697	$ 2,989,653
Supplemental information on cash flows:				
Cash paid during the year for:				
Interest	¥ 348,266	¥ 222,153	¥ 103,440	$ 2,951,407
Income taxes	111,811	11,405	13,690	947,551

See accompanying notes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DAIWA SECURITIES GROUP INC.
Years ended March 31, 2007, 2006 and 2005

1. Basis of financial statements

The consolidated financial statements include the accounts of Daiwa Securities Group Inc. ("Company"), a Japanese corporation, and subsidiaries (collectively "Daiwa"). Daiwa's principal subsidiaries include:

—Daiwa Securities Co. Ltd. ("Daiwa Securities")
—Daiwa Securities SMBC Co. Ltd. ("Daiwa Securities SMBC")
—Daiwa Asset Management Co. Ltd. ("Daiwa Asset Management")
—Daiwa Institute of Research Ltd. ("DIR")
—NIF SMBC Ventures Co., Ltd. ("NIF SMBC")
(NIF Ventures Co., Ltd., a consolidated subsidiary of the Company changed its name to NIF SMBC Ventures Co., Ltd. following the merger with SMBC Capital Co., Ltd. on October 1, 2005.)

Daiwa Securities is the retail-securities arm of Daiwa. This company operates through a network of 117 branches as well as non-face-to-face channels, including the Internet and a full-fledged call center to provide on-line and telephone-based securities-related services. Daiwa Securities SMBC is the wholesale-securities company of Daiwa, a 60%-owned joint venture with Sumitomo Mitsui Financial Group, Inc. Daiwa Asset Management is the asset management company of Daiwa. In addition, Daiwa has several overseas consolidated subsidiaries, mainly engaged in the securities business.

Daiwa is primarily engaged in the business of a securities broker-dealer, pursuant to which Daiwa provides services including brokerage, trading, underwriting, strategic advice, product development, and structured finance. In addition, Daiwa provides asset and capital management, principal finance, venture capital, and research through a network in major capital markets and other services.

The Company and domestic consolidated subsidiaries maintain their official accounting records in yen. The accompanying consolidated financial statements have been prepared in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with generally accepted accounting principles in Japan ("Japanese GAAP"), which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards. The accounts of overseas consolidated subsidiaries are maintained in conformity with generally accepted accounting principles and practices prevailing in the respective countries of domicile.

The accompanying consolidated financial statements have been restructured and translated into English (with some expanded descriptions) from the consolidated financial statements of the Company prepared in accordance with Japanese GAAP and filed with the appropriate Local Finance Bureau of the Ministry of Finance as required by the Securities and Exchange Law. Some supplementary information included in the statutory Japanese language consolidated financial statements, but not required for fair presentation, is not presented in the accompanying consolidated financial statements.

The translations of the yen amounts into U.S. dollars are included solely for the convenience of the reader, using the prevailing exchange rate at March 31, 2007, which was ¥118 to U.S.$1. The convenience translations should not be construed as representations that the yen amounts have been, could have been, or could be, converted into U.S. dollars at this or any other rate of exchange.

2. Significant accounting policies

Consolidation — The consolidated financial statements include the accounts of the Company and significant companies which are controlled by the Company through substantial ownership of more than 50% of the voting rights (excluding companies owned for the purpose of operating principal finance and venture capital business, and not for the purpose of affiliation to the group) or through ownership of at least 40% and less than 50% of the voting rights and the existence of certain conditions evidencing control by the Company of the decision-making body of such companies.

In addition to investments in companies in excess of 20% (excluding companies owned for the purpose of operating principal finance and venture capital business and not for the purpose of affiliation to the group through personnel management, financial resources, technology, transactions, etc.), certain companies for which the Company has at least 15% and less than 20% of the voting rights and in cases where the Company has the ability to exercise significant influence over operating and financial policies of the investees are accounted for by using the equity method.

Practical Issues Task Force No. 20, "Practical Solution on Application of Control Criteria and Influence Criteria to Investment Associations," has been applied from this fiscal year. There was no impact on the financial statements for the year ended March 31, 2007.

Material inter-company balances, transactions and profits have been eliminated in consolidation.

Statements of cash flows — For purposes of the consolidated statements of cash flows, the Company defines cash equivalents as highly liquid investments with original maturities of three months or less.

Trading assets and trading liabilities — Trading assets and liabilities including securities and financial derivatives for trading purposes held by a securities company are recorded on a trade date basis at fair value in the consolidated balance sheets. Gains and losses including unrealized gains and losses related to transactions for trading purposes are reported as "Net gain on trading" in the accompanying consolidated statements of operations. Fair value is determined based on market prices, quoted prices, internal pricing models (utilizing indicators of general market conditions or other economic measurements), or management's estimates of amounts to be realized on settlement, assuming current market conditions and an orderly disposition over a reasonable period of time. Securities owned for non-trading purposes, shown in the accompanying consolidated balance sheets as "Cash and cash equivalents," "Private equity and other securities" and "Investment securities," are discussed below.

Securities other than trading assets and trading liabilities — Daiwa examines the intent of holding securities and classifies those securities as (a) securities intended to be held for trading purposes by non-securities companies, (b) debt securities intended to be held to maturity ("held-to-maturity debt securities") and (c) all other securities not classified in any of the above categories ("available-for-sale securities").

Securities intended to be held for trading purposes by non-securities companies are carried at fair value with recognized unrealized gains or losses included in the consolidated statements of operations.

Held-to-maturity debt securities are stated at amortized cost.

Available-for-sale securities with market value are stated at market value, based on quoted market prices. Realized gains and losses on sale of such securities are computed using the moving-average cost. Unrealized gains and losses on these securities are reported, net of tax effect, as a separate component of net assets.

Available-for-sale securities for which a market value is not available, are stated at the moving-average cost.

If the market value of available-for-sale securities declines significantly, such securities are considered to be impaired and the difference between market value and the carrying amount is recognized as a loss in the period of the decline. For available-for-sale securities, which do not have readily available market value, if the net book value declines significantly and if such decline is considered to be other than temporary, the difference between the carrying amount and the net book value is recognized as a loss in the period of the decline. Impaired losses on these securities are reported in the consolidated statements of operations.

Based on "Practical Solution on Accounting for the Book Value of Class Shares at the Balance Sheet Date" (Practical Issues Task Force No. 10), net unrealized gain on securities, net of tax effect as of March 31, 2007 includes ¥7,974 million ($67,576 thousand) derived from the investments in corporations' class shares, which are in period convertible into common shares.

Of those securities with no fair value, investments in limited partnerships and similar partnerships which are regarded as equivalent to securities by Article 2 (2) of the Securities Exchange Act of 2004, the share of net income of the partnerships has been reflected on the consolidated statements of operations and the share of net unrealized gains and losses held by the partnerships is directly recorded into net assets.

Derivatives used for non-trading purposes — Daiwa states derivative financial instruments at fair value and recognizes changes in the fair value as gains or losses unless the derivative financial instruments are used for hedging purposes. Valuation gains or losses on hedging instruments are mainly deferred as assets or liabilities until the gains or losses on the underlying hedged instruments are realized. Interest received or paid on interest swaps for hedging purposes is accrued without being marked-to-market. The premium or discount on foreign exchange forward for hedging purposes is allocated to each fiscal term without being marked-to-market.

Collateralized short-term financing agreements — Collateralized short-term financing agreements consist of securities purchased under agreements to resell ("resell transactions") or securities sold under agreements to repurchase ("repurchase transactions"), and securities borrowed or loaned. Repurchase transactions and resell transactions are carried at their contractual amounts. Securities borrowed or loaned are recorded at the amount of cash collateral advanced or received.

Allowance for doubtful accounts — Allowance for doubtful accounts is provided based on the actual historical default rate for normal loans, and based on individually assessed amounts for doubtful and default loans.

Property and equipment — Property and equipment are stated at cost. Impairment losses recognized have been deducted from the acquisition costs. The Company and domestic consolidated subsidiaries compute depreciation principally by the declining-balance method over estimated useful lives. Depreciation for buildings purchased in Japan after April 1, 1998 is computed by the straight-line method. In overseas consolidated subsidiaries, depreciation is mainly computed by the straight-line method.

(Additional Information)
The relocation of the headquarter office of the Company and some consolidated subsidiaries has been resolved. The useful lives of the building and equipment for those headquarters were shortened up to planned removal date. Extraordinary depreciation expenses of ¥4,439 million were recorded as other expense, due to application of shortened useful lives for the year ended March 31, 2006. Also "Income before income taxes and minority interests" decreased by that amount as a result.

Intangible fixed assets — Intangible fixed assets are generally amortized under the straight-line method. The Company and domestic consolidated subsidiaries compute depreciation over estimated useful lives, and over internally estimated useful lives (5 years) for software of in-house use.

Bonuses — Accrued bonuses of employees and directors represent liabilities estimated as of the balance sheets date.

Change in the accounting standard—The consolidated financial statements of the Company are adapted to "Accounting Standard for Directors' Bonus (ASBJ Statement No. 4)" from this fiscal year. Directors' bonus is expensed when it is incurred, instead of decreasing retained earnings upon approval of each consolidated subsidiary's annual shareholders' meeting. "Operating income" and "Income before income taxes and minority interests" decreased by ¥1,553 million ($13,161 thousand), due to this accounting change, respectively.

Share-based payment — Change in the accounting standard—The consolidated financial statements of the Company for the fiscal year ended March 31, 2007, are adapted to "Accounting Standard for Share-based Payment (ASBJ Statement No. 8)" and "Implementation Guidance on Accounting Standard for Share-based Payment (ASBJ Guidance No. 11)." "Operating income" and "Income before income taxes and minority interests" decreased by ¥611 million ($5,178 thousand), due to this accounting change, respectively.

Retirement benefits — Daiwa has various benefit plans for eligible employees and directors such as the unfunded plan and closed funded plan.

Provision for relocation costs of headquarter office — Provision for relocation costs of the headquarter office has been booked based on reasonable estimation.

Provision for litigation losses — The estimated amount of restitution is accrued to provide for future monetary damages of litigation regarding financial services based on the status of litigation.

Income taxes — Income taxes consist of corporation, enterprise and inhabitants taxes. The provision for income taxes is computed based on the pre-tax income of each of the Company and consolidated subsidiaries with certain adjustments, if necessary.

Income tax consequences of amounts that will become taxable or deductible in future years are recorded as deferred tax assets and liabilities, which are generally raised from the difference in value of assets and liabilities for statutory accounting and tax accounting. Daiwa recognizes deferred tax assets to the extent of amounts reasonably expected to be realized in future.

The consolidated tax payments system has been applied designating the Company, Daiwa Securities SMBC and NIF SMBC as parent companies of the consolidated tax payments.

Translation of foreign currencies — The Company and domestic consolidated subsidiaries translate assets and liabilities in foreign currencies into yen at the year-end exchange rate.

Translation of foreign currency financial statements — Financial statements of overseas consolidated subsidiaries are translated into yen on the basis of the year-end exchange rates for assets and liabilities except that "Retained earnings" are translated at historical rates. Income and expenses are translated at the average exchange rates of the applicable year. The resulting differences are reported as "Translation adjustments" in net assets in the accompanying consolidated balance sheets.

Net assets — Change in the accounting standard—The consolidated financial statements of the Company are adapted to "Accounting Standard for Presentation of Net Assets in the Balance Sheet (ASBJ Statement No. 5)" and "Guidance on Accounting Standard for Presentation of Net Assets in the Balance Sheet (ASBJ Guidance No. 8)" from this fiscal year. As a result, "Deferred gain (loss) on hedges" and "Minority interests" were included in net assets.

Net income per share — Net income per share of common stock is based on the average number of common shares outstanding.

Diluted net income per share is computed based on the average number of common shares outstanding for the year with an adjustment for dilutive convertible bonds and stock subscription rights based on the number of shares of common stock that would have been issued provided that the outstanding dilutive convertible bonds and stock subscription rights were converted at the beginning of the year.

Reclassification — Certain reclassifications have been made in the 2006 and 2005 consolidated financial statements to conform to the presentation for 2007.

3. Margin transactions

Margin transactions at March 31, 2007 and 2006 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Assets:			
Customers' margin loans	¥339,104	¥359,331	$2,873,762
Cash deposits as collateral for securities borrowed	236,353	204,207	2,002,992
	¥575,457	¥563,538	$4,876,754
Liabilities:			
Payable to securities finance companies	¥ 14,447	¥ 7,570	$ 122,432
Proceeds of securities sold for customers' accounts	218,906	189,913	1,855,136
	¥233,353	¥197,483	$1,977,568

Customers' margin loans are stated at amounts equal to the purchase amounts of the relevant securities, which are collateralized by customers' securities and customers' deposits. Proceeds of securities sold for customers' accounts are stated at the sales amounts.

4. Collateralized short-term financing agreements

Collateralized short-term financing agreements at March 31, 2007 and 2006 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Assets:			
Securities purchased under agreements to resell	¥1,595,729	¥2,184,881	$13,523,124
Securities borrowed	5,218,883	4,089,625	44,227,825
	¥6,814,612	¥6,274,506	$57,750,949
Liabilities:			
Securities sold under agreements to repurchase	¥3,219,353	¥2,811,293	$27,282,652
Securities loaned	1,939,747	1,932,714	16,438,534
	¥5,159,100	¥4,744,007	$43,721,186

5. Trading assets and trading liabilities

Trading assets and trading liabilities at March 31, 2007 and 2006 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Trading assets:			
Equities	¥ 377,531	¥ 371,948	$ 3,199,423
Government, corporate and other bonds	3,720,283	4,005,132	31,527,818
Investment trusts	111,367	95,498	943,788
Commercial paper, certificates of deposits and others	19,714	18,635	167,064
Option transactions	166,603	908,197	1,411,890
Futures and forward transactions	177,068	156,934	1,500,576
Swap agreements	509,663	607,483	4,319,178
Other derivatives	1,927	1,127	16,331
Credit reserves	(1,937)	(2,711)	(16,415)
	¥5,082,219	¥6,162,243	$43,069,653
Trading liabilities:			
Equities	¥ 88,620	¥ 99,551	$ 751,012
Government, corporate and other bonds	3,314,739	3,216,833	28,091,008
Investment trusts	14,475	5,471	122,672
Option transactions	256,023	1,007,981	2,169,686
Futures and forward transactions	46,293	67,232	392,316
Swap agreements	383,702	480,973	3,251,712
Other derivatives	1,510	1,148	12,797
	¥4,105,362	¥4,879,189	$34,791,203

6. Securities other than trading assets and trading liabilities

Securities other than trading assets and trading liabilities are composed of "Cash and cash equivalents," "Private equity and other securities" and "Investment securities" in the accompanying consolidated balance sheets.

Cost and market value of securities intended to be held for trading purposes by non-securities companies as of March 31, 2007 and 2006 consisted of the following:

			Millions of yen
	Cost	Market value	Difference
March 31, 2007	¥ 4,345	¥ 4,589	¥ 244
March 31, 2006	¥ 3,205	¥ 3,543	¥ 338

			Thousands of U.S. dollars
	Cost	Market value	Difference
March 31, 2007	$36,822	$38,890	$2,068

Cost/amortized cost and market value of held-to-maturity debt securities as of March 31, 2007 and 2006 consisted of the following:

			Millions of yen
	Cost/amortized cost	Market value	Difference
Government bonds, local government bonds at March 31, 2007	¥ 1,769	¥ 1,769	¥ 0
Government bonds, local government bonds at March 31, 2006	¥ 2,509	¥ 2,502	¥(7)

			Thousands of U.S. dollars
	Cost/amortized cost	Market value	Difference
Government bonds, local government bonds at March 31, 2007	$14,992	$14,992	$ 0

Cost and market value of available-for-sale securities as of March 31, 2007 and 2006 consisted of the following:

			Millions of yen
	Cost	Market value	Difference
March 31, 2007:			
Equities	¥ 96,500	¥ 220,484	¥ 123,984
Government, corporate and other bonds	150	156	6
Other	8,832	10,228	1,396
	¥105,482	¥ 230,868	¥ 125,386
March 31, 2006:			
Equities	¥ 82,493	¥ 203,127	¥ 120,634
Government, corporate and other bonds	150	158	8
Other	13,719	15,474	1,755
	¥ 96,362	¥ 218,759	¥ 122,397

			Thousands of U.S. dollars
	Cost	Market value	Difference
March 31, 2007:			
Equities	$817,797	$1,868,508	$1,050,711
Government, corporate and other bonds	1,271	1,322	51
Other	74,847	86,678	11,831
	$893,915	$1,956,508	$1,062,593

Securities for which a market value was not readily available as of March 31, 2007 and 2006 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Equities	¥257,288	¥245,399	$2,180,407
Government, corporate and other bonds	802	349	6,797
Investments in limited partnerships	150,435	132,751	1,274,873
Other	45,110	22,631	382,287
	¥453,635	¥401,130	$3,844,364

In addition to the above, equity securities of non-consolidated and affiliated companies amounting to ¥27,623 million ($234,093 thousand) at March 31, 2007 and ¥26,334 million at March 31, 2006, respectively, were included in "Investment securities" in the accompanying consolidated balance sheets.

7. Derivatives used for non-trading purposes

Net unrealized gains of derivatives used for non-trading purposes at March 31, 2007 and 2006 (excluding hedging transactions) consisted of the following:

			Millions of yen
	Contract amount	Market value	Unrealized gains
March 31, 2007:			
Currency swap	¥ 11,922	¥ 10	¥ 10
Foreign exchange forward	3,612	100	100
March 31, 2006:			
Currency swap	¥ 11,289	¥ 17	¥ 17
Foreign exchange forward	801	24	24

			Thousands of U.S. dollars
	Contract amount	Market value	Unrealized gains
March 31, 2007:			
Currency swap	$101,034	$ 85	$ 85
Foreign exchange forward	30,610	847	847

8. Risk management information concerning trading transactions

The two domestic securities subsidiaries, Daiwa Securities and Daiwa Securities SMBC ("Securities subsidiaries"), enter into transactions involving trading assets and liabilities to meet customer needs, and for their proprietary trading activities, as a broker and an end-user. These trading assets and liabilities include (1) shares and bonds, (2) financial derivatives traded on exchanges such as futures and options based on stock price indices, bonds and interest rates, and (3) financial derivatives traded over the counter such as currency and interest rate swaps, foreign exchange forward contracts, bonds with options, currency options, forward rate agreements and OTC equity derivatives.

The principal risks inherent in trading in these markets are market risk and credit risk. Market risk represents the potential for loss from changes in the value of financial instruments due to price and interest rate fluctuations in the markets. As to market risk, Daiwa

Securities SMBC determines the balance of risk and profit or loss on each instrument and uses a value-at-risk method to manage this risk. Credit risk represents the potential for loss arising from the failure of the counter-party in a transaction to fulfill its terms and conditions. Securities subsidiaries assess the credit risk of their counterparties applying internal credit rating and monitor their exposure by measuring notional principal and credit exposure.

Daiwa Securities SMBC has established five risk management policies: active management participation, a system of internal supervision, sound management by risk limit setting, risk management assuming emergency, and transparency in the risk management process. By ensuring these five policies, Daiwa Securities SMBC expects that risks associated with trading activities are well controlled within a range of risk that the management is willing to assume.

9. Pledged assets

At March 31, 2007, short-term borrowings amounting to ¥754,888 million ($6,397,355 thousand) and payables related to margin transactions amounting to ¥14,439 million ($122,364 thousand) and long-term debt amounting to ¥20 million ($169 thousand) were secured by the following assets:

	Millions of yen	Thousands of U.S. dollars
Other deposits	¥ 125	$ 1,059
Loans receivable from other than customers	18,517	156,924
Trading assets	1,072,264	9,086,983
Private equity and other securities	614	5,203
Investment securities	98,496	834,712
Receivables—other	7,973	67,568
	¥1,197,989	$10,152,449

In addition to the above, securities borrowed amounting to ¥535,044 million ($4,534,271 thousand) were pledged as guarantee at March 31, 2007.

Total fair value of the securities pledged as collateral at March 31, 2007 consisted of the following:

	Millions of yen	Thousands of U.S. dollars
Securities loaned	¥6,133,988	$51,982,949
Other	739,061	6,263,229
	¥6,873,049	$58,246,178

Total fair value of the securities received as collateral at March 31, 2007 consisted of the following:

	Millions of yen	Thousands of U.S. dollars
Securities borrowed	¥8,440,583	$71,530,364
Other	659,903	5,592,399
	¥9,100,486	$77,122,763

10. Lease transactions

Financial leases, whose ownership does not transfer to the lessee at the end of the lease term are not capitalized and are accounted for in the same manner as operating leases. Certain information concerning such non-capitalized finance leases and operating leases at March 31, 2007 and 2006 is summarized as follows:

Lessee:	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Non-capitalized finance leases:			
Total assets under non-capitalized finance leases	¥ 6,161	¥7,685	$52,212
Accumulated depreciation	4,338	4,584	36,763
Future lease payments in respect of non-capitalized leases	1,878	3,181	15,915
Due within one year	1,100	1,501	9,322
Operating leases:			
Future lease payments in respect of operating leases	11,767	9,000	99,720
Due within one year	2,239	1,999	18,975

Lessor:	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Operating leases:			
Future lease receipts in respect of operating leases	¥ 1,056	¥1,803	$ 8,949
Due within one year	289	387	2,449

11. Payables to customers and counterparties

Payables to customers and counterparties at March 31, 2007 and 2006 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Cash received for customers' accounts	¥124,851	¥131,335	$1,058,059
Cash deposits received from customers	100,494	99,225	851,644
Other	7,819	20,205	66,263
	¥233,164	¥250,765	$1,975,966

12. Bank borrowings and long-term debt

As is customary in Japan, in the case of unsecured bank borrowings, security must be given under certain conditions if requested by a lending bank. The bank has the right to offset cash deposited by the borrower against any debt or obligation that becomes due, and in the case of default and certain other specified events, against all debts payable to the bank. No such request has been made and no such right has been exercised.

Long-term debt at March 31, 2007 and 2006 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Bond payable in yen: 0.95% due 2008	¥ 120,000	¥ 120,000	$ 1,016,949
Bond payable in yen: 1.30% due 2011	70,000	70,000	593,220
Bond payable in yen: 2.08% due 2016	30,000	30,000	254,237
Bond payable in yen: 1.80% due 2011	50,000	–	423,729
Convertible bond payable in yen, convertible into common stock at ¥1,094.00 per share: 0.5% due 2006	–	79,193	–
Euro medium-term notes issued by the Company and the domestic consolidated subsidiary with various rates and maturities through 2037	774,785	677,159	6,565,975
Euro medium-term notes issued by overseas consolidated subsidiaries with various rates and maturities through 2007	2,000	2,608	16,949
Yen subordinated loan due 2012	60,000	82,000	508,475
Borrowings	105,896	85,952	897,424
	¥1,212,681	¥1,146,912	$10,276,958

The aggregate annual maturities of long-term debt as of March 31, 2007 were as follows:

Year ending March 31	Millions of yen	Thousands of U.S. dollars
2008	¥ 27,913	$ 236,551
2009	142,774	1,209,949
2010	18,129	153,636
2011	109,804	930,542
2012	122,195	1,035,551
2013 and thereafter	791,866	6,710,729
	¥ 1,212,681	$10,276,958

Daiwa has unused commitment line amounting to ¥89,864 million ($761,559 thousand) under agreements with several banks at March 31, 2007.

13. Retirement benefits

Retirement benefits for employees

Retirement benefit plans for eligible employees are discussed below:

• Unfunded plan

The Company and most domestic consolidated subsidiaries provide an unfunded retirement benefit plan to their employees in return for services rendered each year, where the amount to be contributed to the individual employee's account is defined by the plan. Benefits of the plan are accumulated on an annual basis and earn a guaranteed hypothetical return at a rate predetermined by the Company and most domestic consolidated subsidiaries each year. Accumulated contribution plus interest to this unfunded plan are included in "Retirement benefits" in the consolidated balance sheets as of March 31, 2007 and 2006, in the amount of ¥19,903 million ($168,669 thousand) and ¥17,980 million, respectively. Benefit expenses recorded in the consolidated statements of operations for the years ended March 31, 2007, 2006 and 2005 were ¥3,305 million ($28,008 thousand), ¥2,864 million and ¥2,946 million, respectively.

• Closed funded plan

The Company and domestic consolidated subsidiaries closed their defined benefit plan as of April 1, 1999 and accordingly, no new employees have been added to the plan and no service cost has been charged for the plan. The effect on the consolidated financial statements was immaterial.

Retirement benefits for directors

Directors' retirement benefits in consolidated subsidiaries of ¥590 million ($5,000 thousand) and ¥383 million are included in "Retirement benefits" in the accompanying consolidated balance sheets as of March 31, 2007 and 2006, respectively. Benefit expenses recorded in the consolidated statements of operations for the years ended March 31, 2007, 2006 and 2005 were ¥199 million ($1,686 thousand), ¥174 million and ¥439 million, respectively.

The board of the Company resolved to abolish the retirement gratuities system for retiring directors in May 2004. In June 2004, the shareholders' meeting of the Company approved the payments of retirement allowance to directors who were nominated for re-election. The payments will be made in accordance with standards prescribed by the Company and service rendered to the Company during their respective terms of office up to the end of the shareholders' meeting. The payments will be made at the time of their respective retirements from the Board of Directors.

The boards of certain consolidated subsidiaries resolved to abolish the retirement gratuities system for retiring directors in March 2005. In June 2005, the shareholders' meetings of such consolidated subsidiaries approved the payments of retirement allowance to directors who were nominated for re-election. The payments will be made in accordance with standards prescribed by consolidated subsidiaries and service rendered to consolidated subsidiaries during their respective terms of office up to the end of the shareholders' meetings. The payments will be made at the time of their respective retirements from the Board of Directors.

14. Share-based payment

The Company has a stock option plan. The stock option plan which was approved at the shareholders' meeting provides options for purchases of the Company's common stock for the directors and employees.

The date of approval at the shareholders' meeting, the balance of the exercisable options, exercise price and exercise period at March 31,2007 were as follows:

Date of approval at the shareholders' meeting	Balance of the exercisable options (Number of shares)	Exercise price (Yen/share)	(U.S. dollars/share)	Exercise period
June 23, 2004	1,815,000	¥ 756	($ 6.41)	from July 1, 2006 to August 31, 2011
June 24, 2005	528,000	¥ 1	($ 0.01)	from July 1, 2005 to June 30, 2025
	–	¥ 781	($ 6.62)	from July 1, 2007 to August 31, 2012
June 24, 2006	298,000	¥ 1	($ 0.01)	from July 1, 2006 to June 30, 2026
	–	¥1,515	($12.84)	from July 1, 2011 to June 23, 2016

NIF SMBC also has a stock option plan. The date of approval at the shareholders' meeting, the balance of the exercisable options, exercise price and exercise period at March 31,2007 were as follows:

Date of approval at the shareholders' meeting	Balance of the exercisable options (Number of shares)	Exercise price (Yen/share)	(U.S. dollars/share)	Exercise period
June 27, 2002	0	¥308,000	($2,610.17)	from June 28, 2004 to June 27, 2006
June 24, 2004	305	¥201,800	($1,710.17)	from July 1, 2006 to August 31, 2011
June 28, 2005	252	¥ 1	($ 0.01)	from December 1, 2005 to November 30, 2025
	–	¥426,300	($3,612.71)	from July 1, 2007 to August 31, 2012
June 27, 2006	31	¥ 1	($ 0.01)	from September 8, 2006 to September 7, 2026
	50	¥ 1	($ 0.01)	from September 8, 2006 to September 7, 2026
	–	¥430,290	($3,646.53)	from July 1, 2011 to June 26, 2016

15. Income taxes

The Company and domestic consolidated subsidiaries are subject to a number of taxes levied on income. The compounded statutory tax rate in Japan was approximately 40.7% for the years ended March 31, 2007, 2006 and 2005.

Overseas consolidated subsidiaries are subject to income taxes of the countries in which they operate.

Details of deferred tax assets and liabilities at March 31, 2007 and 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2007	2006	2007
Deferred tax assets:			
Net operating losses carried-forward	¥ 42,416	¥ 25,656	$ 359,458
Write-down of investment securities	11,136	10,637	94,373
Retirement benefits	8,939	8,026	75,753
Compensation and bonuses	9,377	15,278	79,466
Allowance for doubtful accounts	1,899	2,423	16,093
Impairment losses on fixed assets	6,988	7,248	59,220
Enterprise tax payable	1,446	8,338	12,253
Elimination of unrealized gain	4,536	1,522	38,441
Allowance for possible investment losses	5,922	5,426	50,184
Other	13,362	8,786	113,242
Gross deferred tax assets	106,021	93,340	898,483
Less: Valuation allowance	(65,378)	(51,824)	(554,051)
Total deferred tax assets	40,643	41,516	344,432
Deferred tax liabilities	48,253	53,935	408,924
Net deferred tax liabilities	¥ (7,610)	¥(12,419)	$ (64,492)

The Company and certain consolidated subsidiaries provided valuation allowance to reflect the estimated unrealized amount of gross deferred tax assets.

A reconciliation of the difference between the Japanese statutory income tax rate and the effective income tax rate reflected in the consolidated statements of operations for the years ended March 31, 2007, 2006 and 2005 was as follows:

	2007	2006	2005
Japanese statutory income tax rate	40.7%	40.7%	40.7%
Valuation allowance	(9.0)	(9.0)	(7.0)
Permanent difference (Non-deductible)	0.9	0.3	1.2
Permanent difference (Non-taxable)	(0.3)	(0.3)	(0.6)
Lower tax rate applicable to income of overseas consolidated subsidiaries	(1.0)	(0.6)	(0.8)
Adjustment of unrealized intercompany profit	5.2	0.6	3.8
Other, net	0.9	(1.5)	(1.6)
Effective income tax rate	37.4%	30.2%	35.7%

16. Statutory reserves

The Securities and Exchange Law of Japan requires a securities company to set aside a reserve in proportion to its securities transactions and other related trading to cover possible customer losses incurred by default of the securities company on securities transactions.

17. Contingent liabilities

At March 31, 2007, Daiwa had contingent liabilities amounting to ¥1,683 million ($14,263 thousand), mainly arising as guarantors of employees' borrowings.

18. Owners' equity

In principle, the Corporate Law of Japan ("Law") requires a company to credit the entire amount of issued shares to common stock (and preferred stock, if any); however, a company may classify the amount not exceeding one-half of the entire issued amount of shares as additional paid-in capital, which is included in capital surplus with a resolution of the Board of Directors.

According to the Law, a company should save 10% of cash dividends and other cash appropriated as "Additional paid-in capital" or "Earned surplus" until the total becomes one quarter of common stock (and preferred stock, if any). "Additional paid-in capital" and "Earned surplus" are allowed to eliminate or reduce a deficit with a resolution of the shareholders' meeting or may be capitalized with a resolution of the Board of Directors. The excess amount of "Additional paid-in capital" and "Earned surplus" of one quarter of capital requirement is available for appropriation with a resolution of the shareholders' meeting. "Additional paid-in capital" and "Earned surplus" are included in "Capital surplus" and "Retained earnings" in the accompanying consolidated balance sheets.

The maximum amount that the Company can distribute as dividends is calculated based on the non-consolidated financial statements of the Company in accordance with the Law. The total amount of retained earnings available for dividends in the Company's statutory book of account as of March 31, 2007 amounted to ¥285,000 million ($2,415,254 thousand).

Under Article 459-1 of the Law, the articles of incorporation of the Company stipulate that the Board of Directors is to determine the dividends. Cash dividends of ¥12 ($0.10) per share amounting to ¥16,741 million ($141,873 thousand) and ¥16 ($0.14) per share amounting to ¥22,332 million ($189,254 thousand) were approved by the Board of Directors on October 26, 2006 and May 18, 2007, respectively.

The shareholders of the Company approved a stock incentive plan on June 23, 2004. The plan provides for the issuance of up to 4,500 thousand shares in the form of options to directors and key employees. The options may be exercised during the period from July 1, 2006 until August 31, 2011, and the exercise price is determined at the grant date. On the same day, the shareholders' meeting of the Company approved a change in the articles of incorporation so that the Company may be entitled to repurchase its shares by the resolution of its Board of Directors.

The shareholders of the Company on June 24, 2005, June 24, 2006 and June 23, 2007 approved stock incentive plans. There are two kinds of stock subscription rights as stock options to directors, executive officers and employees. The first is the stock subscription rights that were issued free to directors and executive officers of the Company and subsidiaries, and the amount paid in upon exercise of such subscription rights is ¥1 per share. The second is the stock subscription rights that shall be issued to employees of the Company, and of affiliated companies, and to directors and executive officers of the Company's affiliated companies, excluding the persons to whom the first stock subscription rights were issued. The amount paid in upon exercise of such subscription rights shall be determined based on the market price of the Company's common stock at the time of the issuance of such subscription rights.

19. Capital adequacy requirements

In Japan, a securities company is subject to risk-based capital adequacy rules established and administered by the Financial Services Agency. Securities subsidiaries report their capital adequacy ratio as defined pursuant to these rules. The authorities will take certain administrative measures if such ratio declines below 140%. Capital adequacy ratios of Daiwa Securities were 319.3% (unaudited) and 323.6% (unaudited) for March 31, 2007 and 2006, respectively, and those of Daiwa Securities SMBC were 465.7% (unaudited) and 336.3% (unaudited) for March 31, 2007 and 2006, respectively.

20. Segment information

Daiwa operates predominantly in a single industry segment. Daiwa's primary business activities include (1) trading in securities and derivatives, (2) brokerage of securities and derivatives, (3) underwriting and distribution of securities, (4) other business related to securities transactions and (5) private offering of securities.

A summary of revenues by geographic area for the years ended March 31, 2007, 2006 and 2005 and a summary of total assets by geographic area at March 31, 2007 and 2006 was as follows:

Millions of yen

	Japan	America	Europe	Asia & Oceania	Elimination or unallocated	Consolidated
Year ended March 31, 2007:						
Net operating revenues:						
Outside customer	¥ 483,875	¥ 9,588	¥ 19,870	¥13,431	¥ –	¥ 526,764
Inter-segment	(8,701)	5,096	16,034	1,298	(13,727)	–
Total	475,174	14,684	35,904	14,729	(13,727)	526,764
Selling, general and administrative expenses	302,606	13,079	27,563	10,851	(13,726)	340,373
Operating income	¥ 172,568	¥ 1,605	¥ 8,341	¥ 3,878	¥ (1)	¥ 186,391
At March 31, 2007:						
Total assets by geographic area	¥10,808,697	¥3,372,712	¥1,238,352	¥81,732	¥(1,090,228)	¥14,411,265
Year ended March 31, 2006:						
Net operating revenues:						
Outside customer	¥ 541,666	¥ 5,528	¥ 21,673	¥ 10,492	¥ –	¥ 579,359
Inter-segment	1,530	8,758	12,085	1,606	(23,979)	–
Total	543,196	14,286	33,758	12,098	(23,979)	579,359
Selling, general and administrative expenses	294,984	11,920	23,679	8,472	(13,856)	325,199
Operating income	¥ 248,212	¥ 2,366	¥ 10,079	¥ 3,626	¥ (10,123)	¥ 254,160
At March 31, 2006:						
Total assets by geographic area	¥ 12,239,143	¥ 2,807,087	¥ 1,145,934	¥ 72,881	¥ (1,366,353)	¥ 14,898,692
Year ended March 31, 2005:						
Net operating revenues:						
Outside customer	¥ 353,827	¥ 3,971	¥ 25,378	¥ 7,256	¥ –	¥ 390,432
Inter-segment	(2,370)	6,641	5,027	1,278	(10,576)	–
Total	351,457	10,612	30,405	8,534	(10,576)	390,432
Selling, general and administrative expenses	244,543	10,595	24,203	6,781	(10,578)	275,544
Operating income	¥ 106,914	¥ 17	¥ 6,202	¥ 1,753	¥ 2	¥ 114,888

	Japan	America	Europe	Asia & Oceania	Elimination or unallocated	Consolidated
						Thousands of U.S. dollars
Year ended March 31, 2007:						
Net operating revenues:						
Outside customer	$ 4,100,636	$ 81,254	$ 168,390	$113,822	$ –	$ 4,464,102
Inter-segment	(73,737)	43,186	135,881	11,000	(116,330)	–
Total	4,026,899	124,440	304,271	124,822	(116,330)	4,464,102
Selling, general and administrative expenses	2,564,457	110,839	233,585	91,958	(116,322)	2,884,517
Operating income	$ 1,462,442	$ 13,602	$ 70,686	$ 32,864	$ (8)	$ 1,579,585
At March 31, 2007:						
Total assets by geographic area	$91,599,127	$28,582,305	$10,494,508	$692,644	$(9,239,220)	$122,129,364

Geographic overseas revenues for the years ended March 31, 2007, 2006 and 2005 were as follows:

	America	Europe	Asia & Oceania	Total
				Millions of yen
Year ended March 31, 2007:				
Overseas revenues	¥ 19,325	¥ 13,101	¥ 11,902	¥ 44,328
Net operating revenues				526,764
% of Net operating revenues	3.7%	2.5%	2.3%	8.4%
Year ended March 31, 2006:				
Overseas revenues	¥ 10,313	¥ 19,370	¥ 11,016	¥ 40,699
Net operating revenues				579,359
% of Net operating revenues	1.8%	3.3%	1.9%	7.0%
Year ended March 31, 2005:				
Overseas revenues	¥ 8,552	¥ 21,149	¥ 8,890	¥ 38,591
Net operating revenues				390,432
% of Net operating revenues	2.2%	5.4%	2.3%	9.9%

	America	Europe	Asia & Oceania	Total
				Thousands of U.S. dollars
Year ended March 31, 2007:				
Overseas revenues	$163,771	$ 111,025	$100,864	$ 375,660
Net operating revenues				4,464,102
% of Net operating revenues	3.7%	2.5%	2.3%	8.4%

21. Commissions

Commissions derived from each department for the years ended March 31, 2007, 2006 and 2005 were as follows:

	Equity	Fixed income (Bond)	Investment trust	Investment banking	Others	Total
						Millions of yen
Year ended March 31, 2007:						
Brokerage	¥ 97,062	¥ 694	¥ 317	¥ –	¥ –	¥ 98,073
Underwriting	–	–	–	54,069	–	54,069
Distribution	–	–	37,211	1,310	–	38,520
Other	1,925	1,973	69,379	19,607	23,190	116,074
	¥ 98,987	¥ 2,667	¥106,906	¥ 74,986	¥ 23,190	¥ 306,736
Year ended March 31, 2006:						
Brokerage	¥ 118,262	¥ 923	¥ 336	¥ –	¥ –	¥ 119,521
Underwriting	–	–	–	64,314	–	64,314
Distribution	–	–	41,799	2,032	–	43,831
Other	1,955	2,279	40,269	16,389	20,631	81,523
	¥ 120,217	¥ 3,202	¥ 82,404	¥ 82,735	¥ 20,631	¥ 309,189
Year ended March 31, 2005:						
Brokerage	¥ 81,919	¥ 1,464	¥ 159	¥ –	¥ –	¥ 83,542
Underwriting	–	–	–	54,744	–	54,744
Distribution	–	–	19,688	3,598	–	23,286
Other	1,968	2,800	25,793	12,828	11,426	54,815
	¥ 83,887	¥ 4,264	¥ 45,640	¥ 71,170	¥ 11,426	¥ 216,387

	Equity	Fixed income (Bond)	Investment trust	Investment banking	Others	Total
						Thousands of U.S. dollars
Year ended March 31, 2007:						
Brokerage	$822,559	$ 5,882	$ 2,686	$ –	$ –	$ 831,127
Underwriting	–	–	–	458,212	–	458,212
Distribution	–	–	315,339	11,102	–	326,441
Other	16,314	16,720	587,958	166,161	196,525	983,678
	$838,873	$22,602	$905,983	$635,475	$196,525	$2,599,458

22. Net gain on trading

Net gain on trading for the years ended March 31, 2007, 2006 and 2005 was as follows:

	Millions of yen			Thousands of U.S. dollars
	2007	2006	2005	2007
Stock and other	¥ 31,288	¥124,271	¥ 56,105	$ 265,153
Bond, forex and other	126,045	100,641	95,013	1,068,178
(Bond and other)	(48,693)	(39,026)	(62,407)	(412,653)
(Forex and other)	(77,352)	(61,615)	(32,606)	(655,525)
	¥157,333	¥224,912	¥151,118	$1,333,331

23. Selling, general and administrative expenses

Major components of selling, general and administrative expenses for the years ended March 31, 2007, 2006 and 2005 were summarized as follows:

			Millions of yen	Thousands of U.S. dollars
	2007	2006	2005	2007
Employees' compensation and benefits	¥163,379	¥171,062	¥142,751	$1,384,568
Commissions and brokerage	37,672	31,508	19,607	319,254
Communications	19,749	18,646	18,174	167,364
Occupancy and rental	38,846	32,659	32,697	329,203
Data processing and office supplies	23,021	17,273	16,805	195,093
Taxes other than income taxes	8,265	8,072	6,756	70,042
Depreciation and amortization	23,117	22,641	22,129	195,908
Other	26,324	23,338	16,625	223,085
	¥340,373	¥325,199	¥275,544	$2,884,517

24. Other income (expenses)

Details of "Other, net" in the accompanying consolidated statements of operations for the years ended March 31, 2007, 2006 and 2005 were as follows:

			Millions of yen	Thousands of U.S. dollars
	2007	2006	2005	2007
Gains on sales of investment securities	¥ 3,602	¥10,030	¥ 5,559	$ 30,525
Losses on sales of investment securities	(363)	(70)	(892)	(3,076)
Write-down of investment securities	(736)	(499)	(3,472)	(6,237)
Valuation losses on fixed assets	(1,510)	–	(114)	(12,797)
Gains or losses on sale or disposal of fixed assets	(1,395)	(548)	465	(11,822)
Losses on sales of loans receivable	–	–	(7,595)	–
Reversal of stock purchase warrant	–	–	502	–
Multiemployer pension plan settlement cost in consolidated subsidiaries	–	–	(188)	–
Allowance for doubtful accounts	(317)	–	(1,639)	(2,686)
Equity in earnings of affiliates	1,424	1,528	1,894	12,068
Impairment losses on fixed assets	(2,975)	(6,851)	–	(25,212)
Losses on liquidation of affiliates	–	–	(51)	–
Relocation costs of headquarter office	(4,681)	–	–	(39,669)
Expenses for reorganization of overseas banking subsidiary	–	–	(779)	–
Gain on charge in stake in subsidiary	–	4,725	–	–
Contribution to the Securities Market Infrastructure Improvement Fund	–	(200)	–	–
Loss on litigation settlement	–	(1,279)	–	–
Foreign exchange loss from overseas subsidiary capital reduction	–	(1,564)	–	–
Extraordinary depreciation	–	(4,439)	–	–
Provision for litigation losses	(551)	–	–	(4,669)
Other	7,600	4,737	4,543	64,406
	¥ 98	¥ 5,570	¥(1,767)	$ 831

For the purpose of identifying impairment of fixed assets, the Company and domestic consolidated subsidiaries grouped their fixed assets principally according to the unit on which decisions for investment are made. The recoverability of book values of the fixed assets was evaluated for each asset group. As a result, fixed assets listed below were identified as being impaired and their book values were reduced to their estimated recoverable amounts. The breakdown of impairment losses recognized in the years ended March 31, 2007, 2006 and 2005 was as follows:

	Millions of yen			Thousands of U.S. dollars
	2007	2006	2005	2007
Fixed assets to be held and used	¥2,975	¥6,201	¥–	$25,212
Fixed assets to be disposed of by sale	–	650	–	–
Total	¥2,975	¥6,851	¥–	$25,212

The book values of fixed assets to be held and used were reduced to their estimated recoverable amounts based on mainly the present values of expected cash flows using the discount rate of 5%.

The book values of fixed assets to be disposed of by sale were reduced to net realizable values based mainly on publicly-assessed values.

25. Subsequent events

Stock incentive plan — The shareholders of the Company approved the issuance of stock subscription rights as stock options on June 23, 2007. In accordance with Articles 236, 238 and 239 of the Corporation Law, the stock subscription rights were issued free to directors and executive officers of the Company and subsidiaries, and the amount paid in upon exercise of such subscription rights was ¥1 ($0.01) per share.

INDEPENDENT AUDITORS' REPORT

KPMG

To the Shareholders and the Board of Directors of Daiwa Securities Group Inc.:

We have audited the accompanying consolidated balance sheets of Daiwa Securities Group Inc. and consolidated subsidiaries as of March 31, 2007 and 2006, and the related consolidated statements of operations, changes in net assets and cash flows for each of the three years in the period ended March 31, 2007, expressed in yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to independently express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Daiwa Securities Group Inc. and subsidiaries as of March 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2007, in conformity with accounting principles generally accepted in Japan.

Without qualifying our opinion, we draw attention to the following. As discussed in Note 2 to the consolidated financial statements, the consolidated financial statements of the Company are adapted to "Accounting Standard for Presentation of Net Assets in the Balance Sheet " and " Guidance on Accounting Standard for Presentation of Net Assets in the Balance Sheet" from this fiscal year.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2007 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 1 to the consolidated financial statements.

KPMG AZSA & Co.

Tokyo, Japan
June 25, 2007