Q&A at 2Q FY2022 Telephone Conference

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Q1. My question is about Tokiwabashi Tower unrealized gains and their impact on revenues. You indicate roughly 100 billion yen in unrealized gains but how much will remain after this most recent transaction? Also, I assume there are various options for you to consider, including property management or sell-off, but how will you utilize those unrealized gains? While I imagine it may be difficult to separate considering you are engaged in various businesses, in terms of IFRS, once the property reaches full operation, how much are you projecting for rental revenues from Tokiwabashi Tower and what are your estimates for depreciation?

- Our equity in Tokiwabashi Tower is roughly 40% and the property is already operating at over 99%.
- As “Rental and other investment property” on the Securities Report indicates both book value and market value, you can ascertain a general image of those figures by calculating unrealized gains. Even when excluding the portion we recently liquidated, our understanding is that, based on the appraised valuation, unrealized gains are roughly 100 billion yen.
- At present, we have no specific plans for additional sell-offs. Moving forward, we will continue to confirm real estate market conditions and investor needs towards the private fund. We will make decisions on the need for further liquidation based on comprehensive evaluations of factors such as the need to increase capital efficiency, strengthen our real estate AM business, and enhance shareholder equity by materializing unrealized gains.
- We do not disclose IFRS figures for rental revenues and depreciation.

Q2. My question is regarding the Retail Division on P14. Revenues from “Others” increased compared to the previous quarter. What impact have overseas interest rate hikes had on Daiwa Next Bank and the Retail Division, and what impact will they have moving forward?

- Increased revenues recorded under “Others” for the Retail Division are attributable to increased bank agency fees.
- Daiwa Next Bank recorded increased revenues on higher investment management profit margins resulting from global interest rate hikes. However, looking to ensure portfolio stability, we were engaged in rebuilding the portion of our portfolio that experienced a valuation decline. As a result, the impact of Daiwa Next Bank’s ordinary income as a nonconsolidated entity on consolidated

ordinary income is not particularly significant.

Q3. The Investment Division appears to have recorded a net loss, with ordinary income down by roughly 4 billion yen compared to the previous quarter and net gains (losses) on private equity also down by roughly 4 billion yen compared to the previous quarter. Please indicate the areas in which the Investment Division recorded a profit and where it recorded losses.

- Due to the complexity, it is difficult to provide a general breakdown. For example, solar power generation retained by Daiwa Energy & Infrastructure often uses SPC to conduct investments. When selling, net gains (losses) on private equity will be recorded as a loss, but other operating revenues will increase. Overall, the total sum of net gains (losses) on private equity, other operating revenues, and operating expenses will be a net positive. The figures are recording in separate accounting categories.
- Also, the Investment Division records gains and losses due to reevaluations and exits. We will refrain from disclosing individual results.

Q4. Why did non-operating income decrease significantly compared to the previous quarter?

- Non-operating income includes numerous items. In addition to equity method investment income and dividends received from investment securities, other major elements include income and losses from various funds, including intellectual property, VC, PE, and business succession, which we strategically hold in relation to the hybrid business.
- 2Q revenues decreased significantly compared to 1Q due to compounding factors.
- During 1Q, multiple funds generated significant income. For example, we are engaged in a capital alliance with the fund management company for an intellectual property-related fund called IP Bridge. This fund produced a lot of income in 1Q. Several other funds also generated income, resulting in a significant amount of income recorded for 1Q.
- On the other hand, in 2Q, multiple funds saw costs outpace income. As a result, there was a significant decrease compared to the previous quarter. Dividends received also decreased compared to the previous quarter.
- Worsening income/losses on derivatives related to hedging for loan interest was another factor resulting in the decrease in non-operating income compared to the previous quarter. In this way, multiple compounding factors resulted in decreased income.

Q5. 2Q M&A appears to have outperformed the market environment. I assume this was influenced by factors such as a shift in the timing when income was recorded. At the same time, overall, the M&A market is shrinking but can we expect 3Q income to be on par with 2Q? Or, was 2Q income at a higher level because of the delayed timing of the closing of certain deals? What is your outlook for 3Q and beyond?

- As you indicated, the global M&A market during 2Q decreased by 60% based on amount, by 30% based on the number of transactions, compared to the same period of the previous fiscal year. Compared to 1Q, we were able to increase deals in Japan and overseas in 2Q. As for our pipeline moving forward, it is in contrast with the market environment as we are steadily expanding our pipeline in Japan and overseas. As a total for both Japan and overseas, we are at a level on par with the number of deals in FY2021, when we secured a very strong pipeline. Based on amount, our current pipeline is trending above levels from FY2021. We are maintaining the same trend overseas. In other words, we have a very strong pipeline.

- Depending on the macro environment moving forward, business could be impacted by transaction delays and other factors but at present, we intend to expand revenues by converting this strong pipeline into deals.
- Looking at our M&A pipeline in Europe and the U.S., we are building our pipeline in a wide range of sectors, including infrastructure, high-tech, industrials, and consumer with a particular focus on debt advisory and restructuring.
- While I cannot disclose whether or not a previously announced potential deal has been closed, I hope you will recognize that we have a very strong pipeline and that M&A revenues are quite firm. Also, M&A needs are increasing in both Japan and overseas, and we will work to convert these needs into revenues.

Q6. My question is about cost structure. Looking at the difference between Retail Division net operating revenues and ordinary income shown on P7, 2Q/FY2020 net operating income was 40 billion yen and ordinary income was 2.6 billion yen. Is it safe to assume that your ability to secure income even when net operating income is stagnant due to progress in your cost structure reforms? Looking at the Wholesale Division, quarterly net operating income transitioned just below 40 billion yen. In FY2019, when revenues were similarly stagnant, you still were able to secure profits. Are losses this fiscal year the result of higher costs? It would be difficult to view two consecutive quarters of losses as being in a healthy financial position. Do you have any measures that can bring down costs for the Wholesale Division?

- Monthly costs for the Retail Division decreased by roughly 1.8 billion yen from the 1Q/FY2019 average of 13.4 billion yen, which is prior to initiating cost structure reforms.
- Early in 1Q/FY2022, outsourcing expenses were low to the point of actually being below normal. In 2Q, expenses rose from those levels. Looking at long-term trends, the Retail Division has made steady progress with cost structure reforms. We will continue with cost structure reforms heading into FY2023 and we think we can achieve additional cost reductions near roughly 200 million yen monthly, including through our site strategy for moving storefront locations to higher floors in buildings. We will continue to review efforts to further strengthen our position.
- The Wholesale Division is active globally. Business is greatly impacted by overseas inflation and particularly foreign currency prices, which lead to cost increases.
- Looking at past ordinary income, GM fluctuates significantly year to year. However, looking at the long-term average over a five or ten-year period, the business produces ordinary income of nearly 40 billion yen per year. Rather than looking at past performance, taking into account the fact that our range of products and customer base are growing, I believe there are more than sufficient opportunities to generate even more ordinary income.
- Wholesale losses are largely due to a drop in our top line resulting in not being able to cover SG&A expenses. If this situation continues, we will consider and implement more aggressive revenue improvement measures.

Q7. I was told that, at the press conference, there were comments regarding feeling that the market correction had bottomed out. Is it safe to assume that we have seen the bottom for all business lines?

- Speaking particularly on deterioration of performance, this will depend on the ability to improve GM. Retail is steadily increasing asset-based revenues and fund wraps have remained steady even after October. Also, we are seeing fund inflow into foreign bonds and foreign currency deposits, so sentiment is changing.

- IB is also seeing large-scale financing deals, so risk appetite among investors is gradually returning. I believe IB revenues will return with the buildup of successful deals.
- GM saw a particularly large drop in equity revenues but this was impacted by both customer order flow and position management. As a ratio of the decrease since last fiscal year, flow and position each account for roughly 50 percent.
- With flow, we are reaching the point where the market will begin to think about an exit from monetary tightening. I think the market will correct upwards if, as we head towards the end of the year, US inflation and interest rate hikes gradually begin to settle, and corporate earnings prove to be resilient.
- I think we will see renewed interest in foreign stocks, which investors avoided amid historical yen depreciation.
- We have similar expectations for foreign bonds. Among corporate customers, we expect to see increased needs for hedging against fluctuations in interest rates and foreign currency.
- This was a difficult market for position management but we are implementing countermeasures, and our measures have become more advanced and refined. We do not think the market for dramatic fluctuations in stocks, interest rates, and foreign currency will continue long-term, and overall, we expect a trend towards recovery.

Q8. Equity indicated that it struggled with position management during 1Q and 2Q. FICC indicated struggles during 1Q, but made no indications regarding 2Q. Have conditions improved?

- The measures implemented during 1Q produced a certain level of results but the market was much more volatile than anticipated, so Equity continued to struggle. On the other hand, bonds improved thanks to risk level adjustments for dynamic hedging and adjustments to improve our position.

Q9. On the subject of Daiwa Next Bank foreign currency deposits, looking back on past years, deposit balances increased significantly in 2013 during that period of yen depreciation. While the environment is right for it, we are not seeing signs of that happening now. How are you positioning foreign currency deposits? Is it your view that, instead of placing expectations on you conducting transactions through foreign currency, it is fine if sales of foreign currency-related products increase?

- Newspapers and other outlets have indicated that foreign currency deposits are growing but, looking at statistics, overall foreign currency deposits have not increased. Instead, foreign currency time deposits have increased. We have also seen customers terminating foreign currency deposits due to rapid yen depreciation, which had driven to a net decrease. However, from a long-term perspective, there is a relatively strong need among customers for high interest rates, so we think there is room for growth.
- When we look at foreign currency time deposits with Daiwa Next Bank as well, deposit amounts are increasing. Balances have increased by 141.8 billion yen over the six-month period since March of this year. The increase in interest rates overseas means a significant improvement in bank revenues, so our Group positions foreign currency deposits as important products and we are strategically incorporating these products. This is why, compared to other companies, we are conducting campaigns offering competitive interest rates and also strengthening promotions.

Q10. How did you determine dividend per share? What factors did you consider regarding the total amount and the dividend payout ratio? Also, please discuss what discussions you have had concerning share buy-backs.

- Our promise is to issue dividends based on a dividend payout ratio of 50% or higher every six months. We decided on 11 yen as the amount to fulfill this promise.
- As for share buy-backs, in April of this year we established a budget for up to 33 million shares. The deadline is through March 24 of next year. As for additional shareholder returns, as per normal, we will conduct a comprehensive evaluation based on our business environment, our growth investment pipeline, our stock price, and regulatory trends.

Q11. On the subject of ordinary income from overseas operations, it appears that income in Europe improved compared to the previous quarter. Through your revenue structure reforms, you focused on controlling middle and back office costs but what specific reforms did you advance and what progress did you make?

- During 1Q, we completed transferring our trading book for bonds and convertible bonds to Tokyo. Transferring the trading book reduces middle and back office functions, which reduces administrative operations. Sales will remain in London so we are able to continue business while still reducing costs. The benefit of reducing middle and back office functions will manifest later, and we are currently in that process of generating those benefits.

Q12. Regarding the segment summary on P6, what factors resulted in further losses compared to the previous quarter for Ordinary Income “Other/Adjustments”?

- We record various revenue and expense items in “Other/Adjustments”, including earnings from roughly 30 Group companies not included in major segments as well as income, losses, and consolidated adjustments not attributable to any segment. Looking on a quarterly basis, we have seen significant fluctuations in the past.
- Compared to 1Q, multiple negative factors resulted in a decrease of 2.3 billion yen. For example, revenues from a strategically held fund decreased.
- Moving forward, it will be difficult to make assumptions due to the extremely large number of items included in this category. However, we do believe we will see a positive effect if we see an increase in earnings from strategic subsidiaries and revenues from funds held as part of our hybrid business.

Q13. Regarding structured bonds, can you indicate the current state of sales? The FSA is engaged in various discussions but will there be some sort of regulatory enhancement? When do you expect to see a recovery in sales amounts and what do you think will drive such a recovery? At present, is Daiwa Securities internally deciding to refrain from sales?

- Since September 28, excluding designated investors, we have temporarily ceased new solicitations targeting individual customers. Other measures we have implemented include reevaluating standards for starting solicitations and we stopped handling public offerings for structured bonds.
- The catalyst for these measures was we, at the management level, conducted an evaluation of the customer attributes and our sales structure based on how we position structured bonds within our sales strategy. We recognized the need to conduct risk profiling for each scheme used for structured bonds and reevaluate whether or not those products were appropriate for customers.
- For individual customers, even those with considerable capital, we determined there was a need for

caution due to the financial literacy required to understand the economic practicality of structured bonds and the complex characteristics of products.

- When looking specifically at individual customers involved in complex structured bonds, which, as noted, are being discussed by the FSA, these products represent less than 2 percent of operating revenues. Even if we were to stop soliciting customers regarding structured bonds, the overall impact would be limited as we would focus on proposing other products that suit customer needs. There are various discussions being had concerning regulations, so we will continue to pay attention to future trends.
- Our main focus is on customer-oriented business operations. We must consider things from a principle-based perspective and, as part of that commitment, evaluate and inspect our sales structure. There are various types of structured bonds, so we will continue to make sales judgments by evaluating which products best suit which customers.

Q14. You explained the Retail Division's impact on income but products include commissions from structured bonds, which makes it difficult to separate revenues. How do you calculate what percentage structured bond revenues account for overall revenues? Also, what level of impact is there on Wholesale Division revenues?

- For the Retail Division, revenues from structured bonds are treated as compensation for sales services. For example, key information documents indicate 2% for a publicly offered structured bond, so we conduct calculations based on a similar line of thinking. Like the Retail Division, we also analyze the impact on revenues had by global markets related to bond structuring. We believe the impact of complex structured bonds on overall GM revenues is limited at 3 to 4 percent.

Q15. (About structured bonds) I have seen reports that financial institutions are facing a lawsuit but what are your thoughts on this?

- We have always worked to fulfill our duty of accountability as it relates to follow-up services. However, we do recognize that there are a certain number of customers with complaints. We will continue to ensure thorough follow-up service for customers.

Q16. On the subject of liquidating Tokiwabashi Tower, it seems wasteful to sell off such an excellent asset in what seems like a half-measure. The sale was to a private fund but what was the purpose? Please explain how transferring partial ownership to a private fund will increase AUM for the private fund?

- The occupancy rate for Tokiwabashi Tower exceeds 99%, so we do not consider this to be poor timing in terms of valuation. Selling to a private fund did not result in a sell below value. We liquidated at an appropriate price. Daiwa Real Estate Asset Management serves as SPC asset manager so this will increase AUM for Daiwa Real Estate Asset Management. As a result, AM fees will increase and lead to stable revenue growth for the Group overall.
- On P20, we indicate the AUM balance for the two real estate asset management companies. In those materials, the increase in "Other" represents the liquidation of Tokiwabashi Tower.