An Interview with President Onodera

KDDI plans to achieve higher profits and increased competitiveness by using structural reforms to improve the profitability of existing operations while extracting additional revenues and income from new areas of activity.

Concentration on CDMA

Q. You have completed your first business year since taking office as President. How would you assess your progress, including the realization of merger synergy effects, during the past year?

A. After the merger of DDI, KDD and IDO in October 2000, KDDI has rapidly carried out its management restructuring. The merger process proceeded very smoothly, and since taking office in June 2001, I have been working with even greater determination to implement the restructuring measures.

Q. The telecommunications industry as a whole has gone through extremely rapid changes. How do you view the impact of those changes?

A. Although, obviously, market growth has slowed—as we see, for example, in the penetration rate trends for cellular telephones, and revenues from fixed-line telephone services—I believe that the telecommunications industry still has excellent growth potential. The rapid expansion of mobile data and broadband services is reflected in dramatic changes in industry and business structures. For example, possession of telecommunications infrastructure once gave carriers a crucial advantage. Now this is not necessarily true. Today the industry has entered a new phase, and competitiveness depends on the ability to develop highly original, high-added-value services by stepping outside the traditional framework of the telecommunications sector.

Q. What are KDDI's advantages in this new phase?

A. In October 2001 we absorbed our subsidiary, au Corporation, to merge into a single company spanning both fixed-line and cellular services. In March 2002 we established the Solution Business Sector, which has the important goal of promoting our solutions business by integrating mobile and fixed-line telephone services to create powerful strategic products unmatched by any competitor. We already have a variety of concepts with huge potential. In particular we anticipate major growth from our *GPS Solutions* business, which is based on links with au's mobile GPS service *GPS Keitai*. KDDI has an overwhelming advantage in this area, and our expectations are high.

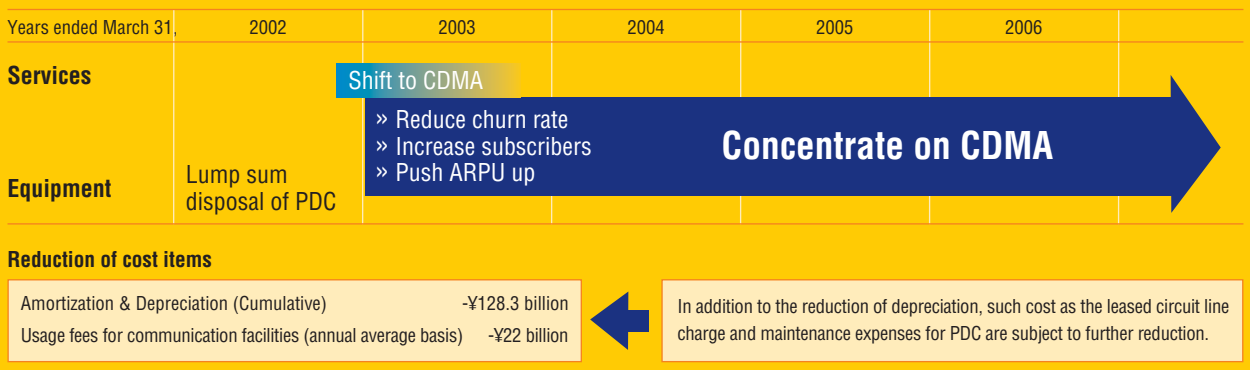
Q. What are the key points of the Medium-Term Management Plan-2002, which you announced in March?

A. The Medium-Term Management Plan-2002 consists of business restructuring measures and business strategies. The first restructuring measure was the write-off of PDC facilities. A large share of our sales and income comes from au, and the poor profitability of cellular-phone services based on the old PDC system is its biggest problem. For that reason, we have decided to terminate these services by the end of March 2003, and the write-offs are shown as a extraordinary loss item in the accounts for the year ended March 31, 2002 (fiscal 2002). This move will result in substantial reductions in costs, including the depreciation of PDC facilities and usage charges for telecommunications facilities. The benefits will become apparent in our earnings from fiscal 2003 onwards (Figure 1).

Because of the technology of our current cdmaOne system, we will be able to make the switch to the more advanced third-generation CDMA2000 1x system simply by changing panels and software in our base stations, making the future outlook much brighter.

A second key feature of Medium-Term Management Plan-2002 is the accelerated realization of merger benefits. We will integrate assets that were operated separately by the individual companies prior to the merger, such as information systems

(Figure 1) EFFECTS OF CONCENTRATION ON CDMA: REDUCTION OF COST



Reduction of cost items

Amortization & Depreciation (Cumulative)	-¥128.3 billion
Usage fees for communication facilities (annual average basis)	-¥22 billion

In addition to the reduction of depreciation, such cost as the leased circuit line charge and maintenance expenses for PDC are subject to further reduction.

and customer centers. In the au category, not only IDO but also DDI's eight cellular subsidiaries all operated separate systems. These nine systems are now being integrated into one. In the area of fixed-line services, we are preparing to integrate the DDI, KDD and TWJ systems. We estimate that this move alone will reduce our costs by ¥19 billion annually.

The third focus of the plan is the reinforcement of our financial structure. Immediately after the merger, we had interest-bearing debt of ¥2,240.9 billion. By the end of fiscal 2002, we had reduced that to ¥1,746.8 billion. We will continue to reduce debt, and by the end of fiscal 2005, we aim to bring the total down to the ¥1,000 billion level. Last year we sought to reduce liabilities through real estate securitization. We have now switched to a strategy based on the achievement of strong free cash flows from our operations. For example, our selection and concentration approach will allow us to keep capital investment to the minimal level required to generate sufficient sales and income.

Q. What are your future strategies? Would you begin with your specific business strategies for the au business?

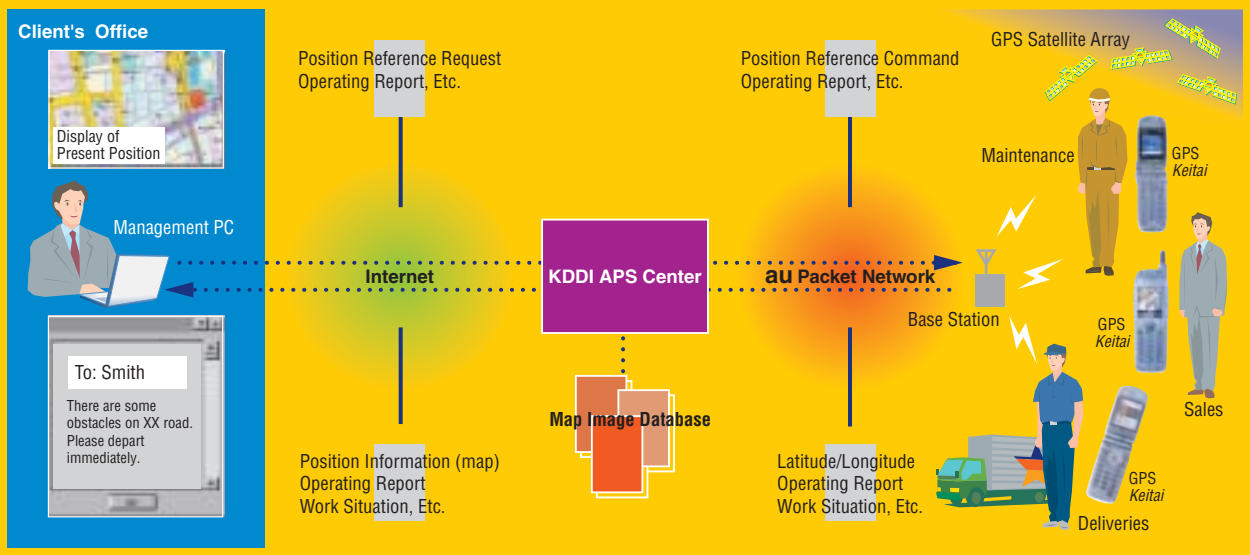
A. We will improve au's profitability now that we have eliminated PDC services, allowing it to specialize in cdmaOne and CDMA2000 1x. Within that framework, we have separate strategic approaches targeting individual and corporate users.

I will look first at our approach in the area of services for individual users. As of March 31, 2002, there were 69.1 million cellular-phone subscribers in Japan, and the penetration rate stood at 54%. We expect the number of subscribers to reach 82.3 million by the end of March 2005, and that the penetration rate will climb to 65%. This is equivalent to an average increase of around 4.4 million subscribers annually, which means that we cannot look forward to growth on the same scale as in the past. Our aim now is to achieve traffic growth by offering new data services that customers will enjoy and want to use. Our *EZweb* content service, which makes it easy for customers to search and download the information they want from our exclusive data source, has been very popular. More recently, however, demand has been shifting to services that allow users to upload and share their own information, as well. We will give priority to this type of capability in our third-generation services. We intend to develop and introduce a wide variety of new services. We have already introduced a mail service that allows users of *GPS Keitai,* which is the name we give to our unique mobile phone GPS service, to attach a variety of map and image information to e-mails. The benefits of this innovation are now starting to emerge.

Our approach to the corporate-use market is somewhat different. As far as the need for voice services is concerned, the diffusion rate in the personal-use cellular-phone market is already high, and it would not be practical to expect people to carry a second cellular telephone for business use. However, we believe that we can create new uses for cellular-phone services by combining GPS with e-mail. For example, au handsets would allow freight distribution centers to monitor the locations and loads of their delivery trucks at all times. In October 2002 we will launch the revolutionary *GPS Map* service for corporate users. Users will be able to ascertain the locations of registered *GPS Keitai* units, the status of work, and other information in real time, simply by issuing requests from PCs via the Internet (Figure 2).

Currently 9% of telephones are registered in corporate names. We expect this to rise to 20% by the year to March 2005.

(Figure 2) SYSTEM CONFIGURATION OF *GPS MAP* SERVICE



Q. What is the status of the Network & Solution Business?

A. We are actively marketing our solutions to corporate users. In the past we have relied on "traffic" to generate much of our income. However, escalating competition from MYLINE, for example, is pushing down call charges and line charges, limiting our ability to rely on income that is generated solely by "traffic." We have therefore decided to focus on the solutions business as a way of building new services around traffic.

We call the linkage of mobile services with Internet services based on fixed-line access "Fixed & Mobile Convergence" (FMC). The GPS solutions that I just referred to is an example of this approach. Another application is interactive data linking between PCs connected to intranets and cellular telephones. Until now intranets have only been able to link places of business, but we are now offering a new service that allows offices to extend their intranet to individual users in the field. If we can offer solutions that help customers to improve management efficiency and reduce costs, I am confident that a wide range of users will be motivated to take up our systems.

Another area with huge growth potential is intelligent transportation system (ITS). We are currently expanding our joint activities in this field with Toyota Motor Corporation, our second largest shareholder. As vehicles become more intelligent, the range of services will expand to include not only the supply of information to vehicles, but also the transmission of information from vehicles. For example, a vehicle could automatically contact a service center at the first indication of a developing fault. I believe that there will be an innovative diversification of demand for telecommunications services. When satellite-based mobile broadcasting and ground-based digital broadcasting commence, users will be able to enjoy interactive broadcasting in their vehicles. As providers of these services work to meet the demand, they will be able to achieve huge cost benefits by taking full advantage of cellular-phone systems, the infrastructure for which is already available nationwide. Another area in which I anticipate significant growth is the combination of cellular telephones with PDAs and laptop PCs for activities involving information volumes beyond the capacity of cellular telephones.

Q. What are your future strategies for the TU-KA and Pocket businesses?

Our reforms in these two areas were already starting to show positive results, including free cash flow, in the previous fiscal year. Our strategy for TU-KA will be to offer it as a low-speed, low-cost alternative for customers who do not require third-generation mobile telephone service. The Pocket business is enjoying considerable popularity with the *AirH"* service. This service provides an unlimited connection, something that was not previously possible with mobile services. Our strategy calls for further specialization in data communications. We aim to create an environment in which the KDDI Group will be able to meet the various needs of all users.

Q. In your flagship au business, you have achieved a very encouraging start with the new CDMA2000 1x system. How do you view the possibility of catch-up moves by competitors in this area?

A. We currently have an advantage over our competitors in the area of 3G CDMA2000 1x services for a number of reasons. A primary strength there is our service area coverage. CDMA2000

1x handsets can be used nationwide, since they can connect via the existing cdmaOne system outside of the CDMA2000 1x service area. Other companies' 3G systems can only be used within their 3G areas. This is an important difference. Another strength is the cost of handsets. CDMA2000 1x is an extension of the existing cdmaOne system, so there is little difference in handset costs. Competing 3G systems require handsets that have been developed from scratch, and costs are likely to be two or three times higher than existing PDC models. Those costs will be directly reflected in the prices at which handsets are supplied to users. Finally, there is the issue of performance. Our handsets are superior in continuous talk time and stand-by time.

However, if our competitors spend sufficient money to develop the necessary technology and facilities, it is quite possible that they will eventually reach the same standard as CDMA2000 1x. That is why KDDI will continue to think about the next stage while it still has the advantage. That next stage will mean faster transmission speeds. CDMA2000 1x supports communications at 144kbps. We are now developing the CDMA2000 1x EV-DO system, which will provide a maximum speed of 2.4Mbps and an average speed of approximately 600kbps. We plan to introduce this technology in the fall of 2003. I believe that this speed advantage will allow us to maintain our competitive edge. The most important feature of the CDMA2000 1x EV-DO system is that will be an IP-based communications system configured for data use and optimized for Internet access. Transmission speeds will increase and costs will fall, giving us the advantage in terms of both price and performance.

Q. This new technology will also open up new possibilities for the development of applications.

A. Indeed. The Solution Business Sector is already working with the KDDI R&D Laboratories to develop applications based on the CDMA2000 1x EV-DO system. I am confident that we will be able to offer a variety of enhanced services.

A key issue for our Solutions business is handset specialization. Mobile handsets combine both hardware and software, so it would be prohibitively expensive to supply handsets with software customized for specific corporate users. KDDI is now studying a concept whereby a new type of middleware called "BREW" would be supplied in cellular-phone handsets. BREW is a common platform that runs on cellular-phone handsets. By downloading software developed for the BREW platform, users will be able to turn their cellular-phone handsets into terminals for running customized applications. The concept is similar to the installation of Windows software on a personal computer. If we can supply services separately from the hardware that exists beneath applications and middleware, we will be able to offer extremely useful services to our corporate users.

Q. The possibilities are very exciting. My next question concerns the numerical targets that you announced in Medium-Term Management Plan-2002 for the fiscal 2005.

A. Our consolidated operating revenues for fiscal 2002 amounted to ¥2,833.8 billion. Our target for fiscal 2005 is ¥3,200 billion. This represents an increase of approximately 13% over a three-year period, but we are determined to reach our target.

In fiscal 2002, our operating income amounted to ¥102.3 billion, and our operating margin was not especially high. We are determined to increase this figure to ¥290 billion by fiscal 2005. Under this plan, our operating margin will climb to 9.1% as we move steadily toward our goal of a 10% margin. Our target for EBITDA is ¥740 billion, which represents a margin of 23.1% on operating revenues.

We plan to achieve these targets by using structural rationalization to improve the profitability of our existing operations while extracting additional revenues and income through the development of new businesses. Our success will depend on our ability to pursue a dual strategy based on structural rationalization and new businesses.

Q. Finally, do you have a message for shareholders and investors?

A. I would first of all like to express our sincere appreciation to our shareholders and investors for their loyal support of KDDI's business activities. We have set ambitious targets in the past, but regrettably we have not always reached them. The targets set down in Medium-Term Management Plan-2002 are also ambitious. However, the entire KDDI organization is united in our determination to achieve our annual targets, especially for income. We will work to build a business structure that will allow us to generate the income levels that we have pledged to achieve for our shareholders and investors. I believe that this culture of determination has permeated the KDDI Group since the second half of last year. I look forward to your continuing confidence and support for in KDDI's future.

Tadashi Onodera
President, Member of the Board,
Representative Director