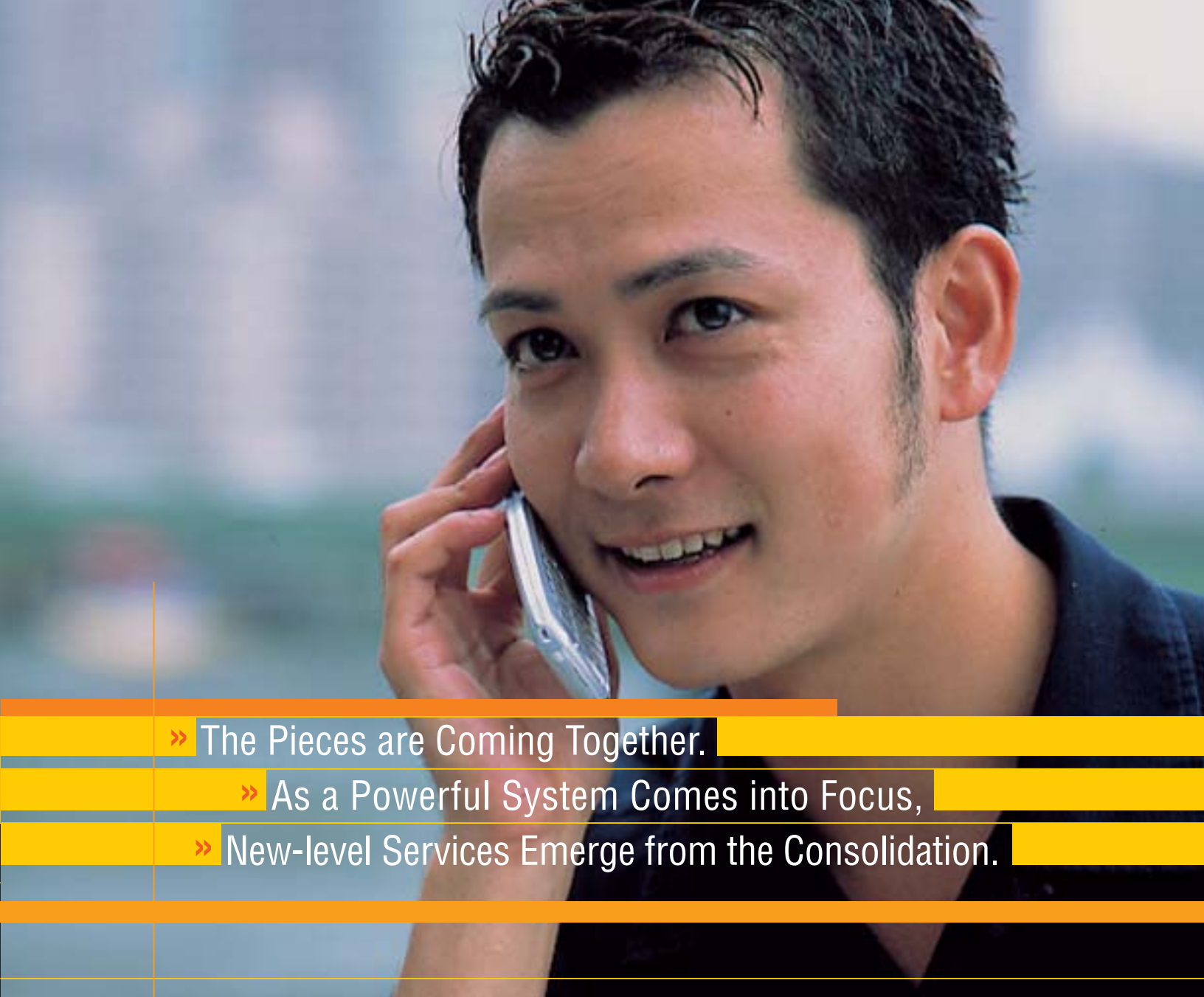


# Meeting the **NEXT-Generation** Needs of People





» The Pieces are Coming Together.

» As a Powerful System Comes into Focus,

» New-level Services Emerge from the Consolidation.



# The au Business

» Positioned for a Highly **Profitable Future**

» Positioned for **Dual Expansion** in Consumer and Corporate Markets

Statistics for the mobile telephone market for the year ended March 31, 2002 (fiscal 2002) show a net increase of 8.18 million in the number of subscribers. This is equivalent to an 83.4% increase compared with the previous fiscal year's net increase. The au business achieved healthy growth in its market share in April and May, but the situation became more difficult from the middle of the year onwards because of a time lag in product deployment resulting from delays in the launch of the CDMA2000 1x system. However, fiscal 2002 was nevertheless an important year that marked a number of turning points in KDDI's strategy. For example, in December KDDI established a foothold in the 3G market with the introduction of next-generation services, including video and GPS capabilities, for cdmaOne users. And at March 31, 2002, it ceased accepting new subscribers under the personal digital cellular (PDC) system.

KDDI's cumulative subscriber base reached 12.21 million as in fiscal 2002. It temporarily fell back into third place in the industry after being overtaken by J-Phone. However, the long-awaited launch of CDMA2001 1x returned KDDI to second place in April.

## NEW MODELS AND CONTENT SERVICES

Over the past few years, cellular telephones with e-mail and Internet access capabilities have become very popular. Many users already access a variety of content through their cellular telephones. There has been sustained growth in the number of subscribers to the *eZweb* Internet connection service provided by au. In March 2002 the total passed the 8 million mark. Moreover, the percentage of total au users who have joined *eZweb* has expanded to 67%. KDDI's ability to maintain this growth potential and expand its earnings will depend on its ability to supply attractive applications to run on the cellular telephone platform. There are plans for the introduction of a variety of new content services via *eZweb*, and for the launch of new cellular handsets capable of supporting those services.

In July 2001 KDDI introduced the *ezplus* application service, which is based on Java technology. With this system, users can download a wide range of Java applications, including games and communications tools, to enjoy on their cellular handsets.

In December 2001, KDDI began to provide content services based on the *eZwebmulti* system which offers significant functional enhancements compared with the *eZweb* system. The transmission rate was increased from 14.4Kbps to 64Kbps. KDDI also introduced *eznavigation*, the first system in Japan to provide GPS navigation through cellular telephones. It also led

the industry with its introduction of the *ezmovie* video transmission system.



## AN *eznavigation* MAP

The *eznavigation* system accurately pinpoints the location of cellular telephone handsets using global positioning satellite (GPS) data. It can be turned into a navigation tool simply by downloading maps. Users can also transmit maps showing



**C451H**

**C452CA**

**C3001H**

**C3002K**

**C3003P**

**C5001T**

**C1001SA**

*Handsets configured for ezplus*

*Handsets configured for eznavigation*

*Handset configured for ezmovie*

*Handset configured for Global Passport*

their present location. By linking this service with the *ezplus* system, it is possible to use positioning data in various other ways, including games and communications.

In addition to these personal uses, the GPS function is also the key to powerful solutions for corporate users. For example, it is possible to build fleet management systems for commercial vehicles, as well as highly efficient personnel deployment systems. GPS technology will be an extremely important factor as KDDI increases its emphasis on solutions in the future.

#### VIEWING A VIDEO CLIP

The *ezmovie* system is a video content service based on the MPEG4 format, which is the global standard for video compression. It allows users to view news, movie trailers and other video information on their cellular telephone. Users can also attach clips taken with video cameras to e-mails processed on PCs. At present the system can play video clips 15-60 seconds in length. These can be downloaded in around 20 seconds.

The *ezmovie* also employs original technology developed by the KDDI R&D Laboratories to support a variety of innovative features not available on competing systems, such as image-text linkage, copyright protection (including limits on playback frequency or period), and stereo sound. These features enhance the system's potential for a wide range of applications.

#### "ezmovie" VIDEO CONTENT



"Disney- ez"

Produced by Walt Disney International, Japan  
© Disney Enterprises, Inc.

KDDI has further enhanced the *ezplus* system to support HTTP data communications between cellular telephones and servers. This feature allows users to play games with other users via servers. It also supports automatic updating of applications downloaded onto cellular handsets.

KDDI was also the first company in Japan to introduce WAP2.0, the world standard for mobile Internet access. This technology allows users to access i-mode sites and improves

Internet linkage and compatibility.

These data services involve larger data volumes than in the past. By switching cdmaOne to CDMA2000 1x, users will be able to enjoy an enhanced experience thanks to higher transmission speeds.

**INTERNATIONAL ROAMING (GLOBAL PASSPORT)**

Unlike the PDC system, cdmaOne has been adopted in many countries. By signing agreements with partner providers in other countries, KDDI has been able to provide Japan's only international roaming service. At present au has alliance carriers in South Korea (SK Telecom), Hong Kong (Hutchison), the United States (Verizon Wireless), Australia (Telstra), Canada (TELUS Mobility) and New Zealand (Telecom Mobile). It is also working actively to expand coverage areas within these six countries. Users were able to use their au handsets at the Winter Olympics in Salt Lake City in January 2002.

In April 2002, KDDI started a roaming service with China United Telecommunications. It also plans to introduce global roaming in Brazil and Mexico.

Users whose handsets support this extremely convenient service can use them without the need to make prior applications or pay additional charges. They can use the same handset and telephone number when traveling overseas.

**SUBSCRIBER TRENDS (THOUSANDS)**

Years ended March 31, 2002 and 2001	2002	2001
au	12,214	10,986
CDMA	10,822	8,277
PDC	1,392	2,708
ezweb	8,228	5,634

In the fiscal year ended March 31, 2002, the number of subscribers increased by 11.2% year-on-year to 12,214 thousand. The increase includes 655 thousand new subscribers attracted by next-generation services introduced in December. A breakdown by system type shows that the number of CDMA subscribers increased by 30.7% to 10,822 thousand, while the number of PDC subscribers declined by 48.6% to 1,392 thousand. KDDI ceased accepting new PDC subscribers at the end of March 2002, and PDC-based services will be terminated at the end of March 2003.

**ARPU TRENDS**

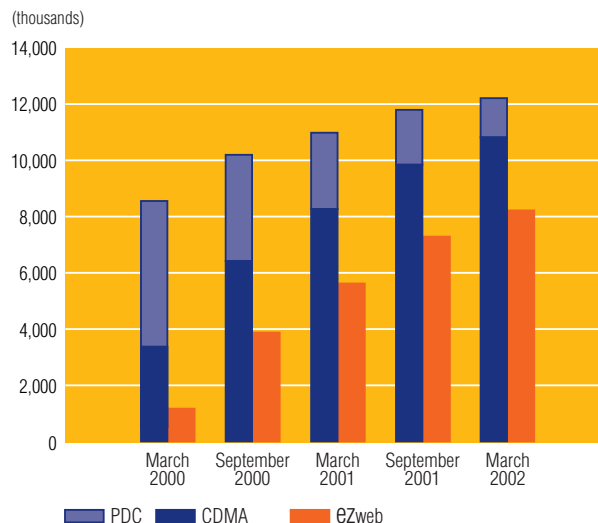
March 31, 2002 and 2001		2002	2001
au	ARPU (¥)	*8,080	8,030
	Subtotal: Data ARPU (¥)	890	430
	MOU (minutes)	184	187
	Churn Rate (%)	2.6	3.2

\*The ARPU figure for the fiscal year ended March 31, 2002 includes a ¥670 increase resulting from the introduction of an "End-to-End Rate System" for mobile-to-mobile (M-M) telephone services.

ARPU: Average revenue per user per month  
 MOU: Minutes of usage per user per month  
 Churn Rate: Cancellation rate per month.

In real terms, the ¥8,080 ARPU for au services represents a decline of ¥620 compared with the previous year's figure. This is explained by economic stagnation and the impact of family discounts and other discount services. The data ARPU of ¥890 is more than double the previous year's figure and represents a year-on-year increase of ¥460. There is potential for further traffic growth driven by next-generation services, such as GPS and video, based on the CDMA2000 1x system.

**TOTAL NUMBER OF au AND ezweb SUBSCRIBERS**



# Network & Solutions Business

» *Spearheading the **Future as IT***

» ***Content and Solutions** in a Single, Integrated Package*

In the past the core sources of revenues have been domestic and international voice communications services, and data services, including Internet access. However, the introduction of the MYLINE system in May 2002 has caused competition to intensify, triggering a steep decline in revenues.

KDDI aims to develop major new sources of revenue. It has substantially expanded its IP Business Sector, and in March 2002 it established the Solution Business Sector. KDDI intends to combine its data services and solutions, and to develop links with its mobile communications services, thereby evolving into the “Ubiquitous Solutions Company” capable of building systems that can be used anytime, anywhere.

## VOICE COMMUNICATIONS SERVICES

In May 2001 registrations under the MYLINE began. This system allows users to select their preferred carrier for fixed-line telephone services. In the past, carriers other than NTT were able to capture traffic preferentially by installing automatic carrier routing (ACR) devices in users' homes. The MYLINE eliminates the need for ACR devices, since users can now register in their local telephone exchange. Its introduction also canceled existing customer relationships and has been followed by a period of fierce competition as carriers vie to attract subscribers, including new subscribers.

By offering new discount services and other incentives, KDDI was able to secure over 20% of the domestic long-distance market, which has been the main battlefield. It has also maintained what is in effect an almost 50% share of the international market. Though discounting eroded revenues from voice services, these figures indicate that KDDI can look forward to ample cash flows in the future.

As the flurry of competition triggered by MYLINE subsides, KDDI has started to roll out integrated services that combine the au and DION system. Its aim is to offer services that will attract users to the KDDI Group as a whole. For example, the *au to Home Discount* services and *DION Set Discount* services

provide users who register with KDDI discounted access to au and DION services. This approach has been reflected in a steady increase in the number of subscribers.

## INTERNET SERVICES

DION is KDDI's Internet connection service. The number of subscribers has grown steadily, thanks to its affordable *Komikomi Course* charging system, which was the first in Japan to integrate access charges and call charges. In August 2001 the number of DION subscribers exceeded the 2 million mark. However, service providers offering low-cost ADSL access have started to move into the Japanese market for personal Internet access, the focus of which is shifting toward unlimited broadband connections. Price competition is intense in the area of ADSL services, and to avoid high-risk capital investment, KDDI has sourced infrastructure by securing circuit lines under a multi-carrier alliance.

Because of the priority that it gave to the MYLINE situation, KDDI delayed the roll-out of ADSL services. As a result, its user base at the end of March 2002 stood at 130,000, which represents a market share of 5.5%. This share will expand as KDDI responds to market needs by expanding its carrier alliance to support enhanced services.

**FIBER TO THE HOME (FTTH)**

In March 2002 KDDI began trial services for FTTH in the Tokyo area. Target users were selected from households who applied as monitors. The purpose of the project is to evaluate commercial services and technology and establish a business model in preparation for a full-scale roll-out of broadband services. KDDI will provide an infrastructure backbone to support a full range of services, including Internet access at speeds up to 100Mbps, streaming video content, karaoke, interactive educational services, links with networked appliances, and security services. KDDI will develop a variety of services that reflect the characteristics of the KDDI Group. For example, users will also be able to use their cellular telephones to control networked appliances.

**IP-VPN**

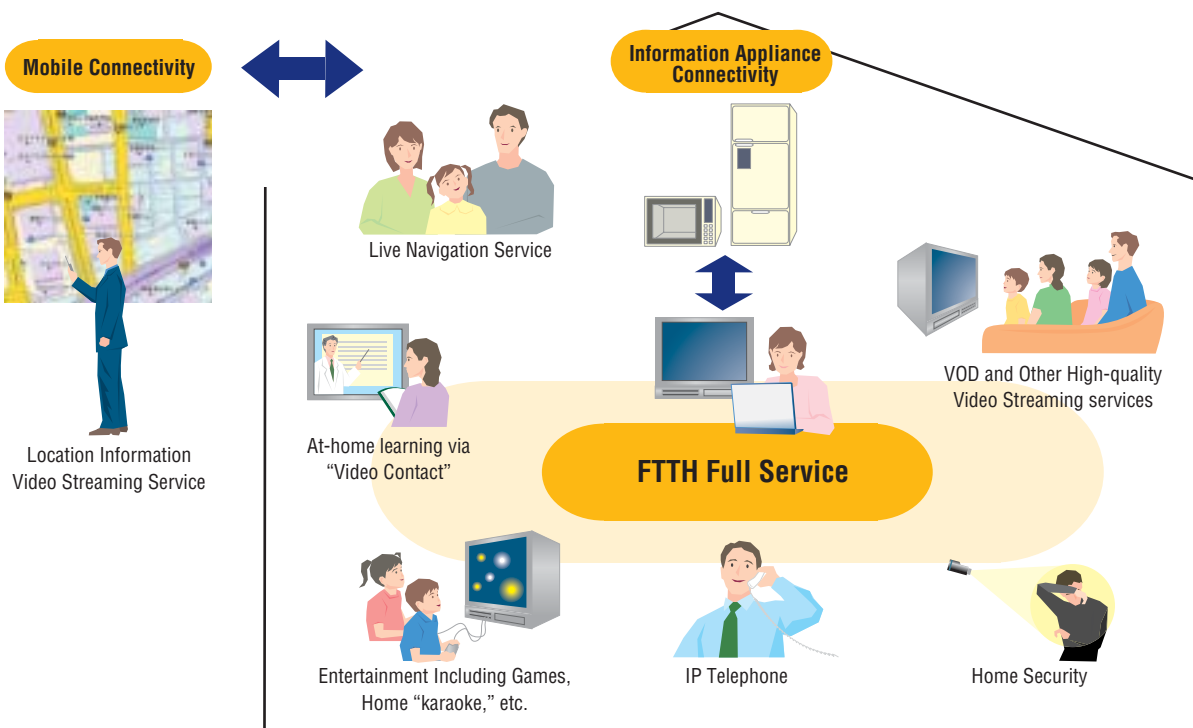
In the corporate data communications market, KDDI is aggressively introducing the IP-VPN system, which supersedes its existing *Frame Relay (FR) leased circuit services*. Demand for corpo-

rate intranets is expanding. IP-VPN offers a comparatively easy way to build IP-based networks, and there has been a steady increase in the number of line contracts, which had reached 30,000 as of the end of March 2002. KDDI led the industry in introducing a service level agreement (SLA) system. KDDI also excels in the provision of access from overseas through its international IP backbone networks. Users benefit from a comprehensive and fine-tuned response to their needs, including remote access via the au and Pocket, and ADSL access. KDDI has earned a reputation in this area through its ability to combine superior quality with excellent cost-performance.

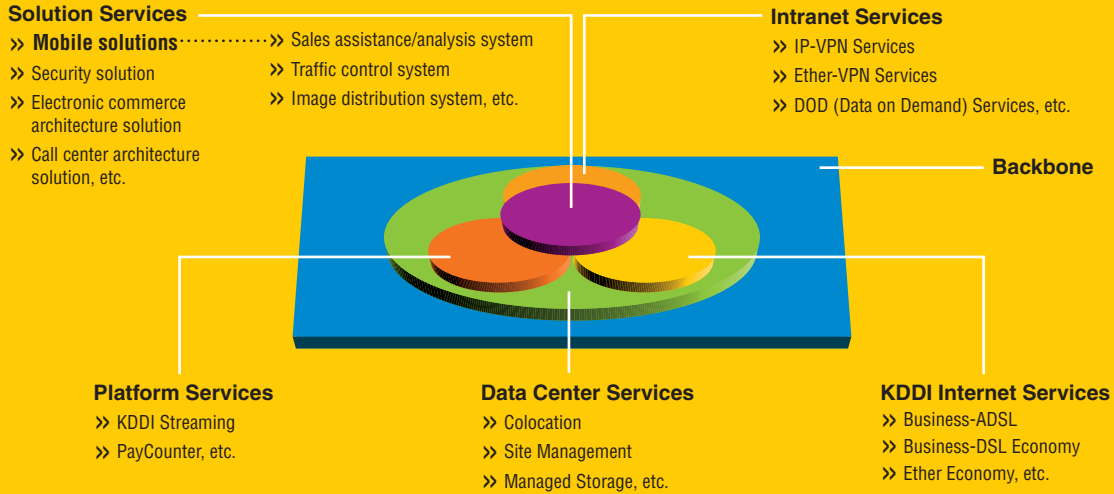
**SOLUTIONS**

KDDI supports companies to build e-business and settlement systems. It is now developing “Ubiquitous Solutions” based on combinations of fixed-line data services and mobile services through the au and Pocket. These high-value solutions can be used anytime, anywhere. KDDI introduced GPS *Keitai* in

**FTTH SERVICE EXAMPLE**



## KDDI'S TOTAL SOLUTIONS



December 2001. Many companies have expressed interest in *GPS Solutions*, which links au and *GPS Keitai*. KDDI is now developing a variety of systems based on this concept. Examples include fleet management systems for the transportation service industry, emergency notification systems for the security service industry, and employee attendance management systems for the business sector. The linkage with positioning data has added a new dimension to systems development.

In the area of intelligent transportation systems (ITS), KDDI is working with manufacturers of automobiles and vehicle navigation systems to develop services based on positioning data. Possible service formats include road traffic management systems and the supply of information to vehicles. KDDI is the only telecommunications carrier in Japan capable of providing of the essential components for ITS, including mobile networks, IP networks and large-capacity optical fiber cables. It is actively developing ITS solutions based on these assets.

Data centers provide behind-the-scenes support for these solutions. In April 2002 KDDI opened the Shibuya Data Center,

its largest so far in terms of area. The excellent location of the new center is reflected in a high level of customer interest, and numerous bookings were received even before the center became operational. KDDI also has large-scale data centers in Otemachi and Shinjuku. The establishment of these facilities in central Tokyo will provide crucial infrastructure for the future development of KDDI's solutions business.

### INTERNATIONAL NETWORKS

In addition to its existing international networks, KDDI continues to develop new overseas interests, especially in Asia. In October 2001 it established KDDI CHINA to provide consulting services and solutions. KDDI has also exchanged memoranda with Beijing Telecom, Shanghai Telecom and Guangdong Telecom in preparation for the development of business relationships since China's admission to the WTO. KDDI is also expanding its telephone line resources in South Korea, which co-hosted the 2002 Soccer World Cup, and it has signed an international telephone service agreement with Hanalo Telecom, Inc.



# The TU-KA Business

- » *Serving Essential **Voice and Mail** Needs*
- » *Focus on **Higher Efficiency** and Lower Cost*

A management restructuring was implemented in October, following a decline in earnings due to cost increases, including higher depreciation resulting from establishment of additional base stations in the previous year. A new business strategy was developed, and management of the three TU-KA companies was integrated. The business strategy, which was the main reason for the high-cost structure, was totally revamped, leading to a transition to a low-cost structure. These changes were reflected in a dramatic improvement in profitability in the second half of fiscal year 2002.

Efforts to boost subscriber numbers focused on the development of unique content services, including the *funstyle* service, which allows users to download high-quality music in MIDI format. Marketing initiatives included commercials fronted by Ayumi Hamasaki, one of Japan's most popular female singers. Unfortunately the number of subscribers declined compared with the level at the end of the previous fiscal year. KDDI has now adopted a new strategy targeting low-volume users whose activity centers on voice calls and mail services. The aim is to take full advantage of the low-cost structure, including the fact that 3G investment is not required, to achieve good margins even when ARPU is low.



funstyle

of ¥940 after adjustment for the effect of an “End-to-End Rate System.” MOU was 149 minutes. A review of marketing policies was reflected in a steady improvement in the churn rate.

## TRENDS IN SUBSCRIBER NUMBERS AND ARPU

March 31,		2002	2001
TU-KA	Subscribers (thousands)*	3,891	3,954
ezWeb	Subscribers (thousands)*	1,410	1,083
ARPU	(¥)	**5,790	6,270
MOU	(minutes)	149	158
Churn Rate	(%)	3.1	3.3

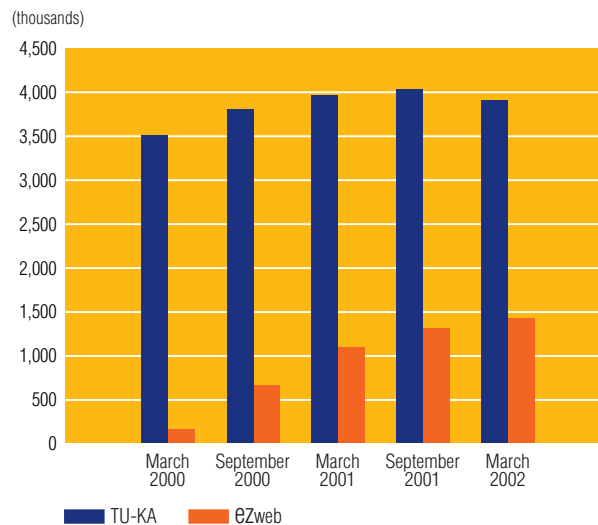
\*Figure at end of year

\*\*The ARPU figure for the year ended March 2002 includes a ¥460 increase resulting from the introduction of an “End-to-End Rate System” for mobile-mobile (M-M) telephone services. The Churn Rate is the cancellation rate per month.

Final statistics show that the number of TU-KA subscribers declined by 15.9% to 3,891 thousand. However, subscribers to the ezWeb Internet access service increased by 30.2% to 1,410 thousand, reflecting a steady upward trend in the number of people using the TU-KA system primarily for mail and other data services.

ARPU was ¥5,790. This represents a year-on-year decline

## TOTAL NUMBER OF TU-KA AND ezWeb SUBSCRIBERS



# The PHS Business

- » *Configuring Services for **Data Communications** Users*
- » *Achieving **Across-the-Board Reductions** in Operating Costs*

DDI Pocket is developing services targeted toward data communications users. In June 2001 it launched the *AirH<sup>o</sup>*, the first PHS packet data communications service. In August it introduced *Tsunagi Hodai*, a full flat-rate access service. This is the first mobile-based service to provide a permanent connection nationwide. With a transmission rate of 32K and a price of ¥4,930 (based on annual contracts), it has become very popular. The number of subscribers, especially individual users, continues to expand, reaching 330 thousand at the end of March 2002.

This strategic focus on data communications, especially *AirH<sup>o</sup>*, will allow the Pocket business to operate extremely efficiently. Development costs will be reduced by keeping version upgrades, such as design changes and the addition of new functions, to a minimum. In this way, DDI Pocket will be able to cut handset procurement costs and reduce incentives, thereby substantially lowering the cost of gaining new users. By using FR networks, DDI Pocket has also achieved substantial reductions in the cost of operating backbone networks, compared with ISDN network costs.

In late March 2002, DDI Pocket launched a new flat-rate service called *Tsunagi Hodai*. The new service operates at a speed of 128K.



*AirH<sup>o</sup> Card*

## TRENDS IN SUBSCRIBER NUMBERS AND ARPU

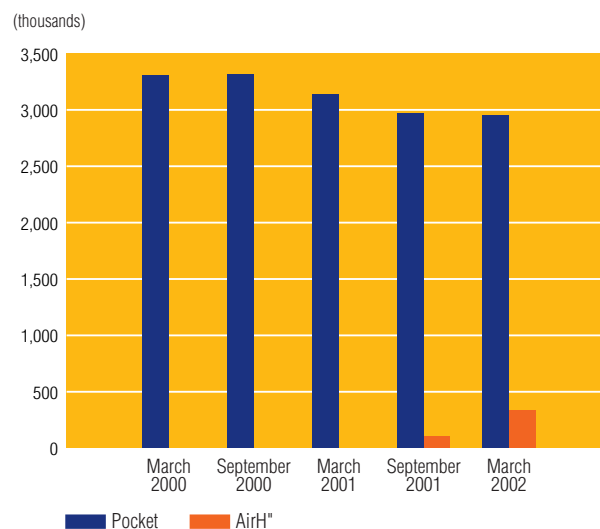
Years ended March 31, 2002 and 2001		2002	2001
Pocket	Subscribers (thousands)*	2,942	3,123
AirH <sup>o</sup>	Subscribers (thousands)*	329	—
ARPU	(¥)	5,330	5,910
MOU	(minutes)	185	226
Churn Rate	(%)	3.2	3.6

\*Figure at end of year

The number of subscribers declined by 5.8% to 2,942 thousand. *AirH<sup>o</sup>* acquired 329 thousand data communication users, but a decline in voice users had a serious impact on the total.

ARPU was ¥5,330 and MOU 185 minutes. Declines in these figures reflect the shift to data. However, margins improved thanks to cost reductions and a lower churn rate.

## TOTAL NUMBER OF Pocket AND AirH<sup>o</sup> SUBSCRIBERS



## ***BENEFITS from MANAGEMENT RESTRUCTURING***

### **1) Restructuring of Management System**

The KDDI Group has implemented a variety of restructuring measures since the October 2000 merger. In October 2001 au Corporation was also merged, and structures were established to support a powerful concentration of resources into the au business. At the same time, the TU-KA Group was strengthened under a new management team. Other group companies have been reviewed, and subsidiaries and affiliates with limited profitability and prospects have been liquidated or consolidated. This process has reduced the total number of group companies from 76 to 64.

### **2) Business Restructuring**

At March 31, 2002, KDDI wrote off all facilities for PDC cellular-phone services. This move reflects the decision to use CDMA as the only format for au services. The value of the facilities concerned, including base stations and networks, was ¥128.3 billion. There will be no further depreciation of these facilities. Beginning in fiscal 2003, depreciation costs will decline by ¥44 billion, and usage charges for related communications facilities will be reduced by an estimated ¥22 billion annually from fiscal 2004.

There has also been a partial write-off of fixed-line network facilities. The facilities in question, which were worth ¥17.5 billion, became surplus because of business integration following the merger. This move will result in reduced depreciation and maintenance costs.

The accounts also show write-offs and a valuation loss relating to old-type au handsets. There was also a valuation loss on PHS handsets. The total cost of these measures was ¥34.5 billion.

These amounts were shown in the accounts as extraordinary losses relating to business restructuring. The costs were covered by an extraordinary gain of ¥144.8 billion from the securitization of four buildings, including the Shinjuku Head Office Building.

### **3) Realization of Merger Effects**

In the corporate purchasing area, volume increases resulting from the merger have brought economies of scale. KDDI has also reviewed its purchasing systems. Systems to control specifications and costs on an individual part level have helped to hold down costs in the area of handset procurement. These measures have brought cost savings amounting to ¥72 billion. In November 2001, a Capital Expenditure Committee was established to screen investment projects from a profitability perspective.

In February 2002, KDDI established a Customer Service Division. The new division is currently studying the integration of customer centers for au and fixed-line telephone services. Integration of the two systems would provide customers with various services to make the necessary arrangements at the same service center, aiming to have a "One-stop Call Center," instead of dealing with multiple centers as is the case under the existing structure. In addition to improved customer satisfaction, integration is also seen as a way of reducing costs.

Work has also started on the integration of information systems. Partial integration of au systems began in some regions in March 2002. The nine systems operated by the eight DDI Cellular companies and IDO will be merged into a single system. The information systems operated by DDI, KDD and TWJ for fixed-line telephone services will also be integrated into a single system. These changes are expected to reduce costs by ¥19 billion.