



Mitsuo Igarashi (left)
Chairman, Member of the Board

Tadashi Onodera (right)
President, Member of the Board

Momentum

Fulfilling Our Commitment through the Building of Solid Brands ➡

BUSINESS ENVIRONMENT

The telecommunications market remained extremely stagnant for the year ended March 31, 2003 (fiscal 2003), following a telecommunications slump emanating from the European and North American markets, and repeated delays in the launch of 3G mobile services.

This was the situation during our third post-merger year. However, KDDI was able to attract 6.8 million subscribers based on pursuit of customer satisfaction in the first year of operation of its CDMA2000 1x system, while operating income increased by ¥38.4 billion compared with the results of the previous fiscal year. In a year in which the true value of the new KDDI was put to the test, we are pleased to report to shareholders that your company achieved solid results.

In terms of our business environment, fiscal 2003 was, first of all, a turning point for change in the Japanese telecommunications market. In the cellular-phone market, highly-functional handsets and diversification of services, especially centering on data communications, made further progress, and all companies introduced camera-equipped handsets. In the fixed-line telephone market, IP telephone services began in earnest, and there was increased col-

laboration among ISPs, including telephone companies, which gives a different insight for the future of the fixed-line telephone market.

A second feature of trends during the year was wide-ranging debate with telephone companies about regulations. NTT East and NTT West had been moving toward the reduction of connection charges, but the outcome for connecting carriers was the first price increase since deregulation, by a decision of the Ministry of Public Management, Home Affairs Posts and Telecommunications. We need to respond with a sense of crisis to actions such as these, which run counter to the goal of encouraging competition policies. Some of the current debates about the right to set charges for calls from fixed-line phones to mobile phones have the potential to cause dramatic changes in the profitability structures.

Third, an analysis of the competitive environment shows that in the cellular-phone market, with the entry of J-Phone into the 3G market, all three operators were in the same playing field. The 3G market is expected to start expanding in earnest in the coming fiscal year. We are currently the leading player in the Japanese 3G market. However, we must accept that competition is about to intensify in the market. New ADSL providers like Yahoo!BB made

significant inroads in the market for consumer Internet services. We are thinking that the development of a broadband strategy will be a major management issue for KDDI.

A rapid change is expected to continue in the market. The telecommunications industry as a whole, however, is likely to enjoy sustained growth driven by the shift to broadband technology for both wired and wireless services, and by the growth of new businesses, such as IP services and solutions. Telecommunications carriers will inevitably face a transition away from their traditional infrastructure-based profit structures. KDDI views this period of change as a time of opportunity. We will move aggressively into areas with growth potential, and we will target our management and business activities toward our future, to improve business performance even under the severe economic environment.

STRENGTHENING MANAGEMENT INFRASTRUCTURE

We have implemented wide-ranging reforms since the merger in October 2000. From a service perspective, we have also enhanced the potential of our au brand through the provision of exciting services, such as GPS, *Movie Mail* and *Chaku-Uta*[™] (downloadable ringtone songs). In addition, KDDI has started to offer distinctive services based on FMC (Fixed & Mobile Convergence), such as *GPS MAP*. On the other hand, from a cost perspective, first of all, in au business, at the end of March 2003, we terminated our old PDC cellular-phone service, so we evolved business operations based on concentration on the CDMA system. Another priority has been the integration of our systems and operational systems so that we can reap the benefits of the merger as quickly as possible. Our asset restructuring is almost complete, and the only task remaining is the retirement plan of our

microwave systems in the year ending March 31, 2004 (fiscal 2004). By integrating our services and support systems and discontinuing unprofitable divisions, we have strengthened our management bases. As a result of these efforts, we are now able to concentrate our management resources into areas offering future growth so that we can keep sustainable profitability even in a deflated economy. Two years have now passed since the merger, and this process is in its final stage.

We will put the finishing touch to the merger process with our office integration project. In Tokyo, our head office functions had been spread among three buildings, located in Shinjuku, Hanzomon and Shiba-Koen. From May 2003, we brought our head office operations together in one location, the Garden Air Tower in Iidabashi. With this integration, the merger processes are completed. From now on, we are heading toward becoming a KDDI which is always a step ahead of the current era.

In keeping with our role as a telecommunications carrier, we aim to create an intelligent new head office with the most advanced information technology (IT). We are reforming our business operations and corporate culture and improving our operational efficiency. The know-how and advanced IT gained in this process will be actively applied to our marketing operations.

For the purpose of accumulating and enhancing skills and know-how essential for success in these new business areas, in April 2003 we established the Competency Enhancement Division. Employees who have enhanced their skills through seminar training there will play a central role in the establishment of new business activities, such as business development in broadband, mobile, solutions and overseas services and in product development using new technologies.

UBIQUITOUS SOLUTION COMPANY

In fiscal 2003, KDDI adopted the concept of "Ubiquitous Solution Company" as the future direction for its corporate group. This phrase means the creation and provision of an information-sharing environment in which any information can be accessed any time, anywhere. The successful realization of this concept will require not only the improvement of the telecommunications environment, but also the use of handsets, applications, content and other assets to provide services that offer enhanced added value from the user's perspective. The basic focus in all cases will be on customer satisfaction.

KDDI has 3G mobile technology in the form of its CDMA2000 1x system, as well as a highly reliable, high-quality fixed-line network. This combination will be a major advantage in terms of the development of the "ubiquitous-network society," encompassing seamless access to all types of telecommunications services. For corporate users, KDDI will develop and supply a variety of proposals for seamless-service solutions, including mobile solutions based on GPS, wireless modules and BREW™.

In the "ubiquitous-network society" of the future, mobile handsets will absorb the functions of wallets, credit cards, keys and train passes. KDDI also plans to incorporate remote control functions for smart appliances, such as refrigerators and air conditioners. For consumers, these mobile handsets will be personal gateways to the "ubiquitous-network society." Through these terminals, KDDI will offer easy-to-use solutions that will become an integral part of day-to-day living.

The Garden Air Tower

This building stands as a model building for solutions services, which KDDI developed in its aim to become a truly "ubiquitous solution company" from the perspective of corporate customers. By actually using its solutions in everyday business situations, KDDI is preparing an environment from which to propose apropos business solutions to customers.





Ubiquitous Solution Company

CUSTOMER-FIRST PRINCIPLE

Toward realizing a “ubiquitous solution company,” the Company will continuously implement activities as the starting point of the “customer-first principle” and “a commitment to optimal customer satisfaction” as the most fundamental components of KDDI’s management policies. In September 2002, KDDI established a Customer Satisfaction Committee, which is now developing company-wide activities under the slogan “Quick & Quality.” As a result, various customer satisfaction surveys are already showing dramatic improvements. Starting in fiscal 2004, KDDI will go beyond its traditional focus on customer satisfaction toward the realization of a new concept contained in the phrase “Total Customer Satisfaction” (TCS).

The definition of “customer” in this concept has been expanded to include not only users of KDDI services, but also all business counterparts. We have gone back to the basics of business activities: customer satisfaction in all contexts. As a company in the service industry, KDDI relies on total customer satisfaction to drive its profitability, so any improvement in customer satisfaction translates into enhanced corporate value. KDDI’s customer satisfaction activities will not be limited to concepts and perceptions. Every division will be required to produce tangible results based on numerical targets.

CORPORATE GOVERNANCE AND CORPORATE SOCIAL RESPONSIBILITIES

Among the many initiatives for TCS, we think our very important responsibility is to enhance our corporate value for shareholders, so we endeavored for efficiency and enhancement of transparency of management.

We have disclosed quarterly results since the third quarter of fiscal 2003. We believe that timely disclosure is vital in order to enhance the understanding of shareholders and investors of the Company’s financial position.

Another important change in fiscal 2003 was the introduction of a stock option system. The aim of this scheme is to give directors and other officers of the Company an incentive to maximize performance. Directors, managing officers, general managers, auditors and employees in managerial positions were eligible to receive options. The Company has acquired treasury stock for allocation when the options are exercised.

On the other hand, we see compliance and protection of the global environment as important responsibilities for business corporations. Last year a number of corporate scandals came to light, causing investors to lose confidence in major telecommunications carriers, especially in the United States. As a result, several companies filed for protection under Chapter 11.

In January of this year, KDDI adopted “Corporate Behavior Guidelines.” It also established a help-line for people inside or outside of the organization to report issues relating to corporate ethics. This system is designed to facilitate early detection of problems and prompt remedial action.

As part of its contribution to the solution of environmental problems and the creation of a recycling society, KDDI is using next-generation information technology to develop environment-friendly services. A particular priority is the reduction of the environmental load associated with mass-consumption items, especially cellular-phone handsets. KDDI will continue to foster corporate culture that allows it to earn the trust and support of the community.

➔ **Addressing Each Facet of Customer Satisfaction to Enhance Corporate Value and Competitiveness. By Securing a Sustainable Competitive Advantage, KDDI Will Earn the Support of all Stakeholders.**

STRATEGIES FOR MEDIUM- AND LONG-TERM GROWTH

Finally we will briefly explain our medium- and long-term strategies for new growth. Our primary focus since the merger has been the reinforcement of our management infrastructure and the rapid creation of a solid and streamlined structure under which we can maximize the benefits of the merger. The internal merger process was completed in fiscal 2003. From now on we can devote 100% of our resources to the market, to the tasks that will allow us to beat the competition.

We have two key priorities. First, we will clearly identify our markets and clarify our approach to customers. To achieve this we have established a new market-oriented organization effective from April 2003. Under the operation system, the au Business Sector and Broadband Consumer Business Sector focus on individual users, while the Solutions Business Sector integrates all KDDI services for corporate users. Second, we will steadily secure a sustainable competitive advantage so that we can withstand price competition in the fiercely competitive telecommunications industry. We will break free of the traditional view that market share expansion and profitability are mutually exclusive goals in an environment of intense competition. Our vision for the future sees KDDI as a company that earns market support by steadily reinforcing its advantages, including its product competitiveness, technology development capability and marketing capability.

In fiscal 2004 it will apply all available resources to strategic introduction and deployment of next-generation products, including CDMA2000 1x EV-DO and FTTH (Fiber To The Home) services. As in the past, KDDI will continue to scrutinize every investment carefully under its selection and concentration policy,

to ensure the expected returns. Based on this scheme, management fully recognizes the need for capital for future growth.

At present we are steadily building the fundamental strength needed to generate cash flows from our core business activities. Even as we continue to invest in the future growth of KDDI, we are confident that we can achieve our goal of reducing interest-bearing debt to within ¥1 trillion in the year ending March 31, 2005 (fiscal 2005). Though the present deflationary trend has created a harsh economic environment, we are determined to achieve the profit targets that we have committed to each year.

We thank our shareholders for their confidence in the future of KDDI. We look forward to your continuing support.



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