STRAIGHT TALK WITH THE PRESIDENT

—KDDI's president, Tadashi Onodera, explains the management strategies that will take advantage of KDDI's unique strengths.

Q1

In the second half of the year ended March 31, 2010, the Mobile Business picked up momentum due to a reduction in sales commissions. Do you feel that KDDI has regained its competitive strength?

A1

I have to admit our response to changing market conditions has been slow.

In the year ended March 31, 2010, we restored our position as the forerunner of setting pricing plans. Also, for handsets, which struggled in the previous year, we were able to reassert the uniqueness of KDDI by unveiling the "iida" brand as a progressive symbol of the "au design project" and by improving the performance of the "KDDI Integrated Platform (KCP+)", which had been an issue. Thanks to these initiatives, we are steadily increasing our competitiveness in the conventional mobile phone business area. This growing competitiveness is clear if we consider that for the year ended March 31, 2010 among mobile communications carriers KDDI claimed the largest share, 38.2%, of net additions of mobile Internet subscriptions, which reflects trends in sales of conventional mobile phone handsets. Nevertheless, KDDI faces many challenges that it must tackle.

One such task is data ARPU*. Although we expected a decrease in voice ARPU because the rate of uptake of the "Simple course" plan directly affects it, we feel that the level of data ARPU is not high enough. Therefore, we have to extend the use of data communications to a wider customer base by increasing the number of subscriptions to data flat-rate pricing plans, enriching our lineup of services and content, and expanding and improving mobile portal sites designed for specific customer segments.

Another important measure for increasing data ARPU is strengthening data cards and smart phones. However, we have to admit that in recent years our responses to market condition changes accompanying the emergence of such new product areas have been slow.

* Average Revenue per Unit

Q2

In October 2010, KDDI will celebrate the 10th anniversary of its establishment. Would you agree that the uniqueness of KDDI—the appetite for challenges that has underpinned growth—is becoming perhaps less evident?

A2

I think it is time to go back to our starting point and regain our venture business spirit.

Established in 2000 through the merger of DDI CORPORATION, KDD Corporation, and IDO CORPORATION, KDDI has a venture business spirit that is always looking to take on new challenges. At present, however, we are gradually losing this uniqueness.

For KDDI, we can divide the past 10 years into two overall stages. The first stage was the five years since our establishment. At the time of the merger, we had interest-bearing debt of more than ¥2 trillion. Therefore, we did our utmost to rebuild our financial position. At the same time, based on a rigorous awareness of competitors, we developed foundations for growth through such initiatives as establishing "au" as a brand. In 2003, we took the lead in infrastructure initiatives by introducing CDMA2000 1x EV-DO*1 ("EV-DO"). Exploiting the resulting advantage, we introduced flat-rate pricing plans ahead of competitors and marketed a series of original services, including "Chaku-Uta®,"*2 "Chaku-Uta Full®,"*2 and "EZ Navi Walk."

These efforts established a customer base. During the following five years, we focused on how to use this base to further expand our business. Our initiatives up to then bore fruit. For example, we had the largest share of net additions for nine consecutive months from August 2006. Moreover, our share of cumulative subscriptions grew significantly. Subsequently, however, our relative advantage in infrastructure lessened as competitors caught up. From around this time, our uniqueness—our constant pursuit of new challenges—undeniably began to weaken. I believe we

lost impetus because, without us realizing it, a conservative approach based on past successes spread throughout the organization. As we approach our 10th anniversary, I feel strongly that we must return to our starting point and regain our venture business spirit.

*1 Evolution Data Only or Evolution Data Optimized. It is a technical specification dedicated to data communications that is included in the CDMA2000 specifications, which are a 3G mobile phone format compatible with CDMA technology. Development of standard specifications is being conducted under 3GPP2.
*2 "Chaku-Uta®" and "Chaku-Uta Full®" are trademarks or registered trademarks of Sony Music Entertainment (Japan) Inc.

Q3

How would you reply to the suggestion that the current market conditions make achieving novelty and originality difficult?

A3

Doing the same as others is meaningless. If we take similar steps as other companies, we will inevitably face strong price competition.

Certainly, being original within the framework of our existing Mobile Business is becoming difficult. Given the outlook of Japan's market, traffic revenues are unlikely to grow significantly. Therefore, how we develop the non-traffic business area becomes important. In this area, we can be original and realize differentiation. One example in this area is the content and media business, which is growing at a rate of approximately 25% a year.

Going forward, it is clear that differentiation will become important in content for smart phone open sites. With that in mind, KDDI is preparing to launch "au one Market" as an applications market for smart phones incorporating Android™*. We will make this new applications market optimally suited to Japan's market by improving customer convenience. In addition to providing the security features and an agency function for collecting charges, as is currently available on "EZweb," it will have outstanding search capabilities thanks to its Japanese-language compatibility. We have an original approach to smart phones, in which we pursue enhanced customer convenience in relation to handsets and services by creating systems that combine the best features of conventional mobile handsets and those of smart phones.

Regardless of the business area, copying competitors is meaningless. Taking the same kind of measures will only lead to strong price competition. To avoid the pitfall of simple price competition, we always focus on being as original as possible so as to have customers choose our services.

* "Android" is a trademark of Google Inc.

Q4

At the moment, the penetration of open platform systems for mobile handsets is advancing. What type of business models are you considering for the future?

A4

We will maintain both our original KCP+ and open platform systems and provide services tailored to suit each.

If we consider the diversification of user needs and services, there are services suited for different demands. Until the introduction of LTE (Long Term Evolution), we will keep KCP+ as the main platform of the "au" lineup and continue its operation while adding more functions and improving performance. We are currently considering strategies for the period from the introduction of LTE onward.

Further, I believe that we need to conduct our business operations based on careful analysis of the balance among handsets, services, and content. "au one Market" is an example where we have realized this. Also, it is clear that successful open platform systems have earned endorsement because of their progressive user interfaces or functions. No matter what the platform may be, I think the key is how far we can give customers a sense of progressiveness.

Q5

What is your strategy for LTE and other networks?

A5 Aiming to maximize performance and reduce cost, we will introduce LTE in December 2012.

The main reason for introducing LTE is to reduce the bit unit cost of transmission, thereby reducing cost. In order to maximize LTE performance by using frequency effectively, we plan to introduce LTE from July 2012, after the completion of 800MHz band reorganization. We plan to expand LTE area coverage to 96.5% by the end of the year ending March 31, 2015.

Further, in response to demand for high speeds, mainly for PCs, Group company UQ Communications Inc. will advance the rollout of WiMAX services. Before the introduction of LTE, we plan to introduce Multi-carrier Rev. A, which realizes downlink speeds of up to 9.3 Mbps, for mobile handsets at the end of 2010.

In the near-term, we intend to further increase our Wi-Fi compatible handsets in order to cater to increasing data traffic. In addition, we plan to rigorously raise the quality of our coverage area by not only promoting such existing services as “au Repeater” (relay stations) and “simple antenna” but also launching the small home-use base station “au Femtocell” in July 2010.

Q6

KDDI has a unique business structure that combines fixed-line and mobile communications in a single company. Going forward, what type of advantages do you expect this structure will enable?

A6 I think we will finally be able to fully realize the advantages of our business structure.

Overall, I think we will have two types of advantage. First, fixed-line communications will become important as backhaul for mobile communications. In mobile communications, data traffic volumes are soaring due to the enrichment of content and the growing popularity of data cards and smart phones. Some say that from around 2014 to 2015, Japan's frequency resources will no longer be able to cope with the increase in data traffic. A significant option for resolving the resulting network bottleneck is the use of fixed broadband lines. In other words, as mobile broadband spreads, having our own fixed-line networks becomes more of an advantage.

Secondly, having such networks allows us to develop new services by using this operational resource. Our FMBC (Fixed Mobile and Broadcast Convergence) services are one such initiative. FMBC, which means combining fixed-line communications, mobile communications, and broadcasting, will move from the stage of consolidated billing and price discounts to one where we can offer customers tangible merits through convergence in the upper layer of devices, services, and content. I believe reaching this stage will further strengthen our customer base. Only KDDI has the practical capabilities for this type of initiative.

Q7

How do you plan to grow your Fixed-line Business?

A7 The main pillar of our strategy is to expand our customer base by strengthening initiatives for the access line business.

Currently, our main business strategy is to switch over from our existing long-distance business and strengthen initiatives for our access line business. In particular, we have accelerated initiatives for FTTH*[1] in recent years. In the year ended March 31, 2009, we dramatically heightened product competitiveness by launching the “Giga Value Plan,” offering the ultra-high speed of 1 Gbps for the lowest price in the industry. Furthermore, in the year ended March 31, 2010, we expanded service availability to achieve a 71% year-on-year increase in net additions. Using this momentum, from the year ending March 31, 2011, we plan to further expand our customer base.

Also, KDDI has repeatedly undertaken mergers since its establishment. The resulting complexity of core networks and metro access networks as well as the dispersal of base stations have become major issues. Aiming to resolve these issues and reduce fixed cost, we are following a new grand design for networks in efforts to streamline[*2] them. This initiative is scheduled for completion by the end of the year ending March 31, 2016. Partly with the help of cost reduction benefits resulting from streamlining. We are planning to achieve operating profit for the Fixed-line Business in the year ending March 31, 2011, and we promise to achieve this goal.

*1 Fiber to the Home. An access format in which fiber-optic cables connect customers' homes to the facilities of a carrier.
*2 Streamlining of fixed-line networks ▶▶ P.27

Q8

Your overseas strategies are also distinctive.

A8

Our basic approach is to concentrate on business areas where we can win in markets with growth potential.

KDDI has set out a target to increase operating revenues in overseas business from approximately ¥100 billion in the year ended March 31, 2010 to approximately ¥200 billion in the year ending March 31, 2013. To that end, one priority measure is expanding our global ICT[*1] business. In the ICT area, we want to cater to the growing demand for one-stop outsourcing as Japanese companies accelerate entry into overseas markets. Our one-stop services will be based on four core ICT services: data center[*2] business, carried out through the TELEHOUSE brand, which we intend to expand; a global network connecting 25 countries; system integration; and overseas regional networks. Moreover, we embarked upon a full-scale entry into the U.S. mobile phone market catering to immigrants, which continues to grow rapidly, by making two U.S. MVNOs[*3] wholly owned subsidiaries in January and March 2010. For these two overseas operations—the global ICT business and MVNOs—we have particularly high expectations.

In November 2009, as a stepping stone for our strategy of opening up the markets of developing nations based on the WiMAX technology of affiliate UQ Communications, we took a stake in bracNet, Bangladesh's largest ISP (Internet service provider), and made it an affiliate. In markets with growth potential, we will specialize in business areas where we can win. This is KDDI's basic strategy for overseas business.

*1 Information and Communication Technologies
*2 Data centers are facilities in which computer equipment or communications equipment is installed. Data centers function as the infrastructure of communications networks by having stable power supplies, connecting with wide area backbone lines, and maintaining operations 24 hours a day 365 days a year.
*3 Mobile Virtual Network Operator. Operators that lease wireless communications infrastructure from other mobile phone carriers and provide services.

Q9

Why did KDDI take a stake in Jupiter Telecommunications Co., Ltd. ("J:COM")? And, how do you plan to realize benefits?

A9

KDDI, J:COM, and Sumitomo Corporation will examine how to rapidly create synergies among the three companies.

One of the reasons why we took a stake in J:COM was to develop our access strategy. In Japan's CATV access network, home-path accounts for 43.41 million households[*1] (coverage ratio of all 49.72 million households[*2] nationwide: 87%). The total number of households actually connected to the networks of CATV operators is 22.80 million households (household connection: 53%), which is at a level equivalent to the networks of NTT East and NTT West. Taking a stake in J:COM will significantly advance the KDDI Group's access strategy by giving it a total of 17.08 million CATV home-path households (J:COM: 12.59 million households*3, JCN: 4.49 million households*3). Furthermore, combining these households with other households that we have access to with our FTTH service will give the Group's FTTH and CATV access networks almost complete coverage of Japan's population centers, such as Tokyo, Nagoya, Osaka, and Kitakyushu. Our FTTH service is comprised of "au HIKARI" in the Kanto region (home-path: 11.73 million households*4, including the JCN and J:COM areas), and "Commuf@-hikari" offered by Chubu Telecommunications Co., Inc. (CTC), in the Chubu region (home-path: 2.80 million households*4).

Another reason we made J:COM an affiliate is because we want to offer our FMBC services, including "au," to J:COM's favorable high-ARPU customer base of 3.29 million households (total subscribed households*4).

Further, J:COM has program suppliers and extensive expertise in television-related operations. Therefore, its addition to the KDDI Group will enable the Group to actively exploit the content of J:COM's program suppliers for "au" and other areas through collaboration with J:COM.

Regarding the creation of specific synergies, KDDI and J:COM have established the Alliance Study Committee, which is tasked with examining the alliance, as well as working groups to examine individual themes. On June 10, 2010, KDDI, J:COM, and J:COM's largest shareholder Sumitomo Corporation announced the conclusion of a memorandum of understanding on consideration of the alliance and the three companies are holding detailed discussions with a view to the early realization of synergies.

*1 As of September 30, 2009 *2 2003 national census *3 As of December 31, 2009 *4 As of March 31, 2010

Alliance Study Committee (details of the announcement on June 10, 2010)

Telecom Business and Products Collaboration Working Group

- Cooperation in fixed line and mobile phones
- Cross-sales promotions
- Collaboration in high-speed wireless data communications business (UQ WiMAX)

Media Business Working Group

- Collaboration and integration in the area of VOD service
- Collaboration in advertising operations leveraging both companies' advertising sales forces
- Mutually distribute contents owned by both Groups

CATV Business Working Group

- Capital/business tie-ups between J:COM and JCN, realization of synergy benefits
- System by which J:COM and JCN mutually introduce their potential customers to each other's company

Technology and Infrastructure Working Group

- Cooperation in the area of infrastructure such as shared use of networks
- Development of devices and products that leverage both companies' technological expertise in areas such as next-generation set-top boxes (STBs) for CATV

Q10

What business result trends do you anticipate going forward?

A10 We are targeting upward-trend earnings after completion of the 800MHz band reorganization.

In the medium-term, we expect operating income to remain flat until the year ending March 31, 2013. This is mainly because voice ARPU is likely to decrease due to the increased customer shift to “Simple course” pricing in the Mobile Business and expenses arising from the 800MHz band reorganization, scheduled for 2012. Expenses arising from the 800MHz band reorganization will include additional expenses incurred due to the changeover to tri-band handsets*, depreciation relating to the operation of facilities for current and new bands, and the overlapping of such expenses as line usage fees. Although we expect such expenses will diminish gradually, the Mobile Business will likely see earnings trend downward until the completion of reorganization in July 2012. During the two years until then, we intend to counteract this trend and maintain operating income at the same level by increasing data ARPU and reducing such expenses as sales commissions in the Mobile Business while increasing the earnings of the Fixed-line Business. From 2012 onward, however, when the negative factors are gone, our goal is to get back on a track of earnings growth. Our investments in new businesses and overseas are preparatory steps taken with this goal in mind.

In addition, for the year ending March 31, 2011, we are projecting a 0.1% year-on-year decline in operating revenues, to ¥3,440 billion, and a 0.3% increase in operating income, to ¥445 billion. For the reasons I just mentioned, the Mobile Business is likely to record lower earnings. On the other hand, we plan to move the Fixed-line Business into the black and post operating income of ¥10 billion through improved profitability resulting from expansion of the customer base of the FTTH business and the benefits of lower expenses accompanying network streamlining.

* Tri-band handsets are mobile handsets that are compatible with three different bands. In this instance, tri-band handsets refers to mobile handsets that are compatible with the current and new 800MHz band as well as 2GHz.

Q11

What is the outlook for KDDI’s capital expenditures?

A11 Capital expenditures have already peaked, so we expect a downward trend.

The Mobile Business’ investment for the development of networks for the new 800MHz band, which has accounted for a large share of total capital expenditures in recent years, will decrease as band reorganization moves toward completion in July 2012. Other investments in the Mobile Business will stem from preparations for the introduction of Multi-carrier Rev. A at the end of 2010. However, we do not expect this to be a large investment because these preparations will only entail the upgrading of software at base stations. Overall, investment in the Fixed-line Business will likely decrease as lower investment for legacy-related areas and other areas offsets a high level of FTTH capital investment aimed at acquiring new subscribers. As a result, we see capital investment declining over the coming several years for existing businesses on a nonconsolidated basis.

As for investment accompanying the Mobile Business’s introduction of LTE, based on our application to the Ministry of Internal Affairs and Communications, we expect it to reach a cumulative total of ¥515 billion from the year ending March 31, 2011 through 2015.

For the year ending March 31, 2011, we are planning consolidated capital investment of ¥490 billion, down 5.4% year on year. This includes investment in the Mobile Business of ¥360 billion, down 4.5%, and investment in the Fixed-line Business of ¥127 billion, down 8.4%.

Q12

What is KDDI's approach to returning profits to shareholders?

A12 Our policy is to steadily raise the consolidated dividend payout ratio to between 25% and 30%.

For the year ended March 31, 2010, we paid a full-year cash dividend of ¥13,000 per share, up ¥2,000 year on year, comprising an interim cash dividend of ¥6,500 per share, which included a commemorative cash dividend of ¥1,000 per share, and a year-end cash dividend of ¥6,500 per share. As a result, the consolidated dividend payout ratio was 27.2% compared with 22.0% for the previous year. Further, KDDI recorded negative free cash flow due to increasing capital investment over the past several years as well as projects that required large amounts of capital such as buying back securitized buildings and taking a stake in J:COM. However, cash flows from operating activities have remained stable—reaching approximately ¥600 billion each year—and have exceeded ¥700 billion since the year ended March 31, 2009. Given these cash flows from operating activities and the fact that capital expenditures have peaked, we expect to post positive free cash flow of ¥230 billion for the year ending March 31, 2011.

Regarding the use of cash flows, we intend to steadily increase cash dividends to maintain a consolidated dividend payout ratio of between 25% and 30%. While we do not foresee the kind of large mergers and acquisitions (M&As) implemented in the year ended March 31, 2010, we will continue to consider options centered on new businesses and overseas projects with a view to sustained growth. Also, in accordance with plans we intend to further heighten the soundness of our financial position by repaying interest-bearing debt, which stood at ¥1,096.8 billion at the end of the year ended March 31, 2010.

Q13

In closing, what is your message for stakeholders?

A13 We will continue to reassess the uniqueness of KDDI and take on challenges to create new value.

Looking ahead, I expect we will face fierce competition in the markets that surround us. However, KDDI will lose value if it simply competes to acquire customer numbers. Based on an awareness of the large impact services of information and communications have on society, we must never forget our mission of meeting the expectations of stakeholders by ambitiously and passionately creating an environment in which anyone can use communications safely and with peace of mind.

Since its establishment 10 years ago, KDDI has rigorously competed with other companies. Going forward, however, I think this approach alone will not be enough. As we approach the 10th anniversary of our establishment, I think we need to reexamine ourselves and ask what we can do that competitors cannot, what the uniqueness of KDDI is, and return our venture business spirit. I think our business vision for the coming 10 years, which we plan to announce in October 2010, will reflect the need for these changes. Therefore, I would like to ask all of our stakeholders to look forward to our future.