

# Defining the future now

The year ended March 2004 was an important one in which execution of KDDI's strategic vision began to yield solid results. We also made significant progress toward achieving our long-term goals.

## Large gains in earnings coupled with major reduction in debt

Consolidated revenues and profits established new record highs in fiscal 2003 (the year ended March 31, 2004). We posted operating income of ¥292.1 billion (up 107.7% year-on-year) on operating revenues of ¥2,846.1 billion (+2.2%). Cash flow also improved substantially, with free cash flows rising 32.4% to ¥404.2 billion. This helped us reduce interest-bearing debt by ¥317.3 billion to ¥1,179.8 billion (against ¥1,497.0 billion at the fiscal 2002 year-end). Our plan is to reduce debt further in fiscal 2004, to ¥1,000 billion. We believe this target is readily achievable.

Recognizing the support that we have received from shareholders, we raised the term-end dividend to ¥2,400 per share. Combined with an interim dividend of ¥1,200, this brought total dividends for the year to ¥3,600 per share. At KDDI, we view the return of profits to shareholders as one of our most important issues. While striving to achieve further growth, we will maintain our policy to pay stable dividends.

## A big leap of au business by capitalizing on shift to 3G

Fiscal 2003 was an extremely fruitful one for our au business. User penetration in Japan has now surpassed 65% of the population, and the cellular-phone market is said to be reaching maturity. Our strategy for generating growth in such a challenging market has been to introduce attractive services and cellular-phone handsets into the market, thereby accelerating the ongoing shift to third-generation (3G) services.

In fiscal 2002, we introduced 3G cellular-phone services under the au brand, starting with CDMA 1X, and expanded our sales

focus on 3G products and services during fiscal 2003. In November 2003 we also launched a more advanced 3G cellular-phone service called CDMA 1X WIN. This offers broadband content supported by connection speeds up to 2.4 Mbps. Cost efficiencies realized by an upgraded network enabled us to offer a range of new benefits such as fixed-rate discount tariffs for data communications. These moves raised our competitiveness, pushing the au brand to the top spot in Japan in terms of share of net increase in cellular-phone subscribers over the year for the first time.

## Secured profits and solid cash flows at other three businesses

Although its revenues and profits were down from the previous year, the BBC (Broadband Consumer) & Solutions business still secured profits close to our initial performance projections. The fixed-line telephone market continued to contract amid an ongoing decline in voice traffic. Combined with a shift to VoIP telephone services, this produced challenging operating conditions for us. In response, we focused on marketing a variety of fixed-line data communications services to compensate for declining voice telephony revenues. Through restructuring measures, such as the retirement of obsolete equipment, we were able to generate solid earnings in this business.

In our TU-KA and Pocket (PHS) businesses, we continued to provide services targeting specific user groups. Efficient cash-flow management enabled us to increase profits on a year-on-year basis in both segments and surpass initial performance targets. Although a decrease in the number of contracts resulted in lower revenues, solid cash flows in these areas enabled steady progress in reducing interest-bearing debt.



Mitsuo Igarashi, Chairman, Member of the Board (left) and Tadashi Onodera, President, Member of the Board

### Structural reforms enhance earnings strength

Since the three-way merger that created KDDI in October 2000, we have steadily addressed a succession of major issues to reinforce our consolidated earnings structure. These structural reforms have laid the basis for realizing the long-term growth potential of the business through strategic initiatives. Specifically, we have focused on three issues: (1) business concentration and selectivity to create

a platform to support sustained growth; (2) construction of a streamlined business structure that can realize the full synergy benefits of the merger; and (3) strengthening of our financial base to ensure high profitability with stable growth. More than three years on from the merger, we have raised operating income to nearly three times our figure posted for the year ended March 2001. We believe this testifies to the effectiveness of our structural reforms.

### Post-merger performance

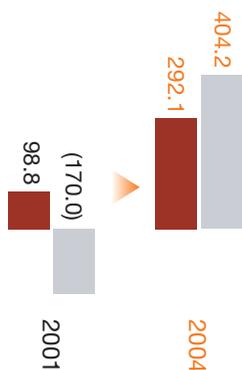
#### Operating Revenues

(Billions of yen)



#### Operating Income Free Cash Flows (FCF)

(Billions of yen)



#### Interest-Bearing Debt

(Billions of yen)



The results for KDD and IDO in the first half of the year ended March 31, 2001 were simply added to each consolidated results.

# The broadband society gains momentum

## Business growth model based on three pillars

At present the au business is the principal driver of sales and earnings growth at KDDI. Going forward, we expect it to remain our leading operations. But we also recognize that we need to develop other areas with strong growth potential if we are to hit our medium- and long-term performance targets. To this end, we aim to develop into the following three pillars of growth for the KDDI Group over the longer term.

### Consumer mobile services

Our business development efforts focus on CDMA 1X WIN. Although the subscriber base as of the end of March 2004 remained relatively small as the service had only just been launched, we expect subscriber numbers to swell as we introduce new handsets and services. Upgraded broadband content through services such as *EZ Channel* and a major push into fixed-rate 3G services promise to differentiate au clearly from other 3G brands.

We expect the increasing prevalence of fixed-rate tariffs will further enrich content, expand e-commerce opportunities and enable broadcast content through *EZ Channel*, which will in turn lead to a boost in non-traffic revenue streams.

### Corporate mobile solutions

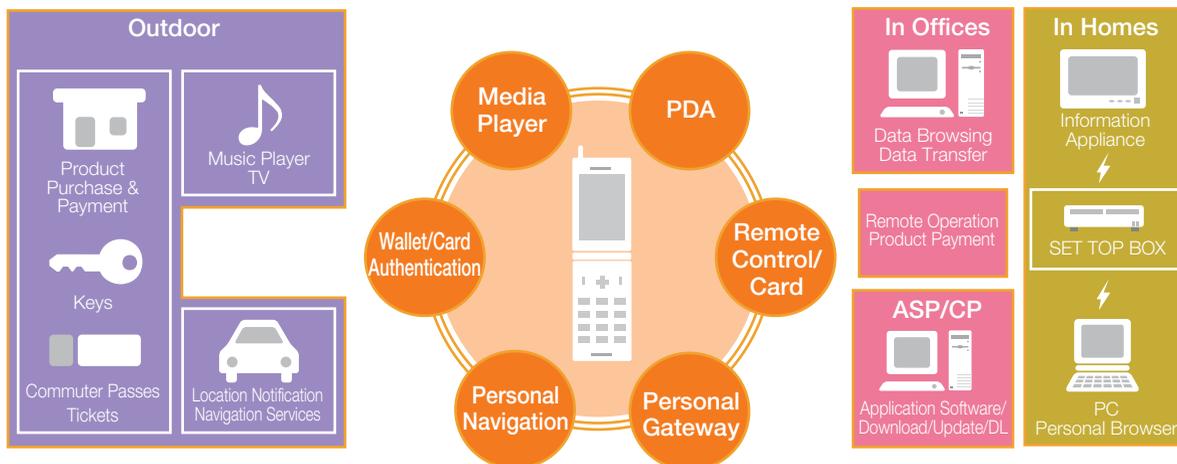
We are developing and supplying a menu of mobile solutions and related services to stimulate fresh demand in the corporate sector

of the market. Our marketing strategy is based on the unique benefits that we can provide corporate users by developing solutions and services that leverage our mobile and fixed-line network infrastructure. For instance, companies can connect all their operating bases across Japan using the au cellular-phone network together with our fixed-line data communications infrastructure. We can also provide customized functions such as downloadable applications using the BREW™ (Binary Runtime Environment for Wireless) platform, or GPS navigation services. We see this business expanding considerably in scale as we seek to apply the KDDI service touch.

### Consumer broadband business

We plan to focus on the full-scale development of the *KDDI Hikari Plus* service that we launched in October 2003. Consumer broadband services in Japan currently center on ADSL. We believe FTTH (Fiber To The Home) offers a better platform for broadband services. The *KDDI Hikari Plus* service uses fiber-optic connections to deliver a package comprising ultra-high-speed Internet access, VoIP telephone services and multi-channel broadcast services. Our sales operations are focusing at the moment on medium-sized and large condominiums. Looking ahead, we expect to broaden sales efforts to include individual homes as a further means to promote this area as a pillar of the BBC & Solutions business.

## Mobile phones as personal gateways



### The ubiquitous network society promises to play to KDDI's core strengths

Our core strength at KDDI is our broad-based communications infrastructure based upon au mobile systems, combined with fixed-line networks. The Japanese communications market is undergoing a commercial revolution amid rapid changes in technologies and business environments. We believe the ongoing shift toward broadband and mobile communications technologies is accelerating the advent of a ubiquitous network society. In this society, people will be able to access various appliances as well as other people anytime, anywhere. We envisage mobile and fixed-line communications increasing in importance as gateways to an astonishing variety of content and services.

au mobile phone services already go well beyond voice and email to encompass a variety of advanced functions such as digital images, music, video and GPS. We believe such services will play a more integral role in our customers' everyday lives in the future. Mobile phones will develop new functions such as wallets, credit cards, keys and commuter passes. They will even be able to operate home appliances by remote control. In our vision of the future, they become personal gateways to access all the benefits of the ubiquitous network society (See the chart on Page 13).

As the data size available over the network will be much larger, mobile digital content such as video and music will also become increasingly sophisticated. We are taking a number of initiatives to develop the links between the broadcast content for *KDDI Hikari Plus* services to au cellular-phone services. The Japanese government also has plans to develop mobile services based on content provided through terrestrial digital broadcasting within the next few years. The processes changing mobile handsets into another media outlet are already evident in Japan. The implication is that mobile handsets will evolve into a key part of the media infrastructure of the ubiquitous network society. Positioning mobile handsets as personal gateways, our intention at KDDI is to develop a broad range of services linked to the evolving communications infrastructure.

### Our commitment to Total Customer Satisfaction

Provision of the most advanced technical services is not the only key to sustainable long-term earnings growth. We think the indispensable element is customer satisfaction with our services. Based on the "customer-first" thrust of our core business principle, our prime aim is to build Total Customer Satisfaction (TCS) to ensure that our customers always rank us first. By "customers," we mean not just those who use KDDI services, but also our various stakeholders, who include sales agents, handset manufacturers, shareholders, employees and local communities—in fact, the whole

of society. As part of this drive, we are seeking feedback and opinions from a wide range of people so that we can improve the quality of our comprehensive lineup of services.

Amid an ongoing technological revolution, the role of telecommunications in society is steadily assuming greater importance. This trend demands that we aim to be a customer oriented communications enterprise rather than simply a company that pursues the development of superior technology. Our business is fundamentally about satisfying customers by providing them with the services that they find useful and convenient. To put it another way, our success is ultimately about "Designing the Future" in partnership with our customers. We are totally committed to realizing this vision, and we ask our shareholders for their continued support as we work toward fulfilling it.

July 2004



Mitsuo Igarashi  
Chairman, Member of the Board



Tadashi Onodera  
President, Member of the Board