Financial Review

KDDI Corporation and Consolidated Subsidiaries

For the purposes of this section's financial analysis, the operations of overseas consolidated subsidiaries plus any non-mobile-related businesses operated by Japanese consolidated subsidiaries are aggregated under other businesses. As a result, the figures for the BBC & Solutions business and other businesses do not match the segment data shown in the notes to the financial statements. In addition, extraordinary income (loss) is included in other expenses (income) of Consolidated Statements Income on Page 37.

Consolidated Financial Review

	Millions of yen				Millions of U.S. dollars
Years ended March 31, 2003 and 2004	2003	**2004**	Change	%	**2004**
Operating revenues	¥ 2,785,343	**¥ 2,846,098**	¥ 60,755	2.2%	**$ 26,929**
Telecommunications business	2,191,887	**2,268,726**	76,839	3.5%	**21,466**
Voice communications	1,574,509	**1,468,961**	(105,548)	(6.7%)	**13,899**
Digital data transmission services and other	617,378	**799,765**	182,387	29.5%	**7,567**
Other business	593,456	**577,372**	(16,084)	(2.7%)	**5,463**
Operating income	140,653	**292,105**	151,452	107.7%	**2,764**
Extraordinary income (loss)	(2,485)	**(82,447)**	(79,962)	–	**(780)**
Net income	57,359	**117,025**	59,666	104.0%	**1,107**
Free cash flows	305,335	**404,232**	98,898	32.4%	**3,825**
EBITDA	563,491	**688,027**	124,528	22.1%	**6,510**
EBITDA margin	20.2%	**24.2%**	3.9%	–	**24.2%**

Operating Revenues

Total operating revenues increased 2.2% year-on-year to ¥2,846.1 billion. Within telecommunications operations, although revenues from voice communication services dipped 6.7% year-on-year to ¥1,469.0 billion, revenues from data transmission services surged 29.5% year-on-year to ¥799.8 billion. The drop in revenues from voice telephony chiefly reflected lower revenues in the BBC & Solutions business caused by ongoing changes in market conditions such as intensified competitions and a shift to discount-priced IP telephony services. This was more than offset by the overall improved competitiveness of CDMA 1X products and services in the au business, which generated a substantial increase in subscriber numbers. Operating revenues from other business declined 2.7% year-on-year to ¥577.4 billion.

Income

Operating income more than doubled compared with the previous fiscal year, soaring 107.7% to ¥292.1 billion. This was mainly attributable to increased earnings at the au business, where the competitiveness and the power of the au brand secured a substantial increase in subscriber numbers. The termination of PDC cellular services in March 2003 resulted in a large reduction in associated expenses in the year ended March 2004. Below the operating level, KDDI recorded total extraordinary losses of ¥82.4 billion, which represented an increase in such losses of ¥79.9 billion relative to the previous fiscal year. This was due primarily to the write-off of microwave transmissions infrastructure as KDDI streamlined a fiber-optic and microwave dual-system capability to a dedicated fiber-optic network. Net income increased 104.0% year-on-year to ¥117.0 billion.

Free Cash Flows/EBITDA

Free cash flows increased 32.4% year-on-year to ¥404.2 billion. This was due mainly to higher operating cash flows generated by the au business. Cash flows from investing activities were constrained by an effective level of capital spending on new and expanded base stations for the au cellular services in connection with the launch of CDMA 1X WIN services and the increase in subscriber numbers for CDMA 1X services. KDDI believes these results confirm that its cash flow-based management approach remains on track. Unrecognized losses on equity holdings fell significantly due to the sale of KDDI's stake in Singapore Telecom. EBITDA rose 22.1% year-on-year to ¥688.0 billion. The EBITDA margin improved by 3.9 points compared with the previous fiscal year to 24.2%.

Segment Financial Reviews

[au Business]

Years ended March 31, 2003 and 2004	Millions of yen 2003	2004	Change	%	Millions of U.S. dollars 2004
Operating revenues	¥ 1,626,273	**¥ 1,825,074**	¥ 198,801	12.2%	**$ 17,268**
Telecommunications business	1,197,244	**1,374,132**	176,888	14.8%	**13,002**
Voice communications	844,225	**833,798**	(10,427)	(1.2%)	**7,889**
Digital data transmission services and other	353,019	**540,334**	187,315	53.1%	**5,112**
Other business	429,029	**450,942**	21,913	5.1%	**4,267**
Operating income	53,786	**239,469**	185,683	345.2%	**2,266**
Extraordinary income (loss)	(4,250)	**1**	4,251	–	**0**
Net income	21,005	**129,995**	108,990	518.9%	**1,230**
Free cash flows	96,571	**207,251**	110,680	114.6%	**1,961**
EBITDA	245,092	**437,651**	192,559	78.6%	**4,141**
EBITDA margin	15.1%	**24.0%**	8.9%	–	**24.0%**

Segment operating revenues rose 12.2% year-on-year to ¥1,825.1 billion. An increase in the competitiveness of au-branded 3G CDMA 1X cellular services resulted in KDDI securing the leading share (averaging 49.6% over the year) of the net increase in subscribers within the Japanese market, which helped to boost overall subscriber numbers substantially to 16,959 million as of the end of March 2004. The churn rate dropped by 0.3 points to 1.5%, from 1.8% in the previous fiscal year, providing further evidence that provision of attractive services and products (including handsets, content, applications and tariffs) successfully enhanced the value of the au brand for the retention of more customers. Monthly average revenue per user (ARPU) showed a small drop by ¥130 compared with the previous fiscal year to ¥7,440. This reflected higher penetration of discount pricing plans (“Student Discount,” “Annual Discount,” “Family Discount,” and “Packet Discount”) and the introduction in April 2003 of lower land-to-mobile call rates. Voice ARPU dropped ¥480 (7.6%) year-on-year to ¥5,800, while data ARPU increased ¥350 (27.1%) to ¥1,640.

Segment operating income increased 345.2% year-on-year to ¥239.5 billion. Besides higher operating revenues, this was due to the cost reductions related to PDC cellular services terminated at the end of the previous fiscal year.

Segment net income rose 518.9% year-on-year to ¥130.0 billion. This largely reflected an absence of extraordinary losses (KDDI booked an extraordinary loss in the previous fiscal year due to reserves against past service year point service program obligations), which meant that the increase in operating income fed through directly to the segment bottom line. Free cash flows increased 114.6% year-on-year to ¥207.3 billion. EBITDA rose 78.6% year-on-year to ¥437.7 billion, and the EBITDA margin was 24.0%.

[BBC & Solutions Business]

Years ended March 31, 2003 and 2004	Millions of yen				Millions of U.S. dollars
	2003	**2004**	Change	%	**2004**
Operating revenues	¥ 601,874	**¥ 542,462**	¥ (59,412)	(9.9%)	**$ 5,133**
Telecommunications business	556,047	**497,010**	(59,037)	(10.6%)	**4,703**
Voice communications	371,248	**320,581**	(50,667)	(13.6%)	**3,033**
Digital data transmission services and other	184,799	**176,429**	(8,370)	(4.5%)	**1,669**
Other business	45,827	**45,452**	(375)	(0.8%)	**430**
Operating income	60,290	**16,381**	(43,909)	(72.8%)	**155**
Extraordinary income (loss)	(3,071)	**(73,823)**	(70,752)	–	**(698)**
Net income	32,264	**(28,803)**	(61,067)	(189.3%)	**(273)**
Free cash flows	116,927	**74,232**	(42,695)	(36.5%)	**702**
EBITDA	176,809	**112,361**	(64,448)	(36.5%)	**1,063**
EBITDA margin	29.4%	**20.7%**	(8.7%)	–	**20.7%**

Segment operating revenues declined 9.9% year-on-year to ¥542.5 billion. The market in Japan for fixed-line telephone services continued to contract amid an ongoing shift to mobile phones, email and discount-priced IP telephone services. Revenues from voice communication services (local, long-distance and international telephony) dropped by ¥50.7 billion compared with the previous fiscal year. In sharp contrast, aggressive promotion of broadband services by KDDI generated increases in subscriber numbers. KDDI mainly targeted individual consumers with ADSL-based internet access services and corporate clients with Ether-VPN and IP-VPN network services. Although the broader menu of services resulted in a larger user base, tariff reductions and lower revenues from other services led to an overall decline in revenues from data transmission services of ¥8.4 billion on a year-on-year basis.

Segment operating income fell 72.8% year-on-year to ¥16.4 billion. This was due principally to the drop in operating revenues from voice communications services, despite assiduous efforts to bolster profitability through comprehensive cost-cutting measures. In addition, specific factors that contributed to higher costs included retrospective increases in connection fees imposed by NTT East and NTT West and higher depreciation costs for undersea fiber-optic cable systems associated with a reduction in useful life.

Extraordinary losses totaled ¥73.8 billion. This mainly reflected a loss on retirement of fixed assets of ¥78.0 billion associated with discontinuation of the microwave network. As a result, the segment recorded a net loss of ¥28.8 billion. Free cash flows decreased 36.5% year-on-year to ¥74.2 billion. EBITDA declined 36.5% year-on-year to ¥112.4 billion, while the EBITDA margin dropped 8.7 points to 20.7%.

[TU-KA Business]

Years ended March 31, 2003 and 2004	Millions of yen 2003	2004	Change	%	Millions of U.S. dollars 2004
Operating revenues	¥ 318,070	**¥ 276,457**	¥ (41,613)	(13.1%)	**$ 2,616**
Telecommunications business	255,412	**230,435**	(24,977)	(9.8%)	**2,180**
Voice communications	234,981	**212,976**	(22,005)	(9.4%)	**2,015**
Digital data transmission services and other	20,431	**17,459**	(2,972)	(14.5%)	**165**
Other business	62,658	**46,022**	(16,636)	(26.6%)	**435**
Operating income	6,200	**15,390**	9,190	148.2%	**146**
Extraordinary income (loss)	(1,713)	**1,104**	2,817	–	**10**
Net income	(3,227)	**9,057**	12,284	–	**86**
Free cash flows	52,137	**54,951**	2,814	5.4%	**520**
EBITDA	66,471	**71,184**	4,713	7.1%	**674**
EBITDA margin	20.9%	**25.7%**	4.9%	–	**25.7%**

Segment operating revenues declined 13.1% year-on-year to ¥276.5 billion. The main reason was a fall in subscriber numbers, which totaled 3.63 million as of the end of March 2004, representing a year-on-year net decline of 150,000. Since TU-KA services mostly target customers wanting just basic voice and email services, KDDI has tried to secure long-term revenue stability by raising the ratio of customers signing up for two-year contracts featuring more attractive discount tariffs. Although this has so far failed to reverse the overall decline in subscriber numbers, it did contribute to a reduction in the average churn rate, which fell from 2.5% in the first half of the fiscal year ended March 2004 to 2.2% in the second half of the year.

Segment operating income increased 148.2% year-on-year to ¥15.4 billion. This reflected the results of sustained sales efforts to target potentially profitable users more efficiently. By concentrating on supplying handsets that feature only easy-to-use, simple functions, TU-KA has been able to reduce handset prices steadily. The increase in operating income also reflected successful efforts to integrate networks and functions across KDDI's three TU-KA regional operators, which resulted in reduced costs and higher operating efficiency.

Segment net income amounted to ¥9.1 billion. Free cash flows rose 5.4% year-on-year to ¥55.0 billion. EBITDA increased 7.1% year-on-year to ¥71.2 billion, and the EBITDA margin was 25.7%.

[Pocket (PHS) Business]

Years ended March 31, 2003 and 2004	Millions of yen				Millions of U.S. dollars
	2003	**2004**	Change	%	**2004**
Operating revenues	¥ 197,579	**¥ 184,017**	¥ (13,562)	(6.9%)	**$ 1,741**
Telecommunications business	181,991	**168,408**	(13,583)	(7.5%)	**1,593**
Other business	15,588	**15,609**	21	0.1%	**148**
Operating income	20,267	**21,093**	826	4.1%	**200**
Extraordinary income (loss)	(649)	**(771)**	(122)	–	**(7)**
Net income	17,030	**19,064**	2,034	11.9%	**180**
Free cash flows	43,015	**47,206**	4,191	9.7%	**447**
EBITDA	62,248	**61,363**	(885)	(1.4%)	**581**
EBITDA margin	31.5%	**33.3%**	1.8%	–	**33.3%**

Segment operating revenues fell 6.9% year-on-year to ¥184.0 billion. This was due mainly to a drop in subscriber numbers, which totaled 2.90 million as of the end of March 2004, representing a year-on-year net decline of 80,000. Promotion of AirH" mobile data transmission services, continued to be the main strategic thrust of the business during the year. An expansion of individual data customers and corporate users, however, was not enough to cover a decline of individual voice customers in subscriber numbers. For the corporate market, DDI Pocket introduced the NET25 Time Share service, which allows pooling and sharing of usage time over multiple connections. For individual customers, DDI Pocket began offering AirH" services bundled with wireline broadband services for a discounted monthly flat-rate fee (marketed as the A&B Discount) in an attempt to attract new mobile data users and to improve convenience.

Segment operating income increased 4.1% year-on-year to ¥21.1 billion. With the overall subscriber base continuing to decline, KDDI focused on measures to boost profitability by making DDI Pocket services a low-cost operation specializing in mobile data transmission services. These included restricting handset prices; lowering levels of commissions for model changes; and cost reductions through greater efficiencies in terms of coverage areas.

Segment net income rose 11.9% year-on-year to ¥19.1 billion. Free cash flows increased 9.7% year-on-year to ¥47.2 billion. EBITDA declined 1.4% year-on-year to ¥61.4 billion. The EBITDA margin was 33.3% - the highest level across all KDDI Group operations.

[Other Businesses]

Years ended March 31, 2003 and 2004	Millions of yen				Millions of U.S. dollars
	2003	**2004**	Change	%	**2004**
Operating revenues	¥ 196,656	**¥ 186,533**	¥ (10,123)	(5.1%)	**$ 1,765**
Telecommunications business	96,496	**109,625**	13,129	13.6%	**1,037**
Other business	100,160	**76,908**	(23,252)	(23.2%)	**728**
Operating income	(1,002)	**797**	1,799	–	**8**
Extraordinary income (loss)	(3,007)	**(4,707)**	(1,700)	–	**(45)**
Net income	(9,868)	**(5,431)**	4,437	–	**(51)**

Compared with the previous fiscal year, segment operating revenues decreased by ¥10.1 billion to ¥186.5 billion, despite a greater focus on supporting the development of businesses with strong growth potential. The primary cause of the drop in revenues was a substantial fall in orders at KDDI Submarine Cable Systems Inc., which provides construction, technical development and consulting services for undersea cables. This chiefly reflected continued constraint in capital budgets among Western carriers amid poor operating performance and a persistent global telecommunications capacity glut. Segment operating income amounted to ¥0.8 billion, due mainly to the pursuit of higher efficiency and reduced costs through the merger of subsidiaries and other measures amid a drive to improve the financial position of the KDDI Group through loss elimination. The segment posted a net loss of ¥5.4 billion.

[Capital Expenditures]

	Millions of yen				Millions of U.S. dollars
Years ended March 31, 2003 and 2004	2003	**2004**	Change	%	**2004**
Capital expenditures (cash flow basis)	¥ 246,200	**¥ 253,257**	¥ 7,057	2.9%	**$ 2,396**
au	167,300	**161,181**	(6,119)	(3.7%)	**1,525**
BBC & Solutions	40,800	**55,126**	14,326	35.1%	**522**
TU-KA	16,200	**14,713**	(1,487)	(9.2%)	**139**
Pocket (PHS)	11,700	**12,909**	1,209	10.3%	**122**
Depreciation	388,968	**365,700**	(23,268)	(6.0%)	**3,460**
au	175,968	**184,857**	8,889	5.1%	**1,749**
BBC & Solutions	105,397	**84,120**	(21,277)	(20.2%)	**796**
TU-KA	59,979	**53,827**	(6,152)	(10.3%)	**509**
Pocket (PHS)	39,583	**38,707**	(876)	(2.2%)	**366**
Balance of interest-bearing debt	1,497,020	**1,179,764**	(317,256)	(21.2%)	**11,162**
au + BBC & Solutions	937,230	**736,026**	(201,204)	(21.5%)	**6,964**
TU-KA	317,821	**262,415**	(55,406)	(17.4%)	**2,483**
Pocket (PHS)	182,690	**134,542**	(48,148)	(26.4%)	**1,273**
Net debt	1,375,165	**983,246**	(391,919)	(28.5%)	**9,303**

On a cash-flow basis, consolidated capital expenditures totaled ¥253.3 billion in the year ended March 2004, a year-on-year increase of 2.9%. Accrued but unpaid capital projects that will be booked in the year ending March 2005 represented an excess of ¥20 billion of this spending total. Consolidated depreciation and amortization declined 6.0% year-on-year to ¥365.7 billion. Consolidated debt amounted to ¥1,179.8 billion as of March 31, 2004. KDDI is targeting a decrease in net debt to the ¥1,000 billion level by the end of March 2005. On current cash-flow projections, management regards this as a feasible objective.