Financial Review

KDDI Corporation and Consolidated Subsidiaries

(1) Significant Accounting Policies and Estimates

The consolidated financial statements of the KDDI Group have been prepared in conformity with accounting standards generally accepted in Japan. In particular, the significant accounting policies described below had a material impact on the major accounting judgments and estimates by the KDDI Group that were used in the compilation of these consolidated financial statements.

(a) Estimated useful lives of fixed assets
The useful lives of fixed assets are based on reasonable estimates. The estimated useful life of submarine cable systems was reduced in the fiscal year ended March 2004 in recognition of major market shifts and other changes in the telecoms business environment in recent years. Currently, the KDDI Group sees no further need to make any further reductions in the estimated useful lives of fixed assets. However, such need may arise in the future if market, environmental or technological changes occur more rapidly than projected, or in the advent of new legal or regulatory developments.

(b) Impairment of fixed assets
The KDDI Group has made an early adoption of fixed-asset impairment accounting standards from the fiscal year ended March 2005. Impairment losses are calculated based on the grouping of assets into the smallest possible units capable of generating cash flows that are independent of other assets or asset groups. Since it is accepted in the telecoms industry that entire communications networks constitute independent cash flow generators, the asset grouping process has been done on a business segment basis. In line with these considerations, extraordinary losses against asset impairment for submarine cable systems and other idle assets were recorded for the fiscal year ended March 2005 in respect of reductions in book value to those amounts deemed recoverable.

(c) Deferred tax assets
Deferred tax assets and liabilities are stated based on the statutory effective tax rate in recognition of any temporary differences between the carrying values of assets and liabilities and corresponding values listed in filings to tax authorities. Valuation allowances are stated for some subsidiaries against deferred tax assets, based on future likelihood. Evaluations of the necessity of recording such valuation allowances take into account projected future taxable income levels and utilizable tax planning.

(d) Retirement benefits and pension obligations
Retirement benefits and pension obligations are calculated based on actuarial assumptions, which include the discount rate, future remuneration levels, employee turnover rates, mortality rates based on the latest statistics and the expected long-term rate of return on pension plan assets. The discount rate is computed based on market yields of long-term Japanese government bonds. The expected rate of return is computed based on expected long-term rates of return for each asset type within the pension fund portfolio. The effects of any material changes in these assumptions or any differences between actual results and the assumptions would by their nature be cumulative and subject to recognition on a regular basis over future fiscal periods. Hence, such changes and differences could potentially have a material effect on the future values of pension-related expenses and liabilities.

(2) Consolidated Financial Review

Please refer to page 43 for the Consolidated Statements of Income.

Total operating revenues increased by ¥73.9 billion (2.6%) on a year-on-year basis to ¥2,920.0 billion. Revenues from voice communications services fell due to fierce competition between carriers in the market for broadband services and an ongoing shift toward low-priced IP telephony services in the fixed-line market. The au mobile business was the principal contributor to revenue growth in this segment. Higher sales of 3G CDMA 1X WIN mobile handsets enabled au to record the largest net increase in market share for the second year running.

Operating expenses increased by ¥69.8 billion (2.7%) on a year-on-year basis to ¥2,623.8 billion. This was mainly attributable to aggressive marketing efforts to expand sales of CDMA 1X WIN handsets and to promote the KDDI Hikari Plus and KDDI Metal Plus services. Operating income increased by ¥4.0 billion to ¥296.2 billion.

Other expenses declined significantly compared with the previous year, falling by ¥97.4 billion to ¥2.6 billion, due to lower interest expense associated with the steady reduction in interest-bearing debt. Another major factor was the absence of significant losses on the disposal of property, plant and equipment (a loss of ¥78.0 billion was recorded in the previous year due to the lump-sum write-off of microwave transmission systems). In the year ended March 2005, the KDDI Group recorded an extraordinary gain of ¥27.6 billion on the sale of PHS business operations and impairment losses of ¥23.4 billion.

Income before income taxes and minority interests increased by ¥101.4 billion to ¥293.5 billion. Total income taxes increased by ¥18.9 billion to ¥88.1 billion, while minority interests declined by ¥1.0 billion to ¥4.8 billion. Net income increased by ¥83.5 billion to ¥200.6 billion.

(3) Segment Financial Reviews

Notes:
1) Effective the fiscal year ended March 2005, the classification of telecommunications business operating revenues into two categories (voice communications and digital data transmission services) was discontinued.
2) The BBC & Solutions Business was renamed the Fixed-line Business. KDDI Network & Solutions Inc. (KNSL), which was

established in November 2004, was consolidated into the accounts of the Fixed-line Business, and, for the purposes of comparison, the segment results are stated retrospectively using the same standards in the fiscal year ended March 2004.

3) Following its transfer, the Pocket (PHS) Business was removed from the scope of consolidation, effective the second half of the fiscal year ended March 2005.

4) In line with changes to the segment presentation, to make it compatible with that used in the Summary of Financial Statements effective the fiscal year ended March 2005 corporate eliminations for inter-segment transactions within KDDI between the au and Fixed-line Businesses are recorded as double-ledger entries against revenues and expenses (previously these were shown only as a net deduction to expenses). For the purposes of comparison, the results for the fiscal year ended March 2004 are restated using the same standard. This change has no effect on operating income.

5) In line with changes to the segment presentation , effective the fiscal year ended March 2005 the figures for the TU-KA Business and Other Businesses were changed to the consolidated values, rather than simple aggregates of individual company figures.

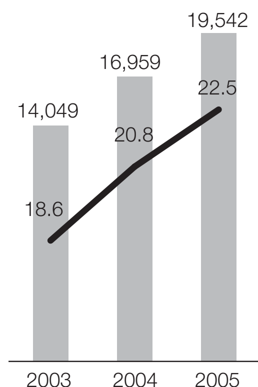
Segment Financial Reviews

[au Business]

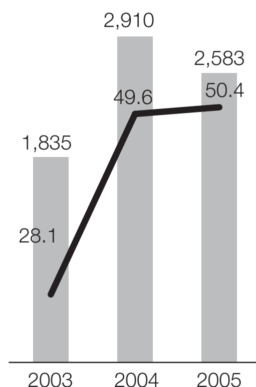
	Millions of yen				Millions of U.S. dollars
Years ended March 31, 2004 and 2005	2004	**2005**	Change	%	**2005**
Operating revenues	¥ 1,831,786	**¥ 2,092,702**	¥ 260,916	14.2%	**$ 19,487**
Operating expenses	1,592,317	**1,819,596**	227,279	14.3%	**16,944**
Operating income	239,469	**273,106**	33,637	14.0%	**2,543**
Free cash flows	207,251	**132,561**	(74,690)	(36.0%)	**1,234**
EBITDA	437,651	**481,387**	43,736	10.0%	**4,483**
EBITDA margin	23.9%	**23.0%**	(0.9%)	—	**—**

Segment operating revenues increased by ¥260.9 billion to ¥2,092.7 billion. This was primarily due to the success of au's advanced 3G mobile services, in which it has been a pioneer in the Japanese market, and the popularity of CDMA 1X and CDMA 1X WIN mobile handsets. Total subscriber numbers posted a net increase of 2.58 million for the year, rising to 19.54 million by the end of March 2005. The au brand secured the leading share (50.4% in fiscal 2004) of the net increase in subscribers within the Japanese market for the second consecutive year. With CDMA 1X WIN services (initiated in November 2003, offering mobile connectivity of up to 2.4Mbps), growth in subscriber numbers accelerated due to an improved handset lineup and upgraded content. The number of CDMA 1X WIN subscribers had reached 3.25 million by the end of March 2005. Although monthly average revenue per user (ARPU) declined for the overall au Business, relatively high ARPU from CDMA 1X WIN services and the strong growth in the subscriber base combined to offset the total decline in ARPU compared with other carriers. Overall, ARPU fell by ¥270 during the year, from ¥7,440 to ¥7,170. The average churn rate dropped from 1.49% to 1.44%, reflecting the overall improvement in the product lineup and higher perceived au brand value.

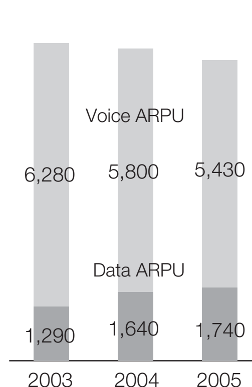
Total au Subscriber Numbers (Thousands)



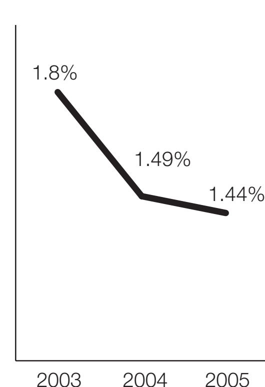
Net Increase in au Subscriber Numbers (Thousands)



ARPU (Yen)



Churn Rate



Segment operating expenses increased by ¥227.3 billion to ¥1,819.6 billion. The cost of sales for cellular-phone handsets rose by ¥57.0 billion, reflecting an increase in new subscribers and upgrades into CDMA 1X WIN models due to enhanced handset design innovation (the au design Project) and lineup of CDMA 1X handsets. Contract-linked sales commissions paid to agency retail outlets increased by ¥60.0 billion to ¥444.0 billion. This reflected greater handset sales volumes (unit sales increased by 1.02 million during the year to 11.59 million) and a ¥2,000 increase in the sales commission level to an average of ¥38,000 per unit. Higher average commissions were partly due to effective measures to boost handset retention by users and partly a reflection of the higher ratio of CDMA 1X WIN handsets in the sales mix, due to their more advanced functions. In other operating expenses, major factors contributing to higher costs were access charges, which rose by ¥8.0 billion in line with the rise in subscribers, and depreciation expenses, which increased by ¥16.8 billion due to investment in base stations and other wireless network infrastructure. Segment operating income increased by ¥33.6 billion to ¥273.1 billion.

[Fixed-line Business]

	Millions of yen				Millions of U.S. dollars
Years ended March 31, 2004 and 2005	2004	**2005**	Change	%	**2005**
Operating revenues	¥ 623,104	**¥ 596,041**	¥ (27,063)	(4.3%)	**$ 5,550**
Operating expenses	606,683	**596,351**	(10,332)	(1.7%)	**5,553**
Operating income (loss)	16,421	**(310)**	(16,731)	(101.9%)	**(3)**
Free cash flows	68,559	**(3,066)**	(71,625)	(104.5%)	**(29)**
EBITDA	112,402	**87,494**	(24,908)	(22.2%)	**815**
EBITDA margin	18.0%	**14.7%**	(3.3%)	—	**—**

Segment operating revenues decreased by ¥27.1 billion to ¥596.0 billion. This was mainly due to a significant decline in revenues from voice communications services (local, long-distance and international telephony) amid an ongoing contraction of the Japanese fixed-line market. This was partly offset by strong growth in revenues from data communications services due to rising Internet usage by individuals. Data revenues also increased due to higher demand from the corporate sector, where revenues increased from VPN services that supported the growth in construction of corporate IP networks. KDDI expects to a turnaround in this segment and focusing on an early deployment of the KDDI Metal Plus service launched in February 2005.

Operating expenses fell by ¥10.3 billion to ¥596.4 billion. KDDI strove to raise profitability in a shrinking market by reducing costs. Cost-cutting efforts were sufficiently effective to offset the additional costs of developing and launching the KDDI Metal Plus service. Overall voice telephony access charges fell due to declining voice traffic, though costs in this category partly rose by ¥4.0 billion to ¥12.4 billion as a result of retrospective increases in access charges levied by NTT East and NTT West. The segment recorded an operating loss of ¥0.3 billion, a deterioration of ¥16.7 billion compared with the previous year

[TU-KA Business]

Years ended March 31, 2004 and 2005	Millions of yen 2004	2005	Change	%	Millions of U.S. dollars 2005
Operating revenues	¥ 274,329	¥ **231,397**	¥ (42,933)	(15.7%)	$ **2,155**
Operating expenses	258,025	**212,965**	(45,060)	(17.5%)	**1,983**
Operating income	16,304	**18,432**	2,127	13.0%	**172**
Free cash flows	54,951	**58,075**	3,124	5.7%	**541**
EBITDA	72,097	**66,811**	(5,286)	(7.3%)	**622**
EBITDA margin	26.3%	**28.9%**	2.6%	—	**—**

Segment operating revenues declined by ¥42.9 billion to ¥231.4 billion, mainly due to a drop in subscriber numbers combined with lower ARPU. KDDI was able to stabilize the customer base, however, using a sales strategy that targets customers wanting just basic voice and e-mail services rather than phones with advanced functions. Total subscriber numbers as of the end of March 2005 were 3.59 million, a drop of only 40,000 on a year-on-year basis. This was an improvement on the net fall of 150,000 in the subscriber base in the year ended March 2004. The introduction in November 2004 of simplified TU-KA S mobile handsets specifically designed for seniors was another contributing factor.

Operating expenses declined significantly, falling by ¥45.1 billion to ¥213.0 billion. This was primarily due to benefits stemming from the simplification strategy as well as efforts to reduce costs. In particular, the cost of sales of handsets fell by ¥11.5 billion compared with the previous year. This was due to a combination of lower purchasing costs resulting from simplified handset functions with less frequent model changes by existing customers, which resulted in a drop in sales volume. Segment operating income increased by ¥2.1 billion to ¥18.4 billion.

[Pocket (PHS) Business]

Years ended March 31, 2004 and 2005	Millions of yen 2004	2005	Change	%	Millions of U.S. dollars 2005
Operating revenues	¥ 184,017	¥ **86,873**	¥ (97,144)	(52.8%)	$ **809**
Operating expenses	162,924	**81,397**	(81,527)	(50.0%)	**758**
Operating income	21,093	**5,476**	(15,617)	(74.0%)	**51**
Free cash flows	47,206	**20,902**	(26,304)	(55.7%)	**195**
EBITDA	61,363	**24,595**	(36,768)	(59.9%)	**229**
EBITDA margin	33.3%	**28.3%**	(5.0%)	—	**—**

As part of the strategy of business concentration and selectivity, and after careful consideration of the best course of action for the PHS business, KDDI transferred the entire operations in October 2004 to a consortium formed with the Carlyle Group, Kyocera Corporation and KDDI.

Segment operating revenues for the period prior to the sale were ¥86.9 billion, a fall of ¥97.1 billion compared with the 12-month total for the previous year. On the same basis, operating expenses decreased by ¥81.5 billion to ¥81.4 billion. Segment operating income fell by ¥15.6 billion to ¥5.5 billion.

[Other Businesses]

Years ended March 31, 2004 and 2005	Millions of yen				Millions of U.S. dollars
	2004	**2005**	Change	%	**2005**
Operating revenues	¥ 80,371	**¥ 81,380**	¥ 1,009	1.3%	**$ 758**
Operating expenses	79,826	**80,429**	603	0.8%	**749**
Operating income	545	**951**	406	74.5%	**9**

In other businesses, the KDDI Group focused on responding to rapid changes in operating conditions in telecoms markets by boosting competitiveness through restructuring of Group operations. This involved moves to consolidate business functions between KDDI Group firms to increase efficiency while also strengthening the operational base to foster future growth. In October 2004, consolidated subsidiaries KDDI Telemarketing Inc. and KDDI Sogo Service Co., Ltd. merged. The merged entity changed its name to KDDI Evolva Inc. in December 2004. Due to particularly difficult conditions in the undersea cable construction business and the lack of recovery prospects, KDDI also liquidated consolidated subsidiary KDDI Submarine Cable Systems Inc. in March 2005.

Segment operating revenues rose by ¥1.0 billion to ¥81.4 billion. Operating expenses increased by ¥0.6 billion to ¥80.4 billion. Segment operating income amounted to ¥1.0 billion, a year-on-year improvement of ¥0.4 billion.

(4) Capital Financing and Liquidity

(a) Cash flows

Operating activities +¥538.7bn (-¥84.0bn year-on-year)

Net cash provided by operating activities amounted to ¥538.7 billion, which marked a decrease of ¥84.0 billion compared with the previous year. Although income before income taxes and minority interests increased by ¥101.4 billion to ¥293.5 billion, primarily due to another strong performance from the au Business and a net positive earnings contribution from extraordinary items, income taxes paid increased by ¥98.9 billion. The figure for income taxes paid in fiscal 2003 (¥16.5 billion) reflected a reduction in taxes following the recognition of tax relief in respect of the costs associated with the disposal in fiscal 2001 of digital mobile phone infrastructure (for the PDC cellular network) and the cessation of related services.

Investing activities -¥136.5bn (+¥82.0bn year-on-year)

Net cash used in investing activities amounted to ¥136.5 billion, representing a year-on-year reduction in cash outflow of ¥82.0bn. Investments in property, plant and equipment were higher than in fiscal 2003 as KDDI continued to pursue cost-effective capital spending programs aimed at improving service reliability and boosting customer satisfaction. Major elements of capital spending in the au business included enhancement of the service coverage for CDMA 1X and CDMA 1X WIN networks as well as construction and upgrading of base stations and wireless exchanges. In the Fixed-line Business, KDDI invested in new infrastructure for the KDDI Metal Plus and KDDI Hikari Plus Home services. The main factor in the year-on-year reduction in cash outflow of ¥82.0 billion was proceeds from the sale of PHS operations, which amounted to ¥206.2 billion.

Financing activities -¥376.1bn (-¥47.1bn year-on-year)

Free cash flows, which equal total net cash generated by operating and investing activities, amounted to ¥402.2 billion, a decline of ¥2.1 billion from the previous year. Consolidated interest-bearing debt was reduced by ¥315.1 billion. Dividend payments totaled ¥24.6 billion and payments for the acquisition of treasury stock amounted to ¥24.4 billion. As a result, net cash used in financing activities amounted to ¥376.1 billion, which represented a year-on-year increase in cash outflow of ¥47.1billion.

(b) Liquidity

Consolidated cash and cash equivalents totaled ¥222.5 billion at March 31, 2005, an increase of ¥26.0 billion from the balance of ¥196.5 billion at March 31, 2004. The balance of liquidity was changed due to our operating performance, financing needs and investments.

(c) Financing

Cash flows from operating and investing activities were sufficient to meet all financial needs during fiscal 2004. The KDDI Group did not issue any bonds or procure any long-term borrowings during the year.

(d) Debt repayments

Contracted debt repayment totals by maturity are given below.

(Units: yen in billions)

	Amount	Less than1yr	1-3yrs	3-5yrs	Above 5yrs
Corporate bonds	328.5	60.3	150.3	59.8	58.0
Bank borrowings	533.4	164.5	312.3	45.2	11.2
Other	2.6	2.6	0	—	—
Total	864.6	227.4	462.7	105.0	69.2

(e) Foreign exchange risk

The policy of the KDDI Group is to use forward exchange contracts, currency swaps and other instruments as necessary to hedge foreign exchange risks associated with business transactions denominated in foreign currencies or overseas investment and financing projects, based on the balance of assets and liabilities in each currency.

(f) Financial policies

The basic policy of the KDDI Group is to secure stable, low-cost financing as required, depending on the financial status of the company and the prevailing conditions in financial markets. The company seeks the most effective means of financing wherever possible.

Consolidated interest-bearing debt totaled ¥864.6 billion at March 31, 2005. The ratio of direct to indirect financing was 38:62 and the long-term financing ratio* was 73.7%. Since the merger in 2000, the primary financial goals of the KDDI Group have been reduction of interest-bearing debt and prioritization of long-term debt in order to realize a rapid improvement in financial position.

*Total proportion of interest-bearing debt due to corporate bonds and long-term borrowings

Although domestic and overseas KDDI Group subsidiaries also procure their own funds, the parent company raised 85.1% of consolidated interest-bearing debt. The policy of the KDDI Group has been to shift the financing burden from subsidiaries to the parent company in order to secure a lower cost of financing, and this has resulted in the parent company financing ratio increasing steadily year by year. Going forward, the company plans to maintain this policy.

Rating and Investment Information Inc. (R&I) upgraded KDDI's long-term senior debt rating in July 2004 from A- to A, citing improved earnings and a healthier financial position.

(g) Contingent liabilities

The balance of third-party guaranteed liabilities at March 31, 2005 amounted to ¥126.7 billion.

Business Risks

This section contains an overview of the principal business-related and other risks facing the KDDI Group that could have a material bearing on the decisions of investors. This section also discloses information on a number of other subjects that, while not explicitly considered business risks, could also be materially relevant to investment decisions. KDDI discloses information on possible risks in the interests of greater transparency. The company strives to take all appropriate measures to avoid risk wherever possible and to develop countermeasures to situations as they arise.

This section contains various forward-looking statements that represent the best judgments of the KDDI Group as of March 31, 2005. Investors should note that future developments are also subject to unknown risks and uncertainties that by their nature cannot be covered by the following discussion.

(1) Competitors, Rival Technologies and Rapid Market Shifts

au business

The KDDI Group launched 3G cellular-phone services in Japan in April 2002 with the introduction of CDMA 1X, followed by CDMA 1X WIN in November 2003. These services are subject to competition from rival mobile carriers and competing technologies and to sudden changes in market conditions. The main business-related factors and uncertainties that could have a negative impact on au operations and thereby affect the financial position and performance of the KDDI Group are summarized and listed below.

* Market demand trends out of line with KDDI Group expectations
* Subscriber growth trends out of line with KDDI Group expectations
* Fall in ARPU (Average Revenue Per Unit) due to tariff discounts sparked by fierce price competition, or higher commission-related or promotional costs to maintain customer base
* Decline in ARPU due to drop in service usage frequency by subscribers
* Drop in customer satisfaction with network quality or capacity (irrespective of any unforeseen developments)
* Decline in attractiveness of handsets or supplied content in comparison with offerings of rival carriers
* Increase in handset prices associated with adoption of more advanced functions, or higher sales commissions
* Drop in customer satisfaction caused by spam or other e-mail abuse, plus related increases in network security costs
* Higher costs of 2GHz spectrum ()
* Increase in competition due to new high-speed data wireless technology
* Effects associated with dependence on specific communications protocol, handset or network technologies or software

Fixed-line business
The KDDI Group's marketing efforts in this sector have been focused on the MYLINE registration service in the fixed-line telephony market. In broadband services, the company markets ADSL services under the DION brand. In October 2003, and launched KDDI Hikari Plus as a FTTH service. In February 2005 KDDI introduced KDDI Metal Plus in high-quality IP telephony market and is expanding its sales as one of the mainstay of direct access services. The KDDI Metal Plus service involves the customer paying basic monthly line charges to KDDI rather than to NTT. The market for fixed-line services has changed radically in recent years and now features competition between fixed-line carriers, ADSL providers, cable TV companies and other firms. The main business-related factors and uncertainties that could have a negative impact on fixed-line operations and thereby affect the financial position and performance of the KDDI Group are summarized and listed below.

* Market demand trends out of line with KDDI Group expectations
* Subscriber growth trends out of line with KDDI Group expectations
* Fall in ARPU due to tariff discounts sparked by fierce price competition, or higher commission-related or promotional costs to maintain customer base
* Decline in ARPU due to drop in service usage frequency by subscribers
* Drop in customer satisfaction with network quality or capacity (irrespective of any unforeseen developments)
* Decline in attractiveness of supplied content relative to rival carriers
* Contraction of fixed-line telephony market due to spread of IP telephony
* Increase in NTT access charges

TU-KA Business
The KDDI Group markets 2G cellular-phone services under the TU-KA brand to customers in the Tokyo, Osaka and Nagoya urban areas, focusing on voice and mail services that emphasize simplicity and ease of use. Amid fierce competition in the mobile-phone services market, the main business-related factors and uncertainties that could have a negative impact on TU-KA operations and thereby affect the financial position and performance of the KDDI Group are summarized and listed below.

* 2G mobile demand trends out of line with KDDI Group expectations
* Subscriber base trends out of line with KDDI Group expectations
* Fall in ARPU due to tariff discounts sparked by fierce price competition
* Decline in ARPU due to drop in service usage frequency by subscribers
* Drop in customer satisfaction with network quality or capacity (irrespective of any unforeseen developments)
* Ineffectiveness of sales strategy targeting seniors with brand image that emphasizes simplicity
* Future provision of national service coverage subject to rival carrier

(2) Communications Security and Protection of Customer Privacy

KDDI is legally obliged as a licensed Japanese telecommunications carrier to safeguard the security of communications over its network. The company is also actively engaged in protecting the confidentiality of customer and other personal information. KDDI has established the Corporate Risk Management Division and a committee for privacy and security issues to formulate and implement measures across the entire KDDI Group to prevent internal privacy breaches or other information leaks. KDDI has tightened the control over an access to the relevant systems. The security of customer data is protected in line with the KDDI Privacy Policy. The company has also published and distributed handbooks on customer privacy issues to all employees.

KDDI's policy on general compliance issues is summarized in a charter of ethical corporate behavior. As part of efforts to strengthen internal compliance oversight, KDDI has established a corporate ethics committee to supervise the maintenance and improvement of compliance systems. Despite all these measures and safeguards, however, KDDI cannot guarantee that breaches of privacy or leakage of confidential customer information will never occur. Any such incident could seriously damage the brand image of the KDDI Group. Besides a loss of customer trust, the company could also be forced to pay substantial compensation, which could have a negative impact on the financial position and performance of the KDDI Group. Going forward, the company may also face higher costs to develop or upgrade privacy protection systems.

(3) Telecommunications Sector Regulation

The revision or repeal of laws and ordinances governing telecommunications, together with related government policies, have the potential to exert a negative impact on the financial position and performance of the KDDI Group. The KDDI Group believes that it is taking all appropriate measures to respond to social issues with potentially injurious implications for its brand image and customer trust. However, the financial position and performance of the KDDI Group could be negatively affected if such measures were to prove ineffective in the future. Major regulatory risks are listed below.

au Business/TU-KA Business
* Introduction of a mobile number portability system (MNP)
* Liberalization of rules governing mutual service provision
* Introduction of rights to set charges fees for fixed-to-mobile calls by fixed-line operators.
* Revisions to inter-operator access charge calculation formulae
* Revisions to system governing radio spectrum usage fees
* Reorganization of 800MHz frequency bands
* Entry of new carriers using frequency bands in 1.7GHz or 2GHz spectrum
* New research into the effect of radio waves on health
* Anti-spam systems or related regulatory developments
* Mobile Internet systems or related regulatory developments
* Systems targeting illegal mobile phone use or related regulatory developments

Fixed-line Business
* Liberalization of rules governing mutual service provision
* Revisions to inter-operator access charge calculation formulae
* Revisions to systems governing universal service fund
* Government policy on deregulation of optical fiber and FTTH
* Anti-spam systems or related regulatory developments
* Internet systems or related regulatory developments

(4) System Failures

Provision of voice communication and packet-switched data communication services by the KDDI Group is dependent on the

smooth functioning of related communications networks in Japan and overseas. Temporary service outages due to systemic problems cannot be ruled out and could theoretically lead to large-scale billing errors.

Temporary cessation of services due to KDDI Group systems going down is another system-related risk with potentially negative effects on the financial position and performance of the KDDI Group. The major potential causes of such an event are listed below.

* Computer viruses or other form of cyberattack
* System hardware or software crashes
* Power brownouts or blackouts
* Natural disasters such as earthquake, typhoon or flood
* War, terrorism, accidents or other events

(5) Litigation and Patents

Litigation stemming from alleged infringement of intellectual property and other rights associated with KDDI Group products, services and technologies could potentially have a negative impact on financial position and performance.

Note: In April 2005, the Tokyo District Court dismissed a suit brought by KDDI against the revocation of a changes in the contractual terms governing connections with the Class I telecommunications carriers NTT East Corporation and NTT West Corporation that was originally approved by the Minister of Public Management, Home Affairs, Posts and Telecommunications of internal Affairs and communications in April 2003. KDDI decided not to appeal the ruling because, subsequent to the filing of the original suit, it transpired that the key point of contention, which concerned retrospective changes to fee formulae, would be resolved in negotiations scheduled for fiscal 2005-7 to amend access charges with the aim of stimulating competition and providing better services for customers. While dismissing the suit, the court did however affirm the rights of the plaintiff (KDDI) to file a suit on those legal grounds.

(6) Personnel Retention and Training

The KDDI Group invests in companywide personnel training to ensure that it can respond rapidly to technological developments, although the training process takes time for the desired effects to manifest. Going forward, KDDI faces the risk of a substantial increase in personnel development costs.

(7) General Legal and Regulatory Risk

In each of the countries in which it operates, the KDDI Group takes steps to secure the appropriate business and investment permits and licenses, to establish procedures in conformity with national safety and security laws, and to apply various other government regulations. The company also seeks to comply fully with commercial, anti-trust, patent, consumer, tax and labor laws as well as legislation covering foreign exchange transactions and issues related to the environment and recycling. Failure to comply with legislation could result in limitations being placed on the future business activities of the KDDI Group or increases in costs.

(8) Pension Liabilities

Following the merger in 2000, KDDI has undertaken efforts to integrate pension systems. This has involved moves to return the government-sponsored substitutional portion of employee welfare pensions and to cut pension liabilities through revisions of retirement benefit rates. KDDI has also revised its pension asset management policies and methods, based on projections of future liabilities. Going forward, the KDDI Group could post extraordinary losses if a fall in yields on managed pension assets leads to a drop in the market value of the pension fund, or in the event of revisions to the actuarial assumptions (such as the discount rate or expected rate of salary increases) on which planned retirement benefit levels are based. Changes to the pension system could also result in higher expenses arising from amortization of unrecognized prior service cost.

(9) Asset-Impairment Accounting

Following the adoption of asset-impairment accounting standards ahead of the timetable mandated by Japanese law, the KDDI Group posted extraordinary losses against asset impairment for submarine cable systems and other idle assets for the fiscal year ended March 2005. Going forward, the KDDI Group may post other impairment losses against property, plant and equipment.

(10) Telecommunications Sector Consolidation (eg: M&A)

Consolidation within the telecoms industry in Japan and abroad could exert a negative impact on the financial position and performance of the KDDI Group.

Going forward, the KDDI Group may undertake further restructuring measures at some later date. The company cannot guarantee that such action would necessarily have a positive impact on the KDDI Group.

Note: As part of a strategy of business concentration and selectivity, and after careful consideration of the best course of action for the PHS business, KDDI reached the agreement to transfer the entire operations of consolidated subsidiary DDI Pocket Inc. to a consortium formed with the Carlyle Group and Kyocera Corporation and KDDI. The transfer took place in October 2004 The KDDI Group cannot guarantee that future effects of this business transfer will necessarily have a positive impact on its financial position and performance.