

Mobile Business

Expanding customer base with attractive all-round package of handsets, content, and tariffs based on infrastructure strengths

Note: As a result of the merger of KDDI Corporation with three TU-KA Group firms in October 2005, the au Business and the TU-KA Business were integrated into a new business segment in the fiscal year ended March 2006. This new segment is our Mobile Business.

Business Conditions in the Fiscal Year Ended March 2006

The Mobile Business remained the main driver of KDDI's strong performance in the fiscal year ended March 2006.

Segment sales and profits increased compared with the previous year. Operating revenues totaled ¥2,510.4 billion, a year-on-year increase of 8.6%. Operating income rose 21.3%, to ¥354.4 billion. On a consolidated basis, the Mobile Business accounted for approximately 80% of total sales. Net income attributable to this segment fell 15.4% year on year, to ¥145.3 billion, reflecting an extraordinary loss of ¥104.3 billion incurred against the impairment of PDC equipment used in our TU-KA operations.

The growth generated by KDDI in the Mobile Business segment over the past few years derives from successful efforts to differentiate product and service offerings from those of rival carriers. To do this, KDDI has leveraged the advantages of au's 3G network infrastructure to create a highly attractive all-round package of handsets, mobile content, and tariffs.

Overview of Business Performance

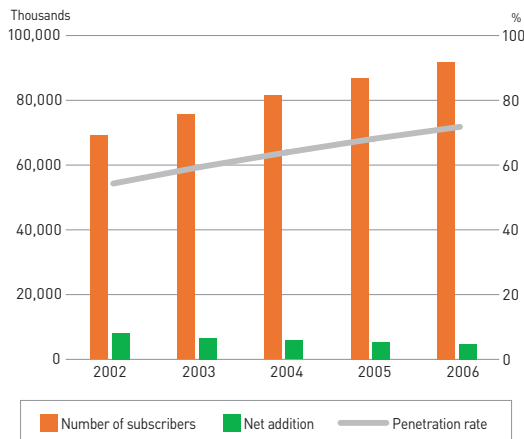
Subscriber numbers

The subscriber base for au and TU-KA services as of the end of March 2006 rose 10% year on year, to 25.44 million customers. This number represents a 27.7% share of cumulative subscriptions.

Cumulative subscriptions to au rose 16.2% year on year, to 22.7 million. Of this figure, 21.83 million customers, or over 90% of the total, subscribed to 3G mobile phone services. The subscriber base for CDMA 1X WIN (WIN) services reached 8.28 million by the end of March 2006, increasing substantially, by 5.03 million users, compared with the previous year-end.

KDDI began shifting TU-KA subscribers to the au brand in October 2005, ahead of the introduction of mobile number portability (MNP). As a result, the number of TU-KA subscribers fell to 2.74 million. In February 2006, KDDI upgraded the terms of service migration to enable users to keep their existing e-mail addresses as well their phone numbers. As of the end of March 2006, approximately 710,000 TU-KA subscribers had moved to au and kept their original numbers.

Spread of Cellular Phones





W425 (Walkman® phone)

Net growth in the au subscriber base compared with the previous year-end equaled 3.16 million. Excluding same-number migration from TU-KA, net growth was 2.45 million. The au brand registered the highest number of net additions for the third consecutive year.

ARPU (au-branded services)

ARPU for au services declined 1.8% year on year, to ¥7,040. The drop in ARPU was less than for rival carriers because growth in data ARPU helped to offset the ongoing downward trend in voice ARPU. Steady growth in the proportion of high-end WIN users also helped to bolster overall ARPU.

Churn rate (au-branded services)

The churn rate for au subscribers was 1.20% in the year ended March 2006, a significant improvement of 0.24 percentage points over the previous year. The low churn rate reflected successful efforts by KDDI to boost customer satisfaction by upgrading its all-round product and service offerings while promoting model upgrades among subscribers using targeted direct-mail campaigns and other methods.

Market Trends and Business Strategy

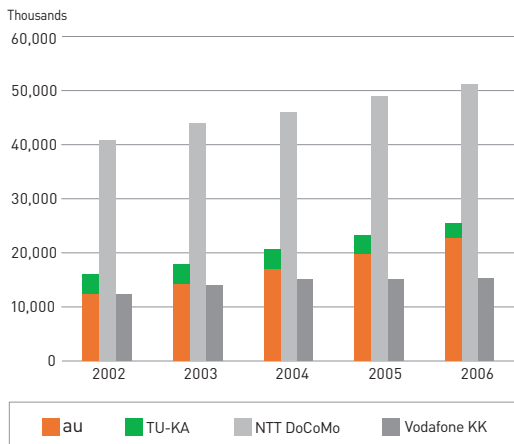
Growth in the overall mobile phone market in Japan has slowed over the past few years. Net additions in the year ended March 2006 equaled 4.8 million subscribers, a decline of 6% compared with the previous year. Competition, meanwhile, is set to intensify following the government authorization in November 2005 for the entry of a new carrier, the announcement in March 2006 of the acquisition of Vodafone Japan by Softbank, and the advent of MNP in autumn 2006.

Amid changing conditions in the Japanese mobile phone market, KDDI's competitive advantage in expanding its customer base lies in the attractiveness of its all-round offering of infrastructure, handsets, content, and tariffs. KDDI views the advent of MNP as an excellent opportunity to further gain market share. The Mobile Business's short-term goals are to achieve a 30% share of cumulative subscriptions and a customer base of 30 million subscribers as quickly as possible.

High-Quality Infrastructure: The Introduction of EV-DO Revision A

The CDMA2000 1X EV-DO (EV-DO) standard that supports WIN services provides KDDI with yet another competitive advantage over other carriers. The EV-DO system is specifically designed for data communication. It provides a network optimized for high-speed,

Trends in Number of Subscriber for Cellular Telephone



large-volume data traffic. EV-DO technology also has realized significant savings for KDDI in the cost per bit of data transmitted. And KDDI is leveraging the technological strengths of EV-DO infrastructure ahead of other carriers with such attractive services as EZ Chaku-uta Full®, along with flat-rate data tariffs.

The launch of High-Speed Downlink Packet Access (HSDPA) services in Japan in mid-2006 has enabled other carriers to catch up with EV-DO. But KDDI remains a technological step ahead. During 2006, KDDI plans to upgrade to EV-DO Revision A, which features improved downlink (3.1 Mbps) and uplink (1.8 Mbps) speeds. The jump in upload quality in particular, from 154 Kbps, promises to be huge. The introduction of EV-DO Revision A will heighten KDDI's edge in network infrastructure capabilities and further differentiate its au service from the offerings of other carriers.

**Attractive Handsets:
A Comprehensive Model Lineup**

In September 2005, KDDI launched new handset models that are compatible with FeliCa, a noncontact IC card technology used in various services, such as Edy and Suica. KDDI began selling a number of other exciting new handsets in February 2006. These include the W41H, which can receive terrestrial digital television broadcasts; the W41T, which features built-in high-HDD capacity; and the neon model, which is the fifth handset from the au design project. The handsets in KDDI's newly expanded range cater to diverse customer requirements and excel in user convenience, functionality, and design attractiveness. KDDI is focused on upgrading the lineup on a continual basis. In June 2006, KDDI introduced Japan's first Walkman® phone, by Sony Ericsson Mobile Communications.

KDDI plans to launch additional new handset models in the year ending March 2007 from such other leading manufacturers as Sharp Corporation and Panasonic Mobile Communications Co., Ltd. Efforts are under way to expand and improve the model lineup ahead of the introduction of MNP.

**Captivating Content:
Fun and Variety Based on WIN Characteristics**

KDDI's pioneering promotion of flat-rate pricing plans has encouraged users to make use of mobile Internet services without worrying about data charges. KDDI is now developing and introducing new ways of using mobile phones that promise to cultivate innovative sources of revenue for the company going forward. Music download services are some of the most popular content-based services among au subscribers. Building on the success of EZ Chaku-Uta® and EZ Chaku-uta Full®, in late January 2006 KDDI launched au LISTEN MOBILE SERVICE (LISMO). LISMO grants au subscribers seamless connectivity between their mobile handsets and PCs. It also is the industry's first comprehensive music service suite for mobile phones. Users are able to enjoy interactive music and to easily share music between mobile phones and PCs with au Music Port music management software. LISMO adds even more advanced music services to KDDI's already strong range of services for au mobile users.

In other content-related developments, in December 2005 KDDI established Media Flow Japan. This joint planning venture with US-based Qualcomm analyzes market possibilities in video distribution services. Then, in February 2006, KDDI launched the e-shopping site au Shopping Mall. Although the amounts consumers are spending remain low, the site's e-commerce rev-





W41CA



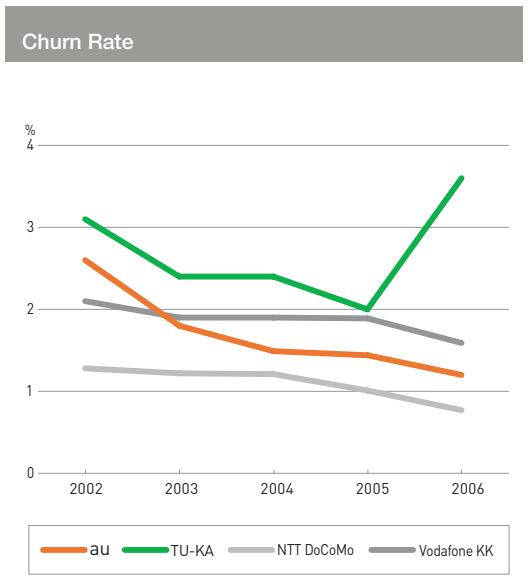
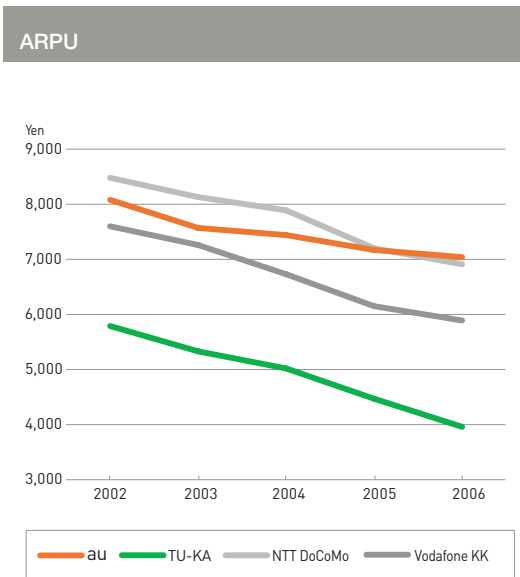
W335A II

enue from product sales, auctions, and other features is rapidly growing. In April 2006, KDDI and The Bank of Tokyo-Mitsubishi UFJ agreed to jointly establish Japan's first mobile Internet bank to promote mobile financial services. (we established the Mobile Net Bank Establishment Investigation Corporation) And in May 2006, KDDI agreed to incorporate Google's search engine into its EZweb Internet service. This gives au mobile phone users access to an extensive search service that targets content aimed at PCs in addition to the mobile-specific content that they already enjoy.

Going forward, KDDI plans to continue differentiating its au content offerings by expanding and upgrading exclusive services centered on downloadable content, including music (EZ Chaku-uta Full®); e-books; and games. KDDI also is incorporating value-added software features into handsets. These features, which include the full-browser functionality of PC Site Viewer, provide mobile users with greater access to the sort of information provided by a fixed-line Internet connection.

**Enticing Tariffs:
Service Menus Expanded to Fit Customer
Needs Using Flat-Rate Pricing Plans**

KDDI leverages the cost advantage provided by EV-DO technology to offer au WIN subscribers its Double Flat Rates tariff option. This two-tiered, flat-rate discount plan for packet-switched data affords customers access to a rich variety of high-quality content for as little as ¥2,100 per month, including tax. In May 2005, KDDI introduced the Double Flat Rates Light plan,



which aims to encourage more users to sample content by cutting the minimum monthly flat-rate charge to ¥1,050. This offer successfully enticed many new users to try KDDI's flat-rate pricing system for mobile data services. About 80% of WIN subscribers have adopted one of these two discount plans.

KDDI has also developed a wide variety of pricing plans for voice services. Conditional on a two-year contract, My Plan Discount, introduced in February 2006, allows single subscribers to benefit from the deeper discounts on the basic monthly charge typically only available using family discount plans. In August 2006, KDDI plans to introduce the Indefinite-Period Carry Over (an endless carryover option) that allows customers to keep their unused call minutes up to a predetermined limit.

Developing Untapped Markets: Mobile Solutions for Corporate Clients

It is KDDI's intention to allocate more resources to developing mobile solution services for the corporate sector. In late March 2006, KDDI launched the au B01K handset, which is equipped with enhanced security features. The B01K Endurance model features a high-capacity battery and remote-control security features, such as data deletion. As such, it matches corporate needs for a phone that combines long conversation capabilities with complete data protection. These handsets are ideal for salespeople because they alleviate any concerns over loss of power or data leakage.

In July 2006, KDDI plans to introduce the E02SA handset. This will be the first au model capable of interfacing with a wireless LAN. The E02SA, therefore, will enable users to access a VoIP internal phone network and the au mobile network with a single handset. This promises to enhance workplace efficiency by allowing workers to remain in contact even if they move around their offices.

KDDI plans to market E02SA handsets in partnership with equipment vendors under a package called OFFICE FREEDOM. The package features a specially developed wireless LAN internal extension solution that promises expanded business possibilities. It facilitates smoother communication between workers in the same company, irrespective of location.

KDDI also is working more closely with consumers to develop various individual solutions for specific cus-

tomers' needs. At the same time, KDDI continues to upgrade its existing services.

Strategy for TU-KA Services

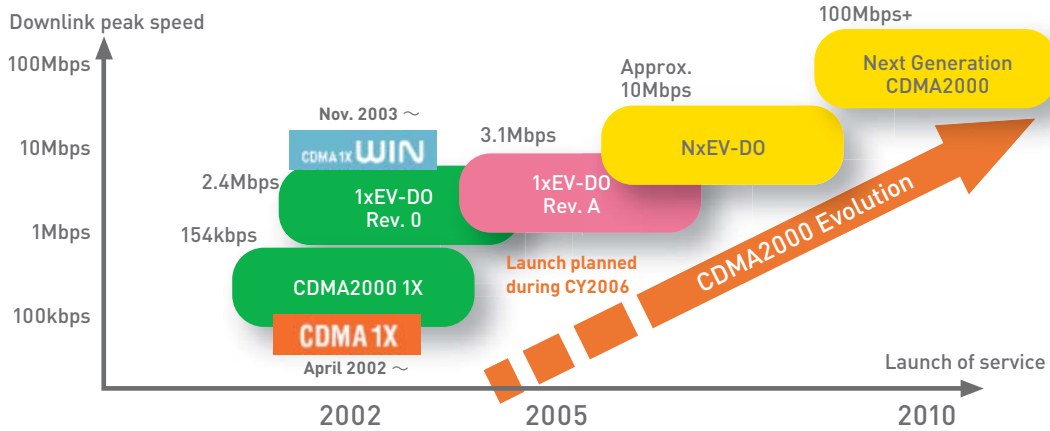
In October 2005, following the merger with three TU-KA group companies, KDDI began offering same-number transfers to entice TU-KA subscribers to shift to the au service. The terms of transfer were further enhanced in February 2006 with the opportunity for users to keep their e-mail addresses as well their phone numbers. User migration from TU-KA to au is proceeding satisfactorily.

KDDI decided to close the TU-KA mobile phone service to new subscribers from June 30, 2006. The timeline for terminating TU-KA services, however, hinge on the continued satisfactory migration to au.



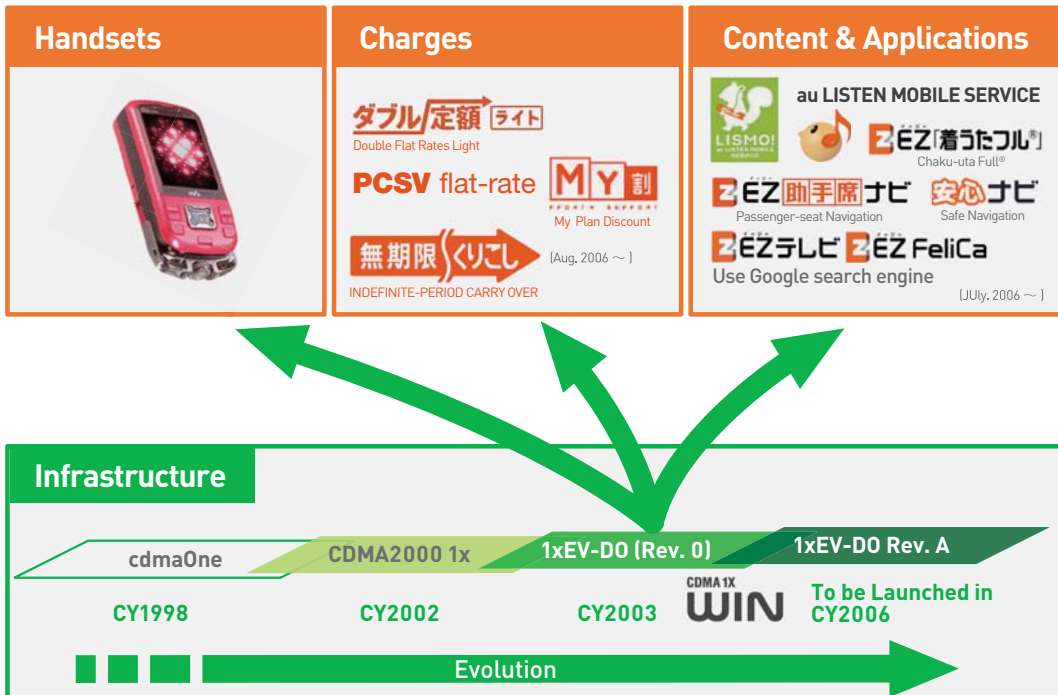
W42CA (G'z One)

Evolution of au/KDDI 3G system



		Current 1xEV-DO (Rev. 0)	1xEV-DO Rev. A
Peak speed	Downlink	2.4Mbps	3.1Mbps
	Uplink	154kbps	1.8Mbps
QoS (Quality of Service)		Strive for top quality in all packets, irrespective of service type	Priority control of packets possible for respective service type
Applied fields		High-speed data download	Bi-directional real time transmission

Boost all-round product attractiveness



Fixed-line Business

Reinforcing business base through direct-access, IP, and broadband services

Business Conditions in the Fiscal Year Ended March 2006

KDDI supplies personal consumers and corporate clients with a full range of fixed-line telecommunications services. Among them are voice telephony and broadband Internet access.

Operating revenues for the Fixed-line Business in the fiscal year ended March 2006 totaled ¥619.3 billion, an increase of 3.9% compared with the previous year. Revenue from voice telephony services rose because of expanded sales of KDDI Metal Plus. And the merger with POWEREDCOM Inc. in January 2006 added to sales in the fourth quarter. These factors resulted in a return to positive growth for KDDI's Fixed-line Business.

The promotion of KDDI Metal Plus, however, involved substantial up-front investment, resulting in a segment operating loss of ¥61.3 billion. KDDI believes that the resources invested in expanding the customer base will generate profits through higher sales.

One of the major developments during the year was the comprehensive telecommunications alliance with The Tokyo Electric Power Co. (TEPCO) that KDDI forged in October 2005. It gave rise to an integrated FTTH service. This alliance also facilitated the January 2006 merger of KDDI Corporation with POWEREDCOM, Japan's leading provider of wide-area Ethernet services for corporate users. In March 2006, KDDI further acquired an equity stake in JAPAN CABLENET LIMITED (JCN) as part of its investment strategy to expand its business base.

Priority Placed on the Promotion of KDDI Metal Plus

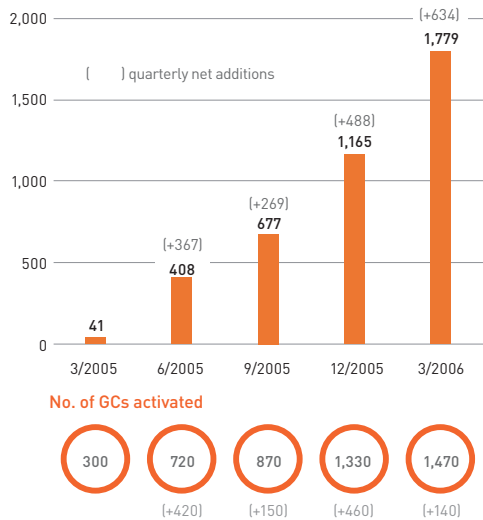
KDDI Metal Plus is a direct-access, fixed-line telephone service. Since KDDI provides the line, customers pay related charges to KDDI rather than to NTT. Compared with fixed-line voice telephony services that only provide call-based revenue, Metal Plus generates additional revenue for KDDI through a basic monthly charge. Metal Plus targets customers who only want a basic telephone service, but it also offers optional Internet access through either ADSL or a dial-up connection.

Subscriber numbers for KDDI Metal Plus had surpassed 1.8 million by the end of March 2006. Delays in expanding the coverage area impeded the line activation of sign-ups in the first half of the year, but a rapid expansion of the coverage area in the second half enabled KDDI to make substantial progress in building up the subscriber base. As of the end of March 2006, service accessibility extended to 1,470 activated GC rings (NTT's Central Offices), covering about 65% of the population of Japan.

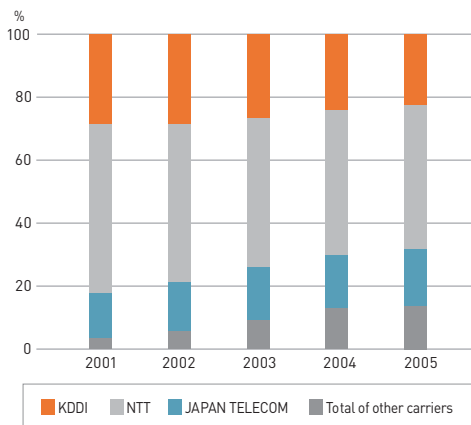
There is an ongoing trend among users in Japan toward the adoption of mobile and IP phone telecommunications services. KDDI capitalized on that trend with the rising penetration of KDDI Metal Plus and in the second half of the year was able to arrest the fall in voice telephony revenue. The first-half network connection delays, however, resulted in insufficient revenue to offset the promotional and related costs, leading to a substantial operating loss.



No. of Metal Plus Subs



Market Share of Myline by Carrier



Market Trends and Business Strategy

The Japanese fixed-line market is in transition, to a new era that will be dominated by IP and broadband services. A committee appointed by the government examined issues affecting the telecommunications and broadcasting markets in Japan in the interests of ensuring fair competition and published a number of recommendations in a report issued in June 2006. Among the issues identified by this committee were the functional separation of bottleneck facilities owned by the NTT regional operating companies NTT East and NTT West, the need to consider the fundamental reform of NTT by 2010, and the urgent need to ensure that any broadcasts over telecom networks using IP multicasting technology comply with broadcasting copyright laws.

The market for fiber-optic services in Japan is poised for accelerated growth. Net quarterly growth in fiber-optic service provision had already begun to outpace ADSL by the end of March 2005. However, the video-based services that could most benefit from the high-quality, large-capacity nature of optical fiber access are not at the same point of imminent takeoff.

Toward the Improved Profitability of KDDI Metal Plus

KDDI Metal Plus registered a steep loss in its first year, but this was generally in line with projections for the start-up phase. KDDI expects sales revenue and profits to improve significantly going forward based on the progress that has already been made in expanding the subscriber base of KDDI Metal Plus. For the second year of the service, to March 2007, KDDI expects the full-year sales contribution from KDDI Metal Plus's 1.8 million subscribers to result in a halving of the operating loss the service experienced in its first year. KDDI is also forecasting that Metal Plus will become profitable in its third year, to March 2008.

As of the end of March 2006, individual customers accounted for more than 90% of the KDDI Metal Plus subscriber base. KDDI plans to focus increased resources on promoting the service to small and medium enterprises during the year ending March 2007, emphasizing the ISDN compatibility option introduced in November 2005.

Construction of the nationwide IP-based Contents Delivery Network (CDN), the backbone for KDDI Metal Plus, is approaching completion. This advanced infrastructure will allow KDDI to shift its sales and marketing resources easily between Metal Plus and FTTH

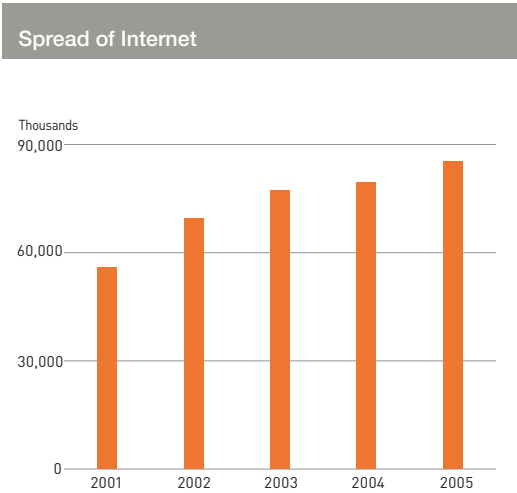
because the same network underpins both services. This will enable KDDI to adopt a flexible marketing strategy depending on how quickly demand for FTTH materializes. Furthermore, the plan to base backbone construction for the future integrated fixed-mobile Ultra 3G network on the CDN promises to help maximize the efficiency of network asset utilization.

Development of the FTTH business (Hikari one)

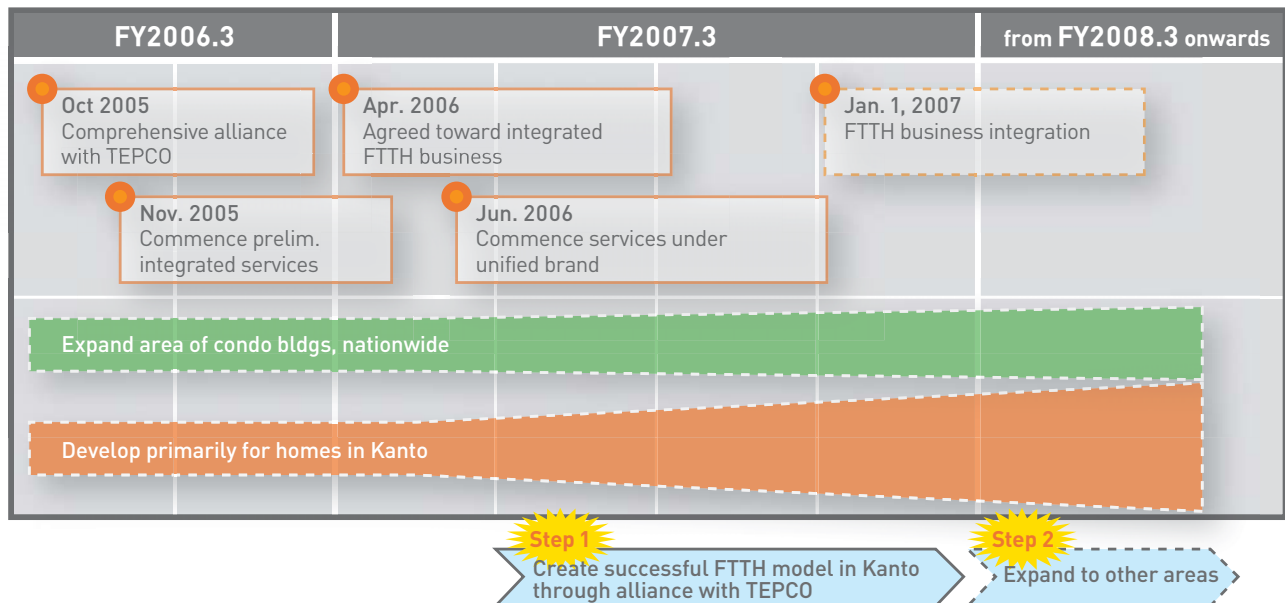
KDDI and TEPCO began promoting the sale of full-scale integrated FTTH services under the Hikari one brand in June 2006. The rollout started in the Kanto region, centered on Tokyo. The KDDI Hikari Plus service marketed to date to residential customers in condominiums and apartment blocks as KDDI Hikari Plus Condos has been re-branded as Hikari one Condos. And Hikari one Home targets residential customers in detached houses and low-rise accommodation of up to three floors. Network provision for the latter service utilizes GE-PON, or Gigabit Ethernet-Passive Optical Network, technology applied to a 1 Gbps fiber to connect KDDI's CDN backbone with the TEPCO fiber-optic access network. This enables multiple customers to gain access to high-speed, high-quality services.

Video-based services are expected to play an extremely important role in the development of FTTH services. KDDI is offering Hikari one users a television service that features a video content distribution platform called MOVIE SPLASH. This service uses IP multi-casting technology (please refer to the Technology and R&D section on p. 31-32 for more details).

To facilitate the swift and effective expansion of the Hikari one business, KDDI is discussing with TEPCO merging TEPCO's FTTH operations (Hikari Network Company) into



FTTH Initiatives



KDDI Corporation by January 2007. The first step in this process is for the KDDI-TEPCO alliance to establish a successful FTTH business model in the Kanto region, where many households already have broadband access.

Upgrading Services Targeting Corporate Clients

POWEREDCOM, which merged with KDDI in January 2006, is Japan's top provider of wide-area Ethernet services in the highly competitive market for fixed-line data communications services targeting corporate users. Demand for wide-area Ethernet services is expected to continue growing. KDDI, by positioning KDDI Powered Ethernet as its main branded service in this segment, is trying to optimally exploit the strengths of POWEREDCOM in high-quality service provision and related customer support. In combining these advantages with KDDI's range of services for corporate users, KDDI seeks to develop new services with added convenience and thereby upgrade the total offering for corporate clients to become a comprehensive solutions provider.

Full IP Conversion of the Fixed-Telephony Network

KDDI is on track to become, by the end of March 2008, one of the first carriers in the world to convert its entire fixed-telephony network to an IP backbone. Full IP conversion will permit a more efficient utilization of network resources and realize significant cost savings through lower backbone maintenance and operating costs.

KDDI's fixed-line business development efforts continue to take advantage of the rapid shift to direct-access, IP, and broadband services. The primary goal at KDDI remains to develop highly competitive services for the fixed-line market ahead of the projected development of FMC networks. In this way, KDDI hopes to establish profitable Fixed-line Business operations.

FMC Development

In June 2005, KDDI unveiled its concept for a fully integrated non-access-dependent Ultra 3G network that achieves FMC. The network provides integrated services to users through various mutual access connections. KDDI plans to begin constructing this integrated fixed and mobile IP network in 2007. In addition to FTTH, 3G mobile phone services, and wireless LAN technologies, the planned network will be compatible with emerging wireless systems that employ such standards as IEEE 802.16e. This fully integrated backbone will capitalize on the unique advantages that KDDI enjoys as a fixed-line carrier.

