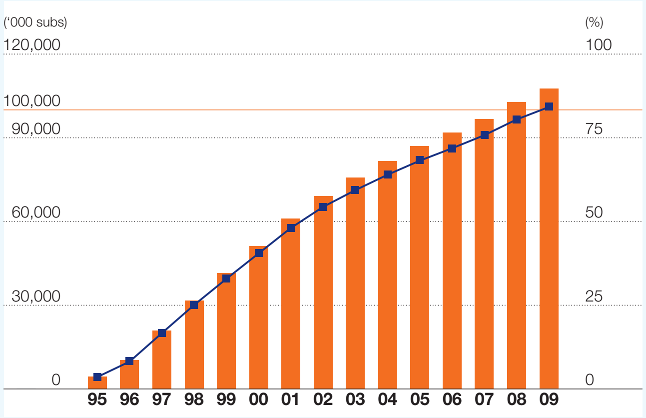
Mobile Business

As Japan's consumer mobile phone market reaches maturity, the increasing penetration of plans that separate tariffs from handset prices, and the effects of the economic downturn, have led to a significant decline in handset sales. Competition continued to escalate in services to attract new customers.

Japan's Maturing Consumer Mobile Phone Market

As of the end of 2007, the total number of mobile phone subscriptions in Japan had climbed past 100 million, with more than 80% penetration rate to population. The consumer market, which has provided the traction for this growth until today, is maturing as the increase in new subscription has gradually slowed down. Continued growth can be expected in communications modules subscriptions and in the corporate market, centered around small and medium-sized enterprises.

Number of Mobile Phone Subscriptions in Japan and Penetration Rate



Souce: Ministry of Internal Affairs and Communications and Telecommunications Carriers Association (TCA)

Note: The number of mobile phone subscriptions is as of March 31 of each year. Penetration rate figures are as of October 1 of each year.

Significant Decline in Handsets Sales Due to Pricing Plans Separating Tariffs from Handset Prices

The Ministry of Internal Affairs and Communications has established a Study Group on Mobile Business as part of its "New Competition Program 2010" to formulate rules for fair competition in the field of mobile communication. In light of the study group's findings, new pricing plans were introduced to separate tariffs from handset prices in addition to existing schemes under which carriers subsidize handset costs. In FY 2009.3, marketing of mobile phones in Japan focused on these new pricing plans, bringing a major change to the conventional business model.

au Purchase Program Illustration

(prices include tax)

au Purchase Program Course name	Simple Course	Full Support Course
Purchase support (handset subsidy)	No	Yes (¥21,000)
Contract on period of handset use	No (except installment payments)	2-year contract
Price plan	Plan SS Simple to Plan LL Simple etc.	Plan SS to Plan LL etc.
Basic monthly charge (for Plan SS)*	¥980/month (includes ¥1,050 free calls)	¥1,890/month (includes ¥1,050 free calls)
Installment payment	Yes (12, 18 or 24 installments)	No

*Basic monthly charge when customer signs "Everybody Discount" contract.

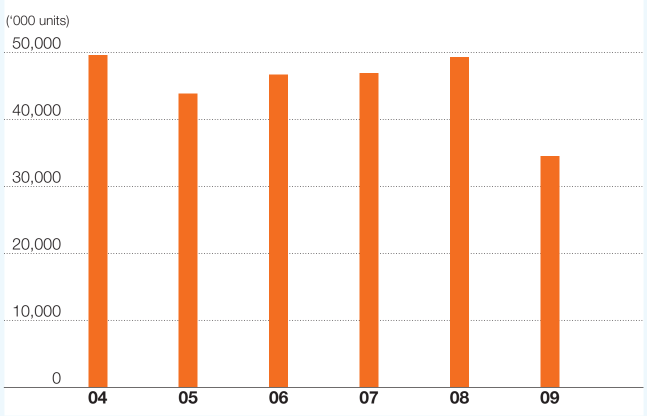
Under the new pricing plans, basically, carriers no longer subsidize handset costs for customers purchasing mobile phones. As a result, the cost of purchasing a handset became higher in comparison with conventional plans.

In addition to the introduction of new pricing plans, FY 2009.3 also saw the effects of the economic recession, and as a result of customers refraining from replacing their handsets, or keeping their existing handsets for a longer time, sales of handsets in Japan declined significantly, by approximately 30% year on year. KDDI saw handset sales fall 32% year on year, and a gap arose between the number of handsets ordered with the manufacturers and numbers sold, resulting in high inventory levels, particularly in the first half of the period.

The number of handsets sold in Japan in FY 2009.3 declined significantly over the previous year's levels, due to the increasing penetration of multi-year service plans, and a percentage of subscribers choosing installment payments when purchasing handsets under the new pricing plans. All these factors contributed to an overall drop in churn rates and replacement rates among all carriers, pointing to a significant decline in consumer mobility in the Japanese mobile phone market.

Under the separate-tariff/handset price plans, an amount equal to the separate handset subsidy is discounted from the monthly basic charges. Thus, as the number of subscribers choosing such plans increases, the average voice ARPU will also decline.

Number of Domestic Handsets Shipped



(Years ended March 31)
Source: Japan Electronics and Information Technology Industries Association (JEITA)

Effects of the Recession

In the midst of this once-in-a-century global recession, the Japanese economy faced extremely difficult conditions in FY 2009.3. One of the effects on the Mobile Business was the significant decline in handset sales, partly attributable to the rise in handset prices brought about by the new separate-tariff/handset price plans. At the same time, particularly in the consumer market, the recession did not result in any significant change in KDDI's ARPU for either voice or data communication. On the other hand, there has been an effect on the corporate market, with existing customers cancelling contracts for unused handsets, and cutbacks, postponements, and cancellations of some new deals.

Content and Media Market

The spread of Packet Flat-rate pricing data plans and the expansion of the 3G network has made it possible to offer a high volume of content at high speed, resulting in steady growth for content and media markets. In addition to traditional downloadable content, use of user-generated content such as social network services (SNS), and video distribution services such as YouTube, have continued to expand to mobile phones.

Although the majority of mobile Internet sites offer useful information, there are others of a more circumspect nature, such as fraudulent or malicious sites, online dating sites and adult content sites that are illegal for anyone under 18 years old to access. To combat this issue, in April 2009 the Law for Promotion of a Safe, Secure Internet Environment for Minors (the "Law for Improvement of the Internet Environment for Youth") was implemented, requiring that filtering services restricting access to harmful Internet content be put in place for anyone under 18 years old purchasing mobile and PHS phones, unless authorized by a parent or guardian. This is one of several efforts to restrict access by young people to such harmful sites, so called "filtering services," being promoted through a collaboration between the government, telecommunications carriers, and content providers.

Note: YouTube is a registered trademark of YouTube, LLC

Fixed-line Business

The shift from long-distance business to access line business continues, as do trends toward direct access, IP, and broadband services.

FTTH Becomes Driver in Broadband Market

Japan's fixed-line market is in a period of transition, entering a new era of direct-access, IP, and broadband services.

About 20 years ago, when long-distance operators entered the fixed-line business in Japan, access portion fees to the owner of the access line, NTT, amounted to less than 10% of the fees paid by customers. With the increasing use of IP systems, however, access portion fees now amount to about 75% of customer payments, a dramatic contraction in net revenues.

From the perspective of securing revenue and income, therefore, in today's market it is essential to shift from a long-distance business that focuses on voice telephony to the access line business.

In the continually growing market for broadband service, the number of subscriptions to FTTH (Fiber to the Home), ADSL, and CATV services combined topped 30 million for the first time as of the end of December 2008, and at the end of March 2009, reached 30.33 million subscriptions. With price competition among FTTH service providers, and products made more attractive through the introduction of "triple play" services combining Internet access, phone, and video, the shift from ADSL to FTTH has progressed to the point where, by June 2008, FTTH subscriptions had exceeded those for ADSL.

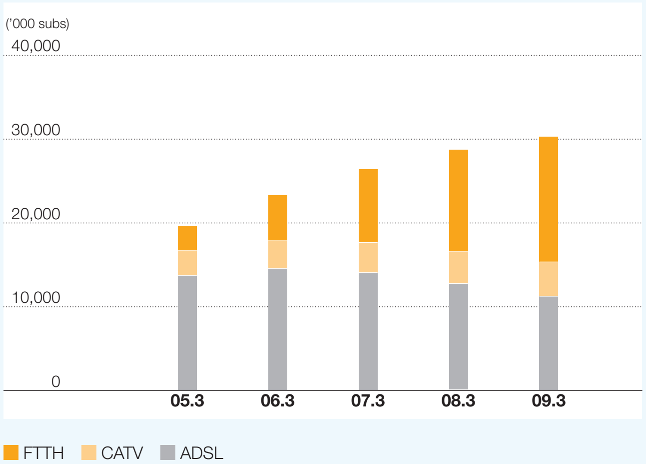
However, customers who do not use video distribution sites or other large-volume data downloads find ADSL service adequate for their needs, and this has slowed the growth in FTTH service subscriptions somewhat.

In addition, issues such as those regarding copyrights have prevented video distribution services, which meant to take advantage of the high-speed, high-definition features of FTTH—features also a factor in ARPU growth—from being developed on a full scale.

For Internet access, meanwhile, there was the development of technology that enables the transmission of Ethernet frames as they are between the carrier exchange facility and the home, while services that achieve uplink and downlink speeds of as much as 1Gbps are gaining attention.

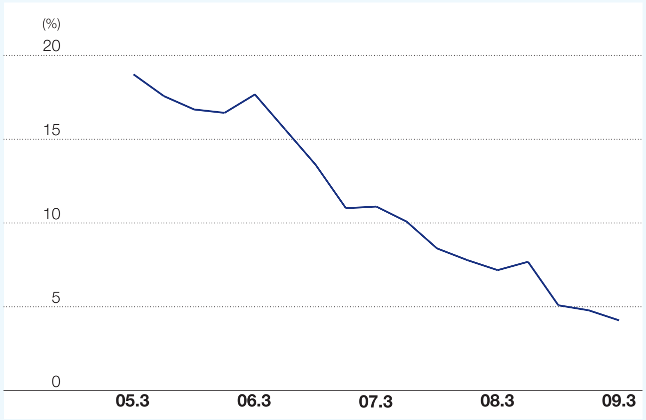
Under these circumstances, in April 2008, KDDI made Chubu Telecommunications Co., Inc. (CTC) a consolidated subsidiary, expanding the Company's customer base so that as of the end of March 2009, FTTH subscriptions had increased by 54.8% year on year, to reach 1.099 million.

Number of Domestic Broadband Subscribers



Source: Ministry of Internal Affairs and Communications, Media Release "Broadband Service Subscriptions" (June 19, 2009)

Domestic FTTH Subscription Growth Rate



Shift from Fixed-line to IP Phone Services Progresses

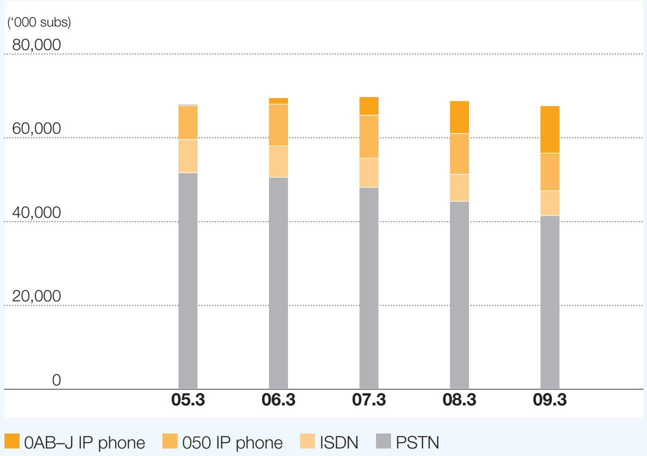
In the fixed-line telephony market (which covers all fixed-line phone subscription, namely, PSTN, ISDN, and IP phone services), subscriptions dropped by 1.8% to 67.52 million, continuing a downward trend partly resulting from the widespread use of mobile phones.

Of these, fixed-line phone and ISDN subscriptions totaled 47.30 million, down 7.7% year on year, and 24.7% below the peak of 62.85 million subscriptions at the end of FY 1998.3.

As fixed-line phone services decline, IP phone services are trending upward, with 0AB-J type and 050 type IP services, which uses FTTH or CATV access lines, growing by 15.3% year on year, to 20.22 million subscriptions.

KDDI has worked aggressively to expand its FTTH and CATV-based services, including “HIKARI-one phone” and “Cable-plus phone”, and they now hold a 9.9% share of IP phone services.

Domestic Fixed-line Subscriptions



Source: Ministry of Internal Affairs and Communications Media Release “Status of Subscriptions to Electronic Communications Services” (May 29, 2009)

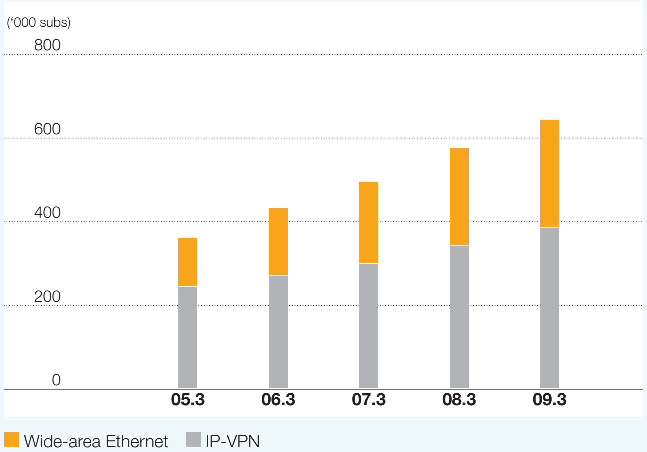
Effects of the Recession

As Japan continues to experience severe economic conditions, the effects of the recession on the consumer market can be seen in a stronger money-saving, which has slowed the shift from ADSL to FTTH, resulting in slowing down of the growth speed in FTTH service subscriptions and a delay in the expansion of multi-channel broadcasting, VOD, and other video-based services utilizing FTTH.

In the corporate market, the recession, in the short term, has brought cutbacks in corporate communications costs and a scaling back of the size or number of sites, resulting in a temporary drop in per-customer revenue and some cancellations.

On the other hand, in response to the growth in high-volume communications between companies, there has been a shift in services used for internal corporate networks, from leased circuit services with guaranteed bandwidth, to IP-VPN and low-priced wide-area Ethernet services, and in the long term, VPN services are expected to grow.

VPN Service Subscriptions



Source: Ministry of Internal Affairs and Communications, Media Release “Broadband Service Subscriptions” (June 19, 2009)