Annual Report 2002

For the year ended March 31, 2002


# Ubiquitous Solution Company

## Setting Our Own Agenda

## SELECTED FINANCIAL DATA

| Years ended March 31, 2002–1998 | 2002 | 2001 | 2000 | 1999 | 1998 (Millions of yen) | 2002 (Millions of U.S. dollars) |
|---|---|---|---|---|---|---|
| **Consolidated Statements of Income:** | | | | | | |
| Total operating revenues | **¥2,833,799** | ¥2,268,646 | ¥1,525,953 | ¥1,246,582 | ¥1,178,345 | **$21,267** |
| Operating income | **102,297** | 88,783 | 19,614 | 69,874 | 79,611 | **768** |
| Income (loss) before income taxes and minority interests (loss) | **20,885** | 45,902 | (42,786) | 49,715 | 65,018 | **157** |
| Net income (loss) | **12,979** | 13,427 | (10,468) | 17,061 | 8,310 | **97** |
| **Consolidated Balance Sheets** (as of March 31,)**:** | | | | | | |
| Total assets | **¥3,203,441** | ¥3,639,364 | ¥1,999,008 | ¥1,585,848 | ¥1,296,747 | **$24,041** |
| Interest-bearing debt | **1,746,784** | 2,097,627 | 1,433,128 | 1,068,616 | 779,786 | **13,109** |
| Total shareholders' equity | **857,081** | 845,091 | 228,574 | 231,208 | 218,321 | **6,433** |
| **Per Share Data** (yen and U.S. dollars) | | | | | | |
| Net income (loss) | **¥ 3,061** | ¥ 4,467 | ¥ (4,603) | ¥ 7,501 | ¥ 3,807 | **$ 22.97** |
| Cash dividends | **1,790** | 1,790 | 1,790 | 1,790 | 1,790 | **13.43** |

Notes: 1. U.S.dollar amounts above and elsewhere in this report are converted from yen, for convenience only, at the rate of ¥133.25=$1, the approximate exchange rate on March 31, 2002.
2. Interest-bearing debt consists of short-term loans and current portion of long-term loans, long-term loans, bonds and long-term accounts payable.

# Aiming to become a Ubiquitous Solution Company, providing anytime, anywhere communications for a new era of connectivity and interaction

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# PROFILE

***DDI Corporation***, one of the forerunners of ***KDDI Corporation***, was ***established in June 1984*** as Dai-ni Denden Planing Company. From the beginning, DDI was distinguished by ***technical advancement***, affordability and ***high-quality*** features that have become ***defining characteristics*** of today's ***KDDI*** in the Japanese telecommunication market. On October 2000, ***DDI Corporation*** merged with ***KDD Corporation*** and ***IDO Corporation*** to form the ***new DDI Corporation***, known unofficially since the merger as ***KDDI****. On April 1, 2001, DDI Corporation ***changed its name officially to KDDI Corporation***. ***KDDI merged au Corporation*** on October 1, 2001 to serve as the core retail service brand of ***KDDI***. au enables customers to realize comprehensive voice and data communication by seamlessly integrating ***fixed-line telephone, IP and cellular phone*** services. ***KDDI's*** aim is to become an integrated telecommunications service provider offering high value derived from the confluence of ***Mobile and Internet communications technologies***—a company providing services that can be used anywhere, at anytime by the fusion of fixed and mobile media. ***FMC (Fixed & Mobile Convergence)*** is the name given to ***KDDI's "mobile & IP"*** strategy. Based on these organizational concepts, ***KDDI*** will continue to expand its activities and depth of service in coming years as it evolves into a ***Ubiquitous Solution Company***.

*References to KDDI in this report in the context of fiscal 2000, ended March 31, 2001, refer to DDI Corporation.

***Jiro Ushio***
Chairman, Member of the Board,
Representative Director
(Center)

***Yusai Okuyama***
Vice Chairman, Member of the Board,
Representative Director
(Left)

***Tadashi Onodera***
President, Member of the Board,
Representative Director
(Right)

## Disclaimer Regarding Forward-Looking Statements

Statements contained in this annual report concerning plans, strategies, beliefs, expectations or projections about the future, and other statements other than those of historical fact, are forward-looking statements based on management' s assumptions in light of information currently available and involve risks and uncertainties. Actual results may differ materially from these statements.

Potential risks and uncertainties include, but are not limited to, domestic and overseas economic conditions; fluctuations in currency exchange rates, particularly those affecting the U.S. dollar, euro and other overseas currencies in which KDDI or KDDI Group companies do business; and the ability of KDDI and KDDI Group companies to continue developing and marketing services that enable it to secure new customers in the communications market—a market characterized by rapid technological advances, the steady introduction of new services and intense price competition.

AN INTERVIEW WITH PRESIDENT ONODERA

**KDDI plans to achieve higher profits and increased competitiveness by using structural reforms to improve the profitability of existing operations while extracting additional revenues and income from new areas of activity.**

# Concentration on CDMA

**Q. You have completed your first business year since taking office as President. How would you assess your progress, including the realization of merger synergy effects, during the past year?**

**A.** After the merger of DDI, KDD and IDO in October 2000, KDDI has rapidly carried out its management restructuring. The merger process proceeded very smoothly, and since taking office in June 2001, I have been working with even greater determination to implement the restructuring measures.

**Q. The telecommunications industry as a whole has gone through extremely rapid changes. How do you view the impact of those changes?**

**A.** Although, obviously, market growth has slowed—as we see, for example, in the penetration rate trends for cellular telephones, and revenues from fixed-line telephone services—I believe that the telecommunications industry still has excellent growth potential. The rapid expansion of mobile data and broadband services is reflected in dramatic changes in industry and business structures. For example, possession of telecommunications infrastructure once gave carriers a crucial advantage. Now this is not necessarily true. Today the industry has entered a new phase, and competitiveness depends on the ability to develop highly original, high-added-value services by stepping outside the traditional framework of the telecommunications sector.

**Q. What are KDDI's advantages in this new phase?**

**A.** In October 2001 we absorbed our subsidiary, au Corporation, to merge into a single company spanning both fixed-line and cellular services. In March 2002 we established the Solution Business Sector, which has the important goal of promoting our solutions business by integrating mobile and fixed-line telephone services to create powerful strategic products unmatched by any competitor. We already have a variety of concepts with huge potential. In particular we anticipate major growth from our *GPS Solutions* business, which is based on links with au's mobile GPS service *GPS Keitai*. KDDI has an overwhelming advantage in this area, and our expectations are high.

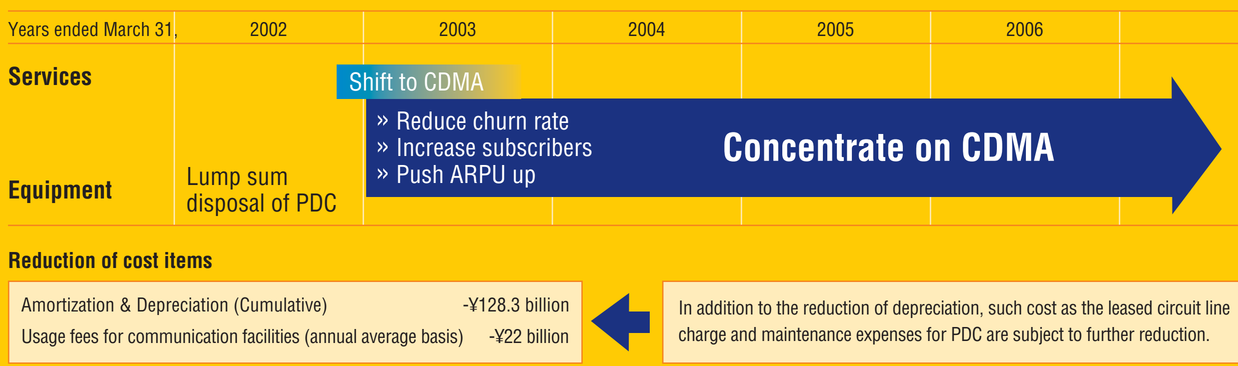
**Q. What are the key points of the Medium-Term Management Plan-2002, which you announced in March?**

**A.** The Medium-Term Management Plan-2002 consists of business restructuring measures and business strategies. The first restructuring measure was the write-off of PDC facilities. A large share of our sales and income comes from au, and the poor profitability of cellular-phone services based on the old PDC system is its biggest problem. For that reason, we have decided to terminate these services by the end of March 2003, and the write-offs are shown as a extraordinary loss item in the accounts for the year ended March 31, 2002 (fiscal 2002). This move will result in substantial reductions in costs, including the depreciation of PDC facilities and usage charges for telecommunications facilities. The benefits will become apparent in our earnings from fiscal 2003 onwards (Figure 1).

Because of the technology of our current cdmaOne system, we will be able to make the switch to the more advanced third-generation CDMA2000 1x system simply by changing panels and software in our base stations, making the future outlook much brighter.

A second key feature of Medium-Term Management Plan-2002 is the accelerated realization of merger benefits. We will integrate assets that were operated separately by the individual companies prior to the merger, such as information systems

(Figure 1) EFFECTS OF CONCENTRATION ON CDMA: REDUCTION OF COST




and customer centers. In the au category, not only IDO but also DDI's eight cellular subsidiaries all operated separate systems. These nine systems are now being integrated into one. In the area of fixed-line services, we are preparing to integrate the DDI, KDD and TWJ systems. We estimate that this move alone will reduce our costs by ¥19 billion annually.

The third focus of the plan is the reinforcement of our financial structure. Immediately after the merger, we had interest-bearing debt of ¥2,240.9 billion. By the end of fiscal 2002, we had reduced that to ¥1,746.8 billion. We will continue to reduce debt, and by the end of fiscal 2005, we aim to bring the total down to the ¥1,000 billion level. Last year we sought to reduce liabilities through real estate securitization. We have now switched to a strategy based on the achievement of strong free cash flows from our operations. For example, our selection and concentration approach will allow us to keep capital investment to the minimal level required to generate sufficient sales and income.

**Q. What are your future strategies? Would you begin with your specific business strategies for the au business?**

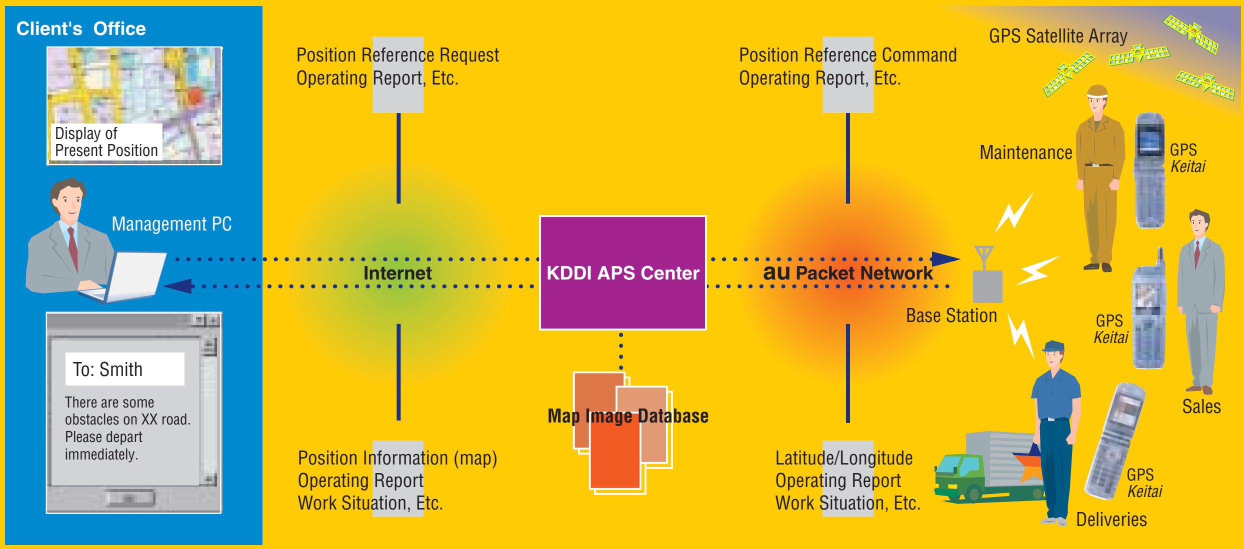
**A.** We will improve au's profitability now that we have eliminated PDC services, allowing it to specialize in cdmaOne and CDMA2000 1x. Within that framework, we have separate strategic approaches targeting individual and corporate users.

I will look first at our approach in the area of services for individual users. As of March 31, 2002, there were 69.1 million cellular-phone subscribers in Japan, and the penetration rate stood at 54%. We expect the number of subscribers to reach 82.3 million by the end of March 2005, and that the penetration rate will climb to 65%. This is equivalent to an average increase of around 4.4 million subscribers annually, which means that we cannot look forward to growth on the same scale as in the past. Our aim now is to achieve traffic growth by offering new data services that customers will enjoy and want to use. Our *EZweb* content service, which makes it easy for customers to search and download the information they want from our exclusive data source, has been very popular. More recently, however, demand has been shifting to services that allow users to upload and share their own information, as well. We will give priority to this type of capability in our third-generation services. We intend to develop and introduce a wide variety of new services. We have already introduced a mail service that allows users of *GPS Keitai,* which is the name we give to our unique mobile phone GPS service, to attach a variety of map and image information to e-mails. The benefits of this innovation are now starting to emerge.

Our approach to the corporate-use market is somewhat different. As far as the need for voice services is concerned, the diffusion rate in the personal-use cellular-phone market is already high, and it would not be practical to expect people to carry a second cellular telephone for business use. However, we believe that we can create new uses for cellular-phone services by combining GPS with e-mail. For example, au handsets would allow freight distribution centers to monitor the locations and loads of their delivery trucks at all times. In October 2002 we will launch the revolutionary *GPS Map* service for corporate users. Users will be able to ascertain the locations of registered *GPS Keitai* units, the status of work, and other information in real time, simply by issuing requests from PCs via the Internet (Figure 2).

Currently 9% of telephones are registered in corporate names. We expect this to rise to 20% by the year to March 2005.

## (Figure 2) SYSTEM CONFIGURATION OF *GPS MAP* SERVICE




### Q. What is the status of the Network & Solution Business?

**A.** We are actively marketing our solutions to corporate users. In the past we have relied on "traffic" to generate much of our income. However, escalating competition from MYLINE, for example, is pushing down call charges and line charges, limiting our ability to rely on income that is generated solely by "traffic." We have therefore decided to focus on the solutions business as a way of building new services around traffic.

We call the linkage of mobile services with Internet services based on fixed-line access "Fixed & Mobile Convergence" (FMC). The GPS solutions that I just referred to is an example of this approach. Another application is interactive data linking between PCs connected to intranets and cellular telephones. Until now intranets have only been able to link places of business, but we are now offering a new service that allows offices to extend their intranet to individual users in the field. If we can offer solutions that help customers to improve management efficiency and reduce costs, I am confident that a wide range of users will be motivated to take up our systems.

Another area with huge growth potential is intelligent transportation system (ITS). We are currently expanding our joint activities in this field with Toyota Motor Corporation, our second largest shareholder. As vehicles become more intelligent, the range of services will expand to include not only the supply of information to vehicles, but also the transmission of information from vehicles. For example, a vehicle could automatically contact a service center at the first indication of a developing fault. I believe that there will be an innovative diversification of demand for telecommunications services. When satellite-based mobile broadcasting and ground-based digital broadcasting commence, users will be able to enjoy interactive broadcasting in their vehicles. As providers of these services work to meet the demand, they will be able to achieve huge cost benefits by taking full advantage of cellular-phone systems, the infrastructure for which is already available nationwide. Another area in which I anticipate significant growth is the combination of cellular telephones with PDAs and laptop PCs for activities involving information volumes beyond the capacity of cellular telephones.

### Q. What are your future strategies for the TU-KA and Pocket businesses?

Our reforms in these two areas were already starting to show positive results, including free cash flow, in the previous fiscal year. Our strategy for TU-KA will be to offer it as a low-speed, low-cost alternative for customers who do not require third-generation mobile telephone service. The Pocket business is enjoying considerable popularity with the *AirH"* service. This service provides an unlimited connection, something that was not previously possible with mobile services. Our strategy calls for further specialization in data communications. We aim to create an environment in which the KDDI Group will be able to meet the various needs of all users.

### Q. In your flagship au business, you have achieved a very encouraging start with the new CDMA2000 1x system. How do you view the possibility of catch-up moves by competitors in this area?

**A.** We currently have an advantage over our competitors in the area of 3G CDMA2000 1x services for a number of reasons. A primary strength there is our service area coverage. CDMA2000

1x handsets can be used nationwide, since they can connect via the existing cdmaOne system outside of the CDMA2000 1x service area. Other companies' 3G systems can only be used within their 3G areas. This is an important difference. Another strength is the cost of handsets. CDMA2000 1x is an extension of the existing cdmaOne system, so there is little difference in handset costs. Competing 3G systems require handsets that have been developed from scratch, and costs are likely to be two or three times higher than existing PDC models. Those costs will be directly reflected in the prices at which handsets are supplied to users. Finally, there is the issue of performance. Our handsets are superior in continuous talk time and stand-by time.

However, if our competitors spend sufficient money to develop the necessary technology and facilities, it is quite possible that they will eventually reach the same standard as CDMA2000 1x. That is why KDDI will continue to think about the next stage while it still has the advantage. That next stage will mean faster transmission speeds. CDMA2000 1x supports communications at 144kbps. We are now developing the CDMA2000 1x EV-DO system, which will provide a maximum speed of 2.4Mbps and an average speed of approximately 600kbps. We plan to introduce this technology in the fall of 2003. I believe that this speed advantage will allow us to maintain our competitive edge. The most important feature of the CDMA2000 1x EV-DO system is that will be an IP-based communications system configured for data use and optimized for Internet access. Transmission speeds will increase and costs will fall, giving us the advantage in terms of both price and performance.

**Q. This new technology will also open up new possibilities for the development of applications.**

**A.** Indeed. The Solution Business Sector is already working with the KDDI R&D Laboratories to develop applications based on the CDMA2000 1x EV-DO system. I am confident that we will be able to offer a variety of enhanced services.

A key issue for our Solutions business is handset specialization. Mobile handsets combine both hardware and software, so it would be prohibitively expensive to supply handsets with software customized for specific corporate users. KDDI is now studying a concept whereby a new type of middleware called "BREW" would be supplied in cellular-phone handsets. BREW is a common platform that runs on cellular-phone handsets. By downloading software developed for the BREW platform, users will be able to turn their cellular-phone handsets into terminals for running customized applications. The concept is similar to the installation of Windows software on a personal computer. If we can supply services separately from the hardware that exists beneath applications and middleware, we will be able to offer extremely useful services to our corporate users.

**Q. The possibilities are very exciting. My next question concerns the numerical targets that you announced in Medium-Term Management Plan-2002 for the fiscal 2005.**

**A.** Our consolidated operating revenues for fiscal 2002 amounted to ¥2,833.8 billion. Our target for fiscal 2005 is ¥3,200 billion. This represents an increase of approximately 13% over a three-year period, but we are determined to reach our target.

In fiscal 2002, our operating income amounted to ¥102.3 billion, and our operating margin was not especially high. We are determined to increase this figure to ¥290 billion by fiscal 2005. Under this plan, our operating margin will climb to 9.1% as we move steadily toward our goal of a 10% margin. Our target for EBITDA is ¥740 billion, which represents a margin of 23.1% on operating revenues.

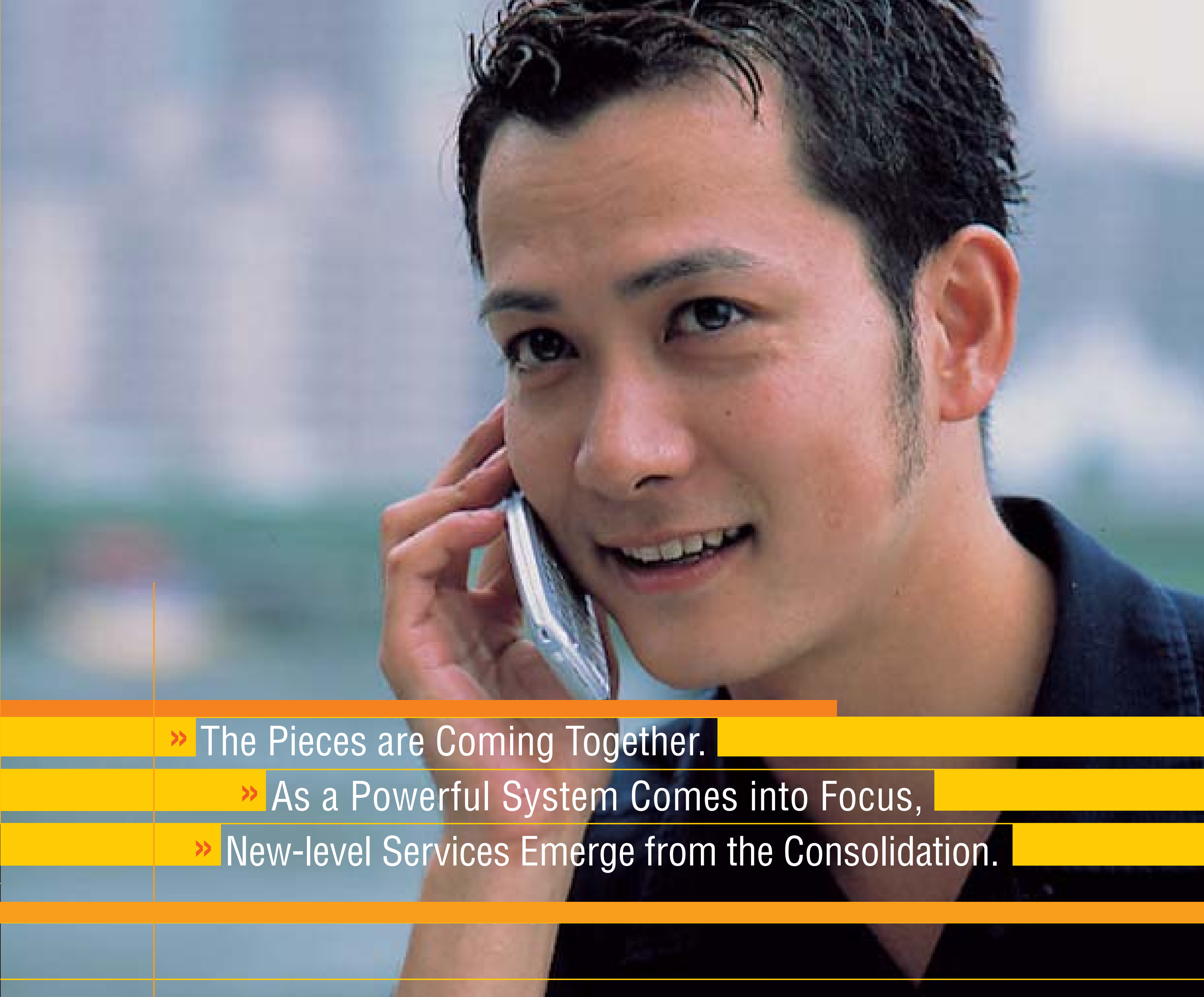
We plan to achieve these targets by using structural rationalization to improve the profitability of our existing operations while extracting additional revenues and income through the development of new businesses. Our success will depend on our ability to pursue a dual strategy based on structural rationalization and new businesses.

**Q. Finally, do you have a message for shareholders and investors?**

**A.** I would first of all like to express our sincere appreciation to our shareholders and investors for their loyal support of KDDI's business activities. We have set ambitious targets in the past, but regrettably we have not always reached them. The targets set down in Medium-Term Management Plan-2002 are also ambitious. However, the entire KDDI organization is united in our determination to achieve our annual targets, especially for income. We will work to build a business structure that will allow us to generate the income levels that we have pledged to achieve for our shareholders and investors. I believe that this culture of determination has permeated the KDDI Group since the second half of last year. I look forward to your continuing confidence and support for in KDDI's future.

**Tadashi Onodera**
President, Member of the Board,
Representative Director

# Meeting the NEXT-Generation Needs of People



» The Pieces are Coming Together.

» As a Powerful System Comes into Focus,

» New-level Services Emerge from the Consolidation.

# The au Business

## » Positioned for a Highly **Profitable Future**

## » Positioned for **Dual Expansion** in Consumer and Corporate Markets

**Statistics for the mobile telephone market for the year ended March 31, 2002 (fiscal 2002) show a net increase of 8.18 million in the number of subscribers. This is equivalent to an 83.4% increase compared with the previous fiscal year's net increase. The au business achieved healthy growth in its market share in April and May, but the situation became more difficult from the middle of the year onwards because of a time lag in product deployment resulting from delays in the launch of the CDMA2000 1x system. However, fiscal 2002 was nevertheless an important year that marked a number of turning points in KDDI's strategy. For example, in December KDDI established a foothold in the 3G market with the introduction of next-generation services, including video and GPS capabilities, for cdmaOne users. And at March 31, 2002, it ceased accepting new subscribers under the personal digital cellular (PDC) system.**

**KDDI's cumulative subscriber base reached 12.21 million as in fiscal 2002. It temporarily fell back into third place in the industry after being overtaken by J-Phone. However, the long-awaited launch of CDMA2001 1x returned KDDI to second place in April.**

### NEW MODELS AND CONTENT SERVICES

Over the past few years, cellular telephones with e-mail and Internet access capabilities have become very popular. Many users already access a variety of content through their cellular telephones. There has been sustained growth in the number of subscribers to the *EZweb* Internet connection service provided by au. In March 2002 the total passed the 8 million mark. Moreover, the percentage of total au users who have joined *EZweb* has expanded to 67%. KDDI's ability to maintain this growth potential and expand its earnings will depend on its ability to supply attractive applications to run on the cellular telephone platform. There are plans for the introduction of a variety of new content services via *EZweb*, and for the launch of new cellular handsets capable of supporting those services.

In July 2001 KDDI introduced the *ezplus* application service, which is based on Java technology. With this system, users can download a wide range of Java applications, including games and communications tools, to enjoy on their cellular handsets.

In December 2001, KDDI began to provide content services based on the *EZwebmulti* system which offers significant functional enhancements compared with the *EZweb* system. The transmission rate was increased from 14.4Kbps to 64Kbps. KDDI also introduced *eznavigation*, the first system in Japan to provide GPS navigation through cellular telephones. It also led the industry with its introduction of the *ezmovie* video transmission system.

**GPS NAVIGATION SYSTEM COMPONENTS**


### AN *eznavigation* MAP

The *eznavigation* system accurately pinpoints the location of cellular telephone handsets using global positioning satellite (GPS) data. It can be turned into a navigation tool simply by downloading maps. Users can also transmit maps showing

| C451H | C452CA | C3001H | C3002K | C3003P | C5001T | C1001SA |
|---|---|---|---|---|---|---|
| *Handsets configured for ezplus* | | *Handsets configured for eznavigation* | | | *Handset configured for ezmovie* | *Handset configured for Global Passport* |

their present location. By linking this service with the *ezplus* system, it is possible to use positioning data in various other ways, including games and communications.

In addition to these personal uses, the GPS function is also the key to powerful solutions for corporate users. For example, it is possible to build fleet management systems for commercial vehicles, as well as highly efficient personnel deployment systems. GPS technology will be an extremely important factor as KDDI increases its emphasis on solutions in the future.

## VIEWING A VIDEO CLIP

The *ezmovie* system is a video content service based on the MPEG4 format, which is the global standard for video compression. It allows users to view news, movie trailers and other video information on their cellular telephone. Users can also attach clips taken with video cameras to e-mails processed on PCs. At present the system can play video clips 15-60 seconds in length. These can be downloaded in around 20 seconds.

The *ezmovie* also employs original technology developed by the KDDI R&D Laboratories to support a variety of innovative features not available on competing systems, such as image-text linkage, copyright protection (including limits on playback frequency or period), and stereo sound. These features enhance the system's potential for a wide range of applications.

### "ezmovie" VIDEO CONTENT

"Disney– ez"
Produced by Walt Disney International, Japan


KDDI has further enhanced the *ezplus* system to support HTTP data communications between cellular telephones and servers. This feature allows users to play games with other users via servers. It also supports automatic updating of applications downloaded onto cellular handsets.

KDDI was also the first company in Japan to introduce WAP2.0, the world standard for mobile Internet access. This technology allows users to access i-mode sites and improves

Internet linkage and compatibility.

These data services involve larger data volumes than in the past. By switching cdmaOne to CDMA2000 1x, users will be able to enjoy an enhanced experience thanks to higher transmission speeds.

### INTERNATIONAL ROAMING (GLOBAL PASSPORT)

Unlike the PDC system, cdmaOne has been adopted in many countries. By signing agreements with partner providers in other countries, KDDI has been able to provide Japan's only international roaming service. At present au has alliance carriers in South Korea (SK Telecom), Hong Kong (Hutchison), the United States (Verizon Wireless), Australia (Telstra), Canada (TELUS Mobility) and New Zealand (Telecom Mobile). It is also working actively to expand coverage areas within these six countries. Users were able to use their au handsets at the Winter Olympics in Salt Lake City in January 2002.

In April 2002, KDDI started a roaming service with China United Telecommunications. It also plans to introduce global roaming in Brazil and Mexico.

Users whose handsets support this extremely convenient service can use them without the need to make prior applications or pay additional charges. They can use the same handset and telephone number when traveling overseas.

## SUBSCRIBER TRENDS (THOUSANDS)

| Years ended March 31, 2002 and 2001 | 2002 | 2001 |
|---|---|---|
| au | 12,214 | 10,986 |
| CDMA | 10,822 | 8,277 |
| PDC | 1,392 | 2,708 |
| *EZweb* | 8,228 | 5,634 |

In the fiscal year ended March 31, 2002, the number of subscribers increased by 11.2% year-on-year to 12,214 thousand. The increase includes 655 thousand new subscribers attracted by next-generation services introduced in December. A breakdown by system type shows that the number of CDMA subscribers increased by 30.7% to 10,822 thousand, while the number of PDC subscribers declined by 48.6% to 1,392 thousand. KDDI ceased accepting new PDC subscribers at the end of March 2002, and PDC-based services will be terminated at the end of March 2003.

## ARPU TRENDS

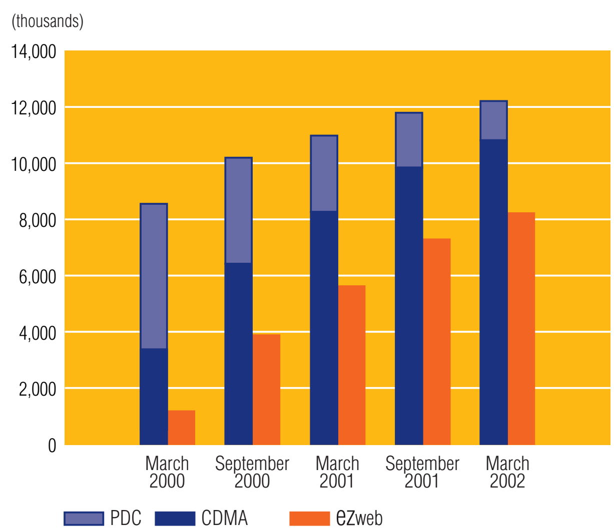
| March 31, 2002 and 2001 | | 2002 | 2001 |
|---|---|---|---|
| au ARPU | (¥) | *8,080 | 8,030 |
| Subtotal: Data ARPU | (¥) | 890 | 430 |
| MOU | (minutes) | 184 | 187 |
| Churn Rate | (%) | 2.6 | 3.2 |

*The ARPU figure for the fiscal year ended March 31, 2002 includes a ¥670 increase resulting from the introduction of an "End-to-End Rate System" for mobile–mobile (M–M) telephone services.

ARPU: Average revenue per user per month
MOU: Minutes of usage per user per month
Churn Rate: Cancellation rate per month.

In real terms, the ¥8,080 ARPU for au services represents a decline of ¥620 compared with the previous year's figure. This is explained by economic stagnation and the impact of family discounts and other discount services. The data ARPU of ¥890 is more than double the previous year's figure and represents a year-on-year increase of ¥460. There is potential for further traffic growth driven by next-generation services, such as GPS and video, based on the CDMA2000 1x system.

## TOTAL NUMBER OF au AND EZweb SUBSCRIBERS



# Network & Solutions Business

## » Spearheading the ***Future as IT***

## » ***Content and Solutions*** *in a Single, Integrated Package*

**In the past the core sources of revenues have been domestic and international voice communications services, and data services, including Internet access. However, the introduction of the MYLINE system in May 2002 has caused competition to intensify, triggering a steep decline in revenues.**

**KDDI aims to develop major new sources of revenue. It has substantially expanded its IP Business Sector, and in March 2002 it established the Solution Business Sector. KDDI intends to combine its data services and solutions, and to develop links with its mobile communications services, thereby evolving into the "Ubiquitous Solutions Company" capable of building systems that can be used anytime, anywhere.**

### VOICE COMMUNICATIONS SERVICES

In May 2001 registrations under the MYLINE began. This system allows users to select their preferred carrier for fixed-line telephone services. In the past, carriers other than NTT were able to capture traffic preferentially by installing automatic carrier routing (ACR) devices in users' homes. The MYLINE eliminates the need for ACR devices, since users can now register in their local telephone exchange. Its introduction also canceled existing customer relationships and has been followed by a period of fierce competition as carriers vie to attract subscribers, including new subscribers.

By offering new discount services and other incentives, KDDI was able to secure over 20% of the domestic long-distance market, which has been the main battlefield. It has also maintained what is in effect an almost 50% share of the international market. Though discounting eroded revenues from voice services, these figures indicate that KDDI can look forward to ample cash flows in the future.

As the flurry of competition triggered by MYLINE subsides, KDDI has started to roll out integrated services that combine the au and DION system. Its aim is to offer services that will attract users to the KDDI Group as a whole. For example, the *au to Home Discount* services and *DION Set Discount* services provide users who register with KDDI discounted access to au and DION services. This approach has been reflected in a steady increase in the number of subscribers.

### INTERNET SERVICES

DION is KDDI's Internet connection service. The number of subscribers has grown steadily, thanks to its affordable *Komi-komi Course* charging system, which was the first in Japan to integrate access charges and call charges. In August 2001 the number of DION subscribers exceeded the 2 million mark. However, service providers offering low-cost ADSL access have started to move into the Japanese market for personal Internet access, the focus of which is shifting toward unlimited broadband connections. Price competition is intense in the area of ADSL services, and to avoid high-risk capital investment, KDDI has sourced infrastructure by securing circuit lines under a multi-carrier alliance.

Because of the priority that it gave to the MYLINE situation, KDDI delayed the roll-out of ADSL services. As a result, its user base at the end of March 2002 stood at 130,000, which represents a market share of 5.5%. This share will expand as KDDI responds to market needs by expanding its carrier alliance to support enhanced services.

### FIBER TO THE HOME (FTTH)

In March 2002 KDDI began trial services for FTTH in the Tokyo area. Target users were selected from households who applied as monitors. The purpose of the project is to evaluate commercial services and technology and establish a business model in preparation for a full-scale roll-out of broadband services. KDDI will provide an infrastructure backbone to support a full range of services, including Internet access at speeds up to 100Mbps, streaming video content, karaoke, interactive educational services, links with networked appliances, and security services. KDDI will develop a variety of services that reflect the characteristics of the KDDI Group. For example, users will also be able to use their cellular telephones to control networked appliances.

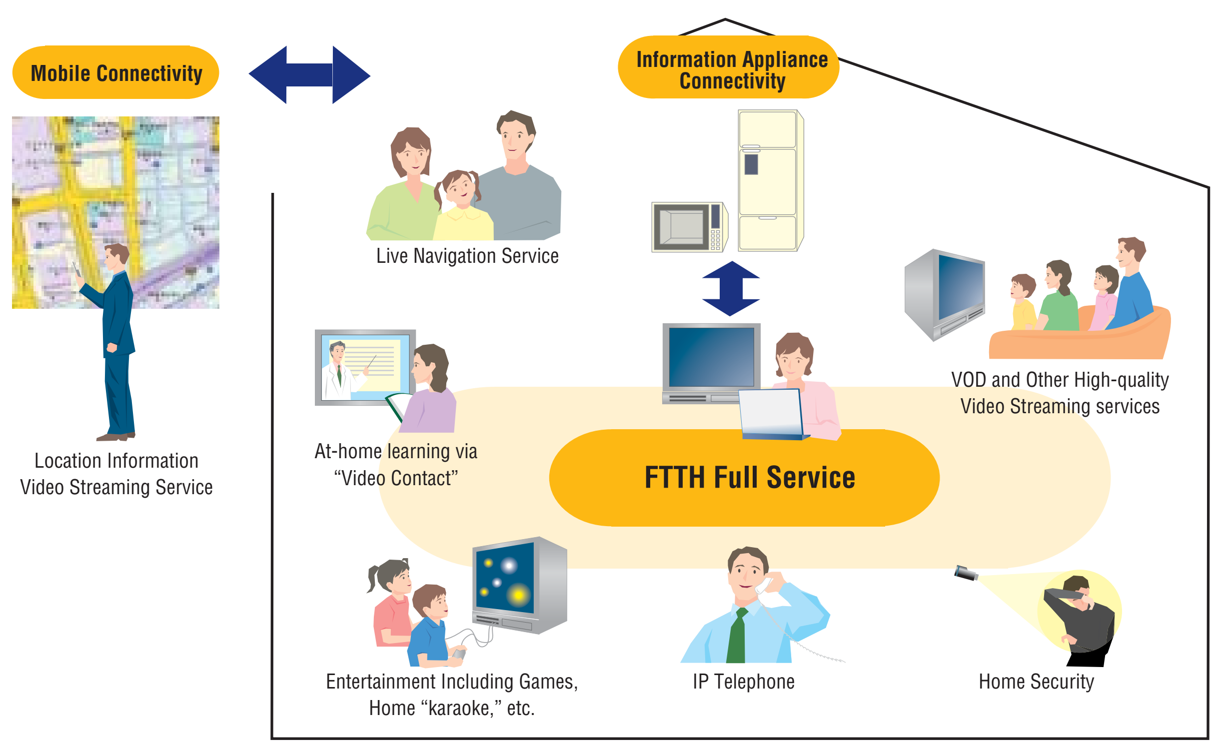
### IP-VPN

In the corporate data communications market, KDDI is aggressively introducing the IP-VPN system, which supersedes its existing *Frame Relay (FR) leased circuit services*. Demand for corporate intranets is expanding. IP-VPN offers a comparatively easy way to build IP-based networks, and there has been a steady increase in the number of line contracts, which had reached 30,000 as of the end of March 2002. KDDI led the industry in introducing a service level agreement (SLA) system. KDDI also excels in the provision of access from overseas through its international IP backbone networks. Users benefit from a comprehensive and fine-tuned response to their needs, including remote access via the au and Pocket, and ADSL access. KDDI has earned a reputation in this area through its ability to combine superior quality with excellent cost-performance.

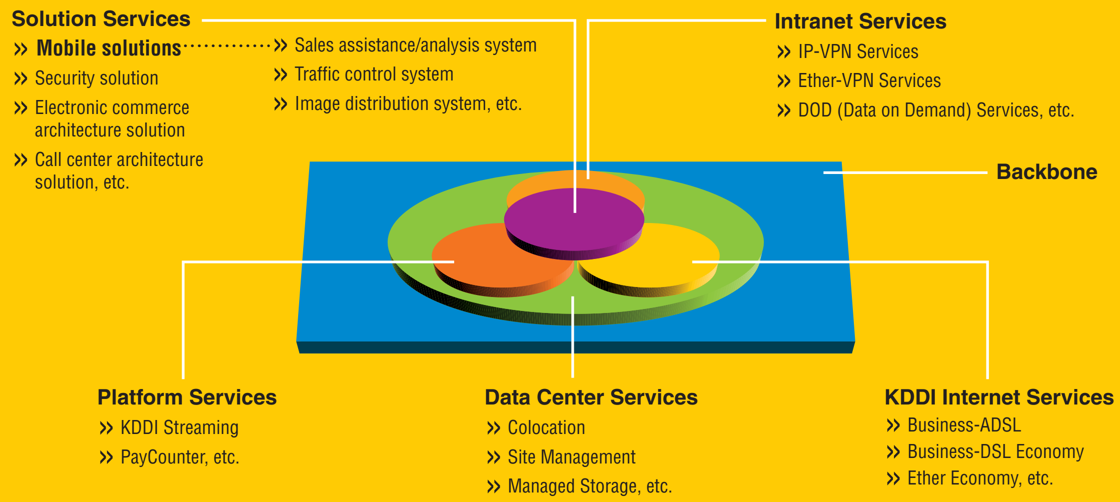
### SOLUTIONS

KDDI supports companies to build e-business and settlement systems. It is now developing “Ubiquitous Solutions” based on combinations of fixed-line data services and mobile services through the au and Pocket. These high-value solutions can be used anytime, anywhere. KDDI introduced GPS *Keitai* in

## FTTH SERVICE EXAMPLE



## KDDI'S TOTAL SOLUTIONS




December 2001. Many companies have expressed interest in *GPS Solutions*, which links au and *GPS Keitai*. KDDI is now developing a variety of systems based on this concept. Examples include fleet management systems for the transportation service industry, emergency notification systems for the security service industry, and employee attendance management systems for the business sector. The linkage with positioning data has added a new dimension to systems development.

In the area of intelligent transportation systems (ITS), KDDI is working with manufacturers of automobiles and vehicle navigation systems to develop services based on positioning data. Possible service formats include road traffic management systems and the supply of information to vehicles. KDDI is the only telecommunications carrier in Japan capable of providing of the essential components for ITS, including mobile networks, IP networks and large-capacity optical fiber cables. It is actively developing ITS solutions based on these assets.

Data centers provide behind-the-scenes support for these solutions. In April 2002 KDDI opened the Shibuya Data Center, its largest so far in terms of area. The excellent location of the new center is reflected in a high level of customer interest, and numerous bookings were received even before the center became operational. KDDI also has large-scale data centers in Otemachi and Shinjuku. The establishment of these facilities in central Tokyo will provide crucial infrastructure for the future development of KDDI's solutions business.

### INTERNATIONAL NETWORKS

In addition to its existing international networks, KDDI continues to develop new overseas interests, especially in Asia. In October 2001 it established KDDI CHINA to provide consulting services and solutions. KDDI has also exchanged memoranda with Beijing Telecom, Shanghai Telecom and Guangdong Telecom in preparation for the development of business relationships since China's admission to the WTO. KDDI is also expanding its telephone line resources in South Korea, which co-hosted the 2002 Soccer World Cup, and it has signed an international telephone service agreement with Hanalo Telecom, Inc.

# The TU-KA Business

» *Serving Essential* ***Voice and Mail*** *Needs*

» *Focus on* ***Higher Efficiency*** *and Lower Cost*

A management restructuring was implemented in October, following a decline in earnings due to cost increases, including higher depreciation resulting from establishment of additional base stations in the previous year. A new business strategy was developed, and management of the three TU-KA companies was integrated. The business strategy, which was the main reason for the high-cost structure, was totally revamped, leading to a transition to a low-cost structure. These changes were reflected in a dramatic improvement in profitability in the second half of fiscal year 2002.

Efforts to boost subscriber numbers focused on the development of unique content services, including the *funstyle* service, which allows users to download high-quality music in MIDI format. Marketing initiatives included commercials fronted by Ayumi Hamasaki, one of Japan's most popular female singers. Unfortunately the number of subscribers declined compared with the level at the end of the previous fiscal year. KDDI has now adopted a new strategy targeting low-volume users whose activity centers on voice calls and mail services. The aim is to take full advantage of the low-cost structure, including the fact that 3G investment is not required, to achieve good margins even when ARPU is low.

### TRENDS IN SUBSCRIBER NUMBERS AND ARPU

| March 31, | | 2002 | 2001 |
|---|---|---|---|
| TU-KA | Subscribers (thousands)* | 3,891 | 3,954 |
| *EZweb* | Subscribers (thousands)* | 1,410 | 1,083 |
| ARPU | (¥) | **5,790 | 6,270 |
| MOU | (minutes) | 149 | 158 |
| Churn Rate | (%) | 3.1 | 3.3 |

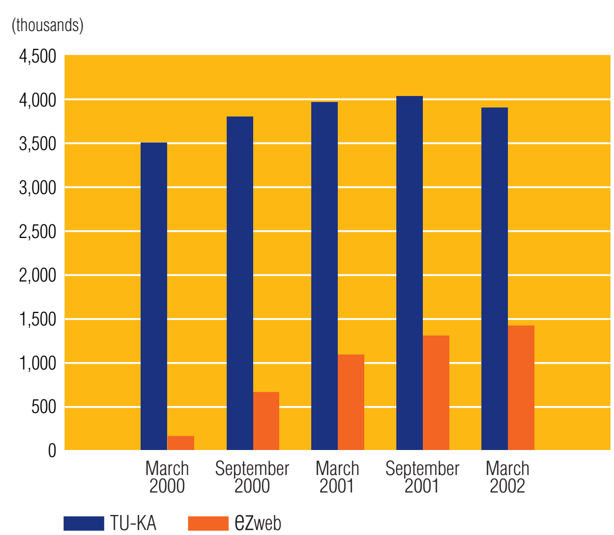
*Figure at end of year
**The ARPU figure for the year ended March 2002 includes a ¥460 increase resulting from the introduction of an "End-to-End Rate System" for mobile-mobile (M-M) telephone services. The Churn Rate is the cancellation rate per month.

Final statistics show that the number of TU-KA subscribers declined by 15.9% to 3,891 thousand. However, subscribers to the *EZweb* Internet access service increased by 30.2% to 1,410 thousand, reflecting a steady upward trend in the number of people using the TU-KA system primarily for mail and other data services.

ARPU was ¥5,790. This represents a year-on-year decline of ¥940 after adjustment for the effect of an "End-to-End Rate System." MOU was 149 minutes. A review of marketing policies was reflected in a steady improvement in the churn rate.

*funstyle*

### TOTAL NUMBER OF TU-KA AND EZweb SUBSCRIBERS



# The PHS Business

» *Configuring Services for **Data Communications** Users*

» *Achieving **Across-the-Board Reductions** in Operating Costs*

DDI Pocket is developing services targeted toward data communications users. In June 2001 it launched the *AirH"*, the first PHS packet data communications service. In August it introduced *Tsunagi Hodai*, a full flat-rate access service. This is the first mobile-based service to provide a permanent connection nationwide. With a transmission rate of 32K and a price of ¥4,930 (based on annual contracts), it has become very popular. The number of subscribers, especially individual users, continues to expand, reaching 330 thousand at the end of March 2002.

This strategic focus on data communications, especially *AirH"*, will allow the Pocket business to operate extremely efficiently. Development costs will be reduced by keeping version upgrades, such as design changes and the addition of new functions, to a minimum. In this way, DDI Pocket will be able to cut handset procurement costs and reduce incentives, thereby substantially lowering the cost of gaining new users. By using FR networks, DDI Pocket has also achieved substantial reductions in the cost of operating backbone networks, compared with ISDN network costs.

In late March 2002, DDI Pocket launched a new flat-rate service called *Tsunagi Hodai*. The new service operates at a speed of 128K.


*AirH"* Card

### TRENDS IN SUBSCRIBER NUMBERS AND ARPU

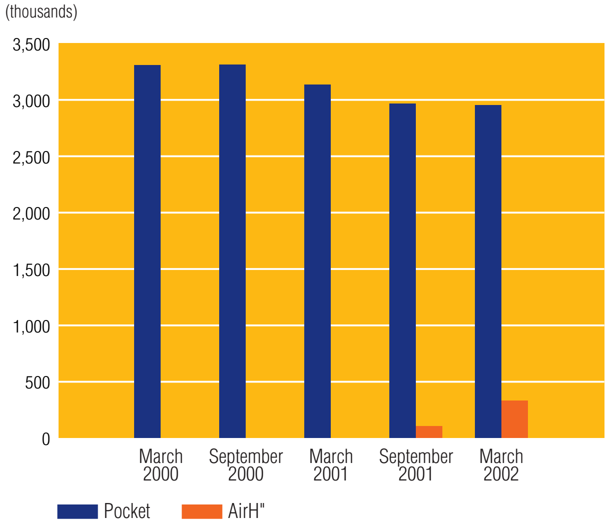
| Years ended March 31, 2002 and 2001 | | 2002 | 2001 |
|---|---|---|---|
| Pocket | Subscribers (thousands)* | 2,942 | 3,123 |
| AirH" | Subscribers (thousands)* | 329 | — |
| ARPU | (¥) | 5,330 | 5,910 |
| MOU | (minutes) | 185 | 226 |
| Churn Rate | (%) | 3.2 | 3.6 |

*Figure at end of year

The number of subscribers declined by 5.8% to 2,942 thousand. *AirH"* acquired 329 thousand data communication users, but a decline in voice users had a serious impact on the total.

ARPU was ¥5,330 and MOU 185 minutes. Declines in these figures reflect the shift to data. However, margins improved thanks to cost reductions and a lower churn rate.

### TOTAL NUMBER OF Pocket AND AirH" SUBSCRIBERS



# BENEFITS from MANAGEMENT RESTRUCTURING

**1) Restructuring of Management System**

The KDDI Group has implemented a variety of restructuring measures since the October 2000 merger. In October 2001 au Corporation was also merged, and structures were established to support a powerful concentration of resources into the au business. At the same time, the TU-KA Group was strengthened under a new management team. Other group companies have been reviewed, and subsidiaries and affiliates with limited profitability and prospects have been liquidated or consolidated. This process has reduced the total number of group companies from 76 to 64.

**2) Business Restructuring**

At March 31, 2002, KDDI wrote off all facilities for PDC cellular-phone services. This move reflects the decision to use CDMA as the only format for au services. The value of the facilities concerned, including base stations and networks, was ¥128.3 billion. There will be no further depreciation of these facilities. Beginning in fiscal 2003, depreciation costs will decline by ¥44 billion, and usage charges for related communications facilities will be reduced by an estimated ¥22 billion annually from fiscal 2004.

There has also been a partial write-off of fixed-line network facilities. The facilities in question, which were worth ¥17.5 billion, became surplus because of business integration following the merger. This move will result in reduced depreciation and maintenance costs.

The accounts also show write-offs and a valuation loss relating to old-type au handsets. There was also a valuation loss on PHS handsets. The total cost of these measures was ¥34.5 billion.

These amounts were shown in the accounts as extraordinary losses relating to business restructuring. The costs were covered by an extraordinary gain of ¥144.8 billion from the securitization of four buildings, including the Shinjuku Head Office Building.

**3) Realization of Merger Effects**

In the corporate purchasing area, volume increases resulting from the merger have brought economies of scale. KDDI has also reviewed its purchasing systems. Systems to control specifications and costs on an individual part level have helped to hold down costs in the area of handset procurement. These measures have brought cost savings amounting to ¥72 billion. In November 2001, a Capital Expenditure Committee was established to screen investment projects from a profitability perspective.

In February 2002, KDDI established a Customer Service Division. The new division is currently studying the integration of customer centers for au and fixed-line telephone services. Integration of the two systems would provide customers with various services to make the necessary arrangements at the same service center, aiming to have a "One-stop Call Center," instead of dealing with multiple centers as is the case under the existing structure. In addition to improved customer satisfaction, integration is also seen as a way of reducing costs.

Work has also started on the integration of information systems. Partial integration of au systems began in some regions in March 2002. The nine systems operated by the eight DDI Cellular companies and IDO will be merged into a single system. The information systems operated by DDI, KDD and TWJ for fixed-line telephone services will also be integrated into a single system. These changes are expected to reduce costs by ¥19 billion.

# FINANCIAL SECTION

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# FINANCIAL REVIEW (Unaudited)

KDDI Corporation and Consolidated Subsidiaries

**This section attempts to avoid fluctuations resulting from the merger and provide a basis for real comparisons of the financial position by adjusting the figures for the years ended March 31, 2001 and 2002. For this reason, the statistics may differ from those shown in the audited financial statements.**

***1) Year ended March 31, 2001***

**The results for KDD and IDO in the first half of the year ended March 31, 2001 were simply added to the consolidated results. In the same way, the results for IDO were added to the au business results, and the results for KDD to the results for network and solutions businesses. The figures have not been adjusted for consolidation elimination.**

***2) Treatment of Consolidated Subsidiaries***

**Domestic consolidated subsidiaries, other than cellular-phone and PHS businesses, and overseas consolidated subsidiaries are all aggregated under other businesses. As a result, the figures for Network & Solutions businesses and other businesses do not match the segment data shown in the notes to the financial statements.**

## Consolidated Financial Review

| | Millions of yen | | | | Millions of U.S. dollars |
|---|---|---|---|---|---|
| Years ended March 31, 2002 and 2001 | 2002 | 2001 | Change | % | 2002 |
| Operating revenues | ¥ 2,833,799 | ¥ 2,816,381 | ¥ 17,418 | 0.6% | $ 21,267 |
| Telecommunications business | 2,247,145 | 2,192,637 | 54,508 | 2.5 | 16,864 |
| Voice communications | 1,767,730 | 1,871,737 | (104,007) | (5.6) | 13,266 |
| Digital data transmission services and other | 479,415 | 320,900 | 158,515 | 49.4 | 3,598 |
| Other business | 586,654 | 623,744 | (37,090) | (5.9) | 4,403 |
| Operating income | 102,297 | 98,794 | 3,503 | 3.5 | 768 |
| Extraordinary income (loss) | (57,871) | 6,498 | (64,369) | — | (434) |
| Net income | 12,979 | 21,668 | (8,689) | (40.1) | 97 |
| Free cash flows | 290,600 | (170,002) | 460,602 | — | 2,181 |
| Depreciation expenses | 423,981 | 407,615 | 16,366 | 4.0 | 3,182 |
| Capital expenditures (payments) | 374,522 | 560,174 | (185,652) | (33.1) | 2,811 |
| EBITDA | 544,805 | 513,853 | 30,952 | 6.0 | 4,089 |
| EBITDA margin | 19.2% | 18.2% | 1.0 % | — | 19.2% |
| Balance of interest-bearing debt | 1,746,784 | 2,097,627 | (350,843) | (16.7) | 13,109 |
| Net debt | 1,678,188 | 1,962,957 | (284,769) | (14.5) | 12,594 |

### Operating Revenues

Operating revenues increased by ¥17.4 billion to ¥2,833.8 billion compared with the previous fiscal year. Under the new accounting standards adopted in April 2001, we introduced an "End-to-End Rate System" for calls between cellular phones. This change resulted in a ¥101.9 billion increase in operating revenues from cellular-phone services (au, TU-KA). Without this factor, operating revenues would have declined by ¥84.5 billion to ¥2,731.9 billion. However, since there was an equivalent increase in operating expenses, there is no effect on income. Revenues from voice communications services decreased by ¥104 billion to ¥1,767.7 billion, but revenues from digital data transmission services increased by ¥158.5 billion to ¥479.4 billion.

### Income

Operating income increased by ¥3.5 billion compared with the previous year's result to ¥102.3 billion, but net income decreased by ¥8.7 billion to ¥13.0 billion. The reduction in net income reflects extraordinary loss of ¥185.4 billion due to restructuring costs. Total extraordinary losses amounted to ¥202.6 billion. Extraordinary income totaled ¥144.8 billion, including a ¥143.7 billion gain from the securitization and sale of four buildings at the Shinjuku headquarters in the second half of the period. After seven years, KDDI has a first-refusal right to buy back the property that was sold.

### Cash Flows

There was a dramatic increase in free cash flows, which expanded by ¥460.6 billion to ¥290.6 billion. This resulted in part from a ¥187.4 billion cash inflow resulting from the securitization of real estate. Another factor was cost-cutting efforts, including restraints on capital investment, in all business areas.

### Capital Expenditures

Capital expenditures amounted to ¥374.5 billion, a decrease of ¥185.7 billion from the previous year's level. This reflects the completion of cdmaOne investment for the au service, as well as a policy of reducing total investment through stringent appraisals of investment projects from the viewpoint of profitability. Depreciation increased by ¥16.4 billion to ¥424.0 billion. EBITDA increased by ¥31.0 billion to ¥544.8 billion, while the EBITDA margin increased by 1.0% to 19.2%.

### Interest-Bearing Debt

The balance of interest-bearing debt decreased by ¥350.8 billion to ¥1,746.8 billion. The cash inflow from the aforementioned securitization of real estate, free cash flows from business activities, and part of cash and deposits were used to retire debt. The debt reduction plan is proceeding steadily, and debt has already been cut by ¥494.1 billion compared with level at the time of the merger of DDI, KDD and IDO.

These results are indicative of an improvement in KDDI's income and expenditure position.

## Segment Financial Reviews

### au services

| | Millions of yen | | | | Millions of U.S. dollars |
|---|---|---|---|---|---|
| Years ended March 31, 2002 and 2001 | 2002 | 2001 | Change | % | 2002 |
| Operating revenues | ¥ 1,524,554 | ¥ 1,373,428 | ¥ 151,126 | 11.0% | $ 11,441 |
| Telecommunications business | 1,155,657 | 1,024,480 | 131,177 | 12.8 | 8,673 |
| Voice communications | 928,833 | 943,088 | (14,255) | (1.5) | 6,971 |
| Digital data transmission services | 226,824 | 81,392 | 145,432 | 178.7 | 1,702 |
| Other business | 368,897 | 348,948 | 19,949 | 5.7 | 2,768 |
| Operating income | 57,396 | 33,361 | 24,035 | 72.0 | 431 |
| Extraordinary income (loss) | (155,071) | (935) | (154,136) | — | (1,164) |
| Net income | (58,713) | 6,976 | (65,689) | — | (441) |
| Free cash flows | 15,643 | (124,400) | 140,043 | — | 117 |
| Depreciation expenses | 199,380 | 173,707 | 25,673 | 14.8 | 1,496 |
| Capital expenditures (payments) | 226,350 | 318,108 | (91,758) | (28.8) | 1,699 |
| EBITDA | 269,127 | 216,620 | 52,507 | 24.2 | 2,020 |
| EBITDA margin | 17.7% | 15.8% | 1.9% | — | 17.7% |

Operating revenues from the au services increased by ¥151.1 billion year-on-year to ¥1,524.6 billion. The introduction of "End-to-End Rate system" added ¥84.8 billion to au revenues, but even without this factor there would have been income growth of ¥66.3 billion. Revenues from voice communications services declined by ¥14.3 billion to ¥928.8 billion. The reduction reflects the impact of discount services, such as "Family Discount". Revenues from digital data transmission services showed a ¥145.4 billion increase to ¥226.8 billion. This substantial growth reflects the spread of the "ЄZweb@mail" e-mail service and the contribution from next-generation services introduced in December 2001.

Operating income increased by ¥24.0 billion to ¥57.4 billion. The operating income ratio improved thanks to cost cutting that included the reduction of incentives based on examination of handset prices and market-making sales accompanying the strengthening of the purchasing function. The net loss of ¥58.7 billion was attributable to extraordinary losses of ¥155.1 billion due to restructuring costs for the au service. The total breaks down into ¥128.3 billion for the one-off write-off of PDC facilities, and ¥26.8 billion due to the disposal of cellular handsets and valuation losses. The EBITDA margin improved by 1.9% to 17.7% because of the aforementioned cost reductions.

Capital expenditures decreased by ¥91.8 billion to ¥226.4 billion. This substantial reduction reflects the completion of cdmaOne investment.

### Network & Solutions Businesses

| Years ended March 31, 2002 and 2001 | Millions of yen 2002 | 2001 | Change | % | Millions of U.S. dollars 2002 |
|---|---|---|---|---|---|
| Operating revenues | ¥ 651,929 | ¥ 711,456 | ¥ (59,527) | (8.4%) | $ 4,892 |
| Telecommunications business | 607,664 | 671,520 | (63,856) | (9.5) | 4,560 |
| Voice communications | 425,062 | 477,574 | (52,512) | (11.0) | 3,190 |
| Digital data transmission services and other | 182,602 | 193,946 | (11,344) | (5.8) | 1,370 |
| Other business | 44,265 | 39,936 | 4,329 | 10.8 | 332 |
| Operating income | 30,525 | 67,484 | (36,959) | (54.8) | 229 |
| Extraordinary income (loss) | (17,462) | (917) | (16,545) | — | (131) |
| Net income | 4,137 | 38,396 | (34,259) | (89.2) | 31 |
| Free cash flows | 55,485 | (20,900) | 76,385 | — | 416 |
| Depreciation expenses | 122,850 | 123,882 | (1,032) | (0.8) | 922 |
| Capital expenditures (payments) | 86,400 | 116,700 | (30,300) | (26.0) | 648 |
| EBITDA | 157,467 | 202,969 | (45,502) | (22.4) | 1,182 |
| EBITDA margin | 24.2% | 28.5% | (4.3%) | — | 24.2% |

Operating revenues from the Network & Solutions businesses declined by ¥59.5 billion to ¥651.9 billion. There was a ¥63.9 billion decrease in operating revenues from telecommunications. This includes a ¥13.4 billion decline due to the transfer of operating revenues from such areas as solutions and service contracting to other business.

Operating revenues from voice communications decreased by ¥52.5 billion to ¥425.1 billion. This reflects increased competition, especially in the long-distance market, following the introduction of the MYLINE system. Participation in the local telephone market brought revenue growth of ¥52.1 billion, but there was an even bigger decline in revenues from long-distance and international services. Operating revenues from digital data transmission services and other non-voice services were ¥11.3 billion below the previous year's level at ¥182.6 billion, but this was mainly the result of the aforementioned transfer of revenues to other categories. Revenues from data services showed strong growth, especially in the area of IP-VPN services.

Operating income declined by ¥37.0 billion to ¥30.5 billion. The decline resulted in part from temporary costs, including special commissions resulting from the introduction of the MYLINE system. Net income declined by ¥34.3 billion to ¥4.1 billion. This reflects extraordinary expenses totaling ¥17.5 billion, which resulted from facility write-offs due to network integration. The lower income figure also affected EBITDA, which declined by ¥45.5 billion year-on-year to ¥157.5 billion. The EBITDA margin was 4.3% lower at 24.2%.

Capital expenditures were reduced by ¥30.3 billion from the previous year's level to ¥86.4 billion. Depreciation remained static at ¥122.9 billion.

### TU-KA

| Years ended March 31, 2002 and 2001 | Millions of yen 2002 | 2001 | Change | % | Millions of U.S. dollars 2002 |
|---|---|---|---|---|---|
| Operating revenues | ¥ 358,260 | ¥ 368,997 | ¥ (10,737) | (2.9%) | $ 2,688 |
| Telecommunications business | 286,278 | 292,189 | (5,911) | (2.0) | 2,148 |
| Other business | 71,982 | 76,808 | (4,826) | (6.3) | 540 |
| Operating income | 3,784 | 8,307 | (4,523) | (54.4) | 28 |
| Extraordinary income (loss) | — | (1,161) | — | — | — |
| Net income | (3,276) | 2,171 | (5,447) | — | (25) |
| Free cash flows | 14,831 | (80,882) | 95,713 | — | 111 |
| Depreciation expenses | 59,237 | 49,149 | 10,088 | 20.5 | 445 |
| Capital investment (payments) | 39,176 | 102,241 | (63,065) | (61.7) | 294 |
| EBITDA | 63,400 | 58,320 | 5,080 | 8.7 | 476 |
| EBITDA margin | 17.7% | 15.8% | 1.9% | — | 17.7% |

Operating revenues from the TU-KA business declined by ¥10.7 billion over the previous year's level to ¥358.3 billion. This result reflects declines in both the number of subscribers and average revenues per user (ARPU). The introduction of "End-to-End Rate system" added ¥17.1 billion, and revenues would have shown a ¥27.8 billion decline under the previous system. Operating income declined by ¥4.5 billion to ¥3.8 billion, and there was a net loss for the year. However, sales systems were restructured in the second half of the year, and cost controls were significantly tightened, including the reduction of incentives through a review of sales policies, and a curb on new capital expenditures. As a result of these measures, free cash flows were sharply higher at ¥14.8 billion, an increase of ¥95.7 billion over the previous year's level. The EBITDA margin improved by 1.9% to 17.7%. Capital expenditures were reduced by ¥63.1 billion compared with the previous year's total to ¥39.2 billion through a curb on the construction of new base stations.

**PHS (DDI Pocket)**

| | Millions of yen | | | | Millions of U.S. dollars |
|---|---|---|---|---|---|
| Years ended March 31, 2002 and 2001 | 2002 | 2001 | Change | % | 2002 |
| Operating revenues | ¥ 211,008 | ¥ 251,883 | ¥ (40,875) | (16.2%) | $ 1,584 |
| Telecommunications business | 195,870 | 237,344 | (41,474) | (17.5) | 1,470 |
| Other business | 15,138 | 14,539 | 599 | 4.1 | 114 |
| Operating income | 6,659 | (12,898) | 19,557 | — | 50 |
| Extraordinary income (loss) | 11,678 | (376) | 12,054 | — | 88 |
| Net income | 14,658 | (18,190) | 32,848 | — | 110 |
| Free cash flows | 14,429 | 11,791 | 2,638 | 22.4 | 108 |
| Depreciation expenses | 38,890 | 61,512 | (22,622) | (36.8) | 292 |
| Capital expenditures (payments) | 17,050 | 32,948 | (15,898) | (48.3) | 128 |
| EBITDA | 47,548 | 49,893 | (2,345) | (4.7) | 357 |
| EBITDA margin | 22.5% | 19.8% | 2.7% | — | 22.5% |

Operating revenue from the Pocket (PHS) business declined by ¥40.9 billion to ¥211.0 billion. Operating income increased by ¥19.6 billion to ¥6.7 billion. Among the factors that contributed to this result were improved profitability thanks to the success of the data specialization strategy, and a reduction in depreciation following the extension of the base station service life from six to nine years to reflect actual conditions of use. Net income amounted to ¥14.7 billion. This resulted from extraordinary income in the DDI Pocket account due to a decision by the parent company, KDDI, to write off a ¥20 billion loan that KDDI had provided to DDI Pocket. The cancellation of this debt restored Pocket to a position of solvency. A ¥7.7 billion valuation loss on PHS handsets was shown in the accounts as an extraordinary expense. There were improvements in both free cash flows and the EBITDA margin.

Under the data specialization strategy, the focus of investment has shifted from base stations to packet servers. As a result, capital expenditure was 48% below the previous year's level at ¥17.1 billion. Depreciation declined by ¥22.6 billion to ¥38.9 billion, reflecting the aforementioned change in the service life of base stations.

**Other Businesses**

| | Millions of yen | | | | Millions of U.S. dollars |
|---|---|---|---|---|---|
| Years ended March 31, 2002 and 2001 | 2002 | 2001 | Change | % | 2002 |
| Operating revenues | ¥ 276,974 | ¥ 316,369 | ¥ (39,395) | (12.5%) | $ 2,078 |
| Telecommunications business | 101,692 | 73,466 | 28,226 | 38.4 | 763 |
| Other business | 175,282 | 242,903 | (67,621) | (27.8) | 1,315 |
| Operating income | 4,063 | (465) | 4,528 | — | 30 |
| Extraordinary income (loss) | (12,921) | (11,910) | (1,011) | — | (97) |
| Net income (loss) | (11,578) | (31,318) | 19,740 | — | (87) |

Operating revenues from other businesses decreased by ¥39.4 billion to ¥277.0 billion compared with the previous year's result. Operating income increased by ¥4.5 billion to ¥4.1 billion. Revenues from the KDDI Submarine Cable System (SCS) remained on a downward trend due to a worldwide decline in demand for undersea cable capacity. However, losses were reduced thanks to tighter control of project contract acceptance and the completion of loss-making projects. There was further progress toward the liquidation and amalgamation of subsidiaries with poor income performance or future prospects, resulting in growth in both revenues and income from domestic and overseas subsidiaries.

# CONSOLIDATED BALANCE SHEETS

KDDI Corporation and Consolidated Subsidiaries

| | Millions of yen | | Millions of U.S. dollars (Note 1) |
|---|---|---|---|
| March 31, 2002 and 2001 | 2002 | 2001 | 2002 |
| **ASSETS** | | | |
| **Current Assets:** | | | |
| Cash and cash equivalents | **¥ 68,596** | ¥ 134,670 | **$ 515** |
| Accounts receivable | **481,064** | 547,202 | **3,610** |
| Allowance for doubtful accounts | **(25,793)** | (13,473) | **(194)** |
| Inventories | **97,797** | 110,044 | **734** |
| Deferred income taxes (Note 12) | **32,860** | 12,381 | **247** |
| Prepaid expenses and other current assets | **36,628** | 63,605 | **275** |
| **Total Current Assets** | **691,152** | 854,429 | **5,187** |
| **Property, Plant and Equipment** (Note 4): | | | |
| Telecommunications equipment | **2,830,078** | 3,079,812 | **21,239** |
| Buildings and structures | **480,666** | 540,528 | **3,607** |
| Machinery and tools | **129,927** | 133,640 | **975** |
| Land | **64,334** | 88,249 | **483** |
| Construction in progress | **144,080** | 127,211 | **1,081** |
| Other property, plant and equipment | **18,649** | 15,440 | **141** |
| | **3,667,734** | 3,984,880 | **27,526** |
| Accumulated depreciation | **(1,716,479)** | (1,739,812) | **(12,882)** |
| **Total Property, Plant and Equipment** | **1,951,255** | 2,245,068 | **14,644** |
| **Investments and Other Assets:** | | | |
| Investments in securities (Note 3) | **65,186** | 62,061 | **489** |
| Deposits and guarantee money | **39,773** | 41,691 | **298** |
| Intangible assets | **244,310** | 261,727 | **1,833** |
| Goodwill | **61,271** | 65,982 | **460** |
| Deferred income taxes (Note 12) | **50,402** | 15,355 | **378** |
| Other assets | **112,050** | 101,205 | **842** |
| Allowance for loss on investments and other assets | **(11,958)** | (8,154) | **(90)** |
| **Total Investments and Other Assets** | **561,034** | 539,867 | **4,210** |
| **Total Assets** | **¥3,203,441** | ¥3,639,364 | **$24,041** |

The accompanying notes are an integral part of these statements.

| March 31, 2002 and 2001 | Millions of yen 2002 | 2001 | Millions of U.S. dollars (Note 1) 2002 |
|---|---|---|---|
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | |
| **Current Liabilities:** | | | |
| Short-term loans and current portion of long-term loans (Note 4) | **¥ 403,309** | ¥ 457,790 | **$ 3,027** |
| Accounts payable | **417,277** | 552,307 | **3,132** |
| Accrued income taxes | **53,339** | 10,258 | **400** |
| Accrued expenses | **24,532** | 31,620 | **184** |
| Allowance for bonuses | **12,220** | 14,393 | **92** |
| Other current liabilities | **32,746** | 47,585 | **245** |
| **Total Current Liabilities** | **943,423** | 1,113,953 | **7,080** |
| **Non-Current Liabilities:** | | | |
| Long-term loans (Note 4) | **970,395** | 1,205,380 | **7,283** |
| Bonds (Note 4) | **354,800** | 380,000 | **2,663** |
| Other non-current liabilities (Note 4) | **67,136** | 83,588 | **502** |
| **Total Non-Current Liabilities** | **1,392,331** | 1,668,968 | **10,448** |
| **Total Liabilities** | **2,335,754** | 2,782,921 | **17,528** |
| **Minority Interests** | **10,606** | 11,352 | **80** |
| **Contingent Liabilities** (Note 5) | | | |
| **Shareholders' Equity** (Note 10)**:** | | | |
| Common stock | | | |
| Authorized—7,000,000 shares | | | |
| Issued and outstanding—4,240,880.38 shares | **141,852** | 141,852 | **1,064** |
| Additional paid-in capital | **304,190** | 304,096 | **2,283** |
| Retained earnings | **407,043** | 401,442 | **3,055** |
| Net unrealized gains on securities | **2,896** | — | **22** |
| | **855,981** | 847,390 | **6,424** |
| **Foreign Currency Translation Adjustments** | **1,140** | (2,290) | **9** |
| Treasury stock, at cost | **(40)** | (9) | **(0)** |
| **Total Shareholders' Equity** | **857,081** | 845,091 | **6,433** |
| **Total Liabilities and Shareholders' Equity** | **¥3,203,441** | ¥3,639,364 | **$24,041** |

# CONSOLIDATED STATEMENTS OF INCOME

KDDI Corporation and Consolidated Subsidiaries

| Years ended March 31, 2002 and 2001 | Millions of yen 2002 | Millions of yen 2001 | Millions of U.S. dollars (Note 1) 2002 |
|---|---|---|---|
| **Operating Revenues:** | | | |
| Voice communications | **¥1,767,730** | ¥1,567,658 | **$13,266** |
| Digital data transmission services | **310,101** | 148,081 | **2,327** |
| Leased circuits | **87,980** | 55,677 | **660** |
| Telegraph and other telecommunications services | **81,334** | 34,403 | **610** |
| Sales of terminal equipment and other | **586,654** | 462,827 | **4,404** |
| **Total Operating Revenues** | **2,833,799** | 2,268,646 | **21,267** |
| **Operating Expenses:** | | | |
| Sales expenses | **981,240** | 866,545 | **7,364** |
| Depreciation | **408,929** | 329,474 | **3,069** |
| Charges for use of telecommunications services of third parties | **467,358** | 311,370 | **3,507** |
| Cost of sales of terminal equipment and other | **577,481** | 448,816 | **4,334** |
| Other | **296,494** | 223,658 | **2,225** |
| **Total Operating Expenses** | **2,731,502** | 2,179,863 | **20,499** |
| **Operating Income** | **102,297** | 88,783 | **768** |
| **Other Expenses (Income):** | | | |
| Interest expense | **44,068** | 40,923 | **331** |
| Interest income | **(1,077)** | (1,077) | **(8)** |
| Loss (Gain) on sales of securities | **2,986** | (16,723) | **22** |
| Loss on devaluation of securities | **720** | — | **5** |
| Gain on sales of property, plant and equipment (Note 6) | **(139,544)** | — | **(1,047)** |
| Equity in loss (profit) of affiliates | **(437)** | 6,674 | **(3)** |
| Gain on delinquency charges from constructor | **(9,328)** | — | **(70)** |
| Impairment and business restructuring charges (Note 7) | **185,406** | — | **1,391** |
| Bad debt expense for specific credits | **7,550** | — | **57** |
| Loss from cancellation of cable contracts | **687** | — | **5** |
| Retirement benefit expenses | **—** | 5,983 | **—** |
| Loss from amendments to submarine cable construction contracts | **—** | 10,594 | **—** |
| Other, net | **(9,619)** | (3,493) | **(72)** |
| **Total Other Expenses** | **81,412** | 42,881 | **611** |
| **Income before Income Taxes and Minority Interests** | **20,885** | 45,902 | **157** |
| **Income Taxes:** | | | |
| Current | **66,037** | 10,843 | **496** |
| Deferred | **(56,193)** | 17,444 | **(422)** |
| **Total Income Taxes** | **9,844** | 28,287 | **74** |
| **Minority Interests in Consolidated Subsidiaries** | **(1,938)** | 4,188 | **(14)** |
| **Net Income** | **12,979** | 13,427 | **97** |

| | Yen 2002 | Yen 2001 | U.S. dollars (Note 1) 2002 |
|---|---|---|---|
| **Per Share Data:** | | | |
| Net income | **¥3,061** | ¥4,467 | **$22.97** |
| Cash dividends | **1,790** | 1,790 | **13.43** |

The accompanying notes are an integral part of these statements.

# CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

KDDI Corporation and Consolidated Subsidiaries

| | Thousands | Millions of yen | | | | | |
|---|---|---|---|---|---|---|---|
| Years ended March 31, 2002 and 2001 | Number of shares of common stock | Common stock | Additional paid-in capital | Retained earnings | Net unrealized gains on securities | Foreign currency translation adjustments | Treasury stock |
| Balance, March 31, 2000 | 2,274 | ¥ 72,635 | ¥ 87,920 | ¥ 68,019 | ¥ — | ¥ — | ¥ (0) |
| New share issue to Toyota Motor Corporation | 124 | 60,002 | 60,002 | | | | |
| Merger with KDD and IDO | 1,345 | 6,726 | 115,780 | 324,182 | | | |
| New share issue to au Corporation for exchange of shares | 498 | 2,489 | 40,394 | | | | |
| Net income for the year | | | | 13,427 | | | |
| Cash dividends | | | | (4,182) | | | |
| Directors' and corporate auditors' bonuses | | | | (4) | | | |
| Foreign currency translation adjustments | | | | | | (2,290) | |
| Net changes in treasury stock | | | | | | | (9) |
| Balance, March 31, 2001 | 4,241 | ¥141,852 | ¥304,096 | ¥401,442 | ¥ — | ¥(2,290) | ¥ (9) |
| Net income for the year | | | | 12,979 | | | |
| Cash dividends (Note 10) | | | | (7,148) | | | |
| Directors' and corporate auditors' bonuses | | | | (5) | | | |
| Decrease in retained earnings due to merger | | | 94 | (225) | | | |
| Net unrealized gains on securities | | | | | 2,896 | | |
| Foreign currency translation adjustments | | | | | | 3,430 | |
| Net changes in treasury stock | | | | | | | (31) |
| **Balance, March 31, 2002** | **4,241** | **¥141,852** | **¥314,190** | **¥407,043** | **¥2,896** | **¥1,140** | **¥(40)** |

| | Thousands | Millions of U.S. dollars (Note 1) | | | | | |
|---|---|---|---|---|---|---|---|
| Years ended March 31, 2002 | Number of shares of common stock | Common stock | Additional paid-in capital | Retained earnings | Net unrealized gains on securities | Foreign currency translation adjustments | Treasury stock |
| Balance, March 31, 2001 | 4,241 | $1,064 | $2,282 | $3,013 | $ — | $(17) | $(0) |
| Net income for the year | | | | 97 | | | |
| Cash dividends (Note 8) | | | | (54) | | | |
| Directors' and corporate auditors' bonuses | | | | (0) | | | |
| Decrease in retained earnings due to merger | | | 1 | (1) | | | |
| Net unrealized gains on securities | | | | | 22 | | |
| Foreign currency translation adjustments | | | | | | 26 | |
| Net changes in treasury stock | | | | | | | (0) |
| **Balance, March 31, 2002** | **4,241** | **$1,064** | **$2,283** | **$3,055** | **$ 22** | **$ 9** | **$(0)** |

The accompanying notes are an integral part of these statements.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

KDDI Corporation and Consolidated Subsidiaries

| Years ended March 31, 2002 and 2001 | Millions of yen 2002 | 2001 | Millions of U.S. dollars (Note 1) 2002 |
|---|---|---|---|
| **Cash Flows from Operating Activities:** | | | |
| Income before income taxes and minority interests | **¥ 20,885** | ¥ 45,902 | **$ 157** |
| Adjustments for: | | | |
| Depreciation and amortization | **427,885** | 338,366 | **3,211** |
| Gain on sales of property, plant and equipment | **(138,411)** | — | **(1,039)** |
| Loss on disposal of property, plant and equipment | **164,210** | 13,677 | **1,232** |
| (Increase) decrease in allowance for doubtful accounts | **16,009** | (3,360) | **120** |
| Increase in reserve for retirement benefits | **2,567** | 7,777 | **19** |
| Interest and dividend income | **(1,790)** | (2,547) | **(13)** |
| Interest expenses | **44,068** | 40,923 | **331** |
| Equity in (gain) loss of affiliates | **(437)** | 6,674 | **(3)** |
| Investment securities write off | **720** | 115 | **5** |
| Loss from amendments to submarine cable construction contracts | **—** | 10,594 | **—** |
| Changes in assets and liabilities: | | | |
| (Increase) in prepaid pension cost | **(7,636)** | — | **(57)** |
| (Increase) decrease in notes and accounts receivable | **71,305** | (37,110) | **535** |
| (Increase) decrease in inventories | **12,821** | (69,074) | **96** |
| (Decrease) in notes and accounts payable | **(85,763)** | (24,482) | **(644)** |
| Other, net | **609** | 579 | **5** |
| Sub total | **527,042** | 328,034 | **3,955** |
| Interest and dividend income received | **1,759** | 2,213 | **13** |
| Interest expenses paid | **(45,207)** | (36,738) | **(339)** |
| Income taxes paid | **(23,062)** | (6,773) | **(173)** |
| Net cash provided by operating activities | **460,532** | 286,736 | **3,456** |
| **Cash Flows from Investing Activities:** | | | |
| Payments for purchase of property, plant and equipment | **(276,464)** | (339,209) | **(2,075)** |
| Proceeds from sale of property, plant and equipment | **201,880** | 8,329 | **1,515** |
| Payments for other intangible assets | **(82,527)** | (76,059) | **(619)** |
| Acquisition of investment securities | **(10,339)** | (2,298) | **(78)** |
| Proceeds from sale of investment securities | **1,505** | 24,015 | **11** |
| Payments for investment in affiliates | **(570)** | (8,592) | **(4)** |
| Proceeds from sale of shares in subsidiaries excluded from consolidation | **—** | 28,421 | **—** |
| Increase in long-term prepayment | **(15,532)** | (15,805) | **(117)** |
| Other, net | **12,115** | 8,935 | **92** |
| Net cash used in investing activities | **(169,932)** | (372,263) | **(1,275)** |
| **Cash Flows from Financing Activities:** | | | |
| Decrease in short-term loans | **(36,114)** | (76,546) | **(271)** |
| Proceeds from issuance of long-term loans | **129,986** | 183,776 | **976** |
| Repayment of long-term loans | **(396,362)** | (250,289) | **(2,975)** |
| Repayment of long-term accounts payable | **(18,758)** | — | **(141)** |
| Payment for redemption of bonds | **(30,000)** | — | **(225)** |
| Proceeds from new share issue | **—** | 120,004 | **—** |
| Dividends paid | **(7,206)** | (4,288) | **(54)** |
| Payments received from minority shareholders | **407** | 632 | **3** |
| Payments for bounty of merger | **—** | (2,000) | **—** |
| Other, net | **134** | 3,359 | **1** |
| Net cash used in financing activities | **(357,913)** | (25,352) | **(2,686)** |
| **Translation Adjustments on Cash and Cash Equivalents** | **1,160** | 365 | **9** |
| **Net (Decrease) in Cash and Cash Equivalents** | **(66,153)** | (110,514) | **(496)** |
| **Cash and Cash Equivalents at Beginning of Year** | **134,670** | 78,300 | **1,010** |
| **Increase in Cash and Cash Equivalents due to Merger and Subsidiaries Newly Consolidated** | **133** | 166,884 | **1** |
| **(Decrease) in Cash and Cash Equivalents due to Deconsolidation of Subsidiaries** | **(54)** | — | **0** |
| **Cash and Cash Equivalents at End of Year** | **¥ 68,596** | ¥134,670 | **$ 515** |

The accompanying notes are an integral part of these statements.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

KDDI Corporation and Consolidated Subsidiaries

## 1. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements are prepared from the consolidated financial statements issued in Japan for domestic reporting purposes.

KDDI Corporation (the "Company") and its domestic subsidiaries maintain their accounts and records in accordance with the Japanese Commercial Code and Japanese Telecommunications Business Law, and in conformity with accounting principles and practices generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Accounting Standards. Its foreign subsidiaries maintain their accounts in conformity with the generally accepted accounting principles and practices of each country of their domicile.

No harmonization of accounting principles adopted by the Company and its consolidated subsidiaries has been made for the preparation of the accompanying consolidated financial statements.

The Company's consolidated financial statements for the year ended March 31, 2002, include 64 consolidated subsidiaries. These are: OKINAWA CELLULAR TELEPHONE Co., TU-KA Cellular Tokyo, Inc., TU-KA Cellular Tokai, Inc., TU-KA Phone Kansai, Inc., DDI POCKET Inc., KCOM Corporation, HOLA PARAGUAY S.A. and 57 other subsidiaries.

During the year ended March 31, 2002, significant changes in the scope were incurred as follows;

*Added:*

*(Consolidated)*

KDDI CHINA Corporation — Established

*(Equity Method)*

Fiberlabs Inc. — Change from "Consolidated"

*Removed:*

*(Consolidated)*

DDI Engineering Corporation — Merger

The above corporation was merged to Kyocera Communication Systems Co., Ltd on April 1, 2001.

TELECOMET, Inc. — Merger

The above corporation was merged to KDDI AMERICA, INC. on June 30,2001.

KDDI Creative Corporation — Merger

The above corporation was merged to KCOM Corporation on July 1, 2001.

KDD (Tokyo Central) Sales Inc. — Merger
KDD (Tokyo South) Sales Inc. — Merger
KDD (Tokyo West) Sales Inc. — Merger
KDD (Osaka) Sales Inc. — Merger

The above four distributors were merged to the Company on September 26, 2001.

au Corporation — Merger

The above corporation was merged to the Company on October 1, 2001.

Kokusai Marine Engineering Corporation — Merger

The above corporation was merged to Kokusai Cable Ship Co., Ltd on October 1, 2001.

TELECOMET International, Inc. — Merger

The above corporation was merged to KDD Network Systems Corporation, which changed its name to K-Solutions Inc. on October 1, 2001.

KDD West Co., Ltd — Liquidation

The above corporation was liquidated on December 31, 2001.

KDDI WinStar Corporation — Merger

The above corporation was merged to the Company on February 1, 2002.

Fiberlabs Inc. — Change to "Equity Method"

The percentage of equity holding of the Company toward the above corporation decreased because of the new share issuance of its corporation.

*(Equity Method)*

Kyocera DDI Institute of Future Telecommunication Inc. — Merger

The above corporation was merged to KDDI Research and Development Laboratories, Inc. on April 1, 2001.

In 2001, KCOM Corporation, KDDI Development Corporation and 13 subsidiaries changed their fiscal year-end to March 31, from December 31. Accordingly, these companies' fiscal 2002 include fifteen months of operations.

The financial statements presented herein are expressed in Japanese yen and, solely for the convenience of the readers, have been translated into United States dollars at the rate of ¥133.25 =$1, the approximate exchange rate on March 31, 2002. These translations should not be construed as representations that the Japanese yen amounts actually are, have been or could be readily converted into U.S. dollars at this rate or any other rate.

## 2. Significant Accounting Policies

### a. Basis of Consolidation and Accounting for Investments in Affiliated Companies

The accompanying consolidated financial statements include the accounts of the Company and its consolidated subsidiaries.

All significant intercompany transactions and accounts are eliminated.

Investments in certain affiliates are accounted for by the equity method, whereby a consolidated group includes in net income its share of the profits or losses of these companies, and records its investments at cost adjusted for such share of profits or losses. Exceptionally, investments in unconsolidated subsidiaries and affiliates for which the equity method have not been applied are stated at cost because the effect of application of the equity method would be immaterial.

### b. Revenue Recognition

For telecommunications services, revenues are recorded mainly on the basis of minutes of traffic processed and contracted fees earned. Revenues from sales of products and systems are recognized upon fulfillment of contractual obligations, which is generally upon shipment. Revenues from rentals and other services are recognized proportionately over the contract period or as services are performed.

### c. Cash and Cash Equivalents

Cash and cash equivalents in the accompanying consolidated statements of cash flows are composed of cash on hand, bank deposits able to be withdrawn on demand and short-term highly liquid investments with an original maturity of three months or less at the time of purchase and which represent a minor risk of fluctuations in value.

### d. Inventories

Inventories are stated at cost. Cost is determined by the moving-average method.

*Change of Valuation Method*

Effective from the year ended March 31, 2002, the Company changed its accounting method for inventory valuation from the average method to the moving-average method in order to speed-up the recognition of revenues and expenses and to harmonize its method of the group accounting method for inventory valuation, following the merger with au Corporation. The adoption of the new method had immaterial impact on “Operating income” and “Income before taxes and minority interests”, compared with the amounts that would have been reported if the previous method had been applied consistently.

### e. Foreign Currency Translation

All assets and liabilities denominated in foreign currencies, whether long-term or short-term, are translated into Japanese yen at the exchange rates prevailing at the balance sheet date. Resulting gains and losses are included in net profit or loss for the period.

Then, all assets and liabilities of foreign subsidiaries and affiliates are translated into Japanese yen at the exchange rates prevailing at the balance sheet date. Shareholders’ equity at the beginning of the year is translated into Japanese yen at the historical rates. Profit and loss accounts for the year are translated into Japanese yen using the average exchange rate during the year. The resulting differences in yen amounts are presented as minority interests and foreign currency translation adjustments in shareholders’ equity.

### f. Property, Plant and Equipment and Depreciation

Property, plant and equipment is stated at cost. Assets are depreciated over their estimated useful lives by applying the declining-balance method to machinery and equipment used for network business held by the Company, and by the straight-line method to machinery and equipment used for mobile communications business and other assets held by the Company, and most of depreciated assets held by its subsidiaries. The main depreciation periods are as follows.

| | |
|---|---|
| Machinery and equipment used for network and mobile communications business : | 6-15 years |
| Submarine cable system, buildings, engineering equipment and telecommunication service lines : | 2-65 years |

*Change of Estimated Useful Lives*

Effective from the year ended March 31, 2002, DDI POCKET Inc. changed the estimated useful lives of their wireless base stations to nine years, previously from six years, for the proper recognition of revenues and expenses.

As a result of the above change, depreciation expense in fiscal 2002 decreased by ¥23,637 million and income before income taxes and minority interests increased by the same amount, compared with the amounts that would have been reported if the previous estimated useful lives had been applied consistently.

Interest incurred is not capitalized with respect to constructed assets.

### g. Financial Instruments

*(1) Derivatives*

All derivatives are stated at fair value, with changes in fair value included in net profit or loss for the period in which they arise, except for derivatives that are designated as hedging instruments.

*(2) Securities*

Held-to-maturity debt securities, which the Company and its subsidiaries have intended to hold to maturity, are stated at cost after accounting for premium or discount on acquisition, and are amortized over the period to maturity.

Investments of the Company in equity securities issued by unconsolidated subsidiaries and affiliates are accounted for by the equity method.

Other securities had been valued at cost, whether listed on stock exchanges or not, but in accordance with adopting the new Japanese accounting standard, effective from the year ended March 31, 2002, other securities which market quotations are available are stated at fair value prevailing at the balance sheet date with unrealized gains and losses, net of applicable deferred tax assets/liabilities, not reflected in earnings, but directly reported as a separate component of shareholder's equity. The cost of securities sold is determined by the moving-average method. As a result of this change, net unrealized gains on securities are appropriated to shareholder's equity (¥2,895 million) and net deferred tax liabilities are appropriated (¥2,083 million).

On the other hand, other securities which market quotations are not available are valued at cost mainly determined by the moving-average method.

*(3) Hedge Accounting*

Gains or losses arising from changes in fair value of the derivatives designated as hedging instruments are deferred as assets or liabilities and included in net profit or loss in the same period during which the gains or losses on the hedged items or transactions are recognized.

The derivatives designated as hedging instruments by the Company are principally interest swaps and forward exchange contracts. The related hedged items are trade accounts receivable and payable, long-term bank loans, and debt securities issued by the Company.

The Company has a policy to utilize the above hedging instruments in order to reduce the Company's exposure to the risk of interest and exchange rate fluctuation. Thus, the Company's purchases of the hedging instruments are limited to, at maximum, the amounts of the hedged items.

The Company evaluates the effectiveness of its hedging activities by semiannually comparing the accumulated gains or losses on the hedging instruments and the gains or losses on the related hedged items.

**h. Research and Development Expenses and Computer Software**

Research and development expenses are charged to income when incurred. Computer software for internal use included in intangible assets is amortized using the straight-line method over the estimated useful lives (five years) except if it contributes to the generation of income or to future cost savings.

**i. Income Taxes**

Income taxes of the Company and its domestic subsidiaries consist of corporate income taxes, local inhabitants' taxes and enterprise taxes. The Company and its domestic subsidiaries have adopted the deferred tax accounting method, which recognizes tax effects of temporary differences between the carrying amounts of assets and liabilities for tax and financial reporting.

**j. Leases**

Leases, other than those leases deemed to transfer the ownership of the leased assets to lessees, are accounted for as operating leases.

**k. Other Assets**

Goodwill is amortized over five and/or 20 years. Amortization of goodwill is included in operating expenses in the accompanying consolidated statements of income.

**l. Net Income and Cash Dividends per Share**

Net income and cash dividends per share are computed based on the weighted average number of shares of common stock outstanding during each year. The amounts of cash dividends used for the above calculation are the total of interim cash dividends paid and dividends declared and paid during the respective periods.

**m. Allowance for Doubtful Accounts**

To prepare for uncollectible credits, the Company and its subsidiaries based an allowance for general credits on the actual bad debt ratio, and appropriated an estimated unrecoverable amount for specific credits deemed to be uncollectible after considering possible losses on collection.

**n. Retirement Benefits**

The reserve for retirement benefits as of March 31, 2002 represents the estimated present value of projected benefit obligations in excess of the fair value of plan assets and the retirement benefit trust. The unrecognized prior service cost of ¥3,055 million are amortized on a straight-line basis over a period of 14 years from the year ending March 31, 2002, and unrecognized actuarial differences of ¥93,015 million are amortized on a straight-line basis over a period of 14 years from the year following that in which they arise.

**o. Introduction of the "End-to-End Rate System" for Interconnected Calls among Mobile Phone Carriers**

From April 1, 2001, an the Company introduced an "End-to End Rate System." Under this new rate system, only one end-user rate is set to cover the entire mobile communications service, and it includes not only the part of the service provided by the Company's carrier, but also the part of the service provided by third-party carriers.

In line with the introduction of the new rate system, the Company and its domestic subsidiaries (OKINAWA CELLULAR TELEPHONE Co., TU-KA Cellular Tokyo, Inc., TU-KA Cellular Tokai, Inc., TU-KA Phone Kansai) recognize the total revenue from the entire service as "Voice communications" within operating revenues and charge the costs of the service provided by third party carriers as "Charges for use of telecommunications services of third parties" within operating expenses.

As a result of this change, both 'Voice communications' and Charges for use of telecommunications service of third parties for the year ended March 31,2002 increased by ¥101,904 million, compared with the amounts that would have been reported if the previous rate system had remained in force. The adoption of the new rate system had no impact on "Operating income" and "Income before taxes and minority interests".

## 3. Market Value Information

At March 31, 2002, book value, market value and net unrealized gains or losses of quoted securities were as follows:

Bonds intended to be held to maturity that have market prices

| | Millions of yen | | | Millions of U.S. dollars | | |
|---|---|---|---|---|---|---|
| 2002 | Book value | Market value | Unrealized gain (loss) | Book value | Market value | Unrealized gain (loss) |
| Bonds for which market value exceeds book value of consolidated balance sheets | ¥118 | ¥121 | ¥3 | $1 | $1 | $0 |
| Bonds for which market value does not exceed book value of consolidated balance sheets | 571 | 568 | (3) | 4 | 4 | (0) |
| Total | ¥689 | ¥689 | ¥0 | $5 | $5 | $0 |

Other securities that have market prices

| | Millions of yen | | | Millions of U.S. dollars | | |
|---|---|---|---|---|---|---|
| 2002 | Historical cost | Book value | Unrealized gain (loss) | Historical cost | Book value | Unrealized gain (loss) |
| Securities for which book value of consolidated balance sheets exceeds historical cost | ¥3,097 | ¥14,943 | ¥11,846 | $23 | $112 | $89 |
| Securities for which book value of consolidated balance sheets does not exceed historical cost | 37,132 | 28,500 | (8,632) | 279 | 214 | (65) |
| Total | ¥40,229 | ¥43,443 | ¥3,214 | $302 | $326 | $24 |

Other securities sold during the current consolidated fiscal year

| | Millions of yen | | | Millions of U.S. dollars | | |
|---|---|---|---|---|---|---|
| 2002 | Amount of sale | Total gain on sale | Total loss on sale | Amount of sale | Total gain on sale | Total loss on sale |
| Other securities sold | ¥124 | ¥0 | ¥3,052 | $1 | $0 | $23 |

Type and book value of securities whose market value is not determinable

| | Millions of yen | Millions of U.S. dollars |
|---|---|---|
| 2002 | Book value | Book value |
| Other securities | | |
| Unlisted equity securities | ¥21,672 | $163 |

Among other securities, scheduled redemption amount of bonds intended to be held to maturity and of instruments that have maturities.

| | Millions of yen | | | Millions of U.S. dollars | | |
|---|---|---|---|---|---|---|
| | Within one year | One to five years | Five to 10 years | Within one year | One to Five years | Five to 10 years |
| Bonds | | | | | | |
| Corporate bonds | ¥99 | ¥ — | ¥— | $1 | $— | $ — |
| Other | 514 | 65 | — | 4 | 0 | — |
| Other securities | 311 | 214 | 29 | 2 | 2 | 0 |
| Total | ¥924 | ¥279 | ¥29 | $7 | $ 2 | $ 0 |

## 4. Short-Term Loans and Long-Term Debt

Short-term bank loans are represented as short-term loans in the accompanying consolidated balance sheets. The annual average interest rate applicable to short-term bank loans at March 31,2002 was 2.59%.

Long-term debt at March 31, 2002 and 2001 consisted of the following:

| | Millions of yen | | Millions of U.S. dollars |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| Domestic unsecured straight bonds due | | | |
| 2002 through 2010 at rates of 1.55% to 2.57% per annum | **¥ 240,000** | ¥ 240,000 | **$ 1,801** |
| General secured bonds due 2006 through | | | |
| 2017 at rates of 2.30% to 3.20% per annum (*) | **139,800** | 170,000 | **1,049** |
| Total bonds | **¥ 379,800** | ¥ 410,000 | **$ 2,850** |
| Loans from banks: | | | |
| Maturing through 2020 at | | | |
| average rates of 2.18% per annum | **¥1,316,423** | ¥1,583,109 | **$ 9,879** |
| Other interest-bearing debt | **36,172** | 54,457 | **271** |
| | **¥1,352,595** | ¥1,637,566 | **$10,150** |
| Total bonds and loans | **¥1,732,395** | ¥2,047,566 | **$13,001** |
| Less, amount due within one year | **388,881** | 426,282 | **2,918** |
| | **¥1,343,514** | ¥1,621,284 | **$10,083** |

(*)The Company has offered overall assets as general collateral for the above corporate bonds

Aggregate annual maturities of long-term debt subsequent to March 31, 2002 were as follows:

| | Millions of yen | Millions of U.S. dollars |
|---|---|---|
| Year ending March 31 | 2002 | 2002 |
| 2003 | **¥ 388,881** | **$ 2,919** |
| 2004 | **278,018** | **2,086** |
| 2005 | **323,590** | **2,429** |
| 2006 | **256,424** | **1,924** |
| 2007 and thereafter | **485,482** | **3,643** |
| | **¥1,732,395** | **$13,001** |

At March 31, 2002, assets pledged as collateral for long-term loans were as follows:

| | Millions of yen | Millions of U.S. dollars |
|---|---|---|
| | 2002 | 2002 |
| Long-term loans | **¥20,149** | **$151** |
| Current portion of long-term loans | **5,650** | **42** |
| | **¥25,799** | **$193** |
| Mortgage on factory foundation | **¥63,150** | **$474** |
| Buildings | **1,637** | **12** |
| Land | **3,927** | **29** |
| | **¥68,714** | **$515** |

## 5. Contingent Liabilities

At March 31, 2002 and 2001, the Company was contingently liable as follows:

| | Millions of yen | | Millions of U.S. dollars |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| As a guarantor for: | | | |
| Loans of affiliated companies | **¥ 419** | ¥12,514 | **$ 3** |
| System supply contract of KDDI Submarine Cable Systems Inc. | **186,817** | 122,965 | **1,402** |
| Office lease contract of KDDI AMERICA, INC. | **1,008** | 1,082 | **8** |
| | **¥188,244** | ¥136,561 | **$1,413** |

## 6. Gain on Sales of Property,Plant and Equipment

Gain on sales of property, plant and equipment, at March 31, 2002, was as follow.

| | Millions of yen | Millions of U.S. dollars |
|---|---|---|
| | 2002 | 2002 |
| (Gain) on sales of buildings by assets backed securities | (143,735) | (1,078) |
| Loss on sales of land of Shibuya Data Center | 5,230 | 39 |
| Other | (1,039) | (8) |

## 7. Impairment and Business Restructuring Charges

Impairment and business restructuring charges, at 31 March 31, 2002, was as follow.

| | Millions of yen | Millions of U.S. dollars |
|---|---|---|
| | 2002 | 2002 |
| Disposal of digital cellular (PDC system) equipment | 128,319 | 963 |
| Abandonment or write down of cellular phone | 26,753 | 201 |
| Write down of PHS handset | 7,749 | 58 |
| Disposal of equipment for integration of network enterprise | 17,464 | 131 |
| Extra retirement allowance for early retirement | 3,768 | 28 |
| Other | 1,353 | 10 |

## 8.Lease Payment

**Lessee side**

*Finance leases without transfer of ownership*

Assumed amounts (inclusive of interest) of acquisition cost, accumulated depreciation and net book value at March 31, 2002 and 2001 were summarized as follows:

| | Millions of yen | | | | | | Millions of U.S. dollars | | |
|---|---|---|---|---|---|---|---|---|---|
| | Acquisition cost | Accumulated depreciation | Net book value | Acquisition cost | Accumulated depreciation | Net book value | Acquisition cost | Accumulated depreciation | Net book value |
| | | | 2002 | | | 2001 | | | 2002 |
| Tools, furniture and fixtures | **¥165,205** | **¥79,207** | **¥85,998** | ¥151,570 | ¥64,392 | ¥87,178 | **$1,240** | **$594** | **$646** |
| Other | **1,051** | **750** | **301** | 960 | 538 | 422 | **8** | **6** | **2** |
| | **¥166,256** | **¥79,957** | **¥86,299** | ¥152,530 | ¥64,930 | ¥87,600 | **$1,248** | **$600** | **$648** |

Future lease payments as of March 31, 2002 and 2001 were as follows:

| | Millions of yen | | Millions of U.S. dollars |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| Within one year | **¥30,168** | ¥25,981 | **$226** |
| Over one year | **56,131** | 61,619 | **421** |
| | **¥86,299** | ¥87,600 | **$647** |

Lease payments and assumed depreciation charges for the years ended March 31, 2002 and 2001 were as follows:

| | Millions of yen | | Millions of U.S. dollars |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| Lease payments | **¥28,641** | ¥17,367 | **$215** |
| Assumed depreciation charges | **28,641** | 17,367 | **215** |

Depreciation charges were computed using the straight-line method over lease terms assuming no residual value.

**Operating leases**

Obligation under non-cancelable operating leases as of March 31, 2002 and 2001 were as follows:

| | Millions of yen | | Millions of U.S. dollars |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| Within one year | ¥ 17,404 | ¥1,293 | $131 |
| Over one year | 103,854 | 8,587 | 779 |
| | ¥121,258 | ¥9,880 | $910 |

**Lessor Side**

*Finance leases without transfer of ownership*

Assumed amounts (inclusive of interest) of acquisition cost accumulated depreciation and net book value at March 31, 2002 and 2001 were summarized as follows:

| | Millions of yen | | | | | | Millions of U.S.dollars | | |
|---|---|---|---|---|---|---|---|---|---|
| | Acquisition cost | Accumulated depreciation | Net book value | Acquisition cost | Accumulated depreciation | Net book value | Acquisition cost | Accumulated depreciation | Net book value |
| | | | 2002 | | | 2001 | | | 2002 |
| Tools, furniture and fixtures | ¥3,427 | ¥1,480 | ¥1,947 | ¥2,369 | ¥1,030 | ¥1,339 | $26 | $11 | $15 |
| Other | 130 | 84 | 46 | 207 | 125 | 82 | 1 | 1 | 0 |
| | ¥3,557 | ¥1,564 | ¥1,993 | ¥2,576 | ¥1,155 | ¥1,421 | $27 | $12 | $15 |

Future lease receipts as of March 31, 2002 and 2001 were as follows:

| | Millions of yen | | Millions of U.S. dollars |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| Within one year | ¥ 788 | ¥ 563 | $ 6 |
| Over one year | 1,369 | 982 | 10 |
| | ¥2,157 | ¥1,545 | $16 |

Lease receipts and assumed depreciation charges for the years ended March 31, 2002 and 2001 were as follows:

| | Millions of yen | | Millions of U.S. dollars |
|---|---|---|---|
| | 2002 | 2001 | 2002 |
| Lease receipts | ¥ 742 | ¥ 298 | $ 6 |
| Assumed depreciation charges | 685 | 275 | 5 |

## 9. Derivatives

For the purpose of minimizing risks of foreign exchange or interest rate fluctuations, the Company and certain of its subsidiaries have entered into particular financial agreements.

Information on such financial arrangements outstanding as of March 31,2002 was summarized as follows:

| | Millions of yen | | | Millions of U.S. dollars | | |
|---|---|---|---|---|---|---|
| 2002 | Notional amount | Market value | Unrealized gain | Notional amount | Market value | Unrealized gain |
| Forward exchange contracts (to buy Danish Kroner) | ¥33 | ¥34 | ¥1 | $0 | $0 | $0 |

| | Millions of yen | | | Millions of U.S.dollars | | |
|---|---|---|---|---|---|---|
| 2002 | Notional amount | Market value | Unrealized gain | Notional amount | Market value | Unrealized gain |
| Interest rate swap agreements: | | | | | | |
| Fixed rate into variable rate obligations | ¥2,000 | ¥250 | ¥250 | $15 | $2 | $2 |
| Variable rate into fixed rate obligations | 6,410 | (191) | (191) | 48 | (1) | (1) |

## 10. Shareholder's Equity

The Japanese Commercial Code provides that an amount equal to at least 10 percent of cash dividends and other distribution paid out of retained earnings by the parent company and its Japanese subsidiaries be appropriated as a legal reserve which is included in retained earnings in the consolidated balance sheets. No further appropriation is required when the legal reserve equals 25 percent of their respective stated capital. This reserve amounted to ¥12,130 million ($91 million) and ¥11,477 million at March 31, 2002 and 2001, respectively. This reserve is not available for dividend payment but may be capitalized by resolution of the Board of Directors or used to reduce a deficit by approval of the shareholders.

Under the Commercial Code, the entire amount of the issue price of new shares is required to be accounted for as common stock, although a company may, by resolution of its Board of Directors, account for an amount not exceeding one-half of the issue price of such new shares as additional paid-in capital. Also, an amount up to the excess of ( i ) the portion of the issue price of new shares accounted for as common stock over ( ii ) the sum of the par value of such new shares and additional paid-in capital may be distributed, by resolution of the Board of Directors, in the form of free share distributions to shareholders.

## 11.Research and Development Expenses

Research and development expenses charged to income were ¥8,954million (US$67million), ¥5,122million for the years ended March 31, 2002 and 2001, respectively.

## 12.Income Taxes

The statutory tax rates used for calculating deferred tax assets and deferred tax liabilities as of March 31, 2002 was 41.9%.

At March 31, 2002 and 2001, significant components of deferred tax assets and liabilities were analyzed as follows:

| | Millions of yen | | Millions of U.S. dollars |
|---|---|---|---|
| | **2002** | 2001 | **2002** |
| Deferred tax assets: | | | |
| Reserve for retirement benefits (lump-sum) | **¥ 16,179** | ¥ 15,713 | **$ 121** |
| Reserve for retirement benefits (pension) | **4,594** | 7,196 | **34** |
| Unrealized profits | **11,137** | 12,525 | **84** |
| Depreciation and amortization | **2,666** | 1,816 | **20** |
| Disposal of fixed assets | **47,560** | — | **357** |
| Inventory write down | **10,586** | — | **79** |
| Allowance for bonus payment | **3,588** | 3,147 | **27** |
| Allowance for doubtful accounts | **9,135** | 948 | **69** |
| Accrued expenses | **4,054** | 2,420 | **30** |
| Accrued enterprise taxes | **4,742** | 824 | **36** |
| Net operating loss carried forward | **49,649** | 58,027 | **373** |
| Other | **5,446** | 7,708 | **41** |
| Gross deferred tax assets | **169,336** | 110,324 | **1,271** |
| Valuation allowance | **(61,310)** | (60,568) | **(460)** |
| **Net deferred tax assets** | **¥108,026** | ¥ 49,756 | **$ 811** |
| Deferred tax liabilities: | | | |
| Special depreciation reserve | **¥ (1,312)** | ¥ (914) | **$ (10)** |
| Gain on establishment of retirement benefit trust | **(21,020)** | (21,091) | **(159)** |
| Retained earnings for overseas affiliates | **(587)** | (507) | **(4)** |
| Net unrealized gains on securities | **(2,085)** | — | **(16)** |
| Other | **(1,408)** | (988) | **(11)** |
| **Total deferred tax liabilities** | **¥(26,412)** | ¥(23,500) | **$(200)** |
| **Net deferred tax assets** | **¥81,614** | ¥ 26,256 | **$ 611** |

The following table summarizes significant differences between the statutory tax rate and the Company's effective tax rate for financial statement purposes for the year ended March 31, 2002.

| | |
|---|---|
| Statutory tax rate | 41.9% |
| Valuation allowance | 53.7% |
| Amortization of goodwill | 7.5% |
| Appropriation of net operating loss carried forward | (51.6%) |
| Write down of investment in consolidated subsidiaries | (7.5%) |
| Other | 3.1% |
| Effective tax rate | 47.1% |

## 13. Retirement Benefits

The Company and its subsidiaries have retirement benefit plans that consist of welfare pension funds, a qualified pension plan, a retirement lump-sum plan and a retirement benefit trust scheme. Substantially all employees of the Company and its domestic subsidiaries are covered by these retirement benefit plans.

The reserve for retirement benefits as of March 31, 2002 was analyzed as follows:

| | Millions of yen | Millions of U.S. dollars |
|---|---|---|
| | **2002** | **2002** |
| Projected benefit obligations | **¥(263,401)** | **$(1,977)** |
| Plan assets | **158,084** | **1,186** |
| Retirement benefit trust | **11,144** | **84** |
| | **¥ (94,173)** | **$ (707)** |
| Unrecognized prior service cost | **(3,055)** | **(23)** |
| Unrecognized actuarial differences | **93,015** | **698** |
| Prepaid pension cost | **(20,397)** | **(153)** |
| Reserve for retirement benefits | **¥ (24,610)** | **$ (185)** |

Net pension expense related to the retirement benefits for the year ended March 31, 2002 was as follows:

| | Millions of yen | Millions of U.S. dollars |
|---|---|---|
| | **2002** | **2002** |
| Service cost | **¥ 9,102** | **$ 68** |
| Interest cost | **7,267** | **55** |
| Expected return on plan assets | **(4,645)** | **(35)** |
| Amortization of prior service cost | **(37)** | **(0)** |
| Amortization of actuarial differences | **3,491** | **26** |
| Net pension cost | **¥ 15,178** | **$ 114** |

Assumptions used in calculation of the above information were as follows:

| | |
|---|---|
| Discount rate | 2.5% (Mainly) |
| Expected rate of return on plan assets | 3.0%–4.6% |
| Expected rate of return concerning retirement benefit trust | 0% |
| Method of attributing the projected benefits to periods of services | straight-line basis |
| Amortization of actuarial differences | 14 years from the year following that in which they arise |
| Amortization of prior service cost | 14 years from the year ending March 31, 2002 |

## 14. Segment Information

Segment Information by business category for the years ended March 31, 2002 and 2001 is as follows;

| | | | | | | | Millions of yen |
|---|---|---|---|---|---|---|---|
| Year ended March 31, 2002 | Network & Solution | au, TU-KA | PHS | Other | Total | Elimination | Consolidation |
| I. Sales and Operating Income: | | | | | | | |
| Outside sales | ¥655,393 | ¥1,863,566 | ¥207,813 | ¥107,027 | ¥2,833,799 | — | ¥2,833,799 |
| Intersegment sales | 94,796 | 5,889 | 3,195 | 45,696 | 149,576 | (149,576) | — |
| Total | 750,189 | 1,869,455 | 211,008 | 152,723 | 2,983,375 | (149,576) | 2,833,799 |
| Operating expenses | 719,556 | 1,812,321 | 204,348 | 149,473 | 2,885,698 | (154,197) | 2,731,501 |
| Operating income | ¥ 30,633 | ¥ 57,134 | ¥ 6,660 | ¥ 3,250 | ¥ 97,677 | ¥ 4,621 | ¥ 102,298 |
| II. Identifiable Assets, Depreciation and Capital Expenditures: | | | | | | | |
| Identifiable assets | ¥1,392,249 | ¥1,722,448 | ¥261,458 | ¥132,432 | ¥3,508,587 | ¥(305,146) | ¥3,203,441 |
| Depreciation | 125,913 | 259,094 | 38,890 | 7,844 | 431,741 | (7,760) | 423,981 |
| Capital expenditures | 92,550 | 198,411 | 20,533 | 4,366 | 315,860 | (1,599) | 314,261 |

| Year ended March 31, 2001 | Network & IP | au, TU-KA | PHS | Other | Total | Elimination | Consolidation |
|---|---|---|---|---|---|---|---|
| | | | | | | | Millions of yen |
| I. Sales and Operating Income (Loss): | | | | | | | |
| Outside sales | ¥ 460,392 | ¥1,491,081 | ¥248,683 | ¥ 68,490 | ¥2,268,646 | ¥ — | ¥2,268,646 |
| Intersegment sales | 90,085 | 3,864 | 3,201 | 38,714 | 135,864 | (135,864) | — |
| Total | 550,477 | 1,494,945 | 251,884 | 107,204 | 2,404,510 | (135,864) | 2,268,646 |
| Operating expenses | 494,330 | 1,458,447 | 264,783 | 102,164 | 2,319,724 | (139,861) | 2,179,863 |
| Operating income (loss) | ¥ 56,147 | ¥ 36,498 | ¥ (12,899) | ¥ 5,040 | ¥ 84,786 | ¥ 3,997 | ¥ 88,783 |
| II. Identifiable Assets, Depreciation and Capital Expenditures: | | | | | | | |
| Identifiable assets | ¥1,783,001 | ¥1,814,749 | ¥298,343 | ¥198,327 | ¥4,094,420 | ¥(455,056) | ¥3,639,364 |
| Depreciation | 93,232 | 185,834 | 61,513 | 4,136 | 344,715 | (10,068) | 334,647 |
| Capital expenditures | 105,137 | 301,630 | 27,320 | 10,466 | 444,553 | (2,513) | 442,040 |

| Year ended March 31, 2002 | Network & Solution | au, TU-KA | PHS | Other | Total | Elimination | Consolidation |
|---|---|---|---|---|---|---|---|
| | | | | | | | Millions of U.S. dollars |
| I. Sales and Operating Income: | | | | | | | |
| Outside sales | $ 4,919 | $13,985 | $1,560 | $ 803 | $21,267 | $ — | $21,267 |
| Intersegment sales | 711 | 44 | 24 | 343 | 1,122 | (1,122) | — |
| Total | 5,630 | 14,029 | 1,584 | 1,146 | 22,389 | (1,122) | 21,267 |
| Operating expenses | 5,400 | 13,600 | 1,534 | 1,122 | 21,656 | (1,157) | 20,499 |
| Operating income | $ 230 | $ 429 | $ 50 | $ 24 | $ 733 | $ 35 | $ 768 |
| II. Identifiable Assets, Depreciation and Capital Expenditures: | | | | | | | |
| Identifiable assets | $10,448 | $12,926 | $1,962 | $ 995 | $26,331 | $(2,290) | $24,041 |
| Depreciation | 945 | 1,944 | 292 | 58 | 3,239 | (58) | 3,181 |
| Capital expenditures | 695 | 1,489 | 153 | 33 | 2,370 | (12) | 2,358 |

Notes: 1 Effective for the year ended March 31, 2001, “Network and IP” industry segment was renamed as “Network and Solution” industry segment in order to newly set up “Solution Business Sector” instead of “IP Business Sector” under the organizational reformation of the Company in March 2002, which had no impact on the operating results of the industry segment.

Business category and Principal Services/Operations of Each Category, Effective from the year ended March 31, 2002

| Business category | Principal services/operations |
|---|---|
| Network & Solution | Domestic and international telecommunications services, Internet services, telehousing services |
| au, TU-KA | au and TU-KA phone services, sale of au and TU-KA phone terminals |
| PHS | PHS services, sale of PHS terminals |
| Other | Construction of communications facilities, sale of information communications equipment and systems, research and development of advanced technology |

2. Change of Valuation Method
As described in Note 2 d to the consolidated financial statements, the Company changed its accounting method for inventory valuation from the average method to the moving-average method, effective from the year ended March 31, 2002. As a result, the new method had no material impact on the segment information.

3. Change of Estimated Useful Lives
As described in Note 2f to the consolidated financial statements, DDI POCKET Inc. changed the estimated useful lives of their wireless base stations from six years to nine years, effective from the year ended March 31, 2002. As a result, operating expenses in “PHS”, “Total” and “Consolidation” for the period under review each decreased by 23,637 million yen, and operating income increased by the same amount, compared with the amounts if the previous estimated useful lives had been applied.

4. Introduction of “End-to-End Rate System” for interconnected calls between mobile phone carriers
As described in Note 2o to the consolidated financial statements, the Company and its domestic subsidiaries introduced “End-to-End Rate System” for interconnected calls between mobile phone carriers, effective from the year ended March 31, 2002. As a result, operating income in “au, TU-KA”, “Total” and “Consolidation” for the period under review each increased by 101,904 million yen, and operating expenses increased by the same amount, compared with the amounts if the previous rate system had remained in force.

5. As described in Note 1 to the consolidated financial statements, KCOM Corporation, KDDI Development Corporation and 13 subsidiaries changed their fiscal year-end to March 31 from December 31 and these companies' fiscal 2002 included fifteen months of operations, which had no impact on the operating results of the industry segment.

6. Information by geographic area and overseas sales is not shown since overseas sales were not material compared to consolidated net sales.

## 15. Subsequent Events

(1) The appropriation of retained earnings of the Company with respect to the year ended March 31, 2002, proposed by the Board of Directors and approved at the shareholder's meeting held on June 25, 2002, was as follows:

| | Millions of yen | Millions of U.S. dollars |
|---|---|---|
| Year-end cash dividends (¥895 = US$6.72) | ¥3,796 | $28 |

(2) On June 25, 2002, the Company's shareholders approved a warrant option plan for the members of the board, managing officers, general managers, statutory auditors and employees of the Company in accordance with the Japanese Commercial Code. Under this plan, the Company is authorized to issue grant warrant options for purchase of the Company's common stock, up to a maximum of 24,000 shares, exercisable between October 1, 2002 and September 29, 2006. On the same date, the shareholders also approved the acquisition of common stock as treasury stock, up to a maximum of 24,000 shares, in accordance with the Japanese Commercial Code.

# REPORT OF INDEPENDENT ACCOUNTANTS

KDDI Corporation and Consolidated Subsidiaries

The Board of Directors
KDDI CORPORATION

We have audited the accompanying consolidated balance sheets of KDDI CORPORATION and its consolidated subsidiaries as of March 31, 2002 and 2001, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended, all expressed in Japanese Yen. Our audits were made in accordance with auditing standards, procedures and practices generally accepted and applied in Japan and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the consolidated financial position of KDDI CORPORATION and its consolidated subsidiaries as of March 31, 2002 and 2001, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles and practices generally accepted in Japan (see Note 1) applied on a consistent basis, except for the changes described in the next paragraph.

As described in Note 2. d. to the accompanying consolidated financial statements, effective from the year ended March 31, 2002, KDDI CORPORATION changed the valuation method for inventories.

As described in Note 2. g. (2) to the accompanying consolidated financial statements, effective from the year ended March 31, 2002, KDDI CORPORATION and its consolidated subsidiaries have adopted new Japanese accounting standards for the valuation method for other securities.

Also, as described in Note 2. g. and Note 2. n. to the accompanying consolidated financial statements, effective from the year ended March 31, 2001, KDDI CORPORATION and its consolidated subsidiaries have adopted new Japanese accounting standards for financial instruments, except for the valuation method for other securities as described above, and retirement benefits.

The amounts expressed in U.S. dollars, which are provided solely for the convenience of the reader, have been translated on the basis set forth in Note 1 to the accompanying consolidated financial statements.

ChuoAoyama Audit Corporation

ChuoAoyama Audit Corporation
Kyoto, Japan
June 25, 2002

# CORPORATE DATA

## CORPORATE OVERVIEW

(As of March 31, 2002)

| | |
|---|---|
| **Company Name:** | KDDI CORPORATION |
| **Date of Establishment:** | June 1, 1984 |
| **Business Objective:** | Type I Telecommunications business |
| **Principal Office:** | 2-3-2, Nishishinjuku, Shinjuku-ku, Tokyo, Japan |
| **Representative Director:** | Tadashi Onodera (President) |
| **Capital:** | ¥141,851 million |
| **Total Employee:** | 13,575 (consolidated) |

## DIRECTORS, AUDITORS AND MANAGING OFFICERS

(As of June 26, 2002)

### Directors

Chairman, Member of the Board, Representative Director
**Jiro Ushio**

Vice Chairman, Member of the Board, Representative Director
**Yusai Okuyama**

President, Member of the Board, Representative Director
**Tadashi Onodera**

Executive Vice Presidents, Members of the Board,
Representative Directors
**Shinji Sakai**
**Mitsuo Igarashi**
**Masahiro Yamamoto**

Member of the Board, Senior Executive Managing Officer
**Yasuo Hirata**

Members of the Board
**Yasuo Nishiguchi**
**Hiroshi Okuda**

Members of the Board, Senior Corporate Advisers
**Tadashi Nishimoto**
**Masao Doi**
**Akira Hioki**

### Auditors

Standing Statutory Auditors
**Masahiro Mino**
**Toshiaki Terui**
**Osamu Ando**

Statutory Auditor
**Atsushi Mori**

### Managing Officers

Senior Executive Managing Officer
**Toshio Okihashi**

Executive Managing Officers
**Takeshi Okada**
**Tadashi Kashiwamura**
**Yoshinori Nakagaki**
**Nariyoshi Tanaka**
**Nobuhiko Nakano**
**Ryoichi Shimojima**
**Seiichiro Oshima**
**Shizuo Koyama**
**Masaru Takahashi**
**Satoshi Nagao**
**Kaoru Tachibana**
**Yasuhiko Ito**

Managing Officers
**Kazuyuki Tsukada**
**Hirofumi Morozumi**
**Nobuo Nezu**
**Hitomi Murakami**
**Akira Itoh**
**Tadashi Kitasako**
**Hajime Nomura**
**Osamu Tateno**
**Tomoyoshi Kaneko**
**Yuji Tsuda**
**Noriyuki Kandori**
**Hiroshi Kitagawa**
**Yuzo Ishikawa**
**Seikichi Sakakibara**
**Yutaka Shono**

# CORPORATE HISTORY

<table>
<tr><th></th><th>DDI</th><th>IDO</th><th>KDD</th><th>TWJ</th><th>Telecommunications sector</th></tr>
<tr><td>1953</td><td></td><td></td><td>established</td><td></td><td></td></tr>
<tr><td>1961</td><td></td><td></td><td>listed on the Second Section of the Tokyo Stock Exchange</td><td></td><td></td></tr>
<tr><td>1964</td><td></td><td></td><td>joined in the INTELSAT<br>the TPC-1 launched</td><td></td><td></td></tr>
<tr><td>1970</td><td></td><td></td><td>listed on the First Section of the Tokyo Stock Exchange</td><td></td><td></td></tr>
<tr><td>1973</td><td></td><td></td><td>International Direct Dialing service launched</td><td></td><td></td></tr>
<tr><td>1976</td><td></td><td></td><td>the TPC-2 launched</td><td></td><td></td></tr>
<tr><td>1977</td><td></td><td></td><td>joined in the INMARSAT</td><td></td><td></td></tr>
<tr><td>1984</td><td>established</td><td></td><td></td><td>established</td><td></td></tr>
<tr><td>1985</td><td></td><td></td><td></td><td></td><td>liberalization of the Telecommunication sector</td></tr>
<tr><td>1987</td><td>domestic telephone service launched</td><td></td><td>KDD R&D Laboratories started up in the Company</td><td>domestic telephone service launched</td><td></td></tr>
<tr><td>1988</td><td>cellular companies established</td><td>established</td><td></td><td></td><td></td></tr>
<tr><td>1989</td><td colspan="2">analog cellular telephone service launched</td><td></td><td></td><td></td></tr>
<tr><td>1990</td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>1991</td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>1992</td><td></td><td></td><td>the TPC-4 launched</td><td></td><td></td></tr>
<tr><td>1993</td><td>listed on the Second Section of the Tokyo Stock Exchange</td><td></td><td></td><td></td><td></td></tr>
<tr><td rowspan="2">1994</td><td colspan="2">digital cellular telephone service “PDC” launched</td><td></td><td></td><td>liberalization of sales of cellular telephone</td></tr>
<tr><td>PHS Company (DDI Pocket) established</td><td></td><td></td><td></td><td></td></tr>
<tr><td rowspan="2">1995</td><td>PHS service launched</td><td></td><td></td><td></td><td></td></tr>
<tr><td>listed on the First Section of the Tokyo Stock Exchange</td><td></td><td></td><td></td><td></td></tr>
<tr><td>1996</td><td></td><td></td><td>the TPC-5 launched</td><td></td><td></td></tr>
<tr><td>1997</td><td>Internet service “DION” launched</td><td></td><td></td><td></td><td></td></tr>
<tr><td>1998</td><td colspan="2">digital cellular telephone service “cdmaOne” launched</td><td colspan="2">Merger of KDD and TWJ</td><td>the KDD law abolished</td></tr>
<tr><td>1999</td><td>Acquisition of TU-KA Group</td><td></td><td>the JIH launched</td><td></td><td></td></tr>
<tr><td>2000</td><td colspan="3">Merger of DDI, KDD and IDO</td><td></td><td></td></tr>
<tr><td>2001</td><td colspan="3">au Corporation merged to KDDI</td><td></td><td>the MYLINE registration started</td></tr>
<tr><td>2002</td><td colspan="3">the Third-Generation cellular telephone service "CDMA2000 1x" launched</td><td></td><td></td></tr>
</table>

Notes 1) TPC : Trans Pacific Cable
2) INTELSAT : International Telecommunications Satellite Organization
3) INMARSAT : International Mobile Satellite Telecommunications Organization
4) TWJ : Teleway Japan Corporation
5) JIH : Japan Information Highway (the submarine fiber-optic cable that encircles the Japanese archipelago in a loop configuration.)

## ORGANIZATION

(As of June 26, 2002)

- Shareholders' Meeting
- Board of Directors
- Board of Auditors
- Chairman of the Board
- Vice Chairman of the Board
- President
- Corporate Management Committee
  - Office of Corporate Auditors
  - Executive Secretariat
  - Preparatory Office of Operations & Maintenance Division
  - Legal & Intellectual Property Division
  - Business Administration Division
  - Corporate Purchasing Division
  - General Administration Division
  - Corporate Communications Division
  - Corporate Business Division
  - Information Systems Division
  - Customer Service Division
  - IT Development Division
  - Solution Business Sector
    - Solution Business Planning Division
    - Solutions Sales Division
    - Content Division
    - Solution Engineering Division
  - Network Business Sector
    - Network Business Planning Division
    - Network Domestic Sales Division
    - Global Business Division
    - Network Engineering Division
    - Network Fiber Optics Network Construction Division
    - Network Oparation & Maintenance Division
  - "au" Business Sector
    - 1xEV-DO Program Management Office
    - "au" Strategic Business Planning Division
    - "au" Sales Division
    - "au" Engineering Division

# MAJOR CONSOLIDATED SUBSIDIARIES

(As of March 31, 2002)

## Mobile Communication Businesses

*Domestic*

| Company Name | Date Established | Paid-in Capital (millions) | Voting Right Percentage | Business Field |
|---|---|---|---|---|
| OKINAWA CELLULAR TELEPHONE COMPANY | Jun.91 | ¥ 1,414 | 51.5% | CDMA and PDC cellular phone services under the 'au' brand |
| Tu-Ka Cellular Tokyo Inc. | Jul.91 | ¥ 6,000 | 55.7% | PDC cellular phone service |
| Tu-Ka Cellular Tokai Inc. | Feb.92 | ¥ 3,000 | 56.2% | PDC cellular phone service |
| Tu-Ka Phone Kansai Inc. | Oct.91 | ¥ 6,000 | 54.0% | PDC cellular phone service |
| DDI Pocket Inc. | Jul.94 | ¥75,251 | 80.8% | PHS service |

*Overseas*

| Company Name | Date Established | Paid-in Capital (millions) | Voting Right Percentage | Business Field |
|---|---|---|---|---|
| HOLA Paraguay S.A. | Sep.98 | GS 90,726 | 68.7% | Cellular service in Paraguay |

## Network & Solutions-related Businesses

*Domestic*

| Company Name | Date Established | Paid-in Capital (millions) | Voting Right Percentage | Business Field |
|---|---|---|---|---|
| KCOM Corporation | May.90 | ¥1,921 | 100.0% | Internet services, data transmission services, etc. |
| KMN Corporation | Jun.98 | ¥ 626 | 90.0% | Internet provider service through CATV |

*Overseas*

| Company Name | Date Established | Paid-in Capital (millions) | Voting Right Percentage | Business Field |
|---|---|---|---|---|
| KDDI AMERICA, INC. | Jul.89 | US$ 84 | 100.0% | Telecommunications services in the U.S. |
| KDDI EUROPE LTD. | Jul.89 | £ 43 | 100.0% | Telecommunications services in Europe |
| KDDI FRANCE SAS. | Jan.89 | EUR 4 | 100.0% | Telecommunications services in France |
| KDDI DEUTSCHLAND GMBH. | Sep.89 | EUR 1 | 100.0% | Telecommunications services in Germany |
| KDDI HONGKONG LIMITED | Apr.98 | HK$ 101 | 100.0% | Telecommunications services in HongKong |
| KDDI SINGAPORE Pte. Ltd. | Apr.96 | S$ 2 | 100.0% | Telecommunications services in Singapore |
| KDDI AUSTRALIA PTY. LIMITED | Jun.87 | A$ 16 | 100.0% | Telecommunications services in Australia |
| KDDI do Brasil Ltda. | Mar.88 | R$ 4 | 50.1% | Internet provider and IT-related business in Brazil |
| TELEHOUSE INTERNATIONAL CORPORATION OF AMERICA LTD. | Jun.87 | US$ 45 | 55.9% | Secure IT housing, telecommunications facilities management in the U.S. |
| TELEHOUSE INTERNATIONAL CORPORATION OF EUROPE LTD. | Mar.88 | £ 47 | 83.9% | Secure IT housing, telecommunications facilities management in Europe |

## Telecom Infrastructure Construction

*Domestic*

| Company Name | Date Established | Paid-in Capital (millions) | Voting Right Percentage | Business Field |
|---|---|---|---|---|
| KDDI Submarine Cable Systems Inc. | May.92 | ¥5,686 | 69.2% | Consulting, integration, construction, and technological development of optical-fiber submarine cable |
| KOKUSAI CABLE SHIP CO., LTD. | Mar.66 | ¥135 | 100.0% | Construction and maintenance of submarine cables |
| Japan Telecommunication Engineering Service Co., Ltd. | Jun.99 | ¥470 | 54.5% | Construction and maintenance of optical fiber network along highway |

## Sales of IT Equipment and System

*Domestic*

| Company Name | Date Established | Paid-in Capital (millions) | Voting Right Percentage | Business Field |
|---|---|---|---|---|
| K-Solutions Inc. | Jul.96 | ¥672 | 85.2% | Planning, development, equipment, and sales and support of communications infrastructure and systems |
| KDDI Technology Corporation | Aug.88 | ¥494 | 100.0% | Development and consulting of image data processing system |
| OSI Plus Corporation | Sep.87 | ¥490 | 100.0% | Designing, consulting and sales of OSI software |
| KDD Media Will Corporation | Aug.99 | ¥ 80 | 96.3% | Research, Development, Production and Sales of Digital Imaging products |

## Other Services

*Domestic*

| Company Name | Date Established | Paid-in Capital (millions) | Voting Right Percentage | Business Field |
|---|---|---|---|---|
| KDDI R&D Laboratories, Inc. | Apr.98 | ¥2,238 | 91.7% | Research and development of new technologies and sales of products developed |
| KDDI Development Corporation | Apr.87 | ¥4,404 | 100.0% | Leasing of offices, store and homes, development, operations and administration of athletic facilities |
| KDDI Telemarketing Inc. | May.96 | ¥ 200 | 100.0% | Call center services |
| KDDI Msat, Inc. | Apr.77 | ¥ 300 | 100.0% | Consulting and sales of Inmarsat satellite communications services |
| KDDI TELESERVE Inc. | Sep.87 | ¥ 100 | 100.0% | Temporary staff placement, recruitment consultancy and language service |
| a1adnet corporation | Dec.00 | ¥ 490 | 51.0% | Planning,producing and distribution of advertisement on mobile Internet |
| KDDI SOGO SERVICE CO., LTD. | Apr.74 | ¥ 160 | 100.0% | Security services; operation and administration of buildings and peripheral facilities |
| KDDI Shoji Co., Ltd. | Aug.86 | ¥ 300 | 100.0% | Sales and leasing of office equipment, telecommunications facilities and sundries |

# STOCK INFORMATION

(As of March 31, 2002)

| | |
|---|---|
| **Total Number of Shares Authorized:** | 7,000,000 |
| **Total Number of Shares Issued and Outstanding:** | 4,240,880.38 |
| **Number of Shareholders:** | 167,611 |

### Major Shareholders

| Name of Corporate Entity | Number of Shares Held | Proportion of Capital |
|---|---|---|
| Kyocera Corporation | 572,675.87 | 13.50% |
| Toyota Motor Corporation | 497,425.23 | 11.72% |
| Japan Trustee Services Bank, Ltd. (Trust Account) | 154,191.00 | 3.63% |
| The Mitsubishi Trust and Banking Corporation (Trust Account) | 116,414.00 | 2.74% |
| UFJ Trust Bank Limited (Trust Account A) | 114,870.00 | 2.70% |
| The Chase Manhattan Bank N.A. London | 100,875.00 | 2.37% |
| Mizuho Trust & Banking Co., Ltd. (Trust Accounts Held by Sony Corporation: 003, 007 and 008) | 94,622.00 | 2.23% |
| The Kansai Electric Power Co., Inc. | 81,200.00 | 1.91% |
| Ministry of Posts and Telecommunications Mutual Aid Association | 76,641.45 | 1.80% |
| Kyushu Electric Power Co., Inc. | 69,662.78 | 1.64% |

### Distribution of Shares

| | Number of Shareholders | Number of Shares Held | Percentage of Total Shares |
|---|---|---|---|
| Financial Institutions | 270 | 1,337,948.55 | 31.55% |
| Securities Firms | 56 | 26,157.33 | 0.62% |
| Foreign corporations, etc. | 565 | 570,777.69 | 13.46% |
| Individuals and other | 164,780 | 428,875.06 | 10.11% |
| Other corporations | 1,940 | 1,877,121.75 | 44.26% |

KDDI CORPORATION

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This annual report is printed on 100% recycled paper.

Printed in Japan