

Internet Initiative Japan Inc.

<http://www.ij.ad.jp/en/>



*For Immediate Release*

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**IIJ Announces Year-Over-Year Improvement in Operating and Net Income  
for the First Quarter of Fiscal Year 2004**

- Sustaining Bottom Line Profitability -

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**Tokyo, August 10, 2004 / New York, August 9, 2004** - Internet Initiative Japan Inc. (Nasdaq: IJJI) ("IIJ"), one of Japan's leading Internet-access and comprehensive network solutions providers, today announced its financial results for the first quarter of the fiscal year ending March 31, 2005 ("FY 2004").<sup>1</sup>

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**Highlights of First Quarter FY2004 Results**

- Revenues totaled JPY 8,675 million (\$79.3 million), an increase of 4.0% compared to 1Q03 and a decrease of 25.3% compared to 4Q03. Value-added service ("VAS") revenue growth, including our internet virtual private networks ("VPNs") service, made up for the decrease in connectivity revenue, which has been declining due to a falling average revenue per user. System integration ("SI") revenue increased 11.9% compared to 1Q03 primarily due to the growth of our operational outsource service.
- Operating loss decreased significantly to JPY 100 million (\$ 0.9 million) from JPY 1,206 million in 1Q03, but decreased from an operating income of JPY 350 million in 4Q03. Historically, IIJ's first quarter has the lowest sales and operating income of our fiscal year due to the seasonal nature of completing and recording revenue for system integration projects. While this quarter's revenue is consistent with that trend, a relatively high level of profitability was sustained from the two previous quarters.
- Adjusted EBITDA<sup>2</sup> was JPY 884 million (\$ 8.1 million), an increase from an adjusted EBITDA loss of JPY 243 million in 1Q03 and a decrease from JPY 1,358 million in 4Q03. Adjusted EBITDA as a source of operating cash has been stable.
- Net income was JPY 1,434 million (\$ 13.1 million), an improvement from a net loss of JPY 2,475 million in 1Q03 and net income of JPY 669 million in 4Q03. IIJ's positive net income in the past three consecutive quarters was achieved due to a substantial decrease in operating loss and the income tax benefit due to the effects of unrealized gains on certain available-for-sale securities during the quarters.

**Outlook for Second Quarter FY2004**

- We expect positive operating income in 2Q04 to cover the 1Q04 operating loss as a result of ongoing efforts to increase financial returns throughout the Company, which efforts include increasing sales through the expansion of profitable business lines, such as VAS and SI, including internet security and mail outsourcing services, and further reducing costs, in particular our backbone costs. As a result, IIJ's annual operating and net income are expected to become positive in FY2004.

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<sup>1</sup> Unless otherwise stated, all financial figures discussed in this announcement are prepared in accordance with U.S. GAAP. All financial figures are unaudited and consolidated. For all 1Q04 results, translations of Japanese yen amounts into US dollars are solely for the convenience of readers outside of Japan and have been made at the rate of JPY 109.43 = US\$1.00, the approximate exchange rate on June 30, 2004.

<sup>2</sup> Please refer to the Reconciliation of Non-GAAP Financial Measures on page 6.

## Overview of 1<sup>st</sup> Quarter Financial Results and Business Outlook<sup>3</sup>

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"With the rapid increase in broadband, Japanese enterprises are beginning to demand reliable services capable of managing their increasingly complicated network operations, although price competition for internet connectivity services is intensifying," said Koichi Suzuki, President and CEO of IJ. "In this changing environment, we believe that IJ's advanced technology differentiate us from our competitors, and we have been working to expand our network solutions operations and customer base. In particular, IJ's managed VAS services, which are meeting and beating several notable end-users' expectations, provide network operations management including internet security services, server outsourcing services, such as Mail Gateway, data center services, and network outsourcing services, such as our highly rated, SMF<sup>4</sup>. We currently have more than 1,200 internet security service users and have taken on approximately 1,000 additional customer location sites for internet VPN multiple base network connectivity in 1Q04. IJ's strategy to promote and expand our network solutions is bearing fruit and our profit base is steadily improving. In 2004, we will continue to pursue our ongoing strategy of strengthening profits in order to continue to be one of Japan's leading Internet network solution providers."

"Typically, our first quarter sales, which are adversely affected by the seasonal variation of Japanese corporate IT investment, are the lowest of the year," said Akihisa Watai, IJ's new CFO. "The quarter-over-quarter decrease in revenue in 1Q04 is consistent with that trend. However, our operating loss in 1Q04 has decreased dramatically as compared to 1Q03. This is evidenced by our ability to sustain a relatively high level of profitability in 1Q04, as we did in the two previous quarters. The results are in line with expectations and represent a very promising start for the year."

"The sales of IJ's managed VAS services are steadily increasing due to the continued introduction of high margin products to our large base of connectivity customers," continued Mr. Watai. "The cost of connectivity and VAS, including backbone costs, decreased over the last quarter. We expect this trend will continue in 2Q04. In our SI business, the sales of outsourced Internet service operations, which produce relatively stable income, are growing steadily. We expect operating positive income in 2Q04 to cover 1Q04 operating loss. We are aiming to be profitable at the operating and net income levels in FY2004, which is in line with our previously stated annual goals."

### 1<sup>st</sup> Quarter FY2004 Financial Results

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#### **Revenues**

Revenues in 1Q04 totaled JPY 8,675 million, an increase of 4.0% from JPY 8,344 million in 1Q03 and a decrease of 25.3% from JPY 11,617 million in 4Q03.

**Connectivity and VAS revenues** were JPY 5,450 million in 1Q04, a decrease of 2.6% from JPY 5,596 million in 1Q03 and a decrease of 0.9% from JPY 5,499 million in 4Q03.

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<sup>3</sup> This Overview and Business Outlook contains forward-looking statements and projections such as statements regarding FY2004 operating and net profitability that are subject to known and unknown risks and uncertainties that could cause actual results to differ materially from those expressed or implied by these statements. These risks and uncertainties include, but are not limited to, the factors noted at the end of this release and to the risk factors and other information contained in IJ's filings on Form 20-F and Form 6-K, as well as other filings and documents furnished to the Securities and Exchange Commission. IJ plans to keep this press release publicly available on its Web site ([www.ij.ad.jp](http://www.ij.ad.jp)), but may discontinue this practice at any time. IJ intends to publish its next Overview and Business Outlook in its 2Q04 earnings release, presently scheduled for November 2004.

<sup>4</sup> SMF ("SEIL Management Framework") is a network operating system that was introduced by IJ in February 2003. By using it with the SEIL Series service router that was also developed by IJ, this system provides the following functionality that enables customers to greatly reduce onsite engineering work and network administration costs.

- "Plug-and-Join": SEIL Series service routers automatically configure themselves for all network functions. The customer only needs to distribute the routers to each location, connect it to the power plug and to the network.

- "Service-on-Demand": All network functions can be easily added, changed, or deleted from a system on the network.

- "Service Control": The status of SEIL Series routers at all customer locations can be monitored and operated 24 hours a day.

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Dedicated access service revenues were JPY 2,918 million in 1Q04, a decrease of 12.1% compared to 1Q03 and a decrease of 5.9% compared to 4Q03. IP Service revenues decreased by 10.1% in 1Q04 compared to 1Q03 and decreased by 5.9% compared to 4Q03, mainly due to the cancellation of service by a regional electric power company's telecom service arm. Broadband Services<sup>5</sup> revenues substantially increased by 33.3% compared to 1Q03 and increased by 5.5% compared to 4Q03. However, the increase did not offset the decreases in Limited Functionality Services<sup>6</sup> revenues, which decreased by 46.4% compared to 1Q03 and decreased by 17.1% compared to 4Q03 as a result of the shift to Broadband Services.

Dial-up access service revenues were JPY 752 million in 1Q04, a decrease of 2.0% compared to 1Q03 and a decrease of 0.8% compared to 4Q03. The declining trend in dial-up access service was reduced due to the steady revenue growth of OEM services, including the CDN<sup>7</sup> ("Contents Delivery Network") platform and NTT's regional L-mode service, which increased by 23.9% compared to 1Q03 and increased by 3.0% compared to 4Q03.

VAS revenues were JPY 1,187 million in 1Q04, an increase of 20.2% compared to 1Q03 and an increase of 7.5% compared to 4Q03. Internet Data Center service revenues increased by 10.5% compared to 1Q03 and by 15.2% compared to 4Q03, due to the increase of large-scale contracts for outsourcing services.

**Systems Integration revenues** increased 11.9% to JPY 2,695 million in 1Q04 from JPY 2,408 million in 1Q03 and decreased 32.7% from JPY 4,001 million in 4Q03. The solid year-over-year growth reflects the growing demand for network services. The quarter-over-quarter decrease in SI revenues is due to seasonal variation within the SI business.

**Equipment sales revenues** were JPY 531 million in 1Q04, an increase of 55.8% compared to 1Q03 and a decrease of 74.9% compared to 4Q03. The year-over-year growth reflects the growing demand for network services. The quarter-over-quarter decrease is due to seasonal variation.

### **Cost and expenses**

Cost of revenues was JPY 7,443 million in 1Q04, a decrease of 5.4% compared to 1Q03 and a decrease of 24.9% compared to 4Q03.

**Cost of Connectivity and VAS revenues** was JPY 4,811 million, a decrease of 8.1% compared to 1Q03 and almost flat compared to 4Q03. The gross-margin ratio for Connectivity and VAS in 1Q04 was 11.7%, compared to 6.5% in 1Q03 and 12.5% in 4Q03. The improvement in gross-margin compared to 1Q03 was the result of our continuous efforts to reduce backbone costs. Backbone costs were JPY 985 million in 1Q04, a decrease of 25.3% compared to 1Q03 and a decrease of 7.7% compared to 4Q03, which reflect the benefits of our on-going efforts to optimize our network. The gross-margin ratio slightly decreased from 4Q03 to 1Q04 due to the increase in personnel expense in our engineering division.

**Cost of SI service revenues** was JPY 2,157 million in 1Q04, a decrease of 7.2% compared to 1Q03 and a decrease of 29.4% compared to 4Q03. The gross margin for SI was 20.0% in 1Q04 compared to 3.5% in 1Q03 and 23.7% in 4Q03. The year-over-year improvement in gross-margin was due to improving profitability of SI development contracts and the steady increase in operation and maintenance revenues.

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<sup>5</sup> IJ FiberAccess/F and IJ DSL/F (shared access using NTT's Flet's ADSL and B Flet's for local access, maximum speed from 1.5Mbps to 100Mbps).

<sup>6</sup> IJ T1 Standard and IJ Economy (local access not shared, limited on several functionality compared to IP Service such as number of IP addresses allocated, and fixed speed of 64kbps, 128kbps or 1.5Mbps).

<sup>7</sup> CDN JAPAN is a platform developed for broadband content providers. It provides capabilities for distributing high-volume multi-media content, managing broadband user accounts, and protecting content against unauthorized use, without using the Internet.

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**Sales and marketing expenses** were JPY 663 million in 1Q04, a decrease of 31.9% compared to 1Q03 and a decrease of 12.3% compared to 4Q03. The year-over-year decrease was mainly due to the absence of bad debt expenses for Crosswave, which had amounted to JPY 146 million in 1Q03.

**General and administrative expenses** were JPY 621 million in 1Q04, an increase of 1.4% compared to 1Q03 and an increase of 19.8% compared to 4Q03. The 1Q04 expenses included the newly introduced uniform enterprise tax, which amounted to JPY 25 million, and the loss on the disposal of fixed assets, which amounted to JPY 33 million. 1Q03 expenses include costs associate with the move to the new head office, which amounted to JPY 70 million.

### **Operating income (loss)**

Operating loss was JPY 100 million in 1Q04, compared to an operating loss of JPY 1,206 million in 1Q03 and operating income of JPY 350 million in 4Q03. The improvement from 1Q03 is mainly due to increased profitability in Connectivity and SI services, and the absence of bad debt expense attributable to Crosswave. In spite of the substantial seasonal decrease in SI revenues, we reduced operating loss in 1Q04 as was expected.

**Other expenses** for 1Q04 were JPY 151 million, compared to JPY 204 million in 1Q03 and JPY 226 million in 4Q03. Other expenses for 1Q04 included a JPY 48 million gain on the sale of an equity investment.

**Income tax benefit** for 1Q04 was JPY 1,657 million, compared to JPY 390 million in 1Q03 and JPY 891 million in 4Q03. The increases as compared to 1Q03 and 4Q03 are due to a decrease in the valuation allowance for deferred tax assets attributable primarily to the income tax effect of increasing unrealized gains on certain available-for-sale securities during the quarter.

**Equity in net loss of equity method investees** amounted to a loss of JPY 11 million in 1Q04, compared to JPY 1,709 million in 1Q03 and JPY 189 million in 4Q03.

**Net income (loss)** was JPY 1,434 million in 1Q04, compared to a net loss of JPY 2,475 million in 1Q03 and net income of JPY 669 million in 4Q03. The improvement in net income reflects the improvement in operating income and the income tax benefit due to the effect of increases in unrealized gains on certain available-for-sale securities during the quarter. Basic net income per ADS equivalent was JPY 18.72 in 1Q04, compared to a net loss of JPY 54.72 in 1Q03 and a net income of JPY 8.73 in 4Q03.

Table 1. Revenues and Cost of Connectivity and Value-added Services (JPY in millions)

	1Q04	1Q03	YoY % change	4Q03	QoQ % change
<b>Connectivity Service Revenues</b>					
<b>IP Service</b> <sup>8</sup>	<b>2,279</b>	2,534	(10.1%)	2,423	(5.9%)
<b>Limited Functionality Services</b>	<b>275</b>	513	(46.4%)	331	(17.1%)
<b>Broadband Services (FTTH, ADSL)</b>	<b>364</b>	274	33.3%	346	5.5%
<b>Total Dedicated Access Service Revenues</b>	<b>2,918</b>	3,321	(12.1%)	3,100	(5.9%)
<b>Dial-up Access Service Revenues</b>					
<b>Under IJ brand</b> <sup>9</sup>	<b>509</b>	571	(10.9%)	522	(2.5%)
<b>OEM</b> <sup>10</sup>	<b>243</b>	196	23.9%	236	3.0%
<b>Total Dial-up Service Revenues</b>	<b>752</b>	767	(2.0%)	758	(0.8%)
<b>Value-added Service Revenues</b>	<b>1,187</b>	987	20.2%	1,104	7.5%
<b>Other Revenues</b>	<b>592</b>	520	14.0%	537	10.4%
<b>Total Connectivity and Value-added Service Revenues</b>	<b>5,450</b>	5,596	(2.6%)	5,499	(0.9%)

<sup>8</sup> Including IJ Data Center Connectivity Service (local access not shared, and fixed speed from 64kbps to 1.2Gbps).

<sup>9</sup> Services marketed and provided to corporate and individual customers under IJ brand name (IJ4U and IJmio). Including contracts with options for FTTH and ADSL services.

<sup>10</sup> Service marketing and provided as other companies' brand name - Original Equipment Manufacturer ("OEM").

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Cost of Connectivity and Value-added Services	4,811	5,234	(8.1%)	4,810	0.0%
Backbone Cost (included in the cost of connectivity and value added services)	985	1,318	(25.3%)	1,067	(7.7%)
Gross Margin	638	361	76.6%	689	(7.3%)
Gross Margin Ratio	11.7%	6.5%		12.5%	

Table 2. Number of Contracts for Connectivity Services and Total Contracted Bandwidth

	1Q04	1Q03	4Q03
IP Service (Low Bandwidth: 64kbps-768kbps)	73	108	88
IP Service (Medium Bandwidth:1Mbps-100Mbps)	638	503	606
IP Service (High Bandwidth: over 100Mbps) <sup>11</sup>	35	26	35
IIJ Data Center Connectivity Service	224	171	196
IPv6 Service	6	12	9
Limited Functionality Services	421	791	504
Broadband Services (FTTH, ADSL)	6,679	4,265	5,788
<b>Total Dedicated Access Service Contracts</b>	<b>8,076</b>	<b>5,876</b>	<b>7,226</b>
Dial-up Access Services, under IIJ Brand	73,225	83,327	75,136
Dial-up Access Services, OEM	635,361	508,245	620,731
<b>Total Dial-up Access Service Contracts</b>	<b>708,586</b>	<b>591,572</b>	<b>695,867</b>
<b>Total Contracted Bandwidth</b>	<b>95.6Gbps</b>	<b>51.4Gbps</b>	<b>80.1Gbps</b>

Table 3. Cross-selling

	1Q04	1Q03	YoY % change	4Q03	QoQ % change
Number of Customers to use both of Connectivity Service and Value-added Services in largest 1,000 customers only	823	823	0.0%	795	3.5%
<b>VAS Cross-selling Rate</b>	<b>82.3%</b>	<b>82.3%</b>		<b>79.5%</b>	
Number of SI Customers to use Connectivity Service in largest 100 SI customers	66	75	(12.0%)	66	0.0%
<b>SI Cross-selling Rate</b>	<b>66.0%</b>	<b>75.0%</b>		<b>66.0%</b>	

Table 4. Systems Integration and Equipment Sales (JPY in millions)

	1Q04	1Q03	YoY % change	4Q03	QoQ % change
<b>Systems Integration Revenues</b>					
Systems Integration Services	1,040	1,211	(14.1%)	2,573	(59.6%)
Operational Outsource Service	1,655	1,197	38.3%	1,428	15.8%
<b>Systems Integration Revenues</b>	<b>2,695</b>	<b>2,408</b>	<b>11.9%</b>	<b>4,001</b>	<b>(32.7%)</b>
<b>Cost of Systems Integration</b>	<b>2,157</b>	<b>2,323</b>	<b>(7.2%)</b>	<b>3,054</b>	<b>(29.4%)</b>
<b>Systems Integration Gross Margin</b>	<b>538</b>	<b>85</b>	<b>536.5%</b>	<b>947</b>	<b>(43.2%)</b>
<b>Systems Integration Gross Margin Ratio</b>	<b>20.0%</b>	<b>3.5%</b>		<b>23.7%</b>	
<b>Equipment Sales Revenues</b>	<b>531</b>	<b>341</b>	<b>55.8%</b>	<b>2,117</b>	<b>(74.9%)</b>
<b>Cost of Equipment Sales</b>	<b>475</b>	<b>311</b>	<b>52.9%</b>	<b>2,051</b>	<b>(76.8%)</b>
<b>Equipment Sales Gross Margin</b>	<b>55</b>	<b>30</b>	<b>86.2%</b>	<b>66</b>	<b>(16.5%)</b>
<b>Equipment Sales Gross Margin Ratio</b>	<b>10.4%</b>	<b>8.7%</b>		<b>3.1%</b>	

<sup>11</sup> In IP Service over 100Mbps, we had 19 contracts for over 1Gbps in 1Q04. We had 9 contracts in 1Q03 and 16 contracts in 4Q03 for over 1Gbps.



Table 5. Gross Margins

	1Q03	2Q03	3Q03	4Q03	1Q04
<b>Connectivity and Value-added Services</b>	6.5%	9.1%	13.4%	12.5%	<b>11.7%</b>
<b>Systems Integration</b>	3.5%	10.7%	23.9%	23.7%	<b>20.0%</b>
<b>Equipment Sales</b>	8.7%	6.4%	5.5%	3.1%	<b>10.4%</b>
<b>Total</b>	5.7%	9.2%	15.7%	14.7%	<b>14.2%</b>

Table 6. Other Financial Statistics (JPY in millions)

	1Q04	1Q03	YoY % Change	4Q03	QoQ % Change
<b>Adjusted EBITDA<sup>12</sup></b>	<b>884</b>	(243)	(463.7%)	1,358	(34.9%)
<b>CAPEX, including capital leases<sup>13</sup></b>	<b>1,300</b>	1,421	(8.5%)	1,014	28.2%
<b>Depreciation and amortization<sup>14</sup></b>	<b>1,004</b>	990	1.4%	1,030	(2.5%)

### ***Reconciliation of Non-GAAP Financial Measures***

The following table summarizes the reconciliation of adjusted EBITDA to net income according to the consolidated statements of operations that are prepared in accordance with U.S. generally accepted accounting principles and presented in Appendix 1:

Table 7. Adjusted EBITDA (JPY in millions)

	1Q04	1Q03	4Q03
<b>Adjusted EBITDA</b>	<b>884</b>	(243)	1,358
<b>Depreciation and amortization<sup>15</sup></b>	<b>(984)</b>	(963)	(1,008)
<b>Operating income (loss)</b>	<b>(100)</b>	(1,206)	350
<b>Other expenses</b>	<b>(151)</b>	(204)	(226)
<b>Income tax benefit</b>	<b>(1,657)</b>	(390)	(891)
<b>Minority interests in consolidated subsidiaries</b>	<b>39</b>	254	(157)
<b>Equity in net loss of equity method investees</b>	<b>(11)</b>	(1,709)	(189)
<b>Net income (loss)</b>	<b>1,434</b>	(2,475)	669

The following table summarizes the reconciliation of capital expenditures to the purchase of property and equipment according to the consolidated statements of cash flows that are prepared and presented in accordance with U.S. generally accepted accounting principles in Appendix 3:

Table 8. CAPEX (JPY in millions)

	1Q04	1Q03	4Q03
<b>Capital expenditures</b>	<b>1,300</b>	1,421	1,014
<b>Acquisition of assets by entering into capital leases</b>	<b>977</b>	487	778
<b>Purchase of property and equipment</b>	<b>323</b>	934	236

<sup>12</sup> Please refer to the Reconciliation of Non-GAAP Financial Measures below.

<sup>13</sup> Please refer to the Reconciliation of Non-GAAP Financial Measures below.

<sup>14</sup> Depreciation and amortization includes amortization of issuance cost of convertible notes.

<sup>15</sup> Depreciation and amortization excludes amortization of issuance cost of convertible notes that was presented as other expenses.

**Key Service Developments**

***Enhancement of security solutions:***

In June 2004, IIJ Technology Inc. ("IIJ-Tech"), IIJ's 67.9% owned subsidiary, launched the Security Alert Service which provides security information customized to the architecture of customer systems. In an environment where new vulnerabilities and security holes are disclosed on an almost daily basis, the security professionals of IIJ-Tech are identifying issues that are directly related to our customer's system architecture. The Security Alert Service evaluates the security issues' impact, updates the customers in daily and monthly reports and provides information on how to take effective countermeasures.

***Auto ID:***

In July 2004, IIJ became a member in EPCglobal, the international standards body for network RFID system (Auto-ID) technology. EPCglobal was established in 2003 and is the world's largest such standards organization, with 191 member companies, including huge international distributors, such as Wal-Mart, Inc., as well as SI vendors, and telecommunication carriers. In addition to creating global standards, they issue and administer EPCs, which are identifiers recorded in RFID systems, and are driving the adoption of Auto-ID in the global market.

**Major Contracts**

***Providing SMF to KCOM:***

In April 2004, IIJ's next generation network operation service, "IIJ SMF Service" was selected to be the platform for "KCOM SMF Service" by KCOM Corporation ("KCOM"). KCOM is a leading ISP and a group company of KDDI. By providing SMF to KCOM, IIJ has taken a further step to introducing this pioneering technology to other ISPs and System Integrators.

***Assisting Sharp in Constructing "BB Space Town":***

In May 2004, IIJ and IIJ-Tech announced that both companies will provide SMF and CDN JAPAN solution services to Sharp Corporation ("Sharp") for use in their broadband connectivity service, "BB Space Town", the latest addition to the Sharp Space Town series of services. BB Space Town will give users access to a plug-and-play network service that allows information devices to plug into a low-cost broadband network in a non-PC environment.

***Received mandate to renovate and operate Japan's Largest Campus Network, Rikkyo V-Campus:***

In May 2004, IIJ and IIJ-Tech successfully received a mandate to renovate and continue operating the Internet connectivity and campus IT infrastructure for "Rikkyo V-Campus", which is Rikkyo University's main campus network.

***Provided Downloading Environment for Online Game "Lineage II":***

IIJ provided the download environment for the commercial release of the online game "Lineage II" to be released by NC Japan K.K. on June 25, 2004.

***Licensed SMF to NESIC for its "SMF SETTERFREE" Service:***

In June 2004, IIJ has licensed SMF to NEC System Integration & Construction, Ltd. ("NESIC"), as the base system for "SMF SETTERFREE", the network management service that NESIC started to provide.

**Management Message/Webcast**

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From August 11, IIJ will webcast its management message regarding the Company's results and outlook. For details, please access the following URL: <http://www.ij.ad.jp/en/IR/>

## Internet Initiative Japan Inc.

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### About Internet Initiative Japan Inc.

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Founded in 1992, Internet Initiative Japan Inc. (IIJ, NASDAQ: IJJI) is one of Japan's leading Internet-access and comprehensive network solutions providers. The company has built one of the largest Internet backbone networks in Japan, and between Japan and the United States. IIJ and its group of companies provide total network solutions that mainly cater to high-end corporate customers. Services range from the delivery of new generation network services over an optical-fiber infrastructure that is optimized for data communications, to the construction of pan-Asian IP backbone networks. The company also offers high-quality systems integration and security services, Internet access, hosting/housing, and content design.

*Statements made in this press release regarding IIJ's or management's intentions, beliefs, expectations, or predictions for the future are forward-looking statements that are based on IIJ's and managements' current expectations, assumptions, estimates and projections about its business and the industry. These forward-looking statements, such as statements regarding FY2004 operating and net profitability, are subject to various risks, uncertainties and other factors that could cause IIJ's actual results to differ materially from those contained in any forward-looking statement. These risks, uncertainties and other factors include: IIJ's expectation that net losses will continue or may increase; IIJ's ability to raise additional capital to cover its indebtedness; the possibility that NTT, IIJ's largest shareholder, may decide to exercise substantial influence over IIJ; IIJ's ability to generate significant revenues from its other services such as systems integration; the ability to compete in a rapidly evolving and competitive marketplace; the impact of technological changes in its industry; and other risks referred to from time to time in IIJ's filings on Form 20-F of its annual report and other filings with the United States Securities and Exchange Commission.*

Tables to follow



**CONSOLIDATED STATEMENTS OF OPERATIONS(UNAUDITED)**

For the Three Months Ended Jun 30, 2004, Jun 30, 2003 and Mar 31, 2004

(Expressed in Thousands of Japanese Yen (JPY) and U.S. Dollars (USD) Except for Per Share and ADS Data) (1)

	Year-over-year Comparison						Sequential Comparison		
	Jun 30, 2004			Jun 30, 2003			Mar 31, 2004		
	USD (1)	JPY	% of Total Revenues	JPY	% of Total Revenues	YOY Chg %	JPY	% of Total Revenues	QOQ Chg %
<b>Revenues:</b>									
Connectivity and value-added services:									
Dedicated access services	26,670	2,918,488	33.6%	3,321,229	39.8%	(12.1%)	3,100,452	26.7%	(5.9%)
Dial-up access services	6,871	751,933	8.7	767,418	9.2	(2.0)	757,947	6.5	(0.8)
Value-added services	10,846	1,186,837	13.7	987,198	11.9	20.2	1,103,558	9.5	7.5
Other	5,413	592,390	6.8	519,709	6.2	14.0	536,590	4.6	10.4
Total connectivity and value-added services	49,800	5,449,648	62.8	5,595,554	67.1	(2.6)	5,498,547	47.3	(0.9)
Systems integration revenues	24,625	2,694,638	31.1	2,407,923	28.8	11.9	4,001,449	34.5	(32.7)
Equipment sales	4,849	530,621	6.1	340,569	4.1	55.8	2,117,006	18.2	(74.9)
<b>Total revenues</b>	<b>79,274</b>	<b>8,674,907</b>	<b>100.0</b>	<b>8,344,046</b>	<b>100.0</b>	<b>4.0</b>	<b>11,617,002</b>	<b>100.0</b>	<b>(25.3)</b>
<b>Costs and expenses:</b>									
Cost of connectivity and value-added services	43,967	4,811,341	55.5	5,234,158	62.7	(8.1)	4,809,831	41.4	0.0
Cost of systems integration revenues	19,708	2,156,620	24.8	2,323,392	27.9	(7.2)	3,053,962	26.3	(29.4)
Cost of equipment sales	4,345	475,466	5.5	310,946	3.7	52.9	2,050,923	17.6	(76.8)
Total costs	68,020	7,443,427	85.8	7,868,496	94.3	(5.4)	9,914,716	85.3	(24.9)
Sales and marketing	6,058	662,950	7.6	973,054	11.7	(31.9)	755,928	6.5	(12.3)
General and administrative	5,672	620,651	7.2	612,047	7.3	1.4	517,884	4.5	19.8
Research and development	442	48,368	0.6	96,098	1.2	(49.7)	78,786	0.7	(38.6)
<b>Total costs and expenses</b>	<b>80,192</b>	<b>8,775,396</b>	<b>101.2</b>	<b>9,549,695</b>	<b>114.5</b>	<b>(8.1)</b>	<b>11,267,314</b>	<b>97.0</b>	<b>(22.1)</b>
<b>Operating income(loss)</b>	<b>(918)</b>	<b>(100,489)</b>	<b>(1.2)</b>	<b>(1,205,649)</b>	<b>(14.5)</b>	<b>(91.7)</b>	<b>349,688</b>	<b>3.0</b>	<b>(128.7)</b>
<b>Other expenses</b>	<b>(1,377)</b>	<b>(150,700)</b>	<b>(1.7)</b>	<b>(204,398)</b>	<b>(2.4)</b>	<b>(26.3)</b>	<b>(226,045)</b>	<b>(1.9)</b>	<b>(33.3)</b>
<b>Income(Loss) before income tax benefit</b>	<b>(2,295)</b>	<b>(251,189)</b>	<b>(2.9)</b>	<b>(1,410,047)</b>	<b>(16.9)</b>	<b>(82.2)</b>	<b>123,643</b>	<b>1.1</b>	<b>(303.2)</b>
<b>Income tax benefit</b>	<b>(15,145)</b>	<b>(1,657,335)</b>	<b>(19.1)</b>	<b>(390,035)</b>	<b>(4.7)</b>	<b>324.9</b>	<b>(890,928)</b>	<b>(7.7)</b>	<b>86.0</b>
<b>Minority interests in consolidated subsidiaries</b>	<b>358</b>	<b>39,184</b>	<b>0.4</b>	<b>254,886</b>	<b>3.0</b>	<b>(84.6)</b>	<b>(157,295)</b>	<b>(1.4)</b>	<b>(124.9)</b>
<b>Equity in net loss of equity method investees:</b>									
Equity method net income(loss)	(101)	(10,995)	(0.1)	10,559	0.1	(204.1)	(188,577)	(1.6)	(94.2)
Impairment loss on investment in and advances to Crosswave				(1,719,981)	(20.6)	0.0			
<b>Net income(loss)</b>	<b>13,107</b>	<b>1,434,335</b>	<b>16.5%</b>	<b>(2,474,548)</b>	<b>(29.7%)</b>	<b>(158.0%)</b>	<b>668,699</b>	<b>5.8%</b>	<b>114.5%</b>
<b>Basic Net Income(Loss) Per Share</b>		37,438		(109,440)			17,454		
<b>Basic Net Income(Loss) Per ADS Equivalent</b>		18.72		(54.72)			8.73		
<b>Weighted Average Number of Shares</b>		38,312		22,611			38,312		
<b>Weighted Average Number of ADS Equivalents</b>		76,623,702		45,222,494			76,623,702		

Note (1): The translation of Japanese yen amounts into US dollar amounts with respect to the three months ended Jun 30, 2004 are included solely for the convenience of readers outside Japan and have been made at the rate of JPY 109.43 = \$1, the approximate rate of exchange on Jun 30, 2004.

**INTERNET INITIATIVE JAPAN INC.**  
**CONSOLIDATED BALANCE SHEETS(UNAUDITED)**

Appendix 2

As of Jun 30, 2004, Jun 30, 2003 and Mar 31, 2004  
(Expressed in Thousands of Japanese Yen (JPY) and U.S. Dollars (USD)) (1)

	Jun 30, 2004			Jun 30, 2003		Mar 31, 2004	
	USD (1)	JPY	%	JPY	%	JPY	%
<b>ASSETS</b>							
<b>Current Assets:</b>							
Cash and cash equivalent	97,114	10,627,203	25.3%	2,819,007	10.2%	12,284,239	28.7%
Accounts receivable, net	49,139	5,377,230	12.8	5,889,315	21.3	8,994,156	21.1
Inventories	3,778	413,477	1.0	347,971	1.3	438,435	1.0
Prepaid expenses	8,518	932,097	2.2	845,908	3.1	557,703	1.3
Other current assets	4,179	457,325	1.1	534,025	1.9	325,422	0.8
<b>Total current assets</b>	<b>162,728</b>	<b>17,807,332</b>	<b>42.4</b>	<b>10,436,226</b>	<b>37.8</b>	<b>22,599,955</b>	<b>52.9</b>
<b>Investments in and Advances to Equity Method Investees</b>	7,031	769,363	1.8	1,141,728	4.1	778,152	1.8
<b>Other Investments</b>	108,921	11,919,229	28.3	3,967,719	14.4	7,931,893	18.6
<b>Property and Equipment, net</b>	78,290	8,567,329	20.4	9,244,442	33.5	8,601,905	20.1
<b>Guarantee Deposits</b>	18,825	2,059,980	4.9	2,082,118	7.6	2,075,123	4.9
<b>Other Assets</b>	8,366	915,548	2.2	714,367	2.6	749,897	1.7
<b>Total assets</b>	<b>384,161</b>	<b>42,038,781</b>	<b>100.0%</b>	<b>27,586,600</b>	<b>100.0%</b>	<b>42,736,925</b>	<b>100.0%</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY(CAPITAL DEFICIENCY)</b>							
<b>Current Liabilities:</b>							
Short-term borrowings	49,008	5,363,001	12.8%	5,675,341	20.6%	6,564,093	15.4%
Accounts payable	34,307	3,754,214	8.9	4,406,928	16.0	7,187,976	16.8
Accrued expenses	4,394	480,824	1.1	537,236	1.9	454,366	1.1
Other current liabilities	6,656	728,386	1.7	542,538	1.9	483,925	1.1
Long-term borrowings-current portion	14,157	1,549,189	3.7	1,545,452	5.6	1,548,246	3.6
Convertible Notes	101,325	11,088,000	26.4			11,832,000	27.7
Capital lease obligations-current portion	21,964	2,403,477	5.7	2,677,038	9.7	2,387,754	5.6
<b>Total current liabilities</b>	<b>231,811</b>	<b>25,367,091</b>	<b>60.3</b>	<b>15,384,533</b>	<b>55.7</b>	<b>30,458,360</b>	<b>71.3</b>
<b>Long-term Borrowings</b>	20,747	2,270,366	5.4	3,419,555	12.4	2,308,019	5.4
<b>Convertible Notes</b>				15,000,000	54.4		
<b>Capital Lease Obligations-Noncurrent</b>	28,547	3,123,878	7.4	3,407,735	12.3	2,880,298	6.7
<b>Accrued Retirement and Pension Costs</b>	814	89,037	0.2	74,764	0.3	72,687	0.2
<b>Other Noncurrent Liabilities</b>	2,129	233,046	0.6	187,579	0.7	161,122	0.4
<b>Total liabilities</b>	<b>284,048</b>	<b>31,083,418</b>	<b>73.9</b>	<b>37,474,166</b>	<b>135.8</b>	<b>35,880,486</b>	<b>84.0</b>
<b>Minority Interest</b>	8,234	901,088	2.2	624,609	2.3	642,311	1.5
<b>Shareholders' Equity(Capital Deficiency):</b>							
<b>Common stock</b>	125,792	13,765,372	32.7	7,765,048	28.2	13,765,372	32.2
<b>Additional paid-in capital</b>	216,007	23,637,628	56.2	17,751,065	64.3	23,637,628	55.3
<b>Accumulated deficit</b>	(304,817)	(33,356,095)	(79.3)	(37,159,839)	(134.7)	(34,790,430)	(81.4)
<b>Accumulated other comprehensive income</b>	55,299	6,051,370	14.4	1,131,644	4.1	3,645,558	8.5
<b>Treasury stock</b>	(402)	(44,000)	(0.1)	(93)	0.0	(44,000)	(0.1)
<b>Total shareholders' equity(capital deficiency)</b>	<b>91,879</b>	<b>10,054,275</b>	<b>23.9</b>	<b>(10,512,175)</b>	<b>(38.1)</b>	<b>6,214,128</b>	<b>14.5</b>
<b>Total liabilities and shareholders' equity(capital deficiency)</b>	<b>384,161</b>	<b>42,038,781</b>	<b>100.0%</b>	<b>27,586,600</b>	<b>100.0%</b>	<b>42,736,925</b>	<b>100.0%</b>

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**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

For the Three Months Ended Jun 30, 2004, Jun 30, 2003 and Mar 31, 2004

(Expressed in Thousands of Japanese Yen (JPY) and U.S. Dollars (USD)) (1)

	Jun 30, 2004		Jun 30, 2003	Mar 31, 2004
	USD (1)	JPY	JPY	JPY
<b>Operating Activities:</b>				
Net income (loss)	13,107	1,434,335	(2,474,548)	668,699
Depreciation and amortization	9,176	1,004,170	990,190	1,030,162
Provision for doubtful accounts	(118)	(12,936)	149,378	27,587
Equity method net loss (income)	101	10,995	(10,559)	188,577
Impairment loss on advances to Crosswave	-	-	1,719,981	-
Minority interests in net income (loss) of consolidated subsidiaries	(358)	(39,184)	(254,886)	157,295
Foreign exchange losses (gains)	(69)	(7,585)	3,245	(13,682)
Loss on retirement of convertible notes	48	5,195	-	-
Net losses on other investments	25	2,749	37,572	42,352
Decrease (increase) in accounts receivable	33,148	3,627,399	4,229,010	(2,483,404)
Increase (decrease) in accounts payable	(28,281)	(3,094,772)	(3,671,049)	2,392,795
Decrease (increase) in inventories	228	24,958	69,689	(245,201)
Deferred income taxes	(15,283)	(1,672,424)	(395,698)	(904,221)
Other	(2,331)	(255,036)	264,043	395,710
<b>Net cash provided by operating activities</b>	<b>9,393</b>	<b>1,027,864</b>	<b>656,368</b>	<b>1,256,669</b>
<b>Investing Activities:</b>				
Purchase of property and equipment	(2,954)	(323,210)	(933,646)	(236,028)
Proceeds from sales of other investment	834	91,286	34,672	66,387
Advances to Crosswave	-	-	(1,719,981)	-
Purchase of other investments	(21)	(2,290)	(12,971)	(2,138)
Refund (payment) of guarantee deposits-net	133	14,528	123,632	(576)
Other	(44)	(4,851)	11	(3,778)
<b>Net cash used in investing activities</b>	<b>(2,052)</b>	<b>(224,537)</b>	<b>(2,508,283)</b>	<b>(176,133)</b>
<b>Financing Activities:</b>				
Proceeds from long-term borrowings	-	-	-	400,000
Repayments of long-term borrowings	(336)	(36,710)	(434,994)	(436,477)
Repurchase of convertible notes	(6,812)	(745,488)	-	-
Principal payments under capital leases	(6,114)	(669,047)	(697,830)	(692,467)
Net increase (decrease) in short-term borrowings	(10,976)	(1,201,093)	851,742	(200,316)
Proceeds from issuance of common stock of a subsidiary	1,724	188,632	-	-
Proceeds from issuance of common stock	-	-	1,365,424	-
<b>Net cash provided by (used in) financing activities</b>	<b>(22,514)</b>	<b>(2,463,706)</b>	<b>1,084,342</b>	<b>(929,260)</b>
<b>Effect of Exchange Rate Changes on Cash</b>	<b>30</b>	<b>3,343</b>	<b>(1,772)</b>	<b>(7,632)</b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>(15,143)</b>	<b>(1,657,036)</b>	<b>(769,345)</b>	<b>143,644</b>
<b>Cash and Cash Equivalents, Beginning of Period</b>	<b>112,257</b>	<b>12,284,239</b>	<b>3,588,352</b>	<b>12,140,595</b>
<b>Cash and Cash Equivalents, End of Period</b>	<b>97,114</b>	<b>10,627,203</b>	<b>2,819,007</b>	<b>12,284,239</b>

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