

Internet Initiative Japan Inc.

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



***For Immediate Release***

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**IIJ Achieves Increased Revenues and Substantially Improved Profits in the First Half of FY2004**

- Growth Expected to Continue in Total Network Solutions -

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**Tokyo and New York, November 11, 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 second quarter of the fiscal year ending March 31, 2005 ("FY2004").<sup>1</sup>

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**Highlights of Second Quarter FY2004 Results**

- Revenue totaled JPY 10,512 million (\$95.4 million), an increase of 14.4% from JPY 9,185 million in 2Q03 and an increase of 21.2% from JPY 8,675 million in 1Q04.
- Operating income turned positive to JPY 282 million (\$2.6 million) from an operating loss of JPY 830 million in 2Q03 and JPY 100 million in 1Q04.
- Revenue in the first half of FY2004 ("1H04") increased by 9.5% compared to 1H03. Operating and net income turned positive in the first half of the fiscal year, which is usually weaker part of the fiscal year compared to the second half. Operating income in 1H04 was JPY 182 million, and net income in 1H04 was JPY 1,162 million.

**Outlook for FY2004**

- We expect that the trend of growing positive operating income will continue into 3Q04.

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**Overview of 2<sup>nd</sup> Quarter Financial Results and Business Outlook<sup>2</sup>**

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"We had a very solid first half of FY2004 and completed a rather significant turnaround compared to 1H03," said Koichi Suzuki, President and CEO of IIJ. "We are confident that our network solutions business is starting to flourish. The demand from corporate customers for more comprehensive and reliable network solutions is growing and the trend of improving corporate IT spending continues. Our strategy is to capture new total network solutions business from existing and new blue-chip customers. We are particularly geared to providing various network solutions that are integrated with corporate business systems, from network design, security consultation and network implementation, to project management and outsourced operations. For example, we acquired contracts of Internet VPN based connectivity for over 1,200 sites in 2Q04 and SEIL Management Framework ("SMF")<sup>3</sup> for over 3,000 sites since 1H03. Additionally, we recently signed agreements with several major telecommunications

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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 2Q04 and 1H04 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 110.20 = US\$1.00, the approximate exchange rate on September 30, 2004.

<sup>2</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 IIJ's filings on Form 20-F and Form 6-K, as well as other filings and documents furnished to the Securities and Exchange Commission. IIJ 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. IIJ intends to publish its next Overview and Business Outlook in its 3Q04 earnings release, presently scheduled for February 2005.

<sup>3</sup> SMF is a network operating system developed by IIJ to provide features of automatic configuration and monitoring of IIJ developed SEIL routers at customer sites.

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carriers, such as NTT Communications Corporation ("NTT Communications") and Kyushu Communications Network Co., Inc ("QTNNet") for SMF and SEIL to be distributed for their Internet VPN service or managed services for their corporate customers."

"In 2Q04, we also made significant progress in breaking into the financial services industry," continued Koichi Suzuki. "In October 2004, the security system business of Yamatane Co.,Ltd. ("Yamatane") was transferred to IJ Financial Systems Inc. ("IJ Financial Systems"), a newly established company that is 100% owned by IJ Technology Inc. ("IJ Technology"), our subsidiary that manages IJ's systems integration business. The finance industry in Japan is expected to expand considerably as the market sees an increase in deregulation, such as the abolishment of laws barring banks from providing their customers with securities trading services. As a result, we are forecasting an increase in network usage and higher demand for network and outsourcing services. This combination of market demand and our focus on a strategy of providing total network solutions, along with continued emphasis on effective cost management, will contribute to continued increases in profitability in the third quarter and beyond."

"As planned, we achieved an increase in revenues in 2Q04 compared to 2Q03 and 1Q04", said Akihisa Watai, CFO of IJ. "At the same time, we substantially improved profits in 1H04, due to the increase of revenues in value-added services ("VAS") and systems integration ("SI"), as well as successfully reduced fixed costs including backbone costs. We believe that we have successfully positioned ourselves for steady operational profit growth for the foreseeable future. This along with increased stable monthly revenues from outsourced operations as well, and we expect the trend of increasing operating profitability to continue in the second half of fiscal year, which typically has stronger SI revenues compared to the first half."

## 2<sup>nd</sup> Quarter FY2004 Financial Results

### Operating Result Summary

(JPY in millions)

	1H04	1H03	YoY % change	2Q04	2Q03	YoY % change	1Q04	QoQ % change
<b>Total Revenues</b>	<b>19,187</b>	17,529	9.5%	<b>10,512</b>	9,185	14.4%	8,675	21.2%
<b>Total Costs</b>	<b>16,297</b>	16,206	0.6%	<b>8,854</b>	8,337	6.2%	7,443	18.9%
<b>SG&amp;A Expenses / R&amp;D</b>	<b>2,708</b>	3,359	(19.4%)	<b>1,376</b>	1,678	(18.0%)	1,332	3.3%
<b>Operating Income (Loss)</b>	<b>182</b>	(2,035)	(108.9%)	<b>282</b>	(830)	(134.0%)	(100)	(380.8%)
<b>Net Income (Loss)</b>	<b>1,162</b>	(2,753)	(142.2%)	<b>(273)</b>	(278)	(2.1%)	1,434	(119.0%)

### Revenues

Revenues in 2Q04 totaled JPY 10,512 million, an increase of 14.4% from JPY 9,185 million in 2Q03 and an increase of 21.2% from JPY 8,675 million in 1Q04.

### Revenues

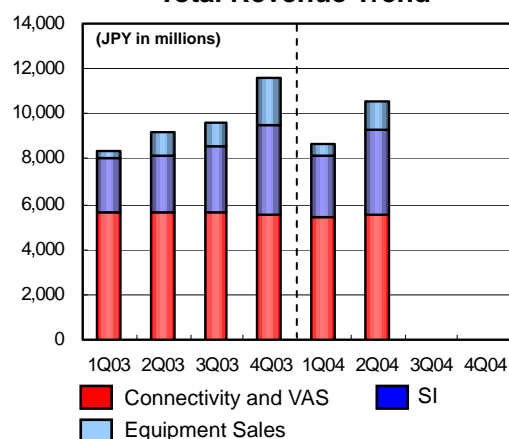
(JPY in millions)

	2Q04	2Q03	YoY % change	1Q04	QoQ % change
<b>Total Revenues</b>	<b>10,512</b>	9,185	14.4%	8,675	21.2%
<b>Connectivity &amp; VAS</b>	<b>5,508</b>	5,637	(2.3%)	5,450	1.1%
<b>SI</b>	<b>3,838</b>	2,549	50.5%	2,695	42.4%
<b>Equipment Sales</b>	<b>1,167</b>	999	16.8%	531	119.8%

**Connectivity and VAS revenues** were JPY 5,508 million in 2Q04, a decrease of 2.3% from JPY 5,637 million in 2Q03 and an increase of 1.1% from JPY 5,450 million in 1Q04.

Dedicated access service revenues were JPY 2,832 million in 2Q04, a decrease of 12.5% compared to 2Q03 and a decrease of 3.0% compared to 1Q04. The increase in revenue from broadband services did not offset the revenue decrease from IJ T1 Standard and IJ Economy. IP Service revenues decreased by 10.6% in 2Q04 compared to 2Q03 and decreased by 2.5% compared to 1Q04 due to the cancellation of the service by certain large customers. However, we see the trend

### Total Revenue Trend



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that the customers' shift from IIJ T1 Standard and IIJ Economy to broadband services is being discontinued and with new contracts, we expect the decrease in dedicated access service revenues to bottom out sometime in 2H04.

Dial-up access service revenues were JPY 740 million in 2Q04, a decrease of 5.6% compared to 2Q03 and a decrease of 1.6% compared to 1Q04 due to the decrease in revenues from IIJ4U.

VAS revenues were JPY 1,220 million in 2Q04, an increase of 12.9% compared to 2Q03 and an increase of 2.8% compared to 1Q04, mainly as a result of the steady increase in security-related services.

**SI revenues** increased 50.5% to JPY 3,838 million in 2Q04 from JPY 2,549 million in 2Q03 and increased 42.4% from JPY 2,695 million in 1Q04. The year-over-year growth was as a result of the solid growth of outsourced operation services, revenue from which increased by 42.8% to JPY 1,737 million from JPY 1,216 million in 2Q03. The quarter-over-quarter increase was due to the increasing contracts of SI development.

**Equipment sales revenues** were JPY 1,167 million in 2Q04, an increase of 16.8% compared to 2Q03 and an increase of 119.8% compared to 1Q04.

### Cost and expense

Cost of revenues was JPY 8,854 million in 2Q04, an increase of 6.2% compared to 2Q03 and an increase of 18.9% compared to 1Q04.

**Cost of Connectivity and VAS revenues** was JPY 4,780 million, a decrease of 6.8% compared to 2Q03 and a decrease of 0.6% compared to 1Q04. The gross-margin ratio for Connectivity and VAS in 2Q04 was 13.2%, compared to 9.1% in 2Q03 and 11.7% in 1Q04 due to a decrease in backbone costs.

**Cost of SI revenues** was JPY 2,983 million in 2Q04, an increase of 31.1% compared to 2Q03 and an increase of 38.3% compared to 1Q04. The gross margin ratio for SI in 2Q04 was 22.3%, compared to 10.7% in 2Q03 and 20.0% in 1Q04. These improvements were due to the increase in profitable outsourced operation services.

**Sales and marketing expenses** were JPY 712 million in 2Q04, a decrease of 35.3% compared to 2Q03 and an increase of 7.3% compared to 1Q04. The decrease in 2Q04 compared to 2Q03 was due to a decrease in bad debt expenses. The expenses in 2Q03 were almost regarding Crosswave Communications Inc.

**General and administrative expenses** were JPY 613 million in 2Q04, an increase of 27.0% compared to 2Q03 and a decrease of 1.3% compared to 1Q04. The increase in year-over-year comparison was due to the increase in personnel expenses and the occurrence of the newly introduced enterprise tax.

### Operating income

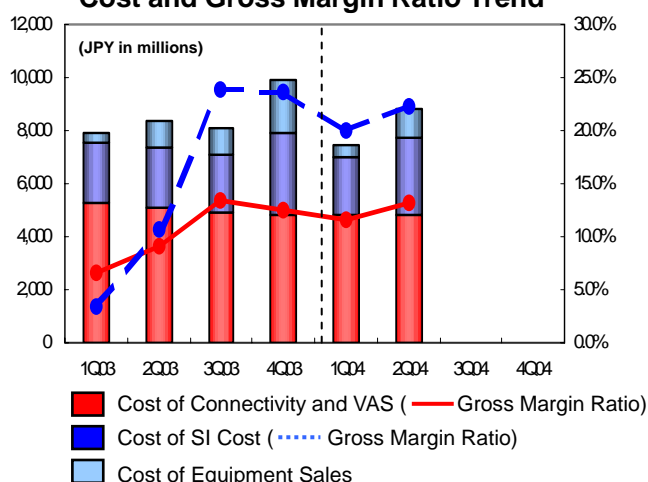
Operating income was JPY 282 million in 2Q04, compared to an operating loss of JPY 830 million in 2Q03 and operating loss of JPY 100 million in 1Q04 due to improvements in profitability for Connectivity,

### Cost of Revenues

(JPY in millions)

	2Q04	2Q03	YoY % change	1Q04	QoQ % change
<b>Total Costs</b>	<b>8,854</b>	8,337	6.2%	7,443	18.9%
<b>Connectivity &amp; VAS</b>	<b>4,780</b>	5,127	(6.8%)	4,811	(0.6%)
<b>SI</b>	<b>2,983</b>	2,276	31.1%	2,157	38.3%
<b>Equipment Sales</b>	<b>1,091</b>	935	16.7%	475	129.4%

### Cost and Gross Margin Ratio Trend



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VAS and SI revenues.

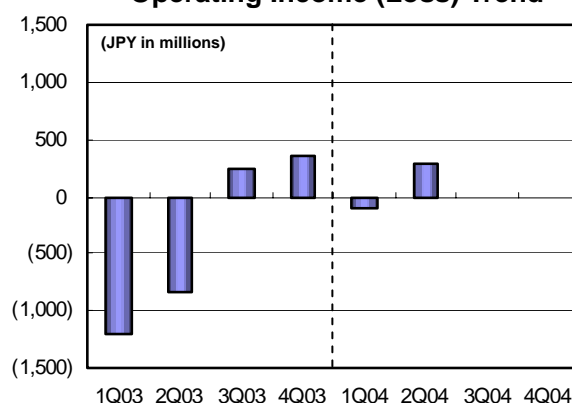
**Other expenses** for 2Q04 were JPY 10 million, compared to JPY 157 million in 2Q03 and JPY 151 million in 1Q04. The gains on the sale and exchange transaction of equity investments, which amounted JPY 121 million offset the interest expenses.

**Income tax expense** for 2Q04 was JPY 517 million, compared to a benefit of JPY 572 million in 2Q03 and a benefit of JPY 1,657 million in 1Q04. The decrease compared to 2Q03 and 1Q04 was due to an increase in valuation allowance for deferred tax assets attributable primarily to the income tax effect of decreasing unrealized gain on certain available-for-securities during the quarter.

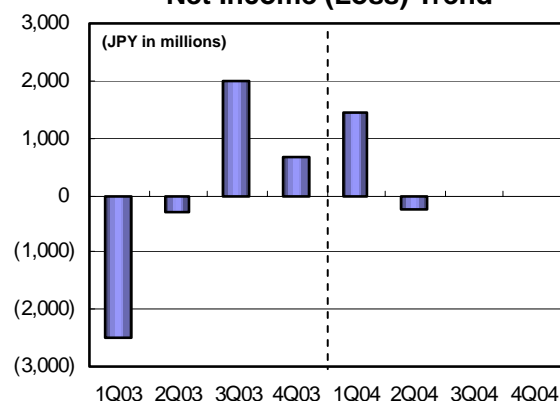
**Equity in net income of equity method investees** amounted to JPY 16 million in 2Q04, compared to loss of JPY 50 million in 2Q03 and loss of JPY 11 million in 1Q04.

**Net income (loss)** was a loss of JPY 273 million in 2Q04, compared to a net loss of JPY 278 million in 2Q03 and net income of JPY 1,434 million in 1Q04, in spite of the improvement in operating income, such income was offset by the increase in income tax expense.

**Operating Income (Loss) Trend**



**Net Income (Loss) Trend**



## 2<sup>nd</sup> Quarter FY2004 Business Review

### Analysis by Service

#### Connectivity and Value-added Services

##### Number of Contracts for Connectivity Services

	2Q04	2Q03	1Q04
<b>Dedicated Access Service Contracts</b>	<b>8,880</b>	6,250	8,076
IP Service (Low Bandwidth: 64kbps-768kbps) <sup>4</sup>	71	102	76
IP Service (Medium Bandwidth: 1Mbps-99Mbps)	597	505	594
IP Service (High Bandwidth: 100Mbps-)	93	57	82
IIJ T1 Standard and IIJ Economy <sup>5</sup>	358	676	421
IIJ Data Center Connectivity Service	225	184	224
IIJ FiberAccess/F and IIJ DSL/F (Broadband Services)	7,536	4,726	6,679
<b>Dial-up Access Service Contracts</b>	<b>711,637</b>	635,646	708,586
Dial-up Access Services, under IIJ Brand	70,629	80,216	73,225
Dial-up Access Services, OEM <sup>6</sup>	641,008	555,430	635,361
<b>Total Contracted Bandwidth</b>	<b>104.9Gbps</b>	66.7Gbps	95.6Gbps

<sup>4</sup> Including IPv6 Services.

<sup>5</sup> Quoted as "Limited Functionality Services" in 1Q04 for the services with local access not shared, limited on several functionality compared to IP service such as number of IP address allocated and fixed speed of 64kbps, 128kbps and 1.5Mbps.

<sup>6</sup> OEM stands for Original Equipment Manufacturer.

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In IP Services, the number of contracts for 100Mbps and over is increasing, since there were customers who shifted to higher bandwidth within IP Service in order to keep more reliable connectivity for critical usage such as main lines for corporate headquarters or upstream for Internet Service Providers. There were 20 customers with contracts for over 1Gbps, and the total contracted bandwidth topped 100Gbps.

Broadband services continued to grow rapidly, mainly due to the new major contracts for multi-site connectivity solutions. A few examples of the new customers that IIJ acquired in the first half of FY2004 were: an information distribution company that broadcasts news to initially approximately 200 sites which might expand to approximately 3,000 sites in the future, a beverage company that has network connections between 15 companies, Weathernews Inc., the world's largest weather information company with branches over 36 cities around the world that broadcasts information via platform built with Internet VPN and SMF, an electronic-powered tool manufacturer that has a combination of network with Wide-area LAN and Internet VPN as backup for connecting approximately 100 sales offices.

OEM contracts for dial-up access services also increased, since our OEM partners continued to increase the number of service contracts in the expanding individual broadband market.

### Connectivity and VAS Revenue Breakdown and Cost

(JPY in millions)

	2Q04	2Q03	YoY % change	1Q04	QoQ % change
<b>Connectivity Service Revenues</b>					
<b>Dedicated Access Service Revenues</b>					
IP Service <sup>7</sup>	2,223	2,485	(10.6%)	2,279	(2.5%)
IIJ T1 Standard and IIJ Economy	228	451	(49.5%)	275	(17.2%)
IIJ FiberAccess/F and IIJ DSL/F (Broadband Services)	382	300	27.2%	365	4.8%
<b>Dial-up Access Service Revenues</b>					
Under IIJ Brand	501	566	(11.5%)	509	(1.5%)
OEM	239	218	9.8%	243	(1.9%)
<b>VAS Revenues</b>	1,220	1,081	12.9%	1,187	2.8%
<b>Other Revenues</b>	716	536	33.4%	592	20.8%
<b>Total Connectivity and VAS Revenues</b>	5,508	5,637	(2.3%)	5,450	1.1%
<b>Cost of Connectivity and VAS</b>	4,780	5,127	(6.8%)	4,811	(0.6%)
<b>Backbone Cost (included in the cost of Connectivity and VAS)</b>	877	1,240	(29.3%)	985	(10.9%)
<b>Connectivity and VAS Gross Margin Ratio</b>	13.2%	9.1%		11.7%	

IP Service revenue declined due to the cancellation of the service by certain large customers. However, we see the trend that the major factor that decreased the IP Service revenues in the past, cancellation of major contracts by a regional electric power company's telecom service arm is being discontinued. We also see the trend that the shift of customers from IIJ T1 Standard and IIJ Economy to broadband services is being discontinued and with newly acquired contracts, we expect the decrease in dedicated access service revenue to bottom out sometime in 2H04.

VAS revenues continued to increase steadily. We had increased revenues from managed security, network operations, hosting and data center services. VAS revenues also increased from revenues from SMF and SEIL rental services due to the acquisition of major contracts for Internet VPN based connectivity. For SMF, we acquired contracts for over 3,000 sites since 1H03.

Backbone costs decreased by 29.3% compared to 2Q03 and by 10.9% compared to 1Q04. We expect that this trend will continue in 3Q04.

The cross-selling ratio between Connectivity and VAS, as the percentage of the largest 1,000 Connectivity service customers that use VAS was 86.9%.

### Cross-selling Ratios

	2Q04	1Q04
<b>VAS Cross-selling Ratio</b>	86.9%	86.8%
<b>SI Cross-selling Ratio</b>	80.0%	66.0%

<sup>7</sup> IP Service revenues includes revenues from Data Center Connectivity Service.



The cross-selling ratio between Connectivity and SI, as the percentage of SI customers that use Connectivity services among the largest 100 SI customers was 80.0%.

## Systems Integration

### Systems Integration Revenue Breakdown and Cost

(JPY in millions)

	2Q04	2Q03	YoY % change	1Q04	QoQ % change
<b>Systems Integration Revenues</b>	<b>3,838</b>	2,549	50.5%	2,695	42.4%
<b>Systems Integration</b>	<b>2,101</b>	1,333	57.5%	1,040	102.0%
<b>Outsourced Operation</b>	<b>1,737</b>	1,216	42.8%	1,655	5.0%
<b>Cost of Systems Integration</b>	<b>2,983</b>	2,276	31.1%	2,157	38.3%
<b>Systems Integration Gross Margin Ratio</b>	<b>22.3%</b>	10.7%		20.0%	

In 1H04, revenues increased primarily in network design and, configuration and installation of equipment to build multi-site connectivity with Internet VPN or Wide-area LAN technology to replace existing Frame Relay network. Revenues also increased in network planning, security consultation, project management and assistance for implementation. These services contributed to increase profits, since we use relatively more internal resources. Stable monthly revenues from outsourced operation increased as well. We expect the transfer of security system business of Yamatame by IIJ Technology will effect positively on our revenue and profits after 3Q04.

## Equipment Sales

### Equipment Sales Revenue and Cost

(JPY in millions)

	2Q04	2Q03	YoY % change	1Q04	QoQ % change
<b>Equipment Sales Revenues</b>	<b>1,167</b>	999	16.8%	531	119.8%
<b>Cost of Equipment Sales</b>	<b>1,091</b>	935	16.7%	475	129.4%
<b>Equipment Sales Gross Margin Ratio</b>	<b>6.5%</b>	6.4%		10.4%	

## Other Financial Statistics

### Other Financial Statistics

(JPY in millions)

	2Q04	2Q03	YoY % change	1Q04	QoQ % change
<b>Adjusted EBITDA<sup>8</sup></b>	<b>1,275</b>	126	909.0%	884	44.3%
<b>CAPEX, including capital leases<sup>9</sup></b>	<b>1,345</b>	579	132.2%	1,300	3.5%
<b>Depreciation and amortization<sup>10</sup></b>	<b>1,012</b>	984	2.8%	1,004	0.7%

## Key Service Developments

### **Transfer of security system business of Yamatame to IIJ Financial Systems:**

On September 17, 2004, IIJ Technology, our subsidiary that manages IIJ's systems integration services, signed a definitive agreement for the transfer of security system business of Yamatame. The business was transferred to IIJ Financial Systems, a newly established company that is 100% owned by IIJ Technology. The transfer was successfully completed on October 1, 2004. We believe that the financial services industry is one area in which we will see particularly strong growth. The finance industry in Japan is an area in which considerable expansion is expected as the market sees an increase in deregulation, such as the abolishment of laws barring banks from providing their customers with securities trading services. As a result, we are forecasting an increase in network usage and higher

<sup>8</sup> Please refer to the Reconciliation of Non-GAAP Financial Measures on the next page.

<sup>9</sup> Please refer to the Reconciliation of Non-GAAP Financial Measures on the next page.

<sup>10</sup> Depreciation and amortization includes amortization of issuance cost of convertible notes.

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demand for network and outsourced operating services.

### ***Addition of anti-spam features to our secure e-mail outsourcing service:***

In 2Q04, IIJ continued to take the initiative to help fight against spam in Japan to capture the demands for more secure corporate information system environment. We started to provide the anti-spam solutions as an additional feature for our corporate e-mail hosting services in October 2004.

### ***Introduction of SMF and SEIL routers to major telecommunication carriers:***

After 2Q04, IIJ came to agreements with several major telecommunication carriers for SMF and SEIL to be distributed for their Internet VPN or managed network services. The carriers include NTT Communications, QTNet and KVH Telecom Co., Ltd.

### ***Waive of service fees for victims of natural disasters:***

Since 2Q03 as a company to provide public telecommunication services, IIJ has waived the service fees for individual dial-up services for individuals in areas where the Disaster Relief Law was invoked due to the natural disasters that occurred during this period. The financial impact by the waive was or will be small since the unit price for our individual customers is relatively low compared to the unit price for our corporate customers.

### **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:

	Adjusted EBITDA		
	(JPY in millions)		
	2Q04	2Q03	1Q04
Adjusted EBITDA	1,275	126	884
Depreciation and Amortization <sup>11</sup>	(993)	(956)	(984)
Operating Income (Loss)	282	(830)	(100)
Other Expenses	(10)	(157)	(151)
Income Tax Expense (Benefit)	518	(572)	(1,657)
Minority Interests in Consolidated Subsidiaries	(43)	187	39
Equity in Net Loss of Equity Method Investees	16	(50)	(11)
Net Income (Loss)	(273)	(278)	1,434

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:

	CAPEX		
	(JPY in millions)		
	2Q04	2Q03	1Q04
Capital Expenditures	1,345	579	1,300
Acquisition of Assets by Entering into Capital Leases	1,294	431	977
Purchase of Property and Equipment	51	148	323

## Management Message/Webcast

On November 12, IIJ will present its management message and the Company's results and outlook by webcast. For details, please access the following URL: <http://www.iij.ad.jp/en/IR/>

<sup>11</sup> Depreciation and amortization excludes amortization of issuance cost of convertible notes that was presented as other expenses.

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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



**INTERNET INITIATIVE JAPAN INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS(UNAUDITED)**

For the Three Months Ended Sept 30, 2004, Sept 30, 2003 and Jun 30, 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		
	Sept 30, 2004			Sept 30, 2003			Jun 30, 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	25,702	2,832,355	27.0%	3,236,405	35.2%	(12.5%)	2,918,488	33.6%	(3.0%)
Dial-up access services	6,714	739,957	7.0	783,589	8.5	(5.6)	751,933	8.7	(1.6)
Value-added services	11,072	1,220,119	11.6	1,080,876	11.8	12.9	1,186,837	13.7	2.8
Other	6,494	715,617	6.8	536,389	5.9	33.4	592,390	6.8	20.8
Total connectivity and value-added services	49,982	5,508,048	52.4	5,637,259	61.4	(2.3)	5,449,648	62.8	1.1
Systems integration revenues	34,825	3,837,711	36.5	2,549,379	27.7	50.5	2,694,638	31.1	42.4
Equipment sales	10,586	1,166,569	11.1	998,621	10.9	16.8	530,621	6.1	119.8
<b>Total revenues</b>	<b>95,393</b>	<b>10,512,328</b>	<b>100.0</b>	<b>9,185,259</b>	<b>100.0</b>	<b>14.4</b>	<b>8,674,907</b>	<b>100.0</b>	<b>21.2</b>
<b>Costs and expenses:</b>									
Cost of connectivity and value-added services	43,378	4,780,268	45.5	5,126,708	55.8	(6.8)	4,811,341	55.5	(0.6)
Cost of systems integration revenues	27,065	2,982,577	28.3	2,275,704	24.8	31.1	2,156,620	24.8	38.3
Cost of equipment sales	9,899	1,090,870	10.4	934,711	10.2	16.7	475,466	5.5	129.4
Total costs	80,342	8,853,715	84.2	8,337,123	90.8	6.2	7,443,427	85.8	18.9
Sales and marketing	6,458	711,661	6.8	1,099,560	12.0	(35.3)	662,950	7.6	7.3
General and administrative	5,558	612,526	5.8	482,218	5.2	27.0	620,651	7.2	(1.3)
Research and development	474	52,237	0.5	96,118	1.0	(45.7)	48,368	0.6	8.0
<b>Total costs and expenses</b>	<b>92,832</b>	<b>10,230,139</b>	<b>97.3</b>	<b>10,015,019</b>	<b>109.0</b>	<b>2.1</b>	<b>8,775,396</b>	<b>101.2</b>	<b>16.6</b>
<b>Operating income(loss)</b>	<b>2,561</b>	<b>282,189</b>	<b>2.7</b>	<b>(829,760)</b>	<b>(9.0)</b>	<b>(134.0)</b>	<b>(100,489)</b>	<b>(1.2)</b>	<b>(380.8)</b>
<b>Other expenses</b>	<b>(93)</b>	<b>(10,188)</b>	<b>(0.1)</b>	<b>(157,294)</b>	<b>(1.7)</b>	<b>(93.5)</b>	<b>(150,700)</b>	<b>(1.7)</b>	<b>(93.2)</b>
<b>Income(Loss) before income tax expense(benefit)</b>	<b>2,468</b>	<b>272,001</b>	<b>2.6</b>	<b>(987,054)</b>	<b>(10.7)</b>	<b>(127.6)</b>	<b>(251,189)</b>	<b>(2.9)</b>	<b>(208.3)</b>
<b>Income tax expense(benefit)</b>	<b>4,695</b>	<b>517,379</b>	<b>4.9</b>	<b>(571,642)</b>	<b>(6.2)</b>	<b>(190.5)</b>	<b>(1,657,335)</b>	<b>(19.1)</b>	<b>(131.2)</b>
<b>Minority interests in consolidated subsidiaries</b>	<b>(388)</b>	<b>(42,837)</b>	<b>(0.4)</b>	<b>186,931</b>	<b>2.0</b>	<b>(122.9)</b>	<b>39,184</b>	<b>0.4</b>	<b>(209.3)</b>
<b>Equity in net income(loss) of equity method investees</b>	<b>141</b>	<b>15,548</b>	<b>0.1</b>	<b>(49,945)</b>	<b>(0.5)</b>	<b>(131.1)</b>	<b>(10,995)</b>	<b>(0.1)</b>	<b>(241.4)</b>
<b>Net income(loss)</b>	<b>(2,474)</b>	<b>(272,667)</b>	<b>(2.6%)</b>	<b>(278,426)</b>	<b>(3.0%)</b>	<b>(2.1%)</b>	<b>1,434,335</b>	<b>16.5%</b>	<b>(119.0%)</b>
<b>Basic Net Income(Loss) Per Share</b>		(7,117)		(10,082)			37,438		
<b>Basic Net Income(Loss) Per ADS Equivalent</b>		(3.56)		(5.04)			18.72		
<b>Weighted Average Number of Shares</b>		38,312		27,617			38,312		
<b>Weighted Average Number of ADS Equivalents</b>		76,623,702		55,233,050			76,623,702		

Note (1): The translation of Japanese yen amounts into US dollar amounts with respect to the three months ended Sept 30, 2004 are included solely for the convenience of readers outside Japan and have been made at the rate of JPY 110.20 = \$1, the approximate rate of exchange on Sept 30, 2004.

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

Appendix 2

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

	Sept 30, 2004			Sept 30, 2003		Jun 30, 2004	
	USD (1)	JPY	%	JPY	%	JPY	%
<b>ASSETS</b>							
<b>Current Assets:</b>							
Cash and cash equivalent	107,098	11,802,165	27.4%	11,782,935	30.7%	10,627,203	25.3%
Accounts receivable, net	61,152	6,739,000	15.6	6,726,563	17.5	5,377,230	12.8
Inventories	2,379	262,180	0.6	268,519	0.7	413,477	1.0
Prepaid expenses	5,917	652,061	1.5	654,269	1.7	932,097	2.2
Other current assets	965	106,364	0.3	464,418	1.2	457,325	1.1
<b>Total current assets</b>	<b>177,511</b>	<b>19,561,770</b>	<b>45.4</b>	<b>19,896,704</b>	<b>51.8</b>	<b>17,807,332</b>	<b>42.4</b>
<b>Investments in and Advances to Equity Method Investees</b>	<b>7,114</b>	<b>783,933</b>	<b>1.8</b>	<b>1,106,062</b>	<b>2.9</b>	<b>769,363</b>	<b>1.8</b>
<b>Other Investments</b>	<b>96,707</b>	<b>10,657,082</b>	<b>24.7</b>	<b>5,513,137</b>	<b>14.3</b>	<b>11,919,229</b>	<b>28.3</b>
<b>Property and Equipment, net</b>	<b>82,081</b>	<b>9,045,349</b>	<b>21.0</b>	<b>9,108,783</b>	<b>23.7</b>	<b>8,567,329</b>	<b>20.4</b>
<b>Guarantee Deposits</b>	<b>18,878</b>	<b>2,080,345</b>	<b>4.8</b>	<b>2,080,764</b>	<b>5.4</b>	<b>2,059,980</b>	<b>4.9</b>
<b>Other Assets</b>	<b>8,747</b>	<b>963,895</b>	<b>2.3</b>	<b>728,580</b>	<b>1.9</b>	<b>915,548</b>	<b>2.2</b>
<b>Total assets</b>	<b>391,038</b>	<b>43,092,374</b>	<b>100.0%</b>	<b>38,434,030</b>	<b>100.0%</b>	<b>42,038,781</b>	<b>100.0%</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>							
<b>Current Liabilities:</b>							
Short-term borrowings	52,016	5,732,204	13.3%	4,304,906	11.2%	5,363,001	12.8%
Payable under securities loan agreement	7,412	816,800	1.9				
Accounts payable	40,856	4,502,356	10.5	4,856,325	12.6	3,754,214	8.9
Accrued expenses	4,071	448,585	1.0	489,568	1.3	480,824	1.1
Other current liabilities	5,489	604,868	1.4	410,577	1.1	728,386	1.7
Long-term borrowings-current portion	14,974	1,650,139	3.8	2,946,377	7.7	1,549,189	3.7
Convertible notes	100,617	11,088,000	25.7			11,088,000	26.4
Capital lease obligations-current portion	22,605	2,491,070	5.8	2,588,505	6.7	2,403,477	5.7
<b>Total current liabilities</b>	<b>248,040</b>	<b>27,334,022</b>	<b>63.4</b>	<b>15,596,258</b>	<b>40.6</b>	<b>25,367,091</b>	<b>60.3</b>
<b>Long-term Borrowings</b>	<b>15,721</b>	<b>1,732,473</b>	<b>4.0</b>	<b>1,982,612</b>	<b>5.2</b>	<b>2,270,366</b>	<b>5.4</b>
<b>Convertible Notes</b>				<b>15,000,000</b>	<b>39.0</b>		
<b>Capital Lease Obligations-Noncurrent</b>	<b>32,855</b>	<b>3,620,613</b>	<b>8.4</b>	<b>3,198,073</b>	<b>8.3</b>	<b>3,123,878</b>	<b>7.4</b>
<b>Accrued Retirement and Pension Costs</b>	<b>928</b>	<b>102,224</b>	<b>0.3</b>	<b>69,794</b>	<b>0.2</b>	<b>89,037</b>	<b>0.2</b>
<b>Other Noncurrent Liabilities</b>	<b>2,724</b>	<b>300,190</b>	<b>0.7</b>	<b>193,043</b>	<b>0.5</b>	<b>233,046</b>	<b>0.6</b>
<b>Total liabilities</b>	<b>300,268</b>	<b>33,089,522</b>	<b>76.8</b>	<b>36,039,780</b>	<b>93.8</b>	<b>31,083,418</b>	<b>73.9</b>
<b>Minority Interest</b>	<b>8,581</b>	<b>945,572</b>	<b>2.2</b>	<b>437,678</b>	<b>1.1</b>	<b>901,088</b>	<b>2.2</b>
<b>Shareholders' Equity:</b>							
<b>Common stock</b>	<b>124,912</b>	<b>13,765,372</b>	<b>31.9</b>	<b>13,765,372</b>	<b>35.8</b>	<b>13,765,372</b>	<b>32.7</b>
<b>Additional paid-in capital</b>	<b>214,497</b>	<b>23,637,628</b>	<b>54.8</b>	<b>23,637,628</b>	<b>61.5</b>	<b>23,637,628</b>	<b>56.2</b>
<b>Accumulated deficit</b>	<b>(305,161)</b>	<b>(33,628,762)</b>	<b>(78.0)</b>	<b>(37,438,265)</b>	<b>(97.4)</b>	<b>(33,356,095)</b>	<b>(79.3)</b>
<b>Accumulated other comprehensive income</b>	<b>48,340</b>	<b>5,327,042</b>	<b>12.4</b>	<b>1,991,900</b>	<b>5.2</b>	<b>6,051,370</b>	<b>14.4</b>
<b>Treasury stock</b>	<b>(399)</b>	<b>(44,000)</b>	<b>(0.1)</b>	<b>(63)</b>	<b>0.0</b>	<b>(44,000)</b>	<b>(0.1)</b>
<b>Total shareholders' equity</b>	<b>82,189</b>	<b>9,057,280</b>	<b>21.0</b>	<b>1,956,572</b>	<b>5.1</b>	<b>10,054,275</b>	<b>23.9</b>
<b>Total liabilities and shareholders' equity</b>	<b>391,038</b>	<b>43,092,374</b>	<b>100.0%</b>	<b>38,434,030</b>	<b>100.0%</b>	<b>42,038,781</b>	<b>100.0%</b>

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

For the Three Months Ended Sept 30, 2004, Sept 30, 2003 and Jun 30, 2004

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

	Sept 30, 2004		Sept 30, 2003	Jun 30, 2004
	USD (1)	JPY	JPY	JPY
<b>Operating Activities:</b>				
Net income (loss)	(2,474)	(272,667)	(278,426)	1,434,335
Depreciation and amortization	9,179	1,011,532	983,736	1,004,170
Provision for doubtful accounts	181	19,968	313,968	(12,936)
Equity method net loss (income)	(141)	(15,548)	49,945	10,995
Minority interests in net income (loss) of consolidated subsidiaries	389	42,837	(186,931)	(39,184)
Foreign exchange losses (gains)	(129)	(14,152)	3,282	(7,585)
Loss on retirement of convertible notes	-	-	-	5,195
Net (gains) losses on other investments	(890)	(98,103)	97,530	2,749
Decrease (increase) in accounts receivable	(12,673)	(1,396,506)	(1,100,671)	3,627,399
Increase (decrease) in accounts payable	5,144	566,837	216,306	(3,094,772)
Decrease in inventories	1,361	149,969	72,432	24,958
Deferred income taxes	4,554	501,873	(577,444)	(1,672,424)
Other	4,927	542,953	(120,151)	(255,036)
<b>Net cash provided by (used in) operating activities</b>	<b>9,428</b>	<b>1,038,993</b>	<b>(526,424)</b>	<b>1,027,864</b>
<b>Investing Activities:</b>				
Purchase of property and equipment	(467)	(51,435)	(148,007)	(323,210)
Proceeds from sales of other investment	1,137	125,281	122,650	91,286
Purchase of other investments	(28)	(3,083)	(304,517)	(2,290)
Refund (payment) of guarantee deposits-net	(174)	(19,193)	1,199	14,528
Other	8	904	9,875	(4,851)
<b>Net cash provided by (used in) investing activities</b>	<b>476</b>	<b>52,474</b>	<b>(318,800)</b>	<b>(224,537)</b>
<b>Financing Activities:</b>				
Proceeds from long-term borrowings	9,074	1,000,000	-	-
Repayments of long-term borrowings	(13,039)	(1,436,943)	(36,017)	(36,710)
Proceeds from securities loan agreement	7,412	816,800	-	-
Repurchase of convertible notes	-	-	-	(745,488)
Principal payments under capital leases	(6,247)	(688,418)	(671,376)	(669,047)
Net increase (decrease) in short-term borrowings	3,350	369,203	(1,370,436)	(1,201,093)
Proceeds from issuance of common stock of a subsidiary	-	-	-	188,632
Proceeds from issuance of common stock	-	-	11,886,887	-
<b>Net cash provided by (used in) financing activities</b>	<b>550</b>	<b>60,642</b>	<b>9,809,058</b>	<b>(2,463,706)</b>
<b>Effect of Exchange Rate Changes on Cash</b>	<b>208</b>	<b>22,853</b>	<b>94</b>	<b>3,343</b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>10,662</b>	<b>1,174,962</b>	<b>8,963,928</b>	<b>(1,657,036)</b>
<b>Cash and Cash Equivalents, Beginning of Period</b>	<b>96,436</b>	<b>10,627,203</b>	<b>2,819,007</b>	<b>12,284,239</b>
<b>Cash and Cash Equivalents, End of Period</b>	<b>107,098</b>	<b>11,802,165</b>	<b>11,782,935</b>	<b>10,627,203</b>

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