



## **Internet Initiative Japan Inc.**

### **First Quarter Results for the Year Ending March 31, 2005**

**August 10, 2004**

Statements made in this material 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.

**Highlights**

**By Service**

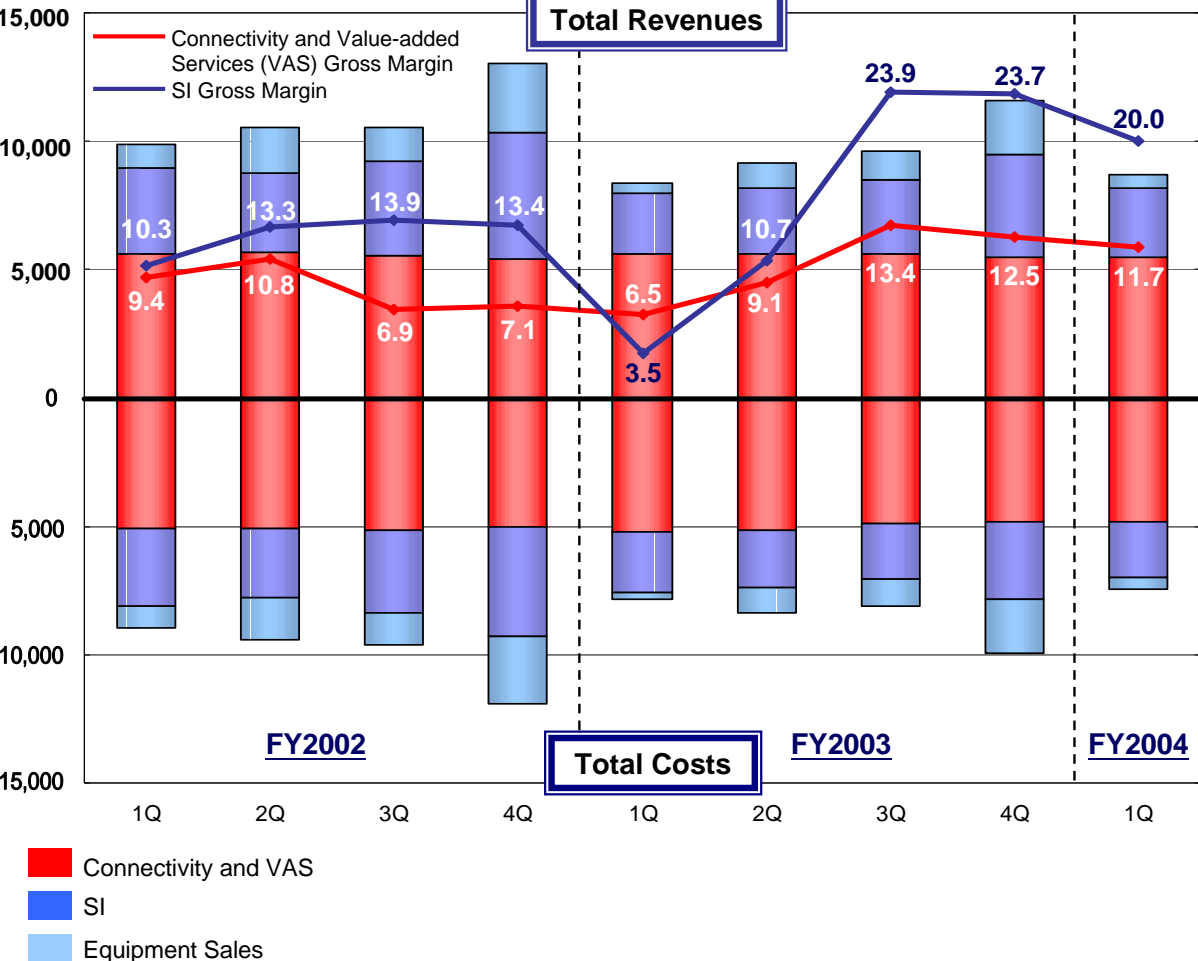
**Future Prospects**

(JPY millions)

	1Q04	1Q03	YoY % change	4Q03	QoQ % change
<b>Total Revenues</b>	<b>8,675</b>	8,344	4.0%	11,617	(25.3%)
<b>Total Costs</b>	<b>7,443</b>	7,868	(5.4%)	9,915	(24.9%)
<b>SG &amp; A Expenses</b>	<b>1,284</b>	1,585	(19.0%)	1,274	0.8%
<b>Operating income (loss)</b>	<b>(100)</b>	(1,206)	(91.7%)	350	(128.7%)
<b>Net income (loss)</b>	<b>1,434</b>	(2,475)	(29.7%)	669	114.5%

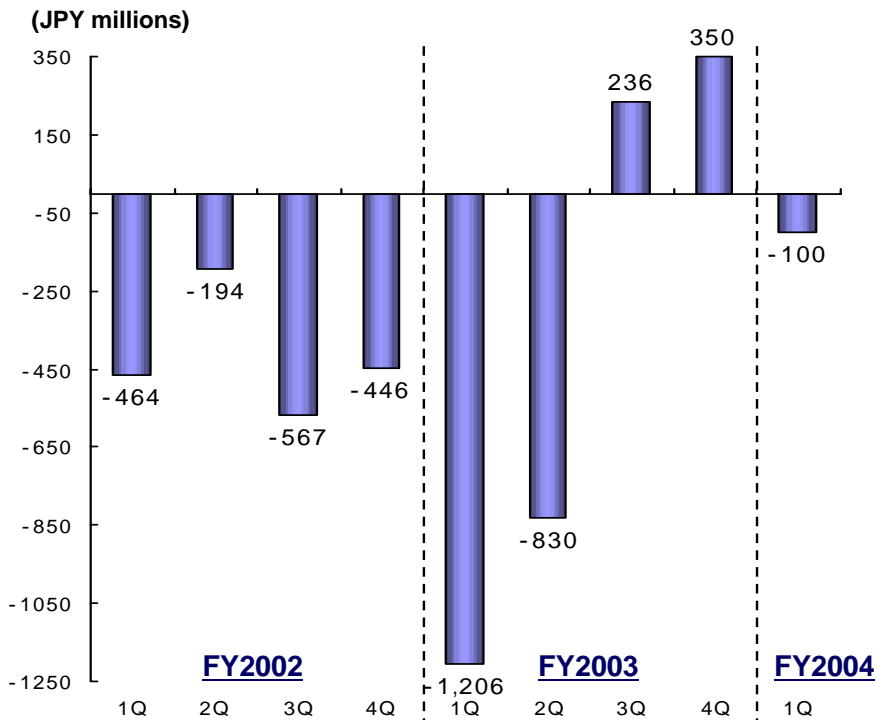
- ▶ **Total Revenues:** An increase of 4.0% compared to 1Q03 and a decrease of 25.3% compared to 4Q03. IIJ's first quarter typically has the lowest sales of its fiscal year due to seasonal variation.
- ▶ **Total Costs:** A decrease of 5.4% compared to 1Q03. A decrease of 24.3% compared to 4Q03 reflecting a decrease in Systems Integration (SI) and Equipment Sales revenues.
- ▶ **SG & A Expenses:** Expenses decreased by 19.0% compared to 1Q03 and are at the same level as 4Q03.
- ▶ **Operating income (loss):** Significantly improved compared to 1Q03. The results are in line with expectations.
- ▶ **Net income (loss):** JPY 1,434 million net profit largely due to income tax benefits from the unrealized gains on certain available-for-sale securities.

(JPY million)



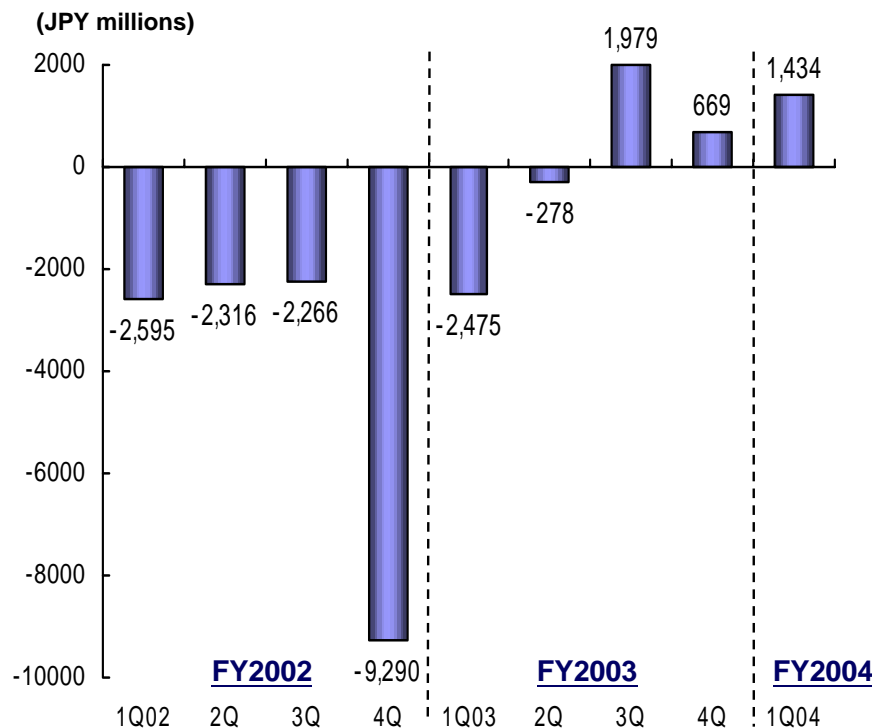
- ▶ Connectivity and VAS revenues have been stable. Decrease of Connectivity revenues is largely covered by growth in VAS revenues.
  - ▶ Connectivity and VAS costs have been stable or decreasing.
  - ▶ SI revenues and the cost of SI revenues are fluctuating. SI Gross margin has improved over time due to the decrease of unprofitable SI related equipment sales.
  - ▶ Equipment sales, which have a low margin, decreased. SEIL revenue increased.
- ▶ Connectivity and VAS Gross Margins improved compared to the first-half of FY2003 due to an increase in VAS revenue and a decrease of costs, including backbone costs.
  - ▶ SI Gross Margin has significantly improved compared to the first-half of FY2003 due to reduced SI service subcontracting and the growth of profitable outsourced Internet service operations and consultation.

## Operating Income (Loss)



- ▶ Minimized 1Q operating loss, which is typically the lowest of the year due to the seasonal nature of the SI business.
- ▶ IIJ has established a profit base due to increasing revenue and cost improvements.

## Net Income (Loss)



- ▶ Significant bottom line improvement since FY2003 due to absence of Crosswave associated net-loss.
- ▶ Achieved significant positive net income in 1Q04 due to income tax benefits from the unrealized gains on certain available-for-sales securities.

**Differentiating itself from the competition through its advanced technology, IIJ is expanding its business and strengthening its market presence by providing reliable network connectivity solutions, including SI and VAS solutions such as internet security, mail outsourcing services and multi-site connectivity. This is all done to help our loyal customer base.**

- ▶ Targeting annual positive operating and net income for FY2004**
- ▶ Expecting positive operating income in 2Q04 to cover 1Q04 operating loss due to:**
  - Growth in VAS and SI sales**
  - Continuous decrease of backbone costs**

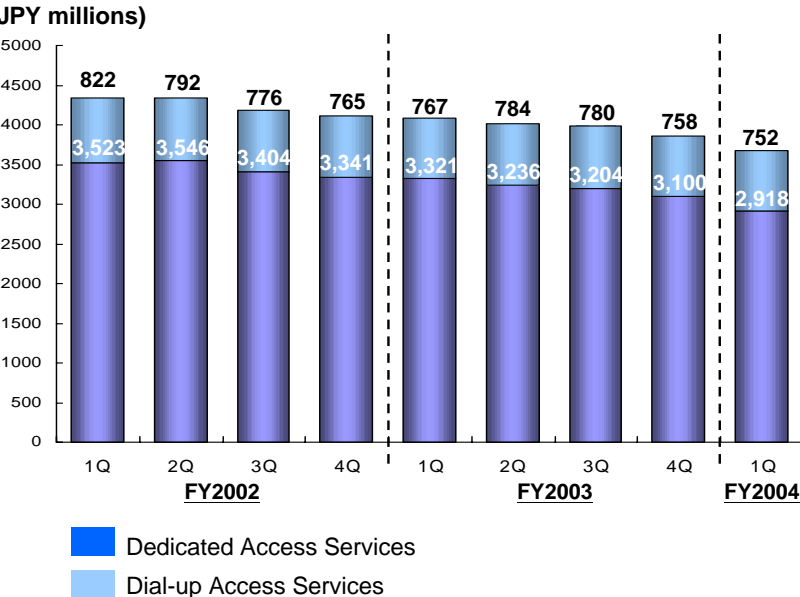
- ▶ **July 23, 2004: filed annual report on Form 20-F for the year ended March 31, 2004 with the US SEC. It includes an unqualified audit opinion with respect to its financial statements for the year ended March 31, 2004.**
- ▶ **On July 29, 2004: IIJ's ticker symbol restored to its original symbol "IIJ" from "IIJIE".**

**Highlights**

**By Service**

**Future Prospects**

## Revenues



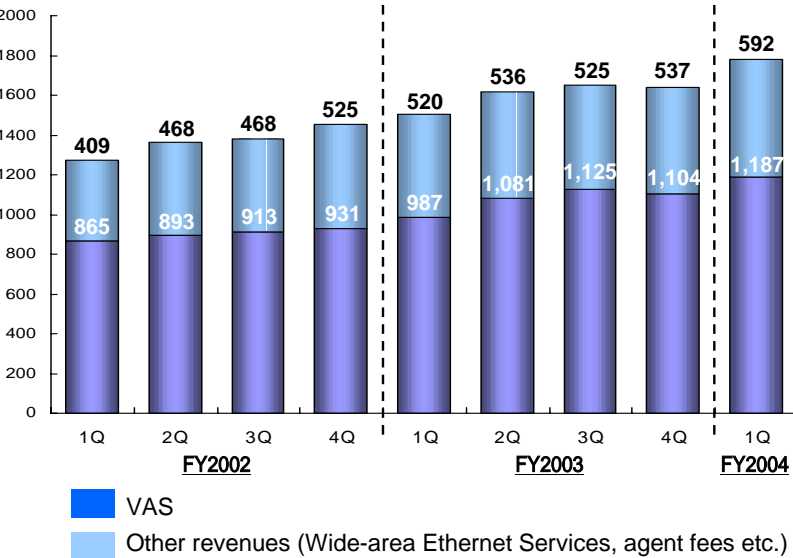
- ▶ Connectivity service revenues decreased by 10.2% YoY and 4.9% QoQ.
- ▶ The trend of declining unit prices for connectivity services and the shift to lower-cost broadband circuits has continued.
- ▶ The number of connectivity contracts has steadily increased.
  - [ Number of contracts for dedicated access services: 4Q03 - 7,226, 1Q04 - 8,076 (increasing by approximately 280 circuits per month) ]
- ▶ Total contracted bandwidth has also steadily increased.
  - [ Total contracted bandwidth for dedicated access services: 4Q03 - 80.1Gpbs, 1Q04 95.6Gpbs ]
- ▶ Number of customers with over 1 Gbps contracts also increasing.
- ▶ A new way of using broadband services has been established. Companies are now using these for internal multi-site connectivity. (IIJ created over approximately 1,000 new site connections in 1Q04)
- ▶ IIJ now typically provides other services, such as security and server outsourcing services, in addition to core connectivity services. These help increase VAS revenues.
- ▶ Backbone cost continued their declining trend.

## Expansion of customer base

- ✓ Expansion of customer base for more value-added and SI services
- ✓ Providing solutions to meet increasing corporate demand for network/service reliability as well as faster and more complicated networks.
- ✓ Promoting multi-site connectivity solutions and increasingly focused on blue-chip customers

## Revenues

(JPY millions)



- ▶ VAS revenues increased by 20.2% YoY and 7.5% QoQ.
- ▶ Steadily increasing revenues, from services such as security, network outsourcing, server outsourcing, data centers etc.
- ▶ Security service base of approximately 1,200 customers.
- ▶ Increasingly critical corporate Internet use: explosive increase in corporate e-mail, and growing demand for highly reliable VAS solutions such as solutions against information leakage.
- ▶ Network management becoming complicated: providing services such as firewall, SMF and other server outsourcing solutions as one package with managed operation and management.
- ▶ Promoting SMF actively through third party agents (KCOM, NEC System Integration & Construction Co., Ltd. (NESIC)).



## Showing more presence

- ✓ Differentiation of services due to IIJ's operating and engineering skills, and knowledge of Internet technologies such as backbone, security, e-mail services, etc.
- ✓ Meeting the demands for security and outsourced solutions with developed service offerings.
- ✓ Maintaining and up-selling customers by meeting their demands with managed services.

## [Security]

Protection of system against inappropriate Internet originated access or attacks

Corporate security assistance such as network vulnerability diagnosis, security policy, internal corporate education

IIJ Security Standard

IIJ Security Premium

IIJ Security Light

IIJ Network Intrusion Detection Service

IIJ Secure Remote Access

Secure Remote Access (IIJ-Tech)

Security Assessment and Security Related Consulting (IIJ-Tech)

## [Network Outsourcing]

Provision of equipment to connect to the Internet with configuration, monitoring and maintenance features as well as automatic configuration and management systems

Provision of safe and low-cost multi-site connectivity utilizing encryption technology

Router Rental Service (SEIL)

Managed Router Service (SEIL)

Rental Router Service

Omnibus

IIJ SMF Service (Patent Pending)

IIJ VPN Standard

## [Server Outsourcing]

Providing mail and mail distribution and, other web servers on behalf of customers

Provision of security features such as limited Internet access, and auditing and recording all incoming and outgoing e-mails

IIJ Mail Gateway Service

IIJ Post Office Service

IIJ Mailbox Service

IIJ Web Standard

IIJ Download Site Service

IIJ URL Filtering Service

IIJ Document Exchange Service

IIJ NetLightning

IIJ DNS Service

Mail Gateway Service/E (IIJ-Tech)

Web Gateway Service (IIJ-Tech)

SoMail(IIJ-Tech)

Mail distribution solutions (IIJ-MC)

Streaming solutions (IIJ-MC)

\* Also making new efforts on anti-spam

## [Data Center]

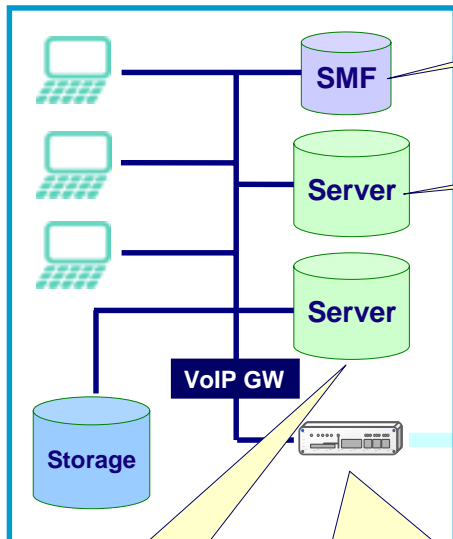
Hosting servers and other equipment in specially designed buildings, and providing equipment and operational, monitoring resources etc. for monthly and as needed fees (resource on demand data centers)

IIJ Group Data Center Solutions

IBPS(Integration & Business Platform Service)(IIJ-Tech)

# Focusing on Multi-site Connectivity (Network Integration)

IIJ Group Data Center/Customer  
Headquarter



SI Revenues (IBPS)  
Equipment Sales/VAS Revenues (Sale or rental of SEIL)

VAS/SI revenues (SMF)

Original technology (patent pending)

VAS/SI revenue (system integration, system operation and consultation)

Capturing SI business by implementing network integration cases

Connectivity Service Revenues (IP Service, High-speed)

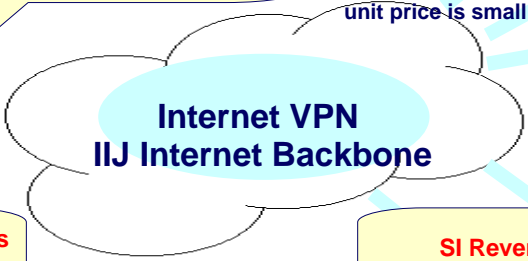
Equipment Sales/VAS revenues (Sale or rental of SEIL)

Originally developed/highly profitable

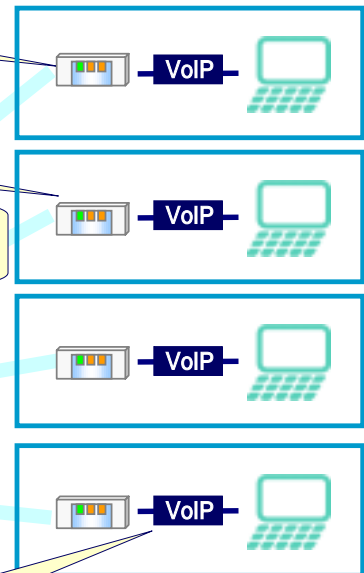
VAS/SI Revenues (SMF)

Connectivity Service Revenues (Broadband Services)

At least for the number of sites as "new demand", although unit price is small



Retail Stores etc. (50-over 100)



SI Revenues (VoIP)

Large-scale branch offices etc.

VAS Revenues (Helpdesk for clients)

Connectivity Revenues (IP Service, High-speed)

- ▶ Demand for utilizing lower-cost circuits for multi-site connectivity -> Provision of Internet VPN
- ▶ Market expansion for IIJ's corporate (virtual) closed network
- ▶ Managed solutions combined with operational outsourcing, SMF etc.
- ▶ Starting to provide network design, consultation and SI
- ▶ Increase proposals of additional values for both WAN and LAN functionality

## An Oil Company

- Ongoing project to expand client's information management systems to better manage gas stations and customer network for over 4,000 retail outlets throughout Japan.
- ✓ Applying Internet VPN and SMF as a platform
- ✓ IIJ's network solutions with lower network costs can easily introduce, high-level customer information security, centralized operations and management. The service is highly valued by client

## A Financial Institution

- Integration and operation of internet based network with branch terminals throughout Japan
- ✓ Providing broadband circuits to connect internet based terminals all over Japan
  - ✓ Utilizing IIJ SMF Service to each bank branch
  - ✓ Internet VPN technology used to maintain security
  - ✓ One-stop integration and operations by IIJ Group companies cooperating to provide a centralized operation and maintenance support center

## A Retail Chain Expanding all over Japan

Built Internet VPN connecting approximately 80 retail shops all over Japan and implemented VoIP for calls between shops

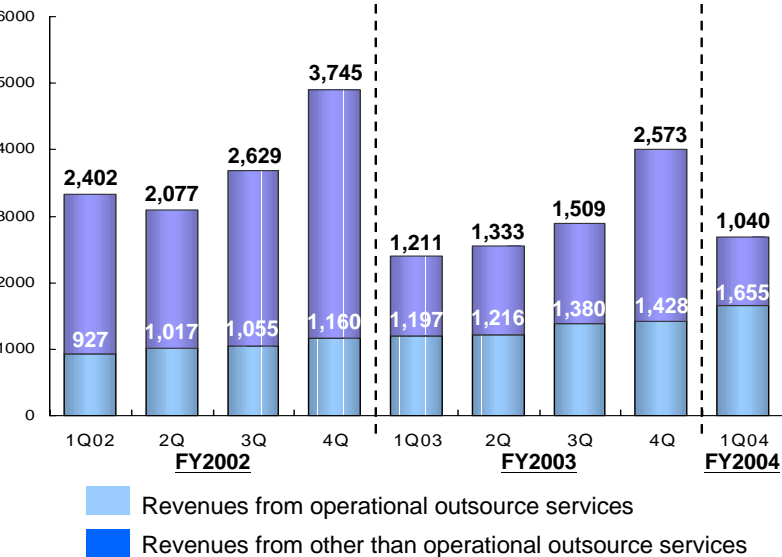
- ✓ Exploring IIJ SMF Service to 80 retail shops all over Japan
- ✓ Internet VPN technology is used over new network between shops. VoIP traffic goes through Internet
- ✓ IIJ designed overall network configuration and implemented center-based integration of the system
- ✓ General and detailed voice functionality designed by IIJ affiliate, Netcare

## An Affiliated Company of Apartment House Developing Company

Preliminary work to introducing the Internet into the apartment houses all over Japan (200 sites new planned per year)

- ✓ Installing SEIL in newly built apartment houses
- ✓ Central management available with IIJ SMF
- ✓ Apartment residents can access the Internet only by connecting the computer to "Information Plug" without configuring routers, etc.

## Revenues



- ▶ Although IIJ's first quarter SI revenues tend to be low, the revenues from operational outsource service increased (by 15.8% QoQ, 38.3% YoY) and contributed to the gross margin improvement.
- ▶ IIJ received several orders for the reconstruction of high profile projects including:
  - Sharp Space Town
    - CDN has been applied to broadband services
    - SMF has been applied to monitoring services of home information appliance (stereos)
  - Rikkyo university
    - Turning the campus network into a broadband environment and expanding portal sites
- ▶ Expanding consulting services such as Security Check Up Service and Security Alert Service to increase demand for corporate security service and as a gateway to provide higher value-added security services

## SI continues to be a key revenue and profit growth driver

- ✓ Stable revenue increase and building of a solid profit base by focusing on outsourced operational services
- ✓ Continuously propose new corporate SI business through new network integrations

	1Q04	1Q03	4Q03
<b>VAS Cross-selling Rate</b> <sup>*1</sup>	<b>82.3%</b>	82.3%	79.5%
<b>SI Cross-selling Rate</b> <sup>*2</sup>	<b>66.0%</b>	75.0%	66.0%

\*1 Percentage of customers to use both connectivity services and value-added services. Largest 1,000 customers only

\*2 Percentage of SI customers to use connectivity services in largest 100 SI customers

**Highlights**

**By Service**

**Future Prospects**

## Business Environment

### Increased Use of the Internet

- Japan's economy is recovering
- Corporate IT investment is showing the sign of this recovery
- Benefiting from the spread of broadband
- Benefiting from the Japanese government's "e-Japan II" initiative
- Home information appliances, spread of the networked home
- Increasing concerns on the security of personal and corporate information

## Corporate Trend

### Requirement of higher reliability

- Increasing corporate broadband use
- Increasing demand for operational outsource of services due to high-level network use
- Increasing complexity of corporate networks
- Increasing demand for security solutions (Increasing concerns of information leakage or anti-virus measures)
- Integrating information system cost and general affair cost

### NTT

- Joint research proceeding
- Interaction between personnel



## Development as a Network Solution Provider

- Providing highly reliable solutions backed by experienced engineering skills
  - Capability to initiate, build, and operate network systems to customers' requirements

### Competitors

- Unification of competitors - paradigm shift
- Continuous price competition

### Vision

- Suggest outline of future network
- Unique insight gained by having helped created Japan's commercial internet network
- Involvement in a wide-range of policy making organizations

### Technology

- Actions taken to maintain technology lead for IPv6, Auto ID, CDN
- Operational capability on giga-bit class network and servers

### Reliability

- Full range of services to operate and manage customers' networks

### Community

- Contributing to the network society's next generation
- Stable corporate finances