



## **Internet Initiative Japan Inc.**

**Second Quarter Results for the Year Ending  
March 31, 2005**

**November 11, 2004**

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✓ **Revenue substantially increased and operating income turned positive in 2Q04**

Total Revenue: JPY 10,512 million

(An increase of 14.4% from 2Q03 and an increase from 21.2% to 1Q04)

Operating income: JPY 282 million

(An operating loss of JPY 830 million in 2Q03 and JPY 100 million in 1Q04)

✓ **Operating and net income turned positive in the first half of FY2004**

Operating income: JPY 182 million

(Operating loss of JPY 2,035 million in 1H03)

Net income: JPY 1,162 million

(Net loss of JPY 2,753 million in 1H03)

- ▶ Operating profit generated by increasing revenues from network solutions and maintaining costs
- ▶ Operating and net income turned positive in the first fiscal year, which is usually the weakest part of the fiscal year, due to the seasonal fluctuation of SI revenues. IIJ expects that the trend of growing positive operating income will continue into 3Q04.

**Highlights**

**By Service**

## Second Quarter of FY2004

(JPY millions)

	2Q04	2Q03	YoY % Change	1Q04	QoQ % Change
Total Revenues	10,512	9,185	14.4%	8,675	21.2%
Total Costs	8,854	8,337	6.2%	7,443	18.9%
SG&A Expenses / R&D	1,376	1,678	(18.0%)	1,332	3.3%
Operating Income (Loss)	282	(830)	-	(100)	-
Net Income (Loss)	(273)	(278)	-	1,434	-

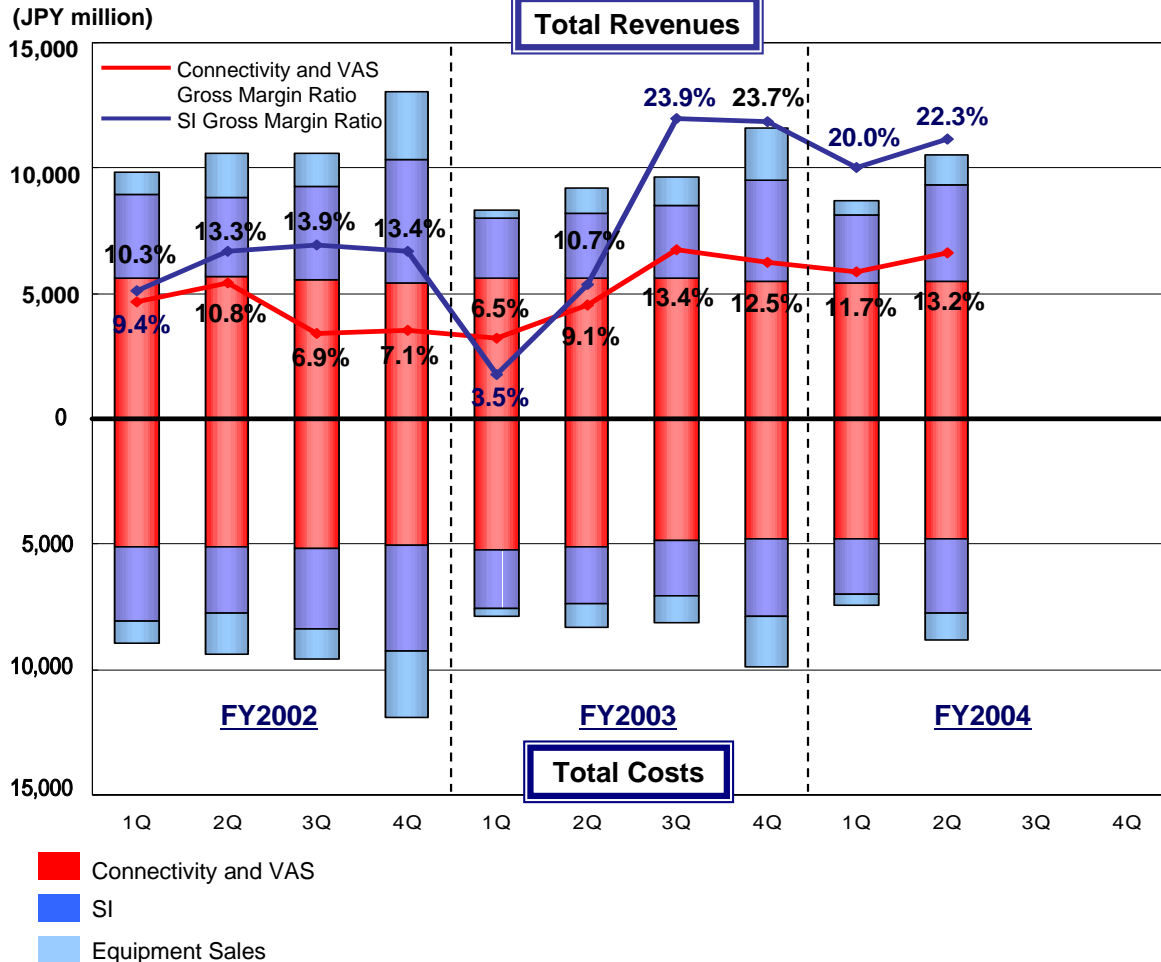
- ▶ Revenues substantially increased compared to 2Q03 and 1Q04, primarily due to an increase in revenues from Value-added Services (VAS) and Systems Integration (SI)
- ▶ The percentage of total costs and SG&A/R&D expenses to total revenues continuously decreased (SG&A expenses in 2Q03 includes the bad debt expenses regarding Crosswave)
- ▶ Operating income in 2Q04 substantially improved compared to 2Q03 and 1Q04

## First Half of FY2004

(JPY millions)

	1H04	1H03	YoY % Change
Total Revenues	19,187	17,529	9.5%
Total Costs	16,297	16,206	0.6%
SG&A Expenses / R&D	2,708	3,359	(19.4%)
Operating Income (Loss)	182	(2,035)	-
Net Income (Loss)	1,162	(2,753)	-

- ▶ Operating profit generated by increasing revenues from network solutions and maintaining costs
- ▶ Operating and net income turned positive in the first fiscal year, which is usually the weakest part of the fiscal year, due to the seasonal fluctuation of SI revenues
- ▶ Guidance met (positive operating and net income in 1H04), and IIJ expects that the trend of growing incomes will continue into 3Q04



▶ **Connectivity and VAS gross margin ratio was 13.2%, showing a stable movement since 2H03**

- Revenue from VAS is steadily increasing, and we hope that it will continue to increase without a large amount of increased costs.

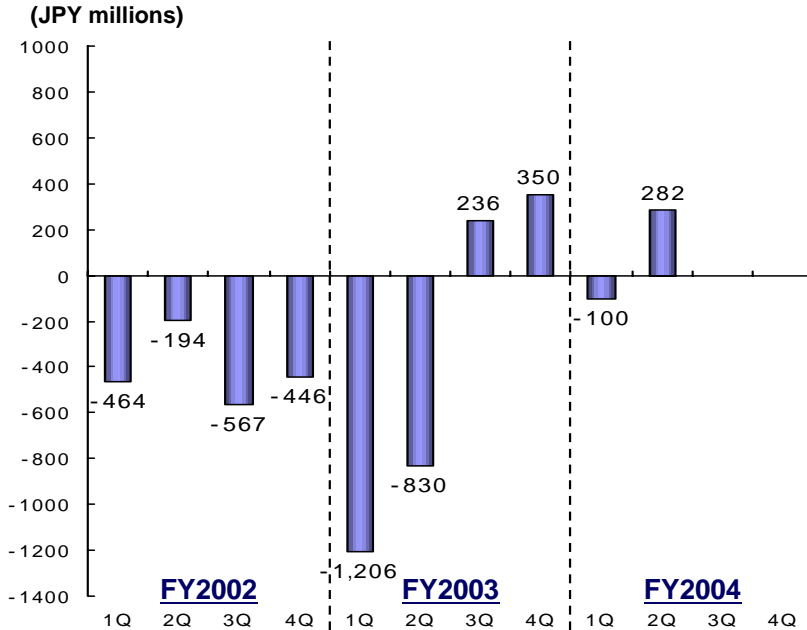
- Fixed costs including backbone costs (which decreased by JPY 107 million from 1Q04) continued to decrease, and we expect that the trend will continue in 3Q04.

▶ **SI gross margin ratio was 22.3%, an increase of 2.3% compared to 1Q04**

- Revenue and the gross margin ratio increased compared to 1Q04, which had lower revenues

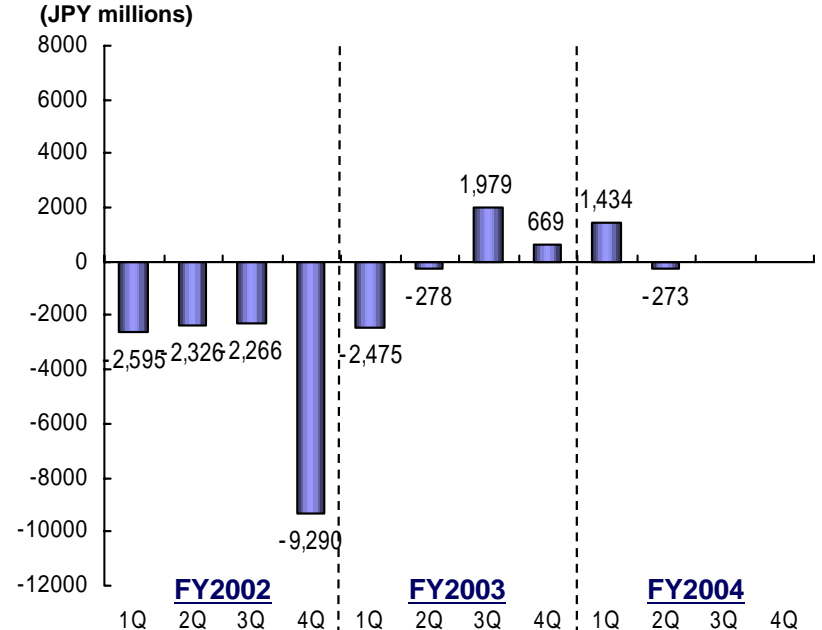
- We expect that the trend of increasing gross margins will continue by increasing revenues from outsourced operations and solution projects including consulting features, especially projects that require a high degree of engineering skill

## Operating Income (Loss)



- ▶ Achieved positive operating income in the first half of the fiscal year, which is usually the weakest half of the fiscal year, mainly due to seasonal fluctuations
- ▶ Operating profit generated by increasing revenues from network solutions and maintaining costs

## Net Income (Loss)



- ▶ The improvement in operating income was offset by the increase in income tax expense primarily to the income tax effect of decreasing unrealized gain on certain available-for-securities.
- ▶ Significant bottom line improvement since FY2003 due to the absence of Crosswave associated net-losses.

- Our business environment is continuously improving. We are seeing increased demand for more reliable, high quality networks for critical usage by corporate customers and more network usage by governmental organizations and private companies
- By differentiating IIJ from the competition through the Company's advanced technology, we will expand the business and strengthen our market presence by providing reliable network connectivity solutions in an effort to continually help our loyal customer base

- ▶ Targeting annual positive operating and net income for FY2004
- ▶ Expecting that the trend of growing positive operating income continue into 3Q04

**The security system business of Yamatane Co. Ltd. was transferred to newly established IIJ Financial Systems Inc.**

**Overview of business transferred**

Details of business: Development and outsourced operation of business systems for security companies with retail outlets

Revenues: Approximately JPY 2.3 billion  
(Actual result in FY2003)

Date of transfer: October 1, 2004

**Overview of IIJ Financial Systems Inc.**

Details of business: Development and operation of systems for financial institutions



Established: September 2004

Capital: JPY 50 million

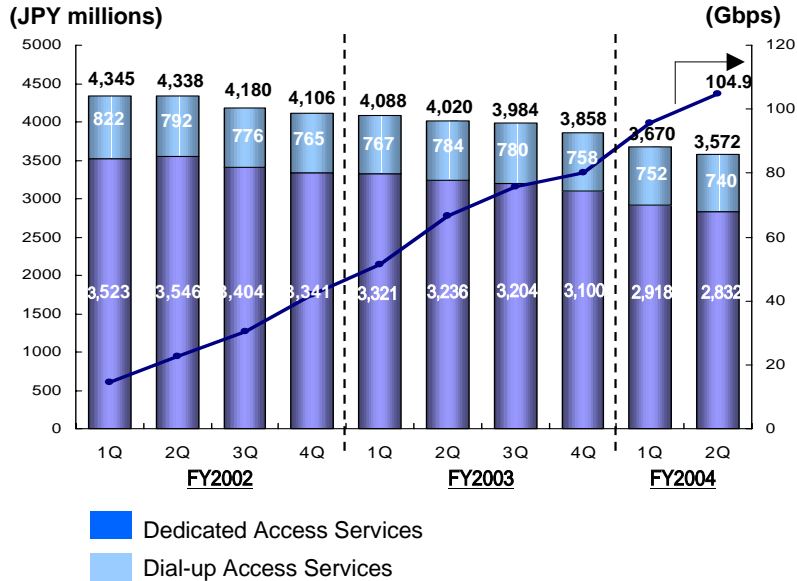
Shareholders: 100% owned by IIJ Technology

- ▶ Allows IIJ to provide total security system solutions by integrating IIJ Group's know-how for the development and operation of on-line security trading systems and Yamatane's know-how for the development and operation of business systems for security companies with retail outlets
- ▶ Creates a platform that allows IIJ to expand its solutions business into the financial service industry, where advanced network usage is expected to increase as a result of deregulation (ie: the abolishment of laws barring banks from providing their customers with security trading services)

**Highlights**

**By Service**

## Revenues



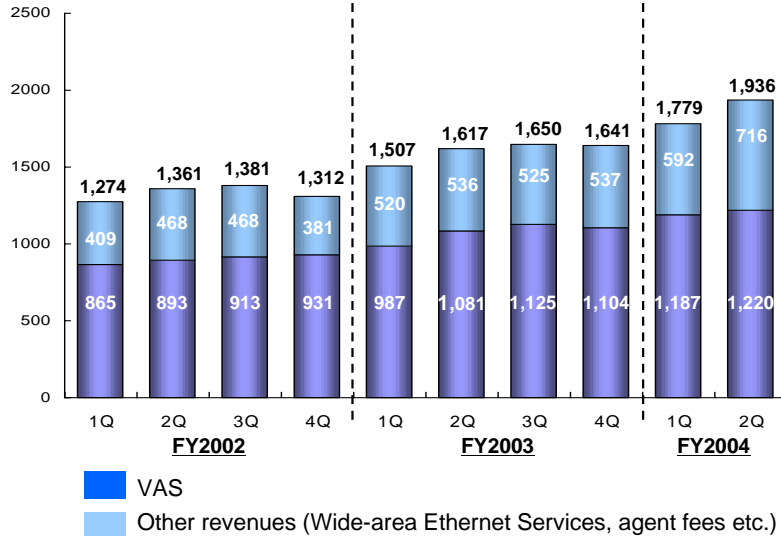
- ▶ Expected slowdown in the trend of cancellations of certain IP Service contracts and/or the shifting of contracts to lower-priced broadband services. Decrease of dedicated access service revenue expected to bottom out sometime in 2H04.
- ▶ Continuously trying to acquire multi-site connectivity, having acquired contracts for approximately 1,200 sites in 2Q04 (1,000 in 1Q04) by expanding our market to WAN and LAN area.
- ▶ The number of connectivity contracts has steadily increased.
  - [ Number of contracts for dedicated access services: 1Q04 - 8,076, 2Q04 - 8,880 (increasing by approximately 270 circuits per month) ]
- ▶ Total contracted bandwidth topped 100Gbps.
  - [ 1Q04 - 95.6Gbps, 2q04 104.9Gbps ]
- ▶ Number of customers with over 1Gbps contracts increased to 20.
- ▶ As a company providing public telecommunication services, we waived the service fees for individual dial-up services for victims of earthquakes or typhoon for a limited period. However the impact to our revenues is expected to be small.
- ▶ Trend of backbone costs continued to decline (declined by 10.9% compared to 1Q04).

## 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)

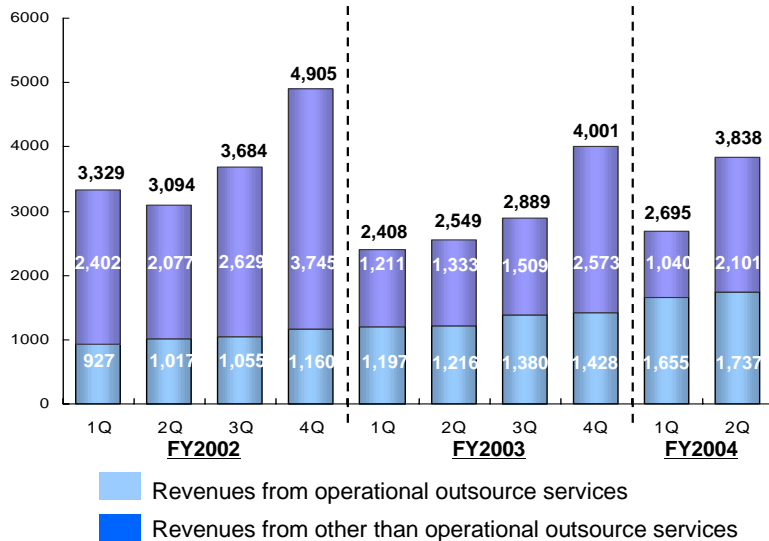


- ▶ VAS revenues continued to improve, increasing 12.9% YoY and 2.8% QoQ, and becoming one of the major revenue sources
- ▶ Continuously increasing revenues from security, server outsourcing and data centers.
- ▶ Increased revenues from network outsourcing services by providing services such as SMF (automatic router configuration and SEIL rental service)
- ▶ Acquired contracts of SMF for approximately 3,000 sites
- ▶ Expanded SMF selling channels through deals with NTT Com, QNet, etc.
- ▶ Started to provide “Line Management/F” to provide one-stop order and maintenance of NTT’s Flet’s local access to enhance our Internet VPN solutions
- ▶ Provided anti-spam service to support the corporate need for secure information systems, combined with our existing e-mail outsourcing services

## 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.

## Revenues



- ▶ Revenues increased substantially by 50.5% compared to 2Q03 and by 42.4% compared to 1Q04. Revenues from SI development increased toward the end of September.
- ▶ Revenues increased primarily in Network design and in the configuration and installation of equipment that is used to build multi-site connectivity with Internet VPN or Wide-area LAN technology
- ▶ Revenue also increased in provision of solutions such as network planning, security consultation, project management and implementation assistance, which increased our profits since IIJ needs to add little in terms of additional internal resources
- ▶ Steady increase of recurring monthly revenues from outsourced operations starting to generate steady revenue streams
- ▶ We expect the transfer of the security system business of Yamatane to positively affect our revenue and profits in and after 3Q04.

## 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

- ✓ Usage (%) of VAS by Connectivity service customers continues to stay at a high level
- ✓ Usage (%) of Connectivity service by SI customers also increased

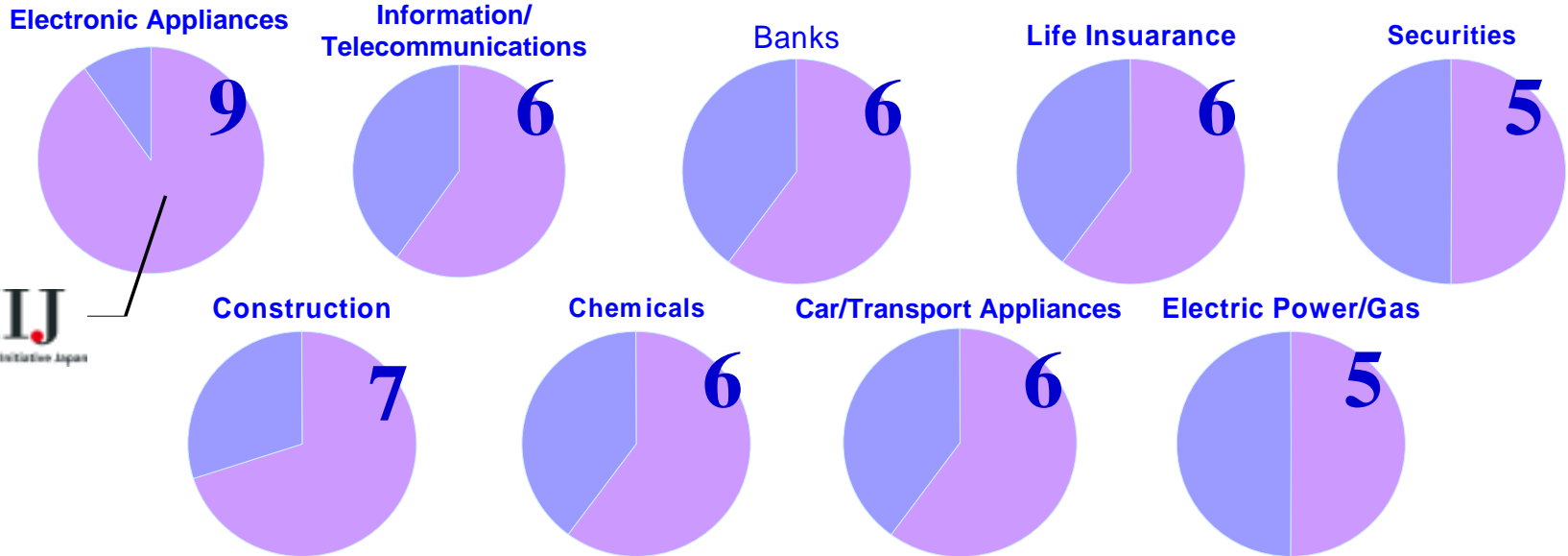
	2Q04	1Q04
VAS Cross-selling Ratio <sup>*1</sup>	86.9%	86.8%
SI Cross-selling Ratio <sup>*2</sup>	80.0%	66.0%

\*1 Percentage of the largest 1,000 connectivity service customers that use VAS

\*2 Percentage of SI customers that use connectivity service among the largest 100 SI customers

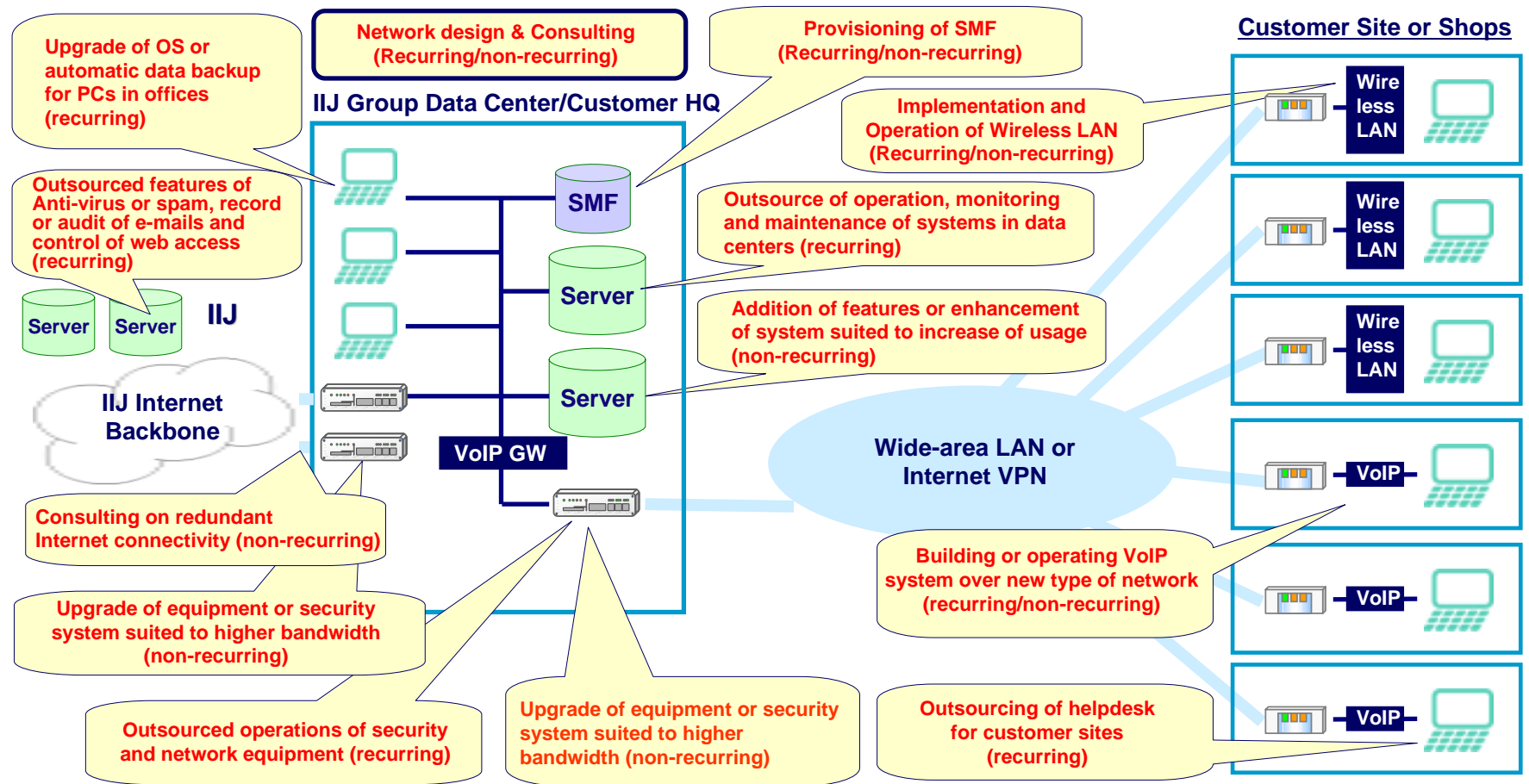
**IIJ's reliable service quality is being supported by many corporations where advanced network usage is being expanded**

▶ Ratio of usage of IIJ services by major enterprises listed in the markets



\* 10 major companies listed by annual consolidated revenue in each industry. Revenue data based on Toyo Keizai Shimbun "Kaisha Shikiho, 4th edition, 2004" (excluding banks, security companies and life insurance companies)

# Model of Network Integration Cases



# Examples of Multi-site Connectivity

## Weathernews Inc.

The world's largest weather information company with branches in 36 cities in 15 countries. Broadcasts information to mobile phones, media, natural disaster protection organizations etc. Currently transferring the existing information distribution network using private lines to broadband WAN.

- ✓ Applying Internet VPN and SMF as a platform
- ✓ Initially over 100 sites, which is planned to expand to a few thousand
- ✓ Using IIJ's international VPN service for Korea

## A Beverage Company

Building large-scale main business network connecting approximately 30 sites including 15 manufacturing and sales companies. Expanding all over Japan.

- ✓ Using the services of IIJ Group since 2000
- ✓ Having evaluated IIJ's network operation's reliability, they have ordered such SI services as database development, outsourced operations and they expanded to manufacturing and sales companies over Japan
- ✓ In 2004, IIJ received an order to design and renovate the main business network (both main and back-up circuits are to be provided by IIJ)

## An Electronic-powered Tool Manufacturer

Transferring Intranet connecting approximately 100 sales offices all over Japan from the existing Frame Relay to Internet VPN. Installing redundancy among major sites with Wide-area LAN and Internet VPN.

- ✓ Applying Internet VPN and SMF as a platform
- ✓ Customer highly valued IIJ's ability to propose a reliable network and to use Internet VPN as back-up and to provide both Wide-area LAN and Internet VPN in "one-stop"

## An News Distribution Company

Broadcasting news and other information to its clients over Japan in real time using a dedicated application. Transferring the current existing network with leased lines to Internet VPN.

- ✓ Applying Internet VPN and SMF as a platform
- ✓ Chose IIJ after having evaluated IIJ's ability on project management
- ✓ Initially to be implemented at 200 sites, which is expected to expand to approximately 3,000 sites in the future

Many telecommunications carriers are choosing SEIL and SMF as one of core features of their Internet VPN services

- ▶ Starting to be chosen as a standard feature for the carriers' Internet VPN and managed services for corporate customers
- ▶ IIJ will pursue a model of providing licenses, such as incorporating the feature into home gateway appliances
- ▶ IIJ will also seek to strategically utilize its advanced technology as intellectual property

## Carriers to which SMF is to be provided



## <Reference>

- Future Prospect
- IIJ's Value-added Services

## Business Environment

- 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

## Increased Use of the Internet

## Corporate Trend

- 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

## Requirement of higher reliability

## 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

## [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)