



## **Internet Initiative Japan Inc.**

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

**February 9, 2005**

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.

✓ **Largely increased operating and net income in 3Q04**

- Operating income: JPY 410 million  
(An increase of 73.9% from 3Q03 and an increase of 45.4% from 2Q04)
- Net income: JPY 920 million  
(Turned positive from a net loss of JPY 273 million in 2Q04)

Higher-margin and recurring revenues such as operational outsourcing and maintenance revenues continued to increase

✓ **We expect sequential and annual increases in revenue and operating income in 4Q04**

- Fourth quarter is usually the strongest part of our fiscal year due to seasonal fluctuation of SI revenues
- We expect that an increase in revenues from operational outsourcing and maintenance will continue

**Highlights**

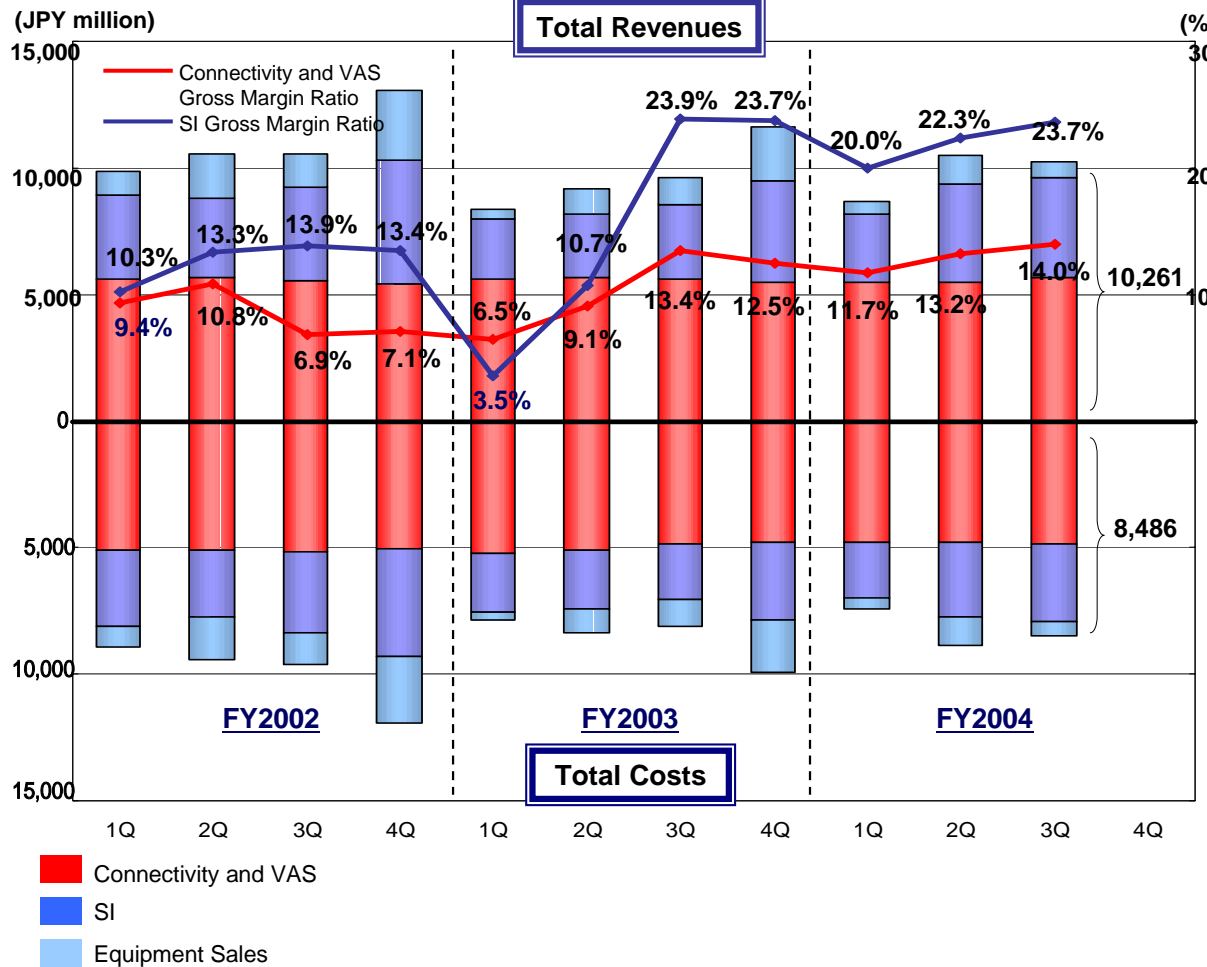
**By Service**

**Topics**

(JPY millions)

	3Q04		3Q03		YoY	2Q04		QoQ
		% of Total Revenues		% of Total Revenues	% change		% of Total Revenues	% change
<b>Total Revenues</b>	<b>10,261</b>	<b>100.0%</b>	9,633	100.0%	6.5%	10,512	100.0%	(2.4%)
<b>Total Costs</b>	<b>8,486</b>	<b>82.7%</b>	8,125	84.3%	4.4%	8,854	84.2%	(4.2%)
<b>SG &amp; A Expenses</b>	<b>1,365</b>	<b>13.3%</b>	1,272	13.2%	7.3%	1,376	13.1%	(0.8%)
<b>Operating income</b>	<b>410</b>	<b>4.0%</b>	236	2.4%	<b>73.9%</b>	282	2.7%	<b>45.4%</b>
<b>Net income (loss)</b>	<b>920</b>	<b>9.0%</b>	1,979	20.5%	(53.5%)	(273)	(2.6%)	-

- Total Revenues ▶ **Increased from 3Q03** due to an increase of solutions related to network and systems operations and maintenance
- Total Costs ▶ **Continued decreases**, especially in backbone costs  
Gross margin ratio improved due to an increase in revenues from relatively higher-margin VAS and SI outsourcing operations
- Operating income ▶ **Substantially increased** from 3Q03 and 2Q04 and in-line with guidance issued in 2Q04, due to the factors mentioned above and a decrease in SG&A expenses
- Net income (loss) ▶ **Substantially improved** due to the improvement in operating income, the sale of available-for-sale securities and the income tax benefit due to the effect of increases in unrealized gains on certain available-for-sale securities



- ▶ **Connectivity and VAS gross margin ratio continued to improve to 14.0%**
- Trend of decreasing connectivity revenues has almost flattened
- VAS revenues increased and backbone costs decreased

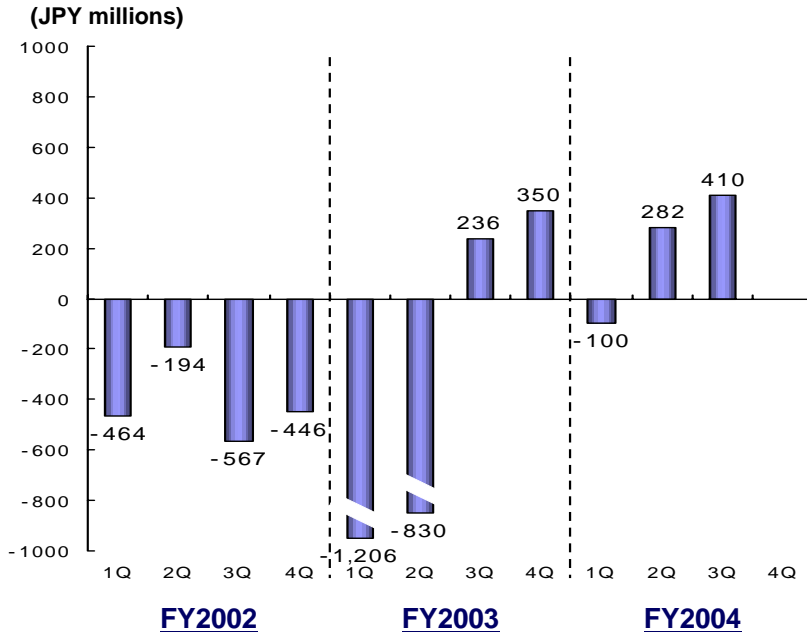
We expect that gross margins will continue to be stable, since there is no large factor increasing costs

- ▶ **SI gross margin ratio was 23.7%, increased by 1.4% from 2Q04**
- Higher-margin outsourced operations revenues steadily increased

We expect that the gross margin ratio will continue to move higher by our promoting highly value-added solution projects that include consulting components

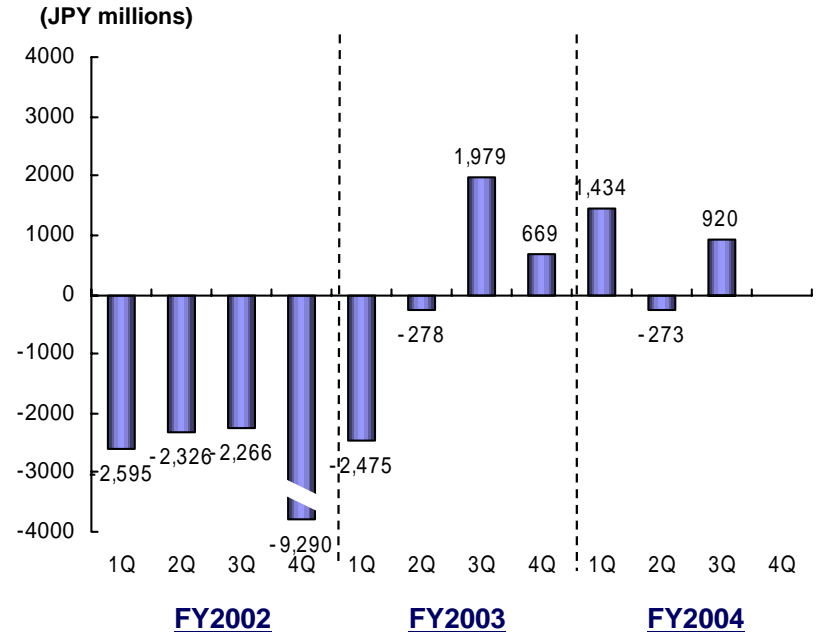
## Operating Income (Loss)

- ▶ Operating income increased compared to 3Q03 and 2Q04
- ▶ Having established a profit base due to increased revenues from relatively higher-margin VAS and outsourced operations etc. and effective cost management



## Net Income (Loss)

- ▶ Substantially improved due to higher operating income, the sale of available-for-sale securities and the increase in income tax benefit



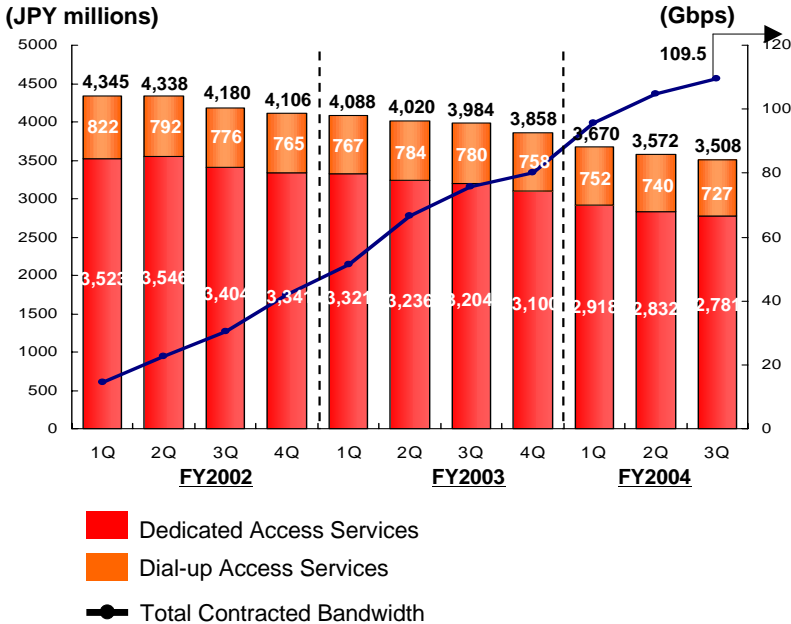
- ✓ **We expect sequential and annual increases in revenue and operating income in 4Q04**
  - Fourth quarter is usually the strongest part of our fiscal year due to seasonal fluctuation of SI revenues
  - We expect that an increase in revenues from operational outsourcing and maintenance will continue

**Highlights**

**By Service**

**Topics**

## Revenues

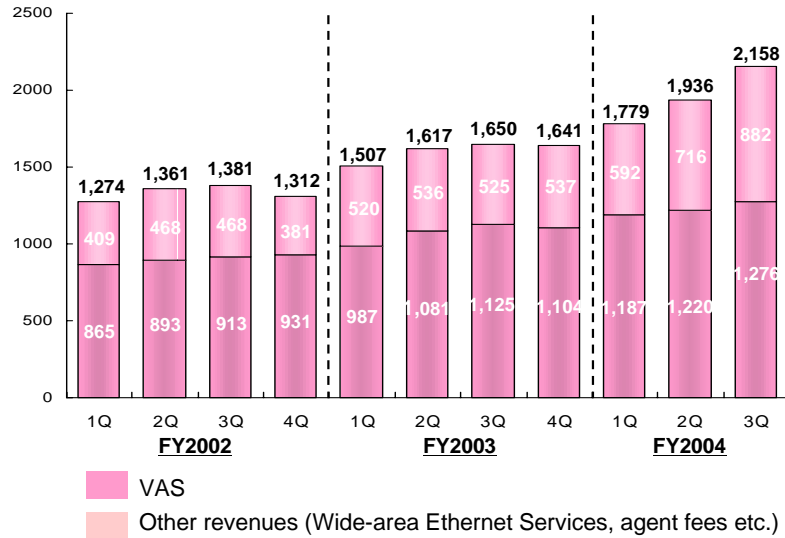


- ▶ Trend of decreasing connectivity service revenues is slowing and has almost become flat (4Q03 to 1Q04: -188M, 1Q04 to 2Q04: -98M, 2Q04 to 3Q04: -64M)
- ▶ Shift to lower-priced broadband services almost completed
- ▶ Broadband service contracts steadily increasing due to acquisition of multi-site connectivity customers
- ▶ The number of connectivity contracts and total contracted bandwidth steadily increased.
  - [ Number of contracts for dedicated access services: 2Q04 -8,880, 3Q04 - 9,427 ]
  - [ 2Q04 - 104.9Gpbs, 3Q04 109.5Gpbs ]
- ▶ Number of customers with 1G+ contracts increased to 22
- ▶ Many corporate customers seeking more bandwidth in IP services (10 or 100Mbps) due to increased business traffic
- ▶ Backbone costs continued to decline - we expect these costs to stabilize

▶ Completion of the shift to lower-priced broadband services and an increase in new contracts caused steady revenue decline to flatten

## Revenues

(JPY millions)

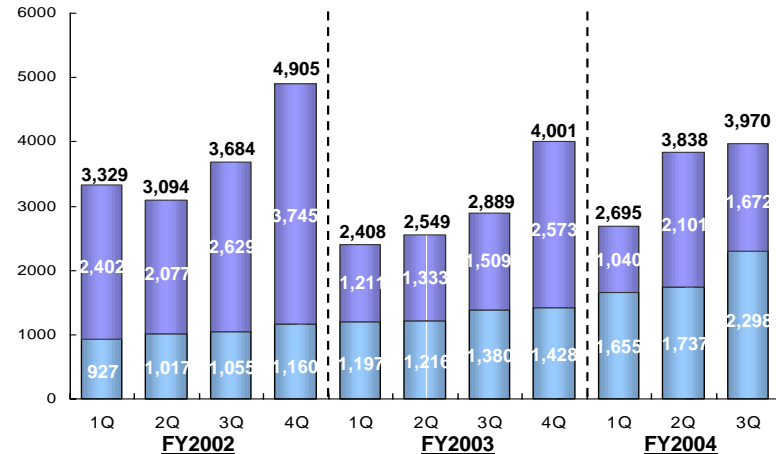


- ▶ VAS and other revenues continued to improve, increasing 30.8% YoY and 11.5% QoQ, to become one of IIJ's major revenue sources
- ▶ Increased awareness of security issues by corporate customers is spurring security-related service sales
  - Number of contracts reached approximately 1,400, an increase of 7.8% compared to 2Q04
- ▶ Revenues from server outsourcing and data centers steadily increasing
- ▶ Increased revenues from network outsourcing services by providing services such as SMF (automatic router configuration) and SEIL rental service
- ▶ "Other revenues" continued to increase steadily
  - Mainly due to revenues from Wide-area Ethernet and corporate LAN-related services

▶ Continuing to capture corporate outsourcing demand to increase revenues and profits

## Revenues

(JPY millions)



- Revenues from operational outsourcing services
- Revenues from services other than operational outsourcing

- ▶ Revenues increased by 37.4% compared to 3Q03 due to an increase in revenues from outsourced operations of SI
- ▶ Revenues from outsourced operation steadily increased by 32.3% from 2Q04 and contributed to a stable increase in revenues and profits
  - Since we received orders for outsourced operation related to the systems that we integrated in 2Q04
- ▶ The purchase of the security system business of Yamatane by IIJ Financial Systems in October 2004 had a positive effect
  - In system development and outsourced operations



**We expect that SI will contribute significantly to revenues and profit as SI revenues are usually the strongest in the fourth quarter**

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

	3Q04	2Q04
VAS Cross-selling Ratio <sup>*1</sup>	87.5%	86.9%
SI Cross-selling Ratio <sup>*2</sup>	90.0%	80.0%

\*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

**Highlights**

**By Service**

**Topics**

- ▶ **Electronic tag market expecting rapid growth**
  - Over 4.7 billion out of 6 billion tags to be used in 2010 will be used with a network such as the Internet\*
- ▶ **IIJ contributed to the standardization and practical usage of network type for electronic tag systems**
  - IIJ delegated a research and development executive to the Auto-ID laboratory
- ▶ **IIJ participated in an RFID pilot project with a large apparel maker in 2003**
- ▶ **IIJ participated in the Ministry of Economy, Trade, and Industry FY2004 RFID Pilot Project**
- ▶ **IIJ planning to introduce new services based on the knowledge and know-how accumulated in the projects**

## Overview of the FY2004 RFID Pilot Project run by the Ministry of Economy, Trade, and Industry

**Project name: Shipping Container RFID Pilot Project**

**Primary Operating Body:  
Japan Federation of Freight Industries**

**Test Period: Until March 2005**

**The world's first full-scale test project of RFID in international shipping involving multiple industries**

- Covering a total of 20 factories or ports in 4 sites each in Japan and overseas

**IIJ Group will contribute network infrastructure and identification verification for the EPC system\*\***

\* Survey by Fuji-Keizai U.S.A., Inc.

\*\* A system developed by IIJ to enable the general recording, referencing, and updating over the Internet of information tied to RFID tags