



Internet Initiative Japan Inc.

7,160,000
American Depositary Shares
Representing
3,580 Shares of Common Stock

This is the initial public offering of Internet Initiative Japan Inc. This prospectus relates to an offering of 7,160,000 American Depositary Shares. Each ADS is equal to 1/200th of a share of common stock of IIJ.

IIJ is offering 6,220,000 ADSs to be sold in the offering. The selling shareholders identified on page 82 of this prospectus are offering 940,000 ADSs. IIJ will not receive any of the proceeds from the sale of ADSs by the selling shareholders.

There has been no public market for the shares or ADSs. IIJ will list the ADSs on the Nasdaq National Market under the symbol "IIJI".

See "Risk Factors" beginning on page 8 to read about factors you should consider before buying the ADSs.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

	<u>Per ADS</u>	<u>Total</u>
Initial public offering price	\$23.00	\$164,680,000
Underwriting discount	\$ 1.55	\$ 11,098,000
Proceeds, before expenses, to IIJ	\$21.45	\$133,419,000
Proceeds, before expenses, to the selling shareholders	\$21.45	\$ 20,163,000

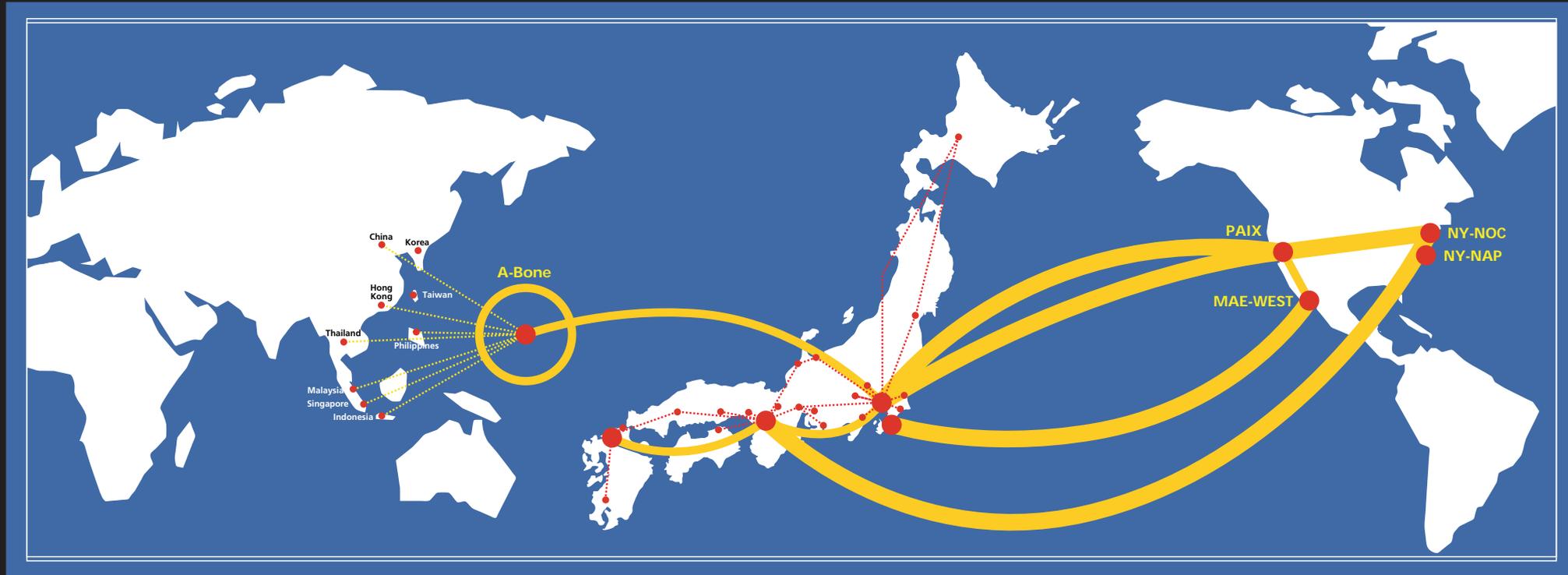
The underwriters may, under the terms of the underwriting agreement, purchase up to an additional 980,000 ADSs from IIJ at the initial public offering price less the underwriting discount.

The underwriters expect to deliver the ADSs in New York, New York on August 9, 1999.

Goldman, Sachs & Co.

Morgan Stanley Dean Witter

IIJ's Network*



*IIJ's interest in the A-Bone is approximately 20%.
In addition, IIJ operates and manages the A-Bone.

PROSPECTUS SUMMARY

You should read the following summary together with the more detailed information regarding our company and the ADSs being sold in the offering and our financial statements and notes to those statements appearing elsewhere in this prospectus.

In this prospectus, you may encounter unfamiliar terms that describe concepts, technologies and products relating to the Internet and the telecommunications industries. For your reference, a glossary that starts on page 102 of this prospectus provides definitions of these terms.

Internet Initiative Japan Inc.

Our Business

We offer a comprehensive range of Internet access services and Internet-related services to our customers in Japan on one of the most advanced and reliable Internet networks available in Japan and between Japan and the United States.

Currently, our main services are our Internet access or connectivity services, which accounted for approximately 80% of our revenue for the year ending March 31, 1999. Our total Internet solutions consist of Internet connectivity and additional value-added services we offer which include:

- network consulting and systems integration services;
- security for and support, maintenance and monitoring of customers' Internet systems;
- co-location services, which allow customers to house their servers and routers at our facilities;
- Web hosting and content development and distribution services; and
- e-mail related services that allow companies to outsource their e-mail functions to us.

Our extensive variety of services and products enables our customers to purchase all their Internet-related services and products through a single source.

We have created a high-quality, high-capacity network that extends throughout Japan and to the United States by leasing lines from telecommunications carriers. Our network backbone is one of the largest in Japan and between Japan and the United

States which allows us to better serve users that require high-speed, high-capacity and reliable services and provides us the ability to handle large amounts of data traffic.

In addition to our network, we have significant interests in two other networks: the A-Bone and the Crosswave network. We currently own 20.6% of Asia Internet Holding, the company that owns the A-Bone. The A-Bone is an Internet network using leased lines to connect eight countries in the Asia-Pacific region. We believe, based on publicly available information, that our network backbone and the A-Bone together form the most extensive Internet backbone connecting the countries in the Asia-Pacific region to each other and to the United States. Using our network and engineering expertise and pursuant to an agreement with Asia Internet Holding, we operate and manage the A-Bone. We expect to increase our interest in Asia Internet Holding with a portion of the proceeds from this offering.

We also have a 40% interest in Crosswave Communications Inc., a joint venture that we formed with Toyota and Sony. Crosswave operates one of the first high-speed telecommunications facilities and networks in Japan designed specifically for data communications such as Internet traffic, computer-to-computer information and voice and video transmissions in digital data form.

Crosswave uses advanced equipment to transport large amounts of data more efficiently and cheaply than traditional telephone networks. Crosswave uses Synchronous Optical Network (SONET) — a standard for multiple optical transmissions that enables data to be transmitted at high speeds over long distances with a high

degree of reliability. Additionally, Crosswave uses a specialized multiplexing-transmission technology known as Dense Wavelength Division Multiplexing (DWDM) to further increase its capacity. DWDM is a means of increasing the capacity of fiber-optic data transmission systems by multiplexing several optical signals simultaneously on each optic fiber line. We believe that through multiplexing and transmission equipment upgrades Crosswave's network will have the capacity to transmit 100 billion bits per second, or 100 Gbps, across its network. Crosswave's network currently operates in the Tokyo-Nagoya-Osaka-Hokuriku ring but will be extended to cover all of Japan except Okinawa by March 2000.

We conduct our business directly and by working together with our subsidiaries and affiliates. We expect that part of our future growth will be through the growth of our group companies' operations, especially those of Crosswave, IJ Technology and Asia Internet Holding. To the extent we are not able to control or significantly influence their operations, our business plans may be frustrated. However, our relationships with our group companies are good and we consider our group companies to be important parts of our business.

Our Market

We believe that the Internet industry in Japan is poised for rapid growth. Although Japan is the second-largest Internet market in terms of numbers of users and devices, Japan's Internet penetration rate at year-end 1998 of 10.8% is considerably lower than the United States which is approximately 24%. In addition, business usage is low as businesses have not exploited the Internet to its full potential. We also believe that Internet usage, particularly among business users, has been negatively affected by the adverse economic conditions in Japan. However, we believe that businesses in Japan are now beginning to use and rely on the Internet for wider purposes. As businesses increase their Internet usage, they will demand advanced, highly reliable, high-quality connectivity and value-added services. We are well-positioned to meet their demands.

The Internet access and other Internet services markets in Japan are crowded and competitive. We compete directly with telecommunications carriers like NTT, KDD, Japan Telecom and AT&T and their affiliates. We also compete with a number of both large and small Internet service providers or ISPs, including well-known new entrants in Japan like UUNET and PSINet.

To effectively compete, we must continue to emphasize the quality and capacity of our services and network which we believe are among our greatest strengths.

Our Competitive Strengths

Our High-Capacity IP Network. Our network is extensive and provides us with a strong presence in Japan and between Japan and the United States. In Japan, we have large trunk lines that connect the major metropolitan and business centers. We have extensive capacity between Japan and the United States with four separate 155 million bits per second, or 155 Mbps, leased trunk lines. We also connect directly to the A-Bone which we operate and manage and we have also recently started adding leased lines from Crosswave to our network.

Our Strength in Network Technology. One of our greatest strengths is the engineering expertise we have amassed. This engineering expertise is a result of a high percentage of employees with engineering degrees, over 30%, and a result of significant experience managing and operating large capacity, high volume networks. Our experience, our personnel and our commitment to research and development provide us with the capability and resources necessary to keep up with the rapid changes in Internet and networking technology.

We are particularly strong in large network traffic management, routing control and facilities operation. We have operated the largest or one of the largest Internet networks in Japan and between Japan and the United States since we began operations. We rated as the top ISP for satisfaction in terms of through-put and network management capability in a survey of Japanese companies by Nikkei Communications. Our engineering

expertise and strength in network technology allow us to provide specifically tailored, advanced Internet solutions to our Internet users.

Our Strong Customer Base and High Reputation. Our customers include valuable leading-edge Internet users, such as large corporations, major Internet service providers (ISPs), telecommunications carriers, cable operators, portal sites, e-commerce businesses and publishers. We have established a strong reputation for quality Internet service. Our customer satisfaction levels are high as evidenced by being rated as the top ISP in through-put and network management capability and receiving high rankings for overall service and troubleshooting in the Nikkei Communications survey.

Our Wide Range of Resources. Our resources are extensive and include our strong technological capabilities, our high-quality network, our group companies, including IJ Technology, and our broad variety of Internet access services and related value-added services.

Our Ability to Draw on the Strength of Our Shareholders. Our shareholders include large, well-known companies in Japan such as Sumitomo Corp., Itochu Corp., NTT Communications, Toyota, Dai-ichi Life, Sumitomo Bank, Fuji Bank and Sanwa Bank.

Benefits of our strong shareholder base include:

- Having leading institutions like these as shareholders is viewed by the Japanese business community as a sign of confidence.
- IJ and its shareholders have combined their strengths in a number of business ventures such as Crosswave (with Toyota), Lycos Japan (with Sumitomo Corp.) and DLJ*direct* SFG (with Sumitomo Bank).

Our Strategy

Our name encapsulates our mission: Internet Initiative Japan from its beginning has taken the initiative in developing the Internet market in Japan. We will continue to be a

leader in promoting and facilitating the growth of the Internet in Japan and we will strengthen our presence in this rapidly expanding market. The principal elements of our business strategy are:

Expand Our Network. Expanding our network is one of our most important objectives. Although our network is already extensive and fully capable of handling our current traffic, we will continue to expand our network as network traffic and demand require. Our domestic network development plan is to increase capacity on our busiest traffic routes, such as between Tokyo and Osaka, and to expand our geographic reach by extending our network into new areas to accommodate growth in our customer base. We expect that we will accomplish most of our capacity and geographic expansion in Japan using Crosswave's network.

Internationally, we have a similar network development plan. We will increase capacity on our main routes between Japan and the United States and we will explore opportunities to expand our network to reach into new areas in the United States, Asia and Europe as network traffic and demand require.

We will strengthen the capability and robustness of our network and will become less reliant on the incumbent telecommunications carriers by utilizing Crosswave's infrastructure. We will develop and construct our own data centers to capture the demand for better Internet environments and business networking and to support e-commerce and content development. We will also connect directly to Crosswave's network at these data centers.

Enhance Our Internet Access Services. We will introduce a greater variety of connectivity and bandwidth options and diversify our pricing structures to meet the needs and requirements of our customers. We will increase access to and geographic coverage of our network by increasing the number of our points of presence (POPs), which is where our customers access our network, and we will increase remote access and roaming options. Currently, we have 23 POPs. By leveraging off of Crosswave's network, we plan to have approximately 80 POPs by March 2000. We offer service level agreements which guarantee service performance levels and distinguish the quality of our services from that of our competitors.

Enrich Our Value-Added Services and Products through Increased R&D

Commitment. We have been pioneers in the Internet industry in Japan, including the development of high-bandwidth dedicated Internet access services and Internet network security. We will continue to take a leading position in the development of Internet access and high value-added services and products and in the research and development of new Internet services.

Provide Total Internet Solutions to

Address Our Clients' Needs. We provide total Internet solutions for our clients' specific needs for Internet Protocol (IP) network systems development and the operation and maintenance of their IP networks. We do this by consulting with our clients to design and develop tailored systems and specific applications that will allow them to optimize their Internet usage. In providing total Internet solutions we draw on our wide range of resources including our extensive network, our strong technological capabilities, our group companies and our variety of services. We are targeting our network consulting and systems integration businesses for growth.

Capture Our Share in the Attractive Growing Internet Markets.

We will focus our efforts to capture market share in the Internet markets that are most attractive to us. By introducing a greater variety of competitive Internet access and value-added services, we believe we are well-positioned to serve businesses' new and rapidly growing uses of the Internet. We seek to encourage new and existing customers to expand their use of our services and to use more value-added services.

Our head office is located at Takebashi Yasuda Bldg., 3-13 Kanda Nishiki-cho, Chiyoda-ku, Tokyo 101-0054 Japan and our telephone number at that address is 81-3-5259-6500. IJ America has offices at 399 Park Avenue, 23rd Floor, New York, New York 10022 and the telephone number at that address is (212) 350-1300. We also maintain an Internet site that you may access at <http://www.ij.ad.jp/>. Information contained at our Web site is not part of this prospectus.

The Offering

The following information assumes that the underwriters do not exercise the option granted by IJ to purchase additional ADSs in the offering. See "Underwriting".

ADSs offered by IJ	6,220,000 ADSs
ADSs offered by the selling shareholders.....	940,000 ADSs
ADS/share ratio	2,000/1
ADS equivalents to be outstanding after the offering.....	43,980,000 ADS equivalents
Nasdaq National Market symbol	"IJI"
Depository	The Bank of New York
Use of proceeds.....	To further develop our network, including international expansion and the building of additional data centers, for investments in affiliates, including Crosswave, IJ Technology and Asia Internet Holding, to pay the current portion of long-term borrowings and for general corporate purposes.

Summary Consolidated Financial Data and Operating Data

	Year Ended March 31,			Year Ended March 31,
	1997	1998	1999	1999
	(thousands of yen, except per ADS data)			(thousands of U.S.\$, except per ADS data)
Statement of Operations Data:				
Connectivity services and other revenues:				
Dedicated access service revenues	¥ 4,291,502	¥ 6,755,402	¥ 7,797,457	\$ 65,840
Dial-up access service revenues	3,477,528	4,474,333	4,101,291	34,630
Other revenues	764,427	1,093,183	2,870,102	24,235
Total	<u>8,533,457</u>	<u>12,322,918</u>	<u>14,768,850</u>	<u>124,705</u>
Cost and expenses:				
Cost of connectivity services and other revenues	5,526,662	9,403,385	13,202,375	111,478
Sales and marketing	1,211,192	1,508,201	1,569,731	13,255
General and administrative	891,821	938,936	1,065,119	8,994
Research and development	103,549	152,362	242,575	2,048
Total cost and expenses	<u>7,733,224</u>	<u>12,002,884</u>	<u>16,079,800</u>	<u>135,775</u>
Operating income (loss)	<u>800,233</u>	<u>320,034</u>	<u>(1,310,950)</u>	<u>(11,070)</u>
Interest expense and other	(144,986)	(243,829)	(199,199)	(1,681)
Income (loss) before income taxes	655,247	76,205	(1,510,149)	(12,751)
Income taxes	376,969	289,453	15,320	129
Minority interest in consolidated subsidiaries	(31,334)	(41,657)	122,866	1,037
Equity in net income (loss) of affiliated companies	(43,665)	(105,312)	(26,089)	(220)
Net income (loss)	<u>¥ 203,279</u>	<u>¥ (360,217)</u>	<u>¥ (1,428,692)</u>	<u>\$ (12,063)</u>
Basic and diluted net income (loss) per ADS equivalent				
	¥ 6.78	¥ (11.78)	¥ (37.86)	\$ (0.32)
Weighted average number of ADS equivalents				
	30,000,000	30,572,000	37,736,000	

	As of March 31,			As of March 31,
	1997	1998	1999	1999
	(thousands of yen)			(thousands of U.S.\$)
Balance Sheet Data:				
Cash	¥ 375,825	¥1,157,971	¥ 1,061,488	\$ 8,963
Total assets	7,615,202	9,339,165	13,359,038	112,801
Short-term borrowings	1,880,000	2,440,000	6,678,717	56,394
Current portion of long-term debt, including capital lease obligations	812,326	1,141,644	1,855,298	15,666
Long-term debt, including capital lease obligations	2,393,736	2,928,806	2,150,763	18,160
Shareholders' equity	1,361,113	1,868,068	484,935	4,095
Operating Data:				
Capital expenditures, including capitalized leases	¥ 2,501,275	¥1,695,974	¥ 1,928,900	\$ 16,287
EBITDA	1,356,062	1,447,641	110,743	935
Operating margin	9.4%	2.6%	(8.9)%	
EBITDA margin	15.9%	11.7%	0.7%	
Net cash provided by (used in):				
Operating activities	¥ 219,228	¥ 291,606	¥ 400,070	\$ 3,378
Investing activities	(1,694,814)	(300,036)	(3,695,008)	(31,200)
Financing activities	1,273,646	784,828	3,186,004	26,902
Number of employees	151	222	266	
Number of POPs	16	20	23	

RISK FACTORS

You should carefully consider the risks described below before making an investment decision. If any of the risks described below actually occurs, our business, financial condition or results of operations could be adversely affected. The trading price of our ADSs could decline, and you may lose all or part of your investment.

We May Not Be Able to Compete Effectively, Especially Against Established Competitors Which Have Greater Financial, Marketing and Other Resources

Some of our major competitors in Japan are major telecommunications carriers like NTT, KDD, Japan Telecom and AT&T and their affiliates and ISPs who are affiliated with large corporations like NEC, Fujitsu, Sony and Matsushita Electric. These competitors have certain advantages over us including:

- substantially greater financial resources,
- more extensive and well developed marketing and sales networks,
- higher brand recognition among consumers, and
- large customer bases.

With these advantages, our competitors may be better able to

- develop, market and sell their services,
- adapt more quickly to new and changing technologies, and
- more easily obtain new subscribers.

In addition, if telecommunications carriers replace their existing switches and equipment with more advanced switches and equipment, this may increase their ability to use their existing extensive networks for Internet and data transmission.

New Competitors May Attract Customers Away From Us

New competitors, both foreign and domestic, may attract customers away from us. Recently, a number of major foreign ISPs have entered or increased their presence in the Japanese market, including PSINet and UUNET, an affiliate of WorldCom, and, AT&T and BT through their significant minority

investment in equity of Japan Telecom. PSINet and UUNET have extensive financial resources and already have extensive global networks and they have substantial resources, including the capability to develop and operate high-quality backbones in Japan. AT&T and BT have announced that they would consider consolidating their Internet and data transmission businesses in Japan into those of Japan Telecom. These new foreign entrants may be strong competitors of ours and if they are successful in the market we could lose subscribers or grow less rapidly.

We will also compete with new ISPs that emerge as the Internet market continues to grow. For example, many of the major cable companies and wireless communications companies have announced that they are exploring the possibility of offering Internet access services. New ISPs may also affect our growth.

Our Competitors' Decisions Can Strongly Influence Our Markets and We May Be Vulnerable to Decisions Resulting in Downward Pricing Pressure

The marketing and pricing decisions of our competitors can strongly influence our markets. Increased competition in the industry has caused significant downward pricing pressure including lower-priced Internet access services offered to small- and medium-sized companies and to larger corporations which are our primary target markets. To the extent that potential and existing customers make decisions solely or primarily on price, we may be unable to retain existing or attract new customers or we may be forced to reduce our prices to keep existing customers. Price satisfaction was our only real weakness in the Nikkei Communications survey of customers.

Our Customers That are Also Our Competitors May Terminate Our Services if They are Able to Do So Without Sacrificing Quality

Currently, because of the high quality of our services and the large capacity of our network, many of the major telecommunications carriers and their affiliated ISPs are our customers. To the extent these customers / competitors are able to increase their ability to use their own networks, they may terminate or reduce our services. They may also terminate or reduce our services when lower cost services of reasonably good quality are available from other providers.

If We Fail to Keep Up With the Rapid Technological Changes in Our Industry Services May Become Obsolete and We May Lose Customers

Our markets are characterized by:

- rapid technological change,
- frequent new product and service introductions,
- changes in customer requirements and
- evolving industry standards.

The introduction of services using new technologies and the emergence of new industry standards could render our existing services obsolete.

If we fail to obtain access to new or important technologies or to develop and introduce new services and enhancements that are compatible with changing industry technologies and standards and customer requirements, we may lose customers.

Our pursuit of necessary technological advances may require substantial time and expense. Many of our competitors have greater financial and other resources than we do and, therefore, may be better able to meet the time and expense demands. Additionally, this may allow our competitors to respond more quickly to new and emerging technologies and standards or invest more heavily in upgrading or replacing equipment to take advantage of new technologies and standards.

We Depend on the Continued Use of TCP/IP Which Could Be Replaced By New Transmission Technologies

The core of IJ's business relies on the continued widespread commercial use of Transmission Control Protocol/Internetwork Protocol, commonly known as TCP/IP, which is an industry standard to facilitate the transfer of data. Alternative open protocol and proprietary protocol standards could emerge and become widely adopted. The resulting reduction in the use of TCP/IP could render our services obsolete and unmarketable.

We Had Operating Losses Last Year Which Will Continue For an Uncertain Period

We incurred net losses of ¥360 million for the year ended March 31, 1998 and ¥1,428 million for the year ended March 31, 1999. We expect to continue to incur net losses for at least the next several quarters. We expect that our losses in the current fiscal year will be larger than in the year ended March 31, 1999 although we do not know by how much. Our results of operations and, therefore, the magnitude of our losses and the extent to which they continue, will be affected by a number of factors. For example:

- Our revenues may be adversely affected by price reductions, or failure to retain our customers or to attract new customers.
- Our costs of revenues may adversely affect our financial results if we contract for more backbone capacity than we need, or if we are unable to reduce our leased line costs as we intend.
- Increased expenses resulting from our leasing of additional equipment will increase our overall cost structure.
- Our growing systems integration business might not be profitable.

Please see "Management's Discussion and Analysis of Financial Condition and Results of Operations" for more detailed information concerning our losses and other operating results.

Our Operating Results are Likely to Fluctuate Significantly and May Differ From Market Expectations

Our annual and quarterly operating results may vary significantly in the future due to a number of factors, many of which are beyond our control. As a result, we believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance. It is likely that in some future quarter, our operating results may be below the expectations of public market analysts and investors. In this event, the trading price of our ADSs may fall.

Factors which may cause fluctuation include:

- the rate at which we add new customers, particularly high-end business customers and increase the bandwidth used by these high-end customers;
- our ability to generate significant revenues from systems integration and sales of equipment in providing total Internet solutions and the timing of the recognition of such revenues; and
- the rate at which we will be able to convert the leased lines we currently have to leased lines from Crosswave.

We May Need Additional Capital and We May Not Be Able to Obtain It

Our capital requirements are difficult to plan in our rapidly changing industry. Consequently, we may need more capital than is currently available to us to implement our strategies, and our use of the proceeds of this offering may differ substantially from the uses we describe in "Use of Proceeds".

Since our industry is growing so strongly and since technology and market developments are producing such rapid changes, we cannot be certain now about the best uses of capital even for the current fiscal year. Our capital investment plans have changed dramatically in the past and it is highly likely that they will do so in the future.

We currently expect that we will need capital for our backbone, our data centers, our investments in Crosswave, strengthening and consolidating our group companies and pursuing attractive business opportunities such as joint ventures and alliances. We believe that we will have sufficient funds upon completion of the offering to meet our anticipated needs for working capital and capital expenditures in connection with the plans that we have formulated as described in "Use of Proceeds". However, some of those uses of proceeds may not be feasible since they require the agreement of other parties. In addition, future market or other developments may make those uses less feasible or attractive than they currently appear to us. Consequently we may substantially modify or abandon some or all of those plans, and we may decide to use the proceeds of the offering for different purposes. We may also decide to expand the scope of some of our plans, or we may formulate entirely new plans.

If we need additional funds, our inability to raise them may prevent us from implementing our plans and may have an adverse effect on our operations. In addition, there can be no assurance that additional financing will be available on terms favorable to us, or at all.

We Depend on Key Personnel and Our Business May Suffer if We Cannot Attract or Retain Qualified Personnel or if We Lose the Services of Our Executive Officers

If we fail to attract or retain the qualified personnel we need, our business may be adversely affected. Because our network, services, products and technologies are complex, we depend on the continued service of our existing engineering and other personnel and we will need to hire additional engineers and research and development personnel. Competition for qualified engineers, research and development personnel and employees in the Internet services industry in Japan is intense and there are a limited number of persons with the necessary knowledge and experience.

Our future success also depends on the continued service of our executive officers, particularly Mr. Koichi Suzuki, who is the President of IJ and also serves as the President of Crosswave and most of the other IJ group companies. We rely on his expertise in the operations of our businesses and on his personal relationships with our shareholders and the shareholders of the IJ group companies and with our business partners. None of our officers or key employees, including Mr. Suzuki, is bound by an employment or noncompetition agreement.

Rapid Growth and Rapidly Changing Operating Environment Strain Our Limited Resources

We have limited operational, administrative and financial resources, which could be inadequate to sustain the growth we want to achieve. As our customers and their Internet use increase, as traffic patterns change and as the volume of information transferred increases, we will need to increase our investment in our network and other facilities in order to adapt our services and to maintain and improve the quality of our services. If we are unable to manage our growth and expansion, the quality of our services could deteriorate and our business may suffer.

Our Business May Be Adversely Affected If We Fail to Maintain the Reliability and Security of Our Network.

The reliability of our network could be affected by damage from fire, earthquakes and other natural disasters, power loss, telecommunications failures and similar events. Much of our computer and networking equipment and the lines that make up our network backbone are concentrated in a few locations that are in earthquake-prone areas. Computer viruses and interruptions in service as a result of the accidental or intentional actions of Internet users and others may also prevent us from providing service to our customers. Any problems that cause interruptions in the services we provide could have a material adverse effect on our business, financial condition and results of operations.

Part of Our Business is Supported by Several Minority-Owned Affiliates Which Limits Their Contribution to Our Results and Limits Our Ability to Control These Companies

We conduct our business directly and by working together with a number of subsidiaries and affiliates. While we have invested heavily in and exercise significant influence over these companies, we do not own a majority of some of these subsidiaries and affiliates. There are risks associated with this group structure:

- We may not be able to control these companies in the future, and our interests may diverge from those of one or more of these companies or their other shareholders.
- These affiliated companies' financial contributions to our results of operations are limited even though we offer our services and operate as a group.

Throughout this prospectus we use the terms "we" and "IJ" to mean both the legal entity, Internet Initiative Japan Inc., and the IJ group but the distinction between the two is generally clear from the context. Where it is important that you understand which members of the IJ group we are talking about, we give you their names or otherwise refer to them more specifically.

Our Large Capital Investment in Crosswave May Not Produce Profits

We recently formed Crosswave Communications Inc. to build and operate an optical fiber network for high-speed data communications throughout Japan. We own 40% of Crosswave and our investment in Crosswave to date is ¥2.56 billion. We expect to invest an additional ¥0.64 billion by August 31, 1999. We plan to make a further investment in Crosswave. Our joint venture agreement with Sony and Toyota contemplates that the shareholders will discuss and agree, by September 26, 1999, as to additional investments of up to ¥12 billion in debt or equity, of which our pro rata share would be up to ¥4.8 billion. Such decision, however, may depend upon a number of variables and uncertainties. Our

investment in Crosswave is substantial and we are not certain that this investment will produce profits.

We expect that Crosswave will lose money for at least the next few fiscal years. These losses will have a direct impact on our financial performance as a portion of these losses will be included in our financial results under the equity method of accounting that we will use to account for our investment in Crosswave; however, we are not directly responsible for any of the expenses of Crosswave beyond our equity investment.

Because Crosswave started operating only in April 1999, it has no operating history. Crosswave could have problems operating and managing its nationwide optical fiber network or attracting customers to its services. The data communications market is a new market in Japan, and Japan's recession has led companies to limit spending on information technology. Although Crosswave will operate the first nationwide optical fiber network dedicated to high-speed data communications in Japan, competitors of Crosswave including Japan Telecom and KDD have announced they will develop their own optical fiber networks that may be strong competitors of Crosswave.

Crosswave is discussed in more detail under "Business — Crosswave Communications Inc." below.

There are Risks Associated With Our Continued International Expansion

By operating and rapidly expanding our network internationally, we expose ourselves to the risks of those markets and other risks that do not exist or are less significant in Japan.

A key component of our strategy is to continue to expand our trans-Pacific, Asian and other international networks and capacity. This will require significant management attention and financial resources. We may have significant exposure to risks in

connection with our international operations. Among these risks are the following:

- the impact of recessions in economies outside Japan like the current recessions in Southeast Asian economies;
- unexpected changes in or delays resulting from regulatory requirements;
- the rate of the development of the Internet industry in countries in Asia; and
- political and economic instability.

These factors could adversely affect our future international operations and, consequently, our business, financial condition and results of operations.

Foreign Exchange Fluctuations Could Negatively Affect Our Results of Operations Because of Committed U.S. Dollar Obligations

Our reporting currency and most of our revenues are in yen. However, a substantial amount of our lease payments for international lines are payable in U.S. dollars. As we expand our international network, we expect the total amount of these payments to increase. Future fluctuations in currency exchange rates may adversely affect our financial results.

We Depend on Telecommunications Carriers and Other Suppliers and We Could Be Affected by Disruptions in Service or Delays in the Delivery of Their Products and Services

We rely on telecommunications carriers like KDD, Japan Telecom and AT&T for our network backbone and NTT for our customers' local access lines and in the future we will also rely on Crosswave to provide telecommunications services that we need. We are subject to potential disruptions in these telecommunications services and we may have no means of replacing these services, on a timely basis or at all, in the event of such disruption.

In the Asia-Pacific region and for the operation of the A-Bone by Asia Internet

Holding, we depend on telecommunications carriers in various countries including lesser developed countries in regions whose quality of service may not be stable or who are more susceptible to economic or political instability in regions where they conduct business.

We also depend on third-party suppliers of hardware components like routers that are used in our network. We acquire some components from only one or two sources, including Cisco Systems and Ascend Communications. A failure by one of our suppliers to deliver quality products on a timely basis, or the inability to develop alternative sources if and as required, could delay our ability to increase the number of our POPs or to expand the capacity of our network.

This Prospectus Contains Forward-Looking Statements which are Inherently Uncertain

This prospectus contains forward-looking statements that are based on our current expectations, assumptions, estimates and projections about us and our industry. These forward-looking statements are subject to various risks and uncertainties. Generally, these forward-looking statements can be identified by the use of forward-looking terminology such as “may”, “will”, “expect”, “anticipate”, “estimate”, “plan” or other similar words. These statements discuss future expectations, identify strategies, contain projections of results of operations or of financial condition of ours or our group companies or state other “forward-looking” information. Known and unknown risks, uncertainties and other factors could cause the actual results to differ materially from those contained in any forward-looking statement.

Although we believe that our expectations that are expressed in these forward-looking statements are reasonable, we cannot promise that our expectations will turn out to be correct. Our actual results could be materially different from and worse than our expectations. Important risks and factors that could cause our actual results to

be materially different from our expectations are generally set forth in this “Risk Factors” section and also include, without limitation:

- that we will not continue to increase subscribers to our connectivity services, particularly subscribers at higher bandwidths, and
- that we will not generate significant revenues from, among others, our value-added services such as systems integration or from OEM arrangements such as those with Sharp.

We May Be Adversely Affected by the Year 2000 Problem

The Year 2000 (“Y2K”) problem results from the fact that many existing computer programs and systems use only two digits to identify the year in the date field. If not corrected, computer applications that use a two-digit format could fail or create erroneous results in any computer calculation or other processing involving the Year 2000 or a later date.

We have detailed plans for making and testing modifications to our key computer systems and equipment to ensure that they are Y2K-compliant. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Impact of the Year 2000 Problem”, which describes these plans. We believe that with these detailed plans and completed modifications, the Y2K problem will not pose significant operational problems for us. However, if the modifications and conversions are not made, or not completed in a timely fashion, the Y2K problem could have a material impact on our operations. In addition, if any of our material third parties are not Y2K-ready, our business could be materially adversely affected.

The major risks we see in connection with the Y2K problem are as follows:

- due to outages or disruptions in our own computer system and/or infrastructures outside our company, such as electricity,

we would become unable to conduct normal business operations;

- due to network disruptions caused by external factors or by our own hardware and software, which we believe would be unlikely if our current Y2K compliance plans proceed as scheduled, we would become unable to provide our services, including connectivity to and from the Internet for our customers; and
- our inability to provide our connectivity services would adversely affect our customers' own infrastructure, such as their own local area networks, as well as other ISPs.

We will continue to evaluate the nature of these risks, but at this time we cannot determine the probability that any of these risks will occur. We also cannot determine the nature, duration or severity of any problems that would arise if any of these risks do occur. If a significant number of our material third parties experience failures in their computer systems or operations due to Y2K non-compliance, it could affect our ability to process transactions or otherwise engage in similar normal business activities.

While we believe that we are adequately addressing the Y2K problem, we cannot assure that our Y2K analyses will be completed on a timely basis or that the cost and liabilities associated with the Y2K problem will not materially adversely impact our business. We are developing a contingency plan to handle our most reasonably likely worst case Y2K scenario and expect to finalize it by September 30, 1999. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Impact of the Year 2000 Problem" for a description of our contingency plan. We cannot assure that the various assumptions we used in creating this plan will hold in the event of the Y2K problem's actual occurrence, and thus that the measures set forth in the plan will be adequate in such event.

Our Business May Continue to Be Adversely Affected by the Economic Situation in Japan

Our business, particularly our dedicated access services designed for businesses and other institutions, is affected by the economic situation in Japan.

The Japanese economy experienced a significant downturn during the early to mid-1990s. Although from 1995 to early 1997 the economy showed signs of a mild recovery, during 1997 and thereafter the recession Japan has been experiencing for most of the decade grew increasingly serious. This renewed decline has been attributed to a number of factors including sluggish consumer spending, decreases in corporate capital expenditures, strains in the Japanese financial system caused by the failure of several major financial institutions, economic difficulties in other Asian and other emerging economies and the uncertain domestic economic outlook in general.

We believe that as a result of the economic conditions in Japan, businesses have not increased, and in many instances have decreased, their budgets for Internet and computer spending. This has resulted in penetration and utilization rates for our primary markets that are lower than we projected. As a significant portion of our revenues is generated by our high-end dedicated access services that are primarily designed for businesses, our customer base and our revenues have not increased as much as we anticipated. If the economic situation in Japan does not improve significantly, our results will continue to be adversely affected.

There Has Been No Prior Market for Our Shares or the ADSs and a Liquid Trading Market May Not Develop

There is no public market for our shares in Japan. Our ADSs will be listed on the Nasdaq National Market. However, being listed on the Nasdaq National Market does not guarantee that a liquid trading market will develop. If no liquid trading market develops, you may have difficulty reselling your ADSs.

The Price of Our ADSs May Be Volatile and Investors May Not Be Able to Resell Their ADSs At or Above the Initial, Public Offering Price

The market price of our ADSs is likely to fluctuate after the offering. In addition, the securities markets have experienced significant price and volume fluctuations and the market prices of the securities of Internet-related companies have been especially volatile. Investors may be unable to resell their ADSs at or above the initial public offering price. In the past, companies that have experienced volatility in the market price of their stock have been the object of securities class action litigation. If we were the object of securities class action litigation, it could result in substantial costs and a diversion of management's attention and resources.

There are a Number of ADSs Eligible for Future Sales and Sales of Additional ADSs to the Public May Cause the Price of the ADSs to Fall

If our shareholders sell substantial amounts of our ADSs in the public market following the offering, the market price of our ADSs could fall. Such sales also might make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate. Upon

completion of the offering, we will have outstanding 43,980,000 ADS equivalents (based upon ADS equivalents outstanding as of June 30, 1999), assuming no exercise of the Underwriters' over-allotment option. Of these, the 36,820,000 ADS equivalents which will continue to be held by existing shareholders following completion of the offering may be sold at any time or in any manner, subject to compliance with applicable securities laws and, in the case of certain shareholders, observance of the lock-up period agreed with the underwriters. This subject is discussed in more detail under "Shares Eligible for Future Sale" and "Underwriting".

You Will Incur Immediate and Substantial Dilution

The initial public offering price of the ADSs is substantially higher than the net tangible book value per share of the outstanding common stock. As a result, if you purchase the ADSs in this offering, you will suffer an immediate and substantial dilution of ¥2,294 per ADS in the net tangible book value per ADS based upon an initial public offering price of ¥2,647 per ADS. In the event we issue additional shares of Common Stock in the future, you may experience further dilution. See "Dilution".

USE OF PROCEEDS

We estimate we will receive net proceeds from the sale of the ADSs offered by us of approximately ¥15.1 billion, or ¥17.5 billion if the Underwriters' over-allotment option is exercised in full, after deducting the estimated underwriting discount and offering expenses payable by us. These estimates are based on an initial public offering price of ¥2,647 per ADS. We will not receive any of the proceeds from the sale of ADSs by the selling shareholders.

We intend to use the net proceeds to us from the offering as follows:

- We will use approximately ¥4.5 billion for further development of our network, including expanding the capacity of our networks, particularly our international capacity, expanding our data center facilities, and facilitating access to our networks by increasing our POPs.
- We will use approximately ¥8.0 billion for our investment in Crosswave, including ¥2.56 billion to prepay the short-term bank loans that financed our initial equity investment in Crosswave. The interest rates on the loans to be repaid vary from 1.375% to 1.5% per annum and the loans mature in December 1999.
- We will use ¥0.7 billion to prepay the short-term bank loan we used to increase our equity ownership of IJJ Technology to 64.1%. The interest rate on the loan to be repaid is 1.375% and the maturity date is December 1999.
- We intend to use approximately ¥0.75 billion to increase our ownership interest in

Asia Internet Holding to approximately 30%. We would like to further increase our ownership in Asia Internet Holding and other affiliates and will use additional proceeds as the opportunities arise, and subject to discussion with the other shareholders.

- In addition to the repayment of short-term bank loans as noted above, we will use ¥0.6 billion to repay the current portion of long-term borrowings. The interest rates on the loans to be repaid vary from 1.58% to 2.00% per annum.
- We will use the rest for general corporate purposes, including increasing our sales and marketing expenditures.

We may use a portion of the net proceeds to acquire or invest in complementary businesses, technologies, services or products; however, we currently have no commitments or agreements and are not involved in any negotiations with respect to any such transactions.

Notwithstanding our current intentions, management will retain a significant amount of discretion over the application of the net proceeds of the offering. Because of the number and variability of factors that determine our use of the net proceeds, our actual application of the net proceeds could vary substantially from our current intentions.

Pending such uses, we intend to invest the net proceeds in short-term, investment grade instruments, certificates of deposit or direct or guaranteed obligations of Japan or the United States.

DIVIDEND POLICY

We have never declared or paid any cash dividends on our capital stock. We currently intend to retain future earnings, if

any, to finance our business and to fund growth and, therefore, do not expect to pay any cash dividends for the foreseeable future.

EXCHANGE RATES

In certain parts of this prospectus, we have translated Japanese yen amounts into U.S. dollars for the convenience of investors. The rate we used for the translations was ¥118.43 equal to \$1.00, which was the noon buying rate announced by the Federal Reserve Bank of New York on March 31, 1999. The following table sets forth the noon

buying rates for Japanese yen expressed in Japanese yen per \$1.00. The noon buying rate on August 3, 1999 was \$1 = ¥115.10. No representation is made that the Japanese yen or U.S. dollar amounts referred to herein could have been or could be converted into U.S. dollars or Japanese yen, as the case may be, at any particular rate or at all.

	Year Ended March 31,				
	1995	1996	1997	1998	1999
Yen exchange rates per U.S. dollar:					
High	¥105.38	¥107.29	¥124.54	¥133.99	¥147.14
Low	86.85	81.12	104.49	111.42	108.83
Average (of month-end rates)	98.48	96.95	113.20	123.57	128.10
At period-end	86.85	107.00	123.72	133.29	118.43

CAPITALIZATION

The following table sets forth our consolidated capitalization as of March 31, 1999 on an actual basis and on an as adjusted basis to give effect to

- an increase of the authorized shares to 75,520 at the shareholders meeting on June 15, 1999;
- the issuance of the shares; and
- the receipt and application of the estimated net proceeds we will receive after deduction of the underwriting discounts and estimated expenses payable by us in the offering from the sale of 6,220,000 ADSs offered by us at an initial public offering price of ¥2,647 per ADS:

	<u>Actual</u>	<u>As Adjusted</u>
	(in thousands)	
Long-term debt, including capital lease obligations, less current portion	¥ 2,150,763	¥ 2,150,763
Shareholders' equity:		
Common stock: ¥50,000 par value		
Authorized: 52,000 shares, as adjusted 75,520		
Issued and outstanding: 18,880 actual, 21,990 as adjusted	1,100,000	8,778,263
Additional paid-in capital	651,906	8,047,929
Deficit	(1,277,611)	(1,277,611)
Accumulated other comprehensive income	10,640	10,640
Total shareholders' equity	<u>484,935</u>	<u>15,559,221</u>
Total capitalization	<u>¥ 2,635,698</u>	<u>¥17,709,984</u>

DILUTION

As of March 31, 1999, our net tangible book value was approximately ¥459.6 million, or approximately ¥12 per ADS. Net tangible book value per ADS represents the amount of our total tangible assets minus total liabilities, divided by the number of ADS equivalents outstanding. Dilution in the net tangible book value per ADS represents the difference between the amount per ADS paid by purchasers of ADSs in the offering and the net tangible book value per ADS immediately after the completion of the offering. After giving effect to the sale by us of 6,220,000 ADSs offered by us hereby at an initial public offering price of ¥2,647 per ADS, and after

deducting the estimated underwriting discounts and expenses payable by us, the net tangible book value at March 31, 1999 would have been ¥15,533.9 million, or approximately ¥353 per ADS. This represents an immediate increase in net tangible book value of ¥341 per ADS equivalent to existing shareholders and an immediate dilution in net tangible book value of ¥2,294 per ADS to new investors purchasing ADSs at the initial public offering price.

The following table illustrates this dilution on a per ADS basis:

Initial public offering price per ADS	¥2,647
Net tangible book value per ADS before giving effect to the offering	12
Increase in net tangible book value per ADS attributable to the sale of ADSs in the offering	<u>341</u>
Net tangible book value per ADS after giving effect to the offering	<u>353</u>
Dilution per ADS to new investors	<u><u>¥2,294</u></u>

The following table sets forth, as of March 31, 1999, the differences between the number of ADSs purchased from us, the total consideration paid and the average price per ADS or ADS equivalent paid by existing shareholders and by new investors, before

deducting the estimated underwriting discounts and offering expenses payable by us, at the initial public offering price of ¥2,647 per ADS, excluding any ADSs issued in connection with the underwriters' over-allotment option.

	ADSs or ADS Equivalents Purchased		Total Consideration		Average Price per ADS or ADS Equivalent
	Number	Percentage	Amount (in thousands)	Percentage	
Existing shareholders.....	37,760,000	85.86%	¥ 1,751,906	9.62%	¥ 46
New investors.....	6,220,000	14.14	16,466,206	90.38	2,647
Total	<u>43,980,000</u>	<u>100.00%</u>	<u>¥18,218,112</u>	<u>100.00%</u>	

SELECTED CONSOLIDATED FINANCIAL DATA AND OPERATING DATA

The selected consolidated financial data set forth below should be read in conjunction with the consolidated financial statements of IIJ and the notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this prospectus. The statement of operations data set forth below for the fiscal years ended March 31, 1997, 1998 and 1999 and the balance sheet data as of March 31, 1998 and 1999 are derived from the audited financial statements of IIJ included elsewhere in this prospectus, which have been prepared in accordance with U.S. GAAP and audited by Deloitte Touche Tohmatsu, independent auditors. The statement of operations data set forth below

for the fiscal years ended March 31, 1995 and 1996 and the balance sheet data as of March 31, 1995, 1996 and 1997 are derived from the unaudited financial statement data. The unaudited data reflect all adjustments, consisting of normal recurring adjustments, that, in the opinion of management, are necessary for a fair presentation of the amount involved, on a basis consistent with selected consolidated financial data derived from the audited financial statements. The historical results are not necessarily indicative of results to be expected for any future period. See "Management's Discussion and Analysis of Financial Condition and Results of Operations".

	Year Ended March 31,					Year Ended March 31,
	1995	1996	1997	1998	1999	1999
	(thousands of yen, except per share and ADS data)					(thousands of U.S.\$, except per share and ADS data)
Statement of Operations Data:						
Connectivity services and other revenues:						
Dedicated access service revenues	¥ 580,865	¥1,881,127	¥4,291,502	¥ 6,755,402	¥ 7,797,457	\$ 65,840
Dial-up access service revenues	366,999	1,631,730	3,477,528	4,474,333	4,101,291	34,630
Other revenues	151,040	544,979	764,427	1,093,183	2,870,102	24,235
Total	<u>1,098,904</u>	<u>4,057,836</u>	<u>8,533,457</u>	<u>12,322,918</u>	<u>14,768,850</u>	<u>124,705</u>
Cost and expenses:						
Cost of connectivity services and other revenues	574,310	2,368,162	5,526,662	9,403,385	13,202,375	111,478
Sales and marketing	135,029	510,697	1,211,192	1,508,201	1,569,731	13,255
General and administrative	185,108	400,662	891,821	938,936	1,065,119	8,994
Research and development	39,788	96,785	103,549	152,362	242,575	2,048
Total cost and expenses	<u>934,235</u>	<u>3,376,306</u>	<u>7,733,224</u>	<u>12,002,884</u>	<u>16,079,800</u>	<u>135,775</u>
Operating income (loss)	<u>164,669</u>	<u>681,530</u>	<u>800,233</u>	<u>320,034</u>	<u>(1,310,950)</u>	<u>(11,070)</u>
Other income (expenses):						
Interest income	3,993	4,833	4,972	6,834	4,035	34
Interest expense	(20,874)	(47,672)	(119,859)	(215,909)	(218,583)	(1,845)
Other — net	2,473	11,272	(30,099)	(34,754)	15,349	130
Other expenses — net	<u>(14,408)</u>	<u>(31,567)</u>	<u>(144,986)</u>	<u>(243,829)</u>	<u>(199,199)</u>	<u>(1,681)</u>
Income (loss) before income taxes, minority interest in consolidated subsidiaries and equity in net income (loss) of affiliated companies						
	150,261	649,963	655,247	76,205	(1,510,149)	(12,751)
Income taxes	91,348	365,604	376,969	289,453	15,320	129
Minority interest in consolidated subsidiaries	12,871	24,031	(31,334)	(41,657)	122,866	1,037
Equity in net income (loss) of affiliated companies	<u>(236)</u>	<u>10,313</u>	<u>(43,665)</u>	<u>(105,312)</u>	<u>(26,089)</u>	<u>(220)</u>
Net income (loss)	<u>¥ 71,548</u>	<u>¥ 318,703</u>	<u>¥ 203,279</u>	<u>¥ (360,217)</u>	<u>¥(1,428,692)</u>	<u>\$(12,063)</u>
Per Share and ADS Data:						
Basic and diluted net income (loss) per share	7,104	24,251	13,552	(23,565)	(75,720)	(639.37)
Basic and diluted net income (loss) per ADS equivalent	3.55	12.13	6.78	(11.78)	(37.86)	(0.32)
Weighted average number of shares	10,071	13,142	15,000	15,286	18,868	
Weighted average number of ADS equivalents	20,142,000	26,284,000	30,000,000	30,572,000	37,736,000	

	As of March 31,					As of
	1995	1996	1997	1998	1999	March 31,
	(thousands of yen)					1999
						(thousands of U.S.\$)
Balance Sheet Data:						
Cash	¥ 511,014	¥ 577,383	¥ 375,825	¥1,157,971	¥ 1,061,488	\$ 8,963
Total assets	1,476,763	3,638,094	7,615,502	9,339,165	13,359,038	112,801
Short-term borrowings	375,000	700,000	1,880,000	2,440,000	6,678,717	56,394
Current portion of long-term debt, including capital lease obligations	103,090	224,345	812,326	1,141,644	1,855,298	15,666
Long-term debt, including capital lease obligations	274,374	634,950	2,393,736	2,928,806	2,150,763	18,160
Shareholders' equity	588,411	1,164,048	1,361,113	1,868,068	484,935	4,095
Operating Data:						
Capital expenditures, including capitalized leases	343,233	884,390	2,501,275	1,695,974	1,928,900	16,287
EBITDA (1)	230,755	901,621	1,356,062	1,447,641	110,743	935
Operating margin (2)	15.0%	16.8%	9.4%	2.6%	(8.9%)	
EBITDA margin (1) (3)	21.0%	22.2%	15.9%	11.7%	0.7%	
Net cash provided by (used in):						
Operating activities	¥ (25,331)	¥ 502,447	¥ 219,228	¥ 291,606	¥ 400,070	\$ 3,378
Investing activities	(178,401)	(717,025)	(1,694,814)	(300,036)	(3,695,008)	(31,200)
Financing activities	595,387	280,948	1,273,646	784,828	3,186,004	26,902
Number of employees	52	89	151	222	266	
Number of POPs	5	9	16	20	23	

(1) EBITDA represents operating income (loss) plus depreciation and amortization. EBITDA is provided because it is a measure commonly used by investors to analyze and compare companies on the basis of operating performance. EBITDA is not a measurement of financial performance under generally accepted accounting principles and should not be construed as a substitute for operating income, net income or cash flows from operating activities for purposes of analyzing IJ's operating performance, financial position and cash flows. EBITDA is not necessarily comparable with similarly titled measures for other companies.

(2) Operating income (loss) as a percentage of total revenues.

(3) EBITDA as a percentage of total revenues.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion of the financial condition and results of operations of IJ together with the consolidated financial statements and the notes to such statements included elsewhere in this prospectus. The discussion in this section contains forward-looking statements and you should read the risk factor relating to forward-looking statements in the section titled "Risk Factors" in this prospectus.

Overview

We are a leading provider of a comprehensive range of Internet access services and Internet-related services in Japan. We were founded in December 1992 and began offering Internet access services commercially in July 1993. We were one of the first commercial ISPs in Japan.

We manage our business and measure our results based on a single Internet-related services industry segment. Our primary sources of revenues are our Internet access or connectivity services. We also generate revenues from our value-added services, from systems integration and from sales of purchased equipment which are components of our total Internet solutions. Substantially all of our revenues are from our customers in Japan.

We provide our services directly or by working together with the subsidiaries and affiliates in the IJ group. IJ provides Internet access and Internet access-related services, such as Internet systems design and integration, security services, co-location services and mail box services. The IJ group also provides value-added and systems integration services, such as systems development and integration, Web hosting, Web design, content development and distribution and call center support. Our customers' main point of contact for our services is IJ. We draw upon our group companies to provide the resources necessary to provide total Internet solutions to our customers.

Although we refer to our subsidiaries and certain affiliates as our group companies, and although we have invested heavily in and exercise significant influence over these companies, until now we have consolidated only two of our group companies — IJ

America and Net Care. Beginning with the quarter ending June 30, 1999, IJ Technology and IJ Media Communications will also be included in the consolidation as a result of the increase of our ownership in these companies to a majority during the quarter. We account for our non-consolidated group companies on the equity method. The primary companies that we consider to be in the IJ group are discussed in "Internet Initiative Japan Inc." and "Business — Our Group Companies" below. In this MD&A, "we" and "our" when used in relation to financial results and information refers to the consolidated financial results and information of Internet Initiative Japan Inc. and its consolidated subsidiaries only.

Factors Affecting Our Future Financial Results

We expect that the following are the most significant factors likely to affect the financial results of IJ and its consolidated subsidiaries.

Connectivity Services and Other Revenues

We derive our revenues primarily from recurring monthly fees from our Internet access services and our value-added services and non-recurring fees for initial Internet access setup, systems integration and sales of equipment. Our Internet access services revenues accounted for over 80% of our revenues for the year ended March 31, 1999 and accounted for over 90% of our revenues for each of the years ended March 31, 1998 and 1997.

Growth in revenues for the year ended March 31, 1999 was limited, except for equipment sales related to systems integration and other equipment sales. Revenues were adversely affected by price competition in the market for Internet access,

adverse general economic conditions in Japan and limited growth in our customer base.

We are seeking to increase the rate of our revenue growth by enhancing our Internet access services through the introduction of a greater variety of access services and bandwidth options, by expanding our value-added services, network consulting, systems integration and OEM businesses and by focusing our efforts on capturing market share in the Internet markets that are most attractive to us.

Dedicated Access Services. Dedicated access services are services that connect our customers directly to one of our POPs by a dedicated line. Our two dedicated access services are our IP Service and IJ Economy. Dedicated access services have been the largest source of revenues for us over the past few years accounting for 52.8% of our revenues for the year ended March 31, 1999, 54.8% for the year ended March 31, 1998 and 50.3% for the year ended March 31, 1997. Dedicated access service revenues include the monthly fees paid by subscribers for dedicated local access lines from the subscribers' locations to our POPs. We collect these fees from the subscribers and pay them over to the carriers.

Our dedicated access service subscribers typically enter into contracts with us that have no fixed period but have penalties for cancellation in the first year. For IP Service subscribers who enter into three-year contracts, we provide a 10% discount on the monthly fees. Approximately 19% of our IP Service contracts at March 31, 1999 were three-year contracts. In light of the relatively short-term nature of the customer contracts, if customers find our competitors' services more attractive than ours, they may switch to our competitors' services and our revenues may be adversely affected.

Our revenues will be affected by our ability to retain our existing business customers and to attract new business customers. Recently, we have had a decline in the number of subscribers to our IP Service. Most of this decline was attributable to subscribers who opted to shift to services

offered by other ISPs because these subscribers had lower bandwidth needs and preferred lower-priced services and to subscribers who terminated services altogether. Of the subscribers that have continued their IP Service, however, many have migrated to higher bandwidth service. As a result, while IP Service prices and the number of IP Service subscribers declined, we have seen an overall increase in our revenues from our IP Service. Although price competition is increasing, we expect market demand for high-end services from business customers to grow further. Our success will depend in large part on our ability to continue to shift existing IP Service subscribers to higher bandwidth levels and to increase the number of subscribers to our IP Service. Further increase in our revenues from IP Service will also depend on the degree to which our customers value and appreciate the high quality of our services, which we have emphasized and will further define and differentiate from our competitors by the service level agreements we have recently introduced. We are not seeking to compete by underpricing our competitors but we may have to reduce our prices in order to meet the competition.

We have had a sharp increase in the number of subscribers to our economy-type dedicated access service that we refer to as IJ Economy. IJ Economy costs less and includes more limited support than IP Service. Our future revenues will be affected by our ability to continue to attract subscribers to IJ Economy, as this is the fastest growing segment of the Japanese dedicated line access market. It is also a market in which there is significant price competition.

Dial-up Access Services. The second largest source of our revenues is our dial-up access services. Dial-up access is access to one of our POPs by making a local call. Dial-up access services, which include services for corporate customers and individual users, accounted for 27.8% of our revenues in the year ended March 31, 1999, 36.3% for the year ended March 31, 1998 and 40.8% for the year ended March 31, 1997.

Our revenues from dial-up access services will be affected primarily by our ability to attract new subscribers to our dial-up access services, to retain our existing subscribers, and to shift existing corporate subscribers to our dedicated access services and by the effect of price competition on our dial-up access services. Our dial-up access service revenues will also be affected by the continued expansion and development of our high-quality network, the rate at which we are able to increase our POPs and the number of subscribers we are able to add in the new coverage areas. We seek to increase revenues from dial-up subscribers by adding POPs in locations where we have not previously had POPs.

Our ability to capture market share among individual customers has been somewhat limited due to our relatively low brand-name recognition among consumers not familiar with the Internet and our limited marketing budget to date. A primary focus of our efforts to increase our revenues from individual customers will be our OEM services, in which our OEM services business partner markets and sells Internet access services to individual customers under its own name, and such services are provided through our Internet network infrastructure. Our ability to introduce and expand these services successfully will affect our revenue growth from this source. For a more complete discussion of our OEM services, please refer to "Business — Sales and Marketing — Sales and Marketing Strategy — Large Companies and General Sales".

Other Revenues. Other revenues include sales of value-added services to support and enhance Internet access, systems integration sales and sales of purchased equipment. Systems integration consisted of systems and contents development, maintenance and operation of networks and equipment sales related to systems integration.

Although growth in other revenues was significant for the year ended March 31, 1999, most of the growth was attributable to equipment sales related to systems integration and other equipment sales. These equipment

sales were sales of telecommunications equipment, servers and other equipment that we acquired from third parties and sold to our customers with a low markup. Crosswave was the largest purchaser of this equipment buying approximately ¥1.1 billion of telecommunications equipment. Other revenues on a quarterly and annual basis will be substantially affected by the timing of future equipment sales.

Other revenues will also be substantially affected by our ability to increase growth in systems integration revenues. We are targeting systems integration to be a driver of growth in revenues and income. As our systems integration business is in the early stages of development, most of our activity has involved sales of equipment. Because the margins on these sales are low, these projects have generated little or no profit. Over the long term, however, we seek to improve revenues and margins through systems integration sales. We seek to retain our systems integration customers as our customers for higher-margin consulting, co-location services, operation and maintenance, software development, and upgrades included in systems integration. Systems integration sales also provide other benefits to us. Most of our systems integration customers also become Internet access service customers, and we expect those relationships to continue. In addition, these projects enable us to accumulate experience and build on our reputation in systems integration, which we believe will give us the opportunity to share in the growth of the market for such services. As with other equipment sales, our revenues in any particular fiscal quarter may vary substantially as a result of concentrated sales from large projects.

Other revenues will also be affected by our ability to develop new value-added services and to increase our sales of our value added services. The two primary factors that will influence value-added services revenue will be the increase in the numbers of our dedicated access service subscribers and the increasing variety of uses of our existing and new subscribers.

Additional Factors Affecting Revenues. Our revenues will be affected by the extent to

which businesses in Japan exploit the Internet to its full potential on a commercial basis, including, for example, creating Internet sites for advertisements, e-commerce between business and consumers or between businesses and businesses and expansion of the range of devices that access the Internet. The active commercial application of the Internet will require high-quality and high-capacity connectivity services for both businesses and individuals. It will also require total Internet solutions provision including various Internet access services, systems integration and other value-added services which we are well positioned to provide.

The degree of business usage will also depend upon a variety of factors including technological advances, reliability of security systems and users' familiarity with and confidence in new technologies. The advancement of business usage will also depend upon the rate at which Japanese companies in certain industries begin or significantly increase their Internet usage, particularly the financial, manufacturing or retail segments. We believe Japanese companies in these and other industries have not yet embraced the Internet to the extent their counterparts in the United States have. However, several financial institutions have begun offering on-line securities trading and other companies are developing portal sites and on-line shopping sites for Internet users in Japan.

Our revenues have suffered from the economic situation in Japan. Although Internet use has continued to grow rapidly in Japan over the last few years, many businesses have limited their expenditures for information technologies, including Internet-related items. As a result, our revenues have not increased as much as we anticipated. If the economic situation continues to decline or does not improve, our revenues will continue to be adversely affected.

We expect Internet usage to continue to grow rapidly in Japan and that businesses will continue to diversify their uses of the Internet. Our ability to offer a broad range of services to meet our customers' demands will significantly influence our future revenues.

Our revenues will be affected by the addition of IJ Technology and IJ Media Communications to the consolidated group. IJ Technology had revenues of ¥1.6 billion and IJ Media Communications had ¥0.5 billion for the year ended March 31, 1999. A portion of these revenues reflected sales to IJ.

Costs of Connectivity Services and Other Revenues

We provide our Internet access services on a high-quality network that we have developed and operate. Our backbone is constructed by using leased lines. Our primary costs of connectivity services and other revenues are the leasing fees that we pay for these lines and for the dedicated local access lines that our subscribers use to connect with our network. Other primary components of our costs of Internet access services and other revenues are depreciation and amortization of capital leases for network equipment, cost of equipment sold, personnel and other expenses for technical and customer support staff and network operation center costs. Most of our network equipment is leased rather than purchased to take advantage of the financing provided by a capital lease arrangement.

We have invested heavily in the last few years in developing and expanding our network. Our costs have increased substantially as a result. In the year ended March 31, 1999, our leased line and other connectivity costs were equal to ¥7.4 billion, or 50.2% of our revenues. Of this ¥7.4 billion, our international backbone cost was ¥3.7 billion, domestic backbone cost was ¥1.1 billion, dedicated local access line cost was ¥1.9 billion and other connectivity cost was ¥0.7 billion. We collect dedicated local access line fees from the subscribers and pay them over to the carriers.

We expect our leased line costs to continue to rise in absolute terms in the near term as we continue to add capacity, particularly international capacity, to handle the additional traffic on our network. It is hard to predict the trend beyond the near term with any certainty. While we expect unit prices for

transmission lines to decline, our overall network capacity will continue to increase, and thus the trend will depend upon the rate at which our capacity will grow, the degree to which the unit prices of the lines will decline, the particular manner in which we procure and contract for the lines, and other factors.

We expect that the per unit cost of leased transmission lines in Japan, and between Japan and the United States, will decline. Existing carriers and new carriers like Crosswave are expanding available bandwidth in Japan through installation of new fiber and through technology that expands bandwidth of existing fiber. We also expect significant additional capacity between Japan and the United States to come on to the market upon the completion of a number of undersea cables expected later this year and in the year 2000. We believe the additional trans-Pacific capacity will be less expensive than capacity obtained from traditional leased lines. These lower prices will help us reduce our costs. Additionally, as we continue to increase our capacity between Japan and the United States to meet increasing volumes of traffic, we expect to be able to obtain larger bulk discounts as we lease larger capacity lines.

Our ability to benefit from any declines in trans-Pacific line lease prices will depend in part on the expiration of commitments under our existing trans-Pacific leased lines. Our future minimum lease payments under non-cancelable trans-Pacific line leases are ¥4.3 billion, ¥3.6 billion and ¥3.1 billion for the years ending March 31, 2000, 2001 and 2002 and ¥1.0 billion thereafter.

As we add new capacity and replace portions of our existing domestic backbone with leased lines from Crosswave, our margins may increase. Crosswave's lines will be significantly less expensive than our current leased lines. Our ability to replace our domestic backbone lines with Crosswave lines will depend in part on the expiration of mandatory lease periods under our existing leases. As of March 31, 1999, approximately 55.5% of our domestic backbone as measured by bandwidth was covered by contracts with fixed periods. Approximately half of those have expiration periods at or

prior to December 2001. Approximately 30% extend into 2002 and approximately 20% into 2003 and thereafter. Our future minimum lease payments under non-cancelable domestic backbone line leases are ¥0.8 billion, ¥0.7 billion and ¥0.7 billion for the years ending March 31, 2000, 2001 and 2002 and ¥0.6 billion thereafter. Our existing long-term leases could cause us to have higher costs than competing ISPs who do not currently have as much bandwidth under long-term leases.

If domestic and trans-Pacific leased line costs do not decline as we expect, our earnings will be adversely affected.

We plan to substantially expand our data center operations through the purchase or lease of facilities to house equipment and the purchase or lease of supporting equipment. We also plan to increase significantly the number of our POPs by using Crosswave's POPs or by other means. As a consequence, our cost of connectivity services and other revenues will increase, principally as a result of associated depreciation and amortization of facilities and equipment and lease expenses under any leases accounted for as operating leases.

We categorize our Internet access services revenues into dedicated access services and dial-up access services; however, there is no reasonable means to, and accordingly we do not, allocate the leasing fees for leased lines, other than customers' local access lines, and the lease payments, depreciation and other charges for network equipment to each such category of our Internet access service revenues.

Sales and Marketing

Our sales and marketing expenses consist primarily of costs related to marketing and general advertising and sales and marketing personnel expenses. Our sales and marketing expenses will increase as we expand our operations significantly and as we increase our sales and marketing activities. These increases will include increases in sales personnel expenses and in expenses payable to sales agents.

General and Administrative

Our general and administrative expenses include primarily expenses associated with our management, accounting, finance and administrative functions, including personnel expenses. We believe that these expenses will increase as we grow our business and as we add additional staff as a result of becoming a public company.

Research and Development

Our research and development expenses include primarily expenses relating to our research and development activities and research and development personnel and will depend in the future upon many factors, including our business strategy, technological changes in the Internet and telecommunications industry and our available resources.

Other Income and Expenses

Our other income and expenses include, among other things, interest income and interest expenses. Most of our interest expense is under capital leases. As we increase capital leases or borrowing in order to finance further development of our backbone and data centers and for other investments, interest expenses will also increase. However, to the extent we use the proceeds of this offering to repay debt, interest expenses will decrease. Interest income and interest expenses are also affected by the fluctuation of market interest rates.

Income Taxes

For the years ended March 31, 1999 and 1998, a valuation allowance was provided with respect to the then outstanding deferred tax assets since future realization or recovery of tax benefits corresponding to such assets is uncertain. If in the future we provide for similar valuation allowance or fail to recognize deferred tax assets our after-tax income will be adversely affected.

Crosswave Communications Inc.

Another important factor that will affect our future financial results is the performance

of Crosswave. Our results of operations will be affected by the results of operations of Crosswave because we account for Crosswave using the equity method.

Crosswave will operate a nationwide network dedicated to data transmission. Crosswave began operations at the end of April 1999 with service in the Tokyo-Nagoya-Osaka-Hokuriku ring. We expect that Crosswave will be operating in all major prefectures by October 1999 and all prefectures other than Okinawa by March 2000. We expect Crosswave will generate three types of revenues:

- fees from leasing its lines as dedicated lines to customers, including IJ;
- fees from its network platform service, which will allow customers to lease dedicated networks from Crosswave thereby using the Crosswave network as their own network infrastructure; and
- fees from its dial-up port service, which will allow customers to use Crosswave's dial-up ports as access points for their own networking purposes.

Crosswave's primary expenses as it starts its operations will be related to the development of its domestic network, including primarily the fees that it will pay to KDD for dark fiber and maintenance of the lines as well as the costs of networking equipment. Other significant expenses will include sales and marketing expenses.

We expect that Crosswave's total expenses to implement its current business plan will be approximately ¥10.0 billion for the year ending March 31, 2000, approximately ¥20.0 billion for the year ending March 31, 2001 and approximately ¥26.5 billion for the year ending March 31, 2002. However, if Crosswave takes initiatives not contemplated by its current business plan, such as expansion of its network to include domestic local lines, expanding its business to include local access through fixed wireless access or entering into arrangements or long-term contracts to obtain rights to international lines or any other businesses, Crosswave's total expenses would increase.

The contract with KDD for dark fiber is treated as an operating lease. Under the contract, which is through April 2009, payments consist of variable and fixed portions. The amount of the variable portions will vary depending upon the level of Crosswave's gross revenue but will increase annually. The amount of the fixed portions will be flat, except that the amount will increase in April 2002. The maintenance fee will also increase annually until the year ending March 31, 2003 and will stay flat thereafter. Accordingly, Crosswave's cash payments under the lease in later years of the contract will be larger than those in earlier years. The fixed portions of the lease payment and the maintenance fee will be averaged over the entire term of the lease so that in the early years Crosswave will recognize expenses which will be greater than cash payments.

We expect that Crosswave will operate at a loss for at least the next few fiscal years. However, Crosswave has no operating history, the business environment surrounding Crosswave is uncertain and the manner in which Crosswave conducts its business may change significantly depending upon a number of considerations (e.g., networking equipment can be leased or purchased, or Crosswave may engage in the domestic local line business, the international leased line business or other businesses that are beyond

the scope of its current business plan). Consequently Crosswave's total annual expenses could be larger than we anticipate, or its revenues could be smaller than we anticipate; however, we are not directly responsible for any of the expenses of Crosswave beyond our equity investment.

Crosswave will require funds in order to meet its operating expenses, including its obligations under its contract with KDD, and to absorb operating losses. We expect that Crosswave will meet its funding requirements with revenues from operations and with the current and planned capital contributions by its shareholders. However, Crosswave might require contributions from its shareholders higher than those currently contemplated by its current business plan which has been approved by its shareholders or it may need to seek additional capital from the equity or debt markets. We expect, but are not required, to pay our pro rata share, which is 40%, of any contributions that may be made to Crosswave.

Results of Operations

As an aid to understanding our operating results, the following table sets forth certain items from our statement of operations for the periods indicated in yen amounts and as a percentage of total revenues.

	Year Ended March 31,					
	1997		1998		1999	
	(millions of yen)					
Statement of Operations Data:						
Connectivity services and other revenues:						
Dedicated access service revenues:						
IP Service	¥4,291	50.3%	¥ 6,703	54.4%	¥ 7,272	49.2%
IJ Economy	—	—	53	0.4	526	3.6
Total dedicated access service revenues	4,291	50.3	6,756	54.8	7,798	52.8
Dial-up access service revenues	3,478	40.8	4,474	36.3	4,101	27.8
Other revenues:						
Value-added services	202	2.4	368	3.0	496	3.3
Systems integration, including related equipment sales	455	5.3	527	4.3	1,179	8.0
Other equipment sales	63	0.7	66	0.5	1,085	7.3
Other	44	0.5	132	1.1	110	0.8
Total other revenues	764	8.9	1,093	8.9	2,870	19.4
Total revenues	<u>8,533</u>	<u>100.0</u>	<u>12,323</u>	<u>100.0</u>	<u>14,769</u>	<u>100.0</u>
Cost and expenses:						
Cost of connectivity services and other revenues:						
International backbone cost	1,372	16.1	3,095	25.1	3,723	25.2
Domestic backbone cost	322	3.8	595	4.8	1,109	7.5
Local access line cost	908	10.6	1,569	12.7	1,884	12.7
Other connectivity cost	240	2.8	535	4.3	703	4.8
Depreciation and amortization	556	6.5	1,008	8.2	1,249	8.4
Cost of equipment sales related to systems integration	151	1.8	44	0.4	410	2.8
Cost of other equipment sales	62	0.7	60	0.5	1,074	7.3
Other	1,916	22.5	2,498	20.3	3,050	20.7
Total cost of connectivity services and other revenues	5,527	64.8	9,404	76.3	13,202	89.4
Sales and marketing	1,211	14.2	1,508	12.3	1,570	10.6
General and administrative	892	10.4	939	7.6	1,065	7.2
Research and development	103	1.2	152	1.2	243	1.7
Total cost and expenses	<u>7,733</u>	<u>90.6</u>	<u>12,003</u>	<u>97.4</u>	<u>16,080</u>	<u>108.9</u>
Operating income (loss)	<u>800</u>	<u>9.4</u>	<u>320</u>	<u>2.6</u>	<u>(1,311)</u>	<u>(8.9)</u>
Other income (expenses):						
Interest income	5	0.1	7	0.1	4	*
Interest expense	(120)	(1.4)	(216)	(1.8)	(218)	(1.4)
Other—net	(30)	(0.4)	(35)	(0.3)	15	0.1
Other expenses—net	(145)	(1.7)	(244)	(2.0)	(199)	(1.3)
Income (loss) before income taxes, minority interests and equity in affiliated companies	655	7.7	76	0.6	(1,510)	(10.2)
Income taxes	377	4.4	289	2.3	16	0.1
Minority interests in consolidated subsidiaries	(31)	(0.4)	(42)	(0.3)	123	0.8
Equity in net income (loss) of affiliated companies	(44)	(0.5)	(105)	(0.9)	(26)	(0.2)
Net income (loss)	<u>¥ 203</u>	<u>2.4%</u>	<u>¥ (360)</u>	<u>(2.9)%</u>	<u>¥ (1,429)</u>	<u>(9.7)%</u>

Year Ended March 31, 1999 Compared to the Year Ended March 31, 1998

Connectivity Services and Other Revenues. Revenues increased 19.8% to ¥14.8 billion in the year ended March 31, 1999 from ¥12.3 billion in the year ended March 31, 1998. This revenue growth included increases in both revenues from Internet access services and other revenues.

Revenues from dedicated access services increased 15.4% to ¥7.8 billion in the year ended March 31, 1999 from ¥6.8 billion in the year ended March 31, 1998. The growth rate declined compared to the 57.4% growth rate in the year ended March 31, 1998. This reduced growth rate reflected the continued sluggish economy in Japan and price competition from other ISPs, primarily in lower bandwidth segments.

The number of overall IP Service subscribers declined from March 31, 1998 to March 31, 1999. We offered price reductions including discounts for three-year contracts. However, in the year ended March 31, 1999, our IP Service revenues increased by approximately ¥0.6 billion due to increased sales of higher bandwidth services, including to IP Service subscribers of ours that migrated to these higher bandwidth services.

Revenues from IJ Economy increased by approximately ¥0.5 billion due to significant growth in the number of subscribers of this service, which was introduced in November 1997.

Revenues from dial-up access services declined 8.3% to ¥4.1 billion in the year ended March 31, 1999 from ¥4.5 billion in the year ended March 31, 1998. The decline was due primarily to a significant decrease in the number of subscribers to our traditional dial-up access services such as Network-type Dial-up IP and Terminal-type Dial-up IP services that we no longer promote. This subscriber decrease was also attributable to price competition from other ISPs and, to a lesser extent, to the prolonged adverse economic situation in Japan. The total number of IJ4U subscribers continued to increase and IJ4U revenues grew by approximately ¥0.4 billion as a result. However, this revenue

increase was not large enough to offset the decrease of approximately ¥0.8 billion in traditional dial-up access service revenues from the other services in part due to the fact that the monthly revenues per subscriber of IJ4U was lower than the monthly revenues per subscriber of our traditional dial-up access services and as a result of price reductions for IJ4U. Revenues from Enterprise Dial-up Standard increased by ¥0.1 billion in the year ended March 31, 1999 primarily because of an increase in subscribers and the fact that this year was its first full year of operations.

Other revenues increased 162.5% to ¥2.9 billion in the year ended March 31, 1999 from ¥1.1 billion in the year ended March 31, 1998. This significant increase was attributable to increases in sales of equipment (to ¥1.5 billion from ¥0.1 billion), including sales of approximately ¥0.4 billion of equipment relating to large systems integration projects and sales of approximately ¥1.1 billion of telecommunications equipment to Crosswave.

Cost of Connectivity Services and Other Revenues. Cost of revenues increased 40.4% to ¥13.2 billion in the year ended March 31, 1999 from ¥9.4 billion in the year ended March 31, 1998. This increase included material increases in our international and domestic backbone costs due to increases in leased capacity. Although our per unit prices declined, international backbone cost increased 20.3% to ¥3.7 billion in the year ended March 31, 1999 from ¥3.1 billion in the year ended March 31, 1998 as we significantly upgraded our capacity between Japan and the United States. Domestic backbone cost increased 86.4% to ¥1.1 billion from ¥0.6 billion as we continued the expansion of our domestic backbone. Dedicated local access line cost increased 20.1% to ¥1.9 billion from ¥1.6 billion as a result of an overall increase in the number of our dedicated access service subscribers.

Cost of equipment sold constituted a substantial portion of cost of revenues for the year ended March 31, 1999. Cost of equipment sold consisted primarily of the cost of equipment sold by our systems integration

business (approximately ¥0.4 billion) and the cost of equipment sold to Crosswave (approximately ¥1.1 billion). Cost of equipment sold increased significantly to ¥1.5 billion in the year ended March 31, 1999 from ¥0.1 billion in the year ended March 31, 1998.

Our costs of revenues increased as a percentage of revenue to 89.4% in the year ended March 31, 1999 from 76.3% in the year ended March 31, 1998. The predominant reason for this substantial increase was material increases in cost of equipment sales related to systems integration projects and costs of equipment sales to Crosswave, as gross margins for those revenues are generally substantially lower than that of Internet access services. Aside from these equipment sales, our costs of revenues still increased as a percentage of revenue in the year ended March 31, 1999 if compared to the year ended March 31, 1998. The principal reasons for the increase were price reductions that we offered during the period and significant expansion of the leased line capacity which was not accompanied by a corresponding increase in revenues.

Sales and Marketing. Sales and marketing costs increased slightly to ¥1.6 billion in the year ended March 31, 1999 from ¥1.5 billion in the year ended March 31, 1998. However, as a percentage of revenue, sales and marketing expenses decreased to 10.6% from 12.3%. A significant increase in costs of sales and marketing staff to ¥0.7 billion from ¥0.5 billion was partially offset by reductions in other marketing expenses, particularly advertising expenses which decreased to ¥0.2 billion from ¥0.3 billion.

General and Administrative. General and administrative expenses increased 13.4% to ¥1.1 billion in the year ended March 31, 1999 from ¥0.9 billion in the year ended March 31, 1998. General and administrative costs decreased slightly, as a percentage of revenues to 7.2% from 7.6%. During this period, we enhanced our administrative functions and increased our administrative staff, as our operations grew rapidly.

Research and Development. Research and development costs increased 59.2% in

the year ended March 31, 1999 from the year ended March 31, 1998 primarily due to increases in research and development activities and staff. Research and development costs increased as a percentage of revenues to 1.7% from 1.2%. The increase reflected increases in the number of research and development staff and costs associated with the establishment of IJ Research Lab in April 1998.

Interest Income. There was no significant interest income in either the year ended March 31, 1999 or 1998.

Interest Expense. Interest expense remained at ¥0.2 billion in the year ended March 31, 1999. As a percentage of revenues, interest expense decreased to 1.4% from 1.8%.

Other Expenses. There were no significant changes in other expenses in the year ended March 31, 1999 from the year ended March 31, 1998.

Income Taxes. In the year ended March 31, 1999, we had pre-tax loss of ¥1.5 billion. Nevertheless, we recorded income tax expenses of ¥15 million. Valuation allowance of ¥0.8 billion was provided for with respect to the entire operating loss carry forward and other items that would have given rise to deferred tax assets for the year because of the uncertainty as to the future realization or recovery of tax benefit corresponding to such assets. For more information about income tax expenses, see Note 8 of the notes to the consolidated financial statements included elsewhere in this prospectus.

Minority Interests in Consolidated Subsidiaries. The amount of minority interest in losses of consolidated subsidiaries was ¥0.1 billion for the year ended March 31, 1999, primarily as a result of start-up cost and expenses at Net Care and operating losses at IJ America.

Equity in Net Income (Loss) of Affiliated Companies. In the year ended March 31, 1999, combined revenues for the affiliated companies were ¥4.5 billion and combined costs and expenses were ¥4.4 billion. This represented an improvement

of revenues from ¥2.6 billion for the year ended March 31, 1998, but costs and expenses also increased from ¥3.0 billion. Many of these affiliates showed improved performance in the year ended March 31, 1999, notably Internet Multifeed and IJ Media Communications, whereas Crosswave recorded material start-up losses. Overall, these affiliated companies incurred a net loss on a combined basis.

Year Ended March 31, 1998 Compared to the Year Ended March 31, 1997

Connectivity Services and Other Revenues. Revenues increased 44.4% to ¥12.3 billion in the year ended March 31, 1998 from ¥8.5 billion in the year ended March 31, 1997. The increase was primarily attributable to increases in revenues from Internet access services. Despite price reductions in certain segments of our services, revenues from overall Internet access services increased, primarily due to an increase in the number of business and ISP customers with higher bandwidth requirements and individual users.

Our dedicated access service revenues increased 57.4% to ¥6.8 billion in the year ended March 31, 1998 from ¥4.3 billion in the year ended March 31, 1997. During this period, we offered unit price reductions for middle to low bandwidth users of our IP Service. We also introduced IJ Economy. Despite the price reductions, overall dedicated access service revenues increased significantly because of a significant increase in the number of our subscribers, particularly IP Service subscribers, and migration of IP service customers to higher bandwidth services.

Dial-up access service revenues increased 28.7% from ¥3.5 billion in the year ended March 31, 1997 to ¥4.5 billion in the year ended March 31, 1998. This increase was due primarily to an increase in number of our dial-up subscribers, while there was no material price change during the period. Despite the migration of some of the dial-up business subscribers to IJ Economy, the overall number of our dial-up access service subscribers increased substantially, notably

with the successful introduction and expansion of IJ4U for individual subscribers.

Other revenues increased to ¥1.1 billion from ¥0.8 billion as sales of our value-added services and systems integration services increased.

Cost of Connectivity Services and Other Revenues. Cost of revenues increased 70.1% to ¥9.4 billion in the year ended March 31, 1998 from ¥5.5 billion in the year ended March 31, 1997. This was primarily due to significant increases in our international and domestic backbone costs. International backbone cost increased 125.5% to ¥3.1 billion from ¥1.4 billion as we upgraded significantly our capacity between Japan and the United States. Domestic backbone cost increased 85.1% to ¥0.6 billion from ¥0.3 billion due to increases in leased capacity. Dedicated local access line cost increased 72.8% to ¥1.6 billion from ¥0.9 billion as a result of an increase in the number of our dedicated access service subscribers. Depreciation and amortization nearly doubled in the year ended March 31, 1998 from the year ended March 31, 1997, and increased as a percentage of revenue because of the significant expansion of our backbone. Personnel expenses also increased significantly to ¥0.6 billion from ¥0.3 billion due to increases in staff for operation of our network and serving customers.

Costs of connectivity services and other revenues increased as a percentage of revenue to 76.3% in the year ended March 31, 1998 from 64.8% in the year ended March 31, 1997. This was primarily because leased line costs increased more rapidly than our customer base grew. There were a number of reasons for this. First, we reduced prices for our dedicated access services, and we introduced less expensive IJ Economy to which some of our IP Service subscribers migrated. Second, we expanded the capacity of our network substantially in order to accommodate a significant increase in traffic at night, primarily by individual users. However, the traffic of our daytime users, which are primarily businesses, did not increase as rapidly and the additional capacity did not produce a proportionate increase in revenue.

Third, we added additional capacity to handle increased traffic from existing customers. However, there was no corresponding increase in revenue associated with much of the increased traffic as customers on average used a higher percentage of the bandwidth they had contracted for. Fourth, we added additional capacity in expectation of significant increases in the number of subscribers. However, the economic downturn in Japan resulted in slower growth of our subscriber base than we anticipated. Fifth, we aggressively expanded the bandwidth and geographic coverage of our network in anticipation of future growth.

Sales and Marketing. Sales and marketing costs increased 24.5% to ¥1.5 billion in the year ended March 31, 1998 from ¥1.2 billion in the year ended March 31, 1997. As a percentage of revenue, sales and marketing costs declined to 12.3% from 14.2%. We limited the growth in marketing staff and reduced advertising expenses.

General and Administrative. General and administrative costs increased slightly in the year ended March 31, 1998 from the year ended March 31, 1997. Such costs decreased as a percentage of revenue to 7.6% from 10.4%. This decrease in part reflects expenses for the year ended March 31, 1997 associated with the relocation of our headquarters and a decrease in cost of life insurance.

Research and Development. Research and development costs increased 47.1% to ¥0.2 billion in the year ended March 31, 1998 from ¥0.1 billion in the year ended March 31, 1997. As a percentage of revenue, research and development costs remained at 1.2%.

Interest Income. There was no significant interest income in either the year ended March 31, 1998 or 1997.

Interest Expense. Interest expense increased to ¥0.2 billion in the year ended March 31, 1998 from ¥0.1 billion in the year ended March 31, 1997 reflecting the effect of

an increase in the amount of capital lease obligations entered into during the latter half of the year ended March 31, 1997.

Other Expenses. There was no significant change in other expenses in the year ended March 31, 1998 from the year ended March 31, 1997.

Income Taxes. In the year ended March 31, 1998, we recorded income tax of ¥0.3 billion, despite the fact that we recorded pre-tax income of only ¥76 million. We are subject to a number of different taxes in Japan which, in the aggregate, indicate a normal statutory tax rate of approximately 51% for the year ended March 31, 1998. Income tax consists, for the year ended March 31, 1998 primarily of valuation allowance of ¥0.2 billion which was provided for with respect to deferred tax assets. The valuation allowance reflects the uncertainty as to the future realization or recovery of tax benefit corresponding to such assets. For more information about income tax, see Note 8 of Notes to the consolidated financial statements included elsewhere in this prospectus.

Minority Interests in Consolidated Subsidiaries. The amount of minority interests was insignificant for each of the years ended March 31, 1998 and 1997.

Equity in Net Loss of Affiliated Companies. In the year ended March 31, 1998, combined revenues for the affiliated companies were ¥2.6 billion and combined costs and expenses were ¥3.0 billion. This represented an increase in revenues from ¥1.6 billion for the year ended March 31, 1997, while costs and expenses also increased from ¥1.8 billion. Because many of these affiliates were start-ups, they operated at a net loss for the year ended March 31, 1997. The affiliated companies experienced an overall increase in combined net losses due primarily to increased losses from several of the affiliated companies.

Apart from the quarter ended March 31, 1999, we have not experienced significant fluctuations in our results of operations from quarter to quarter. In the future, however, our quarterly operating results may vary significantly due to a number of factors beyond our control. We discuss these factors in "Risk Factors" and you should refer to our discussion under the risk "Our Operating Results are Likely to Fluctuate Significantly and May Differ from Market Expectations." In the quarter ended March 31, 1999, we received substantial revenue from sales of the telecommunications equipment to Crosswave (¥1.1 billion) and large systems equipment sales revenues from DLJ (¥0.2 billion) and systems integration revenues from Sharp (¥0.2 billion). These sales are not necessarily indicative of sales that will occur in the future but as we diversify our revenue sources, including increasing our revenues from large systems integration projects, we may see more fluctuation like this.

Liquidity and Capital Resources

Our principal capital and liquidity needs historically have related to the development and expansion of our network infrastructure, our investments in our group companies, including Crosswave, sales and marketing activities and general working capital needs. We have met these capital needs primarily from cash flow from operations, issuance of our shares, capital lease arrangements and short-term and long-term borrowing.

Net cash provided by operating activities was ¥0.4 billion for the year ended March 31, 1999 and ¥0.3 billion for the year ended March 31, 1998. Despite sizable net loss for the year ended March 31, 1999, we had cash provided by operating activities primarily due to a large amount of depreciation and amortization and a significant increase in accounts payable, which were partially offset by an increase in accounts receivable.

Net cash used in investing activities was ¥3.7 billion for the year ended March 31, 1999 and ¥0.3 billion for the year ended March 31, 1998. Cash used in investing activities for the year ended March 31, 1999 included investments in and advances to affiliated

companies, purchases of property and equipment, purchases of other investments and payments for refundable insurance policies.

Net cash provided by financing activities was ¥3.2 billion for the year ended March 31, 1999 and ¥0.8 billion for the year ended March 31, 1998. Cash provided by financing activities for the year ended March 31, 1999 consisted primarily of net increases in short-term borrowing.

As of March 31, 1999, our short-term borrowings consisted primarily of unsecured notes payable to banks and bank overdrafts of ¥6.7 billion. The interest rates of the short-term borrowings varied from 0.82% to 1.63%.

As of March 31, 1999, we had ¥1.3 billion of outstanding long-term borrowings (including the current portion of long-term borrowings) which were all unsecured, fixed rate loans from banks and other financial institutions with interest rates that vary from 1.52% to 2.0%. Most of these loans mature before March 2001.

Substantially all of our short- and long-term bank borrowings contain conditions that would allow the banks to require us to provide collateral or guarantees with respect to the borrowings. However, we have never received a request to provide collateral or guarantees to any bank. Our primary banking relationships are with Sumitomo Bank, Sanwa Bank and Fuji Bank. The banks are also shareholders and customers of ours.

In general, we procure data communication equipment for our network under capital lease arrangements. The terms of the lease are generally set based upon our estimate of the useful life of particular items of equipment, typically four years. As of March 31, 1999, the current portion and the non-current portion of capital lease obligations amounted to ¥1.3 billion and ¥1.5 billion, respectively, compared with ¥1.1 billion and ¥1.8 billion as of March 31, 1998.

Our network backbone is comprised of dedicated lines that we have leased from telecommunications carriers and others. Under these operating lease agreements, our future lease payments under non-cancelable

operating leases as of March 31, 1999 were ¥5.1 billion for the year ending March 31, 2000, ¥4.3 billion for the year ending March 31, 2001, ¥3.7 billion for the year ending March 31, 2002 and ¥1.4 billion for the year ending March 31, 2003. In addition, we expect to use approximately ¥4.0 billion for the further development of our network, and for rapid international capacity expansion through March 2001.

Due to the rapid change and uncertainties in market conditions and the business environment in which we conduct our business, it is difficult for us to establish capital expenditure and investment plans far in advance. Therefore, our plans are generally for short-term periods and are subject to constant review and adjustment. Under current plans, we plan to:

- invest approximately ¥1.0 billion in each of the next few years for capitalized leases relating to our data centers;
- invest approximately ¥0.5 billion in each of the next few years for increased access to our networks by adding more POPs;
- make additional investments in Crosswave including investing an additional ¥0.64 billion by August 31, 1999 and up to an additional ¥4.8 billion thereafter; and
- increase our share ownership in our other affiliates, including Asia Internet Holding, as the opportunities arise.

With respect to the Crosswave investment, our joint venture agreement with Sony and Toyota contemplates that the shareholders will discuss and agree, by September 26, 1999, as to additional investments of up to ¥12 billion in debt or equity, of which our pro rata share would be up to ¥4.8 billion. Such decision, however, will depend upon a number of variables and uncertainties, including how Crosswave will procure network equipment or whether and when it will commence trans-Pacific or other international leased line business or domestic local lines or any other businesses that are beyond the scope of its current business plan which has been approved by Crosswave's shareholders. If we and the

other shareholders agree on further investments in large amounts, we might need to identify new sources of funds in addition to applying a portion of the proceeds from this offering.

The proceeds from this offering are important in order for us to implement our current capital investment plan and to meet our capital and operating lease obligations as discussed above. We believe that the proceeds from this offering, together with existing capital resources and credit available through our existing short-term credit facilities, under which as of April 30, 1999 we had approximately ¥1.5 billion available, will be sufficient to make our additional planned investments and meet our material commitments while still allowing us to meet our current working capital needs. Additionally, we expect that our current capital resources will be sufficient for operations for approximately the next 15-18 months under current plans.

However, we may need to obtain additional financing for a variety of reasons. For example, in order to meet with a growing demand for our services, we may need to expand and enhance our network on a larger scale or quicker, or make available additional working capital in amounts greater, than we currently anticipate. In order to enhance our provision of total internet solutions we may need to increase capital expenditures or make investments in affiliated companies which we do not currently contemplate. Crosswave may require additional capital in amounts greater than or at times earlier than we currently anticipate. We may need to make cash infusion in any affiliated company if it faces financial difficulties and we make a strategic or other decision to address such problem. We may be unsuccessful in raising sufficient additional capital. In particular, we may be unable to secure additional loans from our banks on terms that we consider acceptable or at all. If we fail to raise sufficient funds, we may need to modify, delay or abandon some of our future investment plans which could have a material adverse effect on our business, prospects, financial conditions and results of operations.

Market Risks

Our primary market risk exposures are to foreign exchange rate and interest rate fluctuations.

Our periodic payment obligations under certain trans-Pacific dedicated line leases, including approximately 60% of our lease obligations for international lines, are denominated in U.S. dollars. We do not have any material periodic U.S. dollar revenue to match the dollar payments, and thus we are exposed to fluctuations in the yen-dollar exchange rate to the extent the dollar denominated payments are not hedged. In order to manage the exposure associated with certain of the dollar-denominated payments, we entered into a foreign exchange contract early in the year ended March 31, 1999 to hedge anticipated payments of dollar-denominated line lease obligations covering periods extending into 1999, anticipating a continuing weak yen. Outstanding forward exchange contracts as of March 31, 1999 amounted to \$8.2 million.

Our exposure to fluctuations in interest rates relates primarily to short-term and long-term borrowings and lease obligations related to capitalized equipment. Presently, these borrowings and obligations are payable at a fixed interest rate except for a portion of long-term borrowings which have variable interest rates hedged by interest rate swap instruments. Please see Note 11 to the financial statements for additional discussion.

We will continue to obtain fixed rate borrowings and capital lease obligations to the extent that current favorable interest rate conditions continue. However, we may reconsider this policy if these conditions change.

We hold no material equity price-risk instruments.

The following table provides information about our major market risk-sensitive instruments related to foreign currency exchange transactions existing at March 31, 1999.

	Thousands of Yen					Fair Value
	Expected Payment Date				Total	
	2000	2001	2002	2003		
Foreign currency operating lease commitment and related forward contracts						
U.S. dollar-denominated international line lease commitment (as computed by approximate exchange rate at March 31, 1999 of ¥118.43 = \$1.00) (1)	¥2,919,155	¥2,351,364	¥2,351,364	¥783,768	¥8,405,651	—
Forward exchange contracts—(pay yen, receive U.S. dollar)						
Notional amount	972,784	—	—	—	972,784	—
Fair value	—	—	—	—	—	¥(93,556)
Average contractual exchange rate (single yen)	¥ 131.29	—	—	—	¥ 131.29	—

(1) For each one yen change in the exchange rate total yen payments for lease payments denominated in U.S. dollars will change by ¥69,968 thousand.

Impact of the Year 2000 Problem

What is the Year 2000 Problem?

The Year 2000 (“Y2K”) problem results from the fact that many existing computer programs and systems use only two digits to

identify the year in the date field. If not corrected, computer applications that use a two-digit format could fail or create erroneous results in any computer calculation or other processing involving the year 2000 or a later date.

While, as discussed below, we believe that we are adequately addressing the Y2K problem and that we are almost Y2K-ready, we cannot assure that our Y2K analyses will be completed on a timely basis or that the cost and liabilities associated with the Y2K problem will not materially adversely impact our business, prospects, revenues or financial position.

Our State of Y2K Readiness

The Y2K problem, if not properly addressed, would have material adverse effects on our business in terms of information technology systems that we use. We do not expect that any disruptions that we may experience in non-information technology systems (such as elevators) would have material adverse effects on our business, although we are taking appropriate steps to identify and address potential Y2K problems with such systems.

Our “Year 2000 Task Force”, which we set up in October 1998, is spearheading the IJ group’s efforts to take appropriate measures to ensure the IJ group’s Y2K compliance. Currently this task force has 45 members, 36 of whom are IJ employees that come from various departments, including the Technical Planning Division. The task force exchanges information with our company’s departments and with the IJ group companies, and supervises and coordinates the IJ group’s Y2K compliance efforts.

The task force has developed detailed plans for making and testing modifications to our key computer systems and equipment with embedded chips to ensure that they are Y2K-compliant. Under these plans, we divided our computer systems and equipment into three categories: the business operation system, which includes routers and servers that are used by us in our network and by our customers for their own networks, for connections to our network and for the provision of Internet-related services; the operational support system, which includes customer management, accounting software and payroll systems; and the internal system, which includes various servers that we use internally. Each of these three categories has various subcategories within it. For purposes of

implementing our Y2K compliance plans, the task force has prioritized such subcategories on the basis of importance to the relevant system and to the IJ group’s business operation as a whole, and monitors the implementation of the plans for each such subcategory.

Through the task force, we have been closely monitoring the implementation of the modification and testing phases of our Y2K compliance plans with respect to each subcategory under the three categories discussed above. We have finished both phases in all material respects, with only minor additional work to be performed. As a result, many of our high-priority systems and equipment that are material to our business have already passed the testing phase and are now Y2K compliant. The remaining high-priority systems and equipment, such as those that we have set up at customers’ premises, have not yet gone through the modification and testing phases, but we expect to complete this modification and testing by the end of September 30, 1999. Also, we are now undertaking the Y2K remediation and testing of low-priority systems and equipment, which are not essential to our business operations. We expect to complete all this Y2K-related work by September 30, 1999.

In addition, we have been communicating with our material suppliers, vendors, lenders and other material third parties to determine their Y2K status and any probable impact on us. We have received a response from, and have otherwise obtained information from other sources concerning, each material third party, which have not revealed any significant Y2K compliance issue affecting these parties. However, we cannot independently verify the state of their Y2K compliance. We will continue to track and evaluate our long-term relationships with our material third parties based on such responses and other information.

Our Y2K-Related Costs and Expenses

The costs and expenses that we have incurred so far in connection with the implementation of our Y2K compliance plans have not been material to our business. We

estimate such costs and expenses on a consolidated basis for the year ended March 31, 1999 to be around ¥2.3 million. This amount consists principally of the replacement costs of routers and servers used in the business operation system under capital lease arrangements. There has not been a material difference between the anticipated and actual amounts of our Y2K-related costs and expenses so far.

These costs and expenses do not include the operating costs associated with time spent by our employees, because our Y2K compliance plans involve these employees in the course of their regular business activities. Also, many types of software we use in our business are subject to maintenance services provided by their makers, for which we pay regular maintenance fees. If there were any Y2K problem, the maker of the relevant software would solve it by upgrading the software under such maintenance arrangement. These costs and expenses do include the cost of replacing equipment except when the replacement is part of a total system overhaul. Some non-Y2K compliant equipment has been replaced in connection with such broader system overhauls.

Based upon our review to date, we anticipate future costs and expenses related to our Y2K compliance plans, on a consolidated basis, to be around ¥60.7 million, which will not be material to our business. We estimate the breakdown of this amount to be as follows: ¥40.4 million relating to the business operation system, consisting principally of the aforementioned routers and servers we use under capital lease arrangements; ¥8.8 million relating to the operational support system; and ¥11.5 million relating to the internal system. However, we cannot assure you that these costs and expenses will be at levels we currently anticipate. If they are not, this could have a material adverse effect on our business, results of operations and financial condition.

Our Y2K Contingency Plan

We are in the process of developing a contingency plan to handle the most

reasonably likely worst case Y2K scenarios. Our effort to devise such a plan is consistent with the recommendation of the Ministry of Posts and Telecommunications to telecommunications companies, including our company, that they should prepare Y2K contingency plans under a proposed timetable that calls for completion of such plans by September 30, 1999. In line with that timetable, we have formulated an outline of our contingency plan, and we expect to finalize its details by September 30, 1999.

We are preparing our contingency plan in part by referring to our current operating practice manual for dealing with system outages or disruptions, which our Internet Technology Division is using with respect to our dedicated access services.

Our contingency plan will discuss our most reasonably likely worst case Y2K scenario, which we currently believe will entail the following major adverse events:

- due to outages or disruptions in our own computer system and/or infrastructures outside our company, such as electricity, we would become unable to conduct normal business operations;
- due to network disruptions caused by external factors, or by our own hardware and software, which we believe would be unlikely if our current Y2K-compliance plans proceed as scheduled, we would become unable to provide our services, including connectivity to and from the Internet for our customers; and
- our inability to provide our connectivity services would adversely affect our customers' own infrastructure (such as their own local area networks) as well as other ISPs.

Our contingency plan will: identify those of our systems and equipment that require contingency planning; define, categorize and analyze various Y2K problem-related risks to our business; establish measures intended to alleviate such risks in advance of the occurrence of the Y2K problem; and establish procedures for initial response in the event of such occurrence.

INTERNET INITIATIVE JAPAN INC.

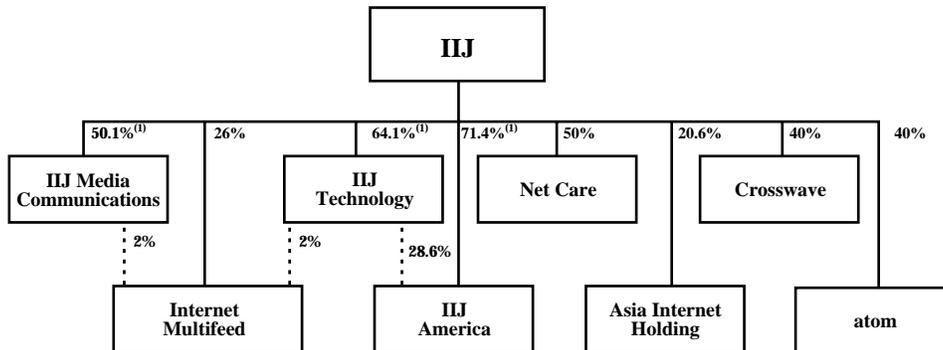
We were incorporated as a limited liability company in Japan in December 1992. We were one of the first commercial Internet service providers in Japan offering Internet access beginning in July 1993.

We were founded by, among others, engineers who were participants in the WIDE project in Japan, which was a pioneering project for the advancement of the Internet in Japan. We were also a founding member of the Internet Society in 1992 and have been a sustaining gold member since 1998. The only other members who were founding members and are currently sustaining gold members are Advanced Network and Services, AT&T Labs, Defense Information Systems Agency,

France Telecom, GTE, IBM, MCI Communications Corporation, Microsoft, Oracle and Telstra.

We applied for and received a Special Type II telecommunications license for the Minister of Posts and Telecommunications in February 1994. As a Special Type II carrier, generally we cannot own our own transmissions lines.

We operate our business and offer our services directly by working with our group companies. The chart below sets out our group companies and our current ownership of each of them:



(1) Our ownership at March 31, 1999 of IIJ Media Communications was 50.0%, IIJ Technology was 39.0% and IIJ America was 50.0%.

Mr. Suzuki, our President, is also the sole Representative Director of each of the group companies except atom where he serves as a director. Therefore, although we don't consolidate all of the group companies, we do exercise significant influence over several of them. However, there can be no assurance that we will be able to continue to exercise influence over these companies.

Chiyoda-ku, Tokyo 101-0054, Japan, and our telephone number at that location is 81-3-5259-6500. We have a Web site that you may access at <http://www.ij.ad.jp/>. Information contained on our Web site does not constitute part of this prospectus and is not intended to be used by anyone considering an investment in the ADSs in making their investment decision.

Our head office is located at Takebashi Yasuda Bldg., 3-13, Kanda Nishiki-cho,

BUSINESS

Overview

We offer a comprehensive range of Internet access services and Internet-related services to our customers in Japan. We offer our services on one of the most advanced and reliable Internet networks available in Japan and between Japan and the United States. Our services are based upon high-quality networking technology tailored to meet the specific needs and demands of our customers.

We manage our business and measure our results based on a single Internet-related services industry segment. We offer a variety of services to our customers as part of our total Internet solutions. Our primary services are our Internet access services which range from low-cost dial-up access to high-speed continuous access through dedicated lines.

We also offer through IJJ, or together with our IJJ group companies, a variety of other value-added Internet services and products, including:

- network consulting and systems integration services;
- security services, such as basic firewalls and complete network security services;
- co-location services which allow companies to house their servers and routers in our facilities;
- support, maintenance and monitoring;
- Web hosting and content development and distribution services;
- remote user access and roaming; and
- hardware, software and other products, such as network equipment, which are mostly sourced from third-party vendors.

This extensive variety of Internet access services, value-added services and products enables our customers to purchase Internet-related services and products, including integration services, through a single source. We aim to be the leading supplier of total Internet solutions in Japan.

Our founders include engineers who were among the pioneers of commercial Internet services in Japan and who participated in the WIDE project, a pioneering

project for the advancement of the Internet in Japan. One of our greatest strengths is the engineering expertise we have amassed. We have continued to hire highly qualified engineers to support our growth and strengthen the quality of services we provide.

We have created a high-quality network that extends throughout Japan. Our backbone is one of the highest capacity Internet backbones in Japan and to the United States by leasing lines from telecommunications carriers. Our domestic backbone is anchored by two 155 Mbps lines between Tokyo (Otemachi) and Tokyo (Ariake) and between Tokyo and Osaka and has large connections to the other major business regions in Japan. Our backbone is also one of the largest between Japan and the United States with a total capacity of 620 Mbps as of June 1999. This allows us to better serve users that require high-speed, high-capacity and reliable services and provides us with the ability to gather and transmit large amounts of data traffic.

In addition to our network, we have significant interests in two other networks: the A-Bone and the Crosswave network. We currently own 20.6% of Asia Internet Holding, the company that owns the A-Bone. We expect to increase our interest in Asia Internet Holding to approximately 30% with a portion of the proceeds from this offering. The A-Bone is an Internet network using leased lines that connects countries in the Asia-Pacific region, including Japan, China, Singapore, Hong Kong, Malaysia, Philippines, Indonesia and Thailand. We believe, based on publicly available information, our network backbone and the A-Bone together form the most extensive Internet backbone connecting the countries in the Asia-Pacific region to each other and to the United States. Using our network and engineering expertise and pursuant to an agreement with Asia Internet Holding, we operate and manage the A-Bone.

We also own 40% of Crosswave, which operates one of the first high-speed telecommunications facilities and networks in Japan designed specifically for data communications. Through DWDM and

SONET, advanced multiplexing and transmission technologies, we believe that Crosswave's network will have the capacity to provide over 100 Gbps of bandwidth with multiplexing and transmission equipment upgrades. Crosswave's network currently operates primarily in the Tokyo-Nagoya-Osaka-Hokuriku ring but will be extended to cover all of Japan except Okinawa with approximately 85 POPs by March 2000.

Crosswave will provide its customers with access to dedicated lines at prices that will be significantly lower than are currently available. We will be one of Crosswave's largest customers as we plan to use Crosswave's lines for our domestic backbone. This will allow us to significantly expand our network by adding additional capacity to handle increasing traffic volume and by increasing the number of our POPs. It will also allow us to reduce our cost structure. We also expect that we will lease significant amounts of our international capacity from Crosswave in the future.

Industry Overview

The Internet

The Internet is a global network of interconnected public and private computer systems and networks that enables commercial organizations, educational institutions, government agencies and individuals to communicate, access and share information, provide entertainment and conduct business.

The Internet has experienced rapid growth since its commercialization began in the early 1990s. International Data Corporation (IDC), a private research organization, projects that the number of devices accessing the World Wide Web will grow from approximately 150 million at year-end 1998 to more than 537 million by year-end 2002, and that the number of users associated with those devices will grow from approximately 142 million at year-end 1998 to approximately 399 million by year-end 2002. In a report issued in April 1998, the U.S. Department of Commerce estimated that traffic on the Internet was doubling every 100 days.

Although many focus on the increasing use of the Internet by consumers, business and professional organizations are increasingly exploring opportunities to provide IP based applications and services within their organizations and to their customers and business partners and to otherwise take full advantage of the Internet.

One of the rapidly expanding Internet applications is E-commerce, which refers to the purchase of goods and services over the World Wide Web. The United States is by far the largest E-commerce market in the world. IDC estimates that global Internet commerce revenues in 1998 were \$50 billion, of which the United States accounted for \$37 billion (74% of total). Global E-commerce market revenue is projected by IDC to reach \$734 billion by 2002, growing at 96% per annum on average between 1998 and 2002.

The Internet in Japan

The Internet has experienced rapid growth in Japan since commercial application of the Internet began in the early 1990s.

Japan is currently the second largest Internet market in the world in terms of the number of Internet devices and users. IDC projects that the number of devices in Japan with Internet access will increase from approximately 12 million at year-end 1998 to over 46 million by year-end 2002. The Internet White Paper, 1999 and Access Media International estimated the number of Internet users in Japan at year-end 1998 at 14 million and project that there will be 30 million Internet users at year-end 2002, representing 21% average annual growth over four years. For the Asia-Pacific region, they estimated 28.5 million users at year-end 1998 and project 97 million users at year-end 2002, one-third of which they estimate will be from Japan. According to the Internet White Paper, Japan's user penetration rate at year-end 1998 was 10.8%, considerably below that of approximately 24% for the United States.

IDC estimated that ISPs at the end of 1998 in Japan had over 12.4 million contracts for service, representing a 20% increase from the previous year. IDC estimates that there will be approximately 24 million contracts by the end of 2003. Of the contracts as of the

end of 1998, approximately 37,000 were for dedicated-line Internet access. Internet access services referred to by IDC as “economy-type” services, which offer lower prices but provide less support, account for approximately 25,500 or 68.9% of dedicated-line contracts and this segment is the fastest growing segment of the dedicated-line service, increasing by over 180% in 1998. IDC estimates that there will be over 242,000 dedicated-line contracts by the end of 2003.

Businesses in Japan have not exploited the Internet to its full potential on a commercial basis, primarily due to their unfamiliarity with the new technology and their concern with security. Currently, many Japanese companies, to the extent they use the Internet, use it mainly for e-mail.

We believe that businesses in Japan are now beginning to use and rely on the Internet for wider purposes, including establishing corporate Internet sites as a means to expand customer reach and improve communications efficiency and creating intranets or virtual private networks. E-commerce is still in its infancy in Japan by comparison to the level of development in other advanced economies. According to IDC, the estimated number of purchasers of goods and services over the WWW in Japan was 1.8 million in 1998, compared to 21 million in the United States and 4.6 million in Western Europe. IDC estimated the total Japanese E-commerce market to be \$2.0 billion in 1998, compared to \$37 billion in the United States and \$5.6 billion in Western Europe. The total Japanese E-commerce market is estimated by IDC to grow at 95% per annum to \$29 billion in 2002. As usage by businesses increases, we expect an increase in the demand for advanced, highly reliable, high-capacity connectivity services and a full-range of value-added services to meet their particular networking and other needs. In other words, we expect businesses will increasingly seek reliable total Internet solutions.

For a description of the regulatory environment of the telecommunications industry, please refer to “Business — Regulation of the Telecommunications Industry in Japan” included in this prospectus.

For a discussion of competition in the Internet industry in Japan, please refer to “Business — Competition” included in this prospectus.

Our Competitive Strengths

We Have a High-Capacity IP Network

Our network is one of our most important assets. Our network is extensive. In Japan, we have large trunk lines that connect major metropolitan and business centers in Japan, which included, as of June 30, 1999, dedicated capacity of:

- 2 lines of 155 Mbps each between Otemachi and Ariake, two of our largest POPs that are both located in Tokyo
- 2 lines of 155 Mbps each between Tokyo and Osaka,
- 45 Mbps or more between Osaka and Nagoya, Tokyo and Yokohama, Osaka and Fukuoka, and Tokyo and Kashiwa, and
- 45 Mbps between our current data center and each of Otemachi and Ariake.

As of June 30, 1999, our network also had four 155 Mbps trunk lines between Japan and the United States for a total of 620 Mbps of capacity.

Our network directly connects to A-Bone, which is owned by an IJ group company, Asia Internet Holding, and is operated and managed by us pursuant to an agreement with Asia Internet Holding. This provides us with a strong presence in the Asia-Pacific region as we believe, based on publicly available information, that when combined with the A-Bone we have the most extensive Internet backbone in the region and we believe it positions us to be the primary conduit to gather and exchange Internet traffic in this region.

We are Strong in Network Technology

Internet technology changes rapidly. Our engineering expertise provides us with the capability and resources necessary to take advantage of the rapid changes. This engineering expertise is a result of the high percentage of our employees with engineering degrees, over 30%, and of our significant experience managing and operating large capacity, high volume

networks. Additionally, our experience, our personnel and commitment to research and development support our ability to keep up with the rapid changes in Internet and networking technology.

Our engineers are at the forefront of the development of new network services, security services and other Internet-related services, as they have been since we began operations. We are particularly strong in large network traffic management, routing control and facilities operation. We have operated the largest or one of the largest Internet networks in Japan and between Japan and the United States since we began operations. We rated as the top ISP for satisfaction in terms of through-put and network management capability in a survey of Japanese companies by Nikkei Communications. Our engineering expertise and strength in network technology allows us to provide specifically tailored, advanced Internet solutions to our Internet users.

We Have a Strong Customer Base and a High Reputation

Our core customers are valuable leading edge Internet users, such as large corporations, major ISPs, telecommunications carriers, cable operators, portal sites, e-commerce businesses and publishers. We work closely with our major customers to provide services that stimulate and develop the Internet market in Japan. We have established a strong brand name and reputation for quality Internet service among the professional communities which has resulted in our strong customer base. Satisfaction levels are high among our customers especially in terms of the quality and reliability of our services.

Our Extensive Resources Allow Us to Offer a Full Range of Services and Infrastructure Expansion

Our resources are extensive and include our strong technological capabilities, our high-quality network, our group companies, including IJ Technology, and our broad variety of Internet access services and related value-added services. Working together with our group companies we offer systems integration, help desk functions, hosting, and

network coverage in the Asia-Pacific region. We have access to a new robust infrastructure for nationwide data communications through Crosswave. Our group resources provide us with more flexibility and freedom to develop new services and decrease our reliance on the incumbent telecommunications carriers.

We Draw on the Strength of Shareholders

Our shareholders include large, well-known companies in Japan such as Sumitomo Corp., Itochu Corp., NTT Communications, Toyota, Dai-ichi Life, Sumitomo Bank, Fuji Bank and Sanwa Bank. Benefits of our shareholder base include:

- Having leading institutions like these as shareholders is viewed by the Japanese business community as a sign of confidence.
- IJ and its shareholders have combined their strengths in a number of business ventures such as Crosswave (with Toyota), Lycos Japan (with Sumitomo Corp.) and DLJ*direct* SFG (with Sumitomo Bank).

Our Strategy

Our name encapsulates our mission: Internet Initiative Japan from its beginning has taken the initiative in developing the Internet market in Japan. We will continue to be a leader in promoting and facilitating the growth of the Internet in Japan and we will strengthen our presence in this rapidly expanding market. The Internet market in Japan is currently under-developed and under-utilized for various reasons such as the economic situation and the industry and regulatory environment in Japan. However, the potential of the market is high and the growth of the market has strong momentum. We believe that the Japanese market is poised for substantial growth. Businesses are just now beginning to take advantage of Internet applications to develop new businesses, increase efficiency and productivity and to reduce costs. Our primary business strategy is to capture our share in this growing market by responding to the demands and requirements of corporate and individual users.

The principal elements of our business strategy are summarized below:

Expand Our Network

Expanding our network is one of our most important objectives. We currently have an extensive network that is fully capable of handling our current traffic but we will continue to expand our network to meet our customer and traffic demands.

In Japan, our network development plan is to increase our capacity on our busiest routes, such as between Tokyo and Osaka, to continue to be able to meet the quality of service our customers have come to expect. We will expand our geographic reach by expanding our POPs so that a greater percentage of the population will have local access to our network. Crosswave will be important to us as we expand our domestic network as we will utilize Crosswave's network for both our capacity and geographic expansion.

Internationally, we will continue to expand our network in much the same way. We will increase our international capacity between the United States and Japan. We will also continue to explore opportunities to expand our geographic coverage into new locations in the United States, Asia and Europe. We will also add additional capacity through the A-Bone to transfer data traffic in the Asia-Pacific region.

We will strengthen the capability and robustness of our network and will become less reliant on the incumbent telecommunications carriers by utilizing Crosswave's network infrastructure, which is specifically designed (by us) to accommodate data communications traffic.

To capture the demand for better Internet environments and business networking and to support growing e-commerce and contents business, we will develop additional data centers which will allow our customers to house their network systems at our own facilities and which will also allow direct connectivity to our backbone. We will also connect directly to Crosswave's network at these data centers.

Enhance Our Internet Access Services

We will introduce a greater variety of connectivity and bandwidth options to meet the diversifying needs and requirements of our customers. As we increase the options available and diversify the pricing of these services, we will increase our ability to retain existing customers and attract new customers and to promote higher levels of services to these customers. Among the options that we offer or will soon introduce are:

- Bandwidth options: a customer will be able to select fixed or burstable service, an increasing variety of bandwidth options and levels of guarantees under the service level agreements.
- Access line type: a customer is able to choose from different transmission technologies and line types which now include ATM.

We will increase access to and geographic coverage of our network. We will increase the number of our POPs in Japan from 23 POPs to approximately 80 POPs by March 2000. We will also continue to increase roaming options through interconnection with other ISPs and alliances such as the roaming alliance between Asia Internet Holding and EUNET.

We offer quality guarantees to distinguish our service from our competitors. We will offer service level agreements to our IP Service customers, becoming the first ISP in Japan to provide these agreements. We will guarantee 100% availability of our network; maximum average latencies, or time necessary to transmit a signal, between POPs; and prompt notification of outage or disruption.

Enrich Our Value-Added Services and Products through Increased Commitment to Research and Development

We will continue to take a leading position in the development of Internet access and high value-added services and products and in the research and development of new Internet services. Currently, we are focusing on expanding our security-related service line-up by introducing security consulting, managed firewall services and virtual private network (VPN) services. We will continue to

improve our bandwidth management and traffic control technologies which will be the key elements toward implementing our quality of service (QoS) standards. We are also actively researching and developing software and services on the IPv6 platform which is a next generation Internet protocol.

Provide Total Internet Solutions to Address Our Clients' Needs

We solve our clients' specific needs for IP network systems development and the operation and maintenance of their IP networks. We help our clients design and develop tailored IP network systems and specific applications that allow them to optimize use of the Internet. We are capitalizing on our advanced network environment and our network engineering experience and knowledge in our network consulting and systems integration businesses. We will operate and manage IP network systems for clients. We will also increase our support to customers by increasing our help desk capability and network maintenance services.

One total Internet solution we offer is OEM services. OEM services provide the IJ network infrastructure and services to third parties which then acquire individual customers through their own distribution and sales networks. This provides a unique combination where our partners gain the ability to offer their customers high-quality Internet services and we gain revenue from individual users that would not be cost-effective for us to acquire independently. For a more complete discussion of our OEM services, please refer to "Business—Sales and Marketing—Sales and Marketing Strategy—Large Companies and General Sales".

We Seek to Capture Our Share in the Attractive Growing Internet Markets

We will focus our efforts to capture market share in the Internet markets that are most attractive to us. By introducing a greater variety of competitive Internet access and value-added services, we believe we are well-positioned to serve businesses' new and rapidly growing uses of the Internet. We seek to encourage new and existing customers to

expand their use of our services and to use more value-added services.

To deliver these strong products to a growing number of customers, we will expand our sales and marketing capability by increasing our sales forces and sales channels, including agents. We will allocate more resources to sales force development and indirect sales channel development and to the deployment of active marketing efforts and campaigns.

With the combination of our expanded product line and our enhanced sales capability, we seek to increase the penetration of our high quality Internet services into more market segments in the corporate market and strengthen our position in lucrative segments of the market.

Our Network

Our network is one of our most important assets. We have developed and operate a high-capacity network that has been designed to provide reliable, high-speed, high-quality Internet access services. Our network has also been designed to minimize our costs through efficient use of our backbone or bandwidth and use of a scalable infrastructure.

Our network is reliable. We achieve reliability in two primary ways. First, our network has been designed by our engineers using leading edge routing and other networking technologies and advanced, high-quality routers and other network equipment. The combination of our accumulated engineering experience and advanced technology makes our network highly reliable. Second, we achieve reliability through redundancy. Our network is specifically designed to minimize the number of points where the failure of a single component of the network could interrupt network operations.

Our network is a high-speed network. Our network is specifically constructed for Internet usage. We are able to achieve and maintain high speeds through our advanced network architecture, routing technology and aggressive load balancing that optimize traffic through our multiple Internet connections. We believe that few other ISPs in Japan have as much experience as we do in managing high-

bandwidth networks. The ability to deliver consistent high-speed services is one of the primary reasons that we are able to offer our customers service level agreements. We believe some carrier-related ISPs are using lines with lower efficiency and reliability that use ATM or frame relay for their backbone which, we believe, ultimately prevent them from achieving the speed, quality and reliability that our Internet-dedicated network is able to achieve.

Our network is secure. We monitor our network at all times. Although in the past we have discovered an apparent attempt at hacking of the network system by a third party, we do not believe that there have been repeated attempts and no damage was caused by this incident. We have not had any material damage caused by computer viruses entering into our network system. We have been, and are, implementing appropriate hardware and software protections to minimize hacking and computer virus infiltration. We believe that our current measures are adequate and reasonable.

Our network is cost-efficient. There are a number of ways we achieve efficiency. First, our network has been designed and configured to maximize efficient use of bandwidth. Our routing technology and aggressive load balancing increase our efficiency. Second, the high volume of our traffic and the concentration of our clients in the major business areas in Japan allow us to lease larger capacity lines which have lower per unit costs than smaller capacity lines. Furthermore, since we are one of the larger users of international leased lines in terms of capacity, we can use our bargaining power to negotiate favorable pricing. Third, because of our mix of customers — high-end business users that use our services more during the day and ISPs and individuals that use our services more at night — we believe we are able to use our capacity more efficiently than many other ISPs. We will be adding to and replacing our existing lines in Japan with lines leased from Crosswave. We plan to use Crosswave's SONET technology to further improve the efficiency of our network.

We have planned for future growth by ensuring that our network is scalable and flexible and that it can easily be adapted to meet new technological standards. We monitor usage and evaluate the network's capacity on an ongoing basis. We continue to upgrade and expand the network as our customers' usage increases and as the number of our customers increases. Because of the scalable nature of our network, we anticipate having few, if any, problems integrating Crosswave's networks with ours. One of the primary means to grow our network in terms of capacity and geographic coverage in the coming years will be through our use of Crosswave's network.

The primary components of our network consist of:

- our backbone, which includes leased lines and network equipment such as advanced Internet routers;
- POPs in major metropolitan areas in Japan;
- data centers; and
- a network operations center or NOC.

Backbone

Leased Lines. Our network is anchored by our backbone that we have developed and operate. We have an extensive Internet backbone in Japan and between Japan and the United States (620 Mbps). We use our expertise in developing and operating our network to organize and connect these leased lines to form a backbone that has substantial transmission capacity.

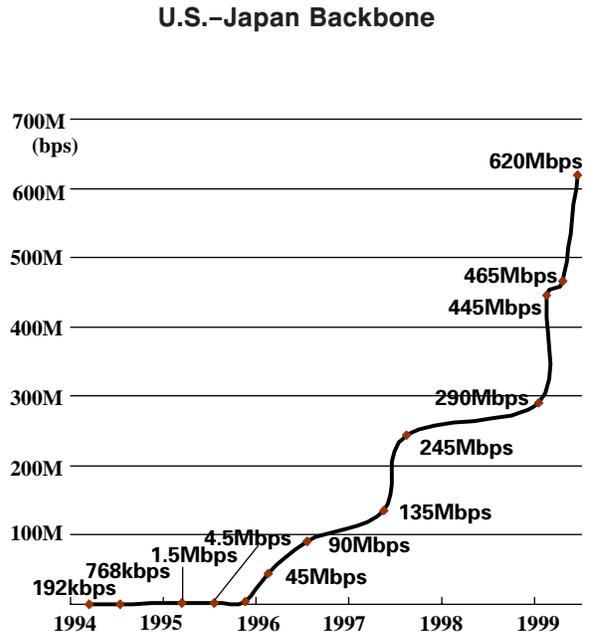
Currently, we lease high-capacity, high-speed digital transmission lines from various carriers. Standard practice in Japan is for the leases to have no specific term but to have penalty clauses for cancellation of leases in the first year. However, we have a number of leases with fixed lengths. As of March 31, 1999, approximately 55.5% of the leased lines comprising our domestic backbone measured by bandwidth were under contracts with fixed termination periods. Approximately half of these have less than two years remaining. In anticipation of Crosswave beginning its operations, we have intentionally decreased

the number of contracts that we have entered that have fixed lengths as it is our current plan to convert our existing leases to leases from Crosswave as soon as the existing leases expire.

With respect to our leased lines to the United States, IJ has long-term contracts with KDD, IDC, WorldCom and AT&T. The contract with KDD for the Japan-half of a 155 Mbps circuit will expire in August 2002. The contract with IDC for the Japan-half of another 155 Mbps circuit will expire in January 2001. The contract with WorldCom for the U.S.-half of the 155 Mbps circuit will expire in February 2000. Our largest contract in terms of total bandwidth is a master lease agreement with AT&T. The contract is as of May 1999 for the U.S.-half of a 155 Mbps circuit and two full 155 Mbps circuits. This agreement was most recently amended in May 1999 and currently has a stated term extending to August 2002. However, the contract may be terminated when the cumulative payments of fees have reached an agreed minimum level. If we keep our current circuits, we will be in a position to terminate the contract in April 2001 if we choose to do so. We can shorten the contract term by adding more AT&T circuits. We are also able to continue leasing under the contract after

we reach the agreed minimum level if we choose to do so.

The graph below shows the growth in capacity of IJ's backbone between Japan and the United States over the five-year period from 1994 to 1999.



The table below sets out our international backbone capacity and cost. Average total capacity is calculated by averaging the international capacity at the end of each month.

International Backbone Capacity and Cost

	Year ended March 31,			
	1996	1997	1998	1999
Backbone cost (thousand yen)	233,174	1,372,452	3,095,149	3,722,676
Average total capacity (Mbps)	12.17	78.75	204.58	282.08
Average cost per 1 Mbps (thousand yen)	19,165	17,428	15,129	13,197

In the United States, our network backbone connects to the following major interexchange points (IX):

- MAE West in San Jose, California;
- PAIX (Palo Alto Internet Exchange) in Palo Alto, California; and
- the Sprint Network Access Point in Pennsauken, New Jersey.

Through these IX points we connect to many other ISPs in the United States, including Sprint, C&W (Internet MCI) and MCI WorldCom (UUNET).

In Asia, we have established a backbone connection through A-Bone, the Internet backbone network covering the Asia-Pacific region. The A-Bone is operated by Asia Internet Holding, of which we own 20.6%.

Asia Internet Holding commissioned IJ to design and build the A-Bone and IJ currently manages the A-Bone.

In Europe, Asia Internet Holding has established a roaming alliance with EUnet through the A-Bone that allows us to offer roaming to our customers.

With the large-capacity of domestic and international backbone networks of IJ and Asia Internet Holding, we seek to provide the best quality of services in connectivity, speed and reliability to customers among ISPs in Japan.

Expansion Plans. We have placed a high priority on the continued expansion of the capacity and geographic reach of our networks. We will look first at increasing our domestic network and our network between Japan and the United States. We will also look at expanding our network in the Asia-Pacific region, into Europe and in the United States as opportunities arise.

With respect to our domestic expansion, we expect to extend our geographic coverage and our capacity by leasing lines from Crosswave, particularly in areas where we do not currently have POPs. We will also replace our existing lines with new lines of the same or higher capacity from Crosswave.

Between Japan and the United States, we will look primarily to increase our capacity by securing long-term committed capacity either directly or through Crosswave, who would then lease all or a substantial portion of the international capacity to us on a long-term basis.

Although we believe that our total expenditures for additional capacity in the near term will increase in absolute terms, we believe that the per unit costs will be significantly reduced because of the availability of lower-cost lines from Crosswave and because of the anticipated increase of available capacity between Japan and the United States from the expected completion later this year of a number of undersea cables. To the extent that domestic and trans-Pacific leased line costs do not decline as anticipated, we may not realize the cost savings we anticipate and/or we may

choose not to add as much capacity as we currently plan to.

Network Equipment. We use advanced equipment in our network. Our primary routers for our dedicated lines are Cisco routers. Our primary dial-up routers are Ascend MAX routers. The size of our routers varies depending on the number of customers and volume of traffic served by our POPs. At each POP we connect our dedicated line and dial-up access routers to Cisco backbone routers which then transmit and receive information throughout our network.

POPs

POPs are the main points at which our customers connect to the IJ backbone. We provide Internet access from our POPs to commercial and residential customers through leased lines and dial-up connections over local exchange facilities. We currently have 23 POPs which cover most of the major metropolitan areas in Japan. As we expand our network by integrating it with the Crosswave network, we plan to increase the number of our POPs to over 80 by March 2000.

Many of our POPs are located in, or in close physical proximity to, "carrier hotels." Carrier hotels are facilities where we and other major carriers and ISPs have POPs. These are mainly located at facilities of various carriers in Japan like NTT, KDD, Japan Telecom and IDC. We lease the physical space from these carriers under leases or use such space under other arrangements with terms ranging from one to two years most of which can be terminated by either party on three to six months' notice. We maintain our routers and other networking equipment at these POPs. Our actual location in, or in close proximity to, the same building in which the switches and routers of these carriers and ISPs are located offers us the ability to quickly and easily interconnect our equipment to theirs.

Although we do not have any of our personnel on these sites, the equipment is well protected on premises that are fully staffed and have uninterrupted power supplies, anti-seismic damage precautions, air conditioning, fire suppression equipment and

components and many other aspects of our network including our customers' dedicated access lines leased from carriers. From our NOC, we will monitor our networks to ensure that we meet our commitments under our service level agreements.

We strive for full customer satisfaction in our efforts to retain customers and achieve subscriber growth. We believe that network performance (primarily the availability, reliability and speed of the Internet access service), customer technical support and the range and quality of our products and services are key factors contributing to customer satisfaction in our existing markets. We are committed to providing the best technical support available in the industry, including the ability to resolve the most difficult problems that a sophisticated user may present. High-quality customer support is provided as it is necessary to meet the differing needs of consumers and corporate customers. We will stand behind our commitments with our service level agreements.

Technical Support. Our technical support group is staffed with knowledgeable and experienced support technicians able to diagnose customer problems and prescribe corrective measures. Technical support is available to customers 24 hours a day, seven days a week.

Customer Support. In addition to diagnosing and resolving customers' technical

problems, our service administrative department answers customer registration and other post-sale questions.

Our Internet Access Services

We are a leading provider of Internet access services in Japan, including a variety of dedicated and dial-up access services and customized wide area networking solutions, which provide high-speed continuous access to the Internet and other networks for our customers. We provide turnkey configuration solutions encompassing such services as domain name registration, leased-line ordering and installation assistance, IP address assignment, router configuration, installation and management, and technical consultation services.

We offer two categories of access services: dedicated access services and dial-up access services. Dedicated access services are based on dedicated local-line connections provided by carriers between our backbone and the customer. Dial-up access services require the customer to connect to IJ through public-switched telephone network or ISDN. The Internet access part of our total Internet solutions ranges from cost-effective, entry-level dial-up connections from home personal computers to customized wide-area network solutions deploying a range of the dedicated and dial-up services listed below to connect the headquarters, data centers, branch offices and mobile personnel.

The following table shows the numbers of our Internet access service subscribers as of the dates indicated.

	As of March 31,			
	1996	1997	1998	1999
Dedicated access service contracts:				
IP Service				
64kbps – 128kbps	320	711	794	654
192kbps – 768kbps	57	122	169	171
1Mbps – 1.5Mbps	12	52	51	66
3Mbps – 45Mbps	<u>2</u>	<u>12</u>	<u>34</u>	<u>57</u>
Total IP Service	391	897	1,048	948
IIJ Economy				
64kbps – 128kbps	<u>—</u>	<u>—</u>	<u>156</u>	<u>708</u>
Total dedicated access service contracts	391	897	1,204	1,656
Dial-up access service contracts:				
IIJ4U	—	10,766	21,422	48,195
Others	<u>17,706</u>	<u>17,929</u>	<u>14,534</u>	<u>10,508</u>
Total dial-up access service contracts	17,706	28,695	35,956	58,703

We currently offer the following Internet access services:

Service Type	Summary Description	Pricing
<i>Dedicated Access Services</i>		
IP Service	Full-scale dedicated line service with high-speed access for businesses and other ISPs with demanding throughput requirements.	The fees include various setup fees and monthly fees that vary according to carrier, line speed, line type and distance involved. See the additional details and chart below.
IIJ Economy	Service for dedicated-line access to the Internet with inexpensive monthly fees primarily for medium and small businesses and local and regional offices of corporate groups.	Initial setup fee of ¥40,000 and ¥15,000 for an IP address application. Monthly access fees of ¥38,000 for 64 kbps service and ¥45,000 for 128 kbps service.
<i>Dial-up Access Services</i>		
IIJ Dial-up Standard	Service for corporate users permitting simultaneous Internet access from several dial-up lines under a single contract.	Initial setup fee of ¥20,000. Monthly basic fee of ¥2,000 plus access charges of ¥10 per minute.
Enterprise Dial-up IP Service	Service for businesses offering multiple dial-up accounts at a fixed monthly fee.	Initial setup fee of ¥50,000. Monthly basic fees from ¥3,000 to ¥4,900 per account depending on the number of accounts.

Service Type	Summary Description	Pricing
IIJ4U	Service for individual users which includes Internet access and 5 megabytes of disk space for personal Web pages and e-mail account options for multiple users.	Initial setup fee of ¥1,900. Monthly service fee of ¥1,900 for the first 10 hours plus ¥5 per minute for next 10 hours. Usage over 20 hours is at a fixed additional fee of ¥3,000 (for a total of ¥4,900 per month).
Dial-up E-rate Service	Service for educational institutions. Services include Internet access, e-mail and disk space for home pages.	Initial setup fee of ¥5,000. ¥30,000 per year.
UUCP Service	Connects customer's network to the Internet with UUCP protocol over public-switched telephone network or ISDN.	Initial setup fee of ¥30,000. Monthly basic fee of ¥2,000 plus usage charges of ¥30 per minute.

Dedicated Access Services

Our dedicated line access services, IP Service and IIJ Economy, are currently our most important Internet access options.

IP Service. Our IP Service is a full-scale, high-speed access service that connects the customer's network to our network and the Internet and is the most important service we offer. Our IP Service allows unlimited, two-way communications not only with sites in Japan, but also with any organization connected to the Internet worldwide. The customer chooses the level of service it needs based upon its throughput requirements. Currently we offer service from 64 kbps to 45 Mbps. We are prepared to introduce service at 150 Mbps if demand warrants.

Our IP Service represented 49.2% of our total revenue for the year ended March 31, 1999. We believe that, as businesses continue to develop Internet capabilities, this service will continue to be the central focus of our business.

As of March 1999, we had 948 subscribers to our IP Service which has declined from 1,048 at March 1998. However the number of subscribers who had subscribed for service at 1 Mbps or higher increased to 123 as of March 1999 from 85 as of March 1998. In addition, the total bandwidth allocated to IP Service has

increased from approximately 410 Mbps at March 1998 to 550 Mbps at March 1999. Each of these trends is continuing.

The subscriber must pay a monthly fee for the leased local access line from the customer's location to one of our POPs. The amount of this fee varies depending on the carrier used and the distance between the customer's site and our POP. We collect this fee from the customer and pay this fee amount over to the carrier.

Although fees are charged on a monthly basis, the minimum contract length is one year. For contracts of three years, a 10% per month discount is given. Approximately 19% of our IP Service contracts as of the end of March 1999 are for at least three years.

We have also recently introduced ATM access to our IP Service in the Tokyo and Nagoya areas. A subscriber may now connect to our network using NTT's ATM MegaLink service or the equivalent service from other carriers. ATM service will be for speeds from 2Mbps to 24 Mbps and will have rates that are comparable to our current IP Service rates.

For our IP Service, we recently began offering service level agreements to our customers and we were the first ISP in Japan to do so. Offering service level agreements will allow us to better define the high quality of the services we offer to our customers.

This will also differentiate our services from the services of other ISPs who are unable to match our service quality.

We will guarantee the performance of the following elements under our service level agreements:

- 100% availability of our network;
- maximum average latencies, or time necessary to transmit a signal, between designated POPs; and
- prompt notification of outage or disruption.

We are able to offer these service level agreements because of the high quality and reliability of our network. Our service level agreements will be backed by credit to customers if our service quality fails to meet the prescribed standards.

Subscribers to our IP Service receive 24-hour-a-day, seven-day-a-week technical support.

IJ Economy. Our IJ Economy is Internet access via a dedicated line at 64 kbps or 128 kbps. IJ Economy represented approximately 3.6% of our total revenue for fiscal 1999. We had 708 subscribers for IJ Economy as of March 1999 compared to only 156 customers in March 1998. We introduced IJ Economy in November, 1997.

IJ Economy is specifically designed for users such as medium and small businesses who don't have large throughput requirements and don't require the higher levels of support available to IP Service subscribers. IJ Economy allows them to access the IJ network at either 64 kbps or 128 kbps at affordable rates but limits the amount of IP addresses a customer may have. In addition to medium and small businesses, another important group of subscribers to this service is regional and local offices of large corporations. The head office and other larger offices would use our IP Service to handle the larger numbers of employees and higher throughput requirements while the local and regional offices would use our IJ Economy.

The monthly fee and the initial setup fee to IJ for dedicated access services as of May 1999 are as follows:

	<u>Access Speed</u>	<u>Monthly Fee</u>	<u>Initial Setup Fee</u>
IJ Economy	64 kbps	¥ 38,000	¥ 40,000
	128 kbps	45,000	40,000
IP Service	64 kbps	120,000	60,000
	128 kbps	240,000	60,000
	192 kbps	320,000	100,000
	256 kbps	450,000	100,000
	384 kbps	590,000	100,000
	512 kbps	730,000	100,000
	768 kbps	810,000	100,000
	1 Mbps	1,020,000	100,000
	1.5 Mbps	1,350,000	100,000
	3 Mbps	2,600,000	100,000
	6 Mbps	3,800,000	100,000
	45 Mbps	26,000,000	200,000

Dial-up Access Services

We offer a variety of dial-up access services. Our dial-up access services provide essentially the same high-quality services on the same high-quality network as our dedicated access services but do not have same variety of options for bandwidth and levels of customer service and support. We consider our dial-up services to be primarily cost-effective, entry-level Internet access services for businesses and individuals.

Our dial-up access services are also, however, an important resource in offering total Internet solutions to corporate customers. It is our dial-up services for example that allow frequent travelers to access our network or their own corporate networks through one of our POPs or through our roaming agreements. Our dial-up access services are also an important option for our large corporate groups that will be linking many offices through our network. Although these corporate groups would use dedicated lines for the main offices and their larger regional and local offices, they would also likely use our dial-up access services for their smaller branch offices.

Our main dial-up access services are our IJ Dial-up Standard, Enterprise Dial-up IP Service, IJ4U, Dial-up E-rate Service and UUCP Service all as described in the table above. We also provide Network-type Dial-up IP Service and Terminal-type Dial-up IP Service to customers but we are no longer promoting these services. Our new IJ Dial-up Standard has essentially the same features and options as the Network-type Dial-up IP Service and the Terminal-type Dial-up IP Service and costs less per month to use.

We will be expanding dial-up access to our network by increasing the number of our POPs. We will do this primarily by leveraging off of Crosswave and its nationwide network of POPs. We believe that increasing our POPs will be the key to increasing our revenues from individuals and other dial-up customers. It will also be one of the key elements in successfully introducing and implementing our OEM services.

We have also expanded access to our network through roaming agreements that are an important part of our dial-up access services. Currently, we offer global Internet roaming areas in 30 countries with over 320 POPs. Additionally, in the United States and Canada through IJ America, we have roaming access through an 800 number for areas where we don't already have local POPs through roaming agreements or otherwise. We will continue to expand our roaming areas through these arrangements.

Our Value-Added Services

Although our primary service to our customers has been Internet access, our customers are increasingly seeking additional services. We provide our customers with a broad range of Internet related, high-quality services and products which allows customers to purchase access, applications and services, in other words total Internet solutions, directly from us.

We believe that business customers will continue to increase their use of the Internet as a business tool and will increasingly rely on an expanding range of value-added services to enhance productivity, reduce costs and improve service reliability.

Value-Added Services to Support Internet Access

We offer a variety of value-added services that complement and enhance our Internet access services. These access-related services are primarily provided directly by IJ. These access-related services include:

- **Security Solutions.** We offer two main security services that protect customers' internal networks from unauthorized access: firewalls and comprehensive network security services.

Firewalls. We sell and install firewall hardware and software. A firewall is a system placed between the customer's internal network and external networks. A firewall stands as a barrier between the areas of a customer's network that are open to the public, such as a Web site, and those that a customer wants to protect

from public access, such as databases. Firewalls also filter data passing through the firewall removing unauthorized traffic. We were the first ISP in Japan to provide firewalls which we first offered in 1994. Our primary firewall product is an integrated hardware and software product we developed based on the Gauntlet system developed in the United States and well recognized in the industry for its reliability. We are the primary provider of Gauntlet-based systems in Japan.

Network Security Services. We offer or will offer a series of services which collectively add up to total security solutions for a customer's corporate network. Our network security services will include:

- *Consultation.* We analyze the security level of a customer's network and suggest measures for security enhancement.
- *Integration.* We develop and implement security measures based upon the results of our consultation review.
- *Monitoring.* We will monitor traffic over the customer's network and report statistics and security events.
- *Operation.* We will operate a customer's network firewall system, including configuration, installation of software upgrades, the handling of alerts, the detection and deflection of attacks on a system's security and the modification of network settings.

We plan to offer year-round, 24-hour-a-day monitoring and firewall operation in order to provide total network security services.

- **Co-location.** Our co-location services allow companies to house their servers and routers off-site in our facilities at our data center. We monitor and maintain the equipment as necessary for our customers. This service enhances reliability, since we provide 24-hour monitoring and have specialized maintenance personnel and facilities. This service also increases the

efficiency of many networks, particularly where the customer's routers and servers are servicing multiple locations. Our co-location services will be enhanced by the completion of our new data center.

- **IJ Post Office Service.** IJ Post Office Service essentially outsources to us the job performed by an e-mail server — an easy, inexpensive way for a customer to allocate and maintain a number of e-mail accounts under its own domain name for its employees, members or other relevant users. We do all the necessary work to set up a mail server so the customer does not have to incur trouble and expense of setting up its own mail server. The customer can administer e-mail accounts on-line through our customer support Web interface. IJ Post Office Service is available to customers subscribing to our IP Service, IJ Economy, Enterprise Dial-Up IP service, IJ Dial-up Standard and to Internet connection services of other ISPs.
- **IJ Mail Box Service.** IJ Mail Box Service is essentially the same as IJ Post Office Service. However, customers do not have to obtain their own domain names. IJ serves as the mail box for the customers. As with IJ Post Office Service, the customer can administer the e-mail accounts on-line through IJ's Customer Support Website.
- **ID Gateway Service.** ID Gateway Service is an access control service available to complement our Enterprise Dial-up IP Service. When used in combination with our Enterprise Dial-up IP Service, ID Gateway Service provides customer's employees and associates the ability to access the customer's networks through any of our POPs. A customer that buys our ID Gateway Service is spared the trouble of authenticating users. ID Gateway systems placed at the entry to the customer's network identify the accessing user by interacting with the ID servers at our sites which keep the information relating to user accounts and IP addresses. ID Gateway provides access control functions based on this user account information.

Value-Added Services to Enhance Our Customers' Use of the Internet

We provide a broad range a value-added services that allow customers to enhance their use of the Internet. We offer these services in working with the IJJ group companies. These value-added services include:

- **Network Consulting and Systems Integration Services.** We offer network consulting and systems integration services. We plan and design server and network configurations, design and implement intranets or virtual private networks and maintenance and operation of network systems using our advanced network and provide other advice with a particular focus on helping customers make effective use of the Internet. For our more sophisticated client projects, network consulting and systems integration is the design platform on which we provide total Internet solutions that incorporate many of our other access and value-added services.
- **Customer Support.** We provide our customers with comprehensive service and support that includes network service and support as well as training seminars to educate new and existing customers about various Internet uses and applications. Most of our customer support services are provided as an integral part of other services we sell, such as Internet access. A portion of our customer support services are provided for a fee, or without compensation as part of our marketing efforts.
- **Web Hosting and Contents Development and Distribution.** We provide Web hosting and contents development and distribution services. These services help our customers to market their own products and services on the Internet without having to invest in technology infrastructure and operations staff. We help customers design their Web pages which they place on our WWW servers that are linked directly to our network. We will also manage the posting of content on the Web page and the distribution of content to mailing lists, to

news groups or to other simultaneous distribution services.

Our Total Internet Solutions

We are a provider of total Internet solutions. We provide our customers with tailored, end-to-end Internet and private network solutions. The diversity of services we offer permits each customer to purchase individual services or a bundle of services that provide the most efficient, reliable and cost-effective solution for that customer's particular needs.

The primary resources that we use to provide total Internet solutions to our customers and the primary reasons that our customers choose us to provide them total Internet solutions include:

- Our extensive network.
- Our Internet access services.
- Our line-up of value-added services, including systems integration.
- Our network technology and personnel.
- Our group companies.

Our total Internet solutions for business users is one of the main focuses of our business. We consult with businesses and other customers to identify their particular situations and needs. We draw upon our extensive resources to address those needs.

The following examples illustrate our success in providing total Internet solutions to address the needs of our customers.

Tokyu Cable Television

Challenge: Tokyu Cable is the largest independent cable company in Japan and has approximately 200,000 CATV subscribers. Tokyu Cable wanted to use its high-bandwidth cable connections to provide its customers with high-speed Internet connectivity. However, Tokyu Cable had no experience in offering Internet services and needed assistance to construct a comprehensive system which would allow it to capitalize on cable connections to provide high-speed connectivity to the Internet.

Solution: In response, we designed and configured a 612 Mbps ATM network which connects the CATV center to each of six broadcasting sub-centers. We also designed and configured a 14 Mbps high-bandwidth Internet connectivity network using cable modems. We also provide our IP Service to Tokyu Cable with Internet access at 20 Mbps. These connections (between the CATV center and our network, between the CATV center and broadcasting sub-centers and between Tokyu Cable and its subscribers) enable Tokyu Cable to provide its CATV subscribers with high-speed access to the Internet via cable modems, allowing for Internet connection which is considerably faster than that available via ISDN lines. We also continue to provide consulting services to Tokyu Cable.

Sharp

Challenge: Sharp has a successful personal digital assistant (PDA), Zaurus, that has been very popular in Japan and has captured approximately two-thirds of the PDA market. However, the current trend for personal digital assistants is to provide direct Internet connectivity through them. Sharp wants to offer a new Zaurus that includes Internet access but Sharp does not own or have an affiliated ISP. Additionally, because of the anticipated popularity of the new Internet-capable Zaurus, the cost and expense of building a satisfactory nationwide network from scratch would be prohibitive.

Solution: Beginning in April, we began offering with Sharp Internet connectivity through the new Zaurus and through other devices including home computers by providing our Internet network to Sharp on an OEM basis. Sharp gains access to our Internet network to offer Internet access to the new Zaurus customers. Sharp's users then use services designed based on our IJ4U. Sharp's customer pay Sharp a set-up fee of ¥1,200, a monthly basic fee of ¥980 which includes 3 hours of free use and a ¥10 per minute fee for use above 3 hours per month. Under our agreements with Sharp, we receive the majority of the fees described above for operating and managing Sharp's Internet access service on an OEM basis.

We design and develop the systems that will be used to provide the "Sharp Space Town" services and set up Sharp's own Web site through which it will distribute contents and software applications and receive fee payments from Sharp for our services. We also provide co-location services for contents servers of Sharp for this Web site.

DLJdirect SFG Securities

Challenge: DLJdirect is expanding its successful on-line trading business into the Japanese market through DLJdirect SFG. DLJdirect SFG needs a computer system and an Internet platform to offer such services to Japanese investors.

Solution: We are primarily responsible for building and developing and will maintain a comprehensive computer system including software and hardware for the web servers, security systems and databases. We will provide the necessary Internet connectivity through our backbone. We will also provide co-location of the servers in our data center. On an ongoing basis, we will monitor and repair the hardware and software used in DLJdirect SFG's operations.

JAFCO

Challenge: JAFCO is a venture capital firm that has made equity investments in over 1,500 unlisted companies in Japan. In order to help its portfolio companies, JAFCO wanted to operate an integrated network system that allowed private communications between JAFCO and the companies in which it invested in Japan and which served as a member-to-member communications and information exchange system. This would also allow JAFCO to provide its member companies with consultation services and other important market information.

Solution: We designed and configured the JAFCONet, a virtual private network, including backbones, access points and security measures. We designed and configured the JAFCONet servers which are co-located in our housing center and we continue to operate and monitor these servers. We provide the IP connectivity services to eight access points of JAFCONet

in main metropolitan areas in Japan. We continue to consult on and design services for JAFCONet such as e-mail systems and online accounting and consulting systems. We also provide customer support and help desk services to JAFCO personnel.

Research and Development

We have always focused on advancing the use of the Internet in Japan. Many of our engineers were among the participants in the WIDE project and continue to regularly participate in industry organizations and government sponsored research projects such as researching new Internet protocol standards such as Internet Protocol Version 6 (IPv6). These engineers have continued to develop innovative services, applications and products many of which have set the standard for the Internet industry in Japan. We continue to strive to develop new services, applications and products. Our research and development efforts are a fundamental part of that effort.

As of June 1999, we had approximately 61 people working on our R&D staff, although not all of these are devoted full time to R&D. Of these, 4 have Ph.D.s and 21 have masters of engineering. Our R&D staff works very closely with our sales and marketing personnel and technical engineers to ensure that our research and development efforts are closely aligned with the demands of our customers.

R&D Organization

We have organized our research and development (R&D) staff to cope promptly and effectively with the rapidly changing technological environment in the Internet. R&D on practical applications of new and developing technologies is the responsibility of the Technology Department, the Service Administrative Department and of the IJ Research Lab.

Technology Department. We have organized the Technology Department into the following divisions:

- Network Engineering Division, which develops network infrastructure, network-related products, such as network monitoring

devices and routers, and software development aimed at enhancing network monitoring and traffic management;

- Applied Technology Division, which develops Internet security technology such as firewalls;
- Media Technology Division, which develops multimedia distribution systems such as IP multicast and Internet broadcasting;
- Planning and Development Division, which plans and develops various new services; and
- Project Promotion Division, which develops backoffice technologies such as customer databases, billing systems and service management systems.

Service Administrative Department. We have an Internet Technology Division in this department which is responsible for closely monitoring new products, developments and initiatives of manufacturers and standards-setting research groups.

A substantial number of significant technological developments relevant to our core Internet access business come from manufacturers of routers and servers and other equipment and from standards-setting and research groups. Our Internet Technology Division monitors developments and also works closely with manufacturers, vendors and others in the development of these products and technologies.

IJ Research Lab. We established the IJ Research Lab in April 1998 to engage in R&D of new basic Internet technologies. For example, through the IJ Research Lab, we are participating in a joint undertaking among WIDE Project and organizations from private and academic sectors to promote the deployment and implementation of IPv6. The output of this joint undertaking will be distributed freely in order to promote the transition to IPv6 on a world-wide scale. IPv6 is designed to solve problems inherent in the current version of IP, IPv4, such as IP address space depletion. In addition, IPv6 will provide features necessary to sustain continuous growth of the Internet as information infrastructure for business and private uses.

R&D Strategy

Our primary R&D objective is to continue to develop innovative services, applications and products that will meet the current and future demands of our customers and that will continue to be at the forefront of the Internet industry in Japan. In furtherance of this objective, our R&D efforts currently are focused on a variety of projects, including:

- continued improvement of our SEIL router, a router we developed specifically to be integrated into IJJ's Internet-related services, including R&D in data packet queuing technologies to implement our QoS standards;
- research relating to the methodology of configuration of routers and other servers;
- research relating to behavior of Internet routing systems.
- software development for management of border gateway protocol or BGP which is protocol that allows routers to exchange routing information on the TCP/IP network;
- research for Internet traffic monitoring and management;
- development of software and evaluation of hardware relating to improving the operations of routers located on our customer's premises; and
- R&D of IPSec which is a secure version of IP that provides secure communication channels over the Internet.

A second R&D objective is to continue participating in or otherwise closely monitoring the new products, developments and initiatives of manufacturers and standards-setting and research groups. Through these efforts we seek to ensure that we have timely and effective access to new technologies and that we implement these technologies effectively. Because the rate of change in technology relevant to our business is so rapid, we believe that the sophistication and experience of our R&D personnel is an important part of our success.

Sales and Marketing

Another group of personnel critical to our success are our sales and marketing personnel. As of June 1999, we had

approximately 100 people working in sales and marketing.

Our sales headquarters is in Tokyo. We also have branches in Osaka, Nagoya, Sapporo, Sendai, Toyama, Hiroshima and Fukuoka in order to cover the major metropolitan areas in which the majority of large Japanese companies operate.

Sales and Marketing Organization

Prior to this year, our sales force was integrated as one group, with the same employees handling marketing, service and new business development and the administration of our sales department. We have recently reorganized our sales personnel into three distinct, separate divisions: sales, marketing, which is responsible for new business and new service development as well as sales promotion, and sales administration.

Our sales division is further separated into three sections:

- A section that focuses on large companies, governmental institutions, universities and other schools and general sales. This section sells the full range of our services and focuses mainly on large companies.
- A section that sells primarily Internet access, focusing on sales of our IJJ Economy, and applications to enhance Internet access for small and medium businesses.
- A section that focuses on carriers and ISPs. This section primarily promotes and sells our network infrastructure.

Sales and Marketing Strategy

We will increase our sales and marketing of our Internet access and value-added services as well as our total Internet solutions. Our three sales division sections will focus their efforts as follows:

Large Companies and General Sales. Our large company section is primarily the group that is focused on creating total Internet solutions for business and other customers. We create solutions both for customers who approach us because of our

reputation and brand name and for customers that our sales personnel target as customers who are in need of or would substantially benefit by our services.

Additionally, this group targets large corporate groups, including financial institutions, manufacturing companies and retail sales operations, that plan on introducing efficient and comprehensive communication networks through the Internet to all of their group companies. If secured as a customer, each corporate group would simultaneously bring to us contracts for several large and small capacity lines.

We are also targeting our current heavy users of our IJ Economy, IJ Dial-up Standard and our other dial-up access services as they are likely candidates to be shifted to our IP Service.

Our large company section also markets our OEM services to potential strategic partners. OEM services are designed to be joint services which combine our network infrastructure with the customer base of our partners. Our partners will gain access to our high-quality network infrastructure to provide their customers with quality Internet access services. We, in turn, will increase significantly the number of individual users of our network which will generate consistent revenues that will increase as the customers to our strategic partners increase.

We currently have an OEM arrangement with Sharp, a leading electronics manufacturing company in Japan. We believe that there are substantial opportunities for us to expand this type of OEM marketing and we are currently negotiating with other potential partners in this regard.

Small and Medium Business Sales. We will increase our sales and marketing to small and medium businesses by expanding the number of agents offering IJ Economy and IJ Dial-up Standard. We currently have approximately 38 agents throughout Japan that promote our services. We will continue to enter agreements to expand the number of our sales agents. We will increase our advertising in business publications. We will also participate in trade shows and host

conferences and lectures to increase the awareness of small and medium businesses of the opportunities available to them through the Internet.

We are also focusing on increasing our brand name recognition by these customers. We have a well-recognized brand name and reputation for quality among large companies. To the extent we are successful in exposing small and medium businesses to our brand name and to our high quality services, we believe our market share of these customers will increase.

Carriers and ISP Sales. We believe our quality and reputation sells itself to these customers and our strong customer base in this area supports our belief. However, we will continue to aggressively market our network infrastructure to these customers. We will also continue to expand and enhance our network, including our large-capacity overseas backbone, as this is one important reason that carriers and ISPs select our services. As we do so, and as Internet usage continues to grow rapidly, we believe carriers and ISPs will increasingly seek high-quality, high-capacity network infrastructures. As a result, we believe our market share among these customers will increase.

Individuals. We don't have a sales division that specifically targets individuals but rather sales to individuals are included in our main section. We market to individuals mainly through magazine and newspaper advertisements, particularly publications with computer-related content. A large proportion of our individual customers are high-usage customers who we believe are technologically oriented. Among this customer group, we believe that our brand recognition is high. We also believe that these customers value the quality of services more than other individuals, and that our reputation for the quality of services has been an important reason for our success with these customers. Customers can sign up for IJ4U by signing up directly online. However, in order to continue attracting these individuals, we will focus on enhancing features of IJ4U in order to differentiate it from the standard Internet

access services for individuals provided by other ISPs.

Customers

We had over 5,500 business and other institutional customers and 52,800 individual subscribers to our Internet access and value-added services as of March 31, 1999. Our main customers are major corporations and ISPs. These customers place a premium on stable and reliable service. Of 1,176 listed companies in Japan with over 1,000 employees, 371 were subscribers to either our Internet access services or our value-added services as of March 31, 1999. No single Internet access service customer accounted for more than three percent of our total revenues in the year ended March 1999.

Many of our major competitors are among our core customers, including carriers,

Carriers

NTT
Japan Telecom
NTT DoCoMo
KDD
DDI
Tokyu Cable Network

Electronics/Computer Companies

Hitachi
Sharp
Dell Computer
Nihon Cisco Systems
Ricoh

Government Organizations

Ministry of Transport
Prime Minister Office
Imperial Household Agency

Financial Institutions

Fuji Bank
Sumitomo Bank
Sanwa Bank
Dai-ichi Life
Meiji Life
Industrial Bank of Japan
IBJ-DL Financial Technology
JAFCO

Research Institutions

Nomura Research Institute
Daiwa Research Institute
Mitsubishi Research Institute

Others

Nippon Television Network
Fuji Xerox
Mitsubishi Motor
Toyota (via Toyota Digital Cruise)
Yamaha
Suzuki Motor
Nintendo
Sumitomo Corporation (via SC Telecom)
Itochu Corporation (via CRC)

major ISPs and electronics companies. These companies all offer and/or operate directly or indirectly internet access services of their own and would therefore be our competitors. However, they are also important customers of ours. We believe these competitors are our customers primarily because of our large capacity and high level of technology. As a result, even as our competitors become stronger, we benefit directly through the increase of usage and revenues we derive as these customers/competitors increase their use of our network.

The following is a representative list of our business customers from selected industry groups to which we provided Internet access and related services for as of March 31, 1999:

Customer Satisfaction

We believe that our customers begin using our services and continue using our services due, in large part, to our strong brand name and reputation for quality, particularly among businesses, including ISPs, and leading edge Internet users.

In terms of customer satisfaction, we rated as the top Internet service provider for satisfaction in terms of through-put and

network management capability for both dedicated line connections and economy-type services according to a Nikkei Communications survey dated December 7, 1998. The Nikkei Communications survey results were based upon questionnaires provided to 2,085 listed and non-listed companies in Japan to which 842 companies responded.

We also ranked as the 3rd best provider of dedicated line connections behind NTT and

Japan Telecom, the 2nd in terms of overall satisfaction for economy type services and the 4th for overall satisfaction of dial-up services. We were able to achieve our 3rd place ranking for best provider in dedicated line connections, according to the survey, primarily because we were the only provider to earn satisfactory rates for network management capability and trouble shooting and support system which offset our low rates with respect to our pricing policy.

We believe that we will be able to further define the quality of our services and differentiate ourselves from our competitors through our service level agreements. We believe that as our customers' Internet usage increases, they will further appreciate the value they receive by getting our high quality services.

Our Group Companies

We offer our services directly and together with our group companies. Our group companies work closely together in providing total Internet solutions to our customers. We collaborate on the development of various services and products and we market our services and products together as a group. However, our group companies specialize in different aspects of the Internet. Our customers' main point of contact is IJ itself. We then draw upon the resources and specialization of the group companies to offer total Internet solutions.

Our group companies are not all majority-owned subsidiaries. Only IJ America and Net Care are subsidiaries that we currently account for on a consolidated basis. Beginning with the quarter ending June 30, 1999, we will also consolidate IJ Technology and IJ Media Communications.

Among the other shareholders of the group companies, are shareholders who are also shareholders of ours. We identify key shareholders of our group companies in the discussion of each of our group companies below.

Our most significant investment in our group companies will be made in Crosswave.

As this investment is significant, we have provided a full discussion of Crosswave immediately after this subsection under the heading "Crosswave Communications Inc." that you should read.

IJ America, Inc.

IJ America is a U.S.-based Internet access provider. Most of IJ America's customers are U.S.-based operations of Japanese companies that use IJ's services in Japan. These customers use IJ America's services to link directly to our seamless high-capacity backbone network connecting the U.S., Japan, and the countries of Asia.

We currently own 71.4% of IJ America and IJ Technology owns 28.6% as a result of a recent issuance of 15,000 new shares to IJ. At the end of the fiscal year ended March 31, 1999, we each owned 50%.

IJ America had revenues of \$918,751 for the year ended December 31, 1998.

As of April 1999, IJ America had 4 full-time employees all of whom were assigned, or seconded, from IJ.

Net Care, Inc.

Net Care provides a broad array of support services, from monitoring and troubleshooting network operations to an end-user help desk. Currently, Net Care services are provided exclusively to IJ. However, we expect that Net Care will begin offering its services to third parties in the near future.

We own 50% of Net Care. Other major shareholders of Net Care include Sumitomo Corp., Itochu Corp., Toyota and Intelligence, each of which owns 10%.

Net Care had sales of approximately ¥292 million for the year ended March 31, 1999.

As of April 1999, Net Care had approximately 47 employees, 3 of whom were seconded from IJ. 34 of the 47 are part-time staff.

IJJ Technology Inc.

In June 1999 we increased our ownership of IJJ Technology from 39% to 64.1%. One of the primary reasons that we increased our percentage of IJJ Technology is because it is becoming an increasingly important element in our providing total Internet solutions to our customers.

IJJ Technology provides comprehensive Internet network systems integration and consulting services, focusing on design, operation, and consulting for corporate networks (LANs, enterprise networks, intranets) and their security systems. IJJ Technology assists customers in creating private IP networks, such as intranets or virtual private networks, that securely isolate internal network traffic from public Internet traffic and provide each site on the private IP network access to other sites as well as to the Internet. IJJ Technology can integrate an organization's multiple sites in different locations in Japan and different countries throughout the world.

We own 64.1% of IJJ Technology. Other major shareholders of IJJ Technology include Sumitomo Corp., Itochu Corp., Sumitomo Electric Industries, Ltd. and Hitachi Software Engineering Co., Ltd., each of which owns 5.9% and Sun Microsystems, Inc., Toyota, Hewlett Packard Japan and Itochu Techno-Science, each of which owns 2.9%.

IJJ Technology had sales of approximately ¥1,602 million for the year ended March 31, 1999.

As of April 1999, IJJ Technology had approximately 28 full-time employees, 18 of whom were seconded from IJJ.

IJJ Media Communications Inc.

In May 1999, we increased our ownership of IJJ Media Communications from 50.0% to 50.1%. IJJ Media Communications provides expert services to help customers exploit the potential of Internet commerce and the World Wide Web. IJJ Media Communications' core business is providing various hosting and home page development services and total Internet solutions based on the WWW. For this purpose, IJJ Media

Communications engages in research and development of the newest technologies for media communications, such as streaming technologies including multicast and portal service applications, and incorporates the technologies into various applications.

IJJ Media Communications also provides total support for customers' contents and systems, particularly those customers who engage in e-commerce related activities. IJJ Media Communications provides consultation, planning, configuration (including selection of hardware and choices of applications), content production and ongoing support for its customers.

Other basic media services offered by IJJ Media Communications include information management services related to the Internet. IJJ Media Communications also offers servers to manage mailing lists, to provide simultaneous distribution services and to operate IJJ Net News services.

We own approximately 50.1% of IJJ Media Communications. Other major shareholders of IJJ Media Communications include Sumitomo Corp. (12.9%), Itochu Corp. (11%) and Tokyu Corp. (10%).

IJJ Media Communications had sales of approximately ¥538 million for the year ended March 31, 1999.

As of April 1999, IJJ Media Communications had approximately 24 full-time employees, 10 of whom were seconded from IJJ.

Asia Internet Holding Co., Ltd.

Asia Internet Holding was created to own and manage the A-Bone, which is a high-speed Internet backbone network that connects countries in the Asia Pacific region to a common network infrastructure.

Currently, the A-Bone ties into networks in Japan and seven other countries in the region: Singapore, Hong Kong, Malaysia, Indonesia, Philippines, Thailand and China. Asia Internet Holding has network operations centers in each of these countries. The A-Bone also connects to the United States through IJJ. Asia Internet Holding is

considering establishing connections to Taiwan, South Korea, Vietnam, India, Australia and Europe in the near future.

The primary customers of Asia Internet Holding are carriers and ISPs throughout Asia including Japan. However, as Internet usage increases in the rest of Asia, ISPs and customers from other countries in the Asia-Pacific region have started using the A-Bone.

We own 20.6% of Asia Internet Holding. We would like to increase our ownership of Asia Internet Holding to have majority control and have initiated discussions with other shareholders to that end. We expect to be able to increase our ownership to approximately 30% after the completion of this offering. Our ability to increase our interests further will depend on the outcome of discussions with the other shareholders. We operate and manage the A-Bone pursuant to an agreement with Asia Internet Holding for which we are paid ¥10 million per month. The agreement is a yearly contract that renews automatically although it may be terminated by either party upon two months prior notice in writing. We operate the A-Bone from our network operations center in Tokyo. Other major shareholders of Asia Internet Holding include:

- Sumitomo Corp., which owns 25.6%
- NTT Communications, which owns 14.8%
- Sembawang Ventures Pte Ltd., which owns 12.1%
- Itochu Corp., which owns 10.8%
- Matsushita Electric Industrial Co., Ltd., Toyota and Telekom Malaysia Berhad, each of which owns 3.1%.

Asia Internet Holding had sales of approximately ¥969 million for the year ended March 31, 1999.

As of April 1999, Asia Internet Holding currently had approximately 9 full-time employees, 4 of whom were seconded from IJ.

Internet Multifeed Co.

Internet Multifeed, known as MFEED, provides a location and facilities for

connecting high-speed Internet backbones with content servers to make distribution on the Internet more efficient. MFEED's technology was jointly developed by IJ and NTT.

MFEED combines two services, Multifeed housing and Multifeed connectivity, for customers receiving and publishing large volumes of data on the Internet. With Multifeed housing, customers can place their routers, servers and other equipment in MFEED's centrally located premises, where maintenance and management are provided. With Multifeed connectivity, customer equipment connects directly to the backbones of IJ and other ISPs at the Multifeed housing site. This central siting of content and connectivity makes the distribution of content more efficient by reducing the number of networks that data must travel through to connect content providers with end users. CNN's and CNNfn's Web sites have launched mirrored sites in Japan using MFEED (Japan.CNN.com and Japan.CNNfn.com).

We own 26% of MFEED and IJ Technology and IJ Media Communications each own 2%. Other major shareholders of MFEED include NTT Communications, which owns 26%, and NTT PC Communications, NEC Corporation, Fujitsu Ltd. and Itochu Corp., each of which owns 5%. NTT also owns indirectly another 6% through NTT-affiliated companies.

MFEED had sales of approximately ¥875 million for the year ended March 31, 1999.

As of April 1999, MFEED had approximately 12 full-time employees, 2 of whom were seconded from IJ.

atom, Co., Ltd.

atom is primarily a Web page design company. atom aims to define new forms of design work using digital technology in all network-based aspects, including from content production to graphic design.

We own 40% of atom. The other shareholders of atom include two individuals that own 25% each and Sumitomo Corp., which owns 10%.

atom had sales of approximately ¥260 million for the six-months ended March 31, 1999.

As of April 1999, atom had approximately 36 employees.

Crosswave Communications Inc.

On October 28, 1998, IJ, Toyota and Sony formed Crosswave Communications Inc. for the purpose of operating a nationwide optical fiber network for high-speed data communications. IJ, Toyota and Sony contributed 40%, 30% and 30%, respectively, of Crosswave's equity.

Crosswave's joint venture agreement provides that IJ, Toyota and Sony have the right to appoint three, two and two directors, respectively. Koichi Suzuki, IJ's president and representative director, currently also serves as Crosswave's president and representative director. As of May 1, 1999, Crosswave had six full-time employees, all of whom were being seconded from the three shareholders. They included three employees seconded from IJ. In addition, pursuant to a service arrangement between IJ and Crosswave, a director and three employees of IJ are devoting part of their time to work for Crosswave. These four individuals head four of the six departments set up at Crosswave, and an employee seconded from IJ co-heads another department.

Crosswave is a Type I carrier, which allows it to provide telecommunications services through its own telecommunications circuit facilities.

Industry Overview

As in the United States, the level of data traffic is rapidly increasing in Japan. In order to handle this increasing data traffic, incumbent telecommunications carriers are increasing their bandwidth capacity by adding additional optical fiber and by applying advanced equipment and transmission technologies to increase the capacity of their existing network. However, the rate of increase of bandwidth has not been as rapid in Japan as it has been in the United States and other western countries. Crosswave

seeks to capitalize on both the increasing data traffic levels and the demand for additional bandwidth by providing a high-capacity nationwide network dedicated to data transmission.

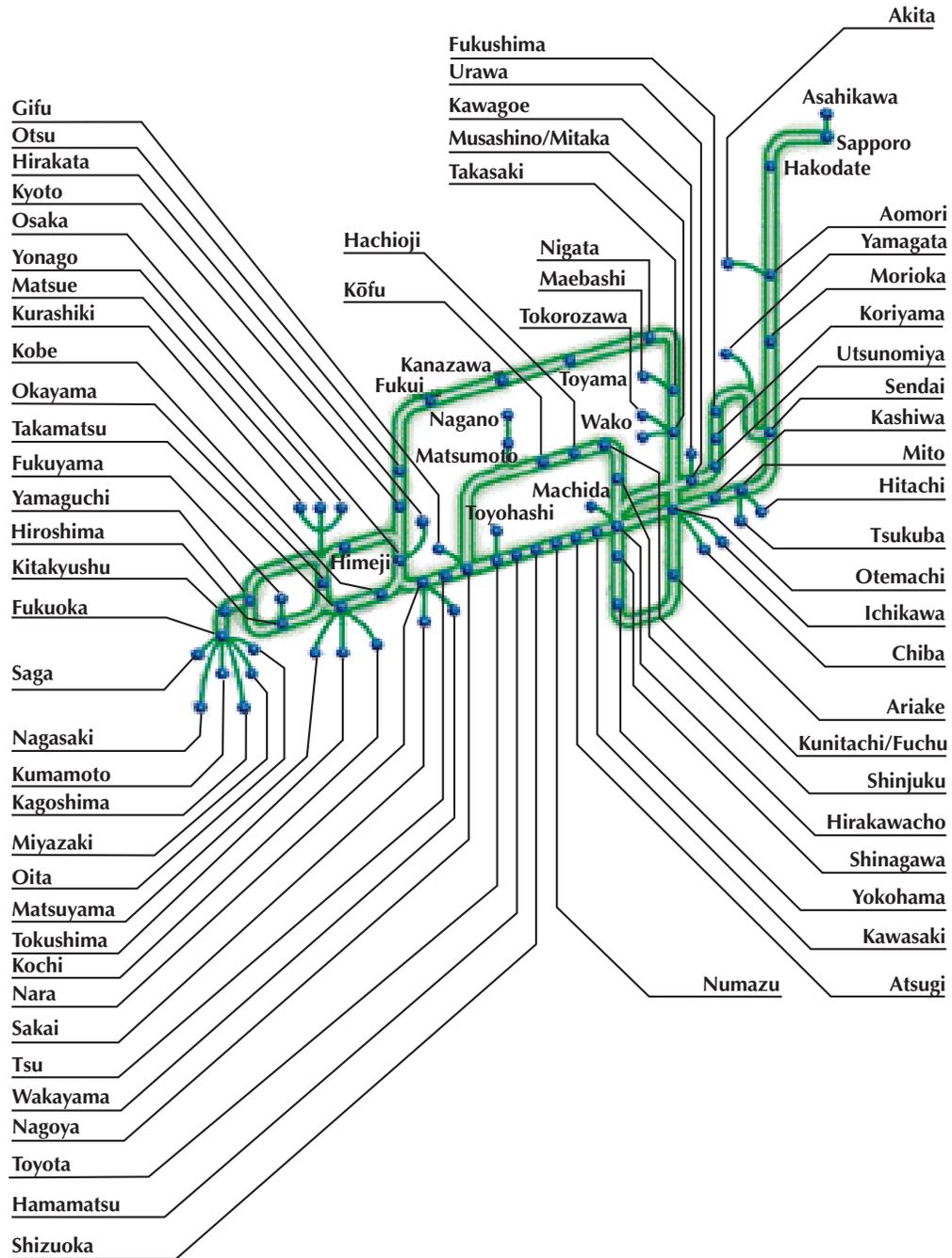
Crosswave's Network

Crosswave's primary asset is its network. Crosswave has secured the rights to a nationwide network of dark fiber through a contract with KDD that runs through April 2009. (Leases of dark fiber include installed fiber strands but do not include the equipment necessary to transmit data through the fiber.) Crosswave's primary expenses will be related to the development of its domestic network. Crosswave is obligated to make monthly lease payments, which consist of fixed and variable portions, to KDD for the dark fiber. Crosswave has also contracted with KDD to receive from KDD maintenance services covering the leased dark fiber. For a discussion of Crosswave's expenses and the contract with KDD, please see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Factors Affecting Our Future Financial Results — Crosswave Communications Inc."

The contract also states that Crosswave will not engage in the voice transmission business using circuit switching and that Crosswave will first discuss with KDD before engaging in the voice transmission business as defined in the Telecommunications Business Law. IJ believes that Crosswave has no intention to engage in the voice transmission business through circuit switching. Crosswave, however, may seek to do other voice transmission businesses, such as voice over Internet services, in a manner consistent with the provisions in the contract with KDD, if an opportunity that it views as potentially profitable is available in the future.

The dark fiber leased from KDD is laid along major highways that run throughout Japan. Currently, Crosswave's network connects Tokyo, Nagoya, Osaka and several cities in the Hokuriku area. Crosswave plans to expand its network to all prefectures other than Okinawa by March 2000.

Crosswave's Planned Network—March 2000



Through this optical fiber network, Crosswave will be able to offer data transmission rates at speeds faster than currently available in Japan and at significantly lower prices than currently available. Crosswave will initially offer transmission at speeds of up to 600 Mbps but this can be increased as necessary to meet increasing traffic requirements.

We have been primarily responsible for and have actively participated, as a third party contractor or through our seconded employees, in the planning and design of the Crosswave network. We worked closely with Crosswave to ensure that its network is well suited, in terms of quality of technology and otherwise, to integrate with our network and the services we currently offer and will offer in the future. In addition, we plan to assist Crosswave in the operation and maintenance of its optical fiber network as a third-party contractor.

In addition to its optical fiber network in Japan, Crosswave may, upon agreement of all the shareholders, seek to expand its network internationally by securing contractual rights from third parties to dedicated capacity between Japan and the United States, in Asia and elsewhere. This would depend upon a number of factors including the price at which dedicated capacity fiber is available, the competitive environment in the trans-Pacific and other data transmission markets, its customers' potential requirements and its performance in the domestic network business. We understand Crosswave is currently negotiating to obtain substantial international capacity by

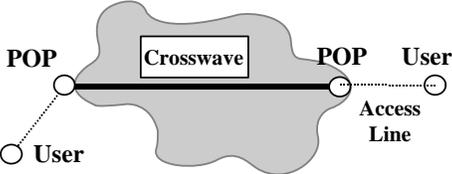
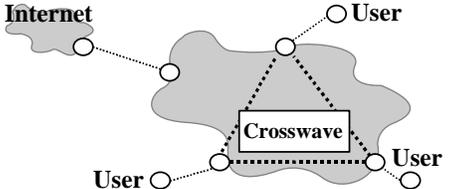
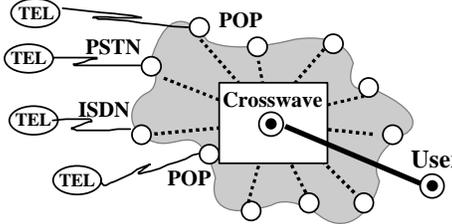
entering into long-term contracts with undersea cable operators or other international telecommunications carriers. We would anticipate securing leases for a large amount of our international capacity from Crosswave in this event. As with domestic leased lines that Crosswave offers, we expect that this international capacity would be available at significantly lower per unit costs than we are currently paying.

Crosswave's Technology

Crosswave is able to provide this data transmission capability by using various networking technologies, including Dense Wavelength Division Multiplexing or DWDM and Synchronous Optical Network or SONET. DWDM is a format for multiplex use of optical fiber by splitting the frequency spectrum into multiple channels. SONET is the North American standard for telecommunications multiplexing and transmission using optical fiber. These technologies make it possible to send multiple light pulses of different wavelengths, each carrying a different set of data, through a single strand of optical fiber. Because a single strand of optical fiber can carry a high volume of data, fewer fiber optic strands are needed to construct large capacity networks as compared to networks without DWDM technology. Using the DWDM and SONET advanced multiplexing and transmission technologies, we believe Crosswave will be able to increase its capacity on its optical fiber network to over 100 Gbps through transmission equipment upgrades.

Crosswave's Services

Crosswave will offer three primary services on its network:

<p>High-Speed Backbone Service</p>		<ul style="list-style-type: none"> • Point to point high-speed backbone service up to 600Mbps. • For large network operators such as ISPs, value-added networks, cable television and media organizations.
<p>Network Platform Service</p>		<ul style="list-style-type: none"> • Point to multi-point platform service. • Distance-free tariff system based on number of access points, bandwidth etc. • For corporations, ISPs and value-added network operators.
<p>Dial-up Port Service</p>		<ul style="list-style-type: none"> • Approximately 85 POPs for nationwide service. • Functions as network gateway from telephone terminal. • For service providers such as value-added network operators and corporations needing nationwide networks.

Crosswave currently offers only high-speed leased line service, and it plans to commence offering network platform service and dial-up port service in October 1999. Crosswave may also seek to exploit other opportunities available based upon its network infrastructure, which may include

- trans-Pacific lines in the event that it procures the right to dedicated capacity between Japan and the United States and
- local access through fixed wireless access service that uses radio frequency allocated for that purpose by the Ministry of Posts

and Telecommunications (MPT) in Japan; Crosswave recently received preliminary permission from the MPT to pursue fixed wireless access service.

Crosswave's Pricing

We believe that Crosswave's prices for leased lines are significantly lower than comparable leased lines offered by its competitor carriers. Crosswave's monthly charges for its high-speed backbone service, excluding charges for local access lines, are as follows:

High-Speed Backbone Service

	<u>1.5Mbps</u>	<u>45Mbps</u>	<u>150Mbps</u>	<u>600Mbps</u>
Up to 200km	¥200,000	¥2,400,000	¥4,800,000	¥12,000,000
Up to 600km	300,000	3,600,000	7,200,000	18,000,000
Above 600km	400,000	4,800,000	9,600,000	24,000,000

To illustrate Crosswave's competitive pricing, the following table shows as of May 1999 end-to-end monthly prices that

Crosswave, KDD and NTT charge for their leased lines between Tokyo and Osaka for the respective bandwidths indicated.

<u>Bandwidth</u>	<u>Carrier</u>		
	<u>Crosswave (1)</u>	<u>KDD (1)</u>	<u>NTT</u>
	(thousands of yen)		
1.5 Mbps	¥ 624	¥ 1,097	¥ 1,546
45 Mbps	5,600	11,394 (2)	12,180 (2)
150 Mbps	9,200	27,100	28,748

(1) Neither Crosswave nor KDD has local access lines operations of its own. For the purpose of this comparison, for 1.5 Mbps, we assumed that NTT's digital access (DA) services at 1.5 Mbps and for 15 km was used and, for 45 Mbps and 150 Mbps, we assumed that ¥1.0 million per month is charged for local access services at each end.

(2) Neither KDD nor NTT offers comparable services for 45Mbps. For the purpose of this comparison, we used KDD's and NTT's prices for 50 Mbps leased lines.

Crosswave's Sales and Marketing

Crosswave's sales and marketing will primarily be done by third-party agents throughout Japan. In addition, IJ will market Crosswave's services as an agent and as part of the services offered by the IJ group.

Crosswave's Customers

Crosswave's main target customers include large corporations, ISPs, such as IJ, VAN operators and broadcasting companies that have needs for high-volume, high-speed data communications. As a Type I carrier, Crosswave is required to make its tariff-based services available on the same terms and conditions to all customers, without special treatment to its shareholders, including IJ.

Our Plan to Increase Our Use of Crosswave's Services

We will benefit from Crosswave's network in four primary ways. First, we will be able over time to replace existing leased lines with Crosswave's leased lines. As the lease periods of our current leased lines expire, we will be able to switch to a Crosswave line if one is available. This will reduce our domestic backbone cost (which was ¥1.1 billion in the year ended March 31, 1999) as Crosswave's leased line rates will be significantly lower than rates we currently pay.

Second, we will be able to add additional capacity to our current network in a more cost effective manner. As the volume of traffic across our network continues to increase, we need to add additional capacity. Crosswave allows us to add significant capacity to our existing networks at lower rates than we are currently paying.

Third, we will be able to leverage off of Crosswave's network infrastructure to expand the geographic coverage of our network. Crosswave will have approximately 85 POPs by March 2000. We will be able to use those POPs if we purchase Crosswave's leased line service or network platform service. We can also use Crosswave's dial-up ports as dial-up access points for our own dial-up access services, including IJ4U and OEM services.

Fourth, we will perform joint service and product development with Crosswave to produce advanced and flexible carrier services which are designed primarily for us. Through this joint development, we should be able to provide unique services using Crosswave's advanced services prior to the introduction of comparable services by our competitors. This will also allow us to reduce our dependence on the incumbent telecommunications carriers.

Our Additional Contributions to Crosswave

In order to complete a nationwide network, Crosswave requires substantial investments. The joint venture agreement provides that the three joint venture partners must provide ¥8 billion of capital contributions on a pro rata basis no later than August 31, 1999. Currently, we have contributed ¥2.56 billion of our pro rata contribution of ¥3.2 billion.

The joint venture agreement further provides that, no later than September 26, 1999, the three investors will discuss and agree on the amount and timing of additional investment in Crosswave in a total amount not to exceed ¥12 billion. Once the three parties agree on the amount of additional investment, Crosswave will request that they provide such investment in the form of additional capital contributions, purchase of corporate debentures issued by Crosswave or shareholder loans to Crosswave. The decision on additional investment may depend upon a number of factors, such as how Crosswave will procure network equipment or whether and when it will commence an international leased line business or any other businesses that are beyond the scope of its current business plan.

We plan to use a portion of the proceeds of this offering to refinance short-term borrowings for our investment already made and to finance our future investments in Crosswave. If IJJ and the other shareholders agree on further investments in a large amount, IJJ might need to identify sources of funds in addition to the proceeds from this offering.

Our financial results will be affected by Crosswave's performance because we account for Crosswave on the equity method. However, we are not directly responsible for any of the expenses of Crosswave beyond our equity investment.

For more detailed financial information on Crosswave including its anticipated expenses, and its financial consequences for IJJ, see Management's Discussion and Analysis of Financial Conditions and Results of Operations — Factors Affecting Our Future

Financial Results — Crosswave Communications Inc.”

Crosswave's Competition

The market for large bandwidth data transmission, although competitive, is not as well developed in Japan as it is in the United States. Currently, there is no other nationwide data-dedicated network. Crosswave is also one of the few carriers in Japan using the DWDM and SONET technology.

Crosswave's major current competitor is NTT, which has an advanced wavelength division multiplexing technology and a nationwide network of optical fiber. Additionally, Crosswave's expects to compete with other existing telecommunications carriers, including Japan Telecom, many of which have announced plans to increase their data transmission capacities through next-generation networks. Japan Telecom may become a stronger competitor due to its alliance with AT&T and British Telecom.

KDD is also a competitor as it also has a nationwide network of optical fiber that is not the subject of KDD's contract with Crosswave.

Crosswave's primary competitive advantages are its advanced technology, its light organization, the fact that it has already started its operations in the Tokyo-Nagoya-Osaka-Hokuriku ring, and the fact that its recent establishment means that it is not burdened with aged equipment or outdated business methods. This should position Crosswave well to capture significant market shares in the large bandwidth data traffic markets.

Partnerships

As with our investment in Crosswave and our group companies, we will continue to invest in Internet-related businesses with strategic partners.

We have recently announced the formation of a strategic and commercial alliance with GTE Internetworking, a division of GTE Corporation, to offer expanded Internet services on a global basis. At this point we have entered into a memorandum of

understanding to interconnect our networks and to start discussions regarding joint marketing and services development.

In April 1998, we formed Lycos Japan, in a joint venture. We own 10% of this joint venture, Sumitomo Corp. and an affiliate own 50% and Lycos owns the remaining 40%. Sumitomo and Lycos will manage the daily operation of the site. We intend to bring our Internet expertise and advanced technologies to bear on the design, implementation, operation and maintenance of the server and connectivity infrastructure.

On March 23, 1999, we entered into a joint venture agreement with DLJ*direct* Japan Holdings, DLJ*direct* Holdings and Sumitomo Bank. The purpose for the joint venture is to establish an online discount brokerage aimed at Japanese individual investors. We will plan, develop and set up the Internet trading system for this joint venture. We own 5% of the shares of the joint venture company.

Competition

The market for Internet access and related services is extremely competitive in Japan. There are no particular substantial barriers to entry into the market in Japan, although there are regulatory requirements that must be met to become carriers and/or major Internet access providers. We anticipate that competition will continue to intensify as the use of the Internet in Japan grows. The tremendous growth and potential size of the Internet access market has attracted many new start-ups as well as existing businesses from different industries.

We believe that the ability to compete successfully depends on a number of factors. Generally, these include:

- speed and reliability of the network;
- price of the services offered;
- value-added services available;
- support services provided;
- ease and availability of dial-up connections;
- number of POPs;
- consulting services offered; and

- technological sophistication of services.

However, we believe that speed and reliability of the network and support and consulting services offered are the most important of these factors for large corporations, which are our primary target market.

Our success in this market will depend not just on our ability to provide high-quality services to large corporations, but on our ability to provide high-quality Internet access services and related value-added services at competitive prices to all of our target markets.

Our current primary competitors are Type I telecommunications carriers and other major ISPs. While we believe that our network and customer service distinguish us from these competitors, some of these competitors have a significantly greater market presence, brand recognition, and financial, technical and personnel resources than we have.

Telecommunications Carriers

We compete for business directly with telecommunications carriers who have Type I carrier licenses. Most of the major telecommunications carriers offer Internet access services. These include:

Telecommunications carrier	Internet access service
NTT Communications	OCN
Japan Telecom	ODN
KDD	NEWEB
DDI	DION

Only Type I carriers are allowed to own lines in Japan. However, it is usually difficult to apply for an approval from the MPT to become a new carrier, primarily because of the large expenditures required to meet the standards for approval as a Type I carrier. As Type I carriers have their own lines, it is easy for them to begin offering Internet access service and expand those services.

Generally, ISPs operated by carriers, such as OCN operated by NTT Communications, offer connectivity services of lesser quality but at lower prices. In the high-end corporate market, which is our

primary target, these lesser quality, lower-priced services do not directly compete with our main IP Service. However, currently the fastest growing market segment for business users has been such low-end services. We view this market segment as one of the other important segments for us. In order to address any actual or potential adverse impacts from competition from these discount services of NTT Communications and others, we launched IJ Economy in 1998 which offers our quality services at competitive prices.

ISPs

Other major ISPs are competitors of ours. ISPs are generally considered as either primary or secondary providers, although there are other lower tier providers. We compete primarily with primary and secondary providers.

We are considered a primary provider. Primary providers lease backbones from the carriers and also serve as POPs for secondary providers and corporate users. In order to lease sufficient lines for a backbone and to establish enough POPs to become a primary provider, it requires large initial investments and requires significant ongoing operating capital.

The primary providers that we compete with in Japan are generally affiliated with large companies in Japan:

Internet access service	Major affiliate
Biglobe	NEC
Infoweb	Fujitsu
So-net	Sony Communication Network
Dream Train Internet	Dream Train Internet, an affiliate of Mitsubishi Electric
SANNET	Sanyo Electric Software
Panasonic Hi-HO	Matsushita Electric Industrial
MSN	Microsoft
JustNet	Justsystem
Dream Net	MediaBank
Plala	GrR HomeNet

Our main competitors among the primary providers listed above are Biglobe and Infoweb as their focus, as ours, is primarily on businesses in Japan. However, as our revenues from all segments continue to increase, we expect to compete with providers in all segments.

In addition to these primary providers, we have recently seen a significant increase in foreign providers including PSINet and UUNET. PSINet has recently acquire three Japanese ISPs: RIMNET, TWICS and Tokyo Internet. With these acquisitions, PSINet is now the second largest ISP in Japan in terms of numbers of contracts. PSINet and UUNET are large ISPs in the United States and throughout the world. They have sizable global networks and have significant financial and other resources available to them. They will be strong competitors of ours.

Although our primary competition from ISPs is from primary providers, we also compete with secondary providers. Secondary providers typically obtain services from primary providers and resell the lines to their own customers. The start-up costs for a secondary providers are low. Secondary providers offer their services primarily to individual customers.

Cable Companies and Wireless Communications Companies

Many of the major cable companies and wireless communications companies have announced that they are exploring the possibility of offering Internet access.

On-line Service Providers

On-line service providers have not been significant competitors of ours to date. However, many on-line service providers have entered the Internet access business by engineering their current proprietary networks to include Internet access capabilities. We expect to compete to a limited extent with these service providers, which currently are primarily focused on the consumer marketplace. However, many of these on-line service providers are entering alliances which will allow them to offer a broader array of IP-

based services and products that could increase their competitiveness.

We believe that we are in a good position to compete with each of these categories of competitors in many respects. We believe that we have competitive advantages in our technology, network, backbone, customer base, brand name, support capability and ability to offer Internet-related services. As to price competition, our fees for our IP Service are generally higher than those of our competitors. We continue to focus, however, on high-end users who pay premium prices for our high-quality IP Service and support. With respect to our other services, we have expanded the variety of services available to provide quality services at competitive prices in all our target market segments. Also, as our services become more closely integrated with those of Crosswave, our price structure should benefit from the low data communication cost of accessing Crosswave's network.

Competition in Total Solutions Businesses and in Network Consulting and Systems Integration

As we increase our revenues from the provision of total Internet solutions, network consulting and systems integration and other value-added services, we compete with a number of other companies in addition to the major ISPs. Our primary competition in this area from non-ISPs is from NTT Data Corporation. Among the carriers and ISPs, our primary competitors are NTT, Japan Telecom, DDI, PSINet and UUNET.

Regulation of the Telecommunications Industry in Japan

The Ministry of Posts and Telecommunications (MPT) regulates the Japanese telecommunications industry. IJ, Crosswave and other Type I and Type II Carriers are regulated by the MPT primarily under the Telecommunications Business Law.

The Telecommunications Business Law

The Telecommunications Business Law (TBL), which became effective in 1985, authorizes the MPT to regulate two types of

telecommunications companies, Type I Carriers and Type II Carriers. Type I Carriers include NTT, KDD and other NCCs (new common carriers), including Crosswave, as well as cellular operators. Type I Carriers provide telecommunications services by establishing their own telecommunications circuit facilities. Type II Carriers, such as IJ, are telecommunications carriers other than Type I Carriers. Type II Carriers include telecommunications circuit resale carriers and Internet service providers. Type II Carriers provide telecommunications services to customers by using the telecommunications facilities of Type I Carriers, typically NTT.

Historically, the MPT required Type I Carriers to own the telecommunications circuit facilities they used to provide telecommunications services. As a result of deregulation, however, this requirement was modified in 1997. Type I Carriers may now lease telecommunications circuit facilities on a long-term basis and under stable conditions from the owner of the facilities. This deregulation allowed Crosswave, which leases fiber-optic lines from KDD, to obtain a Type I Carrier license.

Type II Carriers are not allowed, in principle, to provide telecommunications services through their own telecommunications circuit facilities. Therefore, if a carrier wishes to provide telecommunications services through its own circuit facilities, the carrier has to apply for a Type I permit under the TBL. A telecommunications carrier cannot simultaneously hold a Type I Permit and a Type II registration. However, a carrier of one type is permitted to own a carrier of the other type.

Effective November 1, 1998, the TBL was revised to provide that even Type II Carriers could own telecommunications facilities if such facilities are connected to one specific customer.

Type II Carriers are subdivided into Special Type II Carriers and General Type II Carriers. The definitions for Special Type II Carriers and General Type II Carriers were also amended effective on November 1, 1998. Before the revision, Special Type II Carriers

were defined as carriers which provided telecommunications facilities that exceeded in scale the standards stipulated in the applicable ordinances or provided telecommunications facilities designed for communications between Japan and foreign points of contact. General Type II Carriers were defined as carriers which provided other services. The revised law abolished this scale standard. Under the revised law, Special Type II Carriers are limited to Type II Carriers which provide telecommunications facilities designed for communications between Japan and foreign points or provide telecommunication services to many unspecified members of the public through interconnections of public switched networks and leased circuits at each end. Telecommunications services mainly

dedicated for transmitting signals or images as provided for in the applicable ordinance are excluded from this definition. IJ falls under the category of Special Type II Carriers.

Type I Carriers may offer the same kinds and categories of services provided by Type II Carriers. Therefore, Type I Carriers and Type II Carriers, especially Special Type II Carriers, may be competitors. As of February 1, 1999, there were 174 Type I Carriers and 6,496 Type II Carriers. Type II Carriers included 86 Special Type II Carriers and 6,410 General Type II Carriers.

The following table summarizes certain of the major regulatory requirements applicable to Type I and Type II Carriers:

	<u>Type I Carriers</u>		<u>Type II Carriers</u>	
			<u>Special Type II</u>	<u>General Type II</u>
Government Regulation:				
a. Start-up of Services	Permission from MPT required		Registration with MPT required	Notification to MPT required
b. Rates and Charges	Notification* to MPT required		Notification to MPT required	Unregulated
c. Share acquisition by foreign investors	Unregulated**		Unregulated	Unregulated

* NTT is required to receive MPT approval for interconnection charges.

** Prior notification is required under the Foreign Exchange and Foreign Trade Law. A 20 % foreign ownership restriction is applicable only to NTT.

Regulation of Special Type II Carriers

The following regulations apply to IJ as a Special Type II Carrier.

Registration. Special Type II Carriers must obtain registration from the MPT before commencing Special Type II business. The applicant must specify the categories of service to be provided and the facilities to be used by the carrier. The applicant must also specify the terms and conditions of service, including tariffs, that will initially be offered by the carrier, as well as the carrier’s administrative rules (as described below). MPT is required to accept the registration if the necessary information is furnished and if no disqualifying conditions are found.

Examples of disqualifying conditions include, among other things, not having adequate financial basis and technical capability to properly operate a telecommunications business and having been sentenced to a fine or more severe criminal penalty pursuant to the TBL. Following initial registration, with minor exceptions, changes in the categories, of service to be provided or the facilities to be used by the carrier require additional registrations. Currently, IJ’s registration as a Special Type II Carrier is made under the service category of “data transmission”. This service category does not encompass “voice and sound transmission” or dedicated line service under the TBL.

Terms and Conditions for the Provision of Services. Special Type II Carriers must establish terms and conditions for the provision of telecommunications services that they offer. The terms and conditions may be established and changed simply by prior notification to the MPT and without any need for MPT approval. Special Type II Carriers are prohibited from providing telecommunications services other than pursuant to the terms and conditions notified to the MPT.

Revocation of Registration. If a Special Type II Carrier has violated the provisions of the TBL or any orders or administrative decisions, and is determined to impair the public interest, its registration may be revoked by the MPT.

Withdrawal from Special Type II Carrier business. If a Special Type II Carrier has terminated its business or has determined to dissolve, the Special Type II Carrier must so notify the MPT. Approval by the MPT is not required.

Regulation of Type I Carriers

The following regulations apply to Crosswave as a Type I Carrier.

Permit of MPT. A Type I Carrier must obtain a permit from the MPT before commencing Type I business, by submitting an application to the MPT. The application must set forth, among other things, the categories of service, descriptions of the services, service areas and telecommunications facilities. If any of these matters included in the application is to be changed, with minor exceptions, the Type I Carrier must obtain prior permission from the MPT. A Type I Carrier must obtain approval from the MPT before it enters into an entrustment agreement with any other telecommunications carriers.

Obligation to Provide Services. Type I Carriers must not, without due reason, refuse to provide telecommunications services within their service areas.

Terms and Conditions for the Provision of Services. Type I Carriers must establish standard terms and conditions for the provision of telecommunications services that

they offer. The terms and conditions, and any amendments to them, are subject to MPT approval. Type I Carriers are prohibited from providing telecommunications services other than pursuant to the terms and conditions approved by the MPT, except for the non-tariff based services for which MPT approval is separately required.

Tariff Regulation. Type I Carriers must establish tariffs for the telecommunications services that they offer. Since November 1, 1998, tariffs may be established and changed simply by prior notification to the MPT with no approval necessary. Prior to November 1, 1998, tariffs had to be approved by the MPT before they took effect. The MPT may order a change to the tariffs if it determines that the tariffs are unfair and unreasonable, are not calculated according to a properly and clearly stipulated method or include any provision that unfairly discriminates against any person.

Type I Carriers are prohibited from providing their telecommunications services other than pursuant to the tariffs notified to the MPT. Thus, Type I Carriers are not able to negotiate their tariffs with customers.

Interconnection Regulation. Interconnection tariffs, terms and conditions are subject to special regulation by the MPT. NTT, which is designated by the MPT as a dominant Type I Carrier, must establish uniform interconnection tariffs, terms and conditions which must be applied equally to all other carriers who wish to have access. The MPT only grants approval if it determines that such tariffs and terms are fair and reasonable, considering costs incurred under efficient management and properly allocable. The terms must not be disadvantageous to other carriers who wish to have access compared to the terms applicable to the interconnection with the telecommunications facilities by NTT itself. The tariffs and terms must not include any provisions that unfairly discriminate against any telecommunications carrier.

In the case of other telecommunications carriers (i.e., those not designated as a dominant Type I Carrier), carriers may set interconnection charges and terms by negotiation and agreement. Such

interconnection rates and terms, however, are also subject to MPT approval.

Revocation of Permit. A permit may be revoked by the MPT if a Special Type I Carrier has failed to commence telecommunications business within the time period designated by the MPT or contravened the provisions of the TBL or any orders or administrative decisions and is determined to impair the public interest.

Withdrawal from Type I Carrier Business. If a Type I Carrier intends to abolish or dissolve its business, the Type I Carrier must obtain MPT approval. A business transfer of the going-concern or a merger of a Type I Carrier is also subject to MPT prior approval.

Technical Standard for Type I Carrier and Type II Carrier

Type I Carriers and Special Type II Carriers must maintain their telecommunications facilities in conformity with the technical standards provided in the applicable ordinances of the MPT. If the MPT determines that the telecommunications facilities fail to meet the technical standards, the MPT may order the Type I Carrier or the Special Type II Carrier to improve or repair its telecommunications facilities. The technical standards are specified to avoid damage or failure of or interference to telecommunications facilities, keep proper quality of the telecommunications service, maintain the secrecy of communications and show clearly the demarcation of responsibility between the telecommunications facilities of telecommunications carriers.

In addition, Type I Carriers and Special Type II Carriers must establish their own administrative rules in accordance with MPT ordinances, in order to secure the reliable and stable provision of telecommunications services. Such administrative rules cover such matters as rules of operation and manipulation of telecommunications facilities, rules of safeguarding, inspection and testing regarding the construction, maintenance and administration of telecommunications facilities,

etc. Such administrative rules must be submitted to the MPT prior to the commencement of operations, and changes must be submitted to the MPT after they are implemented without delay.

Proprietary Rights

Although the Company believes that its success is more dependent upon its technical, marketing and customer service expertise than its proprietary rights, the Company relies on a combination of trademark and contractual restrictions to establish and protect its technology.

Licences

IJJ is a licensee under a software agreement for the Gauntlet Internet Firewall software and source code that we use to provide our firewalls. The licence expires next year and it could be difficult to renew on commercially reasonable terms or at all. We believe that it will be possible, although difficult, to move to a different style of firewall service if necessary without Gauntlet.

As of June 1999, IJJ is also a licensee under an agreement with WatchGuard Technologies, Inc. for the right to use WatchGuard's managed firewall service products which provide the ability to manage, update and configure firewalls remotely.

Trademarks

IJJ has applied for trademark registrations of its corporate name "Internet Initiative Japan Inc." and certain other corporate and product names in Japan, the United States and certain European countries. Currently, there are 15 applications pending and 2 which have been completed.

Legal Proceedings

We are not a party to any material legal proceedings.

To our knowledge, there is no material litigation or other legal proceeding, or threat of any such proceeding, involving or against any of the companies in the IJJ group.

Enforceability of Certain Civil Liabilities

We are a limited liability, joint-stock company incorporated under the laws of Japan. All of our directors and executive officers (and certain experts named herein) reside in Japan. Substantially all of our assets and the assets of these persons are located outside the United States. It may not be possible, therefore, for investors to effect service of process within the United States upon us or these persons or to enforce

against us or these persons judgments obtained in United States courts predicated upon the civil liability provisions of the federal securities laws of the United States. We have been advised by our Japanese counsel, Asahi Law Offices, that there is doubt as to the enforceability in Japan, in original actions or in actions for enforcement of judgments of United States courts, of liabilities predicated solely upon the federal securities laws of the United States.

MANAGEMENT

Directors and Executive Officers

The following table sets forth information with respect to the directors and executive

officers and certain other officers of IJJ as of July 1, 1999.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Koichi Suzuki	52	President, Chief Executive Officer and Representative Director
Hiroyuki Fukase	47	Director
Akio Onishi	40	Director and Chief Strategic Officer
Yasuhiro Nishi	40	Director, Chief Financial Officer and Chief Accounting Officer
Toshiya Asaba	37	Director and Co-chief Technology Officer
Shunichi Kozasa	50	Director
Kazumasa Utashiro	38	Co-chief Technology Officer
Hideki Matsushita	56	Standing Statutory Auditor
Yukihiro Yoshida	53	Statutory Auditor
Eizou Kobayashi	50	Statutory Auditor

Koichi Suzuki has been the President and Representative Director of IJJ since April 1994, and has over 20 years of experience in the computer and communication industry. From December 1992 to April 1994, Mr. Suzuki was a Director of IJJ. In addition, Mr. Suzuki is the Representative Director of Crosswave, IJJ America, IJJ Media Communications, IJJ Technology, Internet Multifeed, Net Care, Asia Internet Holding, Asia Internet Holding Taiwan and AIH Korea. He also serves as a Director of Atom and Xing Technology Japan. Prior to joining IJJ, Mr. Suzuki was employed at Japan Management Association where he served as general manager.

Hiroyuki Fukase has been the Chairman and a Director of IJJ since April 1994 and has over 20 years experience in the software industry. From December 1992 to April 1994, Mr. Fukase was the Representative Director of IJJ. Mr. Fukase is also a Director of Asia Internet Holding, IJJ America, AIH Korea, Asia Internet Holding Taiwan, IJJ Technology and Net Care. Prior to joining IJJ, Mr. Fukase was employed at ASCII Corporation where he served as general manager.

Akio Onishi has been the Chief Strategic Officer of IJJ since May 1999 and a Director of IJJ since June 1998. Mr. Onishi joined IJJ in April 1997. Mr. Onishi is also a Director of

Internet Multifeed, Net Care and DLJdirect SFG Securities Inc. Prior to joining IJJ, Mr. Onishi worked at the Organization for Economic Cooperation and Development from February 1995 to April 1997 at McKinsey and Company Japan as a consultant from October 1989 to February 1995, and at the Ministry of International Trade and Industry of Japan from April 1982 to July 1989.

Yasuhiro Nishi has served as a Director of IJJ since June 1999 and as Chief Financial Officer and Chief Accounting Officer of IJJ since May 1999. From March 1999 to June 1999, Mr. Nishi was the Manager of the Corporate Planning Department and the General Manager, Strategic Sales Division. Prior to joining IJJ, Mr. Nishi had 17 years of experience in the finance industry working at The Industrial Bank of Japan, Limited where he had been since 1982.

Toshiya Asaba has served as a Director of IJJ since June 1999 and as Co-Chief Technology Officer of IJJ since May 1999. From 1995 to June 1999, Mr. Asaba was General Manager, Network Engineering Division. Mr. Asaba is also a Director of Asia Internet Holding, Asia Internet Holding Taiwan, IJJ America and Internet Multifeed. Mr. Asaba joined IJJ in 1992. Mr. Asaba had 10 years of internet experience including three years of Internet-related research

experience and seven years of Internet backbone engineering experience, including network design, routing and traffic management.

Shunichi Kozasa has served as a Director of IJ since June 1999. Mr. Kozasa joined IJ in April 1998 as the head of our regional office in Osaka. Prior to joining IJ, Mr. Kozasa worked at NTT for over 20 years, most recently as a general manager of the corporate sales division.

Kazumasa Utashiro has served as Co-Chief Technology Officer of IJ since May 1999 and has 16 years of Unix software development and Internet-related research experiences. From April 1995 to June 1999, Mr. Utashiro was General Manager, Applied Technology Division. Mr. Utashiro joined IJ in 1994. Prior to joining IJ, Mr. Utashiro worked at Software Research Associates.

Hideki Matsushita has been the Standing Statutory Auditor of IJ since June 1998. Mr. Matsushita had been seconded from Dai-ichi Life Insurance, a leading life insurance company in Japan, since April 1997.

Yukihiro Yoshida has served as a Statutory Auditor of IJ since June 1999. Mr. Yoshida has been a deputy general manager, of Sumitomo Corporation since April 1999. He started working at Sumitomo in April 1968.

Eizou Kobayashi has served as a Statutory Auditor of IJ since June 1999. Mr. Kobayashi has been chief operating officer, Information Technology & Telecommunication Division of Itochu Corporation. He started working at Itochu in April 1972.

Compensation of Executive Officers and Directors

For the year ended March 31, 1999, the aggregate compensation paid by IJ to all of its executive officers and directors was approximately ¥83 million.

Stock Option Plans

We currently have no stock options or warrant options outstanding. We amended our Articles of Incorporation by shareholders' resolution at the shareholders' meeting held on March 2, 1998 so that we may grant warrant options to our directors or employees. We can, from time to time, grant warrant options to directors or employees if we obtain approval by special resolutions of the shareholders' meeting.

RELATED PARTY TRANSACTIONS

Transactions between IIJ and its directors, statutory auditors or companies with whom they have a relationship

Since April 1, 1998, there have been no transactions between IIJ and its directors or statutory auditors.

Transactions between IIJ and its principal shareholders

Since April 1, 1998, IIJ received from Sumitomo Corp. ¥22.8 million as revenues from IIJ's Internet business, and paid ¥30 million to Sumitomo Corp. for employees of Sumitomo Corp. that had been assigned, or seconded, to IIJ.

Since April 1, 1998, IIJ received from Itochu Corp. ¥14.4 million as revenues from IIJ's Internet business and paid ¥32.7 million to Itochu Corp. for employees of Itochu Corp. seconded to IIJ.

Since April 1, 1998, IIJ received from NTT ¥124.7 million as revenues from IIJ's Internet business and paid ¥1991.2 million for its leased lines, INS lines and other lines from NTT and ¥63.7 million for NTT's engineering work.

Since April 1, 1998, IIJ received from The Dai-Ichi Mutual Life Insurance Company ¥22.2 million as revenues from IIJ's Internet business, paid insurance premiums to Dai-Ichi Mutual Life in the amount of ¥298.0 million and paid ¥15.5 million to Dai-Ichi Mutual Life for employees of Dai-Ichi Mutual Life seconded to IIJ.

Since April 1, 1998, IIJ received from Software Research ¥19.8 million as revenues from IIJ's Internet business and paid ¥8.6 million to Software Research Associates for employees of Software Research Associates seconded to IIJ.

PRINCIPAL AND SELLING SHAREHOLDERS

The following table sets forth information known to us with respect to the beneficial ownership of our common stock as of March 31, 1999, and as adjusted to reflect the sale of ADSs offered hereby, assuming no exercise of the underwriters' over-allotment

option, by (i) each shareholder known by us to own beneficially more than 5% of our common stock, (ii) all directors and executive officers as a group, and (iii) all other selling shareholders.

<u>Name of Beneficial Owner</u>	<u>Shares of Common Stock Beneficially Owned Before the Offering</u>		<u>Shares to be Sold</u>	<u>Shares of Common Stock to be Beneficially Owned After the Offering</u>	
	<u>Number</u>	<u>Percentage</u>		<u>Number</u>	<u>Percentage</u>
Koichi Suzuki	2,264	11.99	0	2,264	10.30
Itochu Corp. and affiliates	1,611	8.53	0	1,611	7.33
Sumitomo Corp. and affiliates	1,582	8.38	0	1,582	7.19
NTT Communications(1) ..	1,132	6.00	0	1,132	5.15
The Dai-ichi Mutual Life Insurance Company	1,025	5.43	0	1,025	4.66
Software Research Associates	1,006	5.33	0	1,006	4.57
ASCII Corporation	300	1.59	300	0	0.00
JAFCO	800	4.24	80	720	3.27
Nikko Capital	240	1.27	40	200	0.91
ORIX Capital	300	1.59	30	270	1.23
Sanwa Capital	240	1.27	20	220	1.00
Directors and executive officers as a group(2)	2,891	15.31	0	2,891	13.15

(1) As of March 31, 1999, NTT was the shareholder but as a result of NTT's reorganization, NTT's shares are now owned by NTT Communications.

(2) Includes Koichi Suzuki's holding which is also separately set forth above.

DESCRIPTION OF CAPITAL STOCK

The following description of our capital stock is a summary of the material information concerning our shares. For additional information, you should read our Articles of Incorporation and Share Handling Regulations, which are included as exhibits to the Registration Statement of which this prospectus forms a part. Additional information is also contained in the Commercial Code of Japan, but not all of that information is summarized here.

General

Our shares are not listed on any Japanese stock exchange or traded on the over-the-counter market in Japan.

At present, our authorized share capital is 75,520 shares, par value ¥50,000 per share, of which 18,880 shares have been issued. All issued shares are fully paid and non-assessable. Under the Commercial Code, the transfer of shares is made by delivery of share certificates. However, in order to assert shareholders' rights against us, the transferee must have his name and address registered on our register of shareholders. Shareholders are required to file their names, addresses and seal impressions with The Sumitomo Trust and Banking Company, Limited which is the transfer agent for our shares. Foreign shareholders may file a specimen signature in lieu of a seal impression. Non-resident shareholders are required to appoint a standing proxy in Japan or file a mailing address in Japan. Japanese securities firms and commercial banks customarily offer the service of standing proxy, and provide related services on payment of their standard fee.

Dividends

We have never declared or paid any cash dividends on our capital stock. We currently do not expect to pay any cash dividends for the foreseeable future. If we paid annual cash dividends, they would be distributed in cash on a pro rata basis to shareholders of record as at March 31 in each year, following approval by resolution of ordinary general meeting of shareholders. In addition to annual dividends, we may also pay

interim dividends in cash from our retained earnings to shareholders of record as at September 30 in each year by resolution of our Board of Directors. Our Articles of Incorporation provide that we are relieved of our obligation to pay any annual dividends or interim dividends unclaimed for three years after the date they first become payable.

The Commercial Code provides that we may not make any distribution of profits by way of annual cash dividends or interim dividends unless we set aside in our legal reserve an amount equal to at least one-tenth of any amount paid out by us as an appropriation of retained earnings, including any payment by way of annual dividend and bonuses to Directors and Auditors, until our legal reserve is at least one-quarter of our stated capital. The Commercial Code permits us to distribute profits by way of dividends out of the excess of our net assets, on a non-consolidated basis, over the aggregate of:

- our stated capital;
- our additional paid-in capital;
- our accumulated legal reserve;
- the legal reserve to be set aside in respect of the dividends concerned and proposed payment by way of appropriation of retained earnings; and
- the excess, if any, of unamortized expenses incurred in preparation for commencement of business and in connection with research and development over the aggregate of the amounts listed above, other than our stated capital.

In the case of interim dividends, the net assets are calculated by reference to the balance sheet as at the last closing of our accounts, but adjusted to reflect any subsequent payment by way of appropriation of retained earnings and the related transfer to legal reserve, any subsequent transfer of retained earnings to stated capital and the aggregate purchase price of shares determined by a resolution of the ordinary general meeting of shareholders authorizing us to acquire our shares pursuant to the below-mentioned amendments to the

Commercial Code. Interim dividends may not be paid where there is a risk that at the end of the financial year net assets might be less than the aggregate of the amounts listed above.

If we have on our balance sheet a number of shares acquired for the purpose of transferring these shares to our Directors or employees but these shares are yet to be transferred, the book value of these shares shall be deducted from the amount available for payment of annual dividends and interim dividends.

In Japan, the “ex-dividend” date and the record date for any dividends come before the date the issuer decides the amount of the dividends to be paid.

For information as to Japanese taxes on dividends, please refer to the section “Certain Tax Considerations — Japanese Taxation”.

Stock Splits

When we issue new shares, the entire amount of the issue price of the new shares is required to be accounted for as stated capital, although we may account for an amount not exceeding one-half of the issue price as additional paid-in capital. We may at any time transfer the whole or any part of our additional paid-in capital and legal reserve to stated capital by resolution of our Board of Directors. We may also transfer the whole or any part of retained earnings which are distributable as annual dividends or interim dividends to stated capital by resolution of an ordinary general meeting of shareholders.

We may at any time split our shares in issue into a greater number of shares by resolution of the Board of Directors if:

- the total par value of the shares in issue after the stock split does not exceed the stated capital; and
- our net assets divided by the number of the shares in issue after the stock split is at least ¥50,000.

Generally, unless a stock split involves a change in the par value of the shares, shareholders will not be required to surrender share certificates for exchange, but

certificates representing the additional shares resulting from the stock split will be issued to shareholders. If exchange of share certificates is not required, we must give public notice of the stock split and the record date, not less than two weeks prior to such record date. In addition, promptly after the stock split takes effect, we must give notice to each shareholder of the number of shares to be issued to such shareholder by virtue of the stock split. If exchange of share certificates is required, we must give public notice and in addition, notice to each shareholder that, within a period of not less than one month specified in such notice, share certificates must be submitted to us for exchange.

For information as to the treatment under Japanese tax law of a stock split, please refer to the section “Certain Tax Considerations — Japanese Taxation”.

General Meeting of Shareholders

The ordinary general meeting of our shareholders is held within three months from the last day of each fiscal year in Tokyo. In addition, we may hold an extraordinary general meeting of shareholders whenever necessary. We must give notice of a shareholders’ meeting stating the place, the time and the purpose thereof and a summary of the matters to be acted upon at least two weeks prior to the date set for the meeting. We must send such notice to each shareholder having voting rights or, in the case of a non-resident shareholder, to his mailing address or proxy in Japan. Since we suspend the entry of changes into the register of shareholders from April 1 to the date when an ordinary general meeting of shareholders is held each year, shareholders having voting rights at an ordinary general meeting of shareholders are fixed on March 31 each year.

Any shareholder holding 300 shares or one percent of the total number of the outstanding shares for six months or longer may propose a matter to be considered at a general meeting of shareholders. A proposal is made by submitting a written request to the

Board of Directors at least six weeks prior to the date of such meeting.

Voting Rights

A shareholder of record is entitled to one vote per share. Except as otherwise provided by law or by the Articles of Incorporation, a resolution can be adopted at a general meeting of shareholders by a majority of the shares having voting rights represented at the meeting. Shareholders may also exercise their voting rights through proxies, provided that the proxy is one of our shareholders. The Commercial Code provides that the quorum for election of Directors and Statutory Auditors is one-third of the total number of issued shares having voting rights. Our Articles of Incorporation provide that shares may not be voted cumulatively for the election of Directors.

Shareholders of a company having 1,000 or more shareholders may exercise voting rights by sending the voting rights exercise form, indicating consent or dissent to the items on the agenda. As of June 15, 1999, we have 125 shareholders of record and the exercise of voting rights in an exercise form does not apply to us.

The Commercial Code provides that a special resolution of shareholders' meeting is required in order to amend the Articles of Incorporation and in certain other instances, including

- any reduction of the stated capital,
- any removal of a Director or a Statutory Auditor,
- dissolution or merger,
- transfer of the whole or an important part of the business,
- taking over the whole of the business of any other company, or
- any offering of new shares at a "specially favorable" price, or any offering of convertible bonds with "specially favorable" conversion conditions or of bonds with warrants or rights to subscribe for new shares with "specially favorable" conditions.

A special resolution requires the approval of the holders of at least two-thirds of the shares represented at a meeting where a quorum is present. A quorum exists when a majority of the total number of outstanding shares having voting rights is represented.

Liquidation Rights

If we are liquidated, the assets remaining after payment of all taxes, liquidation expenses and debts will be distributed among the shareholders in proportion to the number of shares they hold.

Issue of Additional Shares and Pre-emptive Rights

Holders of our shares have no pre-emptive rights. Authorized but unissued shares may be issued at the times and on the terms as our Board of Directors determines, as long as the limitations on the offering of new shares at a "specially favorable" price mentioned above are observed. Our Board of Directors may, however, give shareholders subscription rights to new shares. Any rights must be given on uniform terms to all shareholders as of a record date. Notice of that record date must be given at least two weeks' in advance. Each shareholder must also be given at least two weeks' prior notice of the date on which the rights expire.

The issue price of new shares with a par value may not be less than the par value and must be paid in full. We may, however, make a rights issue to shareholders at a subscription price per share which is less than the par value thereof if:

- the difference between the subscription price and the par value does not exceed the sum of the amount accounted for as stated capital in excess of par value in connection with previous issues and the amount of additional paid-in capital, legal reserve and retained earnings transferred to stated capital, divided by the number of the new shares;
- the sum of the net assets of IJ and the total subscription price, divided by the number of the shares in issue thereafter, is at least ¥50,000; and

- the subscription rights to the new shares are made transferable.

Dilution

It is possible that, in the future, market conditions and other factors might make rights issues to shareholders desirable at a subscription price substantially below their then current market price. In that case shareholders who do not exercise and are unable otherwise to realize the full value of their subscription rights will suffer dilution of their equity interest in IIJ.

Reports to Shareholders

We currently furnish our shareholders notices of shareholders' meetings, annual business reports, including financial statements, and notices of resolutions adopted at the shareholders' meetings, all of which are in Japanese.

Upon completion of the offering, we will be subject to the information requirements of the Exchange Act and, in accordance therewith, we will file reports and other information in English with the SEC. For information on how to obtain these reports and other information, please refer to the "Additional Information" section of this prospectus.

Record Date and Close of Register of Shareholders

The record date for annual dividends is March 31 and the record date for interim dividends is September 30. In addition, we may set a record date for determining the shareholders entitled to other rights and for other purposes by giving at least two weeks' prior public notice. We may close the register of shareholders for a period not to exceed three months.

Repurchase of Shares by Us

Neither IIJ nor any of its subsidiaries can acquire shares except by means of a reduction of capital in the manner provided in the Commercial Code and except as otherwise permitted by the Commercial Code as summarized below.

The Commercial Code permits us to acquire shares, pursuant to a resolution at an ordinary general meeting of shareholders, only for the purpose of transferring shares to our Directors or employees or to cancel shares.

We can only acquire shares to transfer to our Directors or employees if:

- the number of shares to be acquired does not exceed 10 percent of total issued shares; and
- the aggregate amount of the purchase price does not exceed the amount of the retained earnings available for annual dividend payment less the sum of any amount paid or to be paid by way of appropriation of retained earnings and any transfer of retained earnings to stated capital.

We can only acquire shares to cancel if:

- the aggregate amount of the purchase price does not exceed the amount of the retained earnings available for annual dividend payment less the sum of any amount paid or to be paid by way of appropriation of retained earnings and any transfer of retained earnings to stated capital; and
- there is not a concern that there would be no retained earnings available for annual dividend payment at the close of the current business year.

We can also issue to our Directors or employees warrant options to subscribe for new shares. For information about stock options, please refer to "Management — Stock Option Plans" in this prospectus.

Stock Options

The Commercial Code of Japan permits two types of stock option plans: options by means of repurchase of treasury stock and options by means of issue of warrants.

In order to adopt treasury-stock options, we need to obtain a resolution of the ordinary shareholders which authorizes the options and sets out the identity of directors or employees to be granted the options, as well as the kind and number of treasury-stocks to be transferred on exercise and the price,

exercise period and other terms of the options. The number of shares to be purchased by the directors or employees upon exercise of the options may not exceed one-tenth of the total number of shares in issue of the corporation.

In order to adopt a warrant option plan, we needed to amend our Articles of Incorporation to allow it. In addition, a special resolution of shareholders at the shareholders' meeting is required to grant warrant options. The extraordinary resolution must authorize the identity of directors or employees to be granted the options, and the kind and number of shares to be newly issued on exercise and the price, exercise period and other terms of the options. The special resolution for this purpose requires a quorum of shareholders representing one half of the total number of shares issued and outstanding and a resolution adopted by shareholder representing two thirds or more of the voting rights present at the meeting. The number of shares issuable upon exercise of the warrant options shall not exceed one-tenth of the number of shares in issue and the exercise period shall be not more than ten years.

Exchange Controls and Other Regulations

Japanese Foreign Exchange Regulations

The Foreign Exchange and Foreign Trade Law of Japan, frequently referred to as the Foreign Exchange Law, and the cabinet orders and ministerial ordinances thereunder govern the issuance of shares by companies and the acquisition and holding of shares by "exchange non-residents" and "foreign investors" under the Foreign Exchange Law.

Exchange non-residents are:

- individuals who do not reside in Japan; and
- corporations whose principal offices are not in Japan.

Generally, branches and other offices located within Japan of non-resident corporations are regarded as exchange residents of Japan and branches and other offices of Japanese corporations located outside Japan are regarded as exchange non-residents of Japan.

Foreign investors are:

- individuals who do not reside in Japan;
- corporations which are organized under the laws of foreign countries or whose principal offices are located outside Japan; and
- corporations in which more than 50% of the shares are held by individuals who do not reside in Japan and/or corporations which are organized under the laws of foreign countries or whose principal offices are located outside Japan or a majority of the officers (or officers having the power of representation) are persons who do not reside in Japan.

The Foreign Exchange Law was amended effective April 1, 1998. Pursuant to this amendment all aspects of foreign exchange and foreign trade transactions that were previously subject to licensing or other prior notifications or approvals, with minor exceptions, were changed to require only post-transaction reporting. However, the Minister of Finance of Japan will have the power to impose licensing requirements for transactions in limited circumstances.

Potential Consequences Resulting from Dividends and Proceeds of Sales

Under the current Foreign Exchange Law, dividends paid on, and the proceeds of sales in Japan of, shares held by exchange non-residents may, in general, be converted into foreign currency and repatriated abroad. The acquisition of shares by exchange non-residents of stock splits is not subject to any of the foregoing requirements.

Potential Consequences Resulting from Sale of Securities to Exchange Non-Resident

A Japanese resident is required to file a report with the Minister of Finance concerning the transfer of the securities for value exceeding ¥100,000,000 to an exchange non-resident within 20 days of the date of the transfer. If an exchange resident issues or offers its securities for value of ¥1,000,000,000 or more outside Japan, the exchange resident must file a report of the issuance or offering of securities with Minister of Finance.

DESCRIPTION OF AMERICAN DEPOSITARY RECEIPTS

American Depositary Receipts

The Bank of New York will issue the ADRs. Each ADR is a certificate evidencing a specific number of ADSs. Each ADS will represent ownership interests in 1/2000th of a share or the right to receive shares. The shares will be deposited by IIJ with the Tokyo branch office of The Bank of New York, its custodian in Tokyo, Japan. Each ADS will also represent securities, cash or other property deposited with The Bank of New York but not distributed to ADS holders. The Bank of New York's Corporate Trust office is located at 101 Barclay Street, New York, NY 10286.

You may hold ADSs either directly (by having an ADR registered in your name) or indirectly through your broker or other financial institution. If you hold ADSs directly, you are an ADR holder. This description assumes you hold your ADSs directly. If you hold the ADSs indirectly, you must rely on the procedures of your broker or other financial institution to assert the rights of ADR holders described in this section. You should consult with your broker or financial institution to find out what those procedures are.

As an ADR holder, you will not be treated as one of our shareholders and you will not have shareholder rights which are governed by Japanese law. The Bank of New York will be the legal owner of the shares underlying your ADRs, and you must rely on it to exercise the rights of a shareholder. You will have ADR holder rights. Those rights and the obligations of The Bank of New York are set out in an agreement among IIJ, The Bank of New York and you, as an ADR holder. The agreement and the ADRs are generally governed by New York law.

The following is a summary of the agreement. Because it is a summary, it does not contain all the information that may be important to you. For more complete information, you should read the entire agreement and the ADR. Directions on how to obtain copies of these are provided in the section entitled "Additional Information."

Share Dividends And Other Distributions

How will you receive dividends and other distributions on the shares?

The Bank of New York has agreed to pay to you the cash dividends or other distributions it or the custodian receives on shares or other deposited securities after deducting its fees and expenses. You will receive these distributions in proportion to the number of shares your ADRs represent.

Cash. The Bank of New York will convert any cash dividend or other cash distribution we pay on the shares into U.S. dollars, if it can do so on a reasonable basis and can transfer the U.S. dollars to the United States. If that is not possible or if any approval from the Japanese government is needed and can not be obtained, the agreement allows The Bank of New York to distribute the Japanese yen only to those ADR holders to whom it is possible to do so. It will hold the Japanese yen it can not convert for the account of the ADR holders who have not been paid. It will not invest the Japanese yen and it will not be liable for any interest.

Before making a distribution, the custodian will deduct any withholding taxes that must be paid under Japanese law. See "Certain Tax Considerations — Japanese Taxation". It will distribute only whole U.S. dollars and cents and will round fractional cents to the nearest whole cent. *If the exchange rates fluctuate during a time when The Bank of New York cannot convert the Japanese yen currency, you may lose some or all of the value of the distribution.*

Shares. The Bank of New York may distribute new ADSs representing any shares we may distribute as a dividend or free distribution, if we furnish it promptly with satisfactory evidence that it is legal to do so. The Bank of New York will only distribute whole ADRs. It will sell shares which would require it to use a fractional ADS and distribute the net proceeds in the same way as it does with cash. If The Bank of New York

does not distribute additional ADRs, each ADS will also represent the new shares.

Rights to receive additional shares. If we offer holders of our shares any rights to subscribe for additional shares or any other rights, The Bank of New York may make these rights available to you. We must first instruct The Bank of New York to do so and furnish it with satisfactory evidence that it is legal to do so. If we don't furnish this evidence and/or give these instructions, and The Bank of New York decides it is practical to sell the rights, The Bank of New York will sell the rights and distribute the proceeds, in the same way as it does with cash. The Bank of New York may allow rights that are not distributed or sold to lapse. In that case, you will receive no value for them.

If The Bank of New York makes rights available to you, it will exercise the rights and purchase the shares on your behalf. The Bank of New York will then deposit the shares and issue ADRs to you. It will only exercise rights if you pay it the exercise price and any other charges the rights require you to pay.

U.S. securities laws may restrict the sale, deposit, cancellation and transfer of the ADSs issued after exercise of rights. For example, you may not be able to trade the ADSs freely in the United States. In this case, The Bank of New York may issue the ADRs under a separate restricted deposit agreement which will contain the same provisions as the agreement, except for the changes needed to put the restrictions in place.

Other Distributions. The Bank of New York will send to you anything else we distribute on deposited securities by any means it thinks is legal, fair and practical. If it cannot make the distribution in that way, The Bank of New York has a choice. It may decide to sell what we distributed and distribute the net proceeds in the same way as it does with cash. Or it may decide to hold what we distributed, in which case the ADSs will also represent the newly distributed property.

The Bank of New York is not responsible if it decides that it is unlawful or impractical to make a distribution available to any ADR holders. We have no obligation to register ADSs, shares, rights or other securities under the Securities Act. We also have no obligation to take any other action to permit the distribution of ADRs, shares, rights or anything else to ADR holders.

This means that you may not receive the distributions we make on our shares or any value for them if it is illegal or impractical for us to make them available to you.

Deposit, Withdrawal and Cancellation

How are ADRs issued?

The Bank of New York will issue ADSs if you or your broker deposit shares or evidence of rights to receive shares with the custodian. Upon payment of its fees and expenses and of any taxes or charges, such as stamp taxes or stock transfer taxes or fees, The Bank of New York will register the appropriate number of ADRs in the names you request and will deliver the ADRs at its office to the persons you request.

How do ADS holders cancel an ADR and obtain shares?

You may turn in your ADRs at The Bank of New York's office. Upon payment of its fees and expenses and of any taxes or charges, such as stamp taxes or stock transfer taxes or fees, The Bank of New York will deliver (1) the underlying shares to an account designated by you and (2) any other deposited securities underlying the ADR at the office of the custodian. Or, at your request, risk and expense, The Bank of New York will deliver the deposited securities at its office.

Voting Rights

You may instruct The Bank of New York to vote the shares underlying your ADRs but only if we ask The Bank of New York to ask for your instructions. *Otherwise, you won't be able to exercise your right to vote unless you cancel your ADRs and withdraw the shares.*

However, you may not know about the meeting enough in advance to withdraw the shares.

If we ask for your instructions, The Bank of New York will notify you of the upcoming vote and arrange to deliver IJ's voting materials to you. The materials will (1) describe the matters to be voted on and (2) explain how you, on a certain date, may instruct The Bank of New York to vote the shares or other deposited securities underlying your ADSs as you direct. For instructions to be valid, The Bank of New York must receive them on or before the date specified. The Bank of New York will try, as far as practical, subject to Japanese law and the provisions of IJ's Articles of Incorporation, to vote or to have its agents vote the shares or other deposited securities as you instruct. If you do not validly instruct The Bank of New York, they will deem that

you have instructed them to give a discretionary proxy to a person designated by us to vote such deposited securities, unless substantial opposition exists or the matter materially and adversely affects your rights. No votes will be cast as to fractional shares, which shall be rounded down to the nearest whole share.

We and The Bank of New York cannot assure you that you will receive the voting materials in time to ensure that you can instruct The Bank of New York to vote your shares. In addition, The Bank of New York and its agents are not responsible for failing to carry out voting instructions or for the manner of carrying out voting instructions. *This means that you may not be able to exercise your right to vote and there may be nothing you can do if your shares are not voted as you requested.*

Fees and Expenses

<i>ADR holders must pay:</i>	<i>For:</i>
\$5.00 (or less) per 100 ADSs	Each issuance of an ADR, including as a result of a distribution of shares or rights or other property Each cancellation of an ADR, including if the agreement terminates
\$.02 (or less) per ADS	Any cash payment
Registration or Transfer Fees	Transfer and registration of shares on the share register of the custodian from your name to the name of The Bank of New York or its agent when you deposit or withdraw shares
Expenses of The Bank of New York	Conversion of Japanese yen to U.S. dollars Cable, telex and facsimile transmission expenses
Taxes and other governmental charges The Bank of New York or the custodian have to pay on any ADR or share underlying an ADR, for example, stock transfer taxes, stamp duty or withholding taxes	As necessary
Any charges payable for The Bank of New York or its agents in connection with servicing the deposited securities	As incurred

Payment of Taxes

The Bank of New York may deduct the amount of any taxes owed from any payments to you. It may also sell deposited securities, by public or private sale, to pay any taxes owed. You will remain liable if the proceeds of the sale are not enough to pay

the taxes. If The Bank of New York sells deposited securities, it will, if appropriate, reduce the number of ADRs to reflect the sale and pay to you any proceeds, or send to you any property, remaining after it has paid the taxes.

Reclassifications, Recapitalizations and Mergers

<i>If IJ:</i>	<i>Then:</i>
Changes the nominal or par value of its shares	The cash, shares or other securities received by The Bank of New York will become deposited securities.
Reclassifies, splits up or consolidates any of the deposited securities	Each ADR will automatically represent its equal share of the new deposited securities.
Distributes securities on the shares that are not distributed to you	The Bank of New York may, and will if IJ asks it to, distribute some or all of the cash, shares or other securities it received. It may also issue new ADRs or ask you to surrender your outstanding ADRs in exchange for new ADRs, identifying the new deposited securities.
Recapitalizes, reorganizes, merges, liquidate, sells all or substantially all of its assets, or takes any similar action	

Amendment and Termination

How may the deposit agreement be amended?

We may agree with The Bank of New York to amend the agreement and the ADRs without your consent for any reason. If the amendment adds or increases fees or charges, except for taxes and other governmental charges or certain expenses of The Bank of New York, or prejudices an important right of ADR holders, it will only become effective 30 days after The Bank of New York notifies you of the amendment. *At the time an amendment becomes effective, you are considered, by continuing to hold your ADR, to agree to the amendment and to be bound by the ADRs and the agreement is amended.*

How may the deposit agreement be terminated?

The Bank of New York will terminate the agreement if we ask it to do so. The Bank of New York may also terminate the agreement

if The Bank of New York has told us that it would like to resign and IJ has not appointed a new depository bank within 90 days. In both cases, The Bank of New York must notify you at least 90 days before termination.

After termination, The Bank of New York and its agents will be required to do only the following under the agreement: (1) advise you that the agreement is terminated, and (2) collect distributions on the deposited securities and deliver shares and other deposited securities upon cancellation of ADRs. One year after termination, The Bank of New York may, if practical, sell any remaining deposited securities by public or private sale. After that, The Bank of New York will hold the proceeds of the sale, as well as any other cash it is holding under the agreement, for the pro rata benefit of the ADR holders that have not surrendered their ADRs. It will not invest the money and will have no liability for interest. The Bank of New York's only obligations will be to account for the proceeds of the sale and other cash. After termination, our only obligation will be with

respect to indemnification and to pay certain amounts to The Bank of New York.

Limitations on Obligations and Liability to ADR Holders

Limits on Our Obligations and the Obligations of the Depositary; Limits on the Liability to Holders of ADRs

The agreement expressly limits IIJ's obligations and the obligations of The Bank of New York, and it limits IIJ's liability and the liability of The Bank of New York. IIJ and The Bank of New York:

- are only obligated to take the actions specifically set forth in the agreement without negligence or bad faith;
- are not liable if either is prevented or delayed by law or circumstances beyond their control from performing their obligations under the agreement;
- are not liable if either exercises discretion permitted under the agreement;
- have no obligation to become involved in a lawsuit or other proceeding related to the ADRs or the agreement on your behalf or on behalf of any other party; and
- may rely upon any documents they believe in good faith to be genuine and to have been signed or presented by the proper party.

In the agreement, we and The Bank of New York agree to indemnify each other under certain circumstances.

Requirements for Depositary Actions

Before The Bank of New York will issue or register transfer of an ADR, make a distribution on an ADR, or permit withdrawal of shares, The Bank of New York may require:

- payment of stock transfer or other taxes or other governmental charges and transfer or registration fees charged by third parties for the transfer of any shares or other deposited securities;
- production of satisfactory proof of the identity and genuineness of any signature

or other information it deems necessary; and

- compliance with regulations it may establish, from time to time, consistent with the agreement, including presentation of transfer documents.

The Bank of New York may refuse to deliver, transfer, or register transfers of ADRs generally when the books of The Bank of New York or we are closed, or at any time if The Bank of New York or we think it advisable to do so.

Your Right to Receive the Shares Underlying your ADRs

You have the right to cancel your ADRs and withdraw the underlying shares at any time except:

- when temporary delays arise because: (1) The Bank of New York or IIJ has closed its transfer books; (2) the transfer of shares is blocked to permit voting at a shareholders' meeting; or (3) we are paying a dividend on the shares;
- when you or other ADR holders seeking to withdraw shares owe money to pay fees, taxes and similar charges; or
- when it is necessary to prohibit withdrawals in order to comply with any laws or governmental regulations that apply to ADRs or to the withdrawal of shares or other deposited securities.

This right of withdrawal may not be limited by any other provision of the agreement.

As the ADS/share ratio is 2000/1, you will need to have 2000 ADSs or any integral multiple thereof in order to withdraw any shares.

Information about the Company

We are subject to the periodic reporting requirements of the Securities Exchange Act of 1934 and, accordingly, file certain reports with the SEC.

The Bank of New York will make available for inspection by you at its Corporate Trust Office any reports and

communications, including any proxy soliciting material, received from us. The Bank of New York will also, upon written request, send you copies of any reports furnished by us pursuant to the deposit agreement. These reports and communications, including any such proxy soliciting material, furnished to the Bank of New York by us will be furnished in English to the extent such materials are required to be translated into English pursuant to any regulations of the SEC.

Disclosure of Interests

We may from time to time request you to provide information as to the capacity in which you own or owned ADRs and regarding the identity of any other persons then or previously interested in such ADRs and the nature of such interest.

You agree to provide any information requested by us or The Bank of New York pursuant to the deposit agreement. The Bank of New York has agreed to comply with reasonable written instructions received from us requesting that The Bank of New York forward any such requests to you and to forward to us any such responses to such requests received by The Bank of New York.

Pre-Release of ADRs

In certain circumstances, subject to the provisions of the agreement, The Bank of

New York may issue ADRs before deposit of the underlying shares. This is called a pre-release of the ADR. The Bank of New York may also deliver shares upon cancellation of pre-released ADRs, even if the ADRs are canceled before the pre-release transaction has been closed out. A pre-release is closed out as soon as the underlying shares are delivered to The Bank of New York. The Bank of New York may receive ADRs instead of shares to close out a pre-release. The Bank of New York may pre-release ADRs only under the following conditions: (1) before or at the time of the pre-release, the person to whom the pre-release is being made must represent to The Bank of New York in writing that it or its customer owns the shares or ADRs to be deposited; (2) the pre-release must be fully collateralized with cash or other collateral that The Bank of New York considers appropriate; and (3) The Bank of New York must be able to close out the pre-release on not more than five business days' notice. In addition, The Bank of New York will limit the number of ADRs that may be outstanding at any time as a result of pre-release, although The Bank of New York may disregard the limit from time to time, if it thinks it is appropriate to do so.

SHARES ELIGIBLE FOR FUTURE SALE

Prior to the offering, there has been no market for the shares or ADSs of IJJ, and there can be no assurance that a significant public market for the ADSs will develop or be sustained after the offering. Future sales of substantial amounts of shares following the offering could adversely affect market prices prevailing from time to time and could impair IJJ's ability to raise capital through sale of its equity securities.

Upon completion of this offering, IJJ will have outstanding 21,990 shares of common stock assuming no exercise of the Underwriters' over-allotment option. Of these shares, the 3,580 shares sold in this offering will be freely tradable without restriction under the Securities Act except for any shares purchased by "affiliates" of IJJ as that term is defined in Rule 144 under the Securities Act. In addition, there are 13,983 shares that are freely tradable except for shares held by affiliates.

The remaining 4,427 shares of common stock held by existing shareholders are "restricted shares" as that term is defined in Rule 144 and may not be sold publicly unless they are registered under the Securities Act or are sold pursuant to Rule 144 or another exemption from registration. Of these remaining 4,427 shares, all but the shares held by affiliates will become eligible for sale on or prior to July 31, 2000 subject in some cases to the volume and manner of sale limitations under Rule 144.

The Company, its directors and executive officers and certain other shareholders and the Underwriters entered into lock-up agreements in connection with this offering. These lock-up agreements provide that, with certain limited exceptions,

they will not offer, sell, contract to sell or otherwise dispose of any securities of IJJ that are substantially similar to the common stock, including but not limited to any securities that are convertible into or exchangeable for, or that represent the right to receive, common stock or any such substantially similar securities for a period of 180 days after the date of this prospectus without the prior written consent of Goldman, Sachs & Co.

In general, under Rule 144 as currently in effect, a person, or persons whose shares are aggregated who has beneficially owned restricted shares for at least one year would be entitled to sell within any three-month period commencing 90 days after the effective date of this offering, a number of shares that does not exceed the greater of:

- 1% of the number of shares of common stock then outstanding, equal to approximately 220 shares immediately after this offering; or
- the average weekly trading volume of the common stock during the four calendar weeks preceding the filing of a Form 144 with respect to such sale.

Sales under Rule 144 must also comply with some restrictions regarding the manner of sale, notice requirements and availability of current public information about IJJ. Under Rule 144(k), a person who is not deemed to have been an affiliate of IJJ at any time during the three months preceding a sale, and who has beneficially owned the shares proposed to be sold for at least two years, is entitled to sell such shares without complying with the manner of sale, public information, volume limitation or notice provisions of Rule 144.

TAX CONSIDERATIONS

Japanese Taxation

The following is a discussion, prepared by Asahi Law Offices, summarizing material Japanese tax consequences to an owner of shares or ADSs who is a non-resident of Japan or a non-Japanese corporation without a permanent establishment in Japan to which the relevant income is attributable. The statements regarding Japanese tax laws set forth below are based on the laws in force and as interpreted by the Japanese taxation authorities as at the date hereof. These statements are subject to changes in the applicable Japanese laws or double taxation conventions occurring after that date. This summary is not exhaustive of all possible tax considerations which may apply to a particular investor. Potential investors should satisfy themselves as to

- the overall tax consequences of the acquisition, ownership and disposition of shares or ADSs, including specifically the tax consequences under Japanese law,
- the laws of the jurisdiction of which they are resident, and
- any tax treaty between Japan and their country of residence, by consulting their own tax advisers.

Generally, a non-resident of Japan or a non-Japanese corporation is subject to Japanese withholding tax on dividends paid by Japanese corporations. Stock splits, subject to the following, are not subject to Japanese income tax. However, a transfer of retained earnings or legal reserve to stated capital is treated as a dividend payment to shareholders for Japanese tax purposes and is, in general, subject to Japanese income tax. This is true whether or not the transfer is made in connection with a stock split or otherwise. In general a transfer of additional paid-in capital to stated capital is not treated as a dividend. No transfer of retained earnings or legal reserve to stated capital would be necessary in connection with a stock split if the total par value of shares in issue after the stock split does not exceed the stated capital.

The Convention Between the United States of America and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (the "Treaty"), establishes the maximum rate of Japanese withholding tax which may be imposed on dividends paid to a United States resident or corporation not having a "permanent establishment" in Japan. A "permanent establishment" in Japan is generally a fixed place of business for industrial or commercial activity in Japan. Under the Treaty, the maximum withholding rate for most shareholders is limited to 15% of the gross amount actually distributed. However, the maximum rate is 10% of the gross amount actually distributed, if the recipient is a corporation and

- during the part of the paying corporation's taxable year which precedes the date of payment of the dividend and during the whole of its prior taxable year if any, at least 10% of the voting shares of the paying corporation were owned by the recipient corporation, and
- not more than 25% of the gross income of the paying corporation for such prior taxable year, if any, consists of interest or dividends as defined in the Treaty.

For purposes of the Treaty and Japanese tax law, U.S. holders of ADRs will be treated as the owners of the shares underlying the ADSs evidenced by the ADRs.

Unless an applicable tax treaty, convention or agreement reduces the maximum rate of withholding tax, the rate of Japanese withholding tax applicable to dividends paid by Japanese corporations to a non-resident or non-Japanese corporation is 20%. Japan has entered into income tax treaties, conventions or agreements, reducing the above-mentioned withholding tax rate to 15% for investors with a number of countries. These countries include, among others, Australia, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, The Netherlands, New Zealand, Norway, Singapore, Spain, Sweden, Switzerland, the United Kingdom and the

United States of America. The withholding tax rate is further reduced if investors and IIJ have some capital relationship as provided for in an applicable tax treaty.

Non-resident holders who are entitled to a reduced rate of Japanese withholding tax on payment of dividends by IIJ must submit the required form in advance through IIJ to the relevant tax authority before payment of dividends. The required form is the Application Form for Income Tax Convention regarding Relief from Japanese Income Tax on Dividends. A standing proxy for non-resident holders may provide such application service. See “Description of Capital Stock — General”. With respect to ADSs, the reduced rate is applicable if The Bank of New York, as depositary, or its agent submits two Application Forms for Income Tax Convention — one form must be submitted before payment of dividends, and the other form must be submitted within eight months after our fiscal year-end. To claim the reduced rate, a non-resident holder of ADSs will be required to file proof of taxpayer status, residence and beneficial ownership, as applicable. The non-resident holder will also be required to provide information or documents clarifying its entitlement to the tax reduction as may be required by the depositary.

A non-resident holder of shares or ADSs who does not submit an application in advance will be entitled to claim from the relevant Japanese tax authority a refund of withholding taxes withheld in excess of the rate of an applicable tax treaty.

Gains derived from the sale outside Japan of the shares or ADSs by a non-resident of Japan or a non-Japanese corporation are in general not subject to Japanese income or corporation taxes. In addition, gains derived from the sale of shares or ADSs within Japan by a non-resident of Japan or a non-Japanese corporation not having a permanent establishment in Japan are in general not subject to Japanese income or corporation taxes. An individual who has acquired shares

or ADSs as a distributee, legatee or donee may have to pay Japanese inheritance and gift taxes at progressive rates.

IIJ has paid or will pay any stamp, registration or similar tax imposed by Japan in connection with the issue of the shares, except that IIJ will not pay any tax payable in connection with the transfer or sale of the shares by a holder thereof.

United States Taxation

The following discusses United States federal income tax consequences of the ownership of shares or ADSs. It only applies to you if you purchase your shares or ADSs through this offering and hold your shares or ADSs as capital assets. It does not address special classes of holders, some of whom may be subject to other rules including:

- tax-exempt entities,
- certain insurance companies,
- broker-dealers,
- traders in securities that elect to mark to market,
- investors liable for alternative minimum tax,
- investors that actually or constructively own 10% or more of the voting stock of IIJ,
- investors that hold shares or ADSs as part of a straddle or a hedging or conversion transaction, or
- investors whose functional currency is not the U.S. dollar.

This discussion is based on the tax laws of the United States, including the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations, and administrative and judicial interpretations, as currently in effect, as well as on the Treaty. These laws are subject to change, possibly on a retroactive basis. In addition, this discussion is based in part upon the representations of the depositary and the assumption that each obligation in the deposit agreement relating to the ADRs and any related agreement will be performed in accordance with its terms.

For purposes of this discussion, a “U.S. holder” is a beneficial owner of shares or ADSs that is:

- a citizen or resident of the United States,
- a domestic corporation,
- an estate whose income is subject to United States federal income tax regardless of its source, or
- a trust if a United States court can exercise primary supervision over the trust’s administration and one or more United States persons are authorized to control all substantial decisions of the trust.

A “non-U.S. holder” is a beneficial owner of shares or ADSs that is not a United States person for United States federal income tax purposes.

This discussion addresses only United States federal income taxation. You should consult your own tax advisor regarding the United States federal, state and local and other tax consequences of owning and disposing of shares and ADSs in your particular circumstances.

In general, and taking into account the earlier assumptions, for United States federal income tax purposes, if you hold ADRs evidencing ADSs, you will be treated as the owner of the shares represented by those ADSs. Exchanges of shares for ADSs, and ADSs for shares, generally will not be subject to United States federal income tax.

The discussion under the headings Taxation of Dividends and Taxation of Capital Gains assumes that we will not be treated as a Passive Foreign Investment Company (PFIC) for U.S. federal income tax purposes. For a discussion of the rules that apply if we are treated as a PFIC, see the discussion under the heading below “PFIC Rules.”

Taxation of Dividends

U.S. Holders. Under the United States federal income tax laws if you are a U.S. holder, you must include in your gross income the gross amount of any dividend paid by IJ out of its current or accumulated earnings and profits, as determined for United States federal income tax purposes. You must

include any Japanese tax withheld from the dividend payment in this gross amount even though you do not in fact receive it.

The dividend is ordinary income that you must include in income when you, in the case of shares, or the depositary, in the case of ADSs, receive the dividend, actually or constructively. The dividend will not be eligible for the dividends-received deduction.

The amount of the dividend distribution that you must include in your income as a U.S. holder will be the U.S. dollar value of the Japanese yen payments made, determined at the spot Japanese yen/U.S. dollar rate on the date the dividend distribution is includible in your income, regardless of whether the payment is in fact converted into U.S. dollars. Generally, any gain or loss resulting from currency exchange fluctuations during the period from the date you include the dividend payment in income to the date you convert the payment into U.S. dollars will be treated as ordinary income or loss. The gain or loss generally will be from sources within the United States for foreign tax credit limitation purposes.

Distributions in excess of current and accumulated earnings and profits, as determined for United States federal income tax purposes, will be treated as a return of capital to the extent of your basis in the shares or ADSs and thereafter as capital gain.

Subject to certain limitations, the Japanese tax withheld in accordance with the Treaty and paid over to Japan will be creditable against your United States federal income tax liability. To the extent a refund of the tax withheld is available to you under Japanese law or under the Treaty, the amount of tax withheld that is refundable will not be eligible for credit against your United States federal income tax liability. Please see “Japanese Taxation”, above, for the procedures for obtaining a tax refund.

Dividends constitute income from sources outside the United States, but generally will be “passive income” or, if received by financial institutions, “financial services income”. Passive income or financial

services income must be treated separately from other types of income for purposes of computing the foreign tax credit allowable to you.

Distributions of additional shares to you with respect to shares or ADSs that are made as part of a pro rata distribution to all shareholders of IJJ generally will not be subject to United States federal income tax.

Non-U.S. Holders. If you are a non-U.S. holder, dividends paid to you in respect of shares or ADSs will not be subject to United States federal income tax unless “effectively connected” with your conduct of a trade or business within the United States, and the dividends are attributable to a permanent establishment that you maintain in the United States, if that is required by an applicable income tax treaty as a condition for subjecting you to United States taxation on a net income basis. In such cases you will be taxed in the same manner as a U.S. holder. If you are a corporate non-U.S. holder, “effectively connected” dividends may, under certain circumstances, be subject to an additional “branch profits tax” at a 30% rate or at a lower rate if you are eligible for the benefits of an income tax treaty that provides for a lower rate.

Taxation of Capital Gains

U.S. Holders. If you are a U.S. holder and sell or otherwise dispose of your shares or ADSs, you will recognize capital gain or loss for United States federal income tax purposes equal to the difference between the U.S. dollar value of the amount that you realize and your tax basis, determined in U.S. dollars, in your shares or ADSs. Capital gain of a noncorporate U.S. holder is generally taxed at a maximum rate of 20% for property held more than one year. Additionally, gain or loss will generally be from sources within the United States for foreign tax credit limitation purposes.

Non-U.S. Holders. If you are a non-U.S. holder, you will not be subject to United States federal income tax on gain recognized

on the sale or other disposition of your shares or ADSs unless:

- the gain is “effectively connected” with your conduct of a trade or business in the United States, and the gain is attributable to a permanent establishment that you maintain in the United States, if that is required by an applicable income tax treaty as a condition for subjecting you to United States taxation on a net income basis, or
- you are an individual, you are present in the United States for 183 or more days in the taxable year of the sale and certain other conditions exist.

If you are a corporate non-U.S. holder, “effectively connected” gains, that you recognize may also, under certain circumstances, be subject to an additional “branch profits tax” at a 30% rate or at a lower rate if you are eligible for the benefits of an income tax treaty that provides for a lower rate.

PFIC Rules

We do not believe that we will be treated as a PFIC for United States federal income tax purposes for our most recent taxable year. However, this conclusion is a factual determination made annually and thus may be subject to change. Because of the nature of our income and assets, including our use of the proceeds of this offering, we could be determined to be a PFIC for our current and subsequent taxable years.

In general, if you are a U.S. holder, we will be a PFIC with respect to you if for any of our taxable years in which you held our ADSs or shares:

- at least 75% of our gross income for the taxable year is passive income or
- at least 50% of the value, determined on the basis of a quarterly average, of our assets are attributable to assets that produce or are held for the production of passive income.

Passive income generally includes dividends, interest, royalties, rents, other than certain rents and royalties derived in the active conduct of a trade or business, annuities and gains from assets that produce

passive income. If a foreign corporation owns at least 25% by value of the stock of another corporation, the foreign corporation is treated for purposes of the PFIC tests as owning its proportionate share of the assets of the other corporation, and as receiving directly its proportionate share of the other corporation's income.

If we are treated as a PFIC, and you are a U.S. holder that did not make a mark-to-market election, as described below, you will be subject to special rules with respect to:

- any gain you realize on the sale or other disposition of your shares or ADSs and
- any "excess distribution" that we make to you, generally, any distributions to you during a single taxable year that are greater than 125% of the average annual distributions received by you in respect of the shares or ADSs during the three preceding taxable years or, if shorter, your holding period for the shares or ADSs.

Under these rules:

- the gain or excess distribution will be allocated ratably over your holding period for the shares or ADSs,
- the amount allocated to the taxable year in which you realized the gain or excess distribution will be taxed as ordinary income,
- the amount allocated to each prior year, with certain exceptions, will be taxed at the highest tax rate in effect for that year, and
- the interest charge generally applicable to underpayments of tax will be imposed in respect of the tax attributable to each such year.

Special rules apply for calculating the amount of the foreign tax credit with respect to excess distributions by a PFIC.

If you own shares or ADSs in a PFIC that are treated as "marketable stock," you may also make a mark-to-market election. If you make this election, you will not be subject to the PFIC rules described above. Instead, in general, you will include as ordinary income each year the excess, if any, of the fair market value of your shares or ADSs at the end of the taxable year over your adjusted

basis in your shares or ADSs, and you will recognize the additional gain, if any, on sale or other disposition of your shares or ADSs as ordinary income for that taxable year. You will also be allowed to take an ordinary loss in respect of the excess, if any, of the adjusted basis of your shares or ADSs over their fair market value at the end of the taxable year or over their final sale or disposition prices, but only to the extent of the net amount of previously included income as a result of the mark-to-market election. Your basis in the shares or ADSs will be adjusted to reflect any such income or loss amounts. For purposes of this election, if the ADSs are regularly traded on Nasdaq, the ADSs should be considered as marketable stock.

If you own shares or ADSs during any year that IJ is a PFIC you must file Internal Revenue Service Form 8621.

Backup Withholding and Information Reporting

In general, dividend payments, or other taxable distributions, made within the United States to a non-corporate United States person, will be subject to information reporting requirements and "backup withholding" tax at the rate of 31% if you:

- fail to provide an accurate taxpayer identification number,
- are notified by the Internal Revenue Service that you have failed to report all interest or dividends required to be shown on your federal income tax returns, or
- in certain circumstances, if you fail to comply with applicable certification requirements.

Persons that are not United States persons may be required to establish their exemption from information reporting and backup withholding by certifying their status on Internal Revenue Service Forms W-8.

If you sell your shares or ADSs to or through a United States office of a broker, the payment of the proceeds is subject to both United States backup withholding and information reporting unless you certify that you are a non-U.S. person, under penalties of

perjury, or you otherwise establish an exemption. If you sell your shares or ADS through a non-U.S. office of a non-U.S. broker and the sale proceeds are paid to you outside the United States then information reporting and backup withholding generally will not apply to that payment. However, United States information reporting requirements, but not backup withholding, will apply to a payment of sales proceeds, even if that payment is made to you outside the United States, if you sell your shares or ADSs through a non-U.S. office of a broker that:

- is a United States person,
- derives 50% or more of its gross income for a specified three-year period from the conduct of a trade or business in the United States,
- is a “controlled foreign corporation” as to the United States, or
- with respect to payments made after December 31, 2000, is a foreign

partnership, if at any time during its tax year,

- one or more of its partners are U.S. persons, as defined in U.S. Treasury regulations, who in the aggregate hold more than 50% of the income or capital interest in the partnership, or
- such foreign partnership is engaged in a United States trade or business, unless the broker has documentary evidence in its records that the holder is a non-United States person or otherwise establishes an exemption.

You generally may obtain a refund of any amounts withheld under the backup withholding rules that exceed your income tax liability by filing a refund claim with the United States Internal Revenue Service.

WHERE YOU CAN FIND MORE INFORMATION

We have filed with the SEC a Registration Statement on Form F-1 under the Securities Act with respect to the securities offered hereby. This prospectus does not contain all the information set forth in that Registration Statement and the exhibits and schedules thereto. For further information with respect to IJ and the ADSs to be sold in the offering, please refer to the Registration Statement and to the exhibits and schedules filed therewith. In addition, wherever a reference is made in this prospectus to a contract or other document of IJ, please be aware that such reference is not necessarily complete and that you should refer to the exhibits and schedules that are a part of the Registration Statement for a copy of the contract or other document.

You may review a copy of the Registration Statement without charge at the SEC's public reference room at 450 Fifth Street, N.W., Washington, D.C. 20549 and at the SEC's regional offices located at 7 World Trade Center, Suite 1300, New York, New York 10048 and 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. You may also get copies of all or any portion of the

Registration Statement from the public reference room, the regional offices or by calling the SEC at 1-800-SEC-0330 or by writing the SEC upon payment of a prescribed fee.

Upon completion of the offering, we will be subject to the informational requirements of the Exchange Act and, in accordance therewith, we will file annual reports on Form 20-F within six months of our fiscal year-end and other reports and information on Form 6-K with the SEC. These other reports will include quarterly reports that are not required by the SEC but which we will furnish to the SEC on a voluntary basis, although we could discontinue this practice at any time. These reports and other information can be inspected at the public reference room at the SEC and at the SEC regional offices listed above. You can also obtain copies of such material from the public reference room, the regional offices or by calling or writing the SEC upon payment of a prescribed fee. As a foreign private issuer, we are exempt from the rules under the Securities Exchange Act of 1934 prescribing the furnishing and content of proxy statements to shareholders.

VALIDITY OF SECURITIES

The validity of the ADSs offered hereby will be passed upon for IJ by Sullivan & Cromwell. The validity of the shares of common stock underlying the ADSs will be

passed upon for IJ by Asahi Law Offices. Certain legal matters will be passed upon for the Underwriters by Davis Polk & Wardwell and Mitsui, Yasuda, Wani & Maeda.

EXPERTS

The consolidated financial statements of IJ included in this prospectus have been audited by Deloitte Touche Tohmatsu, independent auditors, as stated in their report

appearing herein, given upon their authority and included in reliance upon the report of such firm as experts in accounting and auditing.

GLOSSARY

Set forth below are definitions of some of the terms used in this prospectus.

ATM	Asynchronous Transfer Mode. ATM is a high bandwidth, low-delay, high speed transmission technology. ATM is a communications standard that provides for information transfer in the form of fixed-length cells of 53 bytes each. The ATM format can be used to deliver voice, video and data traffic at varying rates.
Backbone	A centralized high-speed network that interconnects smaller, independent networks.
Bandwidth.....	The number of bits of information which can move over a communications medium in a given amount of time. Typically measured in kbps and Mbps.
Bit	Bit stands for binary digit. A bit is the smallest unit of information a computer can process. A single bit can have a value of "0" or "1" and normally, seven or eight bits are used to represent an alpha-numeric character on computers. The bit is the basic unit of data communications.
bps	Bits per second. A measure of digital information transmission rates. A rate of one bps can transmit one bit in a second.
Co-location.....	A service whereby a service provider placed customers' servers and/or network equipment on its premises.
CSU/DSU.....	Channel Service Unit/Digital Service Unit. A device used in digital transmission for connecting data terminal equipment, such as a router, to a digital transmission circuit or service.
Dedicated line	Telecommunications lines dedicated or reserved for use by particular customers along predetermined routes.
Dial-up line	Communications circuit that is established on demand by a switched-circuit connection using the telephone network.
DNS	Domain Name System. A distributed database system for translating computer names into IP addresses and vice-versa.
DWDM	See WDM.
Electronic mail or e-mail	An application that allows a user to send or receive multimedia messages to or from any other user with an Internet address, commonly termed an e-mail address.
Frame relay	A communications standard that is optimized for efficient switching of variable-length data packets.
Gbps	Gigabits per second. A measure of digital information transmission rates. One Gbps equals 1,000 Mbps or one billion bps. At a transmission rate of 1 Gbps, you could receive this entire prospectus in less than one second.
Host	A computer with direct access to the Internet.
HTML.....	Hyper Text Markup Language. An authoring software language used on the World Wide Web.

Internet	The open global network of interconnected commercial, educational and governmental computer networks which utilize TCP/IP, a common communications protocol.
Intranet	A TCP/IP based network and Web site which is securely isolated from the Internet and serves the internal needs of a company or institution.
IP	Internet protocol.
ISDN.....	Integrated Services Digital Network. An integrated network service that provides digital voice, fax and data services through a single medium.
ISP	Internet service provider.
kbps	Kilobits per second. A measure of digital information transmission rates. One kbps equals 1,000 bps or one thousand bps.
LAN	Local Area Network. A data communications network designed to interconnect personal computers, workstations, minicomputers, file servers and other communications and computing devices within a localized environment.
Mbps	Megabits per second. A measure of digital information transmission rates. One Mbps equals 1,000 kbps or one million bps.
Network.....	A collection of distributed computers which share data and information through inter-connected lines of communication.
NOC	Network operation center. Serves as a focal point for monitoring network traffic, quality of service and security.
On-line services	Commercial information services that offer a computer user access to a specified slate of information, entertainment and communications menus. These services are generally closed systems, although many are now offering full Internet access.
Peering	The commercial practice under which nationwide ISPs exchange each other's traffic.
POPs	Points-of-presence. An interlinked group of modems, routers and other computer equipment, located in a particular city or metropolitan area, that allows a nearby subscriber to access the Internet through a local telephone call or using a short-distance permanent data circuit. Essentially, a POP is where customers enter our network.
Protocol.....	A formal description of message formats and the rules two or more machines must follow in order to communicate.
Router	A device that forwards data packets between interconnected network segments.
SDH	Synchronous Digital Hierarchy. A set of standard fiber-optic-based serial standards planned for use with SONET and ATM in Europe. Some of the SDH and SONET standards are identical. Standardized by the ITU.

Server	Software that allows a computer to offer a service to another computer. Other computers contact the server program by means of matching client software. The term also refers to the computer on which server software runs.
SONET	Synchronous Optical Network. The North American Synchronous Optical Network standard for telecommunications transmission using fiber-optic cables. It provides a uniform set of protocols for the management of high bandwidth services, including a multiplexing structure.
TCP/IP	Transmission Control Protocol/Internet Protocol. A compilation of network and transport-level protocols that allow computers with different architectures and operating system software to communicate with other computers on the Internet.
UNIX.....	A computer operating system mainly for workstations and personal computers and noted for its portability and communications functionality.
UUCP	Unix-to-Unix copy mechanism. It is usually used for delivering e-mail and Netnews on the Internet.
VoIP	Voice over internet protocol.
WAN.....	Wide Area Network. A network spanning a wide geographic area.
WDM, DWDM	Wavelength Division Multiplexing. A transmission technology which multiplexes several optical signals with differing wavelengths into a single optical fiber medium. This technology enables significant increases in the volume of information conveyed via an optical cable. DWDM is Dense WDM.
Web or World Wide Web (WWW)	A network of computer servers that uses a special communications protocol to link different servers throughout the Internet and permits communication of graphics, video and sound.
Web server.....	The computer system that runs Web software, used to create custom Web sites, Web pages, and home pages.
Web sites or Web pages	A site located on the Web, written in the HTML.
xDSL	A term referring to a variety of new Digital Subscriber Line technologies such as SDSL/ADSL/HDSL/VDSL. Some of these varieties are asymmetric with different data rates in the downstream and upstream directions. Others are symmetric. Downstream speeds range: from 160 kbps to 2 Mbps (SDSL); from 1.5 Mbps to 9 Mbps (ADSL).

**INTERNET INITIATIVE JAPAN INC.
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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of
Internet Initiative Japan Inc.:

We have audited the accompanying consolidated balance sheets of Internet Initiative Japan Inc. as of March 31, 1998 and 1999, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended March 31, 1999 (all expressed in Japanese yen). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material aspects, the financial position of the Company as of March 31, 1998 and 1999, and the results of its operations and its cash flows for each of the three years in the period ended March 31, 1999, in conformity with accounting principles generally accepted in the United States of America.

Our audit also comprehended the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 1. Such U.S. dollar amounts are presented solely for the convenience of readers outside Japan.

DELOITTE TOUCHE TOHMATSU

Tokyo, Japan
May 21, 1999

LIABILITIES AND SHAREHOLDERS' EQUITY	Thousands of Yen		Thousands of U.S. Dollars (Note 1)
	1998	1999	1999
Current Liabilities:			
Short-term borrowings (Note 7)	¥2,440,000	¥ 6,678,717	\$ 56,394
Accounts payable (Note 3)	367,316	1,666,317	14,070
Accrued expenses	146,142	145,261	1,226
Other current liabilities	187,068	122,728	1,036
Long-term borrowings—current portion (Note 7)	64,000	572,000	4,830
Capital lease obligations—current portion (Note 6)	1,077,644	1,283,298	10,836
Total current liabilities	4,282,170	10,468,321	88,392
Long-Term Borrowings (Note 7)	1,162,000	690,000	5,826
Capital Lease Obligations—Noncurrent (Note 6)	1,766,806	1,460,763	12,334
Accrued Retirement and Pension Costs (Note 9)	49,817	82,269	695
Deferred Tax Liabilities—Noncurrent (Note 8)	31,977	932	8
Total liabilities	7,292,770	12,702,285	107,255
Minority Interest	178,327	171,818	1,451
Commitments and Contingencies (Notes 3 and 6)			
Shareholders' Equity (Notes 10 and 11):			
Common stock, ¥50,000 par value— authorized, 52,000 shares; issued and outstanding, 18,880 shares (including 100 shares held as treasury shares at March 31, 1998)	1,100,000	1,100,000	9,288
Additional paid-in capital	619,118	651,906	5,505
Retained earnings (deficit)	151,081	(1,277,611)	(10,788)
Accumulated other comprehensive income ..	7,668	10,640	90
Treasury stock	(9,799)		
Total shareholders' equity	1,868,068	484,935	4,095
Total	¥9,339,165	¥13,359,038	\$112,801

INTERNET INITIATIVE JAPAN INC.
Consolidated Statements of Operations
Three Years in the Period Ended March 31, 1999

	Thousands of Yen			Thousands of U.S. Dollars (Note 1)
	1997	1998	1999	1999
Connectivity Services and Other				
Revenues (Notes 3 and 13):				
Dedicated access revenues	¥4,291,502	¥ 6,755,402	¥ 7,797,457	\$ 65,840
Dial-up access revenues	3,477,528	4,474,333	4,101,291	34,630
Other revenues	764,427	1,093,183	2,870,102	24,235
Total	<u>8,533,457</u>	<u>12,322,918</u>	<u>14,768,850</u>	<u>124,705</u>
Cost and Expenses:				
Cost of connectivity services and other revenues (Notes 3, 6 and 13)	5,526,662	9,403,385	13,202,375	111,478
Sales and marketing (Note 13)	1,211,192	1,508,201	1,569,731	13,255
General administrative	891,821	938,936	1,065,119	8,994
Research and development	103,549	152,362	242,575	2,048
Total cost and expenses	<u>7,733,224</u>	<u>12,002,884</u>	<u>16,079,800</u>	<u>135,775</u>
Operating income (loss)	<u>800,233</u>	<u>320,034</u>	<u>(1,310,950)</u>	<u>(11,070)</u>
Other Income (Expenses):				
Interest income	4,972	6,834	4,035	34
Interest expense	(119,859)	(215,909)	(218,583)	(1,845)
Other—net	(30,099)	(34,754)	15,349	130
Other expenses—net	<u>(144,986)</u>	<u>(243,829)</u>	<u>(199,199)</u>	<u>(1,681)</u>
Income (Loss) before Income Taxes, Minority Interests in Consolidated Subsidiaries and Equity in Net Loss of Affiliated Companies	655,247	76,205	(1,510,149)	(12,751)
Income Taxes (Note 8)	376,969	289,453	15,320	129
Minority Interests in Consolidated Subsidiaries	(31,334)	(41,657)	122,866	1,037
Equity in Net Loss of Affiliated Companies (Note 3)	<u>(43,665)</u>	<u>(105,312)</u>	<u>(26,089)</u>	<u>(220)</u>
Net Income (Loss)	<u>¥ 203,279</u>	<u>¥ (360,217)</u>	<u>¥(1,428,692)</u>	<u>\$ (12,063)</u>
Weighted-Average Common Shares Outstanding	15,000	15,286	18,868	
		Yen		U.S. Dollars
Basic and Diluted Net Income (Loss) per Common Share	¥13,552	¥(23,565)	¥(75,720)	\$(639)

See notes to consolidated financial statements.

INTERNET INITIATIVE JAPAN INC.

Consolidated Statements of Shareholders' Equity
Three Years in the Period Ended March 31, 1999

	Shares of Common Stock Outstanding (including treasury stock)	Thousands of Yen					Total
		Common Stock	Paid-in Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss) (Note 11)	Treasury Stock	
Balance, April 1, 1996	15,000	¥ 750,000	¥102,000	¥ 308,019	¥ 4,029		¥1,164,048
Net income				203,279			203,279
Other comprehensive income, net of tax					(6,214)		(6,214)
Total comprehensive income							197,065
Balance, March 31, 1997	15,000	750,000	102,000	511,298	(2,185)		1,361,113
Net loss				(360,217)			(360,217)
Other comprehensive income, net of tax					9,853		9,853
Total comprehensive income							(350,364)
Common stock issued to minority shareholders	1,840	92,000	114,925			¥(58,500)	148,425
Sale of treasury stock			73,548			48,701	122,249
Exercise of detachable warrants	1,000	50,000	50,000				100,000
Private placement	1,040	208,000	208,000				416,000
Increase in paid-in capital, upon the purchase of new shares of a subsidiary by minority shareholders			70,645				70,645
Balance, March 31, 1998	18,880	1,100,000	619,118	151,081	7,668	(9,799)	1,868,068
Net loss				(1,428,692)			(1,428,692)
Other comprehensive income, net of tax					2,972		2,972
Total comprehensive income							(1,425,720)
Sale of treasury stock			32,788			9,799	42,587
Balance, March 31, 1999	<u>18,880</u>	<u>¥1,100,000</u>	<u>¥651,906</u>	<u>¥(1,277,611)</u>	<u>¥10,640</u>	<u>Nil</u>	<u>¥ 484,935</u>

Thousands of U.S. Dollars (Note 1)

	Common Stock	Paid-in Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Note 11)	Treasury Stock	Total
Net loss			(12,063)			(12,063)
Other comprehensive income, net of tax				25		25
Total comprehensive income						(12,038)
Sale of treasury stock		277			83	360
Balance, March 31, 1999	<u>\$9,288</u>	<u>\$5,505</u>	<u>\$(10,788)</u>	<u>\$90</u>	<u>Nil</u>	<u>\$ 4,095</u>

See notes to consolidated financial statements.

INTERNET INITIATIVE JAPAN INC.
Consolidated Statements of Cash Flows
Three Years in the Period Ended March 31, 1999

	Thousands of Yen			Thousands of U.S. Dollars (Note 1)
	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>1999</u>
Operating Activities:				
Net income (loss)	¥ 203,279	¥(360,217)	¥(1,428,692)	\$(12,063)
Adjustment to reconcile net income (loss) to net cash provided by operating activities:				
Depreciation and amortization	555,829	1,127,607	1,421,693	12,005
Provision for retirement and pension costs, less payments	18,175	24,382	32,452	274
Loss on disposal of property and equipment	3,235	30,820	1,574	13
Write-down of marketable securities ..	14,625	7,157		
Gain on sale of investments			2,975	25
Equity in net loss of affiliated companies	43,665	105,312	26,091	220
Minority interest in net income of consolidated subsidiaries	31,334	41,657	(122,866)	(1,037)
Deferred income taxes	(179,039)	123,113	3,732	31
Increase in accounts receivable	(538,891)	(521,408)	(824,301)	(6,960)
Decrease (increase) in inventories, prepaid expenses and other current assets	(164,376)	153,041	(50,488)	(426)
Increase in accounts payable	14,191	1,536	1,299,001	10,968
Decrease in income taxes payable (increase in refundable income taxes)	46,937	(476,966)	97,163	820
Increase (decrease) in accrued expenses and other current liabilities	170,264	35,572	(58,264)	(492)
Net cash provided by operating activities	<u>219,228</u>	<u>291,606</u>	<u>400,070</u>	<u>3,378</u>
Investing Activities:				
Purchases of property and equipment ..	(248,154)	(353,250)	(759,750)	(6,415)
Investments in and advances to affiliated companies	(422,761)	(222,050)	(2,560,000)	(21,616)
Purchases of other investments	(35,000)	(197,329)	(186,473)	(1,575)
Proceeds from sale of investments			59,260	500
Payments of guarantee deposits	(583,957)	(41,052)	(83,596)	(706)
Refund of guarantee deposits	27,535	257,671	1,972	17
Refund of insurance policies	5,113	318,043	95,802	809
Payment for refundable insurance policies	(363,694)	(218,097)	(230,878)	(1,949)

	Thousands of Yen			Thousands of U.S. Dollars (Note 1)
	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>1999</u>
Cash in a new subsidiary contributed by minority shareholders		180,000		
Other	(73,896)	(23,972)	(31,345)	(265)
Net cash used in investing activities	(1,694,814)	(300,036)	(3,695,008)	(31,200)
Financing Activities:				
Proceeds from issuance of long-term borrowings	700,000	590,000	100,000	844
Repayments of long-term borrowings		(64,000)	(64,000)	(540)
Redemption of bond	(100,000)			
Principal payments under capital leases	(506,354)	(1,015,972)	(1,260,813)	(10,646)
Net increase in short-term borrowings ...	1,180,000	560,000	4,238,717	35,791
Proceeds from issuance of common stock, including exercise of warrants		516,000		
Proceeds from sale of treasury stock		198,800	40,000	338
Proceeds from issuance of subsidiary stock			132,100	1,115
Net cash provided by financing activities	1,273,646	784,828	3,186,004	26,902
Effect of Exchange Rate Changes on Cash				
	382	5,748	12,451	105
Net Increase (Decrease) in Cash	(201,558)	782,146	(96,483)	(815)
Cash, Beginning of Year	577,383	375,825	1,157,971	9,778
Cash, End of Year	¥ 375,825	¥1,157,971	¥ 1,061,488	\$ 8,963
Additional Cash Flow Information:				
Interest paid	¥ 112,931	¥ 217,021	¥ 225,571	\$ 1,905
Income taxes paid (refund)	508,949	642,846	(97,702)	(825)
Noncash Investing and Financing Activities:				
Acquisition of assets by entering into capital leases	2,253,121	1,342,724	1,169,150	9,872
Net assets acquired from minority shareholders by issuance of common stock		148,425		

See notes to consolidated financial statements.

INTERNET INITIATIVE JAPAN INC.

Notes to Consolidated Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Internet Initiative Japan Inc. ("IIJ") was founded in December 1992 to develop and operate Internet access services and other Internet-related services in Japan. IIJ and its subsidiaries (collectively the "Company") provide Internet access services throughout Japan and into the United States of America and into the rest of Asia through a direct connection to the A-Bone, an Internet backbone connecting the countries in the Asian Pacific region. The Company also provides Internet systems design and integration representing principally sales of Internet network systems and equipment and miscellaneous Internet access-related services.

The Company manages its business and measures results based on a single Internet-related services industry segment which generates substantially all of its revenues from its customers operating in Japan.

The Company has incurred net losses for the last two years as it built its customer base and network and at March 31, 1999 has a negative working capital position. The Company intends to fund its future cash flow requirements through capital raising activities, continuing bank financing and/or funding from other sources, including its existing shareholders. If these efforts are not successful, future operations of the Company will be adversely affected.

Basis of Financial Statements—The consolidated financial statements, stated in Japanese yen, reflect certain adjustments not recorded on the accounting books of IIJ. Such adjustments are included to present the statements in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). The principal adjustments relate to: (1) accounting for leases, (2) accounting for treasury stock transactions, (3) accrual of certain expenses, (4) recognition of deferred income taxes on temporary differences and operating loss carry-forward and related valuation allowance, (5) refundable insurance policies and (6) foreign currency transactions.

Translation into U.S. Dollars—IIJ maintains their accounts in Japanese yen, the currency of the country in which it is incorporated and principally operates. The U.S. dollar amounts included herein represent a translation using the approximate exchange rate at March 31, 1999 of ¥118.43 = \$1 solely for convenience. The translation should not be construed as a representation that the yen amounts have been, could have been, or could in the future be converted into U.S. dollars.

Consolidation—The consolidated financial statements include the accounts of IIJ and two of its subsidiaries, Net Care, Inc. and IIJ America, Inc. Although IIJ does not have a direct majority voting interest in these subsidiaries, it exercises control through a significant minority interest, a majority of directors and additional indirect ownership. Effective February 2, 1998, IIJ acquired the remaining minority ownership interest of five of its local marketing subsidiaries, by issuing new shares, which have been consolidated for all periods presented. The increase in equity in net assets of subsidiaries resulting from purchase of its new shares by minority shareholders are included in additional paid-in capital. Significant intercompany transactions and balances have been eliminated in consolidation. Investments in companies over which IIJ has significant influence but not control are accounted for under the equity method.

Concentrations of Credit Risk—Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash investments, accounts receivable, guarantee deposits and refundable insurance policies. The Company management believes that the risks associated with accounts receivable is mitigated by the large number of customers comprising its customer base.

Sources of Supplies—The Company relies on telecommunications carriers to provide long-distance lines for backbone and local connections to customers and third-party suppliers for the use of hardware components like routers and servers.

INTERNET INITIATIVE JAPAN INC.

Notes to Consolidated Financial Statements—(Continued)

The Company believes that its use of multiple carriers, suppliers and alternative facilities significantly mitigate concentrations of credit risk.

However, any disruption of telecommunication services or the inability of suppliers to deliver hardware components on a timely basis or to develop alternative sources of components could have an adverse effect on operating results.

Use of Estimates—The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Significant estimates and assumptions used are primarily in the areas of valuation allowances for deferred tax assets and allowance for doubtful accounts. Actual results could differ from those estimates.

Revenue Recognition—Revenues from customer connectivity services consist principally of dedicated Internet access services and dial-up Internet access services. Dedicated Internet access services represent full-line IP services and standard-level IP services (IIJ Economy). Dial-up Internet access services are provided to both enterprises and individuals (IIJ4U). The term of these contracts is for one or three year periods for dedicated Internet access services and generally one month for dial-up Internet access services. All these services are billed and recognized monthly on a straight-line basis. Setup fees in connection with these connectivity services are recognized when the setup is completed.

Other revenues consist principally of sales of Internet network systems and equipment, and other miscellaneous Internet access related services such as Firewalls and co-location services. Revenues are recognized when network systems and equipment are delivered and accepted by the customer. Other services are recognized as completed or on a straight-line basis during the service period. Also included in other revenues are sales of network systems to Crosswave Communications Inc. (“Crosswave”), an affiliated company, for the year ended March 31, 1999.

Inventories—Inventories consist of routers held for resale and for marketing purposes and are carried at the average cost, which approximate market values.

Property and Equipment—Property and equipment are recorded at cost. Depreciation and amortization of property and equipment, including purchased software and capitalized leases, are computed principally using the straight-line method based on either the estimated useful lives of assets or the lease period, whichever is shorter.

Guarantee Deposits and Refundable Insurance Policies—Guarantee deposits substantially consist of refundable base lease deposits for office premises.

Refundable insurance policies represent a refundable portion of life insurance policies for officers and employees and are recorded on a cash-surrender basis. During April 1999 the Company canceled several policies and received ¥540,171 thousand (\$4,561 thousand) as refunds.

Long-Lived Assets—Long-lived assets consist principally of property and equipment, including those items leased under capital leases. The Company evaluates the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. There was no impairment loss for long-lived assets for the three years in the period ended March 31, 1999.

Income Taxes—The provision for income taxes is based on earnings before income taxes and includes the effects of temporary differences between assets and liabilities recognized for financial reporting purposes and income tax purposes. Valuation allowances are provided against assets which are not likely to be realized.

INTERNET INITIATIVE JAPAN INC.

Notes to Consolidated Financial Statements—(Continued)

Retirement and Pension Plans—IIJ has unfunded retirement benefits and noncontributory defined benefit pension plans which together cover substantially all of its employees who are not directors. The cost of the employees' benefits plans is accrued based on actuarially determined amounts. IIJ also participates in a contributory multi-employer pension plan, the Japan Computer Information Service Employee's Pension Fund (the "Multi-Employer Plan"), covering substantially all of its employees, under which the net pension cost is recognized when contributions become due.

Foreign Currency Transactions—Foreign currency assets and liabilities, which consist substantially of accounts payable for the payment of connectivity leases to international carriers, are stated at the amount as computed by using year-end exchange rates and the resulting transaction gain or loss is recognized in earnings. Gain or losses on foreign exchange forward contracts which are designated and effective as hedges of identifiable commitments (see Note 12) are deferred and included in the measurement of the related transactions.

Advertising—Advertising costs are expensed as incurred.

Basic and Diluted Net Income (Loss) per Share—In February 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share" which replaced the calculation of primary and fully diluted earnings per share with basic and diluted earnings per share. Basic and diluted net income (loss) per share is computed using the weighted average number of shares of common stock outstanding during the year. There were no significant dilutive securities during the years presented.

Other Comprehensive Income—Other comprehensive income consists of translation adjustment resulting from the translation of financial statements of a foreign subsidiary and unrealized gains or losses on available-for-sale marketable securities.

New Accounting Standards—In June 1998, FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards for derivative instruments and for hedging activities. SFAS No. 133 requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or losses or other comprehensive income (loss), depending on whether a derivative is designated as part of a hedge transaction and the type of hedge transaction. The ineffective portion of all hedges will be recognized in earnings. The Company will adopt SFAS No. 133 during the fiscal year in which the statement becomes effective. Currently, the effect on the Company's consolidated financial statements of adopting SFAS No. 133 has not been determined.

2. ALLOWANCE FOR DOUBTFUL ACCOUNTS

An analysis of allowance for doubtful accounts for the years ended March 31, 1997, 1998 and 1999, is as follows:

	Thousands of Yen		
	Balance at Beginning of Year	Provision for Doubtful Accounts	Balance at End of Year
Year ended March 31, 1997	¥ 7,295	¥3,099	¥10,394
Year ended March 31, 1998	¥10,394	¥3,003	¥13,397
Year ended March 31, 1999	¥13,397	¥ 569	¥13,966
Year ended March 31, 1999	\$113	\$5	\$118

INTERNET INITIATIVE JAPAN INC.

Notes to Consolidated Financial Statements—(Continued)

3. INVESTMENTS IN AND ADVANCES TO AFFILIATED COMPANIES

IIJ utilizes various business units in Japan and neighboring countries to form and operate its Internet business. Businesses operated by the non-consolidated investees include Internet connectivity services in Asian countries (Asia Internet Holding Co., Ltd., "AIH"), network integration services (IIJ Technology Inc., "Technology"), www server configuration, Web hosting, content production and home page services (IIJ Media Communications Inc.), Web page design services (atom Co., Ltd.), multifeed technology services and providing a location and facilities for connecting high-speed Internet backbones (Internet Multifeed Co., "Multifeed") and providing dedicated high-speed, data communication services (Crosswave).

These entities have various minority shareholders with individual ownership percentages ranging from 21% to 50%. As the Company has significant influence over the investees' business planning and execution, such investments are accounted for under the equity method.

Transactions between the Company and the affiliates include IIJ's sale of network systems to Crosswave in the amount of ¥1,080,083 thousand (\$9,120 thousand) for the year ended March 31, 1999, of which cost of purchased equipment sold amounted to ¥1,069,282 thousand (\$9,029 thousand). In addition, there are other transactions with affiliated companies for cost of subcontracting services by IIJ Technology Inc., and Internet access cost and revenues with AIH.

The aggregate amounts of balances and transactions of the Company with these affiliated companies as of March 31, 1998 and 1999 and for each of the three years in the period ended March 31, 1999, were summarized as follows:

	<u>Thousands of Yen</u>			<u>Thousands of U.S. Dollars</u>
	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>1999</u>
Accounts receivable		¥ 57,359	¥ 45,835	\$ 387
Accounts payable		45,351	748,599	6,321
Revenues	¥ 16,466	135,778	1,470,196	12,414
Costs and expenses	193,520	406,951	1,056,804	8,923
Guarantees		80,000	54,608	461

The Company's investments in and advances to these affiliated companies and respective ownership percentage at March 31, 1998 and 1999, consisted of the following:

	<u>Thousands of Yen</u>		<u>Thousands of U.S. Dollars</u>	
	<u>1998</u>	<u>1999</u>	<u>1999</u>	
Crosswave		40.0% ¥2,526,762	\$21,336	
Technology	39.0%	¥381,325	39.0 380,041	3,209
AIH	21.2	256,456	20.6 262,125	2,213
Multifeed	26.0	110,017	26.0 123,923	1,046
other		140,117	136,273	1,151
Total		<u>¥887,915</u>	<u>¥3,429,124</u>	<u>\$28,955</u>

INTERNET INITIATIVE JAPAN INC.

Notes to Consolidated Financial Statements—(Continued)

A summary of financial information of these companies as of March 31, 1998 and 1999, and for each of the three years in the period ended March 31, 1999, in the aggregate, is as follows:

	<u>Thousands of Yen</u>		<u>Thousands of U.S. Dollars</u>
	<u>1998</u>	<u>1999</u>	<u>1999</u>
Current assets	¥2,815,416	¥ 8,549,836	\$ 72,193
Noncurrent assets	525,769	3,404,683	28,749
Total assets	3,341,185	11,954,519	100,942
Current liabilities	631,133	2,912,664	24,594
Noncurrent liabilities	44,000	22,400	189
Minority interests other than IJ	1,877,375	5,704,592	48,169
Equity in net assets	¥ 788,677	¥ 3,314,863	\$ 27,990

	<u>Thousands of Yen</u>			<u>Thousands of U.S. Dollars</u>
	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>1999</u>
Revenues	¥1,564,871	¥2,599,421	¥4,483,963	\$37,862
Costs and expenses	(1,797,498)	(2,977,362)	(4,415,874)	(37,287)
Operating income (loss)	(232,627)	(377,941)	68,089	575
Other expense—net	(12,563)	(36,772)	(45,821)	(387)
Income (loss) before income taxes ..	(245,190)	(414,713)	22,268	188
Income taxes (benefits)	11,509	(41,878)	87,147	736
Net loss	¥ (256,699)	¥(372,835)	¥ (64,879)	\$ (548)

IJ's major non-consolidated business unit is Crosswave. IJ, Toyota Motor Corporation ("Toyota") and Sony Corporation ("Sony") incorporated Crosswave, a Japanese stock corporation, in October 1998, to develop a new platform-type high speed network based on large-capacity, ultra-fast infrastructure designed specially for data communications. Under a joint venture agreement dated January 26, 1999, the ownership interest in Crosswave of IJ, Toyota and Sony is 40%, 30% and 30%, respectively. The accumulated capital infusion and IJ's investment in Crosswave at March 31, 1999, were ¥6,400,000 thousand (\$54,040 thousand) and ¥2,560,000 thousand (\$21,616 thousand), respectively. An additional ¥1,600,000 thousand (\$13,510 thousand) of capital infusion will be made by these shareholders by August 31, 1999. Crosswave's activities as a development stage company for the period from inception (October 28, 1998) to March 31, 1999, included developing a business plan, procuring government authorization in the form of a Type I Telecommunications Carrier License, raising capital, working on the design and development of its network architecture and operation support system, acquiring equipment and facilities and negotiating interconnection agreements.

INTERNET INITIATIVE JAPAN INC.

Notes to Consolidated Financial Statements—(Continued)

The major financial accounts of Crosswave as of and for the period from its inception to March 31, 1999, included in the above-summarized financial information, were as follows:

	<u>Thousands of Yen</u>	<u>Thousands of U.S. Dollars</u>
Current assets	¥5,078,193	\$42,879
Noncurrent assets	<u>2,852,552</u>	<u>24,087</u>
Total assets	7,930,745	66,966
Current liabilities	1,659,907	14,016
Noncurrent liabilities	—	—
Minority interests other than IIJ	<u>3,762,503</u>	<u>31,770</u>
Equity in net assets	<u>¥2,508,335</u>	<u>\$21,180</u>
Marketing expenses	¥ 22,010	\$ 186
General and administrative expenses	<u>59,997</u>	<u>507</u>
Operating loss	82,007	693
Other expense—net	<u>1,089</u>	<u>9</u>
Net loss	<u>¥ 83,096</u>	<u>\$ 702</u>

Crosswave has entered into a long-term lease with KDD through the year 2009 for the right to use dark fiber strands and related maintenance contracts. The lease arrangement, which consists of variable and fixed portions, became effective April 1, 1999 and will be accounted for as an operating lease.

4. OTHER INVESTMENTS

Other investments at March 31, 1998 and 1999 represent available-for-sale marketable shares of common stock of Japanese banks and other enterprises of ¥41,804 thousand and ¥42,810 thousand (\$361 thousand) and non-marketable equity and other investments of ¥267,050 thousand and ¥415,657 thousand (\$3,510 thousand). Non-marketable securities include various investments in which IIJ's equity ownership is less than 12%.

5. PROPERTY AND EQUIPMENT

Property and equipment as of March 31, 1998 and 1999:

	<u>Thousands of Yen</u>		<u>Thousands of U.S. Dollars</u>
	<u>1998</u>	<u>1999</u>	<u>1999</u>
Data communications equipment	¥ 157,184	¥ 225,515	\$ 1,904
Office and other equipment	22,928	42,545	359
Leasehold improvements	101,896	137,467	1,160
Purchased software	420,023	1,027,930	8,680
Capitalized leases, primarily data communications equipment	<u>4,356,955</u>	<u>5,248,545</u>	<u>44,318</u>
Total	5,058,986	6,682,002	56,421
Less accumulated depreciation and amortization	<u>(1,789,454)</u>	<u>(2,961,829)</u>	<u>(25,009)</u>
Property and equipment—net	<u>¥3,269,532</u>	<u>¥3,720,173</u>	<u>\$31,412</u>

INTERNET INITIATIVE JAPAN INC.

Notes to Consolidated Financial Statements—(Continued)

The useful lives for depreciation and amortization by major asset classes are as follows:

	<u>Range of Useful Lives</u>
Data communications, office and other equipment.....	2 to 10 years
Leasehold improvements	6 to 15 years
Purchased software	5 years
Capitalized leases	4 to 12 years

6. LEASES

Operating Leases—The Company has operating lease agreements with telecommunications carriers and others for the use of its connectivity lines, including local access lines that its customers use to connect to IJ's network. The leases for domestic backbone are generally either non-cancelable for a minimum one-year lease period or cancelable during a lease period principally of six years, with a significant penalty for cancellation (either 25% or 35%). Non-cancelable leases for international backbone available as of March 31, 1999 are entered into with carriers for lease periods ranging from one to five years. The Company also leases its office premises and certain office equipment under non-cancelable operating leases which expire on various dates through the year 2004.

Lease expenses related to backbone and local access lines for the years ended March 31, 1997, 1998 and 1999 and amounted to ¥2,602,209 thousand, ¥5,259,347 thousand and ¥6,716,433 thousand (\$56,712 thousand), respectively. Included therein are lease expenses for local access lines for the years ended March 31, 1997, 1998 and 1999, amounting to ¥908,174 thousand, ¥1,569,051 thousand and ¥1,884,472 thousand (\$15,912 thousand), respectively, which are only attributable to dedicated access revenues. Also, lease expenses for other than backbone and local access lines for the years ended March 31, 1997, 1998 and 1999, amounted to ¥413,649 thousand, ¥627,180 thousand and ¥647,520 thousand (\$5,468 thousand), respectively.

Capital Leases—The Company conducts its connectivity and other services by using data communications and other equipment leased under capital lease arrangements. The fair values of the assets upon execution of the capital lease agreements and accumulated depreciation at March 31, 1998 and 1999, amounted to ¥4,356,955 thousand, ¥1,610,861 thousand, ¥5,248,545 thousand (\$44,318 thousand) and ¥2,611,270 thousand (\$22,049 thousand), respectively.

INTERNET INITIATIVE JAPAN INC.

Notes to Consolidated Financial Statements—(Continued)

As of March 31, 1999, future lease payments under non-cancelable operating leases, including the aforementioned cancelable connectivity lease agreements (but excluding dedicated access lines which the Company charges outright to customers), and capital leases were as follows:

	Thousands of Yen			Thousands of U.S. Dollars		
	Connectivity	Other	Capital	Connectivity	Other	Capital
	Lines Operating Leases	Operating Leases		Lines Operating Leases	Operating Leases	
Year ending March 31:						
2000	¥ 5,092,419	¥ 556,757	¥1,386,074	\$ 42,999	\$4,701	\$11,703
2001	4,290,855	418,191	973,140	36,231	3,531	8,217
2002	3,746,281		414,358	31,633		3,499
2003	1,426,088		129,350	12,042		1,092
2004	134,988		708	1,140		6
Thereafter	42,405			358		
Total minimum lease payments ..	<u>¥14,733,036</u>	<u>¥974,948</u>	2,903,630	<u>\$124,403</u>	<u>\$8,232</u>	24,517
Less: Amounts representing interest			159,569			1,347
Present value of net minimum capital lease payments			2,744,061			23,170
Less: Current portion			(1,283,298)			(10,836)
Noncurrent			<u>¥1,460,763</u>			<u>\$12,334</u>

The fair value of equipment under purchase commitments with respect to capital lease arrangements outstanding at March 31, 1999, amounted to ¥75,262 thousand (\$635 thousand).

7. SHORT-TERM AND LONG-TERM BORROWINGS

Short-term borrowings at March 31, 1998 and 1999, consist of unsecured notes payable to banks of ¥1,250,000 thousand and ¥1,930,000 thousand (\$16,297 thousand) and bank overdrafts (borrowings) of ¥1,190,000 thousand and ¥4,748,717 thousand (\$40,097 thousand), respectively. Stated annual interest rates on the short-term borrowings ranged from 1.15% to 1.70% and from 0.82% to 1.63% at March 31, 1998 and 1999, respectively, and their weighted average rates at March 31, 1998 and 1999, were 1.47% and 1.37%, respectively.

Long-term borrowings as of March 31, 1998 and 1999, consisted of the following:

	Thousands of Yen		Thousands of U.S. Dollars
	1998	1999	1999
Unsecured long-term loans payable to banks and insurance companies, maturing serially through 1999–2001 annual interest 1.52% to 2.00% at a fixed rate, except for a portion hedged by interest rate swap contracts (see Note 12)	¥1,226,000	¥1,262,000	\$10,656
Less current portion	(64,000)	(572,000)	(4,830)
Long-term debt, less current portion	<u>¥1,162,000</u>	<u>¥ 690,000</u>	<u>\$ 5,826</u>

Substantially all short-term and long-term bank borrowings are made under agreements which, as is customary in Japan, provide that under certain conditions the bank may require the

INTERNET INITIATIVE JAPAN INC.

Notes to Consolidated Financial Statements—(Continued)

borrower to provide collateral or guarantees with respect to the borrowings and that the bank may treat any collateral, whether furnished as security for short-term or long-term loans or otherwise, as collateral for all indebtedness to such bank. The Company has never received requests to provide collateral or guarantees from its banks. Also, provisions of certain loan agreements grant certain rights of possession to the lenders in the event of default.

Annual maturities of long-term debt outstanding as of March 31, 1999, were as follows:

<u>Year Ending March 31</u>	<u>Thousands of Yen</u>	<u>Thousands of U.S. Dollars</u>
2000	¥ 572,000	\$ 4,830
2001	<u>690,000</u>	<u>5,826</u>
Total	<u>¥1,262,000</u>	<u>\$10,656</u>

The Company entered into bank overdraft (borrowing) agreements with certain Japanese banks for which the unused balance outstanding as of March 31, 1999 was ¥1,351,283 thousand (\$11,410 thousand).

8. INCOME TAXES

Income taxes imposed by the national, prefectural and municipal governments of Japan resulted in a normal statutory rate of approximately 51% for the years ended March 31, 1997 and 1998 and 48% for the year ended March 31, 1999. The provision for income taxes consists of the following components:

	<u>Thousands of Yen</u>			<u>Thousands of U.S. Dollars</u>
	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>1999</u>
Current	¥ 556,008	¥166,340	¥11,588	\$ 98
Deferred	<u>(179,039)</u>	<u>123,113</u>	<u>3,732</u>	<u>31</u>
Provision for income taxes	<u>¥ 376,969</u>	<u>¥289,453</u>	<u>¥15,320</u>	<u>\$129</u>

Income taxes—deferred for the years ended March 31, 1998 and 1999 included ¥11,535 thousand and ¥93,844 thousand (\$792 thousand) credit to deferred tax assets, respectively, resulting from the enacted changes in the Japanese income tax rate on March 31, 1998 and 1999. As a result, normal Japanese statutory rates have been and will be reduced by 3% to 48% and by 6% to 42%, respectively, effective from the beginning of the respective next fiscal years.

INTERNET INITIATIVE JAPAN INC.

Notes to Consolidated Financial Statements—(Continued)

The approximate effect of temporary differences and carryforwards giving rise to deferred tax balances at March 31, 1998 and 1999, was as follows:

	Thousands of Yen				Thousands of U.S. Dollars	
	1998		1999		1999	
	Deferred Tax Assets	Deferred Tax Liabilities	Deferred Tax Assets	Deferred Tax Liabilities	Deferred Tax Assets	Deferred Tax Liabilities
Refundable insurance policies		¥30,822		¥55,816		\$471
Capitalized leases.....	¥ 46,011		¥ 44,425		\$ 375	
Free rent adjustment	41,584					
Accrual of expenses	131,224		53,424		451	
Retirement and pension cost	23,911		34,553		292	
Operating loss carryforward	20,816		735,793		6,213	
Other	9,849	31,402	11,169	28,590	94	242
Total	273,395	62,224	879,364	84,406	7,425	713
Valuation allowance	(243,148)		(832,188)		(7,027)	
Total	<u>¥ 30,247</u>	<u>¥62,224</u>	<u>¥ 47,176</u>	<u>¥84,406</u>	<u>\$ 398</u>	<u>\$713</u>

As of March 31, 1998 and 1999, the allowance for deferred tax assets has been provided for in the accompanying financial statements because of uncertainty regarding recovery of such amounts. The net changes in the valuation allowance for deferred tax assets during the years ended March 31, 1997, 1998 and 1999, were an increase of ¥19,683 thousand, ¥188,215 thousand and ¥589,040 thousand (\$4,974 thousand), respectively. As of March 31, 1999, IIJ, Net Care, Inc., a domestic subsidiary, and IIJ America, Inc., a U.S. subsidiary, had tax operating loss carryforwards of ¥1,339,791 thousand (\$11,313 thousand), ¥106,320 (\$898 thousand) and \$2,280 thousand, respectively. These loss carryforwards are available to offset future taxable income, and will expire in the period ending March 31, 2004 in Japan and December 31, 2013 in the United States of America, respectively.

A reconciliation between the amount of reported income taxes and the amount of income taxes computed using the normal statutory rate for the years ended March 31, 1997, 1998 and 1999, is as follows:

	Thousands of Yen			Thousands of U.S. Dollars
	1997	1998	1999	1999
Amount computed by using normal Japanese statutory tax rate	¥334,176	¥ 38,865	¥(724,872)	\$(6,121)
Increase (decrease) in taxes resulting from:				
Expenses not deductible for tax purpose ..	11,363	21,373	16,607	140
Increase in valuation allowance	19,683	243,148	608,764	5,141
Effect of effective income tax rate changes		11,535	93,844	792
Realization of tax benefits of operating loss carryforwards of subsidiaries	(7,284)	(17,935)		
Minimum income tax	1,078	6,019	9,549	81
Other—net	17,953	(13,552)	11,428	96
Income taxes as reported	<u>¥376,969</u>	<u>¥289,453</u>	<u>¥ 15,320</u>	<u>\$ 129</u>

INTERNET INITIATIVE JAPAN INC.

Notes to Consolidated Financial Statements—(Continued)

9. RETIREMENT AND PENSION PLANS

Approximately 70% of the employees' benefits from IJ's severance indemnity plan was transferred in May 1997 to its newly established noncontributory defined benefits pension plan. The following information regarding net periodic pension cost and accrued pension cost includes the 30% of severance benefits not transferred to the noncontributory plan. Under the severance and pension plans, all of IJ's employees are entitled, upon voluntary retirement with 15 years or more service, or upon mandatory retirement at age 60, to a 10-year-period of annuity payments (or lump-sum severance indemnities) based on the rate of pay at the time of retirement, length of service and certain other factors. IJ's employees who do not meet these conditions are entitled to lump-sum severance indemnities.

As stipulated by the Japanese Welfare Pension Insurance Law, the Multi-Employer Plan is composed of a substitutional portion of Japanese Pension Insurance and a multi-employers' portion of a contributory defined benefit pension plan. The benefits for the substitutional portion are based on a standard remuneration schedule under the Welfare Pension Insurance Law and the length of participation. The multi-employers' portion of the benefits is based on the employee's length of service. However, assets contributed by an employer are not segregated in a separate account or restricted to provide benefits only to employees of that employer, including IJ.

IJ applies SFAS No. 87 "Employer's Accounting for Pensions," to these plans. Effective April 1, 1998, the Company also retroactively adopted SFAS No. 132 "Employers' Disclosures about Pensions and Other Postretirement Benefits," which enhances existing disclosures for pensions and other postretirement benefits.

Net periodic pension cost for the years ended March 31, 1997, 1998 and 1999 included the following components:

	<u>Thousands of Yen</u>			<u>Thousands of</u>
	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>U.S. Dollars</u>
Service cost.....	¥17,793	¥43,317	¥71,407	\$603
Interest cost	824	1,722	3,510	30
Net amortization and deferral	<u>708</u>	<u>1,785</u>	<u>2,790</u>	<u>23</u>
Net periodic pension cost	<u>¥19,325</u>	<u>¥46,824</u>	<u>¥77,707</u>	<u>\$656</u>

The funded status as of March 31, 1998 and 1999 is as follows:

	<u>Thousands of Yen</u>		<u>Thousands of</u>
	<u>1998</u>	<u>1999</u>	<u>U.S. Dollars</u>
Change in benefit obligation:			
Benefit obligation at beginning of year	¥ 69,013	¥140,884	\$1,190
Service cost	43,317	71,407	603
Interest cost	1,722	3,510	30
Actuarial (gain) loss.....	26,832	(5,063)	(43)
Benefit paid	<u> </u>	<u>(1,389)</u>	<u>(12)</u>
Benefit obligation at end of year	<u>140,884</u>	<u>209,349</u>	<u>1,768</u>

INTERNET INITIATIVE JAPAN INC.

Notes to Consolidated Financial Statements— (Continued)

	Thousands of Yen		Thousands of U.S. Dollars
	1998	1999	1999
Change in plan assets:			
Fair value of plan assets at beginning of year		21,982	185
Actual return on plan assets		1,329	11
Employer contribution	21,982	44,838	379
Benefits paid		(972)	(8)
Fair value of plan assets at end of year	<u>21,982</u>	<u>67,177</u>	<u>567</u>
Funded status	(118,902)	(142,172)	(1,201)
Unrecognized actuarial loss	61,853	53,073	448
Unrecognized transition amount	7,232	6,830	58
Accrued pension cost	<u>¥(49,817)</u>	<u>¥(82,269)</u>	<u>\$ (695)</u>
Actuarial assumption as of March 31:			
Discount rate	2.5%	2.5%	
Expected long-term rate of return on plan assets	0.75	1.0	
Rate of compensation increase	4.0	3.5	

IIJ's funding policies with respect to the noncontributory plan are generally to contribute amounts considered tax deductible under applicable income tax regulations. Plan assets, including pension trust funds managed by a certain trust bank and a life insurance company, consist of Japanese Government bonds, other debt securities and marketable equity securities. Plan assets managed by the insurance company are included in pooled investment portfolios.

The unrecognized net loss and the unrecognized net obligation at the date of initial application are being amortized over 20 years and 21 years, respectively.

Contributions due and paid during the years ended March 31, 1997, 1998 and 1999, under the Multi-Employer Plan, including its substitutional portion, amounted to ¥43,992 thousand, ¥66,536 thousand and ¥91,699 thousand (\$774 thousand).

Under the Japanese Commercial Code (the "Code"), retirement benefits for directors and corporate auditors are approved by the shareholders. The amount of benefits to retiring directors and corporate auditors of IIJ are also determined by the shareholders. There were no benefits determined or paid to retired directors or corporate auditors for each of the three years in the period ended March 31, 1999.

10. SHAREHOLDERS' EQUITY

Under the Code, the amount available for dividends is based on retained earnings as recorded on the books of IIJ. Certain adjustments not recorded on IIJ's books are reflected in the consolidated financial statements for reasons described in Note 1. At March 31, 1999, the deficit recorded on IIJ's books of account was ¥475,015 thousand (\$4,011 thousand).

The Code requires IIJ to appropriate as a legal reserve portions of retained earnings in amounts equal to at least 10% of cash payments, including dividends and officer's bonuses, in each financial period, until the reserve equals 25% of the stated capital. The retained earnings so appropriated may be used to eliminate or reduce a deficit by resolution of the shareholders or may be transferred to capital stock by resolution of the Board of Directors.

Under the Code, at least 50% of the issue price of new shares, with a minimum of the par value thereof, is required to be designated as stated capital. The portion which is to be designated as

INTERNET INITIATIVE JAPAN INC.

Notes to Consolidated Financial Statements— (Continued)

stated capital is determined by resolution of the Board of Directors. Proceeds in excess of the amounts designated as stated capital, as reduced by stock issue expenses less the applicable tax benefit, are credited to additional paid-in capital. IJ may transfer portions of additional paid-in capital and legal reserve to stated capital by resolution of the Board of Directors. IJ may also transfer portions of retained earnings, available for dividends, to the stated capital by resolution of the shareholders.

Under the Code, IJ may issue new common shares to the existing shareholders without consideration by resolution of the Board of Directors as a stock split to the extent that the aggregated par value of the shares outstanding after the issuance does not exceed the stated capital. However, the amount calculated by dividing the total amount of shareholders' equity by the number of outstanding shares after the issuance shall not be less than ¥50,000.

As described in Note 1, on February 2, 1998 IJ acquired the minority interest of five domestic local marketing companies which were controlled by IJ by issuing 1,840 new shares, including 597 shares issued to IJ and held as treasury stock, in exchange for all outstanding shares of these companies. IJ subsequently sold 497 shares of treasury stock in March 1998 for ¥198,800 thousand and 100 shares in April and July 1998 for ¥40,000 thousand (\$338 thousand). The acquisition of the minority shares was accounted for as a purchase transaction based on the fair value of assets acquired of ¥148,425 thousand. The purchase price was allocated to the fair value of monetary assets acquired and monetary liabilities assumed. The five domestic local marketing companies had operated exclusively as sales agents for IJ services and were controlled by IJ prior to acquisition of the minority interest. Operations of these companies have been consolidated for all periods presented and their revenues (commissions from IJ) were eliminated in consolidation.

The pro forma effect on the results of consolidated operations of the acquisition of the minority interests, as if acquired at the beginning of the fiscal years, is as follows:

	Thousand of Yen	
	1997	1998
Connectivity services and other revenues	8,533,457	12,322,918
Net income (loss)	234,613	(316,887)
Basic and diluted net income (loss) per common share — a single yen	14,444	(19,407)

In March 1998, 1,000 and 1,040 additional common shares were issued upon the exercise of detachable warrants which were issued in March 1996 in a private placement resulting in ¥100,000 thousand and ¥416,000 thousand of net proceeds, respectively. In March 1998, IJ America, Inc., a U.S.-based Internet access provider and a wholly-owned subsidiary, issued 10,000 shares at \$100 per share to IJ Technology Inc., an affiliated company owned 39% by the Company. This transaction resulted in an increase in the Company's equity interest in the subsidiary in the amount of ¥70,645 thousand and decreased the Company's ownership interest from 100% to 69.5%.

INTERNET INITIATIVE JAPAN INC.

Notes to Consolidated Financial Statements—(Continued)

11. OTHER COMPREHENSIVE INCOME

The change in each component of other comprehensive income for the years ended March 31, 1997, 1998 and 1999 is as follows:

	<u>Thousands of Yen</u>			<u>Thousands of</u>
	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>U.S. Dollars</u>
				<u>1999</u>
Other comprehensive income, before tax:				
Foreign currency translation adjustments	¥ 1,300	¥ 7,997	¥ 1,325	\$ 11
Net unrealized holding gain (loss) on securities, net of reclassification adjustment	(15,335)	3,787	3,167	27
Total	(14,035)	11,784	4,492	38
Income tax effect	7,821	(1,931)	(1,520)	(13)
Other comprehensive income, net of tax	<u>¥ (6,214)</u>	<u>¥ 9,853</u>	<u>¥ 2,972</u>	<u>\$ 25</u>

Net unrealized holding gain on securities for the year ended March 31, 1999 included reclassification adjustment for realized gain in the amount of ¥1,205 thousand (\$10 thousand). Accumulated other comprehensive income as of March 31, 1998 and 1999, consisted of translation adjustments in the amount of ¥9,297 thousand and ¥10,622 thousand (\$90 thousand), and net unrealized holding gain or loss on securities in the amount of ¥1,629 thousand (loss) and ¥18 thousand, respectively.

12. FINANCIAL INSTRUMENTS

Derivatives—Company transactions associated with risks that arise from exchange rate fluctuation relate to international connectivity charges from carriers. The Company entered into forward exchange contracts with Japanese banks to hedge a portion of anticipated connectivity lease payments.

With respect to the unsecured long-term loans payable to a bank bearing a floating interest rate at March 31, 1998 and 1999 of ¥136,000 thousand and ¥72,000 thousand (\$608 thousand), respectively, in order to manage its exposure to possible interest rate fluctuation the Company entered into interest rate swap contracts with a Japanese bank resulting in a fixed interest rate of 1.58% per annum.

The following table provides information regarding the above-mentioned derivative instruments as of March 31, 1999, which was translated into Japanese yen at the year-end spot rate.

	<u>Thousands of Yen</u>	<u>Thousands of</u>
		<u>U.S. Dollars</u>
Forward Exchange Contract—buy U.S. dollar, sell yen— expiring through 2000:		
Receive	¥ 972,784	\$8,214
Pay	1,078,386	9,106

INTERNET INITIATIVE JAPAN INC.

Notes to Consolidated Financial Statements—(Continued)

	Weighted Average Rate	Notional Amount	
		Thousands of Yen	Thousands of U.S. Dollars
Interest Rate Swap—expiring through 2000:			
Receive (floating rate interest)	1.00%	¥72,000	\$608
Pay (fixed rate interest)	1.58	72,000	608

Fair Value—In the normal course of business, the Company invests in financial assets and incurs financial liabilities. To estimate the fair value of those financial assets, liabilities and derivatives, the Company used quoted market prices to the extent that they were available. Where a quoted market price is not available, the Company estimates fair value using primarily the discounted cash flow method. For certain financial assets and liabilities which are expected to be collected and settled within one year, the Company assumed that the carrying amount approximates fair value due to their short maturities. The carrying amounts or notional amounts and fair value of financial instruments are summarized as below:

	Thousands of Yen				Thousands of U.S. Dollars	
	1998		1999		1999	
	Carrying Amount or Notional Amount	Fair Value	Carrying Amount or Notional Amount	Fair Value	Carrying Amount or Notional Amount	Fair Value
Other investments	¥ 308,854	¥ 308,854	¥ 458,467	¥ 458,467	\$ 3,871	\$ 3,871
Refundable insurance policies	409,422	409,422	544,498	544,498	4,598	4,598
Long-term borrowings, including current portion	1,226,000	1,230,108	1,262,000	1,271,525	10,656	10,737
Forward exchange contracts				(93,556)		(790)
Interest rate swap contracts	136,000	358	72,000	342	608	3

13. SUPPLEMENTAL REVENUE AND EXPENSE INFORMATION

Revenues derived in the United States of America were ¥20,181 thousand (\$170 thousand) for the year ended March 31, 1999.

Other revenues and cost of other revenues for the years ended March 31, 1997, 1998 and 1999 include equipment sales and purchased equipment cost as follows:

	Thousands of Yen			Thousands of U.S. Dollars
	1997	1998	1999	1999
Sales	¥221,920	¥108,288	¥1,494,650	\$12,621
Cost of sales	212,884	103,586	1,483,835	12,529

Advertising expenses incurred during the years ended March 31, 1997, 1998 and 1999, consist principally of advertisement within magazines, journals and newspapers and amounted to ¥351,761 thousand, ¥315,387 thousand and ¥227,629 thousand (\$1,922 thousand), respectively.

UNDERWRITING

IIJ, the selling shareholders and the Underwriters for the offering named below have entered into an underwriting agreement with respect to the ADSs being offered. Subject to certain conditions, each

Underwriter has severally agreed to purchase the number of ADSs indicated in the following table. Goldman, Sachs & Co., and Morgan Stanley & Co. Incorporated are the representatives of the Underwriters.

Underwriters	Number of ADSs
Goldman, Sachs & Co.	2,510,000
Morgan Stanley & Co. Incorporated	2,510,000
Banc of America Securities LLC	286,000
A.G. Edwards & Sons, Inc.	286,000
EVEREN Securities, Inc.	286,000
Wasserstein Perella Securities, Inc.	286,000
J.C. Bradford & Co.	166,000
Gruntal & Co., L.L.C.	166,000
Legg Mason Wood Walker, Incorporated	166,000
U.S. Bancorp Piper Jaffray Inc.	166,000
C.E. Unterberg, Towbin	166,000
Wit Capital Corporation	166,000
Total	7,160,000

A portion of the offering outside the United States may be in the form of shares rather than ADSs, at an equivalent price per ADS equivalent.

If the Underwriters sell more ADSs than the total number set forth in the table above, the Underwriters have an option to buy up to an additional 980,000 ADSs from IIJ to cover such sales. They may exercise that option for 14 days. If any ADSs are purchased pursuant to this option, the Underwriters will severally purchase ADSs in approximately the same proportion as set forth in the table above.

The following table shows the per ADS and total underwriting discounts and commissions to be paid to the Underwriters by IIJ. Such amounts are shown assuming both no exercise and full exercise of the Underwriters' option to purchase 980,000 additional ADSs.

	Paid by IIJ	
	No Exercise	Full Exercise
Per ADS	\$ 1.55	\$ 1.55
Total	\$ 9,641,000	\$ 11,160,000

ADSs sold by the Underwriters to the public will initially be offered at the initial public offering price set forth on the cover of this prospectus. Any ADSs sold by the Underwriters to securities dealers may be sold at a discount of up to \$0.93 per ADS from the initial public offering price. Any such securities dealers may resell any ADSs purchased from the Underwriters to certain other brokers or dealers at a discount of up to \$0.10 per ADS from the initial public offering price. If all the ADSs are not sold at the initial public offering price, the representatives may change the offering price and the other selling terms.

IIJ, the selling shareholders and certain other shareholders have agreed with the Underwriters not to dispose of or hedge any of their common stock or securities convertible into or exchangeable for shares of common stock during the period from the date of this prospectus continuing through the date 180 days after the date of this prospectus, except with the prior written consent of Goldman, Sachs & Co. on behalf of the Underwriters. See "Shares Eligible for

Future Sale” for a discussion of certain transfer restrictions.

Prior to the offering, there has been no public market for the ADSs. The initial public offering price will be negotiated among IIJ and the representatives. Among the factors to be considered in determining the initial public offering price of the ADSs, in addition to prevailing market conditions, will be IIJ’s historical performance, estimates of the business potential and earnings prospects of IIJ, an assessment of IIJ’s management and the consideration of the above factors in relation to market valuation of companies in related businesses.

IIJ will list the ADSs on the Nasdaq National Market under the symbol “IIJ”.

In connection with the offering, the Underwriters may purchase and sell ADSs in the open market. These transactions may include short sales, stabilizing transactions and purchases to cover positions created by short sales. Short sales involve the sale by the Underwriters of a greater number of ADSs than they are required to purchase in the offering. Stabilizing transactions consist of certain bids or purchases made for the purpose of preventing or retarding a decline in the market price of the ADSs while the offering is in progress. The Underwriters may also effect transactions in the shares of IIJ.

The Underwriters also may impose a penalty bid. This occurs when a particular Underwriter repays to the Underwriters a portion of the underwriting discounts and commissions received by it because the representatives have repurchased ADSs sold by or for the account of such Underwriter in stabilizing or short covering transactions.

These activities by the Underwriters may stabilize, maintain or otherwise affect the market price of the ADSs. As a result, the price of the ADSs may be higher than the price that otherwise might exist in the open market. If these activities are commenced, they may be discontinued by the Underwriters at any time. These transactions may be effected on the Nasdaq National Market, in the over-the-counter market or otherwise.

The Underwriters do not expect sales to discretionary accounts to exceed five percent of the total number of ADSs offered.

IIJ estimates that the total expenses of the offering, excluding underwriting discounts and commissions, will be approximately \$2.5 million.

IIJ and the selling shareholders have agreed to indemnify the several Underwriters against certain liabilities, including liabilities under the Securities Act of 1933.

No dealer, salesperson or other person is authorized to give any information or to represent anything not contained in this prospectus. You must not rely on any unauthorized information or representations. This prospectus is an offer to sell only the securities offered hereby, but only under circumstances and in jurisdictions where it is lawful to do so. The information contained in this prospectus is current only as of its date.

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Through and including August 28, 1999 (the 25th day after the date of this prospectus), all dealers effecting transactions in these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers' obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

Internet Initiative Japan Inc.

7,160,000
American Depositary Shares

Representing
3,580 Shares of Common Stock



Goldman, Sachs & Co.
Morgan Stanley Dean Witter

Representatives of the Underwriters
