



Internet Initiative Japan Inc.

Third Quarter Results for the Year Ending March 31, 2005

February 9, 2005

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

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

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

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

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

Highlights

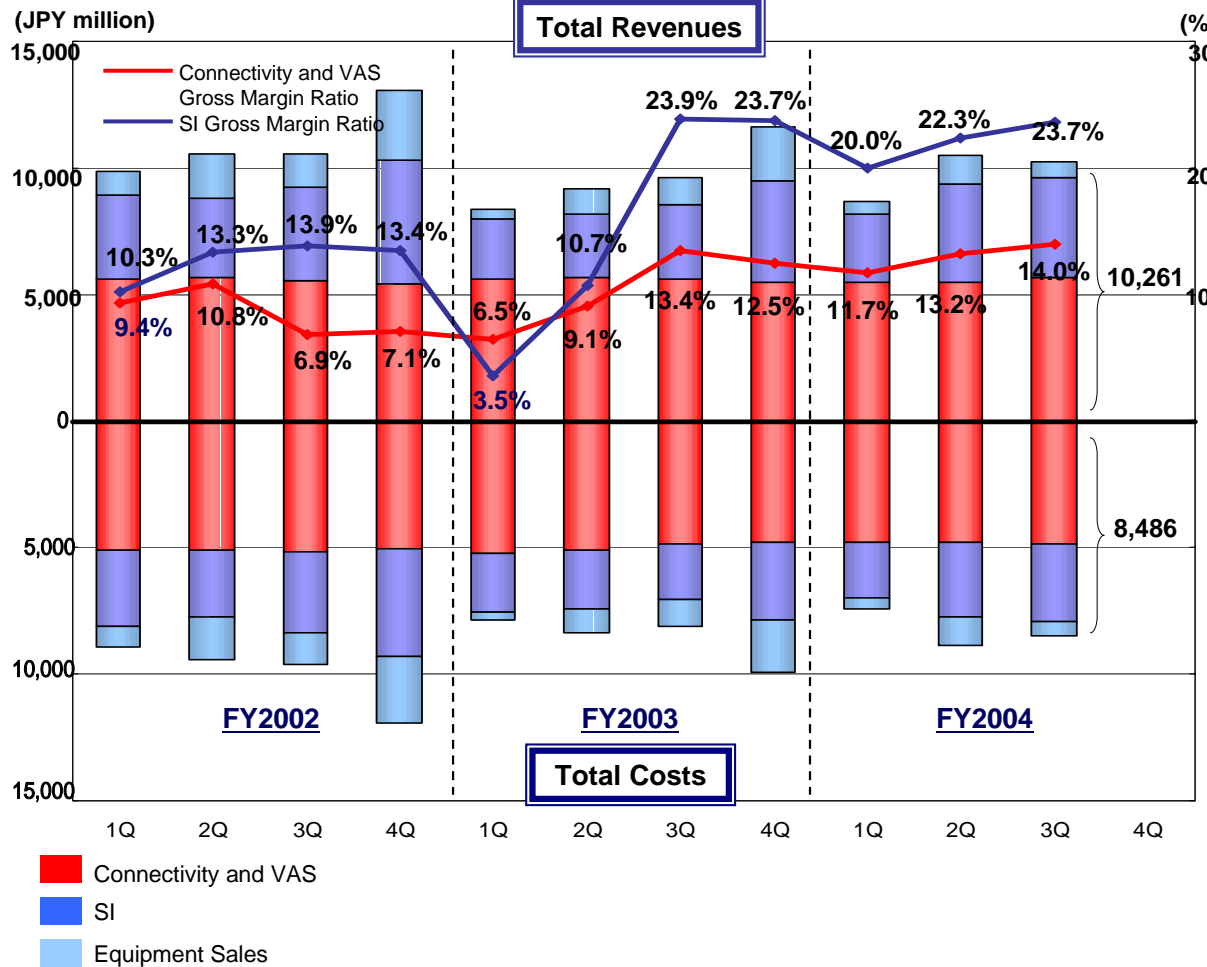
By Service

Topics

(JPY millions)

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

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



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

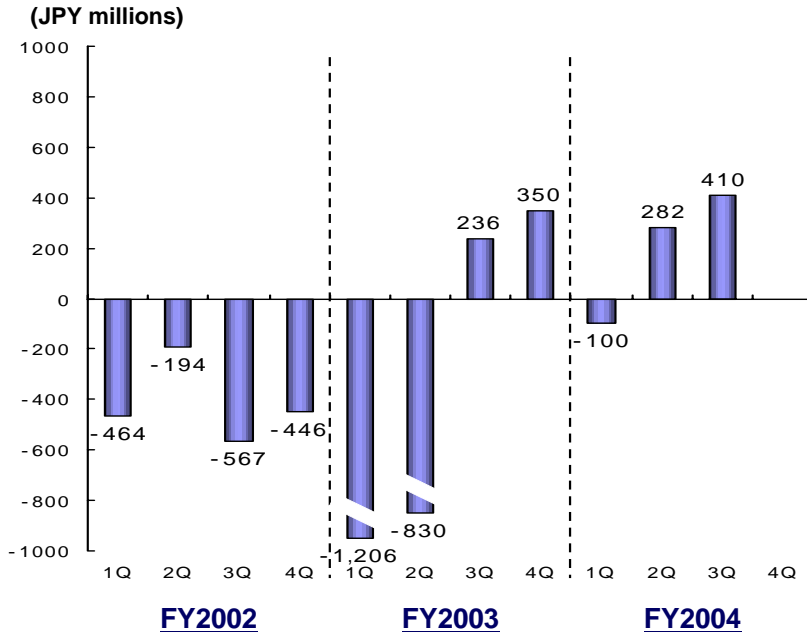
We expect that gross margins will continue to be stable, since there is no large factor increasing costs

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

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

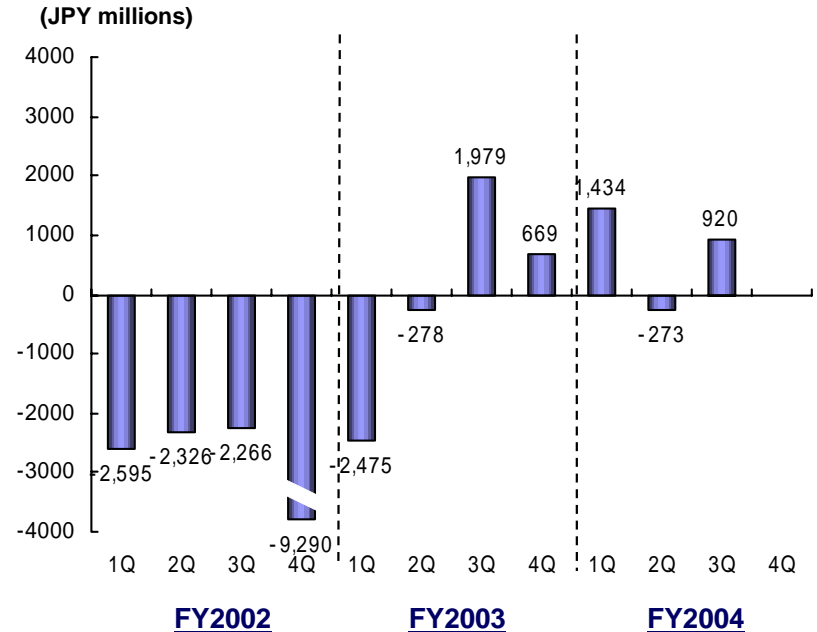
Operating Income (Loss)

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



Net Income (Loss)

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



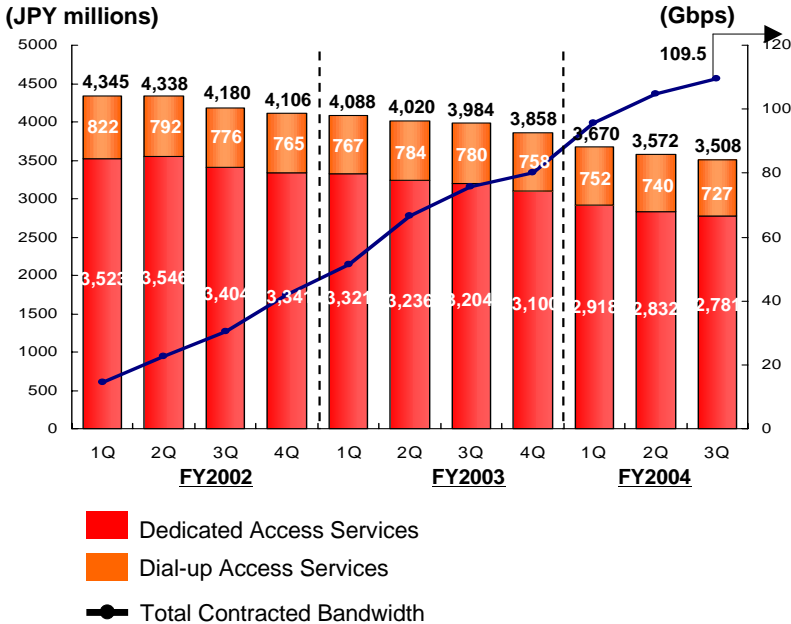
- ✓ **We expect sequential and annual increases in revenue and operating income in 4Q04**
 - Fourth quarter is usually the strongest part of our fiscal year due to seasonal fluctuation of SI revenues
 - We expect that an increase in revenues from operational outsourcing and maintenance will continue

Highlights

By Service

Topics

Revenues

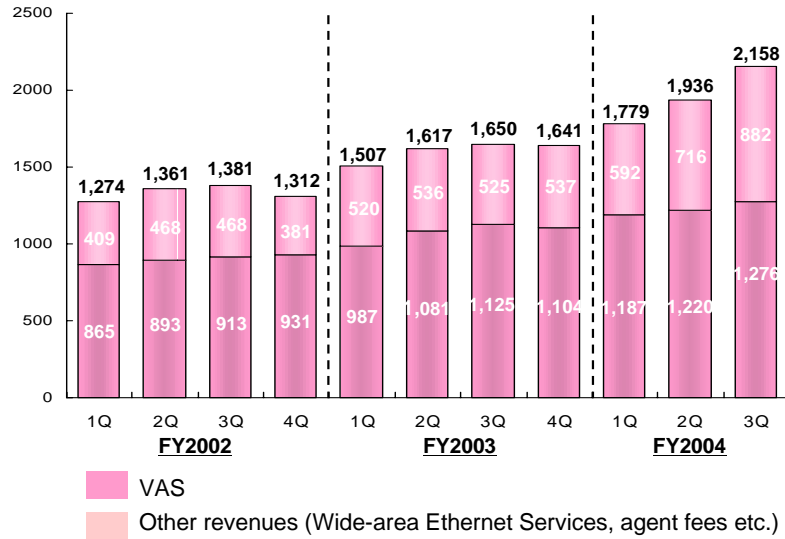


- ▶ Trend of decreasing connectivity service revenues is slowing and has almost become flat (4Q03 to 1Q04: -188M, 1Q04 to 2Q04: -98M, 2Q04 to 3Q04: -64M)
- ▶ Shift to lower-priced broadband services almost completed
- ▶ Broadband service contracts steadily increasing due to acquisition of multi-site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

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

Revenues

(JPY millions)

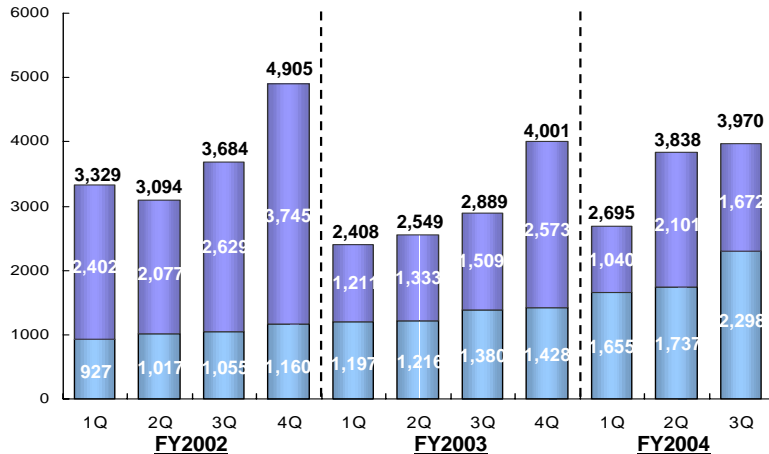


- ▶ VAS and other revenues continued to improve, increasing 30.8% YoY and 11.5% QoQ, to become one of IIJ's major revenue sources
- ▶ Increased awareness of security issues by corporate customers is spurring security-related service sales
 - Number of contracts reached approximately 1,400, an increase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

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

Revenues

(JPY millions)



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

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



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

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

	3Q04	2Q04
VAS Cross-selling Ratio ^{*1}	87.5%	86.9%
SI Cross-selling Ratio ^{*2}	90.0%	80.0%

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

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

Highlights

By Service

Topics

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

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

Project name: Shipping Container RFID Pilot Project

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

Test Period: Until March 2005

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

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

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

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

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