

(TRANSLATION)

Quarterly Securities Report

(The Second Quarter of the 28th Business Term)
From July 1, 2019 to September 30, 2019

Internet Initiative Japan Inc.

Note for readers of this English translation

This is an English translation of the Quarterly Securities Report (*Shihanki-houkokusho*) of Internet Initiative Japan Inc. ("IIJ") filed with the Director-General of the Kanto Local Finance Bureau in Japan through EDINET (Electronic Disclosure for Investors' NETwork). This translation includes an English translation of the Independent Auditor's Report on Quarterly Review by KPMG AZSA LLC IIJ's accounting auditor, of the condensed consolidated financial statements included in the Japanese original Quarterly Securities Report. KPMG AZSA LLC has not audited and makes no warranty as to the accuracy or otherwise of the translation of the condensed consolidated financial statements of other financial information included in this English translation of the Quarterly Securities Report.

This document has been translated from the Japanese original for reference purpose only. In the event of any discrepancy between this English translation and the Japanese original, the Japanese original shall prevail.

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【Cover】

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PART 1 Information on the Company

Item 1. Overview of the Company

1 Selected Financial Data

Fiscal year	IFRS		
	Six months ended September 30, 2018	Six months ended September 30, 2019	27th business term ended March 31, 2019
Revenues (Three months ended September 30)	(thousands of yen) 91,223,901 (46,385,456)	99,219,535 (49,390,691)	192,430,185
Operating profit	(thousands of yen) 3,284,814	3,351,950	6,022,987
Profit before tax	(thousands of yen) 3,429,900	3,043,288	5,842,984
Profit attributable to owners of the parent (Three months ended September 30)	(thousands of yen) 2,095,091 (1,221,348)	1,756,102 (979,589)	3,520,566
Comprehensive income, attributable to owners of the parent	(thousands of yen) 2,303,557	2,459,500	2,902,764
Comprehensive income	(thousands of yen) 2,389,514	2,561,750	3,080,986
Equity attributable to owners of the parent	(thousands of yen) 76,252,358	78,117,387	76,271,438
Total assets	(thousands of yen) 162,536,262	201,972,107	167,289,196
Basic earnings per share (Three months ended September 30)	(yen) 46.48 (27.10)	38.96 (21.73)	78.11
Diluted earnings per share	(yen) 46.31	38.79	77.80
Ratio of owners' equity to gross assets	(%) 46.9	38.7	45.6
Cash flows from (used in) operating activities	(thousands of yen) 13,871,028	13,393,901	25,152,346
Cash flows from (used in) investing activities	(thousands of yen) (3,507,255)	(4,087,434)	(8,687,589)
Cash flows from (used in) financing activities	(thousands of yen) (3,901,866)	(7,138,625)	(5,889,750)
Cash and cash equivalents, at the end of period	(thousands of yen) 27,884,685	34,036,458	31,957,789

(Notes) 1. As IJ and its subsidiaries (collectively “the Company”) prepare quarterly condensed consolidated financial statements reports, changes in non-consolidated financial data, among others, are not provided.

2. All figures presented above are based on the condensed consolidated financial statements prepared in accordance with International Financial Reporting Standards (“IFRS”).

3. Revenues do not include consumption taxes.

2 Description of Business

There were no material changes to the business of the Company or its equity method investees during the first sixth months of the 28th business term (the fiscal year ending March 31, 2020) (“1H19”).

There were no material changes with respect to the associated companies during the 1H19.

Item 2. Business Overview

1 Risk Factors

There were no newly identified matters, relating to the business description or consolidated financial results described in this Quarterly Securities Report, which could have a material effect on the decisions of investors, and there were no material changes in the risk factors described in our Annual Securities Report for the previous fiscal year filed on June 28, 2019.

2. Management's Analysis of Consolidated Financial Position, Results of Operations and Cash Flows

Overview of Business Results

We have adopted IFRS 16 "Leases" (hereinafter "IFRS 16") from the first quarter of the fiscal year ending March 31, 2020. As for the details, please refer to "Notes to Condensed Consolidated Financial Statements, 3. SIGNIFICANT ACCOUNTING POLICIES"

(1) Results of Operations

(i) Overview of consolidated business results for 1H19

For the ICT (*1) related market where we belong to, changes of corporate information system as seen in widespread of cloud computing adoption, advancement of ICT use such as IoT (*2) in corporate business activities, growing demand for security related services against information leakage and others, we expect demands for highly reliable network and systems to continuously increase.

1H19 financial results were steady and the profit exceeded our initial financial targets disclosed in May as the gross profit growth of both network services and systems integration (SI) absorbed an increase of selling, general and administrative expenses. As for enterprise network services, both mobile services revenue for enterprises and consumers continuously increased, and full-MVNO (*3) related services revenue also increased as planned. We also focused on developing full-MVNO related services such as the launch of e-SIM (*4) trial services and SoftSIM (*5) services. As for security, the revenue strongly grew by accumulating revenues of the existing services and we enhanced our security service lineup by adding new services such as "IIJ Managed WAF service (*6)". As for IoT related business, we promoted business alliances with Taiwanese companies of Advantech Co., Ltd. and Kiwi Technology Inc. in order to strengthen our IoT business foundation toward the future IoT demands. Corporate demands for SI continued to be strong, and SI revenue and orders received were up 15.9% year over year ("YoY") and up 4.1% YoY, respectively. Regarding cloud computing related services, a part of which is included in systems operation and maintenance revenue, we continuously focused on promoting multi-cloud strategy, and 1H19 cloud-related revenues increased to JPY11.2 billion as planned. As for new businesses, Decurret Inc., IIJ's equity method investee which carries on digital currency related business, started spot trading service in April and leverage trading service in August.

Consolidated financial results for 1H19 are as follows. Total revenues were JPY99,220 million (JPY91,224 million for 1H18), up 8.8% year over year. Cost of sales was JPY84,020 million (JPY76,977 million for 1H18 and JPY77,962 million as Adjusted (*7)), up 9.1% YoY (up 7.8% YoY as Adjusted). Gross profit was JPY15,200 million (JPY14,247 million for 1H18 and JPY13,262 million as Adjusted), up 6.7% YoY (up 14.6% YoY as Adjusted). As for breakdown, network services revenue was JPY61,204 million (JPY58,158 million for 1H18), up 5.2% YoY and gross profit for network services revenue was JPY10,051 million (JPY9,658 million for 1H18 and JPY8,673 million as Adjusted), up 4.1% YoY (up 15.9% YoY as Adjusted). SI revenues, including equipment sales were JPY35,916 million (JPY30,995 million for 1H18), up 15.9% YoY and gross profit for SI was JPY4,174 million (JPY 3,685 million for 1H18), up 13.3% YoY. ATM operation business revenue was JPY2,100 million (JPY2,071 million for 1H18), up 1.4% YoY and gross profit of ATM operation business was JPY 975 million (JPY904 million for 1H18), up 7.9% YoY. Net amount of selling, general and administrative expenses, other operating income and other operating expenses was JPY11,848 million (JPY10,962 million for 1H18), up 8.1% YoY. Our operating profit for 1H19 was JPY3,352 million (JPY3,285 million for 1H18 and JPY 2,300 million as Adjusted), up 2.0% YoY (up 45.7% as Adjusted). Profit before tax for 1H19 was JPY3,043 million (JPY3,430 million for 1H18 and JPY2,445 million as Adjusted), down 11.3% YoY (up 24.5% as Adjusted). Profit attributable to owners of the parent for 1H19 was JPY1,756 million (JPY2,095 million for 1H18 and JPY1,420 million as Adjusted), down 16.2% YoY (up 23.6% YoY as Adjusted).

In business segments results, revenues for network services and systems integration business segment for 1H19 were JPY97,265 million (JPY89,349 million for 1H18), up 8.9% YoY, and operating profit for 1H19 was JPY2,557 million (JPY2,592 million for 1H18, and 1,607 million as Adjusted), down 1.4% YoY (up 59.1% as Adjusted). As for ATM operation business, revenues for 1H19 were JPY2,100 million (JPY2,071 million for 1H18), up 1.4% YoY, and operating profit for 1H19 was JPY869 million (JPY807 million for 1H18).

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- *1 ICT: Information and Communication Technology (ICT) is a general technological term for hardware, software, systems and data communication tools used for information communication by computers.
- *2 IoT: Internet of Things (IoT) enables not only physical objects but also “things” connected to a network to exchange information automatically.
- *3 Full-MVNO: Compared to conventional MVNO (light MVNO), which is highly dependent upon MNO equipment, full MVNO services are operated using an in-house HLR/HSS (databases for managing SIM cards), thereby making it possible for such providers to procure and issue their own SIM cards and design their services with more freedom. For example, in the IoT field, where future developments are expected, IJ expects to be able to offer embedded SIMs as well as develop services that it can freely control in terms of the management of charges and activation, thereby creating a new MVNO business model.
- *4 eSIM: Embedded SIMs that allows users to remotely download the profiles required to use cellular services.
- *5 SoftSIM: An entirely software-based SIM with no hardware, which can be updated remotely.
- *6 IJ Managed WAF Service: A cloud based new security service, which provides a web application firewall (WAF) to protect corporate customers’ web site from cyber attacks.
- *7 Adjusted figures: Please refer to the next section, “(ii) Regarding the retroactively adjusted 1H18 financial results”.

(ii) Regarding the retroactively adjusted 1H18 financial results

As an MVNO, we purchase mobile infrastructure mainly from NTT Docomo Inc. The unit price for mobile interconnectivity charge is revised every year and has been decreasing. Because the unit price is fixed at the end of our fiscal year, we apply our own estimate of unit price decrease rate to calculate mobile infrastructure cost throughout a fiscal year. Difference amount between our estimate and revised charge is recorded as a one-time cost or reduction in cost in 4Q.

In FY2018, the difference between our estimate and the revised was large and we recorded JPY2.05 billion of cost in 4Q18. Essentially this one-time additional cost should have been allocated to attributable each quarter of FY2018. Adjusted figures by the result of such allocation (“Adjusted”) are as follows:

	1Q18	2Q18	3Q18	4Q18
	JPY billion	JPY billion	JPY billion	JPY billion
Accounting period	—	—	—	2.05
Cost allocated to attributable service period	0.48	0.50	0.52	0.55

Adjusted 1H18 results and Adjusted YoY changes are as follows:

	Adjusted 1H18	1H19	Adjusted YoY change
	JPY millions	JPY millions	(%)
Cost of Network services revenue	(49,485)	(51,153)	3.4
Gross profit of Network services	8,673	10,051	15.9
Total gross profit	13,262	15,200	14.6
Operating profit	2,300	3,352	45.7
Profit before tax	2,445	3,043	24.5
Profit for the period	1,506	1,858	23.4
Profit for the period attributable to owners of the parent	1,420	1,756	23.6
Comprehensive income for the period	1,715	2,562	49.4

1H18 Adjusted Network service and SI business segment operating profit and Adjusted YoY changes are as follows:

	Adjusted 1H18	1H19	Adjusted YoY change
	JPY millions	JPY millions	(%)
Operating profit (consolidated)	2,300	3,352	45.7
Network service and SI business	1,607	2,557	59.1

(iii) Analysis of Consolidated Results of Operations for the first six months of the 28th business term.

We have omitted segment analysis because most of our revenues are dominated by network services and systems integration (SI) business.

Operating Results Summary

	1H18	1H19	YoY Change
	JPY millions	JPY millions	%
Total revenues	91,224	99,220	8.8
Network services	58,158	61,204	5.2
Systems integration (SI)	30,995	35,916	15.9
ATM operation business	2,071	2,100	1.4
Total costs	(76,977)	(84,020)	9.1
Network services	(48,500)	(51,153)	5.5
Systems integration (SI)	(27,310)	(31,742)	16.2
ATM operation business	(1,167)	(1,125)	(3.6)
Total gross profit	14,247	15,200	6.7
Network services	9,658	10,051	4.1
Systems integration (SI)	3,685	4,174	13.3
ATM operation business	904	975	7.9
SG&A, R&D, and other operating income (expenses)	(10,962)	(11,848)	8.1
Operating profit	3,285	3,352	2.0
Profit before tax	3,430	3,043	(11.3)
Profit for the period attributable to owners of the parent	2,095	1,756	(16.2)

(Notes) 1. We have adopted IFRS from the filing of our FY2018 annual report “Yuka-shoken-houkokusho.” The reporting periods of foreign consolidated subsidiaries are different from the period under the Generally Accepted Accounting Principles in the United States (U.S. GAAP). Along with the change, the figures for 1H18 are different from 1H18 results disclosed in the past.

2. Systems integration includes equipment sales.

Segment Results Summary

	1H18	1H19
	JPY millions	JPY millions
Total revenues	91,224	99,220
Network services and SI business	89,349	97,265
ATM operation business	2,071	2,100
Elimination	(196)	(145)
Operating profit	3,285	3,352
Network service and SI business	2,592	2,557
ATM operation business	807	869
Elimination	(114)	(74)

i) Revenues

Total revenues were JPY99,220 million, up 8.8% YoY (JPY91,224 million for 1H18).

Network services revenue was JPY61,204 million, up 5.2% YoY (JPY58,158 million for 1H18).

Revenues for Internet connectivity services for enterprise were JPY18,075 million, up 13.3% YoY from JPY15,955 million for 1H18, mainly due to an increase in mobile-related services revenues such as MVNE and M2M (*) /IoT type revenues by leveraging our full-MVNO infrastructure.

Revenues for Internet connectivity services for consumers were JPY12,997 million, up 3.3% YoY from JPY12,585 million for 1H18. The revenue growth was mainly due to “IIJmio Mobile Service,” consumer mobile services.

Revenues for WAN services were JPY14,342 million, down 7.3% YoY from JPY15,473 million for 1H18, mainly because of the planned migration projects of large enterprises clients who are moving away from dedicated line to mobile to connect their multiple locations.

Revenues for Outsourcing services were JPY15,790 million, up 11.6% YoY from JPY14,145 million for 1H18, mainly due to an increase in security-related services revenues.

* M2M: Machine to Machine (M2M) enables devices connected to network to exchange information automatically and perform designed actions.

Network Services Revenues Breakdown

	1H18	1H19	YoY Change
	JPY millions	JPY millions	%
Total network services	58,158	61,204	5.2
Internet connectivity services (enterprise)	15,955	18,075	13.3
IP services (including data center connectivity services)	5,212	5,314	1.9
IIJ Mobile services	9,162	11,133	21.5
IIJ Mobile MVNO Platform Service	6,927	8,234	18.9
Others	1,581	1,628	3.0
Internet connectivity services (consumer)	12,585	12,997	3.3
IIJmio Mobile Service	11,216	11,710	4.4
Others	1,369	1,287	(6.0)
WAN services	15,473	14,342	(7.3)
Outsourcing services	14,145	15,790	11.6

Number of Contracts and Subscription for Connectivity Services

	As of September 30, 2018	As of September 30, 2019	YoY Change
Internet connectivity services (enterprise)	1,561,978	1,827,220	265,242
IP service (greater than or equal to 1Gbps)	735	743	8
IP service (less than 1Gbps)	1,303	1,240	(63)
IIJ Mobile Services	1,483,479	1,741,824	258,345
IIJ Mobile MVNO Platform Service	936,067	1,090,569	154,502
Others	76,461	83,413	6,952
Internet connectivity services (consumer)	1,395,648	1,408,665	13,017
IIJmio Mobile Service	1,048,136	1,075,758	27,622
Others	347,512	332,907	(14,605)
Total contracted bandwidth (Gbps)	3,548.0	4,454.0	906.0

(Notes) 1. Numbers in the table above show number of contracts except for “IIJ Mobile Services (enterprise)” and “IIJmio Mobile Service” which show number of subscriptions.

2. The numbers of IP service contracts includes the numbers of IIJ data center connectivity service contracts.

3. Total contracted bandwidth is calculated by multiplying number of contracts under “Internet connectivity services (enterprise)” except for “IIJ Mobile Services” and the contracted bandwidths of the services respectively.

4. Along with our change in accounting principle from the U.S. GAAP to IFRS from the filing of our FY2018 annual report “Yuka-shoken-houkokusho,” the reporting period of foreign consolidated subsidiaries are different. As a result, the number of our Internet connectivity service contracts and total contracted bandwidth described above are different from the past disclosure.

SI revenues, including equipment sales were JPY35,916 million, up 15.9% YoY (JPY30,995 million for 1H18).

Systems construction and equipment sales revenue, a one-time revenue, was JPY13,754 million, up 27.5% YoY (JPY10,790 million for 1H18). In addition to an increase in usual revenue of completed project, we recognized JPY1.3 billion of revenue along with construction progresses. Systems operation and maintenance revenue, a recurring revenue, was JPY22,162 million, up 9.7% YoY (JPY20,205 million for 1H18), mainly due to continued accumulation of systems operation orders as well as an increase in private cloud services' revenues.

Orders received for SI and equipment sales totaled JPY36,351 million, up 4.1% YoY (JPY34,928 million for 1H18); orders received for systems construction and equipment sales were JPY14,610 million, almost the same as JPY14,694 million for 1H18, and orders received for systems operation and maintenance were JPY21,741 million, up 7.4% YoY (JPY20,234 million for 1H18).

Order backlog for SI and equipment sales as of September 30, 2019 amounted to JPY51,550 million, up 2.0% YoY (JPY50,529 million as of September 30, 2018); order backlog for systems construction and equipment sales was JPY8,696 million, down 20.7% YoY (JPY10,969 million as of September 30, 2018) and order backlog for systems operation and maintenance was JPY42,853 million, up 8.3% YoY (JPY39,559 million as of September 30, 2018).

ATM operation business revenues were JPY2,100 million, up 1.4% YoY (JPY2,071 million for 1H18).

ii) Cost of sales

Total cost of sales was JPY84,020 million, up 9.1% YoY (JPY76,977 million for 1H18 and JPY77,962 million as Adjusted) and Adjusted YoY change was up 7.8%.

Cost of network services revenue was JPY51,153 million, up 5.5% YoY (JPY48,500 million for 1H18 and JPY49,485 million as Adjusted) and Adjusted YoY change in cost of network services revenue was up 3.4% YoY. There were an increase in outsourcing-related costs along with our mobile-related revenue increase and a decrease in circuit-related costs along with our WAN services revenue decrease. Gross profit was JPY10,051 million, up 4.1% YoY (JPY9,658 million for 1H18 and JPY8,673 million as Adjusted), Adjusted YoY change in gross profit was up 15.9%, and gross profit ratio was 16.4% (16.6% for 1H18 and 14.9% as Adjusted).

Cost of SI revenues, including equipment sales was JPY31,742 million, up 16.2% YoY (JPY27,310 million for 1H18). There were an increase in purchasing costs along with increase in our systems construction revenue and an increase in network operation-related costs. Gross profit was JPY4,174 million, up 13.3% YoY (JPY3,685 million for 1H18) and gross profit ratio was 11.6% (11.9% for 1H18).

Cost of ATM operation business revenues was JPY1,125 million, down 3.6% YoY (JPY1,167 million for 1H18). Gross profit was JPY975 million (JPY904 million for 1H18) and gross profit ratio was 46.4% (43.7% for 1H18).

iii) Selling, general and administrative expenses and other operating income and expenses

Selling, general and administrative expenses, which include research and development expenses, totaled JPY11,901 million, up 8.3% YoY (JPY10,992 million for 1H18), mainly due to increases in personnel-related expenses and sales commission expenses.

Other operating income was JPY159 million (JPY79 million for 1H18).

Other operating expenses was JPY106 million (JPY49 million for 1H18), mainly due to disposal loss on fixed assets.

iv) Operating profit

Operating profit was JPY3,352 million (JPY3,285 million for 1H18 and JPY2,300 million as Adjusted), up 2.0% YoY and Adjusted YoY change was up 45.7%.

v) Finance income and expenses, and share of profit (loss) of investments accounted for using equity method

Finance income was JPY119 million, compared to JPY390 million for 1H18. It included dividend income of JPY61 million (JPY75 million for 1H18).

Finance expense was JPY295 million, compared to JPY222 million for 1H18. It included interest expenses of JPY279 million (JPY214 million for 1H18).

Share of loss of investments accounted for using equity method was JPY133 million (compared to loss of JPY23 million for 1H18), mainly due to our share of loss in DeCurret Inc. of JPY685 million and gains on changes in equity of JPY376 million arisen from issuance of common stock of DeCurret Inc.

vi) Profit before tax

Profit before tax was JPY3,043 million (JPY3,430 million for 1H18 and JPY2,445 million as Adjusted), down 11.3% YoY and Adjusted YoY change was up 24.5%.

vii) Profit for the period

Income tax expense was JPY1,185 million (JPY1,249 million for 1H18). As a result, profit for the period was JPY1,858 million (JPY2,181 million for 1H18 and JPY1,506 million as Adjusted), down 14.8% YoY and Adjusted YoY change was up 23.4%.

Profit for the period attributable to non-controlling interests was JPY102 million (JPY86 million for 1H18) mainly related to net income of Trust Networks Inc. As a result, profit for the period attributable to owners of parent was JPY1,756 million (JPY2,095 million for 1H18 and JPY1,420 million as Adjusted), down 16.2% YoY and Adjusted YoY change was up 23.6%.

(2) Financial Position

As of September 30, 2019, the balance of total assets was JPY201,972 million, increased by JPY34,683 million from the balance as of March 31, 2019 of JPY167,289 million.

As of September 30, 2019, the balance of current assets was JPY79,574 million, increased by JPY602 million from the balance as of March 31, 2019 of JPY78,791 million. The major breakdown of fluctuation and balance of current assets was: an increase in cash and cash equivalents by JPY2,079 million to JPY34,036 million, a decrease in trade receivables by JPY3,164 million to JPY30,212 million, a decrease in inventories by JPY1,360 million to JPY2,044 million and an increase in prepaid expenses by JPY1,720 million to JPY10,242 million.

As of September 30, 2019, the balance of non-current assets was JPY122,398 million, increased by JPY34,081 million from the balance as of March 31, 2019 of JPY88,318 million. Along with the adoption of IFRS 16 from the first quarter of the fiscal year ending March 31, 2020, right-of-use assets were newly accounted. The breakdown of right-of-use assets was: JPY33,942 million of assets under operating lease contracts which was newly recognized, mainly related to our office and data centers lease contracts, and JPY15,827 million of assets under finance lease contracts, most of which were transferred from tangible and intangible assets. Other investments was JPY10,019 million, decreased by JPY1,384 million mainly due to sales of our portion of holding equity securities.

As of September 30, 2019, the balance of current liabilities was JPY62,708 million, increased by JPY9,804 million from the balance as of March 31, 2019 of JPY52,904 million. Trade and other payables decreased by JPY4,916 million to JPY17,046 million. Borrowings increased by JPY3,195 million to JPY15,945 million. The breakdown of increase in the borrowings was: an increase by JPY3,030 million in short-term borrowings, a decrease by JPY750 million due to payment of long-term borrowings, and an increase by JPY915 million due to a transfer from non-current liabilities. Other financial liabilities increased by JPY10,791 million to JPY17,822 million. The increase included JPY10,254 million related to operating lease recognized along with the adoption of IFRS 16.

As of September 30, 2019, the balance of non-current liabilities was JPY60,249 million, increased by JPY22,984 million from the balance as of March 31, 2019 of JPY37,265 million. Long-term borrowings decreased by JPY915 million to JPY13,085 million due to a transfer to current portion. Other financial liabilities increased by JPY23,982 million to JPY36,133 million. The increase included JPY23,749 million related to operating lease recognized along with the adoption of IFRS 16.

As of September 30, 2019, the balance of equity attributable to owners of parent was JPY78,117 million, increased by JPY1,846 million from the balance as of March 31, 2019 of JPY76,271 million. Ratio of owners' equity to total assets was 38.7% as of September 30, 2019.

(3) Cash Flows

Cash and cash equivalents as of September 30, 2019 were JPY34,036 million (JPY27,885 million as of September 30, 2018).

Cash Flows provided by Operating Activities

Net cash provided by operating activities for 1H19 was JPY13,394 million (net cash provided by operating activities of JPY13,871 million for 1H18). There were profit before tax of JPY3,043 million, depreciation and amortization of JPY14,300 million, including JPY6,160 million of depreciation of right-of-use operating lease assets newly recognized by the adoption of IFRS 16, and income taxes paid of JPY1,330 million. Regarding changes in operating assets and liabilities, it was net cash out of JPY2,947 million mainly due to payment of trade and other payables and prepaid expenses in relation to upfront payment for software licenses and maintenance cost for service facilities, while there were cash in by collecting trade receivables and by selling inventories.

Cash Flows used in Investing Activities

Net cash used in investing activities for 1H19 was JPY4,087 million (net cash used in investing activities of JPY3,507 million for 1H18), mainly due to payments for purchase of tangible assets of JPY4,788 million (JPY3,111 million for 1H18), payments for purchase of intangible assets, such as software, of JPY2,422 million (JPY2,510 million for 1H18), and proceeds from sales of other investments, such as equity securities, of JPY2,673 million.

Cash Flows used in Financing Activities

Net cash used in financing activities for 1H19 was JPY7,139 million (net cash used in financing activities of JPY3,902 million for 1H18), mainly due to proceeds from short-term borrowings of JPY3,030 million, payments of other financial liabilities of JPY10,230 million (JPY3,502 million for 1H18), including JPY6,149 million of payment of operating lease obligations newly recognized by the adoption of IFRS 16.

(4) Management policy, management environment and issues to be addressed, etc.

There were no material changes or newly identified matters, relating to the management policy, management environment and issues to be addressed, etc., during 1H19.

(5) Research and developments

For 1H19, research and development expenses, which were in relation to network services and systems integration business segment, were JPY199 million, decreased by 10.8% compared to JPY223 million for 1H18.

(6) Number of employees

There were no material changes in the number of employees of the Company during 1H19.

(i) Consolidated basis

As of September 30, 2019

Number of Employees	3,562 (50)
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(Note) The number of employees indicates the total number of full-time and contract workers. It does not include third-party employees working at the Group. The average number of part-time employees for the full fiscal year is shown in brackets.

(ii) IJ (non-consolidated basis)

As of September 30, 2019

Number of Employees	2,065 (31)
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(Note) The number of employees indicates the total number of full-time and contract workers. It does not include third-party employees working at IJ. The average number of part-time employees for the full fiscal year is shown in brackets.

(7) Production, Orders Received and Sales

(i) Production

Production results for the six months ended September 30, 2019 were as follows :

Type of Services	Three months ended June 30, 2019	
	Production (thousands of yen)	Year over year comparison (%)
Systems Integration, including Equipment Sales	30,784,775	8.2
Total	30,784,775	8.2

(Notes) 1. Amounts do not include consumption taxes.

2. Percentages of year over year comparison indicate year over year rate of change.

3. Since the Company does not engage in production activities in network services and ATM operation business, we do not present production results for network services and ATM operation business.

(ii) Orders Received

Orders received for the six months ended September 30, 2019 and order backlog as of September 30, 2019 were as follows:

Type of Services	Six months ended September 30, 2019			
	Orders Received (thousands of yen)	Year over Year comparison (%)	Order Backlog (thousands of yen)	Year over Year comparison (%)
Systems Construction and Equipment Sales	14,609,714	(0.6)	8,696,323	(20.7)
Systems Operation and Maintenance	21,740,918	7.4	42,853,253	8.3
Total	36,350,632	4.1	51,549,576	2.0

(Notes) 1. Amounts do not include consumption taxes.

2. Percentages of year over year comparison indicate year over year rate of change.

3. Since the Company does not engage in make-to-order production in network services and ATM operation business, we do not present orders received and order backlog for network services and ATM operation business.

(iii) Sales

Quarterly consolidated revenues for the six months ended September 30, 2019 were as follows:

Type of services	Six months ended September 30, 2019	
	Revenue (thousands of yen)	Year over year comparison (%)
Network services	61,203,901	5.2
Internet connectivity services (enterprise)	18,074,951	13.3
Internet connectivity services (consumer)	12,996,891	3.3
WAN services	14,342,498	(7.3)
Outsourcing services	15,789,561	11.6
Systems integration	35,915,608	15.9
Systems construction and equipment sales	13,753,234	27.5
Systems operation and maintenance	22,162,374	9.7
ATM operation business	2,100,026	1.4
Total revenues	99,219,535	8.8

(Notes) 1. Amounts do not include consumption taxes.

2. Percentages of year over year comparison indicate year over year rate of change.

(8) Major property and equipment

There were no material changes in major property and equipment or in our plan in relation to property and equipment during the six months ended September 30, 2019.

3 Material Contracts, etc.

Not applicable.

Item 3. Information on IIJ

1 Information on IIJ's Shares

(1) Total Number of Shares

(i) 【Total Number of Shares】

Class	Total number of shares authorized to be issued (shares)
Common stock	75,520,000
Total	75,520,000

(ii) 【Number of shares issued】

Class	Number of shares issued as of the end of period (shares) (September 30, 2019)	Number of shares issued as of the filing date (shares) (November 14, 2019)	Stock exchange on which IIJ is listed or authorized financial instruments firms association	Description
Common stock	46,734,600	46,734,600	Tokyo Stock Exchange (the first section)	The number of shares constituting a unit is 100.
Total	46,734,600	46,734,600	—	—

(2) Information on Stock Acquisition Rights

(i) Description of Stock Option System

Stock-Compensation-Type Stock Options (Stock Acquisition Rights)

Under this stock compensation-type stock option plan, IIJ's directors (excluding part-time directors and outside directors) and executive officers will receive stock acquisition rights as stock-based compensation stock options, which are issued and allocated in accordance with the Companies Act, as a substitution for the abolished retirement benefit plan for directors.

Stock acquisition rights issued during the three month ended September 30 are as follows.

Date of resolution	June 27, 2019
Class and number of person for subscription rights to shares	7 Full-time Directors and 12 Executive Officers
Number of stock acquisition rights outstanding (Number)	163 (Note 1)
Type of stock and number of shares subject to stock acquisition rights (shares)	Common stock: 32,600 (Note 1)
Amount to be paid in upon exercise of subscription rights to shares	The value of assets to be contributed upon exercise of stock acquisition rights shall be determined by multiplying the price to be paid per share upon exercise of each stock acquisition right (the "exercise price") by the Number of Shares Granted, and the exercise price shall be one (1) Japanese yen (JPY).
Exercise period of subscription rights to shares	From July 13, 2019 to July 12, 2049
Price of issuing shares and amount of capitalization upon exercise of subscription rights to shares	Price of issuing shares : JPY 1,774 Amount of capitalization : JPY 887
Condition for exercise of subscription rights to shares	(Note 2)
Matters regarding acquisition of subscription rights to shares through transfer	Acquisition of subscription rights to shares through transfer shall be subject to approval by resolution of the Board of Directors.
Matters regarding the grant of subscription rights to shares to upon organizational restructuring	(Note 3)

* The contents are described as of July 12, 2019, when the stock acquisition rights were issued.

(Notes)

1. Class and number of shares to be issued upon exercise of stock acquisition rights

The class of shares to be issued upon exercise of stock acquisition rights shall be common stock of IIJ. The number of shares to be issued upon exercise of each stock acquisition right (hereinafter referred as “Number of Shares Granted”) shall be two hundred (200).

Number of Shares Granted after adjustment	=	Number of Shares Granted before adjustment	×	Ratio of share split or share consolidation
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In the case of a share split, the Number of Shares Granted after adjustment shall apply from the day after the record date of said share split. Whereas, in the case of a share consolidation, the Number of Shares Granted after adjustment shall apply from the day the share consolidation becomes effective. This is provided, however, that in cases where IIJ conducts a share split conditional on approval at a General Meeting of Shareholders of IIJ of a proposal to reduce surplus and increase capital stock and capital reserve, the record date for the share split shall be the day prior to the day on which said shareholders’ meeting closes, the Number of Shares Granted after adjustment shall retroactively apply from the day after the day the applicable shareholders’ meeting closes and the day following the applicable record date.

2. Terms and conditions of exercising stock acquisition rights

- 1) Partial execution of each stock acquisition right is not allowed.
- 2) A person granted the stock acquisition rights may exercise these rights only within ten (10) days from the day following the day the person loses his or her position as a Director or Executive Officer of IIJ, except for losing his or her position by passing away. However, this does not apply if his or her legal heir who inherits the stock acquisition rights as described in the following paragraph 3) exercises the rights.
- 3) If a person granted the stock acquisition rights passes away, only one of his or her legal heir is permitted to inherit the granted stock acquisition rights (hereinafter referred to as the “Grantee”). The Grantee can exercise the rights only within six (6) months after inheriting the new share acquisition rights. If the Grantee passes away, the stock acquisition rights cannot be passed on to the legal heir of the Grantee.
- 4) The Share Purchase Warrants shall not be transferred to third parties, offered for pledge or disposed of in any other way
- 5) Matters concerning other conditions for the exercise of stock acquisition rights, other than the items prescribed above, shall be determined at the meeting of the Board of Directors when the terms and conditions of offering of stock acquisition rights are determined.

3. Matters concerning the details of the issuance of stock acquisition rights undergoing Organizational Restructuring

In the event IIJ merges (limited to cases wherein IIJ becomes a dissolving company), performs an absorption-type demerger or an incorporation-type demerger (only if IIJ becomes the split company), or conducts a share exchange or a share transfer (only if IIJ becomes a wholly owned subsidiary) (hereinafter collectively referred to as “Organizational Restructuring”), stock acquisition rights of a corporation described in Article 236, Paragraph 1, Items 8.1 through 8.5 of the Corporation Law of Japan (hereinafter “Restructured Company”) shall be granted to each Stock Acquisition Right Holder remaining unexercised (hereinafter “Remaining Stock Acquisition Rights”) immediately before the date when Organizational Restructuring takes effect (refers to the date when the absorption-type merger takes effect, the date on which the company is incorporated through the incorporation-type merger, the date when the absorption-type demerger takes effect, the date on which the company incorporated through the incorporation-type demerger, the date when share exchange takes effect, or the date when the wholly owning parent company is established by share transfer). However, the foregoing shall apply only to cases in which the delivery of stock acquisition rights of the Restructured Company according to the following conditions is stipulated in the absorption-type merger agreement, the incorporation-type merger agreement, the absorption-type demerger agreement, the incorporation-type demerger plan, the share exchange agreement or the share transfer plan.

- 1) Number of stock acquisition rights of the Restructured Company to be delivered
IIJ shall deliver stock acquisition rights, the number of which shall equal the number of stock acquisition rights held by the holder of the Remaining Stock Acquisition Rights.
- 2) Class of shares of the Restructured Company to be issued upon exercise of stock acquisition rights
Common stock of the Restructured Company
- 3) Number of shares of the Restructured Company to be issued upon exercise of stock acquisition rights
To be decided according to Note 1 above after taking into consideration the conditions, etc., of the Organizational Restructuring.
- 4) Value of the assets to be contributed upon exercise of stock acquisition rights
The value of the assets to be contributed upon exercise of each stock acquisition right shall be the amount obtained by multiplying the amount to be paid after restructuring as stipulated below, and the number of shares of the Reorganized Company to be issued upon exercise of the stock acquisition rights as determined in accordance with 3) above. The amount to be paid after restructuring shall be one (1) yen per share of the Restructured Company that can be granted due to the exercise of each stock acquisition right to be granted.
- 5) Exercise period of stock acquisition rights
Starting from the later of either the commencement date of the exercise period of stock acquisition rights as stipulated above, or the date on which the Organizational Restructuring becomes effective, and ending on the expiration date for the exercise of stock acquisition rights as stipulated in above.
- 6) Matters concerning increase in capital stock and capital reserve to be increased by the issuance of shares upon exercise of stock acquisition rights
 - (a) Amount of increase in capital stock by issuing shares upon exercise of stock acquisition rights shall be half of the upper limit of capital increase as calculated pursuant to the provisions of Article 17, Paragraph 1 of the Ordinance for Corporate Accounting, with the resulting fractions of less than one (1) yen occurring upon such calculation being rounded up to the nearest yen.
 - (b) The amount of increase in capital reserve by issuing shares upon exercise of stock acquisition rights shall be the upper limit of capital increase as described in (a) above less the amount of increase in capital set out therein.
- 7) Restriction on acquisition of stock acquisition rights by transfer
Any acquisition of stock acquisition rights by transfer shall be subject to approval by resolution of the Board of Directors of the Restructured Company.
- 8) Conditions for acquisition of stock acquisition right
Should a resolution for the approval of any of the proposals (a) or (b) below be adopted at the General Meeting of Shareholders of IIJ (or at a meeting of the Board of Directors of IIJ if a resolution at a General Meeting of Shareholders is not required), IIJ may acquire the stock acquisition rights as at the date specifically determined by the Board of Directors of IIJ without contribution.
 - (a) Proposal for approval of a merger agreement under which IIJ shall be merged
 - (b) Proposal for approval of a share exchange agreement or share transfer plan under which IIJ shall be a wholly owned subsidiary
- 9) Other terms and conditions of exercising stock acquisition rights
To be determined in accordance with Note 2 above.

(ii) Other Stock Acquisition Rights

Not applicable

(3) Information on Moving Strike Convertible Bonds

Not applicable.

(4) Changes in the Total Number of Issued Shares and Capital

Date	Changes in the total number of issued shares (shares)	Balance of the total number of issued shares (shares)	Changes in capital (thousands of yen)	Balance of capital (thousands of yen)	Changes in capital reserve (thousands of yen)	Balance of capital reserve (thousands of yen)
From July 1, 2019 to September 30, 2019	13,200	46,734,600	11,909	22,991,399	11,908	9,712,083

(Note) Increased by exercise of stock acquisition rights

(5) Major Shareholders

As of September 30, 2019

Name	Address	Number of shares held (shares)	Ownership percentage of the total number of issued shares other than treasury stock (%) (Note 1)
Nippon Telegraph and Telephone Corporation	5-1 Otemach 1-chome, Chiyoda-ku, Tokyo	10,095,000	22.39
NTT Communications Corporation	3-1 Otemach 2-chome, Chiyoda-ku, Tokyo	2,040,000	4.52
ITOCHU Techno-Solutions Corporation	2-5 Kasumigaseki 3-chome, Chiyoda-ku, Tokyo	1,952,000	4.33
Koichi Suzuki (Note 2)	Chiyoda-ku, Tokyo	1,833,200	4.07
The Master Trust Bank of Japan, Ltd. (Trust account) (Note 3)	11-3 Hamamatsu-cho 2-chome, Chiyoda-ku, Tokyo	1,697,600	3.77
The Dai-ichi Life Insurance Company, Limited (Standing proxy: Trust & Custody Services Bank, Ltd.)	13-1 Yurakucho 1-chome, Chiyoda-ku, Tokyo (Harumi Triton Square Office Tower Z, 8-12 Harumi 1-chome, Chuo-ku, Tokyo)	1,273,000	2.82
Japan Trustee Services Bank, Ltd. (Trust account 9) (Note 3)	8-11, Harumi 1-chome, Chuo-ku, Tokyo	1,186,500	2.63
Japan Trustee Services Bank, Ltd. (Trust account) (Note 3)	8-11, Harumi 1-chome, Chuo-ku, Tokyo	1,073,800	2.38
GOLDMAN, SACHS & CO. REG (Standing proxy: Goldman Sachs Japan Co., Ltd.)	200 West Street New York, NY, U.S.A. (Roppongi Hills Mori Tower, 10-1 Roppongi 6-chome Minato-ku, Tokyo)	990,522	2.20
KS Holdings (Note 2)	5-3 Nishi kanda 3-chome, Chiyoda-ku, Tokyo	810,000	1.80
Total	—	22,951,622	50.91

(Note) 1. The percentage are rounded to two decimal places.

2. Koichi Suzuki, who is a representative director and chairman of IJ, jointly owns IJ stocks through his wholly owned private company called KS Holdings.
3. Numbers of shares held by Japan Trustee Services Bank, Ltd and The Master Trust Bank of Japan, Ltd are those related to trust business.
4. According to the change report of the Report of Possession of Large Volume filed by Dalton Investments LLC on May 22, 2019, Dalton Investments LLC held 2,949,600 shares of common stock, 6.3% of the total outstanding shares as of May 17, 2019. We cannot recognize the number of shares held by Dalton Investments LLC as of September 30, 2019. Therefore, the table above does not include Dalton Investments LLC as a major shareholder.
5. According to the change report of the Report of Possession of Large Volume filed by Global Alpha Capital Management Ltd., on March 15, 2019, Global Alpha Capital Management Ltd. held 2,838,926 shares of common stock, 6.1% of the total outstanding shares as of March 12, 2019. Although we did not recognize change report filed after that day, we cannot recognize the number of shares held by Global Alpha Capital Management Ltd. as of September 30, 2019. Therefore, the table above does not include Global Alpha Capital Management Ltd. as a major shareholder.
6. There were 1,650,911 shares of treasury stock, which were not included in the above table.

(6) Information on Voting Rights

(i) Issued shares

As of September 30, 2019

Classification	Number of Shares (shares)	Number of Voting Rights	Description
Shares without Voting Rights	—	—	—
Shares with Restricted Voting Rights (treasury stock, etc.)	—	—	—
Shares with Restricted Voting Rights (others)	—	—	—
Shares with Full Voting Rights (treasury stock, etc.)	Treasury Stock: 1,650,900 shares of common stock	—	—
Shares with Full Voting Rights (others)	45,071,900 shares of common stock	450,719	—
Shares Representing Less than One Unit	11,800 shares of common stock	—	—
Number of Issued Shares	46,734,600 shares of common stock	—	—
Total Number of Voting Rights	—	450,719	—

(Note) Shares Representing Less than One Unit includes 11 shares of treasury stock held by the Company.

(ii) Treasury Stock

As of September 30, 2019

Name	Address	Number of shares held under own name (shares)	Number of shares held under the name of others (shares)	Total number of shares held (shares)	Ownership percentage of total number of shares outstanding (%)
(Treasury Stock) Internet Initiative Japan Inc.	2-10-2 Fujimi, Chiyoda-ku, Tokyo	1,650,900	—	1,650,900	3.53
Total	—	1,650,900	—	1,650,900	3.53

2 Changes in Directors and Company Auditors

There were no changes in directors and company auditors during the period from the filing date of the Annual Securities Report for the fiscal year ended March 31, 2019 (June 28, 2019) to the September 30, 2019.

Item 4. Financial Information
Condensed Consolidated Financial Statements
Condensed Consolidated Statements of Financial Position

	March 31, 2019	September 30, 2019
	Thousands of yen	Thousands of yen
Assets		
Current Assets		
Cash and cash equivalents	31,957,789	34,036,458
Trade receivables	33,375,808	30,211,635
Inventories	3,403,192	2,043,569
Prepaid expenses	8,522,554	10,242,295
Other financial assets	1,581,212	2,892,338
Other current assets	130,900	147,530
Total Current Assets	<u>78,971,455</u>	<u>79,573,825</u>
Non-current Assets		
Tangible assets	33,136,059	19,189,686
Right-of-use Assets	—	49,768,939
Goodwill	6,082,472	6,082,472
Intangible assets	18,818,707	18,333,822
Investments accounted for using the equity method	4,837,867	5,121,984
Prepaid expenses	8,037,298	8,287,852
Other investments	11,402,365	10,018,633
Deferred tax assets	176,587	329,188
Other financial assets	5,293,547	4,925,548
Other non-current assets	532,839	340,158
Total non-current assets	<u>88,317,741</u>	<u>122,398,282</u>
Total assets	<u><u>167,289,196</u></u>	<u><u>201,972,107</u></u>

	March 31, 2019	September 30, 2019
	Thousands of yen	Thousands of yen
Liabilities and Equity		
Liabilities		
Current liabilities		
Trade and other payables	21,962,239	17,045,749
Borrowings	12,750,000	15,945,000
Income taxes payable	1,139,460	1,747,197
Deferred income	5,461,813	5,799,841
Other financial liabilities	7,031,690	17,822,375
Other current liabilities	4,559,005	4,348,225
Total current liabilities	<u>52,904,207</u>	<u>62,708,387</u>
Non-current liabilities		
Borrowings	14,000,000	13,085,000
Retirement benefit liabilities	3,488,501	3,612,935
Provisions	731,257	732,723
Deferred income	5,518,492	5,614,081
Deferred tax liabilities	421,396	192,934
Other financial liabilities	12,151,346	36,133,307
Other non-current liabilities	954,387	878,335
Total non-current liabilities	<u>37,265,379</u>	<u>60,249,315</u>
Total liabilities	<u>90,169,586</u>	<u>122,957,702</u>
Equity		
Share capital	25,518,712	25,530,621
Share premium	36,225,775	36,242,495
Retained earnings	12,335,035	14,992,750
Other components of equity	4,088,704	3,248,309
Treasury shares	(1,896,788)	(1,896,788)
Total equity attributable to owners of the parent	<u>76,271,438</u>	<u>78,117,387</u>
Non-controlling interests	848,172	897,018
Total equity	<u>77,119,610</u>	<u>79,014,405</u>
Total liabilities and equity	<u>167,289,196</u>	<u>201,972,107</u>

Condensed Consolidated Statements of Profit or Loss for Six-Month Periods

	Six Months Ended September 30, 2018	Six Months Ended September 30, 2019
	Thousands of yen	Thousands of yen
Revenues		
Network services	58,158,157	61,203,901
System integration	30,994,454	35,915,608
ATM operation business	2,071,290	2,100,026
Total revenues	<u>91,223,901</u>	<u>99,219,535</u>
Cost of sales		
Cost of network services	(48,500,372)	(51,153,590)
Cost of systems integration	(27,309,569)	(31,741,986)
Cost of ATM operation business	(1,167,007)	(1,124,746)
Total cost of sales	<u>(76,976,948)</u>	<u>(84,020,322)</u>
Gross Profit	14,246,953	15,199,213
Selling, general and administrative expense	(10,992,414)	(11,900,630)
Other operating income	79,015	159,068
Other operating expenses	(48,740)	(105,701)
Operating Profit	<u>3,284,814</u>	<u>3,351,950</u>
Finance income	389,654	118,609
Finance expenses	(221,334)	(294,150)
Share of profit (loss) of investments accounted for using equity method	(23,234)	(133,121)
Profit (loss) before tax	<u>3,429,900</u>	<u>3,043,288</u>
Income tax expense	(1,248,852)	(1,184,935)
Profit (loss) for the year	<u><u>2,181,048</u></u>	<u><u>1,858,353</u></u>
Profit (loss) for the year attributable to:		
Owners of the parent	2,095,091	1,756,102
Non-controlling interests	85,957	102,251
Total	<u><u>2,181,048</u></u>	<u><u>1,858,353</u></u>
Earnings per share		
Basic earnings per share (yen)	46.48	38.96
Diluted earnings per share (yen)	46.31	38.79

Condensed Consolidated Statements of Profit or Loss for Three-Month Periods

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2019
	Thousands of yen	Thousands of yen
Revenues		
Network services	29,447,133	30,524,316
System integration	15,862,233	17,806,404
ATM operation business	1,076,090	1,059,971
Total revenues	46,385,456	49,390,691
Cost of sales		
Cost of network services	(24,675,282)	(25,492,608)
Cost of systems integration	(13,709,911)	(15,522,606)
Cost of ATM operation business	(584,102)	(557,828)
Total cost of sales	(38,969,295)	(41,573,042)
Gross Profit	7,416,161	7,817,649
Selling, general and administrative expense	(5,470,662)	(5,858,938)
Other operating income	19,439	46,409
Other operating expenses	(31,797)	(34,129)
Operating Profit	1,933,141	1,970,991
Finance income	241,797	97,173
Finance expenses	(176,412)	(148,227)
Share of profit (loss) of investments accounted for using equity method	6,456	(245,328)
Profit (loss) before tax	2,004,982	1,674,609
Income tax expense	(738,238)	(642,010)
Profit (loss) for the year	1,266,744	1,032,599
Profit (loss) for the year attributable to:		
Owners of the parent	1,221,348	979,589
Non-controlling interests	45,396	53,010
Total	1,266,744	1,032,599
Earnings per share		
Basic earnings per share (yen)	27.10	21.73
Diluted earnings per share (yen)	26.99	21.63

Condensed Consolidated Statements of Comprehensive Income for Six-Month Periods

	Six Months Ended September 30, 2018	Six Months Ended September 30, 2019
	Thousands of yen	Thousands of yen
Profit (loss)	2,181,048	1,858,353
Other comprehensive income, net of tax		
Items that will not be reclassified to profit or loss		
Net change in fair value of equity instruments designated as measured at fair value through other comprehensive income	124,285	817,704
Total items that will not be reclassified to profit or loss	124,285	817,704
Items that may be reclassified to profit or loss		
Exchange differences on translation of foreign operations	103,333	(117,773)
Financial assets measured at fair value through other comprehensive income	(1,315)	974
Share of other comprehensive income of investments accounted for using equity method	(17,837)	2,493
Total of items that may be reclassified to profit or loss	84,181	(114,306)
Total other comprehensive income, net of tax	208,466	703,398
Other comprehensive income	2,389,514	2,561,751
Other comprehensive income attributable to:		
Owners of the parent	2,303,557	2,459,500
Non-controlling interest	85,957	102,251
Other comprehensive income	2,389,514	2,561,751

Condensed Consolidated Statements of Comprehensive Income for Three-Month Periods

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2019
	Thousands of yen	Thousands of yen
Profit (loss)	1,266,744	1,032,599
Other comprehensive income, net of tax		
Items that will not be reclassified to profit or loss		
Net change in fair value of equity instruments designated as measured at fair value through other comprehensive income	713,579	165,547
Total items that will not be reclassified to profit or loss	713,579	165,547
Items that may be reclassified to profit or loss		
Exchange differences on translation of foreign operations	54,693	(20,231)
Financial assets measured at fair value through other comprehensive income	(1,294)	289
Share of other comprehensive income of investments accounted for using equity method	(4,121)	(1,469)
Total of items that may be reclassified to profit or loss	49,278	(21,411)
Total other comprehensive income, net of tax	762,857	144,136
Other comprehensive income	2,029,601	1,176,735
Other comprehensive income attributable to:		
Owners of the parent	1,984,205	1,123,725
Non-controlling interest	45,396	53,010
Other comprehensive income	2,029,601	1,176,735

Condensed Consolidated Statements of Changes in Shareholders' Equity

Six months ended September 30, 2018

	Owners of the parent's shareholders' equity						Non-controlling interests	Total equity
	Share capital	Share premium	Retained earnings	Other components of equity	Treasury shares	Total		
	Thousands of yen	Thousands of yen	Thousands of yen	Thousands of yen	Thousands of yen	Thousands of yen	Thousands of yen	Thousands of yen
Balance, March 31, 2018	25,511,804	36,175,936	9,678,821	5,058,955	(1,896,784)	74,528,732	718,500	75,247,232
Comprehensive income								
Profit (loss)	-	-	2,095,091	-	-	2,095,091	85,957	2,181,048
Other comprehensive income	-	-	-	208,466	-	208,466	-	208,466
Total comprehensive income	-	-	2,095,091	208,466	-	2,303,557	85,957	2,389,514
Transactions with owners								
Issuance of common stock	6,908	(6,395)	-	-	-	513	-	513
Dividends paid	-	-	(608,349)	-	-	(608,349)	(48,550)	(656,899)
Stock-based compensation	-	27,905	-	-	-	27,905	-	27,905
Transfer from other components of equity to retained earnings	-	-	27,982	(27,982)	-	-	-	-
Total transactions with owners	6,908	21,510	(580,367)	(27,982)	-	(579,931)	(48,550)	(628,481)
Balance, September 30, 2018	25,518,712	36,197,446	11,193,545	5,239,439	(1,896,784)	76,252,358	755,907	77,008,265

Six months ended September 30, 2019

	Owners of the parent's shareholders' equity						Non-controlling interests	Total equity
	Share capital	Share premium	Retained earnings	Other components of equity	Treasury shares	Total		
	Thousands of yen	Thousands of yen	Thousands of yen	Thousands of yen	Thousands of yen	Thousands of yen	Thousands of yen	Thousands of yen
Balance, March 31, 2019	25,518,712	36,225,775	12,335,035	4,088,704	(1,896,788)	76,271,438	848,172	77,119,610
Cumulative impact of adopting IFRS 16 (Note)	-	-	(33,728)	-	-	(33,728)	-	(33,728)
Comprehensive income								
Profit (loss)	-	-	1,756,102	-	-	1,756,102	102,251	1,858,353
Other comprehensive income	-	-	-	703,398	-	703,398	-	703,398
Total comprehensive income	-	-	1,756,102	703,398	-	2,459,500	102,251	2,561,751
Transactions with owners								
Issuance of common stock	11,909	(11,895)	-	-	-	14	-	14
Dividends paid	-	-	(608,452)	-	-	(608,452)	(53,405)	(661,857)
Stock-based compensation	-	28,615	-	-	-	28,615	-	28,615
Transfer from other components of equity to retained earnings	-	-	1,543,793	(1,543,793)	-	-	-	-
Total transactions with owners	11,909	16,720	935,341	(1,543,793)	-	(579,823)	(53,405)	(633,228)
Balance, September 30, 2019	25,530,621	36,242,495	14,992,750	3,248,309	(1,896,788)	78,117,387	897,018	79,014,405

(Note) This line shows impact from adopting IFRS 16 "Leases."

Condensed Consolidated Statements of Cash Flows

	Six Months Ended September 30, 2018	Six Months Ended September 30, 2019
	Thousands of yen	Thousands of yen
Cash flows from operating activities:		
Profit (loss) before tax	3,429,900	3,043,288
Adjustments		
Depreciation and amortization	7,412,392	14,299,860
Loss on sales of property and equipment	28,118	82,881
Shares of loss (profit) of investments accounted for using the equity method	23,234	133,121
Finance income	(261,831)	(107,725)
Finance expenses	213,571	296,483
Other	(96,044)	39,524
Changes in working capital		
Decrease (increase) in trade receivables	1,879,792	3,126,603
Decrease (increase) in inventories	(1,729,183)	1,353,994
Decrease (increase) in prepaid expenses	(2,111,073)	(1,982,541)
Decrease (increase) in other assets	(67,244)	190,111
Decrease (increase) in other financial assets	1,068,095	(621,923)
Increase (decrease) in trade and other payables	3,715,212	(5,221,511)
Increase (decrease) in deferred income	2,327,831	470,327
Increase (decrease) in other liabilities	(52,305)	(285,697)
Increase (decrease) in other financial liabilities	14,326	(101,021)
Increase (decrease) in retirement benefit liabilities	126,247	124,434
Sub total	15,921,038	14,840,208
Interest and dividends received	157,683	162,887
Interest paid	(211,014)	(279,359)
Income taxes paid	(1,996,679)	(1,329,835)
Cash flows from operating activities	13,871,028	13,393,901

	Six Months Ended September 30, 2018	Six Months Ended September 30, 2019
	Thousands of yen	Thousands of yen
Cash flows from investing activities		
Purchases of tangible assets	(3,110,912)	(4,788,074)
Proceeds from sales of tangible assets	1,757,616	817,601
Purchases of intangible assets	(2,510,077)	(2,422,464)
Proceeds from sales of intangible assets	1,579	260,264
Purchase of investments accounted for using equity method	-	(498,000)
Purchases of other investments	-	(42,740)
Proceeds from sales of other investments	358,251	2,673,101
Payments for leasehold deposits and guarantee deposits	(7,946)	(85,874)
Proceeds from collection of leasehold deposits and guarantee deposits	42,113	12,089
Payments for refundable insurance policies	(28,181)	(28,170)
Other	(9,698)	14,833
Cash flows from investing activities	(3,507,255)	(4,087,434)
Cash flows from financing activities		
Repayment of long-term borrowings	-	(750,000)
Net increase (decrease) in short-term borrowings	-	3,030,000
Proceeds from other financial liabilities	256,608	1,473,000
Payments of other financial liabilities	(3,501,569)	(10,229,755)
Dividends paid	(608,349)	(608,452)
Other	(48,556)	(53,418)
Cash flows from financing activities	(3,901,866)	(7,138,625)
Effect of exchange rate changes on cash and cash equivalents	102,774	(89,173)
Net increase (decrease) in cash and cash equivalents	6,564,681	2,078,669
Cash and cash equivalents, beginning of year	21,320,004	31,957,789
Cash and cash equivalents at beginning of period	27,884,685	34,036,458

Notes to Condensed Consolidated Financial Statements

1. REPORTING ENTITY

Internet Initiative Japan Inc. (“IIJ”) is a company incorporated in Japan. The registered addresses of its headquarters and primary business offices are disclosed on IIJ’s website—URL <https://www.ij.ad.jp/>—. The condensed consolidated financial statements of IIJ for the six months ended September 30, 2019 comprise the financial statements of IIJ and its subsidiaries (collectively “the Company”), and the interests in associated companies.

The details of principal businesses and activities of the Company are stated in Note 5. BUSINESS SEGMENTS.

2. BASIS OF PREPARATION

(1) Compliance with IFRS

The consolidated financial statements of the Company have been prepared in accordance with IAS 34 pursuant to the provision of Article 93 of Regulations for Consolidated Financial Statements, as the Company meets the criteria of a “Designated IFRS Specified Company” defined under Article 1-2 of the regulations.

The condensed interim consolidated financial statements, which do not contain all the information required in annual consolidated financial statements, should be read in conjunction with the annual consolidated financial statements for the previous fiscal year ended March 31, 2019.

(2) Basis of Measurement

The Company’s consolidated financial statements have been prepared on a historical cost basis, except for certain financial instruments measured at fair value.

(3) Functional Currency and Presentation Currency

The Company’s consolidated financial statements are presented in Japanese yen, which is also IIJ’s functional currency, and figures are rounded to the nearest thousand yen.

3. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied to the condensed consolidated financial statements for the six months ended September 30, 2019 are the same as those applied to the consolidated financial statements for the fiscal year ended March 31, 2019 except below. Meanwhile, income taxes for the six months ended September 30, 2019 are calculated based on the estimated annual effective tax rate.

The Company applied the following standard starting from the first quarter of the fiscal year ended March 31, 2020.

IFRS		Outline of a new standard and amendments
IFRS 16	Leases	Amendment concerning accounting treatment for leases

From the fiscal year ending March 31, 2020, the Company, in accordance with IFRS 16, has determined whether a contract is, or contains a lease, at the inception of the contract. A contract is determined to be a lease or contain a lease, if the contract conveys the right to control the use of an identified asset for a period of time in exchange for a consideration.

When a contract is determined to be a lease or contain a lease, the Company initially recognizes a right-of-use asset and a lease liability at the commencement date of the contract.

Lease liabilities are initially measured at the present value of lease payments not paid at the commencement date, discounted by calculated interest rate of the lease or, if the calculated interest rate cannot be determined easily, the Company’s incremental borrowing rate. In general, the Company uses the incremental borrowing rate as a discount rate. Lease liabilities are subsequently measured by increasing the carrying amount to reflect the interest on the lease liability and reducing the carrying amount to reflect the lease payments. In our consolidated statement of financial position, lease liabilities are included in other financial liabilities. In measuring the lease liability, lease fee in each contract is allocated to the lease components and non-lease components based on the ratio of their independent prices. However, for data centers where the Company is a lessee, lease components and non-lease components related to them are not separated and are recognized as a single lease component. When the condition of the leases are changed, the Company remeasures the lease liability.

The right-of-use asset is initially measured at cost, which comprises the initial measurement of lease liability, any initial direct cost incurred and prepaid lease payments. A cost model is used for subsequent measurement after initial recognition. Right-of-use assets are depreciated using the straight-line method. The depreciation period is the estimated useful life of the underlying asset if

ownership of the underlying asset is transferred to the lessee by the end of the lease term or if the exercise of the purchase option by the lessee is reasonably certain. Otherwise, the depreciation period is the shorter of the useful life of the right-of-use asset or the lease term. The Company does not recognize right-of-use assets and lease liabilities for leases with a lease term of 12 months or less or when the underlying assets are of low value, and recognizes lease payments as an expense on a straight-line basis over the lease term.

Lessor accounting is substantially the same as in accordance with IAS 17.

During the year ended March 31, 2019, the Company classified lease arrangements as finance leases when the lessor transfers substantially all the risks and rewards incidental to ownership of an asset to the Company. Leased assets are initially recognized at the lower of the fair value of the asset and the present value of the minimum lease payments. After initial recognition, the leased assets are depreciated using the straight-line method for the estimated useful life if the transfer of ownership is reasonably certain by the end of the lease term, or for the shorter of the lease term and the estimated useful life of the leased asset if it is reasonably uncertain. Lease arrangements other than finance leases are classified as operating leases and are not reported in the Company's consolidated statements of financial position. Lease payments under an operating lease are recognized as an expense on a straight-line basis over the lease term.

According to the transition approach, the Company has adopted IFRS 16 retrospectively and the cumulative effect of applying this standard was recognized as adjustment of retained earnings at the beginning date of the first quarter of the fiscal year ended March 31, 2020. In applying IFRS 16, the Company chooses the practical expedient in IFRS 16 paragraph C3 and assesses whether contracts contain leases in accordance with IAS 17 "Leases" (hereinafter, "IAS 17") and IFRIC 4 "Determining whether an Arrangement contains a lease."

The Company recognized right-of-use assets and other financial liabilities related to leases previously classified as operating leases under the principles of IAS 17 were recognized at the date of initial application of IFRS 16. These liabilities are measured at present value of the remaining lease payments discounted using the lessee's incremental borrowing rate at the date of initial application. Right-of-use assets are measured retrospectively as if IFRS 16 had been applied from the inception date. Right-of-use assets are depreciated using the straight-line method.

For leases that were previously classified as finance leases as a lessee under the principles of IAS 17, the carrying amount of right-of-use assets and other financial liabilities as of the date of initial application has been measured based on the carrying amount of right-of-use assets and other financial liabilities, respectively, under IAS 17 as of the day immediately before that date.

The following is the reconciliation of non-cancelable operating lease contracts disclosed applying IAS 17 as of March 31, 2019 and other financial liabilities related to leases recognized in the consolidated statement of financial position at the date of initial application.

	(Thousands of yen)
Non-cancelable operating lease contracts disclosed as of March 31, 2019	11,305,119
Non-cancelable operating lease contracts discounted using the incremental borrowing rate as of April 1, 2019	11,292,343
Finance lease contracts as of March 31, 2019	18,033,862
Cancellable operating lease contracts, etc.	27,745,102
Other financial liabilities related to leases as of April 1, 2019	57,071,307

As a result of the adoption of IFRS 16, the Company recorded right-of-use assets of ¥38,988,207 thousand and other financial liabilities of ¥39,037,445 thousand at April 1, 2019. In addition, retained earnings decreased by ¥33,728 thousand primarily due to having adopted the method where the cumulative effect of applying this standard is recognized at the date of initial application.

The weighted average of incremental borrowing rates which is applied on the other financial liabilities at the date of initial application is 0.45%.

Also, the cash flows from operating activities increased by ¥6,148,877 thousand and the cash flows from the financing activities decreased by the same amount.

The following practical expedients are used in the adoption of IFRS 16.

- A single discount rate is applied to portfolios of leases with reasonably similar characteristics.
- Leases for which the lease term ends within 12 months of the date of initial application are accounted for in the same way as short-term leases.
- Initial direct costs are excluded from the measurement of the right-of-use asset at the date of initial application.
- The Company uses hindsight to calculate the lease term for lease contracts including options to extend or terminate the lease.

4. Significant accounting estimates and judgements involving estimates

The Company's condensed consolidated financial statements includes management's estimates and assumptions, which should affect the measurements of revenues and expenses, assets and liabilities and the disclosure of contingent assets and liabilities at the end of the reporting period.

The estimates and assumptions are based on the best judgement by management considering factors deemed to be reasonable as of the end date of the reporting period according to factors regarding available past and present information, etc. However, amounts based on the estimates and assumptions may, due to the nature, differ from actual results.

Estimates and assumptions on which estimates are based are reviewed on an ongoing basis. The effects arising from revision of estimates are recognized during the period when the estimates are revised and in future periods.

Estimates and judgements with significant effects on the condensed consolidated financial statements for the six months ended September 30, 2019 are same as those on the consolidated financial statements for the year ended March 31, 2019, except the judgement related to IFRS 16.

5. BUSINESS SEGMENTS

(1) Overview of reportable segments

The reportable segments of the Company are defined as the Company's constituent units for which separated financial information is available and which are regularly reviewed by the representative director, president and COO of IJ, who is the chief decision-maker regarding business operations in order to determine the allocation of resources and evaluate performance. The representative director, president and COO of IJ evaluates the performance of each segment, with operating revenue and operating income as the primary indicator.

The Company primarily operates its network service and system integration business, which provides a comprehensive range of network solutions to meet its customers' needs by cross-selling a variety of services, including Internet connectivity services, WAN services, outsourcing services, systems integration and sales of network-related equipment, and the ATM operation business. Therefore, the Company defined two reportable segments: "Network service and systems integration business" and "ATM operation business."

(2) Revenue and results of reportable segments

Segment information for the Company is as follows:

For the six months ended September 30, 2018

	Reportable segments		Adjustments (Note)	Condensed quarterly consolidated statements of profit or loss
	Network service and systems integration business	ATM operation business		
	Thousands of yen	Thousands of yen		
Revenue				
Customers	89,152,611	2,071,290	—	91,223,901
Intersegment transactions	196,199	—	(196,199)	—
Total revenue	89,348,810	2,071,290	(196,199)	91,223,901
Segment operating profit	2,592,434	806,493	(114,113)	3,284,814
Finance income				389,654
Finance expense				(221,334)
Share of profit (loss) of investments accounted for using the equity method				(23,234)
Profit before taxes				3,429,900
Other				
Depreciation and amortization	7,194,955	217,437	—	7,412,392

(Note) Intersegment transactions are based on market price. Segment operating profit is the amount of revenue less cost of sales and SG&A expenses plus other operating income and less other operating expenses.

For the six months ended September 30, 2019

	Reportable segments			Condensed quarterly consolidated statements of profit or loss
	Network service and systems integration business	ATM operation business	Adjustments (Note)	
	Thousands of yen	Thousands of yen	Thousands of yen	
Revenue				
Customers	97,119,509	2,100,026	—	99,219,535
Intersegment transactions	145,707	—	(145,707)	—
Total revenue	97,265,216	2,100,026	(145,707)	99,219,535
Segment operating profit	2,556,755	868,951	(73,756)	3,351,950
Finance income				118,609
Finance expense				(294,150)
Share of profit (loss) of investments accounted for using the equity method				(133,121)
Profit before tax				3,043,288
Other				
Depreciation and amortization	14,117,298	182,562	—	14,299,860

(Note) Intersegment transactions are based on market price. Segment operating profit is the amount of revenue less cost of sales and SG&A expenses plus other operating income and less other operating expenses.

For the three months ended September 30, 2018

	Reportable segments			Condensed quarterly consolidated statements of profit or loss
	Network service and systems integration business	ATM operation business	Adjustments (Note)	
	Thousands of yen	Thousands of yen	Thousands of yen	
Revenue				
Customers	45,309,366	1,076,090	—	46,385,456
Intersegment transactions	112,056	—	(112,056)	—
Total revenue	45,421,422	1,076,090	(112,056)	46,385,456
Segment operating profit	1,564,266	441,153	(72,278)	1,933,141
Finance income				241,797
Finance expense				(176,412)
Share of profit (loss) of investments accounted for using the equity method				6,456
Profit before taxes				2,004,982
Other				
Depreciation and amortization	3,692,634	110,855	—	3,803,489

(Note) Intersegment transactions are based on market price. Segment operating profit is the amount of revenue less cost of sales and SG&A expenses plus other operating income and less other operating expenses.

For the three months ended September 30, 2019

	Reportable segments			Adjustments (Note)	Condensed quarterly consolidated statements of profit or loss
	Network service and systems integration business	ATM operation business			
	Thousands of yen	Thousands of yen	Thousands of yen		
Revenue					
Customers	48,330,720	1,059,971	—		49,390,691
Intersegment transactions	72,191	—	(72,191)		—
Total revenue	48,402,911	1,059,971	(72,191)		49,390,691
Segment operating profit	1,557,358	450,228	(36,595)		1,970,991
Finance income					97,173
Finance expense					(148,227)
Share of profit (loss) of investments accounted for using the equity method					(245,328)
Profit before tax					1,674,609
Other					
Depreciation and amortization	7,047,788	88,364	—		7,136,152

(Note) Intersegment transactions are based on market price. Segment operating profit is the amount of revenue less cost of sales and SG&A expenses plus other operating income and less other operating expenses.

(3) Material changes in segment assets

As a result of the adoption of IFRS 16, segment assets of the network service and systems integration business segment increased by ¥34,682,911 thousand and amounted to ¥201,972,107 thousand for the six months ended September 30, 2019.

6. OTHER FINANCIAL ASSETS

The components of other financial assets are as follows:

	March 31, 2019	September 30, 2019
	Thousands of yen	Thousands of yen
Financial assets measured at amortized cost		
Other receivable	555,221	1,907,915
Guarantee deposit	3,140,672	3,220,639
Loans receivable	52,788	51,572
Other	185,954	151,635
Allowance for credit losses	(58,790)	(43,757)
Lease receivable	2,998,914	2,529,882
Total	6,874,759	7,817,886
Current assets	1,581,212	2,892,338
Non-current assets	5,293,547	4,925,548
Total	6,874,759	7,817,886

7. OTHER FINANCIAL LIABILITIES

The components of other financial liabilities are as follows:

	March 31, 2019	September 30, 2019
	Thousands of yen	Thousands of yen
Financial liabilities measured at amortized cost		
Lease obligations		
Lease contracts based on financing form	18,033,862	17,939,761
Lease contracts other than based on financing form	—	34,002,528
Total	18,033,862	51,942,289
Account payable—non-current	623,420	1,198,801
Deposit payable	344,510	193,454
Others	181,244	621,138
Total	19,183,036	53,955,682
Current liabilities	7,031,690	17,822,375
Non-current liabilities	12,151,346	36,133,307
Total	19,183,036	53,955,682

8. DIVIDENDS PAID

For the six months ended September 30, 2018

(1) Cash dividends paid.

Resolution date	Total dividends	Dividends per share	Record date	Effective date
	Thousands of yen	Yen		
June 28, 2018 Ordinary General Meeting of Shareholders	608,349	13.50	March 31, 2018	June 29, 2018

(2) Cash dividends of which effective date belongs to next quarter.

Resolution date	Total dividends	Dividends per share	Record date	Effective date
	Thousands of yen	Yen		
November 6, 2018 Board of directors meeting	608,452	13.50	September 30, 2018	December 7, 2018

For the six months ended September 30, 2019

(1) Cash dividends paid

Resolution date	Total dividends	Dividends per share	Record date	Effective date
	Thousands of yen	Yen		
June 27, 2019 Ordinary General Meeting of Shareholders	608,452	13.50	March 31, 2019	June 28, 2019

(2) Cash dividends of which effective date belongs to next quarter.

Resolution date	Total dividends	Dividends per share	Record date	Effective date
	Thousands of yen	Yen		
November 8, 2019 Board of directors meeting	608,630	13.50	September 30, 2019	December 6, 2019

9. REVENUE

The Company classifies the revenues into “Network services,” “Systems integration” and “ATM operation” and breaks them down according to the contents of each services. The components of revenues recognized in the contracts with customers are as follows.

	For the six months ended	For the six months ended
	September 30, 2018	September 30, 2019
	Thousands of yen	Thousands of yen
Network services	58,158,157	61,203,901
Internet connectivity services (enterprise)	15,954,594	18,074,951
Wan services	15,473,029	14,342,498
Outsourcing services	14,145,345	15,789,561
Internet connectivity services (consumer)	12,585,189	12,996,891
Systems integration	30,994,454	35,915,608
Systems construction	10,789,861	13,753,234
Systems operation and maintenance	20,204,593	22,162,374
ATM operation business	2,071,290	2,100,026
Total	91,223,901	99,219,535

	For the three months	For the three months
	ended September 30, 2018	ended September 30, 2019
	Thousands of yen	Thousands of yen
Network services	29,447,133	30,524,316
Internet connectivity services (enterprise)	8,125,881	9,148,830
Wan services	7,745,554	6,918,484
Outsourcing services	7,140,806	7,959,745
Internet connectivity services (consumer)	6,434,892	6,497,257
Systems integration	15,862,233	17,806,404
Systems construction	5,830,840	6,504,025
Systems operation and maintenance	10,031,393	11,302,379
ATM operation business	1,076,090	1,059,971
Total	46,385,456	49,390,691

On the business segment, Network services and Systems integration are included in “Network service and Systems integration service” and ATM operation business is included in “ATM operation business.”

Revenues by segments are stated in Note 5. SEGMENT INFORMATION.

10. SHARE OF PROFIT OF INVESTMENTS ACCOUNTED FOR USING EQUITY METHOD

For the six months ended September 30, 2019, share of profit of investments accounted for using equity method included gains on changes in equity of ¥375,530 thousand from issuance of common stock of DeCurret Inc., which is accounted for equity method.

11. EARNINGS PER SHARE

Basic earnings per share attributable to owners of the parent and diluted earnings per share attributable to owners of the parent were as follows:

	For the six months ended September 30, 2018	For the six months ended September 30, 2019
Numerator :		
Basic earnings attributable to owners of the parent (thousands of yen)	2,095,091	1,756,102
Denominator :		
Weighted average number of shares — basic (shares)	45,070,449	45,077,125
Dilution arising from stock options (shares)	170,330	196,243
Weighted average number of shares — diluted (shares)	45,240,779	45,273,368
Earnings per share attributable to owners of the parent		
Basic (yen)	46.48	38.96
Diluted (yen)	46.31	38.79
	For the three months ended September 30, 2018	For the three months ended September 30, 2019
Numerator :		
Basic earnings attributable to owners of the parent (thousands of yen)	1,221,348	979,589
Denominator :		
Weighted average number of shares — basic (shares)	45,070,491	45,083,689
Dilution arising from stock options (shares)	177,042	196,519
Weighted average number of shares — diluted (shares)	45,247,533	45,280,208
Earnings per share attributable to owners of the parent		
Basic (yen)	27.10	21.73
Diluted (yen)	26.99	21.63

12. FINANCIAL INSTRUMENTS

Fair value of financial instruments

(1) Classification of fair value hierarchy by level

IFRS regulates the three levels of fair value hierarchy and inputs used for the fair value measurement are prioritized according to the observable availability. The contents of each inputs are as follows:

- Level 1: quoted prices in active markets
- Level 2: inputs other than quoted prices included in Level 1 that are observable either directly or indirectly
- Level 3: unobservable inputs

(2) Financial instruments measured at fair value

Measurement methods for major financial instruments measured at fair value are as follows:

Equity securities

Fair values of marketable financial instruments are evaluated at quoted market prices and these instruments are classified as Level 1. If market prices do not exist, the Company evaluates fair value by using equity interest in net asset which is added appropriated adjustments based on recent available information, and these financial assets are classified as Level 3.

Debt securities

Financial instruments which do not have quoted market price, assets measured using observable market data are classified as Level 2.

Investment trust and other securities

Financial instruments which do not have observable market data, the Company evaluates fair value by using equity interest in net asset which is added appropriated adjustments based on recent available information, and these financial assets are classified as Level 3.

Others

Financial instruments which do not have quoted market price, assets measured using observable market data are classified as Level 2.

The following table presents the Company's assets that are measured at fair value consistent with the fair value hierarchy.

March 31, 2019

	Level 1	Level 2	Level 3	Total
	Thousands of yen	Thousands of yen	Thousands of yen	Thousands of yen
Assets :				
Debt-based financial assets measured at FVTOCI				
Debt securities	—	114,010	—	114,010
Equity-based financial assets measured at FVTOCI				
Equity securities	7,619,096	—	1,379,302	8,998,398
Financial assets measured at FVTPL				
Investment trust and other securities	—	—	2,199,303	2,199,303
Other financial assets	—	90,654	—	90,654
Total	<u>7,619,096</u>	<u>204,664</u>	<u>3,578,605</u>	<u>11,402,365</u>

September 30, 2019

	Level 1	Level 2	Level 3	Total
	Thousands of yen	Thousands of yen	Thousands of yen	Thousands of yen
Assets :				
Debt-based financial assets measured at FVTOCI				
Debt securities	—	115,432	—	115,432
Equity-based financial assets measured at FVTOCI				
Equity securities	6,166,229	—	1,433,686	7,599,915
Financial assets measured at FVTPL				
Investment trust and other securities	—	—	2,223,867	2,223,867
Other financial assets	—	79,419	—	79,419
Total	<u>6,166,229</u>	<u>194,851</u>	<u>3,657,553</u>	<u>10,018,633</u>

Financial instruments classified as Level 3 are mainly composed of non-marketable securities and investment trusts. The valuations of these financial instruments are measured using valuation method with appropriate adjustment to our equity in net assets. The result of the valuations are reviewed and authorized by the appropriate authorized person.

For financial instruments classified as Level 3, significant changes in fair value are not expected if the Company changes the unobservable input to an alternative assumption that can reasonably be considered.

The existence or non-existence of the important transfers between the levels of fair value hierarchy are recognized, assuming that the transfers occurred at the end of each quarterly periods. There are no transfers during the fiscal year ended March 31 and six months ended September 30, 2019.

(3) Changes in financial assets classified as Level 3

Changes in financial assets classified as Level 3 during the six-month periods ended September 30, 2018 and 2019 were as follows:

	For the six months ended September 30, 2018	For the six months ended September 30, 2019
	Thousands of yen	Thousands of yen
Balance at the beginning of the period	3,509,612	3,578,605
Total gain or loss	279,353	86,995
Profit or loss (Note 1)	230,809	18,581
Other comprehensive income (Note 2)	48,544	68,414
Purchase	100,000	42,740
Sale	(358,250)	(50,787)
Balance at the end of period	<u>3,530,715</u>	<u>3,657,553</u>

(Note 1) Gain or loss included in profit or loss are related to financial assets that are measured at FVTPL. This gain or loss is included in finance income or finance expenses. Gains and losses recognized in profit or loss are due to changes in unrealized gains and losses on financial assets held at the end of each reporting period.

(Note 2) Gain or loss included in other comprehensive income is related to financial assets that are measured at FVTOCI. This gain or loss is included in “Changes in fair value of financial assets measured at FVTOCI.”

(4) Financial instruments measured at amortized cost

Primary methods of measuring financial instruments at amortized cost are as follows:

(i) Long-term borrowings

Fair values of long-term borrowings are calculated by present value discounted by the expected rates if the Company made borrowings on equal terms for the remaining period.

The carrying amounts of financial assets and liabilities classified by current assets or liabilities approximate the fair values because they are settled in short term. The carrying amounts of financial assets and liabilities classified by non-current assets or liabilities approximate the fair values except aforementioned item.

The following tables present the Company's financial instruments measured at amortized cost consistent with the fair value hierarchy.

March 31, 2019

	Carrying amount	Fair value			
		Level 1	Level 2	Level 3	Total
		Thousands of yen	Thousands of yen	Thousands of yen	Thousands of yen
Liabilities :					
Long-term borrowings (including current portion)	15,500,000	-	15,503,003	-	15,503,003

September 30, 2019

	Carrying amount	Fair value			
		Level 1	Level 2	Level 3	Total
		Thousands of yen	Thousands of yen	Thousands of yen	Thousands of yen
Liabilities :					
Long-term borrowings (including current portion)	14,750,000	-	14,753,440	-	14,753,440

13. CONTINGENT LIABILITIES

The Company is involved in litigation and claims arising in the ordinary course of business. In evaluating matters on an ongoing basis, the Company takes into account estimated amounts accrued on the consolidated balance sheet. The Company believes that exposure to loss does not exist in excess of the amount accrued and the negative adverse outcome of such litigation and claims would not have a significant impact on the consolidated financial position or results of operations. On September 1, 2010, IJJ-Global entered into a Solutions Engagement Agreement with IBM Japan Ltd., IJJ-Global's largest sales partner. This agreement, which establishes the basis for a procurement relationship between IJJ-Global and IBM Japan, contains indemnification for IJJ-Global to perform services, functions, responsibilities and others that were being performed by AT&T Japan. This agreement renews automatically every year. IJJ-Global had no obligation for the indemnification as of September 30, 2019.

14. SUBSEQUENT EVENTS

There are no applicable items.

15. AUTHORIZATION OF CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial statements were authorized by Eijiro Katsu, Representative Director and President, and Akihisa Watai, Managing Director, CFO on November 14, 2019.

Other Information

At the Board of Directors meeting on November 8, 2019, an interim dividend of 13.5 yen per share with a record date of September 30, 2019 was resolved. (Total interim dividend is ¥608,630 thousand. Scheduled date for interim dividend payment: December 6, 2019)

PART 2 Information about Guarantors of the Company

Not applicable.

[English Translation of the Independent Auditor's Report Originally Issued in Japanese Language]

Independent Auditor's Report on Review of Condensed Quarterly Consolidated Financial Statements

November 14, 2019

To the Board of Directors of Internet Initiative Japan Inc.

KPMG AZSA LLC
Hiroto Kaneko (Seal)
Designated Limited Liability Partner
Engagement Partner
Certified Public Accountant

Yusuke Matsumoto (Seal)
Designated Limited Liability Partner
Engagement Partner
Certified Public Accountant

We have reviewed the accompanying condensed quarterly consolidated financial statements of Internet Initiative Japan Inc. and its consolidated subsidiaries provided in the "Financial Information" section in the Company's Quarterly Securities Report, which comprise the condensed consolidated statement of financial position as at September 30, 2019, the condensed consolidated statement of profit or loss, the condensed consolidated statement of comprehensive income, the condensed consolidated statement of changes in equity, the condensed consolidated statement of cash flows for the three and six month periods then ended, and notes to the condensed consolidated financial statements, in accordance with Article 193-2, Paragraph 1 of the Financial Instruments and Exchange Act of Japan.

Management's Responsibility for the Condensed Quarterly Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these condensed quarterly consolidated financial statements in accordance with IAS 34 "Interim Financial Reporting" pursuant to the Article 93 of the "Ordinance on Terminology, Forms and Preparation Methods of Quarterly Consolidated Financial Statements", and for such internal control as management determines is necessary to enable the preparation of condensed consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to independently express a conclusion on these condensed quarterly consolidated financial statements based on our review. We conducted our review in accordance with quarterly review standards generally accepted in Japan.

A review of the condensed quarterly financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with auditing standards generally

accepted in Japan and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit.

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our conclusion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying condensed quarterly consolidated financial statements do not present fairly, in all material respects, the financial position of Internet Initiative Japan Inc. and its consolidated subsidiaries as at September 30, 2019, and their financial performance and cash flows for the three and six month periods then ended, in accordance with IAS 34 “Interim Financial Reporting”.

Emphasis of Matter

As discussed in Note 3. Significant accounting policies to the condensed quarterly consolidated financial statements, the Company has adopted IFRS 16 “Lease” from the beginning of the first quarter ended June 30, 2019 (April 1, 2019). Our conclusion is not modified in respect of this matter.

Other Matter

The consolidated financial statements of Internet Initiative Japan Inc. and its consolidated subsidiaries for the year ended March 31, 2019, in accordance with International Financial Reporting Standards were audited by a predecessor auditor. The predecessor auditor expressed an audit opinion on those statements on June 27, 2019.

However, the condensed quarterly consolidated financial statements prepared as comparative information in accordance with IAS 34 “Interim Financial Reporting” for the three and six month periods ended September 30, 2018, are not subject to quarterly review by the predecessor auditor.

Meanwhile, the quarterly consolidated financial statements of Internet Initiative Japan Inc. and its consolidated subsidiaries for the three and six month periods ended September 30, 2018, pursuant to the Article 95 of the “Ordinance on Terminology, Forms and Preparation Methods for Quarterly Consolidated Financial Statements”, prepared in accordance with accounting principles generally accepted in the United States of America were reviewed by a predecessor auditor. The predecessor auditor expressed a review conclusion on those statements on November 14, 2018.

Interest in the Company

We have no interest in the Company which should be disclosed pursuant to the provisions of the Certified Public Accountants Act of Japan.

Notes to the Reader of Independent Auditor’s Report on Review of Condensed Quarterly Consolidated Financial Statements:

The Independent Auditor’s Report on Review of Condensed Quarterly Consolidated Financial Statements herein is the English translation of the Independent Auditor’s Report on Review of Condensed Quarterly Consolidated Financial Statements as required by the Financial Instruments and Exchange Act of Japan.