



*For Immediate Release*

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## **IIJ Announces Second Quarter Results for the Year Ending March 31, 2004**

**Tokyo, November 21, 2003 / New York, November 20, 2003** -- Internet Initiative Japan Inc. (Nasdaq: IIJE) ("IIJ"), one of Japan's leading Internet access and comprehensive network solutions providers, today announced its financial results for the 2<sup>nd</sup> quarter of the fiscal year ending March 31, 2004 ("Fiscal Year 2003").

### **Second Quarter FY2003 Highlights<sup>1</sup>**

#### **2<sup>nd</sup> Quarter FY2003:**

- Revenues totaled JPY 9,185 million (\$ 82.4 million), an increase of 10.1% from JPY 8,344 million in 1Q03, though a decrease of 13.1% compared to 2Q02. The increase from 1Q03 is mainly due to revenue increases from Systems Integration ("SI"), Data Center and other value-added services.
- Operating loss was JPY 830 million (\$ 7.4 million), a decrease from 1,206 million in 1Q03 and an increase from JPY 194 million in 2Q02. The loss includes accounts receivable write-offs of JPY 287 million that related to transactions with Crosswave Communications Inc. ("Crosswave"), a former equity method affiliate of IIJ. The improvement in operating loss from 1Q03 was mainly due to increased SI profitability and a reduction of domestic backbone costs.
- Adjusted EBITDA<sup>2</sup> was JPY 126 million (\$ 1.1 million), an increase from the JPY 243 million adjusted EBITDA loss in 1Q03, though a decrease from JPY 662 million in 2Q02.
- On August 20, Crosswave filed a voluntary petition for the commencement of corporate reorganization proceedings in Japan. IIJ has written-off all of its investments in, deposits for, loans to and accounts receivable due from Crosswave regarding the above through the end of this quarter. As a result of Crosswave no longer being accounted for under the equity method, the net loss decreased from JPY 2,326 million in 2Q02 to JPY 278 million in 2Q03. IIJ will not have further equity loss from Crosswave, which in the past had a significant negative impact on IIJ's financial statements.
- IIJ completed an approximately JPY 12 billion private placement to NTT Group, Itochu Corporation, Sumitomo Corporation and three other companies on September 17, 2003. With this capital injection, the financial impact due to Crosswave's reorganization proceedings has been offset. As a result, IIJ's shareholders' equity has become positive.
- IIJ received notice from Nasdaq that IIJ's American Depositary Shares will continue to be listed on the Nasdaq National Market, subject to requirements that IIJ file its annual report on Form 20-F for the fiscal year ending March 31, 2004 with the U.S. Securities and Exchange Commission and Nasdaq on or before September 30, 2004, and the IIJ demonstrate compliance with all requirements for continued listing on the Nasdaq National Market throughout this period. The fifth character "E" will remain appended to IIJ's trading symbol pending confirmation that IIJ has evidenced full compliance with Nasdaq's filing requirement and all other requirements for continued listing on the Nasdaq Stock Market.

<sup>1</sup> Unless otherwise stated, all financial figures discussed in this announcement are prepared in accordance with U.S. GAAP. All financial figures are unaudited, consolidated, and represent comparisons between the three-month period ended September 30, 2003, and the equivalent three-month period ended September 30, 2002. For all 2Q03 results, translations of Japanese yen amounts into US dollars are solely for the convenience of readers outside of Japan and have been made at the rate of JPY111.43 = US\$1., the approximate exchange rate on September 30, 2003.

**Outlook:**

- By improving gross-margins and expanding SI service revenues, IJ expects to reach a break-even level of operating income in 3Q03 and to achieve positive operating income in 4Q03. In addition, IJ expects an additional one-time increase in "other income" of approximately JPY 1.6 billion in 3Q03 from the sales of our shares of DLJ*direct*SFG Securities Inc. and approximately JPY 120 million by repurchasing and canceling a portion of IJ's convertible notes that are due in 2005.

**Overview of 2<sup>nd</sup> Quarter FY2003 Financial Results and Business Outlook<sup>3</sup>**

**Financial Results and Business Outlook**

"As Japan's economy is beginning to show indications that it is in a recovery phase, there seems to be an environment where Japanese corporate customers are considering investing in their networks," said Koichi Suzuki, President and CEO of IJ. "With the rapid changes in corporate networks, as expansion of broadband and increasing complexity, Japanese corporate customers are focusing more on in-house networks including the gateway to Internet. For example, Japanese companies are starting to use the latest network technology to connect branch offices or other sites at higher speeds with lower cost, increasing security on Internet traffic and outsourcing the operations of network equipment and servers. We are currently changing our SI development and business to meet those demands rapidly. We call this "Network Integration". Our strategy in the coming quarters is to seek new source of revenue by cross-selling these new solutions to meet the requirements of our current connectivity customers".

Koichi Suzuki continued, "On September 17, we completed the private placement to third parties to improve our capital structure, and NTT Group became our largest shareholder holding 31.6%. While we will retain our operating independence even after the private placement, we are going to have a collaborative relationship with NTT in the technological development and sales partnership".

"In 2Q03, revenues recovered compared to 1Q03, mainly driven by sales of SI, Data Center Services and other value-added services", said Yasuhiro Nishi, CFO of IJ. "We have succeeded in acquiring new customers for network integration services, and the revenue from these cases will be accounted for in 3Q03. By continuing to expand in the higher-margin SI area and cross-selling to customers as well as reducing costs, we will keep on track for a recovery in profitability and hopefully achieve positive operating income in the second half of the year".

Yasuhiro Nishi also stated, "As for Crosswave's commencement of reorganization proceedings, we have written off all investments in, deposits for, loans to and accounts receivable due from Crosswave regarding the above through this quarter. We believe that the private placement on September 17 will cover the financial impact of Crosswave's reorganization, and we will not have further equity losses from Crosswave, which in the past had a significant negative impact on IJ's financial statements".

**Recent Trends in Major Services and Contracts**

As for connectivity services, there appears to be new demand for broadband services such as using

<sup>2</sup> Please refer to the Reconciliation of Non-GAAP Financial Measures on page 6.

<sup>3</sup> This Overview and Business Outlook contains forward-looking statements and projections such as statements regarding 3Q03 total revenues and operating profitability that are subject to known and unknown risks and uncertainties that could cause actual results to differ materially from those expressed or implied by these statements. These risks and uncertainties include, but are not limited to, the factors noted at the end of this release and to the risk factors and other information contained in IJ's filings on Form 20-F and Form 6-K, as well as other filings and documents furnished to the Securities and Exchange Commission. IJ plans to keep this press release publicly available on its Web site ([www.ij.ad.jp](http://www.ij.ad.jp)), but may discontinue this practice at any time. IJ intends to publish its next Overview and Business Outlook in its 3Q03 earnings release, presently scheduled for February 12, 2004.

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these services for access lines for site connectivity utilizing Internet VPN technology. IJ has already acquired several customers for these services connecting over 100 sites. In addition to proposing bandwidth upgrades to existing customers and approaching new customers, we expect these new demands might help us to maintain current levels of revenue of connectivity services, as well as related network integration and equipment sales.

Revenues for SI services benefited as IJ won several network integration customers from the manufacturing and financial sectors. The major contents of the integration work was mail and web gateway services that control outgoing and incoming e-mails and web access, server housing in Data Centers and outsourcing of operation and network consultation for disaster recovery. Also, we increased revenues from equipment sales, such as database servers, web servers, data storage and firewall equipment.

### 2<sup>nd</sup> Quarter FY2003 Financial Results

#### **Revenues**

Revenues in 2Q03 totaled JPY 9,185 million, a decrease of 13.1% compared to 2Q02 and an increase of 10.1% from JPY 8,344 million in 1Q03.

Table 1. Revenues (JPY in millions)

Revenues	2Q03	2Q02	YoY % change	1Q03	QoQ % change
Connectivity and value-added services:					
Dedicated access services	3,236	3,546	(8.7%)	3,321	(2.6%)
Dial-up access services	784	792	(1.0%)	768	2.1%
Total Connectivity Services	4,020	4,338	(7.3%)	4,089	(1.7%)
Value-added services	1,081	893	21.0%	987	9.5%
Other	536	468	14.6%	520	3.2%
Total Connectivity and value-added services	5,637	5,699	(1.1%)	5,596	0.7%
Systems integration revenues	2,549	3,094	(17.6%)	2,408	5.9%
Equipment sales	999	1,775	(43.7%)	340	193.2%
<b>Total revenues</b>	<b>9,185</b>	<b>10,568</b>	<b>(13.1%)</b>	<b>8,344</b>	<b>10.1%</b>

**Connectivity and value-added services revenues** were JPY 5,637 million in 2Q03, a decrease of 1.1% compared to 2Q02, but an increase of 0.7% compared to 1Q03.

Table 2. Connectivity Services (JPY in millions)

Connectivity Services	2Q03	2Q02	YoY % change	1Q03	QoQ % change
Dedicated access services:					
IP Service + DC (connectivity)	2,485	2,657	(6.5%)	2,534	(2.0%)
Others <sup>4</sup>	751	889	(15.4%)	787	(4.5%)
Total Dedicated Access Services	3,236	3,546	(8.7%)	3,321	(2.6%)

Dedicated access services revenues were JPY 3,236 million in 2Q03, a decrease of 8.7% compared to 2Q02 and a decrease of 2.6% compared to 1Q03. IP Service, including Data Center Connectivity services, decreased by 6.5% in 2Q03 compared to 2Q02 and decreased by 2.0% compared to 1Q03, mainly due to the decline of unit prices despite an increase in the number of contracts. Customers continued to shift from dedicated line-based connectivity services such as IJ T1 Standard and IJ Economy, to lower-cost broadband services such as IJ FiberAccess/F service (Maximum 10-100Mbps), and the increase in IJ FiberAccess/F service did not offset the decrease in IJ T1 Standard and IJ Economy.

<sup>4</sup> Others are IJ FiberAccess/F service, IJ Ether Standard, IJ DSL/F service, IJ T1 Standard and IJ Economy.

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Table 3. Number of Contracts

	2Q03	2Q02	1Q03
<b>IP Services</b>			
64kbps – 128kbps	79	111	90
192kbps – 768kbps	23	30	26
1Mbps – 2Mbps	226	266	239
3Mbps – 1.2Gbps	336	205	294
<b>Number of Contracts of DC Connectivity Services</b>	<b>184</b>	129	171
<b>Other</b>	<b>5,402</b>	3,568	5,056
<b>Total Dedicated Access Services</b>	<b>6,250</b>	4,309	5,876
<b>IJ4U (Dial-up access services for retail market)</b>	<b>72,560</b>	84,432	76,209
<b>Other Dial-Up Access Services</b>	<b>563,086</b>	309,950	515,363
<b>Total Dial-Up Access Services</b>	<b>635,646</b>	394,382	591,572

Dial-up access service revenues were JPY 784 million in 2Q03, a decrease of 1.0% compared to 2Q02 and an increase of 2.1% compared to 1Q03. The revenue increased sequentially because of continued revenue increases of OEM services including CDN platform and NTT's regional L-mode service.

Table 4. Number of Contract Bandwidth (Unit: Gbps)

	2Q03	2Q02	1Q03
Dedicated Access Services	51.6	18.0	41.1
DC Connectivity Services	15.1	4.7	10.3
<b>Total Contract Bandwidth</b>	<b>66.7</b>	22.7	51.4

Value-added service revenues were JPY 1,081 million in 2Q03, an increase of 21.0% compared to 2Q02 and an increase of 9.5% compared to 1Q03. These increases were mainly due to revenue increases from Data Center services and security related services, including mail gateway service.

Table 5. Value-added Services (JPY in millions)

Value-Added Services	2Q03	2Q02	YoY % change	1Q03	QoQ % change
Internet Data Center services	371	371	0.0%	337	10.1%
Other value-added services	710	522	36.0%	650	9.2%
<b>Total Value-Added Service Revenues</b>	<b>1,081</b>	893	<b>21.0%</b>	987	<b>9.5%</b>

**Systems integration services revenues** decreased 17.6% to JPY 2,549 million in 2Q03 compared to 2Q02 but recovered 5.9% compared to 1Q03 due to increase of new network integration contracts.

**Equipment sales revenues** were JPY 999 million in 2Q03, a decrease of 43.7% compared to 2Q02 but an increase of 193.2% compared to 1Q03.

### **Cost and expenses**

Cost of total revenues was JPY 8,337 million in 2Q03, a decrease of 11.4% compared to 2Q02, and an increase of 6.0% compared to 1Q03.

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Table 6. Costs and Expenses (JPY in millions)

Costs and expenses:	2Q03	2Q02	YoY % change	1Q03	QoQ % change
Cost of Revenues:					
Cost of connectivity and value-added services	5,127	5,081	0.9%	5,234	(2.1%)
Cost of systems integration	2,275	2,682	(15.1%)	2,324	(2.1%)
Cost of equipment sales	935	1,648	(43.3%)	311	200.6%
Total of Cost of Revenues	8,337	9,411	(11.4%)	7,869	6.0%
Sales and marketing	1,100	743	47.9%	973	13.0%
General and administrative	482	514	(6.2%)	612	(21.2%)
Research and development	96	94	2.7%	96	0.0%
<b>Total costs and expenses</b>	<b>10,015</b>	<b>10,762</b>	<b>(6.9%)</b>	<b>9,550</b>	<b>4.9%</b>

**Cost of connectivity and value-added services** was JPY 5,127 million, an increase of 0.9% compared to 2Q02 and a decrease of 2.1% compared to 1Q03. The gross margin ratio for connectivity and value-added services in 2Q03 was 9.1%, compared to 10.8% in 2Q02 and 6.5% in 1Q03. The improvement of the gross margin ratio compared to 1Q03 was as a result of our effort for overall cost reduction such as backbone costs, the expense for network nodes and office rent expenses.

International backbone costs were JPY 247 million, a decrease of 44.8% compared to 2Q02 and a decrease of 5.2% compared to 1Q03. The monthly unit backbone costs per Mbps declined by 61% compared to 2Q02 and by 29% compared to 1Q03.

Table 7. Backbone Costs (JPY in millions)

Backbone Costs	2Q03	2Q02	YoY % Change	1Q03	QoQ % Change
International Backbone Costs	247	448	(44.8%)	261	(5.2%)
Domestic Backbone Costs	993	815	21.9%	1,057	(6.0%)

Domestic backbone costs were JPY 993 million, an increase of 21.9% compared to 2Q02 and a decrease of 6.0% compared to 1Q03. The year-over-year increase was due to an increase in connection fees with NTT's regional access networks (FLET'S), along with our broadband strategy to strengthen our backbone network to provide various broadband network services and solutions nationwide.

**Cost of SI Revenues** was JPY 2,275 million in 2Q03, a decrease of 15.1% compared to 2Q02 and a decrease of 2.1% compared to 1Q03. The gross margin for SI deteriorated to 10.7% in 2Q03 compared to 13.3% in 2Q02 but improved from 3.5% in 1Q03. The gross margin ratio in 2Q03 improved compared to 1Q03 because of improvement of profitability in SI development contracts.

**Sales and Marketing Expenses** were JPY 1,100 million in 2Q03, an increase of 47.9% compared to 2Q02 and an increase of 13.0% compared to 1Q03. The 2Q03 expenses include the written-off accounts receivable due from Crosswave, which amounted to JPY 287 million.

**General and administrative expenses** were JPY 482 million in 2Q03, a decrease of 6.2% compared to 2Q02 and a decrease of 21.2% compared to 1Q03. The 1Q03 expenses included the cost of the move to new headquarters.

### Operating loss

Operating loss increased to JPY 830 million in 2Q03 compared to a loss of JPY 194 million in 2Q02. The increase is primarily due to the write-off of accounts receivable from Crosswave and a decrease in connectivity service revenues. The operating loss in 2Q03 declined compared to a loss of JPY 1,206 million in 1Q03, due to improved profitability in IJ's SI business.

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**Other expenses** for 2Q03 were JPY 157 million, compared to JPY 160 million in 2Q02 and JPY 204 million in 1Q03. IIJ recorded a gain on sales of available-for-securities, which amounted to JPY 47 million in 2Q03.

**Income tax benefit (expense)** for 2Q03 was a benefit of JPY 572 million, compared to an expense of JPY 515 million in 2Q02 and a benefit of JPY 390 million in 1Q03. This is due to a decrease in the valuation allowance for deferred tax assets attributable primarily to the income tax effect of increasing unrealized gains during the quarter on certain available-for-sale securities.

**Equity in net loss of equity method investees** amounted to JPY 50 million in 2Q03, compared to JPY 1,480 million in 2Q02, and JPY 1,709 million in 1Q03. The equity in net loss of Crosswave is included in the equity in net loss of equity method investees in 1Q03 and 2Q02, but not included in 2Q03.

**Net loss** was JPY 278 million in 2Q03, compared to JPY 2,326 million in 2Q02 and JPY 2,475 million in 1Q03. The decreases in net loss was a result of the increasing income tax benefit reflecting the increasing unrealized gains on available-for-sale securities and the absence of equity method loss in Crosswave due to the full write-down of IIJ's equity investment in Crosswave. Basic net loss per ADS equivalent was JPY -5.04 in 2Q03, compared to JPY -51.74 in 2Q02 and JPY -54.72 in 1Q03.

Table 8. Other Financial Statistics (JPY in millions)

Other Financial Statistics	2Q03	2Q02	YoY % Change	1Q03	QoQ % Change
Adjusted EBITDA <sup>5</sup>	<b>126</b>	662	81.0%	(243)	(152.0%)
CAPEX, including capitalized leases <sup>6</sup>	<b>579</b>	1,504	(61.5%)	1,421	(59.2%)
Depreciation and amortization <sup>7</sup>	<b>984</b>	884	11.3%	990	(0.7%)

### Reconciliation of Non-GAAP Financial Measures

The following table summarizes the reconciliation of adjusted EBITDA to net loss per the consolidated statements of operations prepared and presented in accordance with U.S. generally accepted accounting principles in Appendices 1:

Table 9. Adjusted EBITDA (JPY in millions)

	2Q03	2Q02	1Q03
Adjusted EBITDA	<b>126</b>	662	(243)
Depreciation and amortization <sup>8</sup>	<b>(956)</b>	(856)	(963)
Operating loss	<b>(830)</b>	(194)	(1,206)
Other expenses	<b>(157)</b>	(160)	(204)
Income tax expense (benefit)	<b>(572)</b>	515	(390)
Minority interests in consolidated subsidiaries	<b>187</b>	23	254
Equity in net loss of equity method investees	<b>(50)</b>	(1,480)	(1,709)
Net loss	<b>(278)</b>	(2,326)	(2,475)

The following table summarizes the reconciliation of capital expenditures to purchase of property and equipment per the consolidated statements of cash flows prepared and presented in accordance with the U.S. generally accepted accounting principles in Appendices 3:

<sup>5</sup> Please refer to the Reconciliation of Non-GAAP Financial Measures on this page.

<sup>6</sup> Please refer to the Reconciliation of Non-GAAP Financial Measures on this page.

<sup>7</sup> Depreciation and amortization includes amortization of issuance cost of convertible notes.

<sup>8</sup> Depreciation and amortization excludes amortization of issuance cost of convertible notes that was presented as other expenses.

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Table 10. CAPEX (JPY in millions)

	2Q03	2Q02	1Q03
Capital expenditures	579	1,504	1,421
Acquisition of assets by entering into capital leases	431	1,282	487
Purchase of property and equipment	148	222	934

## 2<sup>nd</sup> Quarter FY2003 Business Review

### **Service Development**

**Outsourcing Solutions:** Under IJ Technology, the IJ Group further expanded its Integration & Business Platform Service (IBPS) product line. IBPS is a service offered to corporate customers which allows them to combine ready-made network service components with integration. These components include network equipment, controlling functions of outgoing and incoming Internet traffic (virus check, auditing and archiving e-mails and controlling web-access), data storage, operational resources, etc. By providing these components on demand at the Group's data centers and allowing customers to use these network components without having to purchase them, IJ's corporate customers can launch the network systems more smoothly and cost effectively. In October 2003, IJ Technology started to provide over 40 terabyte storage service.

**Network Management Solutions:** In 2Q03, we began "IJ NetLightning", based on Netli, Inc's technology which improves web application performance. By using IJ NetLightning, end users can more quickly access to customer websites and customers can reduce the cost to set up mirror sites.

Also in June 2003, IJ launched IJ SMF (SEIL Management Framework), a service which provides remote configuration and monitoring features for IJ's high-end SEIL/neu Series routers at customer remote sites from central management servers at IJ and customer main office/data center. SMF, the technology used for this service is patent pending.

**Hosting Services:** In 2Q03, we began "IJ Document Exchange Service" for medium and small-sized corporate customers. This service allows the creation of virtual folders on Internet, and customers to share files with workers outside the office or with commercial partners.

### **Network Infrastructure Development and Optimization**

In 2Q03, IJ increased the capacity of ten of its domestic backbone network lines and also established two new lines. IJ also increased the capacity of three U.S. backbone network lines and established one additional U.S. backbone network line to maintain current throughput and quality. At the same time, from a cost point of view, IJ is now trying to optimize the network in accordance with the number of customers connected to the network nodes, and has ceased the operations of several network nodes for dedicated line-based Internet connectivity services.

### **Finance**

#### ***Financial Impact of Crosswave's Commencement of Reorganization Proceedings:***

On August 20, Crosswave filed a voluntary petition for the commencement of corporate reorganization. In light of Crosswave's reorganization, IJ has fully written-off the accounts receivable due from Crosswave prior to entering corporate reorganization, amounting to JPY 287 million in 2Q03. As a result, IJ has fully written-off the remaining value of its investment in and deposits for, loans to and accounts receivable due from Crosswave through the end of this quarter.

#### ***Capital Improvement Plan:***

On September 17, 2003, IJ completed a private placement to NTT Group, Itochu Corporation, Sumitomo Corporation and three other companies for a total amount of approximately JPY 12 billion. With this capital injection, the financial impact of Crosswave's commencement of reorganization has been offset and IJ's shareholders' equity has turned positive.

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### **Key Developments of the IJ Group**

#### **IP\*VLAN**

In November 2003, IJ developed and announced a new technology called, IP\*VLAN (Internet Protocol-Virtual Local Area Network). This technology is for the construction and management of layer 2 networks over existing IP networks (layer 3) for Internet or corporate users. It enables PCs and other client devices to connect to the same LAN, regardless of distances between offices, and it enables access control for all services without requiring client certification (patent pending).

### **Teleconference/Webcast**

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On November 21 at 9:00 am (EST), IJ will host a conference call to discuss the results and the Company's outlook. There will be a simultaneous webcast available at [www.vcall.com](http://www.vcall.com). A replay will also be available at the same URL.

### **Company Information**

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Founded in 1992, Internet Initiative Japan Inc. (IJ, NASDAQ: IJIE) is Japan's leading Internet-access and comprehensive network solutions provider. The company has built one of the largest Internet backbone networks in Japan, and between Japan and the United States. IJ and its group of companies provide total network solutions that mainly cater to high-end corporate customers. Services range from the delivery of new generation network services over an optical-fiber infrastructure that is optimized for data communications, to the construction of pan-Asian IP backbone networks. The company also offers high-quality systems integration and security services, internet access, hosting/housing, and content design.

*Statements made in this press release regarding IJ's or management's intentions, beliefs, expectations, or predictions for the future are forward-looking statements that are based on IJ's and managements' current expectations, assumptions, estimates and projections about its business and the industry. These forward-looking statements, such as statements regarding 3Q03 total revenues and operating profitability, are subject to various risks, uncertainties and other factors that could cause IJ's actual results to differ materially from those contained in any forward-looking statement. These risks, uncertainties and other factors include: IJ's expectation that net losses will continue or may increase; IJ's ability to raise additional capital to cover its accumulated deficit; IJ's ability to continue to increase subscribers to its connectivity services, particularly at higher bandwidths; IJ's ability to generate significant revenues from its other services such as systems integration; the ability to compete in a rapidly evolving and competitive marketplace; the impact of technological changes in its industry; and other risks referred to from time to time in IJ's filings on Form 20F of its annual report and other filings with the United States Securities and Exchange Commission.*

Tables to follow

**CONSOLIDATED STATEMENTS OF OPERATIONS(UNAUDITED)**

For the Three Months Ended Sept 30, 2003, Sept 30, 2002 and Jun 30, 2003

(Expressed in Thousands of Japanese Yen (JPY) and U.S. Dollars (USD) Except for Per Share and ADS Data) (1)

	Year-over-year Comparison					Sequential Comparison			
	Sept 30, 2003		% of Total Revenues	Sept 30, 2002		YOY Chg %	Jun 30, 2003		
	USD (1)	JPY		JPY	% of Total Revenues		JPY	% of Total Revenues	QOQ Chg %
<b>Revenues:</b>									
Connectivity and value-added services:									
Dedicated access services	29,044	3,236,405	35.2%	3,546,372	33.6%	(8.7%)	3,321,229	39.8%	(2.6%)
Dial-up access services	7,032	783,589	8.5	791,738	7.5	(1.0)	767,418	9.2	2.1
Value-added services	9,700	1,080,876	11.8	893,135	8.4	21.0	987,198	11.9	9.5
Other	4,814	536,389	5.9	467,976	4.4	14.6	519,709	6.2	3.2
Total connectivity and value-added services	50,590	5,637,259	61.4	5,699,221	53.9	(1.1)	5,595,554	67.1	0.7
Systems integration revenues	22,879	2,549,379	27.7	3,094,168	29.3	(17.6)	2,407,923	28.8	5.9
Equipment sales	8,962	998,621	10.9	1,774,953	16.8	(43.7)	340,569	4.1	193.2
<b>Total revenues</b>	<b>82,431</b>	<b>9,185,259</b>	<b>100.0</b>	<b>10,568,342</b>	<b>100.0</b>	<b>(13.1)</b>	<b>8,344,046</b>	<b>100.0</b>	<b>10.1</b>
<b>Costs and expenses:</b>									
Cost of connectivity and value-added services	46,008	5,126,708	55.8	5,081,186	48.1	0.9	5,234,158	62.7	(2.1)
Cost of systems integration revenues	20,423	2,275,704	24.8	2,681,946	25.3	(15.1)	2,323,392	27.9	(2.1)
Cost of equipment sales	8,388	934,711	10.2	1,648,106	15.6	(43.3)	310,946	3.7	200.6
Total costs	74,819	8,337,123	90.8	9,411,238	89.0	(11.4)	7,868,496	94.3	6.0
Sales and marketing	9,868	1,099,560	12.0	743,230	7.0	47.9	973,054	11.7	13.0
General and administrative	4,327	482,218	5.2	514,082	4.9	(6.2)	612,047	7.3	(21.2)
Research and development	863	96,118	1.0	93,574	0.9	2.7	96,098	1.2	0.0
<b>Total costs and expenses</b>	<b>89,877</b>	<b>10,015,019</b>	<b>109.0</b>	<b>10,762,124</b>	<b>101.8</b>	<b>(6.9)</b>	<b>9,549,695</b>	<b>114.5</b>	<b>4.9</b>
<b>Operating loss</b>	<b>(7,446)</b>	<b>(829,760)</b>	<b>(9.0)</b>	<b>(193,782)</b>	<b>(1.8)</b>	<b>328.2</b>	<b>(1,205,649)</b>	<b>(14.5)</b>	<b>(31.2)</b>
<b>Other expenses</b>	<b>(1,412)</b>	<b>(157,294)</b>	<b>(1.7)</b>	<b>(160,247)</b>	<b>(1.5)</b>	<b>(1.8)</b>	<b>(204,398)</b>	<b>(2.4)</b>	<b>(23.0)</b>
<b>Loss before income tax expense(benefit)</b>	<b>(8,858)</b>	<b>(987,054)</b>	<b>(10.7)</b>	<b>(354,029)</b>	<b>(3.3)</b>	<b>178.8</b>	<b>(1,410,047)</b>	<b>(16.9)</b>	<b>(30.0)</b>
<b>Income tax expense(benefit)</b>	<b>(5,130)</b>	<b>(571,642)</b>	<b>(6.2)</b>	<b>514,872</b>	<b>4.9</b>	<b>(211.0)</b>	<b>(390,035)</b>	<b>(4.7)</b>	<b>46.6</b>
<b>Minority interests in consolidated subsidiaries</b>	<b>1,677</b>	<b>186,931</b>	<b>2.0</b>	<b>23,146</b>	<b>0.2</b>	<b>707.6</b>	<b>254,886</b>	<b>3.0</b>	<b>(26.7)</b>
<b>Equity in net loss of equity method investees:</b>									
Equity method net income(loss)	(448)	(49,945)	(0.5)	(1,480,411)	(14.0)	(96.6)	10,559	0.1	(573.0)
Impairment loss on investment in and advances to Crosswave							(1,719,981)	(20.6)	(100.0)
<b>Net loss</b>	<b>(2,499)</b>	<b>(278,426)</b>	<b>(3.0%)</b>	<b>(2,326,166)</b>	<b>(22.0%)</b>	<b>(88.0%)</b>	<b>(2,474,548)</b>	<b>(29.7%)</b>	<b>(88.7%)</b>
<b>Basic Net Loss Per Share</b>		(10,082)		(103,477)			(109,440)		
<b>Basic Net Loss Per ADS Equivalent</b>		(5.04)		(51.74)			(54.72)		
<b>Weighted Average Number of Shares</b>		27,617		22,480			22,611		
<b>Weighted Average Number of ADS Equivalents</b>		55,233,050		44,960,000			45,222,494		

Note (1): The translation of Japanese yen amounts into US dollar amounts with respect to the three months ended Sept 30, 2003 are included solely for the convenience of readers outside Japan and have been made at the rate of JPY 111.43 = \$1, the approximate rate of exchange on Sept 30, 2003.

**INTERNET INITIATIVE JAPAN INC.**  
**CONSOLIDATED BALANCE SHEETS(UNAUDITED)**

Appendix 2

As of Sept 30, 2003, Sept 30, 2002 and Jun 30, 2003  
(Expressed in Thousands of Japanese Yen (JPY) and U.S. Dollars (USD)) (1)

	Sept 30, 2003			Sept 30, 2002		Jun 30, 2003	
	USD (1)	JPY	%	JPY	%	JPY	%
<b>ASSETS</b>							
<b>Current Assets:</b>							
Cash and cash equivalent	105,743	11,782,935	30.7%	4,772,753	12.2%	2,819,007	10.2%
Accounts receivable, net	60,366	6,726,563	17.5	7,844,256	20.1	5,889,315	21.3
Inventories	2,410	268,519	0.7	415,771	1.1	347,971	1.3
Prepaid expenses	5,871	654,269	1.7	498,668	1.3	845,908	3.1
Other current assets	4,168	464,418	1.2	141,923	0.3	534,025	1.9
<b>Total current assets</b>	<b>178,558</b>	<b>19,896,704</b>	<b>51.8</b>	<b>13,673,371</b>	<b>35.0</b>	<b>10,436,226</b>	<b>37.8</b>
<b>Investments in and Advances to Equity Method Investees</b>	<b>9,926</b>	<b>1,106,062</b>	<b>2.9</b>	<b>5,896,219</b>	<b>15.1</b>	<b>1,141,728</b>	<b>4.1</b>
<b>Other Investments</b>	<b>49,476</b>	<b>5,513,137</b>	<b>14.3</b>	<b>3,751,532</b>	<b>9.6</b>	<b>3,967,719</b>	<b>14.4</b>
<b>Property and Equipment, net</b>	<b>81,744</b>	<b>9,108,783</b>	<b>23.7</b>	<b>8,617,873</b>	<b>22.1</b>	<b>9,244,442</b>	<b>33.5</b>
<b>Restricted Cash</b>				<b>5,000,000</b>	<b>12.8</b>		
<b>Guarantee Deposits</b>	<b>18,673</b>	<b>2,080,764</b>	<b>5.4</b>	<b>1,392,519</b>	<b>3.6</b>	<b>2,082,118</b>	<b>7.6</b>
<b>Other Assets</b>	<b>6,539</b>	<b>728,580</b>	<b>1.9</b>	<b>706,828</b>	<b>1.8</b>	<b>714,367</b>	<b>2.6</b>
<b>Total assets</b>	<b>344,916</b>	<b>38,434,030</b>	<b>100.0%</b>	<b>39,038,342</b>	<b>100.0%</b>	<b>27,586,600</b>	<b>100.0%</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY(CAPITAL DEFICIENCY)</b>							
<b>Current Liabilities:</b>							
Short-term borrowings	38,633	4,304,906	11.2%	4,832,286	12.4%	5,675,341	20.6%
Accounts payable	43,582	4,856,325	12.6	5,131,068	13.1	4,406,928	16.0
Accrued expenses	4,393	489,568	1.3	271,557	0.7	537,236	1.9
Other current liabilities	3,685	410,577	1.1	442,564	1.1	542,538	1.9
Long-term borrowings-current portion	26,442	2,946,377	7.7	1,400,000	3.6	1,545,452	5.6
Capital lease obligations-current portion	23,230	2,588,505	6.7	2,271,145	5.8	2,677,038	9.7
<b>Total current liabilities</b>	<b>139,965</b>	<b>15,596,258</b>	<b>40.6</b>	<b>14,348,620</b>	<b>36.7</b>	<b>15,384,533</b>	<b>55.7</b>
<b>Long-term Borrowings</b>	<b>17,793</b>	<b>1,982,612</b>	<b>5.2</b>	<b>3,400,000</b>	<b>8.7</b>	<b>3,419,555</b>	<b>12.4</b>
<b>Convertible Notes</b>	<b>134,614</b>	<b>15,000,000</b>	<b>39.0</b>	<b>15,000,000</b>	<b>38.4</b>	<b>15,000,000</b>	<b>54.4</b>
<b>Capital Lease Obligations-Noncurrent</b>	<b>28,700</b>	<b>3,198,073</b>	<b>8.3</b>	<b>3,250,922</b>	<b>8.4</b>	<b>3,407,735</b>	<b>12.3</b>
<b>Accrued Retirement and Pension Costs</b>	<b>626</b>	<b>69,794</b>	<b>0.2</b>	<b>83,058</b>	<b>0.2</b>	<b>74,764</b>	<b>0.3</b>
<b>Other Noncurrent Liabilities</b>	<b>1,732</b>	<b>193,043</b>	<b>0.5</b>	<b>153,993</b>	<b>0.4</b>	<b>187,579</b>	<b>0.7</b>
<b>Total liabilities</b>	<b>323,430</b>	<b>36,039,780</b>	<b>93.8</b>	<b>36,236,593</b>	<b>92.8</b>	<b>37,474,166</b>	<b>135.8</b>
<b>Minority Interest</b>	<b>3,928</b>	<b>437,678</b>	<b>1.1</b>	<b>942,650</b>	<b>2.4</b>	<b>624,609</b>	<b>2.3</b>
<b>Shareholders' Equity(Capital Deficiency):</b>							
<b>Common stock(2)</b>	<b>123,534</b>	<b>13,765,372</b>	<b>35.8</b>	<b>7,082,336</b>	<b>18.1</b>	<b>7,765,048</b>	<b>28.2</b>
<b>Additional paid-in capital(2)</b>	<b>212,130</b>	<b>23,637,628</b>	<b>61.5</b>	<b>17,068,353</b>	<b>43.7</b>	<b>17,751,065</b>	<b>64.3</b>
<b>Accumulated deficit</b>	<b>(335,980)</b>	<b>(37,438,265)</b>	<b>(97.4)</b>	<b>(23,129,652)</b>	<b>(59.2)</b>	<b>(37,159,839)</b>	<b>(134.7)</b>
<b>Accumulated other comprehensive income</b>	<b>17,875</b>	<b>1,991,900</b>	<b>5.2</b>	<b>838,062</b>	<b>2.2</b>	<b>1,131,644</b>	<b>4.1</b>
<b>Treasury stock</b>	<b>(1)</b>	<b>(63)</b>	<b>0.0</b>			<b>(93)</b>	<b>0.0</b>
<b>Total shareholders' equity(capital deficiency)</b>	<b>17,558</b>	<b>1,956,572</b>	<b>5.1</b>	<b>1,859,099</b>	<b>4.8</b>	<b>(10,512,175)</b>	<b>(38.1)</b>
<b>Total liabilities and shareholders' equity(capital deficiency)</b>	<b>344,916</b>	<b>38,434,030</b>	<b>100.0%</b>	<b>39,038,342</b>	<b>100.0%</b>	<b>27,586,600</b>	<b>100.0%</b>

Note (1): The translation of Japanese yen amounts into US dollar amounts with respect to Sept 30, 2003 are included solely for the convenience of readers outside Japan and have been made at the rate of JPY111.43 = \$1, the approximate rate of exchange on Sept 30, 2003.

Note (2): New 12,615 shares have been issued on Sept 17, 2003, in the net proceeds of JPY11,886,887.

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

For the Three Months Ended Sept 30, 2003, Sept 30, 2002 and Jun 30, 2003

(Expressed in Thousands of Japanese Yen (JPY) and U.S. Dollars (USD)) (1)

	Sept 30, 2003		Sept 30, 2002	Jun 30, 2003
	USD (1)	JPY	JPY	JPY
<b>Operating Activities:</b>				
Net loss	(2,499)	(278,426)	(2,326,166)	(2,474,548)
Depreciation and amortization	8,828	983,736	883,732	990,190
Provision for doubtful accounts	2,818	313,968	(5,048)	149,378
Equity method net loss (income)	448	49,945	1,480,411	(10,559)
Impairment loss on investment in and advances to Crosswave	-	-	-	1,719,981
Minority interests in net loss of consolidated subsidiaries	(1,677)	(186,931)	(23,146)	(254,886)
Foreign exchange losses (gains)	30	3,282	(39,060)	3,245
Losses on other investments	875	97,530	13,620	37,572
Decrease (increase) in accounts receivable	(9,878)	(1,100,671)	(972,056)	4,229,010
Increase (decrease) in accounts payable	1,941	216,306	7,462	(3,671,049)
Decrease (increase) in inventories	650	72,432	(142,950)	69,689
Deferred income taxes	(5,182)	(577,444)	509,228	(395,698)
Other	(1,078)	(120,151)	(3,003)	264,043
<b>Net cash provided by (used in) operating activities</b>	<b>(4,724)</b>	<b>(526,424)</b>	<b>(616,976)</b>	<b>656,368</b>
<b>Investing Activities:</b>				
Purchase of property and equipment	(1,328)	(148,007)	(222,308)	(933,646)
Proceeds from sales of other investment	1,101	122,650	480	34,672
Investments in and advances to equity method investees	-	-	-	(1,719,981)
Purchase of other investments	(2,733)	(304,517)	(33,294)	(12,971)
Refund (payment) of guarantee deposits-net	11	1,199	(87,518)	123,632
Other	88	9,875	2,473	11
<b>Net cash used in investing activities</b>	<b>(2,861)</b>	<b>(318,800)</b>	<b>(340,167)</b>	<b>(2,508,283)</b>
<b>Financing Activities:</b>				
Repayments of long-term borrowings	(323)	(36,017)	-	(434,994)
Principal payments under capital leases	(6,025)	(671,376)	(601,144)	(697,830)
Net increase (decrease) in short-term borrowings	(12,299)	(1,370,436)	282,164	851,742
Proceeds from issuance of common stock	106,676	11,886,887	-	1,365,424
<b>Net cash provided by (used in) financing activities</b>	<b>88,029</b>	<b>9,809,058</b>	<b>(318,980)</b>	<b>1,084,342</b>
<b>Effect of Exchange Rate Changes on Cash</b>	<b>1</b>	<b>94</b>	<b>34,183</b>	<b>(1,772)</b>
<b>Net Increase (Decrease) in Cash</b>	<b>80,445</b>	<b>8,963,928</b>	<b>(1,241,940)</b>	<b>(769,345)</b>
<b>Cash, Beginning of Period</b>	<b>25,298</b>	<b>2,819,007</b>	<b>6,014,693</b>	<b>3,588,352</b>
<b>Cash, End of Period</b>	<b>105,743</b>	<b>11,782,935</b>	<b>4,772,753</b>	<b>2,819,007</b>

Note (1): The translations of Japanese yen amounts into US dollar amounts with respect to the three months ended Sept 30, 2003 are included solely for the convenience of readers outside Japan and have been made at the rate of JPY111.43 = \$1, the approximate rate of exchange on Sept 30, 2003.