

(TRANSLATION)

Quarterly Securities Report

(The First Quarter of the 28th Business Term)
From April 1, 2019 to June 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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PART 1 Information on the Company

Item 1. Overview of the Company

1 Selected Financial Data

Fiscal year	IFRS		
	Three months ended June 30, 2018	Three months ended June 30, 2019	27th business term ended March 31, 2019
Revenues (thousands of yen)	44,838,445	49,828,844	192,430,185
Operating profit (thousands of yen)	1,351,673	1,380,959	6,022,987
Profit before tax (thousands of yen)	1,424,918	1,368,679	5,842,984
Profit attributable to owners of the parent (thousands of yen)	873,743	776,513	3,520,566
Comprehensive income, attributable to owners of the parent (thousands of yen)	319,352	1,335,775	2,902,764
Comprehensive income (thousands of yen)	359,913	1,385,016	3,080,986
Equity attributable to owners of the parent (thousands of yen)	74,253,988	76,979,198	76,271,438
Total assets (thousands of yen)	155,207,314	204,390,369	167,289,196
Basic earnings per share (yen)	19.39	17.23	78.11
Diluted earnings per share (yen)	19.32	17.15	77.80
Ratio of owners' equity to gross assets (%)	47.8	37.7	45.6
Cash flows from (used in) operating activities (thousands of yen)	6,623,283	5,249,663	25,152,346
Cash flows from (used in) investing activities (thousands of yen)	(2,787,179)	(2,141,406)	(8,687,589)
Cash flows from (used in) financing activities (thousands of yen)	(2,353,740)	(2,096,880)	(5,889,750)
Cash and cash equivalents, at the end of period (thousands of yen)	22,857,292	32,892,657	31,957,789

(Notes) 1. As IJJ 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 quarter of the 28th business term.

There were no material changes with respect to the associated companies during the first quarter of the 28th business term.

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 29, 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 ended June 30, 2019 ("1Q19"). 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 1Q19

For the ICT¹ related market where we belong to, changes of corporate information system as seen in widespread of cloud computing adoption, advancement of ICT such as IoT² in corporate business activities, growing demand for security services against information leakage and others, we expect demands for highly reliable network and systems to continually increase.

As for 1Q19 business environment, enterprises' demands for network services continued to be strong and our financial results started strong from the first quarter. Regarding enterprise network services, our monthly recurring revenue³ strongly grew by offering Internet connectivity services, outsourcing services such as security, and cloud computing services all at once. As for full-MVNO⁴ services revenue, IMSI⁵ services for both domestic and overseas mobile service providers accumulated its revenue, in addition to SIM life-cycle Management⁶ and prepaid SIMs for foreign tourists visiting Japan. As we expect IoT usages to penetrate, we focused on service developments including eSIM⁷ services and SoftSIM⁸. As for systems integration, enterprises demands for systems construction continued to be favorable and the order-received for systems construction increased by 7.1% from 1Q18. As for cloud computing services which is recognized as a part of systems operation and maintenance, we further enhanced our multi-cloud strategy by adding Google cloud services in addition to Microsoft and Amazon as a new connectivity point for a closed network services. As for new businesses, DeCurret Inc., an equity method investee of IIJ, issued new shares of common stock by way of third-party allotment to leading financial institutions in Japan and its share capital and capital reserves were increased to a total of JPY8.63 billion yen (our ownership interest ratio is 30%). As for profit, there was one-time additional network service cost of JPY2.05 billion recorded in 4Q18 as a result of NTT Docomo's mobile interconnectivity unit charge revision. Essentially this one-time additional cost should have been allocated to attributable each quarter of FY2018. In comparison with adjusted figures by the result of such allocation ("Adjusted"), operating profit for 1Q19 increased by 58.8% from Adjusted operating profit for the first quarter of FY2018 ended June 30, 2018 ("1Q18") of JPY870 million. As for the details, please refer "(ii) Regarding the retroactively adjusted 1Q18 financial results" in the next section.

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 Recurring revenues: Revenues that businesses can count on receiving every single month through continuous provision of services to customers.

⁴ 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, IIJ 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.

⁵ IMSI: IMSI is an abbreviation of International Mobile Subscriber Identity. An identifier stored in each SIM cards, which is assigned to each subscriber in mobile communication networks.

⁶ SIM life-cycle management: Function that can set the status to active or suspended. Users and administrators can optionally set it to active and return to suspended after activation. SIM status can be controlled from the manufacturing process of various IoT products to post-shipment process. It is also possible to deactivate SIMs to disable unnecessary or unauthorized use during the period of storage as stock.

⁷ eSIM: Embedded SIMs that allows users to remotely download the profiles required to use cellular services.

⁸ SoftSIMs: an entirely software-based SIMs with no hardware, which can be updated remotely.

Consolidated financial results for 1Q19 are as follows. Total revenues were JPY49,829 million, up 11.1% year over year (“YoY”) (JPY44,838 million for 1Q18). Cost of sales was JPY42,447 million, up 11.7% YoY (JPY38,007 million for 1Q18 and JPY38,490 million as Adjusted) and gross profit was JPY7,382 million, up 8.1% YoY (JPY6,831 million for 1Q18 and JPY 6,349 million as Adjusted). As for breakdown, network services revenue was JPY30,680 million, up 6.9% YoY (JPY28,711 million for 1Q18) and gross profit for network services revenue was JPY5,019 million, up 2.7% YoY (JPY4,886 million for 1Q18 and 4,404 million as Adjusted). SI revenues, including equipment sales were JPY18,109 million, up 19.7% YoY (JPY15,132 million for 1Q18) and gross profit for SI was JPY1,890 million, up 23.3% YoY (JPY1,533 million for 1Q18). ATM operation business revenue was JPY1,040 million, up 4.5% YoY (JPY995 million for 1Q18) and gross profit of ATM operation business was JPY473 million, up 14.8% YoY (JPY412 million for 1Q18). Net amount of selling, general and administrative expenses, other operating income and other operating expenses was JPY6,001 million, up 9.5% YoY (JPY 5,479 million for 1Q18). Our operating profit for 1Q19 was JPY1,381 million, up 2.2% YoY (JPY1,352 million for 1Q18 and JPY870 million as Adjusted). Profit before tax for 1Q19 was JPY1,369 million, down 3.9% YoY (JPY1,425 million for 1Q18 and JPY943 million as Adjusted). Profit attributable to owners of the parent for 1Q19 was JPY777 million, down 11.1% YoY (JPY 874 million for 1Q18 and JPY544 million as Adjusted).

In business segments results, revenues for network services and systems integration business segment for 1Q19 were JPY48,862 million, up 11.2% YoY (JPY43,927 million for 1Q18) and operating profit for 1Q19 was JPY999 million, down 2.8% YoY (JPY1,028 million for 1Q18, and 546 million as Adjusted). As for ATM operation business, revenues for 1Q19 were JPY1,040 million, up 4.5% YoY (JPY995 million for 1Q18) and operating profit for 1Q19 was JPY419 million (JPY365 million for 1Q18).

(ii) Regarding the retroactively adjusted 1Q18 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 1Q18 results and Adjusted YoY changes are as follows:

	Adjusted 1Q18	1Q19	Adjusted YoYchange
	JPY millions	JPY millions	(%)
Cost of Network services revenue	(24,307)	(25,661)	5.6
Gross profit of Network services	4,404	5,019	14.0
Total gross profit	6,349	7,382	16.3
Operating profit	870	1,381	58.8
Profit before tax	943	1,369	45.2
Profit for the period	584	826	41.4
Profit for the period attributable to owners of the parent	544	777	42.9
Comprehensive income for the period	30	1,385	4,566.0

(iii) Analysis of Consolidated Results of Operations for the first quarter 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

	1Q18	1Q19	YoY Change
	JPY millions	JPY millions	%
Total revenues	44,838	49,829	11.1
Network services	28,711	30,680	6.9
Systems integration (SI)	15,132	18,109	19.7
ATM operation business	995	1,040	4.5
Total costs	(38,007)	(42,447)	11.7
Network services	(23,825)	(25,661)	7.7
Systems integration (SI)	(13,599)	(16,219)	19.3
ATM operation business	(583)	(567)	(2.7)
Total gross profit	6,831	7,382	8.1
Network services	4,886	5,019	2.7
Systems integration (SI)	1,533	1,890	23.3
ATM operation business	412	473	14.8
SG&A, R&D, and other operating income (expenses)	(5,479)	(6,001)	9.5
Operating profit	1,352	1,381	2.2
Profit before tax	1,425	1,369	(3.9)
Profit for the period attributable to owners of the parent	874	777	(11.1)

(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 1Q18 are different from 1Q18 results disclosed in the past.

2. Systems integration includes equipment sales.

Segment Results Summary

	1Q18	1Q19
	JPY millions	JPY millions
Total revenues	44,838	49,829
Network services and SI business	43,927	48,862
ATM operation business	995	1,040
Elimination	(84)	(73)
Operating profit	1,352	1,381
Network service and SI business	1,028	999
ATM operation business	365	419
Elimination	(41)	(37)

i) Revenues

Total revenues were JPY49,829 million, up 11.1% YoY (JPY44,838 million for 1Q18).

Network services revenue was JPY30,680 million, up 6.9% YoY (JPY28,711 million for 1Q18).

Revenues for Internet connectivity services for enterprise were JPY8,926 million, up 14.0% YoY from JPY7,829 million for 1Q18, mainly due to an increase in mobile-related services revenues along with an expansion of MVNE business clients' transactions.

Revenues for Internet connectivity services for consumers were JPY6,500 million, up 5.7% YoY from JPY6,150 million for 1Q18. The revenue growth was mainly due to “IImio Mobile Service,” consumer mobile services.

Revenues for WAN services were JPY7,424 million, down 3.9% YoY from JPY7,727 million for 1Q18, mainly due to large enterprise clients' migration to mobile.

Revenues for Outsourcing services were JPY7,830 million, up 11.8% YoY from JPY7,005 million for 1Q18, mainly due to an increase in security-related services revenues.

Network Services Revenues Breakdown

	1Q18	1Q19	YoY Change
	JPY millions	JPY millions	%
Total network services	28,711	30,680	6.9
Internet connectivity services (enterprise)	7,829	8,926	14.0
IP services (including data center connectivity services)	2,578	2,634	2.2
IIJ Mobile services	4,468	5,484	22.8
IIJ Mobile MVNO Platform Service	3,383	4,069	20.3
Others	783	808	3.2
Internet connectivity services (consumer)	6,150	6,500	5.7
IIJmio Mobile Service	5,463	5,855	7.2
Others	687	645	(6.1)
WAN services	7,727	7,424	(3.9)
Outsourcing services	7,005	7,830	11.8

Number of Contracts and Subscription for Connectivity Services

	As of June 30, 2018	As of June 30, 2019	YoY Change
Internet connectivity services (enterprise)	1,483,729	1,792,638	308,909
IP service (greater than or equal to 1Gbps)	721	736	15
IP service (less than 1Gbps)	1,289	1,251	(38)
IIJ Mobile Services	1,407,806	1,709,359	301,553
IIJ Mobile MVNO Platform Service	887,026	1,072,190	185,164
Others	73,913	81,292	7,379
Internet connectivity services (consumer)	1,387,825	1,407,024	19,199
IIJmio Mobile Service	1,035,728	1,073,763	38,035
Others	352,097	333,261	(18,836)
Total contracted bandwidth (Gbps)	3,373.2	4,272.0	898.8

(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 JPY18,109 million, up 19.7% YoY (JPY15,132 million for 1Q18).

Systems construction and equipment sales revenue, a one-time revenue, was JPY7,249 million, up 46.2% YoY (JPY4,959 million for 1Q18). In addition to an increase in usual revenue of completed project, we recognized JPY1.34 billion of revenue along with construction progresses. Systems operation and maintenance revenue, a recurring revenue, was JPY10,860 million, up 6.8% YoY (JPY10,173 million for 1Q18), 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 JPY22,217 million, up 16.7% YoY (JPY19,035 million for 1Q18); orders received for systems construction and equipment sales were JPY8,118 million, up 7.1% YoY (JPY7,578 million for 1Q18) and orders received for systems operation and maintenance were JPY14,099 million, up 23.1% YoY (JPY11,457 million for 1Q18).

Order backlog for SI and equipment sales as of June 30, 2019 amounted to JPY55,222 million, up 9.4% YoY (JPY50,499 million as of June 30, 2018); order backlog for systems construction and equipment sales was JPY8,709 million, down 9.8% YoY (JPY9,657 million as of June 30, 2018) and order backlog for systems operation and maintenance was JPY46,514 million, up 13.9% YoY (JPY40,841 million as of June 30, 2018).

ATM operation business revenues were JPY1,040 million, up 4.5% YoY (JPY995 million for 1Q18).

ii) Cost of sales

Total cost of sales was JPY42,447 million, up 11.7% YoY (JPY38,007 million for 1Q18 and JPY38,490 million as Adjusted) and Adjusted YoY change was up 10.3%.

Cost of network services revenue was JPY25,661 million, up 7.7% YoY (JPY23,825 million for 1Q18 and JPY24,307 million as Adjusted) and Adjusted YoY change in cost of network services revenue was up 5.6% YoY. There was an increase in outsourcing-related costs along with our mobile-related revenue increase. Gross profit was JPY5,019 million, up 2.7% YoY (JPY4,886 million for 1Q18 and JPY4,404 million as Adjusted), Adjusted YoY change in gross profit was up 14.0%, and gross profit ratio was 16.4% (17.0% for 1Q18 and 15.3% as Adjusted).

Cost of SI revenues, including equipment sales was JPY16,219 million, up 19.3% YoY (JPY13,599 million for 1Q18). 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 JPY1,890 million, up 23.3% YoY (JPY1,533 million for 1Q18) and gross profit ratio was 10.4% (10.1% for 1Q18).

Cost of ATM operation business revenues was JPY567 million, down 2.7% YoY (JPY583 million for 1Q18). Gross profit was JPY473 million (JPY412 million for 1Q18) and gross profit ratio was 45.5% (41.4% for 1Q18).

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

Selling, general and administrative expenses, which include research and development expenses, totaled JPY6,042 million, up 9.4% YoY (JPY5,522 million for 1Q18), mainly due to increases in personnel-related expenses and sales commission expenses.

Other operating income was JPY113 million (JPY60 million for 1Q18).

Other operating expenses was JPY72 million (JPY17 million for 1Q18), mainly due to disposal loss on fixed assets.

iv) Operating profit

Operating profit was JPY1,381 million (JPY1,352 million for 1Q18 and JPY870 million as Adjusted), up 2.2% YoY and Adjusted YoY change was up 58.8%.

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

Finance income was JPY90 million, compared to JPY211 million for 1Q18. It included dividend income of JPY61 million (JPY52 million for 1Q18).

Finance expense was JPY215 million, compared to JPY108 million for 1Q18. It included interest expenses of JPY126 million (JPY104 million for 1Q18).

Share of profit of investments accounted for using equity method was JPY112 million (compared to loss of JPY30 million for 1Q18), mainly due to our share of loss in DeCurret Inc. of JPY337 million and gains on changes in equity of JPY374 million arisen from issuance of common stock of DeCurret Inc.

vi) Profit before tax

Profit before tax was JPY1,369 million (JPY1,425 million for 1Q18 and JPY943 million as Adjusted), down 3.9% YoY and Adjusted YoY change was up 45.2%.

vii) Profit for the period

Income tax expense was JPY543 million (JPY511 million for 1Q18). As a result, profit for the period was JPY826 million (JPY914 million for 1Q18 and JPY584 million as Adjusted), down 9.7% YoY and Adjusted YoY change was up 41.4%.

Profit for the period attributable to non-controlling interests was JPY49 million (JPY40 million for 1Q18) mainly related to net income of Trust Networks Inc. As a result, profit for the period attributable to owners of parent was JPY777 million (JPY874 million for 1Q18 and JPY544 million as Adjusted), down 11.1% YoY and Adjusted YoY change was up 42.9%.

(2) Financial Position

As of June 30, 2019, the balance of total assets was JPY204,390 million, increased by JPY37,101 million from the balance as of March 31, 2019 of JPY167,289 million.

As of June 30, 2019, the balance of current assets was JPY79,943 million, increased by JPY971 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 JPY935 million to JPY32,893 million, a decrease in trade receivables by JPY2,112 million to JPY31,264 million, a decrease in inventories by JPY1,568 million to JPY1,836 million and an increase in prepaid expenses by JPY3,046 million to JPY11,568 million.

As of June 30, 2019, the balance of non-current assets was JPY124,448 million, increased by JPY36,130 million from the balance as of March 31, 2019 of JPY88,318 million. Along with the adoption of IFRS 16, right-of-use assets were newly accounted. The breakdown of right-of-use assets was: JPY36,589 million of assets under operating lease contracts which was newly recognized, mainly related to our office and data centers lease contracts, and JPY15,291 million of assets under finance lease contracts, which were transferred from tangible and intangible assets. Other investments was JPY9,691 million, decreased by JPY1,711 million mainly due to sales of our portion of holding equity securities.

As of June 30, 2019, the balance of current liabilities was JPY59,145 million, increased by JPY6,241 million from the balance as of March 31, 2019 of JPY52,904 million. Trade and other payables decreased by JPY4,431 million to JPY17,531 million. Borrowings increased by JPY3,165 million to JPY15,915 million. The breakdown of increase in the borrowings was: an increase by JPY3,000 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 JPY6,775 million to JPY13,807 million. The increase included JPY5,553 million related to operating lease recognized along with the adoption of IFRS 16.

As of June 30, 2019, the balance of non-current liabilities was JPY67,422 million, increased by JPY30,157 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 JPY31,374 million to JPY43,525 million. The increase included JPY31,071 million related to operating lease recognized along with the adoption of IFRS 16.

As of June 30, 2019, the balance of equity attributable to owners of parent was JPY76,979 million, increased by JPY708 million from the balance as of March 31, 2019 of JPY76,271 million. Ratio of owners' equity to total assets was 37.7% as of June 30, 2019.

(3) Cash Flows

Cash and cash equivalents as of June 30, 2019 were JPY32,893 million (JPY22,857 million as of June 30, 2018).

Cash Flows provided by Operating Activities

Net cash provided by operating activities for 1Q19 was JPY5,250 million (net cash provided by operating activities of JPY6,623 million for 1Q18). There were profit before tax of JPY1,369 million, depreciation and amortization of JPY7,164 million, including JPY3,127 million of depreciation of right-of-use operating lease assets newly recognized by the adoption of IFRS 16, and income taxes paid of JPY1,304 million. Regarding changes in operating assets and liabilities, it was net cash out of JPY2,057 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 1Q19 was JPY2,141 million (net cash used in investing activities of JPY2,787 million for 1Q18), mainly due to payments for purchase of tangible assets of JPY2,947 million (JPY1,571 million for 1Q18), payments for purchase of intangible assets, such as software, of JPY1,650 million (JPY1,564 million for 1Q18) and proceeds from sales of other investments, such as equity securities, of JPY2,650 million.

Cash Flows used in Financing Activities

Net cash used in financing activities for 1Q19 was JPY2,097 million (net cash used in financing activities of JPY2,354 million for 1Q18), mainly due to proceeds from short-term borrowings of JPY3,000 million, payments of other financial liabilities of JPY5,158 million (JPY1,697 million for 1Q18), including JPY3,142 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 the first quarter of the 28th business term.

(5) Research and developments

For the three months ended June 30, 2019, research and development expenses, which were in relation to network services and systems integration business segment, were ¥113 million, decreased by 13.3% compared to ¥118 million for the three months ended June 30, 2018.

(6) Number of employees

There were no material changes in the number of employees of the Company during the first quarter of the 28th business term.

(i) Consolidated basis

	As of June 30, 2019
Number of Employees	3,557 (46)

(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 June 30, 2019
Number of Employees	2,056 (30)

(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 three months ended June 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	14,782,248	3.6
Total	14,782,248	3.6

(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 three months ended June 30, 2019 and order backlog as of June 30, 2019 were as follows:

Type of Services	Three months ended June 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	8,118,129	7.1	8,708,763	(9.8)
Systems Operation and Maintenance	14,098,823	23.1	46,513,537	13.9
Total	22,216,952	16.7	55,222,300	9.4

(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 three months ended June 30, 2019 were as follows:

Type of services	Three months ended June 30, 2019	
	Revenue (thousands of yen)	Year over year comparison (%)
Network services	30,679,585	6.9
Internet connectivity services (enterprise)	8,926,121	14.0
Internet connectivity services (consumer)	6,499,634	5.7
WAN services	7,424,014	(3.9)
Outsourcing services	7,829,816	11.8
Systems integration	18,109,204	19.7
Systems construction and equipment sales	7,249,209	46.2
Systems operation and maintenance	10,859,995	6.8
ATM operation business	1,040,055	4.5
Total revenues	49,828,844	11.1

(Note) 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 first quarter of the 28th business term.

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) (June 30, 2019)	Number of shares issued as of the filing date (shares) (August 14, 2019)	Stock exchange on which IIJ is listed or authorized financial instruments firms association	Description
Common stock	46,721,400	46,734,600	Tokyo Stock Exchange (the first section)	The number of shares constituting a unit is 100.
Total	46,721,400	46,734,600	—	—

(Note) On April 11, 2019, IIJ applied for delisting from the NASDAQ exchange and the delisting from NASDAQ exchange became effective on April 22, 2019.

(2) Information on Stock Acquisition Rights

(i) Description of Stock Option System

Not applicable

(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 April 1, 2019 to June 30, 2019	—	46,721,400	—	22,979,490	—	9,700,175

(Note) Increased by exercise of stock acquisition rights

(5) Major Shareholders

Not applicable for the first quarter of the 28th business term.

(6) Information on Voting Rights

All details provided in this section “(6) Information of Voting Rights” are based on the register of shareholders as of March 31, 2019, the preceding reference date, as the register of shareholders as of June 30, 2019 cannot be confirmed.

(i) Issued shares

As of March 31, 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)	45,058,200 shares of common stock	450,582	—
Shares Representing Less than One Unit	12,300 shares of common stock	—	—
Number of Issued Shares	46,721,400 shares of common stock	—	—
Total Number of Voting Rights	—	450,582	—

(ii) Treasury Stock

As of March 31, 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 to the June 30, 2019.

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

	March 31, 2019	June 30, 2019
	Thousands of yen	Thousands of yen
Assets		
Current Assets		
Cash and cash equivalents	31,957,789	32,892,657
Trade receivables	33,375,808	31,264,241
Inventories	3,403,192	1,835,596
Prepaid expenses	8,522,554	11,568,243
Other financial assets	1,581,212	2,140,921
Other current assets	130,900	241,084
Total Current Assets	78,971,455	79,942,742
Non-current Assets		
Tangible assets	33,136,059	18,854,593
Right-of-use Assets	—	51,879,594
Goodwill	6,082,472	6,082,472
Intangible assets	18,818,707	17,944,188
Investments accounted for using the equity method	4,837,867	5,331,456
Prepaid expenses	8,037,298	8,661,814
Other investments	11,402,365	9,691,082
Deferred tax assets	176,587	403,899
Other financial assets	5,293,547	5,132,034
Other non-current assets	532,839	466,495
Total non-current assets	88,317,741	124,447,627
Total assets	167,289,196	204,390,369

	March 31, 2019	June 30, 2019
Liabilities and Equity	Thousands of yen	Thousands of yen
Liabilities		
Current liabilities		
Trade and other payables	21,962,239	17,531,049
Borrowings	12,750,000	15,915,000
Income taxes payable	1,139,460	1,129,949
Deferred income	5,461,813	6,195,367
Other financial liabilities	7,031,690	13,806,657
Other current liabilities	4,559,005	4,567,007
Total current liabilities	<u>52,904,207</u>	<u>59,145,029</u>
Non-current liabilities		
Borrowings	14,000,000	13,085,000
Retirement benefit liabilities	3,488,501	3,532,257
Provisions	731,257	700,471
Deferred income	5,518,492	5,520,296
Deferred tax liabilities	421,396	191,950
Other financial liabilities	12,151,346	43,524,966
Other non-current liabilities	954,387	867,194
Total non-current liabilities	<u>37,265,379</u>	<u>67,422,134</u>
Total liabilities	<u>90,169,586</u>	<u>126,567,163</u>
Equity		
Share capital	25,518,712	25,518,712
Share premium	36,225,775	36,239,940
Retained earnings	12,335,035	14,074,789
Other components of equity	4,088,704	3,042,545
Treasury shares	(1,896,788)	(1,896,788)
Total equity attributable to owners of the parent	<u>76,271,438</u>	<u>76,979,198</u>
Non-controlling interests	848,172	844,008
Total equity	<u>77,119,610</u>	<u>77,823,206</u>
Total liabilities and equity	<u>167,289,196</u>	<u>204,390,369</u>

Condensed Consolidated Statements of Profit or Loss

	Three Months Ended June 30, 2018	Three Months Ended June 30, 2019
	Thousands of yen	Thousands of yen
Revenues		
Network services	28,711,024	30,679,585
System integration	15,132,221	18,109,204
ATM operation business	995,200	1,040,055
Total revenues	44,838,445	49,828,844
Cost of sales		
Cost of network services	(23,825,090)	(25,660,982)
Cost of systems integration	(13,599,658)	(16,219,380)
Cost of ATM operation business	(582,905)	(566,918)
Total cost of sales	(38,007,653)	(42,447,280)
Gross Profit	6,830,792	7,381,564
Selling, general and administrative expense	(5,521,752)	(6,041,692)
Other operating income	59,587	112,659
Other operating expenses	(16,954)	(71,572)
Operating Profit	1,351,673	1,380,959
Finance income	211,404	90,126
Finance expenses	(108,469)	(214,613)
Share of profit (loss) of investments accounted for using equity method	(29,690)	112,207
Profit (loss) before tax	1,424,918	1,368,679
Income tax expense	(510,614)	(542,925)
Profit (loss) for the year	914,304	825,754
Profit (loss) for the year attributable to:		
Owners of the parent	873,743	776,513
Non-controlling interests	40,561	49,241
Total	914,304	825,754
Earnings per share		
Basic earnings per share (yen)	19.39	17.23
Diluted earnings per share (yen)	19.32	17.15

Condensed Consolidated Statements of Comprehensive Income

	Three Months Ended June 30, 2018	Three Months Ended June 30, 2019
	Thousands of yen	Thousands of yen
Profit (loss)	914,304	825,754
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	(589,294)	652,157
Total items that will not be reclassified to profit or loss	(589,294)	652,157
Items that may be reclassified to profit or loss		
Exchange differences on translation of foreign operations	48,640	(97,542)
Financial assets measured at fair value through other comprehensive income	(21)	685
Share of other comprehensive income of investments accounted for using equity method	(13,716)	3,962
Total of items that may be reclassified to profit or loss	34,903	(92,895)
Total other comprehensive income, net of tax	(554,391)	559,262
Other comprehensive income	359,913	1,385,016
Other comprehensive income attributable to:		
Owners of the parent	319,352	1,335,775
Non-controlling interest	40,561	49,241
Other comprehensive income	359,913	1,385,016

Condensed Consolidated Statements of Changes in Shareholders' Equity

Three months ended June 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)	-	-	873,743	-	-	873,743	40,561	914,304
Other comprehensive income	-	-	-	(554,391)	-	(554,391)	-	(554,391)
Total comprehensive income	-	-	873,743	(554,391)	-	319,352	40,561	359,913
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	-	13,740	-	-	-	13,740	-	13,740
Total transactions with owners	6,908	7,345	(608,349)	-	-	(594,096)	(48,550)	(642,646)
Balance, June 30, 2018	25,518,712	36,183,281	9,944,215	4,504,564	(1,896,784)	74,253,988	710,511	74,964,499

Three months ended June 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)	-	-	776,513	-	-	776,513	49,241	825,754
Other comprehensive income	-	-	-	559,262	-	559,262	-	559,262
Total comprehensive income	-	-	776,513	559,262	-	1,335,775	49,241	1,385,016
Transactions with owners								
Dividends paid	-	-	(608,452)	-	-	(608,452)	(53,405)	(661,857)
Stock-based compensation	-	14,165	-	-	-	14,165	-	14,165
Transfer from other components of equity to retained earnings	-	-	1,605,421	(1,605,421)	-	-	-	-
Total transactions with owners	-	14,165	996,969	(1,605,421)	-	(594,287)	(53,405)	(647,692)
Balance, June 30, 2019	<u>25,518,712</u>	<u>36,239,940</u>	<u>14,074,789</u>	<u>3,042,545</u>	<u>(1,896,788)</u>	<u>76,979,198</u>	<u>844,008</u>	<u>77,823,206</u>

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

Condensed Consolidated Statements of Cash Flows

	Three Months Ended June 30, 2018	Three Months Ended June 30, 2019
	Thousands of yen	Thousands of yen
Cash flows from operating activities:		
Profit (loss) before tax	1,424,918	1,368,679
Adjustments		
Depreciation and amortization	3,608,903	7,163,708
Loss on sales of property and equipment	13,548	63,854
Shares of loss (profit) of investments accounted for using the equity method	29,690	(112,207)
Financial income	(207,085)	(75,430)
Financial expenses	104,381	216,748
Other	(33,751)	(43,228)
Changes in working capital		
Decrease (increase) in trade receivables	3,443,262	2,085,868
Decrease (increase) in inventories	(1,046,853)	1,561,660
Decrease (increase) in prepaid expenses	(3,236,927)	(3,680,025)
Decrease (increase) in other assets	(16,309)	(29,414)
Decrease (increase) in other financial assets	1,566,522	(288,799)
Increase (decrease) in trade and other payables	39,350	(3,293,040)
Increase (decrease) in deferred income	1,896,048	770,942
Increase (decrease) in other liabilities	72,773	(78,047)
Increase (decrease) in other financial liabilities	804,088	849,928
Increase (decrease) in retirement benefit liabilities	66,734	43,756
Sub total	8,529,292	6,524,953
Interest and dividends received	130,101	154,876
Interest paid	(106,956)	(126,602)
Income taxes paid	(1,929,154)	(1,303,564)
Cash flows from operating activities	6,623,283	5,249,663

	Three Months Ended June 30, 2018	Three Months Ended June 30, 2019
	Thousands of yen	Thousands of yen
Cash flows from investing activities		
Purchases of tangible assets	(1,570,948)	(2,947,407)
Proceeds from sales of tangible assets	340,667	348,306
Purchases of intangible assets	(1,563,770)	(1,650,369)
Proceeds from sales of intangible assets	-	6,831
Purchase of investments accounted for using equity method	-	(460,000)
Purchases of other investments	-	(8,740)
Proceeds from sales of other investments	-	2,649,631
Payments for leasehold deposits and guarantee deposits	(8,044)	(70,882)
Proceeds from collection of leasehold deposits and guarantee deposits	38,706	5,309
Payments for refundable insurance policies	(14,091)	(14,085)
Other	(9,699)	-
Cash flows from investing activities	<u>(2,787,179)</u>	<u>(2,141,406)</u>
Cash flows from financing activities		
Repayment of long-term borrowings	-	(750,000)
Net increase (decrease) in short-term borrowings	-	3,000,000
Proceeds from other financial liabilities	-	1,473,000
Payments of other financial liabilities	(1,696,834)	(5,158,023)
Dividends paid	(608,349)	(608,452)
Other	(48,557)	(53,405)
Cash flows from financing activities	<u>(2,353,740)</u>	<u>(2,096,880)</u>
Effect of exchange rate changes on cash and cash equivalents	54,924	(76,509)
Net increase (decrease) in cash and cash equivalents	1,537,288	934,868
Cash and cash equivalents, beginning of year	<u>21,320,004</u>	<u>31,957,789</u>
Cash and cash equivalents at beginning of period	<u><u>22,857,292</u></u>	<u><u>32,892,657</u></u>

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.iiij.ad.jp/>—. The condensed consolidated financial statements of IIJ for the three months ended June 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 IFRS 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 three months ended June 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 three months ended June 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 ¥3,141,932 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 three months ended June 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 three months ended June 30, 2018

	Reportable segments		Adjustments (Note 1)	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	Thousands of yen
Revenue				
Customers	43,843,245	995,200	—	44,838,445
Intersegment transactions	84,143	—	(84,143)	—
Total revenue	43,927,388	995,200	(84,143)	44,838,445
Segment operating profit	1,028,168	365,340	(41,835)	1,351,673
Finance income				211,404
Finance expense				(108,469)
Share of profit (loss) of investments accounted for using the equity method				(29,690)
Profit before taxes				1,424,918
Segment assets as of March 31, 2019	164,503,430	4,785,766	(2,000,000)	167,289,196
Other				
Depreciation and amortization	3,502,321	106,582	—	3,608,903

(Note 1) 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 June 30, 2019

	Reportable segments		Adjustments (Note 1)	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	Thousands of yen
Revenue				
Customers	48,788,789	1,040,055	—	49,828,844
Intersegment transactions	73,516	—	(73,516)	—
Total revenue	48,862,305	1,040,055	(73,516)	49,828,844
Segment operating profit	999,397	418,723	(37,161)	1,380,959
Finance income				90,126
Finance expense				(214,613)
Share of profit (loss) of investments accounted for using the equity method				112,207
Profit before tax				1,368,679
Segment assets	200,909,971	5,480,398	(2,000,000)	204,390,369
Other				
Depreciation and amortization	7,069,510	94,198	—	7,163,708

(Note 1) 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.

(Note 2) As a result of the adoption of IFRS 16, segment assets of the network service and systems integration business segment as of April 1, 2019 increased by ¥38,988,207 thousand. As for the details, please refer to Note 3. SIGNIFICANT ACCOUNTING POLICIES.

6. OTHER FINANCIAL ASSETS

The components of other financial assets are as follows:

	March 31, 2019	June 30, 2019
	Thousands of yen	Thousands of yen
Financial assets measured at amortized cost		
Other receivable	555,221	1,147,479
Guarantee deposit	3,140,672	3,208,248
Loans receivable	52,788	51,885
Other	185,954	156,072
Allowance for credit losses	(58,790)	(49,534)
Lease receivable	2,998,914	2,758,805
Total	6,874,759	7,272,955
Current assets	1,581,212	2,140,921
Non-current assets	5,293,547	5,132,034
Total	6,874,759	7,272,955

7. OTHER FINANCIAL LIABILITIES

The components of other financial liabilities are as follows:

	March 31, 2019	June 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	17,456,569
Lease contracts other than based on financing form	—	36,623,297
Total	18,033,862	54,079,866
Account payable—non-current	623,420	1,453,725
Deposit payable	344,510	1,133,964
Others	181,244	664,068
Total	19,183,036	57,331,623
Current liabilities	7,031,690	13,806,657
Non-current liabilities	12,151,346	43,524,966
Total	19,183,036	57,331,623

8. DIVIDENDS PAID

Cash dividends paid are as follows:

For the three months ended June 30, 2018

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

For the three months ended June 30, 2019

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

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 three months ended June 30, 2018	For the three months ended June 30, 2019
	Thousands of yen	Thousands of yen
Network services	28,711,024	30,679,585
Internet connectivity services (enterprise)	7,828,713	8,926,121
Wan services	7,727,475	7,424,014
Outsourcing services	7,004,539	7,829,816
Internet connectivity services (consumer)	6,150,297	6,499,634
Systems integration	15,132,221	18,109,204
Systems construction	4,959,021	7,249,209
Systems operation and maintenance	10,173,200	10,859,995
ATM operation business	995,200	1,040,055
Total	44,838,445	49,828,844

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

Share of profit of investments accounted for using equity method included gains on changes in equity of ¥373,661 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 for the three-month periods ended June 30, 2018 and 2019 were as follows:

	For the three months ended June 30, 2018	For the three months ended June 30, 2019
Numerator :		
Basic earnings attributable to owners of the parent (thousands of yen)	873,743	776,513
Denominator :		
Weighted average number of shares — basic (shares)	45,070,407	45,070,489
Dilution arising from stock options (shares)	163,544	195,963
Weighted average number of shares — diluted (shares)	45,233,951	45,266,452
Earnings per share attributable to owners of the parent		
Basic (yen)	19.39	17.23
Diluted (yen)	19.32	17.15

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>

June 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	—	115,010	—	115,010
Equity-based financial assets measured at FVTOCI				
Equity securities	5,967,159	—	1,391,109	7,358,268
Financial assets measured at FVTPL				
Investment trust and other securities	—	—	2,127,100	2,127,100
Other financial assets	—	90,704	—	90,704
Total	<u>5,967,159</u>	<u>205,714</u>	<u>3,518,209</u>	<u>9,691,082</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.

During the fiscal year ended March 31 and three months ended June 30, 2019, 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.

(3) Changes in financial assets classified as Level 3

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

	For the three months ended June 30, 2018	For the three months ended June 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	123,571	(41,805)
Profit or loss (Note 1)	121,003	(67,611)
Other comprehensive income (Note 2)	2,568	25,806
Purchase	100,000	8,740
Sale	—	(27,331)
Balance at the end of period	<u>3,733,183</u>	<u>3,518,209</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 and long-term accounts payable 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

June 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	-	14,753,226	-	14,753,226

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 June 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 August 14, 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

August 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 financial statement of financial position as at June 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 quarter 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 June 30, 2019, and their financial performance and cash flows for the quarter 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 first quarter of the previous fiscal year ended March 31, 2019, 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 first quarter of the previous fiscal year ended March 31, 2019, 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 August 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.