

INTERNET INITIATIVE JAPAN INC  
Form 20-F  
June 30, 2016

As filed with the Securities and Exchange Commission on June 30, 2016

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

**FORM 20-F**

**..REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

OR

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
1934**

**For the fiscal year ended March 31, 2016**

OR

**..TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

OR

**..SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**Date of event requiring this shell company report \_\_\_\_\_**

Commission file number: **0-30204**

**Kabushiki Kaisha Internet Initiative**

(Exact Name of Registrant as Specified in Its Charter)

**Internet Initiative Japan Inc.**

(Translation of Registrant's Name Into English)

Japan

(Jurisdiction of Incorporation or Organization)

Iidabashi Grand Bloom, 2-10-2 Fujimi, Chiyoda-ku, Tokyo 102-0071 Japan

(Address of Principal Executive Offices)

**Natsuko Kiyoshi, +81-3-5205-6500, +81-3-5205-6441,**

Iidabashi Grand Bloom, 2-10-2 Fujimi, Chiyoda-ku, Tokyo 102-0071 Japan

(Name, Telephone, Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
<b>Common Stock</b>	<b>The NASDAQ Stock Market</b>

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

**As of March 31, 2016, 46,711,400 shares of common stock were outstanding, including 1,016,198 shares represented by an aggregate of 2,032,396 American Depositary Shares.**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes  No

Note—Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP

International Financial Reporting Standards as issued by the International Accounting Standards Board

Other

If “Other” has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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## Cautionary Note Regarding Forward-Looking Statements

This annual report contains forward-looking statements about us and our industry that are based on our current expectations, assumptions, estimates and projections. These forward-looking statements are subject to various risks and uncertainties. These statements discuss future expectations, identify strategies, discuss market trends, contain projections of results of our operations and our financial condition, and state other forward-looking information. Known and unknown risks, uncertainties and other factors could cause our actual results to differ materially from those contained in or suggested by any forward-looking statement. We cannot provide any assurance that our expectations, projections, anticipated estimates or other information expressed in these forward-looking statements will turn out to be correct. We do not undertake any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Important risks and factors that could cause our actual results to differ materially from our forward-looking statements are generally provided in Item 3.D. "Risk Factors" and elsewhere in this annual report on Form 20-F and include, without limitation:

- that we may not be able to achieve or sustain profitability in the near future,
- that we may not be able to compete effectively against competitors which have greater financial, marketing and other resources, and
- that our investments in our subsidiaries, affiliated companies, new business and service developments may not produce the returns we expect or may adversely affect our results of operations and financial condition adversely.

*As used in this annual report, references to “IIJ” are to Internet Initiative Japan Inc. and references to “the Company”, “the Group”, “we”, “our”, “our group” and “us” are to Internet Initiative Japan Inc. and its subsidiaries except as the context otherwise requires.*

*References in this annual report to “yen” or “¥” are to Japanese yen and references to “U.S. dollars” or “\$” are to United States dollars.*

## PART I

### Item 1. Identity of Directors, Senior Management and Advisers

Not applicable.

### Item 2. Offer Statistics and Expected Timetable

Not applicable.

### Item 3. Key Information

#### A. Selected Financial Data

The following tables include selected historical financial data as of and for each of the fiscal years ended March 31, 2012, 2013, 2014, 2015, and 2016. The data in the table is derived from our audited consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”), and audited by Deloitte Touche Tohmatsu LLC, an independent registered public accounting firm. You should read the selected consolidated financial data together with Item 5. “Operating and Financial Review and Prospects” of this annual report on Form 20-F and our consolidated financial statements and the notes to our consolidated financial statements beginning on page F-1.

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As of and for the fiscal year ended March 31,  
2012 2013 2014 2015 2016  
(millions of yen, except per share and ADS data)

Statement of Income Data:

REVENUES:

Network services:

Internet connectivity services (enterprise)	¥14,707	¥16,027	¥16,585	¥16,350	¥17,597
Internet connectivity services (consumer)	5,717	5,466	6,025	8,222	15,256
WAN services	25,667	25,168	25,006	24,326	25,177
Outsourcing services	17,319	18,571	19,670	20,108	21,266
Total	63,410	65,232	67,286	69,006	79,296
Systems integration:					
Systems construction	11,997	15,825	18,673	20,437	21,145
Systems operation and maintenance	19,472	21,380	23,796	27,800	33,043
Total	31,469	37,205	42,469	48,237	54,188
Equipment sales	1,112	1,491	1,690	2,167	3,275
ATM operation business	1,324	2,320	2,827	3,640	3,889
Total revenues	97,315	106,248	114,272	123,050	140,648

COSTS AND EXPENSES:

Cost of network services	49,985	50,692	53,046	54,932	64,239
Cost of systems integration	24,979	30,425	36,510	41,562	46,226
Cost of equipment sales	980	1,318	1,527	1,932	2,969
Cost of ATM operation business	1,382	1,959	2,123	2,552	2,559
Total costs	77,326	84,394	93,206	100,978	115,993
Sales and marketing	7,947	8,059	8,548	9,188	10,589
General and administrative	5,300	5,632	6,374	7,368	7,471
Research and development	389	410	421	441	455
Total costs and expenses	90,962	98,495	108,549	117,975	134,508
OPERATING INCOME	6,353	7,753	5,723	5,075	6,140

OTHER INCOME (EXPENSES):

Dividend income	48	47	51	63	93
Interest income	35	26	27	23	28
Interest expense	(299 )	(287 )	(256 )	(238 )	(241 )
Other — net	(161 )	218	730	216	173
Other income (expenses) — net	(377 )	4	552	64	53

INCOME FROM OPERATIONS BEFORE INCOME TAX

EXPENSE AND EQUITY IN NET INCOME OF EQUITY METHOD INVESTEEES

INCOME TAX EXPENSE

EQUITY IN NET INCOME OF EQUITY METHOD INVESTEEES

NET INCOME

LESS: NET (INCOME) LOSS ATTRIBUTABLE TO NONCONTROLLING INTERESTS

¥3,641 ¥5,301 ¥4,442 ¥3,322 ¥4,038

NET INCOME ATTRIBUTABLE TO INTERNET  
INITIATIVE JAPAN INC.

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As of and for the fiscal year ended March 31,  
2012                      2013                      2014                      2015                      2016  
(millions of yen, except per share and ADS data)

Per Share and ADS Data:

Basic net income attributable to IIJ per common share <sup>(1)</sup>	¥89.82	¥130.76	¥100.26	¥72.31	¥87.88	
Diluted net income attributable to IIJ per common share <sup>(1)</sup>	89.78	130.65	100.14	72.20	87.71	
Basic net income attributable to IIJ per ADS equivalent	44.91	65.38	50.13	36.16	43.94	
Diluted net income attributable to IIJ per ADS equivalent	44.89	65.33	50.07	36.10	43.86	
Cash dividends declared per share:						
Japanese Yen <sup>(1)</sup>	¥16.25	¥18.75	¥22.00	¥22.00	¥22.00	
U.S. Dollars <sup>(1) (2)</sup>	\$0.20	\$0.22	\$0.21	\$0.18	\$0.20	
Basic weighted average number of shares <sup>(1)</sup>	40,536,800	40,536,800	44,306,680	45,942,291	45,950,098	
Diluted weighted average number of shares <sup>(1)</sup>	40,556,400	40,572,600	44,361,083	46,014,737	46,043,383	
Basic weighted average number of ADS equivalents (thousands)	81,074	81,074	88,613	91,885	91,900	
Diluted weighted average number of ADS equivalents (thousands)	81,113	81,145	88,722	92,029	92,087	
Balance Sheet Data:						
Cash and cash equivalents	¥13,537	¥12,259	¥22,421	¥21,094	¥19,569	
Total assets	73,493	82,111	103,867	108,705	117,835	
Short-term borrowings	9,000	9,400	9,400	9,250	9,250	
Long-term borrowings, including capital lease obligations:						
Current portion	4,007	4,515	4,733	3,522	3,954	
Noncurrent portion	6,731	6,350	4,603	4,340	7,779	
Common stock	16,834	16,834	25,497	25,500	25,509	
Total IIJ shareholders' equity	32,688	37,607	59,912	62,504	64,845	
Operating Data:						
Capital expenditures, including capitalized leases <sup>(3)</sup>	¥10,917	¥10,405	¥12,560	¥11,835	¥14,812	
Operating margin ratio <sup>(4)</sup>	6.5	% 7.3	% 5.0	% 4.1	% 4.4	%
Net cash provided by (used in):						
Operating activities	¥11,659	¥9,639	¥8,787	¥12,912	¥12,052	
Investing activities	(5,954)	) (5,946)	) (10,203)	) (8,073)	) (8,377)	)
Financing activities	(5,464)	) (4,996)	) 11,382	) (6,283)	) (5,201)	)

(1)

We conducted a 1 to 200 stock split on common stock with an effective date of October 1, 2012. The figures for the fiscal year ended March 31, 2012 are retroactively adjusted to reflect the stock split.

(2) The dividends per share were translated into U.S. dollars at the relevant record date.

(3) Further information regarding capital expenditures, including capitalized leases and a reconciliation to the most directly comparable U.S. GAAP financial measure can be found in the following page.

(4) Operating income as a percentage of total revenues.

## Reconciliations of the Disclosed Non-GAAP Financial Measures to the Most Directly Comparable GAAP Financial Measures

### Capital expenditures

We define capital expenditures as purchases of property and equipment plus acquisition of assets by entering into capital leases. We have included the information concerning capital expenditures because our management monitors our capital expenditure budgets and believes that it is useful to investors to know the trends of our capital expenditures and analyze and compare companies on the basis of such investments. Capital expenditures, as we have defined it, may not be comparable to similarly titled measures used by other companies.

The following table summarizes the reconciliation of capital expenditures to purchases of property and equipment and acquisition of assets by entering into capital leases as reported in our consolidated statements of cash flows prepared and presented in accordance with U.S. GAAP.

	For the fiscal year ended March 31,				
	2012	2013	2014	2015	2016
	(millions of yen)				
Capital expenditures:					
Acquisition of assets by entering into capital leases	¥4,750	¥4,816	¥3,436	¥3,678	¥6,118
Purchases of property and equipment	6,167	5,589	9,124	8,157	8,694
Total capital expenditures	¥10,917	¥10,405	¥12,560	¥11,835	¥14,812

### Exchange Rates

Fluctuations in exchange rates between the Japanese yen and the U.S. dollar will affect the U.S. dollar and other currency equivalent of the yen price of IIJ shares and the U.S. dollar amounts received on conversion of any cash dividends, which in turn will affect the U.S. dollar price of IIJ ADSs. We have translated some Japanese yen amounts presented in this annual report into U.S. dollars solely for your convenience. Unless otherwise noted, the rate used for the translations was ¥112.42 per U.S. \$1.00, which was the noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York prevailing as of March 31, 2016. Translations do not imply that the yen amounts actually represent, or have been or could be converted into, equivalent amounts in U.S. dollars.

The following table presents the noon buying rates for Japanese yen per U.S. \$1.00 in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York:

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<u>Fiscal year ended March 31.</u> <sup>(1)</sup>	High	Low	Average <sup>(2)</sup>	Period-end
2012	¥85.26	¥75.72	¥ 78.83	¥ 82.41
2013	96.16	77.41	82.96	94.16
2014	105.25	92.96	100.46	102.98
2015	121.50	101.26	110.78	119.96
2016	125.58	111.30	120.13	112.42
Calendar year 2016				
January	¥121.05	¥116.38	¥ 118.23	¥ 121.05
February	121.06	111.36	114.62	112.90
March	113.94	111.30	112.93	112.42
April	112.06	106.90	109.55	106.90
May	110.75	106.34	108.85	110.75
June (through June 24, 2016)	109.55	102.26	105.99	102.26

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(1) Exchange rate refers to the foreign exchange rate as set forth in the H.10 statistical release and historical data of the Board of Governors of the Federal Reserve System.

(2) For fiscal years, calculated from the average of the exchange rates on the last day of each month during the period.  
For calendar year months, calculated based on the average of daily exchange rates.

The noon buying rate on June 24, 2016 was ¥102.26 per \$1.00.

#### B. Capitalization and Indebtedness

Not required.

#### C. Reasons for the Offer and Use of Proceeds

Not applicable.

#### D. Risk Factors

*You should carefully consider the following information, together with the other information contained in this annual report on Form 20-F, including our consolidated financial statements and the related notes, before making an investment decision. Any risks described below could result in a material adverse effect on our business, financial condition or results of operations.*

*We may not maintain our current level of revenues and profits or achieve our expected revenues and profits in the future.*

Our business is principally conducted in Japan and most of our revenues are from customers operating in Japan. For the fiscal year ended March 31, 2016, approximately 96% of our total revenues were from customers operating in Japan. If the Japanese economy deteriorates and that results in significantly lower levels of network and systems related investment and expenditures, customers may respond to such conditions by prioritizing low prices over quality, or we may experience severe price reduction pressure and/or cancellation of large accounts. Such conditions may also make it difficult to maintain our current level of revenues and income, or achieve our expected revenues and income, or payout our target dividends.

In addition to factors related to general economic conditions in Japan, we may not be able to maintain our current level of revenues and income or achieve our expected levels of revenues and income. In fact, we revised our disclosed financial targets downward for the fiscal years ended March 31, 2014 and 2015, due to several factors unrelated to general economic conditions in Japan. Factors that may prevent us from maintaining our current level of revenues and income or achieving our expected levels of revenues and income include but are not limited to the following:

- a decrease or weaker than expected growth in our network services revenues which include Internet connectivity services for enterprise, Internet connectivity services for consumers, Wide Area Network (“WAN”) services, and outsourcing services if, for example, we fail to develop and offer competitive services and solutions in a timely manner, if our service line-ups become obsolete, if we fail to keep up with rapidly changing market trends, especially for the consumer market, if service prices fall dramatically due, for example, to tough competition regarding customer acquisition, especially for our mobile services for consumers which are provided through direct sales, sales partnerships, and Mobile Virtual Network Enabler (“MVNE”) strategy, or if we experience cancellations or usage reductions, especially in large accounts, due, for example, to corporate customers’ demand to cut costs or a decrease in customers’ needs for network usage for enterprise services,

- a decrease or weaker than expected growth in our systems construction revenues and lower margins if, for example, we fail to successfully differentiate our technical skills from those of our competitors, if corporate customers put off placing orders with us, if we fail to hire adequate employees or acquire outsourcing resources to complete systems construction projects appropriately, if we have serious troubles or problems in certain systems construction projects which may become unprofitable or incur losses, especially for large-scale projects, if we pursue unprofitable

construction projects in order to, for example, gain greater business opportunities and to acquire systems operation and maintenance profit in the future, or if cloud computing services continue to replace conventional hardware,

a decrease or weaker than expected growth in our systems operation and maintenance revenues and lower margins if, for example, the number and the size of systems construction projects which contain continuous systems operation and maintenance decrease or do not significantly increase, if our cloud computing services revenues do not grow as anticipated, or if we have serious troubles or problems in the systems operation and maintenance projects which may become unprofitable or incur losses. Also, we may have cancellations or reductions in current systems operation and maintenance revenues due, for example, to severe price reduction requirements, especially for large-scale projects, customers' intention to reduce or eliminate their systems,

an inability to achieve anticipated revenue and income growth for our cloud computing services, in which we have been continuously investing in facilities such as some portion of our data centers, servers, storages, software and other equipment as well as service developments if, for example, the cloud computing market in Japan does not expand as large as we expect or takes a longer time to expand than we expect, if we fail to successfully differentiate our services from those of our increasing number of competitors, including global players, if we have serious system troubles and interruptions with our cloud computing services that damage our credibility or cause customers to question the reliability of our services, if market prices for the services fall dramatically, if we experience cancellations of large contracts or reduction of usage, or if Japanese companies strongly maintain their current systems and fail to adopt cloud computing services to the extent currently anticipated. We may decide to pursue building large-scale data centers in the future which may require large investment. For more discussion on the risks related to our cloud computing services, please refer to other parts of “Risk Factors” including *“our investment in our new business and service developments may not produce the returns we expect or may affect our results of operations and financial condition adversely.”*

an inability to achieve anticipated revenue and income growth for our mobile business for both enterprise and consumer, in which we have been expanding our service infrastructure by increasing the purchasing volume of mobile bandwidth mainly from NTT DoCoMo Inc. (“NTT Docomo”), enhancing marketing activities including increasing related advertisement expenses, if, for example, the Japanese inexpensive LTE Subscriber Identity Module (“SIM”) card market does not expand as we expect or takes a longer time to expand than we expect, if we experience severe price competition, if we fail to maintain appropriate relationships with our sales partners, if we face troubles in providing services which damage our credibility, if we fail to increase our brand awareness, if we fail to successfully differentiate our services from those of increasing number of competitors, or if we experience an unexpected level of wholesale telecommunication services charge changes by NTT Docomo. We may make rather large-scale investments to enhance our mobile service lineups in the future. For more discussion on the risks related to our mobile business, please refer to other parts of “Risk Factors” including *“our investment in our new business and service developments may not produce the returns we expect or may affect our results of operations and financial condition adversely.”*

an inability to achieve anticipated revenue and income growth for our overseas business, in which we have been investing in overseas subsidiaries, facilities and increasing staff, if, for example, we fail to offer competitive services and solutions, if our domestic customers reduce their overseas business and/or refrain from operating overseas business, if we fail to develop a customer base overseas, if we fail to attract and attain qualified personnel overseas, if we fail to provide our services as reliably as we provide them in the domestic market, if we fail to successfully work with business partners in abroad, or if we fail to adequately control overseas subsidiaries and comply with necessary regulations. We may expand our presence overseas by, for example, increasing overseas subsidiaries or participating in more joint ventures with local companies. For more discussion on the risks related to our overseas business, please refer to other parts of “Risk Factors” including *“our investment in our new business and service developments may not produce the returns we expect or may affect our results of operations and financial condition adversely.”*



a decline in the profitability of network services if, for example, we invest in and contract more network capacity, including service facilities, than we actually require to serve our customers, if we experience an unexpected level of increase in prices such as for electricity, leasing lines for our Internet backbone and interconnectivity bandwidth for Mobile Virtual Network Operator (“MVNO”) infrastructure. These price increases could be due, for example, to an increase in Internet traffic volume and general demand for the infrastructure. There may also be price increases for international leasing lines and network equipment for service facilities, including cloud computing services, due, for example, to the weaker Japanese yen,

an unexpected level of increase in expenses and investments such as for research and development, back-office systems and other similar expenses and investments which we may be forced to make in the future in order to remain competitive or support revenue growth, and an unexpected level of increase in amortization and depreciation, loss on disposal, or loss due to obsolescence. We may continuously reinforce our back-office operation by making necessary investments to support revenue growth,

an unexpected level of increase in personnel and outsourcing costs as well as related operating costs and expenses including office rent expenses if, for example, we fail to manage personnel and outsourcing resources effectively, if we experience a shortage of human resources in the market, or if we face pressure to raise individual salaries by a large amount due, for example, to Japanese labor market situation. As for our overall personnel costs, they continuously increase year over year as we acquire new employees in addition to the regular annual pay raise for existing employees. We may fail to raise enough revenue to cover these costs and expenses increase.

an unexpected level of increase in selling, general and administrative expenses, such as personnel-related expenses, office rent-related expenses, sales commission expenses, and advertising expenses,

the recording of an impairment loss on current and future intangible assets, which are recognized in relation to any mergers and acquisitions, that are subject to amortization, such as customer relationships, and/or are not subject to amortization, such as goodwill, as a result of an impairment test,

the recording of foreign exchange gain and/or loss such as for our U.S. dollars and British pounds denominated bank deposits, other overseas assets and liabilities related to our overseas business,

the recording of impairment losses on available-for-sale securities, nonmarketable equity securities and funds,

the decline in the value and trading volume of our holding of available-for-sale securities from which we expect gains on sale,

a negative effect on our revenues and profits if our consolidated subsidiaries and/or equity method investees including newly established ones cannot achieve our expected levels of revenues or manage costs and expenses in a timely and adequate manner,

a negative effect on our credibility, corporate image, or revenues and profits if we are unable to provide our services without interruption to customers due, for example, to power supply shortage, and

a negative effect on our revenues and profits if new business areas to which we are to emphasize business investment such as content distribution, Machine to Machine (“M2M”), Internet of Things (“IoT”), health care and further development of overseas business, cannot achieve our expected level of revenues or manage costs and expenses in a timely and adequate manner.

We disclosed our middle term plan for the period from the fiscal year ending March 31, 2017 to the fiscal year ending March 31, 2021 in our earnings results for the fiscal year ended March 31, 2016, which was filed as Form 6-K on May 13, 2016. The middle term plan was made based on our current expectation about, for example, the related markets and economic situations. The plan, especially regarding our target for the fiscal year ending March 31, 2021, is not made by accumulating each revenue line or operating cost item. We are not certain that we will be able to achieve our middle term plan due to such risks as weaker or slower than expected market expansion or a failure to execute growth strategies effectively. Please see Item 5, “Operating and Financial Review and Prospects” for more detailed information concerning our operations and other results.

*We may not be able to compete effectively, especially against competitors with greater financial, marketing and other resources.*

The major competitors of our network services are major telecommunications carriers such as NTT Communications Corporation (“NTT Communications”) and KDDI Corporation (“KDDI”). Price competition for Internet connectivity services, outsourcing services, and WAN services has been severe. This competition may adversely affect our revenues and profitability and may make it difficult for us to retain existing customers or attract new customers. The major competitors of our systems integration business are systems integrators, such as NEC Corporation, Fujitsu Limited, NTT Data Corporation and their affiliates. Our major competitors have the financial resources to reduce prices in an effort to gain market share. There is strong competition among systems integrators that may adversely affect our revenues and profitability. Even though the NTT Group, which is comprised of companies such as Nippon Telegraph and Telephone Corporation (“NTT”) and NTT Communications, is IJ's largest shareholder, we plan to continue to operate the Company separately and independently from the NTT Group, and will therefore continue to compete with the NTT Group.

We anticipate that cloud computing services for enterprise should become widely used in Japan in the middle- to long-term. In addition to the competitors listed above, global players such as Amazon.com, Inc. and MICROSOFT CORPORATION have been aggressively expanding their business and may put additional business resources into the cloud computing business which may lead to strong competition, including price competition, in Japan. If we fail to successfully differentiate our services and solutions from these competitors, we may not be able to achieve expected future revenues and income, or we may not recoup our investments in cloud computing services, which may adversely affect our financial condition and results of operations.

As for our consumer business, especially our mobile services for consumers, in which we offer inexpensive LTE SIM cards through an MVNO scheme, we may not be able to achieve expected future revenues and income due, for example, to severe price competition and competition for customer acquisition, as a growing number of competitors enter the market, a failure to differentiate our services from competitors, our limited brand recognition among consumers and a lack of experience in providing services to consumers. We may increase our marketing expenses in order to improve our limited brand recognition among consumers.

We are enhancing our indirect sales channels with partnership programs, although currently our sales channels with respect to small and medium enterprises and the consumer market are not as strong as those of our established and well recognized larger competitors.

Our competitors have advantages over us, including, but not limited to:

- substantially greater financial resources, more extensive and well-developed marketing and sales networks,

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- a larger pool of technology human resources including application development engineers,
  - higher brand recognition among consumers and corporate customers,
  - larger customer bases, and
  - more diversified operations which allow profits from some operations to support operations with lower profitability.
- With these advantages, our competitors may be better able to:

- sustain downward pricing pressure, including pressure on low-price Internet connectivity services offered to corporate customers, which are our target customers,
- develop, market and sell their services,
- adapt quickly to new and changing technologies,
- obtain new customers, and
- aggressively pursue mergers and acquisitions to enlarge their customer base and market share.

*Our investment in our new business and service developments may not produce the returns we expect or may affect our results of operations and financial condition adversely.*

We have been investing in new business, service and solution developments to further grow our business. Such investments include, for example, an increase in human resources and capital expenditures. As for the number of our employees, we had 2,353, 2,835 and 2,980 employees as of March 31, 2014, 2015 and 2016, respectively. Capital expenditures, including capitalized leases, and depreciation and amortization expenses for property and equipment are increasing along with our business expansion efforts. Capital expenditures, including capitalized leases, for the fiscal years ended March 31, 2014, 2015 and 2016 were ¥12.6 billion, ¥11.8 billion and ¥14.8 billion, respectively. Depreciation and amortization expenses for property and equipment for the fiscal years ended March 31, 2014, 2015 and 2016 were ¥8.4 billion, ¥9.3 billion and ¥9.5 billion, respectively. If our investment returns are not realized in the future, our investments may become obsolete, which may adversely affect our financial condition and results of operations. Our recent enhanced business investments could lead to a greater uncertainty in our financial outlook.

We are investing heavily in our cloud computing services and infrastructure as the cloud computing services market in Japan is anticipated to grow over the middle term. Revenues for our cloud computing services for the fiscal years ended March 31, 2014, 2015 and 2016 were approximately ¥9.8 billion, ¥12.3 billion and ¥14.1 billion, respectively. The capital expenditures, including capitalized leases, related to our domestic cloud computing services for the fiscal years ended March 31, 2014, 2015 and 2016 were approximately ¥3.7 billion, ¥1.7 billion and ¥4.4 billion, respectively. As we expand our cloud computing services capabilities in order to meet the increasing demand, we will need to acquire more servers, network equipment and data center facilities, as well as human resources. We doubled the capacity of our container-based module type data center in Matsue in November 2013 to meet demand. We anticipate that we can leverage our strong customer base and our engineering skills to further expand our cloud computing related services; however, if the expansion of the cloud computing market does not proceed at its expected pace or takes longer than expected, if we face troubles in providing cloud computing services which damage our credibility or lead customers to question the reliability of our services, if we fail in our marketing strategy and fail to introduce cloud service line-ups that are superior to our competitors and promote business enterprises' cloud usage, if we invest more than customers demand, if severe price competition occurs, or if we should need more human resources and incur unexpected additional costs, we may not be able to achieve the returns or benefits we expect or we may need to increase the amount of our investments.



We have been providing mobile services from January 2008 by purchasing NTT Docomo's mobile network infrastructure as an MVNO. The total (sum of enterprise and consumer) mobile services revenues were approximately ¥4.7 billion, ¥7.7 billion and ¥15.6 billion for the fiscal years ended March 31, 2014, 2015 and 2016, respectively. The total number of our mobile services subscriptions was approximately 384 thousand, 673 thousand and 1,228 thousand as of March 31, 2014, 2015 and 2016, respectively. This increase is mainly due to rapidly growing mobile services for consumers in which we offer inexpensive LTE SIM cards through our website, sales partners and MVNE scheme. Currently, most Japanese mobile phone consumers are contracted with mobile network carriers such as NTT Docomo, KDDI, and Softbank Corp. We anticipate that the inexpensive LTE SIM card market in Japan should expand in the middle-to long-term because only a fraction of Japanese mobile phone users are contracted with inexpensive LTE SIM card services. We may not be able to achieve our anticipated level of business growth if, for example, the market does not expand as currently anticipated, if mobile carriers implement strategies in order to maintain their customer base by dramatically lowering their pricing or offering comprehensive bundled services to make it harder for consumers to switch contracts to other providers, if price competition becomes severe, if we fail to differentiate our services from our competitors, if changes in regulation adversely affect our business, if we significantly damage our reputation or decrease customer trust by failing to offer reliable connectivity or cause serious systems or network troubles or if we fail to maintain or develop appropriate relationships with sales partners, if we face unfavorable changes in business conditions with these sales partners, including sales commission terms, or if we mismanage our marketing expenses, we may not be able to achieve our expected levels of business growth and could negatively impact our profit level. Because business enterprise has been our main customer domain, IJJ is not well known among consumers. Therefore, we rely on our partnerships for sales channels, including prominent consumer retailers who have nationwide stores in order to have face-to-face sales counters, as well as MVNE strategy, through which we provide our MVNO infrastructure to corporate customers so that they can incorporate it into their own services, in order to generate subscriptions. The cost structure of mobile services imposes uncertainty on our financial outlook. Our mobile infrastructure purchasing volume from NTT Docomo has been increasing along with the growing subscriptions of our mobile services for consumers. We pay NTT Docomo a wholesale telecommunication service charge, which is a flat-rate charge per Mbps and the same charge is applied to all of NTT Docomo's MVNOs. The charge is calculated annually and it is mainly based on NTT Docomo's mobile data communication infrastructure volume and its related costs, in accordance with the law and the guidelines administrated by the Ministry of Internal Affairs and Communications ("MIC"). For instance, the charge that was applied to our purchasing volume from NTT Docomo during the fiscal year ended March 31, 2016 was based on NTT Docomo's fiscal year ended March 31, 2015 mobile data communication infrastructure volume and its related costs, and its charge was fixed and notified to NTT Docomo's MVNOs including us in March 2016. The charge has been applied to not only our purchasing volume during the fiscal year ended March 31, 2016, but also during the fiscal year ended March 31, 2015. We need to apply its own estimated charge from the beginning of a fiscal year until the charge is finalized. As the volume we purchase from NTT Docomo increases, the uncertainty regarding our financial outlook, especially income, could also increase. We may make large-scale investments to enhance our mobile service line-ups in the future. For more discussion on mobile services' structure, please refer to Item 5.D "Trend Information."

We plan to increase our investment in the bank automated teller machines ("ATM") operation business by increasing the number of ATMs we place. If our ATM operation business does not proceed as planned, we may lose all or part of our investment in this business which may adversely affect our financial condition and results of operations. For more detailed risks pertaining to our ATM operation business, please refer to the risk described in "Our investments in our subsidiaries and equity method investees may not produce the returns we expect or may affect our results of operations and financial condition adversely."

The Japanese domestic market opportunity is anticipated to be limited over the long run mainly due to the declining Japanese population and along with that many Japanese companies heading overseas to seek opportunities. Under such circumstances, we have been enhancing our overseas business developments mainly to expand our customer base and to meet the range of Information Technology (“IT”) network needs of our Japanese customers operating abroad since the fiscal year ended March 31, 2012. Revenues from our overseas business for the fiscal years ended March 31, 2014, 2015 and 2016 were approximately ¥4.1 billion, ¥4.9 billion and ¥5.3 billion, respectively. Although our overseas revenue is still relatively small, if, for example, we fail to offer competitive services and solutions, if we fail to develop customer base for our overseas business, if we fail to acquire enough qualified personnel, or if we invest and contract more network capacity and service facilities than we actually need to serve our customers, due, for example, to our lack of experience in operating overseas business, our limited brand recognition overseas, and change in our domestic customers’ overseas business expansion strategy and refrain from operating overseas business, we may not be able to achieve our expected levels of revenues and profits. Overseas business expansion may impact our domestic business if, for example, we assign many engineers for our overseas business that our domestic business is left with insufficient resources to complete projects. Overseas business operating expenses and costs may increase due, for example, to commencement of cloud computing services, opening of new overseas subsidiaries, increasing employees, and investing in network facilities. Additionally, we may encounter difficulties in planning and managing operations due to unfavorable political or economic factors, such as cultural and religious conflicts, non-compliance with expected business conduct, local regulations and taxation laws, and a lack of adequate infrastructure. Moreover, changes in local regulations, policies, taxation laws, local regulations, business or investment permit approval requirements, foreign exchange controls, or the nationalization of assets or restrictions on the repatriation of returns from foreign investments in major markets and regions may affect our operating results. Also, a failure to maintain adequate controls to comply with regulations such as the U.S. Foreign Corrupt Practices Act (“FCPA”) may harm our reputation and adversely affect our financial results and business operation.

Other than the above, we will continue to invest in the development of new businesses and services to enhance our current businesses and services. However, there is no assurance that we can achieve the returns or benefits from the development of those businesses and services and this may adversely affect our financial condition and results of operations.

*Our investments in our subsidiaries and equity method investees may not produce the returns we expect or may affect our results of operations and financial condition adversely.*

In the past, we have invested in our group companies to expand our businesses and generate new businesses. As of June 27, 2016, we have 15 consolidated subsidiaries and eight equity method investees. The financial performance of our consolidated subsidiaries directly affects our financial condition and results of operations and the financial performance of our equity method investees affects our financial condition and results of operations through our pro rata interest in our equity method investments. There can be no assurance that we will be able to maintain or enhance the value or the performance of such companies in which we have invested in or may invest in the future, or that we will achieve the returns or benefits from these investments. We may consider further reorganization of our group companies and there is no guarantee that we will be able to achieve the benefits that we expect from such reorganization. We may provide additional financial support in the form of loans, additional equity investments, guarantees, or leases in such companies. We may lose all or part of our investment relating to such companies if their value decreases as a result of their financial performance or if they go bankrupt. If our interests differ from those of other investors in entities over which we do not exercise control, we may not be able to realize synergies with the



investees and it may adversely affect our financial condition and results of operations.

IIJ's substantial investment in Crosswave Communications Inc. ("Crosswave"), IIJ's former equity method investee, became worthless due to Crosswave's commencement of corporate reorganization proceedings. In August 2003, Crosswave filed a voluntary petition for the commencement of corporate reorganization proceedings in Japan, and as a result of IIJ's equity method net loss and an impairment loss taken in respect of IIJ's investment in Crosswave, our net loss for the fiscal year ended March 31, 2003 was ¥15.6 billion, the highest net loss that we have ever experienced.

IIJ Global Solutions Inc. ("IIJ-Global"), which became our 100% owned consolidated subsidiary on September 1, 2010 after acquiring its stock from AT&T Japan LLC ("AT&T Japan") for ¥9.2 billion, mainly provides WAN services. For the fiscal years ended March 31, 2015 and 2016, IIJ-Global had ¥25.2 billion and ¥26.2 billion in revenues, respectively, and ¥0.5 billion and ¥0.7 billion in operating income, respectively. The operating income of IIJ-Global increased mainly because of continuous accumulation of orders from enterprise customers. If IIJ-Global cannot achieve our expected levels of revenues and profits, manage costs and expenses in a timely and adequate manner or incurs unexpected expenses, it may adversely affect our financial condition and results of operations. Intangible assets as of March 31, 2016 related to IIJ-Global were ¥4.2 billion, and if IIJ-Global cannot achieve its future expected revenue and profit, we may incur a substantial impairment loss on intangible assets which may adversely affect our financial condition and results of operations. Related to the acquisition of IIJ-Global, IIJ-Global entered into a Solutions Engagement Agreement with IBM Japan Ltd. ("IBM Japan"), IIJ-Global's largest sales partner. This agreement, which establishes the basis for a procurement relationship between IIJ-Global and IBM Japan, contains an indemnification for IIJ-Global to perform services, functions, responsibilities and others actions in the same way as when the company was a part of AT&T Japan. Failure to perform in this manner may adversely affect our financial condition and results of operations. Furthermore, IIJ-Global and the Company may damage their relationship with IBM Japan, which may indirectly adversely affect our financial condition and results of operations.

Trust Networks Inc. ("Trust Networks"), IIJ's consolidated subsidiary which was established in July 2007, is in charge of the ATM operation business. Trust Networks operates ATMs and the related network systems and receives a commission for each bank withdrawal transaction when a customer uses its serviced ATMs. As of March 31, 2016, 1,087 ATMs were placed in locations such as Japanese pinball shops ("pachinko parlors"). As of March 31, 2016, IIJ has invested a total of ¥2.6 billion in Trust Networks (79.5% share ownership). For the fiscal years ended March 31, 2015 and 2016, the ATM operation business had ¥3.6 billion and ¥3.9 billion in revenues, respectively, and ¥0.9 billion and ¥1.1 billion in operating income, respectively. If Trust Networks is not able to introduce ATMs in accordance with its plan due, for example, to a longer than expected negotiation period with interested parties including banks, if it does not record ATM withdrawal transactions as anticipated due, for example, to a decrease in the number of pinball players as a result of a declining Japanese population or a decrease in consumer demand prompted by an increase in the Japanese consumption tax rate, if it incurs unexpected additional costs, or if regulations change, it may not be able to achieve its future expected revenue and profit, which may adversely affect our financial condition and results of operations. If the number of serviced ATMs increases, our capital expenditures including capitalized leases may increase due to the leasing or purchasing of ATMs.

As of June 27, 2016, we have eight overseas subsidiaries including IJJ America Inc. (“IJJ-America”) and IJJ Europe Limited (“IJJ-Europe”). In addition to the existing subsidiaries in Singapore, Indonesia, Thailand, China and Hong Kong, we may establish more subsidiaries in Asia to seek greater business opportunities as the need for IT is beginning to increase in the region compared to the United States and Europe, where IT-related markets are already established. However, there is no assurance that we will be able to receive the returns we expect from investing due, for example, to our lack of experience in operating businesses in emerging countries, a failure in offering services that meet local needs, shrinking IT needs and change in the political and diplomatic situation. To enhance our overseas business, we have been managing our overseas subsidiaries, for example, by injecting additional capital into them. In April 2012, we acquired the stocks of Exlayer Global Inc., a holding company with five overseas subsidiaries in the systems integration industry for ¥0.3 billion and made it our consolidated subsidiary, IJJ Exlayer Inc., which we absorbed in January 2014. We injected additional capital of ¥0.2 billion into IJJ-Europe, which was formerly known as IJJ Exlayer Europe Limited, for the fiscal year ended March 31, 2015. Together with IJJ-Global, we injected a total of ¥0.1 billion capital into IJJ Global Solutions Indonesia and a total of ¥0.2 billion into IJJ Global Solutions Singapore Pte. Ltd. (“IJJ-Global Singapore”) for the fiscal year ended March 31, 2016. IJJ-Global alone injected additional capital of ¥0.4 billion and ¥0.1 billion into IJJ Global Solutions China Inc. (“IJJ-Global China”) and IJJ Global Solutions (Thailand) Co., Ltd (“IJJ-Global Thailand”), respectively, for the fiscal year ended March 31, 2016. We injected capital of ¥0.3 billion into PT Biznet Gio Nusantara for the fiscal year ended March 31, 2015. We injected capital of ¥0.2 billion into Leap Solutions Asia Co., Ltd. for the fiscal year ended March 31, 2015. As of March 31, 2016, IJJ and IJJ-Global are lending ¥0.2 billion, ¥0.1 billion, ¥0.2 billion, and ¥0.1 billion to IJJ-Europe, IJJ-Global China, IJJ-Global Singapore and IJJ-Global Thailand, respectively. We may continue to inject additional capital into and/or lend money to the existing and/or new affiliated companies.

*If our systems integration revenues fluctuate or if we fail to execute our systems construction projects in a timely or satisfactory manner, our results of operations and financial condition may be adversely affected.*

Systems construction revenues, a one-time revenue that is a part of systems integration revenues, have a tendency to fluctuate from time to time compared to monthly recurring revenues of network services and systems operation and maintenance due to the budget systems in Japan, of which many end in March. If corporate investments decrease, or if we fail to meet customer demands due to a lack of a sufficient number of qualified engineers to execute the projects in a professional manner, corporate customers may put off or stop placing orders with us and we may not be able to record systems construction revenues and operating profit as expected. If we fail to execute the projects as contracted, our recognition of revenues may be delayed or lost altogether, we could be held liable for damages or we could be sued, which could have an adverse impact on our reputation, results of operations and financial condition.

Generally, gross margin of systems construction is low compared to that of systems operation and maintenance, and gross margin for large scale systems construction projects may become even lower due, for example, to price competition in acquiring such construction projects. It is more difficult to effectively control systems construction projects as they become larger in scale, and we have seen an increase in the number of large scale systems construction projects in recent years. Our results of operations and financial condition related to systems integration may be adversely affected if, for example, we fail to control costs such as personnel and outsourcing costs or retain adequate personnel for projects, or if we fail to calculate the necessary timeframe or the manpower to complete a project and the costs exceed the payments received from our customers.

*We may have an impairment loss as a result of an impairment test on the intangible assets that are recorded related to mergers and acquisitions.*

As of March 31, 2016, the total balance of our intangible assets was approximately ¥9.7 billion, of which ¥6.3 billion was intangible assets not subject to amortization such as goodwill and ¥3.4 billion was intangible assets subject to amortization such as customer relationships. Intangible assets in relation to IIJ-Global and IIJ Technology Inc. (“IIJ-Tech”), former subsidiaries of IIJ, were ¥4.2 billion and ¥4.1 billion, respectively, as of March 31, 2016. The amount of our intangible assets may increase if we conduct mergers, acquisitions or investments in affiliates in the future. We conduct impairment testing of goodwill and indefinite-lived intangible assets annually on March 31 or more frequently if events or changes in circumstances indicate that an asset might be impaired. We conduct impairment testing of definite-lived intangible assets whenever events or changes in circumstances indicate that the assets might be impaired. If the business operations are adversely affected by factors such as significant adverse changes in their business climate and others, we may have an impairment loss as a result of an impairment test on intangible assets. The recognition of any impairment losses on intangible assets may result in material adverse effects on our financial condition and results of operations.

*If we fail to attract and retain qualified personnel, we may not be able to achieve our expected business growth.*

Our network, services, products and technologies are complex, and as a result, we depend heavily on the continued service of our engineering, research and development, and other personnel, and as our business grows, we need to hire more of such employees. In particular, in order to continue to increase our revenues from outsourcing services and systems integration, we require more sales and engineering personnel. We are not sure whether we will be able to retain or attract such personnel and control human resources costs adequately. Competition for hiring qualified engineering, research and development personnel is intense in the IT service industry in Japan, and there is a limited number of personnel with the necessary knowledge and experience we require. None of our employees are bound by any employment or noncompetition agreements. The realization of any or all of these risks may result in a failure to achieve our expected business growth.

*Our business may be adversely affected if our network suffers interruptions, errors or delays.*

Interruptions, errors or delays with respect to our backbone network or service facilities may be caused by human errors, interruptions, errors or delays with carriers' service facility or natural factors, many of which are beyond our control, including, but not limited to, damage from fire, earthquakes or other natural disasters, power loss, sabotage, computer hackers, cyber-attack, human error, computer viruses and other similar events. Much of our computer, networking equipment and the lines that make up our backbone network are concentrated in a few locations that are in earthquake-prone areas. Any disruption, outages, delays or other difficulties experienced by any of our technological and information systems and networks could result in a decrease in new or existing accounts, loss or exposure of confidential information, reduction in revenues and profits, costly repairs or upgrades, reputational damage and decreased consumer and corporate customer trust in our business, any or all of which could have a material adverse effect on our business, financial condition and results of operations.

Should we experience further unforeseeable incidents such as the disruption of social infrastructure or power shortages and other impacts due to inoperable or damaged nuclear power plants, our backbone network and service facilities could fail and, as a result, we may suffer direct and indirect damages, which may adversely affect our financial conditions and results of operations.

*If we fail to keep and manage our confidential customer information, we could be subject to lawsuits, incur expenses associated with our security systems or suffer damage to our reputation.*

We keep and manage confidential information and trade secrets obtained from our customers. We exercise much care in protecting the confidentiality of such obtained information and take steps to ensure the security of our network, in accordance with the Personalized Information Protection Law protecting personal information that came into effect in April 2005 and the requirements set by the MIC, and the Ministry of Economy, Trade and Industry. However, our network, like all Information Technology systems, is vulnerable to external attack from computer viruses, hackers,

cyber attack, or other such sources. In addition, despite internal controls, misconduct by an employee could result in the improper use or disclosure of confidential information. If any material leak of such information were to occur, we could be subject to lawsuits for damages from our customers, incur expenses associated with repairing or upgrading our security systems and suffer damages to our reputation that could result in a severe decline in new customers as well as an increase in service cancellations. As our consumer mobile business grows, we are dealing with an increasing number of consumers. Our corporate image and credibility could be negatively impacted, if, for example, we or our sales partners fail to comply with related laws such as consumer-protection laws, or if we fail to securely protect our consumers' individual information. Such failure could ultimately result in an adverse effect on our business, financial condition and result of operations.

*Business growth and a rapidly changing operating environment may strain our limited resources.*

We have limited operational, administrative and financial resources which could be inadequate to sustain the growth we want to achieve. As the number of our customers and their Internet usage increases, as traffic patterns change, as the volume of information transferred increases, and as the need for our cloud computing-related service increases, we will need to increase expenditures for our network and other facilities, including data center facilities in the future, in order to adapt our services and to maintain and improve the quality of our services. If we are unable to manage our growth and expansion adequately, the quality of our services could deteriorate and our business may suffer. If data center facilities do not meet our expectations, the quality of our service could deteriorate and our business may suffer. We may also need to increase office rent expenditures along with our business expansion. If we are unable to prepare our network and other facilities in a timely manner to meet our customers' demand or our business expansion, we may miss growth opportunities or may be obliged to bear higher costs to prepare our network and other facilities.

*If we fail to keep up with the rapid technological changes in our industry, our services may become obsolete and we may lose customers.*

Our markets are characterized by but not limited to:

· rapid technological changes, including the shift to new technology-based networks such as IPv6, cloud computing, Software Defined Network (“SDN”) and Network Functions Virtualization (“NFV”),

· frequent new product and service introductions,

· continually changing customer requirements, and

· evolving industry standards.

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

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





*We depend on our executive officers, and if we lose the service of our executive officers, our business and our relationships with our customers, major shareholders of IJJ and other IJJ Group companies and our employees could suffer.*

Our future success depends on the continued service of our executive officers, particularly Mr. Koichi Suzuki, who is a founder, Chairman, Chief Executive Officer and representative director of IJJ as well as some of IJJ's major subsidiaries, and Mr. Eijiro Katsu, who is President, Chief Operating Officer and representative director. We rely in particular on their expertise in the operation of our businesses and on their relationships with the shareholders of IJJ, our customers, our business partners and our employees. None of our executive officers, including Mr. Suzuki and Mr. Katsu, are bound by an employment or noncompetition agreement.

*We may continuously pursue mergers and acquisitions transactions which may not be effective.*

We recognize that it is important for us to have more business resources such as, but not limited to, human resources, customer base, application layer technology and others, in the middle term. We may continuously pursue mergers and acquisitions transactions to scale up our business. The mergers and acquisitions transactions may not always be on good terms and conditions, or bear the results we expect, or have synergistic effect, and we may incur a large loss of goodwill. We may also exhaust time and our resources through mergers and acquisitions.

As a result, those transactions may strain our financial resources and may adversely affect our financial conditions and results of operations or we will not be able to have enough business resources to scale up due to a failure to engage in adequate mergers and acquisitions transactions.

*Fluctuations in the stock prices of companies or losses on companies in which we have invested may adversely affect our financial condition.*

We have invested in non-affiliated companies in order to further expand our business relationships with those companies. We have also invested in available-for-sale equity securities and in funds which invest mainly in unlisted stocks. While we recorded no impairment losses on available-for-sale equity securities for the fiscal year ended March 31, 2016, we may record an impairment loss in the future. The carrying amount of available-for-sale securities was ¥3.9 billion, nonmarketable equity securities was ¥1.9 billion, which includes ¥0.9 billion of investments in funds through a trust, and investments in funds was ¥1.0 billion as of March 31, 2016. We may invest in additional securities of non-affiliated companies or additional funds. However, these securities or funds can be impaired significantly due to changes in the financial condition of non-affiliated companies, general economic conditions in Japan or fluctuations in the Japanese stock markets. Fluctuations in the fair value of these securities or funds in which we have invested may affect our financial results. In addition, should we choose to sell all or a portion of these securities or funds, it is not certain that we will be able to do so on favorable terms.

*NTT, IJ's largest shareholder, could exercise substantial influence over us in a manner which may not necessarily be in our interest or that of our other shareholders.*

NTT and its affiliates owned 26.4% of IJ's outstanding voting shares as of March 31, 2016. As IJ's largest shareholder, NTT may be able to exercise substantial influence over us. As of June 27, 2016, IJ has no outside director from NTT among IJ's 14 directors. While we intend to conduct our day-to-day operations independently from NTT and its affiliate companies and believe that NTT also plans for us to operate independently, NTT may decide to exercise substantial influence over us in a manner which could impair our ability to operate independently. Furthermore, NTT may take actions that are in its best interest, which may not be in our interest or that of our other shareholders.

*We rely greatly on other telecommunications carriers and other suppliers, and could be affected by disruptions in service or delays in the delivery of their products and services.*

We rely on telecommunications carriers such as NTT Communications and KDDI for a significant portion of our network backbone, Nippon Telegraph and Telephone East Corporation (“NTT East”), Nippon Telegraph Telephone West Corporation (“NTT West”) and KDDI for local access lines for our customers and NTT Docomo and KDDI for mobile connectivity as an MVNO. We procure significant portions of our network backbone and data center facilities pursuant to operating lease agreements with NTT Group, our largest provider of network infrastructure. For the fiscal year ended March 31, 2016, we have spent ¥23.0 billion in the aggregate for international and domestic backbone, local access lines, mobile connectivity and lines for WAN services to NTT Group. As of March 31, 2016, we had ¥1.8 billion of lease obligations with NTT FINANCE CORPORATION (“NTT FINANCE”). We are subject to potential disruptions in these telecommunications services and, in the event of such disruption, we may have no means of replacing these services, on a timely basis or at all.

We also depend on third-party suppliers of hardware components such as routers, servers and software that are used in our network. We purchase certain components from limited sources, typically from Cisco Systems, Inc. (“Cisco”), Juniper Networks, Inc. (“Juniper”), Hewlett-Packard Company, IBM Japan, NEC, Fujitsu and VMware Inc. A failure by one of our suppliers to deliver quality products on a timely basis, or the inability to develop alternative sources if and as required, may delay our ability to expand the capacity and scope of our network.

Any problems experienced by our telecommunications carriers and other suppliers could have a material adverse effect on our business, financial condition and results of operations.

*Regulatory matters and new legislation could impact our ability to conduct our business.*

The licensing, construction and operation of telecommunications systems and services in Japan are subject to regulation and supervision by the MIC. We operate pursuant to licenses and approvals that have been granted by the MIC.

Our licenses have an unlimited duration, but are subject to revocation by the MIC if we violate any telecommunications laws and regulations in a manner that is deemed to harm the public interest, if we or any of our directors are sentenced to a fine or any more severe penalty under the telecommunications laws, if we employ a director who was previously sentenced to a fine or more severe penalty thereunder or if we have had a license revoked in the past.

Existing and future governmental regulation may substantially affect the way in which we conduct our business. These regulations may increase the cost of doing business or may restrict the way in which we offer products and services. We cannot predict future regulatory changes which may affect our business. Any changes in laws, such as those described above, or regulations or MIC policy affecting our business activities and those of our competitors could adversely affect our financial condition or results of operations. For more information, see Item 4. “Business Overview — Regulation of the Telecommunications Industry in Japan.”

*We may be named as defendants in litigation, which could have an adverse impact on our business, financial condition and results of operations.*

We are involved in normal claims and other legal proceedings in the ordinary course of our business. We believe that there are no cases currently pending which would have a significant financial impact on us, but we cannot be certain that we will not be named as a defendant in a future lawsuit. Any judgment against us in such a lawsuit, or in any future legal proceeding, could have an adverse effect on our business, financial condition and results of operations.

*In the event that we need to raise capital, we may issue additional shares of IIJ's common stock or securities convertible into IIJ's common stock, which may cause shareholders to incur substantial dilution.*

IIJ issued 4,700,000 new shares of common stock by way of a public offering in July 2013 and 700,000 new shares by way of a third-party allotment in connection with a secondary offering of shares by way of an over-allotment in August 2013. With this equity finance and the current stable cash flow, in our opinion, our working capital is sufficient for our present requirements. For future strategic M&A transactions and/or large scale business investments, we may choose to raise additional funds from the issuance of equity shares of IIJ's common stock or securities convertible into IIJ's common stock, in which case existing shareholders may incur substantial dilution.

Prior to the above public offering, IIJ issued 2,500,000 new shares of IIJ's common stock along with IIJ's listing on the Mothers market of the Tokyo Stock Exchange in December 2005. On May 11, 2007, IIJ issued 435,600 shares of common stock to make IIJ's two consolidated subsidiaries wholly-owned through share exchanges. The above figures are retroactively adjusted to reflect the 1:5 stock split in October 2005 and the 1:200 stock split in October 2012.

Item 4. Information on the Company

A. History and Development of the Company

IIJ is incorporated under the Corporation Law of Japan as a joint stock corporation under the name Internet Initiative Japan Inc. IIJ was incorporated in December 1992 and operates under the laws of Japan.

IIJ began its operations in July 1993 as one of the first commercial Internet service providers (“ISP”) in Japan to offer Internet connectivity services for both enterprises and consumers. With the emergence of many other commercial ISPs, price competition for Internet connectivity services became severe. Rather than falling into price competition, we strategically shifted our business model towards providing value-added total network solutions to enterprise businesses that tend to choose quality and reliability over price, by fully leveraging our engineering skills to differentiate ourselves from our competitors. Currently, our main business focuses on providing Internet connectivity services, WAN services, outsourcing services, systems integration and equipment sales as total network solutions to mainly Japanese corporate clients and governmental organizations. The Group works closely together as a group in providing total network solutions directly to its customers. With our expertise in Internet related technology, our revenues have been expanding along with our customers’ needs for broader bandwidth for Internet connectivity services and for professional IT support for their network systems.

For descriptions and the history of the Group, see “Our Group Companies” in Item 4.B.

IIJ became a public company in August 1999 with IIJ's initial public offering of ADSs on the NASDAQ National Market. On December 2, 2005, IIJ listed on the Mothers market of the Tokyo Stock Exchange (“TSE”). On December 14, 2006, IIJ moved to the First Section of the TSE for IIJ's listing in Japan. On October 1, 2012, IIJ conducted a 1 to 200 split of IIJ's shares of common stock and the total number of IIJ's issued shares of common stock increased to 41,295,600. IIJ issued 4,700,000 new shares of IIJ's common stock by way of a public offering in July 2013 and 700,000 new shares by way of a third-party allotment in connection with a secondary offering of shares by way of an over-allotment in August 2013.

As for major business combinations, on May 11, 2007, IIJ made IIJ-Tech and Net Care, Inc. (“Netcare”) our 100% owned consolidated subsidiaries through share exchanges. Netcare renamed itself to IIJ Engineering Inc. (“IIJ-EG”) in October 2014. We absorbed IIJ-Tech on April 1, 2010. On September 1, 2010, IIJ made IIJ-Global its 100% owned consolidated subsidiary by acquiring the stock of IIJ-Global from AT&T Japan for ¥9.2 billion by our own cash and bank borrowings.

Please also see Note 2 “Business Combinations” to our consolidated financial statements included in this annual report on Form-20F.

IIJ's head office is located at Iidabashi Grand Bloom, 2-10-2 Fujimi, Chiyoda-ku, Tokyo 102-0071, Japan, and IIJ's telephone number at that location is +81-3-5205-6500. IIJ's agent in the United States is IIJ-America, located at 55 East 59th Street, Suite 18C New York, NY 10022 and the telephone number at that location is (212) 440-8080. IIJ has a web site that you may access at <http://www.iij.ad.jp/en/>. Information contained on IIJ's web site does not constitute part of this annual report on Form 20-F.

For a discussion of capital expenditures and divestitures currently in progress and those for the past three years, see “Capital Expenditures” in Item 4.B.

B.

Business Overview

The Group offers a comprehensive range of Internet connectivity services, WAN services, outsourcing services, systems integration and equipment sales to our customers mainly in Japan. We believe we provide efficient and reliable services and solutions to our customers on one of the most reliable Internet backbone networks available in Japan. Our services are based upon high-quality Internet related networking technology tailored to meet specific needs and demands of our customers.

Our Internet connectivity services include full-spec IP services with bandwidth ranging from 64 kbps up to over 10 Gbps, low-cost broadband services such as optical and/or ADSL lines which are mainly used to connect branch offices, and mobile data communications services for enterprise and consumers. Our WAN services provide closed-network services, mainly operated by IJJ-Global. Our outsourcing services include security-related outsourcing services that protect our customer network systems from unauthorized access and secure remote connections to internal networks, network-related outsourcing services such as router rental and Virtual Private Network (“VPN”), server-related outsourcing services such as web server hosting and e-mail security service, data center-related outsourcing services and our cloud computing service IJJ GIO/Hosting Package. Our systems integration includes systems construction and systems operation and maintenance. Systems construction is tailored to meet each of our customers’ requirements, which include consulting, project planning, systems design and development of network systems, and sales of equipment and software purchased from third parties. Systems operation and maintenance revenues include system related maintenance, monitoring and other operating services and cloud computing services such as IJJ GIO/Component. We aim to be the leading supplier of total network solutions in Japan.

We started to provide our mobile access services for enterprise as an MVNO in January 2008. From February 2012, we also started to offer our mobile services to consumers which became popular in recent years because of their cost-effectiveness; accordingly, mobile services for consumers are one of our strong growth drivers.

From December 2009, we began providing our cloud computing services under the service name “IJJ GIO.” We invest in infrastructures, such as servers, network equipment, virtualization software and data center facilities for IJJ GIO and provide them to users as an Infrastructure as a Service (“IaaS”) platform service basically for a monthly fee. IJJ GIO consists mainly of two types, (1) IJJ GIO/Hosting Package and (2) IJJ GIO/Component. IJJ GIO/Hosting Package is a line-up of services for an all-in-one non-customizable packaged cloud computing service and IJJ GIO/Component is a line-up of services for a semi-customizable cloud computing service. The cloud computing service in Japan is still in its start-up phase and it is anticipated that the market in Japan should grow in the middle term. In November 2015, we launched a new service platform “IJJ GIO Infrastructure P2” for our cloud services. The service provides reliable public cloud infrastructure with increased processing performance as well as private cloud infrastructure.

We have eight overseas subsidiaries in the United States, the United Kingdom, Germany, China, Singapore, Hong Kong, Thailand and Indonesia as of June 27, 2016. We have been enhancing our overseas business primarily to fulfill the broad range of IT network related needs of our Japanese customers who are headed abroad to expand their overseas business. As of June 27, 2016 we provide cloud computing services in the United States, the United



Kingdom, China, Singapore, Indonesia, and Thailand.

In addition, we conduct the ATM operation business through our consolidated subsidiary, Trust Networks, which was established in July 2007. Trust Networks operates ATMs and ATM network systems and receives a commission for each bank withdrawal transaction when a customer uses its serviced ATMs. As of March 31, 2016, 1,087 ATMs were in operation.

Currently, we have two business segments: a network services and systems integration business segment and an ATM operation business segment. Our network services and systems integration business segment is comprised of Internet connectivity services for enterprise and consumers, WAN services, outsourcing services, systems integration and equipment sales.

	For the fiscal year ended March 31, (millions of yen, except for percentage data)					
	2014		2015		2016	
Internet connectivity services	¥22,610	19.8 %	¥24,572	20.0 %	¥32,853	23.4 %
WAN services	25,006	21.9	24,326	19.8	25,177	17.9
Outsourcing services	19,670	17.2	20,108	16.3	21,266	15.1
Systems construction	18,673	16.3	20,437	16.6	21,145	15.0
Systems operation and maintenance	23,796	20.8	27,800	22.6	33,043	23.5
Equipment sales	1,690	1.5	2,167	1.8	3,275	2.3
ATM operation business	2,827	2.5	3,640	2.9	3,889	2.8
Total revenues:	¥114,272	100.0 %	¥123,050	100.0 %	¥140,648	100.0 %

The table below provides a breakdown of the total revenues and percentage by service over the past three fiscal years. Most of our revenues are generated in Japan and are denominated in Japanese yen.

### *Internet Connectivity Services*

We offer two categories of Internet connectivity services: Internet connectivity services for enterprise and Internet connectivity services for consumers. Internet connectivity services for enterprise are based on dedicated local-line connections and high-speed wireless data connections provided by telecommunications carriers between our backbone and customers. Internet connectivity services for consumers mainly require customers to connect to our points of presence (“POPs”) through the publicly-switched telephone network or a variety of broadband access services, such as ADSL and optical lines as well as wireless mobile data communications. High-speed, high-capacity last-one mile access such as dedicated access, ADSL, fiber optic, Ethernet, 3G mobile, LTE mobile and others are provided by large telecommunications carriers such as NTT East, NTT West, NTT Docomo and others. A variety of choices for last-one mile access are provided to our customers independently or together with other network solution line-ups to fulfill their specific and individual needs for tailored total network solutions. The following table shows the number of our Internet connectivity service contracts as of the dates indicated:

	As of March 31,				
	2012	2013	2014	2015	2016
Internet connectivity services (enterprise):					
IP Service (-99 Mbps)	923	905	847	763	690
IP Service (100 Mbps – 999 Mbps)	344	401	448	504	532
IP Service (1 Gbps –)	132	207	271	340	367
IJ Data Center Connectivity Service	323	306	288	278	270

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IIJ FiberAccess/F and IIJ DSL/F (broadband services)	44,510	48,940	56,384	62,926	75,932
IIJ Mobile Service	46,532	74,366	127,057	187,429	431,030
IIJ Mobile Platform Service	0	9,903	32,253	67,434	250,757
Others	1,246	1,338	1,293	1,309	1,246
Total Internet connectivity service (enterprise) subscriptions	94,010	126,463	186,588	253,549	510,067
Internet connectivity services (consumer):					
IIJ	243,087	328,558	626,577	891,519	1,230,600
hi-ho	154,032	149,497	158,233	157,208	146,305
Total Internet connectivity service (consumer) subscriptions	397,119	478,055	784,810	1,048,727	1,376,905

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\*1. Numbers in the table show number of contracts except for “IIJ Mobile service,” “IIJ” and “hi-ho” which show number of subscriptions.

\*2. From Form 20-F for the fiscal year ended March 31, 2016, the following changes are made to the table:

- Number of subscriptions related to “IIJ Mobile MVNO platform services” is now classified under “IIJ Mobile service”
- (1) in Internet connectivity services (enterprise). They were formerly classified under “OEM” in Internet connectivity services (consumer).
  - (2) A counting unit of mobile related services has been changed from number of contracts to number of subscriptions.
  - (3) Under Internet connectivity services (consumer), what were formerly known as “Under IIJ brand” and “OEM” are now merged under a newly created category “IIJ.”
  - (4) Number of subscriptions for prepaid SIM cards are added to “IIJ” in Internet connectivity services (consumer).

#### Internet Connectivity Services for Enterprise

Our lineup of Internet connectivity services for enterprise includes: IP service, IIJ data center connectivity service, IIJ FiberAccess/F and IIJ DSL/F (broadband services), dial-up services and IIJ mobile service.

#### *IP Service and IIJ Data Center Connectivity Service.*

Our IP service and data center connectivity service are full-scale, high-speed internet access services that connect the customer’s network to our backbone with dedicated access lines. The services are used mainly for corporate headquarters or data centers, where reliable network service is indispensable. The customer chooses the level of service it needs based upon its bandwidth requirements. We currently offer service at speeds ranging from 64 kbps to over 10 Gbps. Subscribers pay a monthly fee for the leased local access line from the customer’s location to one of our POPs. The amount of this fee varies depending on the carrier, the distance between the customer’s site and our POPs and its contracted bandwidth. We collect the local access fee from the customer and pay the amount to the carrier. While we prepare and arrange the leased access lines on behalf of customers under our name, the usage fee collected from the customer and paid to the carriers is recorded gross in our consolidated financial statements. For our IP service, we offer Service Level Agreements (“SLA”) to our customers to better define the quality of services our customers receive. We were the first ISP in Japan to introduce this type of agreement. We are able to offer these SLA due to our high quality and reliable network. Our SLA provides customers with credit against the amount invoiced for the services if our service quality fails to meet the prescribed standards. Subscribers to our IP Service receive technical support 24 hours a day and seven days a week. We guarantee the performance of the following elements under our SLA:

- 100% availability of our network,
- the maximum average latency, or time necessary to transmit a signal, between designated POPs, and

prompt notification of outages and/or disruptions.

We believe that business customers will continue to increase their use of the Internet and increasingly rely on the Internet as a business tool.

**IIJ FiberAccess/F and IIJ DSL/F (Broadband Services).** IIJ FiberAccess/F and IIJ DSL/F are broadband Internet connectivity services that use “FLET’S” services for fiber optic access and ADSL access provided by NTT East, NTT West and others, allowing service on a best-efforts basis. The services are used mainly to connect branch offices and headquarters. We support this service by providing guarantees of latency rates under SLA.

**IIJ Mobile Service.** This service provides wireless 3G and LTE Internet connectivity services to enterprise customers as an MVNO. We use the wireless networks of NTT Docomo and KDDI, which we added to our service-lineups from April 2015. We used to use EMOBILE Ltd’s wireless network for this service, but on May 31, 2016 our mobile services using EMOBILE network were terminated. We offer mobile services based on our MVNO infrastructure to meet corporate customers’ needs. Such needs include remote access solutions, which are wireless solutions that allow employees working outside of an office to access work-related files, and other needs including M2M connectivity and MVNO platform services.

**Dial-up Access Services.** We offer a variety of dial-up access services. Our dial-up services allow employees that are out of the office or frequent travelers to access the Internet or their own internal networks through one of our POPs or through our roaming access points. When accessing their internal network, for security purposes, it is usually accessed using the VPN function that is provided by our outsourcing services or systems integration.

**Other Internet connectivity services.** In addition to the services mentioned above, we also offer services such as IIJ ISDN/F which provides Internet access for ISDN lines, IIJ Line Management/F service that procures “FLET’S” services on behalf of customers and “LaIT” (pronounced "light") service, a brand that offers high-quality services at reasonable prices to small and medium enterprises. The main sales channels for LaIT are through direct sales via online sign-up or through sales partners.

#### Internet Connectivity Services for Consumers

We offer internet connectivity services for consumers under the brand names IIJ4U, IIJmio, and hi-ho. We also offer OEM services for other network operators. For Internet connectivity services, there are a variety of different service line-ups depending on the type of local access, such as ADSL, fiber optic, WiMAX, 3G and LTE wireless data communication.

In February 2012, we launched LTE mobile data communications services for consumers in which we offer inexpensive LTE SIM cards to consumers by purchasing NTT Docomo’s mobile infrastructure as an MVNO. We provide the service from the same MVNO infrastructure from which we provide mobile data communications services to enterprises which we launched in January 2008. We mainly offer data communications services in a postpaid scheme with a minimum contract period of one month. The minimum monthly charge is ¥900 with bundled high-speed data volume of 3 GB through one SIM card. The maximum basic monthly charge is ¥2,560 with bundled high-speed data volume of 10 GB which can be shared among up to ten SIM cards. If a customer exceeds the bundled

high-speed data volume, consumer can purchase what we call a “coupon card” which is charged with either 500MB or 2GB high-speed data volume for ¥1,500 and ¥3,000 respectively. We started offering voice function as an optional service with a monthly charge of ¥700 and ¥20 for every 30 seconds for domestic telephone charge from April 2014. We started to accept Mobile Number Portability (“MNP”) transactions from April 2014. We also offer LTE SIM cards through prepaid schemes not only for domestic customers but also for foreigners visiting Japan. “Japan Travel SIM powered by IJmio” is the service name and the card includes either 1GB of high speed data for 30 days or 2GB of high-speed data for a three-month period for approximately ¥2,700 and ¥4,000 respectively, depending on the sales channel. The prices mentioned here are as of June 2016.

### *WAN Services*

We offer WAN services, a closed network service mainly using dedicated lines, wide-area Ethernet services and IP-VPN services to corporate customers. WAN services offer dedicated, reliable, secure connections that allow our customers to better control the traffic over the wide-area networks. While IIJ had been providing WAN services to its corporate customers, the WAN business became a larger portion of the consolidated base business following the acquisition of IIJ Global on September 1, 2010.

### *Outsourcing Services*

Our customers are increasingly seeking additional network-related services, in addition to Internet connectivity. We provide our customers with a broad range of outsourcing services such as security-related, network-related, server-related, data center-related and IIJ GIO/Hosting Package, a line-up of services for an all-in-one non-customizable hosting package cloud computing service.

We believe that business customers will increasingly rely on outsourcing services for cost reduction, improving productivity and ensuring reliable network-related operations. Therefore, we will continue our efforts to improve our services by adding new features and enhancing line-ups through new services by utilizing our Internet expertise in a timely manner.

Our outsourcing services include:

***Security-related outsourcing services.*** We offer services that protect customers' internal network systems from unauthorized, illegal access, such as firewall services and security scan services. We also provide secure remote connections to the internal networks. We were the first ISP in Japan to provide firewall services, which we introduced in 1994.

***Network-related outsourcing services.*** We offer various types of Internet-VPN services and router rental services such as IIJ Internet-LAN Service, IIJ SMFsx Service and IIJ Managed VPN PRO Service. IIJ SMFsx Service is based on patented technology, the SEIL Management Framework ("SMF") which enables centralized management of network-configuration, administration and maintenance, reducing both configuration and maintenance time and costs for large-scale network construction.



***Server-related outsourcing services.*** We offer services such as web hosting, e-mail hosting, document storage and streaming services.

***Data center-related services.*** We offer IJ data center facility services and management and monitoring services. Our Internet data center facility services are co-location services which allow companies to house their servers and routers off-site on our premises. Our Internet data center facilities are leased from third parties such as NTT Communications and are equipped with robust security systems, 24-hours-a-day non-stop power supplies and fire extinguishing systems, and have earthquake-resistant construction and high-speed Internet connectivity with IJ backbones. We also offer basic monitoring and maintenance services for the equipment. This service enhances reliability as we provide 24-hours-a-day monitoring and have specialized maintenance personnel and facilities. We offer management and monitoring services tailored to our customers' requirements.

**IIJ GIO/Hosting package.** IIJ GIO/Hosting Package is a line-up of services for non-customizable packaged cloud computing service.

**Other services.** In addition to the above, we offer customer support and help desk solutions, an IP Phone service and other services.

### *Systems Integration*

Our systems integration consists of systems construction and systems operation and maintenance. Systems construction is tailored to meet each of our customers' requirements, which include consulting, project planning, systems design and development of network systems. Our systems construction mainly focuses on Internet business systems and Intranet and Extranet corporate information systems. We have built a strong record in various business fields.

Examples of systems construction are:

- connecting over a hundred locations such as gas stations, bank branches and retail shops via Internet-VPN, transmission of data over the Internet with an encryption feature and our proprietary SEIL Series routers, SMF, SACM<sup>(1)</sup> and a service adapter "SA-W1,"<sup>(2)</sup>
- construction of large scale e-mail servers or systems to detect or delete e-mails with viruses or spam or record all e-mails incoming to and outgoing from customers,
- construction of websites for online businesses, such as on-line game providers,
- re-construction of overall corporate network systems suited to increased traffic data,
- construction of voice-over IP systems to transmit voice to customer branch offices over the Internet,
- construction of wireless local area networks, and
- consultation on corporate network security.

SACM (Service Adapter Control Manager) is a management service platform for OEMs to provide automatic (1) connection and a comprehensive management mechanism of IIJ's proprietary next-generation network management system, SMFv2.

(2)SA-W1 is a service adapter developed for SACM.

In the consulting and planning phase of a systems construction project, we form special project management teams for the project. We analyze and design the customer's network and systems with three engineering focuses: reliability, flexibility and extendibility.

In the phase of systems design and development of network systems, we procure equipment such as servers or use IIJ GIO/Component services as a component of the system and manage application development and software programming tasks which are, depending on the size of the project, outsourced to third parties. Systems construction is generally provided together with our network services.

In the operation and maintenance phase, by utilizing data center facilities and IIJ GIO/Component services directly linked to our network, we provide a range of operation and maintenance services, which take maximum advantage of the Internet system, network operation and management know-how of the IIJ Group companies. Rather than simply looking after the customer's servers and equipment, we take care of the customer's entire computing environment, as well as custom-designed monitoring systems and provide around-the-clock operation and management services. These outsourcing services enable customers to free themselves from the burden of operating the network systems, which demands professional operation and maintenance to ensure prompt and flexible responses to unexpected system problems.

We develop, provide, and invest in a cloud-based foreign exchange (“FX”) platform which we mainly provide to financial institutions such as securities brokers and FX trading companies who pay monthly fees primarily based on the volume of transactions.

We have provided our customers with basic and easy-to-order systems integration services, including provision of network resources such as network equipment, data storage systems, network monitoring and systems operation management, on demand and on a monthly basis, therefore enabling our customers to launch their internal network system securely and cost effectively.

### *Equipment Sales*

In addition to the network services and systems integration, we sell third-party equipment, such as routers, iPads and other equipment to meet the one-stop needs of our customers together with our in-house developed router, the “SEIL Series.”

**SEIL Series.** In August 1998, we introduced our first SEIL series which was compatible with ISDN. We released our first high-end in-house developed router which was compatible with broadband in August 1998. As of June 27, 2016 there are SEIL/B1, SEIL/X series and SEIL/x2. With the SMF feature, which provides auto-configuration features, it enables customers to create a VPN network simply by connecting the network to SEIL WAN interface.

### *ATM Operation Business*

Our ATM operation business is conducted by our consolidated subsidiary, Trust Networks, which operates ATMs and its network systems and receives a commission for each bank withdrawal transaction when a customer uses its serviced ATMs. As of March 31, 2016, 1,087 ATMs were in operation in places such as Japanese pachinko parlors.

### *Network*

Our network is one of our most important assets. We have developed and currently operate a high-capacity network that has been designed to provide reliable, high-speed, high-quality Internet connectivity services. Our Internet network extends throughout Japan, and to the United States, the United Kingdom, Singapore and Hong Kong.

We are able to achieve and maintain high speeds through our advanced network architecture, routing technology and load balancing that optimize traffic on our multiple Internet connections.

The primary components of our network are:

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

Backbone

Leased lines

Our network is anchored by our extensive Internet backbone that extends throughout Japan, and to the United States, the United Kingdom, Singapore and Hong Kong. We use our expertise in developing and operating our network to organize and connect these leased lines to form a backbone that has substantial transmission capacity. As of June 27, 2016, the total capacity between Japan and the United States was 409.6 Gbps.

The physical lines that comprise our backbone are an assembly of numerous physical lines that are procured from various carriers. The lines which we lease are high-capacity, high-speed digital transmission lines. The topology of the backbone network, in principal, is a mesh topology with redundancy, therefore the connection is secured and IIJ's service will not be interrupted even if either one of the numerous physical lines fails.

The table below lists the total number of contracts comprising IIJ's backbone network as of March 31, 2015 and March 31, 2016. Each contract represents one physical line. The largest contract accounts for only approximately 4% of the total contracted amount.

Total Number of Contracts Comprising IIJ's Backbone Network

	As of March 31, 2015	As of March 31, 2016
Number of Contracts comprising IIJ's backbone network		
NTT Group	99	63
KDDI	50	41
Others	51	35
Total	200	139

If IIJ is unable to renew any of its contracts with either of the companies listed above, IIJ can continue with its business by procuring additional physical line services from other telecommunications carriers that offer the best terms or charges in the ordinary course of business. There are over ten additional telecommunications carriers that we

can procure physical lines from. A majority of the contracts that comprise IIJ's backbone network are one-year renewable contracts and IIJ can renew or upgrade its existing contracts or replace them with other telecommunications carrier services if they can be replaced with better terms in the ordinary course of business.

Accordingly, IIJ is not substantially dependent on a particular contract with either NTT or KDDI nor is the amount of a particular contract substantially large. Further, IIJ is neither substantially dependent on a certain arrangement or relationship with a particular carrier or carriers because IIJ has the ability to replace its existing contracts with others under fair terms.

The table below shows our backbone cost related to leasing lines.

Backbone Cost related to Leased Lines

	For the fiscal year ended March 31, (millions of yen)				
	2012	2013	2014	2015	2016
Backbone cost	¥3,371	¥3,535	¥3,764	¥3,744	¥3,638

## Network equipment

We use advanced equipment in our network. Our primary routers in our network are Cisco and Juniper routers. The size of our routers varies depending on the number of customers and volume of traffic served by our POPs. At each POP we connect our dedicated line to Cisco or Juniper backbone routers which then transmit and receive information throughout our network. We primarily lease our network equipment under capital lease arrangements.

## Points of Presence

POPs are the main points at which our customers connect to our backbone. We provide Internet connectivity from our POPs to commercial and residential customers through leased lines and dial-up connections over local exchange facilities. As of June 27, 2016, we operate 30 primary POPs for dedicated access and one universal POP for nationwide dial-up access in Japan. The universal POP can be accessed from anywhere in Japan with a minimum local telephone charge.

Many of our POPs are located in the same facilities where other major carriers and ISPs have their POPs, in facilities of various carriers in Japan like NTT Communications and KDDI. We mainly lease the physical space. We maintain our routers and other networking equipment at these POPs. Our POPs are in, or in close proximity to, the same buildings in which the switches and routers of these carriers and ISPs are located enabling quick and easy interconnection of our equipment with theirs.

## Internet Data Centers

As of June 27, 2016, we operate 26 Internet data centers, 20 in Japan and six abroad; seven in Tokyo, three in Osaka, two each in Yokohama and Nagoya, and one each in Saitama, Sapporo, Sendai, Kyoto, Fukuoka, Matsue, New York, San Jose, Los Angeles, London, Shanghai and Singapore. These data centers are specifically designed for application hosting, IJ GIO services, co-location services and high capacity access to our networks. Excluding the container-based module type data center in Matsue, our data centers are leased. In Japan, they are mainly leased from NTT Communications, ITOCHU Techno-Solutions Corporation, Mitsubishi Corporation, and KDDI. The container-based module type data center in Matsue is directly owned and operated by us.

These data centers have 24-hours-a-day, seven-days-a-week operations and security and are equipped with uninterruptible power supplies and backup generators, anti-seismic damage precautions, fire suppression equipment and other features to optimize our ability to offer high-quality services through these data centers.



The container-based module type data center in Matsue is specifically designed for the use of our cloud computing service IJ GIO which uses outside-air-cooling, the first in Japan. The main features of the Matsue container-based module type data center are its cost efficiency and its short construction period of approximately two to three months to add one container-based module, which allows it to start small and expand along with the rise in demand, unlike building type data centers where you need to build the whole capacity at once regardless of the demand. The second module type data center site in Matsue opened in December 2013 and can host up to 48 container-based modules, 24 container-based modules per site.

#### Network operations center and technical and customer support

Our NOC in Tokyo operates 24-hours-a-day, seven-days-a-week. From our NOC, we monitor the status of our network, the traffic on the network, the network equipment and components and many other aspects of our network including our customers' dedicated access lines leased from carriers. From our NOC, we monitor our networks to ensure that we meet our commitments under our SLA.

## Our Group Companies

We offer our services directly and with our group companies. As of June 27, 2016, we had 15 consolidated subsidiaries and eight equity method investees. Our group companies work closely together in providing total network solutions to our customers. We collaborate on the development of various services and products and market our services and products together as a group and offer as a group our total network solutions. ATM operation business is conducted by Trust Networks.

The table below sets out our group companies, including our major subsidiaries and equity method investees and our direct and indirect ownership of each of them as of March 31, 2016:

Company Name	Jurisdiction of Incorporation	Proportion of ownership and voting interest
Consolidated Subsidiaries:		
IIJ Global Solutions Inc.	Japan	100.0 %
IIJ Engineering Inc.	Japan	100.0 %
hi-ho Inc.	Japan	100.0 %
Trust Networks Inc.	Japan	79.5 %
IIJ Innovation Institute Inc.	Japan	100.0 %
Net Chart Japan Inc.	Japan	100.0 %
RYUKOSHA NETWARE Inc.	Japan	100.0 %
IIJ America Inc.	U.S.A.	100.0 %
IIJ Europe Limited	U.K.	100.0 %
IIJ Global Solutions China Inc.	China	100.0 % <sup>(1)</sup>
IIJ Global Solutions Singapore Pte. Ltd. <i>and four other subsidiaries<sup>(3)</sup></i>	Singapore	100.0 % <sup>(2)</sup>
Equity method investees:		
Trinity Inc.	Japan	33.8 %
INTERNET MULTIFEED CO.	Japan	33.0 %
Internet Revolution Inc.	Japan	30.0 %
PT Biznet Gio Nusantara	Indonesia	40.0 %
Leap Solutions Asia co. Ltd. <i>and three other equity method investees<sup>(4)</sup></i>	Thailand	40.0 %

(1) 100% owned subsidiary of IIJ Global Solutions Inc.

(2) IIJ owned a 51.1% voting interest directly and a 48.9% indirectly through IIJ-Global.

(3) The four other subsidiaries are IIJ Deutschland GmbH, IIJ Global Solutions Hong Kong Ltd., IIJ-Global Solutions (Thailand) Co., Ltd., and PT. IIJ Global Solutions Indonesia.

(4) The three other equity method investees are Appiaries Corporation, KIS, Inc, and e-CORPORATION.JP. Ltd.

IIJ Global Solutions Inc.

On September 1, 2010, IIJ acquired 100% of the equity of IIJ-Global from AT&T Japan for the amount of ¥9.2 billion. IIJ-Global is incorporated under the laws of Japan. IIJ-Global provides mainly domestic network outsourcing service businesses, such as WAN services. To fulfill the demands of our Japanese clients that are headed abroad to expand their overseas business, together with IIJ, IIJ-Global has been enhancing its business abroad in Asian countries such as China, Singapore and Thailand. As of March 31, 2016, IIJ-Global had 338 employees, 16 of whom were seconded from IIJ.

IIJ Engineering Inc.

IIJ Engineering Inc. (“IIJ-EG”), whose name has been changed from Net Care, Inc. as of October 1, 2014, provides a broad array of support services, from monitoring and troubleshooting to network operations and data center operations. As of March 31, 2016, IIJ-EG had 453 employees, 18 of whom were seconded from IIJ.

hi-ho Inc.

hi-ho Inc. (“hi-ho”) provides Internet connectivity services for consumers under hi-ho brand. As of March 31, 2016, hi-ho had 27 employees, three of whom were seconded from IIJ.

Trust Networks Inc.

Trust Networks Inc. (“Trust Networks”) was established in July 2007 and IIJ had invested a total of ¥2.6 billion in Trust Networks as of March 31, 2016 (79.5% ownership). Trust Networks operates bank ATMs and its network systems and receives a commission for each bank withdrawal transaction when a customer uses its serviced ATMs. As of March 31, 2016, Trust Networks had 1,087 ATMs in operation. As of March 31, 2016, Trust Networks had 14 employees, ten of whom were seconded from IIJ.

IIJ Innovation Institute Inc.

IIJ Innovation Institute Inc. (“IIJ-II”) mainly engages in research and development of basic Internet-related technology. On July 1, 2009, IIJ Research Laboratory, one of the research departments of IIJ, was transferred to IIJ-II to strengthen the Group research and development by reclassifying the Group research and development organization. As of March 31, 2016, IIJ-II had 19 employees, all of whom were seconded from IIJ.

Net Chart Japan Inc.

Net Chart Japan Inc. (“NCJ”) provides network construction services that are mainly related to Local Area Networks, such as installation and configuration of equipment, wiring following network installation, and installation and operation support for applications. As of March 31, 2016, NCJ had 75 employees.

RYUKOSHA NETWARE Inc.

RYUKOSHA NETWARE Inc. (“RYUKOSHA”) engages in human resources outsourcing, including systems operation and service support. RYUKOSHA became IIJ’s wholly owned subsidiary as of December 1, 2014. As of March 31, 2016, RYUKOSHA had 285 employees.

IIJ America Inc.

IIJ America Inc. (“IIJ-America”) is a U.S.-based ISP that also provides cloud computing services and offers systems integration solutions, catering primarily to the U.S.-based operations of Japanese companies. As of March 31, 2016, IIJ-America had 39 employees, nine of whom were seconded from IIJ.

IIJ Europe Limited

IIJ Europe Limited (“IIJ-Europe”) offers systems integration, Internet connectivity services and cloud computing services primarily to Japanese companies operating in Europe. As of March 31, 2016, IIJ-Europe had 57 employees, three of whom were seconded from IIJ.

IIJ Global Solutions China Inc.

IIJ-Global Solutions China Inc. (“IIJ-Global China”) is a China-based systems integrator and cloud computing services provider catering primarily to China-based operations of Japanese companies. As of March 31, 2016, IIJ-Global China had 18 employees.

IIJ Global Solutions Singapore Pte. Ltd.

IIJ-Global Solutions Singapore Pte. Ltd. (“IIJ-Global Singapore”) is a Singapore-based systems integrator and cloud computing services provider catering primarily to Singapore-based operations of Japanese companies. As of March 31, 2016, IIJ-Global Singapore had 15 employees.

Trinity Inc.

Trinity Inc. (“Trinity”) is one of the subsidiaries of Hirata Corporation, which manages customer loyalty reward program systems. As of March 31, 2016, Trinity is our equity method investee with a 33.8% ownership.

INTERNET MULTIFEED CO.

INTERNET MULTIFEED CO. (“Multifeed”) provides high-speed Internet eXchange (“IX” — where major ISPs exchange network traffic) service. Its technology was developed jointly with the NTT Group. Multifeed operates IXs named JPNAP. As of March 31, 2016, Multifeed is our equity method investee with a 33.0% ownership.

Internet Revolution Inc.

In February 2006, IIJ and Konami Corporation established a joint venture company, Internet Revolution Inc. (“i-revo”) initially to operate a portal website. i-revo now provides operation of gaming platform for the Konami Group. As of March 31, 2016, i-revo is our equity method investee with a 30.0% ownership.

PT Biznet Gio Nusantara

In January 2015, IIJ and Biznet Networks, a major communications services company in Indonesia, established a joint venture company, PT Biznet Gio Nusantara (“PT Biznet GIO”), to offer public and private cloud computing services mainly to local companies in Indonesia. As of March 31, 2016, PT Biznet GIO is our equity method investee with a 40.0% ownership.

Leap Solutions Asia co. Ltd.

In February 2016, IIJ and T.C.C. Technology Co., Ltd., a leading data center and IT infrastructure service provider in Thailand, established a joint venture company, Leap Solutions Asia Co. Ltd., to provide full-scale cloud services in Thailand. As of March 31, 2016, Leap Solutions Asia Co. Ltd., is our equity method investee with a 40.0% ownership.

*Capital Expenditures*

The table below shows our capital expenditures, which we define as amounts paid for purchases of property and equipment plus acquisition of assets by entering into capital leases, for the last three fiscal years.

	For the fiscal year ended March 31,		
	2014	2015	2016
	(millions of yen)		
Capital expenditures, including capitalized leases <sup>(1)</sup>	¥12,560	¥11,835	¥14,812

Further information regarding capital expenditures, including capitalized leases and a reconciliation to the most directly comparable U.S. GAAP financial measure, can be found in Item 3.A., “Selected Financial Data—  
(1) Reconciliations of the Disclosed Non-GAAP Financial Measures to the Most Directly Comparable GAAP Financial Measures.”

Most of our capital expenditures, which are funded largely by cash generated from operations, proceeds from issuance of common stock, and leases, relate primarily to the development, expansion, improvement and maintenance of our network and service infrastructures and of our own internal back-office systems. The investments are mostly for routers, servers, network equipment, containers for our container type data centers and other facilities necessary to offer services related to our network and software. Capital expenditures for the fiscal year ended March 31, 2016 increased compared with the previous fiscal year mainly because capital expenditures related to cloud computing services increased along with the development of new cloud services.

We estimate that our expected capital expenditures, including capitalized leases, for the fiscal year ending March 31, 2017 related to our network services and systems integration business will be slightly higher than the amount for the fiscal year ended March 31, 2016.

*Seasonality*

See Item 5.D., “Trend Information — Factors Affecting Our Future Financial Results — Systems integration revenues, including related equipment sales revenues.”

*Sales and Marketing*



Our sales headquarters are located in Tokyo. In addition, we have eight branches, Osaka, Nagoya, Fukuoka, Sapporo, Sendai, Yokohama, Toyama, and Hiroshima and two offices in Toyota and Okinawa in order to cover the major metropolitan areas in which the majority of large Japanese companies operate. As of March 31, 2016, we had 516 employees, on a consolidated basis, working in sales and marketing. The Business Unit, where our domestic sales and marketing employees are assigned, is divided into twelve divisions and two departments:

*Enterprise Business Divisions 1 and 2* focus on selling total network solutions and work with large corporate clients, including manufacturers and retail companies.

*Service Product Business Division* focuses on promoting “IIJ GIO Infrastructure P2” and “IIJ Omnibus Services,” two of our new services and also focuses on enhancing partner business.

*Financial Systems Business Division* focuses on selling its total network solutions and work with financial institutions.

*Government, Public & Educational Organization Business Division* focuses on selling total network solutions and works with governmental institutions, and universities and other schools.

*West Japan Business Division* focuses on developing and strengthening partnerships with customers in the western Japan area. Sales personnel in branch and sales offices are part of this division.

*Central Japan Business Division* focuses on developing and strengthening partnerships with customers in the central Japan area such as Nagoya. Sales personnel in branch and sales offices are part of this division.

*East Japan Business Division* focuses on developing and strengthening partnerships with customers in the eastern Japan area except for the Kanto area. Sales personnel in branch and sales offices are part of this division.

*Enterprise Business System Development Division* is comprised of pre-sales engineers who focus on meeting specific IT needs of corporations by, for example, integrating network services and systems integration.

*Outsourcing Division* focuses on promoting business enterprises to outsource their IT systems by offering needed services and/or operating systems for them.

*Marketing Division* focuses mainly on setting the tariff pricing for each of IIJ's services, makes and conducts promotion plans related to its products and services as well as strengthening partnerships with sales agents such as systems integrators to expand our marketing reach.

*Global Business Division* is in charge of planning and administration of overseas business development.

*Operation Management Department* is in charge of back office operations such as those related to processing sales orders for business divisions.

*Strategic Business Department* focuses on promoting the sales of our focused services such as IIJ GIO services, IP services, security-related services, mobile services and corporate network solutions.

*Business Unit Management Department* is in charge of back office operations such as those related to processing sales order for business divisions.

Customers

As of March 31, 2016, we had over 8,500 business and other institutional customers and approximately 1.4 million individuals including individual customers subscribing to our mobile and OEM services. Our main customers continue to be major corporations, including ISPs.

## Research and Development

### Research and Development Organization

Our research and development activities are conducted by IIJ Innovation Institute (“IIJ-II”) and IIJ’s internal organizations in charge of technology.

***IIJ Innovation Institute.*** IIJ established IIJ-II in June 2008 as a wholly-owned subsidiary, which engages in research and development of basic Internet-related technology development. In July 2009, IIJ Research Laboratory, which was established as a research organization of IIJ in April 1998 to engage in new basic network technologies, was transferred to IIJ-II to reorganize and strengthen the Group's research and development capabilities. IIJ-II is currently participating in various research and development activities in cooperation with organizations from the private and academic sectors. IIJ-II is engaged in research and development activities related to big data, cloud computing-related research and development, security related research, e-mail technologies and network traffic analysis, the deployment and implementation of IPv6, among various other activities.

***IIJ's internal organizations in charge of technology.*** IIJ's internal organizations such as the Service Product Business Division, Infrastructure Division, the Network Division, and the Cloud Division, play an important role in the research and development of technologies to be applied to our services and solutions, collect information, evaluate new technology and conduct business expansion.

## Research and Development Strategy

Our primary research and development objective is to continue to develop innovative services, applications and products that meet the current and future demands of our customers and to continue to be at the forefront of the Internet industry in Japan. Many of our engineers are regularly engaged in research and development activities related to the development of new services, applications and products. These engineers have continued to develop innovative services, applications and products, many of which have set the standard for the Internet industry in Japan. They also work very closely with our sales and marketing personnel and technical engineers to ensure that the innovative services, applications and products will meet the demands of our customers.

Our second research and development objective is to continue participating in or otherwise closely monitor new products, developments and initiatives of manufacturers and standards-setting and research groups. We have also engaged in the research and development of new Internet-related basic technology since 1998. Through these efforts, we seek to ensure that we have timely and effective access to new technologies, and that we implement these technologies effectively.

In furtherance of these objectives, our research and development efforts currently are focused on a variety of projects, including:

- research and development of the basic technologies for cloud computing-related technology including SDN platform software,
- research and development of methodology to solve the technical problems of the current cloud computing systems,
- research and development of the basic technologies for a storage system for a wide area data center operation to enable flexible location and relocation of virtual machines,
- research and development of methodology to construct a virtualized large-scale data center with an assembly of a small-scale data center,
- research and improvement of a next generation container-based module type data center using indirect and/or outside-air cooling systems year-round,
- research and development of electric feeding methodology with high efficiency, and adoption to a next generation container-based module type data center,
- development and commercialization of cloud-based Power Metering System (PMS) Service Platform, a system platform for providing services that make use of smart meter,
- research of Internet traffic monitoring and management,
- research relating to the behavior of Internet routing systems,
- research and development of IPv6-based communication technology,



continued improvement of our SEIL router and SMF, systems which we developed specifically to be integrated into IJ's network-related services,

- research relating to the methodology of configuration of routers and other servers, and
- research and development of the Distributed and Parallel Processing Platform for very large data sets.

Our research and development expenses averaged less than 1.0% of total revenues for the past three consecutive years. For the fiscal years ended March 31, 2014, 2015 and 2016, our research and development expenses were ¥421 million, ¥441 million and ¥455 million, respectively, most of which were for personnel expenses. The level of research and development expenditures is low in relation to our total costs primarily because we do not engage in extensive research and development of new technologies and products that require large investments. Rather, as noted above, we are intensively engaged in research and development related to our ongoing business. We focus on monitoring developments in the industry and in developing new and innovative services and applications by utilizing and enhancing existing technologies and products.

Because the rate of change in technology relevant to our business is so rapid, we believe that the sophistication and experience of our research and development personnel is an important part of our success.

#### Proprietary Rights

Although we believe that our success is more dependent upon our technical, marketing and customer service expertise than our proprietary rights, we rely on a combination of trademark and contractual restrictions to establish and protect our technology.

#### Licenses

For us to provide certain services to our customers, we have, as a licensee, entered into license agreements with suppliers including Trend Micro Incorporated, RSA Security Inc., NRI Secure Technologies, Ltd., McAfee, Inc. (Intel Security), Microsoft Japan Co., Ltd., Adobe Systems Software Ireland Limited and Oracle Corporation Japan.

We have purchased licenses from these suppliers in accordance with customer demands for our services.

#### Trademarks

We have applied for trademark registrations of our corporate name, “Internet Initiative Japan Inc.” and certain other corporate and product names in Japan, the United States and certain European and Asian countries.

#### Patents

We have applied for patent registrations in relation to our technology in Japan and the United States. As of June 27, 2016, ten registrations had been granted, with one pending application. The latest acquired patent is for technology to implement connection credentials using both ID of access point and media access control address of terminal devices in a network environment that has multiple access points.

#### Legal Proceedings

We are involved in normal claims and other legal proceedings in the ordinary course of business. We are not involved in any litigation or other legal proceedings that, if determined adversely to us, we believe would individually or in the aggregate have a material adverse effect on us or our operations.

## Regulations of the Telecommunications Industry in Japan

The MIC regulates the Japanese telecommunications industry. Telecommunications carriers, including us, are regulated by the MIC primarily under the Telecommunications Business Law.

### The Telecommunications Business Law

The Telecommunications Business Law, which became effective in 1985, was established for the purpose of privatization and deregulation in the telecommunications business. After several amendments, the Telecommunications Business Law was considerably amended in July 2003, and the amended Telecommunications Business Law became effective as of April 2004. Further, an amendment to the Telecommunications Business Law was enacted on June 3rd, 2014 and the amended Telecommunications Business Law will become effective on June 1, 2015. From here on, “Telecommunications Business Law” refers to the latest amended Telecommunications Business Law. A summary of the regulations under the current Telecommunications Business Law is as follows:

The Telecommunications Business Law applies to the telecommunications business, except for the telecommunications business exempt under the Telecommunications Business Law (“Exempted Business”<sup>(1)</sup>). The term “telecommunications business” is defined under the Telecommunications Business Law as a business providing telecommunications services in order to meet the demand of others.<sup>(2)</sup> The term “telecommunications services” is defined under the Telecommunications Business Law as intermediating communications of others through the use of telecommunications facilities, or any other acts of providing telecommunications facilities for the use of communications of others. Our business falls under the definition of a telecommunications business, not an Exempted Business, and therefore is subject to the Telecommunications Business Law.

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(1) An Exempted Business is a business related to facilities supplying broadcast services, wire radio broadcasting, wire broadcast telephone services, wire television broadcasting services, or the acceptance of applications for the use of cable television broadcasting facilities.

(2) The provisions of this Law shall not apply to the telecommunications businesses listed in the following items:

- (i) a telecommunications business which exclusively provides telecommunications services to a single person (except one being a telecommunications carrier);
- (ii) a telecommunications business which provides telecommunications services with telecommunications facilities, a part of which is to be established on the same premises (including the areas regarded as the same premises) or in the same building where any other part thereof is also to be established, or with telecommunications facilities which meet the standards stipulated in the ministerial ordinance of the MIC; and
- (iii) a telecommunications business which does not install telecommunications circuit facilities but which provides telecommunications services other than the telecommunications services which intermediate communications of



others by using telecommunications facilities;  
Provided that the provisions of Article 3 and Article 4 of the Telecommunications Business Law apply to communications handled by a person who operates the telecommunications business listed above.

Start-up of Services

Registration/Notification

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Registration with the Minister of the MIC is required for start-up telecommunications businesses that intend to provide telecommunications services. However, for telecommunications businesses which meet either of the following two requirements, only a notification to the Minister of the MIC is required: (i) the scale of the telecommunications circuit facilities which are to be installed and the scope of the area covered thereby do not exceed a certain threshold established by the ministerial ordinance of the MIC (i.e., areas of installation of terminal-related transmission facilities are limited to a single municipality (city, town or village) and areas of installation of relay-related transmission facilities are limited to a single prefecture) or (ii) telecommunications circuit facilities to be installed fall within a certain category of radio facilities as set forth in the Radio Act (i.e., radio facilities which conduct radio communications (except for basic broadcasting) as well as basic broadcasting). Our business is subject to this latter notification requirement.

### **Terms and Conditions of Provision of Services and Charge**

Our business is unregulated, in general, as IJ does not fall under either Basic Telecommunications Services or Designated Telecommunications Services described below.

Prior notification to the Minister of the MIC is required for the Basic Telecommunications Services (universal services specified by the ministerial ordinance of the MIC, i.e., analog or public fixed telephone services, analog or public remote island telephone services, and analog or public emergency call telephone services). Providing these telecommunications services in a manner other than that pursuant to the terms and conditions and charges notified to the Minister of the MIC is prohibited, provided that the charges may be discounted or waived pursuant to the exception criteria provided under the ministerial ordinance of the MIC (i.e., an emergency call for the safety of ships and airplanes, an emergency call for the safety of life and property in case of natural disaster, calls to police agencies regarding crimes, and calls to the fire brigade).

Prior notification to the Minister of the MIC is required for Designated Telecommunications Services (i.e., services provided through Category I Designated Telecommunications Facilities and which meet the criteria provided by the ministerial ordinance of the MIC as the services for which the guarantee of the terms and conditions and charges are necessary for the protection of users, such as the basic fee). “Category I Designated Telecommunications Facilities” are facilities which meet the criteria specified by the ministerial ordinance of the MIC as being fixed telecommunications facilities used for the services which are offered to a substantial percentage of users in a given area, and which are currently only the facilities of NTT East and NTT West. Providing these telecommunications services in a manner other than that pursuant to the terms and conditions and charges notified to the Minister of the MIC is prohibited, unless the telecommunications carrier and the user agree otherwise, provided that the charges may be discounted or waived in Emergency Cases, for emergency calls for injured persons in a ship, and for use by a police agency, fire brigade and broadcasting companies.

The Minister of the MIC at least once a year notifies the telecommunications carrier providing the Specific Designated Telecommunications Services specified by the ministerial ordinance of the MIC (i.e., Designated Telecommunications Services other than voice services, except for telephone and general digital services and data transmission services) the price cap regarding such services. The telecommunications carriers are required to obtain approval from the Minister of the MIC if a proposed change in charges exceeds the price cap.



## Articles of Interconnection Agreements

Our business is unregulated, in general, as IJ does not fall under either Category I Designated Telecommunications Facilities or Category II Designated Telecommunications Facilities described below.

- Approval from the Minister of the MIC is required for Category I Designated Telecommunications Facilities.

Prior notification to the Minister of the MIC is required for Category II Designated Telecommunications Facilities (i.e., the facilities which meet the criteria provided by the ministerial ordinance of the MIC as being mobile telecommunications facilities used for services which are offered to a substantial percentage of users in a given area, and which are currently NTT Docomo, Okinawa Cellular and KDDI).

## Telecommunications Facilities of Carriers

A telecommunications carrier that any of the following items applies to shall maintain its telecommunications facilities (except telecommunications facilities stipulated in the ministerial ordinance of the MIC as those having a minor influence on the users' benefit in the cases of damage or failure thereof) in compliance with the technical standards specified in the applicable ministerial ordinance of the MIC.

(1) telecommunications carrier that installs telecommunications circuit facilities

(2) a telecommunications carrier that provides Universal Telecommunications Services

a telecommunications carrier (excluding those falling under 2 above) that both of the following items apply to and (3) that is designated by the Minister of the MIC as a telecommunications carrier that shall maintain its telecommunications facilities properly (“Carrier without Circuit Facilities”):

- having more than one million users at the end of the previous fiscal year; and

- charging service fees as compensation for providing telecommunications services.

Such telecommunications carriers shall confirm themselves that said telecommunications facilities are in compliance with the technical standards specified in the applicable ministerial ordinance of the MIC.

Telecommunications carriers that install telecommunications circuit facilities, that provide Universal Telecommunications Services or that are Carriers without Circuit Facilities shall establish their own administrative rules governing said telecommunications facilities in accordance with the ministerial ordinance of the MIC in order to ensure the reliable and stable provision of telecommunications services. These administrative rules shall provide the necessary rules with which said telecommunications carriers shall comply with respect to the policy, the structure and the method of the administration of the telecommunication facilities and the appointment of the general administrator of the telecommunication facilities in accordance with the ministerial ordinance of the MIC. Telecommunications carriers that install telecommunications circuit facilities and telecommunications carriers that provide Universal Telecommunications Services shall submit such administrative rules to the Minister of the MIC prior to the commencement of operations and Carriers without Circuit Facilities must submit them within three months after the date they are designated as Carriers without Circuit Facilities by the Minister of the MIC as above. When these telecommunications carriers amend their administrative rules, they shall submit a notification in respect of the amended matters to the Minister of the MIC without delay.

Although the regulations described above currently do not apply to us, there is a possibility that we will be designated as a Carrier without Circuit Facilities in the future depending on the increase of the number of users of our telecommunications services.

### *Protection of users*

Telecommunications carriers, as well as business operators that are entrusted by telecommunications carriers with acting as an intermediary in entering into contracts relating to telecommunications services, etc., are required to explain, in accordance with the ministerial ordinance of the MIC, to users (except for users who are telecommunications carriers) an outline of charges and other terms and conditions of their services, when entering into certain contracts with users in relation to telecommunications services as specified in the Telecommunications Business Law.

Telecommunications carriers shall, when the said contracts are validly established, prepare documents containing items as specified in the ministerial ordinance of the MIC and deliver such documents to the users.

Telecommunications carriers may, by obtaining the approval of the users, provide the users with the said documents by electromagnetic means in lieu of the delivery of them, in accordance with the ministerial ordinance of the MIC.

Telecommunications carriers are required, when a user offers to cancel a contract relating to telecommunications services as specified under the Telecommunications Business Law within a certain period after the receipt of the said document, to accept cancellation of the contract without demanding that the user pay any compensation or cancellation fees, etc. (except for charges for the telecommunications services provided before the cancellation and other charges as specified in the ministerial ordinance of the MIC).

When telecommunications carriers entrust a business operator with acting as an intermediary in entering into contracts relating to telecommunications services and/or performing other business activities incidental thereto, telecommunications carriers shall exercise supervision and necessary measures over them in order to ensure the proper and secure execution of such entrusted business, in accordance with the ministerial ordinance of the MIC.

### Order to Improve Business Activities

The Minister of the MIC may, if it is deemed that business activities of a telecommunications carrier fall under inappropriate cases set forth in the Telecommunications Business Law, insofar as it is necessary to ensure the users' benefit or the public interest, order the telecommunications carrier to take actions to improve operations methods or other measures.

#### Right of Way Privilege for Authorized Carriers

A telecommunications carrier which is engaged, or intends to engage, in the telecommunications business by installing telecommunications circuit facilities and which wishes to have the privileged use of land or other public utilities for circuit facilities deployment, must obtain authorization for the entire or a part of the relevant telecommunications business from the Minister of the MIC.

#### Merger, Business Transfer or Divestiture of Carriers

Post facto notification to the Minister of the MIC without delay is required.

#### Business Suspension, Abolition or Dissolution of Carriers

Post facto notification to the Minister of the MIC without delay is required. Prior announcement of withdrawals to service users is required in accordance with ministerial ordinances of the MIC.

#### Foreign Capital Participation

Prior notification is required under the Foreign Exchange and Foreign Trade Law for the acquisition of shares of telecommunications carriers to which registration for start-up services is applicable. This is not applicable to purchasers of ADSs. The one-third foreign ownership restriction is applicable only to NTT East and NTT West.

### C. Organizational Structure

The information required by this item is included in “Our Group Companies” above.

### D. Property, Plant and Equipment

Property and equipment recorded on our consolidated balance sheet as of March 31, 2015 and March 31, 2016 consisted of the following:

	As of March 31	
	2015	2016
	(millions of yen)	
Data communications equipment	¥11,159	¥14,356
Office and other equipment	2,746	2,065
Land	538	538
Buildings	1,645	1,663
Leasehold improvements	3,798	3,904
Capitalized software	24,805	28,815
Assets under capital leases, primarily data communications equipment	24,271	28,329
Total	68,962	79,670
Less accumulated depreciation and amortization	(39,592)	(45,346)
Property and equipment-net	¥29,370	¥34,324

Our fixed assets consist mainly of (i) data communications equipment necessary to offer services on our network, such as routers, servers and other network equipment, which are mainly acquired under capital leases and (ii) software, such as that for back-office systems, virtualization software and others for cloud computing services, FX service application software and others. Most of our property and equipment are located in Japan. The above-mentioned property and equipment consists of many relatively small assets and, as of March 31, 2016, we did not own any major land, buildings or facilities such as factories except for the properties related to the container-based module type data center in Matsue. The container-based module type data center in Matsue is directly owned and operated by us. Other than the above assets recorded on our consolidated balance sheet, we use operating lease assets such as backbone lines, local access line, office premises, and network operation centers. There are no known environmental issues that may affect our utilization of our property and equipment.

Please also see “Network” above and Note 7 “Property and Equipment” and Note 9 “Leases” to our consolidated financial statements included in this annual report on Form 20-F.

### Item 4A. Unresolved Staff Comments



None.

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Item 5. Operating and Financial Review and Prospects

A. Operating Results

*You should read the following discussion of our financial condition and results of operations together with Item 3.A. of this annual report on Form 20-F and our consolidated financial statements and the notes to those financial statements beginning on page F-1 of this annual report. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of factors including but not limited to those in Item 3.D. of this annual report on Form 20-F.*

Overview

The Group is a provider of a comprehensive range of network services and systems integration mainly in Japan. IIJ was founded in December 1992 and began offering Internet connectivity services commercially in July 1993. IIJ was one of the first commercial ISPs in Japan and has expanded the Group business to outsourcing services, WAN services and systems integration along with the expansion of usage of Internet by customers.

Our primary sources of revenue are Internet connectivity services, outsourcing services, WAN services, systems integration, equipment sales, and ATM operation business. Internet connectivity services consist of Internet connectivity services for enterprise and Internet connectivity services for consumers. For WAN services, which are mainly provided by IIJ-Global, we offer closed network services using connectivity such as Ethernet, IP-VPN and dedicated lines. For outsourcing services, we provide services such as network security services, mail and web server hosting services, managed router services, Internet data center services and cloud computing services such as IIJ GIO/Hosting Package. For systems integration, we provide systems construction such as consulting, project planning, systems design and development of network systems to meet each of our customers' requirements and systems operation and maintenance. IIJ GIO/Component is provided as a part of systems operation and maintenance. For equipment sales, we sell equipment as part of our provision of total network solutions.

We entered into the ATM operation business through our subsidiary, Trust Networks, which was established in July 2007. Trust Networks operates ATMs and its network systems to provide ATM service and receives a commission for each bank withdrawal transaction when a customer uses its serviced ATMs. As of March 31, 2016, 1,087 ATMs were in operation in places such as Japanese pachinko parlors.

Currently, we have two business segments: the network services and systems integration business and the ATM operation business. Our network services and systems integration business is comprised of Internet connectivity services, WAN services, outsourcing services, systems integration and equipment sales.

For the fiscal year ended March 31, 2016, net revenues of network services and systems integration business and ATM operation business before elimination of intersegment revenues were ¥137.1 billion and ¥3.9 billion, respectively. Our consolidated net revenue for the fiscal year ended March 31, 2016 was ¥140.6 billion.

Most of our revenues are from customers operating in Japan.

We refer to our subsidiaries and equity method investees as our group companies, and we have invested heavily in and exercise significant influence over these companies. For the fiscal year ended March 31, 2016, we consolidated all of our 15 subsidiaries. In addition, we had eight equity method investees. For descriptions and the history of our group companies, see “Our Group Companies” in Item 4.B.

**For a discussion of factors affecting our future financial results, see “Item 5.D. Trend Information.”**

## Results of Operations

As an aid to understanding our operating results, the following tables show items from our statements of income for the periods indicated in millions of yen and as a percentage of total revenues. For further discussion about segment reporting, please see “Segment Information” later in this section.

	Fiscal year ended March 31,					
	2014		2015		2016	
	(millions of yen except for percentage data)					
<b>REVENUES:</b>						
Network services:						
Internet connectivity services (enterprise)	¥16,585	14.5 %	¥16,350	13.3 %	¥17,597	12.5 %
Internet connectivity services (consumer)	6,025	5.3	8,222	6.7	15,256	10.9
WAN services	25,006	21.9	24,326	19.8	25,177	17.9
Outsourcing services	19,670	17.2	20,108	16.3	21,266	15.1
Total	67,286	58.9	69,006	56.1	79,296	56.4
Systems integration:						
Systems construction	18,673	16.3	20,437	16.6	21,145	15.0
Systems operation and maintenance	23,796	20.8	27,800	22.6	33,043	23.5
Total	42,469	37.1	48,237	39.2	54,188	38.5
Equipment sales	1,690	1.5	2,167	1.7	3,275	2.3
ATM operation business	2,827	2.5	3,640	3.0	3,889	2.8
Total revenues	114,272	100.0	123,050	100.0	140,648	100.0
<b>COSTS AND EXPENSES:</b>						
Cost of network services:						
Backbone cost	3,762	3.3	3,741	3.0	3,636	2.6
Local access line cost	22,469	19.7	21,860	17.8	22,913	16.3
Other connectivity cost	398	0.3	431	0.3	454	0.3
Depreciation and amortization	3,480	3.0	3,929	3.2	4,458	3.2
Other	22,937	20.1	24,971	20.3	32,778	23.3
Total cost of network services	53,046	46.4	54,932	44.6	64,239	45.7
Cost of systems integration:						
Cost of equipment sales related to systems integration	7,529	6.6	9,240	7.5	7,919	5.6
Other	28,981	25.4	32,322	26.3	38,307	27.3
Total cost of systems integration	36,510	32.0	41,562	33.8	46,226	32.9
Cost of equipment sales	1,527	1.3	1,932	1.6	2,969	2.1
Cost of ATM operation business	2,123	1.9	2,552	2.1	2,559	1.8
Total costs	93,206	81.6	100,978	82.1	115,993	82.5
Sales and marketing	8,548	7.5	9,188	7.5	10,589	7.5
General and administrative	6,374	5.5	7,368	6.0	7,471	5.3
Research and development	421	0.4	441	0.3	455	0.3
Total costs and expenses	108,549	95.0	117,975	95.9	134,508	95.6
OPERATING INCOME	5,723	5.0	5,075	4.1	6,140	4.4
<b>OTHER INCOME (EXPENSES):</b>						

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Dividend income	51	0.0	63	0.1	93	0.0
Interest income	27	0.0	23	0.0	28	0.0
Interest expense	(256 )	(0.2 )	(238 )	(0.2 )	(241 )	(0.0 )
Foreign exchange gain (loss), net	219	0.2	(5 )	(0.0 )	(71 )	(0.0 )
Net gain on sales of other investments	108	0.1	41	0.0	24	0.0
Net gain on other investments	313	0.3	-	-	-	-
Impairment of other investments	-	-	(29 )	(0.0 )	(15 )	(0.0 )
Other—net	90	0.1	209	0.2	235	0.0
Other income (expenses) — net	552	0.5	64	0.1	53	0.0
INCOME FROM OPERATIONS BEFORE INCOME TAX EXPENSE AND EQUITY IN NET INCOME OF EQUITY METHOD INVESTEEs—(FORWARD)	6,275	5.5 %	5,139	4.2 %	6,193	4.4 %

	Fiscal year ended March 31,					
	2014		2015		2016	
	(millions of yen except for percentage data)					
INCOME FROM OPERATIONS BEFORE INCOME TAX EXPENSE AND EQUITY IN NET INCOME OF EQUITY METHOD INVESTEES—(FORWARD)	6,275	5.5	5,139	4.2	6,193	4.4
INCOME TAX EXPENSE	1,795	1.6	1,897	1.5	2,183	1.5
EQUITY IN NET INCOME OF EQUITY METHOD INVESTEES	204	0.2	155	0.1	180	0.1
NET INCOME	4,684	4.1	3,397	2.8	4,190	3.0
LESS: NET INCOME ATTRIBUTABLE TO NONCONTROLLING INTERESTS	(242 )	(0.2)	(75 )	(0.1)	(152 )	(0.1)
NET INCOME ATTRIBUTABLE TO INTERNET INITIATIVE JAPAN INC.	¥4,442	3.9 %	¥3,322	2.7 %	¥4,038	2.9 %

#### The Fiscal Year Ended March 31, 2016 Compared to the Fiscal Year Ended March 31, 2015

##### Total revenues

Our total revenues were ¥140.6 billion for the fiscal year ended March 31, 2016, an increase of 14.3% compared to ¥123.1 billion for the previous fiscal year mainly due to the increase in the revenue for mobile services for consumers and the increase in system integration revenues.

##### *Network Services revenues.*

Revenues from network services, which comprise our Internet connectivity services for enterprise, Internet connectivity services for consumers, WAN services and outsourcing services, increased by 14.9% to ¥79.3 billion for the fiscal year ended March 31, 2016 from ¥69.0 billion for the previous fiscal year.

***Internet connectivity services for enterprise.*** Revenues for Internet connectivity services for enterprise depend on customers' bandwidth usage, the number of contracts and pricing for connectivity services. Revenues increased by 7.6% to ¥17.6 billion for the fiscal year ended March 31, 2016 from ¥16.4 billion for the previous fiscal year. IP connectivity service revenue decreased by 1.6% to ¥9.7 billion for the fiscal year ended March 31, 2016 from ¥9.8

billion for the previous fiscal year because IP services revenue per contract decreased while the total contracted bandwidth increased. Revenues for mobile services for enterprise increased by 45.7% to ¥4.6 billion for the fiscal year ended March 31, 2016 from ¥3.1 billion for the previous fiscal year. The increase was mainly because of the increase in MVNE solution services revenues. The number of MVNE business clients continued to increase and their business volume also expanded. The increase in mobile related services revenues covered the decrease in IP services revenues. Although we do not expect prices of Internet connectivity services to increase significantly in the fiscal year ending March 31, 2017, we anticipate that customer demand, especially network business operators' demand, for broader IP bandwidth should contribute to our revenue growth as the use of broader IP by corporate customers expands. We shall also focus on acquiring new customers and contracts as well as increasing the bandwidth usage of existing customers by maintaining the quality of our services to differentiate them from those of our competitors. We expect MVNE solution services to contribute to continuous growth of mobile services revenues along with rapid MVNO market expansion.

**Internet connectivity services for consumers.** Revenues for Internet connectivity services for consumers depend on the number of service contracts and pricing. For the fiscal year ended March 31, 2016, revenues increased by 85.5% to ¥15.3 billion from ¥8.2 billion for the previous fiscal year. For the fiscal year ended March 31, 2016, the revenues from hi-ho brand services decreased by 9.2% from the previous fiscal year, while the revenues from IIJ brand services increased by 134.3% from the previous fiscal year. The increase was mainly due to the increase in revenues from mobile services for consumers, in which we offer inexpensive data communication and voice services through SIM cards. The increase due to mobile services for consumers covered the decrease in revenues from our network service by hi-ho. Subscriptions to our mobile services for consumers were approximately 747 thousand as of March 31, 2016 as compared to approximately 430 thousand for the previous fiscal year end. For the fiscal year ending March 31, 2017, we anticipate mobile services for consumers should continue to accumulate and contribute to the revenue growth.

**WAN services.** The WAN services that we offer are closed network services using connectivity such as Ethernet, IP-VPN and dedicated access lines, and are mainly provided by IIJ-Global and IIJ. Revenues for WAN services depend on the number of contracted lines for WAN services and the customers' bandwidth usage. For the fiscal year ended March 31, 2016, the revenues from WAN services increased by 3.5% to ¥25.2 billion from ¥24.3 billion for the previous fiscal year as we continued to accumulate orders from enterprise customers. For the fiscal year ending March 31, 2017, we expect to see similar revenue growth rates as compared to the fiscal year ended March 31, 2016.

**Outsourcing services.** For outsourcing services, we are currently offering security-related, network-related, server-related, and data center-related outsourcing services, as well as cloud computing services, such as IIJ GIO/Hosting Package. Examples of our outsourcing services include, among others, firewall services, email-related services, web hosting services, anti-Distributed Denial of Service ("DDoS") attack protection services, internet-VPN services and router rental services, which are provided mainly to our internet connectivity customers. Our revenues depend on our ability to cross-sell our existing outsourcing services, add new features to existing outsourcing services and introduce new services. For the fiscal year ended March 31, 2016, our outsourcing services revenues increased by 5.8% to ¥21.3 billion from ¥20.1 billion for the previous fiscal year. The increases in security-related services revenues and overseas hosting services revenues contributed to the revenue growth. We anticipate that outsourcing services revenues should continue to grow mainly due to increasing demands for security-related services for corporate customers.

### ***Systems integration revenues***

Generally speaking, while Japanese customers, especially blue-chip companies, use ready-made network services to build their network systems, they also require customization to meet their individual needs. To meet such needs, we believe that it is important as a total network solution provider to provide systems construction together with network services. Therefore, we have been focusing on providing systems construction to our corporate customers. Systems construction is mainly IP-related network construction such as VPN networks and IP-based server system construction such as web server and email server systems. Systems construction can be largely affected by the economic situation, as corporations usually reduce their ICT-related investments during economic down times unless such investments are deemed critical.



For the fiscal year ended March 31, 2016, our revenues from systems integration, which include equipment sales related to systems integration, increased by 12.3% to ¥54.2 billion from ¥48.2 billion for the previous fiscal year. Systems construction revenue, a one-time revenue, increased by 3.5% compared to the previous fiscal year. The increase was mainly due to an increase in systems construction projects and execution of several large-scale projects, including one project with approximately ¥2 billion in revenue. Systems operation and maintenance revenue, a recurring revenue, increased by 18.9% compared to the previous fiscal year. The increase was mainly because many of the accumulated systems construction projects have been shifted to operation and maintenance. Also, the increase in “IIJ GIO Component Services” revenues contributed to the revenue growth. Order backlog for systems construction and equipment sales as of March 31, 2016 was ¥6.1 billion, an increase of 28.4% compared to the previous fiscal year end. Order backlog for systems operation and maintenance as of March 31, 2016 was ¥27.6 billion, an increase of 13.4% compared to the previous fiscal year end.

For the fiscal year ending March 31, 2017, systems construction revenue is expected to increase from the previous fiscal year as corporate ICT-related investment steadily increases along with stable Japanese economic situation. However, systems integration revenues can fluctuate significantly in accordance with the absence or addition of large orders. For systems operation and maintenance revenues, a recurring type revenue, we anticipate we can increase revenues compared to the fiscal year ended March 31, 2016 with the accumulation of contracts, including contracts for our cloud computing services, as well as some of our construction projects migrating to the operation and maintenance phases.

***Equipment sales revenues.***

For equipment sales, we sell third-party equipment to meet the one-stop needs of our customers. For the fiscal year ended March 31, 2016, equipment sales revenues increased by 51.1% to ¥3.3 billion from ¥2.2 billion for the previous fiscal year. We saw an increase in revenues of equipment, especially portable devices and similar products along with increasing needs for mobile services for both consumer and enterprise.

***ATM Operation Business revenues.***

Revenues from our ATM operation business were ¥3.9 billion for the fiscal year ended March 31, 2016 compared to ¥3.6 billion for the previous fiscal year. Revenues increased mainly along with the increase in the number of serviced ATMs. Trust Networks, our subsidiary which operates this business, receives a commission for each bank withdrawal transaction when a customer uses its serviced ATMs. For the fiscal year ending March 31, 2017, we anticipate ATM operation business revenues to increase gradually, as in the previous fiscal year, in line with the placement of additional ATMs, despite the possibility that we may see a decrease in daily transactions due, for example, to a decrease in the number of pachinko players due to a declining Japanese population and to a decrease in consumer demand prompted by an increase in the Japanese consumption tax rate.

**Total cost of revenues**

Our total cost of revenues increased by 14.9% to ¥116.0 billion for the fiscal year ended March 31, 2016 from ¥101.0 billion for the previous fiscal year.

***Cost of network services.*** Cost of network services increased by 16.9% to ¥ 64.2 billion for the fiscal year ended March 31, 2016 from ¥54.9 billion for the previous fiscal year. Gross margin ratio for network services revenues, which is the ratio of (1) the amount obtained by subtracting cost of network services from network services revenues to (2) network services revenues, decreased to 19.0% for the fiscal year ended March 31, 2016 from 20.4% for the previous fiscal year. The decrease was mainly due to the increase in mobile connectivity costs along with the increase

in mobile-related services revenues, and the increase in depreciation and amortization cost along with the expansion and upgrade of network facilities.

**Cost of systems integration.** Cost of systems integration increased by 11.2% to ¥46.2 billion for the fiscal year ended March 31, 2016 from ¥41.6 billion for the previous fiscal year. Gross margin ratio for systems integration, which is the ratio of (1) the amount obtained by subtracting cost of systems integration revenues from systems integration revenues to (2) systems integration revenues, increased to 14.7% for the fiscal year ended March 31, 2016 from 13.8% for the previous fiscal year. The increase was mainly because the revenue growth in systems operation and maintenance was greater than the increase in costs such as personnel-related and outsourcing-related.

**Cost of equipment sales.** Cost of equipment sales increased by 53.6% to ¥3.0 billion for the fiscal year ended March 31, 2016 from ¥1.9 billion for the previous fiscal year. The increase was primarily due to the increase in equipment sales revenues. Gross margin ratio for equipment sales, which is the ratio of (1) the amount obtained by subtracting cost of equipment sales from equipment sales revenues to (2) equipment sales revenues, decreased to 9.4% for the fiscal year ended March 31, 2016 from 10.8% for the previous fiscal year.

**Cost of ATM Operation Business.** Cost of the ATM operation business was ¥2.6 billion for the fiscal year ended March 31, 2016 compared to ¥2.6 billion for the previous fiscal year. Gross margin was ¥1.3 billion for the fiscal year ended March 31, 2016 compared to ¥1.1 billion for the previous fiscal year. Gross margin ratio for ATM operation business revenues, which is the ratio of (1) the amount obtained by subtracting cost of ATM operation business from ATM operation business revenues to (2) ATM operation business revenues, increased to 34.2% for the fiscal year ended March 31, 2016 from 29.9% for the previous fiscal year. The cost of ATM operation business slightly increased as we increased the number of serviced ATMs. As of March 31, 2016, 1,087 ATMs were in operation.

#### Total costs and expenses

Total costs and expenses, which includes total cost of revenues, sales and marketing expenses, general and administrative expenses and research and development expenses, increased by 14.0% to ¥134.5 billion for the fiscal year ended March 31, 2016 from ¥118.0 billion for the previous fiscal year.

**Sales and marketing.** Sales and marketing expenses increased by 15.2% to ¥10.6 billion for the fiscal year ended March 31, 2016 from ¥9.2 billion for the previous fiscal year. The increase was mainly due to the increase in sales commission expenses related to mobile services and personnel-related expenses.

**General and administrative.** General and administrative expenses increased by 1.4% to ¥7.5 billion for the fiscal year ended March 31, 2016 from ¥7.4 billion for the previous fiscal year. The increase was mainly due to the increase in personnel-related expenses.

**Research and development.** Research and development expenses increased by 3.1% to ¥0.5 billion for the fiscal year ended March 31, 2016 from ¥0.4 billion for the previous fiscal year.

#### Operating income

As a result of the foregoing factors, operating income increased by 21.0% to ¥6.1 billion for the fiscal year ended March 31, 2016 from ¥5.1 billion for the previous fiscal year. The increase was mainly because of the increase in the gross margin of both systems integration and network services which absorbed the increase in sales and marketing expenses and general and administrative expenses.

Other income (expenses)-net

Other income-net of ¥53 million was recorded for the fiscal year ended March 31, 2016, compared to other income-net of ¥64 million for the previous fiscal year.

**Dividend income.** Dividend income was ¥93 million for the fiscal year ended March 31, 2016 compared to ¥63 million for the previous fiscal year.

**Interest income.** Interest income was ¥28 million for the fiscal year ended March 31, 2016 compared to ¥23 million for the previous fiscal year.

**Interest expense.** Interest expense, comprising interest expense related to borrowings and capital lease obligations, amounted to ¥241 million for the fiscal year ended March 31, 2016 compared to ¥238 million for the previous fiscal year.

**Foreign exchange gain (loss), net.** Net foreign exchange loss amounted to ¥71 million for the fiscal year ended March 31, 2016 compared to the loss of ¥5 million for the previous fiscal year. Foreign exchange loss was mainly the result of the Japanese yen becoming stronger against foreign currencies including the U.S. dollar in the year ended March 31, 2016.

**Net gain on sales of other investments.** For the fiscal year ended March 31, 2016, we recorded net gain on sales of other investments of ¥24 million compared to net gain of ¥41 million for the previous fiscal year.

**Impairment of other investments.** For the fiscal year ended March 31, 2016, we recorded ¥15 million impairment loss on other investments compared to the loss of ¥29 million for the previous fiscal year.

**Other-net.** For the fiscal years ended March 31, 2015 and 2016, we recorded other income of ¥209 million and ¥235 million, respectively.

Income from operations before income tax expense and equity in net income of equity method investees

We recorded income from operations before income tax expense and equity in net income of equity method investees of ¥6.2 billion for the fiscal year ended March 31, 2016 compared to ¥5.1 billion for the previous fiscal year. The increase primarily reflects the increase in operating income.

#### Income tax expense

For the fiscal year ended March 31, 2016, we recorded an income tax expense of ¥2.2 billion compared to income tax expense of ¥1.9 billion for the previous fiscal year. The increase was mainly due to the increase in income from operations before income tax expense and equity in net income of equity method investees.

#### Equity in net income of equity method investees

Equity in net income of equity method investees was ¥180 million for the fiscal year ended March 31, 2016 compared to ¥155 million for the previous fiscal year, mainly due to income of Multifeed.

#### Net income attributable to noncontrolling interests

Net income attributable to noncontrolling interests was ¥152 million for the fiscal year ended March 31, 2016 mainly related to Trust Networks compared to ¥75 million for the previous fiscal year.

#### Net income attributable to III

Net income attributable to III for the fiscal year ended March 31, 2016 was ¥4.0 billion compared to ¥3.3 billion for the previous fiscal year. The increase primarily reflects the increase in operating income.

#### The Fiscal Year Ended March 31, 2015 Compared to the Fiscal Year Ended March 31, 2014

#### Total revenues

Our total revenues were ¥123.1 billion for the fiscal year ended March 31, 2015, an increase of 7.7% compared to ¥114.3 billion for the previous fiscal year mainly due to the increase in the revenue for our LTE mobile data communications services for consumers and the increase in the scale of systems construction projects.

#### *Network Services revenues.*

Revenues from network services, which comprise our Internet connectivity services for enterprise, Internet connectivity services for consumers, WAN services and outsourcing services, increased by 2.6% to ¥69.0 billion for the fiscal year ended March 31, 2015 from ¥67.3 billion for the previous fiscal year.

***Internet connectivity services for enterprise.*** Revenues for Internet connectivity services for enterprise depend on customers' bandwidth usage, the number of contracts and pricing for connectivity services. Revenues decreased by 1.4% to ¥16.4 billion for the fiscal year ended March 31, 2015 from ¥16.6 billion for the previous fiscal year. IP connectivity service revenue decreased by 5.1% to ¥9.8 billion for the fiscal year ended March 31, 2015 from ¥10.4 billion for the previous fiscal year. Revenues for mobile services for enterprise increased by 10.3% to ¥3.1 billion for the fiscal year ended March 31, 2015 from ¥2.9 billion for the previous fiscal year. Revenues from our Internet connectivity services for enterprise were weaker than expected mainly because IP services revenue per contract decreased while the total contracted bandwidth increased.



**Internet connectivity services for consumers.** Revenues for Internet connectivity services for consumers depend on the number of each service contracts and pricing. For the fiscal year ended March 31, 2015, revenues increased by 36.5% to ¥8.2 billion from ¥6.0 billion for the previous fiscal year. For the fiscal year ended March 31, 2015, the revenues from hi-ho brand services decreased by 8.3% from the previous fiscal year, while the revenues from IJ brand services increased by 110.3% from the previous fiscal year. The increase was mainly because of the increase in revenues from LTE mobile data communications services for consumers, in which we offer inexpensive data communication and voice services through SIM cards. The increase due to LTE mobile data communications services for consumers covered the decrease in revenues from our network service by hi-ho. Subscriptions to our LTE mobile data communication services were approximately 430 thousand as of March 31, 2015 as compared to approximately 169 thousand for the previous fiscal year end.

**WAN services.** The WAN services that we offer are closed network services using connectivity such as Ethernet, IP-VPN and dedicated access lines, and are mainly provided by IJ-Global and IJ. Revenues for WAN services depend on the number of contracted lines for WAN services and the customers' bandwidth usage. For the fiscal year ended March 31, 2015, the revenues from WAN services decreased by 2.7% to ¥24.3 billion from ¥25.0 billion for the previous fiscal year.

**Outsourcing services.** For outsourcing services, we are currently offering security-related, network-related, server-related, and data center-related outsourcing services, as well as cloud computing services, such as IJ GIO/Hosting Package. Examples of our outsourcing services include, among others, firewall services, email-related services, web hosting services, anti-Distributed Denial of Service (“DDoS”) attack protection services, internet-VPN services and router rental services, which are provided mainly to our internet connectivity customers. Our revenues depend on our ability to cross-sell our existing outsourcing services, add new features to existing outsourcing services and introduce new services. For the fiscal year ended March 31, 2015, our outsourcing services revenues increased by 2.2% to ¥20.1 billion from ¥19.7 billion for the previous fiscal year. Revenues were weaker than expected mainly because we had a termination of a large-scale overseas data center contract for a game customer and the cloud computing revenue from large game customers did not increase as much as we anticipated.

***Systems integration revenues.***

Generally speaking, while Japanese customers, especially blue-chip companies, use ready-made network services to build their network systems, they also require customization to meet their individual needs. To meet such needs, we believe that it is important as a total network solution provider to provide systems construction together with network services. Therefore, we have been focusing on providing systems construction to our corporate customers. Systems construction is mainly IP-related network construction such as VPN network and IP-based server system construction such as web server and email server systems. Systems construction can be largely affected by the economic situation, as corporations usually reduce their IT-related investments during economic down times unless such investments are deemed critical.

For the fiscal year ended March 31, 2015, our revenues from systems integration, which include equipment sales related to systems integration, increased by 13.6% to ¥48.2 billion from ¥42.5 billion for the previous fiscal year. The increase was mainly due to the increase in the scale of systems construction projects. Systems construction revenue, a one-time revenue, increased by 9.4% compared to the previous fiscal year. Systems operation and maintenance revenue, a recurring revenue, increased by 16.8% compared to the previous fiscal year. “IJ GIO Component Services” revenues increased and systems construction projects that were completed and shifted to operation and maintenance phase contributed to an increase in systems operation and maintenance revenues. Order backlog for systems construction and equipment sales as of March 31, 2015 was ¥4.7 billion, a decrease of 7.2% compared to the previous fiscal year end. Order backlog for systems operation and maintenance as of March 31, 2015 was ¥24.3 billion, an increase of 26.6% compared to the previous fiscal year end.

***Equipment sales revenues.***

For equipment sales, we sell third-party equipment to meet the one-stop needs of our customers. For the fiscal year ended March 31, 2015, equipment sales revenues increased by 28.2% to ¥2.2 billion from ¥1.7 billion for the previous fiscal year. We saw an increase in revenues of equipment such as portable devices and similar products along with increasing needs for mobile data communications services for both consumer and enterprise.

***ATM Operation Business revenues.***

Revenues from our ATM operation business were ¥3.6 billion for the fiscal year ended March 31, 2015 compared to ¥2.8 billion for the previous fiscal year. Revenues increased mainly along with the increase in the number of serviced ATMs. Trust Networks, our subsidiary which operates this business, receives a commission for each bank withdrawal transaction when a customer uses its serviced ATMs.

## Total cost of revenues

Our total cost of revenues increased by 8.3% to ¥101.0 billion for the fiscal year ended March 31, 2015 from ¥93.2 billion for the previous fiscal year.

**Cost of network services.** Cost of network services increased by 3.6% to ¥ 54.9 billion for the fiscal year ended March 31, 2015 from ¥53.0 billion for the previous fiscal year. Gross margin ratio for network services revenues, which is the ratio of (1) the amount obtained by subtracting cost of network services from network services revenues to (2) network services revenues, decreased to 20.4% for the fiscal year ended March 31, 2015 from 21.2% for the previous fiscal year. The decrease was mainly due to the increase in mobile connectivity costs along with the increase in mobile-related services revenues, and the increase in depreciation and amortization cost along with the expansion and upgrade of network facilities.

**Cost of systems integration.** Cost of systems integration increased by 13.8% to ¥41.6 billion for the fiscal year ended March 31, 2015 from ¥36.5 billion for the previous fiscal year. Gross margin ratio for systems integration, which is the ratio of (1) the amount obtained by subtracting cost of systems integration revenues from systems integration revenues to (2) systems integration revenues, decreased to 13.8% for the fiscal year ended March 31, 2015 from 14.0% for the previous fiscal year. The decrease was mainly due to the increase in personnel-related costs and outsourcing-related costs along with the revenue growth and solution development, increase in purchasing costs along with the systems construction revenue growth, and the increase in depreciation and amortization costs was due to the expansion of service facility such as for our cloud computing services.

**Cost of equipment sales.** Cost of equipment sales increased by 26.6% to ¥1.9 billion for the fiscal year ended March 31, 2015 from ¥1.5 billion for the previous fiscal year. The increase was primarily due to the increase in equipment sales revenues. Gross margin ratio for equipment sales, which is the ratio of (1) the amount obtained by subtracting cost of equipment sales from equipment sales revenues to (2) equipment sales revenues, increased to 10.8% for the fiscal year ended March 31, 2015 from 9.7% for the previous fiscal year.

**Cost of ATM Operation Business.** Cost of the ATM operation business was ¥2.6 billion for the fiscal year ended March 31, 2015 compared to ¥2.1 billion for the previous fiscal year. Gross margin was ¥1.1 billion for the fiscal year ended March 31, 2015 compared to ¥0.7 billion for the previous fiscal year. Gross margin ratio for ATM operation business revenues, which is the ratio of (1) the amount obtained by subtracting cost of ATM operation business from ATM operation business revenues to (2) ATM operation business revenues, increased to 29.9% for the fiscal year ended March 31, 2015 from 24.9% for the previous fiscal year. The cost of ATM operation business increased as we increased the number of serviced ATMs. As of March 31, 2015, 1,059 ATMs were in operation.

## Total costs and expenses

Total costs and expenses, which includes total cost of revenues, sales and marketing expenses, general and administrative expenses and research and development expenses, increased by 8.7% to ¥118.0 billion for the fiscal year ended March 31, 2015 from ¥108.5 billion for the previous fiscal year.

**Sales and marketing.** Sales and marketing expenses increased by 7.5% to ¥9.2 billion for the fiscal year ended March 31, 2015 from ¥8.5 billion for the previous fiscal year. The increase was mainly due to the increase in personnel-related expenses and sales commission expenses.

**General and administrative.** General and administrative expenses increased by 15.6% to ¥7.4 billion for the fiscal year ended March 31, 2015 from ¥6.4 billion for the previous fiscal year. The increase was mainly due to the expense related to the headquarter relocation and an increase in personnel-related expenses.

**Research and development.** Research and development expenses increased by 4.7% to ¥441 million for the fiscal year ended March 31, 2015 from ¥421 million for the previous fiscal year.

#### Operating income

As a result of the foregoing factors, operating income decreased by 11.3% to ¥ 5.1 billion for the fiscal year ended March 31, 2015 from ¥5.7 billion for the previous fiscal year. The decrease was mainly because of the decrease in the gross margin of both network services and systems integration and as well as an increase in sales and marketing expenses and general and administrative expenses.

#### Other income (expenses)-net

Other income-net of ¥64 million was recorded for the fiscal year ended March 31, 2015, compared to other income-net of ¥552 million for the previous fiscal year.

**Dividend income.** Dividend income was ¥63 million for the fiscal year ended March 31, 2015 compared to ¥51 million for the previous fiscal year.

**Interest income.** Interest income was ¥23 million for the fiscal year ended March 31, 2015 compared to ¥27 million for the previous fiscal year.

**Interest expense.** Interest expense, comprising interest expense related to borrowings and capital lease obligations, amounted to ¥238 million for the fiscal year ended March 31, 2015 compared to ¥256 million for the previous fiscal year.

**Foreign exchange gain (loss), net.** Net foreign exchange loss amounted to ¥5 million for the fiscal year ended March 31, 2015 compared to the gain of ¥219 million for the previous fiscal year. Foreign exchange loss was mainly the result of the Japanese yen becoming weaker against foreign currencies including the U.S. dollar in the year ended March 31, 2015.

**Net gain on sales of other investments.** For the fiscal year ended March 31, 2015, we recorded net gain on sales of other investments of ¥41 million compared to net gain of ¥108 million for the previous fiscal year.

**Net gain on other investments.** For the fiscal year ended March 31, 2015, we recorded no net gain or loss on other investments compared to net gain of ¥313 million for the previous fiscal year.

**Impairment of other investments.** For the fiscal year ended March 31, 2015, we recorded ¥29 million impairment loss on other investments compared to no impairment loss for the previous fiscal year.

**Other-net.** For the fiscal years ended March 31, 2014 and 2015, we recorded other income of ¥90 million and ¥209 million, respectively.

Income from operations before income tax expense and equity in net income of equity method investees

We recorded income from operations before income tax expense and equity in net income of equity method investees of ¥5.1 billion for the fiscal year ended March 31, 2015 compared to ¥6.3 billion for the previous fiscal year. The decrease primarily reflects the decrease in operating income.

Income tax expense

For the fiscal year ended March 31, 2015, we recorded an income tax expense of ¥1.9 billion compared to income tax expense of ¥1.8 billion for the previous fiscal year. The increase was mainly due to the decrease in deferred income tax benefit mainly related to Trust Networks.

Equity in net income of equity method investees

Equity in net income of equity method investees was ¥155 million for the fiscal year ended March 31, 2015 compared to ¥204 million for the previous fiscal year, mainly due to income of i-revo and Multifeed.

Net income attributable to noncontrolling interests

Net income attributable to noncontrolling interests was ¥75 million for the fiscal year ended March 31, 2015 mainly related to Trust Networks compared to ¥242 million for the previous fiscal year.

Net income attributable to IIJ

Net income attributable to IIJ for the fiscal year ended March 31, 2015 was ¥3.3 billion compared to ¥4.4 billion for the previous fiscal year. The decrease primarily reflects the decrease in operating income of ¥0.6 billion compared to the previous fiscal year.





## Segment Reporting

Currently, we have two business segments: a network services and systems integration business segment and an ATM operation business segment. The network services and systems integration business segment is comprised of Internet connectivity services, WAN services, outsourcing services, systems integration and equipment sales.

The following table presents net revenues and operating income for the fiscal years ended March 31, 2014, 2015 and 2016, respectively, by segment.

## Business Segment Summary:

	Fiscal year ended March 31,		
	2014	2015	2016
	(millions of yen)		
Revenues:			
Network services and systems integration business	¥111,901	¥119,819	¥137,142
ATM operation business	2,827	3,640	3,889
Elimination	456	409	383
Total	114,272	123,050	140,648
Operating income:			
Network services and systems integration business	5,275	4,335	5,128
ATM operation business	578	886	1,149
Elimination	130	146	137
Total	¥5,723	¥5,075	¥6,140

## Year Ended March 31, 2016 Compared to the Year Ended March 31, 2015

## Network services and Systems Integration Business Segment

Net revenues from our network services and systems integration business segment, before elimination of intersegment revenues, increased by 14.5% to ¥137.1 billion for the fiscal year ended March 31, 2016 compared to ¥119.8 billion for the previous fiscal year. The increase in revenues was mainly due to the increase in mobile-related services both for enterprise and consumers and systems integration and outsourcing services. Operating costs and expenses of our network services and systems integration business for the fiscal year ended March 31, 2016 increased by 14.3% to ¥132.0 billion compared to ¥115.5 billion for the previous fiscal year, mainly due to the increases in costs of network services and systems integration, and sales and marketing expenses. As a result, operating income of our network

services and systems integration business for the fiscal year ended March 31, 2016 increased to ¥5.1 billion compared to ¥4.3 billion for the previous fiscal year.

#### ATM Operation Business Segment

Net revenues from our ATM operation business segment, before elimination of intersegment revenues, increased by 6.8% to ¥3.9 billion for the fiscal year ended March 31, 2016 compared to ¥3.6 billion for the previous fiscal year. Operating expense of our ATM operation business for the fiscal year ended March 31, 2016 was ¥2.7 billion compared to ¥2.8 billion for the previous fiscal year. As a result, operating income of our ATM operation business for the fiscal year ended March 31, 2016 was ¥1.1 billion compared to operating income of ¥0.9 billion for the previous fiscal year.

Year Ended March 31, 2015 Compared to the Year Ended March 31, 2014

#### Network services and Systems Integration Business Segment

Net revenues from our network services and systems integration business segment, before elimination of intersegment revenues, increased by 7.1% to ¥119.8 billion for the fiscal year ended March 31, 2015 compared to ¥111.9 billion for the previous fiscal year. The increase in revenues was mainly due to the increase in systems integration revenue, cloud computing services, and mobile-related services both for enterprise and consumers. Operating costs and expenses of our network services and systems integration business for the fiscal year ended March 31, 2015 increased by 8.3% to ¥115.5 billion compared to ¥106.6 billion for the previous fiscal year, mainly due to the increases in costs of network services and systems integration, and general and administrative expenses. As a result, operating income of our network services and systems integration business for the fiscal year ended March 31, 2015 decreased to ¥4.3 billion compared to ¥5.3 billion for the previous fiscal year.

#### ATM Operation Business Segment

Net revenues from our ATM operation business segment, before elimination of intersegment revenues, increased by 28.8% to ¥3.6 billion for the fiscal year ended March 31, 2015 compared to ¥2.8 billion for the previous fiscal year. Operating expense of our ATM operation business for the fiscal year ended March 31, 2015 was ¥2.8 billion compared to ¥2.2 billion for the previous fiscal year. As a result, operating income of our ATM operation business for the fiscal year ended March 31, 2015 was ¥0.9 billion compared to operating income of ¥0.6 billion for the previous fiscal year.

## Application of Critical Accounting Policies

In reviewing our financial statements, you should consider the sensitivity of our reported financial condition and results of operations to changes in the conditions and assumptions underlying the estimates and judgments made by our management in applying critical accounting policies.

The preparation of financial statements requires the use of estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the periods presented. Actual results may differ from these estimates, judgments and assumptions. Note 1 to our consolidated financial statements includes a summary of the significant accounting policies used in the preparation of our financial statements. Certain accounting policies are particularly critical because of their significance to our reported results and because of the possibility that future events may differ significantly from the conditions and assumptions underlying the estimates used and judgments made by our management in preparing our financial statements.

The Company has discussed the development and selection of critical accounting policies and estimates with our Disclosure Committee, and the Disclosure Committee has reviewed the disclosure relating to these, which are included in this “Operating and Financial Review and Prospects.” For all of these policies, we caution that future events rarely develop exactly as forecast, and even the best estimates may require adjustment.

## Revenue recognition

Network service revenues consist of Internet connectivity services, WAN services and outsourcing services.

Revenues from Internet connectivity services consist of Internet connectivity services for enterprise and Internet connectivity for consumers. Internet connectivity services for enterprise represent dedicated Internet access type services, such as IP service and Data Center Connectivity service, broadband Internet connectivity services that use fiber optic and ADSL access, such as IJ FiberAccess/F Service and IJ DSL/F Service and wireless broadband Internet connectivity services, such as IJ Mobile Service. Internet connectivity services for consumers are provided under IJ brands such as IJmio, hi-ho brand and others, and consist of dial-up services, optical based or ADSL based broadband services and wireless broadband internet connectivity services. WAN services are closed network services for enterprise customers which mainly use dedicated lines. Outsourcing service revenues consist principally of sales of various Internet access-related services such as security-related services, network related services, server related services, data center related services, cloud computing services and others.

The term of these contracts is generally one month or one year. All of these services are billed and recognized monthly on a straight-line basis. Initial setup fees received in connection with network services are deferred and recognized over the estimated average period of the subscription for each service.

System integration revenue involves one or more of the following deliverables:

System construction services include all or some of the following elements depending on arrangements to meet each of our customer's requirements: consulting, project planning, system design, and development of network systems. These services also include the installation of software as well as configuration and installation of hardware.

Software we resell third-party software such as Oracle and Windows to our customers, which are installed by us during the system development process.

**Hardware** we also resell third-party hardware, primarily servers, switches and routers, which we install during the system development process. The hardware is generic hardware that is often sold by third party manufacturers and resellers.

**Monitoring and operating service** we monitor our customer's network activity and internet connectivity to detect and report problems. We also provide constant data backup services.

**Hardware and software maintenance service** we repair or replace any malfunctioning parts of hardware. We examine software faults and provide suitable solutions to customers.

The system construction services are generally delivered over a three-month period. All hardware and software are delivered and installed during this period. Customers are required to pay a specified fixed fee that is not payable until after the system construction has been completed and accepted by our customers.

Monitoring, operating and hardware and software maintenance services generally commence once our customers have accepted the systems, and contract periods are generally from one to five years. Our contracts include a stated annual fee for these services.

For multiple-element arrangements that include system construction service, hardware, software essential to the hardware product's functionality and undelivered non-software services (e.g., monitoring and operating services), the Company allocates revenue to all deliverables based on their relative selling prices. The Company uses a hierarchy to determine the selling price to be used for allocating revenue to deliverables: (i) vendor-specific objective evidence of fair value ("VSOE"), (ii) third-party evidence of selling price ("TPE") and (iii) best estimate of the selling price ("ESP"). The allocation of revenue is based mainly on the Company's ESPs except for certain undelivered non-software services for which VSOE has been established. The Company's process for determining its ESP for deliverables includes various factors that may vary depending on the circumstances and specific characteristics related to each deliverable. In developing the ESP, the Company considers customer demand, the existence and effect of competitors, general profit margin realized in the marketplace, volume of the transactions, the Company's internal costs of providing the deliverables, the profit objectives including targeted and historical margins realized on similar sales to similar customers and the historical pricing practices.

The method used to account for each unit and the period over which each unit of accounting is recognized are as follows:

Revenue allocated to system construction services is accounted for using contract accounting. System construction service revenues, which are generally completed within three months, are recognized based on the completed-contract method in compliance with Accounting Standards Codification ("ASC") 605-35-25-92 because the Company is unable to bill customers and the title to the constructed network system is not transferred to the

customers unless they are satisfied with and accept the completed systems.

Revenue related to the hardware and software essential to the hardware product's functionality is not recognized until customer acceptance is received because title to the hardware and software do not transfer to our customers until formal acceptance is received.

Revenue related to undelivered non-software services (monitoring, operating and hardware maintenance services) is recognized on a straight-line basis over the contract period.



The Company also enters into multiple-element arrangements for system integration services that include software not essential to the hardware product's functionality and software-related services and account for them in accordance with ASC 985-605, "Software-Revenue Recognition". The Company has been able to establish VSOE of fair value of the software-related services based on separate renewal contracts of the services that are consistently priced within a narrow range. The Company allocates revenue to such services based on VSOE and recognizes the revenues on a straight-line basis over the contract period. The Company allocates the residual amount to the software.

Equipment sales revenues are recognized when equipment is delivered and accepted by the customer.

The Company evaluates whether it is appropriate to record the gross amount of revenues and related costs or the net amount earned in reporting system construction services and equipment sales, depending on whether the Company functions as principal or agent.

ATM operation business revenues consist primarily of commissions for each withdrawing transaction with the use of ATMs. ATM commission collected from each withdrawal is aggregated every month and recognized as ATM operation revenues.

Revenue is recognized net of consumption tax collected from customers and subsequently remitted to governmental authorities.

#### Useful lives of property and equipment

Property and equipment, net recorded on our balance sheet was ¥34.3 billion at March 31, 2016, representing 29.1% of our total assets. Property and equipment are recorded at cost. Depreciation and amortization of property and equipment, including capitalized software and capital leases, are computed principally using the straight-line method based on either the estimated useful lives of assets or the lease period, whichever is shorter. Our depreciation and amortization expenses for property and equipment for the fiscal years ended March 31, 2014, 2015 and 2016 were ¥8.4 billion, ¥9.3 billion and ¥9.5 billion, respectively.

We estimate the useful lives of property and equipment in order to determine the amount of depreciation and amortization expense to be recorded in each fiscal year. We determine the useful lives of our assets at the time the assets are acquired and base our determinations on expected use, experience with similar assets, established laws and regulations as well as taking into account anticipated technological or other changes. Estimated useful lives by major asset classes at March 31, 2016, were as follows:

Item	Range of useful lives
Data communications, office and other equipment	2 to 20 years
Buildings	20 years
Leasehold improvements	4 to 20 years
Capitalized software	5 to 7 years
Capital leases	4 to 6 years

If technological or other changes were to occur more rapidly or in a different form than anticipated or new laws or regulations are enacted or the intended use changes, the useful lives assigned to these assets may need to be shortened, or we may need to sell or write off the assets, resulting in recognition of increased depreciation and amortization or losses in future periods. Our losses on disposal of property and equipment for the fiscal years ended March 31, 2014, 2015, and 2016 were ¥83 million, ¥101 million and ¥66 million, respectively.

A one-year change in the useful life of these assets would have increased or decreased depreciation expense by approximately ¥5.1 billion and ¥3.1 billion, respectively.

Ordinary maintenance and repairs are charged to income as incurred. Major replacements and improvements are capitalized. When properties are retired or otherwise disposed of, the property and related accumulated depreciation accounts are relieved of the applicable amounts and any differences are included in operating cost and expenses.

#### Goodwill and intangible assets

Goodwill and intangible assets that are deemed to have indefinite useful lives are not amortized, but are subject to impairment testing. Impairment testing is performed annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. The Company performs annual impairment tests on March 31. If the carrying amount of a reporting unit exceeds its fair value, the Company then performs the second step of the goodwill impairment test to measure the amount of impairment loss, if any.

No impairment of goodwill was recognized during the years ended March 31, 2014, 2015 and 2016.

The Company recorded ¥11 million of loss on impairment of the trademark right related to hi-ho in “Sales and marketing” expenses in the Company’s consolidated statement of income for the year ended March 31, 2016. Because of the recent decrease in revenues of hi-ho, the Company recognized that the trademark might be impaired. The carrying value of the trademark exceeded its fair value and the impairment loss was recognized in an amount equal to the excess of the carrying amount of the trademark over the fair value of the trademark. The fair value of the trademark was calculated using the relief-from-royalty method. The amount of loss was included in the network service and system integration business segment.

Intangible assets with finite useful lives, consisting of customer relationships, are amortized using a non-straight-line basis based on the pattern of expected future economic benefit over the estimated useful lives, which range from 7 to 19 years. We estimate the useful lives of the intangible assets, considering the customer attrition rate related to the customer relationships, results of contract update, new technology or economic situation. If the attrition rate increases beyond expectation or rapid technological advances render the existing technology obsolete, we may need to re-evaluate the remaining useful lives, or recognize impairment losses on the customer relationships.

On December 1, 2014, IIJ acquired a new subsidiary, RYUKOSHA and recorded goodwill of ¥200 million. The goodwill components were mainly attributable to human resources and the goodwill was included in the network service and system integration business segment.

### Impairment of long-lived assets

Long-lived assets consist principally of property and equipment, including those items leased under capital leases and amortized intangible assets. We perform an impairment review for our long-lived assets whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. This analysis is separate from our analysis of the useful lives of our assets, but it is affected by some similar factors. Factors that we consider important which could trigger an impairment review include, but are not limited to, the impact of the following trends or conditions:

- significant decline in the market value of an asset,
- current period operating cash flow loss,
- introduction of competing technologies or services,
- significant underperformance of expected or historical cash flows,
- significant or continuing decline in subscribers,
- changes in the manner or use of an asset,
- disruptions in the use of network equipment under capital lease arrangements, and
- other negative industry or economic trends.

When we determine that the carrying amount of specific assets may not be recoverable based on the existence or occurrence of one or more of the above or other factors, we estimate the future cash inflows and outflows expected to be generated by the assets over their expected useful lives. We estimate the sum of expected undiscounted future cash flows based upon historical trends adjusted to reflect our best estimate of future market and operating conditions. If the sum of the expected undiscounted future net cash flows is less than the carrying value of the assets, we record an impairment loss based on the fair values of the assets. Such fair values may be based on established markets, independent appraisals and valuations or discounted cash flows. If actual market and operating conditions under which assets are used are less favorable or shorter than those projected by management, resulting in reduced cash flows, additional impairment for assets may be required.

#### Allowance for doubtful accounts and uncollectible contractual prepayments

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. As of March 31, 2015 and 2016, we maintained allowances for doubtful accounts of ¥148 million and ¥152 million, respectively. Management specifically analyzes accounts and loans receivable including historical bad debts, customer concentrations, customer credit-worthiness and current economic trends when evaluating the adequacy of the allowances for doubtful accounts. If the financial condition of our customers or debtors were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Deferred tax assets

We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. As of March 31, 2016, we had tax operating loss carryforwards not subject to consolidation tax filing of ¥2,924 million, and tax operating loss carryforwards related to enterprise tax and inhabitant tax subject to consolidation tax filing of ¥253 million and ¥19 million, respectively. The tax operating loss carryforwards are available to offset future taxable income and will expire as shown in Note 12 of our consolidated financial statements. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, if there are changes in circumstances that causes a change in judgment about the realizability of the related deferred tax asset in future years, a release of or an increase in valuation allowance against deferred tax assets related to tax operating loss carryforwards and other temporary differences would result in the decrease or increase in deferred tax expense.

## Valuation of investments

We have investments in securities, and the valuation of such investments and funds requires us to make judgments using information that is generally uncertain at the time, such as assumptions regarding future financial conditions and cash flows. As of March 31, 2016, we had available-for-sale securities of ¥3.9 billion and cost method investments of ¥2.0 billion.

We review the fair value of available-for-sale securities on a regular basis to determine if the fair value of any individual security has declined below its cost and if such decline is other-than-temporary. If the decline in value is judged to be other-than-temporary, the cost basis of the investment is written down to fair value.

Other-than-temporary declines in value are determined taking into consideration the extent of decline in fair value, the length of time that the decline in fair value below cost has existed, the financial condition and near-term prospects of the issuer and IIIJ's intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in market value and events that might accelerate the recognition of impairment. For debt securities for which the declines are deemed to be other-than-temporary and there is no intent to sell and it is not more likely than not that we will be required to sell the securities before the recovery of the amortized cost basis, impairments are separated into the amount related to credit loss, which is recognized in earnings, and the amount related to all other factors, which is recognized in other comprehensive income (loss). For debt securities for which the declines are deemed to be other-than-temporary and there is an intent to sell or it is more likely than not that we will be required to sell the securities before the recovery of the amortized cost basis, impairments in their entirety are recognized in earnings. For equity securities for which the declines are deemed to be other-than-temporary, the resulting realized loss is recognized in earnings in the period in which the decline is deemed to be other-than-temporary.

Non-marketable equity securities are carried at cost as fair value is not readily determinable. When we evaluate whether non-marketable equity securities are impaired or not, we evaluate first whether an event or change in circumstances has occurred in the period that may have significant adverse effect on the fair value of the securities (an impairment indicator). We use such impairment indicators as follows:

- A significant deterioration in the earnings performance or business prospects of the investee.
- A significant adverse change in the regulatory, economic, or technological environment of the investee.

A significant adverse change in the general market condition of either the geographic area or the industry in which the investee operates.

- A recent example of the new issuance of a security, in which the issue price is less than our cost.

We estimate the fair value of the non-marketable equity securities when an impairment indicator is present. The fair value is determined as a result of considering various unobservable inputs which are available to us, including expectation of future income of the investees, net asset value of the investees, and material unrealized losses to be considered in assets and liabilities held by the investees. We recognize impairment of non-marketable equity securities when the fair value is below the carrying amount and the decline in fair value is considered to be other-than-temporary.

Our unrealized loss on investments in marketable equity securities as of March 31, 2016 relates to Japanese companies (8 issuers) in various industries. The fair value of each investment is between 5.9% and 36.4% less than its cost. The main duration of the unrealized loss position was less than 12 months. We evaluated the near-term prospects of the issuer and the analyst reports in relation to the severity and duration of impairment. Based on that evaluation and our ability and intent to hold the investments for a reasonable period of time sufficient for a recovery of fair value, we do not consider the investments to be other-than-temporarily impaired at March 31, 2016.



Impairment of investments in certain marketable equity securities and nonmarketable equity securities, including funds, included in "Other income (expenses)" in our consolidated statements of income, were recognized to reflect the decline in value considered to be other-than-temporary. The Company recognized impairment loss of ¥29 million on nonmarketable equity securities for the year ended March 31, 2015 and ¥4 million on marketable equity securities and ¥11 million on nonmarketable equity securities for the year ended March 31, 2016.

In addition to investments in securities, we also have investments in equities for which we have significant influence over the investee's operations and financial positions and are accounted for by the equity method. For other-than-temporary declines in the value of such investments below the carrying amount, the investment is reduced to fair value and an impairment loss is recognized.

#### Pension benefits costs

Employee pension benefit costs and obligations are dependent on certain assumptions including discount rate, retirement rate and rate of increase in compensation levels, which are based upon current statistical data, as well as the expected long-term rate of return on plan assets and other factors. Specifically, the discount rate and expected long-term rate of return on assets are two critical assumptions in the determination of periodic pension cost and pension liabilities. Assumptions are evaluated at least annually and when events occur or circumstances change which could have a significant effect on these critical assumptions. In accordance with U.S. GAAP, actual results that differ from the assumptions are accumulated and amortized over future periods. Therefore, actual results generally affect recognized expenses and the recorded obligations for pensions in future periods. While management believes that the assumptions used are appropriate, differences in actual experience or changes in assumptions may affect our pension obligations and future expenses.

We used a discount rate of 0.7% for the projected benefit obligation as of March 31, 2016. The discount rate was determined by using the market yield of high-quality fixed income securities reflecting the estimated timing of benefit payments.

We used an expected long-term rate of return on pension plan assets of 3.0% as of March 31, 2016. To determine the expected long-term rate of return on pension plan assets, we consider a combination of historical returns and prospective return assumptions derived from the pension trust funds' managing company. The actual return on the pension plan assets for the year ended March 31, 2016 was negative 0.5%.

The following table illustrates the sensitivity to a change in the discount rate and the expected return on pension plan assets, while holding all other assumptions constant, for our pension plan as of March 31, 2016.

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Change in Assumption	Pre-Tax PBO	Pension Expense	Equity (Net of Tax)
	(millions of yen)		
50 basis point increase/decrease in discount rate	(483)/529	(60)/62	41/(43)
50 basis point increase/decrease in expected return on assets	–	(16)/16	–/(11)

Stock Based Compensation

The Company measures and records the compensation cost from stock compensation-type stock options based on fair value. The fair value of the stock option is measured on the date of grant using the Black-Scholes option-pricing model, and amortized over the requisite service period. The compensation cost is mainly included in “General and administrative” expense.

## New Accounting Guidance

### Accounting Guidance Issued But Not Adopted as of March 31, 2016

In May 2014, the FASB issued Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers (Topic 606),” to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and International Financial Reporting Standards. This guidance also requires an entity to improve disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. ASU 2015-14, “Revenue from Contracts with Customers: Deferral of the Effective Date,” which was issued in August 2015, revised the effective date for this ASU to annual and interim periods beginning after December 15, 2017, with early adoption permitted, but not earlier than the original effective date of annual and interim periods beginning after December 15, 2016, for public entities. The Company is currently evaluating the impact of adopting this guidance.

In July 2015, the FASB issued ASU 2015-11, “Inventory (Topic 330): Simplifying the Measurement of Inventory,” which applies to inventory that is measured using first-in, first-out (“FIFO”) or average cost methods. Under the updated guidance, an entity should measure inventory within the scope of the guidance at the lower of cost and net realizable value, which is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. Subsequent measurement is unchanged for inventory that is measured using last-in, first-out (“LIFO”). This ASU is effective for annual and interim periods beginning after December 15, 2016, and should be applied prospectively with early adoption permitted at the beginning of an interim or annual reporting period. The Company is currently evaluating the impact of adopting this guidance.

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities,” which amends the guidance in U.S. GAAP on the classification and measurement of financial instruments. Changes to the current guidance primarily affect the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. In addition, the ASU clarifies guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. The new standard is effective for fiscal years and interim periods beginning after December 15, 2017, and upon adoption, an entity should apply the amendments by means of a cumulative-effect adjustment to the balance sheet at the beginning of the first reporting period in which the guidance is effective. Early adoption is not permitted except for the provision to record fair value changes for financial liabilities under the fair value option resulting from instrument-specific credit risk in other comprehensive income. The Company is currently evaluating the impact of adopting this guidance.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842),” which requires organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. The new guidance requires that a lessee recognizes assets and liabilities for leases with lease terms of more than

twelve months and recognition, presentation and measurement in the financial statements will depend on its classification as a finance or operating lease. In addition, the new guidance will require disclosures to help investors and other financial statement users better understand the amount, timing and uncertainty of cash flows arising from leases. Lessor accounting remains largely unchanged from current U.S. GAAP but does contain some targeted improvements to align with the new revenue recognition guidance issued in 2014. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, using a modified retrospective approach, and early adoption is permitted. The Company is currently evaluating the impact of adopting this guidance.

In March 2016, the FASB issued ASU 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)," which is an amendment to the new revenue recognition standard on assessing whether an entity is a principal or an agent in a revenue transaction. This amendment addresses implementation issues that were discussed by the Revenue Recognition Transition Resource Group ("TRG") to clarify the principal versus agent assessment and provide for more consistent application. This new standard has the same effective date and transition requirements as ASU 2014-09. The Company is currently evaluating the impact of adopting this guidance.

## B. Liquidity and Capital Resources

### Liquidity and Capital Requirements

Our principal capital and liquidity needs in recent years have been for capital expenditures for the development, expansion and maintenance of our network infrastructure, lease payments, payment of principal and interest on outstanding borrowings, investments in group companies and other working capital. In our opinion, our working capital is sufficient for our present requirements.

*Capital expenditures.* Most of our capital expenditures relate primarily to the development, expansion and maintenance of our network and service infrastructures and of our internal back-office systems as well as software development. The investments are mostly for routers, servers, network equipment, containers, other facilities necessary to offer services on our network and software. The table below shows our capital expenditures, which we define as amounts paid for purchases of property and equipment plus acquisition of assets by entering into capital leases, for the last three fiscal years. Capital expenditures for the fiscal year ended March 31, 2016 were larger than the fiscal year ended March 31, 2014 and 2015, mainly because there were capital expenditures including capitalized leases for facilities and equipment related to cloud computing services in the fiscal year ended March 31, 2016 more than the fiscal year ended March 31, 2014 and 2015.

	For the fiscal year ended March 31,		
	2014	2015	2016
	(millions of yen)		
Capital expenditures, including capitalized leases <sup>(1)</sup>	¥12,560	¥11,835	¥14,812

(1) Further information regarding capital expenditures, including capitalized leases and a reconciliation to the most directly comparable U.S. GAAP financial measure, can be found in Item 3.A., "Selected Financial Data— Reconciliation of the Disclosed Non-GAAP Financial Measures to the Most Directly Comparable GAAP Financial Measures."

We expect that our capital expenditures, including capitalized leases, for the fiscal year ending March 31, 2017 related to our network services and systems integration business will be about the same as the amount for the fiscal year ended March 31, 2016 although the amount may fluctuate. There will be capital expenditures for facilities and equipment for cloud computing services and for network equipment and software which are related to the usual expansion and improvement of our existing network. In addition, there will be capital expenditures related to our ATM operation business which is also expected to increase compared to the previous fiscal year along with the placement of new ATMs.

We recorded a loss on disposal of property and equipment of ¥83 million, ¥101 million and ¥66 million for the fiscal years ended March 31, 2014, 2015 and 2016, respectively.

*Lease payments.* We have operating lease agreements with telecommunications carriers and others for the use of connectivity lines, including our domestic and international backbone as well as local access lines that our customers use to connect to our network. The leases for domestic and international backbone connectivity are generally non-cancelable for a minimum one-year lease period. We also lease office premises, for which refundable lease deposits are capitalized as guarantee deposits, certain office equipment under non-cancelable operating leases, and its network operation centers under non-cancelable operating leases which expire on various dates through the year 2021. Lease expenses related to backbone lines for the fiscal years ended March 31, 2014, 2015 and 2016, amounted to ¥3.8 billion, ¥3.7 billion and ¥3.6 billion, respectively. Lease expenses for local access lines for the fiscal years ended March 31, 2014, 2015 and 2016 amounted to ¥22.6 billion, ¥22.0 billion and ¥23.0 billion, respectively. Other lease expenses for the fiscal years ended March 31, 2014, 2015 and 2016, amounted to ¥6.5 billion, ¥7.0 billion and ¥6.9 billion, respectively.

We conduct our connectivity and other services, including cloud computing services by using data communications and other equipment leased under capital lease arrangements. For our ATM operation business, we expect to continuously place new ATMs which are acquired by leasing transactions for the time being into operation; therefore, lease payments for ATMs will increase along with placing new ATMs into operation.

We sold ATM and data communications equipment procured from a third party vendor, which amounted to ¥0.8 billion and ¥2.8 billion respectively, to the leasing company for the years ended March 31, 2015 and 2016 and concurrently entered into capital lease arrangements to lease the equipment back which resulted in total lease payments of ¥0.8 billion due by March 2020 and ¥2.8 billion due by April 2022, related to the lease contracts made in the year ended March 31, 2015 and 2016, respectively.

The fair value of the assets upon execution of the capital lease agreements and accumulated depreciation amounted to ¥24.3 billion and ¥16.6 billion as of March 31, 2015 and ¥28.3 billion and ¥18.7 billion as of March 31, 2016, respectively.

As of March 31, 2016, future lease payments under non-cancelable operating leases, including the aforementioned non-cancelable connectivity lease agreements (but excluding dedicated access lines which we charge outright to customers), and capital leases were as follows:

Payment due by period  
(millions of yen)

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	Total contractual amount	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Connectivity lines operating leases	¥1,853	¥871	¥982	–	–
Other operating leases	5,252	3,579	1,156	¥242	¥ 275
Capital leases	12,162	4,142	5,401	2,281	338
Total minimum lease payments <sup>(1)</sup>	¥19,267	¥8,592	¥7,539	¥2,523	¥ 613

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(1) See Note 9 “Leases” to our consolidated financial statements included in this annual report on Form 20-F.

***Payments of principal and interest on outstanding borrowings.*** We require cash for payments of interest and principal on our outstanding borrowings.



**Short-term borrowings.** As of March 31, 2016, our short-term borrowings consisting of bank overdrafts were ¥9.3 billion. The weighted average interest rate of our short-term borrowings at March 31, 2016 was 0.498%. Our short-term borrowings as of March 31, 2016 stayed the same as the balance of March 31, 2015. Our unused balance under our bank overdraft agreements, uncommitted, was ¥10.8 billion in short-term borrowings as of March 31, 2016.

**Collateral for borrowings.** Substantially all of our short-term and long-term borrowings are made under agreements which, as is customary in Japan, provide that under certain conditions the banks may require us to provide collateral or guarantees with respect to the borrowings. We did not provide banks with any collateral for outstanding loans as of March 31, 2015 and 2016. Our primary banking relationships are with Bank of Tokyo-Mitsubishi UFJ, Ltd., Mizuho Bank, Ltd., Sumitomo Mitsui Banking Corporation, and Mitsubishi UFJ Trust and Banking Corporation. The banks are also shareholders and customers of ours.

**Investments in current and former group companies.** In the past, we have made substantial investments in current and former group companies. We may need to provide additional investment in our group companies to enhance or maintain our business synergy with our affiliated companies in the future. See Item 4.B., “Our Group Companies” for information on investment in equity method investees.

**Working capital needs.** Our principal working capital requirements are for payments for our domestic and international backbone, local access lines, network equipment and software. We also require working capital requirements for personnel expenses, office rents and other operating expenses.

## Capital Resources

We seek to manage our capital resources and liquidity to provide sufficient funds for current and future financial obligations. We have traditionally met our capital and liquidity requirements through cash flows from operating activities, long-term and short-term borrowings from financial institutions, capital leases and issuances of equity securities. At March 31, 2016, we had cash and cash equivalents of ¥19.6 billion.

**Short-term and long-term borrowings.** Short-term and long-term borrowings provide us with an important source for maintaining an adequate level of working capital, acquisition of fixed assets and investments. We plan to refinance our short-term borrowings or use the unused balance outstanding of ¥10.8 billion, uncommitted, as of March 31, 2016 under the bank overdraft agreement for maintaining adequate level of working capital, acquisition of fixed assets and investments. See — “Payments of principal and interest on outstanding borrowings” above.

***Cash flows from operating activities.*** We generated ¥12.0 billion by operating activities for the year ended March 31, 2016. See — “Cash Flows” below.

***Capital leases.*** Capital leases also provide us with an important source of financing. See Note 9 “Leases” to our consolidated financial statements included in this annual report on Form 20-F.

## Cash Flows

We had cash and cash equivalents of ¥19.6 billion at March 31, 2016 compared to ¥21.1 billion at March 31, 2015.

The following table presents information about our cash flows during the fiscal years ended March 31, 2014, 2015 and 2016:

	Fiscal year ended March 31,		
	2014	2015	2016
	(millions of yen)		
Net cash provided by operating activities	¥8,787	¥12,912	¥12,051
Net cash used in investing activities	(10,203)	(8,073)	(8,377)
Net cash provided by (used in) financing activities	11,382	(6,283)	(5,201)
Effect of exchange rate changes on cash and cash equivalents	196	117	2
Net increase (decrease) in cash and cash equivalents	10,162	(1,327)	(1,525)
Cash and cash equivalents at beginning of the year	12,259	22,421	21,094
Cash and cash equivalents at end of the year	¥22,421	¥21,094	¥19,569

## Year Ended March 31, 2016 as Compared to the Year Ended March 31, 2015

Net cash provided by operating activities for the fiscal year ended March 31, 2016 was ¥12.1 billion, a decrease of ¥0.8 billion from ¥12.9 billion for the previous fiscal year. Net income for the fiscal year ended March 31, 2016 increased by ¥0.8 billion from the previous fiscal year. Additionally, deferred income tax expense increased by ¥0.4 billion from the previous fiscal year which is due to a recognition of deferred tax asset for a tax loss carryforward by our consolidated subsidiary in the fiscal year ended March 31, 2014 and depreciation and amortization increased by ¥0.2 billion from the previous fiscal year which is due to our recent years' business investment enhancement. However, the changes in operating assets and liabilities resulted in a temporary negative impact of ¥1.8 billion compared to the previous fiscal year despite the fact that income taxes payable and accounts payable increased and accounts receivable decreased. The temporary negative impact mainly includes the following: an increase in other assets in the fiscal year ended March 31, 2016 which is mainly due to an increase in prepaid expenses-noncurrent related to the payment of license fee along with revenue growth and service developments; an increase in inventories related to several large projects; a decrease in other current and noncurrent liabilities; and changes in accrued expenses associated with our head office relocation in the previous year.

Net cash used in investing activities for the fiscal year ended March 31, 2016 was ¥8.4 billion, an increase of ¥0.3 billion from ¥8.1 billion for the previous fiscal year. The increase mainly reflects the following factors: an increase of ¥2.7 billion in purchases of property and equipment, an increase of ¥1.8 billion in proceeds from sales of property and equipment, a decrease of ¥1.6 billion in refund of guarantee deposits and a decrease of ¥1.2 billion in payments of

guarantee deposits due to our office relocation in the previous year.

Net cash used in financing activities for the fiscal year ended March 31, 2016 was ¥5.2 billion, a decrease of ¥1.1 billion from net cash used in financing activities of ¥6.3 billion for the previous fiscal year. The change resulted from an increase in proceeds from issuance of short-term borrowings by ¥1.5 billion, and an increase in repayments of borrowings by ¥0.5 billion.

Year Ended March 31, 2015 as Compared to the Year Ended March 31, 2014

Net cash provided by operating activities for the fiscal year ended March 31, 2015 was ¥12.9 billion, an increase of ¥4.1 billion from ¥8.8 billion for the previous fiscal year. Net income for the fiscal year ended March 31, 2015 decreased by ¥1.3 billion from the previous fiscal year. However, depreciation and amortization increased by ¥0.9 billion from the previous fiscal year which is due to our recent years' business investment enhancement and deferred income tax expense increased from the previous fiscal year which is due to a recognition of deferred tax asset for tax loss carryforward by our consolidated subsidiary in the previous fiscal year. Additionally, the changes in operating assets and liabilities resulted in a temporary positive impact of ¥3.0 billion compared to the previous fiscal year despite the fact that accounts receivable increased along with the revenue increase. The temporary positive impact mainly includes the followings: an increase in accrued expenses related to our head office relocation in the fiscal year ended March 31, 2015; a recognition of other assets related to the payment of license fees in the previous fiscal year; an increase in other current and noncurrent liabilities in the fiscal year ended March 31, 2015 which is mainly due to an increase in consumption tax payable associated with an increase in revenue and a rise in the Japanese consumption tax rate; and a decrease in inventories which is mainly because we recognized large-scale inventories for certain large projects in the previous fiscal year.

Net cash used in investing activities for the fiscal year ended March 31, 2015 was ¥8.1 billion, a decrease of ¥2.1 billion from ¥10.2 billion for the previous fiscal year. The decrease mainly reflects the following factors: a decrease of ¥1.0 billion in purchases of property and equipment, a decrease of ¥0.9 billion in purchases of other investments, an increase of ¥1.6 billion in refund of guarantee deposits and an increase of ¥0.9 billion in payments of guarantee deposits along with our office relocation.

Net cash used in financing activities for the fiscal year ended March 31, 2015 was ¥6.3 billion, a decrease of ¥17.7 billion from net cash provided by financing activities of ¥11.4 billion for the previous fiscal year. The change resulted from proceeds from issuance of common stock of ¥17.3 billion, net of issuance cost, an increase in principal payments under capital leases by ¥0.2 billion, and an increase in net repayments of borrowings by ¥0.2 billion.

#### Contingencies

We did not have any material contingent liabilities as of March 31, 2016.

C. Research and Development, Patents and Licenses, etc.

See the information in Item 4.B., “Business Overview — Research and Development.”

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## D. Trend Information

### Factors Affecting Our Future Financial Results

We expect that the following are the most significant factors likely to affect our financial results and those of our consolidated subsidiaries. You should also consult Item 3.D. “Risk Factors” and the other portions of this annual report on Form 20-F for additional factors affecting our financial results.

### Revenues

We have two business segments: a network services and systems integration business segment and an ATM operation business segment. The network services and systems integration business segment is comprised of Internet connectivity services, WAN services, outsourcing services, systems integration and equipment sales.

### Network services revenues

Network services revenues consist of our revenues from Internet connectivity services for enterprise, Internet connectivity services for consumers, WAN services and outsourcing services. Our network services revenues accounted for 58.9%, 56.1% and 56.4% of our total revenues for the fiscal years ended March 31, 2014, 2015, and 2016, respectively. As our Internet connectivity services for enterprise and WAN services customers are more likely to use our outsourcing services or systems integration as their network needs develop, Internet connectivity services for enterprise and WAN services are important for the growth of our outsourcing services or systems integration business.

### **Internet connectivity services for enterprise**

Our revenues from Internet connectivity services for enterprise accounted for 14.5%, 13.3% and 12.5% of our total revenues for the fiscal years ended March 31, 2014, 2015 and 2016, respectively. Revenues from Internet connectivity services for enterprise depend on the size of our customer base, the average contracted bandwidth and unit price of our services. The market for Internet connectivity services for enterprise generally follows the trends written below:

***Increase in contracted bandwidth.*** Total contracted bandwidth for Internet connectivity services for enterprise customers increased to 2,315.9 Gbps as of March 31, 2016 from 1,730.8 Gbps for the previous fiscal year end. The number of IP service contracts for the bandwidth over 100 Mbps increased to 899 for the fiscal year ended March 31, 2016 from 844 for the previous fiscal year end. This increase is mainly due to an increase in customers' demand for broader bandwidth for their Internet connectivity. The total contracted bandwidth for Internet connectivity services for enterprise is calculated by adding the contracted bandwidth for each of the following services: IP service, IJ data center connectivity service and broadband services. Although we do not expect revenue per contract to grow largely in the fiscal year ending March 31, 2017 due to continuing competition, we believe that customer demand for broader bandwidth should continue as the use of broadband by corporate customers expands and as we try to acquire new customers and increase the bandwidth of existing customers as well as maintain the quality of our services to differentiate them from those of our competitors.



***Increasing demand for mobile data communications services.*** Demand for our mobile data communications service for enterprise called IIJ Mobile Service, which is provided under an MVNO scheme, has increased since its introduction in January 2008. IIJ Mobile Service's subscriptions increased to 431,030 as of March 31, 2016 from 187,429 for the previous fiscal year end. We target corporate customers who are security conscious and looking for data communication services with strong security features such as VPN access and private access. Increasing demand related to M2M connectivity is another trend in recent years we have been seeing. To capture the demand, we have developed related service line-ups. We expect demand for mobile data communication services to contribute to an increase in our outsourcing services and systems integration revenues as usage and implementation of these connectivity services increase the demand for outsourcing services such as security services and network systems integration. We also started "IIJ Mobile Platform Services" under which we operate as MVNE by providing our MVNO service platform to corporate customers so that they can incorporate MVNO services in their businesses. The related subscriptions, which are included in IIJ Mobile Services subscriptions, increased to approximately 251 thousand as of March 31, 2016 from approximately 67 thousand for the previous fiscal year end.

***Continuous demand for broadband services.*** Demand for broadband services such as IIJ FiberAccess/F, IIJ DSL/F and IIJ DSL/A is steady as the services are used to connect corporate branches and remote offices. For access lines, the services use ADSL lines with a maximum speed of 47 Mbps or optical lines with a maximum speed of 1Gbps. The number of contracts for our broadband services increased to 75,932 as of March 31, 2016 from 62,926 for the previous fiscal year end. We also expect that demand for broadband services should contribute to an increase in our outsourcing services and systems integration revenues as usage and implementation of these connectivity services increase the demand for outsourcing services such as security services and network systems integration.

Although we do not expect prices of Internet connectivity services for enterprise to increase in the fiscal year ending March 31, 2017, we anticipate that corporate customers' demand for broader bandwidth and mobile data communications services should contribute to our revenue growth as the use of broadband and mobile data communications by corporate customers expands. We also plan to focus on acquiring new customers as well as increasing the bandwidth of existing customers by maintaining the quality of our services to differentiate them from those of our competitors.

### **Internet Connectivity services for consumers**

Our revenues from Internet connectivity services for consumers accounted for 5.3%, 6.7% and 10.8% of our total revenues for the fiscal years ended March 31, 2014, 2015 and 2016, respectively. Revenues from Internet connectivity services for consumers mainly depend on the size of our customer base and pricing. The size of our customer base depends primarily on the popularity of services under our brand name, our sales partners as well as the attractiveness of our service offerings which is measured primarily by the quality of service and our ability to attract new customers. Internet connectivity services for consumers' subscriptions increased to 1,230,600 as of March 31, 2016 from 891,519 for the previous fiscal year end. Our mobile services for consumers contributed to the increase in the number of subscriptions.

***Increasing demands for mobile services for consumers.*** From February 2012, we started to provide mobile services to consumers by using our MVNO service infrastructure, which was formerly provided only to corporate customers. The revenue from this service increased to ¥11.0 billion for the fiscal year ended March 31, 2016 from ¥4.3 billion from the previous fiscal year. The subscriptions for this service increased to approximately 747 thousand as of March 31, 2016 from approximately 430 thousand for the previous fiscal year end. We offer inexpensive LTE SIM cards which are inserted to individual smart phones and portable devices. We started to offer voice call function in April 2014 with an expectation that it would generate more subscriptions. From October 2014, we started to provide prepaid SIM cards to foreign tourists visiting Japan. These SIM cards are sold at convenience stores, major electronics retail stores, department stores, airports and to passengers while they are boarding certain flights. Since the inexpensive LTE SIM card market is new in Japan, we are uncertain about the extent of how much the market will expand and the timeframe of that expansion.

**General trends of Internet connectivity services for consumers.** We offer our Internet connectivity services for consumers not only directly, but also through sales partners including hi-ho and Excite Japan Co., Ltd. These service providers sell Internet connectivity services to consumers under their own name but they are using our Internet network infrastructure to provide such services. From March 2015, we started to offer “IIJmio Hikari,” which is a bundled service packaging optical fiber broadband service with ISP services. IIJmio Hikari is replacing our conventional Internet connectivity services for consumers. We also offer our mobile services for consumers as an optional service for IIJmio Hikari with some monthly charge discount.

### **WAN services**

Our revenues from WAN services accounted for 21.9%, 19.8% and 17.9% of our total revenues for the fiscal year ended March 31, 2014, 2015 and 2016, respectively. Demand for WAN services is relatively stable with continuous use by certain large clients who use the services to connect corporate mission critical systems. Such transaction volume tends to be large and unit prices tend to be higher than our other network services. Therefore, revenues can fluctuate significantly with the absence or addition of such large orders, accordingly future revenue is difficult to forecast.

### **Outsourcing Services**

Our revenues from outsourcing services accounted for 17.2%, 16.3% and 15.1% of our total revenues for the fiscal year ended March 31, 2014, 2015 and 2016, respectively. Outsourcing services consist of network-related services, server-related services, security-related services, data center-related facility services and operation and management services, and IIJ GIO/Hosting Package, one of our cloud computing services. For the fiscal year ended March 31, 2016, outsourcing services revenues increased to ¥21.2 billion from ¥20.1 billion for the fiscal year ended March 31, 2015 while IIJ GIO/Hosting Package revenues decreased to approximately ¥2.0 billion from approximately ¥2.2 billion for the previous fiscal year. Excluding the revenue growth from IIJ GIO/Hosting Package, outsourcing services' revenue for the fiscal year ended March 31, 2016 increased by 7.6% compared to the previous fiscal year.

The growth of outsourcing services is primarily due to the increase in demand for security services as there have been security incidents such as targeted and DDoS attacks on Japanese business enterprises and public sector entities. We expect that corporate customers will continue to increase their use of the Internet as a business tool and will increasingly rely on an expanding range of outsourcing services to enhance productivity, reduce costs and improve service reliability. We believe our cloud computing service IIJ GIO/Hosting Package will contribute to the revenue growth for the middle-to long-term although we also expect the current weak growth pace to continue for a while.

Systems integration revenues, including related equipment sales revenues

Our systems integration revenue consists of systems construction and systems operation and maintenance.

Systems construction, which is a one-time revenue, accounted for 16.3%, 16.6% and 15.0% of our total revenues for the fiscal year ended March 31, 2014, 2015 and 2016, respectively. Systems construction revenues, including related equipment sales revenues for the fiscal year ended March 31, 2016 increased from the previous fiscal year as we continued to accumulate orders including large-scale ones.

Systems operation and maintenance, which is a monthly recurring revenue, accounted for 20.8%, 22.6% and 23.5% for the fiscal year ended March 31, 2014, 2015 and 2016, respectively. Revenue for IJ GIO/Component service, one of our cloud computing services, is included in the systems operation and maintenance revenues. Systems operation and maintenance revenues for the fiscal year ended March 31, 2016 increased by 18.9% compared to the previous fiscal year mainly because many of accumulated systems construction projects have been shifted to the operation and maintenance and IJ GIO/Component revenue continued to increase. Excluding the revenue growth from IJ GIO/Component service, systems operation and maintenance revenues increased by 18.2% compared to the previous fiscal year. Approximately 85.5% of our cloud computing service revenues for the fiscal year ended March 31, 2016 was recognized in systems operation and maintenance and 14.5% was recognized in outsourcing services.

For the fiscal year ended March 31, 2016, our cloud computing services revenues were approximately ¥14.1 billion, an increase of approximately ¥1.8 billion from the previous fiscal year, and for the fiscal year ending March 31, 2017, we target approximately ¥16.2 billion in revenue. We launched a new cloud service “IJ GIO Infrastructure P2” in November 2015. The service is targeted towards Japanese enterprises that seek to migrate their core business platform systems to the cloud by offering reliable public cloud infrastructure with increased processing performance as well as private cloud infrastructure.

For the fiscal year ending March 31, 2017, we should continue to see a strong appetite for IT investment along with favorable market situations and we expect revenue to increase from the fiscal year ended March 31, 2016. As systems integration revenues can fluctuate significantly in accordance with the absence or addition of large orders, they are accordingly difficult to forecast. For systems operation and maintenance revenues, we anticipate that we can increase them from the increase in systems construction revenue which should migrate to systems operation and maintenance as well as accumulation of our cloud computing services orders. In the middle-to long-term, we also anticipate that Japanese companies should increase IT-related investments for their network systems when the general economic situation and the business results of Japanese companies recover.

#### Equipment sales revenues

Our equipment sales revenues consist primarily of sales of networking and other related equipment as requested by our customers, other than that provided in connection with our systems integration services. We are seeing an increase in portable devices and smartphone orders along with increasing needs for mobile services for both enterprise and consumer. Our equipment sales revenues accounted for 1.5%, 1.8% and 2.3% of our total revenues for the fiscal year ended March 31, 2014, 2015 and 2016, respectively.

#### ATM Operation Business revenues

ATM operation business revenues consist primarily of commission fees for each withdrawal with the use of ATMs. ATM commission fees collected from each withdrawal are aggregated every month and recognized as ATM operation business revenues. The number of daily withdrawing transactions for the fiscal year ended March 31, 2016 stayed almost the same as the previous fiscal year. Our ATM operation business revenues and its percentage of our total revenue was ¥2.8 billion, ¥3.6 billion and ¥3.9 billion and 2.5%, 3.0% and 2.8% for the fiscal years ended March 31, 2014, 2015 and 2016, respectively. The number of placed ATMs as of March 31, 2016 was 1,087, an increase of 28 ATMs from the previous fiscal year end. We expect a similar ATM placement pace to continue for a while. The ATM operation business revenues should increase along with the placement of additional ATMs despite the possibility that we may see a continuous decrease in the number of daily transaction due, for example, to a decrease in number of pinball players as the Japanese population declines or to a decrease in consumer demand prompted by an increase in the Japanese consumption tax rate.

### **Additional factors affecting revenues**

A number of other factors may affect demand for our services and in turn our revenues, including overall increases in business usage of Internet and network solutions and our range of service offerings.

***Increase in business usage:*** Our revenues will be affected by the extent and speed with which businesses in Japan utilize Internet and network solutions to their full potential, including, for example, electronic transactions between businesses and wider range of devices accessing to Internet. Such services require high-quality and high-capacity connectivity services for both businesses and individuals. Such services also require provision of total network solutions including various Internet connectivity services, systems integration and other outsourcing services which we believe we are well positioned to provide. The degree of business usage will also depend upon a variety of factors including:

- technological advances, reliability of security systems and users' familiarity with and confidence in new technologies,
- the rate at which Japanese companies in certain industries significantly increases their Internet usage, and
- corporate budgets for information technologies, including Internet-related items.

***Range of service offerings:*** To increase our revenues from business users, we provide a wide variety of services and continue to introduce new services. For Internet connectivity services, we have introduced LTE services as an addition to our mobile services. For cloud computing services, we launched a new service platform "IIJ GIO Infrastructure P2" which offers reliable public cloud infrastructure with increased processing performance and private cloud infrastructure. For network services for enterprise, we started to offer "IIJ Omnibus Service" which incorporates SDN and NFV technologies to offer several network elements automatically. We anticipate these steps will allow us to sell a greater variety of services to our high-end corporate users and to meet Japanese enterprises' IT needs. However, we will still be strongly dependent on the Japanese economy and on Japanese companies and their information technology budgets. We expect Internet usage to continue to grow in Japan and that businesses will continue to diversify their uses of the Internet. Our ability to develop and offer a broad range of services to meet our customers' demands will significantly influence our future revenues.

***Synergies between network services and systems integration:*** Most of our systems integration customers come from our Internet connectivity services customers, and we expect these relationships to continue. As part of our systems integration business, we offer solution services for corporate information network systems, consultation, project planning, system design and systems/operation outsourcing or Internet VPN solution services which combine the FLET'S Internet connectivity or mobile connectivity services with SEIL, adopted by customers who have multiple locations, such as branches, offices and factories. Cloud computing services and security-related services are also provided together with connectivity and systems integration services. The ability to introduce a wide range of services, including solutions necessary to build corporate information network systems, like disaster recovery services and Internet VPN, Voice over IP ("VoIP"), SEIL, private mobile access solutions, SEIL/SMF and wireless LAN service, is an important competitive factor.





***Synergies between the Group companies:*** The group works together as a team to provide network solutions to our customers, mainly corporate and governmental organizations.

***Overseas business:*** The Group is enhancing its overseas operations mainly to fulfill the broad range of IT network related needs of our Japanese customers that are headed abroad to expand their overseas business. As a group, we aim to expand our cloud computing related services and overseas business by leveraging our customer base and our engineering skills. However, our overseas business portion is still relatively small. For the fiscal year ended March 31, 2016, our overseas revenue, which is mainly recognized in systems integration revenue, and operating loss were approximately ¥5.3 billion and approximately ¥0.5 billion compared to approximately ¥4.9 billion and ¥0.8 billion for the previous fiscal year, respectively. For the fiscal year ending March 31, 2017, we target overseas business revenue to be approximately ¥7.0 billion.

#### Costs and expenses

Costs and expenses include cost of network services revenues, cost of systems integration revenues, cost of equipment sales revenues, cost of ATM operation business revenues, sales and marketing expenses, general and administrative expenses and research and development expenses.

#### Cost of network services revenues

Our primary cost of network services revenues is the leasing fees that we pay for the leased lines which comprise our network and for the dedicated local access lines that our subscribers use to connect with our network. Other primary components of our costs are leasing fees that we pay for MVNO service infrastructure, depreciation and amortization of capital leases for network equipment, personnel and other costs for technical and customer support staff and network operation center related costs. Most of our network equipment is leased rather than purchased to take advantage of the financing provided by a capital lease arrangement.

We have made continuous investments in past years to develop and expand our network along with our business expansion. For the fiscal year ended March 31, 2016, our leased lines and other connectivity costs were ¥27.0 billion or 34.1% of our total network services revenues. For the previous fiscal year, these costs were ¥26.0 billion or 38.7% of total our network services revenues.

***Backbone cost:*** Backbone cost for the fiscal year ended March 31, 2016 was ¥3.6 billion, a slight decrease compared to the fiscal year ended March 31, 2015. We do not expect that our backbone costs to significantly increase.

***Dedicated local access line costs:*** We collect dedicated local access line fees from subscribers and pay these fees over to the carriers. Dedicated local access line costs for the fiscal year ended March 31, 2016 were ¥22.9 billion compared to ¥21.9 billion for the fiscal year ended March 31, 2015. Other connectivity costs were ¥0.5 billion for the fiscal year ended March 31, 2016, compared to ¥0.4 billion for the previous fiscal year.

Depreciation and amortization cost related to network service revenues increased by ¥0.5 billion to ¥4.5 billion for the fiscal year ended March 31, 2016 from ¥3.9 billion for the fiscal year ended March 31, 2015 along with the increase in capital expenditures related to network service revenues. Along with the increase in capital expenditures, we expect depreciation and amortization to increase.

Outsourcing-related costs increased by ¥7.1 billion from the previous year mainly due to an increase in purchasing volume of mobile-related service facility including mobile bandwidth from NTT Docomo along with an increase in consumer mobile service subscriptions.

The cost of mobile services revenues, most of which is recognized as outsourcing-related costs of network services revenues, has been increasing along with the rapid increase in consumer mobile and MVNE subscriptions. We have been purchasing NTT Docomo's mobile infrastructure to provide our mobile services and we have been increasing our purchasing volume in order to offer reliable connectivity to our customers, both enterprise and consumer. NTT Docomo charges a "wholesale telecommunications service charge" to all of its MVNOs, including us. NTT Docomo calculates the unit price in accordance with the "Telecommunications Business Law" and the "Guidelines related to Operation of the Institution for Category II Designated Telecommunications Facilities," which are both administrated by the MIC. The unit price is a flat-rate per Mbps and is calculated based mainly on NTT Docomo's actual cost related to its mobile data communication business. In recent years, such unit price decreased by 41.2%, 56.6%, 23.5%, and 16.9% annually in the fiscal years 2011, 2012, 2013 and 2014 respectively. The corresponding unit price is approximately ¥2.8 million, approximately ¥1.2 million, approximately ¥0.9 million, and approximately ¥0.8 million in the fiscal years 2011, 2012, 2013 and 2014 respectively. Amounts we pay to NTT Docomo for our mobile services have been increasing along with the purchasing volume increase, while the unit price itself continues to decrease.

#### *Costs of systems integration revenues and equipment sales*

The cost of our systems integration revenues and equipment sales consists of purchasing costs, personnel-related costs, outsourcing-related costs, network operation-related costs and other costs. Purchasing costs increase or decrease in tandem with systems construction revenues and equipment sales revenues. Personnel and outsourcing-related costs are mainly costs of engineering staff. Network operation-related costs are costs such as depreciation and amortization of capital leases for system-related equipment including facilities and equipment for cloud computing services. The main determinant of whether our gross margin will increase or decrease depends on whether we can secure profit for each systems integration project, whether we are able to adequately control the man-hour for each systems integration project as initially estimated, the profitability of our cloud computing services and whether we are able to achieve enough revenue that covers our total costs. For the fiscal year ending March 31, 2017, along with the increase in systems construction revenue which we expect to increase as the Japanese economy recovers, we expect the costs of systems integration revenues to also increase. We should continue to focus on controlling personnel and outsourcing costs adequately as well as carefully consider the timing of increasing facilities and equipment for IIJ GIO as cloud computing services require a large upfront investment.

#### *Costs of ATM Operation Business*

The cost of our ATM operation business consists primarily of systems related costs including up-front system development and outsourcing related costs. For the fiscal year ended March 31, 2016, the ATM operation business recorded approximately ¥2.6 billion in costs. Along with the increased number of serviced ATMs, additional capital

expenditures including capitalized leases related to the placement of ATMs in places such as Japanese pinball parlors, operation and maintenance fees and other costs will increase.

### Sales and marketing

Our sales and marketing expenses consist primarily of personnel expenses related to sales and marketing activities, general advertising expenses and sales commission. Our sales and marketing expenses should increase to the extent that we expand our operations, hire additional employees and increase our sales and marketing activities such as promotion of our cloud services and mobile services for consumers. Sales commission expenses for our sales channels should also increase as we acquire more subscriptions for our mobile services for consumers. We expect sales and marketing expenses to increase in the fiscal year ending March 31, 2017 as we expand our business, increase the number of sales personnel and further promote our cloud computing services and mobile services for consumers. Sales and marketing expenses were ¥10.6 billion for the fiscal year ended March 31, 2016, compared to ¥9.2 billion for the previous fiscal year.

### General and administrative

Our general and administrative expenses primarily include expenses associated with our management, accounting, finance and administrative functions, including personnel expenses. We relocated our head office in the fiscal year ended March 31, 2015. In regards to the contract for the new head office specifically, the related office rent expenses should be reduced for a certain period. Our general and administrative expenses will increase to the extent that we grow our business and hire new employees. We expect general and administrative expenses to increase in the fiscal year ending March 31, 2017 in accordance with our business growth.

### Research and development

Our research and development expenses include primarily expenses associated with personnel expenses related to research and development activities. Our research and development expenses will increase to the extent that we expand our research and development activities. We expect the research and development expenses to slightly increase for the fiscal year ending March 31, 2017.

### Other income (expenses)

Our other income and expenses include interest income and expenses and other primary items such as foreign exchange gains or losses, net gain on other investments and impairment losses on other investments.

**Interest expense:** Most of our interest expense is from capital leases and bank borrowings. Interest income and interest expenses are also affected by the fluctuation of market interest rates and our total amount of outstanding borrowings. If we increase capital leases or borrowings in order to finance further development of our backbone, data centers and for other investments, interest expenses will increase.

**Foreign exchange losses:** Attributed to the weaker Japanese yen against the U.S. dollar and British pound, we recognized foreign currency losses of ¥71 million for the fiscal year ended March 31, 2016. The assets held by us which are exposed to foreign currency exchange risk are mainly U.S. dollar and British pound denominated bank deposits.

**Net gain on other investments:** Gain on other investments are mostly raised from available-for-sale securities and fund investments. Fluctuations in the fair value of other investments may affect our financial results. Currently we do not expect that we will have large capital gains or losses from other investments for the fiscal year ending March 31, 2017.

**Impairment of other investments:** We hold other investments comprised of available-for-sale securities, nonmarketable equity securities and funds. If the fair value of other investments becomes lower than its costs and such decline in fair value is evaluated as other-than-temporary, we will have to recognize an impairment loss on investment.

E. Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements as is defined for purposes of Item 5.E. of Form 20-F.

## F. Tabular Disclosure of Contractual Obligations

The following table shows our material contractual payment obligations under our agreements as of March 31, 2016:

Contractual Obligations	Payments due by period (in millions of yen)				
	Total	less than 1 year	1-3 years	3-5 years	more than 5 years
Capital lease obligations	¥12,162	¥4,142	¥5,401	¥2,281	¥338
Operating lease obligations	7,105	4,450	2,138	242	275
Total <sup>(1)</sup> <sup>(2)</sup>	¥19,267	¥8,592	¥7,539	¥2,523	¥613

The table above does not include short term borrowings. For short term borrowings, see Item 5.B “Liquidity and (1)Capital Resource” and Note 11 “Borrowings” to our consolidated financial statements included in this annual report on Form 20-F.

The table above does not include obligations for interest payments on debt, as such payments are not material. For (2)interest payments regarding capital lease, see Note 9 “Leases” to our consolidated financial statements included in this annual report on Form 20-F.

## G. Safe Harbor

This annual report contains forward-looking statements about us and our industry that are based on our current expectations, assumptions, estimates and projections. These forward-looking statements are subject to various risks and uncertainties. These statements discuss future expectations, identify strategies, discuss market trends, contain projections of results of our operations and our financial condition, and state other forward-looking information. Known and unknown risks, uncertainties and other factors could cause our actual results to differ materially from those contained in or suggested by any forward-looking statement. We cannot provide any assurance that our expectations, projections, anticipated estimates or other information expressed in these forward-looking statements will turn out to be correct. We do not undertake any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Important risks and factors that could cause our actual results to differ materially from our forward-looking statements are generally provided in Item 3.D. “Risk Factors” and elsewhere in this annual report on Form 20-F and include, without limitation:

that we may not be able to achieve or sustain profitability in the near future,  
that we may not be able to compete effectively against competitors which have greater financial, marketing and other resources,  
that our investments in our new business and service developments may not produce the returns we expect or may affect our results of operations and financial condition adversely, and  
that our investments in our subsidiaries and affiliated companies may not produce the returns that we expect or may adversely affect our results of operations and financial condition.



## Item 6. Directors, Senior Management and Employees

## A. Directors and Senior Management

The Company's Board of Directors consists of 13 directors, including four outside directors. The Company's Board of Company Auditors consists of four company auditors, three of whom are outside company auditors, including an attorney from a Japanese law firm and a certified public accountant. Further, the Company has an internal auditing office consisting of three members.

Additionally, we introduced an executive officer system in 2010 with the aim of further enhancing our corporate governance by separating its decision making, supervisory function and business execution function.

There is no family relationship between any director or executive officer and any other director or executive officer. The following table provides information about our directors and company auditors as of June 27, 2016.

Name	Position	Date of birth	Current term expires	Initial appointment date	Numbers of Shares Owned <sup>(1)</sup>	Percentage of Shares Owned <sup>(1)</sup>
Koichi Suzuki	Chairman, Chief Executive Officer and Representative Director	Sep. 3, 1946	June 2017	Dec. 1992	1,815,198	3.89% <sup>(2)</sup>
Eijiro Katsu	President, Chief Operating Officer and Representative Director	June 19, 1950	June 2017	June 2013	14,598	0.03%
Hideshi Hojo	Senior Managing Director	Dec. 22, 1957	June 2017	June 2000	24,929	0.05%
Takeshi Kikuchi	Senior Managing Director	Apr. 27, 1959	June 2018	June 2010	59,538	0.13%
Akihisa Watai	Managing Director, Chief Financial Officer and Chief Accounting Officer	Sep. 30, 1965	June 2018	June 2004	12,264	0.03%
Tadashi Kawashima	Managing Director	Feb. 27, 1963	June 2017	June 2015	429	0.00%
Junichi Shimagami	Director	Apr. 17, 1967	June 2017	June 2015 <sup>(3)</sup>	8,764	0.02%

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Yasuro Tanahashi	Director	Jan. 4, 1941	June 2018	June 2004	0	—
Junnosuke Furukawa	Director	Dec. 5, 1935	June 2017	June 2005	0	—
Shingo Oda	Director	Nov. 8, 1944	June 2018	June 2008	0	—
Toshinori Iwasawa	Director	May 8, 1962	June 2017	June 2013	938	0.00%
Tadashi Okamura	Director	July 26, 1938	June 2017	June 2015	0	—
Hiroki Watanabe	Director	Mar. 15, 1953	June 2017	June 2015	0	—
Kazuhiro Ohira	Company Auditor	Dec. 26, 1957	June 2020	June 2010	0	—
Chiaki Furuya	Company Auditor	July 11, 1949	June 2017	June 2013	7,700	0.02%
Yasuhiro Akatsuka	Company Auditor	Feb. 10, 1947	June 2020	June 2016	0	—
Takashi Michishita	Company Auditor	Feb. 1, 1969	June 2020	June 2016	0	—

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(1) The number of IIJ shares owned as of June 27, 2016.

(2) Mr. Koichi Suzuki jointly owns IIJ stocks through his wholly owned private company called KS Holdings which holds 1.73% of the total company outstanding shares as of March 31, 2016.

(3) Mr. Junichi Shimagami was a director of the company from June 2007 to March 2010.

**Koichi Suzuki** is one of the founders of IIJ and has approximately 30 years of experience in the computer and communications industries. He was appointed as president, representative director and Chief Executive Officer in April 1994. In June 2013, he became our chairman, representative director, and Chief Executive Officer. In addition, Mr. Suzuki is chairman and president of hi-ho, and president of IIJ-EG and Multifeed. He also serves as chairman of IIJ-America, and a director of IIJ-Global, Trinity and IIJ-II. From December 1992 to April 1994, Mr. Suzuki was a director of IIJ. Prior to joining us, Mr. Suzuki was employed at Japan Management Association where he served as a general manager.

**Eijiro Katsu** joined IIJ in November 2012 and was appointed as president, representative director and Chief Operating Officer in June 2013. Prior to joining IIJ, he worked at the Ministry of Finance in Japan and serviced as Vice Minister from July 2010 to August 2012.

**Hideshi Hojo** joined IIJ in 1996. He has served as senior managing director of IIJ since June 2006. Mr. Hojo is also a director of i-revo and NCJ. Since April 2014, he has been in charge of Asian business development. From February 1998 to June 2000, Mr. Hojo acted as general manager of the Sales Division, from June 2000 to June 2002 as a director and from June 2002 to 2006 as managing director. Prior to joining us, Mr. Hojo had 16 years of experience in the field of sales working for the Itochu Group.

**Takeshi Kikuchi** was appointed as senior managing director of IIJ in June 2010 and is serving as executive division director in charge of Business Unit (Sales Divisions). Mr. Kikuchi joined Itochu Corporation in April 1983 and was temporarily seconded to IIJ from April 1996. In July 1999, Mr. Kikuchi joined IIJ-Tech and was president of IIJ-Tech from October 2005 to March 2010.

**Akihisa Watai** was appointed as managing director of IIJ in June 2010 and is serving as division director of the Finance Division. Mr. Watai has served as chief financial officer and chief accounting officer since June 2004. In addition, Mr. Watai is a director of NCJ, Trinity, Trust Networks and RYUKOSHA, and a company auditor of i-revo, IIJ-Global and IIJ-II. From June 2004 to March 2010, Mr. Watai served as director of IIJ. Mr. Watai joined The Sumitomo Bank, Limited (currently Sumitomo Mitsui Banking Corporation) in April 1989 and was temporarily seconded to IIJ from August 1996. In February 2000, Mr. Watai joined IIJ permanently and has been general manager of the Finance Division from April 2004 to March 2016.

**Tadashi Kawashima** has served as a managing director of IIJ since June 2015 and is serving as deputy executive division director in charge of Business Unit (Sales Divisions). Mr. Kawashima joined NTT DATA Corporation in July 1988 and served as Senior Specialist of Public and Financial IT Service Company. Mr. Kawashima served as President and Representative Director of NTT Data Tokai Corporation from June 2013 to June 2015.

***Junichi Shimagami*** has served as a director and Chief Technology Officer of IIJ since June 2015 and is serving as division director in charge of Technology Unit (Technology Divisions) since April 2016. Mr. Shimagami is also a director of Multifeed and hi-ho. Mr. Shimagami served as a director of the Company from June 2007 to March 2010. Mr. Shimagami joined us in 1996. Prior to joining us, Mr. Shimagami worked at Nomura Research Institute, Ltd., which he joined in April 1990.

***Yasuou Tanahashi*** has served as an outside director of IIJ since June 2004. Mr. Tanahashi served as an advisor of NS Solutions Corporation, an affiliated company of Nippon Steel Corporation from June 2007 to June 2009. Mr. Tanahashi had been president and representative director of NS Solutions Corporation since April 2000 and had been chairman of NS Solutions Corporation since April 2003.

**Junnosuke Furukawa** has served as an outside director of IIJ since June 2005. Mr. Furukawa has been an advisor or honorary advisor of The Furukawa Electric Co., Ltd since May 2005. From June 1995 to June 2003, Mr. Furukawa was president and CEO of The Furukawa Electric Co., Ltd. and from June 2003 to June 2004, Mr. Furukawa was chairman and CEO of The Furukawa Electric Co., Ltd. Mr. Furukawa was a director, member of the board and senior advisor of The Furukawa Electric Co., Ltd. from June 2004 to May 2005.

**Shingo Oda** has served as an outside director of IIJ since June 2008. From May 2005 to November 2007, Mr. Oda was president and representative director of Hewlett-Packard Japan, Ltd. From February 2002 to May 2005, Mr. Oda was vice president and representative director of Hewlett-Packard Japan, Ltd.

**Toshinori Iwasawa** was appointed as director of IIJ in June 2013. Mr. Iwasawa has been president and representative director of IIJ-Global since September 2010. Prior to joining IIJ-Global, he was a representative director at AT&T Japan LLC. and worked for IBM Japan from 1985.

**Tadashi Okamura** has served as an outside director of IIJ since June 2015. Mr. Okamura joined Toshiba Corporation in April 1962, and served as Chief Executive Officer of Toshiba Corporation from June 2000 to June 2005 and as Chairman of Toshiba Corporation from June 2005 to June 2009. Mr. Okamura has been serving as an adviser to the Board of Toshiba Corporation since June 2009 and became an honorary advisor to Toshiba Corporation in June 2016.

**Hiroki Watanabe** has served as an outside director of IIJ since June 2015. Mr. Watanabe joined NTT in April 1976 and served as Representative Director and Senior Executive Vice President of NTT from June 2012 to June 2014.

**Kazuhiro Ohira** was appointed as company auditor of IIJ in June 2010. Mr. Ohira is a company auditor of Trust Networks, NCJ, IIJ-Global, Trinity and RYUKOSHA. Mr. Ohira was General Manager of International Business Management Dept. of Dai-Ichi Life Insurance Company, Ltd.

**Chiaki Furuya** was appointed as an auditor of IIJ in June 2013. Mr. Furuya joined us in October 2008 and has worked as a managing director and senior executive officer. Prior to joining IIJ, he worked at NHK, Japan Broadcasting Corporation, from 1973 to 2007. He is also an auditor for IIJ-EG and hi-ho.

**Yasuhiro Akatsuka** has been an outside company auditor of IIJ since June 2016. Mr. Akatsuka is a Japanese Certified Public Accountant and joined Deloitte Haskins & Sells (currently Deloitte Touche Tohmatsu LLC) in November 1972. Mr. Akatsuka left Deloitte Touche Tohmatsu LLC in September 2011 and has been serving as senior technical director of The Japanese Institute of Certified Public Accountants.

***Takashi Michishita*** has been an outside company auditor of IIJ since June 2016. Mr. Michishita admitted to the Tokyo Bar Association and joined Asahi Law Office (currently Nishimura & Asahi LPC) in April 1994. Mr. Michishita has been a partner at Nishimura & Asahi LPC since July 2007.

The following table provides information about our executive officers as of June 27, 2016.

Name	Position and Major Responsibility
Kazuhiro Tokita	Senior Executive Officer in charge of Financial System Business Division, Advanced Security Division and Health Care Business Department
Masayoshi Tobita	CISO, Managing Executive Officer in charge of Administrative Division and General Manager of Business Unit Management Division
Kiyoshi Ishida	Managing Executive Officer in charge of Network Division
Naoshi Yoneyama	Managing Executive Officer in charge of Corporate Planning Division
Makoto Ajsaka	Managing Executive Officer in charge of Service Product Business Division
Yoshikazu Yamai	Managing Executive Officer in charge of Service Infrastructure Division
Yasumitsu Iizuka	Executive Officer in charge of Government, Public & Educational Organization Business Division
Koichi Maruyama	Executive Officer in charge of Global Business Division
Naoya Kaihara	Executive Officer in charge of West Japan Business Division
Seiji Okita	Executive Officer in charge of Outsourcing Division
Masakazu Tachikui	Executive Officer in charge of Cloud Division
Masami Kawamata	Executive Officer in charge of Accounting and General Manager of Accounting Department

## B. Compensation

The aggregate compensation to the IIJ's directors and company auditors during the fiscal year ended March 31, 2016 was as follows:

Position	Breakdown of Compensation (in millions of yen)					Number of Persons
	Total Compensation	Base Salary	Stock Option	Liability for Retirement Benefit	Others	
Directors *	¥ 292	¥256	¥ 36	–	¥ 0	9
Company Auditor **	18	16	–	¥ 2	0	1
Outside Directors/ Outside Company Auditors	35	34	–	1	0	8

Starting with its annual securities report for the year ended March 31, 2010 filed with the Ministry of Finance, a Japanese listed company is required to disclose the individual compensation of any director, executive officer or corporate auditor if it is ¥100 million or more. For fiscal year ended March 31, 2016, there was no director, executive officer or corporate auditor who received compensation of over ¥100 million.

Upper limits on compensation for directors and company auditors are determined at a general meeting of shareholders of the Company. Within the upper limit approved by the shareholders' meeting, the Board of Company Auditors will determine the amount of compensation for each company auditor.

(3) Please see Item 6.E. "Share Ownership" for more detailed information concerning our stock options.

\* Excluding Outside Directors

\*\* Excluding Outside Company Auditors

The retirement benefit plan for full-time directors of IIJ was abolished in June 2011. We recorded a liability for retirement benefits for full-time directors of ¥380 million, which would be required if they retire as of March 31, 2016. For a description of our stock option and warrant issuances to directors and employees, see Item 6.E.

## C. Board Practices

An amendment to the Corporation Law of Japan was enacted on June 20, 2014. The amended Corporation Law came into effect on May 1, 2015. From here on, "Corporation Law" refers to the amended Corporation Law.



In accordance with the Corporation Law and our Articles of Incorporation, our directors are elected at a general meeting of shareholders and our Board of Directors consists of minimum of 3 and maximum of 14 directors. While the normal term of office of a director is two years, a director may serve any number of consecutive terms. We do not have audit or remuneration committees, as is the standard practice in Japan. We do not have any service contracts with any of our directors providing for benefits upon termination of their employment.

We have a Board of Company Auditors as well as an accounting auditor who is an independent certified public accountant or an auditing corporation. In accordance with the Corporation Law and our Articles of Incorporation, our Board of Company Auditors consists of a minimum of three company auditors, of whom at least half must be from outside of the company, and company auditors are elected at a general meeting of shareholders. Currently, three of our four company auditors are outside company auditors. While the normal term of office of a company auditor is four years, a company auditor may serve any number of consecutive terms. Our company auditors are under a statutory duty to supervise the execution of duties by the directors, to investigate proposals and documents to be submitted by the Board of Directors to the general meetings of shareholders and report their opinions thereon to the shareholders, if necessary. They are required to attend meetings of the Board of Directors and to express their opinions if necessary, but they are not entitled to vote. Each of our company auditors also have a statutory duty to audit business reports and examine the audit report on our financial statements prepared by our accounting auditor, and provide a report thereon to the entire Board of Company Auditors, which must, in turn, submit its audit report to the Board of Directors and/or the general meetings of shareholders. The Board of Company Auditors will also determine matters relating to the duties of company auditors, such as audit policy and methods of investigation of our affairs.

Following the requirements of the Corporation Law, we require a director to obtain the approval of the Board of Directors in order for such director to accept a transfer of a product or any other asset of IJJ, to transfer a product or any other asset of such director to IJJ, to receive a loan from IJJ, or to effect any other transaction with IJJ, for himself or a third party.

If we issue common shares or other shares, stock acquisition rights or bonds with stock acquisition rights under the Corporation Law, it is necessary for the Board of Directors to determine the conditions of issuance. Additionally, (i) if the company issues such securities to persons other than shareholders (in the case of common shares or other shares) at a specially favorable issue price or (in the case of stock acquisition rights or bonds with stock acquisition rights) on specially favorable conditions, even if there are provisions related thereto in the Articles of Incorporation, some matters related to such issuance are to be resolved by a special resolution of a shareholders' meeting and (ii) if the company issues such securities to persons other than shareholders whereby the persons will hold more than 50% of the voting rights of all shareholders, the company is to provide notice (including public notice) to its shareholders in advance and if shareholders who hold 10% or more of the voting rights of all shareholders provide notice to the company to dissent from such issuance of securities, an approval by a resolution of a general meeting of shareholders is generally required before the payment date for such issuance or transfer pursuant to the Corporation Law.

The rights of ADR holders, including their rights relating to corporate governance practices, are provided in the deposit agreement which is an exhibit to this annual report.

#### Limitation of Liabilities of some outside Directors and Auditors

As of June 30, 2016, we have entered into an agreement with five of our outside directors, Mr. Junnosuke Furukawa, Mr. Shingo Oda, Mr. Tadashi Okamura, Mr. Yasuro Tanahashi and Mr. Hiroki Watanabe, and two of our outside company auditors, Mr. Yasuhiro Akatsuka and Mr. Takashi Michishita that limits their liabilities to us for damages suffered by us due to their acts taken in good faith and without gross negligence, amounting to ¥10 million or the aggregate of the amounts set forth in Article 427 paragraph 1 of the Corporation Law, whichever is higher. Under the former Corporation Law, we were allowed to enter into such agreements only with outside directors, outside auditors, accounting advisors and accounting auditors, but under the Corporation Law, which amended the range of directors and company auditors that are allowed to be a party to such agreements, we are allowed to enter with all directors (excluding those who are executive directors and who serve in certain other roles in corporate governance.) (hereinafter referred to as “non-executive directors”) and all company auditors. However, we have decided not to enter into such agreements with non-executive directors and company auditors other than our outside directors and outside auditors above. For further discussion, see Item 10.C. Material Contracts and Exhibit 4.5 of this annual report.

## D.

## Employees

As of March 31, 2016, we had 2,980 employees, including employees of our consolidated subsidiaries, and we had 2,835 employees as of March 31, 2015 and 2,353 employees as of March 31, 2014. The following table shows the breakdown of the employees by main category of activity.

	For the fiscal year ended March 31,		
	2014	2015	2016
	(number of employees)		
Engineering	1,606	2,008	2,121
Sales	440	501	516
Administration	307	326	343

We have never experienced any labor disputes and consider our labor relations to be good. To our knowledge, none of our employees are members of any union.

## E.

## Share Ownership

The information on share ownership required by this item is in Item 6.A. “Directors and Senior Management” above.

## Stock Option Plan

**Stock compensation-type stock option.** A stock compensation-type stock option is a stock acquisition right entitling its holder to acquire shares upon the exercise of a stock acquisition right at an exercise price of one yen (¥1) per share. Stock compensation-type stock options are allocated to directors and executive officers as a substitution for the retirement allowance planned for them and to further motivate and incentivize them to enhance IJJ’s middle- to long-term business performance and corporate value. On May 26, 2011, IJJ’s board of directors resolved to introduce stock compensation-type stock options for executive officers of IJJ. On June 28, 2011, IJJ’s ordinary general meeting of shareholders approved the introduction of stock compensation type stock options for directors of IJJ.

1st Series (issued in July 2011)

138 rights

2nd Series (issued in July 2012)

130 rights

(1) Total number of Stock Acquisition Rights:

27,600 shares of the Company's common stock (The number of shares to be issued or transferred for each Stock Acquisition Rights shall be 200 shares. This number is adjusted from 1 share to 200 shares due to the effect of the stock split conducted on October 1, 2012)

26,000 shares of the Company's common stock (The number of shares to be issued or transferred for each Stock Acquisition Rights shall be 200 shares. This number is adjusted from 1 share to 200 shares due to the effect of the stock split conducted on October 1, 2012)

(2) Class and total number of shares underlying the Stock Acquisition Rights:

(3) Amount to be paid in exchange for the Stock Acquisition Rights:

¥259,344 per option (The fair value of stock acquisition rights used to recognize compensation expense was estimated using the Black-Scholes option-pricing model)

¥318,562 per option. (The fair value of stock acquisition rights used to recognize compensation expense was estimated using the Black-Scholes option-pricing model)

(4) Exercise period of stock acquisition rights:

From July 15, 2011 to July 14, 2041

From July 14, 2012 to July 13, 2042

(5) Position and number of persons to be allotted the stock acquisition rights and the number of stock acquisition rights to be allotted:

- Directors (excluding Part-time and Outside Directors) of IJJ: 6 Directors, 89 rights

- Executive Officers of IJJ: 8 Executive Officers, 49 rights

- Directors (excluding Part-time and Outside Directors) of IJJ: 6 Directors, 74 rights

- Executive Officers of IJJ: 11 Executive Officers, 56 rights

	3rd Series (issued in July 2013)	4th Series (issued in July 2014)
(1) Total number of Stock Acquisition Rights:	89 rights	128 rights
(2) Class and total number of shares underlying the Stock Acquisition Rights:	17,800 shares of the Company's common stock (The number of shares to be issued or transferred for each Stock Acquisition Rights shall be 200 shares)	25,600 shares of the Company's common stock (The number of shares to be issued or transferred for each Stock Acquisition Rights shall be 200 shares)
(3) Amount to be paid in exchange for the Stock Acquisition Rights:	¥647,000 per option. (The fair value of stock acquisition rights used to recognize compensation expense was estimated using the Black-Scholes option-pricing model)	¥422,600 per option. (The fair value of stock acquisition rights used to recognize compensation expense was estimated using the Black-Scholes option-pricing model)
(4) Exercise period of stock acquisition rights:	From July 12, 2013 to July 11, 2043	From July 11, 2014 to July 10, 2044
(5) Position and number of persons to be allotted the stock acquisition rights and the number of stock acquisition rights to be allotted:	- Directors (excluding Part-time and Outside Directors) of IJJ: 7 Directors, 60 rights  - Executive Officers of IJJ: 10 Executive Officers, 29 rights	- Directors (excluding Part-time and Outside Directors) of IJJ: 7 Directors, 88 rights  - Executive Officers of IJJ: 10 Executive Officers, 40 rights

	5th Series (issued in July 2015)
(1) Total number of Stock Acquisition Rights:	151 rights
(2) Class and total number of shares underlying the Stock Acquisition Rights:	30,200 shares of the Company's common stock (The number of shares to be issued or transferred for each Stock Acquisition Rights shall be 200 shares)
(3) Amount to be paid in exchange for the Stock Acquisition Rights:	¥369,200 per option. (The fair value of stock acquisition rights used to recognize compensation expense was estimated using the Black-Scholes option-pricing model)
(4) Exercise period of stock acquisition rights:	From July 14, 2015 to July 13, 2045
(5) Position and number of persons to be allotted the stock acquisition rights and the number of stock acquisition rights to be allotted:	- Directors (excluding Part-time and Outside Directors) of IJJ: 7 Directors, 100 rights  - Executive Officers of IJJ: 11 Executive Officers, 51 rights

*6th Series (To be issued in July 2016)*

- (1) Maximum number of Stock Acquisition Rights to be determined on July 11, 2016: 241 rights  
Class of shares underlying the Stock Acquisition Rights, the Company's common stock
- (2) and the total number of shares underlying the Stock Acquisition Rights to be determined accordingly with the number of stock acquisition rights to be allotted (The number of shares to be issued or transferred for each Stock Acquisition Rights shall be 200 shares)  
Amount to be paid in exchange for the Stock Acquisition Rights is to be determined on
- (3) July 11, 2016 based on the fair value of stock acquisition rights used to recognize compensation expense was estimated using the Black-Scholes option-pricing model.
- (4) Exercise period of stock acquisition rights: From July 12, 2016 to July 11, 2046.
- (5) Position and number of persons to be allotted the stock acquisition rights and the maximum number of stock acquisition rights to be allotted:
  - (i) Directors (excluding Part-time and Outside Directors) of IJJ: 7 Directors, 157 rights
  - (ii) Executive Officers of IJJ: 12 Executive Officers, 84 rights

Class and total number of shares to be acquired by exercising stock acquisition rights outstanding, as of March 31, 2016, is as follows:

	1st Series (issued in July 2011)	2nd Series (issued in July 2012)	3rd Series (issued in July 2013)	4th Series (issued in July 2014)	5th Series (issued in July 2015) Common stock
Outstanding: Class and total	Common stock	Common stock	Common stock	Common stock	Common stock
number of shares to be acquired	21,400 shares	20,800 shares	15,600 shares	23,400 shares	30,200 shares

### Employee Stock Purchase Plan

The Group Employee Stock Purchase Plan, which was implemented in December 1995, provides designated employees with the opportunity to purchase shares at market value. Shares are basically held in the name of the group employee stock purchase program until employees leave the association, due to resignation or retirement. The representative of the employee shareholders' association exercises voting rights in accordance with the instructions of each employee shareholder. As of March 31, 2016, the association holds 443,500 shares of common stock, or 0.94% of our outstanding shares.

### Director Stock Purchase Plan

The Director Stock Purchase Plan was implemented in November 2007. On April 1, 2010, the plan was amended in connection with the introduction of the Executive Officer System. The plan provides designated directors and executive officers of IIJ and its wholly-owned subsidiaries in Japan with the opportunity to purchase IIJ common shares at market value, every month, with a fixed amount of their own money through a designated security broker.

## Item 7. Major Shareholders and Related Party Transactions

## A. Major Shareholders

The following table shows information regarding beneficial ownership of our common stock as of March 31, 2016 by each shareholder known by us to own beneficially more than 5% of our common stock and all directors and executive officers as a group. We are not required by Japanese law to disclose beneficial ownership of our common stock. As explained in “Reporting Requirements of Shareholders—Report of Substantial Shareholdings” in Item 10.B. of this annual report on Form 20-F, any person who becomes, beneficially and solely or jointly, a holder of more than 5% of our outstanding common stock must file a report with the relevant local finance bureau of the Ministry of Finance. The information in this table is based upon our shareholders of record and reports filed with the Financial Services Agency and the SEC.

	Outstanding Voting Shares	
	as of March 31, 2016 <sup>(4)</sup>	
	Number	Percentage
Nippon Telegraph and Telephone Corporation and affiliates <sup>(1)</sup>	12,135,000	26.4 %
Koichi Suzuki <sup>(2)</sup>	2,623,900	5.7
Directors, executive officers and company auditor as a group <sup>(3)</sup>	2,883,600	6.3

(1) Includes NTT, which owned 10,095,000 shares, or 22.0% of our outstanding voting shares and 21.6% of our total issued shares, and NTT Communications, which owned 2,040,000 shares, or 4.4% of our outstanding voting shares and 4.4% of our total issued shares.

(2) Mr. Koichi Suzuki directly held 3.9% of our outstanding voting shares and 1.8% indirectly through his wholly owned private company called KS Holdings.

(3) Includes Koichi Suzuki’s holdings which are also separately set forth above. No other director or executive officer except for Koichi Suzuki was a beneficial owner of more than 5%.

(4) As of March 31, 2016, the Company held 758,709 shares of the Company as treasury stock.

Our major shareholders have the same voting rights as other holders of our common stock.



According to our register of shareholders, as of March 31, 2016, there were 7,836 holders of common stock of record worldwide. As of March 31, 2016, The Bank of New York Mellon, depositary for our ADSs, held 2.2% of the outstanding common stock on that date. According to The Bank of New York Mellon, as of March 31, 2016, there were 1,753 ADR holders of record with addresses in the United States. Because some of these shares were held by brokers or other nominees, the number of record holders with addresses in the United States might not fully show the number of beneficial owners in the United States. Of the 46,711,400 shares of common stock outstanding as of March 31, 2016, 1,016,198 shares were held in the form of 2,032,396 ADSs. As of March 31, 2016, the Company held 758,709 shares of the Company as treasury stock.

To the knowledge of the Company, it is not directly or indirectly owned or controlled by any other corporation, by any government, or by any other natural or legal person or persons severally or jointly. As far as is known to the Company, there are no arrangements, the operation of which may at a subsequent date, result in a change in control of IJ.

## B. Related Party Transactions

**NTT-affiliated Companies.** The Company entered into a number of different types of transactions with NTT and its subsidiaries including purchases of wireline telecommunication services for the Company's offices and capital lease arrangements. On an ongoing basis in the ordinary course of business, for the Company's connectivity and outsourcing services, the Company purchases international and domestic backbone services, local access lines, rental rack space in data centers and mobile services from NTT and its subsidiaries. The Company sells to NTT and its subsidiaries its services, systems integration services and monitoring services for their data centers. For the fiscal year ended March 31, 2016, we have spent ¥23.0 billion in the aggregate for international and domestic backbone, local access line, mobile connectivity costs, lines for WAN services and co-location costs to NTT and its subsidiaries such as NTT Communications, NTT East, NTT West and NTT Docomo. As of March 31, 2016 we had ¥1.8 billion of lease obligations with NTT FINANCE.

All the transactions entered into with NTT and its affiliates are entered in the ordinary course of business. Mr. Kawashima, one of our directors, was an employee of NTT DATA Corporation and was Representative Director of NTT DATA TOKAI Corporation, and Mr. Watanabe, one of our outside directors, was Representative Director and Senior Executive Vice President of NTT from June 2012 to June 2014. There is no shareholders' agreement in place with NTT, its affiliates or any other party for the appointment of any of our directors.

**Transactions with equity method affiliates.** In the ordinary course of business, we have various sales, purchase and other transactions with companies which are owned 20% to 50% by us and are accounted for by the equity method. Account balances and transactions with such 20% to 50% owned companies as of and for the fiscal year ended March 31, 2016 are presented as follows:

	millions of yen
Accounts receivable	¥ 122
Accounts payable	47
Revenues	659
Costs and Expenses	502

**Transactions with Outside Directors and Auditors.** On June 25, 2014, we entered into agreements on limited liability with Mr. Yasurou Tanahashi and Mr. Shingo Oda as our outside directors. On June 26, 2015 we entered into additional agreements on limited liability with Mr. Tadashi Okamura, Mr. Hiroki Watanabe, and Mr. Junnosuke Furukawa. On June 24, 2016 we entered into an additional agreement on limited liability with Mr. Yasuhiro Akatsuka and Mr. Takashi Michishita as our outside auditors, pursuant to which their liability for damages sustained by us as a result of their actions is limited to an aggregate of ¥10 million. For further discussion, see Item 10.C. Material Contracts and Exhibit 4.5 of this annual report.

See Note 22 “Related Party Transactions” and Note 6 “Investments in Equity Method Investees” to our consolidated financial statements, included in this annual report on Form 20-F.

C. Interests of Experts and Counsel

Not applicable.

## Item 8. Financial Information

### A. Consolidated Statements and Other Financial Information

#### Financial Statements

The consolidated financial statements required by this item begin on page F-1.

#### Legal or Arbitration Proceedings

The information on legal or arbitration proceedings required by this item is in Item 4.B.

#### Dividend Policy

Our basic dividend policy is that we pay dividends to our shareholders continuously and in a stable manner while considering the need to have retained earnings for the enhancement of financial position, middle-to long-term business expansion, future business investment and other goals. Under Japanese law, a company is required to have retained earnings, without accumulated deficit, in order to be able to conduct certain types of capital-related transactions such as payments of dividends in general. The ordinary general meeting of shareholders held in June 2006 approved the elimination of accumulated deficit through the reduction of additional-paid in capital and common stock in our non-consolidated financial statements under generally accepted accounting principles in Japan. For the fiscal year ended March 31, 2016, IJ paid total cash dividend of ¥22.00 per share of common stock.

### B. Significant Changes

Except as otherwise disclosed in this annual report on Form 20-F, there has been no significant change in our financial condition since March 31, 2016, the date of our last audited financial statements.



## Item 9. The Offer and Listing

## A. Offer and Listing Details

ADSs representing our common stock have been quoted on the NASDAQ market since August 4, 1999 under the symbol “IIJ” and were transferred from the NASDAQ Global Market to the NASDAQ Global Select Market on June 11, 2007. The current ADS/share ratio is 2 ADSs per 1 share of our common stock. Our shares of common stock had been quoted on the Mothers market of the TSE since December 2, 2005 under the stock code number “3774” and were transferred to the First Section of the TSE on December 14, 2006.

The following table shows, for the periods indicated, the high and low price of our ADSs and shares of common stock on the TSE for the periods indicated:

Fiscal year ended/ending March 31,	NASDAQ <sup>(1)</sup> (per ADS)		TSE <sup>(1) (2)</sup> (per share of common stock)	
	High	Low	High	Low
2011	\$8.37	\$5.08	¥1,460	¥815
2012	11.78	6.67	1,830	1,128
2013	17.30	8.24	3,300	1,326
2014	21.21	8.71	4,365	1,797
2015				
First Quarter	12.95	10.11	2,700	2,048
Second Quarter	12.62	9.61	2,589	2,046
Third Quarter	10.92	7.56	2,647	1,802
Fourth Quarter	10.93	8.07	2,657	1,941
2016				
First Quarter	10.01	7.78	2,175	1,910
Second Quarter	10.20	8.00	2,554	2,002
Third Quarter	10.29	8.01	2,508	1,987
Fourth Quarter	10.92	8.62	2,489	1,995
Month				
January 2016	10.49	8.62	2,489	1,995
February 2016	10.24	9.05	2,331	2,007
March 2016	10.92	9.99	2,438	2,243
April 2016	11.12	9.54	2,322	2,081
May 2016	11.13	9.81	2,464	2,107
June 2016 (through June 24, 2016)	11.00	9.24	2,449	1,901

(1) Price data are based on prices throughout the sessions for each corresponding period at each stock exchange.

(2) We conducted a 1 to 200 stock split on common stock with an effective date of October 1, 2012. The figures are retroactively adjusted to reflect the stock split.

B.

Plan of Distribution

Not applicable.

C.

Markets

ADSs representing our common stock have been quoted on the NASDAQ market since August 4, 1999 under the symbol "IIJI" and on June 11, 2007 were transferred from the NASDAQ Global Market to the NASDAQ Global Select Market. Our shares of common stock have been quoted on the Mothers market of the TSE since December 2, 2005 under the stock code number "3774" and were transferred to the First Section of the TSE on December 14, 2006.

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the issue

Not applicable.



Item 10. Additional Information

A. Share Capital

Not required.

B. Memorandum and Articles of Association

Organization

IIJ is a joint stock corporation (kabushiki kaisha) incorporated in Japan under the Corporation Law. It is registered in the Commercial Register (shogyo tokibo) maintained by the Tokyo Legal Affairs Bureau and several other registry offices of the Ministry of Justice.

Objects and Purposes in Our Articles of Incorporation

Article 2 of our Articles of Incorporation states our objects and purposes:

- Telecommunications business under the Telecommunications Business Law,
- Processing, mediation and provision of information and contents by using telecommunications networks,
- Agency for the management business such as the management of networks and the management of information and telecommunications systems,
- Planning, consulting service, development, operation and maintenance of or for information and telecommunications systems,
- Development, sales, lease and maintenance of computer software,
- Development, sales, lease and maintenance of telecommunications machinery and equipment,
- Telecommunications construction,
- Agency for non-life insurance,
- Research, study, education and training related to the foregoing, and
- Any and all businesses incidental or related to the foregoing.

Provisions Regarding Our Directors

There is no provision in our Articles of Incorporation as to a director's power to vote on a proposal, arrangement or contract in which the director is materially interested, but the Corporation Law provides that such director is required to refrain from voting on such matters at the Board of Director's meetings.

The Corporation Law provides that compensation for directors is determined at a general meeting of shareholders of a company. Within the upper limit approved by the shareholders' meeting, the Board of Directors will determine the amount of compensation for each director. The Board of Directors may, by its resolution, leave such decision to the president's discretion.

The Corporation Law provides that a significant loan from a third party to a company should be approved by the Board of Directors. Our regulations of the Board of Directors have adopted this policy.

There is no mandatory retirement age for directors under the Corporation Law or our Articles of Incorporation.

There is no requirement concerning the number of shares one individual must hold in order to qualify him or her as a director under the Corporation Law or our Articles of Incorporation.

## Rights of Shareholders of our Common Stock

We have issued only one class of shares, our common stock. Rights of holders of shares of our common stock have under the Corporation Law and our Articles of Incorporation include:

- the right to receive dividends when the payment of dividends has been approved at a shareholders' meeting, with this right lapsing three full years after the due date for payment according to a provision in our Articles of Incorporation,
- the right to receive interim dividends as provided for in our Articles of Incorporation, with this right lapsing three full years after the due date for payment according to a provision in our Articles of Incorporation,
- the right to vote at a shareholders' meeting (cumulative voting is not allowed under our Articles of Incorporation),
- the right to receive surplus in the event of liquidation, and
- the right to require us to purchase shares subject to certain requirements under the Corporation Law when a shareholder opposes certain resolutions including (i) the transfer of all or material part of the business, (ii) an amendment of the Articles of Incorporation to establish a restriction on share transfer, (iii) a share exchange or share transfer to establish a holding company, (iv) company split or (v) merger, all of which must, in principle, be approved by a Special Resolution of Shareholders' meeting.

Under the Corporation Law, a company is permitted to make distribution of surplus to the extent that the aggregate book value of the assets to be distributed to shareholders does not exceed the Distributable Amount provided for under the Corporation Law and the Ordinance of the Ministry of Justice as of the effective date of such distribution of surplus.

The amount of surplus at any given time shall be the amount of a company's assets and the book value of company's treasury stock after subtracting and adding the amounts of the items provided for under the Corporation Law and the applicable Ordinance of the Ministry of Justice.

So long as we maintain the unit share system (see “–Unit share system” below; currently, 100 shares of Common Stock constitute one unit), a holder of shares constituting one or more full units is generally entitled to one vote per one unit of our shares at a shareholders' meeting. In general, under the Corporation Law and our Articles of Incorporation, a shareholders' meeting may adopt a resolution by a majority of the voting rights represented at the meeting. The Corporation Law and our Articles of Incorporation require a quorum for the election of directors and company auditors of not less than one-third of the total number of voting rights held by all shareholders who can exercise their voting rights. A corporate shareholder, having more than one-quarter of its voting rights directly or indirectly held by us, does not have voting rights. We have no voting rights with respect to our own common stock. Shareholders may exercise their voting rights through proxies, provided that a shareholder may appoint only one shareholder who has a voting right as its proxy. Our Board of Directors may entitle our shareholders to cast their votes in writing. Our Board of Directors may also entitle our shareholders to cast their votes by electrical devices.

While the Corporation Law, in general, requires a quorum of the majority of voting rights and approval of two-thirds of the voting rights presented at the meeting of any material corporate actions, it allows a company to reduce the quorum for such Special Resolutions by its Articles of Incorporation to not less than one-third of the total number of voting rights held by all shareholders who can exercise their voting rights. We adopted a quorum of not less than one-third of the total number of voting rights in our Articles of Incorporation for Special Resolutions for material corporate actions, such as:

a reduction of the stated capital (except when a company reduces the stated capital within certain amount provided for under the Corporation Law concurrently with a share issue),

amendment of our Articles of Incorporation (except amendments that the Board of Directors are authorized to make under the Corporation Law),  
establishment of a 100% parent-sub subsidiary relationship through a share exchange or share transfer requiring shareholders' approval,  
a dissolution, merger or consolidation requiring shareholders' approval,  
a company split requiring shareholders' approval,  
a transfer of (i) the whole or an important part of our business, or (ii) the whole or a part of our shares in any of our subsidiaries,  
the taking over of the whole of the business of any other corporation requiring shareholders' approval, and  
issuance of new shares at a specially favorable price, or issuance of stock acquisition rights or bonds with stock acquisition rights with specially favorable conditions to persons other than shareholders.

The Corporation Law provides additional specific rights for shareholders owning a substantial number of voting rights.

Shareholders holding 10% or more of the total number of voting rights of all shareholders (or our total outstanding shares) have the right to apply to a court of competent jurisdiction, or competent court, for:

- dissolution, and
- commencement of reorganization proceedings as provided for in the Company Reorganization Law of Japan.

Shareholders holding 10% or more of the total number of voting rights of all shareholders have the right to dissent from a third-party allotment of securities (including common shares or other shares, stock acquisition rights or bonds with stock acquisition rights) that will give the third-party more than 50% of the voting rights of all shareholders and also have the right to demand approval by a resolution of a general meeting of shareholders.

Shareholders who have held 3% or more of the total number of voting rights of all shareholders (or our total outstanding shares) for six months or more have certain rights under the Corporation Law which includes the rights to:

- demand the convening of a general meeting of shareholders,
- apply to a competent court for removal of a director or company auditor,
- apply to a competent court for removal of a liquidator, and
- apply to a competent court for an order to inspect our business and assets in a special liquidation proceeding.

Shareholders holding 3% or more of the total number of voting rights of all shareholders (or our total outstanding shares) have certain rights under the Corporation Law which include the rights to:

- examine our accounting books and documents and make copies of them, and
- apply to a competent court for appointment of an inspector to inspect our operation or financial condition.

Shareholders who have held 1% or more of the total number of voting rights of all shareholders for six months or more have the right to:

· apply to a competent court for appointment of an inspector to review the correctness of the convocation and voting procedures of a general meeting of shareholders, and

- demand that we take action against the officers of our wholly owned subsidiaries to hold such officers liable.

Shareholders who have held 1% or more of the total number of voting rights of all shareholders or 300 voting rights for six months or more have the right to demand that certain matters be made objects and added to the agenda items at a general meeting of shareholders.

Shareholders who have held any number of shares for six months or more have the right to demand that we take certain actions under the Corporation Law which include the rights to demand:

- the institution of an action to enforce the liabilities of our directors or company auditors,
- the institution of an action to recover from a recipient the benefit of a proprietary nature given in relation to the exercise of the right of a shareholder, and
- a director on our behalf for the cessation of an illegal or ultra vires action.

There is no provision under the Corporation Law or our Articles of Incorporation which forces shareholders to make additional contributions when requested by us.

Under the Corporation Law, in order to change the rights of shareholders which are stipulated and defined in our Articles of Incorporation, we must amend our Articles of Incorporation. Amendments must, in principle, be approved by a Special Resolution of shareholders.

Annual general meetings and extraordinary general meetings of shareholders are convened by a representative director based on the determination of our Board of Directors. A shareholder having held 3% or more of our total outstanding shares for six months or more is entitled to demand the directors to convene a shareholders' meeting under the Corporation Law. So long as we maintain the unit share system, shareholders who are registered as the holders of one or more full units of shares in our registers of shareholders at the end of each March 31 have the right to attend the annual general meeting of our shareholders. We may, by prescribing a Record Date, determine the shareholders who are stated or recorded in the shareholder registry on the Record Date as the shareholders entitled to extraordinary general meetings of our shareholders, and in this case, we are required to make a public notice of Record Date at least two weeks prior to the Record Date. A convocation notice will be sent to these shareholders at least two weeks prior to the date of the shareholders' meeting.

Acquisition of Own Shares

Under applicable laws of Japan, we may acquire our own shares:

- (i) through market transactions on a stock exchange on which our shares are listed or by way of tender offer (in either case pursuant to a resolution of the Board of Directors as currently authorized by our Articles of Incorporation);
- (ii) from a specific shareholder other than any of our subsidiaries (pursuant to a special resolution of a general meeting of shareholders); or
- (iii) from any of our subsidiaries (pursuant to a resolution of the Board of Directors).



In case the acquisition is made by way of (ii) above, any other shareholder may request within a certain period of time provided under the applicable Ordinance of the Ministry of Justice before a general meeting of shareholders that we also purchase our shares held by the requesting shareholder, unless the purchase price or any other consideration to be delivered in exchange for the acquisition of one of our shares does not exceed the market price of one of our shares calculated by the method prescribed in the applicable Ordinance of the Ministry of Justice.

Any acquisition by us of our own shares must satisfy certain other requirements, including that the total amount of the acquisition price may not exceed the Distributable Amount, as described above.

We may hold the shares which we acquired by way of (i) through (iii) above, and may cancel such shares by a resolution of the Board of Directors. We may also dispose of such shares subject to a resolution of the Board of Directors and subject also to other requirements applicable to the issuance of shares under the Corporation Law.

#### Unit share system

Our Articles of Incorporation provide that 100 shares of Common Stock constitute one unit of shares. Although the number of shares constituting one unit is included in the Articles of Incorporation, any amendment to the Articles of Incorporation reducing (but not increasing) the number of shares constituting one unit or eliminating the provisions for the unit of shares may be made by a resolution of the Board of Directors rather than by a special shareholders' resolution, which is otherwise required for amending the Articles of Incorporation. The number of shares constituting one new unit, however, cannot exceed 1,000 or 0.5 percent of the total number of issued shares, whichever is greater.

Under the unit share system, shareholders shall have one voting right for each unit of shares that they hold. Any number of shares less than a full unit carries no voting rights.

A holder of shares of Common Stock constituting less than a full unit may require us to purchase such shares at their market value in accordance with the provisions of our share handling regulations. In addition, our Articles of Incorporation provide that a holder of shares of Common Stock constituting less than a full unit may request us to sell to such holder such amount of shares of Common Stock that will, when added together with the shares of Common Stock constituting less than a full unit, constitute a full unit of shares, in accordance with the provisions of our share handling regulations.

A holder who owns ADRs evidencing less than 200 ADSs will indirectly own less than one full unit of shares of Common Stock. Although, as discussed above, under the unit share system, holders of less than one full unit have the right to require us to purchase their shares or sell shares held by us to such holders, holders of ADRs evidencing ADSs

that represent other than integral multiples of full units are unable to withdraw the underlying shares of Common Stock representing less than one full unit and, therefore, are unable, as a practical matter, to exercise the rights to require us to purchase such underlying shares or sell shares held by us to such holders. As a result, access to the Japanese markets by holders of ADRs through the withdrawal mechanism will not be available for dispositions of shares of Common Stock in lots less than one full unit. The unit share system does not affect the transferability of ADSs, which may be transferred in lots of any size.

***Restrictions on Holders of our Common Stock***

There is no restriction on non-resident or foreign shareholders on the holding of our shares or on the exercise of voting rights, except for filing requirements with respect to an acquisition of shares by Non-resident of Japan under The Foreign Exchange and Foreign Trade Act of Japan and related rules and regulations, as explained in Item 10.D (Exchange Controls). However, pursuant to a provision of our share handling regulations, a shareholder who does not have an address or residence in Japan is required to file its temporary address to receive notices in Japan or that of a standing proxy having any address or residence in Japan with our transfer agent.

There is no provision in our Articles of Incorporation that would have the effect of delaying, deferring or preventing a change in control that would operate only with respect to a merger, acquisition or corporate restructuring involving us.

There is no provision in our Articles of Incorporation or other subordinated rules regarding the ownership threshold, above which shareholder ownership must be disclosed. Pursuant to the Financial Instruments and Exchange Law of Japan and its related regulations, a shareholder who has become, solely or jointly, a holder of more than 5% of the total issued shares in a company that is listed on any stock exchange in Japan is required to file a report with the Finance Bureau of the Ministry of Finance, and, with certain exceptions, a similar report must also be filed in respect of any subsequent change of 1% or more in the holding or of any change in material matters set forth in any previously filed report.

There is no provision in our Articles of Incorporation governing changes in the capital more stringent than is required by law.

For a description of rights of holders of ADSs, please see the “Description of American Depositary Receipts” section in our Form F-1 Registration Statement (File No. 333-10584), declared effective on August 3, 1999, as amended, hereby incorporated by reference.

### C. Material Contracts

The following are summaries of our material contracts, other than those we entered into in the ordinary course of business.

***Solutions Engagement Agreement.*** IIJ Global entered into a Solutions Engagement Agreement on June 1, 2010, between IBM Japan. The Solutions Engagement Agreement, which contains indemnification, establishes the basis for a procurement relationship between IIJ-Global and IBM Japan, the largest sales partner of IIJ-Global. IIJ-Global will provide and perform services, functions, responsibilities and others in a way that were being provided and performed by AT&T Japan. This agreement will remain in effect until terminated. The Solutions Engagement Agreement is filed as Exhibit 4.7 of this annual report.

***Limitation of Liability Agreements, dated June 26, 2015 and June 24, 2016 between IIJ and outside directors and outside company auditors.*** We entered into a Limitation of Liability Agreement with Mr. Junnosuke Furukawa, Mr. Tadashi Okamura and Mr. Hiroki Watanabe as outside directors on June 26, 2015 and with Mr. Yasuro Tanahashi and Mr. Shingo Oda as outside directors and with Mr. Yasuhiro Akatsuka and Mr. Takashi Michishita as outside company auditors on June 24, 2016 respectively, under which we limit the liability of outside directors in accordance with the rules defined in Article 427 of the Corporation Law. Under the terms of the agreements on limited liability,

the liability of outside directors for damages sustained by us as a result of their actions is limited to an aggregate of ¥10 million or the aggregate of the amounts set forth in Article 427 paragraph 1 of the Corporation Law, whichever is higher. The agreements on limited liability are automatically renewed if the outside directors and auditors are re-elected and terminate when the outside directors, subject to the agreements on limited liability, lose the status of outside director, i.e., become a director, executive officer or employee of the company. The full English translation of the Agreement on Limited Liability is filed as Exhibit 4.5 of this annual report.

D.

Exchange Controls

The Foreign Exchange and Foreign Trade Act of Japan, as amended and the cabinet orders and ministerial ordinances thereunder (the “Foreign Exchange Regulations”), regulate certain transactions involving a “Non-resident of Japan” or a “Foreign Investor,” including the issuance of securities by a resident of Japan outside of Japan, transfer of securities between a resident of Japan and a Non-resident of Japan, “inward direct investment” by a Foreign Investor, and a payment from Japan to a foreign country or by a resident of Japan to a Non-resident of Japan.

“Non-residents of Japan” is defined as individuals who are not resident in Japan and corporations whose principal offices are located outside of Japan. Generally, branches and other offices of Japanese corporations which are located outside of Japan are regarded as Non-residents of Japan, but branches and other offices of non-resident corporations which are located within Japan are regarded as residents of Japan.

“Foreign Investors” is defined as:

individuals who are Non-residents of Japan;

corporations which are organized under the laws of foreign countries or whose principal offices are located outside of Japan; and

corporations (i) of which 50% or more of their voting rights are held by individuals who are Non-residents of Japan and/or corporations which are organized under the laws of foreign countries or whose principal offices are located outside of Japan or (ii) a majority of whose officers, or officers having the power of representation, are individuals who are Non-residents of Japan.

Under the Foreign Exchange Regulations, dividends paid on, and the proceeds of sales in Japan of, shares held by Non-residents of Japan may in general be converted into any foreign currency and repatriated abroad.

Under the Foreign Exchange Regulations, in general, a Non-resident of Japan who acquires shares from a resident of Japan is not subject to any prior filing requirement, although the Foreign Exchange Law empowers the Minister of Finance of Japan to require prior approval for any such acquisition in certain limited circumstances. While such prior approval is not required in general, in the case where a resident of Japan transfers shares of a Japanese company for consideration exceeding ¥100 million to a non-resident of Japan, the resident of Japan that transfers the shares is required to report the transfer to the Minister of Finance of Japan within 20 days from the date of the transfer, unless the transfer is made through a bank, securities company or financial futures trader licensed under Japanese law.

If a Foreign Investor acquires our shares and, together with parties who have a special relationship with that foreign investor, holds 10% or more of our issued shares as a result of such acquisition, the Foreign Investor must, with certain limited exceptions, file a report of such acquisition with the Minister of Finance and any other competent Minister within 15 days from and including the date of such acquisition. In certain limited circumstances, however, a prior notification of such acquisition must be filed with the Minister of Finance and any other competent Minister, who may modify or prohibit the proposed acquisition.

E. Taxation

Japanese Taxation

The following is a discussion summarizing material Japanese tax consequences to an owner of shares or ADSs who is a non-resident of Japan or a non-Japanese corporation without a permanent establishment in Japan to which the relevant income is attributable. The statements regarding Japanese tax laws set forth below are based on the laws in force and as interpreted by the Japanese taxation authorities as at the date hereof. These statements are subject to changes in the applicable Japanese laws or double taxation conventions occurring after that date. This summary is not exhaustive of all possible tax considerations which may apply to a particular investor. Potential investors should consult their own tax advisors as to:

the overall tax consequences of the acquisition, ownership and disposition of shares or ADSs, including specifically the tax consequences under Japanese law,

the laws of the jurisdiction of which they are resident, and

any tax treaty between Japan and their country of residence.

Generally, a non-resident individual of Japan or a non-Japanese corporation as a holder of shares or ADSs is subject to Japanese withholding tax on dividends paid by IIJ. In the absence of any applicable tax treaty, convention or agreement reducing the maximum rate of withholding tax, the rate of Japanese withholding tax applicable to dividends paid by IIJ to non-resident individual of Japan or a non-Japanese corporation is 20% (on or before December 31, 2037, the rate of Japanese withholding tax will be increased to 20.42% including the Special Reconstruction Income Tax, which is described below). With respect to dividends paid on listed shares issued by Japanese Corporation (such as our shares) to a non-resident individual of Japan or a non-Japanese corporation, the aforementioned 20% withholding tax rate is reduced to 15% for dividends to be due and payable thereafter (on or before December 31, 2037, the rate of Japanese withholding tax will be increased to 15.315% including the Special Reconstruction Income Tax). This tax reduction is not available for a non-resident individual who holds 3% of the issued shares of a Japanese corporation. For the purpose of this paragraph, the Special Reconstruction Income Tax is a special surtax at the rate of 2.1% imposed on individuals and corporations (whether residents or non-residents of Japan, or Japanese corporations or non-Japanese corporations) until December 31, 2037 for reconstruction funding after the Great East Japan Earthquake. This special surtax is applicable to various income taxes including withholding tax on dividends and the amount of such special surtax is calculated by multiplying the amount of the original income tax by the surtax rate of 2.1%. In consequence, the amount of the aggregate withholding tax on dividends will be the original amount of such withholding tax plus the original amount multiplied by the surtax rate (i.e. 102.1% of the original amount). Japan has income tax treaties whereby the above-mentioned withholding tax rate is reduced, generally to 15% for portfolio investors with, among other countries, Belgium, Canada, Denmark, Finland, Germany, Ireland, Italy, Luxembourg, New Zealand, Norway, Singapore and Spain while the income tax treaties with Australia, France, Hong Kong, The Netherlands, Portugal, Saudi Arabia, Switzerland, the U.K. and the United States generally reduce the withholding tax

rate to 10% for portfolio investors. In addition, under the income tax treaty between the United States and Japan, dividends paid to pension fund of qualified United States residents eligible to enjoy treaty benefits are exempt from Japanese income taxation by way of withholding or otherwise unless such dividends are derived from the carrying on of a business, directly or indirectly, by such pension funds. Under the income tax treaty between Japan and the U.K., similar treatment will be applied to dividends. Under Japanese tax law, any reduced maximum rate applicable under a tax treaty shall be available when such maximum rate is below the rate otherwise applicable under the Japanese tax law referred to in the preceding paragraph with respect to the dividends to be paid by IJJ on the shares.



Non-resident holders who are entitled to a reduced rate of Japanese withholding tax on payments of dividends on the shares by IJJ are required to submit an Application Form for Income Tax Convention regarding Relief from Japanese Income Tax and Special Reconstruction Income Tax on Dividends in advance through IJJ to the relevant tax authority before the payment of dividends. A standing proxy for non-resident holders may provide such application service. With respect to ADSs, the reduced rate is applicable if The Bank of New York Mellon, as depositary, or its agent submits in duplicate two Application Forms for Income Tax Convention (one is FORM 4 subtitled “Extension of Time for Withholding of Japanese Income Tax and Special Reconstruction Income Tax on Dividends with respect to Foreign Depository Receipt” to the payer of dividends, who has to file the original with the district director of tax office for the place where the payer resides, by the day before the payment of dividends and the other is FORM 5 subtitled “Relief from Japanese Income Tax and Special Reconstruction Income Tax on Dividends with respect to Foreign Depository Receipt” to the district director of tax office through the payer of Dividends in eight months from the day following the base date of payment of dividends for application purposes for which FORM 4 has been submitted). To claim the reduced rate, a non-resident holder of ADSs will be required to file proof of taxpayer status, residence and beneficial ownership, as applicable, and to provide other information or documents as may be required by the depositary. Non-resident holders of shares or ADSs who do not submit an application in advance will generally be entitled to claim a refund from the relevant Japanese tax authority of withholding taxes withheld in excess of the rate of an applicable tax treaty.

Gains derived from the sale of the shares or ADSs outside Japan, or from the sales of shares within Japan by a non-resident holder, generally are not subject to Japanese income or corporation taxes provided that such gains are from portfolio investments where the shareholding ratio is within certain prescribed levels.

Japanese inheritance and gift taxes at progressive rates may be payable by an individual who has acquired share of ADSs as a legatee, heir or donee, even if the individual is not a Japanese resident.

## United States Taxation

The following discusses United States federal income tax consequences of the ownership of shares or ADSs. It only applies to U.S. holders of shares or ADSs, as defined below, who hold their shares or ADSs as capital assets for tax purposes. It does not address special classes of holders, some of whom may be subject to other rules including:

- tax-exempt entities,
- life insurance companies,
- dealers in securities,
- traders in securities that elect to use a mark-to-market method of accounting for securities holdings,
- investors liable for alternative minimum tax,
- investors that actually or constructively own 10% or more of the voting stock of IJJ,
- investors that hold shares or ADSs as part of a straddle or a hedging or conversion transaction,
- a person that purchases or sells shares or ADSs as part of a wash sale for tax purposes, or

investors whose functional currency is not the U.S. dollar.

This discussion is based on the tax laws of the United States, including the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations and administrative and judicial interpretations, as currently in effect, as well as on the Convention Between the United States of America and Japan (the “Treaty”). These laws are subject to change, possibly on a retroactive basis. In addition, this discussion is based in part upon the representations of the depository and the assumption that each obligation in the deposit agreement relating to the ADRs and any related agreement will be performed in accordance with its terms.

If a partnership holds the shares or ADSs, the United States federal income tax treatment of a partner will generally depend on the status of the partner and the tax treatment of the partnership. A partner in a partnership holding the shares or ADSs should consult its tax advisor with regard to the United States federal income tax treatment of an investment in the shares or ADSs.

For purposes of this discussion, a “U.S. holder” is a beneficial owner of shares or ADSs that is:

a citizen or resident of the United States,  
a domestic corporation,  
an estate whose income is subject to United States federal income tax regardless of its source, or  
a trust if a United States court can exercise primary supervision over the trust’s administration and one or more United States persons are authorized to control all substantial decisions of the trust.

This discussion addresses only United States federal income taxation. You should consult your own tax advisor regarding the United States federal, state and local and other tax consequences of owning and disposing of shares and ADSs in your particular circumstances.

In general, and taking into account the earlier assumptions, for United States federal income tax purposes, if you hold ADRs evidencing ADSs, you will be treated as the owner of the shares represented by those ADRs. Exchanges of shares for ADRs, and ADRs for shares, generally will not be subject to United States federal income tax.

The discussion under the headings “Taxation of Dividends” and “Taxation of Capital Gains” assumes that we will not be treated as a Passive Foreign Investment Company (“PFIC”) for U.S. federal income tax purposes. For a discussion of the rules that apply if we are treated as a PFIC, see the discussion under the heading “PFIC Rules” below.

#### Taxation of Dividends

Under the United States federal income tax laws, if you are a U.S. holder, the gross amount of any dividend we pay out of our current or accumulated earnings and profits (as determined for United States federal income tax purposes) is subject to United States federal income taxation. If you are a noncorporate U.S. holder, dividends that constitute qualified dividend income will be taxable to you at preferential rates applicable to long-term capital gains provided that you hold the shares or ADSs for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date and meet other holding period requirements. Dividends we pay with respect to the shares or ADSs generally will be qualified dividend income.

You must include any Japanese tax withheld from the dividend payment in this gross amount even though you do not in fact receive it. The dividend is taxable to you when you, in the case of shares, or the depositary, in the case of ADSs, receive the dividend, actually or constructively. The dividend will not be eligible for the dividends-received deduction generally allowed to United States corporations in respect of dividends received from other United States corporations. The amount of the dividend distribution that you must include in your income as a U.S. holder will be the U.S. dollar value of the Japanese yen payments made, determined at the spot Japanese yen/U.S. dollar rate on the date the dividend distribution is includible in your income, regardless of whether the payment is in fact converted into U.S. dollars. Generally, any gain or loss resulting from currency exchange fluctuations during the period from the date you include the dividend payment in income to the date you convert the payment into U.S. dollars will be treated as ordinary income or loss and will not be eligible for the special tax rate applicable to qualified dividend income. The gain or loss generally will be income or loss from sources within the United States for foreign tax credit limitation purposes.

Distributions in excess of current and accumulated earnings and profits, as determined for United States federal income tax purposes, will be treated as a return of capital to the extent of your basis in the shares or ADSs and thereafter as capital gain. However, we do not expect to calculate earnings and profits in accordance with United States federal income tax principles. Accordingly, you should expect to generally treat distributions we make as dividends.

Subject to certain limitations, the Japanese tax withheld in accordance with the Treaty and paid over to Japan will be creditable or deductible against your United States federal income tax liability. Special rules apply in determining the foreign tax credit limitation with respect to dividends that are subject to the preferential tax rate. To the extent a refund of the tax withheld is available to you under Japanese law or under the Treaty, the amount of tax withheld that is refundable will not be eligible for credit against your United States federal income tax liability.

For foreign tax credit purposes, dividends will generally constitute income from sources outside the United States. Dividends will, depending on your circumstances, be either “passive” or “general” income for purposes of computing the foreign tax credit allowable to you.

#### Taxation of Capital Gains

If you sell or otherwise dispose of your shares or ADSs, you will recognize capital gain or loss for United States federal income tax purposes equal to the difference between the U.S. dollar value of the amount that you realize and your tax basis, determined in U.S. dollars, in your shares or ADSs. Capital gain of a noncorporate U.S. holder is generally taxed at preferential rates where the holder has a holding period greater than one year. Additionally, gain or loss will generally be income or loss from sources within the United States for foreign tax credit limitation purposes.

#### PFIC Rules

We do not believe that we will be treated as a PFIC for United States federal income tax purposes for our most recent taxable year. However, this conclusion is a factual determination made annually and thus may be subject to change.

In general, we will be a PFIC with respect to you if for any of our taxable years in which you held our ADSs or shares:

at least 75% of our gross income for the taxable year is passive income, or

at least 50% of the value, determined on the basis of a quarterly average, of our assets is attributable to assets that produce or are held for the production of passive income.

Passive income generally includes dividends, interest, royalties, rents (other than certain rents and royalties derived in the active conduct of a trade or business), annuities and gains from assets that produce passive income. If a foreign corporation owns at least 25% by value of the stock of another corporation, the foreign corporation is treated for purposes of the PFIC tests as owning its proportionate share of the assets of the other corporation, and as receiving directly its proportionate share of the other corporation's income.

If we are treated as a PFIC and you did not make a mark-to-market election, as described below, you will be subject to special rules with respect to:

- any gain you realize on the sale or other disposition of your shares or ADSs, and
- any “excess distribution” that we make to you (generally, any distributions to you during a single taxable year that are greater than 125% of the average annual distributions received by you in respect of the shares or ADSs during the three preceding taxable years or, if shorter, your holding period for the shares or ADSs).

Under these rules:

- the gain or excess distribution will be allocated ratably over your holding period for the shares or ADSs, the amount allocated to the taxable year in which you realized the gain or excess distribution or to prior years before the first year in which we were a PFIC with respect to you will be taxed as ordinary income,
- the amount allocated to each other prior year, with certain exceptions, will be taxed at the highest tax rate in effect for that year, and
- the interest charge generally applicable to underpayments of tax will be imposed in respect of the tax attributable to each such year.

Special rules apply for calculating the amount of the foreign tax credit with respect to excess distributions by a PFIC.

If your shares or ADSs are treated as marketable stock of a PFIC, you may make a mark-to-market election. If you make this election, you will not be subject to the PFIC rules described above. Instead, in general, you will include as ordinary income each year the excess, if any, of the fair market value of your shares or ADSs at the end of the taxable year over your adjusted basis in your shares or ADSs. These amounts of ordinary income will not be eligible for the favorable tax rates applicable to qualified dividend income or long-term capital gains. You will also be allowed to take an ordinary loss in respect of the excess, if any, of the adjusted basis of your shares or ADSs over their fair market value at the end of the taxable year or over their final sale or disposition prices, but only to the extent of the net amount of previously included income as a result of the mark-to-market election. Your basis in the shares or ADSs will be adjusted to reflect any such income or loss amounts.

Your shares or ADSs will be treated as stock in a PFIC if we were a PFIC at any time during your holding period in your shares or ADSs, even if we are not currently a PFIC. For purposes of this rule, if you make a mark-to-market election with respect to your shares or ADSs, you will be treated as having a new holding period in your shares or ADSs beginning on the first day of the first taxable year beginning after the last taxable year for which the mark-to-market election applies.

In addition, notwithstanding any election you make with regard to the shares or ADSs, dividends that you receive from us will not constitute qualified dividend income to you if we are a PFIC (or treated as a PFIC with respect to you) either in the taxable year of the distribution or the preceding taxable year. Dividends that you receive that do not constitute qualified dividend income are not eligible for taxation at the preferential rates applicable to qualified dividend income. Instead, you must include the gross amount of any such dividend paid by us out of our accumulated earnings and profits (as determined for United States federal income tax purposes) in your gross income, and it will be subject to tax at rates applicable to ordinary income.



If you own shares or ADSs during any year that we are a PFIC with respect to you, you may be required to file Internal Revenue Service Form 8621. You should consult your tax advisor regarding the PFIC rules and potential filing and other requirements.

F. Dividends and Paying Agents

Not required.

G. Statement by Experts

Not applicable.

H. Documents on Display

We file periodic reports and other information with the SEC. The SEC maintains a web site at [www.sec.gov](http://www.sec.gov) that contains reports and other information regarding us and other registrants that file electronically with the SEC. You may read and copy any document we file with the SEC at the SEC's public reference room at 100 F Street, NE, Washington, D.C. 20549. Please call SEC at 1-800-SEC-0330 for further information on the operation of its public reference room. In addition, you may also inspect reports filed with the SEC and other information at our Tokyo headquarters, located at Iidabashi Grand Bloom, 2-10-2 Fujimi, Chiyoda-ku, Tokyo 102-0071, Japan.

I. Subsidiary Information

Not applicable.



## Item 11. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risks from changes in interest rates, equity prices and foreign currency exchange rates.

### Interest Rate Risk

As of March 31, 2016, our interest rate risk on short-term borrowings and capital lease obligations were not material since the weighted average interest rate as of March 31, 2016 is reasonably low and we do not expect interest rates to rise sharply in the near future.

### Equity Price Risk

The fair value of our investments, primarily in marketable securities, exposes us to equity price risks. In general, we have invested in highly liquid and low-risk instruments, which are not held for trading purposes. We are exposed to changes in the market prices of the securities. As of March 31, 2015 and 2016, the fair value of such investments was ¥4,314 million and ¥3,944 million, respectively. The potential loss in fair value resulting from a 10% adverse change in equity prices would be approximately ¥431 million and ¥394 million as of March 31, 2015 and 2016, respectively. See Note 4 “Other Investments” to our consolidated financial statements, included in this annual report on Form 20-F.

### Foreign Currency Exchange Rate Risk

The assets held by us which are exposed to foreign currency exchange risk are mainly U.S. dollar denominated bank deposits. The carrying value, which also represents fair value, amounted to \$9,582 thousand (¥1,155 million) and \$15,880 thousand (¥1,915 million) as of March 31, 2015 and 2016, respectively. The potential loss in fair value for such financial instruments from a 10% adverse change in quoted foreign currency exchange rates would have been approximately ¥116 million and ¥192 million as of March 31, 2015 and 2016, respectively.



Item 12. Description of Securities Other than Equity Securities

A. Debt Securities

Not applicable.

B. Warrants and Rights

Not applicable.

C. Other Securities

Not applicable.

D. American Depositary Shares

***Fees and charges payable by ADR Holders***

The following table shows the fees and charges that a holder of our ADR may have to pay to The Bank of New York Mellon, as Depositary, either directly or indirectly:

Services	Fees (USD)
Taxes and other governmental charges	As applicable
Such registration fees as may from time to time be in effect for the registration of transfers of Shares generally on the Shareholders' register of the Issuer or Foreign Registrar and applicable to transfers of Shares to the name of the Depositary or its nominee or the Custodian or its nominee on the making of deposits or withdrawals hereunder	As applicable
Such cable, telex and facsimile transmission expenses as are expressly provided in this Deposit Agreement	As applicable

Such expenses as are incurred by the Depositary in the conversion of Foreign Currency	As applicable
The execution and delivery of Receipts and the surrender of Receipts	\$5.00 or less per 100 ADR
Any cash distribution made pursuant to the Deposit Agreement	\$0.02 or less per ADR
Receipt or Receipts for transfers made	\$1.50 or less per certificate
The distribution of securities, such fee being in an amount equal to the fee for the execution and delivery of American Depositary Shares referred to above which would have been charged as a result of the deposit of such securities, but which securities are instead distributed by the Depositary to Owners	As applicable

***Fees and other payments made by the Depositary to the Issuer***

For the fiscal year beginning April 1, 2015 and ended March 31, 2016, The Bank of New York Mellon, as Depositary, reimbursed IJ for the NASDAQ Stock Market listing fees of \$40,000. The Bank of New York Mellon, as Depositary has also agreed to reimburse IJ for its annual stock exchange (NASDAQ Stock Market) listing fees for future years. Furthermore, from April 1, 2015 to March 31, 2016, the Bank of New York Mellon has waived a total of \$56,230.94 in fees associated with the administration of the ADR program, investor relations expenses and administrative fees for routine corporate actions in addition to their standard fees for providing investor relations information services.

PART II

Item 13. Defaults, Dividend Arrearages and Delinquencies

None.

Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

None.

Item 15. Controls and Procedures

(a) Disclosure Controls and Procedures

As of the end of the fiscal year ended March 31, 2016, our management, with the participation of Koichi Suzuki, our chairman, chief executive officer and representative director, and Akihisa Watai, our director, chief financial officer and chief accounting officer, performed an evaluation of our disclosure controls and procedures.

Under Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, disclosure controls and procedures means our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Based on that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective as of March 31, 2016.

(b) Management's Annual Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting for our company.

Under Rules 13a-15(f) of the Securities Exchange Act of 1934, internal control over financial reporting means a process designed by, or under the supervision of, our chief executive officer and chief financial officer and effected by our Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America and includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets,

provide reasonable assurance that transactions are recorded as necessary to permit preparation of our financial statements in accordance with accounting principles generally accepted in the United States of America, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors, and



provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluations of effectiveness to future periods are subject to the risk controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management evaluated the effectiveness of our internal control over financial reporting using the criteria set forth in *Internal Control– Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Based on this evaluation, management concluded that our internal control over financial reporting was effective as of March 31, 2016.

The effectiveness of our internal control over financial reporting has been audited by Deloitte Touche Tohmatsu LLC, an independent registered public accounting firm, as stated in their report, presented hereafter.

(c) Attestation Report of the Registered Public Accounting Firm

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders of

Internet Initiative Japan Inc.:

We have audited the internal control over financial reporting of Internet Initiative Japan Inc. and subsidiaries (the “Company”) as of March 31, 2016, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying “Management’s Annual Report on Internal Control Over Financial Reporting.” Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of March 31, 2016, based on the criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended March 31, 2016 of the Company and our report dated June 30, 2016 expressed an unqualified opinion on those financial statements.

/s/ DELOITTE TOUCHE TOHMATSU LLC

Tokyo, Japan

June 30, 2016

(d) Changes in Internal Control Over Financial Reporting

With the participation of our chief executive officer and chief financial officer, our management also evaluated any change in our internal control over financial reporting that occurred during the fiscal year ended March 31, 2016. Based on that evaluation, our chief executive officer and chief financial officer concluded that no changes were made in our internal control over financial reporting that occurred during the fiscal year ended March 31, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Item 16A. Audit Committee Financial Expert**

At our shareholders' meeting in June 2016, two company auditors were nominated and our Board of Company Auditors determined that one of the nominated company auditors serving on the Board of Company Auditors, Yasuhiro Akatsuka, is an "audit committee financial expert" as defined in Item 16A. of Form 20-F and to be independent under the standards of the NASDAQ Stock Market. Mr. Akatsuka is independent from us.

**Item 16B. Code of Ethics**

At our Board of Directors Meeting on April 28, 2004, we adopted a Code of Ethics, the Internet Initiative Japan Code of Conduct, applicable to all employees and officers, including our chief executive officer, chief operating officer, chief financial officer and chief accounting officer. The Code of Conduct is attached as Exhibit 11.1 of this annual report.

**Item 16C. Principal Accountant Fees and Services**

## Independent Auditor Fees and Services

The Board of Directors engaged Deloitte Touche Tohmatsu LLC to perform an annual audit of our financial statements for each of the fiscal years ended March 31, 2015 and 2016. The following table sets forth the aggregate fees billed for services rendered by Deloitte Touche Tohmatsu LLC and its member firm for each of the last two fiscal years.

	Fiscal year ended March 31, 2015    2016 (millions of yen)	
Audit fees <sup>(1)</sup>	¥126	¥127
Audit-related fees	2 <sup>(2)</sup>	—
Tax fees <sup>(3)</sup>	3	5
All other fees	—	—
Total fees	¥131	¥132

These are the aggregate fees billed for the fiscal year for professional services rendered by Deloitte Touche Tohmatsu LLC for the audit of our annual financial statements, the audit of our internal control over financial reporting and services that are normally provided in connection with statutory and regulatory filings or engagements for those fiscal years.

- (1) (2) The fee is for the consultation related to the filing of Form SD (Conflict Minerals).
- (3) These are the aggregate fees billed for the fiscal year for professional services rendered by member firms of Deloitte Touche Tohmatsu Limited, such as Deloitte Tax LLP, for tax compliance, tax advice and tax planning.

#### Board of Company Auditors Pre-Approval Policies and Procedures

The Board of Company Auditors has adopted policies and procedures for pre-approving all audit and permissible non-audit work performed by independent registered public accounting firm in accordance with Rule 2-01(c)(7)(i)(B) under Regulation S-X. Under those policies and procedures, the Board of Company Auditors must pre-approve individual audit and non-audit services to be provided to us by our independent registered public accounting firm and its affiliates. Those policies and procedures also describe prohibited non-audit services that may never be provided by independent registered public accounting firm.

All of the services provided by our independent registered public accounting firm from May 6, 2003, when our pre-approval policies went into effect, through the end of the fiscal year ended March 31, 2016 were pre-approved by the Board of Company Auditors pursuant to the pre-approval policies described above, and none of such services were approved pursuant to the procedures described in Rule 2-01(c)(7)(i)(C) of Regulation S-X, which waives the general requirement for pre-approval in certain circumstances.

**Item 16D. Exemptions from the Listing Standards for Audit Committees**

With respect to the requirements of Rule 10A-3 under the Securities Exchange Act of 1934 relating to listed company audit committees, which apply to us through Rules 5605(c) of the NASDAQ Listing Rules, we rely on an exemption provided by paragraph (c) (3) of that Rule available to foreign private issuers with Boards of Company Auditors meeting certain requirements. For a NASDAQ-listed Japanese company with a Board of Company auditors, the requirements for relying on paragraph (c) (3) of Rule 10A-3 are as follows:

The Board of Company Auditors must be established, and its members must be selected, pursuant to Japanese law expressly requiring such a board for Japanese companies that elect to have a corporate governance system with company auditors,

Japanese law must and does require the Board of Company Auditors to be separate from the Board of Directors,

None of the members of the Board of Company Auditors may be elected by management, and none of the listed company's executive officers may be a member of the Board of Company Auditors,

Japanese law must and does set forth standards for the independence of the members of the Board of Company Auditors from the listed company or its management, and

The Board of Company Auditors, in accordance with Japanese law or the registrant's governing documents, must be responsible, to the extent permitted by Japanese law, for the appointment, retention and oversight of the work of any registered public accounting firm engaged (including, to the extent permitted by Japanese law, the resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the listed company, including its principal accountant which audits its consolidated financial statements included in its annual reports on Form 20-F.

To the extent permitted by Japanese law:

The Board of Company Auditors must establish procedures for (i) the receipt, retention and treatment of complaints received by us regarding accounting, internal accounting controls, or auditing matters, and (ii) the confidential, anonymous submission by our employees of concerns regarding questionable accounting or auditing matters,

The Board of Company Auditors must have the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties, and

The listed company must provide for appropriate funding, as determined by its Board of Company Auditors, for payment of (i) compensation to any registered public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for us, (ii) compensation to any advisers employed by the Board of Company Auditors, and (iii) ordinary administrative expenses of the Board of Company Auditors that are necessary or appropriate in carrying out its duties.

In our assessment, our Board of Company Auditors, which meets the requirements for reliance on the exemption in paragraph (c) (3) of Rule 10A-3 described above, is not materially less effective than an audit committee meeting all the requirements of paragraph (b) of Rule 10A-3 (without relying on any exemption provided by that Rule) at acting independently of management and performing the functions of an audit committee as contemplated therein.



**Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

Not applicable.

**Item 16F. Change in Registrant's Certifying Accountant**

Not applicable.

**Item 16G. Corporate Governance**

NASDAQ Listing Rule 5615 provides that a foreign private issuer may follow its home country practice in lieu of the requirements of Rule 5600, provided that such foreign private issuer discloses in its annual reports filed with the Securities and Exchange Commission or on its website each requirement of Rule 5600 that it does not follow and describes the home country practice followed by the issuer in lieu of such requirements.

NASDAQ Listing Rule 5605(b), Rule 5605(d) and Rule 5605(e) require that (i) a majority of the Board of Directors be independent directors as defined in Rule 5605(a)(2), (ii) independent directors have regularly scheduled meetings at which only they are present, (iii) compensation of the chief executive officer and other executive officers be determined, or recommended to the Board of Directors for determination, either by a majority of the independent directors or by a compensation committee comprised solely of independent directors, and (iv) director nominees be selected, or recommended for selection by the Board of Directors, either by a majority of the independent directors or by a nominations committee comprised solely of independent directors, in accordance with the nominations process set forth in a formal written charter or board resolution. For large Japanese companies under the Corporation Law including us, which employ a corporate governance system based on a Board of Company Auditors, the Corporation Law has no independence requirement with respect to directors. The task of overseeing management and accounting firms is assigned to the company auditors, who are separate and independent from the company's management. We are required to have at least 50% "outside" company auditors who must meet additional independence requirements under the Corporation Law. An outside company auditor is defined in the Corporation Law as a company auditor who had not served as a director, manager or any other employee of the company or any of its subsidiaries at any time prior to the appointment.

NASDAQ Listing Rule 5605(c) requires that (i) each issuer have adopted a formal written audit committee charter meeting the requirements of Rule 5605(c)(1) and (ii) the issuer have an audit committee of at least three members who are independent as defined under Rule 5605(a)(2), meet the independence criteria set forth in Rule 10A-3(b)(1) under

the U.S. Securities Exchange Act of 1934 and satisfy certain other criteria. We employ the company auditor system as described above. Under this system, the Board of Company Auditors is a legally separate and independent body from the Board of Directors. The function of the Board of Company Auditors is similar to that of independent directors, including those who are members of the audit committee, of a U.S. company: to monitor the performance of the directors, and review and express an opinion on the method of auditing by the company's accounting firm and on such accounting firm's audit reports, for the protection of the company's shareholders. We are required to have at least three company auditors. In addition, our auditors serve a longer term than our directors. With respect to the requirements of Rule 10A-3 under the U.S. Securities Exchange Act of 1934 relating to listed company audit committees, we rely on an exemption under paragraph (c)(3) of that rule which is available to foreign private issuers with boards of company auditors meeting certain criteria.

NASDAQ Listing Rule 5620(c) provides that each issuer provide for a quorum as specified in its by-laws for any meeting of holders of common stock, which shall be at least 33 1/3% of the outstanding shares of the issuer's voting common stock. We provide for a quorum as specified in the Articles of Incorporation for any meeting of holders of common stock, which shall be at least one-third of our outstanding shares of voting common stock.

NASDAQ Listing Rule 5620(b) provides that each issuer solicit proxies and provide proxy statements for all meetings of shareholders and provide copies of such proxy solicitation to NASDAQ. As a Japanese company whose shares are listed on the securities exchanges defined in the Financial Instrument and Exchange Act, we may, but are not required to, solicit proxies for meetings of shareholders. If we solicit proxies for a meeting of shareholders, we are required to provide proxy statements and documents for reference as provided for in the Financial Instrument and Exchange Act and provide copies of such proxy statements and documents for reference to the Kanto Local Finance Bureau.

NASDAQ Listing Rule 5630(a) provides that each issuer conduct appropriate review and oversight of all related party transactions for potential conflict of interest situations on an ongoing basis by the issuer's audit committee or another independent body of the Board of Directors. Following the requirements of the Corporation Law, we require a director to obtain the approval of the Board of Directors in order for such director to accept a transfer of a product or any other asset of IJJ, to transfer a product or any other asset of such director to IJJ, to receive a loan from IJJ, or to effect any other transaction with IJJ, for himself or a third party.

NASDAQ Listing Rule 5635 provides that shareholder approval be obtained prior to the issuance of designated securities under subparagraphs (a), (b), (c) or (d) of Rule 5635. Where a Japanese joint stock company (Kabushiki-Gaisha) issues common shares or other shares, stock acquisition rights or bonds with stock acquisition rights under the Corporation Law, it is necessary for the Board of Directors to determine the conditions of issuance; provided, however, that this shall not apply if the Articles of Incorporation provide that such conditions shall be determined by the shareholders' meeting. Currently, IJJ's Articles of Incorporation do not provide for any such exception. Additionally, if the company issues such securities to persons other than shareholders (in case of common shares or other shares) at a specially favorable issue price or (in case of stock acquisition rights or bonds with stock acquisition rights) on specially favorable conditions, even when there are provisions related thereto in the Articles of Incorporation, some matters related to such issuance shall be resolved by special resolution of the shareholders' meeting.

#### Item 16H. Mine Safety Disclosure

Not applicable.

PART III

Item 17. Financial Statements

Not applicable.

Item 18. Financial Statements

See Financial Statements for Internet Initiative Japan Inc. and Subsidiaries beginning on page F-1.

Item 19. Exhibits

- 1.1 Articles of Incorporation, as amended (English translation)<sup>1</sup>
- 1.2 Share Handling Regulations, as amended (English translation)<sup>1</sup>
- 1.3 Regulations of the Board of Directors, as amended (English translation)<sup>1</sup>
- 1.4 Regulations of the Board of Company Auditors, as amended (English translation)
- 2.1 Bylaws of the IIJ Group Employee Shareholders' Association (English translation)<sup>2</sup>
- 2.2 Form of Deposit Agreement among IIJ, The Bank of New York Mellon as depositary and all owners and holders from time to time of American Depositary Receipts, including the form of American Depositary Receipt<sup>3</sup>
- 2.3 Bylaws of the IIJ Group Director Stock Purchase Plan (English translation)<sup>4</sup>
- 4.1 Shareholders' Agreement Relating to the Establishment of INTERNET MULTIFEED CO., dated August 20, 1997, between Nippon Telegraph and Telephone Corporation and the Registrant (English translation)<sup>5</sup>
- 4.2 Basic Agreement to Delegate Services, dated April 1, 1998, between Internet Initiative Japan Inc. and Net Care, Inc. (English translation)<sup>5</sup>
- 4.3 Joint Venture Agreement, dated January 19, 2006, between Internet Initiative Japan Inc. and Konami Corporation (English translation)<sup>6</sup>
- 4.4 Service Agreement, dated March 25, 2004, between Internet Initiative Japan Inc. and IIJ America Inc.<sup>7</sup>
- 4.5 Agreement on Limited Liability, dated June 25, 2014 and June 26, 2015 between Internet Initiative Japan Inc. and outside directors and outside company auditors<sup>8</sup>
- 4.6 Stock Purchase Agreement, dated June 1, 2010, between Internet Initiative Japan Inc. and AT&T Japan LLC.<sup>9</sup>
- 4.7

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Solutions Engagement Agreement, dated May 31, 2010 between Communications Services KK (changed its trade name to IIJ-Global Solutions Inc. on September 1, 2010) and IBM Japan, Ltd.<sup>9</sup>

8.1 List of Significant Subsidiaries (See “Our Group Companies” in Item 4.B. of this Form 20-F)

11.1 Internet Initiative Japan Code of Conduct <sup>10</sup>

12.1 Certification of the principal executive officer required by 17 C.F.R. 240. 13a-14(a)

12.2 Certification of the principal financial officer required by 17 C.F.R. 240. 13a-14(a)

13.1 Certification of the chief executive officer required by 18 U.S.C. Section 1350

13.2 Certification of the chief financial officer required by 18 U.S.C. Section 1350

(1) Incorporated by reference to the corresponding exhibit to our annual report on Form 20-F (File No. 0-30204) filed on June 28, 2013.

(2) Incorporated by reference to the corresponding exhibit to our annual report on Form 20-F (File No. 0-30204) filed on July 10, 2015.

(3) Incorporated by reference to the Registration Statement on Form F-6 (File No. 333-110862) filed on December 2, 2003.

(4) Incorporated by reference to the corresponding exhibit to our annual report on Form 20-F (File No. 0-30204) filed on September 28, 2010.

(5) Incorporated by reference to the corresponding exhibit to our Form F-1 Registration Statement (File No. 333-10584) declared effective on August 3, 1999.

(6) Incorporated by reference to the corresponding exhibit to our annual report on Form 20-F (File No. 0-30204) filed on July 11, 2006.

(7) Incorporated by reference to the corresponding exhibit to our annual report on Form 20-F (File No. 0-30204) filed on July 23, 2004.

(8) We entered into a Limitation of Liability Agreement with Mr. Junnosuke Furukawa, Mr. Tadashi Okamura and Mr. Hiroki Watanabe on June 26, 2015 and with Mr. Yasuhiro Akatsuki and Mr. Takashi Michishita on June 24, 2016

(9) Schedules, annexes and similar attachments have been omitted pursuant to Item 601(b)(2) of Regulation S-K. IIJ agrees to furnish supplementary copies of the omitted schedules, annexes and similar attachments to the SEC upon request. A list briefly describing the omitted schedules, annexes and similar attachments are contained in this exhibit.

(10) Incorporated by reference to the corresponding exhibit to our annual report on Form 20-F (File No. 0-30204) filed on June 30, 2008.

SIGNATURE

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

Internet Initiative Japan  
Inc.

By: /s/ Koichi Suzuki  
Name: Koichi Suzuki  
Chairman,  
Chief  
Executive  
Title: Officer  
and  
Representative  
Director

Date: June 30, 2016

**Internet Initiative Japan Inc. and Subsidiaries**

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders of

Internet Initiative Japan Inc.:

We have audited the accompanying consolidated balance sheets of Internet Initiative Japan Inc. and subsidiaries (the "Company") as of March 31, 2015 and 2016, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended March 31, 2016. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Internet Initiative Japan Inc. and subsidiaries as of March 31, 2015 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2016, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of March 31, 2016, based on the criteria established in *Internal Control Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated June 30, 2016 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ DELOITTE TOUCHE TOHMATSU LLC  
Tokyo, Japan  
June 30, 2016



F-2

**Internet Initiative Japan Inc. and Subsidiaries****Consolidated Balance Sheets****March 31, 2015 and 2016**

<u>ASSETS</u>	Thousands of Yen	
	2015	2016
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	¥21,093,633	¥19,569,095
Accounts receivable, net of allowance for doubtful accounts of ¥54,590 thousand and ¥74,229 thousand at March 31, 2015 and 2016, respectively (Notes 5, 6 and 22)	22,251,818	23,746,683
Inventories (Note 3)	1,229,463	2,003,573
Prepaid expenses—current	3,691,643	4,769,988
Deferred tax assets—current (Note 12)	1,547,474	1,481,651
Other current assets, net of allowance for doubtful accounts of ¥720 thousand and ¥15,693 thousand at March 31, 2015 and 2016, respectively (Notes 5 and 9)	2,272,605	1,834,951
Total current assets	52,086,636	53,405,941
INVESTMENTS IN EQUITY METHOD INVESTEEES (Note 6)	2,560,557	2,979,652
OTHER INVESTMENTS (Notes 4, 17, 18 and 19)	6,660,706	5,948,741
PROPERTY AND EQUIPMENT—Net (Notes 7 and 9)	29,370,054	34,324,150
GOODWILL (Note 8)	6,169,609	6,169,609
OTHER INTANGIBLE ASSETS—Net (Note 8)	3,941,279	3,549,459
GUARANTEE DEPOSITS (Note 9)	2,800,201	3,084,681
DEFERRED TAX ASSETS—Noncurrent (Note 12)	471,087	224,316
NET INVESTMENT IN SALES-TYPE LEASES—Noncurrent (Note 9)	762,159	2,444,848
PREPAID EXPENSES—Noncurrent	2,914,375	4,987,193
OTHER ASSETS, net of allowance for doubtful accounts and loans of ¥92,935 thousand and ¥61,593 thousand at March 31, 2015 and 2016, respectively (Notes 5, 6 and 18)	968,652	716,314
<b>TOTAL</b>	<b>¥108,705,315</b>	<b>¥117,834,904</b>

F-3 (Continued)

**Internet Initiative Japan Inc. and Subsidiaries****Consolidated Balance Sheets****March 31, 2015 and 2016**

<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>	Thousands of Yen	
	2015	2016
<b>CURRENT LIABILITIES:</b>		
Short-term borrowings (Note 11)	¥9,250,000	¥9,250,000
Capital lease obligations—current portion (Note 9)	3,522,113	3,954,386
Accounts payable—trade (Notes 6 and 22)	12,182,908	13,906,703
Accounts payable—other	1,442,810	1,497,767
Income taxes payable (Note 12)	499,104	1,078,412
Accrued expenses	2,968,139	2,932,653
Deferred income—current	2,143,480	2,528,885
Other current liabilities (Notes 10 and 12)	1,732,781	917,300
Total current liabilities	33,741,335	36,066,106
CAPITAL LEASE OBLIGATIONS—Noncurrent (Note 9)	4,340,421	7,779,367
ACCRUED RETIREMENT AND PENSION COSTS— Noncurrent (Note 13)	2,792,617	3,581,426
DEFERRED TAX LIABILITIES—Noncurrent (Note 12)	1,097,650	710,055
DEFERRED INCOME—Noncurrent	2,943,975	3,092,562
OTHER NONCURRENT LIABILITIES (Note 10)	945,537	1,261,413
Total liabilities	45,861,535	52,490,929
COMMITMENTS AND CONTINGENCIES (Note 17)		
<b>SHAREHOLDERS' EQUITY (Notes 4, 13, 14 and 15):</b>		
Common stock—authorized, 75,520,000 shares; issued and outstanding, 46,701,000 and 46,711,400 shares at March 31, 2015 and 2016, respectively	25,499,857	25,509,499
Additional paid-in capital	36,014,128	36,059,833
Retained earnings (Accumulated deficit)	(556,162 )	2,471,276
Accumulated other comprehensive income	1,938,649	1,196,669
Treasury stock—758,709 shares held by the company at March 31, 2015 and 2016, respectively	(392,070 )	(392,070 )
Total Internet Initiative Japan Inc. shareholders' equity	62,504,402	64,845,207

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NONCONTROLLING INTERESTS	339,378	498,768
Total equity	62,843,780	65,343,975
TOTAL	¥108,705,315	¥117,834,904

See notes to consolidated financial statements.

F-4 (Concluded)

**Internet Initiative Japan Inc. and Subsidiaries****Consolidated Statements of Income****Three Years in the Period Ended March 31, 2016**

	Thousands of Yen		
	2014	2015	2016
REVENUES (Notes 6 and 22):			
Network services:			
Internet connectivity services (enterprise)	¥16,585,175	¥16,349,785	¥17,597,343
Internet connectivity services (consumer)	6,024,560	8,222,015	15,255,596
WAN services	25,005,867	24,325,951	25,176,730
Outsourcing services	19,670,127	20,107,850	21,265,895
Total	67,285,729	69,005,601	79,295,564
Systems integration:			
Systems construction	18,673,638	20,437,326	21,144,677
Systems operation and maintenance	23,795,927	27,800,132	33,043,669
Total	42,469,565	48,237,458	54,188,346
Equipment sales	1,690,225	2,166,928	3,275,220
ATM operation business	2,826,832	3,640,128	3,888,878
<b>Total revenues</b>	<b>114,272,351</b>	<b>123,050,115</b>	<b>140,648,008</b>
COSTS AND EXPENSES (Notes 6, 9, 13 and 22):			
Cost of network services	53,045,814	54,932,285	64,239,600
Cost of systems integration	36,510,328	41,561,621	46,225,629
Cost of equipment sales	1,526,618	1,932,180	2,968,711
Cost of ATM operation business	2,123,168	2,551,437	2,558,883
Total costs	93,205,928	100,977,523	115,992,823
Sales and marketing (Note 21)	8,547,693	9,188,425	10,588,887
General and administrative (Note 7)	6,374,057	7,367,600	7,470,746
Research and development	421,361	441,329	455,198
<b>Total costs and expenses</b>	<b>108,549,039</b>	<b>117,974,877</b>	<b>134,507,654</b>
<b>OPERATING INCOME</b>	<b>5,723,312</b>	<b>5,075,238</b>	<b>6,140,354</b>
OTHER INCOME (EXPENSES):			
Dividend income	51,003	63,143	93,054
Interest income	26,719	23,111	27,587
Interest expense	(256,371)	(238,260)	(241,057)
Foreign exchange gain (loss), net	219,381	(5,045)	(71,270)
Net gain on sales of other investments (Note 4)	107,655	41,251	23,765
Net gain on other investments (Note 4)	313,393	—	—

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Impairment of other investments (Note 4)	–	(29,117	) (14,729	)
Other—net	89,799	208,671	235,630	
Other income—net	551,579	63,754	52,980	
INCOME FROM OPERATIONS BEFORE INCOME TAX EXPENSE AND EQUITY IN NET INCOME OF EQUITY METHOD INVESTEES—(FORWARD)	¥6,274,891	¥5,138,992	¥6,193,334	

F-5 (Continued)

**Internet Initiative Japan Inc. and Subsidiaries****Consolidated Statements of Income****Three Years in the Period Ended March 31, 2016**

	Thousands of Yen		
	2014	2015	2016
INCOME FROM OPERATIONS BEFORE INCOME TAX EXPENSE AND EQUITY IN NET INCOME OF EQUITY METHOD INVESTEEES—(FORWARD)	¥6,274,891	¥5,138,992	¥6,193,334
INCOME TAX EXPENSE (Note 12)	1,795,305	1,896,865	2,183,531
EQUITY IN NET INCOME OF EQUITY METHOD INVESTEEES (Note 6)	204,046	154,626	180,219
NET INCOME	4,683,632	3,396,753	4,190,022
LESS: NET INCOME ATTRIBUTABLE TO NONCONTROLLING INTERESTS	(241,395 )	(74,672 )	(151,740 )
NET INCOME ATTRIBUTABLE TO INTERNET INITIATIVE JAPAN INC.	¥4,442,237	¥3,322,081	¥4,038,282
	Shares		
NET INCOME ATTRIBUTABLE TO INTERNET INITIATIVE JAPAN INC. PER SHARE (Note 16):			
Basic weighted-average number of common shares outstanding	44,306,680	45,942,291	45,950,098
Diluted weighted-average number of common shares outstanding	44,361,083	46,014,737	46,043,383
	Yen		
BASIC NET INCOME ATTRIBUTABLE TO INTERNET INITIATIVE JAPAN INC. PER COMMON SHARE	¥100.26	¥72.31	¥87.88
DILUTED NET INCOME ATTRIBUTABLE TO INTERNET INITIATIVE JAPAN INC. PER COMMON SHARE	100.14	72.20	87.71

See notes to consolidated financial statements.



F-6 (Concluded)

**Internet Initiative Japan Inc. and Subsidiaries****Consolidated Statements of Comprehensive Income****Three Years in the Period Ended March 31, 2016**

	Thousands of Yen		
	2014	2015	2016
NET INCOME	¥4,683,632	¥3,396,753	¥4,190,022
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX (Note 15):			
Foreign currency translation adjustments	419,557	243,538	(67,652 )
Unrealized holding gain (loss) on securities	988,139	61,590	(275,952 )
Defined benefit pension plans	41,115	(83,000 )	(394,418 )
TOTAL COMPREHENSIVE INCOME	6,132,443	3,618,881	3,452,000
LESS: COMPREHENSIVE INCOME ATTRIBUTABLE TO NONCONTROLLING INTERESTS	(241,251 )	(70,937 )	(155,698 )
COMPREHENSIVE INCOME ATTRIBUTABLE TO INTERNET INITIATIVE JAPAN INC.	¥5,891,192	¥3,547,944	¥3,296,302

See notes to consolidated financial statements.

F-7 (Concluded)

## Internet Initiative Japan Inc. and Subsidiaries

## Consolidated Statements of Shareholders' Equity

## Three Years in the Period Ended March 31, 2016

Amounts in thousands except share data									
Internet Initiative Japan Inc. Shareholders' Equity									
Total Equity	Retained earnings (Accumulated Deficit) (Note 14)	Other Comprehensive Income (Loss) (Notes 13 and 15)	Shares of Common Stock Outstanding	Common Stock	Treasury Stock (Note 14)	Additional Paid-in Capital	Noncontrol Interests		
BALANCE, MARCH 31, 2013	¥37,634,178	¥(6,399,088)	¥263,770	41,295,600	¥16,833,847	¥(392,079)	¥27,300,325	¥27,403	
Acquisition of noncontrolling interests in consolidated subsidiaries (Note 14)		61			53	99		(213)	
Issuance of common stock, net of issuance cost (Note 14)	17,271,204		5,400,000	8,661,600		8,609,604			
Issuance of common stock upon exercise of stock options	3,151		2,200	1,575		1,576			
Stock-based compensation (Note 14)	50,391					50,391			
Net income	4,683,632	4,442,237							241,395
Other comprehensive income (loss), net of tax	1,448,811	1,448,955							(144)
Dividends paid (Note 14)	(910,697)	(910,697)							

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Purchase of treasury stock	(44 )					(44 )		
BALANCE, MARCH 31, 2014	60,180,626	(2,867,548)	1,712,786	46,697,800	25,497,022	(392,070)	35,961,995	268,441
Issuance of common stock upon exercise of stock options	5,671			3,200	2,835		2,836	
Stock-based compensation (Note 14)	49,297						49,297	
Net income	3,396,753	3,322,081						74,672
Other comprehensive income (loss), net of tax	222,128		225,863					(3,735 )
Dividends paid (Note 14)	(1,010,695 )	(1,010,695)						
BALANCE, MARCH 31, 2015	62,843,780	(556,162 )	1,938,649	46,701,000	25,499,857	(392,070)	36,014,128	339,378
Subsidiary stock issuance	3,692							3,692
Issuance of common stock upon exercise of stock options	10			10,400	9,642		(9,632 )	
Stock-based compensation (Note 14)	55,337						55,337	
Net income	4,190,022	4,038,282						151,740
Other comprehensive income (loss), net of tax	(738,022 )		(741,980 )					3,958
Dividends paid (Note 14)	(1,010,844 )	(1,010,844)						
BALANCE, MARCH 31, 2016	¥65,343,975	¥2,471,276	¥1,196,669	46,711,400	¥25,509,499	¥(392,070)	¥36,059,833	¥498,768

F-8 (Concluded)

## Internet Initiative Japan Inc. and Subsidiaries

## Consolidated Statements of Cash Flows

## Three Years in the Period Ended March 31, 2016

	Thousands of Yen		
	2014	2015	2016
<b>OPERATING ACTIVITIES:</b>			
Net income	¥4,683,632	¥3,396,753	¥4,190,022
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	8,822,981	9,677,339	9,921,555
Impairment loss on intangible assets	—	—	11,000
Provision for retirement and pension costs, less payments	226,599	256,661	200,871
Provision for (reversal of) allowance for doubtful accounts	(46,935 )	33,158	48,407
Gain on sales of property and equipment	—	(29,733 )	(38,219 )
Loss on disposal of property and equipment	83,487	101,189	66,169
Net gain on sales of other investments	(107,655 )	(41,251 )	(23,765 )
Net gain on other investments	(313,393 )	—	—
Impairment of other investments	—	29,117	14,729
Foreign exchange gain, net	(129,916 )	(18,259 )	(51,727 )
Equity in net income of equity method investees, net of dividend received	(204,046 )	(122,286 )	(124,141 )
Deferred income tax expense (benefit)	(699,826 )	211,230	249,115
Others	71,448	8,560	(12,341 )
Changes in operating assets and liabilities net of effects from acquisition of a company:			
Increase in accounts receivable	(342,391 )	(2,819,564 )	(1,565,857 )
Decrease (increase) in net investment in sales-type lease—noncurrent	145,266	(9,385 )	98,511
Decrease (increase) in inventories	(365,533 )	450,256	(777,192 )
Increase in prepaid expenses	(612,802 )	(542,770 )	(1,083,665 )
Decrease (increase) in other current and noncurrent assets	(1,801,403)	715,132	(1,485,629 )
Increase in accounts payable	476,860	648,562	1,760,207
Increase (decrease) in income taxes payable	(594,782 )	(718,737 )	579,414
Increase (decrease) in accrued expenses	(219,277 )	873,815	(32,288 )
Increase (decrease) in deferred income—current	(158,972 )	465,469	418,162
Increase (decrease) in deferred income—noncurrent	91,462	(248,061 )	201,897
Increase (decrease) in other current and noncurrent liabilities	(217,925 )	595,178	(513,647 )
Net cash provided by operating activities—(Forward)	¥8,786,879	¥12,912,373	¥12,051,588

F-9 (Continued)

**Internet Initiative Japan Inc. and Subsidiaries****Consolidated Statements of Cash Flows****Three Years in the Period Ended March 31, 2016**

	Thousands of Yen		
	2014	2015	2016
Net cash provided by operating activities—(Forward)	¥8,786,879	¥12,912,373	¥12,051,588
<b>INVESTING ACTIVITIES:</b>			
Purchases of property and equipment	(9,123,998 )	(8,157,115 )	(10,898,533 )
Proceeds from sales of property and equipment	456,330	772,226	2,574,449
Purchases of available-for-sale securities	(167,545 )	(4,104 )	(59,490 )
Purchases of other investments	(1,185,985 )	(282,478 )	(376,067 )
Investment in equity method investees	(199,920 )	(338,240 )	(338,166 )
Proceeds from sales of available-for-sale securities	391,814	—	141,235
Proceeds from sales of other investments	351,740	40,501	808,465
Payments of guarantee deposits	(688,902 )	(1,635,910 )	(348,005 )
Refund of guarantee deposits	20,233	1,572,885	21,567
Payments for refundable insurance policies	(18,787 )	(47,831 )	(56,362 )
Proceeds from subsidies	—	200,000	200,000
Refund from insurance policies	16,026	—	10,108
Acquisition of a newly controlled company, net of cash acquired (Note 2)	—	(167,678 )	—
Other	(53,766 )	(25,000 )	(56,029 )
Net cash used in investing activities	(10,202,760)	(8,072,744)	(8,376,828 )
<b>FINANCING ACTIVITIES:</b>			
Proceeds from issuance of short-term borrowings with initial maturities over three months	250,000	50,000	1,550,000
Repayments of short-term borrowings with initial maturities of over three months and long-term borrowings	(1,260,000 )	(1,030,000 )	(1,550,000 )
Principal payments under capital leases	(3,968,724 )	(4,193,654 )	(4,194,215 )
Proceeds from sale and lease back	—	50,847	—
Net decrease in short-term borrowings	—	(150,000 )	—
Proceeds from issuance of subsidiary stock to noncontrolling interests	—	—	3,692
Dividends paid	(910,697 )	(1,010,695 )	(1,010,844 )
Proceeds from issuance of common stock, net of issuance cost	17,271,204	—	—
Other	109	3	10
Net cash provided by (used in) financing activities	11,381,892	(6,283,499)	(5,201,357 )
<b>FORWARD</b>	<b>¥9,966,011</b>	<b>¥(1,443,870)</b>	<b>¥(1,526,597 )</b>

F-10 (Continued)



	Thousands of Yen		
	2014	2015	2016
FORWARD	¥9,966,011	¥(1,443,870 )	¥(1,526,597 )
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	196,217	116,403	2,059
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	10,162,228	(1,327,467 )	(1,524,538 )
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	12,258,872	22,421,100	21,093,633
CASH AND CASH EQUIVALENTS, END OF YEAR	¥22,421,100	¥21,093,633	¥19,569,095
ADDITIONAL CASH FLOW INFORMATION:			
Interest paid	¥256,722	¥239,940	¥241,260
Income taxes paid	2,707,784	2,405,067	1,377,753
NONCASH INVESTING AND FINANCING ACTIVITIES:			
Acquisition of assets by entering into capital leases	3,436,245	3,678,012	8,065,674
Facilities purchase liabilities	1,050,429	1,442,810	1,497,767
Asset retirement obligation	170,814	287,036	45,169
Acquisition of a company (Note 2):			
Assets acquired	—	1,064,736	—
Liabilities assumed	—	464,736	—
Cash paid	—	(600,000 )	—
Cash acquired	—	432,322	—
Acquisition of a newly controlled company, net of cash acquired	—	(167,678 )	—

See notes to consolidated financial statements.

F-11 (Concluded)

## **Internet Initiative Japan Inc. and Subsidiaries**

### **Notes to Consolidated Financial Statements**

#### **1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Internet Initiative Japan Inc. (“IIJ,” a Japanese corporation) was founded in December 1992 to develop and operate Internet access services and other Internet-related services in Japan. As of March 31, 2016, 26.4% of IIJ’s voting shares were jointly owned by Nippon Telegraph and Telephone Corporation (“NTT”) and its subsidiary. IIJ and its subsidiaries (collectively, the “Company”) provide customers substantially operating in Japan with Internet connectivity services, Wide Area Network (“WAN”) services and outsourcing services. The Company also provides systems integration which consists of systems construction and systems operation and maintenance. In addition, a subsidiary provides Automated Teller Machines (“ATM”) operation services.

#### **Certain Significant Risks and Uncertainties**

The Company relies on telecommunications carriers for a significant portion of its network backbone and on regional NTT subsidiaries, electric power companies and their affiliates for local connections to customers. Currently, NTT Communications Corporation, a wholly owned subsidiary of NTT, is the largest provider of network infrastructure for the Company. The Company believes that its use of multiple carriers and suppliers significantly mitigates the risk of damages from service disruptions. However, any disruption of telecommunication services could have an adverse effect on operating results.

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of accounts receivable, which includes the accounts receivable from a large customer as noted in Note 20. The Company’s management believes that the risks associated with accounts receivable are mitigated by the large number of customers comprising its customer base and its credit line control. The Company also conducts an evaluation of a new customer’s financial condition at the inception of a transaction and continuously monitors delays in payment for each customer.

#### **Summary of Significant Accounting Policies**

**Basis of Presentation**—IIJ maintains its records and prepares its financial statements in accordance with generally accepted accounting principles in Japan. Certain adjustments and reclassifications have been incorporated in the accompanying consolidated financial statements to conform to generally accepted accounting principles in the United States of America (“U.S. GAAP”). These adjustments were not recorded in the statutory accounts.

**Consolidation**—The consolidated financial statements include the accounts of IIJ and all of its subsidiaries, IIJ Engineering Inc. (“IIJ-EG,” which was renamed from Net Care, Inc), IIJ America, Inc. (“IIJ-America”), Netchart Japan Inc. (“NCJ”), hi-ho Inc. (“hi-ho”), Trust Networks Inc. (“Trust Networks”), IIJ Innovation Institute Inc. (“IIJ-II”), IIJ Global Solutions Inc. (“IIJ-Global”) and its subsidiaries, IIJ Exlayer Inc. (“IIJ-Exlayer”) and its subsidiaries, IIJ Europe Limited (“IIJ-Europe”) and RYUKOSHA NETWARE Inc. (“RYUKOSHA”). IIJ-Exlayer was acquired by IIJ on April 2, 2012. IIJ-Europe was originally a wholly-owned subsidiary of IIJ-Exlayer. IIJ-Exlayer was merged with IIJ on January 1, 2014. RYUKOSHA was acquired by IIJ on December 1, 2014. All of the subsidiaries, except for IIJ-America, IIJ-Europe and other foreign subsidiaries, have fiscal years ending March 31. IIJ-America, IIJ-Europe and other foreign subsidiaries’ fiscal year-end is December 31 and such date was used for purposes of preparing the consolidated financial statements as it is not practicable for the foreign subsidiaries to report their financial results as of March 31. There were no significant events that occurred during the intervening period that would require adjustment to or disclosure in the accompanying consolidated financial statements. Intercompany transactions and balances have been eliminated in consolidation.

Investments in companies over which IIJ has significant influence but not control are accounted for by the equity method. For other-than-temporary declines in the value of investments in equity method investees below the carrying amount, the investments are reduced to fair value and an impairment loss is recognized.

Equity-method goodwill which is the portion of the difference between the cost of an investment and the amount of underlying equity in net assets of an investee is not amortized, but equity-method investments are continuously to be reviewed for impairment in accordance with Accounting Standards Codification (“ASC”) 323 “Investments-Equity Method and Joint Ventures.”

A subsidiary or equity method investee may issue its shares to third parties at amounts per share in excess of or less than the Company's average per share carrying value. Changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary are accounted for as equity transactions.

**Use of Estimates**—The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Significant estimates and assumptions used are primarily in the areas of evaluation of investments, valuation allowances for deferred tax assets, allowance for doubtful accounts, determination of pension benefit costs and obligations, estimated useful lives of fixed assets and intangible assets with finite useful lives and impairment of long-lived assets, goodwill and intangible assets deemed to have indefinite useful lives. Actual results could differ from those estimates.

**Revenue Recognition**—Network service revenues are billed and recognized monthly on a straight-line basis. Initial setup fees received in connection with network services are deferred and recognized over the estimated average period of the subscription for each service.

System integration revenue involves one or more of the following deliverables:

System construction services include all or some of the following elements depending on arrangements to meet each of our customer's requirements: consulting, project planning, system design, and development of network systems. These services also include the installation of software as well as configuration and installation of hardware.

Software we resell third-party software such as Oracle and Windows to our customers, which are installed by us during the system development process.

Hardware we also resell third-party hardware, primarily servers, switches and routers, which we install during the system development process. The hardware is generic hardware that is often sold by third party manufacturers and resellers.

Monitoring and operating service we monitor our customer's network activity and internet connectivity to detect and report problems. We also provide constant data backup services.

Hardware and software maintenance service we repair or replace any malfunctioning parts of hardware. We examine software faults and provide suitable solutions to customers.

The system construction services are generally delivered over a three-month period. All hardware and software are delivered and installed during this period. Customers are required to pay a specified fixed fee that is not payable until after the system construction has been completed and accepted by our customers.

Monitoring, operating, and hardware and software maintenance services generally commence once our customers have accepted the systems, and contract periods are generally from one to five years. Our contracts include a stated annual fee for these services.

For multiple-element arrangements that include system construction service, hardware, software essential to the hardware product's functionality and undelivered non-software services (e.g., monitoring and operating services), the Company allocates revenue to all deliverables based on their relative selling prices. The Company uses a hierarchy to determine the selling price to be used for allocating revenue to deliverables: (i) vendor-specific objective evidence of fair value ("VSOE"), (ii) third-party evidence of selling price ("TPE") and (iii) best estimate of the selling price ("ESP"). The allocation of revenue is based mainly on the Company's ESPs except for certain undelivered non-software services for which VSOE has been established. The Company's process for determining its ESP for deliverables includes various factors that may vary depending on the circumstances and specific characteristics related to each deliverable. In developing the ESP, the Company considers customer demand, the existence and effect of competitors, general profit margin realized in the marketplace, volume of the transactions, the Company's internal costs of providing the deliverables, the profit objectives including targeted and historical margins realized on similar sales to similar customers and the historical pricing practices.

The method used to account for each unit and the period over which each unit of accounting is recognized are as follows:

Revenue allocated to system construction services is accounted for using contract accounting. System construction service revenues, which are generally completed within three months, are recognized based on the completed-contract method in compliance with ASC 605-35-25-92 because the Company is unable to bill customers and the title to the constructed network system is not transferred to the customers unless they are satisfied with and accept the completed systems.

Revenue related to the hardware and software essential to the hardware product's functionality is not recognized until customer acceptance is received because title to the hardware and software do not transfer to our customers until formal acceptance is received.

Revenue related to undelivered non-software services (monitoring, operating and hardware maintenance services) is recognized on a straight-line basis over the contract period.

The Company also enters into multiple-element arrangements for system integration services that include software not essential to the hardware product's functionality and software-related services and accounts for them in accordance with ASC 985-605, "Software-Revenue Recognition." The Company has been able to establish VSOE of fair value of the software-related services based on separate renewal contracts of the services that are consistently priced within a narrow range. The Company allocates revenue to such services based on VSOE and recognizes the revenues on a straight-line basis over the contract period. The Company allocates the residual amount to the software.

Equipment sales revenues are recognized when equipment is delivered and accepted by the customer.

The Company evaluates whether it is appropriate to record the gross amount of revenues and related costs or the net amount earned in reporting system construction services and equipment sales, depending on whether the Company functions as principal or agent.

ATM operation business revenues consist primarily of commissions for each withdrawing transaction with the use of ATMs. ATM commission collected from each withdrawal is aggregated every month and recognized as ATM operation revenues.

Revenue is recognized net of consumption tax collected from customers and subsequently remitted to governmental authorities.

**Cash and Cash Equivalents**—Cash and cash equivalents includes time deposits with original maturities of three months or less.

**Allowance for Doubtful Accounts**—An allowance for doubtful accounts is established in amounts considered to be appropriate based primarily upon the Company's past credit loss experience and an evaluation of potential losses in the receivables outstanding.

**Other Investments**—The Company classifies its marketable equity and debt securities as available-for-sale securities, which are accounted for at fair value with unrealized gains and losses excluded from earnings and reported in accumulated other comprehensive income (loss). The cost of securities sold is determined based on average cost.

The Company reviews the fair value of available-for-sale securities on a regular basis to determine if the fair value of any individual security has declined below its cost and if such decline is other-than-temporary. If the decline in value is judged to be other-than-temporary, the cost basis of the investment is written down to fair value.

Other-than-temporary declines in value are determined taking into consideration the extent of decline in fair value, the length of time that the decline in fair value below cost has existed, the financial condition and near-term prospects of the issuer and the Company's intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in market value and events that might accelerate the recognition of impairment. For debt securities for which the declines are deemed to be other-than-temporary and there is no intent to sell and it is not more likely than not that the Company will be required to sell the securities before the recovery of the amortized cost basis, impairments are separated into the amount related to credit loss, which is recognized in earnings, and the amount related to all other factors, which is recognized in other comprehensive income (loss). For debt securities for which the declines are deemed to be other-than-temporary and there is an intent to sell or it is more likely than not that the Company will be required to sell the securities before the recovery of the amortized cost basis, impairments in their entirety are recognized in earnings. For equity securities for which the declines are deemed to be other-than-temporary, the resulting realized loss is recognized in earnings in the period in which the decline is deemed to be other-than-temporary.

Non-marketable equity securities are carried at cost as fair value is not readily determinable. When the Company evaluates whether non-marketable equity securities are impaired or not, the Company evaluates first whether an event or change in circumstances has occurred in the period that may have significant adverse effect on the fair value of the securities (an impairment indicator). The Company uses such impairment indicators as follows:

A significant deterioration in the earnings performance or business prospects of the investee.

A significant adverse change in the regulatory, economic, or technological environment of the investee.

A significant adverse change in the general market condition of either the geographic area or the industry in which the investee operates.

A recent example of the new issuance of a security, in which the issue price is less than our cost.

The Company estimates the fair value of the non-marketable equity securities when an impairment indicator is present. The fair value is determined as a result of considering various unobservable inputs which are available to the Company, including expectation of future income of the investees, net asset value of the investees, and material unrealized losses to be considered in assets and liabilities held by the investees. The Company recognizes impairment of non-marketable equity securities when the fair value is below the carrying amount and the decline in fair value is considered to be other-than-temporary.

***Inventories***—Inventories consist mainly of network equipment purchased for resale and work-in-process for construction of network systems. Network equipment purchased for resale is stated at the lower of cost, which is determined by the average-cost method, or market. Work-in-process for development of network systems is stated at the lower of actual production costs, including overhead cost, or market. Inventories are reviewed periodically and items considered to be slow-moving or obsolete are written down to their estimated net realizable value.

***Leases***—Capital leases are capitalized at the inception of the lease at the present value of the minimum lease payments. All other leases are accounted for as operating leases. Lease payments for capital leases are apportioned to interest expense and a reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Operating lease payments are recognized as an expense on a straight-line basis over the lease term.

***Sales-Type Leases***—The Company has some sales-type lease agreements with customers. The Company recognizes revenues on sales-type leases when the assets under lease are delivered to and accepted by the customers. The revenue recognized is calculated at the net present value of the future receipt amounts. Interest income in sales-type leases is



recognized in other income using the interest method.

***Property and Equipment***—Property and equipment are recorded at cost. Depreciation and amortization of property and equipment, including capitalized software and capital leases, are computed principally using the straight-line method based on either the estimated useful lives of assets or the lease period, whichever is shorter.

The useful lives for depreciation and amortization by major asset classes are as follows:

	Range of Useful Lives
Data communications, office and other equipment (years)	2 to 20
Buildings (years)	20
Leasehold improvements (years)	4 to 20
Capitalized software (years)	5 to 7
Capital leases (years)	4 to 6

**Impairment of Long-Lived Assets**—Long-lived assets consist principally of property and equipment, including those items leased under capital leases and amortized intangible assets. The Company evaluates the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Long-lived assets to be held and used are reviewed for impairment by comparing the carrying amount of the asset or asset group with their estimated undiscounted future cash flows. If the cash flows are determined to be less than the carrying amount of the asset or asset group, an impairment loss has occurred and the loss would be recognized during the period for the difference between the carrying amount of the asset or asset group and estimated fair value.

**Goodwill and Intangible Assets**—Goodwill and intangible assets that are deemed to have indefinite useful lives are not amortized, but are subject to impairment testing. Impairment testing is performed annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. The Company performs annual impairment tests on March 31. If the carrying amount of a reporting unit exceeds its fair value, the Company then performs the second step of the goodwill impairment test to measure the amount of impairment loss, if any. Intangible assets with finite useful lives, consisting of customer relationships, are amortized using a non-straight-line basis based on the pattern of expected future economic benefit over the estimated useful lives, which range from 7 to 19 years.

**Asset Retirement Obligations**—The Company records the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the Company capitalizes the related cost by increasing the carrying amount of long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated for the period the Company has estimated.

**Pension and Severance Indemnities Plans**—The Company has defined benefit pension plans and severance indemnities plans. The cost of the pension plans and severance indemnities plans are accrued based on amounts determined using actuarial methods. In addition, the Company has defined contribution pension plans. The costs of defined contribution pension plans are charged to expenses when incurred.

**Income Taxes**—Income tax expense is based on reported earnings before income taxes. Deferred income taxes reflect the impact of temporary differences between assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes and tax loss carryforwards. These deferred taxes are measured using the currently enacted tax rates in effect for the year in which the temporary differences or tax loss carryforwards are expected to reverse. Valuation allowances are provided against deferred tax assets when it is more likely than not that a tax benefit will not be realized.

The Company recognizes the financial statement effect of uncertain tax positions when it is more-likely- than not, based on the technical merits, that the tax positions will be sustained upon examination by the tax authorities. Benefits from tax positions that meet the more-likely-than-not recognition threshold are measured at the largest amount of benefit that is greater than 50% likely of being realized upon settlement. Interest and penalties accrued related to unrecognized tax benefits are included in income tax expense in the consolidated statements of income.

**Foreign Currency Translation**—The assets and liabilities of a foreign subsidiary and an equity method investee are translated into Japanese yen at the respective year-end exchange rates. All income and expense accounts are translated at average rates of exchange. The resulting translation adjustments are included in accumulated other comprehensive income (loss).

Foreign currency assets and liabilities are stated at the amount as computed by using year-end exchange rates and the resulting transaction gain or loss is recognized in earnings.

**Stock-Based Compensation**—The Company measures and records the compensation cost from stock compensation-type stock option based on fair value. The fair value of the stock option is measured on the date of grant using the Black-Scholes option-pricing model, and amortized over the requisite service period. The compensation cost is mainly included in “General and administrative” expenses.

**Research and Development Costs**—Research and development costs are expensed as incurred.

**Advertising**—Advertising costs are expensed as incurred and are recorded in “Sales and marketing.”

**Basic and Diluted Net Income attributable to Internet Initiative Japan Inc. per Common Share**—Basic net income attributable to Internet Initiative Japan Inc. per common share is computed by dividing net income attributable to Internet Initiative Japan Inc. by the weighted-average number of shares of common stock outstanding during the year. Diluted net income attributable to Internet Initiative Japan Inc. per common share reflects the potential dilutive effect of stock options.

**Other Comprehensive Income (Loss)**—Other comprehensive income (loss) consists of translation adjustments resulting from the translation of financial statements of a foreign subsidiary, unrealized gains or losses on available-for-sale securities and defined benefit pension plans adjustment.

**Segment Reporting**—ASC 280, “Segment Reporting” establishes standards for reporting information about operating segments. Operating segments are defined as components of an enterprise that engage in business activities from which it may earn revenues and incur expense and for which separate financial information is available that is evaluated regularly by the chief operation decision maker in deciding how to allocate resources and in assessing performance.

The Company 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 ATM operation services. The Company’s chief operating decision maker, who is the Company’s Chief Operating Officer (“COO”), regularly reviews the revenue and cost of sales of the two operating segments, which are the Network service and systems integration business segment and the ATM operation business segment. The COO also makes decisions regarding how to allocate resources and assess performance based on the segments.

### ***New Accounting Guidance***

#### ***Accounting Guidance Issued But Not Adopted as of March 31, 2016***

In May 2014, the FASB issued Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers (Topic 606),” to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and International Financial Reporting Standards. This guidance also requires an entity to improve disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. ASU 2015-14, “Revenue from Contracts with Customers: Deferral of the Effective Date,” which was issued in August 2015, revised the effective date for this ASU to annual and interim periods beginning after December 15, 2017, with early adoption permitted, but not earlier than the original effective date of annual and interim periods beginning after December 15, 2016, for public entities. The

Company is currently evaluating the impact of adopting this guidance.

In July 2015, the FASB issued ASU 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory," which applies to inventory that is measured using the first-in, first-out ("FIFO") or average cost methods. Under the updated guidance, an entity should measure inventory within the scope of the guidance at the lower of cost and net realizable value, which is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. Subsequent measurement is unchanged for inventory that is measured using last-in, first-out ("LIFO"). This ASU is effective for annual and interim periods beginning after December 15, 2016, and should be applied prospectively with early adoption permitted at the beginning of an interim or annual reporting period. The Company is currently evaluating the impact of adopting this guidance.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," which amends the guidance in U.S. GAAP on the classification and measurement of financial instruments. Changes to the current guidance primarily affect the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. In addition, the ASU clarifies guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. The new standard is effective for fiscal years and interim periods beginning after December 15, 2017, and upon adoption, an entity should apply the amendments by means of a cumulative-effect adjustment to the balance sheet at the beginning of the first reporting period in which the guidance is effective. Early adoption is not permitted except for the provision to record fair value changes for financial liabilities under the fair value option resulting from instrument-specific credit risk in other comprehensive income. The Company is currently evaluating the impact of adopting this guidance.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which requires organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. The new guidance requires that a lessee recognizes assets and liabilities for leases with lease terms of more than twelve months and the recognition, presentation and measurement in the financial statements will depend on its classification as a finance or operating lease. In addition, the new guidance will require disclosures to help investors and other financial statement users better understand the amount, timing and uncertainty of cash flows arising from leases. Lessor accounting remains largely unchanged from current U.S. GAAP but does contain some targeted improvements to align with the new revenue recognition guidance issued in 2014. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, using a modified retrospective approach, and early adoption is permitted. The Company is currently evaluating the impact of adopting this guidance.

In March 2016, the FASB issued ASU 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)," which is an amendment to the new revenue recognition standard on assessing whether an entity is a principal or an agent in a revenue transaction. This amendment addresses implementation issues that were discussed by the Revenue Recognition Transition Resource Group ("TRG") to clarify the principal versus agent assessment and provide for a more consistent application. This new standard has the same effective date and transition requirements as ASU 2014-09. The Company is currently evaluating the impact of adopting this guidance.

## 2. BUSINESS COMBINATIONS

There were no business acquisitions during the years ended March 31, 2014 and March 31, 2016.

On December 1, 2014, the Company acquired all the outstanding common shares of RYUKOSHA, which engages in human resources outsourcing services for fields such as systems operation and service support, for total consideration of ¥600,000 thousand paid in cash. The acquisition price of the shares was determined on the basis of the estimated future cash flows and efficiencies gained from an expected reduction in external recruiting expenses. There are no future contingent payments. The objectives of this acquisition are to rapidly strengthen the Company's engineering organization to meet the needs of a growing number of systems integration and outsourcing projects (such as systems construction and operation, and outsourcing for corporate customers' networks and systems) and to increase the Company's in-house business efficiency over the mid- to long-term by bringing more outsourced personnel into the Company.

The fair value of the assets acquired and liabilities assumed recognized in relation to the acquisition of RYUKOSHA was ¥865,078 thousand and ¥464,736 thousand, respectively, and goodwill of ¥199,658 thousand was recorded (see Note 8, "GOODWILL AND OTHER INTANGIBLE ASSETS").

For the year ended March 31, 2015, acquisition-related costs of ¥32,262 thousand were incurred. These costs consisted of professional advisory fees and were recorded in "General and administrative" expenses.

Pro forma results of operations have not been presented because the effect of the acquisition was not material.

## 3. INVENTORY

The components of inventories as of March 31, 2015 and 2016 are as follows:

Thousands of Yen	
2015	2016

Network equipment purchased for resale	¥667,110	¥658,330
Work in process	562,353	1,345,243
Total inventories	¥1,229,463	¥2,003,573



#### 4. OTHER INVESTMENTS

Pursuant to ASC 320, "Investments Debt and Equity Securities," all of the Company's marketable equity and debt securities are classified as available-for-sale securities. Information regarding the securities classified as available-for-sale at March 31, 2015 and 2016 is as follows:

	Thousands of Yen			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
<u>March 31, 2015</u>				
Available-for-sale—Equity securities	¥1,778,803	¥2,528,884	¥95,116	¥4,212,571
Available-for-sale—Debt securities	100,300	1,610	—	101,910
	¥1,879,103	¥2,530,494	¥95,116	¥4,314,481
<u>March 31, 2016</u>				
Available-for-sale—Equity securities	¥1,822,151	¥2,090,940	¥82,244	¥3,830,847
Available-for-sale—Debt securities	100,300	13,250	—	113,550
	¥1,922,451	¥2,104,190	¥82,244	¥3,944,397

Maturities of available-for-sale debt securities are due after 10 years.

The following table provides the fair value and gross unrealized losses of the Company's investments, which have been deemed to be temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of March 31, 2015 and 2016:

	Thousands of Yen					
	Fair Value	Less than 12 Months		12 Months or More		Total Fair Value
Unrealized Losses		Fair Value	Unrealized Losses	Fair Value		
<u>March 31, 2015</u>						
Available-for-sale—Equity securities	¥946,712	¥95,116	—	—	¥946,712	¥95,116
<u>March 31, 2016</u>						
Available-for-sale—Equity securities	¥994,658	¥79,267	¥7,587	¥2,977	¥1,002,245	¥82,244

The Company regularly reviews all of the Company's investments to determine if any are other-than-temporarily impaired. The analysis includes reviewing industry analyst reports, sector credit ratings and volatility of the security's market price.

The Company's unrealized loss on investments in marketable equity securities as of March 31, 2016 relates to Japanese companies (8 issuers) in various industries. The fair value of each investment is between 5.9% and 36.4% less than its cost. The duration of the unrealized loss position was primarily less than 12 months. The Company evaluated the near-term prospects of the issuers and the analyst reports in relation to the severity and duration of impairment. Based on that evaluation and the Company's ability and intent to hold the investments for a reasonable period of time sufficient to recover the unrealized loss, the Company does not consider the investments to be other-than-temporarily impaired at March 31, 2016.

Proceeds from the sale of available-for-sale securities were ¥391,814 thousand and ¥141,235 thousand for the years ended March 31, 2014 and 2016, respectively. Gross realized gains of ¥107,655 thousand and ¥35,934 thousand were included in "Other income (expenses)" for the years ended March 31, 2014 and 2015, respectively.

Net gain on other investments, which was derived from realized gains on investments in funds, for the year ended March 31, 2014 was ¥313,393 thousand.

The aggregate cost of the Company's cost method investments totaled ¥2,346,225 thousand and ¥2,004,344 thousand at March 31, 2015 and 2016, respectively.

Impairment of investments in certain marketable equity securities and nonmarketable equity securities, including funds, included in "Other income (expenses)" in the Company's consolidated statements of income, were recognized to reflect the decline in value considered to be other-than-temporary. The Company recognized impairment loss of ¥29,117 thousand on nonmarketable equity securities for the year ended March 31, 2015, and ¥3,964 thousand on marketable equity securities and ¥10,765 thousand on nonmarketable equity securities for the year ended March 31, 2016.

## 5. ALLOWANCE FOR DOUBTFUL ACCOUNTS AND LOANS

An analysis of the allowance for doubtful accounts and loans for the years ended March 31, 2014, 2015 and 2016 is as follows:

	Thousands of Yen		Provision for (Reversal of) Doubtful Accounts	Other	Balance at End of Year
	Balance at Beginning of Year	Credits Charged Off			
Year ended March 31, 2014	¥176,393	¥(12,067)	¥(46,935)	–	¥117,391
Year ended March 31, 2015	¥117,391	¥(3,153)	¥33,158	¥849	¥148,245
Year ended March 31, 2016	¥148,245	¥(45,108)	¥48,407	¥(29)	¥151,515

## 6. INVESTMENTS IN EQUITY METHOD INVESTEES

IJJ utilizes various companies in Japan to develop and operate its Internet business. Businesses operated by its equity method investees include multifeed technology services and location facilities for connecting high-speed Internet backbones (Internet Multifeed Co., “Multifeed”), comprehensive portal site operations (Internet Revolution Inc., “i-revo”), point management systems operations (Trinity Inc., “Trinity”), research and development of software (Stratosphere Inc., “Stratosphere”), cloud-based systems that undergird smartphone applications (Appiaries Corporation, “Appiaries”), system consultants (e-CORPORATION.JP Ltd, “e-CORPORATION”), cloud computing services in Indonesia (PT. BIZNET GIO NUSANTARA, “BIZNET”), system development and consulting in medical and healthcare business (KIS Inc., “KIS”) and cloud computing services in Thailand (Leap Solutions Asia Co., Ltd, “Leap Solutions”).

The aggregate amounts of balances and transactions of the Company with these equity method investees as of March 31, 2015 and 2016, and for each of the three years in the period ended March 31, 2016 are summarized as follows:

	Thousands of Yen		
	2014	2015	2016
Accounts receivable	–	¥367,741	¥124,923
Accounts payable	–	48,788	46,658
Revenues	¥538,288	956,887	666,554
Costs and expenses	451,342	460,463	502,340

Dividends from the equity method investees for the years ended March 31, 2015 and 2016 were ¥32,340 thousand and ¥48,510 thousand, respectively.

The Company's investments in these equity method investees and its ownership percentage in each at March 31, 2015 and 2016 consisted of the following:

	Thousands of Yen			
		2015		2016
Multifeed	33.00%	¥1,354,932	34.00%	¥1,518,610
i-revo	30.00	676,732	30.00	725,529
Trinity	33.75	101,618	33.75	133,325
Stratosphere	50.00	–	–	–
Appiaries	49.00	106,196	49.00	16,396
e-CORPORATION	35.21	32,839	35.21	29,095
BIZNET	40.00	288,240	40.00	246,193

KIS	–	–	36.10	53,576
Leap Solutions	–	–	40.00	256,928
Total		¥2,560,557		¥2,979,652

The Company also had a loan of ¥30,658 thousand to Stratosphere, which was included in “Other assets” in the Company’s consolidated balance sheet as of March 31, 2015. The Company also provided an allowance for this loan of ¥30,658 thousand as of March 31, 2015. Stratosphere was liquidated during the year ended March 31, 2016.

The Company acquired shares in KIS for ¥39,974 thousand in July 2015 and Leap Solutions for ¥256,928 thousand in March 2016.

The balance of equity-method goodwill was ¥103,841 thousand and ¥57,197 thousand as of March 31, 2015 and 2016, respectively, and was included in “Investments in equity method investees” in the Company’s consolidated balance sheets.

**7. PROPERTY AND EQUIPMENT**

Property and equipment as of March 31, 2015 and 2016 consisted of the following:

	Thousands of Yen	
	2015	2016
Data communications equipment	¥11,159,022	¥14,355,365
Office and other equipment	2,746,153	2,065,039
Land	537,889	537,889
Buildings	1,644,704	1,663,326
Leasehold improvements	3,798,172	3,904,189
Capitalized software	24,804,449	28,815,164
Assets under capital leases, primarily data communications equipment	24,271,434	28,328,721
Total	68,961,823	79,669,693
Less accumulated depreciation and amortization	(39,591,769)	(45,345,543)
Property and equipment—net	¥29,370,054	¥34,324,150

Depreciation and amortization expenses for property and equipment amounted to ¥8,359,907 thousand, ¥9,280,309 thousand and ¥9,533,541 thousand for the years ended March 31, 2014, 2015 and 2016, respectively.

The Company recorded net losses on sales or disposal of property and equipment of ¥83,487 thousand, ¥71,456 thousand and ¥27,950 thousand for the years ended March 31, 2014, 2015 and 2016, respectively, in “General and administrative” expenses in the Company’s consolidated statements of income.

The accumulated amortization for capitalized software were ¥15,298,591 thousand and ¥18,076,113 thousand for the years ended March 31, 2015 and 2016, respectively. The amortization expenses for capitalized software amounted to ¥2,343,155 thousand and ¥2,592,445 for the years ended March 31, 2015 and 2016, respectively. The weighted average amortization period for capitalized software is approximately 5.2 years. The estimated aggregate amortization expense of capitalized software for each of the next five years is as follows:

Year Ending March 31	Thousands of Yen
2017	¥2,990,683
2018	2,747,052
2019	2,048,524
2020	1,385,225

2021

840,041

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## 8. GOODWILL AND OTHER INTANGIBLE ASSETS

The components of intangible assets as of March 31, 2015 and 2016 are as follows:

	Thousands of Yen	
	2015	2016
Intangible assets subject to amortization:		
Customer relationships	¥6,424,471	¥6,424,471
Total	6,424,471	6,424,471
Less accumulated amortization		
Customer relationships	(2,619,544 )	(3,007,558)
Intangible assets subject to amortization—net	3,804,927	3,416,913
Intangible assets not subject to amortization:		
Telephone rights	29,352	36,546
Trademark	107,000	96,000
Goodwill	6,169,609	6,169,609
Total	6,305,961	6,302,155
Total intangible assets	¥10,110,888	¥9,719,068

The weighted average amortization period for customer relationships is approximately 16.2 years. The amortization expenses for the years ended March 31, 2015 and 2016 were ¥397,030 thousand and ¥388,014 thousand, respectively. The estimated aggregate amortization expense of intangible assets for each of the next five years is as follows:

Year Ending March 31	Thousands of Yen
2017	¥380,496
2018	365,460
2019	355,410
2020	346,223
2021	336,787

The Company recorded ¥11,000 thousand of loss on impairment of the trademark right related to hi-ho in “Sales and marketing” expenses in the Company’s consolidated statement of income for the year ended March 31, 2016. Because of the recent decrease in revenues of hi-ho, the Company recognized that the trademark might be impaired. The carrying value of the trademark exceeded its fair value and the impairment loss was recognized in an amount equal to the excess of the carrying amount of the trademark over the fair value of the trademark. The fair value of the



trademark was calculated using the relief-from-royalty method. The amount of loss was included in the network service and system integration business segment.

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The following table shows changes in the carrying amount of goodwill for the years ended March 31, 2015 and 2016, by operating segment:

	Thousands of Yen		
	Network Service and Systems Integration Business	ATM Operation Business	Total
Balance at March 31, 2014			
Goodwill	¥ 5,854,682	¥235,551	¥6,090,233
Accumulated impairment losses	(120,282 )	—	(120,282 )
	5,734,400	235,551	5,969,951
Acquisition	199,658	—	199,658
Impairment losses	—	—	—
Balance at March 31, 2015			
Goodwill	6,054,340	235,551	6,289,891
Accumulated impairment losses	(120,282 )	—	(120,282 )
	5,934,058	235,551	6,169,609
Acquisition	—	—	—
Impairment losses	—	—	—
Balance at March 31, 2016			
Goodwill	6,054,340	235,551	6,289,891
Accumulated impairment losses	(120,282 )	—	(120,282 )
	¥5,934,058	¥235,551	¥6,169,609

No impairment of goodwill was recognized during the years ended March 31, 2014, 2015 and 2016.

On December 1, 2014, IIJ acquired a new subsidiary, RYUKOSHA, and recorded goodwill of ¥199,658 thousand. The goodwill components were mainly attributable to human resources and the goodwill was included in the network service and system integration business segment.



## 9. LEASES

The Company enters into, in the normal course of business, various leases for domestic and international backbone services, office premises, network operation centers and data communications and other equipment. Certain leases that meet one or more of the criteria set forth in the provision of ASC 840, “Leases” have been classified as capital leases and the others have been classified as operating leases.

A portion of the Company’s sales result from multi-year lease agreements, under which the Company leased some network equipment to customers. The leases are classified as sale-type leases which the Company accounts for in accordance with ASC 840.

**Operating Leases**—The Company has operating lease agreements with telecommunications carriers and others for the use of connectivity lines, including local access lines that customers use to connect to IJJ’s network. The leases for domestic and international backbone connectivity are generally non-cancelable for a minimum one-year lease period. The Company also leases its office premises, for which refundable lease deposits are capitalized as guarantee deposits, certain office equipment under non-cancelable operating leases, and its network operation centers under non-cancelable operating leases which expire on various dates through the year 2023.

Refundable guarantee deposits as of March 31, 2015 and 2016 consist of the following:

	Thousands of Yen	
	2015	2016
Head office	¥2,187,901	¥2,462,266
Sales and subsidiaries offices	547,549	551,242
Others	64,751	71,173
Total refundable guarantee deposits	¥2,800,201	¥3,084,681

Lease expenses related to backbone lines for the years ended March 31, 2014, 2015 and 2016 amounted to ¥3,763,803 thousand, ¥3,743,576 thousand and ¥3,638,063 thousand, respectively. Lease expenses for local access lines for the years ended March 31, 2014, 2015 and 2016, which are mainly attributable to Internet connectivity services and WAN services, amounted to ¥22,602,364 thousand, ¥21,967,587 thousand and ¥23,035,615 thousand, respectively. Other lease expenses for the years ended March 31, 2014, 2015 and 2016 amounted to ¥6,513,184 thousand, ¥6,988,368 thousand and ¥6,880,307 thousand, respectively.

The Company has subleased a part of its office premises. Lease expenses mentioned above have been reduced by sublease revenues totaling ¥24,082 thousand, ¥29,521 thousand and ¥41,002 thousand for the years ended March 31,

2014, 2015 and 2016, respectively.

**Capital Leases**—The Company conducts its connectivity and other services by using data communications and other equipment leased under capital lease arrangements.

The Company sold ATM and data communications equipment procured from third party vendors, which amounted to ¥799,232 thousand and ¥2,807,592 thousand, to the leasing companies for the years ended March 31, 2015 and 2016, respectively, and concurrently entered into capital lease arrangements to lease the equipment back, which resulted in total lease payments of ¥819,680 thousand due by March 2020 and ¥2,755,182 thousand due by April 2022, related to the lease contracts made in the years ended March 31, 2015 and 2016, respectively.

The fair values of the assets upon execution of the capital lease arrangements and accumulated depreciation amounted to ¥24,271,434 thousand and ¥16,614,912 thousand, respectively, at March 31, 2015 and ¥28,328,721 thousand and ¥18,728,508 thousand, respectively, at March 31, 2016.

**Lessee Future Minimum Lease Payments**—As of March 31, 2016, future lease payments under non-cancelable operating leases, including the aforementioned non-cancelable connectivity lease agreements and capital leases were as follows:

	Thousands of Yen		
	Connectivity Lines Operating Leases	Other Operating Leases	Capital Leases
Year ending March 31:			
2017	¥870,720	¥3,579,008	¥4,142,275
2018	673,610	981,812	3,074,462
2019	309,032	173,907	2,326,311
2020	—	132,523	1,394,337
2021	—	109,581	886,236
2022 and thereafter	—	274,562	338,174
Total minimum lease payments	¥1,853,362	¥5,251,393	12,161,795
Less amounts representing interest			(428,042 )
Present value of net minimum capital lease payments			11,733,753
Less current portion			(3,954,386 )
Noncurrent portion			¥7,779,367

**Sales-Type Leases**—The components of the net investment in sales-type leases as of March 31, 2015 and 2016 were as follows:

	Thousands of Yen	
	2015	2016
Year ending March 31:		
2017		¥845,336
2018		751,865
2019		617,127
2020		401,579
2021		352,438
2022 and thereafter		379,599
Total minimum lease payments to be received*	¥1,488,656	¥3,347,944
Estimated residual value of leased property (unguaranteed)	—	—
Less unearned income	(24,278 )	(89,407 )

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Net investment in sales-type leases	1,464,378	3,258,537
Less current portion	(702,219 )	(813,689 )
Non-current net investment in sales-type leases	¥762,159	¥2,444,848

\*Estimated executory costs, including profit thereon, of ¥345,698 thousand and ¥646,079 thousand were excluded from total minimum lease payments to be received as of March 31, 2015 and 2016, respectively.

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**10. ASSET RETIREMENT OBLIGATIONS**

The asset retirement obligations are principally related to leasehold office premises and a data center which, at the end of the lease, the Company is contractually obligated to restore.

The movements in asset retirement obligations for the years ended March 31, 2015 and 2016 were as follows:

	Thousands of Yen	
	2015	2016
Balance at beginning of the year	¥513,440	¥568,869
Liabilities incurred	287,036	45,169
Liabilities settled	(243,109)	(31,321)
Accretion expense	11,502	12,466
Balance at end of the year	¥568,869	¥595,183

**11.****BORROWINGS**

Short-term borrowings at March 31, 2015 and 2016 consisted of bank overdrafts that bear fixed rate interest. The weighted average rates at March 31, 2015 and 2016 were 0.568% and 0.498%, respectively.

Substantially all short-term bank borrowings are made under agreements which, as is customary in Japan, provide that under certain conditions the bank may require the borrower to provide collateral (or additional collateral) or a guarantor with respect to the borrowings and that the bank may treat any collateral, whether furnished as security for short-term or long-term loans or otherwise, as collateral for all indebtedness to such bank. Also, provisions of certain loan agreements grant certain rights of possession to the lenders in the event of default. The Company did not provide banks with any collateral for outstanding loans as of March 31, 2016.

The Company entered into bank overdraft agreements with certain Japanese banks for which the unused balance outstanding as of March 31, 2016 was ¥10,750,000 thousand.



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**12. INCOME TAXES**

Income taxes imposed by the national, prefectural and municipal governments of Japan resulted in a normal statutory rate of approximately 38.3% for the year ended March 31, 2014 and 35.9% for the year ended March 31, 2015 and 33.5% for the year ended March 31, 2016.

Income from operations before income tax expense and equity in net income of equity method investees and income tax expense for the years ended March 31, 2014, 2015 and 2016 consist of the following components:

	Thousands of Yen		
	2014	2015	2016
Income from operations before income tax expense and equity in net income of equity method investees:			
Domestic	¥6,406,153	¥5,407,802	¥6,460,898
Foreign	(131,262 )	(268,810 )	(267,564 )
Total	¥6,274,891	¥5,138,992	¥6,193,334
Income taxes current:			
Domestic	¥2,453,549	¥1,720,557	¥1,929,139
Foreign	41,582	(34,922 )	5,277
Total	¥2,495,131	¥1,685,635	¥1,934,416
Income taxes deferred:			
Domestic	¥(729,822 )	¥181,088	¥255,992
Foreign	29,996	30,142	(6,877 )
Total	¥(699,826 )	¥211,230	¥249,115

IJJ and domestic subsidiaries adopted the consolidated tax declaration in the fiscal year ended March 31, 2009.

On March 20, 2014, amendments to Japanese tax regulations were enacted into law. As a result, the normal Japanese statutory rate was reduced from 38.3% to 35.9% from the fiscal year beginning April 1, 2014. On March 31, 2015, new amendments to Japanese tax regulations were enacted into law. As a result, the normal Japanese statutory rate was reduced from 35.9% to 34.2% from the fiscal year beginning April 1, 2015. On March 31, 2016, further amendments to Japanese tax regulations were enacted into law. As a result, the normal Japanese statutory rate will be reduced to 31.7% from the fiscal year beginning April 1, 2016, 31.1% from the fiscal year beginning April 1, 2017 and 30.9% from the fiscal year beginning April 1, 2018. The effect of the changes in the tax rates on the balance of deferred tax assets and liabilities was an increase of income tax expense by ¥106,487 thousand, ¥51,788 thousand and ¥23,183 thousand for the years ended March 31, 2014, 2015 and 2016, respectively.



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The approximate effect of temporary differences and carryforwards giving rise to deferred tax balances at March 31, 2015 and 2016 was as follows:

	Thousands of Yen			
	2015	2015	2016	2016
	Deferred Tax Assets	Deferred Tax Liabilities	Deferred Tax Assets	Deferred Tax Liabilities
Unrealized gains on available-for-sale securities	–	¥832,426	–	¥620,755
Capital leases	¥141,255	–	¥130,365	–
Accrued expenses	995,253	–	933,947	–
Retirement and pension cost	960,151	–	1,102,215	–
Allowance for doubtful accounts	58,760	–	56,534	–
Depreciation	101,652	–	72,109	–
Net loss on other investments	230,794	–	205,373	–
Operating loss carryforwards	1,276,690	–	947,031	–
Transactions in transit*	–	106,631	–	96,714
Impairment loss on telephone rights	74,268	–	67,102	–
Accrued enterprise tax	86,448	–	120,793	–
Asset retirement obligation	194,553	–	183,912	–
Deferred revenue	353,098	–	387,481	–
Customer relationships	–	1,299,335	–	1,058,578
Tax deduction of goodwill	–	810,172	–	791,377
Excess of tax deductible goodwill over the reported amount of goodwill	88,769	–	–	–
Trademark	–	38,413	–	29,664
Investments in equity method investees	–	241,210	–	291,266
Investments in funds	100,045	–	83,818	–
Asset retirement cost	–	160,293	–	146,266
Other	333,752	85,128	329,491	68,941
Total	4,995,488	3,573,608	4,620,171	3,103,561
Valuation allowance	(611,997 )	–	(627,693 )	–
Total	¥4,383,491	¥3,573,608	¥3,992,478	¥3,103,561

\*This item arises from transactions between IIJ and foreign subsidiaries, which were recorded in the different periods as a result of the difference in each company's fiscal year-end.

As of March 31, 2015 and 2016, the valuation allowance for deferred tax assets related principally to operating loss carryforwards, at amounts which are not considered more likely than not to be realized. The net changes in the valuation allowance for deferred tax assets were a decrease of ¥933,623 thousand, an increase of ¥183,813 thousand and an increase of ¥15,696 thousand for the years ended March 31, 2014, 2015 and 2016, respectively.

Undistributed earnings of foreign subsidiaries that are deemed to be permanently invested amounted to ¥458,233 thousand as of March 31, 2016. It is not practicable to calculate the unrecognized deferred tax liability on such undistributed earnings.

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As of March 31, 2016, certain subsidiaries had tax operating loss carryforwards as follows:

Expired in Year Ending March 31	Thousands of Yen		
	Enterprise Tax Subject to Consolidation Tax Filing	Inhabitant Tax Subject to Consolidation Tax Filing	Others
2017	—	—	—
2018	—	—	¥79,790
2019	—	—	214,286
2020	—	—	829,986
2021 and thereafter	¥253,286	¥ 18,663	1,800,221
Total	¥253,286	¥ 18,663	¥2,924,283

“Others” consists of loss carryforwards of subsidiaries not subject to consolidation tax filing, which were composed of ¥652,326 thousand in Japan, ¥1,281,086 thousand in the United States of America, and ¥990,871 thousand in other countries.

These loss carryforwards are available to offset future taxable income, and will expire in the period ending March 31, 2024 in Japan and December 31, 2035 in the United States of America. The loss carryforwards in other countries will expire in the period ending December 31, 2020 or have an indefinite carryforward period.

A reconciliation between the amount of reported income taxes and the amount of income taxes computed using the normal statutory rate for each of the three years in the period ended March 31, 2016 is as follows:

	Thousands of Yen		
	2014	2015	2016
Amount computed by using normal Japanese statutory tax rate	¥2,403,283	¥1,844,898	¥2,074,767
Increase (decrease) in taxes resulting from:			
Expenses not deductible for tax purpose	102,634	76,258	93,262
Inhabitant tax—per capita	37,122	39,114	39,538
Change in valuation allowance	(957,182 )	159,163	15,696
Tax effects on investments in equity method investees	65,489	19,650	48,368
Enterprise tax—not based on income	82,191	90,086	146,883
Tax rate change	106,487	51,788	23,183
Tax credit	—	(232,834 )	(269,145 )
Tax refund by loss carryback	—	(32,275 )	—
Other—net	(44,719 )	(118,983 )	10,979
Income tax expense as reported	¥1,795,305	¥1,896,865	¥2,183,531

There was no unrecognized tax benefit for the years ended March 31, 2015 and 2016. The Company does not reasonably expect that the unrecognized tax benefit will change significantly within the next twelve months.

The Company has open tax years subject to examination by major tax jurisdictions from the year ended March 31, 2013 in Japan and from the year ended December 31, 2006 in the United States of America.

**13. RETIREMENT AND PENSION PLANS**

IIJ and certain subsidiaries have unfunded severance benefit, noncontributory defined benefit pension and defined contribution plans which together cover substantially all of their employees who are not directors. The defined benefit pension plan is operated under the Defined Benefit Corporate Pension Law.

The following information regarding net periodic pension cost and accrued pension cost also includes the unfunded severance benefit plans. Under the severance and defined benefit pension plans, all of IIJ and IIJ-Global's employees are entitled, upon retirement with 20 years or more of service, to a 10-year period of annuity payments from age 60 (or lump-sum severance indemnities) based on the rate of pay at the time of retirement, length of service and certain other factors. IIJ and IIJ-Global's employees who do not meet these conditions are entitled to lump-sum severance indemnities.

Net periodic pension cost for the years ended March 31, 2014, 2015 and 2016 included the following components:

	Thousands of Yen		
	2014	2015	2016
Service cost	¥542,584	¥573,956	¥648,944
Interest cost	45,418	73,902	67,525
Expected return on plan assets	(48,303 )	(63,037 )	(87,909 )
Amortization of transition obligation	369	369	365
Amortization of actuarial gain	–	(2,782 )	(2,971 )
Net periodic pension cost	¥540,068	¥582,408	¥625,954

Other changes in plan assets and benefit obligations recognized in other comprehensive income for the years ended March 31, 2014, 2015 and 2016 are as follows:

	Thousands of Yen		
	2014	2015	2016
Net actuarial loss (gain)	¥(63,775 )	¥127,065	¥585,332
Amortization of transition obligation in net periodic pension cost	(369 )	(369 )	(365 )
Amortization of actuarial gain	–	2,782	2,971
Amounts recognized in other comprehensive income	¥(64,144 )	¥129,478	¥587,938



Total net periodic pension cost and amounts recognized in other comprehensive income	¥475,924	¥711,886	¥1,213,892
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The change in benefit obligation and plan assets for the years ended March 31, 2015 and 2016 and the amounts recognized in the consolidated balance sheets as of March 31, 2015 and 2016 are as follows:

	Thousands of Yen	
	2015	2016
Change in benefit obligation:		
Benefit obligation at beginning of year	¥4,426,598	¥5,285,093
Service cost	573,956	648,944
Interest cost	73,902	67,525
Actuarial loss	283,860	480,755
Benefit paid	(73,223 )	(94,207 )
Benefit obligation at end of year	5,285,093	6,388,110
Change in plan assets:		
Fair value of plan assets at beginning of year	2,424,499	2,930,310
Actual return (loss) on plan assets	219,832	(16,667 )
Employer contribution	322,826	334,252
Benefits paid	(36,847 )	(53,996 )
Fair value of plan assets at end of year	2,930,310	3,193,899
Funded status at end of year	¥(2,354,783)	¥(3,194,211)

Amounts recognized in the consolidated balance sheets as of March 31, 2015 and 2016 consist of:

	Thousands of Yen	
	2015	2016
Accrued retirement and pension costs noncurrent	¥(2,354,783)	¥(3,194,211)
Net amount recognized	¥(2,354,783)	¥(3,194,211)

The accumulated benefit obligation for the Company's defined benefit pension plans as of March 31, 2015 and 2016 was ¥3,323,739 thousand and ¥4,084,419 thousand, respectively.

The aggregate projected benefit obligation and aggregate fair value of plan assets for plans with projected benefit obligations in excess of plan assets were ¥5,285,093 thousand and ¥2,930,310 thousand, respectively, at March 31,

2015 and ¥6,388,110 thousand and ¥3,193,899 thousand, respectively, at March 31, 2016, respectively. The aggregate accumulated benefit obligations of plans with no plan assets were ¥90,851 thousand and ¥104,051 thousand at March 31, 2015 and 2016, respectively.

Amounts recognized in accumulated other comprehensive income at March 31, 2015 and 2016 consist of:

	Thousands of Yen	
	2015	2016
Net actuarial loss	¥371,122	¥959,426
Obligation at transition	365	–
Total	¥371,487	¥959,426

The unrecognized net loss and the unrecognized net obligation at the date of initial application are being amortized over 14 years and 21 years, respectively.

The estimated net actuarial loss for the defined benefit pension plans that will be amortized from accumulated other comprehensive income into net periodic pension cost in the fiscal year ending March 31, 2017 is ¥24,584 thousand.

Actuarial assumptions as of March 31 were as follows:

	Benefit Obligations		Net Periodic Costs		
	2015	2016	2014	2015	2016
Discount rate	1.3%	0.7%	1.2%	1.7%	1.3%
Expected long-term rate of return on plan assets			2.4	2.6	3.0
Rate of increase in compensation	3.2	3.1	3.3	3.2	3.2

The Company sets the discount rate assumption annually at March 31 based on high-quality fixed income securities reflecting the estimated timing of benefit payments.

The basis for determining the long-term rate of returns is a combination of historical returns and prospective return assumptions derived from pension trust funds' managing company.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid.

Years Ending March 31	Thousands of Yen
2017	¥94,235
2018	119,570
2019	132,585
2020	151,505
2021	195,246
2022–2026	1,708,740
Total	¥2,401,881

The Company expects to contribute ¥334,252 thousand to its defined benefit pension plan in the year ending March 31, 2017.

The Company's defined contribution plan, which was established on April 1, 2009, covers substantially all its employees. The Company contributes 1.6% of its employees' base salaries to the plan on a monthly basis. No employee contributions to the plan are allowed. Contributions to the plan were ¥125,195 thousand, ¥134,591 thousand and ¥138,372 thousand for the years ended March 31, 2014, 2015 and 2016, respectively.

The Company's funding policies with respect to the noncontributory plan are generally to contribute amounts considered tax deductible under applicable income tax regulations. Plan assets, including life insurance pooled investment portfolios, consist of Japanese and U.S. government bonds, other debt securities and marketable equity securities.

Life insurance pooled investment portfolios are managed by an insurance company and guarantee a minimum rate of return.

The Company's investment strategy for the plan assets is to manage the assets in order to pay retirement benefits to plan participants from the Company over the life of the plans.

This is accomplished by identifying and managing the exposure to various market risks, and diversifying investments in various asset classes based on a portfolio determined by the insurance company in order to maximize long-term rate of return, while considering the liquidity needs of the plans.

The plan is permitted to use derivative instruments only for the purpose of hedging. Both margin trading and real-estate investment are prohibited in principle.

The Company mitigates the credit risk of investments by establishing guidelines with the insurance company. These guidelines are monitored periodically by the Company for compliance.

The projected allocation of the plan assets managed by the insurance company is developed in consideration of the expected long-term investment returns for each category of the plan assets. Approximately 63.0%, 35.0%, and 2.0% of the plan assets excluding pooled investment portfolios will be allocated to debt securities, equity securities and other financial instruments, respectively, to moderate the level of volatility in pension plan asset returns and reduce risks. 50% of the employer's contribution to the plan during the year ending March 31, 2017 will be allocated to life insurance pooled investment portfolios and the other 50% will be allocated to the aforementioned investments.

The following table summarizes the basis used to measure the Company's pension plan assets at fair value:

Level 1—Inputs are quoted prices in active markets for identical assets or liabilities.

Level 2—Inputs are quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are

observable, and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3—Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable, which reflect the reporting entity's own assumptions about the assumptions that market participants would use in establishing a price.

Basis of Fair Value Measurement of Pension Plan Assets at March 31, 2015	Thousands of Yen			Level 3	Total
	Level 1	Level 2			
Equity securities:					
Japanese equity	¥417,833	—	—	—	¥417,833
U.S. equity	124,670	—	—	—	124,670
Other equity developed countries	78,027	—	—	—	78,027
Total equity securities	620,530	—	—	—	620,530
Debt securities:					
Japanese government and municipalities	—	¥495,637	—	—	495,637
Japanese corporate bonds investment grade	—	256,954	—	—	256,954
U.S. government	—	110,851	—	—	110,851
Other government developed countries	—	152,927	—	—	152,927
Residential mortgage-backed	—	19,256	—	—	19,256
Total debt securities	—	1,035,625	—	—	1,035,625
Other financial instruments*	—	1,109,010	—	—	1,109,010
Cash	165,145	—	—	—	165,145
Total assets at fair value	¥785,675	¥2,144,635	—	—	¥2,930,310

Basis of Fair Value Measurement of Pension Plan Assets at March 31, 2016	Thousands of Yen			Level 3	Total
	Level 1	Level 2			
Equity securities:					
Japanese equity	¥469,780	–	–	–	¥469,780
U.S. equity	144,147	–	–	–	144,147
Other equity developed countries	84,400	–	–	–	84,400
Total equity securities	698,327	–	–	–	698,327
Debt securities:					
Japanese government and municipalities	–	¥577,488	–	–	577,488
Japanese corporate bonds investment grade	–	241,744	–	–	241,744
U.S. government	–	118,099	–	–	118,099
Other government developed countries	–	158,547	–	–	158,547
Residential mortgage-backed	–	21,381	–	–	21,381
Total debt securities	–	1,117,259	–	–	1,117,259
Other financial instruments*	–	1,267,090	–	–	1,267,090
Cash	111,223	–	–	–	111,223
Total assets at fair value	¥809,550	¥2,384,349	–	–	¥3,193,899

\* Other financial instruments are life insurance pooled investment portfolios.

Pension plan assets classified as Level 1 are comprised principally of equity securities, which are valued using an unadjusted quoted market price in active markets with sufficient volume and frequency of transactions.

Pension plan assets classified as Level 2 are comprised principally of government bonds, corporate bonds and life insurance pooled investment portfolios which are valued based on quoted prices obtained from a well-established third-party. The bonds are traded in less active markets and the fair values are based on the price a dealer would pay for the bonds.

IJJ and one subsidiary also participate in a contributory multi-employer pension plan, the Japan Computer Information Service Employee's Pension Fund (the "Multi-Employer Plan"), which covers substantially all of their employees.

As stipulated by the Japanese Welfare Pension Insurance Law, the Multi-Employer Plan is composed of a substitutional portion of Japanese Pension Insurance and a multi-employers' portion of a contributory defined benefit



pension plan. The benefits for the substitutional portion are based on a standard remuneration schedule under the Welfare Pension Insurance Law and the length of participation. The multi-employer portion of the benefits is based on the employee's length of service. However, assets contributed by an employer including IJJ are not segregated in a separate account or restricted to provide benefits only to employees of that employer. The net pension cost under the Multi-Employer Plan is recognized when contributions become due.

Contributions due and paid during the years ended March 31, 2014, 2015 and 2016 under the Multi-Employer Plan, including its substitutional portion, amounted to ¥265,470 thousand, ¥293,132 thousand and ¥123,674 thousand, respectively. The Company's contribution did not represent more than 5% of total contributions to the plan during the years ended March 31, 2014, 2015 and 2016.

The plan is not subject to a funding improvement and was more than 80% funded as of March 31, 2015. The total plan assets were ¥307,788,655 thousand as of March 31, 2016. It was not practical to obtain additional information for the plan for the year ended March 31, 2016.

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The amount of retirement benefits for retiring directors and company auditors must be approved by the shareholders.

IIJ has a retirement plan for full-time company auditors. The Company recorded a liability for retirement benefit for company auditors of ¥5,530 thousand and ¥7,530 thousand, which would be required if they were all to retire at March 31, 2015 and 2016, respectively.

IIJ had a retirement benefit plan for full-time directors, which was abolished in June 2011. The allowance for retirement benefit amounted to ¥255,330 thousand in consideration of their services provided up to the date of abolition of the plan, and this amount will be reserved until each director's retirement date. IIJ's subsidiary also has a retirement benefit plan for full-time directors. The Company recorded a liability for retirement benefit for full-time directors of ¥430,638 thousand and ¥379,685 thousand, which would be required if they were all to retire at March 31, 2015 and 2016, respectively.

The retirement benefits paid to a retired company auditor was ¥2,010 thousand for the year ended March 31, 2014.

#### 14. SHAREHOLDERS' EQUITY

Japanese companies are subject to the Corporation Law of Japan (the "Corporation Law"). The significant provisions in the Corporation Law that affect financial and accounting matters are summarized below:

##### *Dividends*

Under the Corporation Law, companies can pay dividends at any time during the fiscal year in addition to the year-end dividend upon resolution at the shareholders meeting. For companies that meet certain criteria such as: (1) having a Board of Directors, (2) having independent auditors, (3) having a Board of Company Auditors, and (4) the term of service of the directors is prescribed as one year rather than two years of normal term by its articles of incorporation, the Board of Directors may declare dividends (except for dividends in kind) at any time during the fiscal year if the company has prescribed so in its articles of incorporation. However, the Company cannot do so because it does not meet criteria (4) above. The Corporation Law permits companies to distribute dividends-in-kind (non-cash assets) to shareholders subject to a certain limitation and additional requirements. Semiannual interim dividends may also be paid once a year upon resolution by the Board of Directors if the articles of incorporation of the company so stipulate. The Corporation Law provides certain limitations on the amounts available for dividends or the purchase of treasury stock. The limitation is defined as the amount available for distribution to the shareholders, but the amount of net assets after dividends must be maintained at no less than ¥3 million.

At the 14th Ordinary General Shareholders Meeting held on June 28, 2006, IJ's shareholders approved the reductions of additional paid-in capital of ¥21,980,395 thousand and common stock of ¥2,539,222 thousand to eliminate the accumulated deficit for the purpose of reporting under the Corporation Law in its non-consolidated financial statements. The effective date was August 4, 2006.

##### *Increases / decreases and transfer of common stock, reserve and surplus*

The Corporation Law requires that an amount equal to 10% of dividends must be appropriated as legal reserve (a component of retained earnings) or as additional paid-in capital (a component of capital surplus) depending on the equity account charged upon the payment of such dividends until the total of aggregate amount of legal reserve and additional paid-in capital equals 25% of common stock. Under the Corporation Law, the total amount of additional paid-in capital and legal reserve may be reversed without limitation. The Corporation Law also provides that common stock, legal reserve, additional paid-in capital, and other capital surplus and retained earnings can be transferred among the accounts under certain conditions upon resolution of shareholders.

##### *Treasury stock and treasury stock acquisition rights*

The Corporation Law also provides for companies to purchase treasury stock and dispose of such treasury stock by resolution of the Board of Directors. The amount of treasury stock purchased cannot exceed the amount available for

distribution to the shareholders which is determined by a specific formula.

The Corporation Law also provides that companies can purchase both treasury stock acquisition rights and treasury stock.

The amount of retained earnings available for dividends under the Corporation Law is based on the amount of retained earnings recorded in IIJ's general books of account prepared using accepted Japanese accounting practices. The adjustments included in the accompanying consolidated financial statements for U.S. GAAP purposes but not recorded in the general books of account have no effect on the determination of retained earnings available for dividends under the Corporation Law. Retained earnings available for dividends amounted to ¥24,895,644 thousand at March 31, 2016.

IIJ's equity in undistributed earnings of affiliated companies accounted for by the equity method included in retained earnings amounted to ¥869,770 thousand at March 31, 2016.

In July 2013, IIJ completed a public offering of 4,700,000 new shares of common stock by a firm-commitment underwriting at an issue price of ¥3,346 (an amount paid of ¥3,208) per share on the Tokyo Stock Exchange. In August 2013, IIJ issued 700,000 new shares of common stock by way of Third-Party Allotment at an amount paid of ¥3,208 per share. Stock issuance costs of ¥51,996 thousand (net of tax) were deducted from additional paid-in-capital. The total of net proceeds to IIJ from the public offering and the third-party allotment, after deducting stock issuance costs, were ¥17,271,204 thousand.

On June 26, 2013, IIJ's shareholders approved the payment of a cash dividend to shareholders of record at March 31, 2013 of ¥10 per share or the aggregate amount of ¥405,368 thousand.

On November 8, 2013, the Board of Directors of IIJ resolved the payment of a cash dividend to shareholders of record at September 30, 2013 of ¥11 per share or the aggregate amount of ¥505,329 thousand.

On June 25, 2014, IIJ's shareholders approved the payment of a cash dividend to shareholders of record at March 31, 2014 of ¥11 per share or the aggregate amount of ¥505,330 thousand.

On November 7, 2014, the Board of Directors of IIJ resolved the payment of a cash dividend to shareholders of record at September 30, 2014 of ¥11 per share or the aggregate amount of ¥505,365 thousand.

On June 26, 2015, IIJ's shareholders approved the payment of a cash dividend to shareholders of record at March 31, 2015 of ¥11 per share or the aggregate amount of ¥505,365 thousand.

On November 9, 2015, the Board of Directors of IIJ resolved the payment of a cash dividend to shareholders of record at September 30, 2015 of ¥11 per share or the aggregate amount of ¥505,479 thousand.

### ***Stock Option Plans***

On May 26, 2011, IIJ's board of directors resolved to introduce stock compensation-type stock options for executive officers of IIJ. On June 28, 2011, IIJ's ordinary general meeting of shareholders approved the introduction of stock compensation-type stock options for directors of IIJ. Stock compensation-type stock options, which are stock acquisition rights entitling holders to acquire shares upon exercise, at an exercise price of one yen per share, were allocated to directors and executive officers as a substitute for the retirement allowance plan for them and to further promote their motivation and incentives to contribute to the enhancement of the mid- to long-term continuous business performance and corporate value.

The stock acquisition rights become exercisable after a service period of one year and are exercisable up to 29 years from the date of vesting. The stock acquisition rights may be exercised only within 10 days from the day immediately following the day on which the person loses his or her position as either a director or an executive officer.

On July 11, 2013, IIJ granted 89 stock options which were the same type of options granted in 2012 to directors and executive officers. The fair value per option at the date of grant was ¥647,000.

On July 10, 2014, IIJ granted 128 stock options which were the same type of options granted in 2013 to directors and executive officers. The fair value per option at the date of grant was ¥422,600.

On July 13, 2015, IIJ granted 151 stock options which were the same type of options granted in 2014 to directors and executive officers. The fair value per option at the date of grant was ¥369,200.

The fair value of the stock acquisition rights used to recognize compensation expense for the fiscal years ended March 31, 2014, 2015 and 2016 were estimated using the Black-Scholes option-pricing model with the following assumptions:

	2014	2015	2016
Assumptions:			
Risk-free interest rate	1.314 %	0.980 %	0.818 %
Expected lives (years)	15	15	15
Expected volatility	55.861 %	55.217 %	53.794 %
Expected dividends	0.535 %	0.909 %	1.023 %

A summary of the activities for the stock acquisition rights plan for the years ended March 31, 2015 and 2016 is as follows:

	Number of Options	Number of Shares	Yen Exercise Price	Years Remaining Life	Thousands of Yen Total Intrinsic Value
Unexercised options outstanding—March 31, 2014	346	69,200	¥ 1		
Granted	128	25,600	1		
Exercised	(16 )	(3,200 )	1		
Forfeited or expired	—	—	—		
Unexercised options outstanding—March 31, 2015	458	91,600	1		
Granted	151	30,200	1		
Exercised	(52 )	(10,400 )	1		
Forfeited or expired	—	—	—		
Unexercised options outstanding—March 31, 2016	557	111,400	1		
Exercisable options—March 31, 2016	406	81,200	1	26.80	¥190,705
Expected to vest after July 14, 2016	151	30,200	1	29.31	70,927

The Company recognized stock compensation cost on a straight-line basis over the requisite service period.

The Company recognized ¥53,542 thousand, ¥54,965 thousand and ¥55,337 thousand as stock compensation cost for the fiscal years ended March 31, 2014, 2015 and 2016, respectively. The unrecognized expense of ¥13,937 thousand is expected to be recognized over the next 3 months.

IIJ absorbed IIJ-Exlayer on January 1, 2014 with the allotment of 104 shares of IIJ's treasury stock to the shareholders of IIJ-Exlayer.

***Net income attributable to IIJ's shareholders and transfers from the noncontrolling interests***

The following schedule represents the effects of changes in IIJ's ownership interest in its subsidiaries in the Company's shareholder's equity for the years ended March 31, 2014, 2015 and 2016.

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	Thousands of Yen		
	2014	2015	2016
Net income attributable to IIJ	¥4,442,237	¥3,322,081	¥4,038,282
Transfers from the noncontrolling interests			
Increase in additional paid-in capital for acquisition of noncontrolling interest of IIJ-Exlayer	99	–	–
Net transfers from noncontrolling interest	99	–	–
Change from net income attributable to IIJ and transfers from noncontrolling interests	¥4,442,336	¥3,322,081	¥4,038,282

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**15. OTHER COMPREHENSIVE INCOME (LOSS)**

Tax effects allocated to each component of other comprehensive income (loss) and reclassification adjustments for the years ended March 31, 2014, 2015 and 2016 are as follows:

	Thousands of Yen		
	Before Tax Amount	Tax (Expense) Benefit	Net of Tax Amount
Year ended March 31, 2014:			
Foreign currency translation adjustments	¥419,557	–	¥419,557
Unrealized holding gain (loss) on securities:			
Amount arising during the period	1,656,759	¥(594,776)	1,061,983
Less: Reclassification adjustments for gains included in net income	(107,655 )	41,232	(66,423 )
Other	–	(7,421 )	(7,421 )
Net unrealized holding gain (loss) during the period	1,549,104	(560,965)	988,139
Defined benefit pension plans:			
Amount arising during the period	63,775	(22,896 )	40,879
Less: Reclassification adjustments for losses included in net income	369	(133 )	236
Net defined benefit pension plans	64,144	(23,029 )	41,115
Other comprehensive income (loss)	¥2,032,805	¥(583,994)	¥1,448,811
Year ended March 31, 2015:			
Foreign currency translation adjustments	¥243,538	–	¥243,538
Unrealized holding gain (loss) on securities:			
Amount arising during the period	124,370	¥(44,649 )	79,721
Less: Reclassification adjustments for gains included in net income	(35,934 )	12,900	(23,034 )
Other	–	4,903	4,903
Net unrealized holding gain (loss) during the period	88,436	(26,846 )	61,590
Defined benefit pension plans:			
Amount arising during the period	(127,065 )	45,616	(81,449 )
Less: Reclassification adjustments for gains included in net income	(2,413 )	862	(1,551 )
Net defined benefit pension plans	(129,478 )	46,478	(83,000 )
Other comprehensive income (loss)	¥202,496	¥19,632	¥222,128

	Thousands of Yen		
	Before Tax Amount	Tax (Expense) Benefit	Net of Tax Amount
Year ended March 31, 2016:			
Foreign currency translation adjustments	¥(67,652 )	–	¥(67,652 )
Unrealized holding gain (loss) on securities:			
Amount arising during the period	(417,400 )	¥128,977	(288,423)
Less: Reclassification adjustments for losses included in net income	3,965	(1,328 )	2,637
Other	–	9,834	9,834
Net unrealized holding gain (loss) during the period	(413,435 )	137,483	(275,952)
Defined benefit pension plans:			
Amount arising during the period	(585,332 )	192,576	(392,756)
Less: Reclassification adjustments for gains included in net income	(2,606 )	944	(1,662 )
Net defined benefit pension plans	(587,938 )	193,520	(394,418)
Other comprehensive income (loss)	¥(1,069,025)	¥331,003	¥(738,022)

The changes in accumulated other comprehensive income (loss) by component for the years ended March 31, 2014, 2015 and 2016 are as follows:

	Thousands of Yen			
	Unrealized holding gain on securities	Defined benefit pension plans	Foreign currency translation adjustments	Total
Year ended March 31, 2013:	¥495,217	¥(187,318)	¥(44,129 )	¥263,770
Other comprehensive income before reclassifications	1,054,562	40,879	419,701	1,515,142
Amounts reclassified out of accumulated other comprehensive income	(66,423 )	236	–	(66,187 )
Other comprehensive income	988,139	41,115	419,701	1,448,955
Other	–	–	61	61
Year ended March 31, 2014:	¥1,483,356	¥(146,203)	¥375,633	¥1,712,786

	Thousands of Yen			
	Unrealized holding gain on securities	Defined benefit pension plans	Foreign currency translation adjustments	Total
Year ended March 31, 2014:	¥1,483,356	¥(146,203)	¥375,633	¥1,712,786
Other comprehensive income before reclassifications	84,624	(81,449 )	247,273	250,448
	(23,034 )	(1,551 )	–	(24,585 )

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Amounts reclassified out of accumulated other comprehensive income

Other comprehensive income (loss)	61,590	(83,000 )	247,273	225,863
Year ended March 31, 2015:	¥1,544,946	¥(229,203)	¥622,906	¥1,938,649

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	Thousands of Yen			
	Unrealized holding gain on securities	Defined benefit pension plans	Foreign currency translation adjustments	Total
Year ended March 31, 2015:	¥1,544,946	¥(229,203)	¥622,906	¥1,938,649
Other comprehensive loss before reclassifications	(278,589 )	(392,756)	(71,610 )	(742,955 )
Amounts reclassified out of accumulated other comprehensive income	2,637	(1,662 )	–	975
Other comprehensive loss	(275,952 )	(394,418)	(71,610 )	(741,980 )
Year ended March 31, 2016:	¥1,268,994	¥(623,621)	¥551,296	¥1,196,669

The amounts reclassified from accumulated other comprehensive income (loss) to the consolidated statements of income, with presentation location, for the years ended March 31, 2014, 2015 and 2016, are as follows:

	Thousands of Yen			Location
	2014	2015	2016	
Other comprehensive income (loss) components:				
Unrealized holding gain on securities	¥107,655	¥35,934	–	Net gain on sales of other investments
	–	–	¥(3,965)	Impairment of other investments
	(41,232 )	(12,900)	1,328	Income tax expense
	66,423	23,034	(2,637)	Net income
Defined benefit pension plans	(369 )	2,413	2,606	Net periodic pension costs (Note 13)
	133	(862 )	(944 )	Income tax expense
	(236 )	1,551	1,662	Net income
Total amount reclassified	¥66,187	¥24,585	¥(975 )	

## 16. BASIC AND DILUTED NET INCOME PER COMMON SHARE

Basic and diluted net income attributable to Internet Initiative Japan Inc. per common share for the three years ended March 31, 2014, 2015 and 2016 is as follows:

Thousands of Yen

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	2014	2015	2016
Numerator:			
Net income attributable to Internet Initiative Japan Inc. basic and diluted	¥4,442,237	¥3,322,081	¥4,038,282

	Number of Shares		
	2014	2015	2016
Denominator:			
Weighted-average common shares outstanding basic	44,306,680	45,942,291	45,950,098
Dilutive effect of stock options	54,403	72,446	93,285
Weighted-average common shares outstanding diluted	44,361,083	46,014,737	46,043,383

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	Yen		
	2014	2015	2016
Basic net income attributable to Internet Initiative Japan Inc. per common share	¥100.26	¥72.31	¥87.88
Diluted net income attributable to Internet Initiative Japan Inc. per common share	¥100.14	¥72.20	¥87.71

## 17. COMMITMENTS AND CONTINGENT LIABILITIES

The Company is involved in litigation and claims arising in the ordinary course of business. In evaluating the matter on an ongoing basis, the Company takes into account amounts already accrued on the balance sheet. The Company believes that an 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, IIJ-Global entered into a Solutions Engagement Agreement with IBM Japan Ltd, IIJ-Global's largest sales partner. This agreement, which establishes the basis for a procurement relationship between IIJ-Global and IBM Japan, contains indemnification for IIJ-Global to perform services, functions, responsibilities and others in a way that were being performed by AT&T Japan.

In May 2006, January 2007, January 2008 and January 2015, IIJ made agreements (four agreements in total) for investing in funds which invest in mainly unlisted stocks with an investment advisory company. IIJ committed to provide up to \$5,000 thousand for each fund (\$20,000 thousand in total) upon the request of the fund until January 31, 2027. IIJ has provided a total of \$14,093 thousand to them as of March 31, 2016. The amounts invested in their funds were recorded as other investments in the Company's consolidated balance sheets.

In April 2013, IIJ made an agreement for investing in a corporation reconstruction fund with an investment advisory company. IIJ committed to provide up to ¥100,000 thousand upon the request of the fund until April 23, 2018. IIJ has provided a total of ¥87,404 thousand to the fund as of March 31, 2016. The amounts invested in the fund were recorded as other investments in the Company's consolidated balance sheets.

## 18. FINANCIAL INSTRUMENTS

***Fair Value***—In the normal course of business, the Company invests in financial assets. To estimate the fair value of those financial assets, the Company uses quoted market prices to the extent that they are available. Where a quoted market price is not available, the Company estimates fair value using primarily the discounted cash flow method. For certain financial assets and liabilities, such as trade receivables and trade payables, which are expected to be collected and settled within one year, the Company assumes that the carrying amount approximates fair value due to their short maturities. Investments for which it is not practicable to estimate fair value primarily consist of investments in a number of unaffiliated and unlisted smaller sized companies and the estimate of their fair values cannot be made without incurring excessive costs. Refundable insurance policies are carried at cash surrender value. The carrying amounts and fair value of financial instruments are summarized below:

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	Thousands of Yen			
	2015 Carrying Amount	Fair Value	2016 Carrying Amount	Fair Value
Other investments for which it is:				
Practicable to estimate fair value	¥4,314,481	¥4,314,481	¥3,944,397	¥3,944,397
Not practicable	2,346,225	–	2,004,344	–
Noncurrent refundable insurance policies (other assets)	110,894	110,894	155,727	155,727

Cash and cash equivalents were classified as Level 1 instruments and short-term borrowings were classified as Level 2 instruments.

Other investments for which it is practicable to estimate fair value are available-for-sales equity and debt securities disclosed in Note 4.

Other investments for which it is not practicable to estimate fair value were comprised of non-marketable equity securities of ¥853,629 thousand and investments in funds of ¥1,492,596 thousand as of March 31, 2015 and non-marketable equity securities of ¥1,019,685 thousand and investments in funds of ¥984,659 thousand as of March 31, 2016.

## 19. FAIR VALUE MEASUREMENTS

ASC 820, “Fair Value Measurement” defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. ASC 820 establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value as follows:

Level 1—Inputs are quoted prices in active markets for identical assets or liabilities.

Level 2—Inputs are quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable, and inputs that are derived principally from or corroborated by observable market data by correlation or other means.



Level 3—Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable, which reflect the reporting entity's own assumptions about the assumptions that market participants would use in establishing a price.

There were no transfers between Level 1 and Level 2 for the years ended March 31, 2015 and 2016.

***Assets Measured at Fair Value on a Recurring Basis***

The following table presents the Company's assets that are measured at fair value on a recurring basis at March 31, 2015 and 2016, consistent with the fair value hierarchy provisions of ASC 820.

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<u>March 31, 2015</u>	Thousands of Yen			Level 3	Total
	Level 1	Level 2			
Assets—					
Available-for-sale securities—equity securities	¥4,212,571	–	–	–	¥4,212,571
Available-for-sale securities—debt securities	–	¥101,910	–	–	101,910
Total assets	¥4,212,571	¥101,910	–	–	¥4,314,481

<u>March 31, 2016</u>	Thousands of Yen			Level 3	Total
	Level 1	Level 2			
Assets—					
Available-for-sale securities—equity securities	¥3,830,847	–	–	–	¥3,830,847
Available-for-sale securities—debt securities	–	¥113,550	–	–	113,550
Total assets	¥3,830,847	¥113,550	–	–	¥3,944,397

Available-for-sale securities are comprised of marketable equity and debt securities. Marketable equity securities are listed on Japan and Hong Kong securities markets and are valued using an unadjusted quoted market price in active markets with sufficient volume and frequency of transactions. Marketable debt securities are valued using quoted prices obtained from financial institutions.

***Assets Measured at Fair Value on a Nonrecurring Basis***

<u>March 31, 2015</u>	Thousands of Yen			Impairment Loss
	Level 1	Level 2	Level 3	
Assets:				
Non-marketable securities—equity securities	–	–	¥2,435	¥ 29,117
	–	–	¥2,435	¥ 29,117

<u>March 31, 2016</u>	Thousands of Yen			Impairment Loss
	Level 1	Level 2	Level 3	
Assets:				
Non-marketable securities—equity securities—		–	¥235	¥ 10,765
Trademark		–	96,000	11,000
	–	–	¥96,235	¥ 21,765

Non-marketable equity securities with a carrying amount of ¥31,552 thousand, which was included in other investments in the balance sheets, were written down to the fair value of ¥2,435 thousand, resulting in an other-than-temporary impairment charge of ¥29,117 thousand, which was included in the Company's statement of income for the year ended March 31, 2015. Non-marketable equity securities with a carrying amount of ¥11,000 thousand, which was included in other investments in the balance sheets, were written down to the fair value of ¥235 thousand, resulting in an other-than-temporary impairment charge of ¥10,765 thousand, which was included in the Company's statement of income for the year ended March 31, 2016. The Company used unobservable inputs to value the impairment of these non-marketable Level 3 investments. The fair value was determined as a result of considering various unobservable inputs, including expectation of future income of the investees, net asset value of the investees, and material unrealized losses to be considered in assets and liabilities held by the investees.

The trademark right related to hi-ho with a carrying amount of ¥107,000 thousand was written down to a fair value of ¥96,000 thousand, resulting in an impairment charge of ¥11,000 thousand, which was included in the Company's statement of income for the year ended March 31, 2016. The impaired trademark was classified within Level 3 as the Company used unobservable inputs such as expected future income to value the trademark.

Level 3 valuations are determined by the Company's valuation team (accounting and financing managers) based on the methodologies used to perform the valuation of each instrument. The Company uses third-party valuation firms to conduct the valuation of certain instruments, if necessary. Detailed reviews of the methodologies in valuations and the reasonableness of the valuations (including those performed by third parties) are performed by the chief financial officer.

The following table presents information relating to the significant unobservable inputs of the Company's Level 3 non-recurring measurements.

	Thousands of Yen	Valuation technique	Unobservable inputs	Range
<u>March 31, 2016</u>	Fair value			
Trademark	¥ 96,000	Relief from royalty method	Discount Rate Royalty rate	6.3 % 0.3 %

## 20.

## BUSINESS SEGMENTS

The operating segments reported below are those for which segment-specific financial information is available. Accounting policies used to determine segment profit or loss and segment assets are consistent with those used to prepare the consolidated financial statements in accordance with U.S. GAAP. The Company's chief operating decision maker uses this financial information to make decisions on the allocation of resources and to evaluate business performance.

The Network service and systems integration business segment comprises revenues from network services, systems integration and equipment sales.

The ATM operation business segment comprises revenues from the ATM operation business.

**Revenues:**

	Thousands of Yen		
	2014	2015	2016
Network service and systems integration business:			
Customers	¥111,445,519	¥119,409,987	¥136,759,130
Intersegment	455,975	408,567	383,058
Total	111,901,494	119,818,554	137,142,188
ATM operation business:			
Customers	2,826,832	3,640,128	3,888,878
Intersegment	—	—	—
Total	2,826,832	3,640,128	3,888,878
Elimination	(455,975 )	(408,567 )	(383,058 )
Consolidated total	¥114,272,351	¥123,050,115	¥140,648,008

**Segment Profit or Loss:**

	Thousands of Yen		
	2014	2015	2016
Operating income:			
Network service and systems integration business	¥5,274,753	¥4,334,946	¥5,127,807
ATM operation business	578,794	886,340	1,148,922
Elimination	(130,235 )	(146,048 )	(136,375 )
Consolidated total	¥5,723,312	¥5,075,238	¥6,140,354

**Segment Assets:**

	Thousands of Yen	
	2015	2016
Segment assets:		
Network service and systems integration business	¥105,160,187	¥113,747,677
ATM operation business	3,545,128	4,087,227
Elimination	—	—
Consolidated total	¥108,705,315	¥117,834,904

**Other significant items:**

	Thousands of Yen		
	2014	2015	2016
Depreciation and amortization:			
Network service and systems integration business	¥8,405,080	¥9,139,687	¥9,377,657
ATM operation business	417,901	537,652	543,898
Consolidated total	¥8,822,981	¥9,677,339	¥9,921,555

For information regarding the goodwill and the other impairment losses on intangible assets, see Note 8, "Goodwill and Other intangible assets."

Transfers between reportable businesses are made at market-based prices. Operating income is operating revenue less costs and operating expenses.

Substantially all revenues are from customers operating in Japan. Geographic information is not presented due to immateriality of revenue attributable to international operations.

Revenue from IBM Japan, Ltd., related to the Network service and system integration business segment represents ¥13,125,454 thousand for the year ended March 31, 2014, of the Company's revenue.

## **21. ADVERTISING EXPENSES**

Advertising expenses incurred during the years ended March 31, 2014, 2015 and 2016 related primarily to advertisements in magazines, journals and newspapers and amounted to ¥656,890 thousand, ¥574,118 thousand and ¥815,439 thousand, respectively.

## 22. RELATED PARTY TRANSACTIONS

NTT and its subsidiaries own 26.0% of IJJ's outstanding common shares and 26.4% of IJJ's voting shares as of March 31, 2016.

The Company entered into a number of different types of transactions with NTT and its subsidiaries including purchases of wireline telecommunication services for the Company's offices and capital lease arrangements. For the Company's connectivity and outsourcing services, the Company purchases international and domestic backbone services, local access lines and rental rack space in data centers and mobile data communication services from NTT and its subsidiaries. The Company sells to NTT and its subsidiaries its services, system integration services and monitoring services for their data centers.

The amounts of balances as of March 31, 2015 and 2016 and transactions of the Company with NTT and its subsidiaries for the each of the three years in the period ended March 31, 2016, are summarized as follows:

	Thousands of Yen		
	2014	2015	2016
Accounts receivable	–	¥463,613	¥1,184,804
Accounts payable	–	2,535,234	3,041,505
Lease obligations	–	1,268,324	1,750,054
Revenues	¥2,370,954	2,898,040	3,129,622
Costs	15,579,173	16,706,036	24,268,440
Interest expenses	24,756	24,402	30,370

As for balances and transactions with equity method investees, refer to Note 6, "Investments in Equity Method Investees."

## 23. SUBSEQUENT EVENTS

On June 24, 2016, IJJ's shareholders approved the payment of a cash dividend to shareholders of record at March 31, 2016 of ¥11 per share or ¥505,480 thousand in the aggregate.

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