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Exchange Rates

Fluctuations in exchange rates between the Japanese yen and the U.S. dollar and other currencies will affect the U.S. dollar and other currency equivalent of the yen price of our 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 our 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 ¥117.48 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, 2006, the date of our most recent consolidated balance sheet contained in this annual report. 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:

	High	Low	Average(1)	Period-end
Fiscal year ended March 31,				
2002	¥134.77	¥115.89	¥125.64	¥132.70
2003	133.40	115.71	121.10	118.07
2004	120.55	104.18	112.75	104.18
2005	114.30	102.26	107.28	107.22
2006	120.93	104.41	113.67	117.48
Calendar year 2006				
January	¥117.55	¥113.96	¥115.48	¥116.88
February	118.95	115.82	117.86	115.82
March	119.07	115.89	117.28	117.48
April	118.66	113.79	117.07	113.79
May	113.46	110.07	111.73	112.26
June	116.42	111.66	114.63	114.51
July (through July 7, 2006)	115.65	113.98	114.93	113.98

(1) 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 July 7, 2006 was ¥113.98 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 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 or achieve our expected revenues and profits in the future.

Although we recorded operating income and net income in the fiscal years ended March 31, 2005 and 2006, we incurred operating losses and net losses in each of the prior six fiscal years, with the exception of positive operating income for the fiscal year ended March 31, 2002, and our accumulated deficit as of March 31, 2006 amounted to ¥29.7 billion.

As we primarily operate in the Japanese market, if the Japanese economy deteriorates or does not improve, and it results in significantly lower levels of network-related investment or corporate customers respond to conditions by putting a priority on low price rather than quality, it may make it difficult to maintain our current level of revenues or achieve our expected revenues and profits.

In addition to factors related to general economic conditions in Japan, we may not be able to maintain our current level of revenues and profits or achieve our expected levels of revenues and profits due to several other factors, including, but not limited to:

- a continuous decrease in revenues from our Internet connectivity services because of lower unit prices per bandwidth and cancellation of large accounts especially due to severe price competition,
- lower revenue growth and lower margins in our growing value-added services and systems integration, if we fail to successfully differentiate our services from those of our competitors, or experience a significant decrease in systems integration revenues from period to period due to the cancellation of one or more large projects or changes in the number of projects resulting from a seasonal fluctuation in the systems integration business in Japan,
- an increase in backbone costs due to increased volume of Internet traffic and demand for leasing backbone lines, or a decline in the profitability of connectivity services if we contract for more capacity than we actually utilize to serve our customers,
- an increase in expenses for network infrastructure, research and development and other similar investments which we may be forced to make in the future in order to remain competitive, or increased expenses relating to the leasing of additional equipment,
- an increase in outsourcing costs, especially in our systems integration, if we fail to manage outsourcing projects effectively or fail to cover outsourcing costs by raising enough revenues from outsourced projects,
- an increase in SG&A costs, such as personnel expenses, in conjunction with our expected or planned or continued business expansion, and
- a decline in the value and trading volume of our holding of available-for-sale securities from which we expect gains on sale.

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 connectivity and value-added services are major telecommunications carriers like NTT Communications Corporation (“NTT Communications”), KDDI Corporation (“KDDI”) and Japan Telecom Co., Ltd. (“Japan Telecom”). Especially for Internet connectivity services, price competition is still severe and may increase. For value-added services, price competition may also increase. 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 like IBM Japan, 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 Nippon Telegraph and Telephone Corporation (“NTT”) and NTT Communications purchased shares of our company in September 2003, which resulted in the NTT Group becoming our largest shareholder, we plan to continue to operate our company separately and independently from the NTT Group, and will therefore continue to compete with the NTT Group.

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

- substantially greater financial resources,
- more extensive and well-developed marketing and sales networks,
- higher brand recognition among consumers,
- larger customer bases, and
- more diversified operations which allow profits from some operations to support operations with lower profitability, such as the network services, for which we are a competitor.

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.

We depend on our ability to attract and retain qualified personnel.

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. As our business grows, we need to hire additional engineers, research and development and other personnel. In particular, in order to continue to increase our revenues from value-added services and systems integration, we require more sales and engineering personnel to achieve our expectations. We are not sure that we will be able to keep or attract these human resources and control human resources cost adequately. Competition for qualified engineers, research and development personnel and employees in the telecommunications service industry in Japan is intense, and there is a limited number of persons with the necessary knowledge and experience. None of our employees are bound by any employment or noncompetition agreement. The realization of any or all of these risks may result in material adverse effects on our business, financial condition and result of operations.

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

Interruptions, errors or delays with respect to our network may be caused by a number of man made 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, human error, computer viruses and other similar events. Much of our computer and networking equipment and the lines that make up our network backbones are concentrated in a few locations that are in earthquake-prone areas. Any disruption, outages, or 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 confidence in our business, any or all of which could have a material adverse effect on our business, financial condition and results of operations.

The confidential customer information that we keep and manage may be leaked.

We keep and manage confidential information and trade secrets obtained from our customers. We exercise care in protecting the confidentiality of such information and take steps to ensure the security of our network, in accordance with the law protecting personal information that came into effect in April 2005 and the requirements set by the Ministry of Internal Affairs and Communications (“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 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. The realization of these or similar risks may have a material 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 and as the volume of information transferred increases, we will need to increase expenditures for our network and other facilities 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, the quality of our services could deteriorate and our business may suffer.

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:

- rapid technological change,
- 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, particularly Mr. Koichi Suzuki, our business and our relationships with the customers, major shareholders of IIJ and other IIJ 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 our president, chief executive officer and representative director, as well as the president and chief executive officer and representative director of most of other IIJ Group companies. We rely in particular on his expertise in the operation of our businesses and on his relationships with our shareholders, the shareholders of the IIJ Group companies, our business partners and our employees. None of our executive officers, including Mr. Suzuki, is bound by an employment or noncompetition agreement.

Our investments in affiliated companies may not produce the returns we expect and may require additional funding.

As part of our business strategy and for the purpose of maintaining various strategic business relations, we have, in the past, invested in a number of companies. There can be no assurance that we will be able to maintain or enhance the value or performance of such companies in which we have invested or may invest in the future, or that we will achieve the returns or benefits sought from these investments. Our substantial investment in Crosswave, our former equity method investee, for example, 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 our equity method net loss and an impairment loss taken in respect of our 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. We also wrote off ¥2.1 billion of loans and accounts receivable outstanding from Crosswave for the fiscal year ended March 31, 2004. We also had an impairment loss relating to our investment in Asia Internet Holding for the fiscal year ended March 2004. To the extent that these investments are accounted for by the equity-method and to the extent that the investee companies have net losses, our financial results will be adversely affected to the extent of our pro rata portion of these losses. Furthermore, we may lose all or part of our investment in these companies if their value decreases as a result of their financial performance or if these companies 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 enjoy synergies with the investees and it may adversely affect our financial results or financial condition.

We have invested in affiliated companies, such as IIJ Technology Inc. (“IIJ-Tech”) and Net Care, Inc. (“Net Care”), to expand the service offerings available to our customers. In February 2006, we invested ¥750 million in Internet Revolution Inc. (“i-revo”), a joint venture that we established with Konami Corporation, and i-revo is our equity method investee. In the joint venture agreement, we agreed that we will provide funding up to ¥90 million to i-revo between November 2006 and the end of April 2007 for its capital investments and working capital. We may provide additional financial support in the form of loans to or additional equity investments in these affiliated companies to enhance or maintain our business synergies with these affiliated companies.

In October 2005, IIJ Media Communications Inc. (“IIJ-MC”), our former subsidiary, was merged into us after a portion of IIJ-MC’s business was transferred to IIJ-Tech and we have acquired Asia Internet Holding Co., Ltd. (“AIH”), our former equity method investee, after AIH became our wholly owned consolidated subsidiary. We may consider reorganization of other IIJ Group companies in the future which may require additional investments by cash, equity or others.

Fluctuations in the stock prices of companies in which we have invested may significantly influence our financial condition.

We have invested in non-affiliated companies in order to further our business relationships with these companies. We recorded gross realized gains from the sale of available-for-sale securities of ¥3.2 billion for the fiscal year ended March 31, 2006 and the book value of our remaining available-for-sale securities was ¥6.8 billion at March 31, 2006, which is relatively large in relation to other items on our balance sheet. However, the book value can change 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 stock prices of companies in which we have invested may have a significant effect on our financial results. As a result, we may not be able to achieve our expected gains on the sale of available-for-sale securities. In addition, should we choose to dispose of all or a portion of these shares, it is not certain that we will be able to do so on favorable terms.

NTT, our 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 currently own 29.7% of our outstanding shares. In September 2003, we entered into a subscription agreement with NTT in which we granted to NTT pre-emptive rights to subscribe to its pro rata portion of any future issuances of shares by us in order to maintain its shareholding percentage; NTT did not exercise this pre-emptive right when we issued 12,500 additional shares in December 2005. Under this subscription agreement, we have agreed to allow NTT to nominate up to three persons as either directors or statutory auditors, subject to approval by our shareholders at our first general shareholders’ meeting after NTT’s investment. At our general shareholders’ meeting on June 24, 2004, two directors nominated from NTT Group were appointed, one of whom was nominated as an executive vice president. At our general shareholders’ meeting on June 28, 2006, our executive vice president, Mr. Fukuzo Inoue, completed his term and retired, and an other director, Mr. Takashi Hiroi was reapproved to be an outside director. As our largest shareholder, NTT may be able to exercise substantial influence over us. In addition, as part of this subscription agreement, we have agreed to collaborate with NTT in various businesses. While we intend to conduct our day-to-day operations independently of NTT and its group 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 interests, which may not be in our interest or that of 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, KDDI and Japan Telecom for a significant portion of our network backbone and Nippon Telegraph and Telephone East Corporation and Nippon Telegraph Telephone West Corporation and electric power companies and their affiliates for local access lines for our customers. After the transfer of operating lease agreements from Crosswave, our former equity method investee, following its filing for corporate reorganization, we now procure significant portions of our network backbone and data center facilities pursuant to operating lease agreements with NTT Communications, our largest provider of network infrastructure. 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.

In the Asia-Pacific region, we depend on telecommunications carriers in various countries including less-developed countries whose quality of service may not be stable or who are more susceptible to economic or political instability.

We also depend on third-party suppliers of hardware components like routers that are used in our network. We acquire certain components from limited sources, typically from Cisco Systems, 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.

There are risks associated with our international business.

By operating our network internationally, we expose ourselves to the risks of international markets and to other risks that do not exist or are less significant in Japan. One of the components of our strategy is to continue to expand our network reach through our network between the United States and Japan to maintain our network quality. In addition, we have invested in the data center businesses in South Korea. Our international business operations continue to require management attention and financial resources, both of which are in limited supply. We face significant exposure to risks in connection with our international operations, including:

- the impact of economic conditions outside Japan,
- unexpected changes in or delays resulting from regulatory requirements,
- the rate of the development of the Internet industry in countries in Asia,
- political and economic instability, and
- potential unsatisfactory financial returns from our investments in Asia, including the data center businesses in which we have invested in South Korea.

These factors could adversely affect our future international expansion and, consequently, our business, financial condition and results of operations.

If we fail to execute our systems integration projects in a timely or satisfactory manner or if we fail to manage customer data in a professional manner, we could be sued and our reputation could suffer.

A significant portion of our future revenue depends on systems integration projects which we, in cooperation with IIJ-Tech and Net Care, have been contracted to perform. We may not be able to perform our responsibilities under these contracts to the satisfaction of our customers, or at all, if we lack a sufficient number of qualified engineers, lack sufficient task-management capabilities for software-development vendors or fail to manage customer data adequately. If we do not execute these services and projects as contracted or fail to manage customer data in a professional manner, our receipt of revenues may be delayed or lost altogether and we could be sued by our counterparties, which could in turn have an adverse impact on our reputation, results of operation and financial condition.