

# Edgar Filing: JAPAN SMALLER CAPITALIZATION FUND INC - Form N-30D

JAPAN SMALLER CAPITALIZATION FUND INC  
Form N-30D  
June 11, 2003

JAPAN SMALLER CAPITALIZATION FUND, INC.

To Our Shareholders:

April 23, 2003

We present the Annual Report of Japan Smaller Capitalization Fund, Inc. (the "Fund") for the fiscal year ended February 28, 2003. The Net Asset Value per share ("NAV") of the Fund decreased by 2.0% for the year. The closing market price of the Fund on February 28, 2003, on the New York Stock Exchange was \$6.38 representing a premium of 11.2% to the NAV of \$5.74. The net assets of the Fund amounted to \$90,929,599 on February 28, 2003.

The TOPIX, consisting of all companies listed on the Tokyo Stock Exchange (the "TSE") First Section, decreased by 8.5% and the Nikkei Average Index (a price weighted index of 225 leading stocks on the TSE) decreased by 10.5%, in U.S. dollar terms, for the year ended February 28, 2003. The Nikkei JAS-DAQ Average Index (the "OTC Index"), a price-weighted index of the quotations of the OTC registered stocks increased by 0.9%, and the Index of the Japan Securities Dealers Association Quotation System (the "JASDAQ Index"), a capitalization-weighted index of all OTC stocks, decreased by 3.4%, in U.S. dollar terms, during the same period. The Japanese yen ("Yen") appreciated by 11.8% against the U.S. dollar during the year.

The Fund outperformed the JASDAQ Index by 1.4 percentage points and underperformed the OTC Index by 3.0 percentage points, during the year. The stock selection results in the Electronics sector, such as Kuroda Electric Co., Ltd., Digital Electronics Corp. and Chiyoda Integre Co., Ltd. worked positively. Meanwhile, the underexposure to major issues in the Information/System sector, especially to Yahoo Japan Corp., had a negative impact on the

The Portfolio

The Fund's equity exposure rose to 99.1% at February 28, 2003 from 99.0% at November 30, 2002. The Fund was diversified in to 87 issues, of which 59 issues were OTC stocks, 21 were other smaller capitalization stocks and 7 were TSE First Section stocks, comprising 60.8%, 30.3% and 8.0% respectively, of net assets on February 28, 2003.

Japanese Economy and Stock Market Outlook

The JASDAQ Index started to recover sharply in mid-February 2002, along with an explosive rebound in the main market, which was triggered by tighter short selling regulations and later helped by an unexpectedly strong recovery in U.S. economic growth. External factors boosted hopes of a turnaround in Japan's industrial production cycle and the prospects for Japanese exporters. Expectations for a bottoming out of global semiconductor and personal computer ("PC") sales were also a supporting factor. The JASDAQ Index maintained its upward momentum until early June 2002. Corporate financial results were released from mid-April through late May. Although historical figures were unsurprisingly poor, projections for fiscal year 2002 indicated a strong rebound in earnings among certain sectors. The OTC Index recorded an eleven-month high in early June, reflecting these improvements in fundamentals.

However, positive momentum in the spring later gave way to deteriorating investor sentiment. The weakness of the U.S. stock market, owing to concerns about the sustainability of the U.S. economic recovery and the dollar's depreciation against the Yen, overshadowed the Japanese equity market. In July and August, the weak sentiment in the U.S. equity markets, which were the result of growing investor skepticism following a series of accounting fraud allegations against

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relative performance.

The NAV of the Fund declined by 2.9% for the quarter ended February 28, 2003. During the same period, the TOPIX and the Nikkei Average index decreased by 4.8% and 5.8%, respectively, and the OTC Index and the JASDAQ Index increased by 2.9% and 4.1%, respectively, in U.S. dollar terms. For the quarter ended February 28, 2003, the Fund underperformed the OTC index and the JASDAQ Index by 5.8 percentage points and 7.0 percentage points, respectively.

injections and the possible nationalization of some ailing banks. The OTC index declined to the lowest level since March, 1999 in November, 2002.

The JASDAQ Index managed to post a temporary rebound towards late November 2002, supported by improved sentiment on Wall Street, the news of Iraq's acceptance of the United Nations ("UN") resolution on weapons inspections and favorable first half business results from Japanese companies, but the recovery did not last long. The upside was limited by weaker domestic macroeconomic figures and geopolitical risks. Meanwhile, low valuations and rather robust corporate earnings momentum have been supportive factors. The JASDAQ Index moved a relatively narrow range towards the end of the 12-month period.

### Outlook and Future Strategy

Fundamental conditions surrounding the Tokyo stock index have made little progress. The Fund expects the current cyclical recovery to peak soon, weak supply and demand conditions will persist, and the non-performing loan ("NPL") problem should continue to weigh on the banks. Meanwhile, geopolitical risks are adding to this uncertainty. Hence, the Fund still expects the market to trade within a narrow range around the current level for the time being.

major American companies, further aggravated sentiment in the Japanese stock market.

Following the appointment of Mr. Heizo Takenaka as head of the Financial Services Agency ("FSA"), the market declined further, as his initial proposals included measures to accelerate the disposal of bad loans through a hard landing policy for the Banking sector. This would have required public fund

All four banking groups have already announced fresh plans aimed at enhancing their shareholders' equity, together with plans to accelerate the write off of NPL. Although a genuine solution to the NPL problem is still pending, the short-term performance of the Banking sector will be subject to various influences. Mainly, these will include the results of another round of special inspections by the FSA, implementation of the discounted cash flow ("DCF") method for evaluating loans, discussion about treatment of deferred tax accounting, and the effectiveness of the Industrial Revitalization Corporation. In particular, the feed back mechanism whereby share prices are an important factor for balance sheet health of the Banking sector will remain the same.

In the meantime, it is difficult to expect any upside potential in the stock market from the top-down point of view. Nevertheless, the Fund believes the downside risk to the Japanese market is fairly limited, particularly such smaller capitalization stocks as the Fund is investing in, based on current valuation levels. Once investors have gained confidence that earnings will continue into the next fiscal year, the Fund may start to see some upside potential. Under these circumstances, the Fund will continue to identify oversold companies and add value by taking advantage of these opportunities.

We appreciate your continuing support of your Fund.

Sincerely,

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Industrial production, one of the most reliable economic indicators, now appears to have entered a downtrend, after declining for five consecutive months. Despite the evidence of a renewed slow-down, the government failed to propose any serious measures to remedy it, instead offering an ineffective stimulus package that includes tax cuts of 1.8 trillion Yen. The impact will be limited. Although the pressure on monetary policy is growing and the controversy over adopting an inflation-targeting policy is likely to continue, it is premature to expect any beneficial impact on the real economy. Meanwhile, as a practical effort to support the economy, the Bank of Japan is expected to step up its monetary easing through traditional methods such as outright purchases of government bonds.

/s/ Kazuhiko Hama  
Kazuhiko Hama  
President

INTERNET WEBSITE

NAM-U.S.A. has established an Internet website which highlights history, investment philosophy and process and products, which includes the Fund. The Internet web address is www.nomura-asset.com. We invite you to view the Internet website.

JAPAN SMALLER CAPITALIZATION FUND, INC.

FUND HIGHLIGHTS-FEBRUARY 28, 2003

KEY STATISTICS

Net Assets.....	\$90,929,
Net Asset Value per Share.....	\$5
Closing NYSE Market Price.....	\$6
Percentage Change in Net Asset Value per Share**.....	(2
Percentage Change in NYSE Market Price**.....	15

MARKET INDICES

Percentage change in market indices:*	
	YEN
	---
TOPIX.....	(19.2%
Nikkei Average.....	(21.0%

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JASDAQ.....	(14.8%
Nikkei OTC Average.....	(10.9%

\*From March 1, 2002 through February 28, 2003. +Reflects the percentage change in share price.

ASSET ALLOCATION

Japanese Equities	
OTC Stocks.....	
Other Smaller Capitalization Stocks.....	
TSE First Section Stocks.....	
Total Investments.....	
Other Assets Less Liabilities, Net.....	
Net Assets.....	

INDUSTRY DIVERSIFICATION

	% of Net Assets -----	
Retail.....	18.2	Food Manufacturing.....
Chemicals and Pharmaceuticals.....	13.2	Machinery and Machine Tools...
Information and Software.....	11.3	Restaurants.....
Miscellaneous Manufacturing.....	11.2	Electric.....
Services.....	9.2	Real Estate and Warehouse....
Electronics.....	8.6	Textiles and Apparel.....
Wholesale.....	6.2	Banks and Finance.....
Automotive Equipment and Parts.....	4.4	Telecommunications.....

TEN LARGEST EQUITY HOLDINGS BY MARKET VALUE

Security  
-----

Yahoo Japan Corp.....	
Chiyoda Co. Ltd.....	
Hakuto Co., Ltd.....	
C. Uyemura & Co., Ltd.....	
T & K Toka Co., Ltd.....	
Kuroda Electric Co., Ltd.....	
Nitori Co., Ltd.....	
USS Co., Ltd.....	
Toys R Us-Japan, Ltd.....	
Otsuka Kagu, Ltd.....	

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JAPAN SMALLER CAPITALIZATION FUND, INC.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareholders  
of Japan Smaller Capitalization Fund, Inc.

In our opinion, the accompanying statement of assets and liabilities, including the schedule of investments, and the related statements of operations and of changes in net assets and the financial highlights present fairly, in all material respects, the financial position of the Japan Smaller Capitalization Fund, Inc. (the "Fund") at February 28, 2003, the results of its operations for the year then ended, the changes in its net assets for each of the two years in the period then ended and the financial highlights for each of the five years in the period then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements and financial highlights (hereafter referred to as "financial statements") are the responsibility of the Fund's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these financial statements in accordance with auditing standards generally accepted in the United States of America, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits, which included confirmation of securities at February 28, 2003 by correspondence with the custodian and brokers, provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP  
New York, New York  
April 23, 2003

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS\*

FEBRUARY 28, 2003

	Shares	Cost
	-----	-----
EQUITY SECURITIES		
Automotive Equipment and Parts		
Exedy Corporation.....	219,400	\$ 2,040,871
Automobile clutches		
Musashi Seimitsu Industry Co., Ltd.....	49,000	873,699
Ball joints, camshafts and gears		
Nippon Cable Systems Inc.....	135,000	1,238,251
Control cables		
SPK Corporation.....	22,600	247,799

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Replacement parts		
Total Automotive Equipment and Parts.....		4,400,620
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Banks and Finance		
Aiful Corporation.....	17,050	1,440,881
<hr/>		
Consumer loans		
Chemicals and Pharmaceuticals		
Arisawa Manufacturing Co., Ltd.....	73,700	1,279,085
Glassfibers and insulating resins		
C. Uyemura & Co., Ltd.....	174,000	3,203,723
Chemicals		

See notes to financial statements

4

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS\* -- Continued

FEBRUARY 28, 2003

	Shares	Cost
	<hr/>	<hr/>
FP Corporation.....	29,500	\$ 1,115,851
Polystyrene and other synthetic resin foodware		
Konishi Co., Ltd.....	122,500	1,359,853
Adhesives and construction sealants		
Mandom Corporation.....	69,000	962,431
Cosmetic products.....		
Matsumoto Yushi-Seiyaku Co., Ltd. ....	68,000	1,318,945
Analgesic anti-inflammatory agents		
Milbon Co., Ltd.....	51,260	1,526,033
Hair-care products for beauty salons		
Shizuokagas Co., Ltd.....	366,000	1,024,377
Natural gas supplier		
T & K Toka Co., Ltd. ....	94,400	2,438,803
<hr/>		
Ink for printing		
Total Chemicals and Pharmaceuticals.....		14,229,101
<hr/>		
Electric		
Eneserve Corporation.....	28,000	688,269
Electric generators system for supermarkets		
Mirai Industry Co., Ltd.....	261,00	2,586,427
<hr/>		
Plastic molded electric materials		
Total Electric.....		3,274,696
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Electronics		
Chiyoda Integre Co., Ltd.....	103,100	1,219,654
Electronic components		
Consel Co., Ltd.....	76,500	1,986,521
Electrical machinery		
Dainippon Screen Mfg. Co., Ltd.+.....	40,000	168,138
Electronic components		
Fuji Electric Industry Co., Ltd. ....	93,000	993,449
Electronic parts		
Fukuda Denshi Co.....	39,000	961,762
Medical electronic equipment		
Kuroda Electric Co., Ltd.....	110,000	1,595,357
Materials and components		
Nagano Keiki Co., Ltd.....	48,279	811,517
Measuring instruments		
UMC Japan+.....	1,940	3,971,079
		-----
Semiconductor memory chips		
Total Electronics.....		11,707,477
		-----
Food Manufacturing		
Arcs Co., Ltd. ....	125,400	1,606,660
Supermarket chain		
Ariake Japan Co., Ltd. ....	32,300	739,366
Natural seasonings		
Kakiyasu Honten Co., Ltd. ....	62,000	674,732
Processed meat products, fresh meats, and side dishes		

See notes to financial statements

5

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS\* -- Continued

FEBRUARY 28, 2003

	Shares	Cost
	-----	-----
Ozeki Co., Ltd.....	12,000	\$ 1,132,929
Supermarket chain		
Plenus Co., Ltd.....	45,360	1,083,852
		-----
Japanese lunch-boxes		
Total Food Manufacturing.....		5,237,539
		-----
Information and Software		
Argo Graphics Inc.....	36,000	896,182
Computer aided design software		
CAC Corp.....	147,00	2,325,072
Information technology services		
Fuji Soft ABC Inc. ....	13,300	836,138

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Computer systems development		
Fujitsu Broad Solution & Consulting Inc. ....	44,500	1,794,921
Business application software		
Index Corporation.....	231	638,261
Cellular phone, internet content		
Konami Computer Entertainment Tokyo, Inc.....	123,460	1,419,135
Video games software		
Trend Micro Inc.+.....	19,500	1,488,482
Computer software, anti-virus server		
Works Applications Co., Ltd.+.....	342	1,348,540
Software development		
Yahoo Japan Corp.+.....	252	11,237,066
		-----
Internet services		
Total Information and Software.....		21,983,797
		-----
Machinery and Machine Tools		
Disco Corp.....	20,200	1,335,895
Dicing saws for semiconductors		
Suruga Seiki Co., Ltd.....	20,000	540,974
Industrial mechanical equipment		
THK Co., Ltd.....	126,200	3,951,011
Linear motion systems for industrial machines		
Yushin Precision Equipment Co., Ltd.....	57,800	2,342,621
Injection molding related machinery		
Total Machinery and Machine Tools.....		8,170,501
Miscellaneous Manufacturing		
Central Glass Co., Ltd.....	336,000	1,759,202
Glass products		
Eidai Kako Co., Ltd.....	139,000	1,042,977
Synthetic resin processed products		
Fuji Seal, Inc. ....	19,700	542,646
Packing materials		
Fujimi Inc. ....	73,200	2,098,075
Polishing materials for silicone wafers		
Hoden Seimitsu Kako Kenkyusho Co., Ltd. ....	62,000	1,015,688
Aluminum extruding molds		
Mani, Inc. ....	66,200	962,882
Medical goods and equipment		

See notes to financial statements

6

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS\* -- Continued

FEBRUARY 28, 2003

	Shares		Cost
	-----		-----
Maruko Co., Ltd. ....	94,800	#	1,127,947
Intimate apparel			



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Nichiha Corporation.....	194,600	1,739,791
Ceramic exterior walls and fiberboards		
Nippon Kodoshi Corp. ....	188,000	2,839,396
Paper for electric insulation		
Suruga Co., Ltd. ....	83,600	1,270,192
Daily necessities, novelties and promotional items		
Total Miscellaneous Manufacturing.....		14,398,796
Real Estate and Warehouse		
Nippon Kanzai Co., Ltd. ....	75,580	1,103,449
Comprehensive building maintenance		
Recrm Research Co., Ltd.+ ....	945	1,172,071
Total Real Estate and Warehouse.....		2,275,520
Restaurants		
Saint Marc Co., Ltd. ....	34,700	961,983
Restaurants and bakery shop chain		
Saizeriya Co., Ltd. ....	78,260	1,995,846
Italian restaurant chain		
Watami Food Service Co., Ltd. ....	159,350	2,489,530
Restaurant chain		
Total Restaurants.....		5,447,359
Retail		
Cawachi Limited.....	22,400	1,241,833
Drug store chain		
Chiyoda Co., Ltd. ....	402,200	2,708,042
Specialty store chain		
Kyoto Kimono Yuzen Co., Ltd. ....	577	2,014,182
Japanese traditional kimonos		
Nissen Co., Ltd.....	108,600	438,483
Mail-order business		
Nitori Co., Ltd. ....	48,400	1,851,655
Home furnishings		
Otsuka Kagu, Ltd.....	80,400	3,939,939
Furniture		
Prime Network Inc. ....	440	1,037,939
TV shopping business		
Toys R Us-Japan, Ltd.....	150,500	4,069,478
Toy chain stores		
Uoriki Co., Ltd.....	227,200	1,914,960
Fresh fish and sushi stores		
USS Co., Ltd.....	34,900	778,961
Automobile auction		
Yamada Denki Co., Ltd.....	42,200	1,025,120
Consumer electronics		
Total Retail.....		21,020,460

See notes to financial statements

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JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS\* -- Continued

FEBRUARY 28, 2003

	Shares	Cost
	-----	-----
Services		
Alps Logistics Co., Ltd. ....	20,000	\$ 118,171
Transportation		
Bellsystem 24, Inc. ....	3,100	1,015,540
Telemarketing		
E-System Corporation+.....	1,260	1,251,298
Consulting services		
Future System Consulting Corporation.....	192	1,081,561
Information system and consulting services		
Hu-Management Japan Co., Ltd. ....	192	254,370
Employment consulting services		
Nichii Gakkan Company.....	29,600	1,434,734
Hospital administration services		
Nissin Healthcare Food Service Co., Ltd.....	86,400	1,601,713
Nursing home caterer		
Sodexho Japan Co., Ltd. ....	157,000	3,331,323
Nursing home caterer		
Toei Animation Co., Ltd. ....	12,000	634,388
Animated cartoon movies production		
Tow Co., Ltd.....	226,720	1,403,612
Entertainment		
Weathernews Inc.....	147,300	1,816,185
Customer weather forecasting services		
Total Services.....		----- 13,942,895 -----
Telecommunications		
Nippon Antenna Co., Ltd.....	37,000	585,606
Communication related equipment		
Textiles and Apparel		
United Arrows Limited.....	53,800	972,762
Casual clothes		
Wholesale		
ArcLand Sakamoto Co., Ltd.....	125,400	1,502,668
Home appliances		
C-Two Network Co., Ltd.....	42,300	1,313,377
Process foods		
Hakudo Co., Ltd. ....	115,000	555,909
Metal products		
Hakuto Co., Ltd.....	244,300	3,313,603
Electric parts		
Kato Sangyo Co., Ltd.....	54,000	312,406
Processed foods		
Toba, Inc. ....	67,000	1,015,391

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Trading company for control systems	
Total Wholesale.....	8,013,354
TOTAL INVESTMENT IN EQUITY SECURITIES.....	137,101,364

See notes to financial statements

8

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS\* -- Continued

FEBRUARY 28, 2003

INVESTMENTS IN FOREIGN CURRENCY		
Hong Kong Shanghai Bank-Tokyo		
Non-interest bearing account.....	JPY 1,900,000	\$ 16,070
TOTAL INVESTMENTS IN FOREIGN CURRENCY.....		16,070
TOTAL INVESTMENTS.....		137,117,434
OTHER ASSETS LESS LIABILITIES, NET.....		796,054
NET ASSETS.....		\$137,913,488

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 \*The description following each investment is unaudited and not covered by the Report for Independent Accountants.  
 +Non-income producing security.

Portfolio securities and foreign currency holdings were translated at the following exchange rate as of February 28, 2003.

Japanese Yen.....JPY (Y) 118.23 = \$1.00

See notes to financial statements

9

JAPAN SMALLER CAPITALIZATION FUND, INC.

STATEMENT OF ASSETS AND LIABILITIES  
 FEBRUARY 28, 2003

ASSETS:

Investments in securities, at market value (cost--\$137,101,364).....
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Investments in foreign currency, at market value (cost--\$16,070).....  
 Cash.....  
 Receivable for investments sold.....  
 Receivable for dividends and interest, net of withholding taxes.....  
 Prepaid expenses.....  
 Total Assets.....

LIABILITIES:

Payable for investments purchased.....  
 Accrued management fee.....  
 Other accrued expenses.....  
 Total Liabilities.....

NET ASSETS:

Capital stock (par value of 15,846,384 shares of capital stock  
 outstanding, authorized 100,000,000, par value \$0.10 each).....  
 Paid-in capital.....  
 Accumulated net realized loss on investments and foreign currency  
 transactions.....  
 Unrealized net depreciation on investments and foreign exchange.....  
 Net Assets.....  
 Net asset value per share.....

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

STATEMENT OF OPERATIONS  
 FOR THE YEAR ENDED FEBRUARY 28, 2003

INCOME:

Dividend income (less \$158,453 withholding taxes).....  
 Interest income.....  
 Total Income.....

EXPENSES:

Management fee.....  
 Custodian fees.....  
 Legal fees.....  
 Auditing and tax reporting fees.....  
 Registration fees.....  
 Shareholder reports.....  
 Directors' fees and expenses.....

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Annual meeting expenses.....	
Transfer agency fees.....	
Miscellaneous.....	
Insurance.....	
Total Expenses.....	
INVESTMENT LOSS--NET.....	
REALIZED AND UNREALIZED GAIN(LOSS) ON INVESTMENT CURRENCY:	
Realized loss on investments and foreign currency transactions:	
Net realized loss on investments.....	
Net realized gain on foreign exchange.....	
Net realized loss on investments and foreign exchange.....	
Change in net unrealized appreciation on translation of foreign currency and other assets and liabilities denominated in foreign currency.....	
Change in net unrealized depreciation on investments.....	
Net realized and unrealized loss on investments and foreign exchange.....	
NET DECREASE IN NET ASSETS RESULTING FROM OPERATIONS.....	

See notes to financial statements

11

JAPAN SMALLER CAPITALIZATION FUND, INC.

STATEMENT OF CHANGES IN NET ASSETS

	F
	-----
	February 28,
	-----
FROM INVESTMENT ACTIVITIES:	
Net investment loss.....	(\$772,617)
Net realized loss on investments.....	(5,991,125)
Net realized gain/loss on foreign exchange.....	18,060
Change in net unrealized appreciation/depreciation on investments and foreign exchange.....	4,859,812
Decrease in net assets derived from investment activities.....	(1,885,870)
FROM DISTRIBUTIONS TO SHAREHOLDERS:	
Long term capital gains (\$0.00 and \$0.08 per share, respectively).....	0
Decrease in net assets derived from distributions to shareholders.....	0
Net decrease in net assets.....	(1,885,870)

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NET ASSETS:

Beginning of year.....	92,815,469
End of year (including accumulated net investment losses of \$842,382 and \$69,765, respectively.....	\$ 90,929,599

See notes to financial statements

12

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS

1. Significant Accounting Policies

Japan Smaller Capitalization Fund, Inc. (the "Fund") is registered under the Investment Company Act of 1940 as a non-diversified, closed-end management investment company. The Fund was incorporated in Maryland on January 25, 1990 and investment operations commenced on March 21, 1990. The Fund issued to its shareholders of record as of the close of business on October 25, 1999 non-transferable Rights to subscribe for up to an aggregate of 3,804,940 shares of Common Stock of the Fund at a rate of one share of Common Stock for three Rights held ("Primary Subscription"). The Fund had the ability to increase the number of shares subscribed for in this offering by up to 25% of the Primary Subscription, or an additional 951,235 shares, to honor record date shareholder requests to purchase more shares. During November 1999, the Fund issued a total of 4,458,565 shares of Common Stock on exercise of such Rights at the subscription price of \$11.99 per share, compared to a net asset value per share of \$16.20 and a market value per share of \$12.6875. Additionally, a sales load of 3.75% was charged to each share issued. Right offering costs of approximately \$546,000 and the sales load were charged directly

(b) Foreign Currency Transactions  
-- Transactions denominated in Japanese yen are recorded in the Fund's records at the current prevailing rate at the time of the transaction. Asset and liability accounts that are denominated in yen are adjusted to reflect the current exchange rate at the end of the period. Transaction gains or losses resulting from changes in the exchange rate during the reporting period or upon settlement of foreign currency transactions are included in operations for the current period.

The net assets of the Fund are presented at the exchange rate and market values at the end of the period. The Fund isolates that portion of the change in unrealized appreciation (depreciation) included in the statement of operations arising as a result of changes in Japanese yen rates at February 28, 2003 on investments and other assets and liabilities. Net realized foreign exchange gains or losses includes gains or losses arising from sales of portfolio securities, sales and maturities of short-term securities, currency gains or losses realized between the trade and settlement dates on securities transactions, the difference between the amounts of dividends, interest, and foreign withholding taxes recorded on the Fund's books, and the U.S. dollar equivalent of the amounts actually received or paid.

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against the proceeds of the Rights Offering. The following is a summary of significant accounting policies followed by the Fund.

(a) Valuation of Securities -- Investments traded in the over-the-counter market are valued at the last reported sales price as of the close of business on the day the securities are being valued or, if none is available, at the mean of the bid and offer price at the close of business on such day or, if none is available, the last reported sales price. Portfolio securities which are traded on stock exchanges are valued at the last sales price on the principal market on which securities are traded or lacking any sales, at the last available bid price. Short-term debt securities which mature in 60 days or less are valued at amortized cost if their original maturity at the date of purchase was 60 days or less, or by amortizing their value on the 61st day prior to maturity if their term to maturity at the date of purchase exceeded 60 days. Securities and other asset for which market quotations are not readily available are valued at fair value as determined in good faith by or under the direction of the Board of Directors of the Fund.

(c) Security Transactions, Investment Income and Distributions to Shareholders -- Security transactions are accounted for on the trade date. Dividend income and distributions are recorded on the ex-dividend date and interest income is recorded on the accrual basis. Realized gains and losses on the sale of investments are calculated on the identified cost basis.

Distributions from net investment income and net realized gains are determined in accordance with Federal income tax regulations, which may differ from generally accepted accounting principles. To the extent these "book/tax" differences are permanent in nature (i.e., that they result from other than timing of recognition--"temporary"), such accounts are reclassified within the capital accounts based on their Federal tax-basis treatment; temporary differences do not require reclassification. Dividends and distributions which exceed net realized gains for financial reporting purposes, but not for tax purposes, are reported as distributions in excess of net realized gains.

13

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS -- Continued

(d) Income Taxes -- A provision for United States income taxes has not been made since it is the intention of the Fund to qualify as a regulated investment company under the Internal Revenue Code and to distribute within the allowable time limit all taxable income to its shareholders.

Under Japanese tax laws, a withholding tax is imposed on dividends at a rate of 15% and on interest at a rate of 10% and such

2. Management Agreement and Transactions With Affiliated Persons

Nomura Asset Management U.S.A. Inc. (the "Manager") acts as the Manager of the Fund pursuant to a management agreement. Under the agreement, the Manager provides all office space, facilities and personnel necessary to perform its duties. Pursuant to such management agreement, the Manager has retained its parent company, Nomura Asset Management Co., Ltd. (the "Investment Adviser"), to act as

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withholding taxes are reflected as a reduction of the related revenue. There is no withholding tax on realized gains.

(e) Capital Account  
Reclassification -- For the year ended February 28, 2003, the Fund's accumulated net realized loss was increased by \$44,279 and paid in capital was decreased by \$798,103, with an off-setting decrease in accumulated net investment loss of \$842,382. This adjustment was primarily the result of the reclassification of foreign currency gains and the net operating loss.

(f) Use of Estimates in Financial Statement Preparation -- The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from these estimates.

(g) Concentration of Risk -- A significant portion of the Fund's net assets consists of Japanese securities which involve certain considerations and risks not typically associated with investments in the United States. In addition to the smaller size, and greater volatility, there is often substantially less publicly available information about Japanese issuers than there is about U.S. issuers. Future economic and political developments in Japan could adversely affect the value of securities in which the Fund is invested. Further, the Fund may be exposed to currency devaluation and other exchange rate fluctuations.

(h) Indemnifications -- In the normal course of business, the Fund enters into contracts that contain a variety of representations which provide general indemnifications. The Fund's maximum exposure under these agreements is unknown as this would involve future claims that may be made against the Fund that have not yet occurred. However, based on experience, the Fund

investment adviser for the Fund.

As compensation for its services to the Fund, the Manager receives a monthly fee at the annual rate of 1.10% of the value of the Fund's average weekly net assets not in excess of \$50 million, 1.00% of the Fund's average weekly net assets in excess of \$50 million but not exceeding \$100 million, .90% of the Fund's average weekly net assets in excess of \$100 million but not exceeding \$175 million, and .80% of the Fund's average weekly net assets in excess of \$175 million. For services performed under the Investment Advisory Agreement, the Investment Adviser receives a monthly fee from the Manager at the annual rate of .50% of the Fund's average weekly net assets not in excess of \$50 million, .45% of the Fund's average weekly net assets in excess of \$50 million but not in excess of \$100 million, .40% of the Fund's average weekly net assets in excess of \$100 million but not exceeding \$175 million, and .35% of the Fund's average weekly net assets in excess of \$175 million. Under the Management Agreement, the Fund accrued fees to the Manager of \$1,081,500 for the year ended February 28, 2003. Under the Investment Advisory Agreement, the Manager informed the Fund that the Investment Adviser earned fees of \$488,881 for the year ended February 28, 2003. At February 28, 2003, the fee payable to the Manager, by the Fund, was \$68,586.

Certain officers and/or directors of the Fund are officers and/or directors of the Manager. Nomura Securities Co., Ltd. (the Manager's affiliate) and its affiliates earned \$3,588 in commissions on the execution of portfolio security transactions for the year ended February 28, 2003. The Fund pays each Director not affiliated with the Manager an annual fee of \$5,000 plus \$500 per meeting attended, together with such Director's actual expenses related to attendance at meetings. Such fees and expenses for unaffiliated Directors aggregated \$34,150, for the year ended February 28, 2003.



expects the risk of loss to be remote.

14

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS -- Continued

3. Purchases and Sales of Investments

Purchases and sales of investments, exclusive of investments in foreign currencies and short-term securities, for the year ended February 28, 2003 were \$28,744,945 and \$29,642,776, respectively.

As of February 28, 2003, net unrealized depreciation on investments exclusive of investments in foreign currency and short-term securities for Federal income tax purposes was \$47,072,030 of which \$5,905,478 related to appreciated securities and \$52,977,508 related to depreciated securities. The aggregate cost of investments, exclusive of investments in foreign currencies of \$16,070, at February 28, 2003 for Federal income tax purposes was \$137,192,047. In accordance with U.S. Treasury regulations, the Fund elected to defer \$345,077 of net realized foreign currency losses and \$1,945,147 of net realized capital losses arising after October 31, 2002. Such losses are treated for tax purposes as arising on March 1, 2003. The Fund has a capital loss carryforward as of February 28, 2003 of approximately \$28,827,665 of which, \$22,683,799 expires February 28, 2010 and \$6,143,866 expires February 28, 2011.

15

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NOTES TO FINANCIAL STATEMENTS--Continued

FINANCIAL HIGHLIGHTS

Selected per share data and ratios for a share of common stock outstanding throughout the period.

	For the Year End		
	February 28,		
	2003	2002	2001
Net asset value, beginning of year.....	\$5.86	\$7.59	\$16.39
Rights Offering costs*.....	--	--	--
Net investment loss@.....	(0.05)	(0.06)	(0.09)
Net realized and unrealized gain (loss) on investments and foreign currency.....	(0.07)	(1.59)	(7.89)
Total from investment operations.....	(0.12)	(1.65)	(7.98)
Distributions to shareholders from:			
Net realized capital gains.....	--	(0.08)	(0.82)
Net investment income.....	--	--	--
Total distributions.....	0.00	(0.08)	(0.82)
Decrease in net asset value due to shares issued through Rights Offering*.....	--	--	--
Net asset value, end of period.....	\$5.74	\$5.86	\$7.59
Market value, end of period.....	\$6.38	\$5.53	\$6.89
Total investment return+.....	15.4%	(18.6%)	(31.1%)
Ratio to average net assets/supplemental data:			
Net assets, end of period (in 000).....	\$90,930	\$92,815	\$120,275
Operating expenses.....	1.63%	1.58%	1.33%
Net investment loss.....	(0.75%)	(0.84%)	(0.76%)
Portfolio turnover.....	28%	38%	78%

+Based on market value per share, adjusted for reinvestment of income dividends and long term capital gain distributions, and capital shares transactions. Total return does not reflect sales commissions.

\*Decrease is due to Rights Offering (see note 1).

@Based on average shares outstanding.

Supplemental Shareholder Information (Unaudited)

The 2002 Annual Meeting of the Shareholders of the Fund was held at the Fund's offices, 180 Maiden Lane, New York, New York on November 12, 2002. The purpose of the meeting was to elect five Directors to serve for the ensuing year; and to transact such other business as may properly come before the Meeting or any adjournment thereof.

At the Meeting, the following persons were elected by the shareholders to serve as Directors of the Fund: William G. Barker, Jr., Kazuhiko Hama, Chor

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Weng Tan, Arthur R. Taylor, and John F. Wallace. No other business was transacted at the meeting.

The results of the voting at the Annual Meeting are as follows:

1. To elect the Fund's Board of Directors:

	Shares Voted For	% of outstanding Shares	Shares Withhold A
William G. Barker, Jr.....	11,321,612	71.4	281,4
Kazuhiko Hama.....	11,324,223	71.5	215,8
Chor Weng Tax.....	11,336,330	71.5	203,7
Arthur R. Taylor.....	11,317,784	71.4	222,2
John F. Wallace.....	11,323,130	71.5	216,9

### REVIEW OF THE FUND'S MARKET PRICE COMPARED TO NET ASSET VALUE

Shares of closed-end investment companies, including funds focusing on a single country, have at various times traded at both premiums and discounts to their net asset value ("NAV"). Although the shares of the Fund have traded at such a premium, they also have traded at a discount from NAV.

Since the Fund was established, the Board of Directors on a quarterly basis has reviewed the trading price of the Fund's shares. The purpose of such review has been to determine whether a discount exists and, if so, whether it would be in shareholders' overall best interests for the Fund to conduct share repurchases, make an issuer tender offer for shares or consider another means of possibly reducing the discount. For example, the Board of Directors has also considered whether it would be in the best interests of the Fund to convert to an open-end fund or to an interval fund, which is a form of investment company that makes periodic share repurchases at prices based on NAV.

To date, the Board of Directors has not authorized open-market share repurchases or a tender offer for shares of the Fund. The Board of Directors also has not felt that it would be in the best interests of the Fund or its shareholders to convert to an open-end fund or an interval fund. As a "country fund", emphasizing a smaller capitalization segment of the market, the Fund's NAV is more volatile than might be the case for a fund with a broader investment focus. The Board of Directors believe that converting the Fund to either an open-end or interval fund would subject the Fund to redemptions or repurchases at times when liquidation of portfolio securities could disadvantage remaining shareholders, and they believe that the recent volatility of the financial markets in Japan supports their view. Additionally, since an open-end fund has a limited ability to invest in illiquid securities, such a conversion could hinder the Fund's ability to pursue its investment objectives. The Board of Directors intend to continue to review, on a quarterly basis, the trading market for the Fund's shares.

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### JAPAN SMALLER CAPITALIZATION FUND, INC.

#### DIVIDEND REINVESTMENT PLAN

The Dividend Reinvestment Plan (the "Plan") is available automatically for any holder of Common Stock with shares registered in his/her own name who wishes to purchase additional shares with income dividends or capital gains distributions received on shares owned, unless such shareholder elected to receive all dividends and capital gain distributions in cash, paid by check and mailed to the shareholder. If a shareholder holds shares in his/her own name, communications regarding the Plan should be addressed to the Plan Agent, Equiserve Trust Company, N.A. P.O. Box 43011, Providence, RI 02940-3011. Under the Plan, shareholders appoint the Plan Agent to reinvest dividends and distributions in shares of the Fund. Such shares will be acquired by the Plan Agent for shareholders either through open market purchases if the Fund is trading at a discount or through the issuance of authorized but unissued shares if the Fund is trading at net asset value or a premium. If the market price of a share on the payable date of a dividend or distribution is at or above the Fund's net asset value per share on such date, the number of shares to be issued by the Fund to each shareholder receiving shares in lieu of cash dividends or distributions will be determined by dividing the amount of the cash dividends or distributions to which such shareholder would be entitled by the greater of the net asset value per share on such date or 95% of the market price of a share on such date. If the market price of a share on such distribution date is below the net asset value per share, the number of shares to be issued to such shareholders will be determined by dividing such amount, less brokerage commission, by the per share market price.

Purchases will be made by the Plan Agent from time to time on the

purchase shares until all investments by shareholders have been completed or the closing price or the mean between the bid and ask prices of the shares becomes higher than the net asset value, in which case the Fund will issue the necessary additional shares from authorized but unissued shares. If on the last trading day immediately preceding the dividend payable date, the closing price or the mean between the bid and ask prices of the shares is higher than the net asset value per share and if the number of shares previously purchased on the Exchange or elsewhere is insufficient to satisfy dividend investments, the Fund will issue the necessary additional shares from authorized but unissued shares. There will be no brokerage charges with respect to shares issued directly by the Fund to satisfy the dividend investment requirements. However, each participant will pay a pro rata share of brokerage commissions incurred with respect to the Fund's open market purchases of shares. In each case, the cost per share of shares purchased for each shareholder's account will be the average cost, including brokerage commissions, of any shares purchased in the open market plus the cost of any shares issued by the Fund. For the fiscal year ended February 28, 2003, the Fund did not issue any new shares for dividend reinvestment purposes. The Fund purchased 2,344 shares (\$12,752) on the open market for dividend reinvestment purposes.

Shareholders who elect to hold their shares in the name of a broker or other nominee should contact such broker or other nominee to determine whether they may participate in the Plan. To the extent such participation is permitted, the Plan Agent will administer the Plan on the basis of the number of shares certified from time to time by the broker as representing the total amount registered in the shareholder's name and held for the account of beneficial owners who are participating in such Plan. Shareholders that participate in the Plan holding shares in a brokerage account may not be able to transfer the shares to another broker and continue to

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New York Stock Exchange (the "Exchange") or elsewhere to satisfy dividend and distribution investment requirements under the Plan. Purchases will be suspended on any day when the closing price (for the mean between the closing bid and ask prices if there were no sales) of the shares on the Exchange on the preceding trading day was higher than the net asset value per share. If on the dividend payable date, purchases by the Fund are insufficient to satisfy dividend or distribution investments and on the last trading day immediately preceding the dividend payable date the closing price or the mean between the closing bid and ask prices of the shares is lower than or the same as the net asset value per share, the Plan Agent will continue to

participate in the Plan. Shareholders who are participating in the Plan may withdraw from the Plan at any time. There will be no penalty for withdrawal from the Plan, and shareholders who have previously withdrawn from the Plan may rejoin it at any time. Changes in participation in the Plan should be made by contacting the Plan Agent if the shares are held in the shareholder's own name and must be in writing and should include the shareholder's name and address as they appear on the account registration. If

18

the shares are held in the name of a broker or other nominee, such person should be contacted regarding changes in participation in the Plan. Upon withdrawal from the Plan, the Plan Agent will deliver to the shareholder a certificate or certificates for the appropriate number of full shares and a cash payment for any fractional shares. In lieu of receiving a certificate, the shareholder may request the Plan Agent to sell part or all of the shareholder's shares at the market price and remit the proceeds to the shareholder, net of any brokerage commissions. A \$2.50 fee will be charged by the Plan Agent upon any cash withdrawal or termination. An election to withdraw from the Plan will, until such election is changed, be deemed to be an election by a shareholder to take all subsequent distributions in cash. An election will be effective only for a dividend or distribution if it is received by the Plan Agent not less than 10 days prior to such record date.

The Plan Agent will maintain all shareholders' accounts in the

The automatic reinvestment of dividends will not relieve participants of any income taxes that may be payable (or required to be withheld) on such dividends. Shareholders receiving dividends or distributions in the form of additional shares pursuant to the Plan should be treated for Federal income tax purposes as receiving a distribution in an amount equal to the amount of money that the shareholder receiving cash dividends or distributions will receive and should have a cost basis in the shares received equal to such amount.

The Fund reserves the right to amend or terminate the Plan as applied to any dividend paid subsequent to written notice of the change sent to participants in the Plan at least 90 days before the record date for such dividend. There is no service charge to participants in the Plan; however, the Fund reserves the right to amend the Plan to include a service charge payable by the participants. All correspondence concerning the Plan, including requests for additional information about the Plan, should be directed to the Plan Agent.

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Plan, and furnish written confirmation of all transactions in such account, including information needed by shareholders for tax records. Shares in the account of each Plan participant may be held by the Plan Agent in non-certificated form in the name of the participant, and each shareholder's proxy will include those shares purchased or received pursuant to the Plan.

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SHAREHOLDERS ACCOUNT INFORMATION

Shareholders whose accounts are held in their own name may contact the Fund's transfer agent, Equiserve Trust Company, N.A. at (800) 426-5523 for information concerning their accounts.

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19

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BOARD OF DIRECTORS

William G. Barker, Jr.  
Kazuhiko Hama  
Chor Weng tan  
Arthur R. Taylor  
John F. Wallace

OFFICERS

Kazuhiko Hama, President  
Keisuke Haruguchi, Vice President  
Kenneth L. Munt, Vice President  
Rita Chopra-Brathwaite, Treasurer  
Neil A. Daniele, Secretary

MANAGER

Nomura Asset Management U.S.A. Inc.  
180 Maiden Lane  
New York, New York 10038-4936  
Internet Address  
www.nomura.com

INVESTMENT ADVISOR

Nomura Asset Management Co., Ltd.  
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Tokyo 103-8260, Japan

DIVIDEND PAYING AGENT, TRANSFER AGENT AND REGISTRAR

Equiserve Trust Company, N.A.  
P.O. Box 43011 ANNUAL REPORT Providence, RI 02940-3011

JAPAN  
Smaller Cap  
Fund,

CUSTODIAN

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Boston, Massachusetts 02109-3661

COUNSEL

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New York, New York 10019

INDEPENDENT ACCOUNTANTS

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1177 Avenue of the Americas  
New York, New York 10036-2798

JAPAN SMALLER CAPITALIZATION FUND, INC.

180 MAIDEN LANE  
NEW YORK, NEW YORK 10038-4936

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This Report, including the Financial Statements, is transmitted to the Shareholders of Japan Smaller Capitalization Fund, Inc. for their information. This is not a prospectus, circular or representation intended for use in the purchase of shares of the Fund or any securities mentioned in the Report.

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