

Notes to the Financial Statements

1. General

JF Japan OTC Fund Inc. (the “Company”) is an exempted company incorporated in the Cayman Islands with unlimited life. The Company’s objective is to secure long-term capital appreciation of assets through investment in a diversified portfolio of equity securities traded on the Japan OTC market, the Mothers Market and the NASDAQ Japan market offering potentially attractive financial returns through long-term earnings growth. The Company is listed on the Stock Exchange of Hong Kong Limited.

2. Principal Accounting Policies

The principal accounting policies adopted in the preparation of the financial statements are set out below:

(a) Basis of preparation

The financial statements have been prepared in accordance with and comply with International Accounting Standards. The financial statements have been prepared under the historical cost convention as modified by the revaluation of investments. In view of the geographical location of the Company’s investments, the amounts shown in these financial statements are presented in Japanese Yen.

(b) Investments

Listed investments and investments with prices quoted in over the counter markets or by market makers are stated at the last traded price of the relevant stock exchanges at the close of the business on the valuation day. When trading in the securities of an investee company is thin or suspended, the investment is valued at the Board’s estimate of its net realisable value. Purchases and sales of investments are accounted for on the trade date basis. Realised and unrealised gains and losses on investments are initially recognised in the Statement of Operations and thereafter transferred to the Capital Reserve. In accordance with the Company’s Placing Memorandum dated 11 January 1990, such gains are not distributable.

(c) Dividend and interest income

Dividend receivable on quoted equity shares are brought into account on the ex-dividend date.

Interest income on bank deposits is recognised on a time proportion basis, taking into account the principal amounts outstanding and the interest rate applicable.

(d) Borrowing costs and other expenses

Borrowing costs and other expenses are accounted for on an accruals basis.

(e) Translation of foreign currencies

Monetary assets and liabilities expressed in foreign currencies at the balance sheet date are translated into Japanese Yen at the following rates of exchange ruling at the balance sheet date:

HK\$1 = JPY14.6412

US\$1 = JPY114.1999

Transactions in foreign currencies during the year are translated into Japanese Yen at the rate of exchange ruling at the transaction dates. Realised and unrealised gains and losses arising on translation of transactions and balances denominated in foreign currencies are initially recognised in the Statement of Operations and thereafter transferred to the Capital Reserve.

(f) Financial instruments

Financial instruments carried on the Balance Sheet include cash at banks, investments, short-term deposits, dividend and other accounts receivable, accounts payable, amounts due from/to brokers,

Notes to the Financial Statements *(continued)*

bank overdraft and bank loans. The particular recognition methods adopted are disclosed in the individual policy statements associated with each item.

The Company is a party to financial instruments that reduce exposure to fluctuations in interest rates. These instruments comprise interest rate swap agreements. The purpose of these instruments is to reduce risk.

Interest rate swap agreements protect the Company from movements in interest rates. Any differential to be paid or received on an interest rate swap agreement is recognised as a component of interest revenue or expense over the period of the agreement. Gains and losses on early termination of interest rate swaps or on repayment of the borrowing are taken to the statement of operations.

Disclosures about financial instruments to which the Company is a party are provided in Note 12.

(g) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents comprise short-term deposits, cash at bank net of short-term bank loans and overdrafts.

(h) Related parties

Parties are considered related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operating decisions. Parties related to the JPMorgan Chase group, of which the Company's Manager, Investment Manager and Investment Adviser are a member of, are considered to be related to the Company.

(i) Capital reserve

Capital reserve represents accumulated realised and unrealised gains/losses on investments and exchange differences.

3. Taxation

No provision for Hong Kong profits tax has been made as the Company has no assessable income for the year (1999: Nil). The Company is not subject to taxation in the Cayman Islands.

Overseas withholding tax was charged on certain dividend income received during the year.

4. Management Fee

JF Japan OTC Management Limited, the Company's Manager, is entitled to receive a fee calculated at the rate of 1.3% per annum of the Company's total assets less current liabilities (being amounts due to creditors and short-term borrowings with an initial maturity of less than one year) ("TA-CL") on the last business day of the relevant month, but if "TA-CL" exceeds 125% of the net asset value, the rate applicable to such excess would be 1.3% per annum for invested assets e.g. shares, warrants, and 0.25% per annum for uninvested assets e.g. cash at banks and short-term deposits.

The management fee is calculated weekly prior to 28 June 1999 and daily afterwards and payable monthly in arrears.

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5. Directors' Remuneration

The aggregate amounts of fees paid and payable to the Directors and the Chairman of the Company are as follows:

	2000	1999
	JPY	JPY
As Directors and Chairman	9,602,938	8,241,564
As Audit Committee Members	278,100	225,796
	9,881,038	8,467,360

Directors' remuneration included JPY6,228,780 (1999: JPY5,306,212) payable to independent non-executive Directors.

No Director waived emoluments in respect of the years ended 31 December 2000 and 31 December 1999.

The number of Directors whose emoluments fell within the following bands are as follows:

	No. of Directors	
<u>Directors' Fees</u>	2000	1999
Nil - HK\$1,000,000 (equivalent to JPY14,641,000)	5	5
Over HK\$1,000,000 (equivalent to JPY14,641,000)	—	—
	5	5

Pursuant to the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, the above disclosure of payment includes payment to the five highest paid individuals in the Company during the year.

6. Net (Loss)/Income Per Share

The calculation of net loss per share is based on net loss for the year of JPY16,651,474,986 (1999: net income of JPY22,522,159,959) and the weighted average of 22,009,205 shares in issue during the year (1999: 24,897,984, restated as if the share subdivision had occurred at the beginning of 1999). The previously reported net income per share for the year 1999 was JPY3,618, based on the weighted average of 6,224,496 shares in issue.

7. Investments

	2000	1999
	JPY	JPY
Listed/Quoted investments, at market value	6,099,215,290	27,133,619,400
Cost of investments	7,944,578,953	12,229,487,951

Notes to the Financial Statements *(continued)*

8. Long-Term Bank Loan

	2000	1999
	JPY	JPY
Due to be settled:		
Within one year	1,000,000,000	—
More than one year and less than two years	—	1,000,000,000
	1,000,000,000	1,000,000,000

The Company entered into a long-term loan agreement in 1996. The loan is unsecured and interest is charged on the outstanding balance at a rate of 0.6% per annum over JPY LIBOR. The loan will mature in June 2001 with early repayment option on any interest payment date one year after the facility was granted. The loan was fully drawn down in 1996. No partial repayment was made during the year (1999: Nil).

The interest rate swap agreement detailed in Note 12 was entered into on the same day in order to hedge the interest rate risks on the above long-term loan.

9. Share Capital

	2000	1999
	US\$	US\$
Authorised:		
12,000,000 shares of US\$1.00 each	—	12,000,000
48,000,000 shares of US\$0.25 each	12,000,000	—
	2000	1999
	JPY	JPY
Issued and fully paid:		
5,693,000 shares of US\$1.00 each	—	704,139,161
21,470,200 shares of US\$0.25 each	663,885,851	—

At the Annual General Meeting held on 15 May 2000, the shareholders approved the subdivision of every issued and unissued share of US\$1.00 into four shares of US\$0.25 each with effect from 16 May 2000.

During the year, the Company repurchased, for cancellation, 252,000 shares of nominal value US\$1.00 each (1999: 692,000 shares) and 293,800 shares of nominal value US\$0.25 each (1999: N/A), which represented 5.7% of the issued share capital, through the market makers, at a total consideration of US\$7,030,996 (equivalent to JPY754,318,829) (1999: US\$17,068,925 and equivalent to JPY1,791,202,518).

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10. Net Asset Value Per Share

The calculation of net asset value per share is based on the net assets of JPY6,932,384,317 (1999: JPY24,338,178,132) and the number of shares in issue 21,470,200 at 31 December 2000 (1999: 22,772,000, restated as if the share subdivision had occurred at the beginning of 1999. The previously reported net asset value per share as at 31 December 1999 was JPY4,275, based on 5,693,000 shares in issue).

11. Related Party Transactions

In addition to the transactions disclosed in Note 4, the Company had entered into the following transactions with related parties. All such transactions were entered into in the ordinary course of business and on normal commercial terms.

(a) Brokerage commissions in relation to transactions dealt through related parties were as follows:

	Brokerage commission paid JPY	% of the Company's total commission paid in the year	Outstanding balance at year end
Year ended 31 December 2000			
Jardine Fleming Securities Limited	2,294,511	6.38	—
Year ended 31 December 1999			
Jardine Fleming Securities Limited	2,445,327	5.03	—

(b) The Company has a stock lending arrangement with Jardine Fleming Securities Limited ("JFSL"), a related party of the Manager. The securities lending agreement with JFSL has been terminated with effect from 22 August 2000. There was no stock lending transaction with JFSL during the year.

The Company entered into a securities lending agreement with Robert Fleming & Co. Limited ("RF") on 23 May 2000 and has only one transaction with RF during the year with details below:

	2000 JPY	1999 JPY
Aggregate value of security on loan at year end	—	—
Maximum aggregate value of security on loan during the year	66,014,400	291,398,877

In respect of security on loan at 31 December 2000, the Company held nil balance as collateral (1999: Nil).

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- (c) The Company utilises the brokerage, agency and banking services of fellow subsidiaries in the JPMorgan Chase group. Interest income and expenses during the year and balances outstanding at year end were as follows:

	Interest income for the year JPY	Interest expenses for the year JPY	Deposits as at 31 December JPY	Borrowings as at 31 December JPY
2000				
Jardine Fleming Bank Limited	193,408	4,977,400	–	–
Robert Fleming & Co. Limited	–	596,857	–	–
1999				
Jardine Fleming Bank Limited	4,494	10,502,771	–	1,674,189,250
Robert Fleming & Co. Limited	–	484,262	–	250,205,697

12. Financial instruments

Credit risk

Financial assets which potentially subject the Company to concentrations of credit risk consist principally of investments, cash at bank, short-term deposits and amounts due from/to brokers. The exposure to credit risk in respect of investments is controlled by the limits set by the Company on its investment holding in a single issuer.

Derivative instruments and stock lending arrangements are entered into with, and bank balances and deposits are placed with substantial financial institutions. The exposure to credit risk in respect of amounts due from/to brokers is monitored by way of identifying and transacting only with approved brokers. Exposure limits are also set and reviewed on a periodical basis. Furthermore, in respect of stocks on loan at any particular point in time, collateral equivalent to at least 105% of the stocks on loan at the time the loan is provided, is obtained.

Accordingly, the Company has no significant concentration of credit risk.

Interest rate risk

The Company has entered into an interest rate swap agreement that entitles it to receive interest at floating rates on the notional principal amount and oblige it to pay interest at fixed rates on the same amount. The fixed interest rate is 2.75% per annum and the floating rate is linked to JPY LIBOR, with a floating rate reset every 6 months.

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The remaining terms and notional principal amounts of the outstanding interest rate swap agreement as at 31 December were:

	2000	1999
	JPY	JPY
Maturing in 2001	1,000,000,000	1,000,000,000

The unwind cost of the interest rate swap at the balance sheet date was estimated at JPY10,700,000 (1999: JPY35,000,000).

The Company's short-term deposits will mature within three months.

The Company's short-term deposits with maturity less than three months, short-term bank loans and overdrafts at balance sheet date carried interest at the following rates per annum:

	2000	1999
Short-term deposits	0.01% - 1.00%	–
Short-term bank loans and overdrafts	–	0.95% - 2.09%

Fair values

The carrying amounts of investments, dividend and other accounts receivable, cash at bank, short-term bank loans and bank overdrafts, short-term deposits, amounts due from/to brokers, accounts payable and long-term bank loan maturing in 2001 approximate to their fair value.

Information on the fair value of the interest rate swap agreement is included above.

13. Accounts receivable and payable

At 31 December 2000, dividend and other accounts receivable, accounts payable and amount due from/to brokers were either current or due for less than 30 days.