STEAK & SHAKE CO
Form DEF 14A
January 03, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A INFORMATION
Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934

Filed by the Registrant [X]
Filed by a party other than the Registrant [ ]

Check the appropriate box:

[ ] Preliminary Proxy Statement
[ ] Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
[X] Definitive Proxy Statement
[ ] Definitive Additional Materials
[ ] Soliciting Material Pursuant to Section 240.14a-12

The Steak N Shake Company
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

[X] No fee required

[ ] Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11
1) Title of each class of securities to which transaction applies:
2) Aggregate number of securities to which transaction applies:
3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):
4) Proposed maximum aggregate value of transaction:
5) Total fee paid:

[ ] Fee paid previously with preliminary materials.

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1) Amount previously paid:

2) Form, Schedule or Registration Statement No.:
3) Filing Party:
4) Date Filed:

THE STEAK N SHAKE COMPANY

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS
TO BE HELD FEBRUARY 8, 2006

TO THE SHAREHOLDERS OF THE STEAK N SHAKE COMPANY

NOTICE IS HEREBY GIVEN that the Annual Meeting of Shareholders of The Steak n Shake Company (the "Company") will be held on the 1st Floor of the Century Building, 36 South Pennsylvania Street, Indianapolis, Indiana 46204, on Wednesday, February 8, 2006 at 1:30 p.m., Eastern Standard Time, for the following purposes:

1. To elect nine directors to serve until the next Annual Meeting of Shareholders and until their respective successors are elected and qualified;

2. To ratify the selection by the Audit Committee of the Board of Directors of Deloitte & Touche, LLP as the Company's independent auditors for the fiscal year ending September 27, 2006;

3. To approve the 2006 Employee Stock Option Plan;

4. To approve the 2006 Incentive Bonus Plan;

5. To approve the 2006 Employee Stock Purchase Plan;

6. To transact such other business as may properly come before the meeting and any adjournment thereof.

The Board of Directors has fixed the close of business on December 5, 2005 as the record date for the determination of shareholders entitled to notice of and to vote at the Annual Meeting.

We urge you to sign, date and mail the enclosed proxy in the envelope provided or to vote via the telephone or internet (pursuant to instructions contained on the Proxy card) whether or not you expect to be present in person. You may revoke the proxy at any time prior to the time the proxy is exercised by filing with the Secretary of the Company a properly executed instrument revoking such proxy, by filing a properly executed proxy bearing a later date, or by attending the Annual Meeting and withdrawing your proxy and voting in person.

By Order of the Board of Directors

David C. Milne, Secretary
December 30, 2005
Indianapolis, Indiana

PLEASE SIGN AND DATE THE ENCLOSED PROXY CARD AND RETURN IT PROMPTLY IN THE ENCLOSED ENVELOPE OR CAST YOUR VOTE VIA TELEPHONE OR INTERNET VIA INSTRUCTIONS ON THE PROXY CARD

THE STEAK N SHAKE COMPANY
500 Century Building
36 South Pennsylvania Street
Indianapolis, Indiana 46204
(317) 633-4100

PROXY STATEMENT
For the Annual Meeting of Shareholders
To be held February 8, 2006

This proxy statement is furnished to the shareholders of The Steak n Shake Company (the "Company") in connection with the solicitation by the Company of proxies to be voted at the Annual Meeting of Shareholders (the "Annual Meeting") to be held on the 1st Floor of the Century Building, 36 South Pennsylvania Street, Indianapolis, Indiana 46204, on Wednesday, February 8, 2006, at 1:30 p.m., Eastern Standard Time, and at any adjournment thereof. This proxy statement and the accompanying form of proxy were first mailed to shareholders on or about December 30, 2005.

Each properly executed proxy returned prior to the meeting will be voted in accordance with the directions contained therein. The enclosed proxy may be revoked by the person giving it at any time before it is voted by giving written notice to the Secretary of the Company.

OUTSTANDING COMMON STOCK

The record date for shareholders entitled to vote at the Annual Meeting was December 5, 2005. At the close of business on that date, the Company had issued and outstanding 27,900,582 shares of Common Stock entitled to vote at the Annual Meeting. Unless otherwise stated, all references herein to numbers and prices of shares of Common Stock, options and capital appreciation shares of the Company have been adjusted to reflect all stock dividends and stock splits distributed in the past by the Company.

ACTION TO BE TAKEN AT THE ANNUAL MEETING

Unless the shareholder otherwise specifies in the proxy, the accompanying proxy will be voted (i) FOR the election, as directors of the Company, of the nine persons named under the caption "Election of Directors"; (ii) FOR the ratification of Deloitte & Touche, LLP as the Company’s independent auditors for the fiscal year ending September 27, 2006. (iii) FOR the approval of the 2006 Employee Stock Option Plan; (iv) FOR the approval of the 2006 Incentive Bonus Plan, and (v) FOR the approval of the 2006 Employee Stock Purchase Plan.

QUORUM AND VOTING

The presence, in person or by proxy, of the holders of a majority of the outstanding shares of Common Stock is necessary to constitute a quorum at the Annual Meeting. In deciding all questions, a holder of Common Stock is entitled to one vote, in person or by proxy, for each share registered in his/her/its name on the record date. Directors of the Company are elected by a plurality of the votes cast by the holders of the shares represented at the meeting. Abstentions, broker non-votes and instructions on the enclosed form of proxy to withhold authority to vote for one or more of the nominees will result in the nominee receiving fewer votes; however, it will not affect the outcome of the election. Approval of the 2006 Employee Stock Option Plan, the 2006 Incentive Bonus Plan, the 2006 Employee Stock Purchase Plan and the ratification of the selection of the auditors will occur if these proposals receive more votes cast in favor of the proposal than are cast in opposition to it. Abstentions and broker non-votes with respect to those proposals will not be counted as votes for or against those proposals.

SHAREHOLDER PROPOSALS

The bylaws of the Company require shareholders to provide advance notice in order to bring business before an annual meeting or to nominate a candidate for director at the meeting. In order for a shareholder to properly bring business or propose a director at the 2007 Annual Meeting, the shareholder must give written notice to the Company at the address on the front page of this proxy statement. To be timely, a shareholder's notice must be received by the Company on or before September 3, 2006, or in the event that the date of the meeting associated with this notice is changed more than 30 days from February 8, 2006 such notice must be delivered or mailed to and received by the Company not later than 120 days prior to the date the Company mailed proxy materials for the preceding year's annual meeting or 10 calendar days following the date on which public announcement of the date of the meeting is first made. These procedures apply to any matter that a shareholder wishes to raise at the 2007 Annual Meeting, other than those raised pursuant to 17 C.F.R. §240.14a-8 of the Rules and Regulations of the SEC. A shareholder proposal that does not meet the above requirements will be considered untimely, and any proxy solicited by the Company may confer discretionary authority to vote on such proposal.

OWNERSHIP OF COMMON STOCK

The following table shows the number and percentage of outstanding shares of Common Stock beneficially owned as of December 5, 2005 by each person or entity known to be the beneficial owner of more than 5% of the Common Stock of the Company:

Name & Address of Beneficial Owner	Amount and Nature of Beneficial Ownership (1)	Percent of Class
MSD Capital, Inc. MSD SBI, L.P. 645 Fifth Avenue, 21st Floor New York, NY 10022-5910	2,293,700	8.2%

(1) This table is based upon information supplied by MSD Capital, Inc. on Schedule 13G filed with the Securities and Exchange Commission on February 14, 2005. MSD Capital, Inc. and MSD SBI, L.P. share voting and investment power over the shares.

Name of Beneficial Owner	Amount and Nature of Beneficial Ownership [1]	Percent of Class
Jeffrey Blade	28,100 [2]	*
Peter M. Dunn	136,400 [3]	*
Alan B. Gilman	486,710 [4]	1.7%
Wayne L. Kelley	96,270 [5]	*
Charles E. Lanham	388,480 [6]	1.4%
Ruth J. Person	9,000 [7]	*
Steven M. Schmidt	1,000 [8]	*
Gary T. Reinwald	246,106 [9]	*
J. Fred Risk	124,299 [10]	*
John W. Ryan	27,382 [11]	*
Gary S. Walker	65,600 [12]	*
James Williamson, Jr.	230,158 [13]	*
All directors and executive officers as a group (17 persons)	1,922,394[14]	6.8%

* *Less than 1%.*

(1) *Includes shares that may be acquired pursuant to stock options exercisable within 60 days under the Company's stock option plans.*

(2) *Includes 8,100 shares that may be acquired pursuant to stock options exercisable with in 60 days.*

(3) *Includes 43,000 shares that may be acquired pursuant to stock options exercisable with in 60 days.*

(4) *Includes 124,558 shares that may be acquired pursuant to stock options exercisable within 60 days.*

(5) *Includes 7,400 shares that may be acquired pursuant to stock options exercisable within 60 days; also includes 75,670 shares held by Mr. Kelley's late father's estate in three residuary trusts, to which he disclaims beneficial ownership.*

(6) *Includes 14,000 shares that may be acquired pursuant to stock options exercisable within 60 days. Also includes 30,928 shares which were owned of record and beneficially by Mr. Lanham's late wife, over whose estate he is the executor and the voting rights to such shares he possesses, and 21,750 shares owned by Mr. Lanham's affiliate, Hartford Heritage, LLC.*

(7) *Includes 9,000 shares that may be acquired pursuant to stock options exercisable within 60 days.*

(8) *Includes 1,000 shares that may be acquired pursuant to stock options exercisable within 60 days.*

(9) *Includes 58,680 shares that may be acquired pursuant to stock options exercisable within 60 days.*

(10) *Includes 10,000 shares that may be acquired pursuant to stock options exercisable within 60 days. Also includes 7,726 shares owned of record and beneficially by Mr. Risk's wife, with respect to which he disclaims beneficial ownership.*

(11) *Includes 14,000 shares that may be acquired pursuant to stock options exercisable within 60 days.*

(12) *Includes 29,957 shares that may be acquired pursuant to stock options exercisable within 60 days and 300 shares owned of record and beneficially by Mr. Walker's minor children, with respect to which he disclaims beneficial ownership.*

(13) *Includes 14,000 shares that may be acquired pursuant to stock options exercisable within 60 days. Also includes 19,011 shares owned of record and beneficially by Mr. Williamson's wife, with respect to which he disclaims beneficial ownership.*

(14) *Includes 386,366 shares that may be acquired pursuant to stock options exercisable within 60 days held by all directors and executive officers as a group.*

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 sets forth certain filing requirements relating to securities ownership by directors, executive officers and ten percent shareholders of a publicly held company. To the Company's knowledge, based on the representations of its directors and executive officers and copies of their respective reports filed with the Securities and Exchange Commission, all filing requirements were satisfied by each such person during the fiscal year ended September 28, 2005 with the exception of a Form 4 regarding the exercise of stock options which the Company filed 5 days late on behalf of Mr. Gary S. Walker.

INTERESTS OF CERTAIN PERSONS IN MATTERS TO BE ACTED UPON

All persons standing for election as director were unanimously nominated by the Board of Directors. No person being nominated as a director is being proposed for election pursuant to any agreement or understanding between any such person and the Company.

MISCELLANEOUS

a) Creation and Distribution of Proxies

The entire cost of soliciting proxies will be paid by the Company. In addition to the solicitation of proxies by use of the mails, certain officers, directors and employees of the Company, none of whom receive additional compensation therefor, may solicit proxies by telephone, facsimile or personal interview at the expense of the Company. The Company will also request brokers, dealers, banks and voting trustees, and their nominees, to forward this proxy statement and the accompanying form of proxy to beneficial owners and will reimburse such record holders for their reasonable expense in forwarding solicitation material.

b) Code of Business Conduct and Ethics.

The Company has in place a long-standing code of ethics. It applies to its principal executive officer, principal financial officer and principal accounting officer, as well as all officers, directors and employees. A copy of the Code of Business Conduct and Ethics (the "Code") can be obtained without charge on the Company's web site (www.steaknshake.com) or by written request to the Company at the address on the front page of this proxy statement. If the Company makes any substantive amendment of, or grants any waiver of a provision of the Code, the Company will disclose the nature of such amendment or waiver via its website and in a current report on Form 8-K.

1. ELECTION OF DIRECTORS

Nine directors will be elected to serve until the next Annual Meeting and until their respective successors shall have been duly elected and qualified. All of the nominees are currently directors of the Company and were elected at the Annual Meeting of Shareholders held February 11, 2005 except Mr. Schmidt, who was appointed to the Board on April 20, 2005 to fill the vacancy created by Mr. Steven Goldsmith's resignation.

If any of the nominees named below is not available to serve as a director at the time of the Annual Meeting (an event which the Board of Directors does not now anticipate), the proxies will be voted for the election as directors of such other person or persons as the Board of Directors may designate, unless the Board of Directors, in its discretion, amends the Company's Bylaws to reduce the number of directors.

The nominees for the Board of Directors of the Company are listed below, along with the age, tenure as director and business background for at least the last five years for each:

Name	Age	Served As Director Since	Business Experience
Peter M. Dunn	50	2004	Currently President and Chief Executive Officer; President and Chief Operating Officer of the Company from 2002 to February 11, 2004; formerly President, Borden Foods Co., 1997-2001.
Alan B. Gilman	75	1992	Currently Chairman of the Board of Directors; President and Chief Executive Officer of the Company from 1992 to September 30, 2002; Chief Executive Officer and Co-Chairman of the Company from September 30, 2002 through August 11, 2003; Chief Executive Officer and Chairman of the Company from August 11, 2003 through February 11, 2004.
Wayne L. Kelley	61	2003	Director of Steak n Shake Operations, Inc., a subsidiary of the Company, since 1999; President of Kelley Restaurants, Inc., the Company's largest franchisee, from 1988 through 2004; currently employed by the Company in a senior real estate advisory role.
Charles E. Lanham	73	1971	Chairman of the Board of Directors of Overhead Door Company of Indianapolis, Inc. from 1960 until February, 2004; Vice Chairman of Klipsch Lanham Investments, a private investment company; Trustee of Windrose Medical Properties Trust, a publicly traded real estate investment trust.
Ruth J. Person	60	2002	Chancellor, Indiana University Kokomo and Professor of Management; President, American Association of University Administrators 2003-2004; Member of the Board of Directors, Workforce Development Strategies, Inc.; Member, Key Bank Advisory Board - Central Indiana
J. Fred Risk	77	1971	Private investor; Chairman of the Board of Directors of Security Group, Inc.
John W. Ryan	76	1996	Private investor; Chancellor of the State University of New York Systems from 1996 through 1999; President of Indiana University from 1971 through 1987.
Steven M. Schmidt	51	2005	President & CEO, ACNielsen; EVP, VNU Marketing Information New York, NY; formerly President of Pillsbury Foods, Canada. Has also held senior executive posts with Pepsi-Cola and Procter & Gamble.
James Williamson, Jr.	74	1985	Private investor.

The Board has determined that all of the nominees standing for election at the 2006 Annual Meeting, other than Messrs. Dunn, Gilman and Kelley, are "independent" within the meaning of the listing standards of The New York Stock Exchange because such nominees have no material relationship with the Company either directly, or as a partner, shareholder, or affiliate of an organization that has a relationship with the Company. The Board has made this determination based on the following:

1) Other than Messrs. Dunn, Gilman and Kelley, no nominee for director is an officer or an employee of the Company or its subsidiaries or affiliates, nor has he/she been such an employee within the prior three years.
2) Other than Messrs. Dunn, Gilman and Kelley, no nominee for director has received, nor has an immediate family member of the nominee received during any twelve month period in the last three years more than $100,000 in direct compensation from the Company, other than director and committee fees and pension or other forms of deferred compensation for prior service.
3) No nominee or immediate family member of the nominee is or within the past five years has been affiliated with the Company's external auditor.
4) No nominee for director has nor any immediate family members of the nominee have within the last three years been employed as an executive officer of another company on which company's Compensation Committee one of the Company's present executive officers served.
5) No nominee is a current employee or has an immediate family member who is a current executive officer of a company that in any of the last three fiscal years has done business with the Company in an amount of $1 million or 2% of such other company's consolidated gross revenues.
6) No nominee, other than Mr. Dunn, serves as a Director, Trustee, Executive Officer or similar position of a charitable or non-profit organization to which the Company or its subsidiaries made charitable contributions or payments in fiscal year 2005 in excess of 1 million or 2% of the organization's consolidated gross revenues.

THE BOARD OF DIRECTORS RECOMMENDS THAT YOU VOTE "FOR" THE ELECTION OF THE NOMINEES NAMED IN THIS PROXY STATEMENT.

COMMITTEES AND MEETINGS OF THE BOARD OF DIRECTORS

The Board of Directors held five meetings during fiscal year 2005. The Board has five standing committees: an Executive Committee, a Personnel/Benefits Committee, an Audit Committee, a Compensation Committee, and a Nominating/Corporate Governance Committee.

The Executive Committee may exercise all of the powers of the Board of Directors in the management of the affairs of the Company to the extent permitted by law. During the fiscal year ended September 28, 2005, the Executive Committee met four times. Mr. Williamson serves as Chairman and Mr. Risk and Dr. Ryan serve as members of the Executive Committee.

The Audit Committee, among other duties, serves in an oversight role intended to ensure the integrity and objectivity of the Company's financial reporting process. It operates under a written charter which was approved by the Board, a copy of which is available at the Company's website (www.steaknshake.com) or by written request to the Corporate Secretary at the address on the front page of this proxy statement. The Committee meets with representatives of management and the independent auditors to review matters of a material nature related to auditing, financial reporting, internal accounting controls and audit results. The Audit Committee is also responsible for making determinations regarding the independence and selection of the Company's independent auditors. See "Report of the Audit Committee," below. During the fiscal year ended September 28 2005 the Audit Committee met five (5) times. Mr. Risk serves as Chairman of the Committee and Mr. Lanham and Dr. Ryan served as members for the entire year. Mr. Schmidt was appointed to the Committee on April 20, 2005. The Chairman and each member of the Audit Committee are "independent" as that term is defined in Rule 10A-3 of the Exchange Act and the listing standards for the New York Stock Exchange. In addition, the Board of Directors has determined that Mr. Risk qualifies as an "audit committee financial expert" as that term is defined in Item 401(h)(2) of Regulation S-K.

The Compensation Committee is charged with establishing the compensation for the Company's Chief Executive Officer and the other executive officers, as well as guidelines for the administration of incentive and equity-based compensation plans. See "Report of the Compensation Committee" below. The Compensation Committee met four times during fiscal 2005. Mr. Williamson serves as Chairman of the Compensation Committee and Mr. Lanham, Dr. Person and Dr. Ryan serve on the committee. The Chairman and each member of the Committee are "independent" as that term is defined in the listing standards of the New York Stock Exchange. The Committee operates under a written charter approved by the Board of Directors, a copy of which is available on the Company's web site (www.steaknshake.com) or by written request to the Corporate Secretary at the address on the front page of this proxy statement.

The Nominating/Corporate Governance Committee is charged with making recommendations regarding the nomination of appropriate individuals for election to the Board of Directors, overseeing the Company's Corporate Governance Guidelines, allocating Board resources to various committees and evaluating the performance of the Board, its Committees and its individual members. Dr. Ryan is the Chairman of the Committee and Messrs. Lanham and Risk served on the Committee for the entire fiscal 2005. Mr. Schmidt joined the Committee on April 20, 2005. During fiscal year 2005 the Committee met four times. The Committee operates under a written charter that was approved by the Board of Directors, a copy of which may be obtained on the Company's web site (www.steaknshake.com) or by written request to the Corporate Secretary at the address on the front page of this proxy statement. The Chairman and all members of the Committee are "independent" as that term is defined in the listing standards of the New York Stock Exchange.

The Nominating/Corporate Governance Committee has promulgated Corporate Governance Guidelines, which are available on the Company's web site at www.steaknshake.com. Shareholders may also obtain a copy free of charge by directing a request to the Corporate Secretary at the address on the front page of this proxy statement.

The Nominating/Corporate Governance Committee identifies nominees for director from various sources, including, without limitation, its members, other directors, senior management, shareholders and third party consultants. Candidates are evaluated based on their credentials and the then-current needs of the Board and the Company. Of particular importance are the candidate's experience, judgment, integrity, ability to make independent inquiries, understanding of the Company's business environment and willingness and ability to devote adequate time to Board activities. The Nominating/Corporate Governance Committee will identify nominees who meet specific objectives in terms of the composition of the Board, such as financial expertise, and may take into account such factors as geographic, occupational, gender, race and age diversity. In the past year the Committee used a third party search firm (the "Search Firm") to perform a national search to identify qualified individuals to serve on the Company’s Board. Mr. Schmidt was one such individual identified by the Search Firm. The Search Firm supplied the Board with Mr. Schmidt’s resume and other background information regarding his business and other relevant experience. After Messrs. Gilman, Williamson and Dunn and Dr. Ryan interviewed Mr. Schmidt and reviewed the information provided by the Search Firm, Dr. Ryan nominated Mr. Schmidt for election to the Board.

Shareholders who wish to recommend to the Nominating/Corporate Governance Committee a candidate for election to the Board of Directors at the annual meeting should send their suggestions to the Corporate Secretary at the address shown on the first page of this Proxy. The Corporate Secretary will promptly forward all such letters to the members of the Committee. In order for director nominations to be properly brought before an annual meeting by a shareholder, timely notice must be given by the shareholder to the Corporate Secretary. To be timely, the notice must be delivered at the above address not less than 120 days prior to the date the Company mailed proxy materials for the preceding year's annual meeting.

Nominations for directors must include the following information: (i) a statement of the nominee’s qualifications; (ii) all information required to be disclosed in the solicitation of proxies for elections of directors pursuant to Regulation 14A of the Securities Exchange Act of 1934; (iii) the name and address of the shareholder making the nomination; (iv) a representation that the shareholder is a holder of Company's common stock and intends to appear at the meeting to make the nomination; (v) a description of all arrangements or understandings among the shareholder and the nominee; and (vi) the written consent of the nominee to serve as a director if so elected. Other than the submission requirements set forth above, there are no differences in the manner in which the Nominating/Corporate Governance Committee evaluates a nominee for director recommended by a shareholder.

The Personnel/Benefits Committee makes determinations and recommendations to the Board of Directors regarding personnel policies and employee benefit plans, administers the Company’s 401k and Profit Sharing Plan and performs such other functions with respect to personnel and benefit matters as may be requested by the Board. The Personnel/Benefits Committee met one time during fiscal 2005. Mr. Lanham is Chairman of the Committee and Dr. Person and Mr. Kelley are members, together with Mr. Blade, Senior Vice President and Chief Financial Officer, Mr. Reinwald, Executive Vice President, Ms. Crosby, Senior Vice President of Human Resources, and Ms. B. Charlene Boog, Associate Vice President, Administration. Mr. Gilman and Mr. Dunn serve as *ex officio* members of the Committee.

During fiscal year 2005 no director attended less than 75% in the aggregate of: (i) the total meetings of the Board of Directors, and (ii) the total number of meetings held by all Board committees on which he or she served. Directors are expected to attend the Annual Meeting of Shareholders and all attended the 2005 Annual Meeting of Shareholders.

Pursuant to the listing requirements of the New York Stock Exchange, the non-management directors of the Company met in four sessions without management during the 2005 fiscal year. Mr. Williamson, the Lead Outside Director, presides over these meetings of the Outside Directors. Interested parties may communicate directly with the presiding director or with the non-management directors as a group via letter directed to Mr. Williamson at the address shown on the first page of this Proxy.

SHAREHOLDER COMMUNICATION WITH THE BOARD

The Board has implemented a process whereby shareholders of the Company may send communications to the Board's attention. Any shareholder desiring to communicate with the Board, or one or more specified members thereof, should communicate in a writing addressed to the Board, or specified directors, to the Corporate Secretary at the address shown on the first page of this Proxy. The Secretary has been instructed by the Board to promptly forward all such communications to the specified addressees thereof.

COMPENSATION OF DIRECTORS

With the exception of Messrs. Williamson and Risk and Dr. Ryan (whose compensation is summarized below) during fiscal year 2005, all non-employee directors received an annual fee of $20,000. Non-employee directors also receive fees of $3,000 per board meeting attended, $1,000 for each committee meeting attended that was not held in conjunction with a Board of Directors' meeting and $500 for each committee meeting attended that was held in conjunction with a Board of Directors' meeting. Mr. Risk was paid a total annual fee of $40,000 for his services as Chairman of the Audit Committee. Mr. Williamson was paid a total annual fee of $45,000 for his services as Chairman of the Executive Committee, Chairman of the Compensation Committee and Lead Outside Director. Dr. Ryan was paid a total annual fee $35,000 for his services as Chairman of the Nominating/Corporate Governance Committee. Directors who are employees of the Company are not paid for their services on the Board. In the fiscal year ended September 28, 2005, the total compensation paid to non-employee directors was $372,389. This figure includes $44,000 paid to non-employee directors who served on boards of subsidiaries of the Company. In addition, the ordinary and necessary expenses the members of the Board of Directors incurred in attending board and committee meetings are reimbursed by the Company and all non-employee directors are eligible to participate in the Company's Medical Reimbursement Plan, which provides reimbursement up to $3,500 per year for otherwise unreimbursed medical costs.

The Company believes in compensating its non-employee directors on a basis tied to increases in the value of the Company's stock. The Company has had director stock option plans (the "Director Plans") in place since 1990, which provide for non-discretionary grants of nonqualified stock options to the directors of the Company at a price equal to the fair market value of the Common Stock on the date of grant. Options granted under the Director Plans through fiscal 2005 are exercisable as to 20% on the date of grant and 20% on each anniversary thereof until fully exercisable. The options expire five years from the date of grant.

Options for the non-employee directors to purchase an aggregate of 30,000 shares of Common Stock were granted by the Board of Directors on November 8, 2005 to Drs. Person and Ryan and Messrs. Lanham, Risk, Schmidt and Williamson for 5,000 shares each at $19.22, which was the closing per share price on the New York Stock Exchange on that date.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The Company granted franchise rights in 1991 to Kelley Restaurants, Inc. ("KRI") for development of Steak n Shake restaurants in the Atlanta, Georgia and Charlotte, North Carolina markets. Until the merger described below KRI operated 13 restaurants in the Atlanta, Georgia market and 4 in the Charlotte, North Carolina market. The Company recorded $484,998 in revenues from KRI during fiscal year 2005. Mr. Kelley served as President and director, and Mr. Williamson and Mr. Gilman served as directors of KRI and all were likewise shareholders in KRI. Mr. Lanham was also a shareholder in KRI.

As described in its November 11, 2004 Form 8-K and press release, the Company merged SNS Merger Corporation, a subsidiary of Steak n Shake Operations, Inc., with KRI on December 29, 2004. Pursuant to the merger agreement, the total paid by the Company was approximately $16,082,000, after adjustment for working capital and debt repayment. Ten percent (10%) of the adjusted purchase price was deposited in escrow for up to 24 months from the closing of the transaction in order to satisfy indemnification claims. Any amounts remaining in escrow after the escrow period will be distributed to shareholders of KRI.

The amount of cash each shareholder received as their initial payment pursuant to the merger agreement was determined by multiplying the number of shares of KRI common stock owned by each such shareholder by the per share exchange amount of $165. Messrs. Kelley, Williamson, Gilman and Lanham owned (directly or beneficially) 8,942, 3,222, 1,000 and 3,616 shares, respectively, of KRI common stock.

Pursuant to an employment agreement entered into at the time of closing, Mr. Kelley became a full-time employee of KRI or the Company for ---28 months. Mr. Kelley receives an annual salary of $205,000 per year and will be entitled to a bonus of $57,000 if he is still employed at the end of the employment period.

The negotiations for the merger were conducted between the Company’s Acquisitions Committee (a temporary Committee of the Board of Directors consisting of Mr. Risk (Chairman), Drs. Ryan and Person, and Messrs. Dunn and Steven Goldsmith (a former member of the Board)) and Wayne Kelley. Messrs. Gilman, Williamson and Lanham did not participate in negotiations or provide any input to either party regarding the terms of the merger, other than to the extent they voted in favor of the merger in their capacity as shareholders or directors of KRI. The members of the Acquisition Committee determined that Messrs. Williamson and Lanham remained independent after the transaction by applying the standards set forth in NYSE Listing Standard 307.00 after considering that the related party transaction was an isolated, not ongoing event, that neither Mr. Williamson nor Mr. Lanham obtained a material portion of their personal wealth from the transaction, and that neither of them participated in any manner in the Company’s consideration or negotiation of the transaction.

The Company obtained an independent fairness opinion and believes that the terms of the merger were on terms no less favorable to the Company than would have been available in the absence of the relationships described.

COMPENSATION OF EXECUTIVE OFFICERS

The following table shows the compensation paid to the Company’s Chief Executive Officer and its other four most highly compensated executive officers (the "Named Executive Officers") for the last three fiscal years:

Summary Compensation Table

		Annual Compensation		Long-Term Compensation			
	Fiscal Year	Salary ($)	Bonus ($)	Restricted Stock Awards ($)	Stock Options(#) (2)	LTIP Payouts ($) (3)	All Other Compensation ($) (4)

				(1)			
Alan B. Gilman Chairman	2005 2004 2003	500,000 500,000 497,692	89,024 335,023 349,344	None 186,250 None	25,000 32,877 10,000	0 30,625 0	40,292 20,692 14,906
Peter Dunn President; Chief Executive Officer	2005 2004 2003	500,000 463,846 340,577	226,608 335,023 244,541	350,000 298,000 214,000	25,000 45,000 20,000	0 0 0	33,117 16,237 1,442
Jeffrey Blade Senior Vice President, Chief Financial Officer	2005 2004 2003	300,000 165,000 0	71,815 97,764 0	208,000 163,795 None	16,500 12,000 None	0 0 0	18,827 3,650 0
Gary Reinwald Executive Vice President	2005 2004 2003	245,000 245,000 245,000	41,367 84,871 92,226	157,500 134,100 None	7,400 7,166 3,239	0 20,825 0	18,766 12,905 11,386
Gary Walker Senior Vice President	2005 2004 2003	240,000 205,000 205,000	57,207 74,477 78,244	152,125 104,300 None	15,757 11,000 None	0 17,150 0	16,103 16,808 6,915

(1) The amounts shown in this column represent the market value of the restricted stock awarded under the Company's Capital Appreciation Plan and were calculated by multiplying the closing market price of the Company's Common Stock on the date of award by the number of shares awarded. The number and value of the aggregate unvested restricted stock holdings of each of the Named Executive Officers as of September 28, 2005 (based on a closing market price of $18.10 on that date) are as follows: Mr. Gilman, 12,500 shares ($226,250); Mr. Dunn, 60,000 shares ($1,086,000); Mr. Blade, 20,000 shares ($362,000); Mr. Reinwald, 18,000 shares ($325,800) and Mr. Walker, 15,500 shares ($280,550). The shares of Common Stock are issued at the time of the award; however, these shares may not be transferred for a period of three years thereafter and are forfeited to the Company if the grantee is not employed by the Company (except for reasons of retirement, permanent disability or death) at the end of the period. The amounts do not reflect the cash value of book units awarded in tandem with the restricted Common Stock, which is included in the column entitled "LTIP Payouts" when paid. The recipient of the award is entitled to any dividends paid on outstanding Common Stock subsequent to the date of the award.

(2) Options granted under the Employee Stock Option Plans provide for a reload option (the "Reload Option") in the event the optionee surrenders other shares of the Company's Common Stock in payment for option shares, in whole or in part. Any such Reload Option (i) will be for a number of shares equal to the number of shares so surrendered; (ii) will have an expiration date which is 5 years from the Reload Option issuance date; (iii) will be fully exercisable on the date of grant, and (iv) will have an exercise price equal to the average market price of the Company's Common Stock on the five (5) business days before the shares were surrendered to exercise the option. There is no Reload Option with respect to the exercise of a Reload Option. Mr. Gilman's 2003 grant was the grant of a Reload Option for 10,000 shares on July 2, 2003. His 2004 grant was 25,000 options, with a reload option granted in an amount of 7,877 options. His 2005 grant was 25,000 options. Mr. Dunn's 2003 option grant was the grant of options for 20,000 options on September 30, 2002. His 2004 grant was the grant of 45,000 options. His 2005 grant was for 25,000 options. Mr. Blade's 2004 grant was the grant of 12,000 options and his 2005 grant was for 16,500 options. Mr. Reinwald's 2003 option grant was the grant of a Reload Option for 3,239 shares on July 2, 2003. His 2004 grant was the grant of 16,000 options, with a reload option grant in an amount of 1,166 options and his 2005 grant was for 7,400 options. Mr. Walker's 2004 grant was the grant of 11,000 options and his 2005 grant was for 12,500 options.

More information regarding the fiscal 2004 stock option grants to the Named Executive Officers is set forth in the Option/SAR Grants in Last Fiscal Year table, which follows.

(3) Includes cash value paid in respect of book units. Book units are awarded in tandem with restricted stock grants under the Company's Capital Appreciation Plan. They provide for a cash payment at the end of the three-year vesting period equal to: (i) the sum of the cumulative increase in the Company's earnings per share over the vesting period, and (ii) any dividends paid over the vesting period.

(4) Other Compensation Includes: (i) amounts payable pursuant to the Company's executive medical reimbursement plan which provides for payment of certain medical expenses, as defined, of up to $3,500 for each plan year ending October 31, (ii) amounts paid by the Company for or on behalf of each executive with respect to group life insurance premiums for coverage in excess of $50,000, (iii) amounts of annual profit sharing contributions by the Company to the accounts of the Named Executive Officers under the Company's Employee 401k and Profit Sharing Plan and Nonqualified Deferred Compensation Plan, and (iv) amounts of matching contributions made under the Company's 401k and Profit Sharing Plan and Nonqualified Deferred Compensation Plan, which match 50% of up to 6% of total salary deferred into the Plans.

SEPARATION AGREEMENTS WITH EXECUTIVE OFFICERS

The Company has agreed that if Mr. Gilman leaves the Company's employment for any reason other than retirement or termination by the Company for cause, he will be paid at his base compensation rate on the date of termination for a period of nine months thereafter. The Company has agreed that if Mr. Dunn leaves the Company's employment for any reason other than termination for malfeasance or retirement, he will be paid at his base compensation rate on the date of termination for a period of 12 months thereafter. The Company has agreed that if Mr. Blade leaves the Company for any reason except termination for just cause he will be paid 10 months of his then-current salary, a prorated portion of any bonus to which he would have been entitled that year, and outplacement assistance for 10 months.

The following table presents information for the Named Executive Officers who received stock options during fiscal 2005 under the Company's Employee Stock Option Plans:

Options/SAR Grants in Last Fiscal Year

Name	Number of Securities Underlying Options Granted	Percentage of Total Options Granted to Employees in Fiscal 2005	Exercise Price ($ per share)	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term [1] 5% ($)	10% ($)
Alan B. Gilman	25,000	7.7%	19.75	9/14/10	136,414	301,439
Peter Dunn	25,000	7.7%	19.75	9/14/10	136,414	301,439
Gary Reinwald	7,400	2.3%	19.75	9/14/10	40,379	89.226
Gary Walker (Reload Option)	3,257	1.0%	20.06	5/24/10	18,051	39,888
Gary Walker	12,500	3.8%	19.75	9/14/10	68,207	150,720
Jeff Blade	16,500	5.1%	19.75	9/14/10	90,033	198,950

[1] The dollar amounts under these columns are the result of calculations at the 5% and 10% rates as required by the Securities and Exchange Commission and should not be considered a reliable forecast of future appreciation, if any, of the Company's stock price. As an example, the Company's per share stock price would be $25.21 and $31.81 if increased by 5% and 10%, respectively, compounded annually over a five-year option term on a grant price of $19.75.

The following table presents certain information for the Named Executive Officers relating to exercises of stock options during fiscal year 2005 and, in addition, information relating to the valuation of unexercised stock options:

Aggregated Option Exercises In Fiscal 2005 and Fiscal Year End Option Values

			Number of Shares Underlying Unexercised Options On September 28, 2005		Value of Shares Underlying Unexercised Options On September 28, 2005 [2]	
Name	Number of Shares Acquired on Exercise	Dollar Value Realized [1]	Exercisable	Unexercisable	Exercisable	Unexercisable
Alan Gilman	5,000	$ 43,450	124,558	40,000	$ 347,482	$ 29,400

Peter Dunn	0	0	43,000	47,000	166,400	69,600
Gary Reinwald	37,982	317,408	58,680	18,720	239,654	18,816
Gary Walker	6,600	68,640	29,957	18,800	78,914	12,936
Jeff Blade	0	0	8,100	20,400	0	0

(1) *Based on the New York Stock Exchange closing price of the Company's Common Stock on the date of exercise.*
(2) *Based on the New York Stock Exchange closing price of the Company's Common Stock on September 28, 2005, of $18.10 per share.*

The following table presents certain information for the Named Executive Officers relating to the grant of book units pursuant to the Company's Capital Appreciation Plan during fiscal year 2005 and information relating to the valuation of those grants:

Long-Term Compensation Plan - Awards In Last Fiscal Year

Name	Shares, Units Or Other Rights (1)	Performance or Other Period Until Maturation Or Payout	Estimated Future Payouts Under Non-Stock Price-Based Plans Threshold	Target	Maximum
Alan B. Gilman	0	N/A	N/A	N/A	N/A
Peter Dunn	20,000	3 years - October 4, 2007	N/A	N/A	N/A
Gary T. Reinwald	9,000	3 years - October 4, 2007	N/A	N/A	N/A
Gary S. Walker	7,000	3 years - October 4, 2007	N/A	N/A	N/A
Gary S. Walker	1,500	3 years - September 14, 2008	N/A	N/A	N/A
Jeff Blade	8,500	3 years - October 4, 2007	N/A	N/A	N/A
Jeff Blade	3,000	3 years - September 14, 2008	N/A	N/A	N/A

(1) *This represents the number of shares of the Company's Common Stock underlying the book units. A book unit is issued in tandem with a share of restricted stock and provides for a cash payment at the end of the three-year vesting period equal to: (i) the sum of the cumulative increase in the Company's earnings per share over the vesting period and (ii) any dividends paid over the vesting period.*

REPORT OF THE COMPENSATION COMMITTEE

The compensation of the Company’s executive officers is determined by the Compensation Committee of the Board of Directors. The Compensation Committee operates under a written charter approved by the Board of Directors. The Compensation Committee has five members: James Williamson, Jr. (Chairman), Drs. John W. Ryan and Ruth J. Person, and Messrs. Charles E. Lanham and Steven Schmidt. All Committee members meet the independence requirements of the New York Stock Exchange. A sub-Committee of all Committee members except Mr. Williamson considers and approves equity and bonus compensation for the Named Executive Officers, which is intended to qualify as "performance based compensation" under Section 162(m) of the Internal Revenue Code of 1986, as amended (the "Code").

The following report with respect to certain cash and stock compensation paid or awarded to the Company’s executive officers, including the Named Executive Officers, during fiscal 2005 is furnished by the directors who comprise the Compensation Committee.

Compensation Philosophy and Practices

The Company’s compensation programs for executive officers are intended to enable the Company to attract, motivate, reward and retain the high level management talent required to achieve corporate objectives and, thereby, increase shareholder value. It is the Company’s policy to provide cash and stock incentives to achieve both short-term and long-term objectives and to reward exceptional performance and contributions to the success of the Company’s business. To attain these objectives, the Company’s executive compensation program includes a competitive base salary, coupled with an added cash incentive bonus, which is "at risk" based on the performance of the Company’s business, as reflected in the achievement of predetermined financial and operational objectives. The stock-based components of compensation include awards under the Company’s Capital Appreciation Plan and options under the Company’s Employee Stock Option Plans. As a general matter, as an executive officer’s level of management responsibility in the Company increases, a greater portion of his or her potential total compensation depends upon the Company’s performance as measured by the attainment of defined financial and operational performance objectives. In addition, all eligible Company employees, including its eligible executive officers, participate in the matching component of the Company’s Employee 401k Savings Plan and the Company’s Nonqualified Deferred Compensation Plan.

Relationship of Compensation to Performance

From time to time, the Committee establishes the salaries that will be paid to the Company’s executive officers. In setting base salaries, the Committee takes into account a number of factors, including competitive compensation data, the extent to which an individual may participate in the Company’s incentive compensation plans, and qualitative factors bearing on an individual’s experience, responsibilities, management and leadership abilities and job performance.

In connection with its compensation determinations, during fiscal 2005 the Compensation Committee reviewed the Towers Perrin Annual Chain Restaurant Compensation Survey and other available studies. These studies provide reference points for the Committee in establishing executive compensation programs for the Company’s executive officers and other management which are appropriate and competitive within the industry.

During fiscal 2005, each of the Company’s executive officers received compensation pursuant to the Company’s annual incentive bonus plan. At the beginning of fiscal 2005 the Board established targeted earnings and sales growth goals. Each executive job classification had a specific bonus percentage level ascribed to it based on the level of responsibility that it requires, the impact it could have on the business, and prior performance by the associate. Bonuses were determined based on the Company’s actual earnings and sales results as compared to the targeted goals. No bonus would have been paid for performance below a minimum threshold, and the payment was reduced substantially for performance below the targets. The maximum amount payable under the 2005 bonus plan would have been 2.5 times the individual associate's target bonus percentage level, if increases were substantially above the targeted earnings and sales goals. During fiscal 2005 actual performance was at 65% of the targeted bonus level.

Stock Option Awards

Stock options are granted to key employees by the Committee under the Company's Employee Stock Option Plans (the "Plans"). The number of shares subject to options granted to each individual generally depends upon his or her level of management responsibility. The largest grants are awarded to the employees who, in the view of the Board, have the greatest potential to impact the Company's profitability and growth and increase shareholder value. Options under the Plans may be either incentive stock options or nonqualified stock options, at the discretion of the Committee (and subject to limits under Code Section 422), and are granted at an exercise price equal to 100% of the fair market value of the Company's common stock on the date of the grant. The Committee has discretion, as limited by the Plans, as to the duration of the option exercise period and the vesting of the right to exercise the options within that period. Options granted in fiscal 2005 under the Plans are exercisable as to 20% on the date of grant and 20% on each anniversary of the date of grant thereafter until fully exercisable, with the exception of Reload Options, which are fully exercisable on the date of grant. Reload Options represent an option to repurchase shares that are used by the grantee to pay the exercise price of any original option grant. A Reload Option is not granted upon the exercise of a Reload Option, however. Outstanding options expire five years from the date of grant, with the exception of options granted on April 29, 1998 and May 6, 1999, which expire ten years from the date of grant. Stock option awards to the Named Executive Officers over the past three fiscal years are disclosed in the Summary Compensation Table.

Restricted Stock Awards

Restricted stock awards under the Company's Capital Appreciation Plan may be granted by the Committee to executive officers and other key employees of the Company. The number of restricted shares and book units awarded are intended to serve as a retention vehicle and are based on the Compensation Committee's evaluation of the potential contributions of each grantee to the long-term profitability and growth of the Company. The grantee holds all of the ownership rights (other than the right to receive dividends) to the stock from the date of grant, including the right to vote the stock, but may not transfer or assign the stock during a period of three years following the date of the grant. These shares are forfeited to the Company if the grantee is not employed by the Company (except for reasons of retirement, permanent disability or death) at the end of the period. Book units are awarded in tandem with restricted stock grants under the Company's Capital Appreciation Plan and provide for a cash payment at the end of the three-year vesting period equal to: (i) the sum of the cumulative increase in the Company's earnings per share during the vesting period and (ii) any dividends paid over the vesting period. Restricted stock awards and cash payouts in respect of book units granted to the Named Executive Officers over the past three fiscal years are disclosed in the Summary Compensation Table.

Compensation of the Chairman and Chief Executive Officer

The Committee annually reviews and approves the compensation of Alan B. Gilman (Chairman) and Peter M. Dunn (CEO) and the compensation policies described above apply equally to them. They are also eligible to participate in the Company's equity plans, 401k Plan, bonus plans, Nonqualified Deferred Compensation Plan and Medical Reimbursement Plan (up to $3,500 per year for otherwise unreimbursed medical expenses).

Mr. Gilman's total compensation was determined by the Committee in accordance with the "Relationship of Compensation to Performance" and "Stock Option Awards" sections herein. His base compensation was $500,000 in fiscal year 2005 and he earned an incentive bonus of $89,024, which represents 17.8% of his fiscal year 2005 base salary. He also received 25,000 stock options.

The total compensation paid to Mr. Dunn during fiscal year 2005 was determined by the Committee in accordance with the criteria described in the "Relationship of Compensation to Performance," "Stock Option Awards" and "Restricted Stock Awards" sections in this report. His base compensation was $500,000 in fiscal year 2005, and he received an incentive bonus of $226,608, representing 45% of his fiscal 2005 base salary. He also received 25,000 stock options and 20,000 shares of restricted stock (with 20,000 book units).

The overall compensation package for the Chairman and CEO is designed to motivate and reward them for driving the Company to strengthen its competitive position in the casual/family dine segment of the restaurant industry. Accordingly, a significant portion of their compensation is incentive based, providing greater compensation as direct and indirect measures of shareholder value increase. The Compensation Committee believes that their compensation for 2005 was directly related to the size and the overall performance of the Company, as measured by financial criteria and qualitative factors related to the achievement by the Company of the strategic initiatives in which it was engaged. To ensure that the compensation of the Chairman and the CEO is reasonable the Compensation Committee has reviewed benchmarking studies setting forth the compensation paid by the Company's peers to their respective Chairman and Chief Executive Officer and their respective executives. Furthermore, the Compensation Committee has considered internal pay standards, including the relative differences between the Chairman and CEO's compensation and the compensation of the other named executive officers and other executive officers. Based on this review, the Compensation Committee found that the total compensation in fiscal 2005 for Mr. Gilman, Mr. Dunn and the other Named Executive Officers was reasonable and not excessive.

The Compensation Committee's Policy Regarding the Deductibility of Compensation

Pursuant to Code Section 162(m), publicly held corporations are prohibited from deducting compensation paid to the named executive officers, as of the end of the fiscal year, in excess of $1 million unless the compensation is "performance based". It is the Compensation Committee's policy that the compensation paid to executive officers qualified for deductibility to the extent not inconsistent with the Company's fundamental compensation policies. In furtherance of this policy, the Company is seeking shareholder approval for the 2006 Employee Stock Option Plan and the 2006 Incentive Bonus Plan to satisfy the performance based compensation requirements of Code Section 162(m).
The foregoing report is respectfully submitted by the members of the Compensation Committee:

James Williamson, Jr., Chairman, Charles E. Lanham, Dr. Ruth J. Person, Dr. John W. Ryan, and Steven M. Schmidt

REPORT OF THE AUDIT COMMITTEE

The Audit Committee of the Board of Directors is responsible for providing independent, objective oversight of the Company's accounting functions and internal controls. The Audit Committee operates under a written charter approved by the Board of Directors. A copy of the charter is available on the Company's web site, www.steaknshake.com. The Board annually reviews the NYSE listing standards' definition of independence for Audit Committee members and has determined that each of the members of the Audit Committee meets that definition. In addition, the Board has determined that Fred Risk is an "Audit Committee Financial Expert" as defined by SEC rules.

Management is responsible for the Company's internal controls and financial reporting process. The independent auditors are responsible for performing an independent audit of the Company's consolidated financial statements in accordance with auditing standards generally accepted in the United States of America and issuing a report thereon. The Audit Committee's responsibility is to monitor and oversee these processes.

During fiscal year 2005 the Audit Committee fulfilled its responsibilities by meeting with the Company's independent auditors, internal auditors and the Company's management. In the course of doing so it reviewed and discussed the Company's quarterly earnings press releases, quarterly 10-Q filings, consolidated financial statements and related periodic reports filed with the SEC. It also reviewed management's assessment of the effectiveness of the Company's internal control over financial reporting and the independent auditor's opinion regarding management's assessment of the effectiveness of its internal control over financial reporting. It also reviewed with the independent auditors the audit plan and scope.

The Audit Committee reviewed the Company's audited financial statements for the fiscal year ended September 28, 2005, and discussed them with management and the Company's independent auditors. The Audit Committee's review included discussion with the independent auditors of the matters required to be discussed pursuant to the Statement on Auditing Standards No. 61, as amended, (Communication with Audit Committees). The Audit Committee also received written disclosures from the independent auditors as required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees) and discussed with the independent auditors that firm's independence. More information regarding the Company's independent auditors appears elsewhere in connection with the proposal to ratify the Audit Committee's selection of Deloitte &Touche, LLP as the Company's auditors for fiscal 2006.

Based upon the Audit Committee's discussions with management and the independent auditors and the Audit Committee's review of the representations of management and the independent auditors, the Audit Committee recommended that the Board of Directors include the audited financial statements in the Company's Annual Report on Form 10-K for the year ended September 28, 2005, to be filed with the Securities and Exchange Commission.

The foregoing report is respectfully submitted by the members of the Audit Committee.

J. Fred Risk, Chairman, Charles E. Lanham, Dr. John W. Ryan, and Steven M. Schmidt

COMPANY PERFORMANCE

The graph below compares for each of the last five fiscal years the cumulative total return of the Company, the S&P 500, the S&P SmallCap 600 and the S&P Restaurants Indices. The Company is included among the companies comprising the S&P SmallCap 600, a major market index. The S&P Restaurants Index is included in the graph in order to provide a more direct comparison of the Company's returns to those of other companies in the restaurant business. The cumulative total returns displayed below have assumed $100 invested on September 30, 2000, in the Company's Common Stock, the S&P 500, the S&P SmallCap 600 and the S&P Restaurants Indices, and reinvestment of dividends paid since September 30, 2000.

Cumulative Total Return	9/00	9/01	9/02	9/03	9/04	9/05
THE STEAK N SHAKE COMPANY	$ 100.00	$ 123.75	$ 137.50	$ 186.25	$ 213.50	$ 226.88
S & P 500	100.00	73.38	58.35	72.58	82.65	92.78
S & P SMALLCAP 600	100.00	89.39	87.78	111.36	138.73	168.16
S & P RESTAURANTS	$ 100.00	$ 94.63	$ 84.79	$ 104.23	$ 135.53	$ 162.32

Equity Compensation Plan Information

The following table provides information regarding the Company's current equity compensation plans as of September 28, 2005. The information in this table does not include the securities to be issued under the 2006 Employee Stock Option Purchase Plan and 2006 Employee Stock Option Plan, which are subject to approval at the Annual Meeting and discussed more fully herein. The table does include, however, all securities previously approved for issuance.

Equity Compensation Plan Information

Plan Category	Number of Securities To be Issued Upon Exercise of Outstanding Options Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in First Column)
Equity compensation plans by shareholders (1)	1,355,626	$ 16.11	938,928(2)
Equity compensation plans not approved by shareholders (3)	21,000	9.99	0
TOTAL	1,376,626	$ 16.02	938,928

(1) *Consists of 1995 and 1997 ESOP plans, 2003, 2004 and 2005 Director Stock Option Plans, 1997 Capital Appreciation Plan, as amended and restated, and the 1992 Employee Stock Purchase Plan.*

(2) *The Capital Appreciation Plan provides for tandem awards of restricted stock and book units. As of September 28, 2005, 400,922 shares remained available for issuance pursuant to awards under that plan.*

(3) *Consists of the 2002 Director Stock Option Plan.*

2. RATIFICATION OF SELECTION OF INDEPENDENT AUDITORS

The Audit Committee retained Deloitte & Touche LLP ("Deloitte") relative to the Company's fiscal 2005 audit. Deloitte also served as independent auditor for fiscal 2004 and fiscal 2005. In connection with its audits for the two most recent fiscal years ended September 28, 2005 and September 29, 2004, and through the present time, there have been no disagreements with Deloitte on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of Deloitte, would have caused them to make reference to the subject matter of the disagreement in connection with their report on the financial statements for such periods. During the two most recent fiscal years ended September 28, 2005 and September 29, 2004, and through December 5, 2005, there have been no reportable events (as defined in Regulation S-K, Item 304(a)(1)(v)).

If a majority of shareholders voting do not ratify the selection of Deloitte, the Audit Committee will reconsider its choice of independent auditors, taking into consideration the views of the shareholders, and may (but will not be required to) appoint a different auditor for fiscal 2006.

Representatives of Deloitte will be present at the Annual Meeting, will have an opportunity to make a statement, and will be available to respond to appropriate questions. A synopsis of the fees paid to Deloitte and services provided by it are set forth below.

Independent Auditors' Fees

Deloitte has advised the Company that they have billed or will bill the Company the below-indicated amounts for the following categories of services for each of the Company's last two fiscal years.

2005 FISCAL YEAR

TYPE OF FEE	Fiscal 2005	Fiscal 2004
Audit Fees (1)	$ 370,875	$ 171,635
Audit-Related Fees (2)	21,900	13,000
Tax Fees (3)	25,000	6,290
All Other Fees (4)	18,126	30,832
Total Fees for the Applicable Fiscal Year	$ 435,901	$ 221,757

(1) Audit fees include fees for services performed for the audit of the Company's annual financial statements including services related to Section 404 of the Sarbanes-Oxley Act and review of financial statements included in the Company's 10-Q filings, S-3 and S-8 Registration statements, comment letters and services that are normally provided in connection with statutory or regulatory filings or engagements.

(2) Audit-Related Fees include fees for assurance and related services performed that are reasonably related to the performance of the audit or review of the Company's financial statements. This includes the audit of the Company's 401k and Profit Sharing Plan.

(3) Tax Fees are fees for services performed with respect to tax compliance, tax advice and tax return review.

(4) All Other Fees are fees for other permissible work that does not meet the above category descriptions. This includes an on-line research subscription and sales and use tax software.

Pre-approval Policy

The Audit Committee's policy is to pre-approve all audit and permissible non-audit services provided by the independent auditor. These services may include audit services, audit-related services, tax services and other services. Pre-approval is generally provided for up to one year and any pre-approval is detailed as to the particular service or category of services and is generally subject to a specific budget. The independent auditor and management are required to report periodically to the Audit Committee regarding the extent of services provided by the independent auditor in accordance with this pre-approval, and the fees for the services performed to date. The Audit Committee may also pre-approve particular services on a case-by-case basis. In fiscal 2005, the Audit Committee approved the non-audit services performed by Deloitte & Touche described on the prior page.

THE BOARD OF DIRECTORS AND MANAGEMENT RECOMMEND A VOTE "FOR" THE RATIFICATION OF DELOITTE & TOUCHE, LLP AS INDEPENDENT AUDITORS OF THE COMPANY FOR THE FISCAL YEAR ENDING SEPTEMBER 27, 2006.

3. APPROVAL OF THE 2006 EMPLOYEE STOCK OPTION PLAN

On November 8, 2005 the Board of Directors of the Company adopted the 2006 Employee Stock Option Plan (the "Stock Option Plan"), which is being submitted for approval by the shareholders of the Company at the Annual Meeting. The purpose of the Stock Option Plan is to provide officers and other employees, who are materially responsible for the operation or management of the Company or a subsidiary, with a favorable opportunity to acquire shares of the Common Stock of the Company on favorable terms. The Board of Directors considers the Stock Option Plan to be both a retention tool and an incentive for employees to contribute to the profitability of the Company. Under the Stock Option Plan, options are granted at the closing price of the Company’s Common Stock on the date of the grant and only have value if the price of the Company’s stock increases prior to expiration of the option. The options vest over a period of time not to exceed ten years.

Background on the Stock Option Plan

The Stock Option Plan provides both for incentive stock options as defined under Code Section 422 ("ISOs") and non-qualified stock options ("Non-Qualified Options") (collectively, "Options"). No individual may be granted ISOs under the Stock Option Plan if the grant would cause the aggregate fair market value (determined as of the date the ISOs are granted) of the Common Stock with respect to which ISOs are exercisable for the first time by the participant during any calendar year under all stock option plans maintained by the Company and its subsidiaries to exceed $100,000. The Stock Option Plan provides that the purchase price for all common shares covered by each Option granted cannot be less than 100% of the fair market value of the Common Stock on the date of grant.

The purchase price for Common Stock covered by an Option must be paid in full at the time of exercise of the Option by cash or check in United States Dollars, by the delivery of Common Stock of the Company having a fair market value on the date of exercise equal to the exercise price or by tender of other property acceptable to the Committee.

The Stock Option Plan has a term of ten years and authorizes the issuance of options to purchase a total of 750,000 shares (not adjusted for stock dividends or splits) of Common Stock. The Stock Option Plan does not have a reload feature. The Compensation Committee (or duly designated subcommittee) may set certain conditions on the grant or exercise of stock options, including a vesting schedule or making the exercise contingent upon the participant’s achievement of certain performance goals. The Compensation Committee has the authority to determine the term of an Option, up to a maximum of 10 years, and each Option will be exercisable as determined by the Committee. The Committee may also accelerate the exercisability of an unvested Option.

A copy of the Stock Option Plan has been included as Exhibit A to this proxy statement and the foregoing discussion is qualified in its entirety by reference to that Appendix.

See "Plan Benefits" below for a description of certain awards to be made under the Stock Option Plan.

Federal Income Tax Consequences

The following is a brief summary of certain federal income tax aspects of the awards granted under the Stock Option Plan. This summary is not intended to be exhaustive and does not describe state or local tax consequences.

Non-Qualified Stock Options. There will be no federal income tax consequences to the participant or to the Company upon the grant of a Non-Qualified Option. When the participant exercises a Non-Qualified Option, however, he or she will recognize ordinary income in an amount equal to the excess of the fair market value of the Common Stock received upon exercise of the option at the time of exercise over the exercise price, and the Company will be allowed a corresponding federal income tax deduction, subject to any applicable limitations. Any gain that the participant realizes when he or she later sells or disposes of the option shares will be short-term or long-term capital gain, depending on how long the participant held the shares, and will not result in any additional deduction to the Company.

Incentive Stock Options. There typically will be no federal income tax consequences to the participant or to the Company upon the grant or exercise of an ISO. If the participant holds the underlying shares for the required holding period of at least two years after the date the option was granted and one year after exercise, the difference between the exercise price and the amount realized upon sale or disposition of the option shares will be long-term capital gain or loss, and the Company will not be entitled to a federal income tax deduction. If the participant disposes of the Option shares in a sale, exchange, or other disqualifying disposition before the required holding period ends, he or she will recognize taxable ordinary income in an amount equal to the lesser of (i) the total gain recognized on the sale, or (ii) the excess of the fair market value of the option shares at the time of exercise over the exercise price, and the Company will be allowed a federal income tax deduction equal to such amount. While the exercise of an ISO does not result in current taxable income, the excess of the fair market value of the underlying shares at the time of exercise over the exercise price will be an item of adjustment for purposes of determining the optionee’s alternative minimum taxable income.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE "FOR" THE PROPOSAL TO APPROVE THE STEAK N SHAKE COMPANY’S 2006 EMPLOYEE STOCK OPTION PLAN AS DESCRIBED ABOVE.

4. APPROVAL OF THE 2006 INCENTIVE BONUS PLAN

As discussed in its report, the Compensation Committee is committed to ensuring that compensation paid to the Company’s executive officers may be deducted and that the limits on deductibility under Section 162(m) do not apply. Among other things, Code Section 162(m) allows a public company to deduct compensation paid in excess of $1 million to Named Executive Officers so long as that compensation is "performance based". On November 8, 2005, the Board of Directors adopted the 2006 Incentive Bonus Plan (the "Incentive Bonus Plan"). The Incentive Bonus Plan provides for cash bonuses that are "performance based". To further satisfy the requirements of Code Section 162(m), the Incentive Bonus Plan is being submitted for approval by the shareholders of the Company prior to implementation.

The purpose of the Incentive Bonus Plan is to promote the interests of the Company and its shareholders by providing additional cash compensation as an incentive to certain key executives of the Company and its subsidiaries who contribute materially to the success of the Company and such subsidiaries. Participation in the Incentive Bonus Plan will be limited to the Company’s executive officers.

Prior to making a cash award under the Incentive Bonus Plan the Compensation Committee (or a subcommittee of only "outside directors") will, within the time period required to qualify for the Section 162(m) exemption, determine the performance goal applicable to such award using one or more of the criteria specified in the Incentive Bonus Plan, establish the formula for determining the amount payable based upon achievement of the applicable performance goal, and establish such other terms and conditions for the award as are appropriate. Performance goals may take the form of absolute goals or goals relative to the performance of one or more other companies comparable to the Company or of an index covering multiple companies.

The maximum amount that may be paid with respect to a participant for a single award is limited to 175% of such participant's salary. The Compensation Committee expects that awards may have more than one payment level depending on the level and responsibility of a particular participant and the extent to which specific goals are met or exceeded.

Under the Incentive Bonus Plan a participant will receive an award only upon the achievement of the applicable performance goals (except in the event of the participant's death or disability, or in the event of a change in control of the Company). Further, the Compensation Committee may not exercise any discretionary authority to waive the achievement of the applicable performance goals or to increase the amount payable in a manner that would cause the payment to cease to qualify for the Section 162(m) exemption.

A copy of the Incentive Bonus Plan has been included as Appendix B to this proxy statement and the foregoing discussion is qualified in its entirety by reference to that Appendix.

See "Plan Benefits" below for a description of certain awards to be made under the Incentive Bonus Plan.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE "FOR" THE APPROVAL OF THE 2006 INCENTIVE BONUS PLAN, AS DESCRIBED ABOVE.

5. APPROVAL OF THE 2006 EMPLOYEE STOCK PURCHASE PLAN

The Company has maintained an employee stock purchase plan since 1993. The purpose of the employee stock purchase plan is to offer an inducement to eligible employees to remain with the Company by providing them with an opportunity to purchase shares of the Company's stock on favorable terms. The total number of shares that may be purchased each year under the Stock Purchase Plan is limited to 150,000. Certain "highly compensated" employees, as defined by the regulations of the Internal Revenue Service, may not participate in the Stock Purchase Plan.

The employee stock purchase plan has been amended three (3) times, with the most recent amendment being made at the Annual Meeting of Shareholders in 2002. On each occasion the amendments increased the number of shares eligible for purchase thereunder. The shares authorized in 2002 will be exhausted by the end of calendar year 2006.

Believing that the Company benefits from the employee stock purchase plan, on November 8, 2005, the Board of Directors unanimously adopted the 2006 Employee Stock Purchase Plan (the "2006 Stock Purchase Plan"), subject to approval by the shareholders at the Annual Meeting. The material terms of the 2006 Stock Purchase Plan remain substantially the same as those contained in prior plans, except that it makes available for purchase an additional 450,000 shares. The additional shares will be adequate to permit participation in the 2006 Stock Purchase Plan by the Company's eligible employees through calendar year 2009.
The 2006 Stock Purchase Plan will be administered by the Compensation Committee. The Compensation Committee is authorized to make determinations with respect to the administration and interpretation of the 2006 Stock Purchase Plan, and to make such rules as may be necessary to carry out its provisions. The Compensation Committee may designate other persons to administer the 2006 Stock Purchase Plan as necessary for the proper administration of the plan.

Eligibility to participate in the Stock Purchase Plan is limited to those who:

- Customarily worked at least 20 hours per week during the six-month period prior to the beginning of the calendar year;
- Have continuously been employed by the Company for at least six months prior to the beginning of the calendar year; and

- Are not a "highly compensated employee" within the meaning of Section 414(q) of the Code.

Participation in the Stock Purchase Plan is voluntary, and an eligible employee may elect to participate by authorizing the Company to withhold from the participant’s compensation a whole even percentage between and including 2%-10% of their post-tax pay and to apply those amounts to purchase shares of Company Common Stock. A participant may increase, decrease or stop the amount to be deducted from his or her compensation once per year. Participants may terminate their participation in the 2006 Stock Purchase Plan at any time and receive the cash held in their account. No participant may purchase in any calendar year more than 1,000 shares, or shares with a fair market value as of the first trading day of the calendar year of more than $10,000.

A copy of the 2006 Stock Purchase Plan has been included as Appendix C to this proxy statement and the foregoing discussion is qualified in its entirety by reference to that Appendix.

See "Plan Benefits" below for a description of certain awards to be made under the 2006 Stock Purchase Plan.

Federal Income Tax Consequences.

The following is a brief summary of certain federal income tax aspects of the shares purchased under the Stock Purchase Plan. This summary is not intended to be exhaustive and does not describe state or local tax consequences.

The 2006 Stock Purchase Plan is intended to be eligible for the favorable tax treatment provided by Sections 421 and 423 of the Code. There are no tax deductions available for amounts paid by participants to acquire shares under the 2006 Stock Purchase Plan. A participant will realize no income upon the purchase of Common Stock under the 2006 Stock Purchase Plan, and the Company will not be entitled to any deduction at the time of purchase of the shares. Taxable income will not be recognized until there is a sale or other disposition of the shares acquired under the 2006 Stock Purchase Plan.

In the event that the shares are sold or otherwise disposed of more than two (2) years after the beginning of the calendar year in which the shares were purchased and more than one year from the date of transfer of the shares to the participant, then the participant generally will recognize ordinary income measured as the lesser of (i) the actual gain or (ii) an amount equal to 15% of the fair market value of the shares as of the first day of the calendar year in which such shares were acquired. Any additional gain will be long-term capital gain. If the shares are sold or otherwise disposed of before the expiration of this holding period, the participant will recognize ordinary income generally measured as the excess of the fair market value of the shares on the date the shares are purchased over the purchase price. Any additional gain or loss on the disposition will be long-term or short-term capital gain or loss, depending on the holding period.

The Company is not entitled to a deduction for amounts taxed to a participant, except to the extent a participant recognizes ordinary income. In all other cases no deduction is allowed.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE "FOR" THE APPROVAL OF THE 2006 EMPLOYEE STOCK PURCHASE PLAN.

PLAN BENEFITS

The grant of awards under the Stock Option Plan and the Incentive Bonus Plan is entirely within the discretion of the Compensation Committee of the Board of Directors. In addition, participation in the 2006 Stock Purchase Plan is within the discretion of the Company's eligible employees. As a result, the Company cannot determine, and therefore has not disclosed, the benefits or amounts that will be awarded in the future under each of the plans. The closing price of the Company's Common Stock on December 5, 2005 was $17.09.

The following table sets forth the benefits and awards received by or allocated to the persons listed below under the Company's previously existing stock option plan, bonus plan and employee stock purchase plan for fiscal 2005. As previously indicated, the benefits and awards to be issued under the Stock Option Plan, Incentive Bonus Plan and 2006 Stock Purchase Plan are not currently determinable and, therefore, the information set forth in this table is not necessarily indicative of the types or amounts of benefits or awards that the persons identified in the table will receive in the future under such plans.

	Stock Option Plan	Incentive Bonus Plan	Employee Stock Purchase Plan
Name and Position	**Number of Securities Underlying**	**Dollar Value of Cash Awarded**	**Number of Securities Purchased**

	Options Granted			
Alan B. Gilman, Chairman	25,000	$	89,024	0
Peter M. Dunn, President and Chief Executive Officer	25,000		226,608	0
Jeffrey Blade, Senior Vice President, Chief Financial Officer	16,500		71,815	0
Gary Reinwald, Executive Vice President	7,400		41,367	0
Gary S. Walker, Senior Vice President	15,757		57,207	0
All current executive officers as a group	129,837		656,724	0
All current directors who are not executive officers as a group	30,000		0	0
All employees, including all current officers who are not executive officers, as a group	326,422	$	509,696	102,830

6. OTHER MATTERS

As of the date of this proxy statement, the Board of Directors of the Company has no knowledge of any matters to be presented for consideration at the Annual Meeting other than those set forth above. If any other matters should properly come before the meeting, the proxies will be voted in accordance with the recommendations of the Board of Directors of the Company.

APPENDIX A

THE STEAK N SHAKE COMPANY
2006 EMPLOYEE STOCK OPTION PLAN

1. **Purpose:** The purpose of the 2006 Stock Option Plan (the "Plan") is to secure for the Company and its shareholders the benefits inherent in common stock ownership by the officers and key employees of the Company who will be largely responsible for the Company's future growth and continued financial success by providing long-term incentives, in addition to current compensation, to certain key executives of the Company who contribute significantly to the long-term performance and growth of the Company. It is intended that these purposes will be furthered through the granting of options to purchase shares of the Company's common stock.

2. **Definitions:** For purposes of this Plan:

(a) "Affiliate" shall mean any entity in which the Company has, directly or indirectly, an ownership interest of at least 25%.

(b) "Award" shall mean an award of options granted under this Plan.

(c) "Code" shall mean the Internal Revenue Code of 1986, as amended.

(d) "Common Stock" shall mean the Company's common stock.

(e) "Company" shall mean The Steak n Shake Company and its Subsidiaries and Affiliates.

(f) "Disability" or "Disabled" shall mean qualifying for and receiving payments under the Company's Long-Term Disability Plan.

(g) "Exchange Act" shall mean the Securities Exchange Act of 1934, as amended.

(h) "Fair Market Value" shall mean the closing price of a share of Common Stock on the New York Stock Exchange on the date of measurement or on any date as determined by the Committee and, if there were no trades on such date, on the day on which a trade occurred next preceding such date.

(i) "Retirement" shall mean termination of the employment of an employee with the Company on terms that would entitle such person to obtain benefits under the Company's 401k and Profit Sharing Plan or any successor plan.

(j) "Subsidiary" shall mean any corporation which at the time qualifies as a subsidiary of the Company under the definition of "subsidiary corporation" in Section 424 of the Code.

3. **Amount of Stock:**

(a*) Aggregate Limitation*. The aggregate amount of Common Stock which may be made subject to Awards under the Plan shall not exceed 750,000 shares plus the number of shares that are subject to Awards granted hereunder that terminate or expire or are cancelled, forfeited, exchanged or surrendered during the term of this Plan without being exercised or fully vested. Awards granted under Section 16 shall not be considered in applying this limitation.

(b) *Other Limitations*. No individual participant may be granted Awards in any single calendar year of more than 50,000 options. Awards granted under Section 16 shall not be included in applying this limitation.

(c) *Adjustment*. The limitations under Section 3(a) and (b) are subject to adjustment in number and kind pursuant to Section 10.

(d) *Treasury or Market Purchased Shares.* Common Stock issued hereunder may be authorized and unissued shares or issued shares acquired by the Company on the market or otherwise.

4. Administration:

The Plan shall be administered under the supervision of the Board of Directors of the Company through the agency of the Compensation Committee or a subcommittee thereof (the "Committee").

(a) *Composition of Committee*. The Committee shall consist of not less than two (2) members of the Board who are intended to meet the definition of "non-employee director" under the provisions of Section 162(m) of the Code and the definition of "independent directors" under the provisions of the Exchange Act or rules or regulations promulgated thereunder.

(b) *Delegation and Administration*. The Committee may delegate to one or more separate committees (any such committee a "Subcommittee") composed of one or more directors of the Company (who may, but need not be, members of the Committee) the ability to grant Awards with respect to participants who are not executive officers of the Company under the provisions of the Exchange Act or rules or regulations promulgated thereunder, and such actions shall be treated for all purposes as if taken by the Committee. Any action by any such Subcommittee within the scope of such delegation shall be deemed for all purposes to have been taken by the Committee and references in this Plan to the Committee shall include any such Subcommittee. The Committee may delegate the administration of the Plan to an officer or officers of the Company, and such administrator(s) may have the authority to execute and distribute agreements or other documents evidencing or relating to Awards granted by the Committee under this Plan, to maintain records relating to the grant, vesting, exercise, forfeiture or expiration of Awards, to process or oversee the issuance of shares of Common Stock upon the exercise, vesting and/or settlement of an Award, to interpret the terms of Awards and to take such other actions as the Committee may specify, provided that in no case shall any such administrator be authorized to grant Awards under the Plan. Any action by any such administrator within the scope of its delegation shall be deemed for all purposes to have been taken by the Committee and references in this Plan to the Committee shall include any such administrator, provided that the actions and interpretations of any such administrator shall be subject to review and approval, disapproval or modification by the Committee.

5. Eligibility:

Awards may be granted only to present or future officers and employees of the Company whose performance may play a role in the Company's future success, including Subsidiaries and Affiliates which become such after the effective date of the Plan. Any officer or key employee of the Company shall be eligible to receive one or more Awards under the Plan. Any director who is not an officer or employee of the Company shall be ineligible to receive an Award under the Plan. The adoption of this Plan shall not be deemed to give any officer or employee any right to an Award, except to the extent and upon such terms and conditions as may be determined by the Committee.

6. Qualifying Performance Criteria:

Awards under this Plan (other than incentive stock options) in the discretion of the Committee may be contingent upon achievement of Qualifying Performance Criteria.

(a) *Available Criteria*. For purposes of this Plan, the term "Qualifying Performance Criteria" shall mean any one or more of the following performance criteria, either individually, alternatively or in any combination, applied to either the Company as a whole, to a business unit, to a specific geographic region, Affiliate or Subsidiary, either individually, alternatively or in any combination, and measured either annually or cumulatively over a period of years, on an absolute basis or relative to a pre-established target, to previous years' results or to a designated comparison group, in each case as specified by the Committee in the Award:

1. cash flow or free cash flow,
2. earnings per share,
3. earnings before interest, taxes and amortization,
4. return on equity,
5. same store sales,
6. total shareholder return,
7. sales or revenue,
8. income or net income,
9. operating income or net operating income,
10. operating profit or net operating profit,
11. operating margin or profit margin,
12. return on operating revenue,
13. return on invested capital,
14. market segment share,
15. brand recognition/acceptance, or
16. customer satisfaction.

(b) *Adjustments.* The Committee may adjust any evaluation of performance under a Qualifying Performance Criteria to exclude any of the following events that occurs during a performance period: (1) asset write-downs, (2) litigation or claim judgments or settlements, (3) the effect of changes in tax law, accounting principles or other such laws or provisions affecting reported results, (4) accruals for reorganization and restructuring programs and (5) any extraordinary non-recurring items as described in Accounting Principles Board Opinion No. 30 and/or in management's discussion and analysis of financial condition and results of operations appearing in the Company's annual report to shareholders for the applicable year. Notwithstanding satisfaction or completion of any Qualifying Performance Criteria, to the extent specified at the time of grant of an Award, the number of stock options granted, issued, retainable and/or vested under an Award on account of satisfaction of such Qualifying Performance Criteria may be reduced by the Committee on the basis of such further considerations as the Committee in its sole discretion shall determine.

(c) *Establishment and Achievement of Targets*. The Committee shall establish the specific targets for the selected Qualified Performance Criteria. These targets may be set at a specific level or may be expressed as relative to the comparable measure at comparison companies or a defined index. In cases where Qualifying Performance Criteria are established, the Committee shall determine the extent to which the criteria have been achieved and the corresponding level to which vesting requirements have been satisfied or other restrictions to be removed from the Award or the extent to which a participant's right to receive an Award should lapse in cases where the Qualifying Performance Criteria have not been met, and shall certify these determinations in writing. The Committee may provide for the determination of the attainment of such targets in installments where it deems appropriate.

7. Stock Options.

Stock options under the Plan shall consist of incentive stock options under Section 422 of the Code or nonqualified stock options (options not intended to qualify as incentive stock options), as the Committee shall determine.

Each option shall be subject to the following terms and conditions:

(a) *Grant of Options.* The Committee shall (1) select the officers and key employees of the Company to whom options may from time to time be granted, (2) determine whether incentive stock options or nonqualified stock options are to be granted, (3) determine the number of shares to be covered by each option so granted, (4) determine the terms and conditions (not inconsistent with the Plan) of any option granted hereunder including but not limited to restrictions upon the options, conditions of their exercise (including as to nonqualified stock options, subject to any Qualifying Performance Criteria), or restrictions on the shares of Common Stock issuable upon exercise thereof, (5) prescribe the form of the instruments necessary or advisable in the administration of options.

(b) *Terms and Conditions of Option.* Any option granted under the Plan shall be evidenced by a Stock Option Agreement entered into by the Company and the optionee, in such form as the Committee shall approve, which agreement shall be subject to the following terms and conditions and shall contain such additional terms and conditions not inconsistent with the Plan, and in the case of an incentive stock option not inconsistent with the provisions of the Code applicable to incentive stock options, as the Committee shall prescribe:

(1*) Number of Shares Subject to an Option*. The Stock Option Agreement shall specify the number of shares of Common Stock subject to the Agreement.

(2) *Option Price*. The purchase price per share of Common Stock purchasable under an option will be determined by the Committee but will be not less than the Fair Market Value of a share of Common Stock on the date of the grant of the option, except as provided in Section 16.

(3) *Option Period*. The period of each option shall be fixed by the Committee, but no option shall be exercisable after the expiration of ten years from the date the option is granted.

(4) *Consideration*. Unless the Committee determines otherwise, each optionee, as consideration for the grant of an option, shall remain in the continuous employ of the Company for at least one year from the date of the granting of such option, and no option shall be exercisable until after the completion of such one year period of employment by the optionee.

(5) *Exercise of Option*. An option may be exercised in whole or in part from time to time during the option period (or, if determined by the Committee, in specified installments during the option period) by giving written notice of exercise to the Company specifying the number of shares to be purchased. Such written notice must be accompanied by payment in full of the purchase price and Withholding Taxes (as defined in Section 11 hereof), due either (i) by personal, certified or bank check, (ii) by payment through a broker in accordance with procedures permitted by Regulation T of the Federal Reserve Board, (iii) in shares of Common Stock owned by the optionee having a Fair Market Value at the date of exercise equal to such purchase price, (iv) in any combination of the foregoing, or (v) by any other method that the Committee approves. At its discretion, the Committee may modify or suspend any method for the exercise of stock options, including any of the methods specified in the previous sentence. Delivery of shares for exercising an option shall be made either through the physical delivery of shares or through an appropriate certification or attestation of valid ownership. Shares of Common Stock used to exercise an option shall have been held by the optionee for the requisite period of time to avoid adverse accounting consequences to the Company with respect to the option. No shares shall be issued until full payment therefor has been made. An optionee shall have the rights of a shareholder only with respect to shares of stock that have been recorded on the Company's books on behalf of the optionee or for which certificates have been issued to the optionee.

Notwithstanding anything in the Plan to the contrary, the Committee may, in its sole discretion, allow the exercise of a lapsed grant if the Committee determines that: (i) the lapse was solely the result of the Company's inability to execute the exercise of an option Award due to conditions beyond the Company's control and (ii) the optionee made valid and reasonable efforts to exercise the Award. In the event the Committee makes such a determination, the Company shall allow the exercise to occur as promptly as possible following its receipt of exercise instructions subsequent to such determination.

(6) *Nontransferability of Options*. No option granted under the Plan shall be transferable by the optionee oFONT-SIZE: 10pt">
Nihon Kohden Corporation
28,300 1,097,715 1,567,309 0.5
Medical equipment

Osaki Electric Co., Ltd.
234,000 1,347,529 1,376,934 0.4
Measurement and control equipment

Zojirushi Corporation
707,000 2,569,072 3,779,549 1.2
Household appliances

Total Electric Appliances
21,469,469 24,272,571 7.7
Financing Business

Hitachi Capital Corporation
52,700 1,167,292 1,386,349 0.5
Financial services

Ricoh Leasing Company, Ltd.
123,500 3,225,220 3,568,266 1.1
Office automation equipment leasing

Total Financing Business
4,392,512 4,954,615 1.6

Food

Fuji Oil Co., Ltd.	264,800	4,570,538	4,353,714	1.4
Palm oil and coconut oil				
J-Oil Mills Inc.	25,000	77,211	82,929	0.0
Cooking oil				
Kameda Seika Co., Ltd.	36,000	1,082,011	1,126,677	0.4
Rice cookies, snacks, and Japanese cakes				
Taiyo Kagaku Co., Ltd.	38,900	281,727	281,637	0.1
Food additives				
Total Food		6,011,487	5,844,957	1.9

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS—Continued

AUGUST 31, 2014

(Unaudited)

	Shares	Cost	Market Value	% of Net Assets
Glass and Ceramics Products				
Nichiha Corporation	317,600	$3,288,809	$3,255,244	1.0
Ceramic exterior walls and other construction materials				
Total Glass and Ceramics Products		3,288,809	3,255,244	1.0
Information and Communication				
Broadleaf Co., Ltd.	151,400	2,417,530	2,557,664	0.8
Business software development, sales, and technical support				
NS Solutions Corporation	94,200	1,830,591	2,780,578	0.9
System consulting services and software development				
OBIC Co., Ltd.	57,900	1,525,505	1,984,650	0.6
Computer system integration				
Okinawa Cellular Telephone Company	121,400	3,049,540	3,389,699	1.1
Cellular and car phone services				
Otsuka Corporation	37,100	925,346	1,573,107	0.5
Computer information system developer				
Total Information and Communication		9,748,512	12,285,698	3.9
Iron and Steel				
Chubu Steel Plate Co., Ltd.	614,300	2,544,613	3,124,510	1.0
Manufactures electric furnace steel plates				
Mory Industries Inc.	661,000	2,419,002	2,618,451	0.8
Stainless pipes				
Nichia Steel Works, Ltd.	1,417,000	4,523,490	4,305,293	1.4
Produces and sells steel products				
Nippon Seisen Co., Ltd.	267,000	1,251,419	1,840,671	0.6
Secondary products of stainless steel wires				

Osaka Steel Co., Ltd. Electric furnace steelmaker	270,100	4,889,037	5,300,458	1.7
Total Iron and Steel		15,627,561	17,189,383	5.5
Machinery				
Hisaka Works, Ltd. Heat exchangers and evaporators	483,600	4,620,145	4,240,596	1.4
Kitz Corporation Valves and flow control devices	143,900	692,209	769,275	0.3
Nippon Pillar Packing Co., Ltd. Industrial-type mechanical seals	258,600	2,005,709	2,138,320	0.7

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS—Continued

AUGUST 31, 2014

(Unaudited)

	Shares	Cost	Market Value	% of Net Assets
Nissei Corporation	24,500	$218,441	$223,552	0.1
Manufactures transmission gears and precision equipment				
Oiles Corporation	127,000	2,824,109	3,213,922	1.0
Manufactures oilless bearings				
Okano Valve Manufacturing Co.	32,000	97,471	113,225	0.0
Manufactures and maintains industrial high-pressure valves				
Sato Corporation	77,200	961,372	2,226,816	0.7
Automation recognition systems				
Sintokogio, Ltd.	526,800	4,038,788	3,525,338	1.1
Engineering equipment				
Total Machinery		15,458,244	16,451,044	5.3
Metal Products				
Dainichi Co., Ltd.	181,800	1,463,752	1,309,247	0.4
Oil heating equipment				
Mimasu Semiconductor Industry Co., Ltd.	159,100	1,301,179	1,428,772	0.5
Silicon and gallium				
Neturen Co., Ltd.	481,100	3,196,282	3,492,433	1.1
Induction hardening equipment				
NHK Spring Co., Ltd.	165,500	1,564,256	1,581,722	0.5
Automobile-related products				
Piolax, Inc.	83,700	2,565,879	4,056,036	1.3
Production and sale of automobile parts				
Total Metal Products		10,091,348	11,868,210	3.8
Other Products				
Fuji Seal International, Inc.	105,800	3,135,824	3,565,492	1.1
Packaging-related materials and machinery				
Kokuyo Co., Ltd.	134,900	943,440	1,076,554	0.3
Stationery goods and office furniture				
	221,700	3,686,225	3,949,907	1.3

Nishikawa Rubber Company Ltd.				
Rubber products				
The Pack Corporation	43,700	724,462	844,126	0.3
Paper products and plastic bags				
Pigeon Corporation	20,500	841,455	1,212,201	0.4
Baby care goods				
Total Other Products		9,331,406	10,648,280	3.4

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS—Continued

AUGUST 31, 2014

(Unaudited)

	Shares	Cost	Market Value	% of Net Assets
Pharmaceutical				
KYORIN Holdings, Inc.	137,800	$2,948,103	$3,093,726	1.0
Pharmaceuticals manufacturer				
Total Pharmaceutical		2,948,103	3,093,726	1.0
Precision Instruments				
Asahi Intecc Co., Ltd.	28,200	452,365	1,317,744	0.4
Medical tools				
Nakanishi Inc.	17,900	470,724	716,826	0.2
Manufactures gyration equipment for dental & industry use				
Total Precision Instruments		923,089	2,034,570	0.6
Real Estate				
Keihanshin Building Co., Ltd.	882,500	4,940,007	4,675,328	1.5
Real estate leasing and building management				
Sundrug Co., Ltd.	64,600	2,610,435	2,869,593	0.9
Drug store chain				
Total Real Estate		7,550,442	7,544,921	2.4
Retail Trade				
ABC-Mart, Inc.	32,000	1,291,868	1,639,921	0.5
Shoes				
AIN Pharmaciez Inc.	1,000	45,890	48,363	0.0
Pharmacies				
Amiyaki Tei Co., Ltd.	45,300	1,394,472	1,600,668	0.5
Barbecue restaurants				
Arc Land Sakamoto Co., Ltd.	144,800	2,378,773	3,352,516	1.1
Operates home centers				
Asahi Co., Ltd.	34,200	433,086	427,479	0.1
Bicycles, parts and accessories				

Axial Retail Inc.	20,200	337,265	386,306	0.1
Operates food supermarket stores				
Create S D Co., Ltd.	138,100	4,790,151	4,846,546	1.6
Drug store chain				
Daikokutenbussan Co., Ltd.	127,200	3,497,459	3,858,622	1.2
Operates discount stores for food products and sundry goods				
Heiwado Co., Ltd.	148,200	1,862,434	2,408,134	0.8
Supermarkets				

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS—Continued

AUGUST 31, 2014

(Unaudited)

	Shares	Cost	Market Value	% of Net Assets
Hiday Hidaka Corp	112,680	$2,039,548	$2,700,940	0.9
Chinese restaurant chain				
Jin Co., Ltd.	123,100	3,942,502	3,556,709	1.1
Eyeglasses and fashion merchandise				
Shimamura Co., Ltd.	28,500	3,359,959	2,570,357	0.8
Clothing chain				
Saint Marc Holdings Co., Ltd.	30,400	1,195,204	1,718,687	0.6
Restaurants and cafes				
San-A Co., Ltd.	96,000	2,522,853	3,415,220	1.1
Housing related goods and groceries				
Tsuruha Holdings, Inc.	2,700	127,539	147,454	0.1
Management and operation of drugstores				
United Arrows Ltd.	67,100	2,576,238	2,458,065	0.8
Operates fashion stores				
Yamazawa Co., Ltd.	6,000	96,196	94,149	0.0
Supermarket chain				
Total Retail Trade		31,891,437	35,230,136	11.3
Services				
EPS Co., Ltd.	79,300	905,524	1,002,639	0.3
Clinical testing				
JP-Holdings, Inc.	136,700	846,315	554,660	0.2
Child-care center services				
Moshi Moshi Hotline, Inc.	1,300	12,839	12,837	0.0
Telemarketing				
Nihon M&A Center Inc.	46,200	480,635	1,459,228	0.5
Provides merger and acquisition brokerage services				
Step Co., Ltd.	156,100	1,388,289	1,220,223	0.4
Operates preparatory schools				

Tokai Corp.	1,500	39,037	47,089	0.0
Linen supply				
Total Services		3,672,639	4,296,676	1.4

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS—Continued

AUGUST 31, 2014

(Unaudited)

	Shares	Cost	Market Value	% of Net Assets
Textiles and Apparel				
Hogy Medical Co., Ltd.	78,100	$3,643,090	$4,377,895	1.4
Medical supply products				
Komatsu Seiren Co., Ltd.	572,700	2,961,989	2,967,985	1.0
Synthetic fibers, textiles products, and composite thin-membrane				
Total Textiles and Apparel		6,605,079	7,345,880	2.4
Transportation and Warehousing				
Alps Logistics Co., Ltd.	265,500	2,748,045	3,150,108	1.0
Delivery, storage, and forwarding of electronic components				
Japan Transcity Corporation	1,419,000	4,850,024	4,979,905	1.6
Warehousing and transportation services				
Kintetsu World Express Inc.	34,000	992,637	1,351,762	0.4
Distribution services				
Meiko Trans Co., Ltd.	317,000	3,362,375	3,142,416	1.0
Operates port-harbor transport facilities				
Nissin Corporation	407,000	1,190,022	1,119,196	0.4
Transportation services				
Trancom Co., Ltd.	72,700	2,147,602	3,051,156	1.0
Logistics services				
Total Transportation and Warehousing		15,290,705	16,794,543	5.4
Transportation Equipment				
Hi-Lex Corporation	32,700	653,841	877,513	0.3
Control cables				
Nippon Seiki Co., Ltd.	89,000	1,290,025	1,983,578	0.6

Manufactures instrument panels for automobiles				
Nissin Kogyo Co., Ltd.	170,200	3,129,828	3,073,271	1.0
Brake systems				
Sanoh Industrial Co., Ltd.	377,800	2,755,574	2,648,105	0.9
Tubes, wires and electrical products				
Tachi-S Co., Ltd.	323,700	5,260,996	4,892,615	1.6
Child transformation seats, seat components, and rotating units				
Total Transportation Equipment		13,090,264	13,475,082	4.4

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS—Continued

AUGUST 31, 2014

(Unaudited)

	Shares	Cost	Market Value	% of Net Assets
Utilities				
Keiyo Gas Co., Ltd.	374,000	$1,916,413	$1,848,334	0.6
Produces and sells gas and energy products				
The Okinawa Electric Power Company, Incorporated	140,500	4,895,419	4,572,785	1.5
Thermal power				
Total Utilities		6,811,832	6,421,119	2.1
Wholesale Trade				
Kanaden Corporation	174,000	1,137,370	1,259,766	0.4
Components and devices				
Kohsoku Corporation	65,700	588,030	568,530	0.2
Sale of light food packaging materials				
Matsuda Sangyo Co., Ltd.	312,600	3,906,103	3,835,177	1.2
Wholesales precious metals, electronic materials, and food				
Paltac Corporation	122,900	1,534,660	1,570,445	0.5
Daily necessities				
Senshu Electric Co., Ltd.	93,500	1,076,091	1,646,060	0.5
Electric wire and cables				
Shinko Shoji Co., Ltd.	244,300	2,136,675	2,231,479	0.7
Integrated circuits and semiconductor devices				
Siix Corporation	307,100	4,095,020	5,052,143	1.6
Video, audio, and office equipment				
SPK Corporation	15,800	283,633	292,894	0.1
Import, export, and wholesale of automobile parts				
Ryoden Trading Company, Ltd.	825,000	5,610,426	6,084,083	2.0
Electronic components				
Sugimoto & Co., Ltd.	246,200	2,168,491	2,426,374	0.8
Tools and measuring instruments				

Techno Associe Co., Ltd.	248,900	2,300,895	2,441,017	0.8
Produces and distributes screws				
Total Wholesale Trade		24,837,394	27,407,968	8.8
TOTAL INVESTMENTS IN JAPANESE EQUITY SECURITIES		$279,730,901	$304,556,605	97.8

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

SCHEDULE OF INVESTMENTS—Continued

AUGUST 31, 2014

(Unaudited)

	Shares	Cost	Market Value	% of Net Assets
INVESTMENTS IN FOREIGN CURRENCY				
Japanese Yen				
Non-interest bearing account		$3,660,607	$3,660,294	1.2
TOTAL INVESTMENTS IN FOREIGN CURRENCY		3,660,607	3,660,294	1.2
TOTAL INVESTMENTS		$283,391,508	$308,216,899	99.0
OTHER ASSETS LESS LIABILITIES, NET			3,008,009	1.0
NET ASSETS			$311,224,908	100.0

Portfolio securities and foreign currency holdings were translated
at the following exchange rate as of August 31, 2014.

Japanese Yen	JPY¥ 104.005 = $1.00

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

STATEMENT OF ASSETS AND LIABILITIES

AUGUST 31, 2014

(Unaudited)

ASSETS:	
Investments in securities, at market value (cost—$279,730,901)	$304,556,605
Investments in foreign currency, at market value (cost—$3,660,607)	3,660,294
Receivable for investments sold	3,089,858
Receivable for dividends and interest, net of withholding taxes	210,953
Cash and cash equivalents	126,554
Prepaid expenses	37,487
Total Assets	311,681,751
LIABILITIES:	
Accrued management fee	218,313
Payable for investments purchased	65,961
Accrued directors’ fees and expenses	8,323
Other accrued expenses	164,246
Total Liabilities	456,843
NET ASSETS:	
Capital stock (par value of 28,333,893 shares of capital stock outstanding, authorized 100,000,000, par value $0.10 each)	2,833,389
Paid-in capital	286,055,217
Accumulated net realized loss on investments and foreign currency transactions	(481,925)
Net unrealized appreciation on investments and foreign currency transactions	24,820,206
Accumulated net investment loss	(2,001,979)
Net Assets	$311,224,908
Net asset value per share	$10.98

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

STATEMENT OF OPERATIONS

FOR THE SIX MONTHS ENDED AUGUST 31, 2014

(Unaudited)

INCOME:		
Dividend income (less $456,680 withholding taxes)	$2,555,147	
Interest income	153	
Total Income		$2,555,300
EXPENSES:		
Management fee	1,303,276	
Custodian fees	107,228	
Legal fees	77,316	
Directors’ fees and expenses	53,947	
Auditing and tax reporting fees	31,270	
Shareholder reports	18,998	
Registration fees	13,195	
Annual meeting expenses	12,562	
Transfer agency fees	6,261	
Miscellaneous	5,977	
Total Expenses		1,630,030
INVESTMENT INCOME—NET		925,270
REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS AND FOREIGN CURRENCY:		
Realized gain on investments and foreign currency transactions:		
Net realized gain on investments		12,424,170
Net realized loss on foreign currency transactions		(86,245)
Net realized gain on investments and foreign currency transactions		12,337,925
Net change in unrealized depreciation on foreign currency transactions and translation		(1,580,524)
Net change in unrealized appreciation on investments		20,548,257
Net realized and unrealized gain on investments and foreign currency transactions and translation		31,305,658
NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS		$32,230,928

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

STATEMENT OF CHANGES IN NET ASSETS

	For the Six Months Ended August 31, 2014 (Unaudited)	For the Year Ended February 28, 2014
FROM INVESTMENT ACTIVITIES:		
Net investment income	$925,270	$1,452,099
Net realized gain on investments	12,424,170	31,791,420
Net realized loss on foreign currency transactions	(86,245)	(532,929)
Net change in unrealized appreciation on investments and foreign currency transactions and translation	18,967,733	1,648,574
Increase in net assets derived from investment activities	32,230,928	34,359,164
FROM DISTRIBUTIONS TO SHAREHOLDERS:		
Net investment income ($0 and $0.199 per share, respectively)	0	(5,638,445)
Decrease in net assets derived from distributions to shareholders	0	(5,638,445)
NET ASSETS:		
Beginning of period	278,993,980	250,273,261
End of period (including accumulated net investment loss of $2,001,979 and $2,927,249 respectively)	$311,224,908	$278,993,980

See notes to financial statements

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS

August 31, 2014

(Unaudited)

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.

In the opinion of management, all material adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included.

The accompanying financial statements have been prepared in accordance with United States ("U.S.") generally accepted accounting principles ("GAAP") and are stated in U.S. dollars. The following is a summary of the significant accounting and reporting policies used in preparing the financial statements.

(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, which approximates fair value, 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 assets 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.

(b) Foreign Currency Transactions—Transactions denominated in Japanese Yen ("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 results of operations for the current period.

The net assets of the Fund are presented at the exchange rate and market values on August 31, 2014. The Fund does isolate that portion of the results of operations arising as a result of changes in the foreign exchange rates on investments from the fluctuations arising from changes in the market prices of securities held at August 31, 2014. Net realized gains or losses on investments includes gains or losses arising from sales of portfolio securities and sales and maturities of short-term securities. Net realized gains or losses on the foreign currency transactions arise from sale of foreign currencies, currency gains or losses realized on securities transactions between trade and settlement date, and 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.

(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 a first-in, first-out basis.

Distributions from net investment income and net realized capital gains are determined in accordance with Federal income tax regulations, which may differ from GAAP. 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 capital gains for financial reporting purposes, but not for tax purposes, are reported as distributions in excess of net realized gains.

Pursuant to a securities lending agreement with Brown Brothers Harriman & Co., the Fund may lend securities to qualified institutions. It is the Fund’s policy that, at origination, all loans are secured by collateral of at least 102% of the value of U.S. securities loaned and 105% of the value of foreign securities loaned. It is the Fund’s policy that collateral equivalent to at least 100% of the market value of securities on loan is maintained at all times. Collateral is provided in the form of cash, which will be invested in certain money market funds. The Fund is entitled to receive all income on securities loaned, in addition to a portion of the income earned as a result of the lending transaction. Although each security loan is fully collateralized, there are certain risks. On November 21, 2008, the Fund suspended its participation in the securities lending program. The Fund may resume its participation in the future. During the fiscal year ended February 28, 2014 and the semi-annual period ended August 31, 2014, the Fund did not earn fees from lending fund portfolio securities, pursuant to the securities lending agreement.

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS—Continued

(Unaudited)

(d) Capital Account Reclassification — For the year ended February 28, 2014, the Fund's net investment loss was decreased by $918,025 and the accumulated net realized loss was increased by $918,025. These adjustments were primarily due to the result of the reclassification of foreign currency losses and the tax treatment of passive foreign investment companies. These adjustments had no impact on net assets.

(e) Income Taxes — A provision for U.S. 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 7% (effective 4/1/03 to 12/31/12), 7.147% (effective 1/1/13 to 12/31/13) and 15.315% (effective 1/1/14) and on interest at a rate of 15% and such withholding taxes are reflected as a reduction of the related revenue. The 2014 withholding tax rate of 15.315% was reduced to 10% upon the submission of Form 17 - Limitation on Benefits Article. There is no withholding tax on realized gains.

In accordance with U.S. GAAP requirements regarding accounting for uncertainties in income taxes, management has analyzed the Fund's tax positions taken or expected to be taken on federal and state income tax returns for all open tax years (the current and the prior three tax years), and has concluded that no provision for income tax is required in the Fund's financial statements. The Fund recognizes interest and penalties, if any, related to uncertain tax positions as income tax expense in the statement of operations. During the current year and for the prior three tax years, the Fund did not incur any interest or penalties.

(f) Use of Estimates in Financial Statement Preparation — The preparation of financial statements in accordance with GAAP 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 U.S. 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 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 — Under the Fund's organizational documents, its officers and directors are indemnified against certain liabilities arising from the performance of their duties to the Fund. Additionally, 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 expects the risk of loss to be remote and as such no additional accruals were recorded on the statement of assets and liabilities.

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 investment adviser for the Fund, for which it is compensated by the Manager, not the Fund.

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS—Continued

(Unaudited)

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, 0.90% of the Fund's average weekly net assets in excess of $100 million but not exceeding $175 million, 0.80% of the Fund's average weekly net assets in excess of $175 million but not exceeding $250 million, 0.70% of the Fund's average weekly net assets in excess of $250 million but not exceeding $325 million, 0.60% of the Fund's average weekly net assets in excess of $325 million, but not exceeding $425 million and 0.50% of the Fund's average weekly net assets in excess of $425 million. Under the management agreement, the Fund incurred fees to the Manager of $1,303,276 for the six months ended August 31, 2014. Under the investment advisory agreement, the Manager informed the Fund that the Investment Adviser earned fees of $579,026 for the six months ended August 31, 2014 from the Manager, not the Fund. At August 31, 2014, the fee payable to the Manager, by the Fund, was $218,313.

Certain officers and/or directors of the Fund are officers and/or directors of the Manager. Affiliates of Nomura Holdings, Inc. (the Manager's indirect parent) did not earn any fees in commissions on the execution of portfolio security transactions for the six months ended August 31, 2014. The Fund pays each Director not affiliated with the Manager an annual fee of $12,000 plus $1,500 per meeting attended or $1,000 per telephone meeting attended, together with such Director's actual expenses related to attendance at meetings. The Chairman of the Board, presently Rodney A. Buck, who is not affiliated with the Manager, is paid an additional annual fee of $5,000. The Chairman of the Audit Committee, presently David B. Chemidlin, receives an additional annual fee of $1,000. Such fees and expenses for unaffiliated directors aggregated $53,947 for the six months ended August 31, 2014.

3. Purchases and Sales of Investments

Purchases and sales of investments, exclusive of investments in foreign currency and short-term securities, for the six months ended August 31, 2014 were $66,460,574 and $68,920,895, respectively.

4. Federal Income Tax

As of February 28, 2014, net unrealized appreciation on investments, exclusive of investments in foreign currency, for Federal income tax purposes was $3,652,576, of which $17,074,532 related to appreciated securities and $13,421,956 related to depreciated securities. The cost of investments, exclusive of investments in foreign currencies of $3,037,884 at February 28, 2014 for Federal income tax purposes was $271,976,779.

At February 28, 2014, the components of accumulated earnings (deficit) on a tax basis were as follows:

Accumulated capital and other losses	$(12,817,862)	
Qualified late year loss deferral	(719,336)	(a)
Unrealized appreciation on investments and foreign currency transactions	3,642,746	(b)
Total accumulated deficit	$(9,894,452)	

(a) Late year ordinary losses incurred after December 31, 2013 and within the taxable year are deemed to arise on the first business day of the Fund's next taxable year.

(b) The differences between book basis and tax basis unrealized appreciation is attributable to the tax deferral of losses on wash sales and the tax treatment of passive foreign investment companies.

The tax character of distributions paid during the fiscal years ended February 28, 2014 and February 28, 2013 were as follows:

	February-14	February-13
Ordinary Income	$5,638,445	$2,295,680
Capital Gains	$0	$0

On December 22, 2010, the Regulated Investment Company Modernization Act of 2010 (the "Act") was enacted, which changed various technical rules governing the tax treatment of regulated investment companies. The changes are generally effective for taxable years beginning after the date of enactment. One of the more prominent changes addresses capital loss carry-forwards. Under the Act, the Fund will be permit-ted to carry forward capital losses incurred in taxable years beginning after the date of enactment for an unlimited period. However, any losses incurred during those future taxable years will be required to be utilized prior to the losses incurred in pre-enactment taxable years, which carry an expiration date. As a result of this ordering rule, pre-enactment capital loss carryforwards may be more likely to expire unused. Additionally, post-enactment capital loss carryforwards will retain their character as either short-term or long-term capital losses rather than being considered all short-term as permitted under previous regulation.

JAPAN SMALLER CAPITALIZATION FUND, INC.

NOTES TO FINANCIAL STATEMENTS—Continued

(Unaudited)

The Fund has a capital loss carryforward as of February 28, 2014 of $12,817,862 which expires on February 28, 2018. In addition, the Fund utilized $26,291,148 of its accumulated capital losses against current year net realized gains. All of the Fund's capital losses were generated in pre-enactment years.

5. Fair Value Measurements

In accordance with GAAP, fair value is defined as the price that the Fund would receive to sell an asset or pay to transfer a liability in an orderly transaction between market participants at the measurement date. GAAP also establishes a framework for measuring fair value, and a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability. Inputs may be observable or unobservable and refer broadly to the assumptions that market participants would use in pricing the asset or liability. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability based on market data obtained from sources independent of the Fund. Unobservable inputs reflect the Fund's own assumptions about the assumptions that market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. Each investment is assigned a level based upon the observability of the inputs which are significant to the overall valuation. The three-tier hierarchy of inputs is summarized below.

- Level 1—quoted prices in active markets for identical investments
- Level 2—other significant observable inputs (including quoted prices for similar investments, interest rates, prepayment speeds, credit risk, etc.)
- Level 3—significant unobservable inputs (including the Fund's own assumptions in determining the fair value of investments)

The following table summarizes the valuation of the Fund's investments by the above fair value hierarchy levels as of August 31, 2014.

Level	Investments in Securities
Level 1	
Equity Securities*	$304,556,605
Foreign Currency	3,660,294
Level 2	-0-
Level 3	-0-
Total	$308,216,899

* Please refer to the Schedule of Investments for breakdown of the valuation by industry type.

During the six months ended August 31, 2014, there were no transfers between Level 1 and Level 2.

During the six months ended August 31, 2014, the Fund did not hold any instrument which used significant unobservable inputs (Level 3) in determining fair value.

6. Rights Offering

The Fund issued to its shareholders of record as of the close of business on June 23, 2011 transferable rights to subscribe for up to an aggregate of 7,091,723 shares of common stock of the Fund at a rate of one share of common stock for three rights held ("Primary Subscription"). During July 2011, the Fund issued a total of 7,091,723 shares of common stock on exercise of such rights at the subscription price of $7.60 per share, compared to a net asset value per share of $9.88 and a market value per share of $8.45. A sales load of 3.75% was included in the subscription price. Offering costs of $732,014 and the sales load were charged directly against the proceeds of the rights offering. As a result of the rights offering, there was a dilutive effect on the net asset value per share of the Fund in the amount of $0.47 per share.

7. Recent Accounting Pronouncements

In December 2011, FASB issued Accounting Standards Update No. 2011-11 "Disclosures about Offsetting Assets and Liabilities" ("ASU 2011-11"). These disclosures are intended to help investors and other financial statement users to better assess the effect or potential effect of offsetting arrangements on a company's financial position. They also improve transparency in the reporting of how companies mitigate credit risk, including disclosure of related collateral pledged or received. In addition, ASU 2011-11 facilitates comparison between those entities that prepare their financial statements on the basis of GAAP and those entities that prepare their financial statements on the basis of IFRS. ASU 2011-11 requires entities to: disclose both gross and net information about both instruments and transactions eligible for offset in the financial statements; and disclose instruments and transactions subject to an agreement similar to a master netting agreement. ASU 2011-11 is effective for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. In January 2013, FASB issued ASU 2013-01, "Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities" ("ASU 2013-01") that provides clarification about which instruments and transactions are subject to ASU 2011-11. The adoption of ASU 2011-11 and ASU 2013-01 was not material to the financial statements.

JAPAN SMALLER CAPITALIZATION FUND, INC.

FINANCIAL HIGHLIGHTS

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

	For the Six Months Ended August 31, 2014 (Unaudited)	For the Year Ended February 28, 2014	February 28, 2013	February 29, 2012	February 28, 2011	February 28, 2010
Net asset value, beginning of year	$9.85	$8.83	$8.85	$9.80	$8.44	$6.49
Net investment income@	0.03	0.05	0.07	0.06	0.03	0.02
Net realized and unrealized gain (loss) on investments and foreign currency	1.10	1.17	(0.01)	(0.50)	1.41	1.99
Total from investment operations	1.13	1.22	0.06	(0.44)	1.44	2.01
Distributions from net investment income	—	(0.20)	(0.08)	(0.04)	(0.08)	(0.06)
Fund Share Transactions						
Dilutive effect of Rights Offering*	—	—	—	(0.47)	—	—
Net asset value, end of period	$10.98	$9.85	$8.83	$8.85	$9.80	$8.44
Market value, end of period	$9.74	$8.84	$8.00	$7.83	$9.58	$8.13
Total investment return†	10.2%	13.0%	3.4%	(17.9%)	18.9%	41.5%
Ratio to average net assets/supplemental data:						
Net assets, end of period (in 000)	$311,225	$278,994	$250,273	$250,732	$208,211	$179,381
Operating expenses	1.12%**	1.19%	1.19%	1.34%	1.44%	1.46%
Net investment income	0.64%**	0.53%	0.86%	0.67%	0.38%	0.23%
Portfolio turnover	23%	101%	37%	66%	57%	66%

@ Based on average shares outstanding.
* Decrease is due to the Rights Offering.
† Based on market value per share, adjusted for reinvestment of income dividends and long-term capital gain distributions, and capital share transactions. Total return does not reflect sales commissions.
** Annualized

JAPAN SMALLER CAPITALIZATION FUND, INC.

Board Review of the Management and Investment Advisory Agreements

The Board of Directors of the Fund (the "Board") consists of five directors, four of whom are independent or non-interested directors (the "Independent Directors"). The Board considers matters relating to the Fund's management and investment advisory agreements throughout the year. On an annual basis, the Board specifically considers whether to approve the continuance of these agreements for an additional one-year period. The specific agreements (the "Agreements") consist of the Fund's management agreement with Nomura Asset Management U.S.A. Inc. (the "Manager") and the investment advisory agreement between the Manager and its parent, Nomura Asset Management Co., Ltd. (the "Investment Adviser").

The Board, including the Independent Directors, most recently approved the continuance of the Agreements at a meeting held on August 14, 2014. In connection with their deliberations at that meeting and at a separate meeting of the Independent Directors held on August 5, 2014, the Independent Directors received materials that included, among other items, information provided by the Manager regarding (i) the investment performance of the Fund, performance of other investment companies and performance of the Fund's benchmark, (ii) expenses of the Fund and the management fee paid by the Fund to the Manager and the advisory fee paid by the Manager to the Investment Adviser, (iii) advisory fees charged by the Manager and the Investment Adviser to comparable accounts and (iv) the profitability of the Agreements to the Manager and the Investment Adviser. The Independent Directors sought and received additional information from the Investment Adviser. The Independent Directors were advised by, and received materials (including a detailed memorandum reviewing the applicable legal standards and factors taken into account by the Supreme Court and other relevant court decisions) from their independent counsel in considering these matters and the continuance of the Agreements.

In considering the continuance of the Agreements at the meeting held on August 14, 2014, the Board, including the Independent Directors, did not identify any single factor as determinative. Matters considered by the Directors in connection with their review of the Agreements included the following:

The nature, extent and quality of the services provided to the Fund under the Agreements. The Board considered the nature, extent and quality of the services provided to the Fund by the Manager and the Investment Adviser and the resources dedicated by the Manager and the Investment Adviser. These services included both investment advisory services and related services such as the compliance oversight provided by the Manager. Based on its review of all of the services provided by the Manager and the Investment Adviser, the Board, including the Independent Directors, concluded that the nature, extent and quality of these services supported the continuance of the Agreements.

Investment performance. The Board considered performance information provided by the Manager regarding the Fund's investment performance over a number of time periods, including the one-year, three-year and five-year periods recently ended. In response to requests by the Independent Directors, the Manager provided information about the performance of the Fund compared to the Fund's benchmark index, data on the Fund's expense ratio and components thereof, and comparative fee, expense ratio and performance information for other funds investing primarily in Japanese securities. At the request of the Independent Directors, the Manager also provided supplemental information relating to performance, expense ratios, and fees of U.S. investment companies investing in equity securities of Asian and other non-U.S. issuers. In connection with their review of investment performance, the Independent Directors noted that, following a series of discussions with management that focused on the Fund's performance, that Investment Adviser had installed a new investment team as of July 1, 2013. The Independent Directors recognized that, as contemplated at the time of the transition, the new portfolio managers had invested in a more diversified portfolio than the Fund had maintained in recent years with an increased focus on value characteristics evidenced by financial measurements. The Independent Directors also noted that the Fund's comparative performance had improved since the transition and that the Fund’s performance for the one-year period ended June 30, 2014 ranked third of six funds (including the Fund) identified by Manager as having similar investments objectives. Based on their review, the Independent Directors determined it was appropriate to allow the new portfolio managers to continue to implement their strategy.

The costs of the services to be provided and the profits to be realized by the Manager and its affiliates from their advisory relationships with the Funds. The Board considered the fee payable under the Fund’s management agreement in connection with other information provided for the Directors’ consideration. The Manager and its affiliates also act as advisers to additional investment companies registered under the Investment Company Act of 1940 and the Board of Directors of the Fund compared the advisory arrangements and fees for these companies. The Board also considered information provided by the Manager regarding fees charged by the Manager and its affiliates to institutional accounts and other investment companies having investment objectives similar to the Fund’s investment objective, including Japanese retail unit trusts. The Board of Directors of the Fund recognized that the nature of the services provided by the Manager and the Investment Adviser to other investment vehicles and separate accounts differed from the range of services provided to the Fund.

JAPAN SMALLER CAPITALIZATION FUND, INC.

Board Review of the Management and Investment Advisory Agreements (continued)

The Manager also provided the Board with information prepared by the Manager and the Investment Adviser indicating the profitability of the Agreements to these respective advisers. This presentation included information regarding methodologies used to allocate expenses in considering the profitability of the Agreements to the Manager and the Investment Adviser. The Independent Directors reviewed this information with the Manager and requested and received certain supplemental information from the Manager about the expense allocation methodology utilized by the Investment Adviser.

After reviewing the information described above, the Independent Directors concluded that the management fee proposed to be charged to the Fund was reasonable and the profitability of the Agreement to the Manager and the Investment Adviser support the continuance of the Agreements.

Economies of scale. The Board also considered whether the Manager realizes economies of scale as the Fund grows larger and the extent to which any economies of scale are shared with the Fund and its shareholders. The Board noted that the management agreement contains six separate breakpoints in the management fee for net assets above $50 million, with the last breakpoint applicable to net assets in excess of $425 million.

Based on an evaluation of all factors deemed relevant, including the factors described above, the Board, including each of the Independent Directors, concluded that each of the Agreements should be continued through August 31, 2015.

BOARD OF DIRECTORS
Rodney A. Buck
David B. Chemidlin
Yutaka Itabashi
E. Han Kim
Marcia L. MacHarg

OFFICERS
Yutaka Itabashi, President
Hiromichi Aoki, Vice President
Maria R. Premole, Vice President
Neil A. Daniele, Secretary and Chief Compliance Officer
Amy J. Marose, Treasurer
Jamie T. Alusick, Assistant Treasurer

MANAGER
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www.nomura.com

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DIVIDEND PAYING AGENT, TRANSFER AGENT AND REGISTRAR
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CUSTODIAN
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Boston, Massachusetts 02110-1548

COUNSEL
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787 Seventh Avenue
New York, New York 10019

INDEPENDENT REGISTERED PUBLIC ACCOUNTING

JAPAN
Smaller Capitalization
Fund, Inc.

SEMI-ANNUAL REPORT
AUGUST 31, 2014

FIRM
Ernst & Young LLP
5 Times Square
New York, New York 10036

JAPAN SMALLER CAPITALIZATION FUND, INC.
WORLDWIDE PLAZA
309 WEST 49TH STREET
NEW YORK, NEW YORK 10019-7316

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.

The accompanying Financial Statements, including the Schedule of Investments, have not been examined by the Fund's independent accountants, Ernst & Young, LLP, and accordingly, they express no opinion thereon.

ITEM 2. CODE OF ETHICS

Not applicable to this semi-annual report.

ITEM 3. AUDIT COMMITTEE FINANCIAL EXPERT

Not applicable to this semi-annual report.

ITEM 4. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Not applicable to this semi-annual report.

ITEM 5. AUDIT COMMITTEE OF LISTED REGISTRANTS

Not applicable to this semi-annual report.

ITEM 6. SCHEDULE OF INVESTMENTS

The Registrant's investments in securities of unaffiliated issuers as of 8/31/14 are included in the report to shareholders filed under Item 1 of this Form.

ITEM 7. DISCLOSURE OF PROXY VOTING POLICIES AND PROCEDURES FOR CLOSED-END MANAGEMENT INVESTMENT COMPANIES

Not applicable to this semi-annual report.

ITEM 8. PORTFOLIO MANAGERS OF CLOSED-END MANAGEMENT INVESTMENT COMPANIES

(a) Not applicable.

(b)None

ITEM 9. PURCHASES OF EQUITY SECURITIES BY CLOSED-END MANAGEMENT INVESTMENT COMPANY AND AFFILIATED PURCHASERS

(a) Not applicable.

(b) Not applicable.

ITEM 10. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

ITEM 11. CONTROLS AND PROCEDURES

The Registrant’s Principal Executive Officer and Principal Financial Officer have evaluated the Registrant’s disclosure controls and procedures within 90 days of the filing of this report and have concluded that they are effective in providing reasonable assurance that the information required to be disclosed by the Registrant in its reports or statements filed under the 1934 Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission.

There were no changes in the Registrant's internal control over financial reporting that occurred during the second fiscal quarter of the period covered by this Report that have materially affected, or are reasonably likely to materially affect, the Registrant's internal control over financial reporting.

ITEM 12. EXHIBITS

(a) (1)	Not applicable to this semi-annual report.
(a) (2)	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Rule 30a-2 under the Investment Company Act of 1940 are attached hereto as an exhibit.
(a) (3)	Not applicable.
(b)	Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 are furnished herewith as an exhibit.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Japan Smaller Capitalization Fund, Inc.

By: /s/ Yutaka Itabashi
Yutaka Itabashi
(Principal Executive Officer)

Date: 10/29/14

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

By: /s/ Yutaka Itabashi
Yutaka Itabashi
(Principal Executive Officer)

Date: 10/29/14

By: /s/ Amy J. Marose
Amy J. Marose, Treasurer
(Principal Financial Officer)

Date: 10/29/14