

ABERDEEN CHILE FUND, INC.  
Form N-CSR  
March 08, 2018

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM N-CSR**

**CERTIFIED SHAREHOLDER REPORT OF REGISTERED**

**MANAGEMENT INVESTMENT COMPANIES**

Investment Company Act file number:	811-05770
Exact name of registrant as specified in charter:	Aberdeen Chile Fund, Inc.
Address of principal executive offices:	1735 Market Street, 32nd Floor Philadelphia, PA 19103
Name and address of agent for service:	Ms. Andrea Melia Aberdeen Asset Management Inc. 1735 Market Street, 32nd Floor Philadelphia, PA 19103
Registrant's telephone number, including area code:	1-800-522-5465
Date of fiscal year end:	December 31
Date of reporting period:	December 31, 2017

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**Item 1. Reports to Shareholders.**

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## Letter to Shareholders (unaudited)



## Edgar Filing: ABERDEEN CHILE FUND, INC. - Form N-CSR

Dear Shareholder,

We present this Annual Report which covers the activities of Aberdeen Chile Fund, Inc. (the Fund) for the fiscal year ended December 31, 2017. The Fund's principal investment objective is to seek total return, consisting of capital appreciation and income, by investing primarily in Chilean securities.

### Total Investment Return

For the fiscal year ended December 31, 2017, the total return to shareholders of the Fund based on the net asset value (NAV) and market price, respectively, of the Fund compared to the Fund's benchmark are as follows:

NAV*	39.9%
Market Price*	53.5%
Morgan Stanley Capital International (MSCI)	
MSCI Chile1	43.6%

\*assuming the reinvestment of dividends and distributions

The Fund's total return is based on the reported NAV on each financial reporting period end and may differ from what is reported on the Financial Highlights due to financial statement rounding or adjustments. For more information about Fund performance please see Report of the Investment Adviser on Page 3.

### NAV, Share Price and Discount

	NAV	Market Price	Discount
12/31/2016	\$7.20	\$5.96	17.2%
12/31/2017	\$9.83*	\$8.93	9.2%

\*The NAV shown above differs from the financial reporting NAV on December 31, 2017 due to financial statement rounding and/or financial statement adjustments.

### Open Market Repurchase Program

The Fund's policy is to consider buying back Fund shares on the open market when the Fund trades at a discount to the NAV that is above an established threshold and management believes such repurchases may enhance shareholder value. During the fiscal year ended December 31, 2017, the Fund did not repurchase any shares. During the fiscal year ended December 31, 2016, the Fund repurchased 28,807 shares. On December 12, 2017, consistent with Regulation M, which prohibits funds from purchasing its

shares during a restricted period following the announcement of a tender offer by that fund, the Fund's Board of Directors approved a suspension of the Fund's open

market repurchase program until the anticipated tender offer on the Fund following the proposed fund consolidation, discussed below, is complete.

### Fund Consolidation

In light of increasingly challenging conditions for smaller closed-end funds, the Fund's investment adviser presented a proposal to the Fund's Board of Directors (the Board) in an effort to create a more sustainable fund with broader investment appeal, increased portfolio yield characteristics, a bigger fund with increased secondary market liquidity, and the potential for reduced overall expenses. In October 2017, the Fund's Board of Directors and the boards of directors of seven other closed-end funds announced that they had each approved the consolidation of their respective funds (the Target Funds) into the Fund, subject to the receipt of necessary approvals by stockholders of each of the Target Funds. The Fund would serve as the acquiring fund and would, contingent on the consolidation, change its investment strategy to a multi-cap emerging markets equity income investment strategy that utilizes leverage and would be renamed Aberdeen Emerging Markets Equity Income Fund, Inc. At a special meeting of shareholders of the Fund held on January 26, 2018, the shareholders of the Fund approved certain proposals necessary to effectuate the reorganizations and the change in the Fund's strategy, including the following: (i) an amendment to the Fund's Articles of Incorporation to increase the total number of shares of capital stock; (ii) the issuance of additional shares of common stock of the Fund in connection with the potential reorganizations of certain other closed-end funds into the Fund; (iii) the elimination of the Fund's fundamental investment policy to invest primarily in Chilean securities; (iv) an amendment to the Fund's fundamental investment restriction relating to borrowing; and (v) an amendment to the Fund's Investment Advisory Agreement to provide that fees payable thereunder will be calculated at a lower annual rate based solely on net assets. It is anticipated that the Fund's benchmark would change to the MSCI Emerging Markets Index and that the Fund would trade on the NYSE American (formerly, NYSE MKT) under a new ticker symbol, expected to be AEF. The Fund's new strategy would seek to capitalize on Aberdeen's global emerging market equity capability by investing in a global portfolio of emerging market securities. At an annual meeting of shareholders of the Fund held on January 26, 2018, Fund shareholders approved the election of three Directors to the Board of Directors of the Fund, to serve contingent upon the reorganization of the Target Fund for which such Director currently serves as a director. The proposed consolidation is subject to several conditions, including approval by Target Fund stockholders at meetings of stockholders

**All amounts are U.S. Dollars unless otherwise stated.**

1 The MSCI Chile Index is designed to measure the performance of the large and mid cap segments of the Chilean market. With 19 constituents, the index covers approximately 85% of the Chile equity universe. Indexes are unmanaged and have been provided for comparison purposes only. No fees or expenses are reflected. You cannot invest directly in an index. Index performance is not an indication of the performance of the Fund itself. For complete fund performance, please visit <http://www.aberdeench.com>.

Aberdeen Chile Fund, Inc. 1

## Letter to Shareholders (unaudited) (concluded)

expected to be held in March 2018. It is currently anticipated that the proposed consolidation will occur prior to the end of April 2018, subject to all requisite regulatory and stockholder approvals. Following the consolidation, it is anticipated that the Board of Directors of the Combined Fund will consider the approval of a tender offer at 99% of NAV. The tender offer size, in combination with estimated capital gains to be distributed, will be up to a maximum distribution of 50%, and not less than 40%, of the net assets of the Combined Fund. The price, size and terms of the offer will be determined by the Combined Fund's board at a later date. The proposed tender offer would be conducted as soon as practicable following the consolidation. It is currently anticipated that the proposed consolidation will occur prior to the end of April 2018, subject to all requisite regulatory and stockholder approvals. The proposed tender offer would be conducted as soon as practicable following the consolidation.

#### Merger of Aberdeen Asset Management PLC with Standard Life plc

The Fund's investment adviser and administrator are each a subsidiary of Aberdeen Asset Management PLC (Aberdeen PLC). The merger of Standard Life plc and Aberdeen PLC, announced on March 6, 2017 (Merger), closed on August 14, 2017. Aberdeen PLC became a direct subsidiary of Standard Life plc as a result of the Merger and the combined company changed its name to Standard Life Aberdeen plc. Shareholders of the Fund were not required to take any action as a result of the Merger. Following the Merger, the Fund's investment adviser and administrator each became an indirect subsidiary of Standard Life Aberdeen plc, but otherwise did not change. The investment advisory and administration agreements for the Fund, the services provided under the agreements, and the fees charged for services did not change as a result of the Merger. The portfolio management team for the Fund also did not change as a result of the Merger.

#### Unclaimed Share Accounts

Please be advised that abandoned or unclaimed property laws for certain states require financial organizations to transfer (escheat) unclaimed property (including Fund shares) to the state. Each state has its own definition of unclaimed property, and Fund shares could be considered unclaimed property due to account inactivity (e.g., no owner-generated activity for a certain period), returned mail (e.g., when mail sent to a shareholder is returned to the Fund's transfer agent as undeliverable), or a combination of both. If your Fund shares are categorized as unclaimed, your financial advisor or the Fund's transfer agent will follow the applicable state's statutory requirements to contact you, but if unsuccessful, laws may require that the shares be escheated to the appropriate state. If this happens, you will have to contact the state to recover your property, which may involve time and expense. For more information on unclaimed property and how to maintain an active account, please contact your financial advisor or the Fund's transfer agent.

#### Portfolio Holdings Disclosure

The Fund's complete schedule of portfolio holdings for the second and fourth quarters of each fiscal year are included in the Fund's semi-annual and annual reports to shareholders. The Fund files its complete schedule of portfolio holdings with the Securities and Exchange Commission (the SEC) for the first and third quarters of each fiscal year on Form N-Q. The Fund's Form N-Q filings are available on the SEC's website at <http://www.sec.gov> and may be reviewed and copied at the SEC's Public Reference Room in Washington, D.C. Information about the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330. The Fund makes the information on Form N-Q available to shareholders on the Fund's website or upon request and without charge by calling Investor Relations toll-free at 1-800-522-5465.

#### Proxy Voting

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A description of the policies and procedures that the Fund uses to determine how to vote proxies relating to portfolio securities, and information regarding how the Fund voted proxies relating to portfolio securities during the most recent twelve months ended June 30 is available by August 31 of the relevant year: (i) upon request and without charge by calling Investor Relations toll-free at 1-800-522-5465; and (ii) on the SEC's website at <http://www.sec.gov>.

### Investor Relations Information

As part of Aberdeen's commitment to shareholders, we invite you to visit the Fund on the web at [www.aberdeench.com](http://www.aberdeench.com). Here, you can view monthly fact sheets, quarterly commentary, distribution and performance information, updated daily fact sheets courtesy of Morningstar®, portfolio charting and other Fund literature.

#### Contact Us:

- Visit: [cef.aberdeen-asset.us/](http://cef.aberdeen-asset.us/);
- Watch: <http://cef.aberdeen-asset.us/en/cefinvestorcenter/aberdeen-closed-end-fund-tv>;
- Email: [InvestorRelations@aberdeenstandard.com](mailto:InvestorRelations@aberdeenstandard.com); or
- Call: 1-800-522-5465 (toll-free in the U.S.).

Yours sincerely,

**Christian Pittard**  
President

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## Dividend Reinvestment and Direct Stock Purchase Plan (unaudited)



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Computershare Trust Company, N.A. ( Computershare ), the Fund's transfer agent, sponsors and administers a Dividend Reinvestment and Direct Stock Purchase Plan (the Plan ), which is available to shareholders.

The Plan allows registered shareholders and first-time investors to buy and sell shares and automatically reinvest dividends and capital gains through the transfer agent. This is a cost-effective way to invest in the Fund.

Please note that for both purchase and reinvestment purposes, shares will be purchased in the open market at the current share price and cannot be issued directly by the Fund.

For more information about the Plan and a brochure that includes the terms and conditions of the Plan, please call Computershare at 1-800-647-0584 or visit [www.computershare.com/buyaberdeen](http://www.computershare.com/buyaberdeen).

## Report of the Investment Adviser (unaudited)

### Market/economic review

Chilean equities, as measured by the benchmark Morgan Stanley Capital International (MSCI) Chile Index,<sup>1</sup> rose by 43.58% for the 12-month period ended December 31, 2017, outperforming the broader MSCI Emerging Markets Latin America Index,<sup>2</sup> which returned 24.15%. Chilean stocks were buoyed by positive political sentiment, copper price gains and persistent inflows. After the Mexican peso, the Chilean peso was one of the strongest-performing regional currencies against the U.S. dollar over the reporting period.

Investors reacted positively when market-friendly Sebastian Piñera officially launched his bid for the Chilean presidency early in 2017. His candidacy was helped by the departure of incumbent President Michelle Bachelet's well-regarded economic team in August 2017, following the controversial blocking of a vast mining project by a government body, which proved to be a major blow for the ruling Socialist Party of Chile. Although investors were jittery ahead of polls following the first round of voting in mid-November 2017, Piñera eventually secured victory against center-left opponent Alejandro Guillier in mid-December. Investor sentiment subsequently turned positive, domestic flows returned, and deal activity resumed.

On the economic front, Chile's gross domestic product was lifted over the reporting period by an increase in consumer spending, and business confidence improved. Inflation fell by more than expected during the reporting period, prompting the central bank to reduce its benchmark interest rate in March 2017—the first rate cut since 2014.

### Fund performance review

The Fund returned 39.90% on a net asset value basis for the 12-month period ended December 31, 2017, but underperformed the 43.58% return of its benchmark, the MSCI Chile Index. The negative impact of asset allocation offset positive stock selection for the period.

The Fund's underweight allocation to the materials sector relative to the benchmark was a notable detractor from the relative performance, as the sector was the strongest performer within the MSCI Chile Index in 2017. Specifically, the lack of a holding in pulp and paper producer Empresas CMPC detracted from Fund performance, as its shares rebounded on rising global pulp prices. The Fund's underweight allocation to Sociedad Química y Minera de Chile (SQM) also weighed on performance, as the potash and lithium miner was buoyed by an improving outlook for the price of lithium as demand for electric vehicles increases. The Fund's exposure to the information technology sector, which is not represented in the benchmark index, also had a negative impact on performance, as shares of IT services provider Sonda declined due to slowing new business volumes in Brazil during the reporting period. Additionally, the absence of a position in benchmark index constituent Latam Airlines Group was a detractor from the Fund's relative performance, as the regional private-passenger air carrier was boosted by solid results with improved load factors. We remain comfortable with the Fund's lack of exposure to this stock, as we have ongoing concerns about industry overcapacity and the company's debt levels.

1 Indexes are unmanaged and have been provided for comparison purposes only. No fees or expenses are reflected. You cannot invest directly in an index.

2 The MSCI Emerging Markets Latin America Index tracks the performance of large- and mid-cap company shares across five emerging-market countries in Latin America.

## Report of the Investment Adviser (unaudited) (concluded)

Conversely, the Fund's exposure to the healthcare sector, which is not represented in the MSCI Chile Index, was a significant contributor to performance for the reporting period, as hospital operator Banmedica was the Fund's strongest-performing stock. Shares of the company rallied sharply following U.S.-based UnitedHealthcare Group's takeover offer, which pleasantly surprised investors. The Fund's underweight position in Cencosud relative to the benchmark enhanced relative performance, as the retailer's quarterly earnings over the reporting period were hampered by a weak consumption environment in Argentina and Brazil, as well as higher logistics costs in Chile. Meanwhile, the lack of a holding in Itau Corpbanca contributed to performance, as shares of the lender came under pressure after the technical default of the Alto Maipo hydrological project, for which the bank had been the main financier.

## Outlook

In our opinion, the market euphoria from Piñera's presidential election win may continue to buoy Chilean equities for some time, as his

business-friendly leadership could help steer the economy in the right direction through more pro-market policies. However, we think that his lack of a legislative majority in the National Congress merits some caution. We believe that external factors also will continue to influence share prices. The pace at which developed countries, particularly the U.S. and Europe, normalize monetary policy, along with the health of Chinese demand, could have some bearing on the Chilean market. Although oil prices stabilized in early 2018, their trajectory for the remainder of the year remains uncertain. We believe that a broadening recovery in global economic growth and earnings should benefit the Fund's holdings and drive performance. We continue to favor domestically focused businesses that we believe are able to tap into the country's considerable potential.

*Aberdeen Asset Managers Limited*



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## Total Investment Return (unaudited)

The following table summarizes the average annual Fund performance compared to the MSCI Chile Index, the Fund's benchmark, for the 1-year, 3-year, 5-year and 10-year periods as of December 31, 2017.

	1 Year	3 Years	5 Years	10 Years
Net Asset Value (NAV)	39.9%	13.2%	-0.2%	3.3%
Market Price	53.5%	13.5%	-2.1%	0.7%
MSCI Chile Index	43.6%	11.7%	-0.8%	3.8%

*Aberdeen Asset Managers Limited, the Fund's adviser, has entered into a written contract with the Fund to waive certain fees without which total return performance would be lower. See Note 3 in the Notes to Financial Statements. This contract aligns with the term of the advisory agreement and may not be terminated prior to the end of the current term of the advisory agreement. Aberdeen Asset Management Inc. (AAMI), the Fund's administrator, has entered into an agreement with the Fund to limit investor relations services fees, without which performance would be lower. See Note 3 in the Notes to Financial Statements. Returns represent past performance. Total investment return at NAV is based on changes in the NAV of Fund shares and assumes reinvestment of dividends and distributions, if any, at market prices pursuant to the dividend reinvestment program sponsored by the Fund's transfer agent. All return data at NAV includes fees charged to the Fund, which are listed in the Fund's Statement of Operations under Expenses. Total investment return at market price is based on changes in the market price at which the Fund's shares traded on the NYSE American during the period and assumes reinvestment of dividends and distributions, if any, at market prices pursuant to the dividend reinvestment program sponsored by the Fund's transfer agent. The Fund's total investment return is based on the reported NAV on the financial reporting period ended December 31, 2017. Because the Fund's shares trade in the stock market based on investor demand, the Fund may trade at a price higher or lower than its NAV. Therefore, returns are calculated based on both market price and NAV. **Past performance is no guarantee of future results.** The performance information provided does not reflect the deduction of taxes that a shareholder would pay on distributions received from the Fund. The current performance of the Fund may be lower or higher than the figures shown. The Fund's yield, return, market price and NAV will fluctuate. Performance information current to the most recent month-end is available at [www.aberdeench.com](http://www.aberdeench.com) or by calling 800-522-5465.*

*The net operating expense ratio, excluding fee waivers, based on the fiscal year ended December 31, 2017 was 2.38%. The net operating expense ratio, net of fee waivers, based on the fiscal year ended December 31, 2017 was 2.19%.*



## Portfolio Summary (unaudited)

The following table summarizes the sector composition of the Fund's portfolio, in Standard & Poor's Global Industry Classification Standard (GICS) Sectors, expressed as a percentage of net assets as of December 31, 2017. The GICS structure consists of 11 sectors, 24 industry groups, 68 industries and 157 subindustries. As of December 31, 2017, the Fund did not have more than 25% of its assets invested in any industry. The sectors, as classified by GICS, are comprised of several industries.

Sectors	As a Percentage of Net Assets
Consumer Staples	23.7%
Financials	17.5%
Consumer Discretionary	13.7%
Utilities	11.9%
Industrials	8.6%
Real Estate	7.7%
Materials	6.1%
Energy	4.4%
Information Technology	2.4%
Telecommunication Services	2.2%
Health Care	1.5%
Short-Term Investment	0.1%
Other Assets in Excess of Liabilities	0.2%
	100.0%

## Top Ten Equity Holdings (unaudited)

The following were the Fund's top ten holdings as of December 31, 2017:

Name of Security	As a Percentage of Net Assets
S.A.C.I. Falabella	11.1%
Banco Santander Chile	9.6%
Parque Arauco SA	7.7%
Enel Americas SA	5.8%
Embotelladora Andina SA	5.6%
Sociedad Quimica y Minera de Chile SA, ADR, Preferred Shares	4.9%
Cia Cervecerias Unidas SA	4.9%
Cencosud SA	4.8%
Banco de Chile	4.7%
Empresas COPEC SA	4.4%

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## Portfolio of Investments

As of December 31, 2017

Shares	Description	Industry and Percentage of Net Assets	Value (US\$)
<b>LONG-TERM INVESTMENTS 99.7%</b>			
<b>COMMON STOCKS 93.6%</b>			
<b>CHILE 93.6%</b>			
183,000	AntarChile SA	Industrial Conglomerates 3.4%	\$ 3,167,262
27,052,584	Banco de Chile	Banks 4.7%	4,343,184
42,049	Banco de Credito e Inversiones	Banks 3.2%	2,897,104
113,001,987	Banco Santander Chile	Banks 9.6%	8,832,297
395,977	Banmedica SA	Health Care Providers & Services 1.5%	1,379,549
1,484,850	Cencosud SA	Food & Staples Retailing 4.8%	4,367,206
298,583	Cia Cervecerias Unidas SA	Beverages 4.9%	4,468,556
1,576,732	Coca-Cola Embonor SA, Class A(a)(b)	Beverages 4.2%	3,830,378
1,118,761	Embotelladora Andina SA(b)(c)	Beverages 5.6%	5,181,132
181,784	Empresa Nacional de Telecomunicaciones SA	Wireless Telecommunication Services 2.2%	2,044,110
257,639	Empresas COPEC SA	Oil, Gas & Consumable Fuels 4.4%	4,081,866
23,926,400	Enel Americas SA	Electric Utilities 5.8%	5,326,482
16,255,000	Enel Chile SA	Electric Utilities 2.1%	1,927,937
521,534	Forus SA	Textiles, Apparel & Luxury Goods 2.6%	2,347,496
1,935,300	Inversiones Aguas Metropolitanas SA	Water Utilities 4.0%	3,673,108
2,271,500	Parque Arauco SA	Real Estate Management & Development 7.7%	7,031,536
827,300	Quinenco SA	Industrial Conglomerates 3.1%	2,890,038
1,024,483	S.A.C.I. Falabella	Multiline Retail 11.1%	10,229,847
18,377,900	Sociedad Matriz SAAM SA	Transportation Infrastructure 2.1%	1,972,474
1,114,200	Sonda SA	Information Technology Services 2.4%	2,185,490
2,028,000	Vina Concha y Toro SA	Beverages 4.2%	3,839,162
	<b>Total Common Stocks</b>		<b>86,016,214</b>
			<b>86,016,214</b>
<b>PREFERRED STOCKS 6.1%</b>			
<b>CHILE 6.1%</b>			
76,550	Sociedad Quimica y Minera de Chile SA, ADR, Preferred Shares	Chemicals 4.9%	4,544,773
18,400	Sociedad Quimica y Minera de Chile SA, Class B, Preferred Shares	Chemicals 1.2%	1,089,828
			<b>5,634,601</b>

<b>Total Preferred Stocks</b>	<b>5,634,601</b>
<b>Total Long-Term Investments 99.7% (cost \$58,464,351)</b>	<b>91,650,815</b>

## Portfolio of Investments (concluded)

As of December 31, 2017

Shares	Description	Value (US\$)
<b>SHORT-TERM INVESTMENT 0.1%</b>		
<b>UNITED STATES 0.1%</b>		
129,276	State Street Institutional U.S. Government Money Market Fund, Institutional Class, 1.22%(d)	\$ 129,276
	<b>Total Short-Term Investment 0.1% (cost \$129,276)</b>	<b>129,276</b>
	<b>Total Investments 99.8% (cost \$58,593,627)(e)</b>	<b>91,780,091</b>
	Other Assets in Excess of Liabilities 0.2%	<b>144,061</b>
	<b>Net Assets 100.0%</b>	<b>\$ 91,924,152</b>

(a) Illiquid security.

(b) This share class contains full voting rights and no preference on dividends. The two share classes of this company are formally labeled as preferred.

(c) Fair Values are determined pursuant to procedures approved by the Fund's Board of Directors. See Note 2(a) of the accompanying Notes to Financial Statements.

(d) Registered investment company advised by State Street Global Advisors. The rate shown is the current yield as of December 31, 2017.

(e) See accompanying Notes to Financial Statements for tax unrealized appreciation/(depreciation) of securities.

ADR American Depositary Receipt

See Notes to Financial Statements.





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## Statement of Assets and Liabilities

As of December 31, 2017

### Assets

Investments, at value (cost \$58,464,351)	\$ 91,650,815
Short-term investment, at value (cost \$129,276)	129,276
Foreign currency, at value (cost \$472,451)	477,216
Cash	27,726
Receivable for investments sold	2,623,871
Interest and dividends receivable	11,686
Prepaid expenses	9,802
<b>Total assets</b>	<b>94,930,392</b>

### Liabilities

Dividends payable to common shareholders	2,168,177
Chilean repatriation taxes (Note 2)	432,619
Investment advisory fees payable (Note 3)	196,970
Administration fees payable (Note 3)	61,588
Director fees payable	27,000
Investor relations fees payable (Note 3)	9,324
Other accrued expenses	110,562
<b>Total liabilities</b>	<b>3,006,240</b>

### Net Assets

**\$ 91,924,152**

#### Composition of Net Assets:

Common stock (par value \$.001 per share) (Note 5)	\$ 9,358
Paid-in capital in excess of par	57,396,007
Accumulated net investment income	106,779
Accumulated net realized gain from investment and foreign currency transactions	1,394,218
Net unrealized appreciation on investments and other assets and liabilities denominated in foreign currencies	33,017,790

### Net Assets

**\$ 91,924,152**

Net asset value per share based on 9,357,690 shares issued and outstanding \$ 9.82(a)

(a) The NAV shown above differs from the traded NAV on December 31, 2017 due to financial statement rounding and/or financial statement adjustments.

See Notes to Financial Statements.



## Statement of Operations

For the Year Ended December 31, 2017

### Net Investment Income

#### Income

Dividends and other income (net of foreign withholding taxes of \$34,170)	\$ 2,038,508
Total Investment Income	2,038,508

#### Expenses

Investment advisory fee (Note 3)	831,141
Chilean repatriation taxes (Note 2)	273,706
Administration fee (Note 3)	174,226
Directors' fees and expenses	142,500
Legal fees and expenses	129,142
Custodian's fees and expenses	102,807
Independent auditors' fees and expenses	55,550
Reports to shareholders and proxy solicitation	47,083
Investor relations fees and expenses (Note 3)	46,016
Transfer agent's fees and expenses	27,354
Insurance expense	19,849
Miscellaneous	49,182
Total expenses	1,898,556
Less: Investor relations fee waiver (Note 3)	(6,210)
Less: Investment advisory fee waiver (Note 3)	(147,208)
Net expenses	1,745,138
Net Investment Income	293,370

### Net Realized/Unrealized Gain/(Loss) from Investments and Foreign Currency Related Transactions:

#### Net realized gain/(loss) from:

Investment transactions	3,939,454
Foreign currency transactions	28,107
	3,967,561

#### Net change in unrealized appreciation/(depreciation) on:

Investments (including \$84,283 change in Chilean taxes on unrealized gains) (Note 2)	22,443,568
Foreign currency translation	3,140
	22,446,708
Net realized and unrealized gain from investments and foreign currency translations	26,414,269
<b>Net Increase in Net Assets Resulting from Operations</b>	<b>\$26,707,639</b>

See Notes to Financial Statements.

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## Statements of Changes in Net Assets

	For the Year Ended December 31, 2017	For the Year Ended December 31, 2016
<b>Increase/(Decrease) in Net Assets</b>		
<b>Operations:</b>		
Net investment income	\$ 293,370	\$ 433,464
Net realized gain from investment and foreign currency related transactions	3,967,561	2,395,232
Net change in unrealized appreciation on investments and foreign currency translation	22,446,708	8,124,866
Net increase in net assets resulting from operations	26,707,639	10,953,562
<b>Distributions to Shareholders from:</b>		
Net investment income	(200,067)	(437,726)
Net realized gains	(1,968,109)	(2,931,727)
Tax return of capital		(572,876)
Net decrease in net assets from distributions	(2,168,176)	(3,942,329)
<b>Common Stock Transactions:</b>		
Repurchase of common stock resulting in the reduction of 0 and 28,807 shares of common stock, respectively (Note 6)		(182,648)
Change in net assets from capital transactions		(182,648)
Change in net assets resulting from operations	24,539,463	6,828,585
<b>Net Assets:</b>		
Beginning of year	67,384,689	60,556,104
<b>End of year (including accumulated net investment income/(distributions in excess of net investment income) of \$106,779 and (\$14,631), respectively)</b>	<b>\$91,924,152</b>	<b>\$67,384,689</b>

Amounts listed as are \$0 or round to \$0.

See Notes to Financial Statements.



## Financial Highlights

	For the Fiscal Years Ended December 31,				
	2017	2016	2015	2014	2013
<b>PER SHARE OPERATING PERFORMANCE(a):</b>					
Net asset value per common share, beginning of year	\$7.20	\$6.45	\$8.25	\$10.40	\$15.05
Net investment income	0.03	0.05	0.06	0.03	0.06
Net realized and unrealized gains/(losses) on investments and foreign currency transactions	2.82	1.12	(1.18)	(1.13)	(3.24)
Total from investment operations applicable to common shareholders	2.85	1.17	(1.12)	(1.10)	(3.18)
Dividends and distributions to common shareholders from:					
Net investment income	(0.02)	(0.05)	(0.04)	(0.03)	(0.18)
Net realized gains	(0.21)	(0.31)	(0.16)	(0.86)	(1.23)
Tax return of capital		(0.06)	(0.48)	(0.16)	(0.06)
Total distributions	(0.23)	(0.42)	(0.68)	(1.05)	(1.47)
Net asset value per common share, end of year	\$9.82	\$7.20	\$6.45	\$8.25	\$10.40
Market value, end of year	\$8.93	\$5.96	\$5.58	\$7.44	\$10.55
<b>Total Investment Return Based on(b):</b>					
Market value	53.54%	14.30%	(16.68%)	(21.25%)	(21.99%)
Net asset value	39.76%(c)	19.45%	(13.14%)(c)	(11.42%)(c)	(22.89%)(c)
<b>Ratio to Average Net Assets/Supplementary Data:</b>					
Net assets, end of year (000 omitted)	\$91,924	\$67,385	\$60,556	\$77,470	\$97,629
Average net assets (000 omitted)	\$79,610	\$65,918	\$71,342	\$89,231	\$125,669
Total expenses, net of fee waivers(d)	2.19%	2.40%	2.13%	2.58%(e)	1.91%
Total expenses, excluding fee waivers(d)	2.38%	2.62%	2.36%	2.78%(e)	2.09%
Total expenses, excluding Chilean taxes and net of fee waivers	1.85%	1.88%	1.86%	2.29%(e)	1.67%
Net investment income(d)	0.37%	0.66%	0.73%	0.31%(e)	0.43%
Portfolio turnover	13.06%	6.67%	1.08%	5.71%	3.79%

(a) Based on average shares outstanding.

(b) Total investment return based on market value is calculated assuming that shares of the Fund's common stock were purchased at the closing market price as of the beginning of the period, dividends, capital gains, and other distributions were reinvested as provided for in the Fund's dividend reinvestment plan and then sold at the closing market price per share on the last day of the period. The computation does not reflect any sales commission investors may incur in purchasing or selling shares of the Fund. The total investment return based on the net asset value is similarly computed except that the Fund's net asset value is substituted for the closing market value.

(c) Includes adjustments in accordance with accounting principles generally accepted in the United States of America and as such, the net asset value for financial reporting purposes and the returns based upon those net asset values may differ from the net asset value and returns based upon net asset value as reported.

(d) Ratios include the effect of Chilean taxes.



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(e) In May 2014, upon the expiration of the 2011 shelf registration, the remaining prepaid offering costs associated with the shelf registration statement were expensed as a one-time expense.

Amounts listed as are \$0 or round to \$0.

See Notes to Financial Statements.

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## Notes to Financial Statements

December 31, 2017

## 1. Organization

Aberdeen Chile Fund, Inc. (the Fund) was incorporated in Maryland on January 30, 1989 and commenced investment operations on September 27, 1989. The Fund is registered under the Investment Company Act of 1940, as amended (the 1940 Act), as a non-diversified closed-end, management investment company. The Fund trades on the NYSE MKT under the ticker symbol CH.

The Fund seeks total return, consisting of capital appreciation and income, by investing primarily in Chilean securities.

## Fund Consolidation

In October 2017, the Fund's Board of Directors and the boards of directors of seven other closed-end funds announced that they had each approved the consolidation of their respective funds (Target Funds) into the Fund, subject to several conditions including the receipt of necessary approvals by stockholders of each Target Fund. Contingent on the consolidation, the Fund would be renamed Aberdeen Emerging Markets Equity Income Fund, Inc., would invest in emerging market equity securities and would be permitted use leverage to achieve its objective. At a special meeting of shareholders held on January 26, 2018, the shareholders of the Fund approved certain proposals necessary to effectuate the Reorganizations and to change the Fund's strategy. The Letter to Shareholders contains further information about the Fund Consolidation.

## 2. Summary of Significant Accounting Policies

The Fund is an investment company and accordingly follows the investment company accounting and reporting guidance of the Financial Accounting Standards Board (FASB) Accounting Standard Codification Topic 946 Financial Services-Investment Companies. The following is a summary of significant accounting policies followed by the Fund in the preparation of its financial statements. The policies conform to generally accepted accounting principles in the United States of America (GAAP). The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses for the period. Actual results could differ from those estimates. The accounting records of the Fund are maintained in U.S. Dollars.

### a. Security Valuation:

The Fund values its securities at current market value or fair value, consistent with regulatory requirements. Fair value is defined in the Fund's Valuation and Liquidity Procedures as the price that could be received to sell an asset or paid to transfer a liability in an orderly

transaction between willing market participants without a compulsion to transact at the measurement date.

Equity securities that are traded on an exchange are valued at the last quoted sale price on the principal exchange on which the security is traded at the Valuation Time subject to application. The Valuation Time is as of the close of regular trading on the New York Stock Exchange (usually 4:00 p.m. Eastern Time). In the absence of a sale price, the security is valued at the mean of the bid/ask price quoted at the close on the principal exchange on which the security is traded. Securities traded on NASDAQ are valued at the NASDAQ official closing price. Closed-end funds and exchange-traded funds ( ETFs ) are valued at the market price of the security at the Valuation Time. A security using any of these pricing methodologies is determined to be a Level 1 investment.

Short-term investments are comprised of cash and cash equivalents invested in short-term investment funds which are redeemable daily. The Fund sweeps available cash into the State Street Institutional U.S. Government Money Market Fund, which has elected to qualify as a government money market fund pursuant to Rule 2a-7 under the 1940 Act, and has an objective, which is not guaranteed, to maintain a \$1.00 per share NAV. Generally, these investment types are categorized as Level 1 investments.

In the event that a security's market quotations are not readily available or are deemed unreliable (for reasons other than because the foreign exchange on which it trades closes before the Valuation Time), the security is valued at fair value as determined by the Fund's Pricing Committee, taking into account the relevant factors and surrounding circumstances using valuation policies and procedures approved by the Board. A security that has been fair valued by the Fund's Pricing Committee may be classified as Level 2 or Level 3 depending on the nature of the inputs.

In accordance with the authoritative guidance on fair value measurements and disclosures under GAAP, the Fund discloses the fair value of its investments using a three-level hierarchy that classifies the inputs to valuation techniques used to measure the fair value. The hierarchy assigns Level 1, the highest level, measurements to valuations based upon unadjusted quoted prices in active markets for identical assets, Level 2 measurements to valuations based upon other significant observable inputs, including adjusted quoted prices in active markets for similar assets, and Level 3, the lowest level, measurements to valuations based upon unobservable inputs that are significant to the valuation. Observable inputs are inputs that reflect the assumptions market participants would use in pricing the asset or liability, which are based on market data obtained from sources independent of the



## Notes to Financial Statements (continued)

December 31, 2017

reporting entity. Unobservable inputs are inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. A financial instrument's level within the fair value hierarchy is based upon the

lowest level of any input that is significant to the fair value measurement. The three-level 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 securities, interest rates, prepayment speeds, and credit risk); or

Level 3 significant unobservable inputs (including the Fund's own assumptions in determining the fair value of investments).

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The following is a summary of the inputs used as of December 31, 2017 in valuing the Fund's investments and other financial instruments at fair value. The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities. Please refer to the Portfolio of Investments for a detailed breakout of the security types:

<b>Investments, at Value</b>	<b>Level 1 Quoted Prices (\$)</b>	<b>Level 2 Other Significant Observable Inputs (\$)</b>	<b>Level 3 Significant Unobservable Inputs (\$)</b>	<b>Total (\$)</b>
Investments in Securities				
Common Stocks	80,835,082	5,181,132		86,016,214
Preferred Stocks	5,634,601			5,634,601
Short-Term Investment	129,276			129,276
	<b>86,598,959</b>	<b>5,181,132</b>		<b>91,780,091</b>

Amounts listed as are \$0 or round to \$0.



For movements between the Levels within the fair value hierarchy, the Fund has adopted a policy of recognizing transfers at the end of each period. During the fiscal year ended December 31, 2017, a security issued by Coca-Cola Embonor SA, Class A, at the value of \$3,830,378, transferred from Level 2 to Level 1 because the security was fair valued by the Fund's Pricing Committee on December 31, 2016 but market prices were available on December 31, 2017. For the fiscal year ended December 31, 2017, there were no significant changes to the fair valuation methodologies.

**b. Foreign Currency Translation:**

Foreign securities, currencies, and other assets and liabilities denominated in foreign currencies are translated into U.S. Dollars at the exchange rate of said currencies against the U.S. Dollar, as of the Valuation Time, as provided by an independent pricing service approved by the Board.

Foreign currency amounts are translated into U.S. Dollars on the following basis:

- (i) market value of investment securities, other assets and liabilities at the current daily rates of exchange; and
- (ii) purchases and sales of investment securities, income and expenses at the rate of exchange prevailing on the respective dates of such transactions.

The Fund does not isolate that portion of gains and losses on investments in equity securities which is due to changes in the foreign exchange rates from that which is due to changes in market prices of equity securities. Accordingly, realized and unrealized foreign currency gains and losses with respect to such securities are included in the reported net realized and unrealized gains and losses on investment transactions balances.

The Fund reports certain foreign currency related transactions and foreign taxes withheld on security transactions as components of realized gains for financial reporting purposes, whereas such foreign currency related transactions are treated as ordinary income for U.S. federal income tax purposes.

Net unrealized currency gains or losses from valuing foreign currency denominated assets and liabilities at period end exchange rates are reflected as a component of net unrealized appreciation/depreciation in value of investments, and translation of other assets and liabilities denominated in foreign currencies.

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## Notes to Financial Statements (continued)

December 31, 2017

Net realized foreign exchange gains or losses represent foreign exchange gains and losses from transactions in foreign currencies and forward foreign currency contracts, exchange gains or losses realized between the trade date and settlement date on security transactions, and the difference between the amounts of interest and dividends recorded on the Fund's books and the U.S. Dollar equivalent of the amounts actually received.

Foreign security and currency transactions may involve certain considerations and risks not typically associated with those of domestic origin, including unanticipated movements in the value of the foreign currency relative to the U.S. Dollar. Generally, when the U.S. Dollar rises in value against a foreign currency, the Fund's investments denominated in that foreign currency will lose value because the foreign currency is worth fewer U.S. Dollars; the opposite effect occurs if the U.S. Dollar falls in relative value.

**c. Rights Issues and Warrants:**

Rights issues give the right, normally to existing shareholders, to buy a proportional number of additional securities at a given price (generally at a discount) within a fixed period (generally a short-term period) and are offered at the company's discretion. Warrants are securities that give the holder the right to buy common stock at a specified price for a specified period of time. Rights issues and warrants are speculative and have no value if they are not exercised before the expiration date. Rights issues and warrants are valued at the last sale price on the exchange on which they are traded.

**d. Security Transactions, Investment Income and Expenses:**

Security transactions are recorded on the trade date. Realized and unrealized gains/(losses) from security and currency transactions are calculated on the identified cost basis. Dividend income is recorded on the ex-dividend date except for certain dividends on foreign securities, which are recorded as soon as the Fund is informed after the ex-dividend date. Interest income and expenses are recorded on an accrual basis.

**e. Distributions:**

The Fund records dividends and distributions payable to its shareholders on the ex-dividend date. The amount of dividends and distributions from net investment income and net realized capital gains are determined in accordance with federal income tax regulations, which may differ from GAAP. These book basis/tax basis differences are either considered temporary or permanent in nature. To the extent these differences are permanent in nature, such amounts 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 investment income and net realized capital gains for tax purposes are reported as return of capital.

**f. Federal Income Taxes:**

The Fund intends to continue to qualify as a regulated investment company by complying with the provisions available to certain investment companies, as defined in Subchapter M of the Internal Revenue Code of 1986, as amended, and to make distributions of net investment income and net realized capital gains sufficient to relieve the Fund from all federal income taxes. Therefore, no federal income tax provision is required.

The Fund recognizes the tax benefits of uncertain tax positions only where the position is more likely than not to be sustained assuming examination by tax authorities. Management of the Fund has concluded that there are no significant uncertain tax positions that would require recognition in the financial statements. Since tax authorities can examine previously filed tax returns, the Fund's U.S. federal and state tax returns for each of the four fiscal years up to the most recent fiscal year ended December 31 are subject to such review.

**g. Foreign Withholding Tax:**

Income received by the Fund from sources within Chile and other foreign countries may be subject to withholding and other taxes imposed by Chile and such other countries. The Fund incurs foreign Chilean taxes on income as well as realized gains generated from Chilean securities where there is little to no market presence on any of the Chilean stock exchanges. In order to have market presence, a Chilean security must have either: (i) transactions greater than or equal to 1,000 Chilean UF (Unidad de Fomentos, a unit of account used in Chile) in 25% or more of the last 180 days; or (ii) a market maker acting in accordance with General Regulation No. 327 of the Superintendencia de Valores y Seguros, the primary Chilean securities and insurance supervisor. For the fiscal year ended December 31, 2017, the Fund incurred \$273,706 of such expense. The Fund also accrues foreign Chilean taxes on securities with little to no Chilean market presence in an amount equal to what the Fund would owe if the securities were sold and the proceeds repatriated on the valuation date as a liability and reduction of unrealized gains. For the fiscal year ended December 31, 2017, the Fund accrued \$174,491 of such expense.

**h. Repurchase Agreements:**

The Fund may enter into a repurchase agreement under the terms of a Master Repurchase Agreement. It is the Fund's policy that its custodian/counterparty segregate the underlying collateral securities, the value of which exceeds the principal amount of the repurchase



## Notes to Financial Statements (continued)

December 31, 2017

transaction, including accrued interest. The repurchase price generally equals the price paid by the Fund plus interest negotiated on the basis of current short-term rates. To the extent that any repurchase transaction exceeds one business day, the collateral is valued on a daily basis to determine its adequacy. If the counterparty to a repurchase agreement defaults and the value of the collateral declines, or if bankruptcy proceedings are commenced with respect to the counterparty of the security, realization of the collateral by the Fund may be delayed or limited. Repurchase agreements are subject to contractual netting arrangements with the Fund's repurchase agreement counterparty, Fixed Income Clearing Corp. To the extent the Fund enters into repurchase agreements, additional information on individual repurchase agreements is included in the Portfolio of Investments. As of and during the fiscal year ended December 31, 2017, the Fund did not hold any repurchase agreements.

### 3. Agreements and Transactions with Affiliates

#### Merger of Aberdeen Asset Management PLC with Standard Life plc

The Fund's investment adviser and administrator are each a subsidiary of Aberdeen Asset Management PLC (Aberdeen PLC). The merger of Standard Life plc and Aberdeen PLC, announced on March 6, 2017 (Merger), closed on August 14, 2017. Aberdeen PLC became a direct subsidiary of Standard Life plc as a result of the Merger and the combined company changed its name to Standard Life Aberdeen plc. Shareholders of the Fund were not required to take any action as a result of the Merger. Following the Merger, the Fund's investment adviser and administrator each became an indirect subsidiary of Standard Life Aberdeen plc, but otherwise did not change. The investment advisory and administration agreements for the Fund, the services provided under the agreements, and the fees charged for services did not change as a result of the Merger. The portfolio management team for the Fund also did not change as a result of the Merger.

#### a. Investment Adviser:

Aberdeen Asset Managers Limited (AAML or the Adviser) serves as the Fund's investment adviser with respect to all investments. AAML is an indirect wholly-owned subsidiary of Standard Life Aberdeen plc. AAML receives, as compensation for its advisory services from the Fund, an annual fee, calculated weekly and paid quarterly, equal to 1.20% of the first \$50 million of the Fund's average weekly market value or net assets (whichever is lower), 1.15% of amounts from \$50-100 million, 1.10% of amounts from \$100-150 million, 1.05% of amounts from \$150-200 million and 1.00% of amounts over \$200 million. AAML has also agreed to contractually waive 0.21% of its annual advisory fee in an advisory fee waiver agreement (Waiver Agreement). The Waiver

Agreement may not be terminated prior to the end of the current term of the advisory agreement without the prior approval of the Fund's Board of Directors, including a majority of the Directors of the Fund who are not interested persons, as such term is defined in the 1940 Act (the Independent Directors). For the fiscal year ended December 31, 2017, AAML earned \$831,141 for advisory services, of which it waived \$147,208 pursuant to the Waiver Agreement.

#### b. Fund Administration:

Aberdeen Asset Management Inc. (AAMI), an affiliate of the Adviser, is the Fund's administrator, pursuant to an agreement under which AAMI receives a fee paid by the Fund, at an annual fee rate of 0.08% of the Fund's average monthly net assets. For the



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fiscal year ended December 31, 2017, AAMI earned \$28,639 from the Fund for administration services. (This fee is the net amount paid to AAMI adjusted for the portion paid to BTG Pactual Chile as described below).

BTG Pactual Chile S.A. Administradora de Fondos de Inversion de Capital Extranjero (formerly, Celfin Capital S.A. Administradora de Fondos de Capital Extranjero) ( BTG Pactual Chile ) serves as the Fund's Chilean administrator. For its services, BTG Pactual Chile is paid a fee out of the administration fee payable to AAMI, calculated weekly and paid quarterly at an annual rate of 0.05% of the Fund's average weekly market value or net assets (whichever is lower). In addition, BTG Pactual Chile receives a supplemental administration fee, annual reimbursement of out of pocket expenses and an accounting fee from the Fund. For the fiscal year ended December 31, 2017, the administration fees, supplemental administration fees and accounting fees earned by BTG Pactual Chile amounted to \$35,049, \$102,167 and \$8,371, respectively.

### c. Investor Relations:

Under the terms of the Investor Relations Services Agreement, AAMI provides and/or engages third parties to provide investor relations services to the Fund and certain other funds advised by AAMI or its affiliates as part of an Investor Relations Program. Under the Investor Relations Services Agreement, the Fund owes a portion of the fees related to the Investor Relations Program (the Fund's Portion ). However, investor relations services fees are limited by AAMI so that the Fund will only pay up to an annual rate of 0.05% of the Fund's average weekly net assets. Any difference between the capped rate of 0.05% of the Fund's average weekly net assets and the Fund's Portion is paid for by AAMI.

Pursuant to the terms of the Investor Relations Services Agreement, AAMI (or third parties hired by AAMI), among other things, provides

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## Notes to Financial Statements (continued)

December 31, 2017

objective and timely information to shareholders based on publicly-available information; provides information efficiently through the use of technology while offering shareholders immediate access to knowledgeable investor relations representatives; develops and maintains effective communications with investment professionals from a wide variety of firms; creates and maintains investor relations communication materials such as fund manager interviews, films and webcasts, published white papers, magazine articles and other relevant materials discussing the Fund's investment results, portfolio positioning and outlook; develops and maintains effective communications with large institutional shareholders; responds to specific shareholder questions; and reports activities and results to the Board and management detailing insight into general shareholder sentiment.

During the fiscal year ended December 31, 2017, the Fund incurred investor relations fees of approximately \$46,016 of which AAMI waived \$6,210 for investor relations services.

#### d. Directors Purchase Plan:

Fifty percent (50%) of the annual retainer of the Independent Directors is invested in Fund shares and, at the option of each Independent Director, up to 100% of the annual retainer can be invested in shares of the Fund. During the fiscal year ended December 31, 2017, 4,987 shares were purchased pursuant to the Directors' compensation plan. As of December 31, 2017, the Directors as a group owned less than 1% of the Fund's outstanding shares.

#### 4. Investment Transactions

Purchases and sales of investment securities (excluding short-term securities) for the fiscal year ended December 31, 2017, were \$10,252,556 and \$11,990,395, respectively.

#### 5. Capital

The authorized capital of the Fund is 100 million shares of \$0.001 par value per share of common stock. As of December 31, 2017, there were 9,357,690 shares of common stock issued and outstanding.

#### 6. Open Market Repurchase Program

The Board has authorized, but does not require, Fund management to make open market purchases from time to time in an amount up to 10% of the Fund's outstanding shares, in accordance with Rule 10b-18 under the Securities Exchange Act of 1934, as amended (the Exchange Act), and other applicable federal securities laws. Such purchases may be made when, in the reasonable judgment of Fund management, such repurchases may enhance shareholder value. The Fund reports repurchase activity on the Fund's website on a monthly basis. For the fiscal year ended December 31, 2017, the Fund did not repurchase any shares and for the fiscal year ended December 31, 2016, the Fund repurchased 28,807 shares through this program. On December 12,

2017, consistent with Regulation M, which prohibits funds from purchasing its shares during a restricted period following the announcement of a tender offer by that fund, the Fund's Board of Directors approved a suspension of the Fund's open market repurchase program until the anticipated tender offer on the Fund following the proposed fund consolidation.

## 7. Portfolio Investment Risks

### a. Risks Associated with Foreign Securities and Currencies

Investments in securities of foreign issuers carry certain risks not ordinarily associated with investments in securities of U.S. issuers. These risks include future political and economic developments, and the possible imposition of exchange controls or other foreign governmental laws and restrictions. In addition, with respect to certain countries, there is the possibility of expropriation of assets, confiscatory taxation, and political or social instability or diplomatic developments, which could adversely affect investments in those countries.

Certain countries also may impose substantial restrictions on investments in their capital markets by foreign entities, including restrictions on investments in issuers of industries deemed sensitive to relevant national interests. These factors may limit the investment opportunities available and result in a lack of liquidity and high price volatility with respect to securities of issuers from developing countries. Foreign securities may also be harder to price than U.S. securities.

The value of foreign currencies relative to the U.S. Dollar fluctuates in response to market, economic, political, regulatory, geopolitical or other conditions. A decline in the value of a foreign currency versus the U.S. Dollar reduces the value in U.S. Dollars of investments denominated in that foreign currency. This risk may impact the Fund more greatly to the extent the Fund does not hedge its currency risk, or hedging techniques used by the Adviser are unsuccessful.

### b. Risks Associated with Chilean Markets

Investments in Chile may involve certain considerations and risks not typically associated with investments in the United States, including the possibility of future political and economic developments and the level of Chilean governmental supervision and regulation of its securities markets.

The Chilean securities markets are substantially smaller, less liquid and more volatile than the major securities markets in the United States. Consequently, acquisition and disposition of securities by the Fund may be inhibited. A significant proportion of the aggregate market value of equity securities listed on the Santiago Exchange are held by a small number of investors and are not publicly traded. This may limit the number of shares available for acquisition or disposition by the Fund.



## Notes to Financial Statements (continued)

December 31, 2017

### c. Sector Risk

To the extent that the Fund has a significant portion of its assets invested in securities of companies conducting business in a broadly related group of industries within an economic sector, the Fund may be more vulnerable to unfavorable developments in that economic sector than funds that invest more broadly.

In particular, being invested heavily in the financial sector may make the Fund vulnerable to risks and pressures facing companies in that sector, such as regulatory, consolidation, interest rate changes and general economic conditions.

### d. Consumer Staples Sector Risk

To the extent the consumer staples sector represents a significant portion of the Fund, the Fund will be sensitive to changes in, and its performance may depend to a greater extent on, factors impacting this sector. The consumer staples sector may be affected by the regulation of various product components and production methods, marketing campaigns and other factors affecting consumer demand. Tobacco companies, in particular, may be adversely affected by new laws, regulations and litigation. The consumer staples sector may also be adversely affected by changes or trends in commodity prices, which may be influenced by unpredictable factors.

### e. Valuation Risk

The price that the Fund could receive upon the sale of any particular portfolio investment may differ from the Fund's valuation of the

investment, particularly for securities that trade in thin or volatile markets or that are valued using a fair valuation methodology or a price provided by an independent pricing service. As a result, the price received upon the sale of an investment may be less than the value ascribed by the Fund, and the Fund could realize a greater than expected loss or lower than expected gain upon the sale of the investment. The Fund's ability to value its investments may also be impacted by technological issues and/or errors by pricing services or other third-party service providers.

## 8. Contingencies

In the normal course of business, the Fund may provide general indemnifications pursuant to certain contracts and organizational documents. The Fund's maximum exposure under these arrangements is dependent on future claims that may be made against the Fund, and therefore, cannot be estimated; however, based on experience, the risk of loss from such claims is considered remote.



9. Tax Information

The U.S. federal income tax basis of the Fund's investments (including derivatives, if applicable) and the net unrealized appreciation as of December 31, 2017 were as follows:

<b>Tax Basis of Investments</b>	<b>Appreciation</b>	<b>Depreciation</b>	<b>Net Unrealized Appreciation</b>
\$59,170,755	\$34,152,094	\$(1,542,758)	\$32,609,336

Income and capital gains distributions are determined in accordance with federal income tax regulations, which may differ from GAAP. The tax character of distributions paid during the fiscal years ended December 31, 2017 and December 31, 2016 was as follows:

	December 31, 2017	December 31, 2016
Distributions paid from:		
Ordinary Income	\$200,067	\$437,726
Net long-term capital gains	1,968,109	2,931,727
Tax return of capital		572,876
<b>Total tax character of distributions</b>	<b>\$2,168,176</b>	<b>\$3,942,329</b>

## Notes to Financial Statements (continued)

December 31, 2017

As of December 31, 2017, the components of accumulated earnings on a tax basis were as follows:

Undistributed ordinary income net	\$324,898
Undistributed long-term capital gains net	1,971,345
Total undistributed earnings	\$2,296,243
Capital loss carryforward	
Other temporary differences	(218,119)
Unrealized appreciation/(depreciation)	32,440,663*
<b>Total accumulated earnings/(losses) net</b>	<b>\$34,518,787</b>

\* The tax basis of components of distributable earnings differs from the amounts reflected in the Statement of Assets and Liabilities by temporary book/tax differences. These differences are primarily timing differences due to dividends payable and wash sales.

GAAP requires that certain components of net assets be adjusted to reflect permanent differences between financial and tax reporting. Accordingly, the table below details the necessary reclassifications, which are a result of permanent differences primarily attributable to foreign currency gains and losses. These reclassifications have no effect on net assets or NAVs per share.

<b>Accumulated Net Investment Income</b>	<b>Accumulated Net Realized Gain on Investments and Foreign Currency Transactions</b>
\$28,107	\$(28,107)

## 10. Subsequent Events

Management has evaluated the need for disclosures and/or adjustments resulting from subsequent events through the date the financial statements were issued. Based on this evaluation, no disclosures and/or adjustments were required to the financial statements as of December 31, 2017, other than as noted below.

In October 2017, the Fund's Board of Directors and the boards of directors of seven other closed-end funds announced that they had each approved the consolidation of their respective funds (the Target Funds) into the Fund, subject to the receipt of necessary approvals by

stockholders of each of the Target Funds. The Fund would serve as the acquiring fund and would, contingent on the consolidation, change its investment strategy to a multi-cap emerging markets equity income investment strategy that utilizes leverage and would be renamed Aberdeen Emerging Markets Equity Income Fund, Inc. At a special meeting of shareholders of the Fund held on January 26, 2018, the shareholders of the Fund approved certain proposals necessary to effectuate the reorganizations and the change in the Fund's strategy, including the following: (i) an amendment to the Fund's Articles of Incorporation to increase the total number of shares of capital stock; (ii) the issuance of additional shares of common stock of the Fund in connection with the potential reorganizations of certain other closed-end funds into the Fund; (iii) the elimination of the Fund's fundamental investment policy to invest primarily in Chilean securities; (iv) an amendment to the Fund's fundamental investment restriction relating to borrowing; and (v) an amendment to the Fund's Investment Advisory Agreement to provide that fees payable thereunder will be calculated at a lower annual rate based solely on net assets. Additionally, at an annual meeting of shareholders of the Fund held on January 26, 2018, Fund shareholders approved the election of three Directors to the Board of Directors of the Fund, to serve contingent upon the reorganization of the Target Fund for which such Director currently serves as a director. Below is a summary of the changes that the Fund would implement in connection with, and contingent upon, the reorganization with the Target Funds into one combined fund (the Combined Fund).



## Notes to Financial Statements (concluded)

December 31, 2017

	<b>Current Fund</b>	<b>Combined Fund</b>
<b>Fund Name</b>	Aberdeen Chile Fund, Inc.	Aberdeen Emerging Markets Equity Income Fund, Inc.
<b>Ticker</b>	CH	AEF
<b>Exchange</b>	NYSE American (formerly known as NYSE MKT)	NYSE American (formerly known as NYSE MKT)
<b>Investment objective</b>	The Fund seeks total return, consisting of capital appreciation and income, by investing primarily in Chilean securities.	The Fund seeks to provide both current income and long-term capital appreciation.
<b>80% investment policy</b>	Under normal market conditions, substantially all, but not less than 80%, of the Fund's net assets will be invested in Chilean securities.	Under normal market conditions, the Fund will invest at least 80% of its net assets (plus any borrowings for investment purposes) in emerging markets equity securities.
<b>Leverage Restriction</b>	The Fund may not issue senior securities, borrow or pledge its assets, except that the Fund may borrow from a bank for temporary or emergency purposes in amounts not exceeding 5% (taken at the lower of cost or current value) of its total assets (not including the amount borrowed) and may also pledge its assets to secure such borrowings; provided that the Fund may borrow from a bank an amount not exceeding 33 1/3% of its total assets (not including the amount borrowed) for the purpose of (a) obtaining amounts necessary to make distributions for qualification as a registered investment company or to avoid imposition of an excise tax under United States tax laws and (b) to pay Fund expenses outside Chile, and not for the purpose of leveraging. Additional investments may not be made when borrowings exceed 5% of the Fund's total assets.	The Fund may not borrow money or issue senior securities, except that the Fund may enter into reverse repurchase agreements and may otherwise borrow money and issue senior securities as and to the extent permitted by the 1940 Act or any rule, order or interpretation thereunder.
<b>Benchmark</b>	Morgan Stanley Capital International Chile Index	Morgan Stanley Capital International Emerging Markets Index
<b>AUM/Pro Forma AUM as of August 31, 2017</b>	\$85.9 million	\$880.6 million
<b>Number of authorized shares</b>	100 million	1 billion
<b>Advisory fee</b>	<ul style="list-style-type: none"> <li>• 1.20% of the first \$50 million of the Fund's average weekly market value or net assets (whichever is lower);</li> <li>• 1.15% on amounts from \$50 - \$100 million;</li> <li>• 1.10% on amounts from \$100 - \$150 million;</li> </ul>	<ul style="list-style-type: none"> <li>• 0.90% of the first \$250 million of the Fund's average weekly net assets;</li> <li>• 0.80% on the next \$250 million; and</li> <li>• 0.75% on amounts above \$500 million.</li> </ul>

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	<ul style="list-style-type: none"> <li>• 1.05% on amounts from \$150 - \$200 million;</li> <li>• 1.00% on amounts above \$200 million.</li> </ul>	
<p><b>Advisory fee waiver/expense limitation</b></p>	<p>The investment adviser has agreed to waive 0.21% of its annual advisory fee, which may not be terminated prior to the end of the current term of the advisory agreement without the prior approval of the Fund's Independent Directors.</p>	<p>The investment adviser has agreed to cap total operating expenses at 1.20% (excluding leverage costs, taxes, interest, brokerage commissions and any non-routine expenses) for two years from the date of the first Reorganization closing. If certain circumstances are met, the Fund's investment adviser may be able to recoup some or all of these waived fees for up to three years following the waiver.</p>
<p><b>Board of Directors</b></p>	<p>James Cattano, Lawrence Fox and Steven Rappaport</p>	<p>James Cattano, Lawrence Fox, Steven Rappaport, Nancy Yao Maasbach, William Maher and Rahn Porter</p>

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of  
Aberdeen Chile Fund, Inc.:

### *Opinion on the Financial Statements*

We have audited the accompanying statement of assets and liabilities of Aberdeen Chile Fund, Inc. (the Fund), including the portfolio of investments, as of December 31, 2017, the related statement of operations for the year then ended, the statement of changes in net assets for the year then ended, and the related notes (collectively, the financial statements) and the financial highlights for the year then ended. In our opinion, the financial statements and financial highlights present fairly, in all material respects, the financial position of the Fund as of December 31, 2017, the results of its operations for the year then ended, the changes in its net assets for the year then ended, and the financial highlights for the year then ended, in conformity with U.S. generally accepted accounting principles. The statement of changes in net assets for the year ended December 31, 2016 and the financial highlights for each of the years in the four-year period ended December 31, 2016, were audited by other independent registered public accountants whose report, dated February 27, 2017, expressed an unqualified opinion on that financial statement and financial highlights.

### *Basis for Opinion*

These financial statements and financial highlights are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audit. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Fund in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement, whether due to error or fraud. Our audit included performing procedures to assess the risks of material misstatement of the financial statements and financial highlights, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements and financial highlights. Such procedures also included confirmation of securities owned as of December 31, 2017, by correspondence with the custodian. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and financial highlights. We believe that our audit provides a reasonable basis for our opinion.



We have served as the auditor of one or more Aberdeen investment companies since 2009.

Philadelphia, Pennsylvania  
February 27, 2018

## Federal Tax Information: Dividends and Distributions (unaudited)

The following information is provided with respect to the distributions paid by the Fund during the fiscal year ended December 31, 2017:

<b>Payable Date</b>	<b>Total Cash Distribution</b>	<b>Long-Term Capital Gain</b>	<b>Tax Return of Capital</b>	<b>Net Ordinary Dividend</b>	<b>Foreign Taxes Paid(1)</b>	<b>Gross Ordinary Dividend</b>	<b>Qualified Dividends(2)</b>	<b>Foreign Source Income</b>
1/8/2018	0.231700	0.210320		0.021380	0.009592	0.030972	0.017857	0.030947

(1) The foreign taxes paid represent taxes incurred by the Fund on interest received from foreign sources. Foreign taxes paid may be included in taxable income with an offsetting deduction from gross income or may be taken as a credit for taxes paid to foreign governments. You should consult your tax advisor regarding the appropriate treatment of foreign taxes paid.

(2) The Fund hereby designates the amount indicated above or the maximum amount allowable by law.

## Supplemental Information (unaudited)

### Board Approval of Investment Advisory Agreement

The Investment Company Act of 1940 (the 1940 Act ) and the terms of the investment advisory agreement (the Advisory Agreement ) between the Aberdeen Chile Fund, Inc. (the Fund ) and Aberdeen Asset Managers Limited (the Adviser or AAML ) require that the Advisory Agreement be approved annually at an in-person meeting by the Board of Directors (the Board ), including a majority of the Directors who have no direct or indirect interest in the Advisory Agreement and are not interested persons of the Fund, as defined in the 1940 Act (the Independent Directors ).

At its in-person meeting on December 12, 2017 (the Meeting ), the Board voted unanimously to renew the Advisory Agreement between the Fund and the Adviser. In considering whether to approve the renewal of the Fund's Advisory Agreement, the Board members received and considered a variety of information provided by the Adviser relating to the Fund, the Advisory Agreement and the Adviser, including comparative performance, fee and expense information of a peer group of funds selected by Strategic Insight Mutual Fund Research and Consulting, LLC ( SI ), an independent third-party provider of investment company data, performance information for relevant benchmark indices and other information regarding the nature, extent and quality of services provided by the Adviser under the Advisory Agreement. The Board's materials for the Meeting also included: (i) information on the investment performance of the Fund and the performance of a peer group of funds and the Fund's performance benchmark; (ii) information on the Fund's advisory fees and other expenses, including information comparing the Fund's expenses to those of a peer group of funds and information about any applicable expense limitations and fee breakpoints ; (iii) information about the

profitability of the Advisory Agreement to the Adviser; (iv) a report prepared by the Adviser in response to a request submitted by the Independent Directors' independent legal counsel on behalf of such Directors; and (v) a memorandum from the Independent Directors' independent legal counsel on the responsibilities of the Board of Directors in considering approval of the investment advisory arrangement under the 1940 Act and Maryland law.

The Independent Directors were advised by separate independent legal counsel throughout the process. The Independent Directors also consulted in executive sessions with counsel to the Independent Directors regarding consideration of the renewal of the Advisory Agreement. In considering whether to approve the continuation of the Advisory Agreement, the Board, including the Independent Directors, did not identify any single factor as determinative. Individual Directors may have evaluated the information presented differently from one another, giving different weights to various factors. Matters considered by the Board, including the Independent Directors, in connection with its approval of the continuation of the Advisory Agreement included the factors listed below.

The Board also considered other matters such as: (i) the Adviser's financial results and financial condition, (ii) the Fund's investment objective and strategy, (iii) the Adviser's investment personnel and operations, (iv) the procedures employed to determine the value of the Fund's assets, (v) the allocation of the Fund's brokerage, and the use, if any, of soft commission dollars to pay the Fund's expenses and to pay for research and other similar services, (vi) the resources devoted to, and the record of compliance with, the Fund's investment policies and restrictions, policies on personal securities transactions and other compliance policies, and (vii) possible conflicts of interest.

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**Supplemental Information** (unaudited) (continued)

Throughout the process, the Board members were afforded the opportunity to ask questions of and request additional information from management.

In addition to the materials requested by the Board in connection with its consideration of the renewal of the Advisory Agreement, it was noted that the Board received materials in advance of each regular quarterly meeting that provided information relating to the services provided by the Adviser.

As part of their deliberations, the Board members considered the following:

*The nature, extent and quality of the services provided to the Fund under the Advisory Agreement.* The Board considered the nature, extent and quality of the services provided by the Adviser to the Fund and the resources dedicated to the Fund by the Adviser and its affiliates. The Board reviewed, among other things, the Adviser's investment experience. The Board received information regarding the Adviser's compliance with applicable laws and Securities and Exchange Commission and other regulatory inquiries or audits of the Fund and the Adviser. The Board also considered the background and experience of the Adviser's senior management personnel and the qualifications, background and responsibilities of the portfolio managers primarily responsible for the day-to-day portfolio management services for the Fund. In addition, the Board considered the financial condition of the Adviser and the Adviser's ability to provide a high level and quality of service to the Fund. The Board also considered information received from the Fund's Chief Compliance Officer regarding the Adviser's compliance policies and procedures. The Board also took into account the Adviser's risk management processes. The Board considered the Adviser's brokerage policies and practices. Management reported to the Board on, among other things, its business activities and organizational changes. The Directors also took into account their knowledge of management and the quality of the performance of management's duties through Board meetings, discussion and reports during the preceding year.

*Investment performance of the Fund and the Adviser.* The Board received and reviewed with management, among other performance data, information compiled by SI as to the Fund's total return, as compared to the funds in the Fund's Morningstar category (the Morningstar Group).

The Board received and considered: information for the Fund's total return on a gross and net basis and relative to the Fund's benchmark; the Fund's share performance and premium/discount information; and

the impact of foreign currency movements on the Fund's performance. The Board also received and reviewed information as to the Fund's total return against its Morningstar Group average and other comparable Aberdeen-managed funds and segregated accounts. The Board considered management's discussion of the factors contributing to differences in performance, including differences in the investment strategies of each of these other funds and accounts. The Board also reviewed information as to the Fund's discount/premium ranking relative to its Morningstar Group. The Board took into account management's discussion of the Fund's performance.

*The costs of the services provided and profits realized by the Adviser and its affiliates from their relationships with the Fund.* The Board reviewed with management the effective annual management fee rate paid by the Fund to the Adviser for investment management services. Additionally, the Board received and considered information compiled at the request of the Fund by SI, comparing the Fund's effective annual management fee rate with the fees paid by a peer group consisting of other comparable closed-end funds (the Peer Group). The Board also took into account the management fee structure, including that management fees for the Fund were based on the Fund's total managed assets. Management noted that due to the unique strategy and structure of the Fund, Aberdeen currently does not have any closed-end funds that are directly comparable to the Fund.

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Management provided to the Board the annual fee schedules, payable monthly, for each US closed-end, country-specific equity fund managed by AAML. Although there were no other substantially similar Aberdeen-advised US vehicles against which to compare advisory fees, the Adviser provided information for other Aberdeen products with similar investment strategies to those of the Fund where available. In evaluating the Fund's advisory fees, the Board took into account the demands, complexity and quality of the investment management of the Fund.

In addition to the foregoing, the Board considered the Fund's fees and expenses as compared to its Peer Group, consisting of closed-end funds in the Fund's Morningstar expense category as compiled by SI.

*Economies of Scale.* The Board took into account management's discussion of the Fund's management fee structure. The Board determined that the management fee structure for the Fund was reasonable and reflected economies of scale being shared between each of the Fund and the Adviser and that an increase in the size of the Fund's portfolio would add to these economies of scale. This determination was based on various factors, including that the Fund's management fee schedule provides breakpoints at higher asset levels





## Supplemental Information (unaudited) (concluded)

to adjust for anticipated economies in the event of asset increase, and how the Fund's management fees compare relative to its Peer Group at higher asset levels.

The Board also considered other factors, which included but were not limited to the following:

- the effect of any market and economic volatility on the performance, asset levels and expense ratios of the Fund.
- whether the Fund has operated in accordance with its investment objective, the Fund's record of compliance with its investment restrictions, and the compliance programs of the Adviser.
- the nature, quality, cost and extent of administrative services performed by Aberdeen Asset Management Inc. ( AAMI ), an affiliate of the Adviser, under a separate agreement covering administrative services.
- so-called "fallout benefits" to the Adviser or AAMI, such as the benefits of research made available to AAMI by reason of brokerage commissions generated by the Fund's securities transactions or reputational and other indirect benefits. The Board considered any possible conflicts of interest associated with these fallout and other benefits, and the reporting, disclosure and other processes in place to disclose and monitor such possible conflicts of interest.

\* \* \*

Based on their evaluation of all factors that they deemed to be material, including those factors described above, and assisted by the advice of independent counsel, the Directors, including the Independent Directors, concluded that renewal of the Advisory Agreement would be in the best interest of the Fund and its shareholders. Accordingly, the Board, and the Board's Independent Directors voting separately, approved the Fund's Advisory Agreement for an additional one-year period.



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## Management of the Fund (unaudited)

The names of the Directors and Officers of the Fund, their addresses, years of birth, and principal occupations during the past five years are provided in the tables below. Directors that are deemed interested persons (as that term is defined in Section 2(a)(19) of the Investment Company Act of 1940, as amended) of the Fund or the Fund's investment adviser are included in the table below under the heading Interested Directors. Directors who are not interested persons, as described above, are referred to in the table below under the heading Independent Directors.

### Board of Directors Information

Name, Address and Year of Birth	Position(s) Held With the Fund	Term of Office and Length of Time Served	Principal Occupation(s) During Past Five Years	Number of Funds in Fund Complex* Overseen by Director	Other Directorships Held by Director
<u>Independent Directors</u>					
					\$ (155,491,268) \$ (531,384)

The accompanying notes are an integral part of the consolidated financial statements.

## PALIGENT INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the years ended December 31,		
	2005	2004	2003
Cash flows from operating activities:			
Net loss	\$ (303,884)	\$ (105,691)	\$ (188,621)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	941	1,872	65,940
Loss on sale of property and equipment			14,263
Write-off of security deposits		9,543	68,039
Write-down of accrued rent		(114,600)	
Reserve for subtenant receivable and accrued interest		47,250	
Deferred charges			16,442
Reduction in capital lease obligation			(7,225)
Deferred rent		(22,262)	(10,080)
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets		(2,250)	94
Subtenant receivable	30,000	50,000	(125,000)
Accounts payable	(45,369)	(74,249)	28,034
Accrued expenses	5,533	(16,247)	(41,097)
Interest payable to related party	28,072	2,101	1,189
Security deposit payable			(20,000)
Accrued rent		114,600	
Net cash used in operating activities	(284,707)	(109,933)	(198,022)
Cash flows from investing activities:			
Proceeds from sales of assets		10,000	
Net cash provided by investing activities		10,000	
Cash flows from financing activities:			
Proceeds from related party loan	315,000	465,000	140,000
Payments on related party loan		(375,000)	(30,000)
Principal payments on capital lease obligations		(10,000)	(23,703)
Net cash provided by financing activities	315,000	80,000	86,297
Net increase (decrease) in cash and cash equivalents	30,293	(19,933)	(111,725)
Cash and cash equivalents at beginning of year	21,388	41,321	153,046
Cash and cash equivalents at end of year	\$ 51,681	\$ 21,388	\$ 41,321
Supplemental disclosure of cash flow information:			
Cash paid during the year:			
Interest	\$ 2,208	\$ 23,257	\$ 7,326

The accompanying notes are an integral part of the consolidated financial statements.

**PALIGENT INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 NATURE OF BUSINESS**

Paligent Inc., together with its subsidiaries (collectively, Paligent or the Company), is presently seeking business opportunities to maximize value for its stockholders. The Company has evaluated various strategic alternatives, including acquisitions of new operating businesses and technologies as well as potential merger opportunities.

From its inception in 1985 through 1999, Paligent operated, under the name Procept, Inc., as a biotechnology company engaged in the development and commercialization of novel drugs with a product portfolio focused on infectious diseases and oncology. During 1999, the Company's principal efforts were devoted to drug development and human clinical trials focusing on two biotechnology compounds, PRO 2000 Gel and O6-Benzylguanine (O6-BG). During fiscal 2000, the Company closed its research facilities and out-licensed PRO 2000 Gel and O6-BG. In September 2004, the Company transferred all of its rights, title and interest in PRO 2000 Gel pursuant to an option duly exercised by its sublicensee and in March 2005 the Company assigned all of its rights, interests and obligations in O6-BG to an affiliate of its sublicensee.

In January 2000, the Company acquired Heavenly's Door Corporation (HDC), a company that provided products and services over the Internet. Effective with the acquisition of HDC, the Company's name was changed from Procept, Inc. to HeavenlyDoor.com, Inc. and the Company's subsidiary, Pacific Pharmaceuticals, Inc., was renamed Procept, Inc. (hereinafter referred to as Procept). Following the acquisition of HDC, the Company operated this Internet venture until the fourth quarter of 2000, at which time the Company discontinued the pursuit of its Internet strategy after a sustained period of deterioration in the Internet and technology sectors and related capital markets. Shortly thereafter, the Company entered into an agreement to sell all of its Web-based assets and Internet operations, including the name HeavenlyDoor.com, and ceased its Internet activities. In connection with this agreement, the Company's name was again changed, on December 31, 2000, from HeavenlyDoor.com, Inc. to Paligent Inc.

Since 2001, the Company has been engaged in seeking business opportunities to maximize value for its shareholders. During this time, the Company entered into several letters of intent that proposed the acquisition or merger of business ventures, including enterprises controlled by Richard J. Kurtz, the principal stockholder of the Company. The Company conducted significant due diligence in connection with these proposed transactions as well as preliminary due diligence relating to other proposed business combinations. However, the Company ultimately determined not to proceed with any of such transactions and continues to evaluate various strategic alternatives, including acquisitions of new operating businesses and technologies as well as potential merger opportunities.

On July 1, 2003, the Company executed a non-binding letter of intent to acquire privately held Digital Products of Delaware, Inc. (Digital), a company engaged in providing electronic monitoring products and services to the criminal justice and corrections industry. The Company proposed to acquire all of the issued and outstanding stock of Digital in consideration of the issuance of shares of common stock of the Company such that the stockholders of Digital would own 80% of the outstanding stock of the post-acquisition company. Mr. Kurtz was then the principal stockholder of Digital. In January 2004, the Company announced that the contemplated Digital acquisition was being indefinitely postponed due to Digital's need to focus on meeting certain business demands which would hinder its ability to conclude the business combination with the Company. During 2005, the Company renewed its efforts to consummate a business combination with Digital, which included monitoring Digital's progress in





implementing its business plan. In January 2006, Mr. Kurtz sold his interest in Digital. As a result, the Company is no longer pursuing a transaction with Digital.

Since inception, the Company has generated no revenue from product sales or services, has not been profitable, and has incurred an accumulated deficit of \$155.5 million. As the Company continues to evaluate various strategic alternatives in its quest for new growth areas that will maximize value to existing stockholders, the Company expects to incur additional losses.

## **NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### **Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of the Company and all of its subsidiaries, which are wholly owned. All significant intercompany accounts and transactions have been eliminated in consolidation.

### **Risks and Uncertainties**

The accompanying consolidated financial statements have been prepared on a going concern basis which contemplates the realization of assets and the satisfaction of liabilities in the ordinary course of business. The Company has incurred losses from operations since inception, has working capital and stockholders' deficits and has limited cash to fund operations in 2006. Since disposing of its Internet assets and related operations in December 2000, the Company has significantly reduced its operating costs. The Company is presently relying on borrowings from its principal stockholder to fund continuing operations. The stockholder has made no commitment to continue to make loans to the Company. While the Company evaluates strategic alternatives, including potential business investments and related financing, the Company's rate of spending could vary from its current estimate. No assurance can be given that the Company will be able to complete a business investment or that such financing will be available to the Company. If the Company is unable to generate significant revenue from acquired operations, secure additional financing for its present operations, obtain financing from its principal stockholder or secure sufficient financing for operations resulting from acquisition or merger, the Company will experience a cash shortage in 2006, the effect of which could result in the discontinuance of operations. If additional funds are raised by issuing equity securities, further dilution to existing stockholders will result and future investors may be granted rights superior to those of existing stockholders.

These circumstances raise substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

### **Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### **Cash and Cash Equivalents**

The Company considers all short-term investments purchased with an original maturity of three months or less at the date of acquisition to be cash equivalents. The Company invests its excess cash in money market instruments. Cash and cash equivalents are, at times, maintained at financial institutions in amounts that exceed federally insured limits.

### **Property and Equipment**

Property and equipment is recorded at cost and depreciated on a straight-line basis over the following estimated useful lives:

Office equipment	3-5 years
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Major additions and improvements are capitalized, while repairs and maintenance are expensed as incurred. Upon retirement or other disposition, the cost and related accumulated depreciation are removed from the accounts and the resulting gain or loss is included in the determination of net loss.

### **Impairment or Disposal of Long-Lived Assets**

The Company accounts for long-lived assets under Statement of Financial Accounting Standards No. ( FAS ) 144, Accounting for the Impairment or Disposal of Long-Lived Assets which requires the Company to review for impairment of long-lived assets, whenever events or changes in circumstances indicate that the carrying amount of an asset might not be recoverable. When such an event occurs, management determines whether there has been an impairment by comparing the anticipated undiscounted future net cash flows to the related asset's carrying value. If an asset is considered impaired, the asset is written down to fair value, which is determined based either on discounted cash flows or appraised value, depending on the nature of the asset.

Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

### **Income Taxes**

The Company accounts for income taxes under FAS 109, Accounting for Income Taxes utilizing the liability method, which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. A valuation allowance

is provided for net deferred tax assets if, based on the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

**Revenue Recognition**

Interest income is recognized as earned.

### **Fair Value of Financial Instruments**

The fair values of the Company's assets and liabilities that qualify as financial instruments under FAS 107, Disclosures about Fair Value of Financial Instruments, approximate their carrying amounts as presented in the accompanying consolidated balance sheets at December 31, 2005 and 2004.

### **Basic and Diluted Net Loss Per Common Share**

The Company computes and presents its earnings per share in accordance with FAS 128, Earnings Per Share. Basic earnings per share (EPS) excludes dilution and is computed by dividing (loss) income applicable to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS is based upon the weighted average number of common shares outstanding during the period plus the additional weighted average common equivalent shares during the period. Common equivalent shares are not included in the per share calculations where the effect of their inclusion would be anti-dilutive. Inherently, stock options and warrants are deemed to be anti-dilutive when the average market price of the common stock during the period exceeds the exercise price of the stock options or warrants. Common equivalent shares result from the assumed exercises of outstanding stock options and warrants, the proceeds of which are then assumed to have been used to repurchase outstanding shares of common stock (the treasury stock method).

For the years ended December 31, 2005, 2004 and 2003, the Company had stock options and warrants outstanding that were anti-dilutive. These securities could potentially dilute basic EPS in the future and were not included in the computation of diluted EPS because to do so would have been anti-dilutive for the periods presented. Consequently, there were no differences between basic and diluted EPS for these periods.

### **New Accounting Standards**

In December 2004, the Financial Accounting Standards Board (FASB) issued FAS 123R, Share-Based Payment. FAS 123R is a revision of FAS 123, Accounting for Stock Based Compensation, and supersedes Accounting Principles Board Opinion No. (APB) 25. Among other items, FAS 123R eliminates the use of APB 25 and the intrinsic value method of accounting, and requires companies to recognize the cost of employee services received in exchange for awards of equity instruments in the financial statements, based on the grant date fair value of those awards. The effective date of FAS 123R for the Company is the fourth quarter of 2005. FAS 123R permits companies to adopt its requirements using either a modified prospective method, or a modified retrospective method. Under the modified prospective method, compensation cost is recognized in the financial statements beginning with the effective date, based on the requirements of FAS 123R for all share-based payments granted after that date, and based on the requirements of FAS 123 for all unvested awards granted prior to the effective date of FAS 123R. Under the modified retrospective method, the requirements are the same as under the modified prospective method, but also permits entities to restate financial statements of previous periods, either for all prior periods presented or to the beginning of the fiscal year in which the statement is adopted, based on previous pro forma disclosures made in accordance with FAS 123. The Company has not yet determined which of the methods it will use upon adoption.

The Company currently utilizes the Black-Scholes option pricing model to measure the fair value of stock options granted to employees. While FAS 123R permits entities to continue to use such a model, it also permits the use of a lattice model. The Company expects to continue using the Black-Scholes option pricing model upon adoption of FAS 123R to measure the fair value of stock options.



The adoption of this statement, in the first quarter of 2006, will have the effect of reducing net income and income per share as compared to what would be reported under the current requirements. These future amounts cannot be precisely estimated because they depend on, among other things, the number of options issued in the future, and accordingly, the Company has not determined the impact of adoption of this statement on its results of operations.

FAS 123R also requires that the benefits associated with the tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after the effective date. These future amounts cannot be estimated, because they depend on, among other things, when employees exercise stock options.

### **Reclassifications**

Certain prior year amounts have been reclassified to conform to the current year presentation.

### **NOTE 3 SUBTENANT RECEIVABLE**

Effective July 1, 2001, the Company entered into a sublease with its former subtenant (the Subtenant) for the majority of the Lexington Office (see Note 7) (the Sublease). In addition, under a separate agreement with the Subtenant, the Company was entitled to receive a monthly fee for the Subtenant's right to utilize furniture and equipment located in the subleased space. On December 31, 2003, the Company executed a Surrender Agreement and Promissory Note with the Subtenant pursuant to which the Company received cash and a promissory note in exchange for the termination of the Sublease and the separate agreement. The Promissory Note, in the face amount of \$75,000, bore interest at the rate of 6% per annum and was to be payable in three installments of \$25,000, plus accrued interest, on June 30, 2004, December 31, 2004 and June 30, 2005. The cash portion of the settlement, in the amount of \$50,000, was received by the Company in January 2004. The Company did not receive from the Subtenant the installment payment that was due on June 30, 2004. On September 14, 2004, the Company filed an action in the Supreme Court of the State of New York, New York County, alleging that the Subtenant had defaulted on its obligations under the Promissory Note dated December 31, 2003 and, accordingly, discontinued accruing interest income as of June 30, 2004. In February 2005, the Company and the Subtenant reached a settlement of the Company's claim pursuant to which the Company received a one-time payment of \$30,000 in exchange for withdrawing its action.

**NOTE 4 PROPERTY AND EQUIPMENT**

Property and equipment consists of the following:

	December 31,	
	2005	2004
Office equipment	\$ 6,914	\$ 16,438
Less: accumulated depreciation and amortization	(6,914)	(15,497)
Property and equipment, net	\$ 941	\$ 941

In January 2004, the Company vacated its former principal executive offices (see Note 7). Accordingly, the Company charged the \$14,000 balance of unamortized leasehold improvements as of December 31, 2003 to fiscal 2003 amortization expense.

In 2004, the Company sold substantially all of its office furniture and equipment for the amount of \$10,000 and used the proceeds of the sale to satisfy a capital lease obligation under which certain of the furniture was encumbered. Consequently, the Company wrote down the value of the sold assets as of December 31, 2003 to \$10,000 and reclassified the assets sold to property held for sale. For fiscal 2003, the Company recorded a loss of \$14,000 from the disposition of fixed assets, which amount is included in other income, net.

Depreciation and amortization expense of property and equipment was \$941, \$1,872 and \$48,713 for the years ended December 31, 2005, 2004 and 2003, respectively.

**NOTE 5 STOCKHOLDERS EQUITY****Common Stock**

As of December 31, 2005, 2004 and 2003, there were 32,490,948 shares of common stock of the Company ( Common Stock ) outstanding. During fiscal 2005, 2004 and 2003, there were no changes in Common Stock.

**1998 Equity Incentive Plan**

Under the Company's 1998 Equity Incentive Plan (the Plan ), which amended and restated the 1989 Stock Plan, the Company is permitted to sell or award Common Stock or to grant stock options for the purchase of Common Stock to employees, officers and consultants up to a maximum of 4,800,000 shares. In February 2000, the Board of Directors approved an amendment to the Plan to increase the number of shares covered by the Plan by 6,000,000, to 10,800,000, which amendment was approved by the Company's stockholders at the June 19, 2000 Annual Meeting of



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Stockholders. At December 31, 2005, there were 5,408,025 shares available for future grants under the Plan.

The 1998 Plan provides for the granting of incentive stock options ( ISOs ) and non-statutory stock options. In the case of ISOs, the exercise price shall not be less than 100% of the fair market value per share of the Company s common stock, on the date of grant. In the case of non-statutory options, the exercise price shall be determined by a committee appointed by the Board of Directors (the Compensation Committee ). All stock options under the Plan have been granted at exercise prices at least equal to the fair market value of the Common Stock on the date of grant.

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The options either are exercisable immediately on the date of grant or become exercisable in such installments as the Compensation Committee of the Board of Directors may specify, generally over a four year period. Each option expires on the date specified by the Compensation Committee, but not more than ten years from the date of grant in the case of ISOs (five years in other cases).

The Company accounted for stock-based compensation in accordance with FAS 123, Accounting for Stock-Based Compensation. Under FAS 123, the fair value at grant date of all stock-based awards is recognized as expense over the vesting period, except that options granted to employees and directors may be accounted for under the provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). Under APB 25, no compensation expense is recorded for options granted to employees or directors unless the exercise price is lower than the market value of the underlying stock at grant date. The Company has elected to apply APB 25, and to provide disclosures of net income as if the fair value method in FAS 123 had been applied. Had compensation cost for stock option grants under the Company's stock option plans been determined pursuant to FAS 123, the Company's net loss would have increased accordingly. The required disclosures under FAS 123 are made below.

Activity under all stock option plans related to all the incentive stock options and non-qualified stock options for the three years ended December 31, 2005 is listed below:

	Incentive Stock Options	Non-qualified Stock Options	Option Price	Weighted Average Exercise Price
Outstanding at December 31, 2002	3,602,103	1,727,557	\$0.70 - \$89.74	\$ 2.17
Cancelled			\$86.33 - \$89.74	\$ 88.28
		(3,802)		
Outstanding at December 31, 2003	3,602,103	1,723,755	\$0.70 - \$47.22	\$ 2.10
Cancelled			\$32.22 - \$47.22	\$ 45.30
		(21,186)		
Outstanding at December 31, 2004	3,602,103	1,702,569	\$0.70 - \$20.71	\$ 1.93
Cancelled			\$16.11 - \$20.71	\$ 20.17
		(9,234)		
Outstanding at December 31, 2005	3,602,103	1,693,335	\$0.70 - \$17.27	\$ 1.90

Summarized information about stock options outstanding at December 31, 2005 is as follows:

Range of Exercise Prices	Number of Options Outstanding	Weighted Average Remaining Contract Life (in years)	Weighted Average Exercise Price	Number of Options	Exercisable Weighted Average Exercise Price
\$0.70 - \$1.45	471,563	4.11	\$ 1.08	471,563	\$ 1.08
\$1.56	3,852,561	2.92	\$ 1.56	3,852,561	\$ 1.56
\$1.65 - \$3.65	338,029	3.00	\$ 1.93	338,029	\$ 1.93
\$4.25	600,000	4.07	\$ 4.25	600,000	\$ 4.25
\$7.93 - \$17.27	33,285	1.57	\$ 10.11	33,285	\$ 10.11

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Options for the purchase of 5,295,438, 5,304,672 and 5,244,608 shares were exercisable at December 31, 2005, 2004 and 2003, respectively.

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Had compensation cost for the Company's stock option plans been determined based on the fair value at the grant date for awards made in 2000 consistent with the provisions of FAS 123, the Company's net loss and loss per share would have been increased to the pro forma amounts shown below:

	2005	2004	2003
Net loss - as reported	\$ (303,884)	\$ (105,691)	\$ (188,621)
Adjustment to net loss for proforma stock-based compensation expense		(27,089)	(68,120)
Net loss - pro forma	\$ (303,884)	\$ (132,780)	\$ (256,741)
Basic and diluted net loss per common share - as reported	\$ (0.01)	\$ (0.00)	\$ (0.01)
Basic and diluted net loss per common share - pro forma	\$ (0.01)	\$ (0.00)	\$ (0.01)

The Company complies with FAS 148, Accounting for Stock-Based Compensation, Transition and Disclosure. FAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. FAS 148 also requires that disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation be displayed more prominently and in a tabular format. Additionally, FAS 148 requires disclosure of the pro forma effect in interim financial statements.

#### Common Stock Warrants and Unit Purchase Options

The following table sets forth warrants and unit purchase options outstanding as of the dates indicated. The warrants listed are exercisable into shares of Common Stock. Unit purchase options are exercisable into shares of Common Stock plus warrants to purchase additional shares of Common Stock. The exercise prices and balances reflected in the table for unit purchase options reflect the total number of shares of Common Stock of the Company issuable upon the exercise of both the unit purchase options and their underlying warrants. All outstanding warrants and unit purchase options are exercisable upon presentation.

Warrant Description	Exercise Price	Expiration Date	Balance January 1, 2003		Balance December 31, 2003		Balance December 31, 2004		Balance December 31, 2005	
				Expired		Expired		Expired		Expired
Class C	\$ 3.28	04/08/2003	2,859,099	(2,859,099)						
Class C	\$ 3.28	11/08/2003	2,344,929	(2,344,929)						
Class D	\$ 2.11	06/30/2004	924,525		924,525	(924,525)				
Contractual obligation	\$ 2.11	06/30/2004	11,500		11,500	(11,500)				
Contractual obligation	\$ 2.50	04/12/2005	5,000		5,000		5,000	(5,000)		
Class E	\$ 2.11	06/30/2005	1,155,955		1,155,955		1,155,955	(1,155,955)		
1995 Unit Purchase Options	\$ 10.74	11/26/2005	85,194		85,194		85,194	(85,194)		
Class A	\$ 9.20	11/26/2005	722,274		722,274		722,274	(722,274)		
1997 Unit Purchase Options	\$ 2.73	09/07/2007	1,454,143		1,454,143		1,454,143		1,454,143	
			9,562,619	(5,204,028)	4,358,591	(936,025)	3,422,566	(1,968,423)		1,454,143

#### NOTE 6 INCOME TAXES

No federal or state income taxes have been provided for as the Company has incurred losses since its inception. At December 31, 2005, the Company had federal and state tax net operating loss ( NOL ) carryforwards of \$103.0 million and \$68.0 million, respectively, which will expire beginning in the year 2006 through 2025. Additionally, the Company had federal research and experimentation credit carryforwards of \$2.0 million, which expire through 2023. The Internal Revenue Code of 1986, as amended (the Code ), contains provisions that limit the NOL carryforwards and tax credits available to be used in any given year upon the occurrence of certain events, including a significant change in

ownership interests. Such changes in ownership, as defined in the Code, have occurred in conjunction with the initial public offering and the acquisitions of HDC and Procept. Any future acquisition may further limit the NOL carryforwards and tax credits available. In addition, some states impose substantially equivalent restrictions on the utilization of state NOL carryforwards and tax credits.

The components of the Company's net deferred tax assets were as follows at December 31:

	2005	2004
Net deferred tax assets:		
Net operating loss carryforwards	\$ 46,061,000	\$ 47,278,000
Tax credit carryforwards	701,000	701,000
Stock based compensation	195,000	195,000
Valuation allowance	(46,957,000)	(48,174,000)
Total net deferred tax assets	\$	\$

Management of the Company has evaluated the positive and negative evidence bearing upon the realizability of its deferred tax assets, which are comprised principally of NOL and tax credit carryforwards. Based on the Company's history of losses, management concluded that it is more likely than not that the Company will not realize the benefit of the net deferred tax assets. Accordingly, a full valuation allowance has been provided for the deferred tax assets.

## NOTE 7 COMMITMENTS

### Operating Leases

On April 19, 2000, the Company entered into an operating lease (the "Lexington Lease") for its office at 369 Lexington Avenue, New York, New York (the "Lexington Office"), which commenced on May 1, 2000. The commitment under the Lexington Lease required the Company to pay monthly base rent and an allocable percentage of operating costs and property taxes throughout the five-year duration of the lease.

During January 2004, the Company voluntarily vacated the Lexington Office in order to facilitate a reletting of the entire premises. In February 2004, the landlord of the Lexington Office (the "Lexington Landlord") demanded payments of amounts due under the Lexington Lease for the period of October 2003 through February 2004. Subsequently, in May 2004, the Lexington Landlord brought an action against the Company in Civil Court of the City of New York, New York County (the "Action"). The Action alleged that the Company failed to pay its rent beginning in October 2003 and was in default under the Lexington Lease. The Action sought payment of rent through March 30, 2004, the date the Lexington Landlord sold the building. The net amount claimed due and owing by the Lexington Landlord of \$50,000 reflected a total lease obligation through March 30, 2004 of \$125,000 less an offset of \$75,000 from the application of the Company's security deposit. On July 23, 2004, the Company and the Lexington Landlord reached a negotiated settlement in the amount of \$30,000, pursuant to which the Action was fully and completely resolved.

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For the years ended December 31, 2005, 2004 and 2003, rent expense for leased facilities and equipment was \$16,000, \$33,000 and \$246,000, respectively. Under the Sublease (see Note 3), the Company billed

its Subtenant \$262,000 during the year ended December 31, 2003, which amount is reflected as a reduction in general and administrative expenses for the year.

### Capital Leases

During fiscal 2000, the Company entered into capital leases for the purchase of office furniture and equipment. In 2004, the Company sold substantially all of its furniture and office equipment, including furniture that was encumbered by the one capital lease obligation remaining at December 31, 2003, under which capital lease monthly payment obligations were due through April 2005. In connection with this sale of furniture and equipment, the Company reached an agreement with the lessor for a discharge from the remainder of its capital lease obligation for the amount of \$10,000, which was paid in 2004. Accordingly, the Company recorded a gain of \$11,000 to other income for fiscal 2003.

### NOTE 8 RELATED PARTIES

#### *Transactions with Directors and Officers*

On June 14, 2000, the Company licensed to Indevus Pharmaceuticals, Inc., formerly Interneuron Pharmaceuticals, Inc. ( Indevus ), the exclusive, worldwide rights to develop and market PRO 2000 Gel (the PRO 2000 License ). Glenn L. Cooper, M.D., a director of the Company at the time of the agreement, is the President and Chief Executive Officer of Indevus. In addition, the former principal stockholder of the Company is a stockholder of Indevus. The Company had retained certain future rights to PRO 2000 Gel under the PRO 2000 License, including (i) provisions for the receipt of additional payments based upon the achievement of certain milestones; and (ii) royalties from future commercial sales of PRO 2000 Gel, if any. Under the terms of the PRO 2000 License, Indevus was responsible for all remaining development and commercialization activities for PRO 2000 Gel and had an option, for a limited period of time following the completion of a Phase III efficacy trial, to purchase the future royalty rights relating to PRO 2000 Gel. The Company, however, had no further obligation to fund research and development for PRO 2000 Gel. On April 11, 2003, the Company and Indevus executed an amendment to the PRO 2000 License (the PRO 2000 Amendment ) pursuant to which the Company received \$500,000 from Indevus in exchange for (i) the elimination of the \$500,000 milestone payment that was to be paid under the PRO 2000 License upon the initiation of a Phase II safety trial; and (ii) a second option, upon which exercise the Company would receive an additional payment of \$500,000, to acquire all of the Company's rights, title and interest to PRO 2000 Gel as set forth in the PRO 2000 License, provided that such second option was exercised prior to September 30, 2004. On September 27, 2004, Indevus exercised the second option under the PRO 2000 Amendment, at which time Indevus acquired all of the Company's rights, title and interest to PRO 2000 Gel as set forth in the PRO 2000 License. Commensurate with the exercise of the second option under the PRO 2000 Amendment, Indevus paid \$500,000 to the Company.

On October 13, 2000, Procept entered into an agreement with AOI Pharmaceuticals Inc. ( AOI ) to sublicense its exclusive worldwide patent rights and know-how relating to O6-BG (the Sublicense Agreement ). Michael A. Weiss, then a director of the Company, is the Chairman of the Board of AOI. In addition, the former principal stockholder of the Company is a stockholder of an affiliate of AOI. Pursuant to the Sublicense Agreement, Procept sublicensed all development and licensing rights to AOI in exchange for future royalties on net sales of O6-BG. The agreement also provides for cash payments to Procept based upon the achievement of certain developmental milestones. In addition, AOI assumed all financial obligations of Procept relating to its licensing of worldwide patent rights as of the effective



date of the agreement. On February 28, 2002, Procept and the United States Public Health Service ( PHS ) executed an exclusive Patent License Agreement (the New License Agreement ), which superseded the license agreement dated February 6, 1998 between Procept and The Penn State Research Foundation ( PSRF ) (the Original License Agreement ). The New License Agreement affirmed Procept 's worldwide patent rights to O6-Benzylguanine ( O6-BG ) and related compounds, and acknowledges the Sublicense Agreement, as of the date executed by Procept and AOI. At the time of executing the New License Agreement, Procept paid to PHS a one-time license issue royalty fee of \$86,000 for accrued patent prosecution costs. In connection with the execution of the New License Agreement, Procept, together with the National Cancer Institute ( NCI ) and AOI, also executed an amendment to the Cooperative Research and Development Agreement ( CRADA ), originally executed with the NCI in August 1998 (the Amended CRADA ), pursuant to which AOI replaced Procept as Collaborator (*i.e.*, the research and development partner). Under terms of the Amended CRADA, AOI assumed direct responsibility for all remaining research and payment obligations, effective as of February 28, 2002. As part of the Amended CRADA, Procept made a final payment of \$200,000 to NCI for accrued production and clinical distribution costs relating to O6-BG. Also on February 28, 2002, AOI reimbursed Procept \$137,000 for costs that Procept had paid in prior years relating to the maintenance of patent rights and CRADA obligations. Such costs were reimbursable to Procept under the Sublicense Agreement. In May 2002, Procept and PHS executed an amendment to the New License Agreement (the First Amendment ). The First Amendment clarified language in the New License Agreement pertaining to future sublicensing agreements, in the event that such agreements were to be executed. In addition, the Company, together with PHS, PSRF, AOI and the University of Chicago ( UC ), also executed, in May 2002, a Comprehensive Release Agreement (the Release Agreement ). The Release Agreement provides for the irrevocable and absolute release of the Company by PHS, PSRF and UC from any and all claims or obligations arising out of, or related to the Original License Agreement. The Release Agreement was made part of the New License Agreement. In October 2002, Procept and PHS executed a second amendment to the New License Agreement revising certain provisions pertaining to benchmark payments and royalties as set forth in the New License Agreement and First Amendment. In August 2003, AOI and the NCI executed a further amendment to the CRADA, extending the term of the CRADA to August 7, 2005. In February 2005, Procept and PHS executed a third amendment to the New License Agreement revising the provision for payment of an additional royalty to PHS upon the occurrence of an assignment by Procept of the New License Agreement. Such additional royalty was revised from a payment amount of \$20,000 to \$17,500. In March 2005, pursuant to an agreement by and between Procept, Keryx Biopharmaceuticals, Inc., the parent of AOI ( Keryx ), and PHS, Procept assigned all of its rights, interests and obligations under the New License Agreement to Keryx; in exchange, Keryx agreed to pay Procept a total of \$158,750, in two installments. The first installment of \$83,750 was paid on March 30, 2005 from which Procept paid to PHS the additional royalty of \$17,500, in accordance with the New License Agreement, as revised in February 2005. The second installment of \$75,000, which was due and payable on (or before) December 31, 2005 pursuant to a promissory note which did not bear interest until after the maturity date, was paid in December 2005.

On March 3, 2003, Richard J. Kurtz, a director and the principal stockholder of the Company, loaned \$30,000 to the Company to fund its current operations. In April 2003, the Company repaid this loan to Mr. Kurtz from proceeds received under the PRO 2000 Amendment.

On July 1, 2003, the Company executed a non-binding letter of intent to acquire privately held Digital Products of Delaware, Inc. ( Digital ), a company engaged in providing electronic monitoring products and services to the criminal justice and corrections industry. The Company proposed to acquire all of the issued and outstanding stock of Digital in consideration of the issuance of shares of common stock of the Company such that the stockholders of Digital would own 80% of the outstanding stock of the post-acquisition

company. Richard J. Kurtz, a director and the principal stockholder of the Company, was then the principal stockholder of Digital. In January 2004, the Company announced that the contemplated Digital acquisition was being indefinitely postponed due to Digital's need to focus on meeting certain business demands which would hinder its ability to conclude the business combination with the Company. During 2005, the Company renewed its efforts to consummate a business combination with Digital, which included monitoring Digital's progress in implementing its business plan. In January 2006, Mr. Kurtz sold his interest in Digital. As a result, the Company is no longer pursuing a transaction with Digital.

On October 8, 2003, in anticipation of completing a business combination with Digital or another entity, the Company executed a promissory note (the Promissory Note) with Mr. Kurtz under which the Company received, and expects to continue to receive, loans that will enable it to meet its anticipated cash operating needs. The Promissory Note bears interest at 8% per annum and contemplated repayment upon the occurrence of the earlier of (i) the first anniversary of the making of the first loan; and (ii) the first funding of debt and/or equity capital subsequent to the completion of the proposed business combination between the Company and Digital that results in aggregate net proceeds to the Company of not less than \$1 million. As the first anniversary of the Promissory Note has occurred, the amount due under the Promissory Note is payable on demand. Under the Promissory Note, Mr. Kurtz has loaned the Company an aggregate of \$890,000 to fund its continuing operations. In September 2004, the Company paid \$394,418 to Mr. Kurtz from proceeds received under the PRO 2000 Amendment, consisting of \$375,000 in principal plus \$19,418 of accrued interest. As of December 31, 2005, the principal balance and accrued interest due under the Promissory Note are \$515,000 and \$31,362, respectively.

#### NOTE 9 UNAUDITED QUARTERLY FINANCIAL DATA

	Mar. 31,	2005 Quarter Ended		Dec. 31,
		Jun. 30,	Sep. 30,	
Interest income	\$	\$	\$	\$
Net income (loss)	\$ 40,156	\$ (116,372)	\$ (122,667)	\$ (105,001)
Net income (loss) per share basic and diluted	\$ 0.00	\$ (0.00)	\$ (0.00)	\$ (0.00)

	Mar. 31,	2004 Quarter Ended		Dec. 31,
		Jun. 30,	Sep. 30,	
Interest income	\$ 1,125	\$ 1,125	\$	\$
Net income (loss)	\$ (260,565)	\$ (60,930)	\$ 285,863	\$ (70,059)
Net income (loss) per share basic and diluted	\$ (0.01)	\$ (0.00)	\$ 0.01	\$ (0.00)