LJ INTERNATIONAL INC
Form 20-F
March 31, 2004

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U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

o REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______ to ______

Commission file number 0-29620

LJ INTERNATIONAL INC.

(Exact name of Registrant as specified in its charter)

LJ INTERNATIONAL INC.

(Translation of Registrant s name into English)

British Virgin Islands

(Jurisdiction of incorporation or organization)
Unit #12, 12/F, Block A
Focal Industrial Centre
21 Man Lok Street
Hung Hom, Kowloon, Hong Kong
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Name of each exchange

Title of each class	on which registered
None	N/A

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Securities registered or to be registered pursuant to Section 12(g) of the Act.

$.01 Par Value Common Stock (Common Stock)

(Title of Class)

Warrants to Purchase Common Stock (Warrants)

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None

(Title of Class)

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report:

9,890,006 Common Stock
1,679,000 Warrants

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 o Item 18 x

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Not Applicable.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This annual report contains forward-looking statements that involve risks and uncertainties. These include statements about our expectations, plans, objectives, assumptions or future events. In some cases, you can identify forward-looking statements by terminology such as anticipate, estimate, plans, potential, projects, continuing, ongoing, expects, management believes, we believe, we intend and similar expressions. These statements involv estimates, assumptions and uncertainties that could cause actual results to differ materially from those expressed for the reasons described in this annual report. You should not place undue reliance on these forward-looking statements.

You should be aware that our actual results could differ materially from those contained in the forward-looking statements due to a number of factors:

- dependence upon certain customers
- dependence on key personnel
- control by principal shareholder
- competitive factors
- the operation of our business
- general economic conditions

You should also consider carefully the statements under Risk Factors and other sections of this annual report, which address additional factors that could cause our actual results to differ from those set forth in the forward-looking statements and could materially and adversely affect our business, operating results and financial condition. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the applicable cautionary statements.

The forward-looking statements speak only as of the date on which they are made, and, except to the extent required by federal securities laws, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

We use data and industry forecasts in this annual report which we have obtained from internal surveys, market research, publicly available information and industry publications. Industry publications generally state that the information they provide has been obtained from sources believed to be reliable but that the accuracy and completeness of such information is not guaranteed. Similarly, we believe that the surveys and market research we or others have performed are reliable, but we have not independently verified this information.

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA.

SELECTED CONSOLIDATED FINANCIAL DATA
(Dollars in thousands, except per share amounts)

The following selected consolidated financial data with respect to each of the years in the three-year period ended April 30, 2002, the eight months ended December 31, 2002 and the year ended December 31, 2003 have been derived from our audited consolidated financial statements. The following selected consolidated financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and Notes included elsewhere in this annual report.

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Selected Financial Data

	Year ended April 30,			Eight-month period ended December 31,		Year ended December 31,	
	2000	2001	2002	2001	2002	2002	2003
				(Unaudited)		(Unaudited)	
Statement of Operations Data:							
Revenues	38,926	46,285	39,240	25,042	31,809	46,007	58,167
Cost of Goods sold	25,496	31,540	35,731	18,602	22,820	39,951	44,947
Gross profit	13,430	14,745	3,509	6,440	8,989	6,056	13,220
Operating expenses							
Selling, general and administrative	(7,406)	(9,398)	(8,963)	(5,905)	(6,433)	(9,525)	(9,133)
Unrealized gain (loss) on derivatives	44	44	(660)	(119)	(435)	(975)	(162)
Depreciation	(705)	(808)	(1,031)	(565)	(863)	(1,328)	(1,184)
Impairment on property, plant and equipment			(345)		(108)	(417)	(84)
Amortization and impairment loss on goodwill		(27)	(242)	(18)	(400)	(624)	(200)
Income (loss) from operations	5,363	4,556	(7,732)	(167)	750	(6,814)	2,457
Other revenues	458	570	352	265	205	291	453
Interest expenses	(1,446)	(1,780)	(652)	(424)	(441)	(668)	(753)
Issuance costs for convertible debentures	(585)						
Impairment loss on investment security					(200)	(200)	
Operating income (loss) before income taxes and minority interests	3,790	3,346	(8,032)	(326)	314	(7,391)	2,157
Incomes taxes (expense) credit	(3)	(211)	101	(39)	(101)	39	(352)
Income (Loss) before minority interests	3,787	3,135	(7,931)	(365)	213	(7,352)	1,805
Minority interests in consolidated subsidiaries	52		30		120	150	8
Net income (loss)	3,839	3,135	(7,901)	(365)	333	(7,202)	1,813
Net income (loss) per share:							
Basic	0.58	0.37	(0.91)	(0.04)	0.04	(0.84)	0.21
Diluted	0.56	0.37	(0.91)	(0.04)	0.04	(0.84)	0.19
Pro forma basic (Note)	0.57	0.13	(0.91)	(0.04)	0.04	(0.84)	0.19
Pro forma diluted (Note)	0.54	0.13	(0.91)	(0.04)	0.04	(0.84)	0.17

Weighted average number of shares							
Basic	6,589	8,567	8,672	8,672	8,493	8,551	8,757
Diluted	6,944	8,617	8,779	8,832	8,493	8,551	9,706
Pro forma basic (Note)	6,589	8,567	8,672	8,672	8,493	8,551	8,757
Pro forma diluted (Note)	6,944	8,617	8,779	8,832	8,493	8,551	9,706
Balance Sheet Data:							
Working capital	20,561	20,153	12,115	18,537	11,896	11,896	17,053
Total assets	40,049	48,094	43,523	51,062	48,888	48,888	60,686
Long-term obligation	2,943	287	8	12			77
Total stockholders equity	24,739	31,161	23,557	30,943	23,294	23,294	27,902

Note: Pro forma information has been prepared as if compensation expense for stock options be determined based on the fair value at the date of grant and been amortized over the period from

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the date of grant to the date that the award is vested, consistent with the provisions of SFAS No. 123.

B. CAPITALIZATION AND INDEBTEDNESS.

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS.

Not applicable.

D. RISK FACTORS.

We depend upon QVC, Inc. for a large portion of our sales and we cannot be certain that these sales will continue. If they do not, our revenues will likely decline.

Although we sell to a large number of customers in a variety of markets, a large portion of our sales involves offerings to one volume customer, QVC, Inc. For the fiscal years ended December 31, 2002 and 2003, QVC, Inc. accounted for approximately 25% and 10% of our sales. Although we have maintained a good and longstanding relationship with this customer, we do not have any long-term contracts with QVC, Inc., who orders only on a purchase order basis. The loss of QVC, Inc. as a customer or a significant reduction in its orders would have a materially adverse effect.

We are controlled by one of our existing shareholders, whose interests may differ from other shareholders.

Our largest shareholder beneficially owns or controls approximately 38.1% of our outstanding shares as of December 31, 2003. Accordingly, he has controlling influence in determining the outcome of any corporate transaction or other matter submitted to the shareholders for approval, including mergers, consolidations and the sale of all, or substantially all, of our assets, election of directors, and other significant corporate actions. He also has the power to prevent or cause a change in control. In addition, without the consent of this shareholder, we could be prevented from entering into transactions that could be beneficial to us. The interests of this shareholder may differ from the interests of the other shareholders.

We face significant competition from larger competitors.

The making and distribution of jewelry is a highly competitive industry characterized by the diversity and sophistication of the product. We compete with major domestic and international companies with substantially greater financial, technical and marketing resources and personnel than us. There can be no assurance other jewelry makers will not similarly develop low-cost, high-volume production capability or an even better process, providing greater competition for us and materially affecting our business prospects.

There are numerous factors relating to the operations of our business that could adversely affect our success and results.

As a maker and merchandiser of low-cost, high-quality gem-set jewelry, our existing and future operations are and will be influenced by several factors, including:

- technological developments in the mass production of jewelry;
- our ability to meet the design and production requirements of our customers efficiently;
- the market acceptance of our customers jewelry;
- increases in expenses associated with continued sales growth;
- our ability to control costs;
- our management s ability to evaluate the public s taste and new orders to target satisfactory profit margins;
- our capacity to develop and manage the introduction of new designed products; and
- our ability to compete.

Quality control is also essential to our operations since customers demand compliance with design and product specifications and consistency of production. We cannot assure that revenue growth will occur on a quarterly or annual basis.

Our production facilities are located in China. Our results of operations and financial condition may, therefore, be influenced by the economic, political, legal and social conditions in China.

Since 1978, the Chinese government has been reforming, and is expected to continue to reform, China s economic and political systems. Such reforms have resulted in significant social progress. Other political, economic and social factors could also lead to further readjustment of the reform measures. This refinement and readjustment process may not always have a positive effect on our operations in China. At times, we may also be adversely affected by changes in policies of the Chinese government such as changes in laws and regulations or their interpretation, the introduction of additional measures to control inflation, changes in the rate or method of taxation and imposition of additional restrictions on currency conversion and remittances abroad.

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Our products are currently made at our production facility located in Shenzhen, China. However, our insurance may not adequately cover any losses due to fire, casualty or theft.

We have obtained fire, casualty and theft insurance aggregating approximately $19.8 million, covering several of our stock in trade, goods and merchandise, furniture and equipment and production facility in China. The proceeds of such insurance may not be sufficient to cover material damage to, or the loss of, our production facility due to fire, severe weather, flood or other cause, and such damage or loss would have a material adverse effect on our financial condition, business and prospects. Consistent with the customary practice among enterprises in China and due to the cost in relation to the benefit, we do not carry any business interruption insurance in China.

Sales of our jewelry to retailers are generally stronger during the quarter ending December 31 of each year due to the importance of the holiday selling season.

The approximately 35% of our sales during the fiscal year ended December 31, 2003 to our TV shopping channel customers was not seasonal in nature. It has been our management s experience that the remaining 65% of our total sales is seasonally sensitive and is greater during the quarter ending December 31 of each year.

Our holding company structure creates restrictions on the payment of dividends.

We have no direct business operations, other than the ownership of our subsidiaries. While we have no current intention of paying dividends, should we, as a holding company, decide in the future to do so, our ability to pay dividends and meet other obligations depends upon the receipt of dividends or other payments from our operating subsidiaries and other holdings and investments. In addition, our operating subsidiaries are subject to restrictions on their ability to make distributions to us, including as a result of restrictive covenants and minimum net worth requirements in loan agreements, restrictions on the conversion of local currency into U.S. dollars or other hard currency and other regulatory restrictions.

It may be difficult to serve us with legal process or enforce judgments against us or our management.

We are a British Virgin Islands holding company, and all or a substantial portion of our assets are located in China and Hong Kong. In addition, all but one of our directors and officers are non-residents of the United States, and all or substantial portions of the assets of such non-residents are located outside the United States. As a result, it may not be possible to effect service of process within the United States upon such persons. Moreover, there is doubt as to whether the courts of the British Virgin Islands, China or Hong Kong would enforce:

- judgments of United States courts against us, our directors or our officers based on the civil liability provisions of the securities laws of the United States or any state; or

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in original actions brought in the British Virgin Islands, China or Hong Kong, liabilities against us or non-residents based upon the securities laws of the United States or any state.

Some information about us may be unavailable due to exemptions under the Exchange Act for a foreign private issuer.

We are a foreign private issuer within the meaning of the rules under the Exchange Act. As such, we are exempt from certain provisions applicable to United States public companies, including:

- the rules under the Exchange Act requiring the filing with the Securities and Exchange Commission of quarterly reports on Form 10-Q or current reports on Form 8-K;

- the provisions of Regulation FD aimed at preventing issuers from making selective disclosures of material information;

- the sections of the Exchange Act regulating the solicitation of proxies, consents or authorizations in respect of a security registered under the Exchange Act; and

- the sections of the Exchange Act requiring insiders to file public reports of their stock ownership and trading activities and establishing insider liability for profits realized from any short-swing trading transaction.

Because of these exemptions, investors are not provided with the same information which is generally available about public companies organized in the United States.

Since we are a British Virgin Islands company, the rights of our shareholders may be more limited than those of shareholders of a company organized in the United States.

Under the laws of most jurisdictions in the United States, majority and controlling shareholders generally have certain fiduciary responsibilities to the minority shareholders. Shareholder action must be taken in good faith, and actions by controlling shareholders which are obviously unreasonable may be declared null and void. British Virgin Island law protecting the interests of minority shareholders may not be as protective in all circumstances as the law protecting minority shareholders in U.S. jurisdictions. In addition, the circumstances in which a shareholder of a BVI company may sue the company derivatively, and the procedures and defenses that may be available to the company, may result in the rights of shareholders of a BVI company being more limited than those of shareholders of a company organized in the U.S.

Furthermore, our directors have the power to take certain actions without shareholder approval which would require shareholder approval under the laws of most U.S. jurisdictions. The directors of a BVI corporation, subject in certain cases to court approval but without shareholder approval, may implement a reorganization, merger or consolidation, the sale of any assets, property, part of the business, or securities of the corporation. Our ability to amend our Memorandum of Association and Articles of Association without shareholder approval could

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have the effect of delaying, deterring or preventing a change in our control without any further action by the shareholders, including a tender offer to purchase our common stock at a premium over then current market prices.

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ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY.

LJ International Inc. (we) was incorporated as an international business company under the International Business Companies Act of the British Virgin Islands on January 30, 1997. We own all of the issued share capital in the following significant subsidiaries:

Lorenzo Jewelry Limited (Lorenzo Jewelry), a company incorporated in Hong Kong on February 20, 1987.

Lorenzo Gems Manufacturing (Shenzhen) Co., Ltd.

Lorenzo Jewellery (Shenzhen) Co., Ltd.

Shenzhen PGS Jewelry Mfg.

Our principal place of business and our executive offices are located at Units #09-#12, 12/F, Block A, Focal Industrial Centre, 21 Man Lok Street, Hung Hom, Kowloon, Hong Kong, telephone: (011) 852-2764-3622. We have designated CT Corporation, 111 Eighth Avenue, New York, New York 10011 as our agent for service of process in the United States.

During our last three fiscal years, we have made the following significant capital expenditures:

we purchased a 16.8% equity interest in iBBC Inc. for $600,000 during the fiscal year ended April 30, 2001.

we purchased a 20% equity interest in Goldleaves International Inc. for $2,684,000 during the fiscal year ended April 30,2001.

we purchased 68.8% of the common shares of iBBC Inc. for $2,460,000 during the fiscal year ended April 30, 2002

we made a capital contribution of $670,000 for our 95% equity interest in Lorenzo Giftware Inc. during the fiscal year ended December 31, 2002

we invested $721,000 for the purchase of 3,502 square meters of production space in our Shenzhen, China facility during the fiscal year ended December 31, 2002

we invested $390,000 for the purchase of 1,751 square meters of production space in our Shenzhen, China facility during the fiscal year ended December 31, 2003

B. BUSINESS OVERVIEW.

We are a totally vertically integrated company that designs, brands, markets and distributes a complete range of fine jewelry. While we specialize in the semi-precious jewelry segment, we also offer high-end pieces set in yellow gold, white gold, platinum or sterling silver and adorned with semi-precious stones, diamonds, pearls and precious stones. We distribute mainly to fine jewelers, department stores, national jewelry chains and electronic and specialty retailers throughout North America and Western Europe. Our product lines incorporate all major categories sought by major retailers, including earrings, necklaces, pendants, rings and bracelets.

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We believe that our vertically integrated structure provides significant advantages over our competitors. All profits from value added processes are captured internally, rather than shared with third party manufacturers. This results in very competitive pricing for the retailer and enhanced profits for us. Innovative processes in stone cutting and production further enhance our competitive position.

We employ an international design team and all of our designs and merchandising strategies are proprietary. The exclusive and innovative concepts that we create offer brand potential. Our primary marketing focus has been in North America where we have sold directly to certain high volume customers that need specialized product development services, and through a marketing relationship with International Jewelry Connection (IJC) for those customers that need higher levels of service and training.

We organize our marketing and distribution strategies by retail distribution channels. Concepts are developed for the specific needs of different market segments. We have identified the following as prime retail targets:

- fine jewelers;
- national jewelry chains;
- department stores;
- TV shopping channels; and
- discount chain stores.

For the eight-month period ended December 31, 2002 and the year ended December 31, 2003, approximately 77% and 74% of our sales were in North America.

The following is a breakdown of our total revenues (in thousands) by geographic market for each of our past three financial years:

	Year ended April 30,		8 months ended December 31,		Year ended December 31,	
	2001	2002	2001	2002	2002	2003
			(Unaudited)		(Unaudited)	
	US$	US$	US$	US$	US$	US$
US & Canada	38,463	28,810	19,373	24,545	33,886	42,851
Hong Kong	599	4,897	1,383	1,451	4,361	1,961
Europe and other countries	7,028	5,518	4,167	3,469	4,964	8,017
PRC	74	6				
Japan	121	9	119	2,344	2,796	5,338
	46,285	39,240	25,042	31,809	46,007	58,167

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Our Industry

The jewelry industry is comprised of two major groups that distribute finished jewelry to retailers in the United States:

a small number of producers that make and distribute their own jewelry directly to retailers; and

a large number of wholesalers and distributors who purchase products or portions of products from third parties and resell those items to retailers.

We believe that vertically integrated companies that control costs by performing all value added processes enjoy a distinct competitive advantage over wholesalers and distributors who pay premium acquisition prices for items that they intend to resell. We further believe that large retailers want to rely upon prime producers because they believe that prime producers are reliable, low cost producers who can accommodate the large quantities of production that large retailers commonly purchase.

Our Business Strategy

Our business strategy is to:

increase our market share of moderately priced high-quality gem-set semi-precious and precious jewelry by capitalizing on our unique vertically integrated production processes to produce diamond and high-end precious stone jewelry in addition to high volume, high-quality semi-precious products;

further develop our existing customer relationships with our specialized services; and

expand aggressively into new distribution channels, particularly in the United States and throughout Western Europe, Japan, China, and Australia.

We are aggressively developing new product lines in exotic stones, which have high perceived values among semi-precious stones. We continue to expand into new product categories by:

marketing a line of sterling silver jewelry. These are typically merchandised with a retail price range of $30 to $150

adding more lines into our Lorenzo branded products with a retail price range of $199 to $999

offering diamond jewelry and expanding this business to our current client base by adding diamonds to some of our settings, as well as offering newly designed jewelry

launching Lorenzo Gold , a gold products made from Italy .

We intend to implement our business strategy by:

promoting visits with customers to coordinate and cater to their particular promotional sales needs and monitoring their on-hand inventory in order to promote more active sell-through

expanding our distribution channels to include all major TV shopping programs in North America, Japan, Korea and Australia and further developing business with top-40 Retail Jewelry Chains in the U.S.

entering the retail jewelry market in China.

Our Production Capability

We have established a sophisticated facility in China that performs stone cutting and polishing and jewelry production. The facility is located in the city of Shenzhen in Guangdong Province, China. We closed our former second facility in Shantou during the fiscal year ended December 31, 2002 and consolidated all our production in the Shenzhen facility, which has been operating for five years and has 9,232 square meters of production space. We currently employ approximately 2,000 skilled gemstone cutters and production personnel and turned out more than a million pieces of finished fine jewelry during the fiscal year ended December 31, 2003.

We purchase imported choice gemstone material, which are from mines located in Africa, China and South America, especially those concentrated in Brazil. We source our diamonds mainly from suppliers in India. Gemstone craftsmen are trained and managed by our Hong Kong personnel to ensure that the highest levels of cutting and polishing quality are achieved. The professional skills possessed by our cutters are applied to a wide variety of shapes and sizes, maximizing the yield and value of the gemstone material that we purchase. By performing internally the value-added processes of cutting and polishing our semi-precious gemstones, we maximize quality control and improve our profitability. We specialize in a wide range of popular and exotic semi-precious gemstones ranging from amethyst, aquamarine and peridot to tanzanite and tourmaline.

Sales and Marketing

Our merchandising strategy is to provide unique and differentiated products that are enhanced by the favorable pricing that results from our vertically integrated structure. We invest significant effort in design and model making to produce items which are distinctly different from our competitors. We continue to devote our efforts towards brand development and utilize marketing concepts to enhance the saleability of our products. We recognize that retailers favor certain price points. As part of our product development strategy, we strive to align our wholesale prices to match retailers target prices as a means of achieving these popular price targets.

Our sales and marketing team is located in our executive offices in Hong Kong and Los Angeles, California. Our marketing and distribution strategy is to identify the strongest retail customers in each distribution channel and to focus design and sales efforts towards the largest and fastest growing retailers. We maintain a broad base of customers and concentrate our efforts on five major jewelry market segments:

- fine jewelers;
- national jewelry chains;
- department stores;
- TV shopping channels; and
- discount chain stores.

In addition to direct sales to retailers, we also sell our products to retailers through International Jewelry Connection. The principal focus of IJC is on major U.S. department stores and jewelry retailers, who require specialized levels of marketing, service and training. These sales representatives are paid on a commission-only basis.

Our sales promotion efforts include attendance by our representatives at U.S. and international trade shows and conventions, including Las Vegas, Orlando, New York, Basel, Switzerland, Hong Kong and Japan. In addition, we advertise actively in trade journals and related industry publications.

Design and Product Development

We have seven internationally trained designers who work from our Hong Kong executive office and ten designers who work in our Shenzhen facility. Our designers create styles that have been accepted by our various clients worldwide. Our design teams attend trade fairs worldwide to gather product ideas and monitor the latest product trends.

We provide our customers with a broad selection of high-quality 10, 14 and 18 karat gold, platinum and sterling silver jewelry products that incorporate traditional yet fashionable styles and designs. We currently offer approximately 5,000 different styles of rings, bracelets, necklaces, earrings, pendants and matching sets that are contemporary and desired in the market.

We study product trends that are emerging in the international market and adapt these trends to the needs of our retail customers. The jewelry offered for sale considers color, fabric and fashion trends, which are projected over a two-year period. We market our products as lifestyle inspired.

Production Process

We make our jewelry at our facility in Shenzhen, China. Our production processes combine vertical integration, modern technology, mechanization and handcraftsmanship to turn out contemporary and fashionable jewelry. Our production operations basically involve:

- cutting and polishing semi-precious gemstones;

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combining pure gold, platinum or sterling silver with gemstones or diamonds to produce jewelry; and

finishing operations such as cleaning and polishing, resulting in high quality finished jewelry.

Supply

We produce and cut our own semi-precious stones. We purchase imported gemstones which are from South America, Africa and China. South America is the major source of ametrine, amethyst, aquamarine, imperial topaz, tourmaline and white topaz, and Africa is the main source of tanzanite, mandarine garnet, aquamarine and topaz. We also purchase imported aquamarine, peridot and topaz from China. We source our diamonds mainly from suppliers in India. We believe that we have good relationships with our suppliers, most of whom have supplied us for many years.

We maintain our supply of inventory at our warehouse. The amount of our inventory of a particular gemstone determines the extent and size of our marketing program for that product. We purchase our gemstones and diamonds in advance and in anticipation of orders resulting from our marketing programs.

We purchase our gold from banks, gold refiners and commodity dealers who supply substantially all of our gold needs, which we believe is sufficient to meet our requirements.

Gold acquired for production is at least .995 fine and is combined with other metals to produce 10, 14 and 18 karat gold. The term karat refers to the gold content of alloyed gold, measured from a maximum of 24 karats, which is 100% fine gold. Varying quantities of metals such as silver, copper, nickel and zinc are combined with fine gold to produce 14 karat gold of different colors. These alloys are in abundant supply and are readily available to us.

We purchase our gold requirements within a reasonable period after each significant purchase order is received. We believe that any change in the price of gold would have had little, if any, impact on the valuation of our inventories.

We purchase supplies and raw materials from a variety of suppliers and we do not believe the loss of any of the suppliers would have a material adverse effect on our business. Alternative sources of supply for raw materials for production of jewelry are readily available.

Security

We have installed certain measures at our Shenzhen, China, production and our Hong Kong administrative facilities to protect against loss, including multiple alarm systems, infrared motion detectors and a system of closed circuit television cameras, which provide surveillance of all critical areas of our premises.

We inspect carefully all materials sent and received from outside suppliers, monitor the location and status of all inventory, and have strict internal control procedures of all jewelry as it proceeds through the production process. A complete physical inventory of gold and gemstones is taken at our production and administrative facilities on a quarterly basis.

Insurance

We maintain primary all-risk insurance, with limits in excess of our current inventory levels, to cover thefts and damage to inventory located on our premises. We also maintain insurance covering thefts and damage to our owned inventory located off-site. The amount of coverage available under such policies is limited and may vary by location, but is generally in excess of the value of the gold and gemstones supplied by us. We carry transit insurance, the coverage of which includes the transportation of jewelry outside of our office.

Competition

The jewelry production industry is highly competitive, and our competitors include domestic and foreign jewelry manufacturers, wholesalers, and importers who may operate on a national, regional and local scale. Our competitive strategy is to provide competitively priced, high-quality products to the high-volume retail jewelry market. According to our management, competition is based on pricing, quality, service and established customer relationships. We believe that we have positioned ourselves as a low-cost producer without compromising our quality. Our ability to conceive, design and develop products consistent with the requirements of each retail distribution channel represents a competitive advantage.

We believe that few competitors have the capacity and production skills to be effective competitors. We believe that our vertically integrated production capabilities distinguish us from most of our competitors and enable us to produce very competitively priced, high quality and consistent products.

In North America, the market, although highly fragmented, does contain a number of major competitors, many of whom import much of their product from the Far East and many of whom sell higher priced items. The key United States competitors include:

E.E.A.C. Inc.;

Fabrikant.

International competitors include Pranda International and Beauty Gems Limited. Most of these manufacturers/wholesalers have been successful vendors for many years and enjoy good

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relations with their clients. Although it may be difficult for a newcomer to break into established relationships, we have already made substantial inroads in the North American jewelry market and we believe we can remain competitive, based on our vertically integrated, low-cost, high-volume and high-quality production process.

Common Stock Purchase Agreement for Equity Line of Credit Facility

Effective April 15, 2002, we had entered into a common stock purchase agreement with Navigator Investments Holding IX Limited, a Nevis corporation, for the future issuance and purchase of shares of our common stock. This common stock purchase agreement established what is sometimes termed an equity line of credit or an equity drawn down facility. On June 7, 2002, we filed a registration statement (SEC File No. 333-90016) covering the shares issuable under the equity line of credit.

On July 23, 2003, Navigator and we mutually agreed to terminate the common stock purchase agreement. The registration statement had not been declared effective and no securities had been sold in connection with the offering contemplated by the registration statement. Thereafter, in August 2003, we formally withdrew the registration statement with the SEC.

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C. ORGANIZATIONAL STRUCTURE AS OF DECEMBER 31, 2003:

The following diagram provides a listing of our significant subsidiaries. The respective country of organization/incorporation is shown in brackets.

LJ INTERNATIONAL INC.
(British Virgin Islands)

100%

- **Lorenzo Jewelry Limited**
  (Hong Kong)

- **Lorenzo Gems Manufacturing (Shenzhen) Co., Ltd.**
  (P.R.C.)

- **Lorenzo Jewellery (Shenzhen) Co., Ltd.**
  (P.R.C.)

- **Shenzhen PGS Jewelry Mfg.**
  (P.R.C.)

D. PROPERTY, PLANTS AND EQUIPMENT.

Our principal executive offices are located at Units #9-#12, 12/F, Block A, Focal Industrial Centre, 21 Man Lok Street, Hung Hom, Kowloon, Hong Kong. We own approximately 4,800 square feet of office and showroom at this location.

Our jewelry production facility in Shenzhen, China consists of 9,232 square meters of building space located in the Shatoujiao Free Trade Zone, Shenzhen. We own approximately 5,254 square meters of this space. We also currently lease 1,751 square meters for a term of five years expiring August 31, 2007 from an unaffiliated third party at a rental rate of $5,700 per month; 1,751 square meters for a term of two years expiring June 30, 2004, at a rental rate of $3,600 per month; and 476 square meters for a term of one year expiring December 31, 2004, at a rental rate of $862 per month.

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We own two warehouse facilities in Hung Hom and Aberdeen consisting of 5,432 square feet and 2,897 square feet. We also own additional properties in Sai Kung and Hung Hom. We lease all four of these properties to non-affiliated third parties. We have pledged all of our land and buildings to collateralize general banking facilities granted to us.

Our production facilities are currently utilized for one shift per day but are capable of being expanded to accommodate three shifts per day as necessary.

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ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion and analysis should be read in conjunction with our financial statements and notes to the financial statements appearing elsewhere in this Form 20-F. See Special Note Regarding Forward-looking Statements. All amounts referring to 2002 contained herein represent those of year ended December 31, 2002 (which are unaudited).

We exceeded both internal and external expectations in the fiscal year ended 31 December 2003. Since consolidating all our operations under one roof in our expanded, 9,232 square meters Shenzhen facility at the beginning of 2003, we have achieved double-digit growth in both revenue and profit and won important new clients as well as receiving expanded orders from existing ones. Sales revenue jumped from $46 million in 2002 to nearly $58 million in 2003, an impressive climb of almost 26%, while our gross profit margin rose to 23% from 13%. We also made strategic inroads into a major, fast-growing new market China.

Our continuing focused marketing drive clinched us yet another major client, ShopNBC in 2003, so by now we are selling to all the three biggest US shopping networks: QVC, Home Shopping Network and ShopNBC. Additionally, our US clientele includes two thirds of the Top 40 jewelry chains as well as general large retailers. In fact, we even opened our first US sales and marketing office in August to augment the efforts of our team here in their accelerated penetration of this market.

We have also made significant headway in widening our reach in China. The Chinese government has given us the green light to expand our presence in its jewelry market and we are proceeding with plans to market our Lorenzo brand of top-end jewelry through franchises and eMotion on-line sales kiosks throughout the country. The opening of our 5,000 square-foot showroom in Hong Kong s jewelry district in March 2004 forms part of our strategy to expand into China. Meanwhile, our debut in Australia in January this year, when we won an initial sales order from the country s biggest home shopping channel, also allows us not only to establish our footprint in Australia, but also to enhance our presence in China as the network also broadcasts there.

Besides our concerted marketing efforts, the on-going refinement and diversification of our product lines has also contributed in no small way to expanding our sales coffers, attracting new customers, winning large orders from existing ones and our success at high-profile trade shows such as the JCK Gem Show in Las Vegas in 2003. We continue to develop our highly successful and profitable diamond line, introduced in 2002 and for which we installed a high tech facility, fitted out with CAD/CAM model making equipment and a wide range of wax set molding equipment. Our efforts in fashioning new, creative designs with semi-precious gems remain relentless. In April 2003, we won the trademark for our recently-discovered Brazilian plum-rose colored stone we have named the Rosenite Garnet.

While it may still be premature to talk about a definite global economic recovery, we at

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LJ International can say with reasonable confidence that things are picking up in the jewelry sector and we expect to keep registering in the foreseeable years ahead the kind of double-digit growth in both sales and net income that characterized our company in its early years. We continue to benefit from the cost savings and the administrative, sales and operational efficiencies resulting from the corporate reengineering exercise we undertook in late 2001 and saw our selling, general and administrative expenses in fiscal 2003 falling to $9 million, or 16% of our revenue, compared with nearly $9.6 million, or 21% of our revenue, in 2002. At the same time, we are optimistic that our market expansion and product diversification will continue in 2004 and into the years beyond.

A. OPERATING RESULTS.

Reclassifications

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

Revenues

							% change		
	Years ended April 30,		Eight-month period ended December 31,		Year ended December 31,		Years ended April 30,	Eight-month period	Years ended December 31,
(in thousands)	2001	2002	2001	2002	2002	2003	2001-2002	2001-2002	2002-2003
			Unaudited		Unaudited				
Revenues	$ 46,285	$ 39,240	$ 25,042	$ 31,809	$ 46,007	$ 58,167	-15%	27%	26%