

LJ INTERNATIONAL INC  
Form 20-F  
March 31, 2005

Table of Contents

**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

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

For the fiscal year ended December 31, 2004

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.

Title of each  
class

Name of each exchange  
on which registered

\_\_\_\_\_  
None

\_\_\_\_\_  
N/A

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:

12,304,658 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  No

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

Item 17  Item 18

(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.

---

**Table of Contents**

**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 involve 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.

**TABLE OF CONTENTS**

**PART I**

**ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

**ITEM 3. KEY INFORMATION**

**ITEM 4. INFORMATION ON THE COMPANY**

**ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

**ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES**

**ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS**

**ITEM 8. FINANCIAL INFORMATION**

**ITEM 9. THE OFFER AND LISTING**

**ITEM 10. ADDITIONAL INFORMATION**

**ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

**PART II**

**ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

**ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS**

**ITEM 15. CONTROLS AND PROCEDURES**

**ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

**ITEM 16B. CODE OF ETHICS**

**ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

**ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES.**

**ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS.**

**PART III**

**ITEM 17. FINANCIAL STATEMENTS**

**ITEM 18. FINANCIAL STATEMENTS**

**SIGNATURES**

**EXHIBIT INDEX**

**Significant Subsidiaries**

**Certification of CEO**

**Certification of CFO**

**Certification of CEO**

**Certification of CFO**

---

**Table of Contents****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 the year ended April 30, 2002, the eight-month period ended December 31, 2002 and each of the two-year period ended December 31, 2004 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.

**Selected Financial Data**

	Year ended		Eight-month period ended		Year ended		
	April 30, 2001	2002	December 31, 2001	2002	2002	December 31, 2003	2004
			(Unaudited)		(Unaudited)		
<b>Statement of Operations Data:</b>							
Revenues	46,285	39,240	25,042	31,809	46,007	58,167	77,379
Cost of Goods sold	31,540	35,731	18,602	22,820	39,951	44,947	61,265
Gross profit	14,745	3,509	6,440	8,989	6,056	13,220	16,114
Operating expenses							
Selling, general and administrative	(9,398)	(8,963)	(5,905)	(6,433)	(9,525)	(9,133)	(11,578)
	44	(660)	(119)	(435)	(975)	(162)	(482)

Edgar Filing: LJ INTERNATIONAL INC - Form 20-F

Unrealized gain (loss) on derivatives							
Depreciation	(808)	(1,031)	(565)	(863)	(1,328)	(1,184)	(1,032)
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	4,556	(7,732)	(167)	750	(6,814)	2,457	3,022
Other revenues	570	352	265	205	291	453	844
Interest expenses	(1,780)	(652)	(424)	(441)	(668)	(753)	(902)
Issuance costs for convertible debentures							
Impairment loss on investment security				(200)	(200)		
Operating income (loss) before income taxes and minority	3,346	(8,032)	(326)	314	(7,391)	2,157	2,964
Incomes taxes (expense) credit	(211)	101	(39)	(101)	39	(352)	(277)
Income (Loss) before minority interests	3,135	(7,931)	(365)	213	(7,352)	1,805	2,687
Minority interests in consolidated subsidiaries		30		120	150	8	
Net income (loss)	3,135	(7,901)	(365)	333	(7,202)	1,813	2,687
Net income (loss) per share:							
Basic	0.37	(0.91)	(0.04)	0.04	(0.84)	0.21	0.24
Diluted	0.37	(0.91)	(0.04)	0.04	(0.84)	0.19	0.22
Pro forma basic	0.13	(0.91)	(0.04)	0.04	(0.84)	0.19	0.23
Pro forma diluted	0.13	(0.91)	(0.04)	0.04	(0.84)	0.17	0.21
Weighted average number of shares							
Basic	8,567	8,672	8,672	8,493	8,551	8,757	11,119
Diluted	8,617	8,779	8,832	8,493	8,551	9,706	12,107
Pro forma basic	8,567	8,672	8,672	8,493	8,551	8,757	11,119
Pro forma diluted	8,617	8,779	8,832	8,493	8,551	9,706	12,107
<b>Balance Sheet Data:</b>							
Working capital	20,153	12,115	18,537	11,896	11,896	17,053	23,617
Total assets	48,094	43,523	51,062	48,888	48,888	60,686	75,039
Long-term obligation	287	8	12			77	58
Total stockholders equity	31,161	23,557	30,943	23,294	23,294	27,902	34,156

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



**Table of Contents**

**B. CAPITALIZATION AND INDEBTEDNESS.**

Not applicable.

**C. REASONS FOR THE OFFER AND USE OF PROCEEDS.**

Not applicable.

**D. RISK FACTORS.**

**We depend upon one customer for at least 10% 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, at least 10% of our sales involves offerings to one customer. For the fiscal years ended December 31, 2003 and 2004, this customer accounted for approximately 9% and 11% of our sales. Although we have maintained a good and longstanding relationship with this customer, we do not have any long-term contracts with it, who orders only on a purchase order basis. The loss of this 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 27.7% of our outstanding shares as of December 31, 2004. 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.

**Table of Contents**

**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

**Table of Contents**

method of taxation and imposition of additional restrictions on currency conversion and remittances abroad.

**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 \$35.0 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 34% of our sales during the fiscal year ended December 31, 2004 to our TV shopping channel customers was not seasonal in nature. It has been our management's experience that the remaining 66% 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:

**Table of Contents**

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

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

**Table of Contents**

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 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.

**Table of Contents**

**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.

Lorenzo (Shenzhen) Co., Ltd.

Due to the restrictions on foreign ownership on the retail business of jewelries, the Company, through loans to the agents, established Lorenzo (Shenzhen) Co., Ltd (LSC) to carry out the retail business of jewelries in the PRC. LSC is a variable interest entity (VIE) owned by two individuals, who are acting as agents. Pursuant to various agreements entered into between the Company, the agents and LSC on May 21, 2004, the Company generally has control of LSC and is considered the primary beneficiary of LSC.

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 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

**Table of Contents**

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.

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 years ended December 31, 2003 and 2004, approximately 74% and 73% 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	8 Months ended		Year ended December 31,		
	April 30, 2002	December 31, 2001 (Unaudited)	December 31, 2002	December 31, 2002 2003 2004 (Unaudited)		
	US\$	US\$	US\$	US\$	US\$	US\$
US & Canada	28,810	19,373	24,545	33,275	42,851	56,186
Hong Kong	4,897	1,383	1,451	4,379	1,961	3,765
Europe and other countries	5,518	4,167	3,469	4,832	8,017	13,062
PRC	6					208
Japan	9	119	2,344	2,801	5,338	4,158
	39,240	25,042	31,809	45,287	58,167	77,379





**Table of Contents**

**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 which 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 , our new gold jewelry product line

**Table of Contents**

We intend to implement our business strategy by:

expanding our retail jewelry market in China

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.

**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. Our production facility in Shenzhen has been operating for six years and has 9,232 square meters of production space. We currently employ approximately 2,500 skilled gemstone cutters and production personnel and turned out approximately two million pieces of finished fine jewelry during the fiscal year ended December 31, 2004.

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.

## **Table of Contents**

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 20 internationally trained designers who work from our Hong Kong, U.S. and China offices. 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 more than 40,000 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:

**Table of Contents**

cutting and polishing semi-precious gemstones;

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 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.

## **Table of Contents**

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. and 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 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.

**Table of Contents**

**Private Placement Offering**

On September 1, 2004, we entered into securities purchase agreements with a group of investors for issuance of common stock and five-year warrants to purchase shares of common stock. We sold to the investors 1,614,082 units at a price of \$2.20 per unit, each unit consisting of one share of common stock and one warrant to acquire up to 30% of the common stock so issued at an exercise price of \$2.98 per share, which expires on September 3, 2009. At the closing, we issued an aggregate of 1,614,082 shares and 484,221 warrants and received net proceeds after expenses of the transaction of approximately \$2.8 million.

We also entered into registration rights agreements with the investors. Pursuant to the terms of the registration rights agreements, we agreed to register the shares of common stock and the shares underlying the warrants for resale on behalf of the investors. The registration of the common stock and the shares underlying the warrants became effective on October 12, 2004.

**Table of Contents**

**C. ORGANIZATIONAL STRUCTURE AS OF DECEMBER 31, 2004:**

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 \$3,817 per month;

1,751 square meters for a term of two years expiring June 30, 2006, at a rental rate of \$3,567 per month; and

475 square meters for a term of one year expiring December 31, 2005, at a rental rate of \$854 per month.

We own two warehouse facilities in Hung Hom and Aberdeen consisting of 5,432 square feet and 5,200 square feet. We also own additional properties in Sai Kung and Hung Hom. We

**Table of Contents**

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.



**Table of Contents****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 shown for the eight-month period ended December 31, 2001 and for the year ended December 31, 2002 are unaudited.

**A. OPERATING RESULTS.****Reclassifications**

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

**Revenues**

	<b>Eight-month period ended</b>		<b>Year ended December 31,</b>			<b>Eight-month period</b>	<b>% change</b>	
							<b>December 31, 2001</b>	<b>2002</b>
(in thousands)								
	<b>December 31,</b>		<b>Year ended December 31,</b>			<b>period</b>	<b>December 31,</b>	<b>December 31,</b>
	<b>2001</b>	<b>2002</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2001-2002</b>	<b>2002-2003</b>	<b>2003-2004</b>
	Unaudited		Unaudited					
Revenues	\$ 25,042	\$ 31,809	\$ 46,007	\$ 58,167	\$ 77,379	27%	26%	33%

The increase in revenue for the year ended December 31, 2004, compared with the year ended December 31, 2003, and the increases for the year ended December 31, 2003 compared the year ended December 31, 2002 were attributable to the acceptance of new products, the rise in orders from existing customers and new customers.

The increase in revenue for the eight-month period ended December 31, 2002, compared with the same period in 2001, was due to our successful marketing efforts in winning new, major blue chip customers, as well as the positive reception of our new products.

**Table of Contents****Cost of Sales and Gross Profit**

(in thousands)	Eight-month period ended		Year ended December 31,			Eight-month period 2001-2002	% change	
	December 31,		December 31,				Years ended	Years ended
	2001	2002	2002	2003	2004		December 31, 2002-2003	December 31, 2003-2004
Cost of sales	Unaudited \$ 18,602	\$ 22,820	Unaudited \$ 34,241	\$ 44,947	\$ 61,265	23%	31%	36%
% of revenues	74%	72%	75%	77%	79%			
Cost of sales - write down of inventory	\$ 0	\$ 0	\$ 5,710	\$ 0	\$ 0	N/A	-100%	N/A
% of revenues	0%	0%	12%	0%	0%			
Gross profit	\$ 6,440	\$ 8,989	\$ 6,056	\$ 13,220	\$ 16,114	40%	118%	22%
% of revenues	26%	28%	13%	23%	21%			

The gross profit margin dropped to 21% for the year ended December 31, 2004 from 23% for the year ended December 31, 2003. The decrease in gross profit margin was due to the rise in diamond price which we could not pass to customer for orders accepted before the rise in price and also the sales to discount chain stores.

The gross profit margin increased to 23% for the year ended December 31, 2003 from 13% for the year ended December 31, 2002. It was due to the following adjustments on inventory made for the year ended December 31, 2002.

\$5,394,000 for the write-down of cut stones for orders in relation to special programs that were later postponed or cancelled;

\$316,000 for the write-down of fine jewelry cost.

Excluding the above special charge on inventory, the gross profit margin was 25% for the year ended December 31, 2002.

The gross profit margin increased to 28% for the eight-month periods ended December 31, 2002 from 26% for the same period ended December 31, 2001.

**Table of Contents****Selling, General and Administrative Expenses**

(in thousands)	Eight-month period ended		Year ended December 31,			Eight-month period 2001-2002	% change	
	December 31,		December 31,				Years ended	Years ended
	2001	2002	2002	2003	2004		December 31, 2002-2003	December 31, 2003-2004
	Unaudited		Unaudited					
Selling, general and administrative expenses	\$ 5,905	\$ 6,433	\$ 9,525	\$ 9,133	\$ 11,578	9%	-4%	27%
% of revenues	24%	20%	21%	16%	15%			

Selling, general and administrative (SG&A) expenses maintained at 15% of revenue for the year ended December 31, 2004, compared with 16% of revenue for the year ended December 31, 2003.

Selling, general and administrative (SG&A) expenses decreased by 5% of revenue for the year ended December 31, 2003, compared with the year ended December 31, 2002. Between 2002 and 2003, our SG&A expenses fell as a direct result of the corporate reengineering exercise we had undertaken right after the 9/11 terrorist attacks in the US. The measures we instituted led to substantial cost savings and administrative, sales and operational efficiencies.

**Unrealized loss (gain) on derivatives**

(in thousands)	Eight-month period ended		Year ended December 31,			Eight-month period 2001-2002	% change	
	December 31,		December 31,				Years ended	Years ended
	2001	2002	2002	2003	2004		December 31, 2002-2003	December 31, 2003-2004
	Unaudited		Unaudited					
Unrealised loss (gain) on derivatives	\$ 119	\$ 435	\$ 975	\$ 162	\$ 482	266%	-83%	198%
% of revenues	0%	1%	2%	0%	1%			

(with the hedging mechanism in place since 2003, we have the realized gain on hedging activities included in Other Revenues. )

Realized gain on hedging activities	\$ 0	\$ 0	\$ 0	\$ 249	\$ 681	N/A	N/A	173%
% of revenues	0%	0%	0%	0%	1%			

We have secured gold loan facilities with various banks in Hong Kong, which typically bear a below-market interest rate. Under the gold loan arrangements, we may defer the purchase until such time as we decide appropriate, the price to be paid being the current market price at time of payment. The gold loan, however, does expose us to certain market risks associated with

**Table of Contents**

potential future increases in the price of gold. In the past, we did not hedge against such risks and at the close of each reporting period, the gold loan was valued at fair value with changes reflected on the income statement. However, the volatility of prices in the lead-up to the war in Iraq prompted us to make unrealized loss on derivatives of \$119,000 and \$435,000 for the eight months periods ended December 31, 2001 and December 31, 2002 respectively and to cover possible losses resulting from price fluctuations.

Since 2003, we have commenced hedging the fluctuations in the price of gold related to the gold loans by entering into contracts with financial institutions for the future purchase of gold. As a result, we have reduced the unrealized loss to \$162,000 for the year ended December 31, 2003, compared with the unrealized loss of \$975,000 for the year ended December 31, 2002 and have realized gain of \$249,000 before the hedging activities were in place.

With the hedging mechanism in place, we have incurred an unrealized loss of \$482,000 and realized gain of \$681,000 on derivatives, which has been included in Other Revenues of \$844,000, for the year ended December 31, 2004.

**Depreciation**

(in thousands)	Eight-month period ended		Year ended December 31,			Eight-month period 2001-2002	% change	
	December 31,		December 31,				Years ended	Years ended
	2001	2002	2002	2003	2004		December 31, 2002-2003	December 31, 2003-2004
	Unaudited		Unaudited					
Depreciation	\$ 565	\$ 863	\$ 1,328	\$ 1,184	\$ 1,032	53%	-11%	-13%
% of revenues	2%	3%	3%	2%	1%			

Depreciation decreased 13% to \$1,032,000 for the year ended December 31, 2004 from \$1,184,000 for the year ended December 31, 2003. It was due to a portion of furniture, fixtures and equipment acquired were fully depreciated during the year.

Depreciation decreased 11% to \$1,184,000 for the year ended December 31, 2003 from \$1,328,000 for the year ended December 31, 2002, as depreciation of \$158,000 on leasehold improvements in production facilities was included in April 2002 that we ceased to use before the expiry of their leases.

The increase in depreciation costs primarily represents the impact of on-going capital expenditures and assets acquired for the eight months ended December 2002. It also incorporated a provision of \$158,000 for the depreciation on leasehold improvements to production facilities we ceased to use before the expiry of their leases.

**Table of Contents****Impairment on property, plant and equipment**

(in thousands)	Eight-month period ended		Year ended			Eight-month period 2001-2002	% change	
	December 31,		December 31,				Years ended	Years ended
	2001	2002	2002	2003	2004		December 31, 2002-2003	December 31, 2003-2004
	Unaudited		Unaudited					
Impairment on property, plant and equipment	\$ 0	\$ 108	\$ 417	\$ 84	\$ 0	N/A	-80%	-100%
% of revenues	0%	0%	1%	0%	0%			

The impairment loss represents the write-off of property, plant and equipment as a result of the consolidation of production facilities.

**Amortization and impairment loss on goodwill**

(in thousands)	Eight-month period ended		Year ended			Eight-month period 2001-2002	% change	
	December 31,		December 31,				Years ended	Years ended
	2001	2002	2002	2003	2004		December 31, 2002-2003	December 31, 2003-2004
	Unaudited		Unaudited					
Amortization and impairment loss on goodwill	\$ 18	\$ 400	\$ 624	\$ 200	\$ 0	2122%	-68%	-100%
% of revenues	0%	1%	1%	0%	0%			

In July 2001, Financial Accounting Standards Board issued SFAS No. 142, Goodwill and Other Intangible Assets, which provides that goodwill and intangible assets with indefinite useful lives will not be amortized but rather will be tested at least annually for impairment.

In March 2002, goodwill is attributed to the acquisition of a jewelry retail company. Impairment loss of the related goodwill was charged for the eight-month period ended December 31, 2002 and for the year ended December 31, 2002 and for the year ended December 31, 2003.

**Table of Contents****Interest cost**

(in thousands)	Eight-month period ended		Year ended December			Eight-month period 2001-2002	% change	
	December 31,		31,				Years ended	Years ended
	2001	2002	2002	2003	2004		December 31,	December 31,
	Unaudited		Unaudited				2002-2003	2003-2004
Interest expenses	\$ 424	\$ 441	\$ 668	\$ 753	\$ 902	4%	13%	20%
% of revenues	2%	1%	1%	1%	1%			

Interest expenses increased for the years ended December 31, 2003 and 2004 was due to a higher utilization rate of credit line facilities as working capital.

**Impairment loss on investment**

(in thousands)	Eight-month period ended		Year ended			Eight-month period 2001-2002	% change	
	December 31,		December 31,				Years ended	Years ended
	2001	2002	2002	2003	2004		December 31,	December 31,
	Unaudited		Unaudited				2002-2003	2003-2004
Impairment loss on investment securities	\$ 0	\$ 200	\$ 200	\$ 0	\$ 0	N/A	-100%	N/A
% of revenues	0%	1%	0%	0%	0%			

Impairment loss on investment was related to the acquisition in April 2001 for 20% equity interests in a company whose principal activities are the manufacturing and trading of rough and pre-formed gemstones (the Investee).

Pursuant to the purchase agreement dated January 1, 2005, the Company would pay US\$2,827,500 to the Investee for the issuance of 3,900 new shares therein (Acquisition). The Acquisition was completed on January 1, 2005. The Company then became the major stockholder holding 98% equity interests in the Investee, which became a subsidiary of the Company.

**Table of Contents****Income taxes**

(in thousands)	Eight-month period ended		Year ended December			Eight-month period 2001-2002	% change	
	December 31,		31,				Years ended	Years ended
	2001	2002	2002	2003	2004		December 31, 2002-2003	December 31, 2003-2004
	Unaudited		Unaudited					
Incomes taxes expense (credit)	\$ 39	\$ 101	\$ (39)	\$ 352	\$ 277	159%	-1003%	-21%
% of revenues	0%	0%	0%	1%	0%			

We were incorporated in the British Virgin Islands and, under current law of the British Virgin Islands, are not subject to tax on income or on capital gains.

For our subsidiaries in Hong Kong, the prevailing corporate income tax rate is 17.5%.

Two of our subsidiaries in China are registered to qualify as Foreign Investment Enterprises in China and are eligible for certain tax holidays and concessions. Accordingly, certain of our Chinese subsidiaries are exempt from Chinese income tax for two years starting from their first profit-making year, followed by a 50% reduction of tax for the next three years.

One of our subsidiaries in China is currently enjoying the tax concessions which will expire in fiscal 2005. Another subsidiary in China is enjoying the tax holiday as its first profit-making year in 2004. PRC income tax is calculated at the applicable rates relevant to these subsidiaries which currently are 15%.

For other subsidiaries in China, the prevailing corporate income tax rate is 15%.

During the years ended December 31, 2003 and 2004, there included tax overprovision adjustment of \$92,000 and \$22,000 respectively, after the finalization of tax assessment for prior year.

**Inflation**

We do not consider inflation to have had a material impact on our results of operations over the last three years.

**Foreign Exchange**

More than 99% of our sales are denominated in U.S. Dollars whereas the other sales are basically denominated in Hong Kong Dollars. The largest portion of our expenses are denominated in Hong Kong Dollars, followed by U.S. Dollars and Renminbi. The exchange rate



**Table of Contents**

of the Hong Kong Dollar is currently pegged to the U.S. Dollar, but during the past several years the market exchange rate has fluctuated within a narrow range. The Chinese government principally sets the exchange rate between the Renminbi and all other currencies. As a result, the exchange rates between the Renminbi and the U.S. Dollar and the Hong Kong Dollar have fluctuated in the past and may fluctuate in the future. If the value of the Renminbi or the Hong Kong Dollar decreases relative to the U.S. Dollar, such fluctuation may have a positive effect on the results of our operations. If the value of the Renminbi or the Hong Kong Dollar increases relative to the U.S. Dollar, such fluctuation may have a negative effect on the results of our operations. We do not currently hedge our foreign exchange positions.

**Governmental economic and political policies and factors**

For information regarding governmental economic, fiscal, monetary and political policies that could materially affect our operations, directly or indirectly, please refer to the Risk Factors section on pages 7 to 10.

**B. LIQUIDITY AND CAPITAL RESOURCES.**

We have no direct business operations other than the ownership of our subsidiaries and investment securities. Our ability to pay dividends and meet other obligations depends upon our receipt of dividends or other payments from our operating subsidiaries and investment securities.

**Cash Flows**

(in thousands)	Eight-month period ended		Years ended December 31,		
	2001 (Unaudited)	2002	2002 (Unaudited)	2003	2004
Net cash provided by (used in) operating activities	\$ (787)	\$ 3,374	\$ 4,276	\$ 1,489	\$ (5,690)
Net cash provided by (used in) investing activities	(384)	(2,207)	(4,941)	(468)	(1,179)
Net cash provided by (used in) financing activities	185	(824)	1,009	704	7,375
Effect of foreign exchange rate change		(68)	(68)		
Net increase (decrease) in cash and cash equivalents	(986)	275	276	1,725	506
		-26-			

**Table of Contents****Operating Activities:**

The negative cash flow from operating activities for the year ended December 31, 2004 and the decrease in net cash provided by operating activities in the year ended December 31, 2003 compared with the year ended December 31, 2002 reflected our accumulation of inventory of cut stones, diamond in anticipation of significant increase in sales for the new fiscal year, and the build up of inventory for retail business in Hong Kong and China. The rise in the cost of rough gemstones, the build-up of more sample lines of jewelry and the maintaining of sufficient inventory for block-orders also accentuated the negative cash flow.

The increase in cash flow in the eight-month period ended December 31, 2002 compared with the same period in 2001 resulted from growth in revenues and improved working capital management.

**Investing Activities:**

For the year ended December 31, 2004, net cash used in investing activities was for the capital expenditures, mainly for renovation and improvement of the existing production facilities in Shenzhen and renovation of shops for the new retail business and other on-going business necessities, and for increase in restricted cash deposits for securing new banking facilities.

For the year ended December 31, 2003, net cash used in investing activities was for the capital expenditures, mainly for new production facilities in Shenzhen, and for other on-going business necessities, reduced by the release of restricted cash deposits from the bank.

In addition to on-going capital expenditures and restricted cash deposits, we undertook various one-off investments that contributed to changes in our net cash positions for the various reporting periods. The increase in cash used in investing activities for the years ended December 31, 2002, 2003 and 2004 and for the eight-month period ended December 31, 2002, was due to new manufacturing facilities in China, as well as an increase in restricted cash deposits for securing banking facilities.

Our capital expenditure by category for the periods presented were:

## Capital expenditure

(in thousands)	Eight-month period ended		Years ended December 31,		
	December 31, 2001 (Unaudited)	2002	2002 (Unaudited)	2003	2004
Land & buildings	\$	\$ 721	\$ 721	\$ 330	\$
Leasehold improvement	\$ 95	\$ 159	\$ 279	\$ 190	\$ 487
Furniture, fixtures and equipment	\$ 239	\$ 382	\$ 324	\$ 250	\$ 189
Plant and machinery	\$ 21	\$ 282	\$ 285	\$ 93	\$ 51
Motor vehicles	\$	\$ 12	\$ 12	\$ 133	\$
Total	\$ 355	\$ 1,556	\$ 1,621	\$ 996	\$ 727



**Table of Contents****Financing Activities:**

Net cash provided by financing activities for the year ended December 31, 2004 was \$7,375,000, which included proceeds of \$2,746,000 from private placement of common stock, \$810,000 from issuance of shares upon exercise of stock options, increase of new loans and offset by the repayment of matured bank loans, and reduction of bank overdrafts utilization level.

Net cash provided by financing activities for the year ended December 31, 2003 was \$704,000. It was represented by the proceeds from issuance of shares upon exercise of stock options of \$2,245,000 and sales of treasury stock of \$541,000, raise of new bank loans, reduced by repayment of matured bank loans, and decrease in utilization of bank overdraft facilities.

The negative net cash from financing activities for the eight-month period ended December 31, 2002, compared with the same period in 2001, reflected the repayment of gold loan of \$2,474,000 and the repurchase of common stock of the Company at an aggregate consideration of \$391,000. The positive net cash provided by financing activities in each of the other periods mainly reflected our gold loan arrangement and the utilization of overdraft facilities.

Our cash and cash equivalents are mainly held in U.S. dollars and HK dollars.

**Financing Sources****Banking Facilities and Notes Payables**

We have various letters of credit, factoring facilities and overdrafts under banking facilities. The banking facilities are collateralized by land and buildings, investment properties, restricted cash deposits, factored receivables and personal guarantees of and properties owned by one of our directors.

Letters of Credit, overdrafts and others:

(in thousands)	<b>As of December 31,</b>			
	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
	(Unaudited)			
Letters of credit	\$ 14,424	\$ 12,985	\$ 19,005	\$ 26,833
Overdraft	\$ 3,532	\$ 3,244	\$ 3,397	\$ 3,461
	17,956	16,229	22,402	30,294
Utilized :				
Letters of credit utilized	\$ 8,197	\$ 8,559	\$ 13,619	\$ 15,423
Overdraft utilized	\$ 2,313	\$ 3,107	\$ 1,312	\$ 607
	10,510	11,666	14,931	16,030

**Table of Contents**

The letters of credit and bank overdrafts are denominated in H.K. dollars and U.S. dollars, bear interest at the floating commercial bank lending rates in Hong Kong, and are renewable annually with the consent of the relevant banks.

The factoring facilities granted are limited to the extent of accounts receivable collateralized to the banks.

Notes payable:

(in thousands)	As of December 31,			
	2001 (Unaudited)	2002	2003	2004
Notes payable	\$ 447	\$ 1,073	\$ 1,516	\$ 2,487

We have term loans classified under notes payable which are related to the Group's properties. These loans are denominated in H.K. dollars and Renminbi, bear interest at pre-fixed rates in Hong Kong and China upon renewal.

**Gold Loan Facilities:**

(in thousands)	As of December 31,			
	2001 (Unaudited)	2002	2003	2004
Gold loans outstanding (in \$)	\$ 3,627	\$ 3,700	\$ 3,118	\$ 6,488
Gold loans outstanding (in troy ounces)	12,450	12,950	10,900	17,920
Gold loan interest rate	1.65%-4.1%	1.5%-2.4%	1.6%-2.4%	2.1%-2.5%

We have also secured gold loan facilities with various banks in Hong Kong, which bear a below-market interest rate. Due to lower interest rates charged for gold loans, our cost through our gold loan program has been substantially less than the costs that would have been incurred if we were to finance the purchase of all of our gold requirements with borrowings under our letter of credit facility or other credit arrangements. The gold loan, however, does expose us to certain market risks associated with potential future increases in the price of gold, so in 2003, we have put in place mechanisms to hedge against such risks. Under the gold loan arrangements, we may defer the purchase until such time as we deem appropriate, the price to be paid being the current market price at time of payment. At the close of each reporting period, the gold loan is valued at fair value with changes reflected on the income statement.

**Table of Contents**

**Looking Forward:**

We anticipate that cash flow from operations, borrowings available under our existing credit line and our gold loan arrangement will be sufficient to satisfy our capital needs for the next twelve months.

**Impact of recently issued US GAAP accounting standards**

See Note 2(y) to the Consolidated Financial Statements in this Form 20-F for a summary of recently issued accounting pronouncements.

**C. RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES, ETC.**

During each of the last three fiscal years, we did not spend any significant amounts on company-sponsored research and development activities.

**Table of Contents****D. TREND INFORMATION.**

The total production for fiscal year ending December 31, 2005 is estimated to be at least 10% greater than the level for fiscal year 2004. The sales for fiscal year 2005 are estimated at approximately US\$85 million, compared to US\$77 million for the fiscal year ended December 31, 2004. The gross profit margin for fiscal year 2005 is estimated to stay at the same 21% level as fiscal year 2004.

**E. OFF-BALANCE SHEET ARRANGEMENTS.**

Except for those disclosed in the Consolidated Financial Statements, we do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

**F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS.**

As of the December 31, 2004, we had the following known contractual obligations:

Contractual Obligations  
As of December 31, 2004

	Total US\$	Payments due by period			
		Less than 1 year US\$	1-3 years US\$	3-5 years US\$	More than 5 years US\$
Capital (Finance) Lease Obligations	77	19	39	19	
Operating Lease Obligations	1,201	625	489	87	
Total	1,278	644	528	106	

We had entered into finance lease agreements for the purchase of motor vehicles in 2003. The financed amount was \$95,000, bearing interest at 5%-6% per annum, and repayable in 60 monthly installments beginning in 2003. A minimum finance charge may be charged if we pay off all the balance early.

**Table of Contents****ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES****A. DIRECTORS AND SENIOR MANAGEMENT.**

Our senior management and directors are as follows:

<b>Name</b>	<b>Age</b>	<b>Position</b>
Yu Chuan Yih	65	Chairman of the Board of Directors, President and Chief Executive Officer
Ka Man Au	40	Chief Operating Officer, Secretary and Director
Hon Tak Ringo Ng	45	Chief Financial Officer and Director
Po Yee Elsa Yue	40	Non-Executive Director
Lionel C. Wang	49	Non-Executive Director

None of our directors and officers was selected due to any agreement or understanding with any other person. There is no family relationship between any of our directors or executive officers and any other director or executive officer.

**Mr. Yih** established the business of Lorenzo Jewelry Ltd. and has served as president and managing director since 1987. Mr. Yih is primarily responsible for business development and overall company management. He has over 20 years of experience in semi-precious stone production and marketing. Mr. Yih had been a gemstone trader in Brazil and has extensive experience and relationships in gem sourcing and jewelry design. Mr. Yih is also the Founding Sponsor of the Hong Kong branch of the Gemological Institute of America (GIA), the nonprofit educational organization for the jewelry industry.

**Ms. Au** has served as a director of Lorenzo Jewelry Ltd. since its incorporation in 1987. Ms. Au has been our chief operating officer since January 1, 2002 and is primarily responsible for our general administration, human resources, operations and management.

**Mr. Ng** has served as our chief financial officer since September 1997 and as one of our directors since May 1, 2001. He received his Bachelor of Science degree in civil engineering from the University of London in 1984 and his Master of Commerce in accounting and commercial administration from the University of New South Wales in 1994. From July 1994 through September 1997, he was an audit senior with Moores Rowland C.A., Certified Public Accountants. Mr. Ng is a certified practising accountant of the Australian Society of CPAs.

**Ms. Yue** has served as a non-executive director since December 1999. She is a graduate gemologist from the Gemological Institute of America and served as vice president of GIA, Hong Kong, from August 1994 to December 2002. Her responsibilities included managing the Hong Kong office and administering their education programs, marketing and related activities. Since December 2002, Ms. Yue has served as a manager for a colored gems import and export trading company.



**Table of Contents**

**Mr. Wang** has served as a non-executive director since June 1998. He received his Bachelor of Commerce from Tamkung University, Taipei, Taiwan in 1978, his Master of Business Administration from California State Polytechnic University in 1980, and his Master of Science from Stanford University in 1981. From 1984 to 1990, Mr. Wang was a marketing research analyst and senior strategic planning analyst for The Gillette Company, Boston, Massachusetts. From 1990 to 1995, he served as associate director and then director of product development for Information Resources, Inc., Waltham, Massachusetts. From 1995 to 1996, Mr. Wang was vice-president at Nielsen North America, with responsibility for analytical and modeling projects on the Kraft Foods/White Plains account. From 1996 until June 2000, Mr. Wang served as director of analytical services for The NPD Group, Inc., Port Washington, New York. From June 2000 until June 2001, he was vice president of product development for NFO Interactive, Greenwich, Connecticut. Since June 2001, Mr. Wang has been president of his own firm, Marketing and Innovation, LLC., Greenwich, Connecticut.

**B. COMPENSATION.**

The aggregate compensation paid by us to all of our directors and executive officers as a group for the fiscal year ended December 31, 2004 on an accrual basis, for services in all capacities, was \$918,000. During the fiscal year ended December 31, 2004, we contributed an aggregate amount of \$22,000 toward the pension plans of our directors and executive officers.

**Executive Service Contract**

We entered into an employment agreement with Mr. Yu Chuan Yih, effective October 1, 2003, for a period of three years at an annual salary of \$233,000. Mr. Yih's remuneration package includes benefits with respect to an automobile. In addition, Mr. Yih is entitled to an annual management bonus of a sum to be determined by the board at its absolute discretion, having regard for our operating results and the performance of Mr. Yih during the relevant financial year. The amount payable to Mr. Yih will be decided by majority decision of the members of the board present in the meeting called for that purpose. Mr. Yih shall abstain from voting and not be counted in the quorum in respect of the resolution regarding the amount payable to him.

On July 1, 2003, we granted Mr. Yih options exercisable to acquire 800,000 shares of common stock at \$2.00 per share at any time through June 30, 2013.

**C. BOARD PRACTICES.**

Each of our five current directors was elected at our last annual meeting of shareholders held June 25, 2004 to serve a one-year term or until their successor is elected and qualified.

**Table of Contents**

There are no directors' service contracts with us or any of our subsidiaries providing for benefits upon termination of employment.

Our board of directors has established an audit committee, which currently consists of Messrs. Yih and Wang and Ms. Yue. Its functions are to:

- recommend annually to the board of directors the appointment of our independent public accountants;
  - discuss and review the scope and the fees of the prospective annual audit and review the results thereof with the independent public accountants;
  - review and approve non-audit services of the independent public accountants;
  - review compliance with our existing accounting and financial policies;
  - review the adequacy of our financial organization; and
  - review our management's procedures and policies relative to the adequacy of our internal accounting controls and compliance with federal and state laws relating to financial reporting.
- We do not have a remuneration committee of the board of directors.

**D. EMPLOYEES.**

As of December 31, 2004, we employed approximately 2,500 persons on a full-time basis for our production of jewelry and gemstone cutting and polishing. Approximately 100 of these people include our management and executive staff in Hong Kong and China. None of our employees is represented by a labor union and we believe that our employee relations are good.

**E. SHARE OWNERSHIP.**

The following table sets forth certain information regarding the beneficial ownership of our shares of common stock as of December 31, 2004 by:

- each person who is known by us to own beneficially more than 5% of our outstanding common stock;
- each of our current executive officers and directors; and
- all executive officers and directors as a group.

As of December 31, 2004, we had 12,304,658 shares of our common stock issued and outstanding.

This information gives effect to securities deemed outstanding pursuant to Rule 13d-3(d)(1) under the Securities Exchange Act of 1934, as amended.

**Table of Contents**

The address for each person named below is c/o LJ International Inc., Unit #12, 12/F, Block A, Focal Industrial Centre, 21 Man Lok Street, Hung Hom, Kowloon, Hong Kong.

Name of Beneficial Holder	Number Shares Beneficially Owned	Percent Owned
Yu Chuan Yih	3,842,853(1)(2)	27.7%
Ka Man Au	77,500(3)	*
Hon Tak Ringo Ng	62,500(4)	*
Po Yee Elsa Yue	4,000	*
Lionel C. Wang	0	*
All directors and executive officers as a group (5 persons)	3,986,853	28.4%

\* Represents less than 1% beneficial ownership

- (1) Of Mr. Yih's 2,267,853 shares, 1,500,000 shares are owned of record by Pacific Growth Developments Ltd., a British Virgin Islands corporation, which is owned by Mr. Yih (60%), his wife Tammy Yih (20%) and an adult daughter, Bianca Tzu Hsiu Yih (20%).
- (2) Includes options currently exercisable by Mr. Yih to acquire 775,000 shares of common stock at \$2.00 per share at any time until April 30, 2008 and 800,000 shares of common stock at \$2.00 per share at any time until June 30, 2013.
- (3) Represents options currently exercisable to acquire 40,000 shares of common stock at \$2.00 per share at any time until April 30, 2008 and 37,500 shares of common stock at \$2.00 per share at any time until June 30, 2013.
- (4) Represents options currently exercisable to acquire 25,000 shares of common stock at \$2.00 per share at any time until April 30, 2008 and 37,500 shares of common stock at \$2.00 per share at any time until June 30, 2013.

**The 1998 Stock Compensation Plan**

Effective June 1, 1998, we adopted and approved the 1998 Stock Compensation Plan. The purpose of the plan is to:

encourage ownership of our common stock by our officers, directors, employees and advisors;

provide additional incentive for them to promote our success and our business; and

**Table of Contents**

encourage them to remain in our employ by providing them with an opportunity to benefit from any appreciation of our common stock through the issuance of stock options.

Options constitute either incentive stock options within the meaning of Section 422 of the United States Internal Revenue Code of 1986, as amended, or options which constitute nonqualified options at the time of issuance of such options. The plan provides that incentive stock options and/or nonqualified stock options may be granted to our officers, directors, employees and advisors selected by the compensation committee. A total of 4,000,000 shares of common stock are authorized and reserved for issuance during the term of the plan, which expires in June 2008. The compensation committee has the sole authority to interpret the plan and make all determinations necessary or advisable for administering the plan. The exercise price for any incentive option must be at least equal to the fair market value of the shares as of the date of grant. Upon the exercise of the option, the exercise price must be paid in full either in cash, shares of our stock or a combination. If any option is not exercised for any reason, such shares shall again become available for the purposes of the plan.

On October 17, 2000, the Company offered each option holder the opportunity to cancel all or some of the stock options previously granted in exchange for the granting on April 30, 2001 of options to acquire an equal number of shares with an exercise price equal to the then last sale price of the stock on April 30, 2001, for a new term of seven years expiring April 30, 2008.

As of December 31, 2004, 1,507,500 options had been exercised and the following options to purchase shares of our common stock under the plan remained outstanding:

stock options to purchase 1,429,000 and 872,000 shares at \$2.00 per share through April 30, 2008 and June 30, 2013, respectively, of which 1,640,000 are held by our directors and officers as a group.

**The 2003 Stock Compensation Plan**

Effective July 1, 2003, we adopted and approved the 2003 Stock Compensation Plan, which our shareholders approved on December 5, 2003. The purpose of the plan is to:

encourage ownership of our common stock by our officers, directors, employees and advisors;

provide additional incentive for them to promote our success and our business; and

encourage them to remain in our employ by providing them with an opportunity to benefit from any appreciation of our common stock through the issuance of stock options.

Options constitute either incentive stock options within the meaning of Section 422 of the United States Internal Revenue Code of 1986, as amended, or options which constitute nonqualified options at the time of issuance of such options. The plan provides that incentive

**Table of Contents**

stock options and/or nonqualified stock options may be granted to our officers, directors, employees and advisors selected by the compensation committee. A total of 4,000,000 shares of common stock are authorized and reserved for issuance during the term of the plan, which expires in June 2013. The compensation committee has the sole authority to interpret the plan and make all determinations necessary or advisable for administering the plan. The exercise price for any incentive option or nonqualified option may be less than the fair market value of the shares as of the date of grant. Upon the exercise of the option, the exercise price must be paid in full either in cash, shares of our stock or a combination. If any option is not exercised for any reason, such shares shall again become available for the purposes of the plan.

As of December 31, 2004, 20,000 options had been exercised and the following options to purchase shares of our common stock under the plan remained outstanding:

stock options to purchase 1,258,000 shares at \$2.00 per share and 200,000 shares at \$2.35 per share through June 30, 2013, of which 312,000 are held by our directors and officers as a group.

**Other Options and Warrants Outstanding**

As of December 31, 2004, the following additional options and warrants to purchase shares of our common stock were outstanding:

1,679,000 common stock purchase warrants which are publicly traded and which we issued in our April 1998 initial public offering to purchase 1,679,000 shares of common stock at \$5.75 per share through April 15, 2005 (as amended)

146,000 stock purchase options to purchase 146,000 shares of common stock at \$8.25 per share through April 15, 2005 (as amended), which we sold to the IPO underwriter and/or persons related to the underwriter

warrants to purchase 87,500 shares at \$6.9375 per share through March 31, 2005 which we granted to two investors and a placement agent in connection with a tranche of our 3% Convertible Debentures on March 22, 2000

warrants to purchase 80,000 shares at \$4.57 per share through May 31, 2005 which we granted to a former financial consultant on June 1, 2001 for services rendered in connection with corporate development

warrants to purchase 200,000 shares at \$3.00 per share through August 15, 2006 which we granted to The Bauer Partnership, Inc. on August 16, 2001, in connection with a proposed debt placement which was never completed

warrants to purchase 484,221 shares at \$2.98 per share through September 3, 2009 which we sold to a group of investors pursuant to a private placement offering on September 1, 2004

**Table of Contents**

**ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS**

**A. MAJOR SHAREHOLDERS.**

Please see Item 6.E. for share ownership information regarding our major shareholders. Our major shareholders do not have different voting rights.

As of December 31, 2004, we had 280 record holders of our common stock. Of the 12,304,658 shares outstanding as of December 31, 2004, 8,935,917 shares were held by CEDE & Co.

To the extent known to us, we are not directly or indirectly owned or controlled by another corporation, by any foreign government or by any other natural or legal persons severally or jointly.

To our knowledge, there are no arrangements the operation of which may at a subsequent date result in a change in control of our company.

**B. RELATED PARTY TRANSACTIONS.**

Certain of our banking facilities are collateralized by properties owned by Yu Chuan Yih and his personal guarantee to the extent of \$8,311,000, \$9,147,000 and \$12,971,000 as of December 31, 2002, 2003 and 2004. Mr. Yih has not received any additional compensation or consideration from us in return for his personal guarantees.

During the fiscal year ended April 30, 1999, we provided a guarantee to a bank in respect of mortgage loans granted to Yu Chuan Yih to the extent of \$632,000. As of December 31, 2004, the balance of the mortgage loans amounted to \$307,000.

**C. INTERESTS OF EXPERTS AND COUNSEL.**

Not applicable.

**Table of Contents**

**ITEM 8. FINANCIAL INFORMATION**

**A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION.**

The Consolidated Financial Statements are filed in this Annual Report as Item 18.

Export sales constitute significantly all of our total sales volume.

There are no legal or arbitration proceedings, including those relating to bankruptcy, receivership or similar procedures and those involving any third party, which may have, or have had in the recent past, significant effects on our financial position or profitability. We are not aware of any governmental proceedings pending or known to be contemplated.

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.

**B. SIGNIFICANT CHANGES.**

We believe that no significant changes have occurred since the date of the annual financial statements included in this annual report.

**Table of Contents****ITEM 9. THE OFFER AND LISTING****A. OFFER AND LISTING DETAILS.**

Our common stock is listed and quoted for trading on The Nasdaq National Market under the symbol JADE. The following table sets forth, during the periods indicated, the high and low last sale prices for the common stock as reported by Nasdaq:

<b>Period</b>	<b>High</b>	<b>Low</b>
Year ended April 30, 2000	\$ 6.69	\$ 3.00
Year ended April 30, 2001	\$ 3.88	\$ 1.63
Year ended April 30, 2002	\$ 2.79	\$ 1.18
Year ended December 31, 2002	\$ 1.56	\$ 1.11
Year ended December 31, 2003	\$ 5.00	\$ 1.14
Year ended December 31, 2004	\$ 5.74	\$ 2.21
Quarter ended March 31, 2003	\$ 1.30	\$ 1.14
Quarter ended June 30, 2003	\$ 1.85	\$ 1.17
Quarter ended September 30, 2003	\$ 5.00	\$ 1.85
Quarter ended December 31, 2003	\$ 4.89	\$ 3.44
Quarter ended March 31, 2004	\$ 5.74	\$ 3.75
Quarter ended June 30, 2004	\$ 4.23	\$ 3.14
Quarter ended September 30, 2004	\$ 3.79	\$ 2.25
Quarter ended December 31, 2004	\$ 3.36	\$ 2.21
Month ended September 30, 2004	\$ 2.80	\$ 2.25
Month ended October 31, 2004	\$ 2.34	\$ 2.21
Month ended November 30, 2004	\$ 2.82	\$ 2.59
Month ended December 31, 2004	\$ 3.36	\$ 2.85
Month ended January 31, 2005	\$ 3.15	\$ 2.68
Month ended February 28, 2005	\$ 3.46	\$ 2.85



**Table of Contents**

Our warrants are listed and quoted for trading on The Nasdaq National Market under the symbol JADEW. The following table sets forth, during the periods indicated, the high and low last sale prices for the warrants as reported by Nasdaq:

<b>Period</b>	<b>High</b>	<b>Low</b>
Year ended April 30, 2000	\$ 3.25	\$ 1.00
Year ended April 30, 2001	\$ 1.38	\$ 0.22
Year ended April 30, 2002	\$ 0.55	\$ 0.02
Year ended December 31, 2002	\$ 0.15	\$ 0.01
Year ended December 31, 2003	\$ 1.13	\$ 0.02
Year ended December 31, 2004	\$ 1.30	\$ 0.17
Quarter ended March 31, 2003	\$ 0.12	\$ 0.04
Quarter ended June 30, 2003	\$ 0.12	\$ 0.02
Quarter ended September 30, 2003	\$ 1.13	\$ 0.12
Quarter ended December 31, 2003	\$ 1.08	\$ 0.54
Quarter ended March 31, 2004	\$ 1.30	\$ 0.61
Quarter ended June 30, 2004	\$ 0.83	\$ 0.60
Quarter ended September 30, 2004	\$ 0.70	\$ 0.23
Quarter ended December 31, 2004	\$ 0.53	\$ 0.17
Month ended September 30, 2004	\$ 0.46	\$ 0.23
Month ended October 31, 2004	\$ 0.44	\$ 0.19
Month ended November 30, 2004	\$ 0.53	\$ 0.17
Month ended December 31, 2004	\$ 0.35	\$ 0.20
Month ended January 31, 2005	\$ 0.29	\$ 0.16
Month ended February 28, 2005	\$ 0.19	\$ 0.07

We do not believe that there is any principal non-United States trading market for our common stock or our warrants. We believe that Cede & Co. holds a substantial majority of the outstanding common stock and warrants as record holder.

**Table of Contents**

**B. PLAN OF DISTRIBUTION.**

Not applicable.

**C. MARKETS.**

Our common stock and our warrants have been listed and quoted for trading on The Nasdaq National Market System since April 15, 1998.

**D. SELLING SHAREHOLDERS.**

Not applicable.

**E. DILUTION.**

Not applicable.

**F. EXPENSES OF THE ISSUE.**

Not applicable.

**ITEM 10. ADDITIONAL INFORMATION**

**A. SHARE CAPITAL.**

Not applicable.

**B. MEMORANDUM AND ARTICLES OF ASSOCIATION.**

Corporate Powers. We have been registered in the British Virgin Islands since January 30, 1997, under British Virgin Islands International Business Companies number 216796. Clause 4 of our Memorandum of Association states that the objects for which we are established are to engage in any businesses which are not prohibited by law in force in the British Virgin Islands.

**Table of Contents**

Directors. A director who is materially interested in any transaction with us shall declare the material facts of and nature of his interest at the meeting of the Board of Directors. A director may vote or be counted as the quorum on any resolution of the Board in respect of any transaction in which he is materially interested. With the prior or subsequent approval by a resolution of members, the directors may, by a resolution of directors, fix the emoluments of directors with respect to services to be rendered in any capacity to us. The directors may, by a resolution of directors, exercise all the powers of the Company to borrow money. There is no age limit requirement for retirement or non-retirement of directors. A director shall not require a share qualification.

Share Rights, Preferences and Restrictions. Our authorized share capital is US\$1 million divided into 100 million shares of par value US\$0.01 per share. All dividends unclaimed for three years after having been declared may be forfeited by resolution of the directors for our benefit. All shares vote as one class and each whole share has one vote. Directors stand for reelection on an annual basis. Cumulative voting for directors is not authorized. We may redeem any of our own shares for such fair value as we by a resolution of directors determine. All shares have the same rights with regard to dividends and distributions upon our liquidation.

Changing Share Rights. The rights of each class and series of shares that we are authorized to issue shall be fixed by the resolution of directors. If the authorized capital is divided into different classes, the rights attached to any class may be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class and of the holders of not less than three-fourths of the issued shares of any other class which may be affected by such variation.

Shareholder Meetings. The directors may convene meetings of our members at such times and in such manner and places as the directors consider necessary or desirable. The directors shall convene such a meeting upon the written request of members holding 10 percent or more of our outstanding voting shares. At least seven days notice of the meeting shall be given to the members whose names appear on the share register.

Restrictions on Rights to Own Securities. There are no limitations on the rights to own our securities.

Change in Control Provisions. There are no provisions of our Memorandum of Association and Articles of Association that would have an effect of delaying, deferring or preventing a change in our control and that would have operate only with respect to a merger, acquisition or corporate restructuring involving us.

Disclosure of Share Ownership. There are no bylaw provisions governing the ownership threshold above which shareholder ownership must be disclosed.

Applicable Law. Under the laws of most jurisdictions in the US, majority and controlling shareholders generally have certain fiduciary responsibilities to the minority shareholders.

**Table of Contents**

Shareholder action must be taken in good faith and actions by controlling shareholders which are obviously unreasonable may be declared null and void. BVI law protecting the interests of minority shareholders may not be as protective in all circumstances as the law protecting minority shareholders in US jurisdictions.

While BVI law does permit a shareholder of a BVI company to sue its directors derivatively, that is, in the name of, and for the benefit of, our company and to sue a company and its directors for his benefit and for the benefit of others similarly situated, the circumstances in which any such action may be brought, and the procedures and defenses that may be available in respect of any such action, may result in the rights of shareholders of a BVI company being more limited than those of shareholders of a company organized in the US.

Our directors have the power to take certain actions without shareholder approval, including an amendment of our Memorandum of Association or Articles of Association or an increase or reduction in our authorized capital, which would require shareholder approval under the laws of most US jurisdictions. In addition, the directors of a BVI corporation, subject in certain cases to court approval but without shareholder approval, may, among other things, implement a reorganization, certain mergers or consolidations, the sale, transfer, exchange or disposition of any assets, property, part of the business, or securities of the corporation, or any combination, if they determine it is in the best interests of the corporation, its creditors, or its shareholders. Our ability to amend our Memorandum of Association and Articles of Association without shareholder approval could 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.

The International Business Companies Act of the British Virgin Islands permits the creation in our Memorandum and Articles of Association of staggered terms of directors, cumulative voting, shareholder approval of corporate matters by written consent, and the issuance of preferred shares. Currently, our Memorandum and Articles of Association only provide for shareholder approval of corporate matters by written consent, but not for staggered terms of directors, cumulative voting or the issuance of preferred shares.

As in most US jurisdictions, the board of directors of a BVI corporation is charged with the management of the affairs of the corporation. In most US jurisdictions, directors owe a fiduciary duty to the corporation and its shareholders, including a duty of care, under which directors must properly apprise themselves of all reasonably available information, and a duty of loyalty, under which they must protect the interests of the corporation and refrain from conduct that injures the corporation or its shareholders or that deprives the corporation or its shareholders of any profit or advantage. Many US jurisdictions have enacted various statutory provisions which permit the monetary liability of directors to be eliminated or limited.

Under BVI law, liability of a corporate director to the corporation is primarily limited to cases of willful malfeasance in the performance of his duties or to cases where the director has not acted honestly and in good faith and with a view to the best interests of the corporation.

**Table of Contents**

However, under our Articles of Association, we are authorized to indemnify any director or officer who is made or threatened to be made a party to a legal or administrative proceeding by virtue of being one of our directors or officers, provided such person acted honestly and in good faith and with a view to our best interests and, in the case of a criminal proceeding, such person had no reasonable cause to believe that his conduct was unlawful. Our Articles of Association also enable us to indemnify any director or officer who was successful in such a proceeding against expense and judgments, fines and amounts paid in settlement and reasonably incurred in connection with the proceeding.

The above description of certain differences between BVI and US corporate laws is only a summary and does not purport to be complete or to address every applicable aspect of such laws. However, we believe that all material differences are disclosed above.

Changes in Capital. Requirements to effect changes in capital are not more stringent than is required by law.

**C. MATERIAL CONTRACTS.**

None.

**D. EXCHANGE CONTROLS.**

There are no material British Virgin Islands laws, decrees, regulations or other legislation that impose foreign exchange controls on us or that affect our payment of dividends, interest or other payments to non-resident holders of our capital stock. British Virgin Islands law and our Memorandum of Association and Articles of Association impose no limitations on the right of non-resident or foreign owners to hold or vote our common stock.

**E. TAXATION.**

The following is a summary of anticipated material U.S. federal income and British Virgin Islands tax consequences of an investment in our common stock. The summary does not deal with all possible tax consequences relating to an investment in our common stock and does not purport to deal with the tax consequences applicable to all categories of investors, some of which, such as dealers in securities, insurance companies and tax-exempt entities, may be subject to special rules. In particular, the discussion does not address the tax consequences under state, local and other non-U.S. and non-British Virgin Islands tax laws. Accordingly, each prospective investor should consult its own tax advisor regarding the particular tax consequences to it of an investment in the common stock. The discussion below is based upon laws and relevant interpretations in effect as of the date of this annual report, all of which are subject to change.

**Table of Contents**

**United States Federal Income Taxation**

The following discussion addresses only the material U.S. federal income tax consequences to a U.S. person, defined as a U.S. citizen or resident, a U.S. corporation, or an estate or trust subject to U.S. federal income tax on all of its income regardless of source, making an investment in the common stock. For taxable years beginning after December 31, 1996, a trust will be a U.S. person only if:

a court within the United States is able to exercise primary supervision over its administration; and

one or more United States persons have the authority to control all of its substantial decisions.

In addition, the following discussion does not address the tax consequences to a person who holds or will hold, directly or indirectly, 10% or more of our common stock, which we refer to as a 10% Shareholder. Non-U.S. persons and 10% Shareholders are advised to consult their own tax advisors regarding the tax considerations incident to an investment in our common stock.

A U.S. investor receiving a distribution of our common stock will be required to include such distribution in gross income as a taxable dividend, to the extent of our current or accumulated earnings and profits as determined under U.S. federal income tax principles. Any distributions in excess of our earnings and profits will first be treated, for U.S. federal income tax purposes, as a nontaxable return of capital, to the extent of the U.S. investor's adjusted tax basis in our common stock, and then as gain from the sale or exchange of a capital asset, provided that our common stock constitutes a capital asset in the hands of the U.S. investor. U.S. corporate shareholders will not be entitled to any deduction for distributions received as dividends on our common stock.

Gain or loss on the sale or exchange of our common stock will be treated as capital gain or loss if our common stock is held as a capital asset by the U.S. investor. Such capital gain or loss will be long-term capital gain or loss if the U.S. investor has held our common stock for more than one year at the time of the sale or exchange.

A holder of common stock may be subject to backup withholding at the rate of 31% with respect to dividends paid on our common stock if the dividends are paid by a paying agent, broker or other intermediary in the United States or by a U.S. broker or certain United States-related brokers to the holder outside the United States. In addition, the proceeds of the sale, exchange or redemption of common stock may be subject to backup withholding, if such proceeds are paid by a paying agent, broker or other intermediary in the United States.

Backup withholding may be avoided by the holder of common stock if such holder:

is a corporation or comes within other exempt categories; or

-46-

---

**Table of Contents**

provides a correct taxpayer identification number, certifies that such holder is not subject to backup withholding and otherwise complies with the backup withholding rules.

In addition, holders of common stock who are not U.S. persons are generally exempt from backup withholding, although they may be required to comply with certification and identification procedures in order to prove their exemption.

Any amounts withheld under the backup withholding rules from a payment to a holder will be refunded or credited against the holder's U.S. federal income tax liability, if any, provided that amount withheld is claimed as federal taxes withheld on the holder's U.S. federal income tax return relating to the year in which the backup withholding occurred. A holder who is not otherwise required to file a U.S. income tax return must generally file a claim for refund or, in the case of non-U.S. holders, an income tax return in order to claim refunds of withheld amounts.

**British Virgin Islands Taxation**

Under the International Business Companies Act of the British Virgin Islands as currently in effect, a holder of common stock who is not a resident of BVI is exempt from BVI income tax on dividends paid with respect to the common stock and all holders of common stock are not liable for BVI income tax on gains realized during that year on sale or disposal of such shares; BVI does not impose a withholding tax on dividends paid by a company incorporated under the International Business Companies Act.

There are no capital gains, gift or inheritance taxes levied by BVI on companies incorporated under the International Business Companies Act. In addition, the common stock is not subject to transfer taxes, stamp duties or similar charges.

There is no income tax treaty or convention currently in effect between the United States and the British Virgin Islands.

**F. DIVIDENDS AND PAYING AGENTS.**

Not applicable.

**G. STATEMENT BY EXPERTS.**

Not applicable.

**Table of Contents**

**H. DOCUMENTS ON DISPLAY.**

The documents concerning our company, which are referred to in this annual report, may be inspected at our principal executive offices at Unit #12, 12/F, Block A, Focal Industrial Centre, 21 Man Lok Street, Hung Hom, Kowloon, Hong Kong.

**I. SUBSIDIARY INFORMATION.**

Not applicable.

**ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We do not believe that we have any material exposures to market risk associated with activities in derivative financial instruments, other financial instruments, derivative commodity instruments, and other market risk sensitive instruments, positions and transactions.

**ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

Not applicable.

**PART II**

**ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

None.

**ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS**

Effective December 5, 2002, we announced a two-year extension of the exercise term to April 15, 2005 for our 1,679,000 outstanding registered common stock purchase warrants (Nasdaq: JADEW). Each warrant remains exercisable to purchase one share of common stock at \$5.75 per share.



**Table of Contents**

**ITEM 15. CONTROLS AND PROCEDURES**

**(a) Disclosure Controls and Procedures.**

We carried out an evaluation, under the supervision and with the participation of our chairman, chief financial officer and chief operating officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of our fiscal year. Based on this evaluation, which will be used as input for further improvement actions, they concluded that our disclosure controls and procedures are effective to timely alerting them to material information about LJ International Inc. and its consolidated subsidiaries.

There have been no significant changes in our internal controls or in other factors that could significantly affect those controls subsequent to the date of this evaluation.

**(b) Management's annual report on internal control over financial reporting.**

Not applicable.

**ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

Our Board of Directors has determined that we currently do not have at least one audit committee financial expert serving on our audit committee. We intend to identify and retain an audit committee financial expert no later than July 31, 2005.

**ITEM 16B. CODE OF ETHICS**

We have adopted a code of ethics that applies to all of our employees, including our chief executive officer and our chief financial officer.

**ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

**(a) Audit Fees.**

The aggregate fees billed for each of the last two fiscal years for professional services rendered by our principal accountant for the audit of our annual financial statements or services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for those fiscal years were \$120,000 for the fiscal year ended December 31, 2003 and \$140,000 for the fiscal year ended December 31, 2004.

**Table of Contents**

**(b) Audit Related Fees.**

No fees were billed in each of the last two fiscal years for assurance and related services by our principal accountant that are reasonably related to the performance of the audit or review of our financial statements and are not reported under paragraph (a) of this Item for the fiscal year ended December 31, 2003 and for the fiscal year ended December 31, 2004.

**(c) Tax Fees.**

The aggregate fees billed in each of the last two fiscal years for professional services rendered by our principal accountant for tax compliance, tax advice, and tax planning were \$8,000 for the fiscal year ended December 31, 2003 and \$8,000 for the fiscal year ended December 31, 2004. The nature of the services comprising these fees included data gathering for preparation, review and submission as agent of tax filing.

**(d) All Other Fees.**

No fees were billed in each of the last two fiscal years for products and services provided by our principal accountant, other than the services reported in paragraphs (a) through (c) of this Item for the fiscal year ended December 31, 2003 and for the fiscal year ended December 31, 2004.

**(e) Audit Committee Pre-Approval Policies and Procedures.**

To ensure continuing auditor objectivity and to safeguard the independence of our auditors, our audit committee has determined a framework for the type and authorization of non-audit services which our auditors, Moores Rowland Mazars, may provide.

The audit committee has adopted policies for the pre-approval of specific services that may be provided by our principal auditors. These policies are kept under review and amended as necessary to meet the dual objectives of ensuring that we benefit in a cost effective manner from the cumulative knowledge and experience of our auditors whilst also ensuring that the auditors maintain the necessary degree of independence and objectivity.

Our audit committee approved the engagement of Moores Rowland Mazars as our auditors to render audit and non-audit services before Moores Rowland Mazars was engaged by us.

All of the services described in each of paragraphs (b) through (d) of this Item were approved by the audit committee pursuant to paragraph (c)(7)(i)(C) of Rule 2-01 of Regulation S-X.

**(f).** Not applicable.

**Table of Contents**

**ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES.**

Not applicable.

**ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS.**

In September 2001, we announced a common stock repurchase program pursuant to which we may repurchase up to 1,000,000 shares of common stock from time to time in the open market and in negotiated transactions, including block transactions, and may be discontinued at any time without prior notice.

We did not repurchase any of our shares of common stock during the fiscal year ended December 31, 2004.

**Table of Contents**

**PART III**

**ITEM 17. FINANCIAL STATEMENTS**

Not applicable.

**ITEM 18. FINANCIAL STATEMENTS**

The following financial statements are being filed as part of this Annual Report on Form 20-F:

Report of Independent Auditors

Consolidated statements of operations for the year ended April 30, 2002 and for the eight-month period ended December 31, 2002 and for the years ended December 31, 2003 and 2004.

Consolidated balance sheets as of December 31, 2002, 2003 and 2004.

Consolidated statements of shareholders' equity for the year ended April 30, 2002 and for the eight-month period ended December 31, 2002 and for the years ended December 31, 2003 and 2004.

Consolidated statements of cash flows for the year ended April 30, 2002 and for the eight-month period ended December 31, 2002 and for the years ended December 31, 2003 and 2004.

Notes to and forming part of the financial statements

**Table of Contents**

**LJ INTERNATIONAL INC.**

**INDEX TO FINANCIAL STATEMENTS**

	Page
Report of Independent Registered Public Accounting Firm	F-2
Consolidated Statements of Operations	F-3
Consolidated Balance Sheets	F-4
Consolidated Statements of Shareholders' Equity	F-5
Consolidated Statements of Cash Flows	F-6 F-7
Notes to and Forming Part of the Financial Statements	F-8 F-36

F-1

---

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To The Shareholders and The Board of Directors of  
**LJ International Inc.**

We have audited the accompanying consolidated balance sheets of LJ International Inc. and its subsidiaries as of December 31, 2004, December 31, 2003 and December 31, 2002 and the related consolidated statements of operations, shareholders' equity and cash flows for each of the years in the two-year period ended December 31, 2004, for the eight-month period ended December 31, 2002 and for the year ended April 30, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of LJ International Inc. and its subsidiaries as of December 31, 2004, December 31, 2003 and December 31, 2002, and the consolidated results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2004, for the eight-month period ended December 31, 2002 and for the year ended April 30, 2002, in conformity with U.S. generally accepted accounting principles.

As discussed in note 2 to the consolidated financial statements, the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 46 (Revised December 2003), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51 (FIN 46(R)) and, accordingly, began consolidating a variable interest entity as of May 21, 2004.

/s/ Moores Rowland Mazars

**Moores Rowland Mazars**

*Chartered Accountants*

*Certified Public Accountants, Hong Kong*

Dated: March 24, 2005

Table of Contents

## LJ INTERNATIONAL INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in thousands, except share and per share data)

		Year ended December 31, 2004 US\$	Year ended December 31, 2003 US\$	8 months ended December 31, 2002 US\$	Year ended April 30, 2002 US\$
<b>Operating revenue</b>	<i>2(c)</i>	<b>77,379</b>	58,167	31,809	39,240
Costs of goods sold		<b>(61,265)</b>	(44,947)	(22,820)	(35,731)
Gross profit		<b>16,114</b>	13,220	8,989	3,509
Operating expenses					
Selling, general and administrative expenses		<b>(11,578)</b>	(9,133)	(6,433)	(8,963)
Unrealized loss on derivatives		<b>(482)</b>	(162)	(435)	(660)
Depreciation		<b>(1,032)</b>	(1,184)	(863)	(1,031)
Impairment on property, plant and equipment			(84)	(108)	(345)
Amortization and impairment loss on goodwill	<i>8</i>		(200)	(400)	(242)
Operating income (loss)		<b>3,022</b>	2,457	750	(7,732)
Other revenue and expense					
Other revenues	<i>2(c)</i>	<b>844</b>	453	205	352
Interest expenses		<b>(902)</b>	(753)	(441)	(652)
Impairment loss on investment securities	<i>9</i>			(200)	
<b>Income (loss) before income taxes and minority interests</b>		<b>2,964</b>	2,157	314	(8,032)
Income taxes (expense) credit	<i>11</i>	<b>(277)</b>	(352)	(101)	101
<b>Income (Loss) before minority interests</b>		<b>2,687</b>	1,805	213	(7,931)
Minority interests in consolidated subsidiaries			8	120	30

Edgar Filing: LJ INTERNATIONAL INC - Form 20-F

<b>Net income (loss)</b>		<b>2,687</b>	1,813	333	(7,901)
Numerator:					
Net income (loss) used in computing basic earnings (loss) per share		<b>2,687</b>	1,813	333	(7,901)
Denominator:					
Weighted average number of shares used in calculating basic earnings (loss) per share		<b>11,118,995</b>	8,757,266	8,492,851	8,671,615
Effect of dilutive potential ordinary shares:					
Warrants		<b>55,693</b>	183,151		7
Stock options		<b>932,786</b>	765,267		106,759
Weighted average number of shares used in calculating diluted earnings (loss) per share		<b>12,107,474</b>	9,705,684	8,492,851	8,778,381
Earnings (loss) per share:					
Basic	2(g)	<b>0.24</b>	0.21	0.04	(0.91)
Diluted	2(g)	<b>0.22</b>	0.19	0.04	(0.91)

The accompanying notes are an integral part of these financial statements.



**Table of Contents****LJ INTERNATIONAL INC.****CONSOLIDATED BALANCE SHEETS**

(Amounts in thousands, except share and per share data)

		<b>As of December 31,</b>		
	<i>Notes</i>	<b>2004</b>	2003	2002
		<b>US\$</b>	US\$	US\$
<b>ASSETS</b>				
<b>Current asset</b>				
Cash and cash equivalents		<b>3,228</b>	2,722	997
Restricted cash		<b>6,393</b>	5,931	6,358
Trade receivables, net of allowance for doubtful accounts (December 31, 2004: US\$284; December 31, 2003: US\$159; December 31, 2002: US\$280)		<b>15,653</b>	15,243	10,962
Derivatives			651	
Inventories	5	<b>36,629</b>	21,487	17,932
Prepayments and other current assets		<b>2,539</b>	3,726	1,233
<b>Total current assets</b>		<b>64,442</b>	49,760	37,482
Properties held for lease, net	6	<b>1,452</b>	1,506	1,561
Property, plant and equipment, net	7	<b>4,673</b>	4,931	5,153
Due from related parties	16(b)	<b>491</b>	508	511
Goodwill, net	8	<b>1,521</b>	1,521	1,721
Investment securities, net	9	<b>2,460</b>	2,460	2,460
<b>Total assets</b>		<b>75,039</b>	60,686	48,888
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>				
<b>Current liabilities</b>				
Bank overdrafts	10	<b>607</b>	1,312	3,107
Notes payable	10	<b>2,487</b>	1,516	1,073
Capitalized lease obligation, current portion		<b>19</b>	18	23
Letters of credit, gold and others	10	<b>21,911</b>	16,737	12,259
Derivatives		<b>1,462</b>	1,430	739
Trade payables		<b>9,553</b>	8,417	6,620
Accrued expenses and other payables		<b>4,631</b>	2,864	1,696
Income taxes payable		<b>68</b>	326	69
Deferred taxation		<b>87</b>	87	
<b>Total current liabilities</b>		<b>40,825</b>	32,707	25,586
Capitalized lease obligation, non-current		<b>58</b>	77	

<b>Total liabilities</b>		<b>40,883</b>	32,784	25,586
<b>Minority interest</b>				8
Commitments and contingencies	12			
<b>Shareholders equity</b>				
Common stocks, par value US\$0.01 each, Authorized - 100 million shares, Issued 12,304,658 shares as of December 31, 2004; 9,890,006 shares as of December 31, 2003 and 8,671,615 shares as of December 31, 2002	13	<b>123</b>	99	87
Additional paid-in capital		<b>23,382</b>	19,802	17,410
Treasury stock	13(b)			(391)
Accumulated other comprehensive loss		<b>(151)</b>	(151)	(151)
Unearned compensation	2(q)	<b>(37)</b>		
Retained earnings		<b>10,839</b>	8,152	6,339
<b>Total shareholders equity</b>		<b>34,156</b>	27,902	23,294
<b>Total liabilities and shareholders equity</b>		<b>75,039</b>	60,686	48,888

The accompanying notes are an integral part of these financial statements.

**Table of Contents**

**LJ INTERNATIONAL INC.**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY**  
 (Amounts in thousands, except share and per share data)

	Common stock	Additional Paid-in Capital	Treasury stock of	Accumulated other comprehensive loss	Unearned compensation	Retained earnings	Total
Notes	Number of shares	Par Value	Number of shares	Cost	loss	earnings	Total