

U.S. SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 20-F

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

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended April 30, 2002

OR

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

None

Name of each exchange  
on which registered

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 April 30, 2002:

8,671,615 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.

## **FORWARD-LOOKING STATEMENTS**

The Private Securities Litigation Reform Act of 1995 provides a “safe harbor” for forward-looking statements. Certain information included in this Annual Report on Form 20-F and other materials filed or to be filed by us with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by us) contains statements that are forward-looking, such as statements relating to plans for future expansion and other business development activities as well as other capital spending, financing sources and the effects of competition. Such forward-looking information involves important risks and uncertainties that could significantly affect anticipated results in the future and, accordingly, such results may differ from those expressed in any forward-looking statements made by or on our behalf. These risks and uncertainties include, but are not limited to, those relating to dependence upon certain customers, dependence upon key personnel, control by principal shareholder, competition from larger competitors, material factors relating to the operations of the business, People’s Republic of China (“PRC”) and Hong Kong political considerations, dependence on factories in China, and general economic conditions.

**PART I**

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

Not applicable.

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

Not applicable.

**ITEM 3. KEY INFORMATION**

**A. SELECTED FINANCIAL DATA.**

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

The following selected consolidated financial data with respect to each of the years in the five-year period ended April 30, 2002 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.

We prepare our consolidated financial statements in accordance with Hong Kong GAAP, which differs in certain material respects from US GAAP. For a discussion of the significant differences between Hong Kong GAAP and US GAAP, see Note 19 of Notes To And Forming Part Of The Financial Statements.

**Consolidated Statements of Operations Data:**

	<u>Year ended April 30,</u>					
	1998	1999	2000	2001	2002	2002
	HK\$	HK\$	HK\$	HK\$	HK\$	US\$
<b>Amount in accordance with Hong Kong GAAP</b>						
Operating revenues.....	124,199	195,219	300,901	357,785	303,326	39,240
	=====	=====	=====	=====	=====	=====

Operating income (loss).....	31,540	39,723	38,725	36,472	(57,868)	(7,487)
Interest expense, net.....	( 6,964)	( 5,186)	( 2,980)	(2,781)	(3,364)	(435)
Income (loss) before income taxes.	<u>24,576</u>	<u>34,537</u>	<u>35,745</u>	<u>33,691</u>	<u>(61,232)</u>	<u>(7,922)</u>
Income taxes (charge) credit.....	( 2,120)	( 380)	( 25)	(1,637)	784	101
Net income (loss) .....	<u>22,456</u>	<u>34,157</u>	<u>35,720</u>	<u>32,054</u>	<u>(60,448)</u>	<u>(7,821)</u>
	=====	=====	=====	=====	=====	=====
Dividends per share .....	-	-	-	-	-	-
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**Numerator:**

Net income (loss) used in computing basic earnings (loss) per share.....	22,456	34,157	35,720	32,054	(60,448)	(7,821)
Interest on 3% convertible debentures	-	-	251	127	-	-
Adjusted net income (loss) used in computing diluted earnings (loss) per share.....	<u>22,456</u>	<u>34,157</u>	<u>35,971</u>	<u>32,181</u>	<u>(60,448)</u>	<u>(7,821)</u>
	=====	=====	=====	=====	=====	=====

**Denominator:**

Weighted average number of shares outstanding – basic (thousands)	4,539	6,347	6,589	8,567	8,672	8,672
Effect of dilutive potential ordinary shares:						
3% convertible debentures .....	-	-	337	49	-	-
Warrants.....	5	-	7	-	-	-
Options.....	-	1	-	6	-	-
Weighted average number of shares outstanding – diluted (thousands)	<u>4,544</u>	<u>6,348</u>	<u>6,933</u>	<u>8,622</u>	<u>8,672</u>	<u>8,672</u>
	=====	=====	=====	=====	=====	=====
Earnings (loss) per share – basic..	<u>4.95</u>	<u>5.38</u>	<u>5.42</u>	<u>3.74</u>	<u>(6.97)</u>	<u>(0.90)</u>
	=====	=====	=====	=====	=====	=====
Earnings per share – diluted.....	<u>4.94</u>	<u>5.38</u>	<u>5.19</u>	<u>3.73</u>	<u>(N/A)</u>	<u>(N/A)</u>
	=====	=====	=====	=====	=====	=====

	<u>Year ended April 30,</u>					2002 US\$
	1998 HK\$	1999 HK\$	2000 HK\$	2001 HK\$	2002 HK\$	
	(Restated)	(Restated)	(Restated)	(Restated)		
<b>Amount in accordance with US GAAP</b>						
Operating revenues.....	124,199	195,219	300,901	357,785	303,326	39,240
	=====	=====	=====	=====	=====	=====
Operating income (loss) before income taxes (as restated for 1999, 2000 and 2001).....	14,325	32,347	29,698	25,868	(61,853)	(8,002)
	-----	-----	-----	-----	-----	-----
Net income (loss) per US GAAP (as restated for 1999, 2000 and 2001) .....	12,205	31,967	29,673	24,231	(61,069)	(7,901)
	-----	-----	-----	-----	-----	-----
Dividends per share .....	-	-	-	-	-	-
	-----	-----	-----	-----	-----	-----
<b>Numerator:</b>						
Net income (loss) used in computing basic earnings (loss) per share (as restated for 1999, 2000 and 2001) .....	12,205	31,967	29,673	24,231	(61,069)	(7,901)
Interest on 3% convertible debentures	-	-	251	127	-	-
	-----	-----	-----	-----	-----	-----
Adjusted net income (loss) used in computing diluted earnings (loss) per share (as restated for 1999, 2000 and 2001) .....	12,205	31,967	29,924	24,358	(61,069)	(7,901)
	=====	=====	=====	=====	=====	=====
<b>Denominator:</b>						
Weighted average number of shares outstanding under HK GAAP – basic (thousands)	4,539	6,347	6,589	8,567	8,672	8,672
Shares for Deen Merger .....	62	-	-	-	-	-
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Weighted average number of shares outstanding under US GAAP – basic (thousands)	4,601	6,347	6,589	8,567	8,672	8,672
Effect of dilutive potential ordinary shares:						
3% convertible debentures .....	-	-	337	49	-	-
Warrants.....	5	-	18	-	-	-
Options.....	-	1	-	1	107	107
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Weighted average number of shares outstanding under US GAAP - diluted (thousands)	4,606	6,348	6,944	8,617	8,779	8,779
	=====	=====	=====	=====	=====	=====
Earnings (loss) per share – basic (as restated for 1999, 2000 and 2001) .....	2.65	5.04	4.50	2.83	(7.04)	(0.91)
	=====	=====	=====	=====	=====	=====
Earnings (loss) per share – diluted (as restated for 1999, 2000 and 2001) .....	2.65	5.04	4.31	2.83	(7.04)	(0.91)
	=====	=====	=====	=====	=====	=====

### Consolidated Balance Sheet Data:

	As of April 30,					
	1998	1999	2000	2001	2002	2002
	HK\$	HK\$	HK\$	HK\$	HK\$	US\$
	(Restated)					
<b>Amount in accordance with Hong Kong GAAP</b>						
Working capital .....	39,090	75,645	158,795	155,787	93,652	12,115
Total assets .....	154,616	222,875	310,539	367,379	332,177	42,972
Long-term obligations.....	10,544	9,028	29,472	2,216	61	8
Total shareholders' equity.....	90,257	128,428	188,179	242,635	182,187	23,568
<b>Amount in accordance with US GAAP</b>						
Working capital .....	39,090	75,645	158,937	155,787	93,652	12,115
Total assets.....	142,307	213,020	306,881	365,614	332,088	42,961
Long-term obligations.....	10,544	9,028	22,755	2,216	61	8
Total shareholders' equity.....	77,948	118,573	191,235	240,870	182,098	23,557

### Exchange Rate Information

We have prepared our consolidated financial statements in accordance with Hong Kong generally accepted accounting principles consistently applied and publish such statements in Hong Kong dollars, which is the functional currency of our subsidiaries and the legal tender currency of Hong Kong. All references to "Hong Kong dollars" or "HK\$" are to Hong Kong dollars. All references to "U.S. Dollars," "dollars" or "\$" are to United States dollars. Conversion of amounts

from Hong Kong dollars into United States dollars for the convenience of the reader has been made at the exchange rate of US\$1.00 = HK\$7.73.

The following table sets forth certain information concerning exchange rates between Hong Kong dollars and U.S. dollars for the periods indicated. It represents the noon buying rate in New York for cable transfers payable in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York. The average noon buying rate is determined by averaging the rates on the last business day of each month during the relevant period.

<u>Calendar Year</u>	<u>Average Noon Buying Rate</u> (HK\$ per US\$)
1997	7.7431
1998	7.7467
1999	7.7594
2000	7.7924
2001	7.7997

<u>Calendar Month</u>	<u>High</u>	<u>Low</u>
February 2002	7.7999	7.7991
March 2002	7.8000	7.7993
April 2002	7.8095	7.7992
May 2002	7.8001	7.7990
June 2002	7.8005	7.7993
July 2002	7.8005	7.7999

As of August 9, 2002, being the latest practicable date, the exchange rate was US\$1.00 = HK\$7.8000.

**B. CAPITALIZATION AND INDEBTEDNESS.**

Not applicable.

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

Not applicable.

#### **D. RISK FACTORS.**

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

Although we sell to a large number of customers in a variety of markets, a substantial portion of our sales involve rings to one volume customer, QVC, Inc. For the fiscal years ended April 30, 2001 and 2002, QVC, Inc. accounted for approximately 47% and 28% of our sales. Although we have maintained a good and longstanding relationship with this customer, we do not have any long-term contracts with QVC, Inc., who orders only on a “purchase order” basis. The loss of QVC, Inc. as a customer or a significant reduction in its orders would have a materially adverse effect. We cannot assure that QVC, Inc. will continue to use us for the design and manufacture of a portion of their jewelry requirements.

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

Our largest shareholder beneficially owns or controls approximately 36.5% of our outstanding shares as of July 31, 2002. Accordingly, he has controlling influence in determining the outcome of any corporate transaction or other matter submitted to the shareholders for approval, including mergers, consolidations and the sale of all or substantially all of our assets, election of directors, and other significant corporate actions. He also has the power to prevent or cause a change in control. In addition, without the consent of this shareholder, we could be prevented from entering into transactions that could be beneficial to us. The interests of this shareholder may differ from the interests of the other shareholders.

**We face significant competition from larger competitors.**

The manufacture and distribution of jewelry is a highly competitive industry characterized by a diversity and sophistication of 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 manufacturers 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 manufacturer 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 efficiently meet the design and production requirements of our customers;
- 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 sales and marketing operations are performed principally at our executive offices which are located in Hong Kong. As a result, our results of operations and financial condition may be influenced by the political situation in Hong Kong and by the general state of the Hong Kong economy.**

On July 1, 1997, sovereignty over Hong Kong was transferred from the United Kingdom to China, and Hong Kong became a Special Administrative Region of China, an SAR. As provided in the Sino-British Joint Declaration on the Question of Hong Kong, referred to as the Joint Declaration, and the Basic Law of the Hong Kong SAR of China, referred to as the Basic Law, the Hong Kong SAR is to have a high degree of autonomy except in foreign and defense affairs. Under the Basic Law, the Hong Kong SAR is to have its own legislature, legal and judicial system and full economic autonomy for 50 years. We cannot assure, however, that changes in political or other conditions will not result in an adverse impact on our financial and operating condition.

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

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

**Our products are currently manufactured at our factories located in Shantou and Shenzhen, China. However, firefighting and disaster relief or assistance in China are primitive by Western standards.**

We have obtained fire, casualty and theft insurance aggregating approximately \$10.9 million covering several of our stock in trade, goods and merchandise, furniture and equipment and factory buildings in China. The proceeds of such insurance may not be sufficient to cover material damage to, or the loss of, our factories 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 between June and January of each year due to the importance of the holiday selling season.**

The approximately 28% of our sales during the fiscal year ended April 30, 2002 to our largest customer, QVC, Inc., were not seasonal in nature. It has been our management's experience that the remaining 72% of our total sales are seasonally sensitive.

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

We have no direct business operations, other than our ownership of our subsidiaries. While we have no current intention of or restriction on paying dividends, should we decide in the future to do so, as a holding company, 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, from time to time, may be subject to restrictions on their ability to make distributions to us, including as a result of restrictive covenants in loan agreements, restrictions on the conversion of local currency into U.S. dollars or other hard currency and other regulatory restrictions.

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

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

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

- 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 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 the same information which is generally available about public companies organized in the United States.

#### **ITEM 4. INFORMATION ON THE COMPANY**

##### **A. HISTORY AND DEVELOPMENT OF THE COMPANY.**

LJ International Inc. (“we”) were 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 Jewelry owns all of the equity in:
  - Shantou SEZ Lorenzo Gems & Craft Factory Co., Ltd.; and
  - Shantou Lorenzo Jewelry Mfg.
- ? Lorenzo Gems Manufacturing (Shenzhen) Co., Ltd.
- ? Lorenzo Jewellery (Shenzhen) Co., Ltd.
- ? Lorenzo Diamond Jewelry Mfg. Co. Limited.
- ? iBBC, Inc.

Under a cooperative joint venture agreement between Lorenzo Jewelry and Guangdong Province Shantou Artcrafts Imports and Exports Co., we control the operating and financial activities of Shantou Lorenzo Jewelry Mfg. and are responsible for all of its profits and losses.

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.

We have not made any significant capital expenditures or divestitures during our last three fiscal years, nor are any currently in progress. Our purchases of property, plant and equipment consisted of the following, presented in HK\$ in thousands:

	<u>Year ended April 30,</u>		
	<u>2000</u>	<u>2001</u>	<u>2002</u>
Leasehold improvement	1,041	2,654	1,664
Furniture, fixtures & equipment	1,219	2,442	1,397
Plant and machinery	<u>1,364</u>	<u>1,374</u>	<u>187</u>
Total	<u>3,624</u>	<u>6,470</u>	<u>3,248</u>

##### **B. BUSINESS OVERVIEW.**

We are a totally vertically integrated company that designs, brands, markets and distributes a complete range of fine jewelry. While we specialize in the semi-precious jewelry

segment, we also offer high-end pieces set in yellow gold, white gold, platinum or sterling silver and adorned with semi-precious stones, diamonds, pearls and precious stones. We distribute mainly to fine jewelers, department stores, national jewelry chains and electronic and specialty retailers throughout North America and Western Europe. Our product lines incorporate all major categories sought by major retailers, including earrings, necklaces, pendants, rings and bracelets.

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 manufacturing further enhance our competitive position.

We employ an international design team and all of our designs and merchandising strategies are proprietary. Our 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 who 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;
- electronic retailers; and
- specialty retailers.

For the fiscal years ended April 30, 2001 and 2002, approximately 83% 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 last three financial years:

	<u>Year ended April 30,</u>			
	<u>2000</u> HK\$	<u>2001</u> HK\$	<u>2002</u> HK\$	<u>2002</u> US\$
United States and Canada	231,751	297,321	222,704	28,810
Hong Kong	20,395	4,631	37,855	4,897
Europe and other countries	45,330	54,330	42,653	5,518
China	2,413	569	49	6

Japan	<u>1,012</u>	<u>934</u>	<u>65</u>	<u>9</u>
	300,901	357,785	303,326	39,240

Approximately 28% of our sales during the fiscal year ended April 30, 2002 were to our largest customer, QVC, Inc., and were not seasonal in nature. It has been our management's experience that the remaining 72% of our total sales are seasonally sensitive and occur primarily during August to January of each year.

### **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 manufacturers 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 manufacturers because they believe that prime manufacturers 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 manufacturing 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
- aggressively expand into new distribution channels, particularly in the United States and throughout Western Europe, Japan, and China.

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

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

- offering a new branded collection of sterling silver and 18 karat gold jewelry with a retail price range of \$199 to \$999; and
- 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.

We intend to implement our business strategy by:

- developing a new 18,000 square feet CAD/CAM enabled production facility devoted to diamonds and high-end precious stones, with technology to fully integrate computer design from prototype to sample
- promoting visits with customers to coordinate and develop 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 and Korea and further developing business with top-20 discount department store chains and one prominent warehouse club in the U.S.
- acquiring an electronic supply and replenish module for independent jewelry stores in the U.S., and building a European platform in Paris, France to network with key supersellers.

### **Our Manufacturing Capability**

We have established two sophisticated factories located in China that perform stone cutting and polishing and jewelry manufacturing. The factories are located in the cities of Shantou and Shenzhen in Guangdong Province, China. The Shantou facility is the older of the two facilities. It consists of 45,000 square feet and has been operating for ten years. The Shenzhen facility has been operating for five years and has 50,000 square feet of manufacturing space. We currently employ approximately 2,000 skilled gemstone cutters and manufacturing personnel and are producing approximately two million carats of cut gemstones and two million pieces of finished fine jewelry annually.

We purchase imported choice gemstone material which are from mines located in Africa, China and South America, especially concentrated in Brazil. Gemstone craftsmen are trained and managed by our Hong Kong personnel to insure 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.

We employ specialized manufacturing processes that deliver large quantities of high quality finished jewelry. We are currently producing approximately 160,000 pieces of finished

jewelry per month from our two facilities. Each piece of jewelry receives hand made attention, resulting in fine quality finishing at popular prices.

### **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 intend to devote our efforts towards brand development and utilize marketing concepts to enhance the saleability of our production. We recognize that retailers favor certain price points. As part of our product development strategy, we attempt to align our wholesale prices to match retailers' target prices as a means of achieving these popular price targets.

Our sales and marketing team is located in our executive offices in Hong Kong. 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;
- electronic retailers; and
- specialty retailers.

Our single largest customer is QVC, Inc. which accounted for approximately 47% of our sales during fiscal 2001 and 28% of our sales during fiscal 2002. We do not sell to QVC, Inc. pursuant to any formal or long-term contracts but only on a purchase order basis. Although we have developed and maintained a good and longstanding relationship with QVC, Inc., the loss of QVC, Inc. as a customer or a significant reduction in its orders would have a materially adverse effect on us.

In March 2000, our wholly-owned subsidiary Lorenzo Jewelry Mfg. (H.K.) Limited (n/k/a Lorenzo Jewelry Limited) entered into a three-year agreement with QVC, Inc. Under the terms of the agreement, QVC has the exclusive right to promote, market, sell and distribute all of the jewelry and watches which we manufacture, develop or sell through direct response television programs in North America, the United Kingdom and Germany. Upon expiration of the initial three-year term, the agreement automatically renews for additional three-year terms if QVC issued purchase orders to us of at least \$80 million during the initial term, with certain minimum increases in purchase orders for each succeeding three-year term. The agreement does not, however, obligate QVC to issue any purchase orders to us.

In addition to direct sales to QVC, Inc. and other 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 actively advertise in trade journals and related industry publications.

### **Design and Product Development**

We have seven internationally trained designers who work from our Hong Kong executive office and a growing team of twelve designers who work in a designated area within the Shenzhen manufacturing facility. The Hong Kong design director and the most experienced Hong Kong design staff closely supervises the China-based designers. The China-based designers create designs that have been accepted by our various clients worldwide. The Hong Kong design team attends trade fairs worldwide to gather product ideas and monitor the latest product trends.

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

### **Manufacturing Process**

We manufacture our products at our facilities in Shantou and Shenzhen, China. Our manufacturing processes combine vertical integration, modern technology, mechanization and handcraftsmanship to produce contemporary and fashionable jewelry. Our manufacturing operations basically involve:

- cutting and polishing semi-precious gemstones;
- combining pure gold, platinum and sterling silver with other metals to produce jewelry; and
- finishing operations such as cleaning, polishing and setting, resulting in high quality finished jewelry.

We have developed a process of cost-effectively producing quality, gem-set jewelry. We believe that we have a substantial competitive advantage due to our unique, vertically integrated manufacturing process.

## **Supply**

We manufacture and cut our own semi-precious stones. We purchase imported gemstones which are from South America, Africa and China. South America is the major source of ametrine, amethyst, aquamarine, imperial topaz, tourmaline and white topaz, and Africa is the main source of tanzanite, mandarine garnet, garnet aquamarine and topaz. We also purchase imported aquamarine, peridot and topaz from China. 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 preformed and semi-finished cut gemstones 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 manufacture 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 do not presently engage in hedging activities with respect to possible fluctuations in the price of gold. We believe the risk of not engaging in such activities is minimal, since we purchase our gold requirements after each significant purchase order is received. We believe that any change in the price of gold would have 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 Shantou and Shenzhen, China manufacturing and our Hong Kong administrative facilities to protect against loss, including multiple alarm systems, infrared motion detectors and a system of closed circuit television cameras which provide surveillance of all critical areas of our premises.

We carefully inspect 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 manufacturing process. A complete physical inventory of gold and gemstones is taken at our manufacturing and administrative facilities on an annual 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 generally is in excess of the value of the gold and gemstones supplied by us. We carry transit insurance which coverage includes the transportation of jewelry outside of our office.

## **Competition**

The jewelry manufacturing 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 manufacturing skill to be effective competitors. We believe that our vertically integrated manufacturing capabilities distinguish us from most of our competitors and enables 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.;
- Aurafin; and
- PACE Enterprises.

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 already have 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 manufacturing process.

**C. ORGANIZATIONAL STRUCTURE AS OF JUNE 30, 2002:**

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)

100%

- **Shantou SEZ Lorenzo Gems & Craft Factory Co., Ltd.**  
(P.R.C.)

- **Shantou Lorenzo Jewelry Mfg.**  
(P.R.C.)

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

- **Lorenzo Diamond Jewelry Mfg. Co. Limited**  
(Hong Kong)

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

85.59%

- **iBBC, Inc.**  
(USA.)

**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, showroom and manufacturing space at this location.

Our jewelry production facility in Shantou, China consists of 10,000 square feet of building space which we own in the Yubao Industrial Building, Longhu District, Shantou Special Economic Zone, Guangdong Province, China. We currently lease on a month-to-month basis the adjacent 16,000 square feet on the same floor of that building as one of our gem cutting facilities at a rental rate of approximately HK\$18,000 (US\$2,200) per month.

Our second production facility in Shenzhen, China consists of 50,000 square feet of building space. This facility is located in the Shatoujiao Free Trade Zone, Shenzhen. We currently lease on a month-to-month basis this space from an unaffiliated third party at a rental rate of HK\$74,120 (US\$9,500) per month.

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

Our production facilities are currently utilized by one shift per day and are capable of expanding to three shifts per day as necessary.

## **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. The amounts reflected in the following discussion are in Hong Kong Dollars, the functional currency of our subsidiaries and the legal tender currency of Hong Kong Special Administrative Region of China. The average exchange rate adopted for the periods presented is US\$1 = HK\$7.73 and unless otherwise indicated is the rate used in this discussion.

In fiscal 2002, amid a generally depressed retail market worldwide, we initiated several measures to maintain our position as one of the world's largest publicly traded designer, marketer and distributor of a full range of fine jewelry.

As consumers tightened their belts, the retail market suffered accordingly, in particular, luxury sectors such as jewelry. The horrific events in the U.S. on Sept. 11, 2001 put a further damper on consumer confidence and as a result, LJ International, like all others in our industry, faced enormous challenges.

We moved quickly to take stock of the changed situation and to introduce the appropriate measures to face the still uncertain economic climate in 2002. First, we made provisions for inventory that was built up to meet previously anticipated orders from our biggest client, one of the major TV home shopping networks. Because of an agreement signed with this client in March 2000 when the global economy was rosier, we undertook not to sell to other TV retailers in the U.S. for three years, and, if the client produced total orders of US\$80 million in the period up to March 2003, this exclusive agreement would be extended for another three years. As a result, we had forecast sales orders of about US\$30 million from this major customer in fiscal 2002, up from US\$22 million in 2001 and nearly US\$18 million in 2000.

Based on the projected sales order and pattern, we kept a significant inventory of the stock needed to fulfil large-quantity orders of between 5,000 and 10,000 pieces per style per design. However, due to the downturn and a change in the client's marketing focus and strategy, orders for our fiscal 2002 only totaled US\$11 million in value, leaving us with a rather huge stock, largely of jade, fancy-cut stones and stones in particular color grading, which were exclusively for this client. As these are natural stones, available not to order but only when found, we needed to keep an ample level of inventory.

With these developments, we knew we had to reduce our reliance on this key customer and increase our market share instead. And, to do so, we had to step up our marketing efforts with the Top40 jewelry retailers, whom we were already selling to. Servicing the Top40 involved increasing our range and inventory of sample styles for trials with them, which meant crafting 50 to 500 pieces for each style in each color. As part of our efforts to enhance our market share, we are also giving these Top40 customers more favorable terms by accepting limited consignment orders from them. This also entails keeping larger inventory levels of finished jewelry.

Meanwhile, the depressed global retail scene prompted us to review our corporate strategy and we carried out a re-engineering exercise within our organizational structure so we have a leaner and even nimbler team. The re-engineering exercise extended to our sales and operations and we have now succeeded in decreasing our inventory levels, not only by keeping orders optimal, but also by selling surplus stocks of cut stones at market value to manufacturers, a practice we previously avoided. With better inventory management we are seeing improved cash flows.

To be more cost efficient, we have consolidated our gemstone cutting and polishing processes in our Shantou factory to our Shenzhen factory.

We completed our initial public offering and raised gross proceeds of HK\$58,051,000 (US\$7,510,000) from the sale of common stock and warrants during fiscal year ended 1998. Additional amounts were received during the year ended April 30, 1999 from the exercise of the over-allotment of common stock in the offering. In the fiscal year ended 2000, we raised gross proceeds of HK\$50,245,000 (US\$6,500,000) from an issue of 3% convertible debentures. The proceeds were allocated to working capital for general corporate purposes.

Given the measures we took in fiscal 2002, which will start to show results in the first half of fiscal 2003, we are confident that we are well-positioned to seize the opportunities a rebound in the jewelry industry will bring. And there are already signs that things have started to look up. Since Sept.11, we are witnessing clients' increasing acceptance of new products, additions to our client list and rises in orders from existing customers.

Another important initiative we adopted recently is giving the first guidance in the company's history on our last quarter results for fiscal 2002. Although we are a foreign company technically exempt from some key U.S. reporting requirements, we have decided to bring our reporting and accounting as close in line as possible with U.S. GAAP reporting and U.S. investor expectations. Taking this step is part of our strategy to maintain our position as the world's largest publicly traded designer, marketer and distributor of a full range of fine jewelry. It is also a reflection of our unwavering commitment to shareholders, clients and staff alike.

## **A. OPERATING RESULTS.**

### **Fiscal 2002 compared with Fiscal 2001**

#### **Net Sales**

Net sales decreased 15% to HK\$303,326,000 (US\$39,240,000) in fiscal year ended 2002 from HK\$357,785,000 (US\$46,285,000) in fiscal year ended 2001. We experienced a decline of 23% in sales in the first three fiscal quarters in 2002 compared with the same period in fiscal 2001. But in the fourth fiscal quarter in this year we recorded a growth of 17% compared with the same fiscal quarter in the previous year.

The decrease in first three quarters, as expected, was mainly attributable to the global economic downturn since the beginning of the year 2001 and was accelerated by the September 11 attacks in the US. The increase of sales in the fourth quarter was due to the acceptance of our new products, the addition of new customers and the large incremental increases in orders from existing customers.

#### **Gross Profit**

The gross profit margin dropped from 36% in 2001 to 15% in 2002. The decrease, as explained above, was due to various adjustments on inventory in the fourth quarter, which are largely related to the reduced orders from our key customers during fiscal year 2002.

- ? HK\$41,701,000 (US\$5,395,000) for write-down of cut stones for orders in relation to special programs that were later postponed or cancelled;
- ? HK\$2,443,000 (US\$316,000) for write-down of fine jewelry cost.

Excluding the above special charge on inventory, the gross profit margin was 30% for fiscal 2002.

#### **Other Revenue**

Interest income decreased from HK\$3,929,000 (US\$508,000) in fiscal 2001 to HK\$1,674,000 (US\$217,000) in fiscal 2002. The decrease was mainly due to the consecutive cuts of interest rate from early 2001 and stabilized in early 2002.

Rental income increased 118% from HK\$480,000 (US\$62,000) in fiscal 2001 to HK\$1,047,000 (US\$135,000) in fiscal 2002. Additional investment property was rented out in fiscal 2002.

## **Selling, General and Administrative Expenses**

Selling, general and administrative (SG&A) expenses increased 13% to HK\$105,195,000 (US\$13,609,000) or 35% of net sales in 2002, compared with HK\$93,182,000 (US\$12,055,000) or 26% of net sales in 2001. The increase was mainly attributable to the following charges, two of which are non-recurring:

### Non-recurring:

- ? HK\$1,697,000 (US\$220,000) as severance payment on cost-cutting program; and
- ? HK\$5,330,000 (US\$690,000) for impairment loss and write off of property, plant & equipment as a result of the consolidation of manufacturing facilities.

### Recurring :

- ? HK\$3,518,000 (US\$455,000) for impairment and amortization of goodwill of investments; and
- ? HK\$5,102,000 (US\$660,000) for unrealized loss on the unsettled gold loan.

Excluding the above charges, SG&A expenses was HK\$89,548,000 (US\$11,584,000) or 30% of net sales, which was a decrease of HK\$3,627,000 (US\$469,000) compared with fiscal 2001.

## **Finance cost**

Interest expenses decreased from HK\$6,710,000 (US\$868,000) in fiscal 2001 to HK\$5,038,000 (US\$652,000) in fiscal 2002. The decrease was due to the consecutive cuts of interest rate from early 2001 to early 2002.

## **Income taxes**

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 16%.

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.

Two of our subsidiaries in China are currently enjoying the tax holidays or concessions which will expire in fiscal 2005 and 2006 respectively. Other subsidiaries in China either no

longer enjoy the tax holiday and concession or have not yet commenced its first profit-making year. PRC income tax is calculated at the applicable rates relevant to these subsidiaries which currently are 15%.

Net income tax decreased from HK\$1,637,000 (US\$211,000) in fiscal 2001 to a net tax credit of HK\$784,000 (US\$101,000) in fiscal 2002. There were Hong Kong tax over provision of HK\$208,000 (US\$27,000) in fiscal 2001 and HK\$800,000 (US\$103,000) in fiscal 2002, after the finalization of tax assessment for previous years.

### **Net Incomes/(Loss)**

There was a net loss of HK\$60,448,000 (US\$7,821,000), or HK\$6.97 (US\$0.90) per share on 8.7 million shares outstanding for fiscal 2002, compared with net income of HK\$32,054,000 (US\$4,147,000), or HK\$3.74 (US\$0.48) per share on 8.6 million shares outstanding in fiscal 2001.

### **Fiscal 2001 compared with Fiscal 2000**

#### **Net Sales**

Net sales increased 19% to HK\$357,785,000 (US\$46,285,000) in fiscal year ended 2001 from HK\$300,901,000 (US\$38,926,000) in fiscal year ended 2000. We experienced a 38% growth in sales in the first three fiscal quarters in 2001 compared with the same period in fiscal 2000, but the fourth fiscal quarter in this year recorded a reduction of 35% compared with the same fiscal quarter in the previous year.

The overall increase in sales is primarily attributable to increased diamond jewelry sales and higher sales to existing customers of jewelry from the Lorenzo-branded line.

#### **Gross Profit**

The gross profit margin dropped from 38% in 2000 to 36% in 2001 due to:

- ? A change in the product mix. Increasingly more sales are made with precious stones and diamonds and diamonds alone. Diamond jewelry generally has higher sales value but much lower profit margin;
- ? Additional model-making charges were incurred and expensed to build up the European jewelry sample lines; and
- ? Discounts were given on certain volume sale programs for existing customers and discounts given to new customers to induce businesses.

As the proportion of the diamond jewelry sales is expected to rise, while on the other hand the profit margin for the European jewelry market is traditionally higher compared with the US market, the profit margin is expected to stabilize at around 35% to 38% in the next few years.

### **Other Revenue**

Interest income increased from HK\$2,668,000 (US\$345,000) in fiscal 2000 to HK\$3,929,000 (US\$508,000) in fiscal 2001. The increase was mainly due to the increase in restricted cash as security deposit for banking facilities.

Rental income decreased 45% from HK\$875,000 (US\$113,000) in fiscal 2000 to HK\$480,000 (US\$62,000) in fiscal 2001. One of the investment properties was left vacant during the year after the expiry of a short-term lease. The said property is being rented to a new tenant for a period of 2 years.

### **Selling, General and Administrative Expenses**

Selling, general and administrative expenses increased 27% to HK\$93,182,000 (US\$12,055,000) or 26% of net sales in 2001, compared with HK\$73,174,000 (US\$9,466,000) or 24% of net sales in 2000. The increase was mainly due to commission paid to salesmen or agents to attract new (or induce) businesses.

### **Finance cost**

Finance cost consisted of interest expenses and issuing costs for convertible debentures, decreased from HK\$10,172,000 (US\$1,316,000) in fiscal 2000 to HK\$6,710,000 (US\$868,000) in fiscal 2001.

Interest expenses increased from HK\$5,648,000 (US\$731,000) in fiscal 2000 to HK\$6,710,000 (US\$868,000) in fiscal 2001 due to higher utilization rate of credit line facilities.

During 2000, we issued convertible debentures with gross proceeds of HK\$50,245,000 (US\$6,500,000) and incurred HK\$4,524,000 (US\$585,000) in issuing expenses.

### **Income taxes**

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 16%.

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.

Two of our subsidiaries in China are currently enjoying the tax holidays or concessions in fiscal 2001, with one of which commenced its first profit-making year. Accordingly, their entitlements will expire in fiscal 2005 and 2006 respectively. Other subsidiaries in China either no longer enjoy the tax holiday and concession or have not yet commenced its first profit-making year. As a result, HK\$18,000 (US\$2,000) of Chinese income tax expense was recorded. Chinese income tax is calculated at the applicable rate relevant to the Chinese subsidiaries, which currently is 15%.

Net income tax increased from HK\$25,000 (US\$3,000) in fiscal 2000 to HK\$1,637,000 (US\$211,000) in fiscal 2001. There were Hong Kong tax overprovision of HK\$1,207,000 (US\$156,000) in fiscal 2000 and HK\$208,000 (US\$27,000) in fiscal 2001, after the finalization of tax assessment for previous years.

### **Fiscal 2000 compared with Fiscal 1999**

#### **Net Sales**

Net sales increased 54% to HK\$300,901,000 (US\$38,926,000) in fiscal year ended 2000 from HK\$195,219,000 (US\$25,255,000) in fiscal year ended 1999. This increase is primarily driven by volume increases in sales to new and existing customers, including QVC, Sterling Inc. and Mervyn's. We also expanded our gem lines during the year in order to provide a complete range of jewelry to our existing and new customers. Our diamond jewelry sales accounted for 6% of the total net sales in fiscal year 2000.

#### **Gross Profit**

The gross profit margin dropped from 48% in 1999 to 38% in 2000 due to:

- ? a change in the product mix. Previously, most of our sales were made with jewelry set with semi-precious stones; in 2000, more sales were made with precious stones and diamonds. Diamond jewelry generally has a higher sales value but a much lower profit margin;
- ? additional model-making charges incurred and expensed to build up the diamond jewelry sample lines; and
- ? discounts given on certain volume-sales programs for existing customers and discounts given to new customers to induce businesses.

As the proportion of our diamond jewelry sales is expected to rise, the profit margin is expected to drop and stabilize at around 38% in the next few years.

## **Other Revenue**

Interest income increased from HK\$1,690,000 (US\$219,000) in fiscal 1999 to HK\$2,668,000 (US\$345,000) in fiscal 2000. The increase was mainly due to the increase in restricted cash as security deposit for banking facilities.

Rental income increased 85% to HK\$875,000 (US\$113,000) in 2000 from HK\$474,000 (US\$61,000) in 1999, due mainly to the short-term lease of one of the investment properties during 2000.

## **Selling, General and Administrative Expenses**

Selling, general and administrative expenses increased 33% to HK\$73,174,000 (US\$9,466,000) or 24% of net sales in 2000, compared with HK\$55,003,000 (US\$7,116,000) or 28% of net sales in 1999.

The decrease of 4% is the net effect of :

- ? more contributions to the fixed cost even though the profit margin is lower; and
- ? increased personnel in sales and marketing, design and logistics to cope with the significant sales growth. As a result, we have leased an additional office space of around 2,000 square feet in our Hong Kong headquarters.

## **Finance cost**

Finance cost is principally consisted of interest expenses, and issuing cost for convertible debentures, increased to HK\$10,172,000 (US\$1,316,000) in 2000 from HK\$6,876,000 (US\$890,000) in 1999.

Interest expenses decreased 18% to HK\$5,648,000 (US\$731,000) in 2000 from HK\$6,876,000 (US\$890,000) in 1999. The proceeds from the issuance of the convertible debentures during fiscal 2000 provided us with working capital and our level of borrowings dropped during 2000.

During 2000, we issued convertible debentures with gross proceeds of HK\$50,245,000 (US\$6,500,000) and incurred HK\$4,524,000 (US\$585,000) issuing expenses.

## **Income Taxes**

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 16%.

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 the subsidiaries initiated its first year of tax holidays during 2000 and the entitlement will therefore expire fiscal 2005. Other subsidiaries in China either no longer enjoy the tax holiday and concession or have not yet commenced its first profit-making year. As a result, we have not recorded any Chinese income tax expense. Chinese income tax in the future will be calculated at the applicable rates relevant to the Chinese subsidiaries, which currently are 15%.

Net income tax decreased 93% to HK\$25,000 (US\$3,000) in 2000 from HK\$380,000 (US\$49,000) in 1999. This is the net effect of a current-year Hong Kong tax provision of HK\$1,207,000 (US\$156,000) and the previous years' over provision of HK\$1,182,000 (US\$153,000).

## **B. LIQUIDITY AND CAPITAL RESOURCES.**

### **Fiscal 2002 compared with Fiscal 2001**

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. There are currently no known restrictions on our subsidiaries and investment securities to pay dividends to us; however, we do not currently intend to pay dividends to our shareholders.

#### Cash:

For the fiscal year ended April 30, 2002, as a result of HK\$20,652,000 (US\$2,673,000) provided by financing activities and HK\$919,000 (US\$120,000) and HK\$14,843,000 (US\$1,920,000) used by operating and investing activities, as well as HK\$3,258,000 (US\$421,000) used in returns on investments and servicing of finance and HK\$1,642,000 (US\$212,000) paid for incomes taxes, cash and cash equivalents decreased by HK\$10,000 (US\$1,000).

Net cash used by operating activities in fiscal 2002 was HK\$919,000 (US\$120,000) as compared with net cash provided of HK\$31,033,000 (US\$4,015,000) in fiscal 2001. The negative cash flows from operating activities in fiscal 2002 was primarily due to decrease in sales and gross profit margin.

For the fiscal year ended April 30, 2002, net cash outflow from investing activities was HK\$14,843,000 (US\$1,920,000) as compared with HK\$31,740,000 (US\$4,106,000) in fiscal 2001. The net cash used in investing activities during fiscal 2002 were HK\$18,406,000 (US\$2,381,000) for the further acquisition of 68.8% of a subsidiary, iBBC Inc. which engaged in marketing jewelry from its display cases in retail shops, HK\$3,248,000 (US\$420,000) for the acquisition of property, plant and equipment, and less proceed of HK\$91,000 (US\$12,000) on disposal of plant and equipment, and HK\$6,720,000 (US\$869,000) from related parties.

Net cash provided by financing activities in fiscal 2002 was HK\$20,652,000 (US\$2,672,000) as compared with net cash used in HK\$399,000 (US\$52,000) in fiscal 2001. There was HK\$24,658,000 (US\$3,190,000) received in respect of new gold loan arrangement in fiscal 2002.

#### Accounts Receivable:

As of April 30, 2002, net accounts receivable increased by HK\$13,529,000 (US\$1,750,000) to HK\$61,944,000 (US\$8,013,000) from HK\$48,415,000 (US\$6,263,000) as of April 30, 2001. The increase in net accounts receivable was due to some customers have prolonged the credit period. The sales-to-customers accounts receivable are generally offered a 60-day credit period.

#### Inventory:

Inventory decreased by HK\$38,807,000 (US\$5,020,000) from HK\$160,955,000 (US\$20,822,000) as of April 30, 2001 to HK\$122,148,000 (US\$15,802,000). During the year, special charge of HK\$44,144,000 (US\$5,711,000) has been made on inventory largely related to reduced orders from key customers. Excluding this special charge, and in view of the possible sluggish market, the rate of growth in inventory was 3% in fiscal 2002 as compared with 8% in fiscal 2001.

#### Letters of Credit:

As of April 30, 2002, we had various letters of credit under banking facilities which totaled HK\$90,000,000 (US\$11,643,000). We had HK\$43,642,000 (US\$5,646,000) and HK\$28,206,000 (US\$3,649,000) outstanding under letters of credit as of April 30, 2002 and 2001. Under the banking facilities arrangement, we are required to maintain certain cash balances which totaled HK\$41,000,000 (US\$5,304,000) as of April 30, 2002 and 2001.

#### Gold Loan Facilities:

We have also secured “gold loan” facilities with various banks in Hong Kong, which typically bear a below-market interest rate. At the close of each reporting period, the gold loan is

“marked to market” with changes reflected on the income statement. 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, and we currently do not hedge against such risks. 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. We had outstanding loans to purchase 14,850 and 6,950 ounces of gold as of April 30, 2002 and 2001, with the related balances being HK\$44,038,000 (US\$5,697,000) and HK\$14,278,000 (US\$1,847,000) respectively. Interest rates for these loans were 1.7% to 3.4% as of April 30, 2002 (2001: 2% to 2.9%). Unrealized loss on the unsettled gold loans for the year ended April 30, 2002 was HK\$5,102,000 (US\$660,000) compared with unrealised gain of HK\$343,000 (US\$44,000) for the year ended April 30, 2001.

Notes Payable:

Long-term mortgage loans on our properties totaled HK\$2,180,000 (US\$282,000) and HK\$5,971,000 (US\$773,000) as of April 30, 2002 and 2001. All of our properties are pledged substantially as collateral for our banking facilities.

**Fiscal 2001 compared with Fiscal 2000**

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. There are currently no known restrictions on our subsidiaries and investment securities to pay dividends to us; however, we do not currently intend to pay dividends to our shareholders.

Cash:

The primary sources of our cash flow for working capital and capital expenditure for fiscal 2001 had been the net cash inflows from operating revenue. Seasonal working capital needs have been met through short-term borrowing under revolving lines of credit.

For the fiscal year ended April 30, 2001, as a result of HK\$31,033,000 (US\$4,015,000) provided by operating activities and a tax refund of HK\$363,000 (US\$47,000), less HK\$31,740,000 (US\$4,106,000) used in investing activities, HK\$399,000 (US\$52,000) used by financing activities, as well as HK\$2,737,000 (US\$354,000) used in returns on investments and servicing of finance, cash and cash equivalents decreased by HK\$3,480,000 (US\$450,000).

Net cash provided by operating activities in fiscal 2001 was HK\$31,033,000 (US\$4,015,000) as compared with net cash used of HK\$9,076,000 (US\$1,174,000) in fiscal 2000. Negative cash flows from operating activities in previous year was principally due to deliberate accumulation of cut stones inventory.

For the fiscal year ended April 30, 2001, net cash outflow from investing activities was HK\$31,740,000 (US\$4,106,000) as compared with HK\$5,162,000 (US\$668,000) in fiscal 2000. The net cash used in investing activities during fiscal 2001 were used for the acquisition of investment securities for HK\$25,386,000 (US\$3,284,000), and purchase of property, plant and equipment for HK\$6,429,000 (US\$832,000), and less proceed of HK\$75,000 (US\$10,000) on disposal of property, plant and equipment. During fiscal year 2001, we acquired 20% equity interests in a company whose principle activities are the manufacturing and trading of rough and pre-formed gemstones, and 16.8% equity interests in a jewelry retail company, for further expansion through vertical integration and the development of distribution channel in the United States. We had no significant control and influence over both companies' operating and financial policies.

Net cash used in financing activities in fiscal 2001 was HK\$399,000 (US\$52,000) as compared with net cash provided of HK\$41,314,000 (US\$5,345,000), There was HK\$45,721,000 (US\$5,915,000) received in respect of convertible loans issued in previous year.

#### Accounts Receivable:

As of April 30, 2001, net accounts receivable increased by HK\$5,726,000 (US\$741,000) to HK\$48,415,000 (US\$6,264,000) from HK\$42,689,000 (US\$5,523,000) as of April 30, 2000. The increase in net accounts receivable is in line with increase in sales. The sales-to-customers accounts receivable are generally offered a 60-day credit period.

#### Inventory:

Inventory increased by HK\$12,513,000 (US\$1,619,000) from HK\$148,442,000 (US\$19,203,000) as of April 30, 2000 to HK\$160,955,000 (US\$20,822,000). In view of the possible sluggish market, the rate of growth in inventory was dropped from 58% in fiscal 2000 to 8% in fiscal 2001.

#### Letters of Credit:

As of April 30, 2001, we had various letters of credit under banking facilities which totaled HK\$86,000,000 (US\$11,125,000). We had HK\$25,941,000 (US\$3,356,000) and HK\$28,206,000 (US\$3,649,000) outstanding under letters of credit as of April 30, 2000 and 2001. Under the banking facilities arrangement, we are required to maintain certain cash balances which totaled HK\$26,000,000 (US\$3,363,000) and HK\$41,000,000 (US\$5,304,000) as of April 30, 2000 and 2001.

### Gold Loan Facilities:

We have also secured “gold loan” facilities with various banks in Hong Kong, which typically bear a below-market interest rate. At the close of each reporting period, the gold loan is “marked to market” with changes reflected on the income statement. Due to lower interest rates charged for gold loans and declining prices of gold, 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, and we currently do not hedge against such risks. 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. We had outstanding loans to purchase 4,850 and 6,950 ounces of gold as of April 30, 2000 and 2001, with the related balances being HK\$10,259,000 (US\$1,327,000) and HK\$14,278,000 (US\$1,847,000) respectively. Interest rates for these loans were 2% to 2.9% as of April 30, 2001 (2000: 3.15% to 3.45%). Unrealized gain on the unsettled gold loans as of April 30, 2000 and 2001 were HK\$338,000 (US\$44,000) and HK\$343,000 (US\$44,000).

### Notes Payable:

Long-term mortgage loans on our properties totaled HK\$10,139,000 (US\$1,311,000) and HK\$5,971,000 (US\$773,000) as of April 30, 2000 and 2001. All of our properties are pledged substantially as collateral for our banking facilities.

### **Fiscal 2000 compared with Fiscal 1999**

We have no direct business operations other than our ownership of our subsidiaries. Our ability to pay dividends and meet other obligations depends upon our receipt of dividends or other payments from our operating subsidiaries. There are currently no known restrictions on our subsidiaries to pay dividends to us; however, we do not currently intend to pay dividends to our shareholders.

### Cash:

The primary sources of our cash for working capital and capital expenditure for fiscal 2000 had been the net cash inflows from operating revenue and the issue of the 3% convertible debentures. Seasonal working capital needs have been met through short-term borrowing under revolving lines of credit.

For the fiscal year ended April 30, 2000, as a result of HK\$41,314,000 (US\$5,345,000) cash provided by financing activities and HK\$9,076,000 (US\$1,174,000) and HK\$5,162,000 (US\$668,000) used by operating and investing activities, as well as HK\$2,804,000 (US\$363,000)

net cash used for returns on investments and servicing of finance and HK\$93,000 (US\$12,000) paid for income taxes, cash and cash equivalents increased by HK\$24,179,000 (US\$3,128,000).

Net cash used by operating activities in fiscal 2000 was HK\$9,076,000 (US\$1,174,000) as compared with net cash provided of HK\$1,269,000 (US\$164,000) in fiscal 1999. Negative cash flows from operating activities are principally the result of improved operating results, offset by increased working capital requirement attributable to the increase in accounts receivable and inventory levels.

For the fiscal year ended April 30, 2000, net cash used in investing activities was HK\$5,162,000 (US\$668,000), a decrease of HK\$2,640,000 (US\$341,000) compared with HK\$7,802,000 (US\$1,009,000) in fiscal 1999. The net cash used in investing activities during fiscal 2000 were used for the acquisition of the remaining 40% of the share capital of Lorenzo Giftware Ltd. (f/k/a Lorenzo Marketing Co., Ltd.) for HK\$1,830,000 (US\$237,000) for further expansion of market share in Japan and Europe; and purchase of property, plant and equipment for HK\$3,477,000 (US\$450,000) and less proceed of HK\$145,000 (US\$19,000) on disposal of property, plant and equipment.

#### Accounts Receivable:

As of April 30, 2000, net accounts receivable increased by HK\$8,517,000 (US\$1,102,000) to HK\$42,689,000 (US\$5,523,000) from HK\$34,172,000 (US\$4,421,000) as of April 30, 1999. The increase in net accounts receivable is in line with the increase in sales. Receivables for sales to customers are generally offered a 60-day credit period.

#### Inventory:

Inventory increased by HK\$54,806,000 (US\$7,090,000) from HK\$93,636,000 (US\$12,113,000) as of April 30, 1999 to HK\$148,442,000 (US\$19,203,000) as of April 30, 2000. The increase was due to our management's anticipation of significant increase in sales for the new fiscal year, increase in the cost of rough gemstones, more sample lines of jewelry built up, and maintaining sufficient inventory for block-orders, especially for QVC.

#### Prepayment and Other Current Assets:

We advanced HK\$15,460,000 (US\$2,000,000) to one of our principal gemstone suppliers to secure the first right to, and steady gemstone supplies. The advance was included in the balance of the accounts receivable as of April 30, 1999, and has been reclassified retrospectively to prepayment and other current assets in fiscal 1999 and 2000.

### Letters of Credit:

As of April 30, 2000, we had various letters of credit under banking facilities which totaled HK\$66,500,000 (US\$8,603,000). We had HK\$34,193,000 (US\$4,423,000) and HK\$25,941,000 (US\$3,356,000) outstanding under letters of credit as of April 30, 1999 and 2000. Under the banking facilities arrangement, we are required to maintain certain cash balances which totaled HK\$15,185,000 (US\$1,964,000) and HK\$26,000,000 (US\$3,363,000) as of April 30, 1999 and 2000.

### Gold Loan Facilities:

We have also secured “gold loan” facilities with various banks in Hong Kong, which typically bear a below-market interest rate. At the close of each reporting period, the gold loan is “marked to market” with changes reflected on the income statement. Due to lower interest rates charged for gold loans and declining prices of gold, 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, and we currently do not hedge against such risks. Under the gold loan arrangements, we may defer the purchase until such time as we decide appropriate, the price paid to be paid being the current market price at time of payment. We had outstanding loans to purchase 4,300 and 4,850 ounces of gold as of April 30, 1999 and 2000, with the related balances being HK\$9,500,000 (US\$1,229,000) and HK\$10,259,000 (US\$1,327,000). Interest rates for these loans were 3.15% to 3.45% as of April 30, 2000 (1999: 3.1% to 3.3%). Unrealized gain on the unsettled gold loans as of April 30, 1999 and 2000 were HK\$630,000 (US\$82,000) and HK\$338,000 (US\$44,000).

### Notes Payable:

Long-term mortgage loans on our properties totaled HK\$13,923,000 (US\$1,801,000) and HK\$10,139,000 (US\$1,311,000) as of April 30, 1999 and 2000. All of our properties are substantially pledged as collateral for our banking facilities.

### Promissory Notes:

On October 17, 1997, we completed the sale of promissory notes amounting to HK\$6,049,000 (US\$783,000). These notes provided for interest of 7% and the note holders were repaid in full from the proceeds of our initial public offering. In addition, they received 156,500 shares of our common stock upon completion of the public offering. As of April 30, 1998, we had outstanding promissory notes amounting to HK\$2,184,000 (US\$283,000), which were repaid during the year ended April 30, 1999.

### Initial Public Offering - 1998:

In April 1998, we completed an initial public offering in which we sold 1,460,000 shares of common stock and 1,679,000 warrants. We realized gross proceeds of HK\$58,051,000 (US\$7,510,000) from this offering. We may realize additional proceeds from the exercise of the warrants, although there can be no assurance that such warrants will be exercised. During the fiscal year ended April 30, 1999, we received gross proceeds of HK\$8,464,000 (US\$1,095,000) from the sale of 219,000 shares of common stock pursuant to an over-allotment option granted in the offering.

### Convertible Debentures - 2000:

On October 29, 1999, we entered into a Securities Purchase Agreement with an accredited investor pursuant to which we agreed to issue, and the investor agreed to purchase, up to HK\$81,165,000 (US\$10,500,000) of 3% convertible debentures, as well as common stock purchase warrants. During the fiscal year ended April 30, 2000, we received gross proceeds of HK\$50,245,000 (US\$6,500,000) from the issue of the 3% convertible debentures to that investor. HK\$27,055,000 (US\$3,500,000) of the gross proceeds and related interest expenses have been converted into 1,072,412 shares of our common stock as of April 30, 2000. The remaining HK\$23,190,000 (US\$3,000,000) and accrued interest was subsequently converted into 1,233,557 shares of our common stock during the fiscal year ended April 30, 2001. The proceeds of convertible debentures was used to provide restricted cash of HK\$7,000,000 (US\$906,000) and HK\$15,000,000 (US\$1,940,000) as collateral for general banking facilities in fiscal 2000 and 2001, and partly used to finance the purchases of investment securities in 2001.

### Looking Forward:

We anticipate that cash flow from operations, proceeds from the issue of the convertible debentures, 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.

### **Reconciliation to US GAAP**

We prepare our financial statements under Generally Accepted Accounting Principles as practiced in Hong Kong, which we refer to as HK GAAP. There are certain differences between HK GAAP and GAAP as practiced in the United States, which we refer to as US GAAP. In consideration of US GAAP, certain adjustments would have been provided.

Under US GAAP, for the fiscal year ended April 30, 2002, HK\$472,000 (US\$61,000) would be recorded as depreciation expenses on properties and investment properties, HK\$2,297,000 (US\$297,000) of compensation cost in connection with the fair value of options granted to consultants would be expensed. Furthermore, HK\$1,648,000 (US\$213,000) in

relation to the amortization of goodwill and HK\$500,000 (US\$65,000) in relation to the deficit on revaluation of investment properties would also be credited. As a result, our net loss for the year ended April 30, 2002 under US GAAP would be HK\$61,069,000 (US\$7,901,000).

Under US GAAP, for the fiscal year ended April 30, 2001, HK\$472,000 (US\$61,000) would be recorded as depreciation expenses on properties and investment properties and HK\$143,000 (US\$18,000) would be recorded as amortization of financial consulting fee for the IPO. In addition, HK\$754,000 (US\$98,000) of compensation cost in connection with the fair value of options granted to consultants and HK\$296,000 (US\$38,000) for the amortization of discount on convertible debentures would be expensed. Furthermore, HK\$7,000 (US\$1,000) in relation to the amortization of goodwill and HK\$1,885,000 (US\$244,000) in relation to the deficit on revaluation of investment properties would also be credited. Adjustments were also made in respect of costs associated with stock-based transactions and interest expenses arising from beneficial conversion features of convertible debentures which amounted to HK\$1,299,000 (US\$168,000) and HK\$6,751,000 (US\$873,000) respectively (see below for details). As a result, our net income for the year ended April 30, 2001 under US GAAP would be HK\$24,231,000 (US\$3,136,000).

Under US GAAP, for the fiscal year ended April 30, 2000, HK\$472,000 (US\$61,000) would be recorded as depreciation expenses on properties and investment properties and HK\$275,000 (US\$36,000) would be recorded as amortization of financial consulting fee for the IPO. In addition, HK\$136,000 (US\$18,000) of compensation cost in connection with the fair value of warrants granted to a consultant, HK\$238,000 (US\$31,000) for the amortization of discount on convertible debentures and HK\$328,000 (US\$42,000) of compensation cost of the fair value of warrants granted to the convertible debentures placement agent, would be expensed.

Furthermore, HK\$7,000 (US\$1,000) in relation to the amortization of goodwill and HK\$686,000 (US\$89,000) in relation to the amortization of certain offering costs in which the related deferred costs were expensed under US GAAP in previous years would also be credited. Adjustments were also made in respect of interest expense arising from beneficial conversion features of convertible debentures which amounted to HK\$5,291,000 (US\$684,000) (see below for details). As a result, our net income for the year ended April 30, 2000 under US GAAP would be HK\$29,673,000 (US\$3,839,000).

### **Stock-Based Compensation (In relation to The 1998 Stock Compensation Plan)**

In 1998, we adopted The 1998 Stock Compensation Plan which allows the Board of Directors to grant stock options to individuals to purchase common stock of the Company. Under HK GAAP, there are no specific requirements to recognize the compensation cost arising from stock options granted to these individuals on the financial statements.

Under US GAAP, we adopted the provisions of SFAS No. 123 "Accounting for Stock-Based Compensation" in respect of options granted to employees. As permitted by SFAS No. 123, we have chosen to account for stock-based compensation using the intrinsic value

method. Accordingly, because the exercise price of our incentive stock options is same as or higher than the market price of the underlying stock on the date of grant, no compensation expense has been recognized for its stock-based compensation plan. Had compensation expense for the incentive stock option plan been 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, our net income and earnings per share would have been reported as follows:

	<u>Year ended April 30</u>	
	<u>2000</u>	<u>2001</u>
	HK\$	HK\$
Pro forma net income (as restated)	<u>28,833,000</u>	<u>8,567,000</u>
Pro forma earnings per share (as restated)		
Basic	4.38	1.00
Diluted	<u>4.19</u>	<u>1.00</u>

There were no stock options granted to employees during the year ended April 30, 2002, and all previously granted options were immediately exercisable, and accordingly no pro forma net loss and loss per share for 2002 are presented.

The fair value of these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

	<u>Year ended April 30</u>	
	<u>2000</u>	<u>2001</u>
Expected dividend yield	Nil	Nil
Expected stock price volatility	19%	22%
Risk-free interest rate	6.49%	5.34%
Expected life of options	3 years	3 years

The weighted average fair value per option granted during the year ended April 30, 2000 and 2001 was US\$0.41 and US\$0.45 respectively.

Our stock option activities and related information for the years ended April 30, 2000, 2001 and 2002 are summarized as follows:

As of April 30

	<u>2000</u>		<u>2001</u>		<u>2002</u>	
	Options	Weighted Average Exercise Price US\$	Options	Weighted average exercise price US\$	Options	Weighted average exercise price US\$
Outstanding and exercisable, beginning of year	1,285,000	5.00	1,550,000	5.00	3,376,000	2.00
Granted	265,000	5.00	5,226,000	2.35	-	-
Cancelled	-	-	(3,400,000)	3.91	(458,000)	2.00
Outstanding and exercisable, end of year	<u>1,550,000</u>	5.00	<u>3,376,000</u>	2.00	<u>2,918,000</u>	2.00
Weighted average remaining contractual life	<u>9.13 years</u>		<u>7.06 years</u>		<u>6.06 years</u>	

### Stock-Based Transactions

We issued to a consultant a warrant to purchase 35,000 shares of common stock as part of the consultancy fee on July 31, 1999. In addition, we issued to a placement agent two warrants to purchase an aggregate of 65,000 shares of common stock for the services rendered in respect of the issue of the convertible debentures on November 5, 1999 and March 22, 2000. During the financial year 2002, we further issued to consultants, agents or investor warrants to purchase an aggregate of 860,000 shares of our common stock. Under HK GAAP, there are no specific requirements to recognize the compensation costs arising from these transactions. Under US GAAP, the costs associated with these transactions are accounted for based on fair value of the warrants at the date of issue.

In addition, options were issued to consultants/advisers under The 1998 Stock Compensation Plan to purchase our common stock as part of their fees during the year ended April 30, 2001. Under US GAAP, the costs associated with these transactions are also accounted for based on the fair value of these options at the date of issue.

Using the Black-Scholes option pricing model with the following weighted-average assumptions:

Year ended April 30

	<u>2000</u>	<u>2001</u>	<u>2002</u>
Expected dividend yield	Nil	Nil	Nil
Expected stock price volatility	19%	22%	23%
Risk-free interest rate	6.49%	5.34%	4.23%
Expected life of options	3 years	3 years	3.21 years

The fair value of these warrants and options was estimated as HK\$464,000, HK\$2,053,000 and HK\$2,297,000 respectively for the years ended April 30, 2000, 2001 and 2002. The additional expense was recognized in the statement of operations under US GAAP and the same amount was recorded in our reserve account. Effectively, there was no net effect on the shareholders' equity under US GAAP.

In respect of the fair value of HK\$2,053,000 estimated for options granted in financial year 2001, as only HK\$754,000 was reported in the previous year's financial statements, the profit for 2001 previously reported under US GAAP has been restated for the amount undercharged.

### **Beneficial Conversion Features of Convertible Debentures**

Under US GAAP, the embedded beneficial conversion feature associated with the issue of a convertible debt security should be recognized and measured by an amount equal to the intrinsic value of that feature reflected as a discount from the convertible debentures with a corresponding credit to additional paid-in capital. That amount is calculated at the commitment date (i.e. issue date of the convertible debentures in this case) as the difference between the conversion price and the fair value of the common stock into which the security is convertible, multiplied by the number of shares into which the security is convertible. The intrinsic value of the beneficial conversion feature is amortized to the statement of operations over the life of the convertible debentures. There is no such requirement under HK GAAP. The beneficial conversion feature charged to income as interest expense amounted to HK\$5,291,000 and HK\$6,751,000 for the year ended April 30, 2000 and 2001 respectively. As of April 30, 2000, the unamortized portion of beneficial conversion feature was HK\$6,717,000. Accordingly, the shareholders' equity under US GAAP was increased by that amount. As these amounts were not reported in previous years' financial statements, the profit for the year of 2000 and 2001 and the shareholders' equity as of April 30, 2000 have been restated in this respect.

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

Effective July 1, 2001, we adopted Statement of Financial Accounting Standard ("SFAS") No. 141 "Business Combinations". In accordance with SFAS No. 141, all business combinations initiated after June 30, 2001 are to be accounted for using the purchase method; the pooling of

interest method of accounting is prohibited. The acquisition of the jewelry retail company on March 21, 2002 (see note 17 (a)) was accounted for by purchase method of accounting.

In July 2001, Financial Accounting Standards Board (“FASB”) issued SFAS No. 142, “Goodwill and Other Intangible Assets”. SFAS No. 142 provides that goodwill and intangible assets which have indefinite useful lives will not be amortized but rather will be tested at least annually for impairment. Consequently, the goodwill arisen from the acquisition of the jewelry retail company on March 21, 2002 is not amortized and subject to impairment test in this financial year. We adopted SFAS No. 142 effective on May 1, 2002, the first day of our fiscal year 2003. Other than the goodwill arisen from the acquisition on March, 21, 2002, we have no other goodwill and intangible assets as of April 30, 2002. We do not believe that the adoption of the statement will have a material impact on our financial position or results of operations.

In June 2001, the FASB issued SFAS No. 143 “Accounting for Asset Retirement Obligations”. SFAS No. 143 addresses accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This statement is effective for financial years beginning after June 15, 2002. The impact of the adoption of SFAS No. 143 on the Group’s financial statements is not expected to be material.

In October 2001, the FASB issued SFAS No. 144 “Accounting for the Impairment or Disposal of Long-Lived Assets”. SFAS No. 144 replaces SFAS No. 121, “Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of”. SFAS No. 144 requires long-lived assets be measured at the lower of selling amount or fair value less cost to sell, whether reported in continuing operations or discontinued operations. SFAS No. 144 also broadens the reporting of discontinued operations to include all components of an entity with operations that can be distinguished from the rest of the entity and that will be eliminated from the ongoing operations of the entity in a disposal transaction. The provisions of SFAS No. 144 are effective for consolidated financial statements issued for financial years beginning after December 15, 2001. The Group does not expect that the adoption of SFAS No. 144 will have a material impact on the Group’s financial statements.

In April 2002, the FASB issued SFAS No. 145 “Rescission of FASB Statement No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections”. This statement made revisions to the accounting for gains and losses from the extinguishment of debt, rescinded SFAS No. 44, and required certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. The Group is required to and will adopt SFAS No. 145 on May 1, 2002. The adoption of SFAS No. 145 is not expected to have a material impact on the Group’s financial statements.

### **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 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 our results of 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 our results of operations. We do not currently hedge our foreign exchange positions.

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

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

### **D. TREND INFORMATION.**

#### Production

The total production for fiscal year 2003 is estimated at 1,400,000 pieces compared to 1,200,000 pieces for fiscal year 2002.

#### Sales

Due to weak demand in the U.S. market, the sales for fiscal year 2003 is estimated at US\$46 million, compared to US\$39 million for the fiscal year 2002.

The gross profit margin for the fiscal year 2003 is estimated to be approximately 30%, which is the same level as the fiscal year 2002 before giving effect to special charges.

#### Inventory

The average inventory level for fiscal year 2003 is estimated to be approximately US\$16 million compared with the fiscal year 2002, which approximately amounted to US\$21 million.

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

### **A. DIRECTORS AND SENIOR MANAGEMENT.**

Our senior management and directors are as follows:

<b><u>Name</u></b>	<b><u>Age</u></b>	<b><u>Position</u></b>
Yu Chuan Yih .....	63	Chairman of the Board of Directors, President and Chief Executive Officer
Ka Man Au .....	38	Chief Operating Officer, Secretary and Director
Hon Tak Ringo Ng.....	42	Chief Financial Officer and Director
Po Yee Elsa Yue.....	38	Non-Executive Director
Lionel C. Wang.....	46	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 has been a gemstone trader in Brazil and has extensive experience and relationships in gem sourcing and jewelry design. Mr. Yih is also president 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 practicing 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 Gemology Institute of America and serves as vice president of GIA, Hong Kong since August 1994. Her responsibilities include managing the Hong Kong office and administering their education programs, marketing and related activities.

**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 served as 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 served as vice-president at Nielsen North America with responsibility for analytical and modeling projects on 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 served as vice president of product development for NFO Interactive, Greenwich, Connecticut. Since June 2001, Mr. Wang serves as 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 April 30, 2002 on an accrual basis, for services in all capacities, was HK\$5,909,000 (US\$764,000). During the fiscal year ended April 30, 2002, we contributed an aggregate amount of HK\$240,000 (US\$31,000) 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, 2000 for a period of three years at an annual salary of HK\$1,800,000 (US\$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 May 8, 2000, we granted Mr. Yih options exercisable to acquire 600,000 shares of common stock at \$3.00 per share at any time until May 7, 2010.

On October 17, 2000, we offered all option holders the opportunity to cancel all or some of their stock options in exchange for new options to be granted on April 30, 2001 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. Mr. Yih has accepted the

offer and now holds an option to acquire an aggregate of 775,000 shares exercisable at \$2.00 per share at any time until April 30, 2008.

### **C. BOARD PRACTICES.**

Each of our five current directors was elected at our last annual meeting of shareholders held December 5, 2001 to serve a one-year term or until their successor is elected and qualified.

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 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.

### **D. EMPLOYEES.**

As of July 31, 2002, we employed approximately 2,000 persons on a full-time basis for our manufacturing 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 employees' 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 July 31, 2002 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 directors and executive officers as a group.

As of July 31, 2002, we had 8,671,615 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.

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.

<u>Name of Beneficial Holder</u>	<u>Number</u>	<u>Percent</u>
	<u>Shares Beneficially</u>	<u>t</u>
	<u>Owned</u>	
Yu Chuan Yih	3,529,553(1)(2)	36.5%
Ka Man Au	200,000(3)	2.3%
Hon Tak Ringo Ng	200,000(4)	2.3%
Po Yee Elsa Yue	6,000(5)	*
Lionel C. Wang	0	*
Debora Mu Yong Yih	1,260,000(6)	13.9%
All directors and executive officers as a group (5 persons)	3,935,553	37.5%

\* Represents less than 1% of the outstanding common stock.

- (1) Of Mr. Yih's 2,524,553 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 to acquire 775,000 shares of common stock held by Mr. Yih and options currently exercisable to acquire 230,000 shares of common stock held by Mr. Yih's wife at \$2.00 per share at any time until April 30, 2008.
- (3) Represents options currently exercisable to acquire 200,000 shares of common stock at \$2.00 per share at any time until April 30, 2008.
- (4) Represents options currently exercisable to acquire 200,000 shares of common stock at \$2.00 per share at any time until April 30, 2008.
- (5) Represents options currently exercisable to acquire 6,000 shares of common stock at \$2.00 per share at any time until April 30, 2008.

- (6) Includes options currently exercisable to acquire 400,000 shares of common stock at \$2.00 per share at any time until April 30, 2008.

### **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
- encourage them to remain in our employ by providing them 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 April 30, 2002, no options had been exercised and the following exchanged options to purchase shares of our common stock under the Plan remained outstanding:

- stock options to purchase 2,918,000 shares at \$2.00 per share through April 30, 2008, of which 1,181,000 are held by our directors and officers as a group.

### **Other Options and Warrants Outstanding**

As of April 30, 2002, 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, 2003
- 146,000 stock purchase options to purchase 146,000 shares of common stock at \$8.25 per share through April 15, 2003 which we sold to the IPO underwriter and/or persons related to the underwriter
- 146,000 warrant purchase options to purchase 146,000 warrants at \$0.20625 per warrant to purchase shares of common stock at \$8.25 per share through April 15, 2003 which we sold to the IPO underwriter and/or persons related to the underwriter
- options to purchase 35,000 shares at \$5.00 per share through July 30, 2004 which we granted to a former financial consultant on July 31, 1999 for services rendered in connection with public relations
- warrants to purchase 75,000 shares at \$3.75 per share through November 30, 2004 and 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 two tranches of our 3% Convertible Debentures on November 5, 1999 and March 22, 2000
- warrants to purchase 100,000 shares at \$2.79 per share exercisable through May 26, 2002 which we granted to a former financial consultant on May 27, 2001 for services rendered in connection with financial advice
- warrants to purchase shares which we granted to a former financial consultant on June 1, 2001 for services rendered in connection with corporate development as follows:
  - 100,000 shares at \$2.29 per share exercisable through May 31, 2003;
  - 80,000 shares at \$3.43 per share exercisable through May 31, 2004; and
  - 80,000 shares at \$4.57 per share exercisable through May 31, 2005.
- 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 150,000 shares at \$1.7892 per share through April 14, 2005 which we granted to Navigator Investments Holding IX Limited on April 15, 2002 as a commitment fee in connection with an equity line of credit facility
- warrants to purchase 150,000 shares at \$1.7892 per share through April 14, 2005 which we granted to The Bauer Partnership, Inc. on April 15, 2002 as a placement fee in connection with an equity line of credit facility

## **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.

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.**

Yu Chuan Yih, our chairman and president, is a director and principal shareholder of Gemological Institute of America, Hong Kong Limited. Mr. Yih is also a director of iBBC Inc. which has a subsidiary, Gemriver Jewelry Limited. During the fiscal years ended April 30, 2000, 2001 and 2002, Mr. Yih and these affiliated companies received unsecured advances from, and made unsecured advances to us, which were interest free and repayable on demand. The maximum amount due from Mr. Yih were HK\$7,018,000 (US\$908,000), HK\$4,806,000 (US\$622,000) and HK\$1,882,000 (US\$243,000) during the fiscal years ended April 30, 2000, 2001 and 2002. The closing balance due to Mr. Yih were HK\$12,000 (US\$2,000) and HK\$1,913,000 (US\$248,000) at April 30, 2000 and 2001. There was no outstanding amount with Mr. Yih at April 30, 2002.

Certain of our banking facilities are collateralized by properties owned by Yih Yu Chuan and his personal guarantee to the extent of HK\$59,390,000 (US\$7,683,000) as of April 30, 2001 and HK\$65,239,000 (US\$8,440,000) as of April 30, 2002. 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 HK\$4,882,000 (US\$632,000). As of April 30, 2002, the guarantee amount was HK\$4,807,000 (US\$622,000).

During the fiscal year ended April 30, 2000, we received management fee income of HK\$282,000 (US\$36,000) from Gemological Institute of America, Hong Kong Limited, which were determined by the directors for the services provided.

During the fiscal year ended April 30, 2001, we sold finished goods of HK\$1,219,000 (US\$158,000) to Gemriver Jewelry Limited, which were made according to the published prices and conditions offered to our major customers. We also received from Gemriver Jewelry Limited for rental and management fee income of HK\$161,000 (US\$21,000) and HK\$250,000 (US\$32,000) respectively. In addition, we received management fee income of HK\$212,000 (US\$27,000) from Gemological Institute of America, Hong Kong Limited, which were determined by the directors for the services provided.

During the fiscal year ended April 30, 2002, we further acquired 68.8% equity interest of iBBC Inc. from entities controlled by a director for a consideration for HK\$19,016,000 (US\$2,460,000).

For additional information, refer to Footnote 13 to the Consolidated Financial Statements.

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

Not applicable.

**ITEM 8. FINANCIAL INFORMATION**

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

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

**B. SIGNIFICANT CHANGES.**

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

## **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><u>Period</u></b>	<b><u>High</u></b>	<b><u>Low</u></b>
Year ended April 30, 1999	\$9.813	\$4.00
Year ended April 30, 2000	\$6.688	\$3.00
Year ended April 30, 2001	\$3.875	\$1.625
Year ended April 30, 2002	\$2.79	\$1.18
Quarter ended July 31, 2000	\$3.531	\$2.438
Quarter ended October 31, 2000	\$3.875	\$2.156
Quarter ended January 31, 2001	\$2.50	\$1.625
Quarter ended April 30, 2001	\$2.313	\$1.656
Quarter ended July 31, 2001	\$2.79	\$2.00
Quarter ended October 31, 2001	\$2.11	\$1.48
Quarter ended January 31, 2002	\$1.56	\$1.22
Quarter ended April 30, 2002	\$1.74	\$1.18
Quarter ended July 31, 2002	\$1.56	\$1.11
Month ended February 28, 2002	\$1.45	\$1.18
Month ended March 31, 2002	\$1.50	\$1.18
Month ended April 30, 2002	\$1.74	\$1.52
Month ended May 31, 2002	\$1.56	\$1.21
Month ended June 30, 2002	\$1.36	\$1.12
Month ended July 31, 2002	\$1.26	\$1.11

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:

<u>Period</u>	<u>High</u>	<u>Low</u>
Year ended April 30, 1999	\$5.375	\$0.625
Year ended April 30, 2000	\$3.25	\$1.00
Year ended April 30, 2001	\$1.375	\$0.219
Year ended April 30, 2002	\$0.55	\$0.02
Quarter ended July 31, 2000	\$1.375	\$0.75
Quarter ended October 31, 2000	\$1.25	\$0.50
Quarter ended January 31, 2001	\$0.688	\$0.281
Quarter ended April 30, 2001	\$0.625	\$0.219
Quarter ended July 31, 2001	\$0.55	\$0.30
Quarter ended October 31, 2001	\$0.44	\$0.06
Quarter ended January 31, 2002	\$0.22	\$0.02
Quarter ended April 30, 2002	\$0.20	\$0.06
Quarter ended July 31, 2002	\$0.13	\$0.04
Month ended February 28, 2002	\$0.12	\$0.09
Month ended March 31, 2002	\$0.14	\$0.06
Month ended April 30, 2002	\$0.20	\$0.11
Month ended May 31, 2002	\$0.13	\$0.10
Month ended June 30, 2002	\$0.13	\$0.08
Month ended July 31, 2002	\$0.05	\$0.04

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

**B. PLAN OF DISTRIBUTION.**

Not applicable.

**C. MARKETS.**

Our common stock and our warrants are 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 are 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.

**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. 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 name appears 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 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. 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.

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. 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 that impose foreign exchange controls on us or that affect our payment of dividends, interest or other payments to nonresident 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 nonresident 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.

### **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
- 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.

**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**

Not applicable.

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

Not applicable.

**PART II**

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

Not applicable.

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

Not applicable.

**PART III**

**ITEM 17. FINANCIAL STATEMENTS**

Not applicable.

**ITEM 18. FINANCIAL STATEMENTS**

## **ITEM 19. EXHIBITS**

(a) 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 years ended April 30, 2000, 2001 and 2002  
Consolidated balance sheets at April 30, 2001 and 2002  
Consolidated statements of shareholders' equity for the years ended April 30, 2000, 2001 and 2002  
Consolidated statements of cash flows for the years ended April 30, 2000, 2001 and 2002  
Notes to and forming part of the financial statements

(b) The following exhibits are being filed as part of this Annual Report on Form 20-F:

- 1.1 Memorandum of Association of the Company\*
- 1.2 Articles of Association of the Company\*
- 1.3 Amendment to Articles of Association of the Company\*
- 4.1 Employment Agreement of Yu Chuan Yih with the Registrant - incorporated by reference to the Exhibits to our Annual Report on Form 20-F for the fiscal year ended April 30, 2001, SEC File No. 0-29620.
- 4.2 Agreement with QVC, Inc.\*
- 4.3 Securities Purchase Agreement dated as of October 29, 1999 and exhibits and amendments thereto - incorporated by reference to the Exhibits to our Registration Statement on Form F-3 and amendments thereto, SEC File No. 333-11482, declared effective on April 3, 2000.
- 4.4 Common Stock Purchase Agreement, dated as of April 15, 2002, between Navigator Investments Holding IX Limited and the Registrant\*\*
- 4.5 Registration Rights Agreement, dated as of April 15, 2002, between Navigator Investments Holding IX Limited and the Registrant\*\*
- 4.6 Warrant Agreement, dated as of April 15, 2002, between Navigator Investments Holding IX Limited and the Registrant\*\*
- 8.1 List of Subsidiaries of the Company\*
- 99.1 Certification of Chief Executive Officer
- 99.2 Certification of Chief Financial Officer

\* Incorporated by reference to the Exhibits to our Registration Statement on Form F-1 and pre-effective and post-effective amendments thereto, SEC File No. 333-7912, declared effective on April 15, 1998.

\*\* Incorporated by reference to the Exhibits to our pre-effective Registration Statement on Form F-1, SEC File No. 333-90016, filed on June 7, 2002

## **SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

**LJ INTERNATIONAL INC.**  
(Registrant)

Date: August 22, 2002

By:           /s/ YU CHUAN YIH

Yu Chuan Yih  
Chairman

## EXHIBIT INDEX

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**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of LJ International Inc. (the "Company") on Form 20-F for the fiscal year ended April 30, 2002, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Yu Chuan Yih, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ YU CHUAN YIH  
Yu Chuan Yih  
Chief Executive Officer  
August 22, 2002

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of LJ International Inc. (the "Company") on Form 20-F for the fiscal year ended April 30, 2002, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Hon Tak Ringo Ng, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ HON TAK RINGO NG  
Hon Tak Ringo Ng  
Chief Financial Officer  
August 22, 2002