

LJ INTERNATIONAL INC
Form 20-F
April 11, 2011

**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 December 31, 2010
OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the transition period from _____ to _____
OR**

**SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
Date of event requiring this shell company report _____
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)
**Hon Tak Ringo NG, CFO
011-852-2764-3622 (telephone)
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Unit #12, 12/F, Block A
Focal Industrial Centre
21 Man Lok Street
Hung Hom, Kowloon, Hong Kong**

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(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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

Title of each class	Name of each exchange on which registered
---------------------	-------------------------------------------

\$.01 Par Value Common Stock (Common Stock)	NASDAQ
--------------------------------------------------	--------

Securities registered or to be registered pursuant to Section 12(g) of the Act.
None

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.
None

(Title of Class)

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

29,153,672 Shares of Common Stock as of December 31, 2010

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes No

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

- U.S. GAAP
 International Financial Reporting Standards as issued by the International Accounting Standards Board
 Other

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

- Item 17
 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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

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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.

**SPECIAL NOTE REGARDING
FORWARD-LOOKING STATEMENTS**

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

You should be aware that our actual results could differ materially from those contained in the forward-looking statements due to a number of factors, such as but not limited to:

dependence upon certain customers

dependence on key personnel

control by principal shareholder

competitive factors

the operation of our business

general economic conditions

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

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

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

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

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

The following selected consolidated financial data with respect to the five-year period ended December 31, 2010 have been derived from our audited consolidated financial statements. The following selected consolidated financial data should be read in conjunction with Operating and Financial Review and Prospects and the Consolidated Financial Statements and Notes included elsewhere in this annual report.

Selected Financial Data

	Year ended December 31,				
	2010	2009	2008	2007	2006
Statement of Operations Data:					
Revenues	140,548	110,523	136,268	152,037	123,791
Cost of Goods sold	(85,737)	(72,173)	(97,031)	(112,508)	(88,867)
Gross profit	54,811	38,350	39,237	39,529	34,924
Operating expenses					
Selling, general and administrative	(37,303)	(31,039)	(34,815)	(30,399)	(23,114)
Net loss on derivatives	(476)	(503)	(86)	(4)	(29)
Depreciation	(2,779)	(2,197)	(3,373)	(3,095)	(2,039)
Operating income	14,253	4,611	963	6,031	9,742
Other income and expense					
Interest income	69	147	199	273	282
Gain on currency translation	643		1,473		
Gain on sales of securities	258		49		
Gain on disposal of property held for lease	1,635		2,210		
Interest expenses	(978)	(842)	(1,789)	(3,103)	(3,258)
Operating income before income taxes and noncontrolling interest	15,880	3,916	3,105	3,201	6,766
Income taxes expense	(2,877)	(231)	(569)	(1,711)	(1,403)
Income before noncontrolling interest	13,003	3,685	2,536	1,490	5,363
Net (income) loss attributable to noncontrolling interest	(9)	4	(6)	(1)	(38)
Net income attributable to LJ International Inc. common shareholders	12,994	3,689	2,530	1,489	5,325
Net income per share:					
Basic	0.51	0.16	0.11	0.07	0.31
Diluted	0.49	0.15	0.11	0.07	0.29
Weighted average number of shares					
Basic	25,344	23,230	22,246	21,064	17,390
Diluted	26,657	24,102	22,449	22,289	18,303

Balance Sheet Data:

Working capital	100,584	77,614	72,059	62,786	50,134
Total assets	175,757	133,757	131,190	134,144	124,522
Long-term obligation	1,651	2,322	2,219	1,335	1,640
Total LJ International Inc. shareholders equity	110,921	83,872	78,329	72,668	59,739

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B. CAPITALIZATION AND INDEBTEDNESS.

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS.

Not applicable.

D. RISK FACTORS.

We do not have any long-term contracts with our customers and, therefore, we cannot be certain that all of our sales will continue; if not, our revenues will likely decline.

We sell to a large number of customers in a variety of markets. Although we believe that we have maintained good and longstanding relationships with our principal customers, we do not have any long-term contracts with any of them, and they order only on a purchase order basis. The loss of a significant number of our principal customers or a significant reduction in their orders would have a materially adverse effect on our revenues.

We face significant competition from larger competitors in our wholesale and retail operations.

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

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

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

technological developments in the mass production of jewelry

our ability to meet the design and production requirements of our customers efficiently

the market acceptance of our and 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

our ability to compete

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

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

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

Changes to PRC tax laws may adversely affect our financial condition and results of operations in the future.

The National People's Congress, the Chinese legislature, on March 16, 2007 passed a new enterprise income tax law, which became effective on January 1, 2008. The new law applies a uniform 25% enterprise income tax rate (EIT) to both foreign invested enterprises and domestic enterprises, except that enterprises that were approved to be established prior to March 16, 2007 may continue to enjoy the applicable preferential tax treatments until December 31, 2012. Eligible companies are required to transition to the new EIT rate over a five-year period starting January 1, 2008.

Under the New EIT Law, an enterprise established outside of China with de facto management bodies within China is deemed to be considered as a resident enterprise, meaning that it can be treated in a manner similar to a Chinese enterprise for enterprise income tax purposes. The implementing rules of the New EIT Law define de facto management as substantial and overall management and control over the production and operations, personnel, accounting, and properties of the enterprise. Currently, no official interpretation or application of this new resident enterprise classification is available and, therefore, it is unclear how tax authorities will determine tax residency based on the facts of each case.

If the PRC tax authorities determine that our British Virgin Islands holding company is a resident enterprise for PRC enterprise income tax purposes, a number of unfavorable PRC tax consequences could follow. First, we may be subject to enterprise income tax at a rate of 25% on our worldwide taxable income as well as PRC enterprise income tax reporting obligations. In our case, this would mean that non-PRC source income would be subject to PRC enterprise income tax at a rate of 25%, in comparison to no taxation in the British Virgin Islands. Second, under the New EIT Law and its implementing rules dividends paid to us from our PRC subsidiaries would be subject to a 10% withholding income tax. Finally, if

our British Virgin Islands holding company is deemed to be a PRC tax resident enterprise, a 10% withholding tax shall be imposed on dividends we pay to our non-PRC shareholders and with respect to gains derived from our non-PRC shareholders transferring our shares.

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

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

Sales of our jewelry at both the retail and wholesale levels are seasonally sensitive and are generally strongest during the quarter ending December 31 of each year due to the importance of the holiday selling season.

Our retail sales are typically seasonally greater in the fourth quarter and the first quarter of each year due to high spending of consumers during the Christmas and Chinese New Year holidays. Our wholesale sales are typically greater in the third and fourth quarters of each year in anticipation of the Thanksgiving and Christmas holidays.

The success of our retail store expansion program in China is dependent upon numerous factors over which we have limited control.

The future success of our ENZO retail stores in China is partially dependent upon general economic conditions in China, competitive developments within the retail jewelry sector in China and consumer attitudes, including changes in consumer preferences for certain jewelry styles and materials. In addition, our retail expansion program is also dependent upon a number of factors relating to our stores, including the availability of property for lease, the location of the mall or shopping centre, the availability of desirable locations within a mall, the terms of leases, our relationship with major landlords, and the design and maintenance of our stores.

We rely on short-term financing from banks for our daily operation.

We rely on short-term borrowings as part of our financing needs. If we fail to achieve timely rollover, extension or refinancing of our short-term debt, we may be unable to meet our obligations in connection with debt service, accounts payable and/or other liabilities when they become due and payable. In addition, we may be exposed to changes in interest rates. If interest rates increase substantially, our results of operations could be adversely affected.

Certain of our banking facilities that offer short-term borrowings are collateralized by properties owned by our Chairman, Yu Chuan Yih, and by his personal guarantee. If Mr. Yih withdraws the properties or his personal guarantee, the banking facilities may no longer

remain available for use by us. In that event, our daily operations would be adversely affected.

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

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

As a foreign private issuer, we are not subject to certain rules promulgated by Nasdaq that other Nasdaq-listed issuers are required to comply with.

Our shares of common stock are currently listed on The Nasdaq Global Market and, for so long as our securities continue to be listed, we will remain subject to the rules and regulations established by Nasdaq applicable to listed companies. As permitted under Nasdaq rules applicable to foreign private issuers, we have determined not to comply with the following Nasdaq rules:

our independent directors do not hold regularly scheduled meetings in executive session

the compensation of our executive officers is not determined by an independent committee of the board or by the independent members of the board of directors, and our CEO may be present and participate in the deliberations concerning his compensation

related party transactions are not required to be reviewed or approved by our audit committee or other independent body of the board of directors

we are not required to solicit shareholder approval of stock plans, including those in which our officers or directors may participate; stock issuances that will result in a change in control; the issuance of our stock in related party transactions or other transactions in which we may issue 20% or more of our outstanding shares; or, below market issuances of 20% or more of our outstanding shares to any person

We may in the future determine to voluntarily comply with one or more of the foregoing provisions.

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 substantially all 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 domestic public companies, including:

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

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

the sections of the Exchange Act regulating the solicitation of proxies, consents or authorizations applicable to a security registered under the Exchange Act

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

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

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

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

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

amend our Memorandum of Association and Articles of Association without shareholder approval could 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.

We may need to raise capital in the future. Such funds may not be available on acceptable terms or at all, and, without additional funds, we may not be able to expand our retail business in China.

We expect to expend significant resources to expand our retail business in China. We will require substantial funds in order to finance our retail distribution and fund operating expenses. In addition to the funds required to open additional retail locations, additional working capital will be needed to operate these additional retail locations due to longer sales and collection cycles and high inventory levels required to support them. Without these funds, we may not be able to meet our goals. We may seek additional funding through equity or debt financing or through collaborative arrangements with strategic partners.

You should also be aware that in the future:

We cannot be certain that additional capital will be available on favorable terms, if at all;

Any available additional financing may not be adequate to meet our goals; and

Any equity financing would result in dilution to stockholders.

If we cannot raise additional funds when needed and on acceptable terms, we may not be able to effectively execute our growth strategy (including expanding the number of our retail stores in China), take advantage of future opportunities, or respond to competitive pressures or unanticipated requirements.

We are dependent on certain key personnel and the loss of these key personnel could have a material adverse effect on our business, financial condition and results of operations.

Our success is, to a certain extent, attributable to the management, sales and marketing, and operational and technical expertise of certain key personnel. Each of our named executive officers, including our Chief Executive Officer, Mr. Yu Chuan Yih, performs key functions in the operation of our business. There can be no assurance that we will be able to retain these officers or that such personnel may not receive and/or accept competing offers of employment. The loss of a significant number of these employees could have a material adverse effect upon our business, financial condition, and results of operations. We do not maintain key-man life insurance on any of our senior management.

Risks Related to Doing Business in the People's Republic of China

A substantial portion of our retail business operations are conducted entirely in the People's Republic of China (PRC). Because China's economy and its laws, regulations and policies are different from those typically found in Western countries and are continually changing, we will face risks, including those summarized below.

We are subject to comprehensive regulation by the PRC legal system, which is uncertain. As a result, it may limit the legal protections available to you and us and we may not now be, or remain in the future, in compliance with PRC laws and regulations.

Our subsidiaries that own our production facilities and retail stores in China are incorporated under and are governed by the laws of the PRC; a significant portion of our operations are conducted in the PRC; and many of our suppliers are located in the PRC. The PRC government exercises substantial control over virtually every sector of the PRC economy, including the production, distribution and sale of our merchandise. We are required to obtain several membership and approval certificates from these government agencies in order to continue to conduct our business. We may be required to renew such memberships and to obtain approval certificates periodically. In order to operate under PRC law, our PRC subsidiaries require valid licenses, certificates and permits, which must be renewed from time to time. If we were to fail to obtain the necessary renewals for any reason, including sudden or unexplained changes in local regulatory practice, we could be required to shut down all or part of our operations temporarily or permanently.

The legal and judicial systems in the PRC are still rudimentary. The laws governing our business operations are sometimes vague and uncertain and enforcement of existing laws is inconsistent. Thus, we can offer no assurance that we are, or will remain, in compliance with PRC laws and regulations.

Anti-inflation measures could harm the economy generally and could harm our business.

The PRC government exercises significant control over the PRC economy. In recent years, the PRC government has instituted measures to curb the risk of inflation. These measures have included monitoring the exchange rate of the RMB, restrictions on the availability of domestic credit, and limited re-centralization of the approval process for some international transactions. These measures may not succeed in controlling inflation, or they may slow the economy below a healthy growth rate and lead to economic stagnation or recession; in the worst-case scenario, the measures could slow the economy without curbing inflation, causing stagflation. The PRC government could adopt additional measures to further combat inflation, including the establishment of price freezes or moratoriums on certain projects or transactions. Such measures could harm the economy generally and hurt our business by limiting the income of our customers available to purchase our merchandise, by forcing us to lower our profit margins, and by limiting our ability to obtain credit or other financing to pursue our expansion plan or maintain our business.

ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY.

LJ International Inc. (we , LJI or the Company) was incorporated as an international business company under the International Business Companies Act of the British Virgin Islands on January 30, 1997. As of December 31, 2010, we owned 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

ENZO International Holdings Ltd.

ENZO Jewelry Inc.

Lorenzo Crystal Ltd.

Lorenzo (Shenzhen) Co., Ltd.

Wonderful (Shenzhen) Ltd.

Shanghai Enzo Diamond Co., Ltd.

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

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

we spent \$2,650,000 on capital expenditures, excluding inventory, for ENZO retail store openings during the fiscal year ended December 31, 2010

we spent \$1,415,000 on capital expenditures, excluding inventory, for ENZO retail store openings during the fiscal year ended December 31, 2009

we spent \$1,199,000 on capital expenditures, excluding inventory, for ENZO retail store openings during the fiscal year ended December 31, 2008

B. BUSINESS OVERVIEW.

We established a major manufacturing presence in Shenzhen, China in 1998. In that same year, our shares began trading on The Nasdaq Stock Market and entered the select ranks of major publicly-traded firms in the jewelry business. In December 2004, we began our retail jewelry operations in China by introducing our own ENZO brand as a jewelry retail chain following the country's acceptance into the World Trade Organization (WTO). We are a vertically integrated company that designs, brands, markets, distributes and retails a complete range of fine jewelry. In 1998 we established a major manufacturing presence in Shenzhen, China, and in the same year our shares began trading on the Nasdaq Stock Market, putting us in the select ranks for major publicly-traded firms in the jewelry business. In recent years we have been aggressively extending our vertical integration to retailing. Following China's acceptance into the World Trade Organization, we began our retail jewelry operations in that country in December 2004 under the brand name ENZO. As of December 31, 2010, we have established more than 130 ENZO points of sale.

While we specialize in the colored jewelry segment, we also offer high-end pieces set in yellow gold, white gold or sterling silver and adorned with colored stones, diamonds, pearls and precious stones. 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 our

retail partners, as well as for our own retail operations, and enhanced profits for us. Innovative processes in stone cutting and production further enhance our competitive position.

We employ an international design team, and all of our designs and merchandising strategies are proprietary. The exclusive and innovative concepts that we create offer brand potential. Our expertise in stone sourcing, cutting and production, product development and jewelry manufacturing has formed a very solid foundation for the development of ENZO.

LJI continues its expansion strategy in China's retail market.

Ever since we opened the first ENZO stores in December 2004, we have been committed to a strategy based on retailing. Already, ENZO has developed its self-managed national chain stores rapidly and has become a conspicuous luxury jewelry brand in the China market, which we regard as having one of the largest and fastest growing consumer markets for luxury items. Being a market leader in luxury color stone jewelry, ENZO enjoys a uniquely popular status among jewelry lovers and collectors.

Our wholesale and manufacturing operations play crucial supporting roles, but we have consistently envisioned China's untapped retail market as the key long-term driver of growth in revenues and profits. We will continue to expand our retail operations in China by opening new self-managed ENZO stores. We have not and do not intend to grant franchising licenses for our ENZO brand.

LJI continues to focus in North America for our wholesale business.

Our primary wholesale marketing focus has been in North America. There we have sold directly to certain high-volume customers that need specialized product development services, and through a marketing relationship with International Jewelry Connection for those customers that need higher levels of service and training.

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

fine jewelers

national jewelry chains

department stores

TV shopping channels

discount chain stores

For the years ended December 31, 2009 and 2010, approximately 35% and 30% of our total sales, respectively, were in North America.

Our Retail Business Strategy

Our retail business strategy is to:

expand our market share by having a total of 200 points of sale in operation by the end of 2011

improve the performance of our existing stores by making appropriate adjustments on product mix and by stepping up our marketing and promotional activities

further expand our product range by introducing new collections for both colored gemstones and diamonds to capture different market segments

expand customers base by opening of new shops and through effective marketing and promotional campaigns

Our Wholesale Business Strategy

Our wholesale business strategy is to:

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

further develop our existing customer relationships with our specialized services

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

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

Our ENZO operation also gets the benefit of full vertical integration, beginning with the sourcing of gemstones directly from mines around the world to cutting, designing and setting them in our state-of-the-art factory. This control over the entire supply chain backs up ENZO's commitment to providing excellent quality and service in the jewelry market. It ensures that every piece of jewelry is perfectly designed and made to meet world-class professional standards.

The following is a breakdown of our total revenues, including wholesale and retail, by geographic market for each of our past three fiscal years:

(in thousands)	Year ended December 31,		
	2010	2009	2008
	US\$	US\$	US\$
US & Canada	42,400	39,225	69,232
Europe and other countries	16,752	18,110	27,455
Japan	1,291	1,115	989
PRC (including Hong Kong and Macau)	80,105	52,073	38,592
	140,548	110,523	136,268

Our Production Capability

We have established a sophisticated facility in China that performs stone cutting, polishing and jewelry production. The facility is located in the city of Shenzhen in Guangdong Province, China. Our production facility in Shenzhen has been operating for 12 years and has more than 150,000 square feet of production space. We currently employ approximately 1,300 skilled gemstone cutters and production personnel excluding managerial, sales and marketing staff. The plant turned out approximately 1.6 million pieces of finished fine jewelry during the fiscal year ended December 31, 2010.

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

Sales and Marketing

Retail

The strategy of our retail brand, ENZO, focuses on differentiating ENZO from the many mass-market local competitors. This is the result of continuous marketing programs that built a unique image and identity for ENZO.

ENZO has combined its product, sales and marketing programs that align with the strategic direction of reinforcing the brand as one of the most recognized foreign jewelry brands in China. Ever since its first store opened in 2004, ENZO has established a brand image unique to the Chinese market that of fashionable luxury that is affordable, distinct from other market players (both local and international). It pursues this brand-building strategy through a number of methods, including:

Continuous macro marketing and PR programs to deliver the brand messages, using channels such as national magazines, weekly magazines, newspaper, outdoor advertising space, and MTR advertisement.

Localized marketing programs to fit local markets of different cities. Trunk shows and workshops are arranged for building up close relationship with the media and customers, letting them know more about the brand and doing business at the same time.

Participating in jewelry shows, both for brand building and business development. In 2010, for instance, we had a high-profile presence at the June and September Jewellery Fair in Hong Kong

Seasonal promotional programs based on the festival seasons - e.g. Chinese New Year, Valentine's Day etc.

Working closely with malls in organizing various localized promotional programs.

Wholesale

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 that are distinctly different from those of our competitors. We continue to devote our efforts toward brand development and utilize marketing concepts to enhance the salability of our products. We recognize that retailers favor certain price points. As part of our product development strategy, we strive to align our wholesale prices to match retailers' target prices as a means of achieving these popular price targets.

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

We exhibited at the following international jewelry shows in 2010:

Show Name	Show Date
The First, Vicenzaoro Fair	Jan 16 - 21, 2010
Tucson Gem & Mineral Show	Feb 11 - 14, 2010
JA Int'l Jewelry (Winter) Show	Feb 28 - Mar 03, 2010
Hong Kong Int'l Jewellery Show	Mar 05 - 09, 2010
Basel 2010	Mar 18 - 25, 2010
The Charm, Vicenzaoro Fair	May 22 - 26, 2010
JCK Las Vegas 2010	Jun 04 - 07, 2010
JA Int'l Jewelry Show	Jul 25 - 28, 2010
The Choice, Vicenzaoro Fair	Sep 11 - 15, 2010
September HK Jewellery & Gem Fair	Sep 14 - 18, 2010
JA Int'l Jewelry Show	Oct 24 - 26, 2010

Design and Product Development

We have a group of internationally trained designers who work in our Shenzhen, China office. Our designers create styles that have been accepted by our various clients worldwide. Our design teams attend trade fairs worldwide to gather product ideas and monitor the latest product trends.

We provide our customers with a broad selection of high-quality 10-, 14- and 18-karat gold and sterling silver jewelry products that incorporate traditional yet fashionable styles and designs.

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

Production Process

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

- cutting and polishing colored gemstones

- combining pure gold or sterling silver with gemstones or diamonds to produce jewelry

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

We strive to commit to high standards and continual improvement for success through improved customer satisfaction and staff motivation. We obtained the Quality Management System ISO 9001:2008 Certificates on June 30, 2008.

Supply

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

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

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

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

We purchase our gold requirements within a reasonable period after each significant purchase order is received.

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

Security

We have installed certain measures at our Shenzhen, China production facility, all of our retail stores and our Hong Kong 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 for all jewelry as it proceeds through the production process. A complete physical inventory count of gold and gemstones is taken at our production and facilities on a quarterly basis.

Insurance

We appoint a worldwide insurance brokerage firm, Aon, to advise and co-ordinate all our insurance needs. We maintain primary all-risk insurance, with limits which may not meet our inventory levels from time to time, to cover thefts and damage to inventory located on our premises. We also maintain insurance covering thefts and damage to our owned inventory located off-site. The amount of coverage available under such policies is limited and may vary by location, but is generally in excess of the value of the gold, diamonds and gemstones supplied by us. We carry transit insurance, the coverage of which includes the transportation of jewelry outside of our office.

Competition

Retail

Regarding the China retail jewelry market, there are many Hong Kong, local and foreign competitors. Those competitors may have product type, price range, market segment, target customer, size, history, strategy and background similar to or different from ENZO. Hong Kong competitors include Hong Kong-listed chain store operators such as Chow Tai Fook, Chow Sang Sang, Tse Sui Luen and Luk Fook; the local Chinese retail competitors include Laofengxiang, Chaohongji, and Laomiao; and foreign competitors include Tiffany, Cartier and Bulgari.

Wholesale

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

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

C. ORGANIZATIONAL STRUCTURE AS OF DECEMBER 31, 2010.

The following chart 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 (HK)

ENZO International Holdings Ltd. (BVI)

ENZO Jewelry Inc. (BVI)

Lorenzo Crystal Ltd. (HK)

Lorenzo (Shenzhen) Co., Ltd. (PRC)

Wonderful (Shenzhen) Ltd. (PRC)

Shanghai Enzo Diamond Co., Ltd. (PRC)

D. PROPERTY, PLANTS AND EQUIPMENT.

Our principal executive office is located at Unit #12, 12/F, Block A, Focal Industrial Centre, 21 Man Lok Street, Hung Hom, Kowloon, Hong Kong. We own and lease 9,700 square feet of office and showroom at this location.

Our jewelry production facility in Shenzhen, China consists of 151,557 square feet of building space located inside of and close to the Shatoujiao Free Trade Zone, Shenzhen. We own approximately 74,196 square feet of this space. We also currently lease:

18,848 square feet for a term of five years expiring June 30, 2011 from an unaffiliated third party at a rental rate of \$3,817 per month;

18,848 square feet for a term of two years expiring August 31, 2010 from an unaffiliated third party at a rental rate of \$5,811 per month;

19,364 square feet for a term of three years expiring March 31, 2012 from an unaffiliated third party at a rental rate of \$4,883 per month; and

20,301 square feet for a term of three years expiring March 31, 2012 from an unaffiliated third party at a rental rate of \$5,119 per month.

We own a w