2003 and 2004 Financial Statement

REPORT OF INDEPENDENT AUDITOR

To the Board of Directors and Stockholders
Elegant Illusions, Inc.

I have audited the accompanying consolidated balance sheets of Elegant Illusions, Inc. and Subsidiaries as of December 31, 2003 and 2004, and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. My responsibility is to express an opinion on these financial statements based on my audits.

I conducted my audits in accordance with generally accepted auditing standards of the United States of America. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audits provide a reasonable basis for my opinion.

In my opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Elegant Illusions, Inc. and Subsidiaries as of December 31, 2003 and 2004 and the consolidated results of operations, stockholders' equity and cash flows for the years then ended, in conformity with generally accepted accounting principles of the United States of America.

Jeffrey S. Gilbert,
CPA

Los Angeles, California
March 29, 2005

ELEGANT ILLUSIONS, INC AND SUBSIDARIES
CONSOLIDATED BALANCE SHEETS

ASSETS

	December 31, 2003	December 31, 2004
CURRENT ASSETS		
Cash and cash equivalents	$1,294,713	$1,229,305
Accounts receivable	140,702	110,479
Income taxes receivable		92,521
Inventory	4,435,058	4,815,770
Prepaid expenses	438,696	319,980

TOTAL CURRENT ASSETS	6,309,168	6,568,055
PROPERTY AND EQUIPMENT, NET	1,621,891	1,361,539
OTHER ASSETS	75,175	73,451
	$8,006,234	$8,003,045

LIABILITIES AND STOCKHOLDERS EQUITY

CURRENT LIABILITIES		
Current portion of long term debt	$31,803	$28,930
Accounts payable and accrued expenses	150,898	224,738
Income taxes payable	67,580	0
TOTAL CURRENT LIABILITIES	250,281	253,668
LONG TERM DEBT		
Mortgage payable	387,920	337,601
Deferred income taxes	120,871	65,000
	508,791	402,601
TOTAL LIABILITES	759,073	656,269
STOCKHOLDERS' EQUITY		
Common stock-authorized 10,000,000 shares, $.001 per value, issued and outstanding 6,146,446 shares in 2003 and 2004	6,147	6,147
Additional paid in capital	3,914,509	3,914,509
Retained earnings	3,410,515	3,510,128
Less treasury stock at cost (62,067 shares in 2003 and 2004)	(84,008)	(84,008)
	7,247,162	7,346,776
	$8,006,234	$8,003,045

See accompanying notes to Consolidated Condensed Financial Statements

ELEGANT ILLUSIONS, INC AND SUBSIDARIES CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2004

	2003	2004
REVENUES	$10,535,098	$9,592,778

COST OF GOODS SOLD	2,839,525	2,448,686
GROSS PROFITS	7,695,573	7,144,092
EXPENSES		
SELLING, GENERAL AND ADMINISTRATION	6,704,737	6,681,619
DEPRECIATION, AND AMORTIZATION	361,243	283,637
INTEREST EXPENSE	55,339	16,223
	7,121,319	6,981,479
INCOME BEFORE INCOME TAXES	574,254	162,613
PROVISION FOR INCOME TAXES	220,000	63,000
NET INCOME	$354,254	$99,613
WEIGHTED AVERAGE SHARES OUTSTANDING	6,084,379	6,084,379
BASIC AND DILUTED INCOME PER SHARE	$0.06	$0.02

See accompanying notes to Consolidated Condensed Financial Statements

ELEGANT ILLUSIONS, INC AND SUBSIDIARIES CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2003 AND 2004

	2003	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$354,254	$99,613
Adjustments to reconcile net income To net cash provided by (used in) operating activities		
Depreciation and amortization	361,243	283,637
Abandonment of property and equipment		105,290
Changes in operating assets and liabilities		
(Increase) Decrease in :		
Accounts receivable	64,251	30,223
Inventory	(140,538)	(380,712)
Prepaid expenses	(153,903)	118,715
Income tax receivable		(92,521)
Increase (Decrease in)		
Accounts payable and accrued expenses	(10,261)	73,840
Income taxes payable	(34,915)	(123,451)

NET CASH PROVIDED BY OPERATIONS	440,131	114,634
CASH FLOW FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(306,495)	(128,574)
Other assets	(4,362)	1,724
NET CASH USED IN INVESTING ACTIVITIES	(310,857)	(126,850)
CASH FLOW FROM FINANCING ACTIVITIES		
Mortgages payable	(33,883)	(53,192)
NET CASH USED IN FINANCING ACTIVITIES	(33,883)	(53,192)
NET INCREASE IN CASH AND CASH EQUIVALENTS	95,391	(65,408)
CASH AND CASH EQUIVALENT BALANCE		
Beginning of period	1,199,322	1,294,713
CASH AND CASH EQUIVALENT BALANCE		
End of Period	$1,294,713	$1,229,305
SUPPLEMENTAL CASH FLOW DISCLOSURE		
Interest paid	$55,339	$16,223
Income taxes paid	$109,944	$211,392

See accompanying notes to Consolidated Condensed Financial Statements

ELEGANT ILLUSIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2003 AND 2004

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Description of Business -

Elegant Illusions, Inc. was incorporated in Delaware in March 1988. The Company is engaged in the retail sale of fine jewelry in two locations and created gem jewelry at locations in California , Nevada , Missouri , Louisiana , Hawaii , Michigan , Georgia , Florida , Colorado and U.S. Virgin Islands. Created gem jewelry items are replications of fine jewelry, manufactured with synthetic stones set in 14 carat gold, sterling silver vermeil or plated brass. In addition, the Company sells original oil paintings, lithographs and other art in three stores in New Orleans , Vail and Sarasota.

Principles of Consolidation -

The financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated.

Cash and Cash Equivalents -

Cash equivalents are purchased short-term highly liquid investments readily convertible to cash with original maturities of no more than three months. There are cash balances in certain Federal insured banks that exceed the maximum insured amounts. However, management of the Company does not consider this a significant risk. As of December 31, 2004 , the Company has deposits in excess of the FDIC limit in the amount of approximately $1,000,000.

Inventories -

Inventories are stated at the lower of cost or market determined on a first-in, first-out (FIFO) basis.

Use of Estimates -

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Fair Value of Financial Instruments –

The Company’s financial instruments consists of cash equivalents, receivables, accounts payable, accrued expenses, notes payable and due to related parties. The fair values of the Company’s financial instruments approximates the carrying value of the instruments.

Impairment of Long-Lived Assets -

The Company periodically assesses the recoverability of the carrying amounts of long-lived assets, including intangible assets. A loss is recognized when expected undiscounted future cash flows are less than the carrying amount of the asset. The impairment loss is the difference by which the carrying amount of the assets exceeds its fair value. The Company does not expect to have any significant losses resulting from its review of impairment of long-lived assets. The loss on disposition of property and equipment relates to stores closed.

Stock-Based Compensation –

The Company has chosen to account for stock-based compensation using the intrinsic value method as prescribed in Accounting Principles Board (“APB”) opinion No.25, Accounting for Stock Issued to Employees and related interpretations, under which no compensations cost related to stock options has been recognized at the exercise price of each option at the date of grant was equal to the fair value of the underlying common stock. The Company has no stock option plan nor has it issued stock for compensation.

Property and Equipment -

Property and equipment is stated at cost. Depreciation is computed on the straight-line method based upon the estimated useful life of the asset. Useful lives are generally as follows:

Office furniture, fixtures & equipment 5-7 years

Store furniture, fixtures & equipment 5-7 years
Leasehold improvements 5-7 years

Income Taxes -

The Company utilizes the asset and liability method for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Basic and Diluted Loss per Share –

Basic earnings per common share is based upon the net earnings divided by the weighted average number of common shares outstanding during the period. Diluted loss per common share adjusts for the effect of convertible securities, stock options and warrants, if applicable, only in the periods presented in which effect would have been diluted. The Company did not grant options and warrants during 2003 and 2004 and there are no outstanding convertible securities, options and warrants as of December 31, 2003 and 2004.

Start-up Costs -

Costs of start-up activities, including organization costs, is expensed as incurred.

Revenue –

Revenues related to the sale of jewelry and art are recognized at the time the items are delivered to the customer.

Advertising -

Advertising costs are expensed the first time the advertisement is run. Total advertising and promotion expenses were $312,899 and $245,538 for the years ended December 31, 2003 and 2004, respectively.

2. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at December 31, 2003 and 2004:

	2003	2004
Real Estate	$759,940	$759,940
Office furniture, fixtures & equipment	305,100	330,541
Store furniture, fixtures & equipment	2,359,375	2,244,601
Vehicles	90,100	103,600
Leasehold improvements	1,031,936	842,742
	4,546,451	4,281,424
Less: accumulated depreciation and amortization	2,924,560	2,919,885
	$1,621,891	$1,361,539

3. INCOME TAXES

The components of income tax expense for the years ended December 31, 2003 and 2004 follow:

	Federal	State	Total
2003			

Current	$182,000	$38,000	$220,000
Deferred			
	$182,000	$38,000	$220,000
2004			
Current	$52,000	$11,000	$63,000
Deferred			
	$52,000	$11,000	$63,000

The component of deferred tax liability was as follows at December 31:

Deferred tax liability:	2003	2004
Depreciation	$120,871	$63,000

Income tax expense amounted to $220,000 in 2003 and $63,000 in 2004 (effective tax rates of 38.3% and 38.2 %, respectively). The actual tax expense differs from the expected tax expense (computed by applying the Federal corporate tax rate of 34% to earnings before income taxes) as follows:

	2003	2004
Expected statutory tax	$195,246	$55,288
State income tax, net of federal tax benefit	25,080	7,260
Other	7,183	7,961
Impact from initial lower Federal Tax rates	(7,509)	(7,509)
Other		
Actual tax	$220,000	$63,000

4. OPERATING LEASES

The Company leases its office and retail store facilities and certain equipment under operating leases with terms ranging from three to ten years. Certain of the leases include percentage rates of 3% to 12% of revenues as defined. The Company has placed with various lessors approximately $65,000 in deposits as required by the leases as of December 31, 2004 .

Future minimum lease payments by year and in the aggregate, under noncancelable operating leases with initial or remaining lease terms in excess of one year, as of December 31, 2004 are as follows:

Year Ended December 31

2005	$ 903,000
2006	446,000
2007	311,000

2008	231,000
2009	85,000
Thereafter	36,000
	$ 2,012,000

Rent expense for the fiscal years ended December 31, 2003 and 2004 were $1,504,228 and $1,450,176.

During 2002, the Company entered into a lease arrangement with its three major shareholders to lease a store location in Sarasota , Florida . In the opinion of Management the lease is at market value for that location. The specific lease terms require 60 monthly base payments of $7,200. In additions those same majority shareholders have leased two condominium locations to the Company that they own near existing store locations that are used by management in lieu of hotels. The terms of the leases require aggregate monthly payments of $3,480.

5. Long term debt

The Company owns a sales location in Vail, Colorado . It purchased the property for approximately $595,000 of which $480,000 of the purchased price was funded by a mortgage note secured by the property at 8.96% per annum. The mortgage was modified effective April 2003 reducing the interest rate to the bank's cost of funds plus 2.25% (as of December 31, 2004 the rate was 4.50%). The mortgage is stated at fair value. The Company is now required to make monthly payments of $3,766 for 120 months and the remaining is all due at April 1, 2013 . Estimated principal repayments over the next five years are as follows:

2005 - $28,930

2006 - $30,259

2007 - $31,659

2008 - $33,103

2009 - $34,162

7. SAVINGS PLAN - 401 (k)

The Company, effective June 1, 2001 established a 401(k) profit sharing plan. For eligible employees, the Company savings and investment plan will allow eligible employees to allocate up to 20% of salary through payroll deductions. The Company matches 60% of the employee's pre-tax contributions, up to plan limits. In 2003, the costs of this plan was approximately $22,000 and $52,000 in 2004.

Signature	Title	Date

James Cardinal	Chief Executive Officer and Director	March 31, 2005