NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORP /DC/
Form 424B3
April 12, 2018
Rule 424 (b) (3)
Registration No. 333-221261

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities Offered	Maximum Aggregate Offering Price	Amount of Registration Fee(1)(2)
Senior Debt Securities	$2,500,000.00	$311.25

(1)
Calculated in accordance with Rule 457 (r) of the Securities Act of 1933.

(2)
The amount in this column has been transmitted to the SEC in connection with the securities offered by means of this pricing supplement.

TRADE DATE: 04/11/2018
PRICING SUPPLEMENT NO. 7754 DATED April 11, 2018
TO PROSPECTUS SUPPLEMENT DATED November 3, 2017
AND BASE PROSPECTUS DATED November 1, 2017

NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION
Medium-Term Notes, Series D
Due Nine Months or More from Date of Issue

Principal Amount:	$2,500,000.00
Issue Price:	100% of Principal Amount
Original Issue Date:	04/16/2018
Maturity Date:	04/15/2019
Interest Rate:	2.59% per annum
Regular Record Dates:	Each January 1 and July 1
Interest Payment Dates:	Each January 15 and July 15
Redemption Date:	None

Agent’s Commission:	None
Form of Note: (Book-Entry or Certificated)	Certificated
Other Terms:	None

Medium-Term Notes, Series D may be issued by the Company in an unlimited aggregate principal amount.

Validity of the Medium-Term Note

In the opinion of Hogan Lovells US LLP, as counsel to the Company, when the notes offered by this pricing supplement have been executed and issued by the Company and authenticated by the trustee pursuant to the indenture, and delivered against payment as contemplated herein, such notes will constitute valid and binding obligations of the Company, subject to bankruptcy, insolvency, reorganization, receivership, moratorium and other laws affecting creditors' rights (including, without limitation, the effect of statutory and other law regarding fraudulent conveyances, fraudulent transfers and preferential transfers), and by the exercise of judicial discretion and the application of principles of equity, good faith, fair dealing, reasonableness, conscionability and materiality (regardless of whether the applicable agreements are considered in a proceeding in equity or at law).

This opinion is based as to matters of law solely on applicable provisions of the following, as currently in effect: (i) the District of Columbia Cooperative Association Act, as amended (the "Cooperative Association Act") and (ii) the laws of the State of New York (but not including any laws, statutes, ordinances, administrative decisions, rules or regulations of any political subdivision below the state level). In addition, this opinion is subject to customary assumptions about the trustee's authorization, execution and delivery of the indenture and its authentication of the notes and the validity, binding nature and enforceability of the indenture with respect to the trustee, all as stated in the letter of such counsel dated November 3, 2017, which has been filed as an exhibit to a Current Report on Form 8-K by the Company on November 3, 2017.

	599				
Inventories	9,914	10,204	5,181	6,619	14,049
Accounts payable	37,775	26,288	15,791	5,253	4,084
Working capital(1)	77,838	16,663	1,795	9,021	14,372
Total assets	128,382	62,305	30,914	26,545	34,056
Total long-term obligations	1,071	1,126	1,091	10,789	16,361
Mandatorily redeemable convertible preferred stock		57,485	57,215	57,215	50,570
Total stockholders equity (deficit)	83,620	(27,238)	(54,560)	(56,199)	(48,723)

(1) Working capital consists of total current assets, including cash and cash equivalents, less total current liabilities.

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion should be read in conjunction with the consolidated financial statements and related notes which appear elsewhere in this report. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed below and elsewhere in this report, particularly under the heading Risk Factors.

Overview

Blue Nile is a leading online retailer of high quality diamonds and fine jewelry. We have built a well respected consumer brand by employing an informative sales process that empowers our customers while offering a broad selection of high quality jewelry at competitive prices. Our primary web site at www.bluenile.com showcases over 55,000 independently certified diamonds and more than 1,000 styles of fine jewelry, including rings, wedding bands, earrings, necklaces, pendants, bracelets and watches.

Our business model enables us to eliminate much of the cost associated with carrying diamond inventory. We generally do not hold in our inventory the diamonds we offer for sale until we receive a customer order. With limited exceptions, the diamonds we display are owned by our suppliers. Upon receipt of a customer order for a specific diamond, we purchase that diamond from one of our suppliers, who generally ships it to us in one business day. We take title to the diamond at the time of its shipment from our supplier. Unlike diamonds, we typically take rings, wedding bands, earrings, necklaces, pendants, bracelets and watches into inventory before they are ordered by our customers. As such, we are subject to costs associated with carrying such jewelry products and risks of potential mark-downs.

We review our operations based on both our financial results and various non-financial measures. Among the key financial factors upon which management focuses in reviewing performance are gross profit margin, operating income, net cash provided by operating activities and growth in net sales. As an online retailer, we do not incur most of the operating costs associated with physical retail stores, including the costs of maintaining significant inventory and related overhead. As a result, while our gross profit margins are lower than those typically maintained by traditional diamond and fine jewelry retailers, we are able to realize relatively higher operating income as percentage of net sales. In 2004, we had a 22.2% gross profit margin, as compared to gross profit margins of up to 50% by some traditional retailers. We believe our lower gross profit margins result from lower retail prices that we offer to our customers. We believe these lower prices, in turn, contribute to increased net sales. Our financial results, including our net sales, gross profit and operating income can and do vary significantly from quarter to quarter as a result of a number of factors, many of which are beyond our control. These factors include the seasonality of our net sales, general economic conditions, the costs to acquire diamonds and precious metals, and our competitors pricing and marketing strategies.

Among the key non-financial measures of our success are customer feedback and customer satisfaction ratings compiled by third parties. We believe that maintaining high overall customer satisfaction is critical to our ongoing efforts to promote the Blue Nile brand and to increase our net sales and net income. We actively solicit customer feedback on our web site functionality as well as on the entire purchase experience. To maintain a high level of performance by our diamond and jewelry consultants, we also undertake an ongoing customer feedback process.

In August 2004, the Company launched a web site in the United Kingdom, www.bluenile.co.uk through which the Company offers for sale a limited number of products. During 2004, sales through the new web site were immaterial.

Critical Accounting Policies

The preparation of our consolidated financial statements requires that we make certain estimates and judgments that affect amounts reported and disclosed in our consolidated financial statements and related notes. We base our estimates on historical experience and on other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates. The following are the critical accounting policies that we believe require significant estimation and management judgment.

Revenue Recognition

Blue Nile recognizes revenue and the related gross profit on the date on which we estimate that customers have received their products. As we require customer payment prior to order shipment, any payments received prior to the customer receipt date are recorded as deferred revenue. We utilize our freight vendors tracking information to determine when delivery has occurred, which is typically within one to six days after shipment. We reduce revenue by a provision for returns, which is based on our historical product return rates. Our contracts with our suppliers generally allow us to return to our suppliers diamonds purchased and returned by our customers at no additional costs other than costs of insurance, shipping and handling, if any.

Fraud Reserve

A majority of our sales is paid by credit card. Although we have measures in place to detect and prevent credit card fraud, we have exposure to losses from fraudulent charges. We record a reserve for fraud losses based on our historical rate of such losses, which has been minimal.

Income Taxes

We use the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized by applying statutory tax rates in effect in the years in which the differences between the financial reporting and tax filing bases of existing assets and liabilities are expected to reverse. We have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for a valuation allowance against our deferred tax assets; we believe that all net deferred tax assets shown on our balance sheet are more likely than not to be realized in the future and no valuation allowance is therefore necessary. In the event that actual results differ from those estimates or we adjust those estimates in future periods, we may need to record a valuation allowance, which will impact deferred tax assets and the results of operations in the period the change is made.

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Stock-based Compensation

We account for our employee compensation plans under the recognition and measurement provisions of APB 25 and related interpretations. We amortize stock-based compensation using the straight-line method over the vesting period of the related options, which is generally four years.

We have recorded deferred stock-based compensation on certain grants prior to May 19, 2004, representing the difference between the option exercise price and the deemed fair value of our common stock on the grant date for financial reporting purposes. We determined the deemed fair value of our common stock based upon several factors and information available at the time of grant, including the market capitalization of similar retailers and the expected valuation of our initial public offering. Had different assumptions or criteria been used to determine the deemed fair value of our common stock, different amounts of stock-based compensation could have been reported.

Pro forma information regarding net income attributable to common stockholders and net income per share attributable to common stockholders is required in order to show our net income as if we had accounted for employee stock options under the fair value method of SFAS 123, as amended by SFAS 148. This information is contained in Note 1 to our financial statements. The fair values of options and shares issued pursuant to our option plan at each grant date were estimated using the Black-Scholes option pricing model.

As discussed in Note 1 to our financial statements, in December 2004, the FASB issued SFAS 123R. This statement addresses the accounting for share-based payment transactions in which a company receives employee services in exchange for the company s equity instruments or liabilities that are based on the fair value of the company s equity securities or may be settled by the issuance of these securities. SFAS 123R eliminates the ability to account for share-based compensation using APB 25 and generally requires that such transactions be accounted for using a fair value method. The provisions of this statement are effective for financial statements issued for fiscal periods beginning after June 15, 2005 and will become effective for the Company beginning with the third quarter of our 2005 fiscal year.

Results of Operations

The following table presents our historical operating results for the periods indicated as a percentage of net sales:

	Year Ended January 2,	Year Ended December 31,	
	2005	**2003**	**2002**
Net sales	100.0%	100.0%	100.0%
Gross profit	22.2	22.8	25.2
Selling, general and administrative expenses	13.5	14.1	19.6
Restructuring charges		(0.1)	0.6
Operating income	8.7	8.8	5.0
Other income (expense), net	0.5		(2.7)
Income before income taxes	9.2	8.8	2.3
Income tax expense (benefit)	3.3	(12.2)	
Net income	5.9%	21.0%	2.3%

The following describes certain line items set forth in our consolidated statement of operations:

Net Sales. Substantially all of our net sales consist of diamonds and fine jewelry sold via the Internet, net of estimated returns. We also generate net sales from upgrades to our free standard shipping. Historically, net sales have been higher in the fourth quarter as a result of higher consumer spending during the December holiday season. We expect this seasonal trend to continue in the foreseeable future.

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Gross Profit. Our gross profit consists of net sales less the cost of sales. Our cost of sales consists of the cost of diamonds and jewelry products sold to customers, inbound and outbound shipping costs, insurance on shipments and the costs incurred to set diamonds into ring, earring and pendant settings, including labor and related facilities costs. Our gross profit has fluctuated historically based primarily on our product acquisition costs, product mix and pricing decisions.

Selling, General and Administrative Expenses. Our selling, general and administrative expenses consist primarily of payroll and related benefit costs for our employees, marketing costs, credit card fees and costs associated with being a publicly traded company. These expenses also include certain facilities, fulfillment, customer service, technology and depreciation expenses, as well as professional fees and other general corporate expenses.

As of January 2, 2005, we had an aggregate of $929,000 of unamortized deferred stock-based compensation relating to certain stock option grants. These options are considered compensatory because the fair value of our stock on the grant date for financial reporting purposes was greater than the exercise price of the options. We amortize deferred stock-based compensation over the vesting period of the related options, which is generally four years. Substantially all of these expenses are included in selling, general and administrative costs. Assuming these options fully vest, we will recognize amortization of deferred stock-based compensation from these options of $347,000, $346,000 and $232,000 in 2005, 2006 and 2007, respectively.

Income Taxes. In 2004, we recognized an income tax expense of $5.6 million related to provision for income taxes at the federal statutory rate. In 2003, we recognized an income tax benefit of $15.7 million due to the release of our valuation allowance relating primarily to our net operating loss carryforwards. Prior to 2003, we had recorded no provision for federal and state income taxes since inception. Our aggregate net operating loss carryforwards for federal income tax purposes were approximately $26.0 million at January 2, 2005. These net operating loss carryforwards expire periodically between 2019 and 2021, although we expect to utilize all loss carryforwards in advance of their expiration dates. We expect to continue to recognize expense related to provision for income taxes in future periods.

Comparison of Year Ended January 2, 2005 to Year Ended December 31, 2003

Net Sales

Net sales increased 31.3% to $169.2 million in 2004 from $128.9 million in 2003. The increase in net sales was primarily due to an increase in the net sales volume of engagement and customized non-engagement diamond jewelry. The remaining increase in net sales resulted from growth in demand for our other jewelry products.

Gross Profit

Gross profit increased 28.0% to $37.7 million in 2004 from $29.4 million in 2003. The increase in gross profit in 2004 primarily resulted from increases in sales volume, partially offset by an increase in wholesale prices for gold and platinum in 2004 that we did not fully pass on to our customers. Gross profit as a percentage of net sales was 22.2% and 22.8% in 2004 and 2003, respectively. The decrease in gross profit as a percentage of net sales resulted primarily from an increase in our average order size caused by a shift in our product mix toward higher priced items, which typically carry a lower gross margin. We expect that gross profit will fluctuate in the future based primarily on changes in product acquisition costs, product mix and pricing decisions.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased 25.8% to $22.8 million in 2004 from $18.2 million in 2003. The increase in selling, general and administrative expenses in 2004 was due primarily to an increase in marketing costs, the costs associated with being a public company, higher credit card processing fees based on increased volume and higher payroll and payroll related expenses resulting

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from the addition of new employees. As a percentage of net sales, selling, general and administrative expenses were 13.5% and 14.1% in 2004 and 2003, respectively. The decrease in selling, general and administrative expenses as a percentage of net sales in 2004 resulted primarily from our ability to leverage our fixed cost base and a shift in our product mix toward higher priced items, which typically require less selling, general and administrative costs as a percentage of their selling price. In 2004, we recorded approximately $355,000 of stock compensation expense as compared to $90,000 in 2003.

We expect selling, general and administrative expenses to increase in absolute dollars in future periods as a result of expansion of our marketing efforts to drive increases in net sales, growth in our fulfillment and customer service operations to support higher sales volumes, increases in credit card processing fees and other variable expenses, and increases in administrative costs related to being a public reporting company.

Other Income (Expense), Net

Other income (expense), net primarily consists of interest income offset by interest expense, if any. Other income, net was income of approximately $772,000 in 2004 as compared to expense of approximately $12,000 in 2003. The increase in other income (expense), net was primarily attributable to increased interest income from cash and marketable securities purchased in 2004 following our initial public offering in May 2004, which resulted in net proceeds of $42.5 million. Interest expense was reduced as a result of the repayment of the outstanding balances on our notes payable and capital lease obligations in early 2003.

Income Taxes

In 2004, we recognized income tax expense of $5.6 million related to the provision for income taxes at the federal statutory rate. This compares to a tax benefit of $15.7 million recorded in 2003 due to the release of our valuation allowance relating primarily to our net operating loss carryforwards. Prior to 2003, our financial statements reflected a valuation allowance against the deferred tax asset, and we did not recognize any income tax benefit related to the unutilized net operating loss carryforwards. In 2003, we concluded that a valuation allowance was no longer necessary based on the determination that it was more likely than not that our net operating loss carryforwards would be utilized in the future. As a result, the existing valuation allowance of $19.7 million was reversed in the fourth quarter of 2003. We expect that in future periods we will continue to recognize expense related to the provision for income taxes at the federal statutory rate. The Company expects that it will utilize all or most of its net operating loss carryforwards in 2005 and will therefore become a cash taxpayer for federal income tax purposes beginning in its 2006 fiscal year.

Comparison of Year Ended December 31, 2003 to Year Ended December 31, 2002

Net Sales

Net sales increased 78.7% to $128.9 million in 2003 from $72.1 million in 2002. This increase in net sales was due primarily to an approximate $40.3 million increase in net sales of diamonds and customized diamond jewelry. The remaining increase in net sales resulted from growth in demand for our other jewelry products.

Gross Profit

Gross profit increased 62.1% to $29.4 million in 2003 from $18.2 million in 2002. The increase in gross profit in 2003 primarily resulted from increases in sales volume. Gross profit as a percentage of net sales was 22.8% and 25.2% in 2003 and 2002, respectively. The decrease in gross profit as a percentage of net sales resulted primarily from the retail price reductions we instituted beginning in the second quarter of 2003 as part of our strategy to stimulate growth in net sales and optimize aggregate gross profit.

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Selling, General and Administrative Expenses

Selling, general and administrative expenses increased 28.9% to $18.2 million in 2003 from $14.1 million in 2002. The increase in selling, general and administrative expenses in 2003 was due primarily to an increase in marketing costs, higher payroll and payroll related expenses resulting from the addition of new employees, and an increase in credit card processing fees due to higher sales volumes. As a percentage of net sales, selling, general and administrative expenses were 14.1% and 19.6% in 2003 and 2002, respectively. The decrease in selling, general and administrative expenses as a percentage of net sales in 2003 resulted primarily from our ability to leverage our fixed cost base. During 2003, we recorded deferred stock compensation of approximately $1.4 million, of which approximately $90,000 was amortized as stock compensation expense in 2003. There was no corresponding expense in 2002.

Restructuring Charges

We recorded a restructuring benefit of approximately $87,000 in 2003 as compared to a restructuring charge of approximately $400,000 in 2002 resulting from a leased facility that we no longer occupied. As of December 31, 2003, the remaining liability related to this facility was $0.

Other (Income) Expense, Net

Other income (expense), net was an expense of approximately $12,000 in 2003 as compared to an expense of approximately $2.0 million in 2002. The decrease in other income (expense), net was primarily attributable to a reduction in interest expense resulting from the repayment of the outstanding balances on our notes payable and capital lease obligations in early 2003, compared to a full year of interest expense in 2002 on outstanding balances on our notes payable and capital lease obligations.

Income Taxes

In 2003, we recognized an income tax benefit of $15.7 million due to the release of our valuation allowance relating primarily to our net operating loss carryforwards. Prior to 2003, our financial statements reflected a valuation allowance against the deferred tax asset, and we did not recognize any income tax benefit related to the unutilized net operating loss carryforwards. In 2003, we concluded that a valuation allowance was no longer necessary based on the determination that it was more likely than not that our net operating loss carryforwards would be utilized in the future. As a result, we reversed the existing valuation allowance of $19.7 million in the fourth quarter of 2003.

Liquidity and Capital Resources

Since inception, we have funded our operations through the sale of equity securities, subordinated indebtedness, credit facilities, capital lease obligations and cash generated from operations. The significant components of our working capital are inventory and liquid assets such as cash, marketable securities and trade accounts receivable, reduced by accounts payable and accrued expenses. Our business model provides certain beneficial working capital characteristics. While we collect cash from sales to customers within several business days of the related sale, we typically have extended payment terms with our suppliers.

As of January 2, 2005, we had working capital of $77.8 million, which is comprised of cash, cash equivalents and marketable securities of $101.4 million, partially offset by accounts payable of $37.8 million. Due to the seasonal nature of our business, cash and cash equivalents, inventory and accounts payable are generally higher in the fourth quarter, resulting in fluctuations in our working capital.

Net cash provided by operating activities was $29.8 million, $19.8 million and $16.7 million in 2004, 2003 and 2002, respectively. The increase in cash provided by operating activities in 2004 as compared to 2003 was primarily due to an increase in pretax income, a favorable change in inventory balances compared to the prior year and growth in accounts payable related to net sales growth. The increase in cash provided by operating activities in 2003 as compared to 2002 was primarily due to an increase in net income, which was partially offset by an increase in inventory balances. The Company expects that it will

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utilize all or most of its net operating loss carryforwards in 2005 and will therefore become a cash taxpayer for federal income tax purposes beginning in its 2006 fiscal year.

Net cash used in investing activities was $43.3 million in 2004, and was primarily related to the purchase of marketable securities. Net cash used in investing activities was $3.5 million and $1.0 million in 2003 and 2002, respectively, and was primarily related to capital expenditures for our technology system infrastructure, including software. In 2003, we utilized $1.3 million to undertake certain leasehold improvements for our new corporate office under a lease that began in August 2003.

Net cash provided by financing activities was $42.7 million in 2004, resulting primarily from the net proceeds of our initial public offering. Net cash used in financing activities was $8.5 million and $9.4 million in 2003 and 2002, respectively, and primarily related to payments on the remaining balances on our notes payable and capital lease obligations.

The following table summarizes our contractual obligations and the expected effect on liquidity and cash flows.

Contractual Obligations	**Total**	**Less Than 1 Year**	**1-3 Years**	**4-5 Years**	**Over 5 Years**
Operating leases	$ 2,046	$ 393	$ 674	$ 582	$ 397
Purchase obligations	3,752	3,752			
	$ 5,798	$ 4,145	$ 674	$ 582	$ 397

We believe that cash and cash equivalents currently on hand as well as cash flows from operations will be sufficient to continue our operations for the foreseeable future. While we anticipate that our cash flows from operations will be sufficient to fund our operational requirements, future capital and operating requirements may change and will depend on many factors, including the level of our net sales, the expansion of our sales and marketing activities, the cost of our fulfillment operations, potential investments in businesses or technologies and continued market acceptance of our products. We could be required, or could elect, to seek additional funding through a public or private equity or debt financing in the future, and this financing may not be available on terms acceptable to us, or at all.

Off-Balance Sheet Arrangements

At January 2, 2005, we did not have any off-balance sheet arrangements or relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purposes entities, which are typically established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Impact of Inflation

The effect of inflation and changing prices on our operations was not significant during the periods presented.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

The primary objective of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we invest in short-term, high quality, interest bearing securities. Our investments in debt securities are subject to interest rate risk. To minimize our exposure to an adverse shift in interest rates, we invest in short-term securities and maintain an average maturity of one year or less. We do not believe that a 10% change in interest rates would have a significant impact on our interest income.

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Item 8. ***Financial Statements and Supplementary Data***

Index to Consolidated Financial Statements

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Blue Nile, Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Blue Nile, Inc. and its subsidiary at January 2, 2005 and December 31, 2003, and the results of their operations and their cash flows for each of the three years in the period ended January 2, 2005 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedules are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

Seattle, Washington

March 25, 2005

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BLUE NILE, INC.
Consolidated Balance Sheets

	January 2, 2005	December 31, 2003
	(In thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 59,499	$ 30,383
Restricted cash		400
Marketable securities	41,868	
Accounts receivable	760	843
Inventories	9,914	10,204
Deferred income taxes	8,442	5,300
Prepaids and other current assets	1,046	465
Total current assets	121,529	47,595
Property and equipment, net	3,916	3,979
Intangible assets, net	385	
Deferred income taxes	2,475	10,654
Other assets	77	77
Total assets	$ 128,382	$ 62,305
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	$ 37,775	$ 26,288
Accrued liabilities	5,713	4,467
Current portion of deferred rent	203	177
Total current liabilities	43,691	30,932
Deferred rent, less current portion	1,071	1,126
Commitments and contingencies		
Mandatorily redeemable convertible preferred stock, $0.001 par value; 25,856 shares authorized; no shares and 10,000 shares outstanding at January 2, 2005 and December 31, 2003, respectively; aggregate liquidation preference of $0 and $78,664 at January 2, 2005 and December 31, 2003, respectively		57,485
Stockholders equity (deficit):		
Preferred stock, $0.001 par value; 5,000 shares authorized, none issued and outstanding as of January 2, 2005; no shares authorized, issued and outstanding as of December 31, 2003		
Common stock, $0.001 par value; 300,000 shares and 48,000 shares authorized as of January 2, 2005 and December 31, 2003, respectively; 18,478 shares and 5,128 shares issued as of January 2, 2005 and December 31,	18	5

2003, respectively; 17,728 shares and 4,378 shares outstanding as of January 2, 2005 and December 31, 2003, respectively				
Additional paid-in capital		104,684		4,247
Deferred compensation		(929)		(1,352)
Accumulated other comprehensive loss		(2)		
Accumulated deficit		(19,515)		(29,502)
Treasury stock, at cost; 750 shares outstanding at January 2, 2005 and December 31, 2003		(636)		(636)
Total stockholders equity (deficit)		83,620		(27,238)
Total liabilities and stockholders equity (deficit)	$	128,382	$	62,305

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

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BLUE NILE, INC.
Consolidated Statements of Operations

	Year Ended January 2,	Year Ended December 31,	
	2005	2003	2002
	(In thousands, except per share data)		
Net sales	$ 169,242	$ 128,894	$ 72,120
Cost of sales	131,590	99,476	53,967
Gross profit	37,652	29,418	18,153
Operating expenses:			
Selling, general and administrative	22,795	18,207	14,126
Restructuring charges		(87)	400
	22,795	18,120	14,526
Operating income	14,857	11,298	3,627
Other income (expense), net:			
Interest income	709	109	215
Interest expense		(209)	(2,327)
Other income	63	88	112
	772	(12)	(2,000)
Income before income taxes	15,629	11,286	1,627
Income tax expense (benefit)	5,642	(15,700)	
Net income	$ 9,987	$ 26,986	$ 1,627
Basic net income per share	$ 0.80	$ 6.98	$ 0.49
Diluted net income per share	$ 0.56	$ 1.65	$ 0.11

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

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BLUE NILE, INC.
Consolidated Statements of Changes in Mandatorily Redeemable Convertible Preferred Stock and Stockholders Equity (Deficit)

	Mandatorily Redeemable Convertible Preferred Stock		Common Stock		Additional Paid-In	Deferred Stock	Accumulated	Accumulated Other Comprehensive	Treasury Stock		Total Stockholders Equity
	Shares	Amount	Shares	Amount	Capital	Compensation	Deficit	Loss	Shares	Amount	(Deficit)
						(In thousands)					
Balance, December 31, 2001	9,859	$ 57,215	4,116	$ 4	$ 2,540	$	$ (58,115)	$	(748)	$ (628)	$ (56,199)
Exercise of warrants			14		4						4
Exercise of common stock options			9		8						8
Net income and comprehensive income							1,627				1,627
Balance, December 31, 2002	9,859	57,215	4,139	4	2,552		(56,488)		(748)	(628)	(54,560)
Exercise of common stock options			989	1	253						254
Repurchase of stock									(2)	(8)	(8)
Conversion of debt to mandatorily redeemable convertible preferred stock	141	270									
Deferred stock compensation on issuance					1,442	(1,442)					

of stock options											
Amortization of deferred stock compensation						90					90
Net income and comprehensive income							26,986				26,986
Balance, December 31, 2003	10,000	57,485	5,128	5	4,247	(1,352)	(29,502)		(750)	(636)	(27,238)
Net income							9,987				9,987
Other comprehensive income (loss):											
Unrealized loss on marketable securities, net of tax								(2)			(2)
Total comprehensive income											9,985
Sale of common stock, net of offering expenses			2,301	2	42,514						42,516
Conversion of mandatorily redeemable convertible preferred stock to common stock	(10,000)	(57,485)	10,920	11	57,474						57,485
Deferred stock compensation on issuance of stock options					228	(228)					
Tax effect of stock option exercises					352						352

Amortization of deferred stock compensation				355					355
Reversal of deferred compensation relating to cancelled options			(296)	296					
Exercise of common stock options and warrants	128		145						145
Issuance of common stock to directors	1		20						20
Balance, January 2, 2005	$ 18,478	$ 18	$ 104,684	$ (929)	$ (19,515)	$ (2)	(750)	$ (636)	$ 83,620

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

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BLUE NILE, INC.
Consolidated Statements of Cash Flows

	Year Ended January 2,	Year Ended December 31,	
	2005	2003	2002
	(In thousands)		
Operating activities:			
Net income	$ 9,987	$ 26,986	$ 1,627
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,510	1,293	1,757
(Gain) loss on asset retirements	(5)	14	
Stock-based compensation	375	90	
Warrant-based interest expense		87	597
Restructuring charges		(87)	400
Deferred income taxes	5,388	(15,700)	
Changes in assets and liabilities:			
Receivables, net	83	(441)	(331)
Inventories	290	(5,023)	1,438
Prepaid expenses and other assets	(581)	(235)	(82)
Accounts payable	11,487	10,497	10,538
Accrued liabilities	1,246	1,044	777
Deferred rent	(29)	1,291	9
Net cash provided by operating activities	29,751	19,816	16,730
Investing activities:			
Purchases of property and equipment	(1,417)	(3,506)	(991)
Purchases of intangible assets	(416)		
Proceeds from sales of property and equipment	7	3	
Purchases of marketable securities	(82,870)		
Proceeds from the sale of marketable securities	41,000		(50)
Transfers of restricted cash	400		
Net cash used in investing activities	(43,296)	(3,503)	(1,041)
Financing activities:			
Proceeds from the sale of common stock, net of issuance costs	42,516		
Repurchase of restricted and common stock		(8)	
Payments on subordinated notes payable		(6,638)	(8,362)
Payments on capital lease obligations		(995)	(790)
Payments on note payable to related party		(1,140)	(250)
Proceeds from warrant and stock option exercises	145	254	12
Net cash provided by (used in) financing activities	42,661	(8,527)	(9,390)
Net increase in cash and cash equivalents	29,116	7,786	6,299
Cash and cash equivalents, beginning of period	30,383	22,597	16,298

Cash and cash equivalents, end of period	$ 59,499	$ 30,383	$ 22,597
Supplemental disclosure of cash flow information:			
Cash paid for interest	$	$ 154	$ 1,682
Cash paid for income taxes	$ 235	$	$
Non-cash investing and financing activities:			
Conversion of related party note payable to Series E mandatorily redeemable convertible preferred stock	$	$ 270	$

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

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BLUE NILE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Description of the Company and Summary of Significant Accounting Policies

The Company

Blue Nile, Inc. (the Company) is a leading online retailer of high quality diamonds and fine jewelry in the United States. In addition to sales of diamonds, fine jewelry and watches, the Company provides guidance and support to enable customers to more effectively learn about and purchase diamonds as well as classically styled fine jewelry. The Company, a Delaware corporation, based in Seattle, Washington, was formed in March 1999. The Company maintains its primary web site at www.bluenile.com. The Company also operates the www.bluenile.co.uk and www.bluenile.ca web sites.

Change in Fiscal Year

On January 1, 2004, the Company s fiscal year-end changed from December 31 to the Sunday closest to December 31. Each fiscal year consists of four 13-week quarters, with an extra week added onto the fourth quarter every five to six years. There were the same number of days of operations in 2003 as in 2004.

Reclassifications

Certain reclassifications of prior period balances have been made for consistent presentation with the current period. These reclassifications had no impact on net income or stockholders equity (deficit) as previously reported.

Basis of Presentation

The consolidated financial statements include the balances of Blue Nile, Inc. and its subsidiary for the entire fiscal year. All significant intercompany transactions and balances are eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Some of the more significant estimates include the allowance for sales returns, the reserve for estimated fraud losses and the deferred tax valuation reserve. Actual results could differ materially from those estimates.

Concentration of Risk

The Company maintains its cash and cash equivalents and marketable securities in accounts with two major financial institutions in the United States of America, in the form of demand deposits, certificates of deposit, money market accounts and U.S. government securities. Deposits in these banks may exceed the amounts of insurance provided on such deposits. The Company has not experienced any losses on its deposits of cash and cash equivalents. The Company s accounts receivable are derived from credit card purchases from customers and are typically settled within one to two business days.

The Company s ability to acquire diamonds and fine jewelry is dependent on its relationships with various suppliers from whom it purchases diamonds and fine jewelry. The Company has reached agreements with certain suppliers to provide access to their inventories of diamonds for its customers, but the terms of these agreements are limited and do not govern the purchase of diamonds for its inventory. The Company s inability to maintain these and other future diamond and fine jewelry supply relationships

BLUE NILE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

on commercially reasonable terms would cause its business to suffer and its revenues to decline. Purchase concentration by major supply vendor is as follows:

	2004 Payments	2003 Payments	2002 Payments
Vendor A	10%	15%	21%
Vendor B	9%	12%	15%
Vendor C	6%	9%	9%

Cash and Cash Equivalents

The Company considers all highly liquid investments with maturity of three months or less when purchased to be cash equivalents.

Restricted Cash

Restricted cash at December 31, 2003 consists primarily of cash pledged as collateral to a credit card processing bank. There were no restrictions on cash at January 2, 2005.

Marketable Securities

The Company s marketable securities are classified as available-for-sale as defined by Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS 115). At January 2, 2005, marketable securities consisted of U.S. government and agencies securities maturing within one year. The securities are carried at fair value, with the unrealized gains and losses included in accumulated other comprehensive income (loss). Realized gains or losses on the sale of marketable securities are identified on a specific identification basis and are reflected as a component of interest income or expense. The cost, fair value and unrealized gains and losses of marketable securities as of and for the fiscal year ended January 2, 2005 are as follows (in thousands):

	Cost	Unrealized Gain	Unrealized Loss	Fair-Value
U.S. government and agencies securities	$ 41,870	$	$ (2)	$ 41,868

There were no realized gains or losses on sales of marketable securities in 2004, 2003 or 2002.

Inventories

The Company s diamond, fine jewelry and watch inventories are classified at the lower of cost or market, using the specific identification method for diamonds and weighted average cost method for fine jewelry and watches. The Company also lists loose diamonds on its web site that are not included in inventory until the Company receives a customer order for those diamonds. Upon receipt of a customer order, the Company purchases a specific diamond and records it in inventory until it is delivered to the customer, at which time the revenue from the sale is recognized and inventory is relieved.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Maintenance and repairs are expensed as incurred. Depreciation is calculated on a straight-line basis over the estimated useful lives of the related assets. The cost and related accumulated depreciation of assets sold or otherwise disposed of is

BLUE NILE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

removed from the accounts and the related gain or loss is reported in the statement of operations. Estimated useful lives by major asset category are as follows:

Asset	Life (In Years)
Computers and equipment	3
Software	2-3
Leasehold improvements	Shorter of lease term or asset life
Furniture and fixtures	7

Capitalized Software

The Company capitalizes internally developed software costs and web site development costs in accordance with the provisions of Statement of Position 98-1, Accounting for Costs of Computer Software Developed or Obtained for Internal Use (SOP 98-1) and Emerging Issues Task Force No. 00-2, Accounting for Web site Development Costs (EITF 00-2) Capitalized costs are amortized on a straight-line basis over the estimated useful life of the software once it is available for use.

Impairment of Long-Lived Assets

The Company reviews the carrying value of its long-lived assets, including property and equipment, whenever events or changes in circumstances indicate that the carrying value may not be recoverable. To the extent the estimated future cash inflows attributable to the assets, less estimated future cash outflows, are less than the carrying amount, an impairment loss would be recognized.

Intangible Assets

Intangible assets are recorded at cost and consist primarily of the costs incurred to acquire licenses and other similar agreements with finite lives, which were acquired in October 2004. Amortization is calculated on a straight-line basis over the estimated useful lives of the related assets, which range from 10 years to 17 years. The carrying amount of these assets was $385,000, net of accumulated amortization of $31,000 at January 2, 2005. Amortization expense related to intangible assets was $31,000 in 2004. Amortization expense is estimated to be $33,000 in each fiscal year for 2005 through 2009.

Fair Value of Financial Instruments

The carrying amounts for the Company s cash, accounts receivable, accounts payable and accrued liabilities approximate fair value due to their short maturities.

Treasury Stock

Treasury stock is recorded at cost and primarily consists of the repurchase of restricted common stock issued to founders and unvested stock issued to employees in connection with early exercises of stock options.

Income Taxes

Deferred tax assets and liabilities are determined based on the differences between financial reporting and tax bases of assets and liabilities and are measured using the tax rates that will be in effect when the differences are expected to reverse. Future tax benefits, such as net operating loss carryforwards, are recognized to the extent that realization of such benefits is considered to be more likely than not.

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BLUE NILE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Revenue Recognition

Net sales consist of products sold via the Internet and shipping revenue, net of estimated returns and promotional discounts. The Company recognizes revenues when all of the following have occurred: persuasive evidence of an agreement with the customer exists, products are shipped and the customer takes delivery and assumes the risk of loss; the selling price is fixed or determinable and collectibility of the selling price is reasonably assured. The Company evaluates the criteria outlined in EITF 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent , in determining whether it is appropriate to record the gross amount of product sales and related costs or the net amount earned.

The Company requires payment at the point of sale. Amounts received prior to delivery of goods to customers are recorded as deferred revenue. The Company offers a return policy of generally 30 days and provides an allowance for sales returns during the period in which the sales are made. At January 2, 2005 and December 31, 2003, the reserve for sales returns was $988,000 and $769,000, respectively, and was recorded as an accrued liability. Sales revenues and cost of sales reported in the Statement of Operations are reduced to reflect estimated returns.

The Company generally does not extend credit to customers, except through third party credit cards. The majority of sales are through credit cards, and accounts receivable are composed primarily of amounts due from financial institutions related to credit card sales. The Company does not maintain an allowance for doubtful accounts because payment is typically received one to two business days after the sale is complete.

The Company has procedures in place to detect and prevent credit card fraud since the Company has exposure to losses from fraudulent charges. The Company records a reserve for fraud losses based on our historical rate of such losses. This reserve is recorded as an accrued liability and amounted to $152,000 at January 2, 2005 and $188,000 at December 31, 2003.

Cost of Sales

Cost of sales consists of the cost of merchandise sold to customers, inbound and outbound shipping costs, insurance on shipments and jewelry assembly costs.

Selling, General and Administrative Expense

Selling, general and administrative expenses consist primarily of marketing and sales expenses, fulfillment (handling) costs and customer service center costs. Credit card fees, insurance, personnel costs and other corporate administrative expenses are also included in selling, general and administrative expenses.

Fulfillment (handling) costs include costs incurred in operating and staffing the fulfillment center, including costs attributable to: receiving, inspecting and warehousing inventories and picking, packaging and preparing customers orders for shipment. Fulfillment (handling) costs in 2004, 2003 and 2002 were approximately $1.6 million, $1.5 million and $1.2 million, respectively.

Advertising

Advertising production costs are expensed as incurred. Costs of advertising associated with television, radio, print and other media are expensed when such services are used. Costs associated with web portal advertising contracts are amortized over the period such advertising is expected to be used. Advertising expense for the years ended January 2, 2005 and December 31, 2003 and 2002 was approximately $6.5 million, $4.5 million and $3.2 million, respectively.

BLUE NILE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock Compensation

The Company accounts for stock-based employee compensation arrangements in accordance with the provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and related interpretations including Financial Accounting Standards Board (FASB) Interpretation No. 44, Accounting for Certain Transactions involving Stock Compensation, an interpretation of APB Opinion No. 25 (FIN 44), which is described more fully in Note 7. The Company has elected to apply the disclosure-only provisions of SFAS No. 123, Accounting for Stock Based Compensation (SFAS 123). Had compensation cost for the Company s stock options been determined based on the fair value of the options at the date of grant, the Company s pro forma net income would have been as shown below (in thousands, except per share data).

	Year Ended January 2,	Year Ended December 31,	
	2004	**2003**	**2002**
Net income, as reported	$ 9,987	$ 26,986	$ 1,627
Add: Stock-based compensation expense, as reported	355	90	
Deduct: Stock-based employee compensation expense determined under fair-value-based method, net of tax	(1,086)	(352)	(279)
Pro forma net income	$ 9,256	$ 26,724	$ 1,348
Income per share:			
Basic as reported	$ 0.80	$ 6.98	$ 0.49
Basic pro forma	$ 0.74	$ 6.91	$ 0.40
Diluted as reported	$ 0.56	$ 1.65	$ 0.11
Diluted pro forma	$ 0.52	$ 1.63	$ 0.10

See Note 7 for the assumptions used to compute the pro forma amounts.

Segments

The Company has one operating segment, online retail jewelry. No foreign country or geographic area accounted for more than 10% of net sales in any of the periods presented, and the Company does not have any long-lived assets located in foreign countries.

Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123R (Revised 2004), Share-Based Payment (SFAS 123R). This statement addresses the accounting for share-based payment transactions in which a company receives employee services in exchange for the company s equity instruments or liabilities that are based on the fair value of the company s equity securities or may be settled by the issuance of these securities. SFAS 123R eliminates the ability to account for share-based compensation using APB 25 and generally requires that such transactions be accounted for using a fair value method. The provisions of this statement are effective for financial statements issued for fiscal periods beginning after June 15, 2005 and will become effective for the Company beginning with the third quarter of the 2005 fiscal year. The stock-based compensation the Company will recognize after the adoption of SFAS 123R will be affected by the number and type of stock-based awards granted in the future and the pricing model and related assumptions the Company decides to use to estimate the fair values of options. The Company is currently evaluating which pricing model it will use to estimate the value of its options and which transition method it will use to implement SFAS 123R.

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BLUE NILE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 2. Initial Public Offering

On May 19, 2004, the Company s registration statement on Form S-1 was declared effective for its initial public offering, pursuant to which the Company sold 2,300,910 shares of common stock at $20.50 per share. The Company s common stock commenced trading on May 20, 2004. The offering closed on May 25, 2004, and, as a result, the Company received net proceeds of approximately $43.9 million (after underwriters discounts of $3.3 million). The Company incurred additional related expenses of approximately $1.4 million.

On April 30, 2004, the Company effected a 1 for 2.5 reverse split of its common stock and mandatorily redeemable convertible preferred stock. All shares and per share amounts and any other references to shares included in the accompanying unaudited consolidated financial statements have been adjusted to reflect this split on a retroactive basis.

Simultaneous with its initial public offering, the Company s 10.0 million outstanding shares of mandatorily redeemable convertible preferred stock were automatically converted into approximately 10.9 million shares of common stock.

Note 3. Inventories

Inventories consists of the following (in thousands):

	January 2, 2005	December 31, 2003
Loose diamonds	$ 293	$ 124
Fine jewelry, watches and other	9,621	10,080
	$ 9,914	$ 10,204

Note 4. Property and Equipment

Property and equipment consists of the following (in thousands):

	January 2, 2005	December 31, 2003
Computers and equipment	$ 3,777	$ 3,204
Software and website development	4,409	3,892
Leasehold improvements	2,545	2,310
Furniture and Fixtures	567	537
	11,298	9,943
Less: accumulated depreciation	(7,382)	(5,964)
	$ 3,916	$ 3,979

Capitalized software costs include external direct costs and internal direct labor and related employee benefits costs of developing software for internal use. Amortization begins in the period in which the software is ready for its intended use. The Company had $837,000 and $815,000 of unamortized computer software and web site development costs at January 2, 2005 and December 31, 2003, respectively. Total depreciation expense was $1.5 million,

$1.3 million and $1.8 million in 2004, 2003 and 2002, respectively. Of this amount, depreciation and amortization of capitalized software development costs was $476,000, $331,000 and $490,000 in 2004, 2003 and 2002, respectively.

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BLUE NILE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 5. Commitments and Contingencies

Leases

The Company leases its office facilities and fulfillment center under noncancelable operating lease agreements that expire through 2011. Lease incentives of $1.3 million for reimbursement of certain leasehold improvement expenditures are recorded as deferred rent and are being amortized against lease payments over the life of the lease. Future minimum lease payments as of January 2, 2005 are as follows (in thousands):

	Operating Leases
2005	$ 393
2006	383
2007	291
2008	291
2009	291
Thereafter	397
Total minimum lease payments	$ 2,046

Rent expense, which includes certain common area maintenance costs was approximately $347,000, $406,000 and $501,000, for the years ended January 2, 2005 and December 31, 2003 and 2002, respectively.

Litigation

The Company is party to various legal proceedings arising in the ordinary course of its business. It is not currently a party to any legal proceedings that management believes would have a material adverse effect on the consolidated financial position or results of operations of the Company.

Note 6. Preferred Stock

During 2004, the Company authorized 5,000,000 shares of undesignated preferred stock. Shares of preferred stock may be issued from time to time in one or more series, with designations, preferences, and limitations established by the Company s board of directors.

At December 31, 2003 the Company had authorized 25,855,991 shares of mandatorily redeemable convertible preferred stock designated as the series set forth in the table below. All such series of

BLUE NILE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

mandatorily redeemable convertible preferred stock were at $0.001 par value. Amounts at December 31, 2003 were as follows (in thousands):

	December 31, 2003				
	Authorized Shares	Shares Outstanding	Shares Issuable upon Conversion to Common	Amount	Liquidation Preference
Series A mandatorily redeemable convertible preferred stock	6,667	2,667	2,770	$ 5,989	$ 6,000
Series B mandatorily redeemable convertible preferred stock	3,353	1,326	1,488	4,508	4,510
Series C mandatorily redeemable convertible preferred stock	3,906	1,560	1,996	26,023	26,045
Series D mandatorily redeemable convertible preferred stock	1,930	772	991	14,050	14,050
Series E mandatorily redeemable convertible preferred stock	10,000	3,675	3,675	6,915	28,059
	25,856	10,000	10,920	$ 57,485	$ 78,664

As discussed in Note 2, on May 19, 2004, the Company s registration statement on Form S-1 was declared effective for its initial public offering. Upon the closing of the Company s initial public offering on May 25, 2004, the 10.0 million shares of Series A through E mandatorily redeemable convertible preferred stock were automatically converted into approximately 10.9 million shares of common stock.

The following table summarizes information about mandatorily redeemable convertible preferred stock for the years ended January 2, 2005 and December 31, 2003 and 2002 (in thousands):

	Series A		Series B		Series C		Series D		Series E	
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount
Balance, December 31, 2001	2,667	$ 5,989	1,326	$ 4,508	1,560	$ 26,023	772	$ 14,050	3,534	$ 6,645
Balance, December 31,	2,667	5,989	1,326	4,508	1,560	26,023	772	14,050	3,534	6,645

2002										
Conversion of debt to mandatorily redemable convertible preferred stock									141	270
Balance December 31, 2003	2,667	5,989	1,326	4,508	1,560	26,023	772	14,050	3,675	6,915
Conversion of mandatorily redeemable convertible preferred stock to common stock	(2,667)	(5,989)	(1,326)	(4,508)	(1,560)	(26,023)	(772)	(14,050)	(3,675)	(6,915)
Balance January 2, 2005		$		$		$		$		$

Preferred Stock Warrants

In connection with certain capital leases entered into during 1999, the Company issued warrants to purchase 14,706 shares of Series B mandatorily redeemable convertible preferred stock at $3.40 per share and warrants to purchase 2,994 shares of Series C mandatorily redeemable convertible preferred stock at $16.70 per share (Series C warrants) to a financial institution. These warrants converted into warrants to purchase an aggregate of 20,234 shares of common stock upon the closing of the Company s initial public offering. These warrants were exercised on October 15, 2004.

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BLUE NILE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 7. Stock-Based Compensation

Stock Option Plan

The Company has an equity incentive plan that was adopted in 1999 (the 1999 Plan). The 1999 Plan provides for the grant of incentive stock options, non-statutory stock options, stock bonuses and restricted stock awards, which may be granted to employees, including officers, non-employee directors and consultants. An aggregate of 3,310,400 shares of common stock are reserved for issuance under the 1999 Plan. Options granted under the 1999 Plan generally provide for 25% vesting on the first anniversary from the date of grant with the remainder vesting monthly over three years and expire 10 years from the date of grant. Options granted under the 1999 Plan are generally granted at fair value on the date of the grant. For options granted prior to February 2001, the options included an early exercise provision that allowed early exercise of unvested stock options subject to a repurchase right at original cost on unvested shares. As of May 19, 2004, the effective date of the Company s initial public offering, no additional awards were granted under the 1999 Plan.

In April 2004, the Company adopted an equity incentive plan (the 2004 Plan). The 2004 Plan provides for the grant of non-statutory stock options, restricted stock awards, stock appreciation rights, restricted stock units and other forms of equity compensation, which may be granted to employees, including officers, non-employee directors and consultants. As of January 2, 2005, the Company reserved 3,446,365 shares of common stock for issuance under the 2004 Plan, which amount will be increased annually on January 1st of each year, up to and including 2014, by five percent of the number of shares of common stock outstanding on such date unless a lower number of shares is approved by the board of directors.

Options granted under the 2004 Plan generally provide for 25% vesting on the first anniversary from the date of grant with the remainder vesting monthly over three years, and expire 10 years from the date of grant. Options granted under the 2004 Plan are generally granted at fair value on the date of the grant.

In April 2004, the Company adopted the 2004 Non-Employee Directors Stock Option Plan (the Directors Plan). The Directors Plan provides for the automatic grant of non-statutory stock options to purchase shares of common stock to non-employee directors. As of January 2, 2005, common stock reserved for the plan is 400,000 shares, which amount will be increased annually on January 1st of each year, up to and including 2014, by the number of shares of common stock subject to options granted during the prior calendar year unless a lower number of shares is approved by the board of directors. There were no options granted under this plan in 2004.

In April 2004, the Company adopted the 2004 Employee Stock Purchase Plan (the Purchase Plan). As of January 2, 2005, the Purchase Plan authorized the issuance of 1,000,000 shares of common stock, which amount will be increased on January 1st of each year following the year in which the Company commences the first offering under the plan for 20 years by the lesser of 320,000 shares or one and one half percent of the number of shares of common stock outstanding on each such date unless a lower number of shares is approved by the board of directors. The Purchase Plan is intended to qualify as an employee stock purchase plan within the meaning of Section 423 of the Internal Revenue Code. As of January 2, 2005, no shares of common stock have been purchased under the Purchase Plan.

As mentioned in Note 1, the Company accounts for stock-based employee compensation arrangements in accordance with APB 25 and FIN 44. Under APB 25, compensation expense is recognized for the difference between the fair value of the Company s stock on the date of grant and the exercise price. During 2004 and 2003, the Company issued options to certain employees under the 1999 Plan with exercise prices below the deemed fair market value of the Company s common stock at the date of grant. In accordance with the requirements of APB 25, the Company has recorded deferred stock-based compensation for the difference between the exercise price of the stock option and the deemed fair market

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BLUE NILE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

value of the Company s stock at the grant date. In 2004 and 2003, the Company recorded deferred stock-based compensation of $228,000 and $1.4 million, respectively, related to these options. This amount is being amortized over the vesting period of the awards, generally four years. During 2004 and 2003, the Company recorded compensation expense of $355,000 and $90,000, respectively, related to the amortization of deferred compensation.

The Company accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS 123 and EITF Issue No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services (EITF 96-18). EITF 96-18 requires such equity instruments be recorded at their fair value on the measurement date.

In August 2001, the Company offered a voluntary stock option cancellation and re-grant program to its employees. The plan allowed employees, at their election, to cancel a portion or all of their unexercised stock options effective August 15, 2001, provided that, should an employee participate, any option granted to that employee during the period February 15, 2001 to August 15, 2001 would be automatically canceled and the Company would grant no options to the participants from August 15, 2001 through February 18, 2002. In exchange, in February 2002, the employee would be granted new options at the then fair value of the underlying common stock to purchase a number of shares equal to the number of shares underlying the canceled options provided they were still employed by the Company at that time. Options to purchase approximately 1,061,600 shares of the Company s common stock were canceled, and new options to purchase approximately 961,000 shares of the Company s common stock were granted.

A summary of activity related to the above described plans is as follows (in thousands, except exercise price):

	Year Ended January 2,		Year Ended December 31,			
	2005		2003		2002	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Balance, beginning of year	1,403	$ 2.47	2,078	$ 0.27	207	$ 0.48
Granted	712	27.10	379	8.48	1,906	0.25
Exercised	(103)	0.92	(989)	0.26	(9)	0.87
Canceled	(95)	11.31	(65)	0.91	(26)	0.30
Balance, end of year	1,917	$ 11.26	1,403	$ 2.47	2,078	$ 0.27
Exercisable at end of year	918	$ 1.81	650	$ 0.30	1,166	$ 0.28

BLUE NILE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes information about stock options outstanding at January 2, 2005:

	Outstanding			Exercisable	
		Weighted Average			
Range of Exercise Price	Options	Remaining Contractual Life	Exercise Price	Options	Weighted Average Exercise Price
	(In thousands)			(In thousands)	
$ 0.25	743	7	$ 0.25	642	$ 0.25
$ 0.28-$ 8.75	505	8	5.64	245	3.95
$ 9.38-$29.40	153	9	19.20	31	17.41
$30.00	487	10	30.00		
$32.24-$34.29	29	10	34.12		
	1,917	8	11.26	918	1.81

The weighted-average fair value at grant date of options granted during 2004, 2003 and 2002 was $14.06, $5.10 and $0.25, respectively. There were 55,700 options granted in 2004 with exercise prices less than the market value on the date of grant. The weighted-average fair value at the date of grant for these options was $12.69. The remaining options granted in 2004 had exercise prices equal to the market value on the date of grant and had a weighted-average fair value at the date of grant of $28.32. The exercise price of all options granted in 2003 was less than the fair value of the stock on the grant date. The exercise price of all options granted in 2002 was equal to the fair value on the grant date. The fair value for each option grant is estimated on the date of grant using the fair value method for grants after May 19, 2004 and the minimum value method for grants prior to May 20, 2004 and the following assumptions:

	Year Ended January 2,	Year Ended December 31,	
	2005	2003	2002
Expected dividend rate	0%	0%	0%
Expected volatility	0% - 79%	0%	0%
Expected lives (years)	4-5	5	5
Risk-free interest rate	2.8% - 3.7%	2.6% - 3.6%	2.9% - 4.8%

See Note 1 for the pro forma effect of accounting for stock options using the fair value method.

Note 8. Common Stock

Common Stock Warrants

At December 31, 2003, the Company had warrants outstanding to purchase a total of 8,000 shares of common stock at an exercise price of $6.25 per share. In March 2004 all 8,000 warrants were exercised.

Note 9. Employee Benefit Plan

The Company has a defined contribution plan pursuant to Section 401(k) of the Internal Revenue Code covering all eligible officers and employees. The Company provides a matching contribution of $0.50 for every $1.00 contributed by the employee up to 2% of each employee s salary. Such contributions were approximately $108,000, $97,000 and $67,000 for the years ended January 2, 2005, December 31, 2003 and 2002, respectively.

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BLUE NILE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 10. Income Taxes

The provision (benefit) for income taxes consists of the following (in thousands):

	Year Ended January 2, 2005	Year Ended December 31, 2003	Year Ended December 31, 2002
Current income tax expense	$ 605	$ 254	$
Deferred income tax benefit:			
Utilization of net operating losses	5,162	4,438	
Adjustment to beginning of year valuation allowance		(19,702)	
Other	(125)	(690)	
Total income tax expense (benefit)	$ 5,642	$ (15,700)	$

A reconciliation of the statutory Federal income tax rate to the effective tax rate is as follows:

	Year Ended January 2, 2005	Year Ended December 31, 2003	Year Ended December 31, 2002
Statutory federal income tax rate	35.0%	35.0%	35.0%
Change in valuation allowance		(174.4)	(35.2)
Other	1.1	0.3	0.2
Effective tax rate	36.1%	(139.1)%	%

Deferred income taxes reflect the net tax effect of temporary differences between amounts recorded for financial reporting purposes and amounts used for tax purposes. The major components of deferred tax assets are as follows (in thousands):

	January 2, 2005	December 31, 2003
Deferred tax assets:		
Current:		
Net operating loss carryforwards	$ 7,945	$ 4,500
Deferred rent		456
Reserves and allowances	422	344
Other	75	

Noncurrent:				
Net operating loss carryforwards		1,146		8,682
Excess of book over tax depreciation and amortization		792		1,363
Tax credit carryforwards		495		254
Other		42		355
Gross deferred tax assets		10,917		15,954
Valuation allowance				
Net deferred tax assets	$	10,917	$	15,954

During 2003, the Company recorded a reduction in the valuation allowance of $19.7 million, primarily due to the Company realizing net income in 2002 and 2003. The Company believes that it is more likely

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BLUE NILE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

than not that it will generate sufficient taxable income to utilize its deferred tax assets, including net operating loss carryforwards, within any applicable carryover periods.

At January 2, 2005 the Company had net operating loss carryforwards for federal income tax purposes of approximately $26.0 million that expire between 2019 and 2021. Under the Tax Reform Act of 1986, the amounts of and benefits from net operating losses may be limited in certain circumstances.

Note 11. Income Per Share

Basic net income per share is based on the weighted average number of common shares outstanding, excluding unvested common shares issued to the Company s founders, and employees upon early exercise of options, which are subject to repurchase by the Company. Diluted net income per share is based on the weighted average number of common shares and equivalents outstanding. Common share equivalents included in the computation represent unvested common shares issued to founders, and common shares issued upon early exercise of options which are subject to repurchase rights, shares issuable upon assumed exercise of outstanding stock options, warrants and mandatorily redeemable convertible preferred stock except when the effect of their inclusion would be antidilutive.

The following table sets forth the computation of basic and diluted net income per share (in thousands, except per share data):

	Year Ended January 2,	Year Ended December 31,	
	2005	2003	2002
Net income	$ 9,987	$ 26,986	$ 1,627
Weighted average common shares outstanding	12,450	3,868	3,336
Basic net income per share	$ 0.80	$ 6.98	$ 0.49
Dilutive effect of restricted stock issued to founders			37
Dilutive effect of options early exercised with repurchase rights		2	8
Dilutive effect of stock options and warrants	1,132	1,608	
Dilutive effect of convertible preferred stock	4,303	10,885	10,779
Common stock and common stock equivalents	17,885	16,363	14,160
Diluted net income per share	$ 0.56	$ 1.65	$ 0.11

The following is a summary of the securities outstanding during the respective periods that have been excluded from the calculations because the effect on net income per share would have been antidilutive (in thousands):

	Year Ended January 2,	Year Ended December 31,	
	2005	2003	2002
Stock options	230	86	694

Preferred stock warrants		3	147
Common stock warrants			10
	230	89	851

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BLUE NILE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 12. Restructuring Costs

In 2001, the Company recorded a restructuring charge of $1,017,000 related to the loss on facilities the Company no longer occupied and the write-off of leasehold improvements at these facilities. In 2002, the Company recorded an additional restructuring charge of $400,000 reflecting a decrease in estimated sublease income at one of these facilities. During 2003, the Company negotiated the termination of one the leases and reversed $87,000 of the restructuring charge previously recorded. A summary of activity related to the restructuring charge for the years ended January 2, 2005 and December 31, 2003 and 2002 is as follows (in thousands):

	Lease Obligations
Restructuring accrual at December 31, 2001	$ 587
Changes in estimates	400
Cash paid	(395)
Restructuring accrual at December 31, 2002	592
Changes in estimates	(87)
Cash paid	(472)
Restructuring accrual at December 31, 2003	33
Cash paid	(33)
Restructuring accrual at January 2, 2005	$

Note 13. Subsequent Events

On February 8, 2005, the board of directors announced the authorization for the Company to repurchase up to $30 million of the Company s common stock during the next 12 months. The shares may be repurchased from time to time in open market transactions. The timing and amount of any shares repurchased will be determined by the Company s management based on its evaluation of market conditions and other factors. Repurchases may also be made under a Rule 10b5-1 plan, which would permit shares to be repurchased when the Company might otherwise be precluded from doing so under insider trading laws.

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BLUE NILE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 14. Selected Quarterly Financial Information (unaudited)

Summarized quarterly financial information for fiscal years 2004 and 2003 is as follows (in thousands, except per share data):

	Q1	Q2	Q3	Q4
2004 quarter:				
Net sales	$ 35,784	$ 35,022	$ 33,888	$ 64,548
Gross profit	8,212	7,927	7,369	14,144
Net income	1,904	1,864	1,656	4,563
Basic net income per share	0.43	0.18	0.09	0.26
Diluted net income per share	$ 0.12	$ 0.11	$ 0.09	$ 0.24

	Q1	Q2	Q3	Q4
2003 quarter:				
Net sales	$ 24,628	$ 27,254	$ 27,457	$ 49,555
Gross profit	6,153	6,107	6,071	11,087
Net income	1,691	2,243	2,188	20,864**(A)**
Basic net income per share	0.50	0.65	0.51	4.80
Diluted net income per share	$ 0.10	$ 0.14	$ 0.13	$ 1.27

(A) Net income for the fourth quarter of 2003 includes a $15.7 million tax benefit from the realization of deferred tax assets related primarily to net operating loss carryforwards.

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BLUE NILE, INC.
SCHEDULE II
VALUATION AND QUALIFYING ACCOUNTS

Description	Balance at Beginning of Period	Charged to Revenue, Costs or Expenses	Deductions(A)	Balances at End of Period
Reserve deducted from asset to which it applies:				
Year ended January 2, 2005				
Reserve for deferred income tax assets	$	$	$	$
Year ended December 31, 2003				
Reserve for deferred income tax assets	$ 19,702	$	$ (19,702)	$
Year ended December 31, 2002				
Reserve for deferred income tax assets	$ 20,276	$	$ (574)	$ 19,702
Reserve deducted from asset to which it applies:				
Year ended January 2, 2005				
Reserve for sales returns	$ 769	$ 15,422	$ (15,203)	$ 988
Reserve for fraud	$ 188	$ 8	$ (44)	$ 152
Year ended December 31, 2003				
Reserve for sales returns	$ 601	$ 11,714	$ (11,546)	$ 769
Reserve for fraud	$ 113	$ 88	$ (13)	$ 188
Year ended December 31, 2002				
Reserve for sales returns	$ 261	$ 7,151	$ (6,811)	$ 601
Reserve for fraud	$ 72	$ 61	$ (20)	$ 113

(A) Adjustments to reduce the deferred tax valuation allowance were credited to the Company s consolidated statements of operations. Deductions for sales returns and fraud consist of actual credit card chargebacks and sales returns in each period.

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Item 9. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

None.

Item 9A. ***Controls and Procedures***

As of the end of the period covered by this report, an evaluation was performed under the supervision and with the participation of our management, including our chief executive officer and chief financial officer (collectively, our certifying officers), of the effectiveness of the design and operation of our disclosure controls and procedures. Disclosure controls and procedures are controls and other procedures designed to ensure that information required to be disclosed by us in our periodic reports filed with the Securities and Exchange Commission (SEC) is recorded, processed, summarized and reported within the time periods specified by the SEC s rules and SEC reports. Based on their evaluation, our certifying officers concluded that these disclosure controls and procedures were effective as of the end of the period covered by this report.

We believe that a controls system, no matter how well designed and operated, is based in part upon certain assumptions about the likelihood of future events, and therefore can only provide, reasonable, not absolute, assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

There were no changes in our internal control over financial reporting during the quarter ended January 2, 2005, that our certifying officers concluded materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

At the end of the fiscal year 2005, Section 404 of the Sarbanes-Oxley Act will require the Company s management to provide an assessment of the effectiveness of the Company s internal control over financial reporting, and the Company s independent registered public accounting firm will be required to audit management s assessment. The Company is in the process of performing the system and process documentation, evaluation and testing required for management to make this assessment and for its independent auditors to provide its attestation report. The Company has not completed this process or its assessment, and this process will require significant amounts of management time and resources. In the course of evaluation and testing, management may identify deficiencies that will need to be addressed and remediated.

Item 9B. ***Other Information***

None.

PART III

Item 10. ***Directors and Executive Officers of the Registrant***

The information required by this Item is incorporated herein by reference to the Company s Proxy Statement with respect to the Company s 2005 Annual Meeting of Stockholders. The Proxy Statement will be filed with the Securities and Exchange Commission within 120 days of the end of the Company s fiscal year.

Item 11. ***Executive Compensation***

The information required by this Item is incorporated herein by reference to the Company s Proxy Statement with respect to the Company s 2005 Annual Meeting of Stockholders. The Proxy Statement will be filed with the Securities and Exchange Commission within 120 days of the end of the Company s fiscal year.

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Item 12. ***Security Ownership of Certain Beneficial Owners and Management***

The information required by this Item is incorporated herein by reference to the Company s Proxy Statement with respect to the Company s 2005 Annual Meeting of Stockholders. The Proxy Statement will be filed with the Securities and Exchange Commission within 120 days of the end of the Company s fiscal year.

Item 13. ***Certain Relationships and Related Transactions***

The information required by this Item is incorporated herein by reference to the Company s Proxy Statement with respect to the Company s 2005 Annual Meeting of Stockholders. The Proxy Statement will be filed with the Securities and Exchange Commission within 120 days of the end of the Company s fiscal year.

Item 14. ***Principal Accountant Fees and Services***

The information required by this Item is incorporated herein by reference to the Company s Proxy Statement with respect to the Company s 2005 Annual Meeting of Stockholders. The Proxy Statement will be filed with the Securities and Exchange Commission within 120 days of the end of the Company s fiscal year.

PART IV

Item 15. ***Exhibits and Financial Statement Schedules***

Index to Consolidated Financial Statements

a. The following documents are filed as part of this report:

The exhibits listed in the Index to Exhibits, which appears immediately following the signature page and is incorporated herein by reference, are filed as part of this Annual Report on Form 10-K.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Blue Nile, Inc.
(Registrant)

By /s/ Diane M. Irvine

Diane M. Irvine
Chief Financial Officer

March 24, 2005

This report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated, pursuant to the requirements of the Securities Exchange Act of 1934.

By	/s/ Mark C. Vadon Mark C. Vadon	President, Chief Executive Officer and Director *(Principal Executive Officer)*	March 24, 2005
By	/s/ Diane M. Irvine Diane M. Irvine	Chief Financial Officer *(Principal Financial and Accounting Officer)*	March 24, 2005
By	/s/ Augustus O. Tai Augustus O. Tai	Director	March 24, 2005
By	/s/ Brian P. McAndrews Brian P. McAndrews	Director	March 24, 2005
By	/s/ Joanna A. Strober Joanna A. Strober	Director	March 24, 2005
By	/s/ Joseph Jimenez Joseph Jimenez	Director	March 24, 2005
By	/s/ Mary Alice Taylor Mary Alice Taylor	Director	March 24, 2005
By	/s/ W. Eric Carlborg W. Eric Carlborg	Director	March 24, 2005

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EXHIBIT INDEX

The following exhibits are filed as part of this Annual Report on Form 10-K or are incorporated herein by reference. Where an exhibit is incorporated by reference, the number in parentheses indicates the document to which cross-reference is made. See the end of this exhibit index for a listing of cross-reference documents.

Exhibit Number	Description
3.1(1)	Amended and Restated Certificate of Incorporation of Blue Nile, Inc.
3.2(2)	Amended and Restated Bylaws of Blue Nile, Inc.
4.1	Reference is made to Exhibits 3.1 and 3.2.
4.2(3)	Specimen Stock Certificate.
4.3(2)	Amended and Restated Investor Rights Agreement dated June 29, 2001 by and between Blue Nile, Inc. and certain holders of Blue Nile, Inc. s preferred stock.
10.1.1(2)*	Blue Nile, Inc. Amended and Restated 1999 Equity Incentive Plan.
10.1.2(2)*	Form of Stock Option Agreement pursuant to the Blue Nile, Inc. 1999 Equity Incentive Plan.
10.2.1(3)*	Blue Nile, Inc. 2004 Non-Employee Directors Stock Option Plan.
10.2.2(6)*	Form of Stock Option Agreement pursuant to the Blue Nile, Inc. 2004 Non-Employee Directors Stock Option Plan.
10.3(2)*	Blue Nile, Inc. 2004 Employee Stock Purchase Plan.
10.4.1(4)*	Blue Nile, Inc. 2004 Equity Incentive Plan.
10.4.2(6)*	Form of Stock Option Agreement pursuant to the 2004 Equity Incentive Plan.
10.4.3(5)*	Blue Nile, Inc. Stock Grant Notice pursuant to the 2004 Equity Incentive Plan.
10.5.1(4)	Sublease Agreement, dated May 22, 2003, between Amazon.com Holdings, Inc. and the registrant.
10.5.2(4)	First Amendment to Sublease Agreement, dated July 3, 2003, between Amazon.com Holdings, Inc. and the registrant.
10.6.1(4)	Lease, dated June 28, 2001, between Gull Industries, Inc. and the registrant.
10.6.2(4)	First Amendment to Lease, dated December 11, 2002 between Gull Industries, Inc. and the registrant.
10.6.3(4)	Second Amendment to Lease, dated November 15, 2003, between Gull Industries, Inc. and the registrant.
10.7(2)*	Offer Letter with Diane M. Irvine, dated December 1, 1999.
10.8(2)*	Offer Letter with Robert L. Paquin, dated September 7, 1999.
10.9(2)*	Offer Letter with Dwight Gaston, dated May 14, 1999.
10.10(2)*	Offer Letter with Susan S. Bell, dated August 22, 2001.
10.11(2)*	Offer Letter with Darrell Cavens, dated July 30, 1999.
10.12(6)*	Offer Letter with Terri Maupin, dated July 22, 2003.
10.13(4)	Form of Indemnification Agreement entered into between Blue Nile, Inc. and each of its directors and executive officers.
21.1(6)	Subsidiaries of the Registrant.
23.1(6)	Consent of PricewaterhouseCoopers LLP.
31.1(6)	Certification of Chief Executive Officer Required Under Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.2(6)	Certification of Principal Financial Officer Required Under Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.

Exhibit Number	Description
32.1(7)	Certification of Chief Executive Officer Required Under Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.
32.2(7)	Certification of Principal Financial Officer Required Under Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.

* Denotes a compensatory plan, contract or agreement, in which the Company s directors or executive officers may participate.

(1) Previously filed as Exhibit 3.1 to Blue Nile, Inc. s Form 10-Q for the quarterly period ended July 4, 2004 (No. 000-50763), as filed with the Securities and Exchange Commission on August 6, 2004, and incorporated by reference herein.

(2) Previously filed as the like numbered exhibit to Blue Nile, Inc. s Registration Statement on Form S-1 (No. 333-113494), as filed with the Securities and Exchange Commission on March 11, 2004, as amended, and incorporated by reference herein.

(3) Previously filed as the like numbered exhibit to Blue Nile, Inc. s Registration Statement on Form S-1/ A (No. 333-113494), as filed with the Securities and Exchange Commission on May 4, 2004, as amended, and incorporated by reference herein.

(4) Previously filed as the like numbered exhibit to Blue Nile, Inc. s Registration Statement on Form S-1/ A (No. 333-113494), as filed with the Securities and Exchange Commission on April 19, 2004, as amended, and incorporated by reference herein.

(5) Previously filed as Exhibit 10.1 to Blue Nile, Inc. s Current Report on Form 8-K (No. 000-50763), as filed with the Securities and Exchange Commission on December 13, 2004 and incorporated by reference herein.

(6) Filed herewith.

(7) The certifications attached as Exhibits 32.1 and 32.2 accompanies this Annual Report on Form 10-K pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed filed by Blue Nile, Inc. for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.