LJ INTERNATIONAL INC
Form 20-F/A
February 06, 2007

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U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 20-F/A

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

OR

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

For the fiscal year ended December 31, 2005

OR

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

For the transition period from __________ to __________

Commission file number 0-29620

OR

o **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Date of event requiring this shell company report __________

LJ INTERNATIONAL INC.
(Exact name of Registrant as specified in its charter)

LJ INTERNATIONAL INC.
(Translation of Registrant s name into English)

British Virgin Islands
(Jurisdiction of incorporation or organization)

Unit #12, 12/F, Block A
Focal Industrial Centre
21 Man Lok Street
Hung Hom, Kowloon, Hong Kong
(Address of principal executive offices)

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

Title of each class	Name of each exchange on which registered
None	N/A

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

$.01 Par Value Common Stock (Common Stock)
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None
(Title of Class)

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

15,521,203 Shares of Common Stock

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

Yes o No þ

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

Yes o No þ

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

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

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

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

Item 17 o Item 18 þ

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

Yes o No þ

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

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

Not Applicable.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

You should be aware that our actual results could differ materially from those contained in the forward-looking statements due to a number of factors:

- dependence upon certain customers
- dependence on key personnel
- control by principal shareholder
- competitive factors
- the operation of our business
- general economic conditions

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

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

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

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA.

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

The following selected consolidated financial data with respect to the two-year period ended April 30, 2002, eight months ended December 31, 2002 and the three-year period ended December 31, 2005 have been derived from our audited consolidated financial statements. The following selected consolidated financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and Notes included elsewhere in this annual report.

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Selected Financial Data

	Years ended December 31,				Eight-month period ended December 31,		Years ended April 30,	
	2005	2004	2003	2002 (Unaudited)	2002	2001 (Unaudited)	2002	2001
		(Restated)	(Restated)	(Restated)	(Restated)		(Restated)	(Restated)
Statement of Operations Data:								
Operating revenues	94,612	77,379	58,167	46,007	31,809	25,042	39,240	46,285
Cost of goods sold	72,642	61,265	44,947	39,951	22,820	18,602	35,731	31,540
Gross profit	21,970	16,114	13,220	6,056	8,989	6,440	3,509	14,745
Other operating income	549	125	163	200	157	93	135	62
Operating expenses								
Selling, general and administrative	(15,488)	(11,578)	(9,133)	(9,525)	(6,433)	(5,905)	(8,963)	(9,398)
Net gain (loss) on derivatives	8	199	87	(975)	(435)	(119)	(660)	44
Depreciation	(1,368)	(1,032)	(1,184)	(1,328)	(863)	(565)	(1,031)	(808)
Impairment on property, plant and			(84)	(417)	(108)		(345)	
Amortization and impairment loss on goodwill			(200)	(624)	(400)	(18)	(242)	(27)
Income (loss) from operations	5,671	3,828	2,869	(6,613)	907	(74)	(7,597)	4,618
Other income	139	38	41	91	48	172	217	508
Interest expenses	(1,991)	(902)	(753)	(668)	(441)	(424)	(652)	(1,780)
Impairment loss on investment security				(200)	(200)			
Operating income (loss) before income taxes, minority interests, equity in results of investment securities and extraordinary item	3,819	2,964	2,157	(7,390)	314	(326)	(8,032)	3,346
Incomes taxes (expense) credit	(739)	(277)	(352)	39	(101)	(39)	101	(211)

Income (Loss) before minority interests, equity in results of investment securities and extraordinary item	3,080	2,687	1,805	(7,351)	213	(365)	(7,931)	3,135
Minority interests in consolidated	(20)		8	150	120		30	
Income before equity in results of investment securities and extraordinary item	3,060	2,687	1,813	(7,201)	333	(365)	(7,901)	3,135
Equity in results of investment securities		133	(851)	24	16	26	34	
Income before extraordinary item	3,060	2,820	962	(7,177)	349	(339)	(7,867)	3,135
Extraordinary gain on negative goodwill	378							
Net income (loss)	3,438	2,820	962	(7,177)	349	(339)	(7,867)	3,135
Net income (loss) per share:								
Basic	0.26	0.25	0.11	(0.84)	0.04	(0.04)	(0.91)	0.37
Diluted	0.24	0.23	0.10	(0.84)	0.04	(0.04)	(0.90)	0.37
Weighted average number of shares								
Basic	13,439	11,119	8,757	8,551	8,493	8,672	8,672	8,567
Diluted	14,322	12,107	9,706	8,551	8,493	8,832	8,779	8,617
Balance Sheet Data:								
Working capital	35,554	23,617	17,053	11,896	11,896	18,537	12,115	20,153
Total assets	108,230	74,371	59,885	48,938	48,938	51,088	43,557	48,094
Long-term obligation	43	58	77			12	8	287
Total stockholders equity	45,008	33,488	27,101	23,344	23,344	30,969	23,591	31,161

Note 1: Pursuant to the purchase agreement dated January 1, 2005, the Company paid $2,827,500 for new issuance of 3,900 common stock of Goldleaves International Limited (GIL), in which the Company had 20% equity interests and was classified as investment security as of

December 31, 2004. The Company then became the major stockholder holding 98% equity interests in GIL, which became a subsidiary of the Company. As of December 31, 2004, this investment was accounted for using the cost method. As appropriate for a step-acquisition, in the 2005 financial statements, the investment has been restated to account for under the equity method.

B. CAPITALIZATION AND INDEBTEDNESS.

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS.

Not applicable.

D. RISK FACTORS.

We depend upon three customers who each account for at least 10% of our sales. We cannot be certain that these sales will continue; if they do not, our revenues will likely decline.

Although we sell to a large number of customers in a variety of markets, three of our customers each account for at least 10% of our sales. For the fiscal years ended December 31, 2005 and 2004, these customers accounted for approximately 14%, 11% and 10% of our 2005 sales and 9%, 7% and 11% of our 2004 sales. Although we have maintained good and longstanding relationships with these customers, we do not have any long-term contracts with them, each of whom orders only on a purchase order basis. The loss of any of these customers or a significant reduction in their orders would have a materially adverse effect on our revenues.

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

Our largest shareholder beneficially owns or controls approximately 22.5% of our outstanding shares as of December 31, 2005. Accordingly, he has controlling influence in determining the outcome of any corporate transaction or other matters submitted to our shareholders for approval, including mergers, consolidations and the sale of all or substantially all of our assets, election of directors, and other significant corporate actions. He also has the power to prevent or cause a change in control. In addition, without the consent of this shareholder, we could be prevented from entering into transactions that could be beneficial to us. The interests of this shareholder may differ from the interests of our other shareholders.

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We face significant competition from larger competitors.

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

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

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

- technological developments in the mass production of jewelry;
- our ability to meet the design and production requirements of our customers efficiently;
- the market acceptance of our and our customers jewelry;
- increases in expenses associated with continued sales growth;
- our ability to control costs;
- our management s ability to evaluate the public s taste and new orders to target satisfactory profit margins;
- our capacity to develop and manage the introduction of new designed products; and
- our ability to compete.

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

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

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

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

We have obtained fire, casualty and theft insurance aggregating approximately $37 million, covering several of our stock in trade, goods and merchandise, furniture and equipment and production facility in China. The proceeds of such insurance may not be sufficient to cover material damage to, or the loss of, our production facility due to fire, severe weather, flood or other cause, and such damage or loss would have a material adverse effect on our financial condition, business and prospects. Consistent with the customary practice among enterprises in China and due to the cost in relation to the benefit, we do not carry any business interruption insurance in China.

Sales of our jewelry to retailers are generally stronger during the quarter ending December 31 of each year due to the importance of the holiday selling season.

The approximately 33% of our sales during the fiscal year ended December 31, 2005 to our TV shopping channel customers was not seasonal in nature. It has been our management s experience that the remaining 67% of our total sales is seasonally sensitive and is greater during the quarter ending December 31 of each year.

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

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

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

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

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

- in original actions brought in the British Virgin Islands, China or Hong Kong, liabilities against us or non-residents based upon the securities laws of the United States or any state.

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Some information about us may be unavailable due to exemptions under the Exchange Act for a foreign private issuer.

We are a foreign private issuer within the meaning of the rules under the Exchange Act. As such, we are exempt from certain provisions applicable to United States public companies, including:

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

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

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

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

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

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

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

Furthermore, our directors have the power to take certain actions without shareholder approval which would require shareholder approval under the laws of most U.S. jurisdictions. The directors of a BVI corporation, subject in certain cases to court approval but without shareholder approval, may implement a reorganization, merger or consolidation, the sale of any assets, property, part of the business, or securities of the corporation. Our ability to amend our Memorandum of Association and Articles of Association without shareholder approval could have the effect of delaying, deterring or preventing a change in our control without any further action by the shareholders, including a tender offer to purchase our common stock at a premium over then current market prices.

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ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY.

LJ International Inc. (we) was incorporated as an international business company under the International Business Companies Act of the British Virgin Islands on January 30, 1997. As of December 31, 2005, we owned all of the issued share capital in the following significant subsidiaries:

Lorenzo Jewelry Limited (Lorenzo Jewelry), a company incorporated in Hong Kong on February 20, 1987

Lorenzo Jewellery (Shenzhen) Co., Ltd.

Shenzhen PGS Jewelry Mfg.

Lorenzo (Shenzhen) Co., Ltd.

Lorenzo Crystal Ltd.

Enzo (Shenzhen) Co., Ltd.

Enzo Ltd.

Goldleaves Gems (Shenzhen) Co., Ltd. (98% equity ownership)

Due to the restrictions on foreign ownership on the retail business of jewelries, the Company, through loans to the agents, established LSC and ESC to carry out the retail business of jewelries in the PRC. Pursuant to various agreements entered into between the Company, the agents and LSC on May 21, 2004, the agents and ESC on July 14, 2005, the Company generally has control of LSC and ESC, absorbs majority of expected losses and receives majority of residual return of LSC and ESC. The Company is therefore considered the primary beneficiary of LSC and ESC. Accordingly, the results of LSC and ESC are consolidated in the financial statements of the Company since May 21, 2004 and July 14, 2005 respectively.

Our principal place of business and our executive offices are located at Units #09-#12, 12/F, Block A, Focal Industrial Centre, 21 Man Lok Street, Hung Hom, Kowloon, Hong Kong, telephone: (011) 852-2764-3622. We have designated CT Corporation, 111 Eighth Avenue, New York, New York 10011 as our agent for service of process in the United States.

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

we invested $390,000 for the purchase of 1,751 square meters of production space in our Shenzhen, China facility during the fiscal year ended December 31, 2003

we invested $670,000 for the purchase of 1,639 square meters of production space in our Shenzhen, China facility during the fiscal year ended December 31, 2005

we acquired additional 78% of the equity of Goldleaves International Limited for $2,827,500 during the fiscal year ended December 31, 2005

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B. BUSINESS OVERVIEW.

We are a totally vertically integrated company that designs, brands, markets and distributes a complete range of fine jewelry. While we specialize in the semi-precious jewelry segment, we also offer high-end pieces set in yellow gold, white gold, platinum or sterling silver and adorned with semi-precious stones, diamonds, pearls and precious stones. We distribute mainly to fine jewelers, department stores, national jewelry chains and electronic and specialty retailers throughout North America and Western Europe. Our product lines incorporate all major categories sought by major retailers, including earrings, necklaces, pendants, rings and bracelets.

We believe that our vertically integrated structure provides significant advantages over our competitors. All profits from value added processes are captured internally, rather than shared with third party manufacturers. This results in very competitive pricing for the retailer and enhanced profits for us. Innovative processes in stone cutting and production further enhance our competitive position.

We employ an international design team and all of our designs and merchandising strategies are proprietary. The exclusive and innovative concepts that we create offer brand potential. Our primary marketing focus has been in North America where we have sold directly to certain high volume customers that need specialized product development services, and through a marketing relationship with International Jewelry Connection (IJC) for those customers that need higher levels of service and training.

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

- fine jewelers;
- national jewelry chains;
- department stores;
- TV shopping channels; and
- discount chain stores.

For the years ended December 31, 2004 and 2005, approximately 73% and 72% of our sales were in North America.

In addition to our supply chain line of business involving direct sales to retailers, we have expanded into the retail sales line of business involving direct sales to consumers in China through company-owned retail stores under the brand name ENZO. In March 2004, we opened our first ENZO store in Hong Kong and we opened our flagship store in Shanghai in November 2004. We currently operate18 ENZO retail stores in Hong Kong and China, and we expect to open an additional 20 retail stores in 2006.

The following is a breakdown of our total revenues (in thousands) by geographic market for each of our past three financial years:

	Year ended December 31,		
	2005	2004	2003
US & Canada	67,780	56,186	42,851
Europe and other countries	20,527	13,062	8,017
Japan	3,686	4,158	5,338
PRC (including Hong Kong and Macau)	2,619	3,973	1,961
	94,612	77,379	58,167

Our Industry

The U.S. jewelry industry is a highly fragmented $45 billion market, with no single entity having more than 6% market share. The industry consists primarily of three retail sectors:

specialty retailers account for $27 billion in sales

mass merchants and department stores account for $12 billion in sales

direct avenues (television shopping, e-commerce, catalogs) account for $6 billion

The U.S. jewelry industry is comprised of two major groups that distribute finished jewelry to retailers in the United States:

a small number of producers that make and distribute their own jewelry directly to retailers; and

a large number of wholesalers and distributors who purchase products or portions of products from third parties and resell those items to retailers.

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

The Chinese jewelry industry has experienced rapid development due to a series of major reforms, including the liberalization of China s gold market, the lowering of tariff rates, and the decision of the Chinese Government to open up the retail sector to international companies.

In addition, rising income levels coupled with the growing urban population in China has helped the jewelry market record double-digit growth annually. The continuing acceleration of the urbanization trend in China will likely result in improved income levels, thereby increasing private consumption. The Chinese Government has also encouraged consumer spending by instituting longer national holidays and increasing the salary of civil servants.

China is the largest consumer of platinum and jade in the world for the past three years, the largest consumer of diamonds in Asia, and the fourth largest consumer of gold in the world.

Our Business Strategy

Our business strategy is to:

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

- further develop our existing customer relationships with our specialized services; and

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

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

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

- adding more lines into our Lorenzo branded products with a retail price range of $199 to $999

- offering diamond jewelry and expanding this business to our current client base by adding diamonds to some of our settings, as well as offering newly designed jewelry

- launching Lorenzo Gold , our new gold jewelry product line

Our China Retail Sales Strategy

In 2004, we initiated a retail sales strategy aimed at gaining market share in the rapidly growing consumer market in China. We opened three ENZO stores, two in China (including a flagship store in Shanghai) and one in Hong Kong. We believe that China represents an excellent retail sales opportunity for several reasons:

- enormous retail market China s retail sales exceed $600 billion annually, making China the third largest market in the world.

- large and growing jewelry market we estimate that China s jewelry sales totaled nearly $15 billion in 2002, up 19% year over year.

- huge pool of consumers China has a population of 1.3 billion persons. We estimate that roughly 160 million Chinese have enough income to purchase luxury goods.

- favorable regulatory changes as a member of the World Trade Organization (WTO), China is eliminating many restrictions on foreign ownership and operation of retail stores. Tariffs on colored gem stones, gold, silver and pearls have been sharply reduced, and economic and trade relationships between China and Hong Kong have been liberalized.

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- changing consumer preferences Chinese consumers are no longer purchasing jewelry solely as an investment. More Chinese consumers are embracing a more Western view of jewelry as a fashion accessory and now demand more contemporary, colorful designs.

We are expanding into China by means of Company-owned and operated retail stores and supplier relationships with leading retailers, such as Carrefour.

We intend to implement our business strategy by:

- expanding our retail jewelry market in China by planning to open an additional 20 ENZO stores in China during 2006
- promoting visits with customers to coordinate and cater to their particular promotional sales needs and monitoring their on-hand inventory in order to promote more active sell-through
- expanding our distribution channels to include all major TV shopping programs in North America, Japan, Korea and Australia and further developing business with top-40 Retail Jewelry Chains in the U.S.

Our Production Capability

We have established a sophisticated facility in China that performs stone cutting and polishing and jewelry production. The facility is located in the city of Shenzhen in Guangdong Province, China. Our production facility in Shenzhen has been operating for seven years and has more than 10,000 square meters of production space. We currently employ approximately 2,800 skilled gemstone cutters and production personnel and turned out approximately two million pieces of finished fine jewelry during the fiscal year ended December 31, 2005.

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

Sales and Marketing

Our merchandising strategy is to provide unique and differentiated products that are enhanced by the favorable pricing that results from our vertically integrated structure. We invest significant effort in design and model making to produce items which are distinctly different from those of our competitors. We continue to devote our efforts towards brand development and utilize marketing concepts to enhance the saleability of our products. We recognize that

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retailers favor certain price points. As part of our product development strategy, we strive to align our wholesale prices to match retailers target prices as a means of achieving these popular price targets.

Our sales and marketing team is located in our executive offices in Hong Kong and Los Angeles, California. Our marketing and distribution strategy is to identify the strongest retail customers in each distribution channel and to focus design and sales efforts towards the largest and fastest growing retailers. We maintain a broad base of customers and concentrate our efforts on five major jewelry market segments:

fine jewelers;

national jewelry chains;

department stores;

TV shopping channels; and

discount chain stores.

In addition to direct sales to retailers, we also sell our products to retailers through International Jewelry Connection. The principal focus of IJC is on major U.S. department stores and jewelry retailers, who require specialized levels of marketing, service and training. These sales representatives are paid on a commission-only basis.

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

Design and Product Development

We have 20 internationally trained designers who work from our Hong Kong, U.S. and China offices. Our designers create styles that have been accepted by our various clients worldwide. Our design teams attend trade fairs worldwide to gather product ideas and monitor the latest product trends.

We provide our customers with a broad selection of high-quality 10, 14 and 18 karat gold, platinum and sterling silver jewelry products that incorporate traditional yet fashionable styles and designs. We currently offer more than 50,000 different styles of rings, bracelets, necklaces, earrings, pendants and matching sets that are contemporary and desired in the market.

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

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Production Process

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

cutting and polishing semi-precious gemstones;

combining pure gold, platinum or sterling silver with gemstones or diamonds to produce jewelry; and

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

Supply

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

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

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

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

We purchase our gold requirements within a reasonable period after each significant purchase order is received. We believe that any change in the price of gold would have had little, if any, impact on the valuation of our inventories.

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

Security

We have installed certain measures at our Shenzhen, China, production and our Hong Kong administrative facilities to protect against loss, including multiple alarm systems, infrared

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motion detectors and a system of closed circuit television cameras, which provide surveillance of all critical areas of our premises.

We carefully inspect all materials sent and received from outside suppliers, monitor the location and status of all inventory, and have strict internal control procedures of all jewelry as it proceeds through the production process. A complete physical inventory of gold and gemstones is taken at our production and administrative facilities on a quarterly basis.

Insurance

We maintain primary all-risk insurance, with limits in excess of our current inventory levels, to cover thefts and damage to inventory located on our premises. We also maintain insurance covering thefts and damage to our owned inventory located off-site. The amount of coverage available under such policies is limited and may vary by location, but is generally in excess of the value of the gold and gemstones supplied by us. We carry transit insurance, the coverage of which includes the transportation of jewelry outside of our office.

Competition

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

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

The North American market is highly fragmented but does contain a number of major competitors, many of whom import much of their product from the Far East and many of whom sell higher priced items. The key United States competitors include E.E.A.C. Inc. and Fabrikant. International competitors include Pranda International and Beauty Gems Limited. Most of these manufacturers/wholesalers have been successful vendors for many years and enjoy good relations with their clients. Although it may be difficult for a newcomer to break into established relationships, we have already made substantial inroads in the North American jewelry market and we believe we can remain competitive, based on our vertically integrated, low-cost, high-volume and high-quality production process.

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C. ORGANIZATIONAL STRUCTURE AS OF DECEMBER 31, 2005:

The following diagram provides a listing of our significant subsidiaries. The respective country of organization/incorporation is shown in brackets.

LJ INTERNATIONAL INC.
(British Virgin Islands)

100%

- **Lorenzo Jewelry Limited** (Hong Kong)
- **Lorenzo Jewellery (Shenzhen) Co., Ltd.** (P.R.C.)
- **Shenzhen PGS Jewelry Mfg.** (P.R.C.)
- **Goldleaves Gems (Shenzhen) Co., Ltd.** (P.R.C.) (98% equity ownership)
- **Lorenzo (Shenzhen) Co., Ltd.** (P.R.C.)
- **Lorenzo Crystal Ltd.** (Hong Kong)
- **Enzo (Shenzhen) Co., Ltd.** (P.R.C.)
- **Enzo Ltd.** (Macau)

D. PROPERTY, PLANTS AND EQUIPMENT.

Our principal executive offices are located at Units #9-#12, 12/F, Block A, Focal Industrial Centre, 21 Man Lok Street, Hung Hom, Kowloon, Hong Kong. We own approximately 4,800 square feet of office and showroom at this location.

Our jewelry production facility in Shenzhen, China consists of 12,918 square meters of building space located in the Shatoujiao Free Trade Zone, Shenzhen. We own approximately 6,893 square meters of this space. We also currently lease:

- 1,751 square meters for a term of five years expiring August 31, 2007 from an unaffiliated third party at a rental rate of $3,817 per month;

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

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- 475 square meters for a term of one year expired December 31, 2005, at a rental rate of $854 per month, extension of lease is under negotiation;

- 600 square meters for a term of three years expired October 31, 2005, at a rental rate of $1,333 per month, extension of lease is under negotiation; and

- 1,886 square meters for a term of three years and eleven months expiring September 30, 2006, at a rental rate of $4,425 per month.

We own two warehouse facilities in Hung Hom and Aberdeen consisting of 5,432 square feet and 5,200 square feet. We also own additional properties in Sai Kung and Hung Hom. We lease all four of these properties to non-affiliated third parties. We have pledged all of our land and buildings to collateralize general banking facilities granted to us.

Our production facilities are currently utilized for one shift per day but are capable of being expanded to accommodate three shifts per day as necessary.

ITEM 4A.UNRESOLVED STAFF COMMENTS

Not applicable.

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ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion and analysis should be read in conjunction with our financial statements and notes to the financial statements appearing elsewhere in this Form 20-F. See Special Note Regarding Forward-looking Statements.

We design, manufacture, distribute and market full range of fine jewelry for sale in the worldwide jewelry market.

Our products include rings, bracelets, necklaces, earrings and pendants, and we are one of the strongest players in color gemstones that employs the mine-to-market strategy. Most of the color gemstones are imported from Brazil which supplies the best color gemstones in the world, the choices of which to customers are many and diversified that includes, amongst others, ametrine, amethyst, aquamarine, imperial topaz, tourmaline, white topaz, tanzanite, mandarine garnet, topaz, ruby, sapphire and emerald. Our customers include fine jewelers, national jewelry chain stores, department stores and television shopping networks in North America, Western Europe, Japan and China. The business strategies of the Company include broadening the product line, and diversifying its customer base.

We are based in Hong Kong and our business model comprises two streams: Supply Chain and Retail Chain. The revenue mix of the two businesses was roughly in the ratio of 97% to 3% for the year ended December 31, 2005.

The Supply Chain focuses on the US market with sales made to those $100 Million Supersellers such as Sterling Jewelers Inc., Fred Meyer Jewelers, Helzberg Diamonds, ShopNBC, Zales Corporation, QVC, Wal-Mart, Finlay Fine Jewelry, Home Shopping Network, Ben Bridge Jeweler, Kohl s Corporation, Macy s East, Macy s West and J.C. Penney. The turnover of our sales to those Supersellers in the US and Canada amounted to $67.8 million for 2005 compared to $56.2 million in 2004, an increase of 20.6%.

Employing the brand new ENZO name, the Retail Chain focuses primarily on the China market. Shortly after the year end date, on January 20, 2006, ENZO in China reached the 20-store milestone, which was well-ahead of our schedule of achieving at least 40 retails stores by the end of 2006. ENZO now has one or more retail locations in China s richest and largest population cities, including Shanghai, Beijing, Harbin, Qingdao, Shenyang, Ningbo, Chengdu, Changsha, Wuxi and Shenzhen. The best selling jewelries are in the price range of $300 to $500, and the population groups with annual income of $800 to $1,200 are most eager to buy fine jewelries. Jewelries made of 18K gold are most popular, followed by 24K s. Most popular diamonds are of 0.21 carats to 0.49 carats.

ENZO is opening another two retail locations in the coming months, one at the SkyPlaza of the Hong Kong International Airport and one at Parklane of Tsim Sha Tsui. In the middle of 2006, ENZO is opening a 10,000 square feet mega store in Macau which is located in the Palace of the Fisherman s Wharf. The opening of the Macau mega store will be truly be a significant

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milestone in the execution of the retail strategy in Greater China as well as in Asia. Macau is a prime destination not only for gambling but for other recreation as well both for dining and other family activities. The Fisherman s Wharf is expected to draw at least 15 million people in just its first year of opening and will steadily grow from there. Our mega store, located in the central of the Wharf, offers a full range of products to millions of affluent customers throughout the year, and we are pleased to be able to execute a faster track record of new store openings than all other competitors put together.

A. OPERATING RESULTS.

Reclassifications

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

Revenues

	Year ended December 31			% change Years ended December 31,	
(in thousands)	2005	2004	2003	2005-2004	2004-2003
Revenue					
Existing customers	$ 86,643	$ 64,411	$ 52,590	35%	22%
New customers					
Jewelry product	$ 3,641	$ 7,801	$ 2,789	-53%	180%
Giftware product	$ 1,827	$ 4,359	$ 2,788	-58%	56%
Total wholesales business	$ 92,111	$ 76,571	$ 58,167	20%	32%
Retail business	$ 2,501	$ 808	$	210%	N/A
	$ 94,612	$ 77,379	$ 58,167	22%	33%

The increase in revenue of $22,232,000 from existing customers of wholesales business for the year ended December 31, 2005 was attributable to an increase in average selling price of 2% amounting to $1.3 million and increase in order quantity of 32% amounting to $20.9 million.

The increase in revenue of $11,821,000 from existing customers of wholesales business for the year ended December 31, 2004 was attributable to an increase in average selling price of 10% amounting to $5.3 million and increase in order quantity of 11% amounting to $6.5 million.

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Cost of Sales and Gross Profit

	Year ended December 31			% change Years ended December 31,	
(in thousands)	2005	2004	2003	2005-2004	2004-2003
Cost of sales					
Wholesales	$ 71,237	$ 60,727	$ 44,947	17%	35%
Retail	$ 1,405	$ 538	$	161%	N/A
Total	$ 72,642	$ 61,265	$ 44,947	19%	36%
% of revenues					
Wholesales	77%	79%	77%		
Retail	56%	67%	N/A		
Total	77%	79%	77%		
Gross profit					
Wholesales	$ 20,874	$ 15,844	$ 13,220	32%	20%
Retail	$ 1,096	$ 270	$	306%	N/A
Total	$ 21,970	$ 16,114	$ 13,220	36%	22%
% of revenues					
Wholesales	23%	21%	23%		
Retail	44%	33%	N/A		
Total	23%	21%	23%		

The gross profit margin increased to 23% for the year ended December 31, 2005 from 21% for the year ended December 31, 2004 was attributable to the closure of the low profit margin of giftware products lines in wholesales business; and to the newly incepted retail business with higher gross margin for the year ended December 31, 2005.

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

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Selling, General and Administrative Expenses

(in thousands)	Year ended December 31 2005	2004	2003	% change Years ended December 31, 2005-2004	2004-2003
Wholesales business	$ 12,398	$ 10,944	$ 9,133	13%	20%
Acquired manufacturing subsidiaries	$ 479	$ 0	$ 0	N/A	N/A
Retail business	$ 2,611	$ 634	$ 0	312%	N/A
	$ 15,488	$ 11,578	$ 9,133	34%	27%
% of revenues	16%	15%	16%		

Selling, general and administrative expenses increased by 34% for the year ended December 31, 2005, compared with the year ended December 31, 2004. It was attributed to the increase in development cost of new products, designs and markets by 21% for wholesale business, and expenses incurred by the retail business of $2,611,000 comprising advertising cost of $816,000, rental cost of $275,000, staff cost of $727,000 and other expenses of $793,000, or 312% increase of the same for the year ended December 31, 2004.

Selling, general and administrative expenses increased by 27% for the year ended December 31, 2004, compared with the year ended December 31, 2003. It was attributed to the development cost of new products, designs and markets of $1,200,000 for wholesales business, and expenses incurred by the newly incepted retail business of $634,000 comprising advertising cost of $135,000, rental cost of $85,000, staff cost of $306,000 and other expenses of $108,000, for the year ended December 31, 2004.

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Net gain (loss) on derivatives

				% Change	
	Year ended December 31,			Years ended December 31,	Years ended December 31,
(in thousands)	**2005**	**2004**	**2003**	**2005-2004**	**2004-2003**
Unrealised loss on derivatives	$ (88)	$ (482)	$ (162)	-82%	198%
% of revenues	0%	-1%	0%		

We have secured gold loan facilities with various banks in Hong Kong, which typically bear a below-market interest rate. Under the gold loan arrangements, we may defer the purchase until such time as we decide appropriate, the price to be paid being the current market price at time of payment. The gold loan, however, does expose us to certain market risks associated with potential future increases in the price of gold. In the past, we did not hedge against such risks and at the close of each reporting period, the gold loan was valued at fair value with changes reflected on the income statement.

Since 2003, we have commenced hedging the fluctuations in the price of gold related to the gold loans by entering into contracts with financial institutions for the future purchase of gold. With the hedging mechanism in place, we have incurred an unrealized loss of $88,000 (2004: $482,000) and realized gain of $96,000 (2004: $681,000) on derivatives, for the year ended December 31, 2005.

Persistently, after the hedging mechanism in place since 2003, we secured position of a net gain on derivative hedging activities of $87,000, $199,000 and $8,000 for each of the years ended December 31, 2003, December 31, 2004 and December 31, 2005 respectively.

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Depreciation

				% Change	
	Year ended December 31,			Years ended December 31,	Years ended December 31,
(in thousands)	2005	2004	2003	2005-2004	2004-2003
Depreciation	$ 1,368	$ 1,032	$ 1,184	33%	-13%
% of revenues	1%	1%	2%		

Depreciation increased by 33% to $1,368,000 for the year ended December 31, 2005 from $1,032,000 for the year ended December 31, 2004, reflecting the amortization on the on-going capital expenditures, capitalized computer system and renovation of retail shops during the year.

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

Amortization and impairment loss on goodwill

				% Change	
	Year ended December 31,			Years ended December 31,	Years ended December 31,
(in thousands)	2005	2004	2003	2005-2004	2004-2003
Amortization and impairment loss on goodwill	$ 0	$ 0	$ 200	N/A	N/A
% of revenues	0%	0%	0%		

In March 2002, goodwill was arisen as a result of the acquisition of a jewelry retail company. Impairment loss of $200,000 of the related goodwill was charged for the year ended December 31, 2003.

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Interest cost

(in thousands)	Year ended December 31, 2005	2004	2003	% Change Years ended December 31, 2005-2004	Years ended December 31, 2004-2003
Interest expenses	$ 1,991	$ 902	$ 753	121%	20%
% of revenues	2%	1%	1%		

Interest expenses increased for the years ended December 31, 2003, 2004 and 2005 reflecting the continuous increase in interest rate and a higher utilization rate of credit line facilities as working capital.

Income taxes

(in thousands)	Year ended December 31, 2005	2004	2003	% Change Years ended December 31, 2005-2004	Years ended December 31, 2004-2003
Incomes taxes expense	$ 739	$ 277	$ 352	167%	-21%
% of revenues	1%	0%	1%		

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

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

Three of our subsidiaries in China are registered to be qualified as Foreign Investment Enterprises in China and are eligible for certain tax holidays and concessions. Accordingly,

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certain of our Chinese subsidiaries are exempt from Chinese income tax for two years starting from their first profit-making year, followed by a 50% reduction of tax for the next three years.

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

For other subsidiaries in China, the prevailing corporate income tax rate is 33%. The prevailing corporate income rate is 15% for companies operating in special economic zones of China.

During the year ended December 31, 2005, incomes taxes included tax under provision adjustment of $88,000, and for the years ended December 31, 2004 and 2003, incomes taxes included tax overprovision adjustment of $22,000 and $92,000 respectively, after the finalization of tax assessment for prior years.

Extraordinary gain on negative goodwill

				% Change	
	Year ended December 31,			Years ended December 31,	Years ended December 31,
(in thousands)	2005	2004	2003	2005-2004	2004-2003
Extraordinary gain on negative goodwill	$ 378	$ 0	$ 0	N/A	N/A
% of revenues	0%	0%	0%		

Extraordinary gain on negative goodwill of $378,000 was arisen from the sequential acquisition of a company whose principal activities are the manufacturing and trading of rough and pre-formed gemstones (the Investee)

Pursuant to the purchase agreement dated January 1, 2005, the Company would pay US$2,827,500 to the Investee for the issuance of 3,900 new shares therein (Acquisition), in which the Company had 20% equity interests. The Company then became the major stockholder holding 98% equity interests in the Investee, which became a subsidiary of the Company.

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Inflation

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

Foreign Exchange

Approximately 97% of our sales are denominated in U.S. Dollars whereas the other sales are basically denominated in Hong Kong Dollars and Renminbi. The largest portion of our expenses are denominated in Hong Kong Dollars, followed by U.S. Dollars and Renminbi. The exchange rate of the Hong Kong Dollar is currently pegged to the U.S. Dollar, but during the past several years the market exchange rate has fluctuated within a narrow range. The Chinese government principally sets the exchange rate between the Renminbi and all other currencies. As a result, the exchange rates between the Renminbi and the U.S. Dollar and the Hong Kong Dollar have fluctuated in the past and may fluctuate in the future. If the value of the Renminbi or the Hong Kong Dollar decreases relative to the U.S. Dollar, such fluctuation may have a positive effect on the results of our operations. If the value of the Renminbi or the Hong Kong Dollar increases relative to the U.S. Dollar, such fluctuation may have a negative effect on the results of our operations. We do not currently hedge our foreign exchange positions.

Governmental economic and political policies and factors

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

B. LIQUIDITY AND CAPITAL RESOURCES.

We have no direct business operations other than the ownership of our subsidiaries and investment securities. Our ability to pay dividends and meet other obligations depends upon our receipt of dividends or other payments from our operating subsidiaries and investment securities. Our operating subsidiaries are subject to restrictions on their ability to make distributions to us, including as a result of restrictive covenants and minimum net worth requirements in loan agreements, restrictions on the conversion of local currency into U.S. dollars or other hard currency and other regulatory restrictions.

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Cash Flows

(in thousands)	Years ended December 31, 2005	2004	2003
Net cash (used in) provided by operating activities	$ (7,758)	$ (5,690)	$ 1,489
Net cash used in investing activities	(4,655)	(1,179)	(468)
Net cash provided by financing activities	13,986	7,375	704
Effect of foreign exchange rate change	(5)		
Net increase in cash and cash equivalents	1,568	506	1,725

Operating Activities:

(in thousands)	Year ended December 31, 2005	2004	2003
Cash flows from operating activities			
Net income	3,438	2,820	962
Adjustments to reconcile income to net cash (used in) provided by operating activities :			
Depreciation of property, plant and equipment and properties held for lease	1,368	1,032	1,184
Impairment loss on property, plant and equipment			84
Amortization and impairment loss on goodwill			200
Extraordinary (gain) on negative goodwill	(378)		
Unrealized loss on derivatives	88	482	162
Loss (Gain) on disposal and write-off of property, plant and equipment	8	(3)	2

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	Year ended December 31,		
(in thousands)	2005	2004	2003
Allowance for doubtful debts	(72)	125	5
Minority interests	20		(8)
Compensation costs for warrants granted	118		
Compensation expenses recognized during the year	18	11	9
Equity in results of investment securities		(133)	851
Change in operating assets and liabilities :			
Trade receivables	(8,607)	(535)	(4,286)
Inventories	(12,060)	(15,142)	(3,555)
Prepayments and other current assets	601	1,187	(2,493)
Due from / to related parties	7	17	3
Trade payables	1,883	1,136	1,797
Accrued expenses and other payables	(854)	1,767	1,168
Letters of credit and others	6,464	1,804	5,060
Income taxes payables and deferred taxation	200	(258)	344
Net cash (used in) provided by operating activities	(7,758)	(5,690)	1,489

Net cash (used in) provided by operating activities was net income (loss) adjusted for certain non-cash items and changes in assets and liabilities.

For the year ended December 2005, net cash used in operating activities was comprised of a net income of $3,438,000, non-cash adjustment of $1,170,000 including adjustment of $1,368,000 for depreciation and $378,000 for extraordinary gain on negative goodwill.

For the year ended December 2004, net cash used in operating activities was comprised of a net income of $2,820,000, non-cash adjustment of $1,514,000 including adjustment of $1,032,000 for depreciation and $482,000 for unrealized loss on derivatives.

Significant changes in assets and liabilities were as follows:

Trade receivables were increased by $8,607,000 for the year ended December 31 2005. It was due to the sales was near the year end during the last quarter.

Inventory balance was increased by$12,060,000 and $15,142,000 for the year ended December 31, 2005 and 2004 respectively. It was the accumulation of inventory of gemstones in anticipation of significant increase in sales for the new fiscal year, and the build up of inventory for retail business in Hong Kong, Macau and China. The rise in the cost of gold and rough gemstones, the build-up of more sample lines of jewelry and the maintaining of sufficient inventory for block-orders.

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Trade payables increased by $1,883,000 and $1,136,000 for the year ended December 31, 2005 and 2004 respectively. The increase was primarily due to the better credit term obtained from suppliers.

Letters of credit and others were increased by $6,464,000 and $1,804,000 for the year ended December 31, 2005 and 2004 respectively. The increase was to principally increase the company s working capital for daily operations.

Investing Activities:

For the year ended December 31, 2005, net cash used in investing activities was for the capital expenditures and purchase of capital guaranteed fund. Capital expenditure were mainly for acquisition of a production facility in Shenzhen, renovation and improvement of the existing production facilities in Shenzhen, renovation of shops for the new retail business and other on-going business necessities including a new computer system. The capital guaranteed fund was purchased from banks for securing new banking facilities, which was partially offset by the deduction in restricted cash.

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

Our capital expenditure by category for the periods presented were:

	Years ended December 31,		
(in thousands)	**2005**	**2004**	**2003**
Land & buildings	$ 617	$	$ 330
Leasehold improvement	$ 783	$ 487	$ 190
Furniture, fixtures and equipment	$ 1,060	$ 189	$ 250
Plant and machinery	$ 209	$ 51	$ 93
Motor vehicles	$ 200	$	$ 133
Total	$ 2,869	$ 727	$ 996

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Financing Activities:

Net cash provided by financing activities for the year ended December 31, 2005 was $13,986,000, which included proceeds of $7,736,000 from issuance of shares upon exercise of stock options and warrants, increase of new loans and offset by the repayment of matured bank loans, and increase in bank overdrafts utilization level.

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

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

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

Financing Sources

Banking Facilities and Notes Payables

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

Letters of Credit, overdrafts and others:

	Years ended December 31,		
(in thousands)	2005	2004	2003
Letters of credit	$ 31,533	$ 26,833	$ 19,005
Overdraft	$ 3,461	$ 3,461	$ 3,397
	34,994	30,294	22,402
Utilized :			
Letters of credit utilized	$ 21,887	$ 15,423	$ 13,619
Overdraft utilized	$ 2,028	$ 607	$ 1,312
	23,915	16,030	14,931

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

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

Notes payable:

	Years ended December 31,		
(in thousands)	**2005**	**2004**	**2003**
Notes payable	$3,079	$2,487	$1,516

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

Gold Loan Facilities:

	Years ended December 31,		
(in thousands)	**2005**	**2004**	**2003**
Gold loans outstanding (in $)	$ 10,756	$ 6,488	$ 3,118
Gold loans outstanding (in troy ounces)	27,920	17,920	10,900
Gold loan interest rate	2.4%-2.6%	2.1%-2.5%	1.6%-2.4%

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

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Looking Forward:

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

Impact of recently issued US GAAP accounting standards.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised), Share-Based Payment (SFAS No. 123R), which requires all companies to measure compensation cost for all share-based payments (including employee stock options) at fair value. In April 2005, the Securities and Exchange Commission announced that it would provide a phased-in implementation process for SFAS No. 123R. As a result of this phased-in process, the provisions of SFAS No. 123R must be adopted by most public entities no later than the beginning of the first fiscal year commencing after June 15, 2005. SFAS No. 123R applies to all awards granted after the required effective date and to awards modified, repurchased, or cancelled after that date.

Effective for the fiscal year beginning January 1, 2006, the Company will adopt the provisions of SFAS No. 123R using a modified version of prospective application. Under this transition method, compensation cost will be recognized on or after the effective date for the portion of outstanding awards for which the requisite service has not yet been rendered, based on the grant date fair value of those awards previously calculated under SFAS No. 148 for pro forma disclosures.

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, Inventory Costs an amendment of ARB No. 43, Chapter 4 (SFAS No. 151), which clarifies that abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) should be recognized as a current period expense. In addition, SFAS No. 151 requires that allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005. The Company does not believe that the implementation of this standard will have a material impact on its financial position, results of operations or cash flows of the Company.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 153 Exchanges of Non-monetary Assets an amendment of APB Opinion No. 29 (SFAS No. 153). SFAS No. 153 addresses the measurement of exchanges of non-monetary assets. It eliminates the exception from fair value measurement for non-monetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29 Accounting for Non-monetary Transactions and replaces it with an exception for exchanges that do not have commercial substance. A non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. As required by SFAS No. 153, we will adopt this new accounting standard effective July 1, 2005. The adoption of SFAS No. 153 is not expected to have a material impact on the financial position, results of operations or cash flows of the Company.

In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3 (SFAS No. 154), which changes the requirements for the accounting and reporting of a change in accounting principle. The Statement requires retrospective application to prior periods financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. In addition, the Statement also requires that a change in depreciation or amortization for long-lived assets be accounted for as a change in accounting estimate effected by a change in accounting principle. The provisions of SFAS No. 154 are generally effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company does not expect the adoption of SFAS No. 154 to have a material impact on its financial position or results of operations.

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

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

D. TREND INFORMATION.

The total revenue for fiscal year ending December 31, 2006 is estimated to be at least 10% greater than the level for fiscal year 2005. The sales for fiscal year 2006 are estimated at approximately US$105 million, compared to US$95 million for the fiscal year ended December 31, 2005. The gross profit margin for fiscal year 2006 is estimated to remain at the same 23% level as fiscal year 2005.

E. OFF-BALANCE SHEET ARRANGEMENTS.

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

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F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS.

As of the December 31, 2005, we had the following known contractual obligations:

	Payments due by period				
	Total US$	Less than I year US$	1-3 years US$	3-5 years US$	More than 5 years US$
Long-Term Debt Obligations					
Capital (Finance) Lease Obligations	63	20	41	2	
Operating Lease Obligations	2,036	835	1,070	131	
Purchase Obligations					
Other Long-Term Liabilities Reflected on the Company s Balance Sheet under the GAAP of the primary financial statements					
Total	2,099	855	1,111	133	

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

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. DIRECTORS AND SENIOR MANAGEMENT.

Our senior management and directors are as follows:

Name	**Age**	**Position**
Yu Chuan Yih	66	Chairman of the Board of Directors, President and Chief Executive Officer
Ka Man Au	41	Chief Operating Officer, Secretary and Director
Hon Tak Ringo Ng	46	Chief Financial Officer and Director
Po Yee Elsa Yue	41	Non-Executive Director
Andrew N. Bernstein	53	Non-Executive Director
Wing Kwan Ted Lai	43	Non-Executive Director
Kelvin Wong	39	Non-Executive Director

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

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

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

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

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

Mr. Bernstein joined us as a director in July 2005. He earned his Bachelor of Science degree from Cornell University in 1974 and his Juris Doctor degree from Boston College Law School in 1977. Since 1978, Mr. Bernstein has been engaged in the private practice of law in Denver, Colorado, with emphasis on the representation of private and public companies and their transactional, corporate and securities matters. Mr. Bernstein has served as our U.S. securities counsel since March 1997.

Mr. Lai joined us as a director in July 2005. He is a lawyer by profession. Mr. Lai received his law degree from the University of London in 1984. He progressed from his legal career to become the managing director of a listed company in Hong Kong at the age of 26 from 1987 to 2001. Mr. Lai was in charge of the legal, accounting and investment operations of the company. Since 2001, he manages his own investments and serves as a consultant of a law firm.

Mr. Wong joined us as a director in July 2005. Since 2002, he serves as the finance director of a Hong Kong-based private conglomerate group which mainly engages in garment manufacturing and property investments. Mr. Wong earned a Bachelor of Science degree from the University of Southern California in 1990, majoring in accounting. He was formerly the manager of the Assurance and Business Advisory Services division of PriceWaterhouseCoopers in Hong Kong. Mr. Wong has over 13 years of experience in the accounting and finance field.

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He is currently a member of the American Institute of Certified Public Accountants, the California State Board of Accountancy and the Hong Kong Institute of Certified Public Accountants.

B. COMPENSATION.

The aggregate compensation paid by us to all of our directors and executive officers as a group for the fiscal year ended December 31, 2005 on an accrual basis, for services in all capacities, was $1,146,000. During the fiscal year ended December 31, 2005, we contributed an aggregate amount of $33,000 toward the pension plans of our directors and executive officers.

Executive Service Contract

We entered into an employment agreement with Mr. Yu Chuan Yih, effective October 1, 2003, for a period of three years at an annual salary of $233,000. Mr. Yih s remuneration package includes benefits with respect to an automobile. In addition, Mr. Yih is entitled to an annual management bonus of a sum to be determined by the compensation committee of the board of directors at its discretion, having regard for our operating results and the performance of Mr. Yih during the relevant financial year.

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

On January 3, 2005, we granted Mr. Yih, Ms. Au and Mr. Ng options exercisable to acquire 500,000 shares, 100,000 shares and 100,000 shares at $3.00 per share at any time through March 30, 2005.

C. BOARD PRACTICES.

Each of our seven current directors was elected at our last annual meeting of shareholders held September 26, 2005 to serve a one-year term or until their successor is elected and qualified.

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

We have established an audit committee, which currently consists of Kelvin Wong, Wing Kwan Ted Lai and Po Yee Elsa Yue. Its functions are to:

recommend annually to the board of directors the appointment of our independent public accountants;

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- discuss and review the scope and the fees of the prospective annual audit and review the results with the independent public accountants;
- review and approve non-audit services of the independent public accountants;
- review compliance with our existing accounting and financial policies;
- review the adequacy of our financial organization; and
- review our management s procedures and policies relative to the adequacy of our internal accounting controls and compliance with U.S. federal and state laws relating to financial reporting.

We have established a nominating committee, which currently consists of Andrew N. Bernstein, Kelvin Wong and Po Yee Elsa Yue. Its purpose and functions are to:

- assess the size and composition of the board of directors in light of our operating requirements and existing social attitudes and trends;
- develop membership qualifications for the board of directors and all board committees;
- monitor compliance with board of director and board committee membership criteria;
- review and recommend directors for continued service as required based on our evolving needs;
- coordinate and assist management and the board of directors in recruiting new members to the board of directors; and
- investigate suggestions for candidates for membership on the board of directors and recommend prospective directors, as required, to provide an appropriate balance of knowledge, experience and capability on the board of directors, including stockholder nominations for the board of directors.

We have established a compensation committee, which currently consists of Andrew N. Bernstein, Kelvin Wong and Wing Kwan Ted Lai. Its purpose and functions are to:

- review and approve corporate goals and objectives relevant to the compensation of the chief executive officer and other executive officers;
- evaluate the chief executive officer s performance in light of such goals and objectives at least annually and communicate the results to the chief executive officer and the board of directors;
- set the chief executive officer s compensation levels based on the foregoing evaluation (including annual salary, bonus, stock options and other direct and indirect benefits), with ratification by the independent directors of the full board of directors; and
- set the other executive officers compensation levels (including annual salary, bonus, stock options and other direct and indirect benefits).

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D. EMPLOYEES.

As of December 31, 2005, we employed approximately 2,800 persons on a full-time basis for our production of jewelry and gemstone cutting and polishing. Approximately 100 of these people include our management and executive staff in Hong Kong and China. None of our employees is represented by a labor union and we believe that our employee relations are good.

E. SHARE OWNERSHIP.

The following table sets forth certain information regarding the beneficial ownership of our shares of common stock as of December 31, 2005 by:

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

As of December 31, 2005, we had 15,521,203 shares of our common stock issued and outstanding.

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

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

Name of Beneficial Holder	**Number Shares Beneficially**	**Percent Owned**
Yu Chuan Yih	3,856,353(1)(2)	22.5%
Ka Man Au	202,000(3)	1.3%
Hon Tak Ringo Ng	100,000(4)	*
Po Yee Elsa Yue	4,000(5)	*
Andrew N. Bernstein	100,000(6)	*
Kelvin Wong	0	*
Wing Kwan Ted Lai	0	*
All directors and executive officers as a group (7 persons)	4,262,353	24.4%

* Represents less than 1% beneficial ownership

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(1) Of Mr. Yih s 2,267,853 shares, 1,500,000 shares are owned of record by Pacific Growth Developments Ltd., a British Virgin Islands corporation, which is owned by Mr. Yih (60%), his wife Tammy Yih (20%) and an adult daughter, Bianca Tzu Hsiu Yih (20%).

(2) Includes options currently exercisable to acquire:

766,500 shares of common stock at $2.00 per share at any time until April 30, 2008;

22,000 shares of common stock at $2.25 per share at any time until April 30, 2008; and

800,000 shares of common stock at $2.00 per share at any time until June 30, 2013.

(3) Represents options currently exercisable to acquire:

27,000 shares of common stock at $2.00 per share at any time until April 30, 2008;

100,000 shares of common stock at $2.25 per share at any time until April 30, 2008; and

75,000 shares of common stock at $2.00 per share at any time until June 30, 2013.

(4) Represents options currently exercisable to acquire:

25,000 shares of common stock at $2.00 per share at any time until April 30, 2008; and

75,000 shares of common stock at $2.00 per share at any time until June 30, 2013.

(5) Represents options currently exercisable to acquire:

4,000 shares of common stock at $2.00 per share at any time until June 30, 2013.

(6) Includes options currently exercisable to acquire:

50,000 shares of common stock at $2.00 per share at any time until April 30, 2008.

The 1998 Stock Compensation Plan

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

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

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

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

Options constitute either incentive stock options within the meaning of Section 422 of the United States Internal Revenue Code of 1986, as amended, or options which constitute nonqualified options at the time of issuance of such options. The plan provides that incentive stock options and/or nonqualified stock options may be granted to our officers, directors, employees and advisors selected by the compensation committee. A total of 4,000,000 shares of common stock are authorized and reserved for issuance during the term of the plan, which expires in June 2008. The compensation committee has the sole authority to interpret the plan

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and make all determinations necessary or advisable for administering the plan. The exercise price for any incentive option must be at least equal to the fair market value of the shares as of the date of grant. Upon the exercise of the option, the exercise price must be paid in full either in cash, shares of our stock or a combination. If any option is not exercised for any reason, such shares shall again become available for the purposes of the plan.

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

As of December 31, 2005, 1,985,500 options had been exercised and the following options to purchase shares of our common stock under the plan remained outstanding:

- a total of 2,014,500 stock options, consisting of stock options to purchase 761,000 and 862,000 shares at $2.00 per share through April 30, 2008 and June 30, 2013, respectively, and 391,500 stock options to purchase 391,500 shares at $2.25 per share through April 30, 2008. A total of 1,668,500 stock options are held by our directors and officers as a group.

The 2003 Stock Compensation Plan

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

- encourage ownership of our common stock by our officers, directors, employees and advisors;
- provide additional incentive for them to promote our success and our business; and
- encourage them to remain in our employ by providing them with an opportunity to benefit from any appreciation of our common stock through the issuance of stock options.

Options constitute either incentive stock options within the meaning of Section 422 of the United States Internal Revenue Code of 1986, as amended, or options which constitute nonqualified options at the time of issuance of such options. The plan provides that incentive stock options and/or nonqualified stock options may be granted to our officers, directors, employees and advisors selected by the compensation committee. A total of 4,000,000 shares of common stock are authorized and reserved for issuance during the term of the plan, which expires in June 2013. The compensation committee has the sole authority to interpret the plan and make all determinations necessary or advisable for administering the plan. The exercise price for any incentive option or nonqualified option may be less than the fair market value of the shares as of the date of grant. Upon the exercise of the option, the exercise price must be paid in full either in cash, shares of our stock or a combination. If any option is not exercised for any reason, such shares shall again become available for the purposes of the plan.

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As of December 31, 2005, 2,704,000 options had been exercised and the following options to purchase shares of our common stock under the plan remained outstanding:

- a total of 1,296,000 stock options, consisting of stock options to purchase 1,174,000 shares at $2.00 per share through June 30, 2013 and 122,000 shares at $2.25 per share through April 30, 2008. A total of 434,000 stock options are held by our directors and officers as a group.

The 2005 Stock Compensation Plan

Effective July 1, 2005, we adopted and approved the 2005 Stock Compensation Plan, which our shareholders approved on September 26, 2005. The purpose of the plan is to:

- encourage ownership of our common stock by our officers, directors, employees and advisors;
- provide additional incentive for them to promote our success and our business; and
- encourage them to remain in our employ by providing them with an opportunity to benefit from any appreciation of our common stock through the issuance of stock options.

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Options constitute either incentive stock options within the meaning of Section 422 of the United States Internal Revenue Code of 1986, as amended, or options which constitute nonqualified options at the time of issuance of such options. The plan provides that incentive stock options and/or nonqualified stock options may be granted to our officers, directors, employees and advisors selected by the compensation committee. A total of 4,000,000 shares of common stock are authorized and reserved for issuance during the term of the plan, which expires in June 2015. The compensation committee has the sole authority to interpret the plan and make all determinations necessary or advisable for administering the plan. The exercise price for any incentive option or nonqualified option may be less than the fair market value of the shares as of the date of grant. Upon the exercise of the option, the exercise price must be paid in full either in cash, shares of our stock or a combination. If any option is not exercised for any reason, such shares shall again become available for the purposes of the plan.

As of December 31, 2005, no options had been granted under the plan.

Other Options and Warrants Outstanding

As of December 31, 2005, the following additional options and warrants to purchase shares of our common stock were outstanding:

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

- warrants to purchase 429,676 shares at $2.98 per share through September 3, 2009 which we sold to a group of investors pursuant to a private placement offering on September 1, 2004

- warrants to purchase an aggregate of 500,000 shares through April 4, 2008 which we granted to a consultant pursuant to a consulting agreement dated April 5, 2005 on the following terms:

50,000 warrants at $2.80 per warrant
150,000 warrants at $3.00 per warrant
150,000 warrants at $3.50 per warrant
100,000 warrants at $4.00 per warrant
50,000 warrants at $4.50 per warrant

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ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. MAJOR SHAREHOLDERS.

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

As of December 31, 2005, we had 265 record holders of our common stock. Of the 15,521,203 shares outstanding as of December 31, 2005, 12,968,107 shares were held by CEDE & Co.

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

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

B. RELATED PARTY TRANSACTIONS.

Certain of our banking facilities are collateralized by properties owned by Yih Yu Chuan and his personal guarantee to the extent of $21,244,000, $12,971,000 and $9,147,000 as of December 31, 2005, 2004 and 2003. Mr. Yih has not received any additional compensation or consideration from us in return for his personal guarantees.

During the fiscal year ended April 30, 1999, we provided a guarantee to a bank in respect of mortgage loans granted to Yu Chuan Yih to the extent of $632,000. As of December 31, 2005, the balance of the mortgage loans amounted to $237,000.

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C. INTERESTS OF EXPERTS AND COUNSEL.

Not applicable.

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ITEM 8. FINANCIAL INFORMATION

A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION.

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

Export sales constitute significantly all of our total sales volume.

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

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

B. SIGNIFICANT CHANGES.

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

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ITEM 9. THE OFFER AND LISTING

A. OFFER AND LISTING DETAILS.

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

Period	High	Low
Year ended April 30, 2001	$3.88	$1.63
Year ended April 30, 2002	$2.79	$1.18
Year ended December 31, 2002	$1.56	$1.11
Year ended December 31, 2003	$5.00	$1.14
Year ended December 31, 2004	$5.74	$2.21
Year ended December 31, 2005	$3.95	$2.03
Quarter ended March 31, 2004	$5.74	$3.75
Quarter ended June 30, 2004	$4.23	$3.14
Quarter ended September 30, 2004	$3.79	$2.25
Quarter ended December 31, 2004	$3.36	$2.21
Quarter ended March 31, 2005	$3.59	$2.68
Quarter ended June 30, 2005	$2.80	$2.07
Quarter ended September 30, 2005	$3.19	$2.03
Quarter ended December 31, 2005	$3.95	$3.00
Month ended September 30, 2005	$3.19	$2.79
Month ended October 31, 2005	$3.19	$3.00
Month ended November 30, 2005	$3.81	$3.08
Month ended December 31, 2005	$3.95	$3.26
Month ended January 31, 2006	$3.50	$3.34
Month ended February 28, 2006	$4.16	$3.50

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B. PLAN OF DISTRIBUTION.

Not applicable.

C. MARKETS.

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

D. SELLING SHAREHOLDERS.

Not applicable.

E. DILUTION.

Not applicable.

F. EXPENSES OF THE ISSUE.

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. SHARE CAPITAL.

Not applicable.

B. MEMORANDUM AND ARTICLES OF ASSOCIATION.

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

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

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

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

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

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

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

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

Applicable Law. Under the laws of most jurisdictions in the US, majority and controlling shareholders generally have certain fiduciary responsibilities to the minority shareholders. Shareholder action must be taken in good faith and actions by controlling shareholders which are obviously unreasonable may be declared null and void. BVI law protecting the interests of minority shareholders may not be as protective in all circumstances as the law protecting minority shareholders in US jurisdictions.

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

Our directors have the power to take certain actions without shareholder approval, including an amendment of our Memorandum of Association or Articles of Association or an increase or reduction in our authorized capital, which would require shareholder approval under the laws of most US jurisdictions. In addition, the directors of a BVI corporation, subject in certain cases to court approval but without shareholder approval, may, among other things, implement a reorganization, certain mergers or consolidations, the sale, transfer, exchange or disposition of any assets, property, part of the business, or securities of the corporation, or any combination, if they determine it is in the best interests of the corporation, its creditors, or its shareholders. Our ability to amend our Memorandum of Association and Articles of Association without shareholder approval could have the effect of delaying, deterring or preventing a change in our control without any further action by the shareholders, including a tender offer to purchase our common stock at a premium over then current market prices.

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

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

Under BVI law, liability of a corporate director to the corporation is primarily limited to cases of willful malfeasance in the performance of his duties or to cases where the director has not acted honestly and in good faith and with a view to the best interests of the corporation. However, under our Articles of Association, we are authorized to indemnify any director or officer who is made or threatened to be made a party to a legal or administrative proceeding by virtue of being one of our directors or officers, provided such person acted honestly and in good faith and with a view to our best interests and, in the case of a criminal proceeding, such person

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had no reasonable cause to believe that his conduct was unlawful. Our Articles of Association also enable us to indemnify any director or officer who was successful in such a proceeding against expense and judgments, fines and amounts paid in settlement and reasonably incurred in connection with the proceeding.

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

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

C. MATERIAL CONTRACTS.

None.

D. EXCHANGE CONTROLS.

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

E. TAXATION.

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

United States Federal Income Taxation

The following discussion addresses only the material U.S. federal income tax consequences to a U.S. person, defined as a U.S. citizen or resident, a U.S. corporation, or an estate or trust subject to U.S. federal income tax on all of its income regardless of source, making

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an investment in the common stock. For taxable years beginning after December 31, 1996, a trust will be a U.S. person only if:

- a court within the United States is able to exercise primary supervision over its administration; and
- one or more United States persons have the authority to control all of its substantial decisions.

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

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

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

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

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

- is a corporation or comes within other exempt categories; or
- provides a correct taxpayer identification number, certifies that such holder is not subject to backup withholding and otherwise complies with the backup withholding rules.

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

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

British Virgin Islands Taxation

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

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

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

F. DIVIDENDS AND PAYING AGENTS.

Not applicable.

G. STATEMENT BY EXPERTS.

Not applicable.

H. DOCUMENTS ON DISPLAY.

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

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I. SUBSIDIARY INFORMATION.

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

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

None.

ITEM 15. CONTROLS AND PROCEDURES

(a) Disclosure Controls and Procedures.

We carried out an evaluation, under the supervision and with the participation of our chairman, chief financial officer and chief operating officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of our fiscal year. Based on this evaluation, which will be used as input for further improvement actions, we concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission s rules and forms, and is accumulated and communicated to management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

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There were no changes in our internal control over financial reporting identified in connection with the evaluation that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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

Not applicable.

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our Board of Directors has determined that it considers Kelvin Wong as the audit committee financial expert serving on our audit committee. Mr. Wong is an independent non-executive director as defined in the Nasdaq Stock Market s listing standards.

ITEM 16B. CODE OF ETHICS

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

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

(a) Audit Fees.

The aggregate fees billed for each of the last two fiscal years for professional services rendered by our principal accountant for the audit of our annual financial statements or services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for those fiscal years were $140,000 for the fiscal year ended December 31, 2004 and $158,000 for the fiscal year ended December 31, 2005.

(b) Audit Related Fees.

No fees were billed in each of the last two fiscal years for assurance and related services by our principal accountant that are reasonably related to the performance of the audit or review of our financial statements and are not reported under paragraph (a) of this Item for the fiscal year ended December 31, 2004 and for the fiscal year ended December 31, 2005.

(c) Tax Fees.

The aggregate fees billed in each of the last two fiscal years for professional services rendered by our principal accountant for tax compliance, tax advice, and tax planning were $8,000 for the fiscal year ended December 31, 2004 and $10,000 for the fiscal year ended December 31, 2005. The nature of the services comprising these fees included data gathering for preparation, review and submission as agent of tax filing.

(d) All Other Fees.

No fees were billed in each of the last two fiscal years for products and services provided by our principal accountant, other than the services reported in paragraphs (a) through (c) of this Item for the fiscal year ended December 31, 2004 and for the fiscal year ended December 31, 2005.

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

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

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

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

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

(f). Not applicable.

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

Not applicable.

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

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

We did not repurchase any of our shares of common stock during the fiscal year ended December 31, 2005.

PART III

ITEM 17. FINANCIAL STATEMENTS

Not applicable.

ITEM 18. FINANCIAL STATEMENTS

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

Report of Independent Registered Public Accounting Firm

Consolidated statements of operations for the years ended December 31, 2003, 2004 and 2005.

Consolidated balance sheets as of December 31, 2004 and 2005.

Consolidated statements of shareholders equity and comprehensive income for the years ended December 31, 2003, 2004 and 2005.

Consolidated statements of cash flows for the years ended December 31, 2003, 2004 and 2005.

Notes to and forming part of the financial statements

LJ INTERNATIONAL INC.
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of LJ International Inc. and its subsidiaries as of December 31, 2005 and 2004 and the related consolidated statements of operations, shareholders equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2005. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of LJ International Inc. and its subsidiaries as of December 31, 2005 and 2004 and the consolidated results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

Moores Rowland Mazars
Chartered Accountants
Certified Public Accountants, Hong Kong
Dated: March 27, 2006

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

	Notes	**Year ended December 31, 2005 US$**	Year ended December 31, 2004 US$ (Restated)	Year ended December 31, 2003 US$ (Restated)
Operating revenue	*2(c)*	**94,612**	77,379	58,167
Costs of goods sold (Exclusive of depreciation)		**(72,642)**	(61,265)	(44,947)
Gross profit		**21,970**	16,114	13,220
Other operating income		**549**	125	163
Operating expenses				
Selling, general and administrative expenses		**(15,488)**	(11,578)	(9,133)
Net gain (loss) on derivatives		**8**	199	87
Depreciation		**(1,368)**	(1,032)	(1,184)
Impairment on property, plant and equipment				(84)
Impairment loss on goodwill	*8*			(200)
Operating income		**5,671**	3,828	2,869
Other income and expense				
Interest income	*2(c)*	**139**	38	41
Interest expenses		**(1,991)**	(902)	(753)
Income before income taxes, minority interests, equity in results of investment securities and extraordinary item		**3,819**	2,964	2,157
Income taxes expense	*11*	**(739)**	(277)	(352)
Income before minority interests, equity in results of investment securities and extraordinary item		**3,080**	2,687	1,805
Minority interests in consolidated subsidiaries		**(20)**		8
Income before equity in results of investment securities and extraordinary item		**3,060**	2,687	1,813
Equity in results of investment securities			133	(851)

Income before extraordinary item		**3,060**	2,820	962
Extraordinary gain on negative goodwill	*3*	**378**		
Net income		**3,438**	2,820	962
Numerator:				
Net income used in computing basic earnings per share		**3,438**	2,820	962
Denominator:				
Weighted average number of shares used in calculating basic earnings per share		**13,438,578**	11,118,995	8,757,266
Effect of dilutive potential ordinary shares:				
Warrants		**28,738**	55,693	183,151
Stock options		**854,568**	932,786	765,267
Weighted average number of shares used in calculating diluted earnings per share		**14,321,884**	12,107,474	9,705,684

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

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LJ INTERNATIONAL INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Notes	**Year ended December 31, 2005 US$**	Year ended December 31, 2004 US$	Year ended December 31, 2003 US$
Basic earnings per share:	*2(g)*			
Income before extraordinary item		**0.23**	0.25	0.11
Extraordinary item		**0.03**		
Net income		**0.26**	0.25	0.11
Diluted earnings per share:	*2(g)*			
Income before extraordinary item		**0.21**	0.23	0.10
Extraordinary item		**0.03**		
Net income		**0.24**	0.23	0.10

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

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LJ INTERNATIONAL INC.
CONSOLIDATED BALANCE SHEETS
(Amounts in thousands, except share and per share data)

		As of December 31,	
	Notes	**2005**	2004
		US$	US$
			(Restated)
ASSETS			
Current asset			
Cash and cash equivalents		**4,796**	3,228
Restricted cash		**5,839**	6,393
Trade receivables, net of allowance for doubtful accounts (December 31, 2005: US$212; December 31, 2004: US$284)		**24,960**	15,653
Derivatives		**2,034**	
Investment in capital guaranteed fund		**2,496**	
Inventories	*5*	**55,941**	36,629
Prepayments and other current assets		**2,538**	2,539
Total current assets		**98,604**	64,442
Properties held for lease, net	*6*	**1,400**	1,452
Property, plant and equipment, net	*7*	**6,221**	4,673
Due from related parties	*16(b)*	**484**	491
Goodwill, net	*8*	**1,521**	1,521
Investment securities, net	*9*		1,792
Total assets		**108,230**	74,371
LIABILITIES AND SHAREHOLDERS EQUITY			
Current liabilities			
Bank overdrafts	*10*	**2,028**	607
Notes payable	*10*	**3,079**	2,487
Capitalized lease obligation, current portion		**20**	19
Letters of credit, gold and others	*10*	**32,643**	21,911
Derivatives		**3,567**	1,462
Trade payables		**12,168**	9,553
Accrued expenses and other payables		**7,280**	4,631
Due to related parties	*16(b)*	**1,910**	
Income taxes payable		**201**	68
Deferred taxation	*11*	**154**	87
Total current liabilities		**63,050**	40,825
Capitalized lease obligation, non-current		**43**	58

Total liabilities		**63,093**	40,883
Minority interest		**129**	
Commitments and contingencies	*12*		
Shareholders equity			
Common stocks, par value US$0.01 each, Authorized - 100 million shares, Issued 15,521,203 shares as of December 31, 2005 and 12,304,658 shares as of December 31, 2004	*13*	**155**	123
Additional paid-in capital		**31,419**	23,382
Accumulated other comprehensive loss		**(156)**	(151)
Unearned compensation	*2(q)*	**(19)**	(37)
Retained earnings		**13,609**	10,171
Total shareholders equity		**45,008**	33,488
Total liabilities and shareholders equity		**108,230**	74,371

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

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

	Notes	Common stock Number of shares	Common stock Par Value US$	Additional Paid-in Capital US$	Treasury stock Number of shares	Treasury stock Cost US$	Accumulated other comprehensive loss US$ (Note 2(y))	Unearned compensation US$	Retained earnings US$ (Restated)	Total US$ (Restated)
Balance as of January 1, 2003		8,671,615	87	17,410	(318,200)	(391)	(151)		6,389	23,344
Comprehensive income:										
Net income									962	962
Issuance of common stock upon exercise of stock options	13(a)(i)	1,122,500	11	2,234						2,245
Issuance of common stock upon exercise of warrants	13(a)(i)	95,891	1	(1)						
Compensation costs for stock-based transactions	15(b)			9						9
Sales of treasury stock	13(b)			150	318,200	391				541
Balance as of December 31, 2003		9,890,006	99	19,802			(151)		7,351	27,101
Comprehensive income:										
Net income									2,820	2,820
Issuance of common stock on private placement	13(a)(ii)	1,614,082	16	2,730						2,746
Issuance of common stock upon exercise of stock options	13(a)(iii)	405,000	4	806						810
Issuance of common stock	13(a)(iii)	395,570	4	(4)						

upon exercise of warrants				
Stock options granted	2(q)	48	(48)	
Compensation expense recognized during the year	2(q)		11	11

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