LJ INTERNATIONAL INC
Form 20-F
December 28, 2007

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

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

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2006
OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________
Commission file number 0-29620
OR

[ ] SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
Date of event requiring this shell company report __________
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
$.01 Par Value Common Stock (Common Stock)	NASDAQ

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

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

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

18,977,371 Shares of Common Stock as of December 31, 2006

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

Yes ___ No X

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

Yes ___ No X

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 X No ___

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

Large accelerated filer ___ Accelerated filer ___ Non-accelerated filer X

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

Item 17 ___ Item 18 X

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

Yes ___ No X

(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, such as but not limited to:

dependence upon certain customers

dependence on key personnel

control by principal shareholder

competitive factors

the operation of our business

general economic conditions

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

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

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

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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
(US Dollars in thousands, except per share amounts)

The following selected consolidated financial data with respect to eight months ended December 31, 2002 and the four-year period ended December 31, 2006 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, 2006	2005	2004	2003	Eight-month period ended December 31, 2002	2001 (Unaudited)	Year ended April 30, 2002
Statement of Operations Data:							
Revenues	123,791	99,646	77,504	58,330	31,966	25,135	39,375
Cost of Goods sold	(88,867)	(77,127)	(61,265)	(44,947)	(20,565)	(16,228)	(35,731)
Gross profit	34,924	22,519	16,239	13,383	11,401	8,907	3,644
Operating expenses							
Selling, general and administrative	(23,114)	(15,488)	(11,578)	(9,133)	(8,688)	(8,279)	(8,963)
Net gain (loss) on derivatives	(29)	8	199	87	(435)	(119)	(660)
Depreciation	(2,039)	(1,368)	(1,032)	(1,184)	(863)	(565)	(1,031)
Impairment on property, plant and equipment	-	-	-	(84)	(108)	-	(345)
Amortization and impairment loss on goodwill	-	-	(698)	(200)	(600)	(18)	(242)
Operating income (loss)	9,742	5,671	3,130	2,869	707	(74)	(7,597)
Other income and expenses							
Interest income	282	139	38	41	48	172	217
Interest expenses	(3,258)	(1,991)	(902)	(753)	(441)	(424)	(652)
Operating income (loss) before income taxes, minority interests, equity in results of investment securities and extraordinary item	6,766	3,819	2,266	2,157	314	(326)	(8,032)
Income taxes (expense) credit	(1,403)	(739)	(277)	(352)	(101)	(39)	101
Income (Loss) before minority interests, equity in results of investment securities and extraordinary item	5,363	3,080	1,989	1,805	213	(365)	(7,931)

Minority interests in consolidated subsidiaries	(38)	(20)	-	8	120	-	30
Income before equity in results of investment securities and extraordinary item	5,325	3,060	1,989	1,813	333	(365)	(7,901)
Equity in results of investment securities	-	-	133	(851)	16	26	34
Income before extraordinary item	5,325	3,060	2,122	962	349	(339)	(7,867)
Extraordinary gain on negative goodwill	-	1,291	-	-	-	-	
Net income (loss)	5,325	4,351	2,122	962	349	(339)	(7,867)
Net income (loss) per share:							
Basic	0.31	0.32	0.19	0.11	0.04	(0.04)	(0.91)
Diluted	0.29	0.30	0.18	0.10	0.04	(0.04)	(0.90)
Weighted average number of shares							
Basic	17,390	13,439	11,119	8,757	8,493	8,672	8,672
Diluted	18,303	14,322	12,107	9,706	8,493	8,832	8,779
Balance Sheet Data:							
Working capital	50,134	35,554	23,617	17,053	11,896	18,537	12,115
Total assets	124,522	108,230	73,673	59,885	48,938	51,088	43,557
Long-term obligation	1,640	43	58	77	-	12	8
Total stockholders equity	59,739	45,008	32,790	27,101	23,344	30,969	23,591

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Pursuant to the purchase agreement dated January 1, 2005, the Company paid $2,827,500 for new issuance of 3,900 shares of 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.

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D. RISK FACTORS.

We depend upon one customer who accounts 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, one of our customers accounts for at least 10% of our sales. For the fiscal years ended December 31, 2005 and 2006, this customer accounted for approximately 11% of our 2005 sales and 10% of our 2006 sales. This customer is a non-affiliated third party and is not a related party of the Company or any of its subsidiaries. Although we have maintained good and longstanding relationship with this customer, we do not have any long-term contract with it and it orders only on a purchase order basis. The loss of this customer or a significant reduction in its orders would have a materially adverse effect on our revenues.

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

The making and distribution of jewelry is a highly competitive industry characterized by the diversity and sophistication of the product. We compete with major domestic and international companies with substantially greater financial, technical and marketing resources and personnel than us. There can be no assurance 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.

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

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

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

The National People s Congress, the Chinese legislature, on March 16, 2007 passed a new enterprise income tax law, which will become effective on January 1, 2008. The new law applies a uniform 25% enterprise income tax rate (EIT) to both foreign invested enterprises and domestic enterprises, except that enterprises that were approved to be established prior to March 16, 2007 may continue to enjoy the existing preferential tax treatments until December 31, 2012. An enterprise registered under the laws of a jurisdiction outside China may be deemed a Chinese tax resident if its place of effective management is in China and it will consequently be subject to the EIT upon its worldwide income. Existing companies are required to transition to the new EIT rate over a five-year period starting January 1, 2008. The new Enterprise Income Tax Law empowers the PRC State Council to promulgate detailed implementation rules. Since the implementation rules are not yet promulgated, there is uncertainty as to how the new law will be interpreted or implemented. Although we are carefully monitoring these legal developments and will timely adjust our effective income tax rate when necessary, we cannot assure that the new Enterprise Income Tax Law will not cause increases in the EIT rates applicable to our PRC subsidiaries, which could have a material adverse effect on our financial condition and results of operations.

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 $42 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.

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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 28% of our wholesale sales during the fiscal year ended December 31, 2006 to our TV shopping channel customers was not seasonal in nature. It has been our management s experience that the remaining 72% of our total wholesale sales is seasonally sensitive and is greater during the quarter ending December 31 of each year.

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

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

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

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

Certain of our banking facilities that offer short-term borrowings are collateralized by properties owned by Yu Chuan Yih and by his personal guarantee. If Mr. Yih withdraws the properties or his personal guarantee, the banking facilities may no longer remain available for use by us. In that event, our daily operations may be adversely affected.

We rely geographically on the US market for the majority of our revenue.

Our wholesale business is our major revenue contributor and accounts for 88% of our total revenue. Geographically, North America is a major market for our wholesale business and contributes 71% of our revenues. Accordingly, the revenue of our wholesale business in the US market accounts for 62% of our total revenue. Any substantial decline of the economy may adversely affect the spending patterns of the US consumers which could in turn adversely affect our revenue and the income from the region.

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

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

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

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

- our independent directors do not hold regularly scheduled meetings in executive session;
- the compensation of our executive officers is not determined by an independent committee of the board or by the independent members of the board of directors, and our CEO may be present and participate in the deliberations concerning his compensation;
- related party transactions are not required to be reviewed or approved by our audit committee or other independent body of the board of directors; and
- we are not required to solicit shareholder approval of stock plans, including those in which our officers or directors may participate; stock issuances that will result in a change in control; the issuance of our stock in related party transactions or other transactions in which we may issue 20% or more of our outstanding shares; or, below market issuances of 20% or more of our outstanding shares to any person.

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

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

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

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

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

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

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

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

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

the sections of the Exchange Act regulating the solicitation of proxies, consents or authorizations applicable to a security registered under the Exchange Act; 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 domestic public companies organized in the United States.

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

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

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

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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.

Legal proceedings related to our historical reporting of financial results and other issues may significantly harm our business.

Several lawsuits have been filed against us and current officers and members of the Board of Directors, alleging false representations and material omissions in connection with press releases, SEC filings and other statements that purportedly overstated the Company s business prospects and financial results. These lawsuits are described more fully in Part I, Item 8 and in Part III, Item 18, Note 12 to our consolidated financial statements contained in this Form 20-F. Defending these lawsuits will result in significant expenditures and the diversion of our management s time and attention from the operation of our business, which could have a negative effect on our business operations. From time to time, we may become involved in other litigation or other proceedings. Matters arising out of or related to the delayed filing of our audited financial statements, the outcome of our delisting proceedings and the outcome of litigation could possibly harm our future results of operations or financial condition due to expenses we may incur to defend ourselves or the ramifications of an adverse decision.

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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, 2006, we owned all of the issued share capital in the following significant subsidiaries except Goldleaves Gems (Shenzhen) Co., Ltd.:

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. (LSC)

Lorenzo Crystal Ltd.

Enzo (Shenzhen) Co., Ltd. (ESC)

Enzo Ltd.

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

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

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

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

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

- we spent $1,105,000 on capital expenditures, excluding inventory, for ENZO retail store openings during the fiscal year ended December 31, 2006

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B. BUSINESS OVERVIEW.

We are a vertically integrated company that designs, brands, markets, distributes and retails a complete range of fine jewelry. While we specialize in the colored jewelry segment, we also offer high-end pieces set in yellow gold, white gold, platinum or sterling silver and adorned with colored stones, diamonds, pearls and precious stones. We distribute to fine jewelers, department stores, national jewelry chains and electronic and specialty retailers throughout North America and Western Europe; and we conduct our jewelry retail business through the ENZO brand in the Asia Pacific region, with the primary focus in the PRC market, which we regard as having one of the largest and fastest growing consumer demands for luxury items. 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, 2005 and 2006, approximately 72% and 62% of our sales were in North America.

In addition to our wholesale 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 retail store in Hong Kong and opened our flagship store in Shanghai in November 2004. As of December 10, 2007, we currently operate 88 ENZO retail stores across Hong Kong, China and Macau, and we expect to open and operate a total of at least 100 stores by the beginning of 2008.

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

	Year ended December 31,		
(in thousands)	2006	2005	2004
	US$	US$	US$
US & Canada	76,889	67,780	56,186
Europe and other countries	24,452	20,527	13,062
Japan	2,454	3,686	4,158
PRC (including Hong Kong and Macau)	19,996	7,653	4,098
	123,791	99,646	77,504

Our Industry

The US 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 US 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.

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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.

Management believes that 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 colored and precious jewelry by capitalizing on our vertically integrated production processes to produce diamond and high-end precious stone jewelry in addition to high volume, high-quality colored products;

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

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

We are aggressively developing new product lines in exotic stones, which have high perceived values among colored 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; and

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

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:

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

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- large and growing jewelry market - we estimate that China s jewelry sales totaled nearly $17 billion in 2006, up 15% year over year.

- large pool of consumers - China has a population of 1.3 billion people. 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, China is eliminating many restrictions on foreign ownership and operation of retail stores. Tariffs on colored gemstones, gold, silver and pearls have been sharply reduced, and economic and trade relationships between China and Hong Kong have been liberalized.

- 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 at least 100 ENZO stores in China by the beginning of 2008

- 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 US.

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 eight years and has more than 14,000 square meters of production space. We currently employ approximately 3,000 skilled gemstone cutters and production personnel and turned out approximately two million pieces of finished fine jewelry during the fiscal year ended December 31, 2006.

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 and Africa. Gemstone craftsmen are trained to ensure that the highest levels of cutting and polishing quality are achieved. The professional skills possessed by our cutters are applied to a wide variety of shapes and sizes, maximizing the yield and value of the gemstone material that we purchase. By performing internally the value-added processes of cutting and polishing our colored gemstones, we maximize quality control and improve our

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profitability. We specialize in a wide range of popular and exotic colored gemstones ranging from amethyst, aquamarine and peridot to tanzanite and tourmaline.

Sales and Marketing

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

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

Our sales promotion efforts include attendance by our representatives at US 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 in our Hong Kong, US 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 colored, fabric

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and fashion trends, which are projected over a two-year period. We market our products as lifestyle inspired.

Production Process

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

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

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

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

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

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Security

We have installed certain measures at our Shenzhen, China, production and our Hong Kong facilities to protect against loss, including multiple alarm systems, infrared motion detectors and a system of closed circuit television cameras, which provide surveillance of all critical areas of our premises.

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

Insurance

We maintain primary all-risk insurance, with limits which may be less than 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, diamonds 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 competitor is E.E.A.C. Inc. 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.

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

C. ORGANIZATIONAL STRUCTURE AS OF DECEMBER 31, 2006:

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.** (PRC)
- **Shenzhen PGS Jewelry Mfg.** (PRC)
- **Lorenzo (Shenzhen) Co., Ltd.** (PRC)
- **Lorenzo Crystal Ltd.** (Hong Kong)
- **Enzo (Shenzhen) Co., Ltd.** (PRC)
- **Enzo Ltd.** (Macau)

98%

- **Goldleaves Gems (Shenzhen) Co., Ltd.** (PRC)

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D. PROPERTY, PLANTS AND EQUIPMENT.

Our principal executive office is located at Unit #12, 12/F, Block A, Focal Industrial Centre, 21 Man Lok Street, Hung Hom, Kowloon, Hong Kong. We own approximately 11,100 square feet of office and showroom at this location.

Our jewelry production facility in Shenzhen, China consists of 14,080 square meters of building space located inside of and close to 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 June 30, 2011 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 August 31, 2008, at a rental rate of $4,490 per month;

- 1,799 square meters for a term of three years expiring March 31, 2009, at a rental rate of $4,381 per month; and

- 1,886 square meters for a term of three years expiring September 30, 2009 at a rental rate of $4,593 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.

LJ International Inc, via its operating subsidiaries, designs, manufactures, distributes and markets a full range of fine jewelry through both wholesale and retail channels under the tradenames of LORENZO and ENZO, respectively. In term of sales revenue, geographically the US and the PRC are the two major contributors.

The product types include rings, bracelets, necklaces, earrings and pendants, and we are one of the strongest companies in colored gemstones that employs the mine-to-market strategy. Substantially all of our colored gemstones are imported from Brazil and Africa which supplies the best colored 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 wholesale customers comprise fine jewelers, national jewelry chain stores, department stores and television shopping networks in North America, Western Europe, Japan and China.

Our retail customers in China are individual consumers. Under the segment of retail business, besides classic affordable luxury jewelry items that are available in our ENZO retail shops, the Company also operates the ENZO Signature line that represents a luxury premium line of jewelries that comprises, amongst others, diamonds, rubies, sapphire and tourmaline.

The sales of ENZO Signature are made by invitation to customers, at sales events such as the Millionaire Fair; and via jewelry exhibitions such as The JCK Show, Hong Kong International Jewellery Show, Basel Show and VicenzaOro. Customers of our ENZO Signature line are primarily international tycoons, high net worth individuals, royalty and celebrities.

Our business strategies include broadening the retail product line, and diversifying our customer base. Besides focusing on our traditional color gemstone jewelry business, we are also contnuing to develop our diamond jewelry business at our ENZO stores. Product initiatives include a variety of different sizes, shape and cutting methods. Successful examples include our ENZO88 and Gabrielle Diamond lines. The expansion of our diamond jewelry business will diversify our already strong presence in colored jewelry, offering increasing choices of jewelry products to our customers.

We are based in Hong Kong. The revenue mix of the two streams of business of LORENZO (wholesale) and ENZO (retail) were roughly in the ratio of 88% to 12% for the year ended December 31, 2006.

The wholesale business focuses on the US market with sales made to those $100 Million Supersellers such as Sterling Jewelers Inc., Fred Meyer Jewelers, Helzberg Diamonds,

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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 $76.9 million for 2006 compared to $67.8 million in 2005, an increase of 13%.

Employing the brand new ENZO name, the retail business operates in the Asia Pacific region, with a primary focus on the PRC market. On August 28, 2007, we opened a 1,000-square-foot ENZO store at The Venetian® Macau, a 3,000-room resort hotel being built by Las Vegas Sands Corp. ENZO currently has 83 stores in the PRC, two stores in Macau and three stores in Hong Kong, totaling 88 stores. ENZO is steadily and progressively achieving the target number of at least 100 retail stores by the beginning of 2008. 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, Tianjin, Dalian, Shenzhen, Changchun, Tangshan, Guiyang, Xian and Jinan. The best selling jewelry are in the price range of $300 to $500, and the population groups with monthly income of $800 to $1,200 are most eager to buy fine jewelry. 18K gold is the most popular, followed by 24K jewelry. The most popular diamonds are of 0.21 carats to 0.49 carats in size.

The launch of the ENZO Signature reiterates ENZO renowned brand recognition as well as the development of a portfolio of new customers with the greatest spending power. Since the inception of the business in the fourth quarter of 2006, ENZO Signature generated sales of over $4 million and $13 million in 2006 and 2007, respectively. As a result of our initial success with our high-end jewelry and the subsequent continued success we are experiencing in 2007, we have branded this new high-end line as ENZO Signature to signify its importance to the Company and the devotion of resources, time and concentration to it.

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

Critical Accounting Policies and Estimates

The preparation of our consolidated financial statements requires us to make estimate and judgments that affect the reported amounts of our assets, liabilities, revenue and expenses. These estimates are based on our historical experience and on various other assumptions that we believe to be reasonable. Estimates are evaluated on an ongoing basis, but actual results may differ from these estimates.

Critical accounting policies are those that, in management s view, are most important in the portrayal of our financial condition and results of operations. Those that require significant judgments and estimates include:

Collectibility of Accounts Receivable. Our management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. Credit evaluations are performed on all customers requiring credit over a certain amount. Our international sales are settled via letter of credit or open account. For export sales on open account, we purchased trade credit insurance to cover the risk of collectability, the insured percentage is 85% on the invoiced amount to

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customers. Past due balances over 90 days and over a specified amount are reviewed individually for collectability.

We make specific allowance for doubtful accounts based on our best estimate of the amount of losses that could result from the inability or intention of our existing customers not to make the required payments. We generally review the allowance by taking into account factors such as historical experience, age of the accounts receivable balances and economic conditions that may affect a customer s ability to pay.

Stock-based Compensation. Prior to 2006, we applied the intrinsic value method as allowed in APB Opinion No. 25, Accounting for Stock in accounting for stock options. Under the intrinsic value method, compensation cost for stock options is measured as the excess, if any, of the quoted market price of our common stock at the date of the grant over the amount an employee must pay to acquire the stock. Compensation cost is recognized on a straight line basis over the requisite service period, which is generally the same as the vesting period.

Effective January 1, 2006, we adopted SFAS No. 123R, Share-Based Payment (SFAS No. 123R). SFAS No. 123R replaces SFAS No. 123. SFAS No. 123R requires that all stock-based compensation be recognized as an expense in the consolidated financial statements and that such cost be measured at the fair value of the award and requires compensation cost to reflect estimated forfeitures. SFAS No. 123R was adopted using the modified prospective method of application. Under this method, we recorded stock-based compensation expense for awards granted prior to, but not yet vested as of January 1, 2006 and for stock-based awards granted after January 1, 2006. Compensation cost is recognized on a straight line basis over the requisite service period, which is generally the same as the vesting period.

We currently use authorized and unissued shares to satisfy share award exercises.

The adoption of SFAS No. 123R effective January 1, 2006 did not result in any recognition of any incremental stock-based compensation expense since there were no stock options granted for the year ended December 31, 2006.

Goodwill Impairment. Goodwill is tested for impairment at least annually based on a two-step approach. The first step is conducted by comparing the fair value of each reporting unit to its carrying amount. If the fair value of a reporting unit is less than its carrying amount, the second step requires a comparison of the implied fair value of goodwill to its carrying value. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. This allocation process is only performed for purposes of evaluating goodwill impairment and does not result in an entry to adjust the value of any assets or liabilities. An impairment loss is recognized for any excess in the carrying value of goodwill over its implied fair value.

We have determined that iBBC Inc. is the reporting unit for goodwill impairment testing. The fair value of iBBC Inc. is determined based on the discounted expected cash flow method. The discount rate was based on the subsidiary s weighted average cost of capital. The use of discounted cash flow methodology requires significant judgments including estimation of future revenues and costs, industry economic factors, future profitability, determination of iBBC Inc s weighted average cost of capital and other variables. Although we believe that the assumptions adopted in our discounted cash flow model are reasonable, those assumptions are inherently unpredictable and uncertain.

We had goodwill of US$1,521,000 as of December 31, 2005 and 2006. The estimated fair value of the reporting unit exceeded its carrying value at December 31, 2006. Consequently, no goodwill impairment has been recognized.

Allowance for Obsolete Inventories. We established inventory allowance for unmarketable inventory in an amount equal to the difference between the cost of inventory and its estimated net realizable value based upon assumptions about future demand and market conditions. Management records a write-down against inventory based on several factors, including expected sales price of the item and the length of time the item has been in inventory. If actual demand and market conditions are less favorable than those projected by management, additional inventory allowance could be required. In that event, our gross margin would be reduced.

A. OPERATING RESULTS.

Reclassifications

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

Revenues

				% Change	
	Year ended December 31,			Years ended December 31,	Years ended December 31,
(in thousands)	2006	2005	2004	2006-2005	2005-2004
Revenues					
Wholesale					
Jewelry product	$ 108,679	$ 95,318	$ 72,337	14%	32%
Giftware product	$ -	$ 1,827	$ 4,359	-100%	-58%
	$ 108,679	$ 97,145	$ 76,696	12%	27%
Retail	$ 15,112	$ 2,501	$ 808	504%	210%
	$ 123,791	$ 99,646	$ 77,504	24%	29%

The increase in revenue of jewelry product of wholesale of $13,361,000 or 14% to $108,679,000 for the year ended December 31, 2006, compared to the year ended December 31, 2005, was primarily attributable to the increase in average selling price of 1% , increase in order quantity of 7% and increase of $3.2 million from newly launched gold jewelry product line.

The increase in revenue of jewelry product of wholesale of $22,981,000 or 32% to $95,318,000 for the year ended December 31, 2005, compared to the year ended December 31, 2004, was attributable to an increase in average selling price of 2% and increase in order quantity of 34%.

The decrease in revenue of giftware product of wholesale of $2,532,000 for the year ended December 31, 2005, compared to the year ended December 31, 2004, was due to the closure of this product line with low profit margin during the third quarter of 2005.

The Company s retail business increased by $12,611,000, or 504%, from 2005 to $15,112,000 for the year ended December 31, 2006. This increase was primarily due to the successful launch of the new ENZO Signature line of high-end jewelry which accounted for $4,130,000 of the Company s retail business in 2006. The remaining increase was due to the Company s new ENZO retail store openings and the continued operation of its existing 26 ENZO retail stores, that is, a total of 44 ENZO retail stores in full operation compared to a total of 18 ENZO retail stores on December 31, 2005.

The revenue of retail business increased by $1,693,000 or 210% for the year ended December 31, 2005 from the revenue of $808,000 for the year ended December 31, 2004. The retail business was newly launched in 2004 which involved direct sales to consumers in Hong Kong and China through company-owned retail stores under the brand name ENZO. Due to the expansion, the number of retail stores was increased to 18 ENZO retail stores in Hong Kong and China at December 31, 2005, compared to three stores at December 31, 2004.

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Cost of Sales and Gross Profit

				% Change	
	Year ended December 31,			Years ended December 31,	Years ended December 31,
(in thousands)	2006	2005	2004	2006-2005	2005-2004
Cost of sales and gross profit					
Cost of sales					
Wholesale	$ 83,387	$ 75,645	$ 60,564	10%	25%
% of revenues	77%	78%	79%		
Retail	$ 5,480	$ 1,482	$ 701	270%	111%
% of revenues	36%	59%	87%		
Total	$ 88,867	$ 77,127	$ 61,265	15%	26%
% of revenues	72%	77%	79%		
Gross profit					
Wholesale	$ 25,292	$ 21,500	$ 16,132	18%	33%
% of revenues	23%	22%	21%		
Retail	$ 9,632	$ 1,019	$ 107	845%	852%
% of revenues	64%	41%	13%		
Total	$ 34,924	$ 22,519	$ 16,239	55%	39%
% of revenues	28%	23%	21%		

The gross profit margin of wholesale increased to 23% for the year ended December 31, 2006 from 22% for the year ended December 31, 2005 and was attributable to the sales of a higher-end product mix.

The gross profit margin of wholesale increased to 22% for the year ended December 31, 2005 from 21% for the year ended December 2004 and was attributable to the sales of a higher-end product mix.

The gross profit margin of our ENZO retail operation increased to 64% for the year ended December 31, 2006 compared to 41% for the year ended December 31, 2005 and was attributable to the launch of our new ENZO Signature line of jewelry products which substantially increased the retail division s gross profit margins.

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The gross profit margin of retail increased to 41% for the year ended December 31, 2005 from 13% for the year ended December 31, 2004 and was due to the low profit margin at the beginning of the new business at 2004.

Selling, General and Administrative Expenses

				% Change	
	Year ended December 31,			Years ended December 31,	Years ended December 31,
(in thousands)	2006	2005	2004	2006-2005	2005-2004
Selling, general and administrative expenses					
Wholesale	$ 13,324	$ 11,545	$ 8,981	15%	29%
Retail	$ 7,562	$ 2,653	$ 634	185%	318%
Corporate	$ 2,228	$ 1,290	$ 1,963	73%	-34%
	$ 23,114	$ 15,488	$ 11,578	49%	34%
% of revenues	19%	16%	15%		

Selling, general and administrative expenses increased by 49% for the year ended December 31, 2006, compared to the year ended December 31, 2005. For the wholesale business, the selling, general and administrative expenses increased by 15% for the year ended December 31, 2006, compared to the same of year 2005. The increase mainly comprised 2% increase in selling and distribution expenses which varied to sales revenues, 2% increase in manpower on development of new products, designs and markets and 5% increase in staff cost. The expenses incurred by the retail business of $7,562,000, or 185% increase of the same for the year ended December 31, 2005, comprised advertising cost of $1,142,000, rental cost of $2,454,000, staff cost of $2,198,000 and other expenses of $1,768,000 as a result of higher sales and increased store counts. The corporate expenses included items of corporate overheads, such as charges for legal and professional advisory services.

Selling, general and administrative expenses increased by 34% for the year ended December 31, 2005, compared to the year ended December 31, 2004. For the wholesale business, the selling, general and administrative expenses increased by 29% for the year ended December 31, 2005, compared to the same of year 2004. It mainly comprised 1% increase in selling and distribution expenses which varied to sales revenues, 5% increase in manpower on development of new products, designs and markets, 13% increase in staff cost and 5% increase or $479,000 contributed to expenses incurred by the acquired subsidiaries engaged in manufacturing activities for wholesale business. The expenses incurred by the retail business of $2,653,000 comprising advertising cost of $816,000, rental cost of $275,000, staff cost of

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$727,000 and other expenses of $835,000, or 318% increase of the same for retail for the year ended December 31, 2004. The corporate expenses included items of corporate overheads, such as charges for legal and professional advisory services.

Net gain (loss) on derivatives

				% Change	
	Year ended December 31,			Years ended December 31,	Years ended December 31,
(in thousands)	2006	2005	2004	2006-2005	2005-2004
Unrealised (loss) gain on derivatives	$ 190	$ (88)	$ (482)	-316%	-82%
% of revenues	0%	0%	-1%		
(With the hedging mechanism in place, we have the realised gain on hedging activities)					
Realized (loss) gain on hedging activities	$ (219)	$ 96	$ 681	-328%	-86%
% of revenues	0%	0%	1%		
Net (loss) gain on derivatives and hedging activities	$ (29)	$ 8	$ 199	-463%	-96%
% of revenues	0%	0%	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 gain of $190,000 for the year ended December 31, 2006, and an unrealized loss of $88,000 and $482,000 for each of the years ended December 31, 2005 and 2004 respectively; and a realized loss of $219,000 for the year ended December 31, 2006, and a realized gain of $96,000 and $681,000 on derivatives for each of the years ended December 31, 2005 and 2004 respectively.

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The hedging mechanism has been in place since 2003. We secured position of a net loss of $29,000 for the year ended December 31, 2006 and a net gain on derivative hedging activities of $8,000 and $199,000 for each of the years ended December 31, 2005 and 2004 respectively.

Depreciation

				% Change	
	Year ended December 31,			Years ended December 31,	Years ended December 31,
(in thousands)	2006	2005	2004	2006-2005	2005-2004
Depreciation					
Wholesale	$ 1,425	$ 1,154	$ 991	23%	16%
% of revenues	1%	1%	1%		
Retail	$ 614	$ 214	$ 41	187%	422%
% of revenues	4%	9%	5%		
Total	$ 2,039	$ 1,368	$ 1,032	49%	33%
% of revenues	2%	1%	1%		

Depreciation of wholesale business increased by 23% to $1,425,000 for the year ended December 31, 2006 from $1,154,000 for the year ended December 31, 2005, and reflected the amortization on the on-going capital expenditures, renovation and new motor vehicles. Depreciation of retail business increased by 187% to $614,000 for the year ended December 31, 2006 from $214,000 for the year ended December 31, 2005 and reflected the amortization of the capital expenditures of renovation on the increased number of retail stores during the year.

Depreciation of wholesale increased by 16% to $1,154,000 for the year ended December 31, 2005 from $991,000 for the year ended December 31, 2004, and reflected the amortization on the on-going capital expenditures, capitalized computer system. Depreciation of retail business increased by 422% to $214,000 for the year ended December 31, 2005 from $41,000 for the year ended December 31, 2004, and reflected the amortization of the capital expenditures of renovation on the opening of new retail stores during the year.

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Amortization and impairment loss on goodwill

				% Change	
	Year ended December 31,			Years ended December 31,	Years ended December 31,
(in thousands)	2006	2005	2004	2006-2005	2005-2004
Amortization and impairment loss on goodwill	$ 0	$ 0	$ 698	N/A	-100%
% of revenues	0%	0%	1%		

In April 2001, we acquired a 20% equity interest in a company whose principal activities are the manufacturing and trading of rough and pre-formed gemstones, of which we had no significant control and influence over its operating and financial policies, the investment is stated at cost previously. On January 1, 2005, an additional equity interest was acquired in this company, which become a subsidiary of the Company. As appropriate for a step-acquisition, the interest as of December 31, 2004 was restated to account for under equity method. As a result, an impairment loss of $698,000 arising from investment securities was charged for the year ended December 31, 2004.

Interest cost

				% Change	
	Year ended December 31,			Years ended December 31,	Years ended December 31,
(in thousands)	2006	2005	2004	2006-2005	2005-2004
Interest expenses	$ 3,258	$ 1,991	$ 902	64%	121%
% of revenues	3%	2%	1%		

Interest expenses increased for the years ended December 31, 2006, 2005 and 2004 reflecting the continuous increase in interest rates and a higher utilization level of credit line facilities as working capital.

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Income taxes

				% Change	
	Year ended December 31,			Years ended December 31,	Years ended December 31,
(in thousands)	2006	2005	2004	2006-2005	2005-2004
Income taxes expense					
Wholesale	$ 682	$ 739	$ 277	-8%	167%
% of revenues	1%	1%	0%		
Retail	$ 721	$ 0	$ 0	N/A	N/A
% of revenues	5%	0%	0%		
Total	$ 1,403	$ 739	$ 277	90%	167%
% of revenues	1%	1%	0%		

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, 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.

Incomes taxes included tax under provision adjustment of $71,000 and $88,000 for the years ended December 31, 2006 and 2005 respectively, and tax overprovision adjustment of $22,000 for the year ended December 31, 2004, after the finalization of tax assessment for prior years.

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Extraordinary gain on negative goodwill

				% Change	
	Year ended December 31,			Years ended December 31,	Years ended December 31,
(in thousands)	2006	2005	2004	2006-2005	2005-2004
Extraordinary gain on negative goodwill	$ 0	$ 1,291	$ 0	-100%	N/A
% of revenues	0%	1%	0%		

Extraordinary gain on negative goodwill of $1,291,000 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 paid US$2,827,500 to the Investee for the issuance of 3,900 new shares therein, 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.

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 86% of our sales are denominated in US 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 US Dollars and Renminbi. The exchange rate of the Hong Kong Dollar is currently pegged to the US 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 US 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 depreciates relative to the US 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 appreciates relative to the US Dollar, such fluctuation may have a negative effect on the results of our operations. We do not currently hedge our foreign exchange positions.

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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 12.

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 US dollars or other hard currency and other regulatory restrictions.

Cash Flows

	Years ended December 31,		
(in thousands)	**2006**	**2005**	**2004**
Net cash used in operating activities	$ (6,200)	$ (14,222)	$ (7,494)
Net cash used in investing activities	(3,829)	(4,655)	(1,179)
Net cash provided by financing activities	11,096	20,450	9,179
Effect of foreign exchange rate change	-	(5)	-
Net increase in cash and cash equivalents	1,067	1,568	506

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Operating Activities:

(in thousands)	Years ended December 31, 2006	2005	2004
Cash flows from operating activities:			
Net income	$ 5,325	$ 4,351	$ 2,122
Adjustments to reconcile income (loss) to net cash used in operating activities:			
Depreciation of property, plant and equipment and properties held for lease	2,039	1,368	1,032
Amortization and impairment loss on goodwill	-	-	698
Extraordinary gain on negative goodwill	-	(1,291)	-
Unrealized (gain) loss on derivatives	(48)	88	482
Loss (Gain) on disposal and write-off of property, plant and equipment	3	8	(3)
(Reversal of) Allowance for doubtful debts	(40)	(72)	125
Minority interests	37	20	-
Compensation costs for warrants granted	158	118	-
Compensation expenses recognized during the year	213	18	11
Equity in results of investment securities	-	-	(133)
Changes in operating assets and liabilities:			
Trade receivables	1,106	(8,607)	(535)
Inventories	(12,810)	(12,060)	(15,142)
Prepayments and other current assets	(580)	601	1,187
Due from related parties	463	7	17
Trade payables	(2,955)	1,883	1,136
Accrued expenses and other payables	272	(854)	1,767
Income taxes payable and deferred taxation	617	200	(258)
Net cash used in operating activities	(6,200)	(14,222)	(7,494)

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

For the year ended December 2006, net cash used in operating activities was comprised of a net income of $5,325,000, non-cash adjustment of $2,362,000 including adjustment of $2,039,000 for depreciation.

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For the year ended December 2005, net cash used in operating activities was comprised of a net income of $4,351,000, non-cash adjustment of $257,000 including adjustment of $1,368,000 for depreciation and $1,291,000 for extraordinary gain on negative goodwill.

Significant changes in assets and liabilities were as follows:

Trade receivables were decreased by $1,106,000 for the year ended December 31, 2006, and increased by $8,607,000 for the year ended December 31 2005. It was mainly due to the sales of the last quarter of 2005 near the year end, accumulating higher level of trade receivables at the end of 2005.

Inventory balance was increased by $12,810,000 and $12,060,000 for the year ended December 31, 2006 and 2005 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.

Trade payables decreased by $2,955,000 for the year ended December 31, 2006 due to reduced level of material purchases during last quarter of the year. The increase by $1,883,000 for the year ended December 31, 2005 was primarily due to the better credit term obtained from suppliers.

Investing Activities:

For the year ended December 31, 2006, net cash used in investing activities was for capital expenditures and partially offset by the deduction in restricted cash. Capital expenditures were mainly for on-going improvements of the existing production facilities in Shenzhen, and other business necessities including computer system upgrade, acquisition of motor vehicles, and renovation of stores for the retail business.

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

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Our capital expenditures by category for the periods presented were:

(in thousands)	Years ended December 31, 2006	2005	2004
Land & buildings	$ -	$ 617	$ -
Leasehold improvement	$ 2,852	$ 783	$ 487
Furniture, fixtures and equipment	$ 690	$ 1,060	$ 189
Plant and machinery	$ 260	$ 209	$ 51
Motor vehicles	$ 381	$ 200	$ -
Total	$ 4,183	$ 2,869	$ 727

Financing Activities:

Net cash provided by financing activities for the year ended December 31, 2006 was $11,096,000, which included proceeds of $4,191,000 from issuance of shares in private placement, proceeds of $4,744,000 from issuance of shares upon exercise of stock options and warrants, sales proceeds of derivatives, increase of new loans and offset by the repayment of matured bank loans, change in letter of credit and factoring and decrease in bank overdrafts utilization level.

Net cash provided by financing activities for the year ended December 31, 2005 was $20,450,000, 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, change in letter of credit and factoring and increase in bank overdrafts utilization level.

Our cash and cash equivalents are mainly held in US 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.

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Letters of Credit, overdrafts and others:

(in thousands)	Years ended December 31, 2006	2005	2004
Letters of credit	$ 41,046	$ 31,533	$ 26,833
Overdraft	$ 3,564	$ 3,461	$ 3,461
	44,610	34,994	30,294

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

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

Notes payable:

(in thousands)	Years ended December 31, 2006	2005	2004
Notes payable	$ 3,987	$ 3,079	$ 2,487

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

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Gold Loan Facilities:

(in thousands)	Years ended December 31, 2006	2005	2004
Gold loans outstanding (in $)	$ 11,079	$ 10,756	$ 6,488
Gold loans outstanding (in troy ounces)	26,920	27,920	17,920
Gold loan interest rate	2.6%-3.1%	2.4%-2.6%	2.1%-2.5%

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.

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 2007.

Impact of recently issued US GAAP accounting standards

In July 2006, the FASB issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes , which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes . FIN 48 provides guidance on the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. FIN 48 is effective for years beginning after December 15, 2006. The Company does not expect the adoption of FIN 48 will have a material impact on its financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 applies under other existing accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS 157 does not require any new fair value measurements. However, the application of this statement may change the current practice for fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company does not expect the adoption of FIN 157 will have a material impact on its financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159) which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS 159 will be effective for the Company on January 1, 2008. The Company does not expect the adoption of SFAS 159 will have a material impact on its financial statements.

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, 2007 is estimated to be at least 5% greater than the level for fiscal year 2006. The sales for fiscal year 2007 are estimated at approximately $130 million, compared to $123 million for the fiscal year ended December 31, 2006. The gross profit margin for fiscal year 2007 is estimated to remain at the same 28% level as 2006.

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.

F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS.

As of the December 31, 2006, 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	356	94	171	91	-
Operating Lease Obligations	4,685	2,584	2,101	-	-
Purchase Obligations	-				
Other Long-Term Liabilities Reflected on the Company s	-				
Balance Sheet under the GAAP of the primary financial statements	-				
Total	5,041	2,678	2,272	91	-

We had entered into finance lease agreements for the purchase of motor vehicles in 2003 and 2006. The financed amounts were $95,000 and $366,000, bearing interest at 5%-6% and 3.25%-3.5% per annum, and repayable in 60 monthly installments beginning in 2003 and 2006 respectively. A minimum finance charge may be charged if we pay off all the balances early**.**

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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	67	Chairman of the Board of Directors, President and Chief Executive Officer
Ka Man Au	42	Chief Operating Officer, Secretary and Director
Hon Tak Ringo Ng	47	Chief Financial Officer and Director
Po Yee Elsa Yue	42	Independent Non-Executive Director (1)
Andrew N. Bernstein	54	Independent Non-Executive Director
Wing Kwan Ted Lai	44	Independent Non-Executive Director (3)
Kelvin Wong	40	Independent Non-Executive Director (3)
Chi Fai Frank Cheung	44	Independent Non-Executive Director (2) (3)
Xiang Xiong Deng	42	Independent Non-Executive Director (4)
Jin Wang	36	Independent Non-Executive Director (4)
Jieyun Yu	41	Independent Non-Executive Director (4)

(1) Resigned effective June 1, 2007

(2) Appointed effective June 1, 2007

(3) Resigned effective October 15, 2007

(4) Appointed effective October 29, 2007

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 colored 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 non-profit 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

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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 served as a non-executive directorfrom December 1999 to June 2007. 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 non-executive director in July 2005. He serves on the Compensation and Nominating Committees. 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 US securities counsel since March 1997.

Mr. Lai served as a non-executive director from July 2005 to October 2007. 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 25 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 served as a non-executive director from July 2005 to October 2007. 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 14 years of experience in the accounting and finance field. 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.

Mr. Cheung served as a director from June 2007 to October 2007. He has over 20 years of experience in accounting, finance and administration and has held senior positions in various multinational companies. He is the chief financial officer and an executive director of Sun Innovation Holdings Ltd., a Hong Kong Stock Exchange-listed company engaged in property investment and in providing value-added media and entertainment products to mobile phone users. He holds an MBA from University of Technology, Sydney, Australia, and is an associate member of the Hong Kong Institute of Certified Public Accountants as well as fellow member of the Association of Chartered Certified Accountants. From 2001 to 2003, he was a director of e-Lux (Hong Kong) Ltd., a subsidiary of e-Lux Corporation, in charge of value-added telecommunications in Hong Kong, Taiwan and the People s Republic of China.

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Mr. Deng joined us as a non-executive director in October 2007. He serves on the Audit and Nominating Committees. He has served as a Director of Intermost Corp. (OTCBB: IMOT) since August 2005 and was appointed Acting Chief Executive Officer of that company from August 2005 to September 2007. Mr. Deng graduated from Shenzhen University (Bachelor of Law) and Shanghai Jiao Tong University (MBA). He is a member of the Shenzhen Board of Arbitration and formerly the General Manager of a number of state-owned and private enterprises. He is experienced in both capital management and investment banking.

Mr. Wang joined us as a non-executive director in October 2007. He serves as chair of the Audit Committee and a member of the Nominating and Compensation committees. He is currently Vice President of the Shenzhen Shengwei Taxation Co. Ltd. and has held that position since January 2006. Before that, he served in a number of posts with responsibilities for financial management and auditing. These include Project Manager of the Audit Department at the accounting firm Shenzhen Changcheng (2004-2005), Assistant Financial Manager at Shenzhen Jinggong Design and Decoration Co. Ltd. (2003-2004) and Manager of the Finance Department at Jiaguo Trading (Shenzhen) Co. Ltd., a wholly owned subsidiary of Bank of China Group Investment Co. Ltd (1997-2003).

Ms. Yu joined us as a director in October 2007. She serves on the Audit and Compensation committees. She is currently Assistant Manager of Finance at the headquarters of the Bank of China Group Insurance Co. Ltd. and General Manager of Finance at the company s Shenzhen Branch Office. She has held these positions since June 2003. Earlier, she served in finance management positions for Midland Realty (Shenzhen) Co. Ltd. (2001-2002), Intermost Corp. (1998-2001) and Guanghua Zhaori Production Co. Ltd. (1992-1998). Before that she was a statistician and auditor (1998-2002) at the Shenzhen Culture Bureau.

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, 2006 on an accrual basis, for services in all capacities, was $1,432,000. During the fiscal year ended December 31, 2006, we contributed an aggregate amount of $40,000 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 January 1, 2007, for a period of three years at an annual salary of $308,000. 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 January 3, 2005, we had granted Mr. Yih, Ms. Au and Mr. Ng options exercisable to acquire 500,000 shares, 100,000 shares and 100,000 shares respectively, at $3.00 per share at any time through March 30, 2005.

On July 22, 2005, we granted Mr. Yih, Ms. Au and Mr. Ng options exercisable to acquire 413,500 shares, 300,000 shares and 300,000 shares respectively, at $2.25 per share at any time through April 30, 2008.

We did not grant any options to any of our directors or executive officers during the fiscal years ended December 31, 2004 and 2006.

C. BOARD PRACTICES.

Each of our current directors (except Xiang Xiong Deng, Jin Wang and Jieyun Yu) was elected at our last annual meeting of shareholders held August 4, 2006 to serve a one-year term or until his/her 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.

Audit Committee

We have established an audit committee, which currently consists of Xiang Xiong Deng, Jin Wang and Jieyun Yu. Its functions are to:

- recommend annually to the board of directors the appointment of our independent public accountants;
- discuss and review the scope and the fees of the prospective annual audit and review the results with the independent public accountants;
- review and approve non-audit services of the independent public accountants;

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- 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 US federal and state laws relating to financial reporting.

Nominating Committee

We have established a nominating committee, which currently consists of Xiang Xiong Deng, Jin Wang and Andrew N. Bernstein. 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.

Compensation Committee

We have established a compensation committee, which currently consists of Andrew N. Bernstein, Jieyun Yu and Jin Wang. 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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Nasdaq Requirements

Our common shares are currently listed on the Nasdaq Global Market and, for so long as our securities continue to be listed, we will remain subject to the rules and regulations established by Nasdaq as being applicable to listed companies. Nasdaq has adopted amendments to its Rule 4350 to impose various corporate governance requirements on listed securities. Section (a)(1) of Rule 4350 provides that foreign private issuers such as our company are required to comply with certain specific requirements of Rule 4350, but, as to the balance of Rule 4350, foreign private issuers are not required to comply if the laws of their home country do not otherwise require compliance.

We currently comply with the specifically mandated provisions of Rule 4350. In addition, we have elected to voluntarily comply with certain other requirements of Rule 4350, notwithstanding that our home country does not mandate compliance; although we may in the future determine to cease voluntary compliance with those provisions of Rule 4350. However, we have determined not to comply with the following provisions of Rule 4350 since the laws of the British Virgin Islands do not require compliance:

- our independent directors do not hold regularly scheduled meetings in executive session;
- the compensation of our executive officers is not determined by an independent committee of the board or by the independent members of the board of directors, and our CEO may be present and participate in the deliberations concerning his compensation;
- related party transactions are not required to be reviewed or approved by our audit committee or other independent body of the board of directors; and
- we are not required to solicit shareholder approval of stock plans, including those in which our officers or directors may participate; stock issuances that will result in a change in control; the issuance of our stock in related party transactions or other transactions in which we may issue 20% or more of our outstanding shares; or, below market issuances of 20% or more of our outstanding shares to any person.

We may in the future determine to voluntarily comply with one or more of the foregoing provisions of Rule 4350.

D. EMPLOYEES.

As of December 31, 2006, we employed approximately 3,600 persons on a full-time basis for our production of jewelry, gemstone cutting and polishing, and retailing. Approximately 100 of these people were our management and executive staff in Hong Kong and China. None of our employees are represented by a labor union and we believe that our employee relations are good.

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E. SHARE OWNERSHIP.

The following table sets forth certain information regarding the beneficial ownership of our shares of common stock as of December 31, 2006 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, 2006, we had 18,977,371 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	1,556,353 (1)	7.9%
Ka Man Au	116,500 (2)	*
Hon Tak Ringo Ng	137,500 (3)	*
Po Yee Elsa Yue	4,000 (4)	*
Andrew N. Bernstein	0	*
Kelvin Wong	0	*
Wing Kwan Ted Lai	0	*
Chi Fai Frank Cheung	0	*
Xiang Xiong Deng	0	*
Jin Wang	0	*
Jieyun Yu	0	*
All directors and executive officers as a group (8 persons)	1,814,353	9.2%
Pacific Growth Developments Ltd.	1,500,000	7.9%

* Represents less than 1% beneficial ownership

(1) Includes options currently

exercisable to acquire: 766,500 shares of common stock at $2.00 per share at any time until April 30, 2008; and

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

(2) Represents options currently exercisable to acquire:

4,000 shares of common stock at $2.00 per share at any time until April 30, 2008; and

112,500 shares of common stock at $2.00 per share at any time until June 30, 2013.

(3) 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

112,500 shares of common stock at $2.00 per share at any time until June 30, 2013.

(4) Represents options currently exercisable to acquire:

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

The 1998 Stock Compensation Plan

Effective June 1, 1998, we adopted and approved the 1998 Stock Compensation Plan, which our shareholders approved on December 9, 1998. 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 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.

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As of December 31, 2006, 3,144,500 options had been exercised and the following options to purchase shares of our common stock under the plan were outstanding:

- a total of 855,500 stock options, consisting of stock options to purchase 444,000 and 20,000 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 795,500 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.

As of December 31, 2006, 3,024,500 options had been exercised and the following options to purchase shares of our common stock under the plan were outstanding:

- a total of 965,500 stock options, consisting of stock options to purchase 943,500 shares at $2.00 per share through June 30, 2013 and 22,000 shares at $2.25 per share through April 30, 2008. A total of 326,000 stock options are held by our directors and officers as a group.

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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.

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, 2006, no options had been issued under the 2005 Stock Compensation Plan.

Other Options and Warrants Outstanding

As of December 31, 2006, the following additional options and warrants to purchase shares of our common stock were outstanding:

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

On September 25, 2006, we issued and 11 institutional investors purchased an aggregate of 1,466,668 shares of our common stock at $3.75 per share, as well as an aggregate of 236,909 warrants to purchase 236,909 shares at an exercise price of $4.221 per share (the Short Term Warrants) and 366,668 warrants to purchase 366,668 shares at an exercise price of $4.50 per share (the Long Term Warrants). In addition, our placement agent received 29,333 Long Term Warrants with identical terms to the Long Term Warrants issued to the investors (the Placement Agent

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Warrants). The Short Term Warrants are exercisable at any time through February 5, 2007. The Long Term Warrants are exercisable at any time on or after March 25, 2007 for a term of five years thereafter.

As of December 31, 2006, the following warrants remained outstanding:

236,909 Short Term Warrants

366,668 Long Term Warrants

29,333 Placement Agent Warrants

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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, 2006, we had 270 record holders of our common stock. Of the 18,977,371 shares outstanding as of December 31, 2006, 16,940,611 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 Yu Chuan Yih and his personal guarantee to the extent of $12,971,000, $21,244,000 and $23,161,000 as of December 31, 2004, 2005 and 2006 respectively. 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, 2006, the balance of the mortgage loans amounted to $158,000.

We paid Andrew N. Bernstein, P.C., the law firm of which Andrew N. Bernstein, one of our directors, is the sole shareholder, less than $200,000 for legal services rendered to us during the fiscal year ended December 31, 2006.

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 a substantial majority of our total sales volume.

Derivative Litigation. Two purported shareholder derivative lawsuits, Vaughn v. Yih, et al. (Los Angeles Superior Court No. BC 378903) and Cooke vs. LJ, et al. (Los Angeles Superior Court No. BC 380214), were filed in California in Los Angeles County Superior Court on October 10 and November 5, 2007, respectively.

The Plaintiffs in both actions, who purport to bring suit on behalf of the Company against various of its officers and directors, did not make any demand on the Board of Directors, nor did they apply for permission to the High Court of the British Virgin Islands to bring this action. The complaints in the derivative actions allege, among other things, that the defendants caused the Company to issue a series of press releases, Securities and Exchange Commission filings and other statements that significantly overstated the Company s business prospects and financial results. They further allege that, as a result of these statements, the Company s share price traded at artificially inflated levels, and that defendants actions led to a delay in the release of the Company s financial statements for the fiscal fourth quarter of 2006 and the fiscal first quarter of 2007. Plaintiffs purport to state causes of action for breach of fiduciary duty, waste of corporate assets and unjust enrichment. By their complaints, they seek, among other relief, unspecified damages to be paid to the Company, corporate governance reforms, and equitable and injunctive relief, including restitution and the creation of a constructive trust.

The Defendants have not yet responded to the complaints. Initial responses to the complaints are due in January 2008. The Company intends to vigorously defend against the lawsuits. However, the ultimate outcome of these matters cannot be predicted with certainty.

Securities Litigation. In September 2007, several plaintiffs filed shareholder class actions in the United States District Court for the Central District of California against the Company and certain of its officers and directors, entitled Apple v. LJ International, Inc., et al. (No. 07-06076), Cooper v. LJ International, Inc., et al. (No. 07-06213), and Lieben v. LJ International Inc. et al. (No. 07-06216) (the Class Actions). The Class Actions generally allege, on behalf of all persons who purchased LJ common stock during the period from February 15, 2007 to September 6, 2007 (the Class Period), that LJ and the individual defendants made misleading statements and omissions of material fact, overstating the Company s fiscal 2005 and 2006 financial results, and thereby artificially inflated the market price of LJ s common stock throughout the Class Period. Plaintiffs further allege that defendants violated Sections 10(b) and 20(a) of the Securities and Exchange Act of 1934 and Rule 10b-5 promulgated thereunder by releasing fiscal 2006 earnings and EPS results that significantly understated the Company s tax liability and that overstated its earnings and EPS, that the Company s internal controls were inadequate, and that, as a result, defendants engaged in improper accounting practices. Plaintiffs seek an unspecified amount of damages.

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The cases have all been referred to one judge and competing motions for appointment as lead plaintiff and lead counsel are pending. The Company anticipates that, following those appointments, the district court will consolidate the cases and set a deadline for lead plaintiff to file an amended, consolidated class action complaint that will supersede the pending complaints.

The Company intends to vigorously defend against the Class Actions. However, the ultimate outcome cannot be predicted with certainty.

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 US 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 Global 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, 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
Year ended December 31, 2006	$4.60	$3.08
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
Quarter ended March 31, 2006	$4.16	$3.34
Quarter ended June 30, 2006	$3.79	$3.08
Quarter ended September 30, 2006	$4.59	$3.67
Quarter ended December 31, 2006	$4.60	$3.71
Quarter ended March 31, 2007	$12.00	$4.42
Quarter ended June 30, 2007	$12.86	$8.93
Quarter ended September 30, 2007	$12.37	$3.99
Month ended January 31, 2007	$7.53	$4.42
Month ended February 28, 2007	$12.00	$6.86
Month ended March 31, 2007	$10.46	$9.02
Month ended April 30, 2007	$11.19	$8.93
Month ended May 31, 2007	$12.86	$9.63
Month ended June 30, 2007	$11.90	$10.76
Month ended July 31, 2007	$12.12	$10.75
Month ended August 31, 2007	$8.23	$5.95
Month ended September 30, 2007	$7.95	$3.99
Month ended October 31, 2007	$6.15	$4.07
Month ended November 30, 2007	$4.13	$2.18
Month ended December 31, 2007*	$5.38	$3.19

*Through December 20, 2007

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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 Global Market System (formerly 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

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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 US 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-US 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 US federal income tax consequences to a US person, defined as a US citizen or resident, a US corporation, or an estate or trust subject to US federal income tax on all of its income regardless of source, making an investment in the common stock. For taxable years beginning after December 31, 1996, a trust will be a US 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-US 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 US 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 US federal income tax principles. Any distributions in excess of our earnings and profits will first be treated, for US federal income tax purposes, as a nontaxable return of capital, to the extent of the US 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 US investor. US 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 US investor. Such capital gain or loss will be long-term capital gain or loss if the US 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 US 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 US 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.

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

British Virgin Islands Taxation

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

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

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

F. DIVIDENDS AND PAYING AGENTS.

Not applicable.

G. STATEMENT BY EXPERTS.

Not applicable.

H. DOCUMENTS ON DISPLAY.

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

I. SUBSIDIARY INFORMATION.

Not applicable.

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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, they concluded that our disclosure controls and procedures are effective to timely alerting them to material information about LJ International Inc. and its consolidated subsidiaries.

There have been no significant changes in our internal controls or in other factors that could significantly affect those controls subsequent to the date of this evaluation.

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

Not applicable.

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ITEM 16. [RESERVED]

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our Board of Directors has determined that it considers Jin Wang as the audit committee financial expert serving on our audit committee. Mr. Wang 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.

Moores Rowland Mazars was our principal accountant for the audit of our financial statements for the fiscal year ended December 31, 2005. Gruber & Company, LLC was our principal accountant for the audit of our financial statements for the fiscal year ended December 31, 2006.

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 $158,000 for the fiscal year ended December 31, 2005 and $200,000 for the fiscal year ended December 31, 2006.

The foregoing excludes our payments to Moores Rowland Mazars of $200,000 and KPMG of $400,000.

(b) Audit - Related Fees.

No fees were billed in each of the last two fiscal years for assurance and related services by our principal accountants 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 years ended December 31, 2005 and 2006.

(c) Tax Fees.

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The aggregate fees billed in each of the last two fiscal years for professional services rendered by our principal accountants for tax compliance, tax advice, and tax planning were $10,000 for the fiscal year ended December 31, 2005 and $nil for the fiscal year ended December 31, 2006. 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 years ended December 31, 2005 and 2006.

(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 current accountant, Gruber & Company, LLC, 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 Gruber & Company, LLC as our principal accountant to render audit and non-audit services before Gruber & Company, LLC 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, 2006.

PART III

ITEM 17. FINANCIAL STATEMENTS

Not applicable.

ITEM 18. FINANCIAL STATEMENTS

The following financial statements, together with the reports of the independent registered public accounting firms Gruber & Company, LLC for the year ended December 31, 2006 and Moores Rowland Mazars for the years ended December 31, 2005 and 2004, respectively, are being filed as part of this Annual Report on Form 20-F.

The audit report of Moores Rowland Mazars for the years ended December 31, 2005, 2004 and 2003 that was issued on May 18, 2007 was previously filed as part of our annual report on Form 20-F for the year ended December 31, 2005. After using reasonable efforts, we were unable to obtain the written consent of Moores Rowland Mazars to the use of their audit report for the years ended December 31, 2005 and 2004. Therefore, a copy of such report, which has not been reissued by Moores Rowland Mazars, is attached to this annual report.

Consolidated statements of operations for the years ended December 31, 2004, 2005 and 2006.

Consolidated balance sheets as of December 31, 2005 and 2006.

Consolidated statements of shareholders equity for the years ended December 31, 2004, 2005 and 2006.

Consolidated statements of cash flows for the years ended December 31, 2004, 2005 and 2006.

Notes to and forming part of the financial statements.

LJ INTERNATIONAL INC.
INDEX TO FINANCIAL STATEMENTS

Gruber & Company, LLC

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and
Stockholders of **LJ International Inc.**

We have audited the accompanying consolidated balance sheet of LJ International Inc. as of December 31, 2006, and the related consolidated statements of operations, shareholders equity and comprehensive income, and cash flows for the year then ended. 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 audit.

We conducted our audit 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. The company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of LJ International Inc. as of December 31, 2006 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Gruber & Company, LLC
Lake Saint Louis, Missouri
December 21, 2007

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM[1]

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 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, except for notes 3 and 9 which are May 18, 2007

[1]This report is a copy of the previously issued report. Moores Rowland Mazars has not reissued this report.

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

	Notes	**Year ended December 31, 2006 US$**	Year ended December 31, 2005 US$	Year ended December 31, 2004 US$
Operating revenue	*2(c)*	**123,791**	99,646	77,504
Costs of goods sold (Exclusive of depreciation shown separately below.)		**(88,867)**	(77,127)	(61,265)
Gross profit		**34,924**	22,519	16,239
Operating expenses				
Selling, general and administrative expenses		**(23,114)**	(15,488)	(11,578)
Net (loss) gain on derivatives		**(29)**	8	199
Depreciation		**(2,039)**	(1,368)	(1,032)
Impairment loss on goodwill		**-**	-	(698)
Operating income		**9,742**	5,671	3,130
Other income and expense				
Interest income	*2(c)*	**282**	139	38
Interest expenses		**(3,258)**	(1,991)	(902)
Income before income taxes, minority interests, equity in results of investment securities and extraordinary item		**6,766**	3,819	2,266
Income taxes expense	*10*	**(1,403)**	(739)	(277)
Income before minority interests, equity in results of investment securities and extraordinary item		**5,363**	3,080	1,989
Minority interests in consolidated subsidiaries		**(38)**	(20)	-
Income before equity in results of investment securities and extraordinary item		**5,325**	3,060	1,989
Equity in results of investment securities		**-**	-	133
Income before extraordinary item		**5,325**	3,060	2,122

Extraordinary gain on negative goodwill	*3*	**-**	1,291	-
Net income		**5,325**	4,351	2,122
Numerator:				
Net income used in computing basic earnings per share		**5,325**	4,351	2,122
Denominator:				
Weighted average number of shares used in calculating basic earnings per share		**17,390,093**	13,438,578	11,118,995
Effect of dilutive potential ordinary shares:				
Warrants		**118,717**	28,738	55,693
Stock options		**794,467**	854,568	932,786
Weighted average number of shares used in calculating diluted earnings per share		**18,303,277**	14,321,884	12,107,474

See accompanying notes to consolidated financial statements.

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

	Notes	**Year ended December 31, 2006 US$**	Year ended December 31, 2005 US$	Year ended December 31, 2004 US$
Basic earnings per share:	*2(g)*			
Income before extraordinary item		**0.31**	0.23	0.19
Extraordinary item		**-**	0.09	-
Net income		**0.31**	0.32	0.19
Diluted earnings per share:	*2(g)*			
Income before extraordinary item		**0.29**	0.21	0.18
Extraordinary item		**-**	0.09	-
Net income		**0.29**	0.30	0.18

See accompanying notes to consolidated financial statements.

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

	Notes	As of December 31, 2006 US$	2005 US$
ASSETS			
Current asset			
Cash and cash equivalents		**5,863**	4,796
Restricted cash	*9(a)*	**5,489**	5,839
Trade receivables, net of allowance for doubtful accounts (December 31, 2006: US$30; December 31, 2005: US$212)		**23,894**	24,960
Derivatives		**3,400**	2,034
Available-for-sale securities	*2(n)*	**2,596**	2,496
Inventories	*5*	**68,751**	55,941
Prepayments and other current assets		**3,118**	2,538
Total current assets		**113,111**	98,604
Properties held for lease, net	*6*	**1,346**	1,400
Property, plant and equipment, net	*7*	**8,412**	6,221
Due from related parties	*16(b)*	**21**	484
Deferred tax assets		**111**	-
Goodwill, net	*8*	**1,521**	1,521
Total assets		**124,522**	108,230
LIABILITIES AND SHAREHOLDERS EQUITY			
Current liabilities			
Bank overdrafts	*9*	**1,591**	2,028
Notes payable	*9*	**3,987**	3,079
Capitalized lease obligation, current portion	*11*	**94**	20
Letters of credit, gold loan and others	*9*	**33,423**	32,643
Derivatives		**6,034**	3,567
Trade payables		**9,213**	12,168
Accrued payroll and staff benefits		**2,043**	1,773
Accrued expenses and other payables		**5,509**	5,507
Due to related parties	*15(b)*	**-**	1,910
Income taxes payable		**735**	201
Deferred taxation	*10*	**348**	154
Total current liabilities		**62,977**	63,050
Notes payable, non-current portion		**1,378**	-
Capitalized lease obligation, non-current portion	*11*	**262**	43

Total liabilities		**64,617**	63,093
Minority interest		**166**	129
Commitments and contingencies	*12*		
Shareholders equity			
Common stocks, par value US$0.01 each, Authorized - 100 million shares, Issued 18,977,371 shares as of December 31, 2006 and 15,521,203 shares as of December 31, 2005	*13*	**190**	155
Additional paid-in capital		**40,456**	31,204
Accumulated other comprehensive loss		**(56)**	(156)
Unearned compensation	*2(q)*	**-**	(19)
Retained earnings		**19,149**	13,824
Total shareholders equity		**59,739**	45,008
Total liabilities and shareholders equity		**124,522**	108,230

See accompanying notes to consolidated 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	Par Value US$	Additional Paid-in Capital US$	Accumulated other comprehensive income (loss) US$ (Note 2(x))	Unearned compensation US$	Retained earnings US$	Total US$
Balance as of January 1, 2004		9,890,006	99	19,802	(151)	-	7,351	27,101
Comprehensive income, net of tax:								
Net income		-	-	-	-	-	2,122	2,122
Issuance of common stock on private placement	13(a)(i)	1,614,082	16	2,730	-	-	-	2,746
Issuance of common stock upon exercise of stock options	13(a)(ii)	405,000	4	806	-	-	-	810
Issuance of common stock upon exercise of warrants	13(a)(ii)	395,570	4	(4)	-	-	-	-
Stock options granted	2(q)	-	-	48	-	(48)	-	-
Compensation expense recognized during the year	2(q)	-	-	-	-	11	-	11
Balance as of December 31, 2004		12,304,658	123	23,382	(151)	(37)	9,473	32,790
Comprehensive income, net of tax:								
Net income		-	-	-	-	-	4,351	4,351
Exchange translation difference		-	-	-	(5)	-	-	(5)
Issuance of common stock upon exercise of stock options	13(a)(iii)	3,162,000	31	7,542	-	-	-	7,573
Issuance of common stock upon exercise of warrants	13(a)(iii)	54,545	1	162	-	-	-	163
Compensation costs for warrants granted	15(b)	-	-	118	-	-	-	118
Compensation expense recognized during the year	2(q)	-	-	-	-	18	-	18
Balance as of December 31, 2005		15,521,203	155	31,204	(156)	(19)	13,824	45,008

See accompanying notes to consolidated 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	Par Value US$	Additional Paid-in Capital US$	Accumulated other comprehensive income (loss) US$	Unearned compensation US$	Retained earnings US$	Total US$
Balance as of December 31, 2005		15,521,203	155	31,204	(156)	(19)	13,824	45,008
Comprehensive income, net of tax:								
Net income		-	-	-	-	-	5,325	5,325
Unrealized holding gain on investment in available-for-sale securities	2(n)	-	-	-	100	-	-	100
Issuance of common stock on private placement	13(a)(iv)	1,466,668	15	4,176	-	-	-	4,191
Issuance of common stock upon exercise of stock options	13(a)(v)	1,489,500	15	2,989	-	-	-	3,004
Issuance of common stock upon exercise of warrants	13(a)(v)	500,000	5	1,735	-	-	-	1,740
Elimination of unearned compensation	2(q)	-	-	(19)	-	19	-	-
Compensation costs for warrants granted	15(b)	-	-	158	-	-	-	158
Stock-based compensation	2(q)	-	-	213	-	-	-	213
Balance as of December 31, 2006		**18,977,371**	**190**	**40,456**	**(56)**	**-**	**19,149**	**59,739**

See accompanying notes to consolidated financial statements.

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

	Year ended December 31 2006 US$	Year ended December 31 2005 US$	Year ended December 31 2004 US$
Cash flows from operating activities:			
Net income	**5,325**	4,351	2,122
Adjustments to reconcile income (loss) to net cash (used in) provided by operating activities:			
Depreciation of property, plant and equipment and properties held for lease	**2,039**	1,368	1,032
Amortization and impairment loss on goodwill	**-**	-	698
Extraordinary gain on negative goodwill	**-**	(1,291)	-
Unrealized (gain) loss on derivatives	**(48)**	88	482
Loss (Gain) on disposal and write-off of property, plant and equipment	**3**	8	(3)
(Reversal of) Allowance for doubtful debts	**(40)**	(72)	125
Minority interests	**37**	20	-
Compensation costs for warrants granted	**158**	118	-
Compensation expenses recognized during the year	**213**	18	11
Equity in results of investment securities	**-**	-	(133)
Changes in operating assets and liabilities:			
Trade receivables	**1,106**	(8,607)	(535)
Inventories	**(12,810)**	(12,060)	(15,142)
Prepayments and other current assets	**(580)**	601	1,187
Due from related parties	**463**	7	17
Trade payables	**(2,955)**	1,883	1,136
Accrued expenses and other payables	**272**	(854)	1,767
Income taxes payable and deferred taxation	**617**	200	(258)
Net cash used in operating activities	**(6,200)**	(14,222)	(7,494