

China Direct Industries, Inc.
Form 10-Q
May 16, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended March 31, 2011

or

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number: 001-33694

CHINA DIRECT INDUSTRIES, INC.
(Exact name of registrant as specified in its charter)

Florida
(State or other jurisdiction of incorporation or
organization)

13-3876100
(I.R.S. Employer Identification No.)

431 Fairway Drive, Suite 200, Deerfield Beach, Florida
(Address of principal executive offices)

33441
(Zip Code)

954-363-7333
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if

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any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>

(Do not check if smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes No

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date. 35,313,390 shares of common stock were issued and outstanding as of May 12, 2011.

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INDEX OF CERTAIN DEFINED TERMS USED IN THIS REPORT

When used in this report the terms:

- “China Direct Industries”, “we”, “us” or “our” refers to China Direct Industries, Inc., a Florida corporation, and our subsidiaries;
- “CDI China”, refers to CDI China, Inc., a Florida corporation, and a wholly owned subsidiary of China Direct Industries; and
- “PRC” refers to the People’s Republic of China.

Magnesium Segment

- “Chang Magnesium”, refers to Taiyuan Changxin Magnesium Co., Ltd., a company organized under the laws of the PRC and a 51% owned subsidiary of CDI China;
- “Chang Trading”, refers to Taiyuan Changxin YiWei Trading Co., Ltd., a company organized under the laws of the PRC and a wholly owned subsidiary of Chang Magnesium;
- “Excel Rise”, refers to Excel Rise Technology Co., Ltd., a Brunei company and a wholly owned subsidiary of Chang Magnesium;
- “CDI Magnesium”, refers to CDI Magnesium Co., Ltd., a Brunei company and a 51% owned subsidiary of Capital One Resources;
- “Asia Magnesium”, refers to Asia Magnesium Corporation Limited, a company organized under the laws of Hong Kong and a wholly owned subsidiary of Capital One Resource;
- “Golden Magnesium” refers to Shanxi Gu County Golden Magnesium Co., Ltd., a company organized under the laws of the PRC and a 52% owned subsidiary of Asia Magnesium;
- “Pan Asia Magnesium”, refers to Pan Asia Magnesium Co., Ltd., a company organized under the laws of the PRC and a 51% owned subsidiary of CDI China;
- “Baotou Changxin Magnesium”, refers to Baotou Changxin Magnesium Co., Ltd., a company organized under the laws of the PRC, a 51% owned subsidiary of CDI China, and a 39% owned subsidiary of Excel Rise. Effectively China Direct holds a 70.9% interest;
- “IMG” or “International Magnesium Group”, refers to International Magnesium Group, Inc., a Florida corporation and a 100% owned subsidiary of China Direct Industries; and
- “IMTC” or “International Magnesium Trading”, refers to International Magnesium Trading Corp., a company organized under the laws of Brunei and a 100% owned subsidiary of IMG.
- “Ruiming Magnesium”, refers to Taiyuan Ruiming Yiwei Magnesium Co., Ltd., a company organized under the laws of the PRC and an 80% majority owned subsidiary of CDI China.

Basic Materials Segment

- “Lang Chemical”, refers to Shanghai Lang Chemical Co., Ltd., a company organized under the laws of the PRC and a 51% owned subsidiary of CDI China;
- “CDI Jingkun Zinc”, refers to CDI Jingkun Zinc Industry Co., Ltd., a company organized under the laws of the PRC and a 95% owned subsidiary of CDI Shanghai Management;
- “CDI Jixiang Metal”, refers to CDI Jixiang Metal Co., Ltd., a company organized under the laws of the PRC and a wholly owned subsidiary of CDI China;
- “CDI Metal Recycling”, refers to Shanghai CDI Metal Recycling Co., Ltd., a company organized under the laws of the PRC and an 83% owned subsidiary of CDI Shanghai Management;

- “CDI Beijing”, refers to CDI (Beijing) International Trading Co., Ltd., a company organized under the laws of the PRC and a 51% owned subsidiary of CDI Shanghai Management; and
- “CDII Trading”, refers to CDII Trading, Inc., a Florida corporation and a 100% owned subsidiary of China Direct Industries.

Consulting Segment

- “China Direct Investments”, refers to China Direct Investments, Inc., a Florida corporation, and a wholly owned subsidiary of China Direct;
- “CDI Shanghai Management”, refers to CDI Shanghai Management Co., Ltd., a company organized under the laws of the PRC and a wholly owned subsidiary of CDI China; and
- “Capital One Resource”, refers to Capital One Resource Co., Ltd., a Brunei company, and a wholly owned subsidiary of CDI Shanghai Management.

PART 1 - FINANCIAL INFORMATION

Item 1. Financial Statements.

CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

ASSETS	March 31, 2011 (Unaudited)	September 30, 2010
Current Assets:		
Cash and cash equivalents	\$ 9,434,042	\$ 10,110,818
Marketable securities available for sale	12,806,973	2,221,290
Marketable securities available for sale-related parties	334,521	672,735
Accounts receivables, net of allowance of \$289,597 and \$214,701, respectively	20,042,890	15,235,983
Accounts, loans and other receivables, and prepaid expenses - related parties	8,229,764	7,680,222
Inventories, net	9,628,413	6,372,925
Prepaid expenses and other current assets, net	11,213,182	8,552,369
Current assets of discontinued operations	51,345	51,345
Restricted cash, current	427,531	5,091,023
Total current assets	72,168,661	55,988,710
Property, plant and equipment, net	37,141,282	37,512,261
Intangible assets	179,175	194,541
Property use rights, net	2,242,187	1,970,585
Long-lived assets of discontinued operations	196,078	196,078
Total assets	\$ 111,927,383	\$ 95,862,175
LIABILITIES AND EQUITY		
Current Liabilities:		
Loans payable-short term	\$ 2,423,635	\$ 5,613,532
Accounts payable and accrued expenses	9,976,539	11,250,879
Accounts and other payables-related parties	8,034,734	3,973,704
Advances from customers and deferred revenue	2,205,131	2,797,315
Other liabilities	3,073,997	1,073,926
Taxes payable	1,232,300	877,840
Current liabilities of discontinued operations	49,538	80,000
Total liabilities	26,995,874	25,667,196
CHINA DIRECT INDUSTRIES INC. EQUITY		
Series A Convertible Preferred Stock: \$.0001 par value, stated value \$1,000 per share; 10,000,000 authorized, 1,006 shares outstanding at September 30, 2010 and March 31, 2011.	1,006,250	1,006,250
Common Stock: \$.0001 par value; 35,267,096 and 31,657,244 shares outstanding, respectively	3,527	3,166
Additional paid-in capital	69,749,929	65,032,845
Accumulated other comprehensive income	7,100,609	1,795,387
Accumulated deficit	(14,882,056)	(17,643,217)

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Total China Direct Industries, Inc. stockholders' equity	62,978,259	50,194,431
Noncontrolling interests	21,953,250	20,000,548
Total equity	84,931,509	70,194,979
Total liabilities and equity	\$ 111,927,383	\$ 95,862,175

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

CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	For the three months ended March 31,		For the six months ended March 31,	
	2011	2010	2011	2010
Revenues	\$40,670,183	\$21,223,422	\$86,433,072	\$41,034,154
Revenues-related parties	1,597,830	2,147,104	1,604,543	4,588,900
Total revenues	42,268,013	23,370,526	88,037,615	45,623,054
Cost of revenues	39,042,825	21,376,375	78,281,381	41,804,685
Gross profit	3,225,188	1,994,151	9,756,234	3,818,369
Operating income (expenses):				
Selling, general, and administrative	3,212,630	2,469,306	6,814,911	5,262,809
Other operating income-related party	(102,872)	-	(102,872)	-
Other operating expense (income)	19,782	-	(355,198)	-
Total Operating income (expenses)	95,648	(475,155)	3,399,393	(1,444,440)
Other (expenses) income:				
Other income (expense):	93,842	(53,920)	265,361	48,485
Interest (expense) income	(59,297)	4,614	(67,044)	3,614
Realized (loss) income on investment securities available for sale	(261,557)	2,066,497	(379,969)	2,101,188
Total other (expenses) income	(227,012)	2,017,191	(181,652)	2,153,287
(Loss) income from continuing operations before income taxes	(131,364)	1,542,036	3,217,741	708,847
Income tax expense	(140,925)	(15,206)	(67,641)	(54,924)
Net (loss) income	(272,289)	1,526,830	3,150,100	653,923
Net loss attributable to noncontrolling interests-continuing operations	278,664	130,354	322,111	18,746
Net income attributable to China Direct Industries	\$6,375	\$1,657,184	\$3,472,211	\$672,669
Deduct dividends on Series A Preferred Stock:				
Preferred stock dividend	(20,130)	(20,125)	(40,260)	(60,308)
Deemed dividend - beneficial conversion feature	-	-	(600,693)	-
Dividend - warrant valuation	-	-	(76,705)	-
Net income attributable to common stockholders	\$(13,755)	\$1,637,059	\$2,754,553	\$612,361
Basic and diluted income per common share				
Basic	\$(0.00)	\$0.06	\$0.08	\$0.02
Diluted	\$(0.00)	\$0.06	\$0.08	\$0.02
Basic weighted average common shares outstanding	34,728,413	28,594,256	33,257,657	27,981,440
Diluted weighted average common shares outstanding	34,728,413	29,057,018	33,257,657	28,444,202

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

CHINA DIRECT INDUSTRIES INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF EQUITY
For the six months ended March 31, 2011
(Unaudited)

	Preferred Stock Amount	Common Stock Amount	Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total China Direct Shareholders' Equity	Noncontrolling Interest	Total
Balance, September 30, 2010	\$1,006,250	\$3,166	\$65,032,845	\$(17,643,217)	\$1,795,387	\$50,194,431	\$20,000,548	\$70,194,979
Dividends paid to preferred stockholders	-	2	40,258	(40,260)	-	-	-	-
Public offering	-	222	3,771,280	-	-	3,771,502	-	3,771,724
Ruiming acquisition	-	77	(77)	-	-	-	-	-
Restricted stock award-employees	-	45	213,389	-	-	213,434	-	213,434
Restricted stock award-consultants	-	1	31,314	-	-	31,315	-	31,315
Restricted stock award-board of directors	-	6	51,606	-	-	51,612	-	51,612
Stock option exercised	-	8	103,194	-	1.00	103,203	-	103,204
Noncontrolling interest of acquired entities	-	-	-	-	-	-	2,274,812	2,274,812
Comprehensive income (loss)								
Net earnings	-	-	-	3,472,211	-	3,472,211	(322,111)	\$3,150,100
Other comprehensive income								
Changes in cumulative foreign currency translation	-	-	-	-	978,955	978,955	-	978,955
Unrealized gain on marketable securities available for sale	-	-	-	-	4,326,266	4,326,266	-	4,326,266
Deemed dividends adjustment	-	-	-	(677,398)	-	(677,398)	-	(677,398)
Deemed dividends - warrants adjustment	-	-	506,120	-	-	506,120	-	506,120
Reclassification adjustment for welfare benefit included in other comprehensive income	-	-	-	6,607	-	6,607	-	6,607

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Total other comprehensive income	-	-	-	-	-	-	-	\$5,140
Total comprehensive income	-	-	-	-	-	\$-	-	\$8,290
Balance, March 31, 2011	\$1,006,250	\$3,527	\$69,749,929	\$(14,882,056)	\$7,100,609	\$62,978,259	\$21,953,250	\$84,93

CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the six months ended March 31,	
	2011	2010
OPERATING ACTIVITIES:		
Net income	\$ 3,150,100	\$ 653,924
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	1,910,931	1,128,648
Allowance for bad debt	137,492	(528,911)
Stock based compensation	368,248	517,472
Realized loss (gain) on investments in marketable securities	379,969	(2,101,208)
Gain on preferred stock revaluation	(159,467)	-
Fair value of marketable securities received for services	(6,852,529)	(1,737,248)
Fair value of marketable securities paid for services	314,815	177,830
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	(2,645,447)	(1,507,712)
Accounts receivable and other assets-related parties	(549,542)	1,647,046
Inventories	(3,255,488)	(1,857,858)
Accounts receivable	(4,944,399)	(1,630,245)
Accounts payable and accrued expenses	(1,274,340)	(568,861)
Accounts and other payable - related parties	4,061,031	374,503
Advances from customers	(592,184)	(20,160)
Other payables	2,312,258	(2,320,140)
CASH USED IN OPERATING ACTIVITIES	(7,638,552)	(7,772,920)
INVESTING ACTIVITIES		
Repayment of loans	-	(276,605)
Proceeds from the sale of marketable securities available for sale	818,456	5,758,313
Increase in property use right	(270,827)	
Purchases of property, plant and equipment	(1,493,649)	(95,547)
CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES	(946,020)	5,386,161
FINANCING ACTIVITIES		
Decrease in restricted cash	4,663,493	5,541
Payments/proceeds from loans payable	(3,189,897)	431,866
Increase in loans payable-related party	-	(399,629)
Net proceeds from sale of stocks and exercise of warrants/options	3,771,502	4,955,845
Capital contributions from noncontrolling interest owners	1,710,909	-
Cash dividend payment to preferred stock holders	-	(20,125)
CASH PROVIDED BY FINANCING ACTIVITIES	6,956,007	4,973,498
EFFECT OF EXCHANGE RATE ON CASH	951,789	(365,843)
Net (decrease) increase in cash	(676,776)	2,220,896
Cash and equivalents, beginning of the period	10,110,818	12,851,310
Cash and equivalents, end of the period	\$ 9,434,042	\$ 15,072,206
Supplemental disclosures of cash flow information:		

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Preferred stock dividend paid in our common stock	\$ 40,260	\$ 60,308
Deemed dividend - beneficial conversion feature	\$ 600,693	\$ -
Dividend - warrant valuation	\$ 76,705	\$ -

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

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CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2011

NOTE 1 - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business and Organization

China Direct Industries, Inc., a Florida corporation and its subsidiaries are referred to in this report as “we”, “us”, “our”, or “China Direct Industries.”

We are a U.S. company that manages a portfolio of Chinese entities. We also provide consulting services to both American and Chinese businesses. We operate in three identifiable segments, as defined by the Financial Standard Board Accounting Standard Codifications (“ASC”) 280, “Segment Reporting:” Magnesium, Basic Materials and Consulting. In 2006 we established our Magnesium and Basic Materials segments which have grown through acquisitions of controlling interests in Chinese private companies. We consolidate these acquisitions as either wholly or majority owned subsidiaries. Through this ownership control, we provide management, marketing, sales and business development services, strategic planning, macroeconomic industry analysis and financial management, seeking to improve the quality and performance of each portfolio company. We also provide our subsidiaries with investment capital and loans to expand their businesses.

In our Magnesium segment, currently our largest segment by revenues and assets, we produce, sell and distribute pure magnesium ingots, magnesium powder and magnesium scraps. In our Basic Materials segment, we sell and distribute a variety of products, including industrial grade synthetic chemicals, steel products, non ferrous metals, recycled materials, and industrial commodities. This segment also includes our zinc ore mining property which has not commenced operations.

In our Consulting segment, we provide a suite of consulting services to U.S. public companies that operate primarily in China. The consulting fees we charge vary based upon the scope of the services we provide.

We have defined various periods that are covered in this report as follows:

- “fiscal 2011” – October 1, 2010 through September 30, 2011
- “first quarter of fiscal 2011” – October 1, 2010 through December 31, 2010
- “second quarter of fiscal 2011” – January 1, 2011 through March 31, 2011
- “first six months of fiscal 2011” – October 1, 2010 through March 31, 2011
- “fiscal 2010” — October 1, 2009 through September 30, 2010.
- “first quarter of fiscal 2010” – October 1, 2009 through December 31, 2009
- “second quarter of fiscal 2010” – January 1, 2010 through March 31, 2010
- “first six months of fiscal 2010” – October 1, 2009 through March 31, 2010
- “2009 transition period” — January 1, 2009 through September 30, 2009.
- “fiscal 2008” — January 1, 2008 through December 31, 2008.

Basis of Presentation

Our interim consolidated financial statements are unaudited. We prepared the consolidated financial statements in accordance with U.S. generally accepted accounting principles for interim financial statements and pursuant to U.S. Securities and Exchange Commission (“SEC”) rules for interim reporting. In the opinion of management, we included all adjustments that are necessary for the fair presentation of our financial position, results of operations, and cash flows for the interim periods presented. Except as disclosed herein, such adjustments are of a normal and recurring

nature. Results for the first six months of the year may not necessarily be indicative of full year results. It is suggested that these consolidated financial statements be read in conjunction with the audited financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2010 and our Quarterly Reports on Form 10-Q for interim periods.

CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2011

Summary of Significant Accounting Policies

Concentration of Credit Risks

Financial instruments which potentially subject us to concentrations of credit risk consist principally of cash and trade accounts receivable. We deposit our cash with high credit quality financial institutions in the United States and China. As of March 31, 2011, we had no bank deposits in the United States that exceeded federally insured limits. At March 31, 2011, we had deposits of \$4,489,308 banks in China. In China, there is no equivalent federal deposit insurance as in the United States, so the amounts held in banks in China are not insured. We have not experienced any losses in such bank accounts through March 31, 2011.

At March 31, 2011 and September 30, 2010, bank deposits by geographic area were as follows:

Country	March 31, 2011			September 30, 2010		
United States	4,944,734	52	%	4,851,329	48	%
China	4,489,308	48	%	5,259,489	52	%
Total cash and cash equivalents	9,434,042	100	%	10,110,818	100	%

In an effort to mitigate any potential risk, we periodically evaluate the credit quality of the financial institutions at which we hold deposits, both in the United States and China.

Foreign Currency Translation

The accompanying consolidated financial statements are presented in United States dollars. The functional currency of our Chinese subsidiaries is Renminbi (“RMB”), the official currency of the People’s Republic of China. Capital accounts of the consolidated financial statements are translated into United States dollars from RMB at their historical exchange rates when the capital transactions occurred. Assets and liabilities are translated at the exchange rates as of the balance sheet dates. Income and expenditures are translated at the average exchange rates for the six month periods ended March 31, 2011 and 2010. A summary of the conversion rates for the periods presented is as follows:

	March 31, 2011	March 31, 2010	September 30, 2010
Period end RMB: U.S. dollar exchange rate	6.5501	6.8361	6.6981
Average fiscal-year-to-date RMB: U.S. dollar exchange rate	6.6103	6.8360	6.8214

RMB is not freely convertible into foreign currency and all foreign exchange transactions must take place through PRC authorized institutions. No representation is made that RMB amounts could have been, or could be, converted into United States dollars at the rates applied in the translation.

Fair Value of Financial Instruments

We adopted on a prospective basis certain required provisions of ASC Topic 820, “Fair Value Measurements.” These provisions relate to our financial assets and liabilities carried at fair value and our fair value disclosures related to

financial assets and liabilities. ASC Topic 820 defines fair value, expands related disclosure requirements and specifies a hierarchy of valuation techniques based on the nature of the inputs used to develop the fair value measurements. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. There are three levels of inputs to fair value measurements - Level 1, meaning the use of quoted prices for identical instruments in active markets; Level 2, meaning the use of quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active or are directly or indirectly observable; and Level 3, meaning the use of unobservable inputs. Observable market data should be used when available.

Most of our financial instruments are carried at fair value, including, all of our cash equivalents, investments classified as available for sale securities and assets held for sale, with unrealized gains or losses recognized as Other Comprehensive Income (OCI), net of tax. Virtually all of our valuation measurements are Level 1 measurements.

CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2011

Marketable Securities

Marketable Securities that we receive from our clients as compensation are generally restricted for sale under Federal securities laws. Our policy is to liquidate securities received as compensation when market conditions are favorable for sale. Since these securities are often restricted, we are unable to liquidate them until the restriction is removed. We recognize revenue for the common stock we receive as compensation based on the fair value at the time the common stock is granted or at the time service has been rendered and for common stock purchase warrants based on the Black-Scholes valuation model. Pursuant to ASC Topic 320, "Investments –Debt and Equity Securities" our marketable securities have a readily determinable and active quoted price, such as from NASDAQ, NYSE Amex, the Over the Counter Bulletin Board, and the OTC Markets Group (formerly known as the Pink Sheets) and any unrealized gain or loss is recognized as an element of comprehensive income based on changes in the fair value of the security as quoted on an exchange or an inter-dealer quotation system. Once liquidated, any realized gain or loss on the sale of marketable securities is reflected in our net income for the period in which the security was liquidated.

We perform an analysis of our marketable securities at least on an annual basis to determine if any of these securities have become other than temporarily impaired. If we determine that the decline in fair value is other than temporary we recognize the amount of the impairment as a realized loss into our current period net income (loss). This determination is based on a number of factors, including but not limited to (i) the percentage of the decline, (ii) the severity of the decline in relation to the enterprise/market conditions, and (iii) the duration of the decline.

Derivative Warrant Liabilities

ASC Subtopic 815-40 (formerly EITF 07-5), "Contracts in Entity's Own Equity," requires that entities recognize as derivative liabilities the derivative instruments, including certain derivative instruments embedded in other contracts that are not indexed to an entity's own stock. Pursuant to the provisions of ASC Section 815-40-15, an entity should use a two-step approach to evaluate whether an equity-linked financial instrument (or embedded feature) is indexed to its own stock, including evaluating the instrument's contingent exercise and settlement provisions. The adoption of ASC Subtopic 815-40 has affected the accounting for (i) certain freestanding warrants that contain exercise price adjustment features and (ii) convertible bonds issued by foreign subsidiaries with a strike price denominated in a foreign currency. In the case of any such warrants and convertible bonds, ASC Subtopic 815-40 provides that such warrants and bonds are to be treated as a liability at fair value with changes in fair value recognized in earnings.

We adopted ASC Subtopic 815-40 on December 31, 2010 and reclassified certain warrants we issued in connection with our February 2008 series A convertible preferred stock offering as a liability rather than as stockholders' equity and recognized the changes in fair value in earnings. The balance of the derivative liabilities as of March 31, 2011 was \$11,811 which is classified as other liabilities on our consolidated balance sheet. The cumulative unrealized gain on the change in fair value was \$159,467. See Note 11 – Capital Stock – Reclassification of Derivative Liabilities for more details.

Accrual of Environmental Obligations

ASC Section 410-30-25 "Recognition" of environmental obligations requires the accrual of a liability if both of the following conditions are met:

- a. Information available before the financial statements are issued or are available to be issued indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements.

- b. The amount of the loss can be reasonably estimated.

As of March 31, 2011, we do not have any environmental remediation obligations, nor do we have any asset retirement obligations under ASC 410. Furthermore, we do not have any environmental remediation loss contingencies requiring recognition or disclosure in our financial statements.

Recent Pronouncements

Business Combinations

In January 2011, Accounting Standards Update (ASU) No. 2010-29 clarifies that pro forma revenue and earnings for a business combination occurring in the current year should be presented as though the business combination occurred as of the beginning of the year or, if comparative statements are presented, as though the business combination took place as of the beginning of the comparative year.

The disclosures required of public entities in respect of a business combination occurring during the current reporting period called for in ASC Section 805-10-50 have been amended as follows:

CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2011

- If comparative financial statements are not presented, pro forma revenue and earnings of the combined entity should be based on the assumption that the business combination took place as of the beginning of the current year.
- If comparative financial statements are presented (1) pro forma revenue and earnings of the combined entity should be based on the assumption that the business combination occurred as of the beginning of the comparative year, and (2) in the year following the business combination, pro forma information should not be revised if comparative statements for the year in which the acquisition occurred are presented (even if such year is the earliest period presented).
- To require disclosure of the nature and amounts of any material nonrecurring adjustments directly attributable to the business combination included in the pro forma revenue and earnings (i.e., supplemental pro forma information).

The new and amended disclosures should be applied prospectively to business combinations consummated on or after the start of the first annual reporting period beginning on or after December 15, 2010, with earlier application permitted. We have adopted this guidance.

A variety of proposed or otherwise potential accounting standards are currently under study by standard setting organizations and various regulatory agencies. Due to the tentative and preliminary nature of those proposed standards, management has not determined whether implementation of such proposed standards would be material to our consolidated financial statements.

NOTE 2 – EARNINGS PER SHARE

Under the provisions of ASC Topic 260, “Earnings Per Share,” basic income (loss) per common share is computed by dividing income (loss) available to common shareholders by the weighted average number of shares of common stock outstanding for the periods presented. Diluted income (loss) per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that would then share in the income of the company, subject to anti-dilution limitations. For the three months and six months ended March 31, 2011, the effect of stock options, warrants and restricted stock awards is anti-dilutive. Accordingly, basic and diluted income (loss) per share is the same for both periods presented.

The following table sets forth the computation of basic and diluted income (loss) per share for the three and six months ended March 31, 2011 and 2010 (unaudited):

	For three months ended March 31,		For six months ended March 31,	
	2011	2010	2011	2010
NUMERATOR:				
Net income attributable to China Direct Industries Inc.	\$ 6,375	\$ 1,657,184	\$ 3,472,211	\$ 672,669
Series A preferred stock:				
Preferred stock dividend	(20,130)	(20,125)	(40,259)	(60,308)
Deemed dividend - beneficial conversion feature	-	-	(600,693)	-
Dividend - warrant valuation	-	-	(76,705)	-
	\$ (13,755)	\$ 1,637,059	\$ 2,754,554	\$ 612,361

Numerator for basic EPS, net
(loss) income attributable to
common stockholders (A)

DENOMINATOR (1):

Denominator for basic and
diluted earnings per

share-weighted average number
of common shares outstanding (

B)	34,728,413	28,594,256	33,257,657	27,981,440
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Stock awards, options, and
warrants (1) (2)

-	462,762	-	462,762
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Denominator for diluted
earnings per share-adjusted
weighted average numbers of
common shares outstanding (C)

34,728,413	29,057,018	33,257,657	28,444,202
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Basic and Diluted Income per
Common Share:

Income per share-basic and
diluted (A)/(B)

\$ (0.00)	\$ 0.06	\$ 0.08	\$ 0.02
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Income per share-basic and
diluted (A)/(C)

\$ (0.00)	\$ 0.06	\$ 0.08	\$ 0.02
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(1) Securities are not included in the denominator in periods when anti-dilutive. We excluded 2,292,980 options to acquire our common stock, 6,264,942 common stock purchase warrants and 175,155 shares of restricted common stock awarded as of March 31, 2011 as their effect was anti-dilutive.

(2) The number of outstanding shares of restricted stock awards and warrants included were 435,814 and 26,948, respectively, for the three month and six month periods ended March 31, 2010.

CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 3 – COMPREHENSIVE INCOME

Comprehensive income is comprised of net income and other comprehensive income or loss. Other comprehensive income or loss refers to revenue, expenses, gains and losses that under US GAAP are included in comprehensive income but excluded from net income as these amounts are recorded directly as adjustments to stockholders' equity.

Our other comprehensive income (loss) consists of currency translation adjustments, unrealized gain (loss) on marketable securities available for sale. The following table sets forth the computation of comprehensive income for the three and six months ended March 31, 2011 and 2010, respectively (unaudited):

	For three months ended March 31,		For six months ended March 31,	
	2011	2010	2011	2010
Net (loss) income	\$ (272,289)	\$ 1,526,830	\$ 3,150,100	\$ 653,923
Other comprehensive income (loss), net of tax				
Changes in foreign currency translation	744,548	(147,143)	1,536,506	192,234
Unrealized gain on marketable securities available for sale	3,423,130	1,878,670	3,946,297	1,645,554
Reclassification adjustment for loss (gain) included in net income	261,557	(2,066,498)	379,969	(2,101,189)
Total other comprehensive income (loss)	4,429,235	(334,971)	5,862,772	(263,401)
Comprehensive income	4,156,946	1,191,859	9,012,872	390,522
Comprehensive loss attributable to the noncontrolling interests	278,664	130,354	322,111	18,746
Foreign currency translation (gain) loss - noncontrolling interests	(283,373)	288,408	(557,551)	(95,416)
Comprehensive income attributable to China Direct Industries, Inc.	\$ 4,152,237	\$ 1,610,621	\$ 8,777,432	\$ 313,852

The total accumulated other comprehensive income as of March 31, 2011 and September 30, 2010 was \$7,100,309 and \$1,795,387, respectively. The accumulated foreign currency translation gain as of March 31, 2011 and September 30, 2010 was \$4,041,734 and \$3,062,779, respectively. The accumulated unrealized gain (loss) on marketable securities available for sale as of March 31, 2011 and September 30, 2010 was \$3,166,231 and (\$1,160,035), respectively. The accumulated loss resulting from sale of subsidiaries as of March 31, 2011 and September 30, 2010 was \$107,357.

NOTE 4 – MARKETABLE SECURITIES

Marketable securities available for sale and marketable securities available for sale-related party at March 31, 2011 and September 30, 2010 consist of the following:

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Company	March 31, 2011 (Unaudited)	% of Total	September 30, 2010	% of Total
China America Holdings, Inc.	\$ 277,128	2 %	\$ 950,250	33 %
China Logistics Group, Inc.	849,393	6 %	515,625	18 %
Dragon International Group Corp.	22,816	0 %	22,815	1 %
China Armco Metals, Inc.	-	0 %	277,600	10 %
Sunwin International Neutraceuticals, Inc.	-	0 %	455,000	16 %
Dragon Capital Group Corp.	334,521	3 %	672,735	23 %
China Education International, Inc.	11,657,636	89 %	-	0 %
Marketable securities available for sale	\$ 13,141,494	100 %	\$ 2,894,025	100 %

CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
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On December 31, 2010, we received a total of 4,740,694 shares of China Education International, Inc., formerly known as USChina Channel, Inc. (“USCC”) common stock as the stock-based payment for consulting services we provided to USCC in connection with USCC’s acquisition of China Education Schools, Ltd. In connection with the consulting service, we also paid \$170,000 to acquire 758,124 shares of USCC’s common stock in a private sale. We accounted for this class of securities as marketable securities available for sale. Pursuant to ASC Topic 820, “Fair Value Measurement”, we used the quoted price for the USCC’s securities to value the shares of USCC’s common stock and recognized \$4,977,728 or \$1.05 per share as our consulting service revenue for the three months ended December 31, 2010.

Invictus Advisory Services, Inc., USCC and our company entered into a Consulting and Management Agreement as of December 31, 2010 whereby we agreed to perform certain consulting and business advisory services for USCC, including advising USCC on financing matters, assistance with acquisitions, and coordination of SEC filings. The term of the agreement is for one year, beginning January 1, 2011. On February 15, 2011, Invictus transferred to us on behalf of USCC a total of 600,000 shares of USCC’s common stock previously issued to Invictus as payment for our services. The 600,000 shares of USCC’s common stock we received were fully vested and non-forfeitable at the time of transfer and were valued at \$1,800,000.

For the six months ended March 31, 2011, the total fair value of USCC’s common stock we received for services was \$6,852,529. We transferred shares of USCC’s common stock with a value of \$283,500 to Animus Advisory Group, Inc. as a fee for its work for us in connection with work we performed for USCC. As of March 31, 2011, the aggregated carrying value of the USCC common stock was \$11,657,636. The USCC common stock is quoted in the over the counter market system, but restricted and cannot be readily sold by us absent a registration of those securities under the Securities Act of 1933 (the “Securities Act”) or the availability of an exemption from the registration requirements under the Securities Act. Our policy is to liquidate the securities we receive as compensation on a regular basis. As these securities are often restricted, we are unable to liquidate them until the restriction is removed. Unrealized gains or losses on marketable securities available for sale are recognized on a periodic basis as an element of comprehensive income based on changes in the fair value of the security. Once liquidated, realized gains or losses on the sale of marketable securities available for sale and marketable securities available for sale-related party are reflected in our net income for the period in which the security was liquidated.

The investments in marketable securities available for sale-related party totaled \$334,521 and \$672,735 at March 31, 2011 and September 30, 2010, respectively and are comprised solely of the securities of Dragon Capital Group Corp. (“Dragon Capital”). Mr. Lisheng (Lawrence) Wang, the CEO and Chairman of the Board of Dragon Capital, is the brother of Dr. James Wang, our CEO and Chairman of the Board of Directors. These securities were issued by Dragon Capital as compensation for consulting services. Dragon Capital is a non-reporting company whose securities are quoted on the OTC Pink Tier of the OTC Markets Group. As such, under Federal securities laws, securities of Dragon Capital generally cannot be resold by us absent a registration of those securities under the Securities Act.

NOTE 5 - INVENTORIES

Inventories at March 31, 2011 and September 30, 2010 consisted of the following:

	March 31, 2011 (Unaudited)	September 30, 2010
Raw materials	\$ 3,183,406	\$ 3,478,947

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Finished goods	6,445,007	2,893,978
Total Inventory	\$ 9,628,413	\$ 6,372,925

Due to the nature of our business and the short duration of the manufacturing process for our products, there is no material work in progress inventory at March 31, 2011 and September 30, 2010.

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CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2011

NOTE 6 - PREPAID EXPENSES AND OTHER CURRENT ASSETS

At March 31, 2011 and September 30, 2010, prepaid expenses and other current assets, consisted of the following:

Description	March 31, 2011 (Unaudited)	September 30, 2010
Prepayments to vendors for merchandise that had not yet been shipped or services that had not been performed	\$ 6,345,735	\$ 4,469,249
Prepaid expenses (1)	2,471,433	\$ 2,546,278
Other receivables (2)	1,457,012	911,217
Loans receivable	939,002	608,904
Security deposits	-	16,721
Total	11,213,182	8,552,369

For the fiscal year ended September 30, 2010, prepayments to vendors for merchandise that had not yet been shipped or services that had not been performed included \$2,546,278 non-trade related prepaid expenses. We reclassified the amount to prepaid expenses to better reflect the nature of the item.

Other receivables as of March 31, 2011 include a prepaid cost for Baotou Changxin Magnesium land use rights. Baotou Changxin Magnesium owns and operates a magnesium facility capable of producing 20,000 metric tons of pure magnesium per year located on approximately 406,000 square feet of land located in the Shiguai district of Baotou city, in Inner Mongolia. Baotou Changxin Magnesium occupies this land pursuant to an asset acquisition agreement entered into with Baotou Sanhe Magnesium Co., Ltd. to acquire the land use rights for this property, among other assets. Since the land use right has yet to be transferred from Baotou Sanhe Magnesium Co. to Baotou Changxin Magnesium, the land use right balance of \$1,111,885 is included in other receivables. The land use right expires in May 2045.

NOTE 7 - PROPERTY, PLANT AND EQUIPMENT

At March 31, 2011 and September 30, 2010, property, plant and equipment, consisted of the following:

Property, Plant and Equipment Description	Useful Life	March 31, 2011 (Unaudited)	September 30, 2010
Building	10-40 years	\$ 15,374,937	\$ 14,978,242
Manufacturing equipment	5-10 year	19,050,608	18,650,462
Office equipment and furniture	3-5 year	53,103	470,238
Autos and trucks	5 year	1,015,634	995,963
Construction in progress	N/A	8,393,464	7,716,777
Total		43,887,747	42,811,682
Less: accumulated depreciation		(7,164,049)	(5,299,421)
Property, Plant and Equipment, Net		\$ 36,723,698	\$ 37,512,261

For the six months ended March 31, 2011 and 2010, depreciation expense totaled \$1,864,627 and \$1,104,512, respectively.

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CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 8 - PROPERTY USE RIGHTS

For the six months ended March 31, 2011 and 2010, amortization expense of the property use rights totaled \$46,304 and \$24,136, respectively. Property use rights, net of accumulated amortization, consisting of mining and property use rights, amounted to \$2,242,187 and \$1,970,585 at March 31, 2011 and September 30, 2010, respectively. During the six months ended March 31, 2011, our subsidiary Shanxi Gu County Golden Magnesium Industry Co., Ltd. (“Golden Magnesium”) paid an additional \$270,827 for governmental fees required to complete the transfer of the land use right to Golden Magnesium.

In connection with our acquisition of CDI Jixiang Metal Co., Ltd. (“CDI Jixiang”) in December 2007, we acquired mining rights to 51 acres of land located in the Yong shun Kaxi Lake Mining area of China. We began the process of obtaining a 5-year renewal for these mining rights in early 2010 as the current lease expired in October 2009. The receipt of the renewal has been delayed due to changes in the Chinese government procedures in granting such renewals. At no time subsequent to October 2009 have we had any indication that the mining rights would not ultimately be renewed. Based on our periodic evaluation of its long-lived assets, we have concluded that none of the assets related to CDI Jixiang are impaired.

NOTE 9 - LOANS PAYABLE

The majority of our loans payable are borrowed for general working capital purposes. Loans payable at March 31, 2011 and September 30, 2010 consisted of the following:

Description	March 31, 2011 (Unaudited)	September 30, 2010
Lang Chemical loan from Bank of Shanghai. Due on February 20, 2011. 5.31% annual interest rate. Guaranteed by China Investment Guarantor Co. Ltd.	\$-	\$447,888
Lang Chemical loan from China Mingsheng Bank. Due on May 26, 2011. 6.638% annual interest rate. Guaranteed by Chen Jingdong.	702,279	686,762
CDI Beijing non-interest bearing loan from Beijing Mingshang Investment Guarantee Co. Ltd. Due on August 31, 2011. Guaranteed by Chi Chen.	-	4,478,882
CDI China, Inc. (“CDI China”) loan from Sunwin Tech Group, Inc. Due on December 31, 2011. 3% annual interest rate. Secured by pledge of CDI China assets.	500,000	-
Lang Chemical loan from Industrial and Commercial Bank of China. Due on October 15, 2011. 5.576% annual interest rate. Guaranteed by Zhu Qian and Chen Jingdong.	305,339	-
CDI Beijing loan from Bank of Hongzhou. Due on October 21, 2011. 6.672% annual interest rate. Guaranteed by Chi Chen.	916,017	-
Total	2,423,635	5,613,532
Less: Current Portion	(2,423,635)	(5,613,532)

Loans payable, long-term	\$-	\$-
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We plan to renew the loan from China Mingsheng Bank due on May 26, 2011 up on it's maturity.

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CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2011

NOTE 10 - RELATED PARTY TRANSACTIONS

List of Related Parties

We have specified the following persons and entities as related parties with ending balances as of March 31, 2011 and September 30, 2010:

Yuwei Huang, is executive vice president of our Magnesium segment, a member of the board of directors, chief executive officer and chairman of Chang Magnesium, chairman of Baotou Changxin Magnesium, chairman of YiWei Magnesium, and chief executive officer and vice chairman of Golden Magnesium; Taiyuan YiWei Magnesium Industry Co., Ltd., a company organized under the laws of the PRC (“YiWei Magnesium”), is a minority interest owner in Chang Magnesium;

Lifei Huang, is the daughter of Yuwei Huang;

Suihuan Huang is the sister of Yuwei Huang;

Lifei Huang, is a registered representative of Pine Capital Enterprises Inc., a company organized under the laws of the Cayman Islands (“Pine Capital”);

Lifei Huang, is a registered representative of Wheaton Group Corp., a company organized under the laws of Brunei Darussalam (“Wheaton?”);

LuCheng Haixu Magnesium Co., Ltd., a company organized under the laws of the PRC (“Haixu Magnesium”), is legally represented by an officer of Chang Magnesium;

Lingshi Xinghai Magnesium Co., Ltd., a company organized under the laws of the PRC (“Xinghai Magnesium”), is legally represented by an officer of Chang Magnesium;

NanTong Langyuan Chemical Co., Ltd., a company organized under the laws of the PRC (“NanTong Chemical”), is owned by Jingdong Chen and Qian Zhu, the minority interest owners of Lang Chemical; Jingdong Chen, is vice president of our Basic Materials segment and chief executive officer of Lang Chemical;

Qian Zhu, is chief financial officer of Lang Chemical. Jingdong Chen and Qian Zhu are husband and wife; Chen Chi is vice president of our Basic Materials Segment and minority interest owner of CDI Beijing; and Zhongmen International Investments Co., Ltd., a company organized under the laws of the PRC (“Zhongmen International”), is legally represented by an officer of CDI Beijing.

As of March 31, 2011, accounts, loans, and other receivables and prepaid expenses- related parties were \$8,229,764 and consist of Accounts receivable – related party of \$1,236,071, Prepaid expenses – related parties of \$3,406,370, Loans receivable – related parties of \$1,061,235, and Due from related parties of \$2,526,088 as set forth below:

Accounts Receivable – related parties

At March 31, 2011, we reported accounts receivable – related parties of \$1,236,071 comprised of the following:

\$682,630 due Baotou Changxin Magnesium from YiWei Magnesium for inventory provided;

\$4,740 due Chang Magnesium from Wheaton for inventory provided;

\$57,935 due Chang Magnesium from Pine Capital for inventory provide;

\$147,031 due Ruiming Magnesium from YiWei Magnesium for inventory provided; and

\$343,735 due Golden Magnesium from YiWei Magnesium for inventory provided.

At September 30, 2010, we reported accounts receivable – related parties of \$2,119,582 comprised of the following:

\$834,758 due Baotou Changxin Magnesium from YiWei Magnesium for inventory provided;
\$4,635 due Chang Magnesium from Wheaton for inventory provided; and
\$1,280,189 due Golden Magnesium from YiWei Magnesium for inventory provided.

CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
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Prepaid Expenses – related parties

At March 31, 2011, we reported prepaid expenses – related parties of \$3,406,370 comprised of the following:

\$76,343 prepaid by Chang Magnesium to Haixu Magnesium for future delivery of inventory;
\$2,545,244 prepaid by Chang Magnesium to YiWei Magnesium for future delivery of inventory;
\$109,148 prepaid by IMTC to YiWei Magnesium for future delivery of inventory;
\$520,000 prepaid by IMTC to Wheaton for future delivery of inventory;
\$29,824 prepaid by Golden Magnesium to YiWei Magnesium for future delivery of inventory; and
\$125,811 prepaid by Ruiming Magnesium to YiWei Magnesium for future delivery of inventory.

At September 30, 2010, we reported prepaid expenses – related parties of \$3,982,163 comprised of the following:

\$204,536 prepaid by Baotou Changxi Magnesium to YiWei Magnesium for future delivery of inventory;
\$74,656 prepaid by Chang Magnesium to Haixu Magnesium for future delivery of inventory;
\$120,838 prepaid by Chang Magnesium to Xinghai Magnesium for future delivery of inventory;
\$3,217,076 prepaid by Chang Magnesium to YiWei Magnesium for future delivery of inventory,
\$4,544 prepaid by Golden Magnesium to Senrun Coal for future delivery of coke gas for fuel;
\$120 prepaid by Golden Magnesium to YiWei Magnesium for future delivery of inventory; and
\$360,393 prepaid by IMTC to YiWei Magnesium for future delivery of inventory.

Loans Receivable – related parties

At March 31, 2011, we reported loan receivables – related parties of \$1,061,235 comprised of the following:

\$1,044,441 due Lang Chemical from NanTong Chemical for funds advanced for working capital purposes;
and
\$16,794 due Chen Chi from CDI Beijing for funds advanced for working capital purposes.

At September 30, 2010, we reported loan receivables – related parties of \$1,528,911 comprised of the following:

\$1,324,309 due Lang Chemical from NanTong Chemical for funds advanced for working capital purposes;
\$74,648 due Chen Chi from CDI Beijing for funds advanced for working capital purposes;
\$119,437 due Baotou Changxi Magnesium from Haixu Magnesium for funds advanced for working capital purposes; and
\$10,517 due Ruiming Magnesium from YiWei Magnesium for funds advanced for working capital purposes.

Due from related parties

At March 31, 2011, we reported due from related parties of \$2,526,088 comprised of the following:

\$152,670 due Baotou Changxi Magnesium from YiWei Magnesium for working capital purposes;
\$1,911,929 due Chang Magnesium from YiWei Magnesium for working capital purposes;
\$122 due Golden Magnesium from Yiwei Magnesium for working capital purposes;
\$412,207 due Ruiming Magnesium from Haixu Magnesium for working capital purposes; and
\$49,160 due CDI Beijing from Zhongmen International for working capital purposes.

At September 30, 2010, we reported due from related parties of \$49,566 comprised of the following:

\$49,566 due CDI Beijing from Zhongmen International for working capital purposes.

As of March 31, 2011, Accounts and other payables – related parties were \$8,034,734 which consist of Accounts payable – related parties of \$1,623,010, Loans payable – related parties of \$628,998, and Due to related parties of \$5,782,726 as set forth below:

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CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
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Accounts Payable – related parties

At March 31, 2011, we reported accounts payable – related party of \$1,623,010 comprised of the following:

\$15,477 due from Baotou Changxi Magnesium to Haixu Magnesium for purchases of goods;
\$1,449,348 due from IMTC to Pine Capital for purchases of goods;
\$156,658 due from IMTC to Yiwei Magnesium for purchases of goods; and
\$1,527 due from Golden Magnesium to Xinghai Magnesium for purchases of goods.

At September 30, 2010, we reported accounts payable – related party of \$40,558 comprised of the following:

\$12,200 due from Chang Magnesium to Pine Capital for purchases of goods;
\$15,135 due from Baotou Changxi Magnesium to Haixu Magnesium for purchases of goods;
\$11,396 due from Golden Magnesium to YiWei Magnesium for purchases of goods;
\$1,493 due from Golden Magnesium to Haixu Magnesium for purchases of goods; and
\$334 due from Golden Magnesium to Xinghai Magnesium for purchases of goods.

Loan Payable – related parties

At September March 31, 2011, we reported loan payable – related parties of \$628,998 comprised of the following:

\$628,998 due to Zhu Qian for funds advanced for working capital of Lang Chemical.

At September 30, 2010 we reported loan payable – related parties of \$60,990 comprised of the following:

\$60,990 due to Pine Capital for funds advanced for working capital of Golden Magnesium.

Due to related parties

At March 31, 2011, we reported due to related parties balance of \$5,782,726 comprised of the following:

\$3,176,659 due to YiWei Magnesium for the balance of the purchase price for Ruiming Magnesium;
\$2,178,593 due YiWei Magnesium for working capital of Ruiming Magnesium; and
\$427,474 due to Suihuan Huang for working capital of Ruiming Magnesium.

At September 30, 2010, we reported due to related parties balance of \$3,872,157 comprised of the following:

\$3,872,157 due to YiWei Magnesium for the balance of the purchase price for Ruiming Magnesium.

NOTE 11 – CAPITAL STOCK

Preferred Stock and Related Dividends

We have 10,000,000 shares of preferred stock, par value \$.0001, authorized, of which we designated 12,950 as our Series A Convertible Preferred Stock in February 2008. At March 31, 2011 and September 30, 2010 there were 1,006 shares of Series A Convertible Preferred Stock outstanding. The Series A Convertible Preferred Stock has a stated

value per share of \$1,000, carries an 8% per annum dividend rate payable quarterly in arrears and is convertible into common stock at \$1.80 per share after giving effect to a price reduction in connection with a December 30, 2010 offering of our securities. During the six months ended March 31, 2011, we paid \$40,260 ordinary dividends in the form of 26,290 shares of our common stock. During the six months ended March 31, 2010, we paid \$60,308 in the form of 29,255 shares of our common stock and cash of \$20,125, respectively.

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CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
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On February 11, 2008, we entered into a Securities Purchase Agreement with accredited investors to sell 12,950 shares of our Series A Preferred Stock which was convertible into common stock at \$7.00 per share. This class of preferred stock carries an embedded contingent beneficial conversion option that allows the conversion price to reset, contingent upon certain future transactional events. As of May 31, 2009, only 1,006 shares of our Series A Preferred Stock were issued and outstanding. On June 15, 2009, we registered a direct offer of our common stock at \$1.85 per share, and therefore as provided under the original Securities Purchase Agreement, we should have accounted for this conversion price reduction from \$7.00 to \$1.85 per share as additional intrinsic values beneficially extended to this class of stockholders in the three month interim period ended June 30, 2009, in which the first conversion price reset occurred. We made a determination that even if we retrospectively applied the adjustments to reflect such accounting changes to the prior periods, the net effect would be immaterial from both a quantitative and qualitative standpoint.

ASC 470-20 provides that upon the resolution of the contingency, a corresponding adjustment is required to account for and recognize the excess number of shares to be received multiplied by the stock price on the original commitment date as additional intrinsic economic benefits extended to this class of shareholders. Based on the facts and circumstances in our case, the preliminary re-measurement for this contingent beneficial conversion option amounted to \$600,693, representing the remaining undiscounted portion of the net proceeds allocated to the outstanding 1,006 shares of Series A Preferred Stock at the original offer. As of December 31, 2010, we recorded a total discount of \$600,693 to account for the additional intrinsic values for the outstanding 1,006 shares of Series A Preferred Stock, accreted the full amount immediately as this class of preferred stock does not have a stated redemption date or finite life, and recognized it as a one-time deemed dividend or a reduction to our retained earnings and a corresponding increase in additional paid-in capital.

Reclassification of Derivative Liabilities

As of March 31, 2011 the Series A Preferred stockholders held an aggregate of 143,750 common stock purchase warrants, which contained a downside ratchet provision, that would allow the exercise price of these warrants to reset, contingent upon certain future transactional events. The terms of these warrants provide that if we sell common stock at a price per share less than the then exercise price of the warrants then we are required to reduce the exercise price of those warrants to the lower price of the subsequent sale. On June 15, 2009, we registered a direct offering of our common stock, which reduced the exercise price of the 143,750 warrants to purchase our common stock from \$8.00 to \$1.85 per share. On December 30, 2010, we entered into an engagement letter with Rodman & Renshaw for the sale of our common stock at \$1.80 per share, which again reset the exercise price of the aforementioned warrants from \$1.85 to \$1.80 per share.

ASC Topic 815 "Derivatives and Hedging" requires any warrant (or embedded feature) that is not indexed to an entity's own stock to be classified as a derivative liability instead of part of the permanent equity, with changes in fair value to be recognized into the then current earnings. Even though we should have adopted EITF 07-05 (currently ASC 815-40), beginning on January 1, 2009, applicable to our financial statements, we made a determination that even if we retrospectively applied the adjustments to reflect such accounting changes to the prior periods, the net effect would be immaterial from both a quantitative and qualitative standpoint.

As of December 31, 2010, we reclassified the 143,750 common stock purchase warrants with the downside ratchet provision from additional paid-in capital of the permanent equity into derivative liabilities to reflect the cumulative accounting effects on our balance sheet, with the cumulative effects on changes in fair values of derivative liabilities recognized in the current period of our statement of operations. In conjunction with the re-measurements and reclassifications, we recognized \$76,705 as a one-time deemed dividend and a reduction to retained earnings, and

recorded a corresponding increase in additional paid-in capital, to reflect the increase in fair value of the 143,750 warrants for the reduction of their exercise price. We reclassified \$171,278 to derivative liabilities from additional paid-in capital on our balance sheet, and recorded a net amount of \$104,305 as an unrealized gain into our current earnings to reflect the cumulative effects on changes in fair value of derivative liabilities.

As of December 31, 2010, the carrying amount of \$66,973 reflected the then current fair value of the derivative liabilities. As of March 31, 2011, the balance of the derivative liabilities was \$11,811.

CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
 March 31, 2011

Inputs used in making the above determinations included:

	2009		
	June 30	September 30	December 31
Value of per common share	\$ 1.72	\$ 1.57	\$ 1.18
Expected time to exercise (year)	2	1.75	1.5
Expected volatility	130%	127%	102%
Risk-free interest rate	1.11%	0.81%	1.14%
Dividend yield	0%	0%	0%

2010 March 31,
2011