

China Direct, Inc.  
Form 10-Q  
May 08, 2008

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

(Mark One)

**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, 2008

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, INC.**

(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)

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**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 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 []

Indicated the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. 23,041,039 shares of common stock are issued and outstanding as of May 8, 2008.

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**TABLE OF CONTENTS**

	Page <u>No.</u>
<b>PART I - FINANCIAL INFORMATION</b>	
Item 1. Financial Statements	5
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.	31
Item 3. Quantative and Qualitative Disclosures About Market Risk.	52
Item 4T Controls and Procedures.	52
<b>PART II - OTHER INFORMATION</b>	
Item 1. Legal Proceedings.	53
Item 1A. Risk Factors.	53
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.	53
Item 3. Defaults Upon Senior Securities.	53
Item 4. Submission of Matters to a Vote of Security Holders.	53
Item 5. Other Information.	53
Item 6. Exhibits.	53

**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION**

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. These forward-looking statements were based on various factors and were derived utilizing numerous assumptions and other factors that could cause our actual results to differ materially from those in the forward-looking statements. These factors include, but are not limited to, the risk of doing business in the People's Republic of China (the "PRC"), our ability to implement our strategic initiatives, our access to sufficient capital, the effective integration of our subsidiaries in the PRC into our U.S. public company structure, economic, political and market conditions and fluctuations, government and industry regulation, Chinese and global competition, and other factors. Most of these factors are difficult to predict accurately and are generally beyond our control. You should consider the areas of risk described in connection with any forward-looking statements that may be made herein. Readers are cautioned not to place undue reliance on these forward-looking statements and readers should carefully review this report in its entirety. Except for our ongoing obligations to disclose material information under the Federal securities laws, we undertake no obligation to release publicly any revisions to any forward-looking statements, to report events or to report the occurrence of unanticipated events. These forward-looking statements speak only as of the date of this report, and you should not rely on these statements without also considering the risks and uncertainties associated with these statements and our business.

**OTHER PERTINENT INFORMATION**

All share and per share information contained in this report gives effect to the 100 for 1 (100:1) reverse stock split of our common stock effective June 28, 2006.

The information which appears on our websites at [www.chinadirectinc.com](http://www.chinadirectinc.com) and [www.cdii.net](http://www.cdii.net) are not part of this report.



**ORGANIZATIONAL CHART**

We operate our company in two primary divisions. Our Management Services division acquires controlling interests of Chinese business entities which we consolidate as either our wholly or majority owned subsidiaries. Our Advisory Services division provides consulting services to Chinese entities seeking access to the U.S. capital markets. The following chart reflects our current organizational structure.

For financial reporting purposes, we report in four segments, including:

Magnesium,  
Basic Materials,  
Consulting, and  
Clean Technology.

## INDEX OF CERTAIN DEFINED TERMS USED IN THIS REPORT

When used in this report the terms:

China Direct , we , us or our refers to China Direct, Inc., a Florida corporation, and our subsidiaries,  
China Direct Investments , refers to China Direct Investments, Inc., a Florida corporation, and a wholly owned subsidiary of China Direct,  
CDI China , refers to CDI China, Inc., a Florida corporation, and a wholly owned subsidiary of China Direct,  
CDI Shanghai Management , refers to CDI Shanghai Management Co., Ltd., a Chinese limited liability company and a wholly owned subsidiary of CDI China,  
Capital One Resource , refers to Capital One Resource Co., Ltd., a Brunei company, and a wholly owned subsidiary of CDI Shanghai Management,  
Lang Chemical , refers to Shanghai Lang Chemical Co., Ltd. a Chinese limited liability company, and a 51% majority owned subsidiary of CDI China,  
Chang Magnesium , refers to Taiyuan Changxin Magnesium Co., Ltd., a Chinese limited liability company and a 51% majority owned subsidiary of CDI China,  
Chang Trading , refers to Taiyuan Changxin YiWei Trading Co., Ltd., a Chinese limited liability company 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% majority owned subsidiary of CDI China,  
Asia Magnesium , refers to Asia Magnesium Corporation Ltd., a Hong Kong limited liability company and a wholly owned subsidiary of Capital One Resource  
Golden Magnesium , refers to Shanxi Gu County Golden Magnesium Co., Ltd., a Chinese limited liability company, formerly referred to by us in filings and press releases as Jinwei Magnesium , and a 52% majority owned subsidiary of Asia Magnesium,  
Pan Asia Magnesium , refers to Pan Asia Magnesium Co., Ltd., a Chinese limited liability company and a 51% majority owned subsidiary of CDI China,  
Baotou Changxin Magnesium , refers to Baotou Changxin Magnesium Co., Ltd., a Chinese limited liability company and a 51% majority owned subsidiary of CDI China,  
Xinjin Magnesium , refers to Baotou Xinjin Magnesium Co., Ltd., a Chinese limited liability company. In April 2008 CDI China entered into an agreement to acquire a 51% majority owned subsidiary of Xinjin Magnesium,  
CDI Clean Technology , refers to CDI Clean Technology Group, Inc., a Florida corporation formerly known as Jinan Alternative Energy Group Corp., and a wholly owned subsidiary of CDI China,  
CDI Wanda , refers to Shandong CDI Wanda New Energy Co., Ltd., a Chinese limited liability company and a 51% majority owned subsidiary of CDI Clean Technology,  
Yantai CDI Wanda , refers to Yantai CDI Wanda Renewable Resources Co., Ltd., a Chinese limited liability company and a 52% majority owned subsidiary of CDI Wanda,  
CDI Jingkun Zinc , refers to CDI Jingkun Zinc Industry Co., Ltd., a Chinese limited liability company and a 95% majority owned subsidiary of CDI Shanghai Management,  
CDI Jixiang Metal , refers to CDI Jixiang Metal Co., Ltd., a Chinese limited liability company and a wholly owned subsidiary of CDI China  
CDI Metal Recycling , refers to Shanghai CDI Metal Recycling Co., Ltd., a Chinese limited liability company and an 83% majority owned subsidiary of CDI Shanghai Management

**PART 1 - FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

**CHINA DIRECT, INC. AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

**ASSETS**

Current Assets:

Cash and cash equivalents

Investment in marketable securities held for sale

Investment in marketable securities held for sale-related party

Accounts receivable, net of allowance for doubtful accounts of \$294,455 and \$290,456 at March 31, 2008 and December 31, 2007, respectively

Accounts receivable-related parties

Inventories

Prepaid expenses and other current assets

Prepaid expenses-related parties

Loans receivable-related parties

Due from related parties

Total current assets

Restricted cash

Property, plant and equipment, net of accumulated depreciation of \$1,004,121 and \$577,801 at March 31, 2008 and December 31, 2007, respectively

Prepaid expenses and other assets

Property rights, net

Total assets

**LIABILITIES AND STOCKHOLDERS' EQUITY**

Current Liabilities:

Loans payable-short term

Accounts payable and accrued expenses

Accounts payable-related parties

Notes payable-related party

Accrued dividends payable

Advances from customers

Advances from customers-related parties

Other payables

Income tax payable

Due to related parties

Total current liabilities

Loans payable-long term

Minority interest

Stockholders' Equity:

Preferred Stock: \$.0001 par value, stated value \$1,000 per share; 10,000,000 authorized, 12,950 shares and 0 shares issued and outstanding at March 31, 2008

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Common Stock: \$.0001 par value, 1,000,000,000 authorized, 21,007,010 and 20,982,010 issued and outstanding at March 31, 2008 and December 31, 2007  
Additional paid-in capital  
Deferred compensation  
Accumulated comprehensive income  
Retained earnings

Total stockholders' equity

Total liabilities and stockholders' equity

See notes to unaudited consolidated financial statements

5

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**CHINA DIRECT, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

**(Unaudited)**

Revenues

Revenues-related parties

Total revenues

Cost of revenues

Gross profit

Operating expenses:

Selling, general, and administrative

Operating income

Other income (expense):

Other income

Interest income

Realized loss on sale of marketable securities

Realized loss on sale of marketable securities-related party

Total other income

Net income before income taxes

Income taxes expense

Income before minority interest

Minority interest in income of subsidiaries

Net income

Deduct required dividends on Series A 8% Cumulative Preferred Stock:

Cumulative preferred stock dividend

Relative fair value of detachable warrants issued

Preferred stock beneficial conversion feature

Income (loss) applicable to common stockholders

Basic and diluted income (loss) per common share after deduction in 2008, of noncash deemed dividends attributable to Series A Preferred Stock as described

Basic

Diluted

Basic weighted average common shares outstanding

Diluted weighted average common shares outstanding

See notes to unaudited consolidated financial statements

6

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## CHINA DIRECT , INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	<b>For the Three Months</b>	
	<b>Ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
Cash flows from operating activities:		
Net income	\$4,752,876	\$1,870,869
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation	426,320	56,821
Bad debt recovery		(102,253 )
Allowance for doubtful accounts	3,999	
Stock based compensation	207,273	83,248
Realized loss on investment in marketable securities	39,461	15,973
Fair value of shares received for services	(140,650 )	(1,311,950 )
Fair value of warrants granted for services	46,364	
Minority Interest	4,532,224	554,105
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	274,863	(4,763,732 )
Prepaid expenses-related parties	(3,104,661 )	
Inventories	(6,758,275 )	3,444,443
Accounts receivable	(4,792,186 )	(3,337,203 )
Accounts receivable-related parties	1,284,250	
Accounts payable and accrued expenses	(1,940,021 )	(1,068,939 )
Accounts payable-related party	(530,228 )	1,208,879
Advances from customers	747,524	3,366,519
Advances from customers-related parties	1,314,716	
Other payables	2,034,201	1,675,498
Deferred income tax		61,995
Income tax payable	368,307	9,190
Net cash (used in) provided by operating activities	(1,233,643 )	1,763,463
Cash flows from investing activities:		
Cash acquired from acquisitions		55,777
Decrease in notes receivable	167,741	897,366
Increase in loans receivable	(569,622 )	
Increase in loans receivable-related parties	(1,569,309 )	
Proceeds from the sale of marketable securities	239,579	125,638
Purchases of property, plant and equipment	(2,300,528 )	(23,480 )
Net cash (used in) provided by investing activities	(4,032,139 )	1,055,301
Cash flows from financing activities:		
Decrease in restricted cash	644,160	447,713
Proceeds from loans payable	2,082,912	(1,228,272 )
Repayment of loans payable	(1,859,423 )	
Decrease in notes payable	(592,007 )	
Decrease in notes payable-related party	(410,167 )	
Repayment of advances from executive officers		(140,893 )
Due from related parties	1,043,185	(996,783 )
Due to related parties	(1,653,274 )	
Payment of offering expenses	(100,000 )	
Gross proceeds from sale of preferred stock	12,950,000	1,425,000

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Payment of offering expenses	(1,404,345	)
Net cash provided by (used in) financing activities	10,701,041	(493,235 )
EFFECT OF EXCHANGE RATE ON CASH	1,000,269	52,752
Net increase in cash	6,435,528	2,378,281
Cash, beginning of year	20,394,931	3,030,345
Cash, end of period	\$26,830,459	\$5,408,626
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid for taxes	\$6,166	\$165,161
Cash paid for interest	\$27,156	\$3,025
Non-cash preferred stock deemed dividend	\$5,217,392	\$

See notes to unaudited consolidated financial statements

7

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**CHINA DIRECT, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2008**

**NOTE 1 ORGANIZATION AND DESCRIPTION OF BUSINESS**

*Business and Organization*

China Direct, Inc., a Florida corporation formerly known as Evolve One, Inc., and its subsidiaries are referred to in this report as the "Company", we, us, our, or "China Direct". China Direct Investments, Inc., a Florida corporation and a wholly owned subsidiary of China Direct is referred to in this report as China Direct Investments. CDI China, Inc., a Florida corporation and a wholly owned subsidiary of China Direct is referred to in this report as CDI China.

China Direct is a management and advisory services organization which owns and consults business entities operating in the People's Republic of China ( PRC ). China Direct operates in two primary divisions; (i) Management Services and (ii) Advisory Services. Our Management Services division acquires controlling interests of Chinese business entities which we consolidate as either our wholly or majority owned subsidiaries. Through this ownership control, we provide management advice as well as investment capital. We refer to these subsidiaries as our portfolio companies. Our Advisory Services division provides consulting services to Chinese entities seeking access to the U.S. capital markets. We currently have service contracts with various clients who conduct business within China or seek to conduct business in China. We refer to these companies as client companies.

Our primary, but not exclusive, method of acquiring a portfolio company in the PRC is to create a foreign invested entity ( FIE ), or a joint venture entity ( JV ). Generally, to create a FIE or a JV, an application is made to the local PRC government to increase the registered capital of a Chinese domestic company. The Chinese domestic company will contribute its assets and we will contribute investment funds. A new FIE or JV is created, with our ownership percentage represented by the value of our capital contribution as compared to the new total registered capital amount. Our investments in the PRC adhere to the rules and regulations governing foreign investment in China and we obtain all relevant and necessary governmental approvals and business licenses.

**NOTE 2 BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Basis of Presentation*

The unaudited consolidated financial statements of China Direct, Inc. and all its subsidiaries (the Company) have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and pursuant to the requirements for reporting on Form 10-Q. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for annual financial statements. However, the information included in these interim financial statements reflects all adjustments (consisting solely of normal recurring adjustments) which are, in the opinion of management, necessary for the fair presentation of the consolidated financial position and the consolidated results of operations. Results shown for interim periods are not necessarily indicative of

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the results to be obtained for a full year. The consolidated balance sheet information as of December 31, 2007 was derived from the audited consolidated financial statements included in the Company's Annual Report on Form 10-K. These interim financial statements should be read in conjunction with our Form 10-K for the year ended December 31, 2007. Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

**CHINA DIRECT, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2008**

**NOTE 2 BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES***(Continued)*

*Basis of Presentation (Continued)*

In January 2008, our majority owned subsidiary, CDI Wanda, entered into an agreement with Messrs. Shicheng Zhang, Li Yang and Chi Chen to form Yantai CDI Wanda Renewable Resources Co., Ltd., a Chinese limited liability company ( Yantai CDI Wanda ). CDI Wanda contributed \$712,329 as registered capital to acquire its 52% interest and Shicheng Zhang, Li Yang, and Chi Chen each contributed \$219,278 to hold a 16% interest, respectively. Yantai CDI Wanda was formed to construct and operate a scrap tire recycling center utilizing a recycling process developed by CDI Wanda.

In February 2008, our wholly owned subsidiary, CDI Shanghai Management, entered into an agreement with Mr. Weiyi Zhou, an individual, to form Shanghai CDI Metal Recycling Co., Ltd., a Chinese limited liability company ( CDI Metal Recycling ) as a joint venture entity. CDI Shanghai Management agreed to contribute \$347,222 to the registered capital of the joint venture, representing an 83% interest and Mr. Zhou agreed to contribute cash and assets valued at \$69,444 for a 17% interest. CDI Metal Recycling will recycle aluminum wire into aluminum powder. CDI Metal Recycling expects to commence operations in October 2008.

In February 2008, our subsidiary, CDI China, entered into an agreement with Excel Rise and Three Harmony (Australia) Party, Ltd. ( Three Harmony ) to form Baotou Changxin Magnesium Co., Ltd., a Chinese limited liability company ( Baotou Changxin Magnesium ) as a FIE. CDI China will contribute approximately \$7,084,000 to the registered capital of this entity, Excel Rise \$5,417,000 and Three Harmony \$1,389,000, representing a 51%, 39% and 10% interest, respectively. Baotou Changxin Magnesium is a 51% owned subsidiary of CDI China and a 39% owned subsidiary of Excel Rise. Accordingly, China Direct holds a 70.9% interest in Baotou Changxin Magnesium.

*Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results when ultimately realized could differ from those estimates. Significant estimates include the allowance for doubtful accounts of accounts receivable, stock-based compensation, and the useful life of property, plant and equipment.

*Cash and Cash Equivalents*

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For purposes of the consolidated statements of cash flows, the Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.



**CHINA DIRECT, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****MARCH 31, 2008****NOTE 2 BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES(Continued)***Concentration of Credit Risks*

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash and trade accounts receivable. The Company places its cash with high credit quality financial institutions in the United States and China. As of March 31, 2008, bank deposits in the United States exceeded federally insured limits by \$7,736,370. At March 31, 2008, the Company had deposits of \$14,406,837 in banks in China. In China, there is no equivalent federal deposit insurance as in United States; as such, these amounts held in banks in China are not insured. The Company has not experienced any losses in such bank accounts through March 31, 2008.

At March 31, 2008 and December 31, 2007, our bank deposits by geographic area were as follows:

	<b>March 31, 2008</b>		<b>December 31, 2007</b>	
Country				
United States	\$ 12,423,622	46%	\$ 9,942,948	49%
China	14,406,837	54%	10,451,983	51%
Total cash and cash equivalents	\$ 26,830,459	100%	\$ 20,394,931	100%

In an effort to mitigate any potential risk, the Company periodically evaluates the credit quality of the financial institutions at which it holds deposits, both in the United States and China.

Marketable securities held for sale at March 31, 2008 and December 31, 2007 consist of the following:

	<b>March 31, 2008</b>		<b>December 31, 2007</b>	
Client Company				
China America Holdings, Inc.	\$ 860,840	14%	\$ 1,828,481	23%
China Logistics Group, Inc.	3,609,375	57%	4,042,500	52%
Dragon International Group Corp.	1,176,916	19%	1,171,844	15%
Other	667,010	10%	777,675	10%
Total Marketable securities held for sale	\$ 6,314,141	100%	\$ 7,820,500	100%

We categorize securities as investment in marketable securities held for sale and investment in marketable securities held for sale-related party. The securities of one client, Dragon Capital Group Corp., accounted for all investment in marketable securities held for sale related party at

March 31, 2008 and December 31, 2007.

**CHINA DIRECT, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2008**

**NOTE 2 BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES***(Continued)*

*Concentration of Credit Risks (Continued)*

Dragon Capital Group Corp. ( Dragon Capital ) is a related party. Mr. Lisheng (Lawrence) Wang, the CEO and Chairman of the Board of Dragon Capital, is the brother of Dr. James Wang, CEO and Chairman of China Direct. These securities were issued by Dragon Capital as compensation for services. Dragon Capital is a non-reporting company whose securities are quoted on the Pink Sheets, as such, under Federal securities laws, securities of Dragon Capital cannot be readily resold by us generally, absent a registration of those securities under the Securities Act of 1933. Dragon Capital does not intend to register the securities. Accordingly, while under generally accepted accounting principles we are required to reflect the fair value of these securities on our consolidated balance sheet, they are not readily convertible into cash and we may never realize the carrying value of these securities.

At March 31, 2008 our consolidated balance sheet includes accounts receivable related party of \$999,350. Accounts receivable-related party represents \$999,350 due from Taiyuan YiWei Magnesium Industry Co., Ltd. to Chang Magnesium for other income generated in the three month period ended March 31, 2008, for which payment had not yet been collected.

Yuwei Huang, CEO and Chairman of Chang Magnesium, Chairman of Baotou Changxin Magnesium, and CEO and Vice Chairman of Golden Magnesium, is the Chairman of Taiyuan YiWei Magnesium Industry Co., Ltd., a Chinese limited liability company ( YiWei Magnesium ).

*Accounts receivable*

Accounts receivable are reported at net realizable value. We have established an allowance for doubtful accounts based upon factors pertaining to the credit risk of specific customers, historical trends, age of the receivable and other information. Delinquent accounts are written off when it is determined that the amounts are uncollectible. At March 31, 2008 and December 31, 2007, allowances for doubtful accounts were \$294,455 and \$290,456, respectively.

*Inventories*

Inventories, consisting of raw materials and finished goods related to our products are stated at the lower of cost or market utilizing the weighted average method.

*Accounts payable-related parties*

At March 31, 2008 our consolidated balance sheet reflects accounts payable related party of \$433,886 comprised of \$368,671 and \$65,215 due YiWei Magnesium for the purchase of inventory by our portfolio companies, Chang Magnesium and Golden Magnesium, respectively. At December 31, 2007 our consolidated balance sheet reflects accounts payable related party of \$964,114 comprised of \$604,596 and \$359,518 due YiWei Magnesium for the purchase of inventory by our portfolio companies, Chang Magnesium and Golden Magnesium, respectively.

**CHINA DIRECT, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2008**

**NOTE 2 BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES(Continued)**

*Fair Value of Financial Instruments*

The carrying value of cash and cash equivalents, investments in marketable securities held for sale, investment in marketable securities held for sale-related party, accounts payable and accrued expenses, income tax payable and due to related parties approximates their fair value due to their short term maturities. The carrying value of marketable securities held for sale and marketable securities held for sale-related party is reflected at their fair value based on the price of the security as quoted on national or inter-dealer stock exchanges as of the balance sheet date.

*Marketable Securities*

Through our Advisory Services division, the Company receives securities which include common stock and common stock purchase warrants from client companies as compensation for consulting services. The Company classifies these securities as investments in marketable securities held for sale or investment in marketable securities held for sale-related party. These securities are stated at their fair value in accordance with SFAS #115 "Accounting for Certain Investments in Debt and Equity Securities", and EITF 00-8 "Accounting by a Grantee for an Equity Instrument to be Received in Conjunction with Providing Goods or Services". All of the securities are received from client companies whose common stock is listed either on the Over the Counter Bulletin Board or Pinks Sheets. The common stock and the shares underlying common stock purchase warrants received as compensation are typically restricted as to resale. Our policy is to sell securities received as compensation when permitted rather than hold on to these securities as long term investments, regardless of market conditions in an effort to satisfy our current obligations. As these securities are often restricted, we are unable to liquidate these securities until the restriction is removed. The Company recognizes revenue for such common stock based on the fair value at the time common stock is granted and for common stock purchase warrants based on the Black-Scholes valuation model. Unrealized gains or losses on marketable securities held for sale and on marketable securities held for sale-related party are recognized as an element of comprehensive income in our consolidated statements of operations on a monthly basis based on changes in the fair value of the security as quoted on national or inter-dealer stock exchanges. Once liquidated, realized gains or losses on the sale of marketable securities held for sale and marketable securities held for sale-related party are reflected in our net income for the period in which the security was liquidated.

The unrealized losses on marketable securities held for sale, net of the effect of taxes, for the three months ended March 31, 2008 and 2007 were \$1,128,124 and \$ 607,539, respectively. The unrealized losses on marketable securities held for sale-related party, net of the effect of taxes, for the three months ended March 31, 2008 and 2007 were \$462,223 and \$341,458, respectively.

The realized loss related to investments in marketable securities held for sale for the three months ended March 31, 2008 and 2007 were \$39,461 and \$0, respectively. Net realized losses on the sale of marketable securities held for sale-related party for the three months ended March 31, 2008 and 2007 were \$0 and \$15,973, respectively.



**CHINA DIRECT, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2008**

**NOTE 2 BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES***(Continued)*

*Prepaid Expenses and Other Current Assets*

Prepaid expenses and other current assets consist of (i) prepayments to vendors for merchandise that had not yet been shipped, (ii) the fair value of securities received from client companies associated with our Consulting segment which were assigned to our executive officers, (iii) value added tax refunds available from the Chinese government, (iv) loan receivable and (v) other receivables. At March 31, 2008 and December 31, 2007 our consolidated balance sheet includes prepaid expenses and other current assets of \$15,934,127 and \$15,439,462, respectively.

Prepaid expenses related parties were \$7,255,604 and \$4,150,943, at March 31, 2008 and December 31, 2007, respectively. Lang Chemical within our Basic Materials segment advanced \$1,535,155 to NanTong LangYuan Chemical Co., Ltd. for the future delivery of inventory which has not yet been received. Chang Magnesium advanced \$3,975,320 to YiWei Magnesium for the future delivery of inventory which has not yet been received. Golden Magnesium advanced \$1,745,129 to Shanxi Senrun Coal Chemistry Co., Ltd., for the future delivery of gas supplies which has not yet been received.

NanTong LangYuan Chemical Co., Ltd. is a Chinese limited liability company, ( NanTong Chemical ) owned by Jingdong Chen and Qian Zhu, the two minority shareholders of Lang Chemical.

Non-current prepaid expenses and other assets consist of (i) the fair value of client company securities which were assigned to executive officers for services to be rendered over the term of the respective consulting agreement which will be amortized beyond the twelve month period, and (ii) other assets acquired in connection with the acquisition of Pan Asia Magnesium. Accordingly we reflect a non-current prepaid expense of \$238,910 and \$433,075 at March 31, 2008 and December 31, 2007, respectively.

*Property, Plant and Equipment*

Property, plant and equipment are recorded at cost and depreciated on a straight line basis over their estimated useful lives of three to forty years. Maintenance and repairs are charged to expense as incurred. Significant renewals and improvements are capitalized.

*Advances from customers*

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Advances from customers represent (i) prepayments to the Company for merchandise that had not yet been shipped to customers and (ii) the fair value of securities received which will be amortized over the term of the respective consulting agreement. The Company will recognize these advances as revenues as customers take delivery of the goods, in compliance with our revenue recognition policy. Advances from customers were \$7,710,585 and \$6,963,061 at March 31, 2008 and December 31, 2007, respectively.

Advances from customers related party were \$1,314,716 and \$0 at March 31, 2008 and December 31, 2007, respectively. Golden Magnesium within our Magnesium segment received advance payment of \$1,314,716 from YiWei Magnesium for magnesium which had not yet been shipped.



**CHINA DIRECT, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****MARCH 31, 2008****NOTE 2 BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES(Continued)***Comprehensive income*

The Company follows Statement of Financial Accounting Standards No. 130 (SFAS 130) "Reporting Comprehensive Income" to recognize the elements of comprehensive income. Comprehensive income is comprised of net income and all changes to the statements of stockholders' equity, except those due to investments by stockholders, changes in paid-in capital and distributions to stockholders. For the Company, comprehensive income for the three months ended March 31, 2008 and 2007 included net income, foreign currency translation adjustments, unrealized gains or losses on marketable securities held for sale, net of income taxes, and unrealized gains or losses on marketable securities held for sale-related party, net of income taxes.

*Foreign currency translation*

The accompanying consolidated financial statements are presented in United States dollars. The functional currency of our Chinese subsidiaries is the 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 date. Income and expenditures are translated at the average exchange rate of the quarter.

	<b>2008</b>	<b>2007</b>
Quarter end RMB : U.S. Dollar exchange rate	7.0222	7.7409
Average quarterly RMB : U.S. Dollar exchange rate	7.1757	7.7714

The 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 the RMB amounts could have been, or could be, converted into US dollars at the rates used in translation.

*Impairment of long-lived assets*

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", the Company periodically reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable. The Company recognizes an impairment loss when the sum of expected undiscounted future cash flows is less than the carrying amount of the asset. The amount of impairment is measured as the difference between the asset's estimated fair value and its book value. The

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Company did not record any impairment charges during the three months ended March 31, 2008 or 2007.

### *Minority interest*

Under generally accepted accounting principles when losses applicable to the minority interest in a subsidiary exceed the minority interest in the equity capital of the subsidiary, the excess is not charged to the majority interest since there is no obligation of the minority interest to make good on such losses. The Company, therefore, has absorbed all losses applicable to a minority interest where applicable. If future earnings do materialize, the Company shall be credited to the extent of such losses previously absorbed.

**CHINA DIRECT, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2008**

**NOTE 2 BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES(Continued)**

*Income Taxes*

We accounted for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*. SFAS No. 109 requires the recognition of deferred tax assets and liabilities to reflect the future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Measurement of the deferred items is based on enacted tax laws. In the event the future consequences of differences between the financial reporting basis and tax bases of the Company's assets and liabilities result in a deferred tax asset, SFAS No. 109 requires an evaluation of the probability of our being able to realize the future benefits indicated by such assets. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that some or the entire deferred tax asset will not be realized.

*Basic and Diluted 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 show in the income of the company, subject to anti-dilution limitations.

*Revenue Recognition*

The Company follows the guidance of the Securities and Exchange Commission's Staff Accounting Bulletin 104 for revenue recognition. In general, we record revenue when persuasive evidence of an arrangement exists, services have been rendered or product delivery has occurred, the sales price to the customer is fixed or determinable, and collectability is reasonably assured.

*Stock Based Compensation*

The Company accounts for stock options issued to employees in accordance with SFAS 123R, *Share-Based Payment, an Amendment of FASB Statement No. 123* (SFAS 123R). SFAS 123R requires companies to recognize in the statement of operations the grant-date fair value of stock options and other equity based compensation issued to employees.



**CHINA DIRECT, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**MARCH 31, 2008**

**NOTE 2 BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES(Continued)**

*Recent Pronouncements*

In February 2007, the FASB issued SFAS No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FAS 115*". SFAS 159 allows entities to choose, at specified election dates, to measure eligible financial assets and liabilities at fair value that are not otherwise required to be measured at fair value. If a company elects the fair value option for an eligible item, changes in that item's fair value in subsequent reporting periods must be recognized in current earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the potential impact of SFAS 159 on our financial statements.

In December 2007, the FASB issued SFAS 141 (revised 2007), "*Business Combinations*". SFAS 141R is a revision to SFAS 141 and includes substantial changes to the acquisition method used to account for business combinations (formerly the "purchase accounting" method), including broadening the definition of a business, as well as revisions to accounting methods for contingent consideration and other contingencies related to the acquired business, accounting for transaction costs, and accounting for adjustments to provisional amounts recorded in connection with acquisitions. SFAS 141R retains the fundamental requirement of SFAS 141 that the acquisition method of accounting be used for all business combinations and for an acquirer to be identified for each business combination. SFAS 141R is effective for periods beginning on or after December 15, 2008, and will apply to all business combinations occurring after the effective date. The Company is currently evaluating the requirements of SFAS 141R.

In December 2007, the FASB issued SFAS 160, "*Non-controlling Interests in Consolidated Financial Statements - an amendment of Accounting Research Bulletin No. 51, Consolidated Financial Statements*" ( ARB 51 ). This Statement amends ARB 51 to establish new standards that will govern the (1) accounting for and reporting of non-controlling interests in partially owned consolidated subsidiaries and (2) the loss of control of subsidiaries. Non-controlling interest will be reported as part of equity in the consolidated financial statements. Losses will be allocated to the non-controlling interest, and, if control is maintained, changes in ownership interests will be treated as equity transactions. Upon a loss of control, any gain or loss on the interest sold will be recognized in earnings. SFAS 160 is effective for periods beginning after December 15, 2008. The Company is currently evaluating the requirements of SFAS 160.

In March 2008, the FASB issued SFAS 161, "*Disclosures about Derivative Instruments and Hedging Activities*". The new standard is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. We are currently evaluating the impact of adopting SFAS 161 on our consolidated financial statements.

## CHINA DIRECT, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2008

## NOTE 3 EARNINGS (LOSS) PER SHARE

Under the provisions of SFAS 128, *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 show in the income of the company, subject to anti-dilution limitations.

	Quarter Ended March 31,			
	2008	Per Share	2007	Per Share
<b>Numerator:</b>				
Net earnings	\$4,752,876	0.23	\$1,870,869	0.14
Series A cumulative preferred stock:				
Cumulative preferred stock dividend	(141,530 )	(0.01 )		
Relative fair value of detachable warrants issued	(2,765,946 )	(0.13 )		
Preferred stock beneficial conversion feature	(2,451,446 )	(0.12 )		
Net (loss) earnings applicable to common stock holders (A)	(606,046 )	(0.03 )	1,870,869	0.14
<b>Denominator:</b>				
Denominator for basic (loss) earnings per share - weighted average number of common shares outstanding (B)	21,003,439		13,043,826	
Effect of dilutive securities			3,172,558	
Denominator for diluted (loss) earnings per share - adjusted weighted average outstanding average number of common shares outstanding (C)	21,003,439		16,216,384	
<b>Basic and Diluted Income (loss) Per Common Share:</b>				
(Loss) earnings per share - basic (A)/(B)	(0.03 )		0.14	
(Loss) earnings per share - diluted (A)/(C)	(0.03 )		0.12	

EITF Issue No. 03-6, *Participating Securities and the Two-Class Method under FASB Statement No. 128* ( EITF 03-6) requires companies with participating securities to calculate earnings per share using the two-class method. The Company's shares of Series A Convertible Preferred Stock are considered to be participating securities as these securities are entitled to dividends declared on the Company's Common Stock; therefore, EITF 03-6 requires the allocation of a portion of undistributed earnings to the Series A Convertible Preferred Stock in the calculation of basic earnings per share.

**CHINA DIRECT, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****MARCH 31, 2008****NOTE 4 COMPREHENSIVE INCOME (LOSS)**

Comprehensive Income (Loss) is comprised of net income and other comprehensive income (loss). Other comprehensive income (loss) refers to revenue, expenses, gains and losses that under accounting principals generally accepted in the United States are included in comprehensive income (loss) but are excluded from net income (loss) as these amounts are recorded directly as an adjustment to stockholders' equity.

Our other comprehensive income consists of currency translation adjustments, unrealized loss on marketable securities held for sale, net of taxes and unrealized loss on marketable securities held for sale - related parties, net of taxes. The following table sets forth the computation of comprehensive income for the three month periods ended March 31, 2008 and 2007, respectively.

	<b>March 31, 2008</b>	<b>2007</b>
Net Income	\$4,752,876	\$1,870,869
Foreign Currency Translation Gains	1,797,699	80,158
Unrealized loss on marketable securities held for sale, net of income taxes	(1,128,124 )	(607,539 )
Unrealized loss on marketable securities held for sale-related parties, net of income taxes	(462,223 )	(341,458 )
Comprehensive Income	\$4,960,228	\$1,002,030

**NOTE 5 INVENTORIES**

At March 31, 2008 and December 31, 2007, inventories consisted of the following:

	<b>March 31, 2008</b>	<b>December 31, 2007</b>
Raw materials	\$ 5,238,749	\$ 4,217,788
Finished goods	6,813,512	1,076,198
	\$ 12,052,261	\$ 5,293,986

Due to the nature of our business, there is no work in progress inventory at March 31, 2008 and December 31, 2007.

**CHINA DIRECT, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****MARCH 31, 2008****NOTE 6 PREPAID EXPENSES AND OTHER ASSETS**

At March 31, 2008 and December 31, 2007, prepaid expenses and other assets consist of the following:

	<b>March 31, 2008</b>	<b>December 31, 2007</b>
Prepayments to vendors for merchandise that had not yet been shipped	\$ 11,295,182	\$ 11,557,231
Other receivables	3,581,254	3,043,193
Fair value of client securities received for payment of services which were assigned to executive officers	490,236	638,961
Loan receivable	569,622	
Other assets acquired in connection with acquisition of CDI Pan Asia	143,830	138,089
VAT Tax refund available from Chinese government	49,750	143,784
Security deposits	43,163	351,279
Total	16,173,037	15,872,537
Less: Current Portion	(15,934,127 )	(15,439,462 )
Prepaid expenses and other assets, non-current	\$ 238,910	\$ 433,075

**NOTE 7 PROPERTY, PLANT AND EQUIPMENT**

At March 31, 2008 and December 31, 2007, property, plant and equipment consisted of the following:

	<b>Useful Life</b>	<b>March 31, 2008</b>	<b>December 31, 2007</b>
Building	10-40 years	\$ 5,192,693	\$ 4,904,304
Manufacturing equipment	10 years	10,870,879	7,765,130
Office equipment and furniture	3-5 years	526,039	380,846
Autos and trucks	5 years	665,431	468,761
Construction in progress	N/A		