

China Direct Industries, Inc.
Form 10-Q
February 14, 2012

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 December 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 [X] 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. 40,766,419 shares of common stock were issued and outstanding as of February 13, 2012.

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

- “fiscal 2012” — October 1, 2011 through September 30, 2012.
- “fiscal 2011” — October 1, 2010 through September 30, 2011.

When used in this report the terms:

- “China Direct Industries”, “China Direct”, “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; 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;
- “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 wholly 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 wholly owned subsidiary of China Direct Industries;
- “IMTC” or “International Magnesium Trading”, refers to International Magnesium Trading Corp., a company organized under the laws of Brunei and a wholly 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; and
- “Beauty East” refers to Beauty East International, Ltd., a Hong Kong company and a wholly 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;

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- “CDI Metal”, refers to Shanghai CDI Metal Material Co., Ltd. (a/k/a Shanghai CDI Metal Recycling Co., Ltd.), a company organized under the laws of the PRC and a wholly owned subsidiary of CDI Shanghai Management; and
- “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.
- “CDII Trading” refers to CDII Trading, Inc., a Florida corporation and a wholly 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 STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(Unaudited)

	Three months ended	
	December 31, 2011	December 31, 2010
Revenues	\$ 36,364,466	\$ 45,762,889
Revenues-related parties	547,431	6,713
Total revenues	36,911,897	45,769,602
Cost of revenues	31,314,543	39,238,556
Gross profit	5,597,354	6,531,046
Operating (expenses) income:		
Selling, general, and administrative	(3,420,273)	(3,602,281)
Other operating income	-	374,980
Total operating expenses	(3,420,273)	(3,227,301)
Operating income	2,177,081	3,303,745
Other income (expenses):		
Other income	483,710	171,519
Interest income (expense)	59,009	(7,747)
Realized gain (loss) on available-for-sale securities	14,256	(118,412)
Total other income	556,975	45,360
Income before income taxes	2,734,056	3,349,105
Income tax benefit	7,456	73,284
Net income	2,741,512	3,422,389
Net loss attributable to noncontrolling interests	389,192	43,447
Net income attributable to China Direct Industries	\$ 3,130,704	\$ 3,465,836
Deduct dividends on Series A Preferred Stock:		
Preferred stock dividend	(20,130)	(20,130)
Net income attributable to common stockholders	\$ 3,110,574	\$ 3,445,706
COMPREHENSIVE INCOME:		
Net income	\$ 2,741,512	\$ 3,422,389
Foreign currency translation adjustments	514,983	791,958
Unrealized gains on available-for-sale securities	3,208,566	404,754
Comprehensive income	\$ 6,465,061	\$ 4,619,101
Net loss attributable to noncontrolling interests	389,192	43,447
Foreign currency translation adjustments - noncontrolling interests	(52,931)	(274,178)
Comprehensive income attributable to China Direct Industries	\$ 6,801,322	\$ 4,388,370
Preferred stock dividend	(20,130)	(20,130)
Comprehensive income attributable to common stockholders	\$ 6,781,192	\$ 4,368,240
Basic and diluted income per common share		
Basic	\$ 0.08	\$ 0.11
Diluted	\$ 0.08	\$ 0.11

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Basic weighted average common shares outstanding	40,565,910	31,818,874
Diluted weighted average common shares outstanding	41,126,275	31,818,874

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

CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

ASSETS	December 31, 2011 (Unaudited)	September 30, 2011
Current Assets:		
Cash and cash equivalents	\$ 6,092,506	\$ 12,563,126
Marketable securities available for sale (Note 4)	11,418,140	8,292,837
Marketable securities available for sale-related parties (Note 4)	212,238	542,386
Accounts and notes receivables, net of allowance of \$266,508 and \$276,069, respectively (Note 5)	22,297,006	20,428,217
Accounts, loans and other receivables, and prepaid expenses - related parties (Note 10)	11,566,473	9,598,583
Inventories, net (Note 6)	12,271,818	9,625,774
Prepaid expenses and other current assets, net (Note 7)	16,648,414	14,389,065
Restricted cash, current	1,644,404	1,547,159
Total current assets	82,150,999	76,987,147
Property, plant and equipment, net (Note 8)	36,320,715	36,873,988
Intangible assets	153,271	163,447
Property use rights, net	2,235,665	2,252,445
Other long-term assets	289,690	58,192
Total assets	\$ 121,150,340	\$ 116,335,219
LIABILITIES AND EQUITY		
Current Liabilities:		
Loans payable-short term (Note 9)	\$ 2,846,515	\$ 2,657,091
Accounts payable and accrued expenses	15,527,101	15,468,902
Accounts and other payables-related parties (Note 10)	4,108,852	4,590,045
Advances from customers and deferred revenue	2,097,811	3,821,208
Other liabilities	4,859,190	4,315,858
Taxes payable	543,512	1,349,611
Total current liabilities	29,982,981	32,202,715
Long-term liabilities	32,501	107,231
Total Liabilities	30,015,482	32,309,946
TOTAL EQUITY		
Series A Convertible Preferred Stock: \$.0001 par value, stated value \$1,000 per share; 10,000,000 authorized, 1,006 shares outstanding at December 31 and September 30, 2011. (Note 11)	1,006,250	1,006,250
Common Stock: \$.0001 par value; 1,000,000,000 authorized; 40,652,582 and 40,353,828 issued and outstanding as of December 31 and September 30, 2011, respectively (Note 11)	4,065	4,035
Additional paid-in capital	75,729,218	75,279,087
Accumulated other comprehensive income	3,799,562	128,943
Accumulated deficit	(5,000,604)	(8,111,323)
Total China Direct Industries, Inc. stockholders' equity	75,538,491	68,306,992
Noncontrolling interests (Note 12)	15,596,367	15,718,281
Total equity	91,134,858	84,025,273
Total liabilities and equity	\$ 121,150,340	\$ 116,335,219

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

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

	Three months ended	
	December 31, 2011	December 31, 2010
OPERATING ACTIVITIES:		
Net income	\$ 2,741,512	\$ 3,422,389
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	985,501	1,010,572
Allowance for bad debt	9,562	-
Stock based compensation	321,159	122,081
Realized (gain) loss on investments in marketable securities	(14,256)	118,412
Gain on derivative liabilities revaluation	(74,730)	(104,305)
Fair value of marketable securities received for services	(5,191,364)	(5,201,329)
Fair value of securities paid for services	129,000	-
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	(2,555,452)	(3,817,534)
Accounts receivable and other assets-related parties	(1,967,890)	79,409
Inventories	(2,646,043)	(2,098,160)
Accounts receivable	3,337,741	(911,868)
Accounts payable and accrued expenses	58,200	(1,261,941)
Accounts and other payable - related parties	(481,193)	4,497,855
Advances from customers	(1,723,397)	(918,597)
Other payables	(853,770)	859,794
CASH USED IN OPERATING ACTIVITIES	(7,925,420)	(4,203,221)
INVESTING ACTIVITIES:		
Gross Proceeds from the sale of marketable securities available for sale	459,381	284,863
Purchases of property, plant and equipment	(405,273)	(1,317,572)
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	54,108	(1,032,709)
FINANCING ACTIVITIES:		
(increase) decrease in restricted cash	(97,245)	4,470,878
Loans payable	189,424	(2,754,114)
Gross proceeds from sale of stock and exercise of warrants/options	-	103,200
Cash dividend payment to preferred stockholders	(20,130)	-
Capital contribution from noncontrolling interest owners	214,348	302,489
	286,397	2,122,453

CASH PROVIDED BY FINANCING
ACTIVITIES

EFFECT OF EXCHANGE RATE ON CASH	1,114,295	1,080,096
Net decrease in cash	(6,470,620)	(2,033,381)
Cash and cash equivalents, beginning of the period	12,563,126	10,110,818
Cash and cash equivalents, end of the period	\$ 6,092,506	\$ 8,077,437
Supplemental disclosures of cash flow information:		
Preferred dividend paid	\$ 20,130	\$ 20,130

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

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

NOTE 1 – ORGANIZATION, BASIS OF PRESENTATION, 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. based company that sources, produces and distributes industrial products in Asia, Europe, Australia, and the Americas. We also provide business and financial consulting services to public and private American and Chinese businesses. We operate in three identifiable segments, as defined by the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 280, “Segment Reporting:” Magnesium, Basic Materials and Consulting. Beginning 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 our U.S. based industrial commodities business, established in 2009, we source, finance, manage logistics, and sell industrial commodities from North and South America for ultimate distribution in China.

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 business and financial 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.

Basis of Presentation

Our interim consolidated financial statements are unaudited. We prepared the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and pursuant to the U.S. Securities and Exchange Commission (“SEC”) rules for interim reporting. 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 three months of the fiscal year 2012 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 included in our 2011 Annual Report on Form 10-K for the fiscal year ended September 30, 2011.

Summary of Significant Accounting Policies

Foreign Currency Translation

Our reporting currency is the U.S. dollar. The functional currency of the parent company is the U.S. dollar and 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

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exchange rates as of the balance sheet dates. Income and expenditures are translated at the average exchange rates for the three months ended December 31, 2011 and 2010. A summary of the conversion rates for the periods presented is as follows:

	December 31, 2011	September 30, 2011	December 31, 2010
Period end RMB: U.S. dollar exchange rate	6.3523	6.3885	6.6118
Average fiscal-year-to-date RMB: U.S. dollar exchange rate	6.3535	6.5287	6.6670

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CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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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 and cash equivalents, accounts and notes receivable, prepayments and other current assets, accounts payable, taxes payable, accrued expenses and other current liabilities, 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.

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 securities we receive as compensation based on the fair value at the time the securities are 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 Euronext, 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, "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.

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

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 December 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 Accounting Pronouncements

Comprehensive Income

Accounting Standards Update ("ASU") No. 2011-05 amends FASB Codification Topic 220 on comprehensive income (1) to eliminate the current option to present the components of other comprehensive income in the statement of changes in equity, and (2) to require presentation of net income and other comprehensive income (and their respective components) either in a single continuous statement or in two separate but consecutive statements. These amendments do not alter any current recognition or measurement requirements in respect of items of other comprehensive income.

The amendments in this Update are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. We adopted this guidance in our first quarter of fiscal 2012.

Business Combinations

In January 2011, ASU No. 2010-29 clarified 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:

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.

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

NOTE 2 - EARNINGS PER SHARE

Under the provisions of ASC 260, "Earnings Per Share," basic earnings per common share ("EPS") is computed by dividing earnings available to common shareholders by the weighted average number of shares of common stock outstanding for the periods presented. Diluted earnings per common share is computed assuming that all potentially dilutive securities, including "in-the-money" stock options, were converted into common shares at the beginning of each period. A reconciliation of the amounts included in the computation of basic earnings per common share, and diluted earnings per common share is as follows:

	For the three months ended December 31,	
	2011 (Unaudited)	2010 (Unaudited)
Earnings attributable to common shareholders	\$ 3,110,574	\$ 3,445,706
Plus: preferred stock dividends	20,130	20,130
Effect of assumed conversions	20,130	20,130
Earnings available to common stockholders plus assumed conversions	\$ 3,130,704	\$ 3,465,836
Weighted average common shares outstanding	40,565,910	31,818,874
Plus: incremental shares from assumed conversions (1)		
Convertible preferred stock	558,889	-
Unvested stock-based compensation	1,476	-
Dilutive potential common shares	560,365	-
Adjusted weighted-average shares	41,126,275	31,818,874
Net income per common share - basic:	\$ 0.08	\$ 0.11 (2)
Net income per common share - diluted:	\$ 0.08	\$ 0.11 (2)

(1) Securities are not included in the denominator in periods when anti-dilutive. We excluded 2,142,980 and 2,292,980 shares of our common stock issuable upon exercise of options and 4,179,130 and 5,499,664 shares of our common stock issuable upon exercise of warrants as of December 31, 2011 and 2010, respectively, as their effect was anti-dilutive.

(2) The increase in the earnings per share for the three months ended December 31, 2010 resulted from a correction of prior year accounting errors related to the conversion price change of the preferred stock and the exercise price change of the remaining warrants (See Note 12 – CAPITAL STOCK in Form 10-K for the fiscal year ended September 30, 2011.)

NOTE 3 – ACCUMULATED OTHER COMPREHENSIVE INCOME

Our other comprehensive income consists of currency translation adjustments, unrealized loss on available-for-sale marketable securities and unrealized loss on available-for-sale marketable securities-related party. The following table shows the accumulated other comprehensive income balance as of December 31, 2011.

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	Foreign Currency Items	Unrealized Gains on Securities	Accumulated Other Comprehensive Income
Balance at September 30, 2011	\$ 5,238,092	\$ (5,109,146)	\$ 128,943
Current-period change (Unaudited)	462,052	3,208,566	3,670,619
Balance at December 31, 2011	\$ 5,700,144	\$ (1,900,580)	\$ 3,799,562

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

NOTE 4 – AVAILABLE-FOR-SALE MARKETABLE SECURITIES

Available-for-sale marketable securities and available-for-sale marketable securities-related party as of December 31, 2011 and September 30, 2011 consist of the following financial instruments:

Company	December 31, 2011 (unaudited)	% of Total		September 30, 2011	% of Total	
Ziyang Ceramics Corp. (1)	\$ 354,852	3	%	\$ 426,791	5	%
China Logistics Group, Inc.	197,148	2	%	196,208	2	%
Dragon International Group Corp.	22,816	0	%	22,816	0	%
Decor Products Internationa, Inc.	47,500	0	%	-	0	%
Sunwin International Neutraceuticals, Inc.	123,500	1	%	361,000	4	%
Dragon Capital Group Corp.	212,238	2	%	542,386	6	%
China Education International, Inc.	10,491,874	90	%	7,286,022	83	%
Others	180,450	2	%	-	0	%
Marketable securities available for sale	\$ 11,630,378	100	%	\$ 8,835,223	100	%

(1) China American Holdings, Inc. changed its name to Ziyang Ceramics Corp. on January 27, 2012.

Our available-for-sale marketable securities are carried at fair value. 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, quoted prices for identical instruments in active markets; Level 2, 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, unobservable inputs. All our available-for-sale marketable securities were measured using Level 1 inputs for the period ended December 31, 2011.

The investments in marketable securities available for sale-related party totaled \$212,238 and \$542,386 at December 31 and September 30, 2011, 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 – ACCOUNTS AND NOTES RECEIVABLE

Accounts and notes receivable include a note receivable obtained in connection with the settlement of a lawsuit we filed seeking repayment of a loan from a former client. The total settlement amount was \$373,902 at December 31, 2011, of which \$243,968 was classified as other long-term assets and included in our balance sheet for the period ended December 31, 2011. Accounts and notes receivable also include available-for-sale securities receivable. These receivables are carried at fair market value. Unrealized gains or loss on these receivables are recognized on a quarterly

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basis as an element of comprehensive income based on changes in the fair market value of the securities underlying the receivables. At December 31, 2011, the fair value of available-for-sale securities receivable was \$7,886,525. The table below presents the details on the accounts and notes receivable:

Accounts and notes receivable	December 31, 2011 (Unaudited)	% of Total		September 30, 2011	% of Total	
Available-for-sale securities receivable	\$ 7,886,525	35	%	\$ 3,691,735	18	%
Notes receivable	921,751	4	%	364,718	2	%
Other trade receivable	13,755,238	61	%	16,647,833	80	%
Total accounts and notes receivable	\$ 22,563,514	100	%	\$ 20,704,286	100	%
Allowance for uncollectible accounts	(266,508)			(276,069)		
Net accounts and notes receivable	\$ 22,297,006			\$ 20,428,217		

CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
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NOTE 6 - INVENTORIES

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

	December 31, 2011 (Unaudited)	September 30, 2011
Raw materials	\$ 6,101,323	\$ 3,061,481
Finished goods	6,170,495	6,564,293
Total Inventory	\$ 12,271,818	\$ 9,625,774

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 December 31, 2011 and September 30, 2011.

NOTE 7 - PREPAID EXPENSES AND OTHER CURRENT ASSETS

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

Description	December 31, 2011 (Unaudited)	September 30, 2011
Prepayments to vendors for merchandise that had not yet been shipped or services that had not been performed	\$ 8,179,652	\$ 6,519,123
Prepaid expenses	2,755,054	2,448,248
Other receivables	4,077,432	3,865,525
Loans receivable	1,617,420	1,537,420
Security deposits	18,856	18,749
Total	\$ 16,648,414	\$ 14,389,065

Prepaid expenses include prepaid cost for Baotou Changxin Magnesium's land use rights. Baotou Changxin Magnesium owns and operates a magnesium facility capable of producing 24,000 metric tons of pure magnesium per year on approximately 406,000 square feet of land located in the Shiguai district of Baotou city, Inner Mongolia. The land use rights are valued at \$1,140,011 as of December 31, 2011. Baotou Changxin Magnesium occupies this land pursuant to an asset acquisition agreement entered into with Baotou Sanhe Mangesium Co., Ltd. to acquire the land use rights for this property, among other assets. Since the land use right is yet to be transferred from Baotou Sanhe Magnesium Co. to Baotou Changxin Magnesium, the cost of \$1,140,011 is accounted for as prepaid expenses. The company has not started amortizing the land use right prepaid as of December 31, 2011. The land use right expires in May 2045.

NOTE 8 - PROPERTY, PLANT AND EQUIPMENT

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

Property, Plant and Equipment

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Description	Useful Life	December 31, 2011 (unaudited)	September 30, 2011
Building	10-40 years	\$ 14,350,042	\$ 14,260,280
Manufacturing equipment	5-10 year	21,688,815	21,535,796
Office equipment and furniture	3-5 year	664,249	646,244
Autos and trucks	5 year	1,193,955	1,187,281
Construction in progress	N/A	8,436,935	8,295,743
Total		46,333,996	45,925,344
Less: accumulated depreciation		(10,013,281)	(9,051,356)
Property, Plant and Equipment, Net		\$ 36,320,715	\$ 36,873,988

For the three months ended December 31, 2011 and 2010, depreciation expense totaled \$958,545 and \$1,010,572, respectively.

CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
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NOTE 9 - LOANS PAYABLE

Loans payable at December 31, 2011 and September 30, 2011 consisted of the following:

Description	December 31, 2011 (unaudited)	September 30, 2011
CDI China loan from Sunwin Tech Group, Inc. Due on December 31, 2012. 3% annual interest rate. Secured by pledge of CDI China assets.	312,000	450,000
Lang Chemical loan from China Mingsheng Bank. Due on May 16, 2012. 6.941% annual interest rate. Guaranteed by Zhu Qian and Chen Jingdong.	724,147	720,044
Lang Chemical loan from Bank of Shanghai. Due on March 22, 2012. 6.666% annual interest rate. Guaranteed by China Investment Guarantor Co. Ltd. and Zhu Qian.	550,982	547,859
CDI Beijing loan from Bank of Hangzhou. Due on October 21, 2011. 6.672% annual interest rate. Guranteed by Chi Chen	-	939,188
Lang Chemical loan from China Merchants Bank. Due on October 20, 2012. 8.590% annual interest rate. Guaranteed by Zhu Qian.	1,259,386	-
Total	2,846,515	2,657,091
Less: Current Portion	(2,846,515)	(2,657,091)
Loans payable, long-term	\$ -	\$ -

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 December 31, 2011 and September, 2011:

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

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

- Shuihuan Huang, is the sister of Yuwei Huang;
- Kong Tung, a member of the board of directors, and chairman of Golden Magnesium and Beauty East;

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CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
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- LingShi County Yihong Magnesium Co., Ltd., a company organized under the laws of the PRC (“Yihong Magnesium”), is legally represented by an officer of Chang Magnesium;
- 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 (“Lingshi 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;
- Chi Chen is vice president of our Basic Materials Segment and minority interest owner of CDI Beijing;
- 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 December 31, 2011, Accounts, loans, and other receivables and prepaid expenses- related parties were \$11,566,473 and were comprised of accounts receivable – related party of \$1,554,210, Prepaid expenses – related parties of \$3,788,533, and Due from related parties of \$6,223,730 as set forth below:

Accounts Receivable – related parties

At December 31, 2011, accounts receivable – related parties of \$1,554,210 were comprised of the following:

\$403,452 due Baotou Changxin Magnesium from YiWei Magnesium for inventory provided;
\$4,887 due Chang Magnesium from Wheaton for inventory provided;
\$731,215 due Chang Magnesium from YiWei Magnesium for inventory provided; and
\$414,656 due Ruiming Magnesium from YiWei Magnesium for inventory provided.

At September 30, 2011, accounts receivable – related parties of \$1,211,079 were comprised of the following:

\$364,705 due Baotou Changxin Magnesium from YiWei Magnesium for inventory provided;
\$4,860 due Chang Magnesium from Wheaton for inventory provided;
\$296,156 due Chang Magnesium from YiWei Magnesium for inventory provided; and
\$545,358 due Ruiming Magnesium from YiWei Magnesium for inventory provided.

Prepaid Expenses – related parties

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At December 31, 2011, prepaid expenses – related parties of \$3,788,533 were comprised of the following:

\$3,599,546 prepaid by Chang Magnesium to YiWei Magnesium for future delivery of inventory;
\$157,423 prepaid by YiHong Magnesium to YiWei Magnesium for future delivery of inventory; and
\$31,564 prepaid by Ruiming Magnesium to Yiwei Magnesium for future delivery of inventory.

At September 30, 2011, prepaid expenses – related parties of \$2,687,928 were comprised of the following:

\$2,654,384 prepaid by Chang Magnesium to YiWei Magnesium for future delivery of inventory; and
\$33,544 prepaid by Ruiming Magnesium to Yiwei Magnesium for future delivery of inventory.

CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
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Loans Receivable – related parties

At December 31, 2011, we had no loan receivables – related parties.

At September 30, 2011, loan receivables – related parties of \$1,320,324 were due Lang Chemical from NanTong Chemical for funds advanced for working capital purposes.

Due from related parties

At December 31, 2011, due from related parties of \$6,223,730 was comprised of the following:

\$26,301 due Baotou Changxi Magnesium from YiWei Magnesium for working capital purposes;
\$111,760 due Baotou Changxi Magnesium from YiHong Magnesium for working capital purposes;
\$4,242,317 due Chang Magnesium from YiWei Magnesium for working capital purposes;
\$300,678 due Chang Magnesium from YiHong Magnesium for working capital purposes;
\$12,000 due IMTC from YuWei Huang for working capital purposes;
\$182,611 due Ruiming Magnesium from YiWei Magnesium for working capital purposes;
\$1,276,599 due Golden Magnesium from YiWei Magnesium for working capital purposes;
\$11,013 due CDI Shanghai from YiWei Magnesium for working capital purpose; and
\$60,451 due CDI Beijing from Zhongmen International for working capital purposes.

At September 30, 2011, due from related parties of \$4,379,252 was comprised of the following:

\$78,266 due Baotou Changxi Magnesium from YiWei Magnesium for working capital purposes;
\$118,954 due Baotou Changxi Magnesium from YiHong Magnesium for working capital purposes;
\$3,850,151 due Chang Magnesium from YiWei Magnesium for working capital purposes;
\$3,130 due Chang Magnesium from Shuihuan Huang for working capital purposes;
\$12,000 due IMTC from YuWei Huang for working capital purposes;
\$42,263 due Ruiming Magnesium from YiWei Magnesium for working capital purposes;
\$200,924 due Ruiming Magnesium from YiHong Magnesium for working capital purposes;
\$10,951 due CDI Shanghai from YiWei Magnesium for working capital purpose; and
\$62,613 due CDI Beijing from Zhongmen International for working capital purposes.

As of December 31, 2011, Accounts and other payables – related parties were \$4,108,852 which consist of Accounts payable – related parties of \$226,186, and Due to related parties of \$3,882,666 as set forth below:

Accounts Payable – related parties

At December 31, 2011, accounts payable – related party of \$226,186 was due from IMTC to Pine Capital for purchases of goods.

At September 30, 2011, accounts payable – related party of \$896,878 was comprised of the following:

\$142,479 due from Golden Magnesium to YiWei Magnesium for purchases of goods;
and

\$754,399 due from IMTC to Pine Capital for purchases of goods.

Due to related parties

At December 31, 2011, due to related parties balance of \$3,882,666 was comprised of the following:

\$9,953 due to Yuwei Huang for the working capital of Chang Magnesium;
\$102,111 due to Kung Tong for the working capital of Beauty East;
\$195,976 due to NanTong Chemical for the working capital of Lang Chemical;
\$397,967 due to Chi Chen for the working capital of CDI Beijing; and
\$3,176,659 due to YiWei Magnesium for the balance of the purchase price for Ruiming Magnesium.

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CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
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At September 30, 2011, due to related parties balance of \$3,683,482 was comprised of the following:

\$9,953 due to Yuwei Huang for the working capital of Chang Magnesium;
\$97,089 due to Kung Tong for the working capital of Beauty East;
\$399,781 due to Chi Chen for the working capital of CDI Beijing; and
\$3,176,659 due to YiWei Magnesium for the balance of the purchase price for Ruiming Magnesium.

NOTE 11 – CAPITAL STOCK

Preferred Stock and Related Dividends

During the three months ended December 31, 2011, we paid \$20,130 of ordinary dividends in cash. During the three months ended December 31, 2010, we paid \$20,130 of ordinary dividends in the form of 11,911 shares of our common stock.

Derivative liabilities

As of December 31, 2011, the carrying amounts of the derivative liabilities for preferred stock conversion option and warrants were \$24,711 and \$7,790, respectively. As of September 30, 2011, the carrying amounts of the derivative liabilities for conversion option and warrants were \$69,295 and \$37,936, respectively. The fair value of derivative liabilities is included in other liabilities, and the net change in fair value during the period is included in operating expenses. Inputs used in making the determination are as follows:

	December 31, 2011		September 30, 2011	
Inputs for conversion option valuation – covered call				
Asset price on valuation date	\$	0.76	\$	1.01
Exercise price	\$	9.80	\$	9.80
Estimated years to exercise		6.16		6.5
Expected volatility factor		106	%	93
Risk free rate		1.09	%	1.31
				%
Inputs for conversion option valuation – short call				
Asset price on valuation date	\$	0.76	\$	1.01
Exercise price	\$	1.80	\$	1.80
Estimated years to exercise		6.16		6.5
Expected volatility factor		106	%	93
Risk free rate		1.09	%	1.31
				%
Inputs for warrant valuation				
Asset price on valuation date	\$	0.76	\$	1.01
Exercise price	\$	1.80	\$	1.80
Estimated years to exercise		1.12		1.5
Expected volatility factor		72	%	93
Risk free rate		0.12	%	0.19
				%

Common Stock

During the three months ended December 31, 2011, we issued a total of 298,754 shares of our common stock comprised of: 34,100 shares to members of our board of directors as compensation, 153,000 shares to consultants for services, and 111,654 shares to employees as compensation.

During the three months ended December 31, 2010, we issued a total of 308,777 shares of our common stock comprised of: 11,911 shares to pay dividends on our series A preferred stock; 29,250 share to members of our board of directors as compensation, 3,000 shares to consultants for services; 184,616 shares to employees as compensation.

During the three months ended December 31, 2011 and 2010, stock-based compensation expense amounted to \$321,160 and \$122,081, respectively. During the three months ended December 31, 2011, the fair value of securities paid for consulting services was \$129,000; during the three months ended December 31, 2010, there was no stock-based compensation paid for consulting services.

CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
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Common Stock Purchase Warrants

A summary of the status of our outstanding common stock purchase warrants granted as of December 31, 2011 and changes during the period as follows:

	Shares underlying warrants	Exercise price
Outstanding and exercisable at September 30, 2011	4,229,130	
Expired	(50,000)	\$ 2.50
Outstanding and exercisable at December 31, 2011	4,179,130	

The following information applies to all warrants outstanding and exercisable at December 31, 2011:

Number of Warrants outstanding and exercisable	Exercise Price	Remaining contractual life (Years)
143,750	\$ 1.80	1.12
777,778	\$ 2.00	5.58
1,351,352	\$ 2.31	2.96
1,906,250	\$ 8.00	1.12
4,179,130		

NOTE 12 – NONCONTROLLING INTEREST

As of December 31, 2011 and September 30, 2011, our consolidated balance sheets reflected total non-controlling interest of \$15,596,367 and \$15,718,281, respectively, which represent the equity portion of our subsidiaries held by non-controlling interest shareholders in two of our segments, as follows:

Segment	December 31, 2011	September 30, 2011
Magnesium Segment	\$ 11,783,017	\$ 12,002,000.00
Basic Materials Segment	3,813,350	3,716,281
Total	\$ 15,596,367	\$ 15,718,281

NOTE 13 - SEGMENT INFORMATION

Revenues by segment for the three months ended December 31, 2011 and 2010, as follows:

	2011	2010
Magnesium(1)	\$ 17,977,559	\$ 21,288,764
Basic Materials	13,767,912	19,181,960
Consulting	5,166,426	5,298,878
Total revenue	\$ 36,911,897	\$ 45,769,602

(1)We had revenue from related parties of \$547,431 and \$6,713 during the three months ended December 31, 2011 and 2010, respectively.

CHINA DIRECT INDUSTRIES, INC. AND SUBSIDIARIES
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Operating income (loss) by segment for the three months ended December 31, 2011 and 2010:

	2011	2010
Magnesium	\$ (871,191)	\$ (579,346)
Basic Materials	(312,240)	223,123
Consulting	3,360,512	3,659,968
Total operating income	\$ 2,177,081	\$ 3,303,745

Total assets by segment as of December 31, 2011 and September 30, 2011 were as follows:

	December 31, 2011	September 30, 2011
Magnesium	\$ 65,495,062	\$ 65,321,257
Basic Materials	30,043,896	31,286,610
Consulting	25,611,382	19,727,352
Total assets	\$ 121,150,340	\$ 116,335,219

Geographic Information

Revenues for the three months ended December 31, 2011 and 2010, classified by the major geographic areas in which our customers are located, were as follows:

	2011	2010
People's Republic of China	\$ 20,127,381	\$ 24,384,898
Other Asian countries	4,085,878	1,052,843
Australia	1,950,329	5,138,574
Europe	1,008,779	2,065,614
North America	8,426,514	12,771,525
South America	1,313,016	356,148
Total Revenues	\$ 36,911,897	\$ 45,769,602

Total of long-term assets as of December 31, 2011 and September 30, 2011, classified by the major geographic areas, were as follows:

	December 31, 2011	September 30, 2011
People's Republic of China	\$ 38,887,199	\$ 39,219,251
South America	29,552	\$ 34,166
United States of America	82,590	94,654
Total	\$ 38,999,341	\$ 39,348,071

NOTE 14 – INCOME TAXES

Our income (loss) in the U.S. is subject to applicable Federal, State, and Local tax statutes. Our income (loss) in China is subject to taxation in the Peoples Republic of China concerning Foreign Investment Enterprises and local income tax laws (the "PRC Income Tax Laws). Pursuant to the PRC Income Tax Laws, unless special tax incentives are granted, all enterprises in China are subject to taxation at a statutory rate of 25%. Our income (loss) in Brunei is

exempt from Brunei Darussalam income tax.

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The components of income (loss) for the three months ended December 31, 2011 and 2010 before income tax consisted of the following:

Description	December 31, 2011	December 31, 2010
U.S. Operations	\$ 2,255,782	\$ 1,460,778
China Operations	(1,046,106)	(507,288)
Brunei Operations		