China Direct Industries, Inc.
Form 10-K
January 04, 2010

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

(Mark One)

Form 10-K

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

or

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

For the transition period from January 1, 2009 to September 30, 2009

Commission file number: 001-33694

CHINA DIRECT INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

Florida	13-3876100
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

431 Fairway Drive, Suite 200, Deerfield Beach, Florida 33441
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (954) 363-7333
Securities registered under Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common stock, par value $0.0001	Nasdaq Global Market

Securities registered under Section 12(g) of the Act:
None
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ¨ Yes þ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ¨ Yes þ No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ¨ Yes ¨ No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company:

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer (Do not check if a smaller reporting company)	¨	Smaller reporting company	þ

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked prices of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter. $27,677,561 on March 31, 2009.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date. 27,420,873 shares of common stock are issued and outstanding as of December 24, 2009.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant’s definitive proxy statement relating to its 2009 Annual Meeting of Shareholders, to be filed no later than 120 days after the close of the Registrant’s year ended September 30, 2009, are hereby incorporated by reference in Part III of this Transition Report on Form 10-K.

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INDEX OF CERTAIN DEFINED TERMS USED IN THIS REPORT

Change in Fiscal Year

Effective August 13, 2009, we changed our fiscal year end from December 31 to September 30. We have defined various periods that are covered in this report as follows:

- “2009 transition period” — January 1, 2009 through September 30, 2009.
- “first nine months of 2008” — January 1, 2008 through September 30, 2008.
- “fiscal 2010” — October 1, 2009 through September 30, 2010.
- “fiscal 2008” — January 1, 2008 through December 31, 2008.
- “fiscal 2007” — January 1, 2007 through December 31, 2007.

When used in this report the terms:

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

Basic Materials Segment

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“Lang Chemical”, refers to Shanghai Lang Chemical Co., Ltd. a company organized under the laws of the PRC and a 51% owned subsidiary of CDI China;

- “CDI Jingkun Zinc”, refers to CDI Jingkun Zinc Industry Co., Ltd., a company organized under the laws of the PRC and a 95% owned subsidiary of CDI Shanghai Management;
- “CDI Jixiang Metal”, refers to CDI Jixiang Metal Co., Ltd., a company organized under the laws of the PRC and a wholly owned subsidiary of CDI China;
- “CDI Metal Recycling”, refers to Shanghai CDI Metal Recycling Co., Ltd., a company organized under the laws of the PRC and an 83% owned subsidiary of CDI Shanghai Management; 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 100% owned subsidiary of China Direct Industries.

Consulting Segment

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

Clean Technology Segment: (All operations related to the following entities were discontinued in September 2008)

- "CDI Clean Technology", refers to CDI Clean Technology Group, Inc., a Florida corporation formerly known as Jinan Alternative Energy Group Corp., effective October 30, 2008, CDI China holds a 19% interest;
- "CDI Wanda", refers to Shandong CDI Wanda New Energy Co., Ltd., a company organized under the laws of the PRC and a 51% owned subsidiary of CDI Clean Technology; and
- "Yantai CDI Wanda", refers to Yantai CDI Wanda Renewable Resources Co., Ltd., a company organized under the laws of the PRC and a 52% owned subsidiary of CDI Wanda.

All share and per share information contained herein gives retroactive effect to the 1-for-100 shares reverse split of our common stock on September 19, 2008 which was immediately followed by a 100-for-1 forward split of our common stock.

PART I

ITEM 1. BUSINESS.

Overview

We are a U.S. company that manages a portfolio of Chinese entities. We also provide consulting services to Chinese businesses. We operate in three identifiable business segments: Magnesium, Basic Materials and Consulting. In the fourth quarter of fiscal 2006, we established our Magnesium and Basic Materials segments which have grown in fiscal 2007 and fiscal 2008 through acquisitions of controlling interests of Chinese private companies. We consolidate these acquisitions as either our wholly or majority owned subsidiaries. Through this ownership control, we provide management advice, business development services, strategic planning, macroeconomic industry analysis and financial management seeking to improve the quality and performance of each portfolio company. We also provide our subsidiaries with investment capital to expand their businesses.

In our Magnesium segment, our largest segment, we produce, sell and distribute pure magnesium ingots, magnesium powders 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 and zinc concentrate distribution businesses which have not commenced operations.

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

Our corporate headquarters are in Deerfield Beach, Florida which houses the U.S. executive and administrative team that guides our overall operations. Our U.S. office employs both English and Chinese speaking business and accounting staff and our legal and other executive management. These professionals focus on due diligence, business development, finance, accounting and compliance with the reporting requirements of the Securities and Exchange Commission (“SEC”) and other applicable laws in the U.S. and the PRC.

Magnesium Segment

We operate three magnesium facilities in China that produce and/or distribute magnesium products such as pure magnesium ingots, magnesium powders, granules and alloy. In the 2009 transition period revenues from this segment were $26.7 million, including revenues of $11.5 million from related parties, and represented 38.9% of our total consolidated revenues. In the first nine months of 2008 revenues from this segment were $129.6 million, including revenues of $3.1 million from related parties, and represented 70.6% of our total consolidated revenues.

Magnesium is the third most commonly used structural metal, following steel and aluminum, and is used in the manufacturing process of steel and titanium. Magnesium is the lightest and strongest of the structural metals; it is one fourth the weight of steel, two fifths the weight of titanium and two thirds the weight of aluminum. Due to its light weight and high strength, magnesium and magnesium related products have a variety of technological and consumer applications. Magnesium alloys which are produced from the magnesium we make, are used in aircraft and automobile parts. In addition, magnesium in various forms is used in the manufacture of electronic equipment such as computers, cameras and cell phones. Magnesium powder is used as desulphurizer that removes sulfur in the production of steel.

Our magnesium production facilities are located in the Shanxi Province and Inner Mongolia, China. These regions are rich in natural resources such as dolomite and ferrosilicon, the primary raw materials used to produce pure magnesium. In addition, these areas have vast deposits of coal. Our magnesium facilities in the Shanxi Province utilize waste gas to fuel their furnaces. The waste gas is a by-product in the processing of coal into coke. This utilization of waste gas as an energy source is less expensive than burning coal. Additionally, the use of waste gas is a more environmentally friendly source of energy compared to magnesium producers who burn coal to fuel their furnaces. Our magnesium facility in Inner Mongolia burns coal in order to generate coke gas to fuel its furnaces.

This exploitation of waste gas as energy is an important element to our Magnesium segment in light of recent regulations implemented by the PRC to control industrial pollution. In April 2008, the PRC amended the Energy Conservation Law, previously adopted in 1997 which regulates national standards on energy conservation. The amendment establishes per unit energy consumption quotas for magnesium smelting, effective as of June 2008. Companies failing to meet the new environmental protection standards may be subject to penalties, in the form of fines and/or suspension. Our facilities have obtained a license from the appropriate provincial environmental protection administrations permitting them to produce magnesium.

Our Magnesium segment utilizes a production method known as the silicothermic manufacturing process, sometimes referred to as the 'pigeon process', as the primary production method of its magnesium products. The pigeon process, a common method employed in China, offers several advantages including reduced costs and production cycles. From an environmental perspective the process is beneficial when compared with alternative production methods. In addition, all of our facilities utilize high temperature air combustion technology, also known as flameless combustion in an attempt to further reduce production costs.

We produced, sold and distributed approximately 11,775 metric tons of magnesium in the 2009 transition period. As of September 30, 2009, we have total annual magnesium production capacity of 42,000 metric tons. In the 2009 transition period, we expanded Chang Magnesium from 8,000 metric ton capacity to 10,000 metric ton capacity. In addition, we expanded the capacity at Baotou Changxin Magnesium from 12,000 to 20,000 tons as of the end of the 2009 transition period. In the 2009 transition period our average selling price of magnesium was approximately $2,270 per metric ton as compared to $3,390 per metric ton in the first nine months of fiscal 2008.

Magnesium Segment Initiatives

Since late fiscal 2006 we have invested approximately $20.5 million in this segment to acquire a controlling interest in our Magnesium segment. Additionally we began to restructure our senior management in the 2009 transition period to add personnel with magnesium operating experience in the PRC. As a result, Yuwei Huang was appointed executive vice president for the Magnesium segment and as a member of our board of directors. Mr. Huang has served as chief executive officer of Chang Magnesium since June 2006 and has over 15 years of experience in the production and sale of magnesium in the PRC. He is the principal owner of the minority shareholder in our magnesium production subsidiaries and an owner of several other magnesium factories in China.

The continuing effects of the global economic slowdown throughout the 2009 transition period substantially affected demand from key end markets such as steel production, parts die casting for the automobile industry, and aluminum alloying. As a result, management responded by reducing our Magnesium segment workforce and idling facilities to reduce expenses. We have seen, however, an improvement in quoting activity and a stabilization in prices late in the 2009 transition period and believe this improvement will carry into fiscal 2010. Management plans to restart production at certain locations to further ramp up production in fiscal 2010.

Additionally, with the worldwide, and more specifically, the Chinese economy showing signs of rebounding, management has undertaken or is evaluating several key initiatives to continue the expansion into magnesium begun in fiscal 2006. In an effort to move into the next phase of growth for our Magnesium segment, management is currently considering a plan to further consolidate our Magnesium segment holdings as well as acquire additional operations owned or controlled by Yuwei Huang. Toward that end we signed a non-binding letter of intent in October, 2009 outlining the proposed targets and are currently in the process of reviewing the operations, performing necessary due diligence and evaluating financing options. Additionally, as it is our intention to focus on our magnesium operations associated with Mr. Huang, our board of directors committed to a plan to sell our interest in Pan Asia Magnesium and present it as a discontinued operation beginning with our financial statements for the fiscal year ended September 30, 2009. On December 29, 2009, our audit committee approved the establishment of a $7.2 million reserve for a contingent loss from discontinued operations. Should we be unable to negotiate an amicable resolution of our dispute, we will take appropriate legal action in China which may include a court supervised dissolution and audit of Pan Asia Magnesium in addition to appropriate legal action against its noncontrolling Chinese shareholders and Mr. Zhao based upon the findings in an audit. See Note 17 – Commitments and Contingencies to our consolidated financial statements included in this report.

We intend to brand our current magnesium operations and planned acquisitions under our International Magnesium Group ("IMG") subsidiary. We intend to promote our IMG brand as the premier global source for quality and reliability for magnesium related products. We also intend to expand our domestic and international sales capabilities under the IMG brand to create a cohesive and unified worldwide marketing effort for our production and distribution operations. We believe these actions will allow us to become more effective in our global sales efforts and a strong, reliable source of greater quantities of magnesium needed to meet the needs of customers in the automotive, aerospace, transportation and consumer electronics industries. In addition, we believe the launch of the IMG brand will enable us to fully realize the value of our magnesium holdings in the future.

Sources and Availability of Raw Materials

We obtain dolomite and ferrosilicon, the primary raw materials used to produce pure magnesium and waste gas used to fuel our magnesium producing furnaces from a variety of sources including mining companies, coke refineries who produce waste gas as a by-product in the production of coke, washing coal, coal tar, sulfur, ammonium sulfate and benzene. We have a fixed price supply agreement for a specified quantity of waste gas for our Golden Magnesium facility which expires in August 2027. In the 2009 transition period, we have two suppliers that accounted for over 10% of the purchases of finished goods for resale and raw materials used in magnesium production, Pine Capital Enterprises, Inc., a related party, and China Shanxi Xinghua Cun International Trading Co. We purchase dolomite and ferrosilicon on a purchase order basis from local suppliers at market prices based on our production requirements.

We believe we will have access to sufficient dolomite, ferrosilicon and gas to meet our needs for the foreseeable future.

Basic Materials Segment

In our Basic Materials segment, we sell and distribute a variety of products in Asia including industrial grade synthetic chemicals, steel products, non ferrous metals, recycled materials and industrial commodities. This segment also includes our zinc mining property and zinc concentrate distribution businesses which have not commenced operations. In the 2009 transition period our Basic Materials segment generated revenues of $41.1 million, representing approximately 60% of our total consolidated revenues. In the first nine months of 2008 revenues from this segment were $39.5 million and represented 21.5% of our total consolidated revenues.

Distribution of Synthetic Chemicals and Basic Resources. We act as a third party agent in the sale and distribution of industrial chemicals which are employed as raw materials in the production of a variety of finished products such as paint, glue, plastics, textiles, leather goods as well as various medical products. We sell and distribute four primary product categories of industrial grade synthetic chemicals, glacial acetic acid and acetic acid derivatives, acrylic acid and acrylic ester, vinyl acetate-ethylene (“VAE”) and polyvinyl alcohol (“PVA”). We also sell and distribute steel and non-ferrous metals such as aluminum, zinc and lead in China.

In July 2009, we launched CDII Trading. CDII Trading is engaged in the global purchase and sale of industrial commodities which includes mineral ores, non-ferrous metals, scrap metals, rare metals, petrochemicals, and other related commodities. CDII Trading also markets products from our other business units as well as some of our consulting clients by leveraging our relationships with buyers in China and abroad with worldwide suppliers we source.

Recycling. In fiscal 2007 we operated a Clean Technology segment which primarily focused on a process to recycle waste tires into tire derived fuel. While management believes in the long term viability of this technology, falling fuel prices have reduced the demand for alternative energy sources. In the third quarter of fiscal 2008, we elected to exit the alternative energy and recycling business conducted by CDI Clean Technology and its subsidiaries, CDI Wanda and Yantai CDI Wanda, and the Company now owns a minority interest in these operations.

We are evaluating the feasibility of continuing the development of a proposed facility to create aluminum powder from recycled aluminum. While the market price of aluminum did not support the economic viability of a recycling operation in the 2009 transition period, we believe aluminum wire recycling will become viable as natural resources continue to be depleted. Additionally, this operation possesses a license to import metal into China and management is evaluating the potential use of this license for additional purposes within the organization. This subsidiary was consolidated with our Basic Materials segment in the first quarter of the 2009 transition period.

Zinc Ore Mining and Distribution Operations. We hold mining rights to approximately 51 acres located in the Yongshun Kaxi Lake Mining area which is known to hold zinc ore. The mining rights we obtained from the Ministry of Land and Resources in 2004 allow for the mining of an aggregate of 10,000 metric tons of zinc ore per year. As of the date of this report, we have not commenced operations or established a reserve on this property. We also have a distribution agreement to distribute zinc concentrate for a zinc processing company that was suspended as a result of current weakness in the market price of zinc and zinc-related products in fiscal 2008.

Management is currently re-negotiating its zinc concentrate distribution agreement and evaluating strategic alternatives for these two operations including the partial or full sale of its interest in these businesses, the launch of operations in fiscal 2010 or potential joint venture partners to operate the mining and distribution operations. Presently we do not have a timetable for when or if these operations will commence, be operated or sold.

Consulting Segment

In our Consulting segment, we provide a suite of consulting services to U.S. public companies that operate primarily in China. We currently have service contracts with various clients who conduct business in China or seek to conduct business within China. We generate revenues by providing consulting services in the areas of financing structures and arrangements, mergers, acquisitions and other business transactions, identifying potential areas of growth, translation services, managing and coordinating all necessary government approvals and licenses in the PRC, marketing services, investor relations services, and coordination of the preparation of required SEC filings.

Our consulting fees vary based upon the scope of the services to be rendered. Historically, a significant portion of the fees we earned have been paid in the form of our clients' securities which include preferred stock, common stock and common stock purchase warrants from clients. We classify these securities as investments in marketable securities available for sale or investment in marketable securities available for sale-related party. We value these securities at fair market value at the time of receipt for the purposes of our revenue recognition. Primarily all of the securities we receive as compensation pursuant to agreements in our Consulting segment are from small public companies and are typically restricted under Federal securities laws as to resale. Generally we recognize revenue from such securities based on the fair value at the time preferred stock or common stock is granted and for common stock purchase warrants based on the Black-Scholes valuation model.

Our Consulting segment was also affected by the global economic slowdown and during the course of the 2009 transition period as our revenues in this segment were $0.81 million compared to $14.5 million in the first nine months of fiscal 2008. As markets have rebounded and the environment for small to medium sized companies in China has improved we intend to pursue the addition of clients in fiscal 2010, focusing on emerging companies with greater potential for growth and profitability who are in need of business development and consulting services and capital.

EMPLOYEES

As of November 30, 2009 we have approximately 515 full time employees, including 16 employees in the United States and 499 employees in the PRC. We believe we have good working relationships with our employees. We are currently not a party to any collective bargaining agreements.

For our employees in the PRC, we are required to contribute a portion of their total salaries to the Chinese government's social insurance funds, including medical insurance, unemployment insurance and job injuries insurance, as well as a housing assistance fund, in accordance with relevant regulations. We expect the amount of our contribution to the government's social insurance funds to increase in the future as we expand our workforce and operations.

Executive Officers of the Company

The following sets forth the names and ages of each of our executive officers as of September 30, 2009 and the positions they hold:

Name	Age	Position with the Company
Yuejian (James) Wang, Ph.D	47	Chairman, President and Chief Executive Officer
Andrew X. Wang	47	Executive Vice President and Chief Financial Officer
Yuwei Huang	54	Executive Vice President - Magnesium
Lazarus Rothstein	51	Executive Vice President, General Counsel and Secretary

Each of our executive officers holds office for such term as may be determined by our board of directors. Set forth below is a brief description of the business experience of each of our executive officers.

Yuejian (James) Wang, Ph.D. has served as our CEO and Chairman of the board of directors since August 2006. Dr. Wang, a co-founder of China Direct Investments, has served as its CEO and Chairman of its board of directors since its inception in January 2005. Dr. Wang has also been a member of the board of directors of CIIC Investment Banking Services (Shanghai) Company Limited from since June 2004 to 2007. From 2001 to 2004, he was President and Chairman of the board of directors of Jiangbo Genesis Pharmaceuticals Enterprises, Inc. (formerly Genesis Pharmaceuticals Enterprises, Inc.) (OTCBB: JGBO). From 2000 until 2001, Dr. Wang was President, Chief Operating Officer and director of China Net & Technologies, Inc., a technology firm. From 2000 until 2001, Dr. Wang was Vice President, Chief Operating Officer and director of Ten Sleep Corporation, a California-based integrated Internet company that acquired and licensed technology, identified, acquired and developed development-stage technology and service entities and focused on the internet infrastructure market-PC, application-ready devices. From January 2000 until November 2000, Dr. Wang was President of Master Financial Group, Inc., a St. Paul, Minnesota-based company which was a wholly-owned subsidiary of Ten Sleep Corporation that provided consulting services for small private and public entities in the area of corporate finance, investor relations and business management. Between 1997 and 2000, Dr. Wang was a research scientist and Assistant Professor, Lab Director at the University of Minnesota, School of Medicine. Dr. Wang received a Bachelor of Science degree from the University of Science and Technology of China in He Fei, China in 1985, a Master of Science Degree from the Shanghai Second Medical University, Shanghai, China in 1988, and his Ph.D. degree from the University of Arizona in 1994.