China Direct, Inc.
Form 10-Q
November 13, 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 September 30, 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.
(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 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	[ ]	Accelerated filer	[ ]
Non-accelerated filer	[ ]	Smaller reporting company	[√]
(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. 23,477,142 shares of common stock are issued and outstanding as of November 13, 2008.

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INDEX OF CERTAIN DEFINED TERMS USED IN THIS REPORT

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 list reflects our primary business entities.

When used in this report the terms:

- "China Direct", "we", "us" or "our" refers to China Direct, Inc., a Florida corporation, and our subsidiaries,

Management Services Division

- “CDI China”, refers to CDI China, Inc., a Florida corporation and a wholly owned subsidiary of China Direct,

Magnesium Segment

- “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 Capital One Resource,
- “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,

Basic Materials Segment

- “Lang Chemical”, refers to Shanghai Lang Chemical Co., Ltd. a Chinese limited liability company and a 51% majority owned subsidiary of CDI China,

- “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 Beijing” refers to CDI (Beijing) International Trading Co., Ltd., a Chinese limited liability company and a 51% majority owned subsidiary of CDI Shanghai Management,
- “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.

Advisory Services Division

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 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,

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PART 1 - FINANCIAL INFORMATION

Item 1. Financial Statements.

CHINA DIRECT, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	September 30, 2008 (Unaudited)	December 31, 2007
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 19,636,862	$ 19,024,604
Investment in marketable securities available for sale	8,559,219	7,820,500
Investment in marketable securities available for sale-related party	209,351	1,315,488
Accounts receivable, net of allowance	17,535,988	10,529,316
Accounts receivable-related parties	750,419	2,283,600
Inventories	15,416,872	5,270,388
Prepaid expenses and other current assets	21,301,463	13,951,918
Prepaid expenses-related parties	9,420,705	4,150,943
Loans receivable-related parties	1,525,114	-
Due from related parties	14,588	1,287,877
Subsidiaries held for sale	7,180,439	3,604,849
Total current assets	101,551,020	69,239,483
Restricted cash	1,420	646,970
Property, plant and equipment, net of accumulated depreciation of $1,792,566 and $509,247 at September 30, 2008 and December 31, 2007, respectively	28,618,127	17,413,489
Prepaid expenses and other assets	229,058	433,075
Property use rights, net	583,918	553,304
Total assets	$ 130,983,543	$ 88,286,321
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Loans payable-short term	$ 1,159,721	$ 1,909,781
Accounts payable and accrued expenses	9,986,741	9,524,411
Accounts payable-related parties	3,285,754	964,114
Notes payable-related party	-	410,167
Accrued dividends payable	20,235	-
Advances from customers	6,848,069	6,891,788
Other payables	3,945,819	3,090,790
Income taxes payable	757,125	304,977
Due to related parties	734,996	3,137,233
Subsidiaries held for sale	6,668,981	2,303,405
Total current liabilities	33,407,441	28,536,666
Loans payable-long term	198,392	166,573
Minority interest	27,977,974	16,957,503
Stockholders' Equity:		
	1,006,250	-

Preferred Stock: $.0001 par value, stated value $1,000 per share; 10,000,000 authorized, 1,006 shares and 0 shares issued and outstanding at September 30, 2008 and December 31, 2007, respectively		
Common Stock: $.0001 par value, 1,000,000,000 authorized, 23,545,236 and 20,982,010 issued and outstanding at September 30, 2008 and December 31, 2007, respectively	2,355	2,098
Additional paid-in capital	51,542,323	30,257,644
Deferred compensation	(22,000)	(55,000)
Accumulated comprehensive income (loss)	(7,166,802)	54,688
Retained earnings	24,037,610	12,366,149
Total stockholders' equity	69,399,736	42,625,579
Total liabilities and stockholders' equity	$ 130,983,543	$ 88,286,321

See notes to unaudited consolidated financial statements

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Revenues	$ 62,297,299	$ 43,013,630	$ 196,956,852	$ 111,298,794
Revenues-related parties	1,065,720	580,777	3,144,366	1,460,777
Total revenues	63,363,019	43,594,407	200,101,218	112,759,571
Cost of revenues	52,772,513	39,009,589	166,080,439	101,426,722
Gross profit	10,590,506	4,584,818	34,020,779	11,332,849
Operating expenses:				
Selling, general, and administrative	3,168,049	1,031,238	7,265,630	2,351,485
Operating income	7,422,457	3,553,580	26,755,149	8,981,364
Other income (expense):				
Other income	126,635	9,723	423,127	382,981
Interest income	93,782	44,847	333,659	118,086
Realized gain (loss) on sale of marketable securities	-	494,605	(35,705)	700,841
Realized loss on sale of marketable securities-related party	(2,400)	(9,871)	(2,400)	(41,885)
Total other income	218,017	539,304	718,681	1,160,023
Income from continuing operations before income taxes	7,640,474	4,092,884	27,473,830	10,141,387
Income tax benefit (expense)	567,272	(173,737)	(473,152)	(903,488)
Income from continuing operations before minority interest	8,207,746	3,919,147	27,000,678	9,237,899
Minority interest	(2,303,585)	(1,030,591)	(8,902,123)	(2,236,598)
Income from continuing operations	5,904,161	2,888,556	18,098,555	7,001,301
Income (loss) from discontinued operation, net of tax	(18,738)	92,021	54,619	117,887
Net income	5,885,423	2,980,577	18,153,174	7,119,188
Deduct dividends on Series A Preferred Stock:				
Preferred stock dividend	(20,235)	-	(1,209,702)	-
Relative fair value of detachable warrants issued	-	-	(2,765,946)	-
	-	-	(2,451,446)	-

Preferred stock beneficial conversion feature								
Income applicable to common stockholders	$	5,865,188	$	2,980,577	$	11,726,080	$	7,119,188
Basic and diluted income per common share after deduction in the first quarter of 2008, of noncash deemed dividends attributable to Series A Preferred Stock as described in Notes 3 & 11 of the Notes to the unaudited consolidated financial statements:								
Basic	$	0.25	$	0.18	$	0.52	$	0.49
Diluted	$	0.23	$	0.16	$	0.48	$	0.44
Basic weighted average common shares outstanding		23,522,179		16,339,868		22,403,054		14,431,869
Diluted weighted average common shares outstanding		25,661,353		18,241,143		24,687,015		16,106,921

See notes to unaudited consolidated financial statements

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

	For the Nine Months Ended September 30, 2008	2007
Cash flows from operating activities:		
Net income	$ 18,153,174	$ 7,119,188
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation	1,283,319	112,216
Bad debt recovery	-	(102,005)
Stock based compensation	1,672,263	576,557
Realized loss (gain) on investment in marketable securities	35,705	(700,841)
Realized loss on investment in marketable securities-related party	2,400	41,885
Fair value of securities received for services	(10,300,138)	(4,362,275)
Minority interest	11,020,471	1,745,197
Changes in operating assets and liabilities:		
Prepaid expenses and other current assets	(5,609,520)	(9,082,939)
Prepaid expenses-related parties	(5,269,762)	(1,423,766)
Inventories	(10,146,484)	2,079,260
Accounts receivable	(7,932,422)	(7,018,584)
Accounts receivable-related parties	1,533,181	(140,777)
Accounts payable and accrued expenses	1,054,337	2,826,854
Accounts payable-related party	2,321,640	2,232,636
Advances from customers	(43,719)	1,275,847
Other payables	855,029	(106,994)
Deferred income taxes	-	(72,346)
Income taxes payable	452,148	(448,164)
Net cash used in continuing activities	(918,378)	(5,449,051)
Net cash provided by (used in) discontinued operations	735,367	(765,495)
Net cash used in operating activities	(183,011)	(6,214,546)
Cash flows from investing activities:		
Cash acquired from acquisitions	-	2,229,742
Decrease (increase) in notes receivable	937,843	(71,581)
Increase in loans receivable	(1,531,138)	-
Increase in loans receivable-related parties	(1,525,114)	-
	432,395	1,887,735

Proceeds from the sale of marketable securities available for sale				
Purchases of property, plant and equipment		(11,243,330)		(1,411,740)
Net cash (used in) provided by investing activities		(12,929,344)		2,634,156
Cash flows from financing activities:				
Decrease (increase) in restricted cash		645,550		(160,634)
Proceeds from loans payable		2,147,997		1,558,528
Payment of loans payable		(2,866,238)		(22,793)
Payment of notes payable		(592,007)		-
Payment of notes payable-related party		(410,167)		-
Payment of advances from executive officers		-		(140,893)
Due from related parties		1,273,289		369,900
Due to related parties		(2,402,237)		
Gross proceeds from sale of preferred stock		12,950,000		-
Proceeds from exercise of warrants/options		2,982,376		14,908,028
Cash payment for stock split/forward and stock buy-back		(41,438)		
Cash dividend payment to preferred stock holders		(141,530)		
Offering expenses		(1,504,345)		-
Net cash provided by financing activities		12,041,250		16,512,136
EFFECT OF EXCHANGE RATE ON CASH		1,683,363		235,355
Net increase in cash		612,258		13,167,101
Cash, beginning of year		19,024,604		3,030,345
Cash, end of period	$	19,636,862	$	16,197,446
Supplemental disclosures of cash flow information:				
Cash paid for taxes	$	250,059	$	626,995
Cash paid for interest	$	187,188	$	5,936
Dividend payment in stock to preferred stock shareholders	$	1,047,937	$	-
Non-cash preferred stock deemed dividend	$	5,217,392	$	-

See notes to unaudited consolidated financial statements

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CHINA DIRECT, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2008

NOTE 1 - ORGANIZATION AND DESCRIPTION OF BUSINESS

Business and Organization

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

We are a management and advisory services organization, which owns and consults with 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 assets and we will contribute investment capital. When a new FIE or JV is created, our ownership is determined by the value of our capital contribution as compared to the new total registered capital amount, giving effect to the value of assets contributed. 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

Our unaudited consolidated financial statements 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 U.S. generally accepted accounting principles 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 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 our Annual Report on Form 10-K for the year ended December 31, 2007. 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 and to disclose our reclassification of discontinued operations.

During the third quarter of 2008, we elected to exit the alternative energy and recycling business conducted by CDI Clean Technology Group, Inc. (“CDI Clean Technology”). Included as part of the sale of CDI Clean Technology are: (i) Shandong CDI Wanda New Energy Co., Ltd., a Chinese limited liability company, a 51% majority owned subsidiary of CDI Clean Technology ("CDI Wanda") and (ii) Yantai CDI Wanda Renewable Resources Co., Ltd., a Chinese limited liability company, a 52% majority owned subsidiary of CDI Wanda ("Yantai CDI Wanda"). We formed CDI Clean Technology in January 2007. We classified CDI Clean Technology as "Subsidiaries held for sale" in accordance with the provisions of Statement of Financial Accounting Standards ("SFAS") No. 144. On October 30, 2008, we completed the sale of an 81% interest in our wholly owned subsidiary CDI Clean Technology to PE Brothers Corp. for $1,240,000, accordingly no loss was recognized during the nine months ended September 30, 2008.

During the quarter ended September 30, 2008, we ceased depreciation of CDI Clean Technology and its subsidiaries and as a result of the held for sale classification, we assessed the estimated fair value of the subsidiary and no impairment charge was recognized. The results of operations from CDI Clean Technology and its subsidiaries are classified as discontinued operations in 2008. Prior period reported results of operations of CDI Clean Technology and its subsidiaries have been reclassified to reflect the assets and liabilities of these subsidiaries as held for sale. As a result of this transaction, we will account for our 19% ownership interest in CDI Clean Technology as an investment using the equity method of accounting.

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CHINA DIRECT, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
SEPTEMBER 30, 2008

As disclosed in earlier filings, on April 26, 2008 CDI China entered into an Investment Framework Agreement to form Baotou Xinjin Magnesium Co., Ltd., a Chinese limited liability company (“Xinjin Magnesium”) to jointly invest and increase the registered capital thereby forming an FIE. During the quarter ended September 2008, we elected not to pursue this venture. We did not contribute any capital to Xinjin Magnesium.

In March 2008, CDI Shanghai Management formed CDI Metal Recycling as a joint venture entity. CDI Shanghai Management contributed $347,222 to the registered capital of the joint venture, representing an 83% interest. CDI Metal Recycling will recycle aluminum wire into aluminum powder. CDI Metal Recycling expects to commence operations in 2009.

In February 2008, CDI China, entered into an agreement with Excel Rise and Three Harmony (Australia) Party, Ltd. (“Three Harmony”) to form Baotou Changxin Magnesium, a Chinese limited liability company as a FIE. Prior to September 30, 2008 CDI China contributed approximately $7,084,000 to the registered capital of this entity, Excel Rise contributed $5,417,000 and Three Harmony contributed $1,389,000, representing a 51%, 39% and 10% interest, respectively. We own a 70.9% interest in Baotou Changxin Magnesium based on our 51% ownership interest through our wholly owned subsidiary CDI China and a 19.9% ownership interest through our 51% ownership interest in Excel Rise.

In June 2008, CDI Shanghai Management entered into an agreement to form CDI Beijing, a Chinese limited liability company. Under the terms of the agreement, CDI Shanghai Management acquired a 51% interest in CDI Beijing, which became effective in September 2008 when CDI Beijing received a business license from the Chinese government. CDI Beijing is engaged in the sale and distribution of steel, non ferrous metals and lumber products in China. Under the terms of the agreement, the initial registered investment amount of CDI Beijing is $7.27 million; $3.57 million and $3.7 million to be contributed by Mr. Chen and CDI Shanghai Management Mr. Chen and CDI Shanghai Management respectively, in installments on or before September 2009. On August 28, 2008, we contributed $750,000 while Mr. Chen made his capital contribution of $720,000. As of the date of this report, CDI Shanghai Management has a commitment to contribute an additional $2.95 million to CDI Beijing by March 31, 2009.

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, certain assumptions underlying the calculation of stock-based compensation, investments in marketable securities available for sale, assets and liabilities held for sale and the useful life of property, plant and equipment.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, we consider all highly liquid investments with original maturities of three months or less to be cash equivalents. The carrying value of these investments approximate their fair value.

Concentration of Credit Risks

Financial instruments which potentially subject us to concentrations of credit risk consist principally of cash and trade accounts receivable. We deposit our cash with high credit quality financial institutions in the United States and China. As of September 30, 2008, bank deposits in the United States exceeded federally insured limits by $130,068. At September 30, 2008, we had deposits of $12,131,796 in banks in China. Our deposits in China are not insured as there is no equivalent of the FDIC as in the United States. We have not experienced any losses in such bank accounts through September 30, 2008.

At September 30, 2008 and December 31, 2007, bank deposits, (reclassified to reflect discontinued operations), by geographic area were as follows:

Country	September 30, 2008		December 31, 2007	
United States	$ 7,505,066	38%	$ 9,942,948	52%
China	12,131,796	62%	9,081,656	48%
Total cash and cash equivalents	$ 19,636,862	100%	$ 19,024,604	100 %

In addition, at December 31, 2007, we held an additional $1,370,327 in China which has been reclassified as “Subsidiaries held for sale” at September 30, 2008.

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CHINA DIRECT, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
SEPTEMBER 30, 2008

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

Marketable securities available for sale at September 30, 2008 and December 31, 2007 consist of the following:

Client Name	September 30, 2008		December 31, 2007	
China America Holdings, Inc.	$ 589,810	7%	$1,828,481	23%
China Logistics Group, Inc. ("China Logistics")	4,085,215	48%	4,042,500	52%
Dragon International Group Corp.	953,123	11%	1,171,844	15%
China Armco Metals, Inc.	2,798,822	33%		
Other	132,249	1%	777,675	10%
Total marketable securities available for sale	$8,559,219	100%	$7,820,500	100%

We categorize securities as investment in marketable securities available for sale and investment in marketable securities available for sale-related party. The securities of China Logistics we own are restricted securities and cannot be readily resold by us absent a registration of those securities under the Securities Act of 1933 (the "Securities Act") or the availability of an exemption from the registration requirements under the Securities Act. The exemption from registration under Rule 144 of the Securities Act is not available because China Logistics is deemed not to be current in its filings with the SEC as a result of its need to restate its financial statements for the year ended December 31, 2007, the three months ended March 31, 2008 and the six months ended June 30, 2008.

The securities of one client, Dragon Capital Group Corp. ("Dragon Capital"), accounted for all investment in marketable securities available for sale-related party and totaled $209,351 and $1,315,488 at September 30, 2008 and December 31, 2007, respectively. 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 consulting services. Dragon Capital is a non-reporting company whose securities are quoted on the Pink Sheets, and 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. Dragon Capital does not intend to register the securities.

Accordingly, while under generally accepted accounting principles we are required to reflect the fair market value of our holdings in China Logistics and Dragon Capital, they are not readily convertible into cash and we may never realize the carrying value of these securities.

At September 30, 2008 our consolidated balance sheet includes accounts receivable-related party of $558,044 and $192,375 due from Taiyuan YiWei Magnesium Industry Co., Ltd. to Chang Magnesium and Golden Magnesium, respectively. The $558,044 resulted from sales generated during the nine months ended September 30, 2008 of residual scrap products created during the manufacturing process, which are outside the ordinary course of business for our Magnesium segment. These amounts reflect payment, which had not yet been collected as of September 30, 2008. 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 risks 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 September 30, 2008 and December 31, 2007, allowances for doubtful accounts were $278,363 and $290,456, respectively.

Inventories

Inventories, consisting of raw materials and finished goods are stated at the lower of cost or market utilizing the weighted average method. Inventories as of September 30, 2008 and December 31, 2007 totaled $15,416,872 and $5,270,388, respectively. Due to the nature of our business and the short duration of the manufacturing process of our products, there was no work-in-process inventory at September 30, 2008 and December 31, 2007.

Accounts Payable-Related Parties

At September 30, 2008 our consolidated balance sheet reflects accounts payable-related party of $3,285,754, which is comprised of $2,186,773, $34,823, and $738,381 due YiWei Magnesium for the purchase of inventory by Chang Magnesium, Baotou Changxin Magnesium and Golden Magnesium, respectively, and $325,777 due to Shanxi Senrun Coal Chemistry Co., Ltd., from Golden Magnesium. 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 Chang Magnesium and Golden Magnesium, respectively.

Shanxi Senrun Coal Chemistry Co., Ltd., a Chinese limited liability company, holds a 20% interest in Golden Magnesium, (“Senrun Coal”).

Fair Value of Financial Instruments

As of January 1, 2008, we adopted on a prospective basis certain required provisions of Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements, as amended by Financial Accounting Standards Board (FASB) Financial Staff Position (FSP) No. 157-2, on the effective date of FASB Statement No. 157. Those provisions relate to our financial assets and liabilities carried at fair value and our fair value disclosures related to financial assets and liabilities. SFAS 157 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 measures. 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, but not all, of our financial instruments are carried at fair value, including, all of our cash equivalents, investments classified as available for sale securities and assets held for sale and are carried at fair value, with unrealized gains and losses, net of tax. Virtually all of our valuation measurements are Level 1 measurements. The adoption of SFAS 157 did not have a significant impact on our consolidated financial statements.

Marketable Securities

Through our Advisory Services division, we receive securities which include common stock and common stock purchase warrants from client companies as compensation for consulting services. We classify these securities as investments in marketable securities available for sale or investment in marketable securities available for sale-related party. These securities are stated at their fair value in accordance with SFAS No. 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 ”. Unrealized gains or losses in investments in marketable securities available for sale are recognized as an element of other comprehensive income on a monthly basis based on fluctuations in the fair value of the security as quoted on an exchange or an inter-dealer quotation system. Realized gains or losses are recognized in the consolidated statements of operations when the securities are liquidated.

To date, all securities (exclusive of preferred stock and warrants) received from our client companies as compensation are quoted either on the Over the Counter Bulletin Board or the Pink Sheets. The securities are typically restricted as to resale. Our policy is to liquidate securities received as compensation when market conditions are favorable for sale. As these securities are often restricted, we are unable to liquidate these securities until the restriction is removed. We recognize revenue for 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 available for sale and on marketable securities available for sale-related party are recognized as an element of comprehensive income on a monthly basis based on changes in the fair value of the security as quoted on an exchange or an inter-dealer quotation system. Once liquidated, realized gains or losses on the sale of marketable securities available for sale and marketable securities available for sale-related party are reflected in our net income for the period in which the security was liquidated.

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Other-than-temporary impairment of securities are evaluated periodically to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other-than-temporary" is not intended to indicate that the decline is permanent. It indicates that the prospects for a near term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the investment. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding impairment charge to earnings is recognized.

The unrealized loss on marketable securities available for sale, net of the effect of taxes, for the three months ended September 30, 2008 and 2007 was $6,323,015 and $763,053, respectively. The unrealized loss on marketable securities available for sale-related party, net of the effect of taxes, for the three months ended September 30, 2008 and 2007 was $641,139 and $467,269 respectively.

The unrealized loss on marketable securities available for sale, net of the effect of taxes, for the nine months ended September 30, 2008 and 2007 was $9,097,319 and $1,322,277, respectively. The unrealized loss on marketable securities available for sale-related party, net of the effect of taxes, for the nine months ended September 30, 2008 and 2007 was $1,099,737 and $1,023,351 respectively.

The realized (loss) gain on investments in marketable securities available for sale for the three months ended September 30, 2008 and 2007 was $0 and $494,605, respectively. The net realized loss on the sale of marketable securities available for sale-related party for the three months ended September 30, 2008 and 2007 was $2,400 and $9,871, respectively.

The realized (loss) gain on investments in marketable securities available for sale for the nine months ended September 30, 2008 and 2007 was ($35,705) and $700,841, respectively. Net realized loss on the sale of marketable securities available for sale-related party for the nine months ended September 30, 2008 and 2007 was $2,400 and $41,885, respectively.

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 assigned to our executive officers and employees as compensation, (iii) value added tax refunds available from the Chinese government, (iv) loans receivable and (v) other receivables. At September 30, 2008 and December 31, 2007 our consolidated balance sheets include prepaid expenses and other current assets of $21,301,463 and $13,951,918, respectively.

Prepaid expenses-related parties were $9,420,705 and $4,150,943, at September 30, 2008 and December 31, 2007, respectively. Chang Magnesium and Golden Magnesium advanced $4,391,173 and $28,497, respectively to YiWei Magnesium for the future delivery of inventory which has not yet been received. Golden Magnesium advanced $1,568,221 to Senrun Coal for the future supply of gas, which had not yet been provided. Pan Asia Magnesium advanced $1,682,292 to Shanxi Jinyang Coal and Coke Group Co., Ltd., for the future supply of gas, which had not yet been provided. The gas to be provided will be utilized in future periods as energy to fuel our magnesium production facilities. Baotou Changxin Magnesium advanced Youbing Yang, a member of its board of directors,

$1,750,522 for its purchase of a magnesium facility. This amount is classified as “other receivable-related party” as the transaction is pending as of the report date. Upon completion of a final agreement, this amount will be reclassified as a fixed asset.

Non-current prepaid expenses and other assets consist of (i) the fair value of the securities of our client companies assigned to executive officers and employees as compensation 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, non-current prepaid expenses totaled $229,058 and $433,075 at September 30, 2008 and December 31, 2007, respectively.

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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.

Acquisitions

We account for acquisitions using the purchase method of accounting in accordance with the provisions of SFAS No. 141. In each of our acquisitions for the periods presented, we determined that fair values were equivalent to the acquired historical carrying costs.

Advances from Customers and Deferred Revenues

Advances from customers represent (i) prepayments to us for merchandise that had not yet been shipped to customers of $5,155,244, and (ii) the fair value of securities received as compensation which will be amortized over the term of the respective consulting agreement totaled $1,692,825. We will recognize these advances as revenues as customers take delivery of the goods or when the services have been rendered, in compliance with our revenue recognition policy. Advances from customers totaled $6,848,069 and $6,891,788 at September 30, 2008 and December 31, 2007 (reclassified to reflect discontinued operation), respectively.

Comprehensive Income

We follow 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. Comprehensive income for the nine months ended September 30, 2008 and 2007 included net income, foreign currency translation adjustments, unrealized gains or losses on marketable securities available for sale, net of income taxes, and unrealized gains or losses on marketable securities available 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, the official currency of the People’s Republic of China, (“RMB”). 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 rates for the three and nine month periods ended September 30, 2008 and September 30, 2007. A summary of the conversion rates for the periods presented is as follows:

	September 30,	
	2008	2007

Quarter end RMB : U.S. Dollar exchange rate	6.8551	7.5176
Average year-to-date RMB : U.S. Dollar exchange rate	6.9989	7.6758

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 United States dollars at the rates applied in the translation.

Impairment of Long-Lived Assets

In accordance with SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”, we periodically review our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable. We recognize 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 estimated fair value and the book value of the underlying asset. We did not record any impairment charges during the nine months ended September 30, 2008 or 2007.

Subsidiaries Held for Sale

Long-lived assets are classified as held for sale when certain criteria are met. These criteria include management’s commitment to a plan to sell the assets; the availability of the assets for immediate sale in their present condition; an active program to locate buyers and other actions to sell the assets has been initiated; the sale of the assets is probable and their transfer is expected to qualify for recognition as a completed sale within one year; the assets are being marketed at reasonable prices in relation to their fair value; and it is unlikely that significant changes will be made to the plan to sell the assets. We measure long-lived assets to be disposed of by sale at the lower of carrying amount or fair value, less cost to sell. See Note 14, “Subsidiaries Held for Sale,” for further information.

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. We, therefore, absorbed all losses applicable to a minority interest where applicable. If future earnings do materialize, we shall be credited to the extent of such losses previously absorbed.

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 our 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 and tax basis of our 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 per common share is computed by dividing income available to common shareholders by the weighted average number of shares of common stock outstanding for the periods presented. Diluted income per share reflects the potential dilution that could occur if securities were exercised or converted into common stock or other contracts to issue common stock resulted in the issuance of common stock that would then share in our income, subject to anti-dilution limitations.

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Revenue Recognition

We follow the guidance of the Securities and Exchange Commission's Staff Accounting Bulletin ("SAB") No. 104 and SAB Topic 13 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

We account for the grant of stock options and restricted stock awards 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.

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. SFAS 159 had no impact on our financial statements as of September 30, 2008, and we will continue to evaluate the impact, if any, 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. We are currently evaluating the requirements of SFAS 141R and the impact of adoption on our consolidated financial statements.

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. A 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. We are currently evaluating the requirements of SFAS 160 and the impact of adoption on our consolidated financial statements.

In March 2008, the FASB issued SFAS 161, “Disclosures about Derivative Instruments and Hedging Activities” (“SFAS 161”). SFAS 161 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 requirements of SFAS 161 and the impact of adoption on our consolidated financial statements.

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In May 2008, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement). FSP APB 14-1 clarifies that convertible debt instruments that may be settled in cash upon either mandatory or optional conversion (including partial cash settlement) are not addressed by paragraph 12 of APB Opinion No. 14, Accounting for Convertible Debt and Debt issued with Stock Purchase Warrants. Additionally, FSP APB 14-1 specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. FSP APB 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. We will adopt FSP APB 14-1 beginning in the first quarter of fiscal 2009, and this standard must be applied on a retrospective basis. We are evaluating the impact the adoption of FSP APB 14-1 will have on our consolidated financial position and results of operations.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles. This standard is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with generally accepted accounting principles in the United States for non-governmental entities. SFAS No. 162 is effective 60 days following approval by the U.S. Securities and Exchange Commission ("SEC") of the Public Company Accounting Oversight Board's amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. We do not expect SFAS No. 162 to have a material impact on the preparation of our consolidated financial statements.

On September 16, 2008, the FASB issued FSP No. EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities" to address the question of whether instruments granted in share-based payment transactions are participating securities prior to vesting. The FSP determines that unvested share-based payment awards that contain rights to dividend payments should be included in earnings per share calculations. The guidance will be effective for fiscal years beginning after December 15, 2008. We are currently evaluating the requirements of FSP No. EITF 03-6-1.

On October 10, 2008, the FASB issued FSP No. 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active. This FASB Staff Position (FSP) clarifies the application of FASB Statement No. 157, Fair Value Measurements ("Statement 157"), in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset under those circumstances. Statement 157 was issued in September 2006, and is effective for financial assets and financial liabilities for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We have adopted FSP 157-3 and determined that it had no impact as of September 30, 2008 on our financial statements, and we will continue to evaluate the impact, if any, of FSP 157-3 on our financial statements.

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NOTE 3 - EARNINGS (LOSSES) 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 share in the income of the company, subject to anti-dilution limitations.

	Three Months Ended September 30,			
	2008	Per Share	2007	Per Share
Numerator:				
Income from continuing operations	$ 5,904,161	0.25	$ 2,888,556	0.18
Income (loss) from discontinued operations, net of tax	(18,738)	0.00	92,021	0.00
Series A preferred stock:				
Preferred stock dividend	(20,235)	0.00	-	
Relative fair value of detachable warrants issued	-		-	
Preferred stock beneficial conversion feature	-		-	
Numerator for basic EPS, Income applicable to common stock holders (A)	5,865,188	0.25	2,980,577	0.18
Plus: Income impact of assumed conversions				
Preferred stock dividends - unconverted	20,235		-	
Numerator for diluted EPS, Income applicable to common stock holders plus assumed conversions (*)(B)	$ 5,885,423	0.23	$ 2,980,577	0.16
Denominator:				
Denominator for basic earnings per share - weighted average number of common shares outstanding (C)	23,522,179		16,339,868	
Stock Awards, Options, and Warrants	1,995,424		1,901,275	
Preferred stock dividends - unconverted	143,750		-	
	25,661,353		18,241,143	

Denominator for diluted earnings per share - adjusted weighted average outstanding average number of common shares outstanding (D)							
Basic and Diluted Income Per Common Share:							
Earnings per share - basic (A)/(C)		0.25			0.18		
Earnings per share - diluted (B)/(D)		0.23			0.16		

	Nine Months Ended September 30,						
		2008	Per Share		2007	Per Share	
Numerator:							
Income from continuing operations	$	18,098,555	0.81	$	7,001,301	$	