

DEFENSE INDUSTRIES INTERNATIONAL INC  
Form 10-Q  
May 17, 2010

---

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

FORM 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended March 31, 2010

Transition report pursuant to Section 13 or 15(d) of the Exchange Act for the transition period from [ ] to [ ]

Commission file number: 0-30105

DEFENSE INDUSTRIES INTERNATIONAL, INC.  
(Exact Name of Registrant as Specified in Its Charter)

Nevada  
(State or Other Jurisdiction of  
Incorporation or Organization)

84-1421483  
(I.R.S. Employer  
Identification No.)

12 Hamefalsim Street, Petach Tikva 49514, Israel  
(Address of Principal Executive Offices)

(011) 972-3-7168383  
(Registrant's Telephone Number, Including Area Code)

N/A  
(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 any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is large accelerated filer, an accelerated filer, or a non-accelerated filer.

Edgar Filing: DEFENSE INDUSTRIES INTERNATIONAL INC - Form 10-Q

See of “accelerated filer and large accelerated filer” 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

As of May 11, 2010 the issuer had 28,150,535 shares of Common Stock, par value \$0.0001, outstanding.

---

DEFENSE INDUSTRIES INTERNATIONAL, INC. AND SUBSIDIARIES

INDEX

|   | Page |
|---|------|
| <u>PART I - FINANCIAL INFORMATION:</u>  |      |
| <u>Item 1.</u>  | 3    |
| <u>Condensed Consolidated Balance Sheets as of March 31, 2010 (Unaudited) and December 31, 2009</u>                             |      |
|   | 5    |
| <u>Condensed Consolidated Statements of Operations for the Three Months Ended March 31, 2010 and 2009 (Unaudited)</u>           |      |
|   | 6    |
| <u>Condensed Consolidated Statement of Changes in Equity for the Three Months Ended March 31, 2010 and 2009 (Unaudited)</u>     |      |
|   | 7    |
| <u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2010 and March 31, 2009 (Unaudited)</u> |      |
|   | 8    |
| <u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>   |      |
| <u>Item 2.</u>  | 16   |
| <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                                    |      |
| <u>Item 3.</u>  | 23   |
| <u>Quantitative and Qualitative Disclosures About Market Risk</u>   |      |
| <u>Item 4.</u>  | 24   |
| <u>Controls and Procedures</u>  |      |
| <u>PART II - OTHER INFORMATION:</u>   |      |
| <u>Item 1.</u>  | 24   |
| <u>Legal Proceedings</u>  |      |
| <u>Item 1A.</u>   | 25   |
| <u>Risk Factors</u>   |      |
| <u>Item 2.</u>  | 25   |
| <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>  |      |
| <u>Item 3.</u>  | 25   |
| <u>Defaults Upon Senior Securities</u>  |      |
| <u>Item 4.</u>  | 25   |
| <u>(Removed and Reserved)</u>   |      |
| <u>Item 5.</u>  | 25   |
| <u>Other Information</u>  |      |
| <u>Item 6.</u>  | 25   |
| <u>Exhibits</u>   |      |
| <u>SIGNATURES</u>   | 25   |



## PART I – FINANCIAL INFORMATION:

## Item 1.

DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARY COMPANIESCONDENSED CONSOLIDATED BALANCE SHEETS  
AS OF MARCH 31, 2010 (UNAUDITED) AND DECEMBER 31, 2009

## ASSETS

|  | March 31,<br>2010<br>(Unaudited) | December<br>31,<br>2009 |
|--|----------------------------------|-------------------------|
| <b>CURRENT ASSETS</b>  |                                  |                         |
| Cash and cash equivalents  | \$4,499,878                      | \$3,783,631             |
| Accounts receivable, net of allowance for doubtful accounts of \$339,638 and \$343,629, respectively | 2,467,333                        | 3,352,751               |
| Inventories  | 4,055,047                        | 4,124,141               |
| Trading securities   | 2,393,808                        | 2,312,048               |
| Deferred taxes   | 147,270                          | 148,710                 |
| Other current assets   | 247,957                          | 225,112                 |
| <b>Total Current Assets</b>  | <b>13,811,293</b>                | <b>13,946,393</b>       |
| <b>PROPERTY, PLANT AND EQUIPMENT, NET</b>  | <b>1,728,851</b>                 | <b>1,741,594</b>        |
| <b>OTHER ASSETS</b>  |                                  |                         |
| Funds in respect of employee rights upon retirement  | 814,404                          | 780,960                 |
| Deferred taxes   | 27,499                           | 25,659                  |
| Refundable deposits for the purchase of a business (Note 2)  | 2,022,799                        | 1,993,696               |
| <b>Total Other Assets</b>  | <b>2,864,702</b>                 | <b>2,800,315</b>        |
| <b>TOTAL ASSETS</b>  | <b>\$18,404,846</b>              | <b>\$18,488,302</b>     |

The accompanying notes are an integral part of the condensed consolidated financial statements

DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARY COMPANIES

CONDENSED CONSOLIDATED BALANCE SHEETS  
AS OF MARCH 31, 2010 (UNAUDITED) AND DECEMBER 31, 2009

LIABILITIES AND EQUITY

|   | March 31,<br>2010<br>(Unaudited) | December<br>31,<br>2009 |
|---|----------------------------------|-------------------------|
| <b>CURRENT LIABILITIES</b>  |                                  |                         |
| Accounts payable  | \$1,600,272                      | \$1,408,741             |
| Accounts payable – related parties  | 455,078                          | 462,968                 |
| Short-term debt   | 659,550                          | 876,554                 |
| Other current liabilities   | 966,891                          | 1,047,771               |
| <b>Total Current Liabilities</b>  | <b>3,681,791</b>                 | <b>3,796,034</b>        |
| <b>LONG-TERM LIABILITIES</b>  |                                  |                         |
| Long-term portion of debt   | 279,020                          | 268,250                 |
| Deferred tax liability  | 231,536                          | 229,191                 |
| Liability for employee rights upon retirement   | 956,046                          | 911,440                 |
| <b>Total Long-Term Liabilities</b>  | <b>1,466,602</b>                 | <b>1,408,881</b>        |
| <b>TOTAL LIABILITIES</b>  | <b>5,148,393</b>                 | <b>5,204,915</b>        |
| <b>COMMITMENTS AND CONTINGENCIES</b>  |                                  |                         |
| <b>EQUITY</b>   |                                  |                         |
| Preferred stock, \$0.0001 par value, 50,000,000 shares<br>authorized, none issued and outstanding   | ---                              | ---                     |
| Common stock, \$0.0001 par value, 250,000,000 shares<br>authorized, 29,200,535 shares issued and 28,150,535<br>shares outstanding at March 31, 2010 and December 31, 2009 | 2,920                            | 2,920                   |
| Additional paid-in capital  | 2,997,370                        | 2,997,370               |
| Treasury stock (1,050,000 shares at cost)   | (252,000 )                       | (252,000 )              |
| Retained earnings   | 9,921,763                        | 10,176,352              |
| Accumulated other comprehensive income  | 586,400                          | 358,745                 |
| <b>Total Equity</b>   | <b>13,256,453</b>                | <b>13,283,387</b>       |
| <b>TOTAL LIABILITIES AND EQUITY</b>   | <b>\$18,404,846</b>              | <b>\$18,488,302</b>     |

The accompanying notes are an integral part of the condensed consolidated financial statements

DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARY COMPANIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009 (UNAUDITED)

|   | For the Three Months<br>Ended March 31, |             |
|---|---|-------------|
|   | 2010                                    | 2009        |
| NET REVENUES  | \$2,993,731                             | \$5,813,288 |
| COST OF SALES   | 2,390,352                               | 4,321,560   |
| GROSS PROFIT  | 603,379                                 | 1,491,728   |
| OPERATING EXPENSES  |   |             |
| Selling   | 115,772                                 | 183,776     |
| General and administrative  | 697,409                                 | 529,894     |
| Total Operating Expenses  | 813,181                                 | 713,670     |
| INCOME (LOSS) FROM OPERATIONS                                     | (209,802 )                              | 778,058     |
| OTHER INCOME (EXPENSES)   |   |             |
| Financial expenses  | (127,892 )                              | (32,687 )   |
| Financial income  | 37,858                                  | 473,712     |
| Other income (expenses), net                                      | 50,372                                  | 164,204     |
| Total Other Income (Expenses)                                     | (39,662 )                               | 605,229     |
| INCOME (LOSS) BEFORE INCOME TAXES                                 | (249,464 )                              | 1,383,287   |
| Income tax expenses   | (5,125 )                                | (284,851 )  |
| NET INCOME (LOSS)   | \$(254,589 )                            | \$1,098,436 |
| Net income (loss) per share - basic and diluted                   | \$(0.009 )                              | \$0.039     |
| Weighted average number of shares outstanding - basic and diluted | 28,150,535                              | 27,941,111  |

The accompanying notes are an integral part of the condensed consolidated financial statements

DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARY COMPANIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY  
FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009 (UNAUDITED)

|   | Common Stock |         | Treasury Stock |             | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total<br>Comprehensive<br>Loss | Total<br>Comprehensive<br>Earnings |
|---|--------------|---------|----------------|-------------|----------------------------------|----------------------|---|--------------------------------|------------------------------------|
|   | Shares       | Dollars | Shares         | Dollars     |                                  |                      |   |                                |                                    |
| Balance as of<br>January 1, 2010        | 29,200,535   | \$2,920 | 1,050,000      | \$(252,000) | \$2,997,370                      | \$10,176,352         | \$358,745   |                                | \$13,522,737                       |
| Comprehensive loss:                     |              |         |                |             |                                  |                      |   |                                |                                    |
| Net loss                                | -            | -       | -              | -           | -                                | (254,589 )           | -   | \$(254,589 )                   | (254,589 )                         |
| Foreign<br>currency<br>translation gain | -            | -       | -              | -           | -                                | -                    | 227,655   | 227,655                        | 227,655                            |
| Total<br>comprehensive<br>loss          |              |         |                |             |                                  |                      |   | \$(26,933 )                    | \$(26,933 )                        |
| Balance as of<br>March 31, 2010         | 29,200,535   | \$2,920 | 1,050,000      | \$(252,000) | \$2,997,370                      | \$9,921,763          | \$586,400   |                                | \$13,252,800                       |
| Balance as of<br>January 1, 2009        |              |         |                |             |                                  |                      |   |                                |                                    |
| Balance as of<br>January 1, 2009        | 28,991,111   | \$2,899 | 1,050,000      | \$(252,000) | \$2,957,391                      | \$9,654,086          | \$236,503   |                                | \$12,989,981                       |
| Comprehensive loss:                     |              |         |                |             |                                  |                      |   |                                |                                    |
| Net income                              | -            | -       | -              | -           | -                                | 1,098,436            | -   | \$1,098,436                    | 1,098,436                          |
| Foreign<br>currency<br>translation loss | -            | -       | -              | -           | -                                | -                    | (1,191,637)   | (1,191,637)                    | (1,191,637)                        |
| Total<br>comprehensive<br>loss          |              |         |                |             |                                  |                      |   | \$(93,201 )                    | \$(93,201 )                        |
|   | 28,991,111   | \$2,899 | 1,050,000      | \$(252,000) | \$2,957,391                      | \$10,752,522         | \$(955,134 )  |                                | \$12,702,758                       |



Balance as of  
March 31, 2009

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

6

---

DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARY COMPANIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009 (UNAUDITED)

|  | For the Three Months<br>Ended March 31, |             |
|--|---|-------------|
|  | 2010                                    | 2009        |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |   |             |
| Net income (loss)  | \$(254,589 )                            | \$1,098,436 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities:             |   |             |
| Items not effecting cash:  |   |             |
| Depreciation and amortization  | 144,606                                 | 136,867     |
| Provision for doubtful accounts  | (9,058 )                                | 5,631       |
| Deferred taxes   | 1,024                                   | 27,197      |
| Net unrealized (gain) on trading securities  | (18,686 )                               | (105,578 )  |
| Gain from the disposal of Dragonwear Trading Ltd.  | (13,717 )                               | ---         |
| Gain from settlement of long term note   | (8,968 )                                |             |
| Accrued interest and exchange rate differences of long-term debt                                     | 1,685                                   | (1,263 )    |
| Accrued interest and exchange rate differences on refundable deposits for the purchase of a business | (15,320 )                               | (112,090 )  |
| Accrued interest and exchange rate differences on deposits   | ---                                     | (240,761 )  |
| Changes in assets and liabilities:   |   |             |
| Decrease (increase) in accounts receivable   | 942,143                                 | (1,052,033) |
| Decrease (increase) in inventories   | 134,069                                 | (290,005 )  |
| (Increase) decrease in trading securities  | (24,221 )                               | 486,105     |
| Decrease in related parties accounts   | (15,177 )                               | (112,990 )  |
| (Increase) decrease in other current assets  | (17,600 )                               | 458,564     |
| Increase in funds in respect of employee rights upon retirement                                      | (20,288 )                               | (38,751 )   |
| Increase in accounts payable   | 170,580                                 | 286,337     |
| (Decrease) increase in other current liabilities   | (82,935 )                               | 59,365      |
| Increase in liability for employee rights upon retirement  | 29,219                                  | 17,696      |
| Net cash provided by Operating Activities  | 942,767                                 | 622,727     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |   |             |
| Redemption of restricted bank deposits   | ---                                     | 2,000,000   |
| Purchases of property, plant and equipment   | (107,817 )                              | (41,455 )   |
| Refundable deposits for purchase of a business   | (13,782 )                               | (832,453 )  |
| Net cash (used in) provided by Investing Activities  | (121,599 )                              | 1,126,092   |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |   |             |
| Short-term debt, net   | (219,301 )                              | 166,459     |
| Proceeds from long-term debt   | 85,920                                  | ---         |
| Repayment of long-term debt  | (78,161 )                               | (101,295 )  |
| Redemption of related party creditors  | -                                       | (905,721 )  |
| Net cash used in Financing Activities  | (211,542 )                              | (840,557 )  |

|  |             |             |
|--|-------------|-------------|
| EFFECT OF CHANGES IN EXCHANGE RATES ON CASH AND CASH EQUIVALENTS | 106,621     | (79,043 )   |
| NET INCREASE IN CASH AND CASH EQUIVALENTS                        | 716,247     | 829,219     |
| CASH AND CASH EQUIVALENTS – BEGINNING OF PERIOD                  | 3,783,631   | 1,719,921   |
| CASH AND CASH EQUIVALENTS – END OF PERIOD                        | \$4,499,878 | \$2,549,140 |
| INTEREST PAID  | \$13,430    | \$17,372    |
| TAXES PAID   | \$91,879    | \$210,724   |

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

DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARY COMPANIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENT  
FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009 (UNAUDITED)

NOTE 1 BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

- A. The accompanying unaudited interim consolidated financial statements as of March 31, 2010 and for the three month period then ended (the “interim financial statements”) were prepared in a condensed form in accordance with the instructions for Form 10-Q and, therefore, do not include all disclosures necessary for a complete presentation of financial condition, results of operations, changes in shareholders’ equity, cash flows and all the data and notes which are required when preparing annual financial statements, in conformity with generally accepted accounting principles accepted in the United States.
- B. The accounting principles used in the presentation of the interim financial statements are consistent with those principles used in the presentation of the latest annual financial statements. All significant accounting policies have been applied consistently with the year ended December 31, 2009.
- C. The preparation of the interim financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates. In the opinion of management, all adjustments considered necessary for fair presentation of the interim financial statements have been included. The results of operations for the three months period ended March 31, 2010, are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. The interim financial statements should be read in conjunction with the Company’s annual financial statements as of December 31, 2009 and for the year then ended and the accompanying notes thereto.

D. Principles of Consolidation

The interim financial statements include the accounts of Defense Industries International, Inc., its wholly owned subsidiaries, Export Erez USA, Inc., Rizzo Inc.(doing business as Owen Mills Company), Export Erez, Ltd. (“Export Erez”), Mayotex, Ltd. (“Mayotex”), Dragonwear Trading Ltd. (“Dragonwear”), and Achidatex Nazareth Elite (1977) Ltd. (“Achidatex”).

During 2009, Dragonwear ceased its operations and was dissolved and deleted from the Register of Companies on March, 14, 2010. Dragonwear had no operational activities, therefore, its discontinuance had no impact for measurement and disclosure purposes in all reported periods.

All significant inter-company accounts and transactions have been eliminated in consolidation.

DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARY COMPANIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENT  
FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009 (UNAUDITED)

E. Per share data

Basic net income per share of common stock is computed based on the weighted average number of shares of common stock outstanding during the period. Diluted net income per share of common stock is computed based on the weighted average number of shares of common stock and common stock equivalents outstanding during the period. For the three months ended March 31, 2010 and 2009 common stock equivalents to purchase 202,500 shares of common stock were not included in diluted income (loss) per share because their effect is anti-dilutive.

F. Fair value

The Company categorizes the fair value of its financial assets and liabilities according to the hierarchy of Financial Accounting Standard Board ("FASB") Accounting Standards Codification ("ASC") No. 820 "Fair Value Measurements and Disclosures", which establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements.

FASB ASC 820 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. FASB ASC 820 also requires disclosure about how fair value is determined for assets and liabilities and establishes a hierarchy for which these assets and liabilities must be grouped, based on significant levels of inputs, as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities;

Level 2 Quoted prices in active markets for similar assets and liabilities and inputs that are observable for the asset or liability; or

Level 3 Unobservable inputs, such as discounted cash flow models or valuations.

The Company's trading securities and bank deposits are measured at fair value based on quoted market prices in active markets for identical assets (Level 1).

The Company funds in respect to employees' rights upon retirement are measured at fair value based upon unobservable inputs (Level 3).

In addition to the assets and liabilities described above, our financial instruments also include cash, accounts receivable, other receivables, accounts payable, accounts payable to related parties, accrued expenses and other payables. The fair value of these financial instruments was not materially different from their carrying value at March 31, 2010 and December 31, 2009 due to the short-term maturity of these instruments.

DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARY COMPANIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENT  
FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009 (UNAUDITED)

H. Recent accounting pronouncements issued and adopted in the reported period

With the exception of those stated below, there have been no recent accounting pronouncements or changes in accounting pronouncements during the three months ended March 31, 2010, as compared to the recent accounting pronouncements described in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2009, that are of material significance, or have potential material significance, to the Company.

Effective January 1, 2010, the Company adopted the FASB's ASU No. 2010-06 "Improving Disclosures about Fair Value Measurements". The updated guidance related to fair value measurements and disclosures, which requires a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and to describe the reasons for the transfers. In addition, in the reconciliation for fair value measurements using significant unobservable inputs, or Level 3, a reporting entity should disclose separately information about purchases, sales, issuances and settlements (that is, on a gross basis rather than one net number). The updated guidance also requires that an entity should provide fair value measurement disclosures for each class of assets and liabilities and disclosures about the valuation techniques and inputs used to measure fair value for both recurring and non-recurring fair value measurements for Level 2 and Level 3 fair value measurements. The guidance is effective for interim or annual financial reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the roll forward activity in Level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The Company has updated its disclosures to comply with the updated guidance; however, adoption of the updated guidance did not have an impact on the Company's consolidated results of operations or financial condition.

NOTE 2

PENDING ACQUISITION

On December 17, 2008, Mayotex entered into an agreement with Sarino Crystal Technologies Ltd. and Sarino Optronics Ltd. ("Sarino") to cooperate in the manufacture of optical grade Germanium crystals and sales of lenses to be used in optical and infra-red night vision products utilizing the Germanium crystals (the "Sarino Agreement").

On December 21, 2008, Mayosar Ltd. (incorporated by Mayotex and Sarino) ("Mayosar"), through its wholly owned subsidiary Isorad IR Optics Ltd., ("Optics"), entered into an agreement to purchase the Germanium Crystals Business of Isorad Ltd., an Israeli governmental company ("Isorad"). The Isorad Agreement provided for the purchase of certain know-how, equipment, inventories and production activities of Germanium Crystals for lenses used in infra-red night vision system applications ("Isorad Agreement"). As of March 31, 2010, Isorad has not met certain conditions set out in the Isorad Agreement and, based on a legal advice received, this agreement has not been consummated.

DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARY COMPANIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENT  
FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009 (UNAUDITED)

Pursuant to the Sarino Agreement and subject to the approval of the Isorad Agreement:

(1) Mayotex and Sarino agreed to incorporate Mayosar, with Mayotex being the majority shareholder owning 50.1% and Sarino owning 49.9%. As majority shareholder, Mayotex will have operational control of Mayosar.

(2) In consideration of the above, Mayotex will pay Sarino \$1 million, out of which, \$300,000 will be non-refundable to Mayotex upon 24 months following the execution of the Isorad Agreement, and the remaining \$700,000 will be earned by Sarino based on 10% of sales over \$3 million and up to \$10 million during the first 36 months of operations. Amounts not earned are to be refunded to Mayotex, including interest of Libor + 2% per annum. The refundable consideration is secured by Sarino's interest in Mayosar and personal guarantees provided by Sarino Crystal Technologies Ltd.'s controlling shareholders.

(3) Mayotex agreed to provide Mayosar with a loan of up to \$2 million. Such loan will bear interest at the rate of Libor + 2%, and is payable from profits generated by Mayosar.

As of March 31, 2010, Mayotex provided loans of \$1 million to Sarino and \$1 million to Mayosar. Such payments are recognized as refundable deposits pending resolution of the Isorad Agreement.

Isorad Agreement (subject to approval):

Pursuant to the Isorad Agreement, Optics is to pay royalties of 3% out of sales for a period of 15 years commencing the effective date of the Isorad Agreement ( the "Effective Date"), with a minimum amount of approximately \$133,000 payable per year during the first 18 months or until the date of completion of the transfer of the site of the Germanium Crystals Business, whichever is earlier (this payment includes a reimbursement of costs for the usage of the site and equipment in this initial period), and approximately \$53,000 per year during the following years of the royalties payment period.

Pursuant to the Isorad Agreement, Isorad was granted the right to acquire 5% of the share capital of Optics on a fully diluted basis for their nominal value during the 24 month period beginning on the Effective Date. If the Israeli Government does not approve the 5% purchase of the Optics shares by Isorad within twelve (12) months of the Effective Date, the right to acquire the shares will expire and Isorad will be entitled to a payment of \$75,000.

DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARY COMPANIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENT  
FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009 (UNAUDITED)

In the event of an allotment of shares to Isorad, representing 5% of Optics' share capital, Mayosar will issue to Mayotex additional shares of Mayosar on a pro rata basis, in order for Mayotex to retain a 50.01% indirect interest in Optics' share capital.

Optics has the right during the four year period following the Effective Date to redeem and purchase from Isorad its option to purchase 5% of its shares and to cancel its commitment to pay royalties under the Isorad agreement, in consideration of a fixed payment of \$750,000, less all royalties paid to Isorad through that date.

Management is currently assessing its legal position. Management is of the opinion, based on legal advice received, that the amounts paid under the Sarino and Isorad agreements should be fully refunded to the Company in the event that the Isorad Agreement is not consummated.

## NOTE 3

## INVENTORIES

Consist of:

|                   | March 31,<br>2010 | December 31,<br>2009 |
|-------------------|-------------------|----------------------|
| Raw materials (1) | \$ 2,794,787      | \$ 2,597,759         |
| Work in progress  | 551,867           | 642,132              |
| Finished goods    | 708,393           | 884,250              |
|                   | \$ 4,055,047      | \$ 4,124,141         |

(1) As of March 31, 2010 and December 31, 2009, includes advanced payments to purchase inventory for \$84,421 and \$52,894, respectively.



DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARY COMPANIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENT  
FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009 (UNAUDITED)

NOTE 4 SEGMENT INFORMATION AND CONCENTRATIONS

The Company has two strategic business segments: sales to the civilian market and the military market.

The military and the civilian markets are further broken down between Israel (local) and other (export) sales in order to better analyze trends in sales and profit margins. The Company does not allocate assets between segments because assets are used in more than one segment and any allocation would be impractical.

A. Sales and Income from Operations:

|  | Civilian     |            | Military     |              |              |
|--|--------------|------------|--------------|--------------|--------------|
|  | Local        | Export     | Local        | Export       | Consolidated |
| For the three months ended March 31, 2010: |              |            |              |              |              |
| Revenue from sales                         | \$ 1,033,658 | \$ 229,631 | \$ 1,165,142 | \$ 565,300   | \$ 2,993,731 |
| Gross Profits                              | 179,200      | 25,294     | 272,308      | 126,577      | 603,379      |
| Corporate unallocated costs                |              |            |              |              | 813,181      |
| Loss from operations                       |              |            |              |              | (209,802 )   |
| For the three months ended March 31, 2009: |              |            |              |              |              |
| Revenue from sales                         | \$ 821,276   | \$ 160,459 | \$ 2,430,937 | \$ 2,400,616 | \$ 5,813,288 |
| Gross Profits                              | 321,123      | (38,046 )  | 523,646      | 685,005      | 1,491,728    |
| Corporate unallocated costs                |              |            |              |              | 713,670      |
| Income from operations                     |              |            |              |              | 778,058      |

DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARY COMPANIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENT  
FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009 (UNAUDITED)

B.Geographic Areas – revenues:

|                    | Three Months Ended<br>March 31, |                     |
|--------------------|---------------------------------|---------------------|
|                    | 2010                            | 2009                |
| Israel             | \$ 2,198,800                    | \$ 3,252,213        |
| South America      | 218,360                         | 754,527             |
| North America      | 230,945                         | 160,459             |
| Europe and Asia    | 343,449                         | 459,734             |
| Africa             | 2,177                           | 1,186,355           |
| <b>Total Sales</b> | <b>\$ 2,993,731</b>             | <b>\$ 5,813,288</b> |

C.Single Customer Exceeding 10% of Sales:

|                              | For the three<br>months ended<br>March 31,<br>2010 | For the three<br>months ended<br>March 31,<br>2009 |
|------------------------------|--|--|
| Customer A (Military Local)  | \$ 1,139,476                                       | \$ 2,430,937                                       |
| Customer B (Military Export) | 2,177  | 1,063,923  |

DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARY COMPANIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENT  
FOR THE THREE MONTHS ENDED MARCH 31, 2010 AND 2009 (UNAUDITED)

NOTE 5

COMMITMENTS AND CONTINGENCIES

- A. On February 11, 2009, a lawsuit was filed in the Jerusalem District Court against the Company's subsidiaries, Export Erez USA Inc. and Achidatex, and its chief executive officer, Mr. Avraham Hazor. The suit alleges that Achidatex materially breached its agreement with the plaintiff, dated February 22, 2000, relating to the development of inflatable mine-field crossing enabling sandals, because Achidatex allegedly failed to register patents for the technology worldwide and only registered patents in the United States. The plaintiff further claims that the defendants, jointly and severally, committed a breach of trust. The plaintiff is seeking damages in the amount of NIS 10 million (approximately \$2.4 million), and claiming for all rights in the patent. Contemporaneously with the filing of the claim, the plaintiff also filed a motion seeking an exemption from payment of the requisite court filing fee, and stated that he would withdraw the lawsuit if the motion is not granted. On March 12, 2009, Achidatex filed a request to respond to the motion and requested a 30 day extension to file its statement of defense. On May 24, 2009, Achidatex filed its statement of defense. The Company believes that it is likely that the plaintiff's motion for an exemption from payment of the court filing fee will be granted and that the lawsuit will therefore proceed. The Company believes that the plaintiff's claim is unfounded and intends to vigorously defend against the claim. Due to the preliminary stage of the claim, management and its legal advisors cannot currently assess the outcome or possible adverse effect on its financial position or results of operations, however, management believes the Company has substantial legal arguments to oppose the allegations.
- B. On April 7, 2010, a lawsuit was filed against Achidatex and another lawsuit was filed against Export Erez in the Nazareth Magistrates' Court (the "Court"), each to obtain an eviction order for the premises leased by these subsidiaries. The plaintiffs in the suits, a company owned by the former shareholders of Achidatex and a company owned by the Company's principal shareholder, allege that Achidatex and Export Erez each materially breached their respective lease agreement with the plaintiff, dated January 1, 2008. The premises from which the plaintiff seeks to evict Achidatex and Export Erez, are used by Achidatex and Export Erez to conduct their operational activities. The parties are currently attempting to settle the dispute out of court. Therefore, Achidatex and Export Erez have not yet filed their statements of defense in the above lawsuits.

NOTE 6

SUBSEQUENT EVENTS

The Company has evaluated all events or transactions that occurred after March 31, 2010 through the filing date of this document and did not have any material recognizable and unrecognizable subsequent events.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This discussion should be read in conjunction with the condensed consolidated financial statements and notes included in Item 1 of Part I of this Quarterly Report and the audited consolidated financial statements and notes thereto, and Management's Discussion and Analysis of Financial Condition and Results of Operations for the Year Ended December 31, 2009 contained in our 2009 Annual Report on Form 10-K. The discussion and analysis which follows may contain trend analysis and other forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 which reflect our current views with respect to future events and financial results. These include statements regarding our earnings, projected growth and forecasts, and similar matters that are not historical facts.

We remind shareholders that forward-looking statements are merely predictions and therefore are inherently subject to uncertainties and other factors that could cause the future results to differ materially from those described in the forward-looking statements.

The following is management's discussion and analysis of certain significant factors which have affected our financial position and operating results during the periods included in the accompanying consolidated financial statements, as well as information relating to the plans of our current management.

### Overview

We are a manufacturer and global provider of personal military and civilian protective equipment and supplies. Our products are used by military, law enforcement, border patrol enforcement, and other special security forces, corporations, non-governmental organizations and individuals throughout the world.

Our main products include body armor, bomb disposal suits, bullet proof vests and jackets, ballistic wall coverings, bullet proof ceramic and polyethylene panels, V.I.P. car armoring and lightweight armor kits for vehicles, personal military equipment, dry storage systems, liquid logistic products, tents and other camping and travel gear.

We believe that current international tensions, the continuing war on terrorism and conflicts in Iraq and Afghanistan are all likely to result in additional interest in our products, and that the demand for our products will continue to grow.

We expect to address this growth by offering a comprehensive array of high quality branded security products that meet our customers' increasingly complex security products requirements.

### Material Trends

**Local Military Market.** The demand for our products increased significantly in the first quarter of 2009, mainly due to the effect of the hostilities between Israel and the Hamas in Gaza, which took place in December 2008 and January 2009. During the end of 2009 and the first quarter of 2010, the demand for our products decreased due to a break in the hostilities in Gaza. We believe that the demand for our products from the Israeli Ministry of Defense will continue at the current levels during 2010.

As of May 10, 2010, we had a backlog of firm orders from the Israeli Ministry of Defense of approximately \$2.1 million, including orders of approximately \$0.5 million that we received subsequent to March 31, 2010. In the three month periods ended March 31, 2010 and 2009, sales to the Israeli Ministry of Defense were \$1.1 million and \$2.4 million, accounting for 38% and 41.8% of our sales, respectively.

Export Military Market. Our customers in this market are military and law enforcement organizations mostly in South America, North America, Africa and Europe. Their budgets fluctuate, and as a result, we cannot identify definite trends in these markets. In the three months ended March 31, 2010 and 2009, we had sales of \$218,360 and \$754,527 in South America, sales of \$230,945 and \$160,459 in North America, sales of \$343,449 and \$459,734 in Europe and Asia, and sales of \$2,177 and \$1,186,355 in Africa, respectively.

Since 2003, we have increased our export efforts and are continuing our efforts to strengthen our position in our existing export markets in the U.S., South America, Asia and Europe, and to extend our presence to new export markets in South America, Africa, Europe and Australia. Any future success in such markets is mainly dependant on our marketing efforts, our ability to be competitive in our pricing and the quality of our products.

The following table presents details of our export military sales during the three month periods ended March 31, 2010 and 2009:

|                             | Three Months Ended<br>March 31, |             |
|-----------------------------|---------------------------------|-------------|
|                             | 2010                            | 2009        |
| Sales to South America      | \$218,360                       | \$754,527   |
| Sales to North America      | 230,945                         | 160,459     |
| Sales to Europe and Asia    | 343,449                         | 459,734     |
| Sales to Africa             | 2,177                           | 1,186,355   |
| Total Export Military Sales | \$794,931                       | \$2,561,075 |

Local Civilian Market. Our product range for the civilian market is diversified. In the three months ended March 31, 2010, our local market business increased to \$1,033,658 compared to \$821,276 for the three months ended March 31, 2009, mainly due to the sale of civilian trucks covers. We expect to maintain the same level of revenues in the next quarter, due to marketing efforts and increased demand for armor of civilian facilities.

Backlog. We had approximately \$3.5 million of unfilled customer orders at March 31, 2010, compared to \$6 million of unfilled customer orders at March 31, 2009. Of our \$3.5 million of unfilled customer orders at March 31, 2010, approximately \$0.4 million was attributable to orders from military customers in South America, approximately \$0.1 million was attributable to orders from military customers in Europe and Asia, approximately \$0.2 million was attributable to orders from military customers in Africa, approximately \$0.5 million was attributable to local civilian market, approximately \$0.3 million was attributable to the U.S. civilian market and approximately \$2 million was attributable to the Israeli Ministry of Defense.

**Current Economic Overview.** We generate revenues from sales of our products to the civilian and military markets. Accordingly, our business is affected by economic conditions. The volatile economic conditions throughout 2009 slowed down our sales process and complicated our ability to conduct transactions. The current economic climate and the uncertainty in the global economic conditions could impact the ability of our customers, including governmental entities, to make capital expenditures, thereby affecting their ability to purchase our products. Our business and financial performance, including collection of our accounts receivable, realization of inventory and recoverability of assets including investments, may be adversely affected if economic conditions deteriorate or continue to be volatile. Our profitability may also be adversely affected by our fixed costs and the possibility that we would be unable to scale back other costs within a time frame sufficient to match any decreases in revenue relating to changes in market and economic conditions. The turmoil in the financial markets may limit our ability to obtain financing for our working capital requirements.

**Exchange rate fluctuation.** Exchange rate fluctuations affect our financial results in several ways. Most of our deposits and a portion of our tradable securities are linked to the rate of exchange between the U.S. dollar and the NIS. Accordingly, devaluation of the U.S. dollar against the NIS is reflected as comprehensive income in our consolidated statement.

In addition, we develop products in Israel and sell them in Israel, North and South America, Asia, Africa and several European countries. Our sales in Israel are denominated in NIS, while most of our export sales are denominated in U.S. dollars. Under U.S. GAAP we report all of our sales in U.S. dollars. Accordingly, appreciation of the U.S. dollar against the NIS reduces our reported sales while the devaluation of the U.S. dollar against the NIS increases our reported sales.

Our cost of sales and operating expenses are affected in the same manner. Most of our purchases of raw material are made in U.S. dollars while most of our labor and other operating expenses are in NIS, however, under U.S. GAAP we report our cost of sales and operating expenses in U.S. dollars. Accordingly, appreciation of the U.S. dollar against the NIS reduces our reported cost of sales and operating expenses while the devaluation of the U.S. dollar against the NIS increases our reported cost of sales and operating expenses.

In the quarter ended March 31, 2010, the NIS depreciated against the U.S. dollar by approximately 1.64%, and our financial results were negatively impacted. Exchange rates between the U.S. dollar and the NIS fluctuate continuously. As a result, exchange rate fluctuations and especially larger periodic devaluations will have an impact on our profitability and period-to-period comparisons of our results. We cannot assure you that in the future our results of operations may not be materially adversely affected by currency fluctuations.

#### Pending acquisition

On December 17, 2008, our subsidiary, Mayotex Ltd., or Mayotex, entered into an agreement with Sarino Crystal Technologies Ltd. and Sarino Optronics Ltd., or Sarino, to cooperate in the manufacture of optical grade Germanium crystals and sales of lenses to be used in optical and infra-red night vision products utilizing the Germanium crystals, or the Sarino Agreement.

On December 21, 2008, Mayosar Ltd., or Mayosar, which was incorporated by Mayotex and Sarino, through its wholly owned subsidiary Isorad IR Optics Ltd., or Optics, entered into an agreement, or the Isorad Agreement, to purchase the Germanium Crystals Business of Isorad Ltd., an Israeli governmental company, or Isorad. The Isorad Agreement provided for the purchase of certain know-how, equipment, inventories and production activities of Germanium Crystals for lenses used in infra-red night vision system applications. As of March 31, 2010, Isorad has not met certain conditions set out in the Isorad Agreement and therefore, based on legal advice received, we are of the opinion that the Isoard Agreement has not been consummated.





Pursuant to the Sarino Agreement and subject to the approval of the Isorad Agreement:

- Mayotex and Sarino agreed to incorporate Mayosar, with Mayotex being the majority shareholder owning 50.1% and Sarino owning 49.9%. As majority shareholder, Mayotex will have operational control of Mayosar.
- In consideration of the above, Mayotex will pay Sarino \$1 million, out of which \$300,000 will be non-refundable to Mayotex upon 24 months following the execution of the Isorad Agreement, and the remaining \$700,000 will be earned by Sarino based on 10% of sales over \$3 million and up to \$10 million during the first 36 months of operations. Amounts not earned are to be refunded to Mayotex, including interest of Libor + 2% per annum. The refundable consideration is secured by Sarino's interest in Mayosar and personal guarantees provided by Sarino Crystal Technologies Ltd.'s controlling shareholders.
- Mayotex agreed to provide Mayosar with a loan in the aggregate amount of \$2 million under a timetable to be determined by Mayosar's board of directors. Such loan will bear interest at the rate of Libor + 2%, and is payable from profits generated by Mayosar.

As of March 31, 2010, Mayotex has provided loans of \$1 million to Sarino and \$1 million to Mayosar. Such payments are recognized as refundable deposits pending resolution of the Isorad Agreement.

Pursuant to the Isorad Agreement, Optics is to pay annual royalties of 3% out of sales for a period of 15 years commencing the effective date of the Isorad Agreement, or the Effective Date, with a minimum amount of approximately \$133,000 payable per year during the first 18 months or until the date of completion of the transfer of the site of the Germanium Crystals Business, whichever is earlier (this payment includes a reimbursement of costs for the usage of the site and equipment in this initial period), and approximately \$53,000 per year during the following years of the royalties payment period.

Pursuant to the Isorad Agreement, Isorad was granted the right to acquire 5% of the share capital of Optics on a fully diluted basis for their nominal value during the 24 month period beginning on the Effective Date. If the Israeli Government does not approve the 5% purchase of the Optics shares by Isorad within twelve (12) months of the Effective Date, the right to acquire the shares will expire and Isorad will be entitled to a payment of \$75,000.

In the event of an allotment of shares to Isorad, representing 5% of Optics' share capital, Mayosar will issue to Mayotex additional shares of Mayosar on a pro rata basis, in order for Mayotex to retain a 50.01% indirect interest in Optics' share capital.

Optics has the right during the four year period following the Effective Date to redeem its commitment to pay royalties under the Isorad Agreement in consideration of a fixed payment of \$750,000, less all royalties paid to Isorad through that date.

Our management is of the opinion, based on legal advice received, that the amounts paid under the Sarino and Isorad agreements should be fully refunded to us in the event that the Isorad Agreement is not consummated.

## Results of Operations

## Key Indicators

Our management views revenues, the sources of our revenues, gross profit margin and the level of inventory compared to revenues as the key performance indicators in assessing our company's financial condition and results of operations. While our management believes that demand for our products will continue to grow, our business is subject to a high degree of volatility because of the impact of geopolitical events, government budgeting, and competition.

## Three Months Ended March 31, 2010 Compared with Three Months Ended March 31, 2009

**Net Revenues.** Net revenues for the three months ended March 31, 2010 decreased to \$2,993,731 from \$5,813,288 in the three months ended March 31, 2009, a decrease of 48.5%. The decrease is mainly attributable to a decrease in our local military and export military market segments. In the period ended March 31, 2010, revenues from our local military market segment decreased by approximately \$1.2 million and our military export market segment decreased by approximately \$1.8 million. The decreased revenues in our local military market segment are attributable to a general decrease in demand for our products. The decreased revenues in our export military market segment are attributable to a general decrease in demand for our products, especially armored vehicles. These decreases were partially offset by an increase of \$212,382 or 25.9% in the local civilian market attributable to increased sales to our existing customers in this market, including sales of civilian truck covers. We expect to maintain the same level of revenues in the next quarter.

The following table sets forth the breakdown of sales by segment for the three months ended March 31, 2010 and 2009.

|                        | Three Months Ended<br>March 31, |             |
|------------------------|---------------------------------|-------------|
|                        | 2010                            | 2009        |
| Local civilian market  | \$1,033,658                     | \$821,276   |
| Export civilian market | 229,631                         | 160,459     |
| Local military market  | 1,165,142                       | 2,430,937   |
| Export military market | 565,300                         | 2,400,616   |
| Total                  | \$2,993,731                     | \$5,813,288 |

**Gross Profit.** Gross profit for the three months ended March 31, 2010 was \$603,379 compared to \$1,491,728 for the three months ended March 31, 2009. This decrease in gross profit is primarily attributable to the decrease in revenues from sales. Our gross profit margin for the three months ended March 31, 2010 decreased to 20.15% compared to 25.7% for the three months ended March 31, 2009.

**Selling Expenses.** Selling expenses for the three months ended March 31, 2010 decreased by 37% to \$115,772 from \$183,776 for the three months ended March 31, 2009. The decrease in our selling expenses was attributable primarily to the decrease in export sales and commissions paid on export sales.

**General and Administrative Expenses.** General and administrative expenses for the three months ended March 31, 2010 increased by 31.6% to \$697,409 from \$529,894 for the three months ended March 31, 2009. The increase in our general and administrative expenses was attributable primarily to an increase of \$123,562 in salaries and \$36,258 in professional fees.

Financial (Expenses) Income, Net. We had financial expenses, net of \$90,034 for the three months ended March 31, 2010 compared to financial income, net of \$441,025 for the three months ended March 31, 2009. Our financial expenses is primarily due to the change in the U.S. dollar exchange rate versus the NIS, which resulted in a loss of \$99,068 for the three months ended March 31, 2010 compared to a gain of \$390,967 for the three months ended March 31, 2009.

Other Income (Expense), Net. We had other income, net for the three months ended March 31, 2010 of \$50,372 as compared to other income, net of \$164,204 for the three months ended March 31, 2009. Our other income in three months ended March 31, 2010 is attributable primarily to realized and unrealized gains on trading securities of \$17,003 and gains due to changes in the fair market value of investments allocated to funds invested in respect of employee rights upon retirement of \$10,685, compared to realized and unrealized gains on trading securities of \$125,453 and gains due to changes in the fair market value of investments allocated to funds invested in respect of employee rights upon retirement of \$38,751 in the three months ended March 31, 2009.

Income Tax Expense. Our income tax expense for the three months ended March 31, 2010 was \$5,125 compared to income tax expense of \$284,851 for the three months ended March 31, 2009. The decrease in income tax expense is due to the decrease in our operating income in the three months ended March 31, 2010 compared to the comparable period in 2009.

Net Income (Loss). In the three months ended March 31, 2010 our net loss was \$254,589, compared to net income of \$1,098,436 for the three months ended March 31, 2009.

#### Liquidity and Capital Resources

As of March 31, 2010, we had \$4,499,878 in cash and cash equivalents, \$2,393,808 in trading securities and working capital of \$10,129,502 as compared to \$3,783,631 in cash and cash equivalents, \$2,312,048 in trading securities and working capital of \$10,150,359 at December 31, 2009.

The current economic climate and the uncertainty in the global financial markets resulting from the recent disruption in credit markets may affect our ability to raise additional funds in the future, if required. There can be no assurance that such additional financing will be available to us, or if available, will be on terms favorable to our company.

#### Cash Flows

The following table summarizes our cash flows for the periods presented:

|   | Three months ended |                   |
|---|--------------------|-------------------|
|   | March 31,<br>2010  | March 31,<br>2009 |
| Net cash provided by operating activities           | \$942,767          | \$622,727         |
| Net cash (used in) provided by investing activities | (121,599 )         | 1,126,092         |
| Net cash used in financing activities               | (211,542 )         | (840,557 )        |
| Net increase in cash and cash equivalents           | 716,247            | 829,219           |
| Cash and cash equivalents at beginning of period    | 3,783,631          | 1,719,921         |
| Cash and cash equivalents at end of period          | \$4,499,878        | \$2,549,140       |

Operating activities. Net cash provided by operating activities was \$942,767 for the three months ended March 31, 2010 as compared to \$622,727 provided by operating activities in the three months ended March 31, 2009. This was primarily provided from a decrease in accounts receivable of \$942,143, a decrease in inventories of \$134,069 and an increase in accounts payable of \$170,580, offset by a net loss of \$254,589 and a decrease in other current liabilities of \$82,935.

Investing activities. Net cash used in investing activities was \$121,599 for the three months ended March 31, 2010 as compared to \$1,126,092 provided by investing activities in the three months March 31, 2009. During the three months ended March 31, 2010, \$107,817 was used to purchase fixed assets and \$13,782 was used as a refundable deposit for the purchase of a business.

Financing activities. Net cash used in financing activities was \$211,542 for the three months ended March 31, 2010 as compared to \$840,557 used in financing activities for the three months ended March 31, 2009. During the three months March 31, 2010, we repaid \$219,301 of short-term debt and \$78,161 of long-term debt, offset by proceeds of \$85,920 from new long-term debt.

Most of our large contracts, which are Israeli Governmental contracts, are supported by letters of credit. As a result, we believe that we have limited exposure to doubtful accounts receivables. We have endeavored to balance our accounts payable and accounts receivable.

We believe that we have sufficient working capital and borrowing capability to sustain our current level of operations for the next twelve months.

#### Foreign Currency Exchange Risk

We develop products in Israel and sell them in Israel, North and South America, Asia, Africa and several European countries. Our sales in Israel are denominated in NIS while most of our export sales are denominated in U.S. dollars. In addition, our labor expenses are primarily paid in NIS while our expenses for raw materials are paid primarily in U.S. dollars. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets.

Our foreign currency exposure is significant due to the depreciation of the U.S. dollar versus the NIS. We expect our exposure will continue to be significant, since a significant portion of the prices of our raw material purchases, as well as part of our sales are denominated in U.S. dollars.

In the year ended December 31, 2009, the inflation rate in Israel was 3.91% and the NIS appreciated in relation to the U.S. dollar at a rate of 0.71%, from NIS 3.802 per \$1 on December 31, 2008 to NIS 3.775 per \$1 on December 31, 2009. In the period ended March 31, 2010, inflation in Israel was (0.86%) while the NIS appreciated in relation to the U.S. dollar at a rate of 1.64%. If future inflation in Israel exceeds the devaluation of the NIS against the U.S. dollar or if the timing of such devaluation lags behind increases in inflation in Israel, our results of operations may be materially adversely affected.

We did not enter into any foreign exchange contracts in the three months ended March 31, 2010.

#### Inflation and Seasonality

We do not believe that our operating results have been materially affected by inflation during the preceding two years. There can be no assurance, however, that our operating results will not be affected by inflation in the future. Our business is subject to minimal seasonal variations with slightly increased sales historically in the second and third quarters of fiscal year. We expect to continue to experience slightly higher sales in the second and third quarters, and slightly lower sales in the fourth and first quarters, as a result of reduced sales on nondairy frozen desserts during those periods.

#### Off-balance Sheet Arrangements

None.

## Contractual Obligations

The following table summarizes our contractual obligations and commercial commitments as of March 31, 2010.

| Contractual Obligations                                   | Total       | Payments due by Period |            |            |                   |
|---|-------------|------------------------|------------|------------|-------------------|
|   |             | Less than 1 year       | 2 -3 years | 4 -5 years | more than 5 years |
| Long-term debt obligations                                | \$571,269   | \$292,249              | \$261,065  | \$17,955   | -                 |
| Estimated interest payments on long-term debt obligations | 40,257      | 24,421                 | 15,598     | 238        | -                 |
| Operating lease obligations                               | 877,284     | 512,073                | 365,211    | -          | -                 |
| Total   | \$1,488,810 | \$828,743              | \$641,874  | \$18,193   | -                 |

## Critical Accounting Policies

A discussion of our critical accounting policies was provided in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2009. There were no significant changes to these policies in the three months ended March 31, 2010.

## Recent Accounting Pronouncements

See Note 1H to the unaudited condensed consolidated financial statements included in Part I, Item 1, Financial Statements, of this Quarterly Report on Form 10-Q.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk

## Interest Rate Risk

We do not believe that we have any material exposure to interest rate risk other than sensitivity to prevailing interest rates that may affect income from our cash deposits and marketable securities.

## Foreign Exchange Risk

Most of our sales are currently denominated in dollars, while the majority of our operating expenses are incurred in foreign currencies, principally the NIS. As a result, the decrease in the value of the U.S. dollar against these currencies has resulted in increased expenses for our company. In 2007, 2008 and 2009, the U.S dollar depreciated against the NIS by approximately 9%, 1% and 1%, respectively. In the first three months of 2010, the U.S dollar depreciated by approximately 2% in relation to the NIS.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act of 1934, or the Exchange Act, reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our chief executive officer and chief financial officer to allow timely decisions regarding required disclosure. Our management, including our chief executive officer and chief financial officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures, as defined under Exchange Act Rule 13a-15(e), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based upon that evaluation, our chief executive officer and chief financial officer have concluded that, as of such date, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the quarter ended March 31, 2010 that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

PART II - OTHER INFORMATION:

Item 1. Legal Proceedings

On February 11, 2009, a lawsuit was filed at the Jerusalem District Court (the "Court") against our subsidiary, Achidatex, its chief executive officer, Mr. Avraham Haztor, and our subsidiary Export Erez USA Inc. The plaintiff filed a petition to add Export Erez Ltd., or Export Erez, to the claim. Export Erez objected to the plaintiff's petition. The plaintiff's petition is still pending the Court's ruling as the Court has allowed Export Erez to respond to the plaintiff's answer to Export Erez's objection. The suit alleges that Achidatex materially breached its agreement with the plaintiff, dated February 22, 2000, relating to the development of inflatable mine-field crossing enabling sandals, by failing to register patents for the technology underlying the sandals worldwide and only registered patents in the United States. The plaintiff further claims that the defendants, jointly and severally, committed a breach of trust. The plaintiff is seeking damages in the amount of NIS 10 million (approximately \$2.6 million). Achidatex filed a statement of defense rejecting the plaintiff's claims and a claim against the plaintiff and others for a declaratory judgment that the plaintiff has breached his contractual undertakings towards Achidatex.

Achidatex's petition to consolidate its claim with the plaintiff's claim was ordered by the Court and the claims are now being heard together. Achidatex also filed a petition to remove the claim against Mr. Haztor and Export Erez USA Inc. based on the assertion that there is no contractual or any other kind of privity between the plaintiff and Mr. Haztor and Export Erez USA Inc. and, therefore, no cause of action against them exists. This petition is pending.

We intend to vigorously defend against the claim. Due to the preliminary stage of the above claims, we and our legal advisors cannot currently assess the outcome or possible adverse effect on our financial position or results of operations.

On April 7, 2010 a lawsuit was filed against Achidatex and another lawsuit was filed against Export Erez in the Nazareth Magistrates' Court (the "Court"), each to obtain an eviction order for the premises leased by these subsidiaries. The plaintiff in the suits, a company owned by the former shareholders of Achidatex, and a company owned by our Company's principal shareholder, alleges that Achidatex and Export Erez each materially breached their respective lease agreement with the plaintiff, dated January 1, 2008. The premises from which the plaintiff seeks to evict Achidatex and Export Erez, are used by Achidatex and Export Erez to conduct their operational activities. The



parties are currently attempting to settle the dispute out of court. Therefore, Achidatex and Export Erez have not yet filed their statements of defense in the above lawsuits.

Item 1A. Risk Factors

There have been no material changes to our “Risk Factors” set forth in Item 1A. of our Annual Report on Form 10-K for the year ended December 31, 2009.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. (Removed and Reserved)

Item 5. Other Information

None.

Item 6. Exhibits

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act, as amended.

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act, as amended.

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DEFENSE INDUSTRIES INTERNATIONAL,  
INC.

Dated: May 17, 2010

/S/ Uri Nissani

Name: Uri Nissani

Title: Chief Executive Officer and President

26

---

---