

DEFENSE INDUSTRIES INTERNATIONAL INC
Form 10-Q
August 15, 2011

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 June 30, 2011

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
Non-accelerated filer
(Do not check if smaller reporting
company)

Accelerated filer
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 August 12, 2011 the issuer had 28,150,535 shares of Common Stock, par value \$0.0001, outstanding.

DEFENSE INDUSTRIES INTERNATIONAL, INC. AND SUBSIDIARIES

INDEX

| | Page |
|---------------------------------|--|
| PART I - FINANCIAL INFORMATION: | |
| <u>Item 1.</u> | <u>Condensed Consolidated Balance Sheets as of June 30, 2011 (Unaudited) and December 31, 2010</u> 3 |
| | <u>Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2011 and 2010 (Unaudited)</u> 5 |
| | <u>Condensed Consolidated Statement of Changes in Equity for the Three and Six Months Ended June 30, 2011 and 2010 (Unaudited)</u> 6 |
| | <u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2011 and June 30, 2010 (Unaudited)</u> 8 |
| | <u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u> 9 |
| <u>Item 2.</u> | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 20 |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures About Market Risk</u> 29 |
| <u>Item 4.</u> | <u>Controls and Procedures</u> 30 |
| PART II - OTHER INFORMATION: | |
| <u>Item 1.</u> | <u>Legal Proceedings</u> 31 |
| <u>Item 1A.</u> | <u>Risk Factors</u> 32 |
| <u>Item 2.</u> | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 32 |
| <u>Item 3.</u> | <u>Defaults Upon Senior Securities</u> 32 |
| <u>Item 4.</u> | <u>(Removed and Reserved)</u> 32 |
| <u>Item 5.</u> | <u>Other Information</u> 32 |
| <u>Item 6.</u> | <u>Exhibits</u> 32 |
| SIGNATURES | |

PART I - FINANCIAL INFORMATION:

Part I-Financial Information:

Item 1.

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED BALANCE SHEETS
AS OF JUNE 30, 2011 (UNAUDITED) AND DECEMBER 31, 2010

| | June 30, 2011 (Unaudited) | December 31, 2010 |
|--|---------------------------------|-------------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$1,722,581 | \$3,502,461 |
| Trading securities | 1,402,109 | 1,894,864 |
| Accounts receivable, net of allowance for doubtful accounts of \$ 382,514, and \$368,477, respectively | 3,938,029 | 2,324,985 |
| Inventories | 5,835,790 | 4,402,517 |
| Deferred taxes | 277,580 | 191,318 |
| Other current assets | 1,334,198 | 398,297 |
| Total Current Assets | 14,510,287 | 12,714,442 |
| PROPERTY, PLANT AND EQUIPMENT, NET | 2,378,779 | 1,864,346 |
| INVESTMENT AND LOANS TO ASSOCIATED COMPANIES | 1,350,193 | 1,274,991 |
| OTHER ASSETS | | |
| Funds in respect of employee rights upon retirement | 867,508 | 881,184 |
| Intangible assets, net | 1,840,956 | 1,300,445 |
| Deferred taxes | 30,828 | 22,155 |
| Total Other Assets | 2,739,292 | 2,203,784 |
| TOTAL ASSETS | \$20,978,551 | \$18,057,563 |

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 JUNE 30, 2011 (UNAUDITED) AND DECEMBER 31, 2010

LIABILITIES AND EQUITY

| | June 30, 2011 (Unaudited) | December 31, 2010 |
|--|---------------------------------|----------------------|
| CURRENT LIABILITIES | | |
| Accounts payable | \$3,757,533 | \$1,519,545 |
| Accounts payable – related parties | 132,444 | 156,753 |
| Short-term debt | 2,071,539 | 1,299,546 |
| Other current liabilities | 2,896,500 | 1,674,027 |
| Total Current Liabilities | 8,858,016 | 4,649,871 |
| LONG-TERM LIABILITIES | | |
| Long-term portion of debt | 509,814 | 240,945 |
| Long-term portion of minimum royalty payment to the Government of Israel | 484,805 | 466,500 |
| Deferred tax liability | 333,858 | 261,866 |
| Liability for employee rights upon retirement | 991,786 | 967,309 |
| Total Long-Term Liabilities | 2,320,263 | 1,936,620 |
| TOTAL LIABILITIES | 11,178,279 | 6,586,491 |
| COMMITMENTS AND CONTINGENCIES | | |
| EQUITY | | |
| Preferred stock, \$0.0001 par value, 50,000,000 shares authorized, none issued and outstanding | - | - |
| Common stock, \$0.0001 par value, 250,000,000 shares authorized, 29,200,535 shares issued and | | |
| 28,150,535 shares outstanding at June 30, 2011 and December 31, 2010 | 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 | 5,603,724 | 7,603,276 |
| Accumulated other comprehensive income | 1,448,258 | 1,119,506 |
| Total Equity | 9,800,272 | 11,471,072 |
| TOTAL LIABILITIES AND EQUITY | \$20,978,551 | \$18,057,563 |

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 AND SIX MONTHS ENDED JUNE 30, 2011 AND 2010 (UNAUDITED)

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|--|-------------|--------------------------------------|-------------|
| | 2011 | 2010 | 2011 | 2010 |
| NET REVENUES | \$4,593,340 | \$2,887,814 | \$8,186,777 | \$5,881,545 |
| COST OF SALES | 3,348,368 | 2,719,034 | 6,278,285 | 5,109,386 |
| GROSS PROFIT | 1,244,972 | 168,780 | 1,908,492 | 772,159 |
| OPERATING EXPENSES | | | | |
| Selling | 652,964 | 216,735 | 1,430,008 | 332,507 |
| General and administrative | 1,518,788 | 702,886 | 2,240,683 | 1,400,295 |
| Total Operating Expenses | 2,171,752 | 919,621 | 3,670,691 | 1,732,802 |
| LOSS FROM OPERATIONS | (926,780) | (750,841) | (1,762,199) | (960,643) |
| OTHER (EXPENSES) INCOME | | | | |
| Financial expenses | (128,607) | --- | (213,838) | --- |
| Financial income | 840 | 241,714 | 922 | 151,680 |
| Other income (expenses), net | (81,574) | 39,839 | (85,292) | 90,211 |
| Total Other (Expenses) Income | (209,341) | 281,553 | (298,208) | 241,891 |
| LOSS BEFORE INCOME TAXES | (1,136,121) | (469,288) | (2,060,407) | (718,752) |
| Tax (expenses) benefit | 24,146 | (2,859) | 23,281 | (7,984) |
| LOSS BEFORE SHARE IN PROFIT OF ASSOCIATED COMPANY | (1,111,975) | (472,147) | (2,037,126) | (726,736) |
| Share in profit of associated company | 29,069 | --- | 37,574 | --- |
| NET LOSS | (1,082,906) | (472,147) | (1,999,552) | (726,736) |
| Net loss attributable to controlling interest | (1,082,906) | (472,147) | (1,999,552) | (726,736) |
| Net income per share attributable to controlling interest - basic and diluted | \$(0.038) | \$(0.017) | \$(0.071) | \$(0.026) |
| Weighted average number of shares outstanding - basic and diluted | 28,150,535 | 28,150,535 | 28,150,535 | 28,150,535 |

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 SIX MONTHS ENDED JUNE 30, 2011 AND 2010 (UNAUDITED)

| | Common Stock | | Treasury Stock | | Additional Paid-In | Retained | Accumulated Other Comprehensive Income | Total Comprehensive Income | Total Comprehensive Income |
|---|--------------|---------|----------------|-------------|-----------------------|--------------|---|----------------------------------|----------------------------------|
| | Shares | Dollars | Shares | Dollars | Capital | Earnings | (Loss) | (Loss) | Equity |
| Balance as of January 1, 2011 | 29,200,535 | \$2,920 | 1,050,000 | \$(252,000) | \$2,997,370 | \$7,603,276 | \$1,119,506 | | \$11,400,000 |
| Comprehensive loss: | | | | | | | | | |
| Net loss | | | | | | (1,999,552) | | (1,999,552) | (1,999,552) |
| Foreign currency translation gain | | | | | | | 328,752 | 328,752 | 328,752 |
| Total comprehensive loss | | | | | | | | (1,670,800) | (1,670,800) |
| Balance as of June 30, 2011 | 29,200,535 | 2,920 | 1,050,000 | (252,000) | 2,997,370 | 5,603,724 | 1,448,258 | | 9,800,000 |
| Balance as of January 1, 2010 | 29,200,535 | \$2,920 | 1,050,000 | \$(252,000) | \$2,997,370 | \$10,176,352 | \$358,745 | | \$13,200,000 |
| Comprehensive loss: | | | | | | | | | |
| Net loss | - | - | - | - | - | (726,736) | - | (726,736) | (726,736) |
| Foreign currency translation gain | - | - | - | - | - | - | (331,838) | (331,838) | (331,838) |
| Total comprehensive loss | | | | | | | | \$(1,058,574) | \$(1,058,574) |
| Balance as of June 30, 2010 | 29,200,535 | \$2,920 | 1,050,000 | \$(252,000) | \$2,997,370 | \$9,449,616 | \$26,907 | | \$12,200,000 |

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 JUNE 30, 2011 AND 2010(UNAUDITED)

| | Common Stock | | Treasury Stock | | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Comprehensive Income Loss | Total Comprehensive Income Loss |
|---|--------------|----------|----------------|-------------|----------------------------------|----------------------|---|--|--|
| | Shares | Dollars | Shares | Dollars | | | | | |
| Balance as of April 1, 2011 | 29,200,535 | \$ 2,920 | 1,050,000 | \$(252,000) | \$ 2,997,370 | \$ 6,686,630 | \$ 1,274,582 | | 10,700,000 |
| Comprehensive loss: | | | | | | | | | |
| Net loss | | | | | | (1,082,906) | | (1,082,906) | (1,082,906) |
| Foreign currency translation gain | | | | | | | 173,676 | 173,676 | 173,676 |
| Total comprehensive loss | | | | | | | | (909,230) | (909,230) |
| Balance as of June 30, 2011 | 29,200,535 | 2,920 | 1,050,000 | (252,000) | 2,997,370 | 5,603,724 | 1,448,258 | | 9,800,000 |
| Balance as of April 1, 2010 | 29,200,535 | \$ 2,920 | 1,050,000 | \$(252,000) | \$ 2,997,370 | \$ 9,921,763 | \$ 586,400 | | 13,250,000 |
| Comprehensive loss: | | | | | | | | | |
| Net loss | - | - | - | - | - | (472,147) | - | (472,147) | (472,147) |
| Foreign currency translation gain | - | - | - | - | - | - | (559,493) | (559,493) | (559,493) |
| Total comprehensive loss | | | | | | | | \$(1,031,640) | \$(1,031,640) |
| Balance as of June 30, 2010 | 29,200,535 | \$ 2,920 | 1,050,000 | \$(252,000) | \$ 2,997,370 | \$ 9,449,616 | \$ 26,907 | | 12,220,000 |

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

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2010 (UNAUDITED)

| | For the Six Months Ended June 30, | |
|--|--------------------------------------|---------------|
| | 2011 | 2010 |
| Net loss | \$ (1,999,552) | \$ (726,736) |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Items not effecting cash: | | |
| Depreciation and amortization | 466,986 | 284,890 |
| Provision for doubtful accounts | 999 | (7,064) |
| Deferred taxes | (24,081) | 7,984 |
| Net unrealized gain on trading securities | --- | (51,347) |
| Gain from the disposal of Dragonwear Trading Ltd. | --- | (13,911) |
| Gain from settlement of long- term note | --- | (8,968) |
| Accrued interest and exchange rate differences of long-term debt | (1,693) | (946) |
| Accrued interest and exchange rate differences on refundable deposits for the purchase of a business | --- | (15,320) |
| Equity Gains | 37,574 | --- |
| Changes in assets and liabilities: | | |
| Decrease (increase) in accounts receivable | (1,387,907) | 749,306 |
| Increase in inventories | (1,091,181) | (1,537,363) |
| Decrease (increase) in trading securities | 549,721 | (21,278) |
| Increase (decrease) in related parties accounts | (28,714) | 69,189 |
| Increase in other current assets | (866,603) | (256,113) |
| (Increase) decrease in funds in respect of employee rights upon retirement | 46,774 | (35,495) |
| Increase in accounts payable | 1,957,282 | 1,018,418 |
| Increase in other current liabilities | 792,555 | 269,240 |
| Increase (decrease) in liability for employee rights upon retirement | (13,066) | 59,446 |
| Net cash provided by Operating Activities | (1,560,906) | (216,068) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property, plant and equipment | (738,839) | (113,729) |
| Purchase of the Philcar business (a) | (235,502) | --- |
| Refundable deposits for purchase of a business | --- | (13,782) |
| Net cash used in Investing Activities | (974,341) | (127,511) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Short-term debt, net | 534,410 | (97,615) |
| Proceeds from long-term debt | 318,295 | 85,319 |
| Repayment of long-term debt | (124,840) | (148,961) |

| | | |
|--|--------------|--------------|
| Net cash used in Financing Activities | 727,865 | (161,257) |
| EFFECT OF CHANGES IN EXCHANGE RATES ON CASH AND CASH EQUIVALENTS | 27,502 | (128,953) |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (1,779,880) | (633,789) |
| CASH AND CASH EQUIVALENTS – BEGINNING OF PERIOD | 3,502,461 | 3,783,631 |
| CASH AND CASH EQUIVALENTS – END OF PERIOD | \$ 1,722,581 | \$ 3,149,841 |
| INTEREST PAID | \$82,592 | \$22,099 |
| TAXES PAID | \$41,424 | \$132,309 |

(a) Purchase of the Philcar business (see also Note 1):

Net fair value of the assets acquired and liabilities assumed at the acquisition date was as follows:

| | |
|------------------------|---------------|
| Working capital, net | \$ (329,187) |
| Property and equipment | 100,883 |
| Intangible assets | 597,756 |
| | \$ 369,452 |

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

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2010 (UNAUDITED)

NOTE 1 BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

- A. The accompanying unaudited interim consolidated financial statements as of June 30, 2011 and for the six 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 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 of America.
- 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, 2010.
- 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 six months period ended June 30, 2011, are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. The interim financial statements should be read in conjunction with the Company’s annual financial statements as of December 31, 2010 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”), Mayosar Technologies Ltd. (“Mayosar”), Philcar Ltd. (“Philcar”), and Achidatex Nazareth Elite (1977) Ltd. (“Achidatex”). In addition, the Company holds 82% of the issued and outstanding share capital of Isorad IR Optics Ltd. (“Optics”).

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

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2010 (UNAUDITED)

NOTE 1 BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 each of the six months periods ended June 30, 2011 and 2010 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's 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 June 30, 2011 and December 31, 2010 due to the short-term maturity of these instruments.

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2010 (UNAUDITED)

NOTE 1 BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

With the exception of those pronouncements stated below, there have been no recent accounting pronouncements or changes in accounting pronouncements during the six months ended June 30, 2011, 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, 2010, that are of material significance, or have potential material significance, to the Company.

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-05 for the presentation of comprehensive income thereby amending Accounting Standards Codification (ASC) 220, Comprehensive Income. The amendment requires that all non-owner changes in stockholder's equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendment is effective in fiscal years beginning after December 15, 2011 and should be applied retrospectively. These amendments will not impact the presentation of our financial statements upon adoption.

In May 2011, the FASB issued ASU No. 2011-04 thereby amending ASC 820, Fair Value Measurement, to achieve common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards (IFRS). The amendments are effective in fiscal years beginning after December 15, 2011 and will be applied prospectively. We are currently evaluating the impact on our financial statements of adopting these amendments to ASC 820 and cannot estimate the impact of adoption at this time.

NOTE 2 BUSINESS COMBINATION AND CERTAIN TRANSACTIONS

1. On December 21, 2008, Mayosar, through its wholly owned subsidiary, Optics, entered into an agreement (the "Isorad Agreement") to purchase the Germanium Crystals Business of Isorad Ltd. ("Isorad"), an Israeli governmental company. 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. After a period of uncertainty, in August 2010, Mayosar, Optics and Isorad executed an addendum to the 2008 agreement, according to which the parties confirmed the validity of the Isorad Agreement under certain conditions. On December 19, 2010 (the "Effective Date"), the Isorad Agreement was approved and became effective. Pursuant to the Isorad Agreement, Optics is to pay annual royalties to Isorad 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 of approximately \$133,000, payable on an annual basis 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 years following the above initial period. Isorad also has the right to acquire 5% of the share capital of Optics on a fully diluted basis for a nominal value during an original 24-month period beginning on the Effective Date. Such right was extended until January 1, 2012. In the event of an allotment of shares representing 5% of Optics' share capital to Isorad upon the exercise by Isorad of its option, Optics will issue additional shares of Optics to Mayotex on a pro rata basis, in order for Mayotex to retain a 82% interest in Optics' share capital.

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2010 (UNAUDITED)

NOTE 2 BUSINESS COMBINATION AND CERTAIN TRANSACTIONS (Continued)

If the Israeli Government does not approve the 5% purchase of the Optics shares by Isorad within the above period, the right to acquire the shares will expire and Isorad will be entitled to a payment of \$75,000 from Optics. Optics has the right during the four-year period following the Effective Date to redeem its commitment to pay royalties and the right by the Israeli government to purchase 5% of Optics for a fixed payment of \$750,000, less all royalties paid to Isorad through that date.

In order to complete this transaction, the Company incurred \$1,058,814 in acquisition costs. These costs were expensed in 2010.

The following table summarizes the consideration transferred and estimated fair values of the assets acquired and liabilities assumed at the date of acquisition:

| | |
|--|--------------------|
| Cash payment to Isorad (in the form of a deposit paid in January 2009) | \$698,570 |
| Minimum guaranteed royalty payments | 750,000 |
| Total consideration | 1,448,570 |
| Recognized amounts of identifiable assets acquired and liabilities assumed: | |
| Current assets (including cash and cash equivalents of \$82,947) | 196,539 |
| Property and equipment | 152,284 |
| Intellectual properties and technology | 817,000 |
| Non-compete agreement | 50,000 |
| Customer relationships | 100,000 |
| Trade name | 300,000 |
| Accounts payable and other current liabilities | (92,253) |
| Deferred income taxes liabilities | (75,000) |
| Total identifiable net assets acquired | \$1,448,570 |

The allocation of purchase price for customer relationships, non-compete agreement, trade name, intellectual property and technology are provisional pending receipt of the final valuations of those assets. These assets have an expected future life of 10 years, 3 years, 10 years, and 6 years, respectively.

Amortization cost for the six months ended June 30, 2011 for the customer relationships, non-compete agreement, trade name, intellectual property and technology are \$5,000, \$8,334, \$15,000 and \$68,084, respectively.

The unaudited pro forma information below assumes that the acquisition of the Isorad business was consummated on January 1, 2009, and includes the effect of amortization of intangible assets from that date. This data is presented for information purposes only and is not necessarily indicative of the results of future operations or the results that would have been achieved had the acquisition taken place at those dates.

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2010 (UNAUDITED)

NOTE 2- BUSINESS COMBINATION AND CERTAIN TRANSACTIONS (Continued)

The pro forma information is as follows:

| | For the Six Months Ended June 30, 2011 | For the Six Months Ended June 30, 2010 | For the three Months Ended June 30, 2011 | For the three Months Ended June 30, 2010 |
|--------------------------------------|--|--|--|--|
| | Unaudited | Unaudited | Unaudited | Unaudited |
| Net revenues | 8,186,777 | 5,914,368 | 4,593,340 | 2,904,226 |
| Net loss | (1,999,552) | (984,600) | (1,082,906) | (601,110) |
| Basic and diluted net loss per share | (0.071) | (0.035) | (0.038) | (0.021) |

2. In December 2008, Mayotex entered into an investment agreement (the "Sarino Agreement") with Sarino Crystal Technologies Ltd. and Sarino Optronics Ltd. (together, "Sarino"), to form an entity which would acquire part of Isorad (see Note 2.1). Pursuant to the Sarino Agreement, Mayotex and Sarino incorporated Mayosar, in which Mayotex held 50.1% of the outstanding shares and Sarino held the remaining 49.9% of the outstanding shares. Mayotex paid Sarino (the "Sarino Payment") \$1,000,000 (recorded as refundable deposit on purchase of business on the balance sheet as of December 31, 2009). The completion of the agreement was contingent on the completion of the Isorad Agreement (see Note 2.1). This agreement was finally approved in December 2010.

After this period of uncertainty, in December 2010, Sarino and Mayotex entered into a settlement agreement (the "December Agreement") according to which Mayotex was registered as the holder of 100% of the issued and outstanding share capital of Mayosar and Mayosar in turn transferred 82% of its ownership interest in its then wholly owned subsidiary, Optics, to Mayotex and 18% of its ownership interest in Optics to Sarino. In the December Agreement, the parties agreed to amend the terms and conditions of the Sarino Payment to provide for: (i) repayment of the Sarino Payment plus interest at LIBOR plus 1% per year, commencing as of December 19, 2010 and due on December 19, 2020; or (ii) Sarino could require Mayotex to acquire its interest in Optics as repayment of the Sarino Payment and accrued interest. As of December 31, 2010 the Company's accumulated amount for accrued interest on the Sarino Payment was \$58,814 and the value recorded for the put option granted to Sarino was \$ 1,058,814. The entire value of the put option was recorded as an acquisition expense during 2010.

In accordance with the December Agreement, Optics shall distribute as dividends, once per calendar year, at least 30% of its distributable profits to its shareholders, pro rata to their holdings in Optics as at the date of such distribution. The remaining 70% of Optics' distributable profits shall be used to repay any and all amounts granted or deemed granted by Mayotex to Optics, until their full repayment. As of June 30, 2011 the amount granted or deemed granted by Mayotex to Optics was \$1,027,339 of which no amount has been repaid as of June 30, 2011.

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2010 (UNAUDITED)

NOTE 2 BUSINESS COMBINATION AND CERTAIN TRANSACTIONS (Continued)

3. On February 22, 2010, Mayotex entered into a contract for the acquisition of the business of Vacutec Industries Ltd., a manufacturer of fiberglass product products for the automotive industry. Pursuant to the agreement Mayotex acquired certain fixed assets, inventories, customer list and backlog in consideration of \$23,000, of which \$13,243 was paid prior to December 31, 2010.

Management allocated the purchase price to the following assets on the basis of their fair value:

| | |
|---------------------------|-----------|
| Fixed assets | \$ 22,205 |
| Inventory | 1,830 |
| Customer list and backlog | 28,445 |

Accordingly the excess fair value of the assets purchased over the purchase price (bargain gain), in the amount of \$25,994 was recognized in to the income statement at the date of the acquisition.

4. In May 3, 2011, Mayotex entered into an agreement with Rabintex Industries Ltd. ("Rabintex"), to purchase Philcar Ltd. ("Philcar"), a company that specializes in equipping and protecting vehicles, for an amount of \$235,502. Under the terms of the agreement, Mayotex may pay Rabintex additional compensation of up to \$160,728, depending on the amount of orders that Philcar receives from certain customers during the six-month period following the closing of the transaction.

The following table summarizes the consideration transferred and estimated fair values of the assets acquired and liabilities assumed at the date of acquisition (preliminary):

| | |
|---|-----------|
| Cash payment | \$235,502 |
| Contingent consideration liability at fair value | 133,950 |
| Total consideration | 369,452 |
| Recognized amounts of identifiable assets acquired and liabilities assumed: | |
| Current assets | 197,711 |
| Property and equipment | 100,883 |
| Backlog | 84,823 |
| Contractor Number | 129,814 |
| Goodwill | 383,119 |
| Accounts payable and other current liabilities | (526,898) |
| Total identifiable net assets acquired | \$369,452 |

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2010 (UNAUDITED)

NOTE 2 BUSINESS COMBINATION AND CERTAIN TRANSACTIONS (Continued)

The allocation of purchase price for backlog, contract number and goodwill are provisional pending receipt of the final valuations of those assets. These assets have an expected future life of 2.67 years for the backlog and indefinite for all the others.

Amortization cost for the two months ended June 30, 2011 for the backlog are \$5,102

The unaudited pro forma information below assumes that the acquisition of the Philcar business was consummated on January 1, 2010, and includes the effect of amortization of intangible assets from that date. This data is presented for information purposes only and is not necessarily indicative of the results of future operations or the results that would have been achieved had the acquisition taken place at those dates.

The pro forma information is as follows:

| | For the Six Months Ended June 30, 2011 Unaudited | For the Six Months Ended June 30, 2010 | For the three Months Ended June 30, 2011 Unaudited | For the three Months Ended June 30, 2010 |
|----------------------------|--|---|--|---|
| Net revenues | 8,329,045 | 6,263,677 | 4,655,903 | 3,078,880 |
| Net loss | (2,257,905) | (977,140) | (1,018,055) | (597,380) |
| Basic net loss per share | (0.080) | (0.035) | (0.036) | (0.021) |
| Diluted net loss per share | (0.080) | (0.035) | (0.036) | (0.021) |

NOTE 3 INVENTORIES

Consist of:

| | June 30, 2011 | December 31, 2010 |
|------------------|------------------|----------------------|
| Raw materials | \$ 3,306,198 | \$ 3,030,442 |
| Work in progress | 695,202 | 607,328 |
| Finished goods | 1,834,390 | 764,747 |
| | \$ 5,835,790 | \$ 4,402,517 |

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2010 (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 six months ended June 30, 2011: | | | | | |
| Revenue from sales | \$ 1,386,739 | \$ 1,964,626 | \$ 1,569,595 | \$ 3,265,817 | \$ 8,186,777 |
| Gross Profits | 493,491 | 541,854 | 199,830 | 673,317 | 1,908,492 |
| Corporate unallocated costs | | | | | 3,670,691 |
| Loss from operations | | | | | (1,762,199) |
| For the three months ended June 30, 2011: | | | | | |
| Revenue from sales | \$ 813,557 | \$ 1,528,195 | \$ 554,606 | \$ 1,696,982 | \$ 4,593,340 |
| Gross Profits | 276,537 | 558,237 | 73,021 | 337,177 | 1,244,972 |
| Corporate unallocated costs | | | | | 2,171,752 |
| Loss from operations | | | | | (926,780) |
| For the six months ended June 30, 2010: | | | | | |
| Revenue from sales | \$ 1,685,147 | \$ 608,718 | \$ 2,675,768 | \$ 911,912 | \$ 5,881,545 |
| Gross Profits | 229,520 | 82,789 | 357,808 | 102,042 | 772,159 |
| Corporate unallocated costs | | | | | 1,732,802 |
| Income from operations | | | | | (960,643) |
| For the three months ended June 30, 2010: | | | | | |
| Revenue from sales | \$ 651,489 | \$ 379,087 | \$ 1,510,626 | \$ 346,612 | \$ 2,887,814 |
| Gross Profits | 50,320 | 57,495 | 85,500 | (24,535) | 168,780 |

| | |
|-----------------------------|------------|
| Corporate unallocated costs | 919,621 |
| Income from operations | (750,841) |

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2010 (UNAUDITED)

NOTE 4

SEGMENT INFORMATION AND CONCENTRATIONS (Continued)

B. Geographic Areas – revenues:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--------------------|--------------------------------|---------------------|------------------------------|---------------------|
| | 2011 | 2010 | 2011 | 2010 |
| Israel | \$ 1,368,163 | \$ 2,162,115 | \$ 2,956,334 | \$ 4,360,915 |
| South America | 1,169,812 | 249,083 | 1,459,996 | 467,443 |
| North America | 1,528,195 | 374,798 | 1,997,550 | 605,743 |
| Europe and Asia | 56,804 | 101,734 | 515,780 | 445,183 |
| Africa | 470,366 | 84 | 1,257,117 | 2,261 |
| Total Sales | \$ 4,593,340 | \$ 2,887,814 | \$ 8,186,777 | \$ 5,881,545 |

C. Single Customer Exceeding 10% of Sales:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|-----------------------------|---|--------------|---|--------------|
| | 2011 | 2010 | 2011 | 2010 |
| Customer A (Military Local) | \$ 445,416 | \$ 1,316,296 | \$ 1,372,217 | \$ 2,455,772 |

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2010 (UNAUDITED)

NOTE 5

COMMITMENTS AND CONTINGENCIES

- A. On February 11, 2009, a lawsuit was filed in the Jerusalem District Court, or the Court, against our subsidiary, Achidatex Nazareth Elite (1977) Ltd., or Achidatex, Mr. Avraham Haztor, the then chief executive officer of Achidatex, and our subsidiary Export Erez USA Inc., or Export Inc. Our subsidiary Export Erez Ltd., or Export Erez, was subsequently added as a defendant in the action. The suit alleges that Achidatex materially breached its February 22, 2000 agreement with the plaintiff, relating to the development of inflatable mine-field crossing enabling sandals, by failing to register patents for the technology underlying the sandals, worldwide as it 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 \$2.9 million). We filed a statement of defense rejecting the plaintiff's claims and asserted a claim against the plaintiff and others for a declaratory judgment that the plaintiff breached his contractual undertakings towards Achidatex. The petition to consolidate the counter-claim with the plaintiff's claim was ordered by the Court and the claims are now being heard together. Our subsidiaries filed a statement of defense and the proceedings are currently at the stage at which the parties have to submit affidavits stating evidence to support their case. We believe that the risk under the above lawsuit is not material to the business of our subsidiaries. We intend to vigorously defend our position against the lawsuit. Recently the plaintiff requested court permission to amend its statement of claims to increase the amount of damages sought to NIS 20 million (approximately \$5.6 million). This motion was rejected recently by the court.
- B. On July 12, 2010, a lawsuit was filed in the Tel-Aviv Regional Labor Court, or the Labor Court against our company, our subsidiaries, Mayotex Ltd, or Mayotex and Export Erez, and against an officer of our company, by a former employee. The plaintiff alleged that we breached her employment agreement and violated certain Israeli labor related legislation by not paying her severance payment in lieu of vacation, recuperation payments, contribution to a study fund, payments due during a prior notice period and compensation for unpaid overtime. The plaintiff also claimed that she was the subject of sexual harassment and consequently we violated certain applicable Israeli legislation. The plaintiff sought damages of \$414,775. On June 6, 2011, we entered into a settlement agreement with the former employee in which we paid a total of NIS 244,856 NIS (approximately \$71,700) in full settlement of her claims.

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2011 AND 2010 (UNAUDITED)

NOTE 6

SUBSEQUENT EVENTS

On July 11, 2011, Achidatex entered into an agreement to purchase the personal protection activity of Rabintex Ltd.(the “Agreement”). The acquired personal protection activity included Rabintex’s activities in respect to the development, manufacture, assembly and marketing of protection products, mainly based on lining of ballistic clothing and its manufacture of dry storage.

Achidatex agreed to purchase the activities free from any warranty, debt, lien, claim or third party rights and on “as is where is” basis. Achidatex also agreed to take all action reasonably necessary to complete a project Italy for the supply of bullet proof vests to the Italian army, which project is encumbered by a lien to Bank Hapoalim. Achidatex has the right to decide whether to employ the employees of Rabintex after the later of (i) the date of approval of the Agreement by it, the banks whose loans are secured by the assets of Rabintex (the “Banks”) , or the court enables the sale; (ii) approval of the Agreement by the Anti-Trust Authority; or (iii) the supply of documents and approvals required by Achidatex pursuant to the conditions precedent to closing the Agreement (the “Determination Date”). Rabintex agreed to change its name so as to no longer include “Rabintex” within 30 days of the Determinative Date. Rabintex also agreed to keep confidential any information related to the personal protection activity and to not compete with Achidatex for a period of three years from the date of receipt of the last payment.

The consideration to be paid by Achidatex is NIS 42 million (approximately \$12.3 million) together with V.A.T. as required by law and 10% of the issued and outstanding share capital of the Company (2,815,053 shares of common stock). The consideration is to be paid as follows: (i) NIS 9 million (approximately \$2.6 million) to be paid Rabintex in installments;(ii) NIS 14.5 million (approximately \$4.25 million) to be paid directly to the Banks; (iii) NIS 6.5 million (approximately \$1.9 million) to be paid to the accounts of Rabintex at the Banks for the purchase of real estate; and (iv) Achidatex agreed to take all action reasonably necessary to enable the collection of the amounts receivable under the project in Italy for the Italian army. Payment is to be guaranteed by a NIS 15 million (approximately \$4.4 million) lien on the personal protection activity assets purchased, including a floating lien on the inventory purchased in the framework of the Agreement, and a writ of guarantee from the Company’s Export-Erez. and Mayotex Ltd, subsidiaries.

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, 2010 contained in our 2010 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.

As a supplier of products to the civilian and military markets, our business is affected by economic conditions. The volatile economic conditions of 2010 have continued into 2011 and slowed down our sales process and complicated our ability to conduct transactions. The economic climate and ongoing uncertainty in global economic conditions could impact the ability of our customers, including governmental entities, to make capital expenditures, which would affect 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 continue to be volatile or weaken further. 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.

We develop our 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, the appreciation of the U.S. dollar against the NIS reduces the U.S. dollar value of our NIS denominated sales, while the depreciation of the U.S. dollar against the NIS increases the U.S. dollar value of our NIS denominated 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, the appreciation of the U.S. dollar against the NIS reduces the U.S. dollar value of our NIS denominated cost of sales and operating expenses, while the depreciation of the U.S. dollar against the NIS increases the U.S. dollar value of our NIS denominated cost of sales and

operating expenses.

Exchange rate fluctuations also affect our financial results in other 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, a depreciation of the U.S. dollar against the NIS is reflected as comprehensive income in our consolidated statement.

In the quarter ended June 30, 2011, the NIS appreciated against the U.S. dollar by approximately 1.85% and our financial results were negatively impacted. Exchange rates between the U.S. dollar and the NIS fluctuate continuously. 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 will not be materially adversely affected by currency fluctuations

Material Trends

Local Military Market. In the three and six month periods ended June 30, 2011, our local military market revenues decreased to \$554,606 and \$1,569,595, respectively, compared to \$1,510,626 and \$2,675,768 for the three and six month periods ended June 30, 2010. As of August 3, 2011, we had a backlog of firm orders from the Israeli Ministry of Defense of approximately \$1,490,108 including orders of approximately \$364,881 that we received subsequent to June 30, 2011. In the six month periods ended June 30, 2011 and 2010, sales to the Israeli Ministry of Defense were approximately \$1,372,217 and \$2,455,772, accounting for 16.8% and 41.7% of our total sales, respectively. We believe that the demand for our products from the Israeli Ministry of Defense will continue at the current levels during the remainder of 2011.

Export Military Market. Our customers in this market are military and law enforcement organizations mostly in South America, North America, Africa and Europe. In the three and six month periods ended June 30, 2011, our export military market revenues increased to \$1,696,982 and \$3,265,817, respectively, compared to \$346,612 and \$911,912 for the three and six month periods ended June 30, 2010. Our customers' budgets fluctuate, and as a result, we cannot identify definite trends in these markets.

The following table presents details of our export military sales during the three and six month periods ended June 30, 2011 and 2010:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------------|--------------------------------|-----------|------------------------------|-----------|
| | 2011 | 2010 | 2011 | 2010 |
| Sales to South America | \$1,169,812 | \$249,083 | \$1,459,996 | \$467,443 |
| Sales to North America | --- | 6,042 | 32,924 | 7,356 |
| Sales to Europe and Asia | 56,804 | 91,403 | 515,780 | 434,852 |
| Sales to Africa | 470,366 | 84 | 1,257,117 | 2,261 |
| Total Export Military Sales | \$1,696,982 | \$346,612 | \$3,265,817 | \$911,912 |

Local Civilian Market. In the three and six month periods ended June 30, 2011, our local market revenue were \$813,557 and \$1,386,739, respectively, compared to \$651,489 and \$1,685,147 for the three and six month periods ended June 30, 2010. During the second quarter of 2011 our sales increased significantly over the first quarter of 2011, as a result of our marketing efforts and increased demand for armor in the civilian market.

The following table sets forth the breakdown of sales by segment for the three and six month periods ended June 30, 2011 and 2010.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|------------------------|--------------------------------|-------------|------------------------------|-------------|
| | 2011 | 2010 | 2011 | 2010 |
| Local civilian market | \$813,557 | \$651,489 | \$1,386,739 | \$1,685,147 |
| Export civilian market | 1,528,195 | 379,087 | 1,964,626 | 608,718 |
| Local military market | 554,606 | 1,510,626 | 1,569,595 | 2,675,768 |
| Export military market | 1,696,982 | 346,612 | 3,265,817 | 911,912 |
| Total | \$4,593,340 | \$2,887,814 | \$8,166,777 | \$5,881,545 |

Backlog. We had approximately \$3.6 million of unfilled customer orders at June 30, 2011, compared to \$5.2 million of unfilled customer orders at June 30, 2010. Of our \$3.6 million of unfilled customer orders at June 30, 2011, approximately \$0.2 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 \$1 million was attributable to orders from military customers in Africa, approximately \$0.96 million was attributable to the local civilian market, approximately \$0.48 million was attributable to the U.S. civilian market and approximately \$1.1 million was attributable to the Israeli Ministry of Defense. The decline in our backlog is primarily attributable to decrease in orders from 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 economic climate and uncertainty in global economic conditions could impact the ability of our customers, including governmental entities, to make capital expenditures, which would affect their ability to purchase our products. In addition, turmoil in financial markets may limit our ability to obtain financing for our working capital requirements. 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 continue to be uncertain or weaken further. 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.

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, the depreciation of the U.S. dollar against the NIS is reflected as comprehensive income in our consolidated statement.

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, the appreciation of the U.S. dollar against the NIS reduces the U.S. dollar value of our NIS denominated sales, while the depreciation of the U.S. dollar against the NIS increases the U.S. dollar value of our NIS denominated 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, the appreciation of the U.S. dollar against the NIS reduces the U.S. dollar value of our NIS denominated cost of sales and operating expenses, while the

depreciation of the U.S. dollar against the NIS increases the U.S. dollar value of our NIS denominated reported cost of sales and operating expenses.

In the three and six month periods ended June 30, 2011, the NIS appreciated against the U.S. dollar by approximately 1.85% and 3.8%, respectively, and our financial results were negatively impacted. Exchange rates between the U.S. dollar and the NIS fluctuate continuously. 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 will not be materially adversely affected by currency fluctuations.

The Sarino Agreement

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 form an entity which will 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 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.

After a period of uncertainty, in August 2010, Mayosar, Optics and Isorad executed an addendum to the 2008 agreement, according to which the parties confirmed the validity of the Isorad Agreement under certain conditions.

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 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 Optics business from Isorad's premises, 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 years following the initial 18 month period.

Isorad has 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. Such right was extended for an additional 12-month period until January 1, 2012. If the Israeli Government does not approve the 5% purchase of the Optics shares by Isorad within the above period, the right to acquire the shares will expire and Isorad will be entitled to a payment of \$75,000.

Optics has the right during the four-year period following the Effective Date to redeem its commitment to pay royalties under the Isorad Agreement and to repurchase Isorad's shares (or Isorad's option above to acquire shares) in consideration of a fixed payment of \$750,000, less all royalties and the above \$75,000 payment (in the event Isorad waived its right to be issued Optics shares) paid to through that date.

Pursuant to the Sarino Agreement:

- Mayotex will have operational control of Mayosar.
- Mayotex paid Sarino Crystal Technologies Ltd. \$1 million, or the Sarino Payment, out of which \$300,000 is non-refundable to Mayotex 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 year. 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.

In December 2010 Sarino and Mayotex entered into an agreement, or the December Agreement, pursuant to which the parties agreed to amend the terms and conditions of the Sarino Payment to provide for: (i) a loan term of 10 years, commencing as of December 19, 2010; (ii) interest at LIBOR plus 1% per year commencing as of December 19, 2010; and (iii) the grant to Sarino Crystal Technologies Ltd. of a put option under which it could repay the Sarino Payment by selling its stake in Optics to Mayotex. Based on a purchase price allocation analysis, we recorded the Sarino loan as a liability against the minority interest.

In the event of an allotment of shares representing 5% of Optics' share capital to Isorad upon the exercise by Isorad of its option, Optics will issue additional shares of Optics to Mayotex on a pro rata basis, in order for Mayotex to retain a 82% interest in Optics' share capital.

Acquisition of Philcar Ltd.

In May 3, 2011, Mayotex entered into an agreement with Rabintex Industries Ltd., or Rabintex, to purchase Philcar Ltd., or Philcar, a company that specializes in equipping and protecting vehicles, for \$235,502.

Agreement to Acquire the Israel-Based Armoring Business of Rabintex On July 11, 2011, Achidatex entered into an agreement to purchase the personal protection activity of Rabintex (the "Agreement"). The acquired personal protection activity included Rabintex's activities in respect to the development, manufacture, assembly and marketing of protection products, mainly based on lining of ballistic clothing and its manufacture of dry storage.

Achidatex agreed to purchase the activities free from any warranty, debt, lien, claim or third party rights and on "as is where is" basis. Achidatex also agreed to take all action reasonably necessary to complete a project Italy for the supply of bullet proof vests to the Italian army, which project is encumbered by a lien to Bank Hapoalim. Achidatex has the right to decide whether to employ the employees of Rabintex after the later of (i) the date of approval of the Agreement by it, the banks whose loans are secured by the assets of Rabintex (the "Banks") , or the court enables the sale; (ii) approval of the Agreement by the Anti-Trust Authority; or (iii) the supply of documents and approvals required by Achidatex pursuant to the conditions precedent to closing the Agreement (the "Determination Date"). Rabintex agreed to change its name so as to no longer include "Rabintex" within 30 days of the Determinative Date. Rabintex also agreed to keep confidential any information related to the personal protection activity and to not compete with Achidatex for a period of three years from the date of receipt of the last payment.

The consideration to be paid by Achidatex is NIS 42 million (approximately \$12.3 million) together with V.A.T. as required by law and 10% of the issued and outstanding share capital of the Company (2,815,053 shares of common stock). The consideration is to be paid as follows: (i) NIS 9 million (approximately \$2.6 million) to be paid Rabintex in installments;(ii) NIS 14.5 million (approximately \$4.25 million) to be paid directly to the Banks; (iii) NIS 6.5 million (approximately \$1.9 million) to be paid to the accounts of Rabintex at the Banks for the purchase of real estate; and (iv) Achidatex agreed to take all action reasonably necessary to enable the collection of the amounts receivable under the project in Italy for the Italian army. Payment is to be guaranteed by a NIS 15 million (approximately \$4.4 million) lien on the personal protection activity assets purchased, including a floating lien on the inventory purchased in the framework of the Agreement, and a writ of guarantee from the Company's Export-Erez and Mayotex Ltd. subsidiaries.

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 is stable, our business is subject to a high degree of volatility because of the impact of geopolitical events and government budgeting.

Three Months Ended June 30, 2011 Compared with Three Months Ended June 30, 2010

Net Revenues. Net revenues for the three months ended June 30, 2011 increased to \$4,593,340 from \$2,887,815 in the three months ended June 30, 2010, an increase of 59.1%. The increase is mainly attributable to an increase of approximately \$1.35 million in our export military market segment and an increase of approximately \$1.14 million in our export civilian market segment due to increased sales of armored vehicles for civilian purposes. We expect that our revenues will increase in the next quarter.

The following table sets forth the breakdown of sales by segment for the three months ended June 30, 2011 and 2010.

| | Three Months Ended June 30, | |
|------------------------|--------------------------------|--------------|
| | 2011 | 2010 |
| Local civilian market | \$ 813,557 | \$ 651,489 |
| Export civilian market | 1,528,195 | 379,087 |
| Local military market | 554,606 | 1,510,626 |
| Export military market | 1,696,982 | 346,612 |
| Total | \$ 4,593,340 | \$ 2,887,814 |

Gross Profit. Gross profit for the three months ended June 30, 2011 was \$1,244,972 compared to \$168,780 for the three months ended June 30, 2010. Our gross profit margin for the three months ended June 30, 2011 increased to 27.1% compared to 5.8% for the three months ended June 30, 2010. This increase in gross profit is primarily attributable to the increase in revenues from sales. The increase in gross profit margin is primarily attributable to the 59.1% increase in revenues while our cost of sales increased by only 23.1%, which is primarily due to the relatively stable level of our fixed costs that are not revenue dependent.

Selling Expenses. Selling expenses for the three months ended June 30, 2011 increased by 201.3% to \$652,964 from \$216,735 for the three months ended June 30, 2010. The increase in our selling expenses was primarily attributable to sales consulting expenses incurred during the period in an effort to increase future sales and increased commission sales.

General and Administrative Expenses. General and administrative expenses for the three months ended June 30, 2011 increased by 116.1% to \$1,518,788 from \$702,886 for the three months ended June 30, 2010. The increase in general and administrative expenses was attributable primarily to an increase of \$378,448 in professional fees and an increase of \$234,449 in depreciation expenses.

Financial (Expenses) Income, Net. We had financial expenses, net of \$127,767 for the three months ended June 30, 2011 compared to financial income, net of \$241,714 for the three months ended June 30, 2010. The increase in 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 \$21,331 for the three months ended June 30, 2011 compared to a gain of \$134,577 for the three months ended June 30, 2010.

Other Income (Expenses), Net. We had other expenses, net for the three months ended June 30, 2011 of \$81,574 as compared to other income, net of \$39,839 for the three months ended June 30, 2010. Our other expenses in three months ended June 30, 2011 are attributable to a \$32,878 unrealized loss on tradable securities, a \$1,879 loss derived from sales of tradable securities and a \$65,903 loss derived from revaluation of funds in respect of employee rights upon retirement. Our other income in three months ended June 30, 2010 is primarily attributable to a \$41,477

gain derived from sales tradable securities, offset by a \$1,833 loss derived from revaluation of funds in respect of employee rights upon retirement.

Income Tax Expense (Benefit). Our income tax benefit for the three months ended June 30, 2011 was \$24,146 compared to income tax expense of \$2,859 for the three months ended June 30, 2010. The decrease in income tax expense was mainly due to the decrease in our income before income taxes in the three months ended June 30, 2010.

Net Loss. For the three months ended June 30, 2011, our consolidated net loss attributable to controlling interest was \$1,082,906 compared to a consolidated net loss attributable to controlling interest of \$472,147 for the three months ended June 30, 2010.

Six Months Ended June 30, 2011 Compared with Six Months Ended June 30, 2010

Net Revenues. Net revenues for the six months ended June 30, 2011 increased to \$8,186,777 from \$5,881,545 in the six months ended June 30, 2010, an increase of 39.2%. The increase is mainly attributable to an increase in revenues attributable to military and civilian market segments. In the six-month period ended June 30, 2011, revenues from the military export market segment increased by approximately \$2.36 million and revenues from our export civilian market segment increased by approximately \$1.36 million. These increases were partially offset by a decrease of \$1.1 million, or 41%, in the local military market, reflecting lower demand in this market.

The following table sets forth the breakdown of sales by segment for the six months ended June 30, 2011 and 2010.

| | Six Months Ended June 30, | |
|------------------------|------------------------------|--------------|
| | 2011 | 2010 |
| Local civilian market | \$ 1,386,739 | \$ 1,685,147 |
| Export civilian market | 1,964,626 | 608,718 |
| Local military market | 1,569,595 | 2,675,768 |
| Export military market | 3,265,817 | 911,912 |
| Total | \$ 8,186,777 | \$ 5,881,545 |

Gross Profit. Gross profit for the six months ended June 30, 2011 was \$1,908,492 compared to \$772,159 for the six months ended June 30, 2010. This increase in gross profit is primarily attributable to the increase in revenues. Our gross profit margin for the six months ended June 30, 2011 increased to 23.3% compared to 13.1% for the six months ended June 30, 2010. The increase is primarily due to the relatively stable level of our fixed costs that are not revenue dependent.

Selling Expenses. Selling expenses for the six months ended June 30, 2011 increased by 330.1% to \$1,430,008 from \$332,507 for the six months ended June 30, 2010. The increase in our selling expenses was attributable primarily to sales consulting expenses incurred during the period in an effort to increase future sales and increased commission sales.

General and Administrative Expenses. General and administrative expenses for the six months ended June 30, 2011 increased by 60% to \$2,240,683 from \$1,400,295 for the six months ended June 30, 2010. The increase in general and administrative expenses was attributable primarily to an increase of \$319,612 in professional fees, an increase of \$236,978 in depreciation expenses and an increase of \$102,108 in salaries.

Financial (Expenses)Income , Net. We had financial expenses, net of \$212,916 for the six months ended June 30, 2011 compared to financial income, net of \$151,680 for the six months ended June 30, 2010. The increase in 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 \$63,202 for the six months ended June 30, 2011 compared to a gain of \$134,577 for the six months ended June 30, 2010.

Other Income (Expenses), Net. We had other expenses, net for the six months ended June 30, 2011 of \$85,292 as compared to other income, net of \$90,211 for the six months ended June 30, 2010. Our other expenses in the six months ended June 30, 2011 are attributable to a \$48,112 unrealized loss on tradable securities and a \$1,879 loss derived from sales of tradable securities. Our other income in the six months ended June 30, 2010 is mainly attributable to the revaluation of funds in respect of employee rights upon retirement of \$8,852, an unrealized loss of \$58,752 on tradable securities and a gain from dissolving Dragonwear of \$22,879, offset by a loss derived from sales of tradable securities of \$272.

Income Tax Expense (Benefit). Our income tax benefit for the six months ended June 30, 2011 was \$23,281 compared to income tax expense of \$7,984 for the six months ended June 30, 2010. The decrease in income tax expense was mainly due to the decrease in our income before income taxes in the six months ended June 30, 2011.

Net Income (Loss). In the six months ended June 30, 2011, our consolidated net loss attributable to controlling interest was \$1,999,552, compared to a net loss attributable to controlling interest of \$726,736 for the six months ended June 30, 2010.

Liquidity and Capital Resources

We assess liquidity in terms of our ability to generate cash to fund our operating and investing activities. Of particular importance to management are cash flows generated by operating activities and cash used for capital and financing expenditures.

In the last few years we have financed our operating needs and capital expenditures through cash flows from our operations, payments from the Israeli government relating to the evacuation by our Erez Export and Mayotex subsidiaries from their manufacturing facilities in the Erez Industrial Zone in the Gaza Strip and existing cash. We expect to continue to finance current and planned operating requirements principally through cash from operations, as well as existing cash resources. We believe that these funds will be sufficient to meet our operating requirements for the foreseeable future. However, we may, from time to time, seek additional funding through a combination of equity and debt financings or from other sources. The economic climate and any uncertainty in the global financial markets resulting from the 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.

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.

As of June 30, 2011, we had \$1,722,581 in cash and cash equivalents, \$1,402,109 in trading securities and working capital of \$5,652,271, as compared to \$3,502,461 in cash and cash equivalents, \$1,894,864 in trading securities and working capital of \$8,064,571 at December 31, 2010.

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

Cash Flows

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

| | Six Months Ended | |
|---|------------------|------------------|
| | June 30, 2011 | June 30, 2010 |
| Net cash used in operating activities | \$(1,560,906) | \$(216,068) |
| Net cash used in investing activities | (974,341) | (127,511) |
| Net (cash used) provided by in financing activities | 727,865 | (161,257) |
| Net decrease in cash and cash equivalents | (1,779,880) | (633,789) |
| Cash and cash equivalents at beginning of period | 3,502,461 | 3,783,631 |
| Cash and cash equivalents at end of period | \$1,722,581 | \$3,149,841 |

Operating activities. Net cash used in operating activities was \$1,560,906 for the six months ended June 30, 2011 as compared to \$216,068 used in operating activities in the six months ended June 30, 2010. Net cash used in operating activities in the 2011 period was primarily attributable to our net loss of \$1,999,552 in the period, an increase in accounts receivable of \$1,387,907, an increase in inventories of \$1,091,181, offset by an increase in accounts payable of \$1,957,282, an increase in other current liabilities of \$792,555, a decrease in trading securities of \$549,721.

Investing activities. Net cash used in investing activities was \$974,341 for the six months ended June 30, 2011 as compared to \$127,511 used in investing activities for the six months ended June 30, 2010. During the six months ended June 30, 2011, \$738,839 was used to purchase fixed assets and \$235,502 was used to purchase Philcar Ltd.

Financing activities. Net cash provided by financing activities was \$727,865 for the six months ended June 30, 2011 as compared to \$161,257 used in financing activities for the six months ended June 30, 2010. During the six months ended June 30, 2011, we incurred \$534,410 of short-term and \$318,295 of long-term debt, offset by a reduction of \$124,840 of long-term debt.

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 fluctuations of the U.S. dollar against 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 six month period ended June 30, 2011, the inflation rate in Israel was 0.4% and the NIS appreciated against the U.S. dollar by 3.8%. 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 six months ended June 30, 2011.

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 fourth quarters of fiscal year. We generally experience a slight increase in sales of our camping equipment during the second quarter and in sales of our protective clothing during the fourth quarter.

Off-balance Sheet Arrangements

None.

Contractual Obligations

The following table summarizes our contractual obligations and commercial commitments as of June 30, 2011.

| Contractual Obligations | Total | Less than 1 year | Payments due by Period | | |
|---|-----------|---------------------|------------------------|------------|----------------------|
| | | | 2 -3 years | 4 -5 years | more than 5 years |
| Long-term debt obligations | 328,366 | 147,041 | 165,129 | 16,196 | --- |
| Estimated interest payments on long-term debt obligations | 27,105 | 13,094 | 8,821 | 5,190 | --- |
| Operating lease obligations | 1,981,528 | 304,933 | 991,183 | 685,412 | --- |
| Total | 2,336,999 | 465,068 | 1,165,133 | 706,798 | --- |

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, 2010. There were no significant changes to these policies in the period ended June 30, 2011.

Recent Accounting Pronouncements

See Note 1G 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 have variable rate loans that we borrow from Israeli banks which are based on the local Prime Rate. Each increase of 1% in the Prime Rate will increase our interest expense approximately \$21,600 on an annualized basis.

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 depreciation of the U.S. dollar against these currencies increases the U.S. dollar value of our expenses denominated in such currencies. In the first six months of 2011, the U.S. dollar depreciated against the NIS by approximately 3.8%.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. As of June 30, 2011, our company's chief executive officer and acting chief financial officer conducted an evaluation regarding the effectiveness of our company's disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Exchange Act. Based upon the evaluation of these controls and procedures, our chief executive officer and acting chief financial officer concluded that our disclosure controls and procedures were not effective as of June 30, 2011, due to the material weaknesses described below in our internal control over financial reporting.

Disclosure Controls and Internal Controls. As provided in Rule 13a-14 of the General Rules and Regulations under the Securities and Exchange Act of 1934, as amended, Disclosure Controls are defined as meaning controls and procedures that are designed with the objective of insuring that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, designed and reported within the time periods specified by the SEC's rules and forms. Disclosure controls include, within the definition under the Exchange Act, and without limitation, controls and procedures to insure that information required to be disclosed by us in our reports is accumulated and communicated to our management, including our chief executive officer and principal financial officer, as appropriate to allow timely decisions regarding disclosure. Internal controls are procedures are designed with the objective of providing reasonable assurance that (1) our transactions are properly authorized; (2) our assets are safeguarded against unauthorized or improper use; and (3) our transactions are properly recorded and reported, all to permit the preparation of our financial statements in conformity with generally accepted accounting principles.

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed by, or under the supervision of the Chief Executive Officer and acting chief financial officer and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management's evaluation of internal control over financial reporting includes using the Committee of Sponsoring Organizations of the Treadway Commission, or COSO, framework, an integrated framework for the evaluation of internal controls issued by COSO, to identify the risks and control objectives related to the evaluation of our control environment.

Based on their evaluation under the framework described above, our chief executive officer and chief financial officer have concluded that our internal control over financial reporting was ineffective as of June 30, 2011, due to material weaknesses related to our financial statement closing process resulting from insufficient knowledge of our financial staff regarding the application of U.S. GAAP to complex transactions.

Remediation Plan

We have taken the following steps to remediate the material weaknesses:

- we are implementing revised policies and procedures and enhancing our review of complex transactions to ensure consistent application of U.S. GAAP and enhanced internal control over financial reporting; and
- we are increasing the level of preparation and review of our financial statements, and in connection therewith, we are implementing additional control procedures as part of our quarter and year-end close processes as well as adding resources in connection with our review of key financial estimates.

Changes in Internal Control over Financial Reporting

No change in our internal control over financial reporting occurred during the three month period ended June 30, 2011, that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. However, subsequent to March 31, 2011, we made changes to our internal control over financial reporting and took remedial actions, as described above.

PART II - OTHER INFORMATION:

Item 1. Legal Proceedings

On February 11, 2009, a lawsuit was filed in the Jerusalem District Court, or the Court, against our subsidiary, Achidatex Nazareth Elite (1977) Ltd., or Achidatex, Mr. Avraham Haztor, the then chief executive officer of Achidatex, and our subsidiary Export Erez USA Inc., or Export Inc. Our subsidiary Export Erez Ltd., or Export Erez, was subsequently added as a defendant in the action. The suit alleges that Achidatex materially breached its February 22, 2000 agreement with the plaintiff, relating to the development of inflatable mine-field crossing enabling sandals, by failing to register patents for the technology underlying the sandals, worldwide as it 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 \$2.9 million). We filed a statement of defense rejecting the plaintiff's claims and asserted a claim against the plaintiff and others for a declaratory judgment that the plaintiff breached his contractual undertakings towards Achidatex. The petition to consolidate the counter-claim with the plaintiff's claim was ordered by the Court and the claims are now being heard together. Our subsidiaries filed a statement of defense and the proceedings are currently at the stage at which the parties have to submit affidavits stating evidence to support their case. We believe that the risk under the above lawsuit is not material to the business of our subsidiaries. We intend to vigorously defend our position against the lawsuit. Recently the plaintiff requested court permission to amend its statement of claims to increase the amount of damages sought to NIS 20 million (approximately \$5.6 million). This motion was rejected recently by the court.

On July 12, 2010, a lawsuit was filed in the Tel-Aviv Regional Labor Court, or the Labor Court against our company, our subsidiaries, Mayotex Ltd. and Export Erez, and against an officer of our company, by a former employee. The plaintiff alleged that we breached her employment agreement and violated certain Israeli labor related legislation by not paying her severance payment in lieu of vacation, recuperation payments, contribution to a study fund, payments due during a prior notice period and compensation for unpaid overtime. The plaintiff also claimed that she was the subject of sexual harassment and consequently we violated certain applicable Israeli legislation. The plaintiff sought damages of \$414,775. On June 6, 2011, we entered into a settlement agreement with the former employee in which we paid a total of NIS 244,856 NIS (approximately \$71,700) in full settlement of her claims.

Item 1A. Risk Factors

We may encounter difficulties in realizing the potential financial or strategic benefits of recent business acquisitions.

In May 2011 we acquired Philcar, a company that specializes in equipping and protecting vehicles, from Rabintex for \$235,502, and in July 2011 we entered into an agreement to purchase the remaining Israel-based armoring business activity of Rabintex.

Acquisitions involve numerous risks, including the following:

- Difficulties in integrating the operations, systems, technologies, products, and personnel of the acquired companies;
- Diversion of management's attention from normal daily operations of the business and the challenges of managing larger and more widespread operations resulting from acquisitions;
- Difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions;
 - Initial dependence on unfamiliar supply chains or relatively small supply partners;
 - Insufficient revenue to offset increased expenses associated with acquisitions; and
- The potential loss of key employees, customers, distributors, vendors and other business partners of the companies we acquire following and continuing after announcement of acquisition plans.

Mergers and acquisitions are inherently risky and subject to many factors outside of our control and no assurance can be given that these acquisitions will be successful and will not materially adversely affect our business, operating results, or financial condition. Failure to manage and successfully integrate these acquisitions could materially harm our business and operating results.

There have been no other 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, 2010.

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

| | |
|---------|--------------------------------|
| 101.INS | Instance Document |
| 101.SCH | Schema Document |
| 101.CAL | Calculation Linkbase Document |
| 101.DEF | Definition Linkbase Document |
| 101.LAB | Labels Linkbase Document |
| 101.PRE | Presentation Linkbase Document |

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: August 15, 2011

By: /s/ Uri Nissani
Uri Nissani
Chief Executive Officer and
President

/s/ Meir Ben-Hayon
Meir Ben-Hayon
Acting Chief Financial Officer