DEFENSE INDUSTRIES INTERNATIONAL INC
Form 10-Q
November 15, 2010

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

FORM 10-Q

S Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 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 | 84-1421483 |
| (State or Other Jurisdiction of Incorporation or Organization) | (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 T 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. See of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act.

Large accelerated filer * Accelerated filer *

| | |
|---|---|
| Non-accelerated filer *<br>(Do not check if smaller reporting company) | Smaller reporting company T |

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

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

DEFENSE INDUSTRIES INTERNATIONAL, INC. AND SUBSIDIARIES

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DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES

CONDENSED CONSOLIDATED BALANCE SHEETS
AS OF SEPTEMBER 30, 2010 (UNAUDITED) AND DECEMBER 31, 2009

ASSETS

| | September 30, 2010 (Unaudited) | December 31, 2009 |
|---|---|---|
| CURRENT ASSETS | | |
| Cash and cash equivalents | $ 3,101,257 | $ 3,783,631 |
| Accounts receivable, net of allowance for doubtful accounts of $337,759 and $343,629, respectively | 4,402,970 | 3,352,751 |
| Inventories | 4,434,970 | 4,124,141 |
| Trading securities | 2,005,294 | 2,312,048 |
| Deferred taxes | 141,574 | 148,710 |
| Other current assets | 514,731 | 225,112 |
| Total Current Assets | 14,600,796 | 13,946,393 |
| PROPERTY, PLANT AND EQUIPMENT, NET | 1,521,124 | 1,741,594 |
| OTHER ASSETS | | |
| Funds in respect of employee rights upon retirement | 869,519 | 780,960 |
| Deferred taxes | 28,803 | 25,659 |
| Refundable deposits for the purchase of a business (Note 2) | 2,063,059 | 1,993,696 |
| Total Other Assets | 2,961,381 | 2,800,315 |
| TOTAL ASSETS | $ 19,083,301 | $ 18,488,302 |

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 SEPTEMBER 30, 2010 (UNAUDITED) AND DECEMBER 31, 2009

LIABILITIES AND EQUITY

| | September 30, 2010 (Unaudited) | December 31, 2009 |
|---|---|---|
| CURRENT LIABILITIES | | |
| Accounts payable | $2,411,716 | $ 1,408,741 |
| Accounts payable – related parties | 38,458 | 462,968 |
| Short-term debt | 1,063,816 | 876,554 |
| Other current liabilities | 795,263 | 1,047,771 |
| Total Current Liabilities | 4,309,253 | 3,796,034 |
| LONG-TERM LIABILITIES | | |
| Long-term portion of debt | 234,128 | 268,250 |
| Deferred tax liability | 229,476 | 229,191 |
| Liability for employee rights upon retirement | 1,027, 561 | 911,440 |
| Total Long-Term Liabilities | 1,491,165 | 1,408,881 |
| TOTAL LIABILITIES | 5,800,418 | 5,204,915 |
| 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 September 30, 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 | 9,774,271 | 10,176,352 |
| Accumulated other comprehensive income | 760,322 | 358,745 |
| Total Equity | 13,282,883 | 13,283,387 |
| TOTAL LIABILITIES AND EQUITY | $ 19,083,301 | $ 18,488,302 |

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 NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)

| | For the Three Months Ended September 30, 2010 | For the Three Months Ended September 30, 2009 | For the Nine Months Ended September 30, 2010 | For the Nine Months Ended September 30, 2009 |
|---|---|---|---|---|
| NET REVENUES | $6,581,429 | $ 3,554,137 | $12,462,974 | $ 12,943,562 |
| COST OF SALES | 4,865,555 | 2,837,920 | 9,974,941 | 9,982,992 |
| GROSS PROFIT | 1,715,874 | 716,217 | 2,488,033 | 2,960,570 |
| OPERATING EXPENSES | | | | |
| Selling | 460,788 | 153,485 | 793,295 | 485,540 |
| General and administrative | 631,357 | 551,053 | 2,031,652 | 1,537,421 |
| Compensation from government (Note 5) | --- | (4,452) | --- | (228,365) |
| Total Operating Expenses | 1,092,145 | 700,086 | 2,824,947 | 1,794,596 |
| INCOME (LOSS) FROM OPERATIONS | 623,729 | 16,131 | (336,914) | 1,165,974 |
| OTHER (EXPENSES) INCOME | | | | |
| Financial expenses | (330,727) | (330,934) | (216,905) | (808,516) |
| Financial income | 17,857 | 75,542 | 55,715 | 770,093 |
| Other income, net | 10,483 | 71,999 | 100,694 | 293,204 |
| Total Other (Expenses) Income | (302,387) | (183,393) | (60,496) | 254,781 |
| INCOME (LOSS) BEFORE INCOME TAXES | 321,342 | (167,262) | (397,410) | 1,420,755 |
| Income tax (expense) benefit | 3,313 | 16,878 | (4,671) | (341,348) |
| NET INCOME (LOSS) | $324,655 | $(150,384) | $(402,081) | $1,079,407 |
| Net income (loss) per share - basic and diluted | $ 0.012 | $( 0.005) | $ (0.014) | $ 0.039 |
| Weighted average number of shares outstanding - basic and diluted | 28,150,535 | 28,150,535 | 28,150,535 | 28,028,563 |

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 NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)

| | Common Stock Shares | Common Stock Dollars | Treasury Stock Shares | Treasury Stock Dollars | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Comprehensive Loss | Total Equity |
|---|---|---|---|---|---|---|---|---|---|
| Balance as of January 1, 2010 | 29,200,535 | $ 2,920 | 1,050,000 | $ (252,000) | $ 2,997,370 | $ 10,176,352 | $ 358,745 | | $ 13,283,387 |
| Comprehensive loss: | | | | | | | | | |
| Net loss | - | - | - | - | - | (402,081) | - | $ (402,081) | (402,081) |
| Foreign currency translation gain | - | - | - | - | - | - | 401,577 | 401,577 | 401,577 |
| Total comprehensive loss | | | | | | | | $ (504) | |
| Balance as of September 30, 2010 | 29,200,535 | $ 2,920 | 1,050,000 | $ (252,000) | $ 2,997,370 | $ 9,774,271 | $ 760,322 | | $ 13,282,883 |
| Balance as of January 1, 2009 | 28,991,111 | $ 2,899 | 1,050,000 | $ (252,000) | $ 2,957,391 | $ 9,654,086 | $ 236,503 | | $ 12,598,879 |
| Common stock issued to acquire Rizzo Inc | 209,424 | 21 | | | 39,979 | | | | 40,000 |
| Comprehensive loss: | | | | | | | | | |
| Net income | - | - | - | - | - | 1,079,407 | - | $ 1,079,407 | 1,079,407 |
| Foreign currency translation loss | - | - | - | - | - | - | 224,125 | 224,125 | 224,125 |
| Total comprehensive loss | | | | | | | | $ 1,303,532 | |
| | 29,200,535 | $ 2,920 | 1,050,000 | $ (252,000) | $ 2,997,370 | $ 10,733,493 | $ 460,628 | | $ 13,942,411 |

Balance as of
September 30
2009

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

| | Common Stock Shares | Common Stock Dollars | Treasury Stock Shares | Treasury Stock Dollars | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Comprehensive Income | Total Shareholders' Equity |
|---|---|---|---|---|---|---|---|---|---|
| Balance as of July 1, 2010 | 29,200,535 | $ 2,920 | 1,050,000 | $ (252,000) | $ 2,997,370 | $ 9,449,616 | $ 26,907 | | $ 12,224,813 |
| Common stock issued to acquire Rizzo Inc. | | | - | - | | - | - | | |
| Comprehensive income: | | | | | | | | | |
| Net income | - | - | - | - | - | 324,655 | - | $ 324,655 | 324,655 |
| Foreign currency translation gain | - | - | - | - | - | - | 733,415 | 733,415 | 733,415 |
| Total comprehensive income | | | | | | | | $ 1,058,070 | |
| Balance as of September 30, 2010 | 29,200,535 | $ 2,920 | 1,050,000 | $ (252,000) | $ 2,997,370 | $ 9,774,271 | $ 760,322 | | $ 13,282,883 |
| Balance as of July 1, 2009 | 29,200,535 | $ 2,920 | 1,050,000 | $ (252,000) | $ 2,997,370 | $ 10,883,877 | $ (85,251) | | $ 13,546,916 |
| Common stock issued to acquire Rizzo Inc. | | | - | - | | - | - | | |
| Comprehensive income: | | | | | | | | | |
| Net income | - | - | - | - | - | (150,384) | - | $ (150,384) | (150,384) |
| Foreign currency translation gain | - | - | - | - | - | - | 545,879 | 545,879 | 545,879 |
| Total comprehensive income | | | | | | | | $ 395,495 | |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Balance as of September 30, 2009 | 29,200,535 | $ 2,920 | 1,050,000 | $ (252,000) | $ 2,997,370 | $ 10,733,493 | $ 460,628 | $ | 13,942,411 | $ |

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

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)

| | For the Nine Months Ended September 30, 2010 | 2009 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income (loss) | $ (402,081) | $ 1,079,407 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Items not effecting cash: | | |
| Depreciation and amortization | 425,163 | 414,058 |
| Gain from sale of property, plant and equipment | 1,829 | (29,789) |
| Provision for doubtful accounts | (14,642) | (4,734) |
| Deferred taxes | 2,556 | 93,833 |
| Net unrealized (gain) on trading securities | (53,966) | (148,783) |
| Gain from the disposal of Dragonwear Trading Ltd. | (14,001) | --- |
| Gain from settlement of long term note | (8,968) | --- |
| Accrued interest and exchange rate differences of long-term debt | 479 | (842) |
| Accrued interest and exchange rate differences on refundable deposits for the purchase of a business | (15,320) | 46,800 |
| Accrued interest and exchange rate differences on deposits | --- | (175,287) |
| Changes in assets and liabilities: | | |
| Decrease (increase) in accounts receivable | (912,700) | 429,389 |
| Decrease (increase) in inventories | (189,693) | 504,660 |
| (Increase) decrease in trading securities | 419,346 | 276,488 |
| Decrease in related parties accounts | (425,233) | 13,472 |
| (Increase) decrease in other current assets | (272,625) | 38,971 |
| Increase in funds in respect of employee rights upon retirement | (63,255) | (111,570) |
| Increase in accounts payable | 936,561 | (227,654) |
| (Decrease) increase in other current liabilities | (261,004) | (689,791) |
| Increase in liability for employee rights upon retirement | 86,225 | 79,145 |
| Net cash provided by Operating Activities | (761,329) | 1,587,773 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Redemption of restricted bank deposits | --- | 3,000,000 |
| Purchases of property, plant and equipment | (174,239) | (91,118) |
| Proceeds from sale of property, plant and equipment | 6,891 | 52,189 |
| Refundable deposits for purchase of a business | (13,782) | (918,861) |
| Net cash (used in) provided by Investing Activities | (181,130) | 2,042,210 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Short-term debt, net | 232,736 | (231,278) |
| Proceeds from long-term debt | 124,794 | - |

| | | | | |
|---|---|---|---|---|
| Repayment of long-term debt | | (224,877) | | (264,388) |
| Redemption of related party creditors | | - | | (1,200,000) |
| Net cash used in Financing Activities | | 132,653 | | (1,695,666) |
| EFFECT OF CHANGES IN EXCHANGE RATES ON CASH AND CASH EQUIVALENTS | | 127,433 | | 221,092 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | | (682,373) | | 2,155,409 |
| CASH AND CASH EQUIVALENTS – BEGINNING OF PERIOD | | 3,783,631 | | 1,719,921 |
| CASH AND CASH EQUIVALENTS – END OF PERIOD | $ | 3,101,258 | $ | 3,875,330 |
| INTEREST PAID | $ | 36,567 | $ | 46,400 |
| TAXES PAID | $ | 134,414 | $ | 748,964 |

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 NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)

NOTE 1 BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

A. The accompanying unaudited interim consolidated financial statements as of September 30, 2010 and for the nine 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 nine months period ended September 30, 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 NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (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 the three and nine months ended September 30, 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 was 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 September 30, 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 NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)

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

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 nine months ended September 30, 2010 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 relates 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.

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENT
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)

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”).

After a period of uncertainty, in August 2010, Mayosar, Optics and Isorad Ltd. 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 Sarino 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 paid Sarino $1 million, out of which, $300,000 is 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 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 September 30, 2010, Mayotex has provided loans of $1.0 million to Sarino and $1.0 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 (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.

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENT
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)

NOTE 2 PENDING ACQUISITION (CONTINUED)

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 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 recently extended for an additional 12-month period ending 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.

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.

As of the balance sheet date management assessed its legal position and 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:

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| Raw materials (1) | $ 3,100,885 | $ 2,597,759 |
| Work in progress | 608,753 | 642,132 |
| Finished goods | 725,332 | 884,250 |
| | $ 4,434,970 | $ 4,124,141 |

(1) As of September 30, 2010 and December 31, 2009, includes advanced payments to purchase inventory for $62, 213 and $52,894, respectively.

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENT
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 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 nine months ended September 30, 2010: | | | | | |
| Revenue from sales | $2,996,771 | $1,096,859 | $3,805,094 | $4,564,250 | $ 12,462,974 |
| Gross Profits | 531,011 | 282,657 | 767,714 | 906,651 | 2,488,033 |
| Corporate unallocated costs | | | | | 2,824,947 |
| Loss from operations | | | | | (336,914) |
| For the three months ended September 30, 2010: | | | | | |
| Revenue from sales | $1,311,624 | $488,141 | $1,129,326 | $3,652,338 | $ 6,581,429 |
| Gross Profits | 301,491 | 199,868 | 409,906 | 804,609 | 1,715,874 |
| Corporate unallocated costs | | | | | 1,092,145 |
| Income from operations | | | | | 623,729 |
| For the nine months ended September 30, 2009: | | | | | |
| Revenue from sales | $1,640,218 | $763,342 | $6,089,191 | $4,450,811 | $ 12,943,562 |
| Gross Profits | 525,099 | 139,881 | 1,248,834 | 1,046,756 | 2,960,570 |
| Corporate unallocated costs | | | | | 1,794,596 |
| Income from operations | | | | | 1,165,974 |

| | | | | | |
|---|---|---|---|---|---|
| For the three months ended September 30, 2009: | | | | | |
| Revenue from sales | $ 484,888 | $340,489 | $1,883,167 | $845,593 | $ 3,554,137 |
| Gross Profits | 136,395 | 85,319 | 375,523 | 118,980 | 716,217 |
| Corporate unallocated costs | | | | | 700,086 |
| Income from operations | | | | | 16,131 |

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENT
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)

B. Geographic Areas – revenues:

| | Three Months Ended September 30, 2010 | Three Months Ended September 30, 2009 | Nine Months Ended September 30, 2010 | Nine Months Ended September 30, 2009 |
|---|---|---|---|---|
| Israel | $ 2,440,950 | $ 2,368,055 | $ 6,801,865 | $ 7,729,409 |
| South America | 2,825,282 | 335,766 | 3,292,725 | 1,544,182 |
| North America | 488,175 | 351,703 | 1,093,918 | 951,210 |
| Europe and Asia | 190,230 | 147,896 | 635,413 | 980,553 |
| Africa | 636,792 | 350,717 | 639,053 | 1,738,208 |
| Total Sales | $ 6,581,429 | $ 3,554,137 | $ 12,462,974 | $ 12,943,562 |

B. Single Customer Exceeding 10% of Sales:

| | For the Three Months Ended September 30, 2010 | For the Three Months Ended September 30, 2009 | For the Nine Months Ended September 30, 2010 | For the Nine Months Ended September 30, 2009 |
|---|---|---|---|---|
| Customer A (Military Local) | $1,059,509 | $1,795,385 | $3,515,281 | $5,936,523 |
| Customer B (Military Export) | ---* | 346,099 | ---* | 1,501,304 |
| Customer C (Military Export) | 1,777,869 | ---* | 1,777,869 | ---* |

* did not exceed 10% of sales for the respective period

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENT
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)

NOTE 5 COMMITMENTS AND CONTINGENCIES [ fix indent]

A. On February 11, 2009, a lawsuit was filed in the Jerusalem District Court (the "Court") against the Company's subsidiaries, Export Erez USA Inc. and Achidatex, and the then chief executive officer of Achidatex, Mr. Avraham Hatzor. Export Erez was subsequently added as a defendant in the action. 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 $2.8 million). The Company’s subsidiaries 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. Achidatex also filed a petition to strike the claim against Mr. Hatzor 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. Hatzor and Export Erez USA Inc. and, therefore, no cause of action against them exists. This petition is pending. The Company intends to vigorously defend against the lawsuit. Due to the preliminary stage of the lawsuit, management and its legal advisors cannot currently assess the outcome or possible adverse effect of the lawsuit on the Company’s financial position or results of operations.

B. On 12 July 2010, a lawsuit was filed in the Tel-Aviv Regional Labor Court (the "Labor Court") against the Company, its subsidiaries Mayotex and Export Erez (the "Group") and against an officer of the Group, by a former employee. The plaintiff alleges that the Group breached her employment agreement and violated certain Israeli labor related legislation, by not paying her severance payment, payment in lieu of vacation, recuperation payments, contribution to Study Fund, due to her claiming to being subject to sexual harassment and consequently violation of certain applicable Israeli legislation, not making the payments due to the employee during the prior notice period and compensation for overtime. The amount claimed under the above claim is NIS 1,472,035 ($379,880). The Labor Court has imposed a gag order on the parties to the lawsuit. The Company believes that the amounts sought are exaggerated and that the exposure, if any, to the lawsuit is not material to the business of the Company. The Company intends to vigorously defend its position.

NOTE 6 SUBSEQUENT EVENTS

On October 27 2010, the Company’s subsidiary Mayotex Ltd., or Mayotex, entered into an agreement to purchase shares of Mayo-Ben Investments and Development Ltd., or Mayo-Ben. Pursuant to the agreement, Mayotex agreed to invest up to $1.5 million in Mayo-Ben, a real estate company holding industrial properties in Israel which are partially occupied by the Company's subsidiaries, in consideration for the purchase of approximately 20 per cent of the share capital of Mayo-Ben on a fully diluted basis. The subscription price is subject to adjustment based on an appraisal of the properties to be conducted by a major accounting firm in Israel.

Mayotex also agreed to lend Mayo-Ben $1 million, which funds will be utilized by Mayo-Ben to improve and renovate its industrial properties, subject to and upon the terms of the agreement. Within the framework of a recent amendment to the Evacuation Compensation Law, under which several of our subsidiaries received compensation for their forced evacuation from the Gaza Strip area, such subsidiaries are eligible to apply for additional compensation under such law, subject to certain requirements, including investment in the factories and properties to which they moved their activities and businesses, such as the properties held by Mayo-Ben. The Company expects that a portion of the grants, if any, to be received from the Israeli government within the above framework, will be used (subject to the amount granted), with the funds to be invested by Mayo-Ben, for renovations and improvements to the properties occupied by the Company's subsidiaries and will entitle the Company's subsidiaries to apply for additional grants and tax benefits.

The Company has agreed to forgive the loan in the event that Mayo-Ben invests at least $1 million in the renovation and improvement of the properties in accordance with a renovation plan agreed to by both parties and to the complete satisfaction of the Company within a three (3) year period commencing on the first closing date of the transaction, of which at least $200,000 must be spent for such renovations prior to August 30, 2011.

## 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.

As a supplier of products to the civilian and military markets, our business is affected by economic conditions. The volatile economic conditions of 2009 have continued into 2010 and 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.

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, 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.

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 devaluation of the U.S. dollar against the NIS is reflected as comprehensive income in our consolidated statement. In the period ended September 30, 2010, the NIS appreciated in relation to the U.S. dollar at a rate of 2.9% and our accumulated comprehensive income as of September 30, 2010 was $760,000
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 September 30, 2010, the NIS depreciated against the U.S. dollar by approximately 5.42% 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 will not be materially adversely affected by currency fluctuations.

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 nine months 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 the remainder of 2010.

As of November 9, 2010, we had a backlog of firm orders from the Israeli Ministry of Defense of approximately $1.3 million, including orders of approximately $500,000 that we received subsequent to September 30, 2010. In the nine month periods ended September 30, 2010 and 2009, sales to the Israeli Ministry of Defense were $3.5 million and $5.9 million, accounting for 28.2% and 45.9% 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.

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 and nine month periods ended September 30, 2010 and 2009:

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| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Sales to South America | $2,825,282 | $ 335,766 | $3,292,725 | $ 1,544,182 |
| Sales to North America | --- | 11,214 | 7,356 | 187,868 |
| Sales to Europe and Asia | 190,264 | 147,896 | 625,116 | 980,553 |
| Sales to Africa | 636,792 | 350,717 | 639,053 | 1,738,208 |
| Total Export Military Sales | $3,652,338 | $ 845,593 | $4,564,250 | $ 4,450,811 |

Local Civilian Market. Our product range for the civilian market is diversified. In the three and nine month periods ended September 30, 2010, our local market business increased to $1,311,624_ and $2,996,771 respectively, compared to $485,000 and $1,6 million for the three and nine month periods ended September 30, 2009, mainly due to sales of armored vehicles for civilian use. We expect to maintain the same level of revenues in the fourth quarter, due to marketing efforts and increased demand for armored vehicles in the civilian market.

The following table sets forth the breakdown of sales by segment for the three and nine month periods ended September 30, 2010 and 2009.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Local civilian market | $1,311,624 | $ 484,888 | $2,996,771 | $ 1,640,218 |
| Export civilian market | 488,141 | 340,489 | 1,096,859 | 763,342 |
| Local military market | 1,129,326 | 1,883,167 | 3,805,094 | 6,089,191 |
| Export military market | 3,652,338 | 845,593 | 4,564,250 | 4,450,811 |
| Total | $6,581,429 | $ 3,554,137 | $12,462,974 | $ 12,943,562 |

Backlog. We had approximately $3.3 million of unfilled customer orders at September 30, 2010, compared to $3.5 million of unfilled customer orders at September 30, 2009. Of the $3.3 million of unfilled customer orders at September 30, 2010, approximately $270,000 was attributable to orders from military customers in South America, approximately $140,000 was attributable to orders from military customers in Europe and Asia, approximately $600,000 was attributable to orders from military customers in Africa, approximately $400,000 was attributable to the local civilian market , approximately $400,000 was attributable to the U.S. civilian market and approximately $1.5 million was attributable to the Israeli Ministry of Defense.

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 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.

After a period of uncertainty, in August 2010, Mayosar, Optics and Isorad Ltd. 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 Sarino 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 paid Sarino $1 million, out of which $300,000 is 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 September 30, 2010, Mayotex has provided loans of $1.0 million to Sarino and $1.0 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 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 recently extended for an additional 12-month period 1 January 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.

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.

As of the balance sheet date Management assessed its legal position and 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.

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.

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Three Months Ended September 30, 2010 Compared with Three Months Ended September 30, 2009

Net Revenues. Net revenues for the three months ended September 30, 2010 increased to $6.6 million from $3.6 million in the three months ended September 30, 2009, a increase of 85.2_%. The increase is mainly attributable to a increase of approximately $827,000 in our local civilian market segment, a increase of approximately $2.8 million in our export military market segment, and a increase of approximately $150,000 in our export civilian market segment which was offset by an decrease of approximately $750,000 in our local military market segment. The decreased revenues in our local military market segment are attributable to an decrease in demand for our products from the Israeli Ministry of Defense. The increased revenues in our export military market and local civilian market segments are attributable to a general increase in demand for our products in those markets, especially in South America.

Gross Profit. Gross profit for the three months ended September 30, 2010 was $1.7 million compared to $716,000 for the three months ended September 30, 2009. Our gross profit margin for the three months ended September 30, 2010 increased to 26.1% compared to 20.2% for the three months ended September 30, 2009. The increase in gross profit margin is primarily attributable to the 85.2% increase in revenues while our cost of sales increased by only 71.4%, which is primarily due to our fixed costs that are not revenue dependent.

Selling Expenses. Selling expenses for the three months ended September 30, 2010 increased by 200.2% to $461,000 from $153,000 for the three months ended September 30, 2009. The increase in our selling expenses was attributable primarily to the increase in export sales commissions.

General and Administrative Expenses. General and administrative expenses for the three months ended September 30, 2010 increased by 14.6% to $631,000 from $551,000 for the three months ended September 30, 2009. This increase is primarily attributable to an increase in professional services expenses.

Compensation from Israeli Government. In the second quarter of 2009, our subsidiaries Export Erez and Mayotex received a total of $224,000, as compensation from the Israeli Government under the "Property tax and compensation payments for war damages" regulations, for the loss of employment days and potential revenues during the last two years due to the security and military situation in the area in which Export Erez and Mayotex are located. We recorded approximately $4,500 of income due to exchange rate differences in the third quarter of 2009 with respect to the compensation received from the Israeli Government. .

Financial Income (Expenses), Net. We had financial expenses, net of $313,000 for the three months ended September 30, 2010 compared to financial expenses, net of $255,000 for the three months ended September 30, 2009. Our financial expenses are primarily due to the change in the U.S. dollar exchange rate versus the NIS, which resulted in a loss of $304,000 for the three months ended September 30, 2010 compared to a loss of $255,000 for the three months ended September 30, 2009.

Other Income, Net. We had other income, net for the three months ended September 30, 2010 of $10,000 as compared to other income, net of $72,000 for the three months ended September 30, 2009. Our other income in the three months ended September 30, 2010 is attributable to a $11,000 gain derived from the revaluation of funds in respect of employee rights upon retirement, which was offset by a small loss derived from the sale of tradable securities and a small unrealized gain on tradable securities. Our other income in the three months ended September 30, 2009 is attributable to a $30,000 gain derived from the revaluation of funds in respect of employee rights upon retirement, a $9,000 gain derived from sales of tradable securities and a $33,000 unrealized gain on tradable securities.

Income Tax Benefit. We recorded an income tax benefit of $3,000 for the three months ended September 30, 2010 compared to an income tax benefit of $17,000 for the three months ended September 30, 2009. The decrease in the income tax benefit was mainly due to increased income before income taxes in the three months ended September 30, 2010 compared to the loss before income taxes in the three months ended September 30, 2009

Net Income (Loss). For the three months ended September 30, 2010, our consolidated net income was $325,000 compared to a net loss of $150,000 for the three months ended September 30, 2009.

Nine Months Ended September 30, 2010 Compared with Nine Months Ended September 30, 2009

Net Revenues. Net revenues for the nine months ended September 30, 2010 decreased to $12.5 million from $12.9 million in the nine months ended September 30, 2009, an decrease of 3.7%. The decrease is mainly attributable to an decrease in revenues from our local military market segment. In the period ended September 30, 2010, revenues from our local military market segment decreased by approximately $2.3 million due to a decrease in demand for our products. This decrease was offset by a increase of approximately $1.4 million in our local civilian market segment and an increase of approximately $300,000 in our export civilian market segment.

Gross Profit. Gross profit for the nine months ended September 30, 2010 was $2.5 million compared to $3.0 million for the nine months ended September 30, 2009. This decrease in gross profit is primarily attributable to the decrease in sales. Our gross profit margin for the nine months ended September 30, 2010 decreased to 20% compared to 22.9% for the nine months ended September 30, 2009 due to the change in the mix of products sold and the impact of our fixed costs that are not revenue dependent.

Selling Expenses. Selling expenses for the nine months ended September 30, 2010 increased by 63.4% to $793,000 from $486,000 for the nine months ended September 30, 2009. The increase in our selling expenses was primarily attributable to increased commissions due to a different mix of products sold and an increase in sales through agents.

General and Administrative Expenses. General and administrative expenses for the nine months ended September 30, 2010 increased by 32.1% to $2 million from $1.5 million for the nine months ended September 30, 2009. This increase is primarily attributable to an increase in professional services expenses.

Compensation from Israeli Government. In the second quarter of 2009, Export Erez and Mayotex received a total of $224,000 as compensation from the Israeli Government under the "Property tax and compensation payments for war damages" regulations, for the loss of employment days and potential revenues during the last two years due to the security and military situation in the area in which Export Erez and Mayotex are located. We recorded $4,000 of income due to exchange rate differences in the third quarter of 2009 with respect to the compensation received from the Israeli Government.

Financial (Expenses), Net. We had financial expenses, net of $161,000 for the nine months ended September 30, 2010 compared to financial expenses, net of $38,000 for the nine months ended September 30, 2009. Our financial expense is primarily due to the change in the U.S. dollar exchange rate versus the NIS, which resulted in a loss of $170,000 for the nine months ended September 30, 2010 compared to a loss of $98,000 for the nine months ended September 30, 2009.

Other Income, Net. We had other income, net for the nine months ended September 30, 2010 of $101,000 as compared to other income, net of $293,000 for the nine months ended September 30, 2009. Our other income in the nine months ended September 30, 2010 is mainly attributable to the revaluation of funds in respect of employee rights upon retirement of $20,000, an unrealized gain of $59,000 on tradable securities and a gain of $23,000 from the dissolution of Dragonwear. Our other income in the nine months ended September 30, 2009 was mainly attributable to revaluation of funds in respect of employee rights upon retirement of $112,000 a gain derived from sales of tradable securities of $34,000 and an unrealized gain of $148,000 on tradable securities.

Income Tax Expense. Our income tax expense for the nine months ended September 30, 2010 was $5,000 compared to income tax expense of $341,000 for the nine months ended September 30, 2009. The decrease in income tax expense was mainly due to the decrease in our income before income taxes in the nine months ended September 30, 2010.

Net Income(Loss) . In the nine months ended September 30, 2010 our consolidated net loss was $402,081 compared to net income of $1.1 million for the nine months ended September 30, 2009.

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 current economic climate and the 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 September 30, 2010, we had $3.1 million in cash and cash equivalents, $2.0 million in trading securities and working capital of $10.3 million as compared to $3.8 million in cash and cash equivalents, $2.3 million in trading securities and working capital of $10.2 million at December 31, 2009.

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

Subsequent Event

On October 27, 2010, our subsidiary Mayotex Ltd., or Mayotex, entered into an agreement to purchase shares of Mayo-Ben Investments and Development Ltd., or Mayo-Ben. Pursuant to the agreement, Mayotex agreed to invest up to $1.5 million in Mayo-Ben, a real estate company holding industrial properties in Israel which are partially occupied by the Company's subsidiaries, in consideration for the purchase of approximately 20 per cent of the share capital of Mayo-Ben on a fully diluted basis. The subscription price is subject to adjustment based on an appraisal of the properties to be conducted by a major accounting firm in Israel.

Mayotex also agreed to lend Mayo-Ben $1 million, which funds will be utilized by Mayo-Ben to improve and renovate its industrial properties, subject to and upon the terms of the agreement. Within the framework of a recent amendment to the Evacuation Compensation Law, under which several of our subsidiaries received compensation for their forced evacuation from the Gaza Strip area, such subsidiaries are eligible to apply for additional compensation under such law, subject to certain requirements, including investment in the factories and properties to which they moved their activities and businesses, such as the properties held by Mayo-Ben. We expect that a portion of the grants, if any, to be received from the Israeli government within the above framework, will be used (subject to the amount granted), with the funds to be invested by Mayo-Ben, for renovations and improvements to the properties occupied by the Company's subsidiaries and will entitle the Company's subsidiaries to apply for additional grants and tax benefits.

The Company has agreed to forgive the loan in the event that Mayo-Ben invests at least $1 million in the renovation and improvement of the properties in accordance with a renovation plan agreed to by both parties and to the complete satisfaction of the Company within a three (3) year period commencing on the first closing date of the transaction, of which at least $200,000 must be spent for such renovations prior to August 30, 2011.

Cash Flows

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

| | Nine months ended September 30, 2010 | Nine months ended September 30, 2009 |
|---|---|---|
| Net cash provided by (used in) operating activities | $(761,329) | $ 1,587,773 |
| Net cash provided by (used in) investing activities | (181,130) | 2,042,210 |
| Net cash used in financing activities | 132,653 | (1,695,666) |
| Net (decrease) increase in cash and cash equivalents | (682,373) | 2,155,409 |
| Cash and cash equivalents at beginning of period | 3,783,631 | 1,719,921 |
| Cash and cash equivalents at end of period | $3,101,258 | $3,875,330 |

Operating activities. Net cash used in operating activities was $761,000 for the nine months ended September 30, 2010 as compared to $1.6 million provided by operating activities in the nine months ended September 30, 2009. This was primarily due to our net loss of $402,000, an increase in accounts receivable of $913,000, a decrease in other current liabilities of $261,000, an increase in other current assets of $273,000, a decrease in related parties accounts of 425,000 and a increase in inventories of $190,000, offset by an increase in accounts payable of $937,000 and a decrease in trading securities of $419,000. The $1.6 million provided by operating activities in the 2009 period was primarily provided from net income of $1.1 million, a decrease in accounts receivable of $429,000, a decrease in inventories of $505,000 and a decrease in trading securities of $276,000, offset by a decrease in accounts payable of $228,000 and a decrease in other current liabilities of $690,000.

Investing activities. Net cash used in investing activities was $181,000 for the nine months ended September 30, 2010 as compared to $2.0 million provided by investing activities in the nine months ended September 30, 2009. During the nine months ended September 30, 2010, $174,000 was used to purchase fixed assets and $14,000 was used for the purchase of a business. During the nine months ended September 30, 2009, $3.0 million was provided from the redemption of bank deposits, $52,000 was provided from the sale of fixed assets, $91,000 was used to purchase fixed assets and $919,000 was used for the purchase of a business.

Financing activities. Net cash provided in financing activities was $133,000 for the nine months ended September 30, 2010 as compared to $1.7 million used in financing activities for the nine months ended September 30, 2009. During the nine months ended September 30, 2010, we incurred additional short-term debt of $233,000 and long-term debt of $125,000, which was offset by the repayment of $225,000 of long-term debt. During the nine months ended September 30, 2009, we incurred additional short-term debt of $231,000, repaid $264,000 of long-term debt and paid $1.2 million to related parties for the purchase of their minority interest in Achidatex and 1,050,000 of our Company's shares held by them..

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 nine months ended September 30, 2010, inflation in Israel was 1.9% while the NIS appreciated in relation to the U.S. dollar at a rate of 2.9%. 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 or hedging transactions in the nine months ended September 30, 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 third quarter, 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 September 30, 2010.

| Contractual Obligations | Payments due by Period | | | | |
|---|---|---|---|---|---|
| | Total | Less than 1 year | 2 -3 years | 4 -5 years | more than 5 years |
| Long-term debt obligations | $466,748 | $232,620 | $224,745 | $9,383 | $ -- |
| Estimated interest payments on long-term debt obligations …….. | 29,478 | 18,913 | 10,401 | 164 | -- |
| Operating lease obligations | 646,986 | 486,164 | 160,822 | - | -- |
| Total | $1,143,212 | $737,697 | $395,968 | $9,547 | $ -- |

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 nine months ended September 30, 2010.

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 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 nine months of 2010, the U.S dollar depreciated by approximately 2.9% in relation to the NIS.

Changes in Market Risk

The ongoing global recession, driven initially by the crisis in global credit and financial markets, has severely diminished liquidity and credit availability, declines in consumer confidence, increases in unemployment rates, and uncertainty about economic stability. There can be no assurance that there will not be further deterioration in credit and financial markets and confidence in economic conditions. These economic uncertainties affect businesses such as ours in a number of ways, making it difficult to accurately forecast and plan our future business activities. The current constriction of credit in financial markets may continue to lead governments and businesses to postpone spending.

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 September 30, 2010 that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting. . The company has hired the services of an external controller for the purposes of assisting the Company with preparation of the financial reports.

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## PART II - OTHER INFORMATION:

### Item 1.Legal Proceedings

On February 11, 2009, a lawsuit was filed in the Jerusalem District Court (the "Court") against the Company's subsidiaries, Export Erez USA Inc. and, Achidatex, and the then chief executive officer of Achidatex, Mr. Avraham Hatzor. Export Erez was subsequently added as a defendant in the action. 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 $2.77 million). The Company’s subsidiaries 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. Achidatex also filed a petition to strike the claim against Mr. Hatzor 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. Hatzor and Export Erez USA Inc. and, therefore, no cause of action against them exists. This petition is pending. The Company intends to vigorously defend against the lawsuit. Due to the preliminary stage of the lawsuit, management and its legal advisors cannot currently assess the outcome or possible adverse effect of the lawsuit on the Company’s financial position or results of operations.
On 12 July 2010, a lawsuit was filed in the Tel-Aviv Regional Labor Court (the "Labor Court") against the Company, its subsidiaries Mayotex and Export Erez (the "Group") and against an officer of the Group, by a former employee. The plaintiff alleges that the Group breached her employment agreement and violated certain Israeli labor related legislation, by not paying her severance payment, payment in lieu of vacation, recuperation payments, contribution to Study Fund, due to her claiming to being subject to sexual harassment and consequently violation of certain applicable Israeli legislation, not making the payments due to the employee during the prior notice period and compensation for overtime. The amount claimed under the above claim is NIS 1,472,035 ($379,880). The Company believes that the amounts sought are exaggerated and that the exposure, if any, to the lawsuit, is not material to the business of the Company. The Company intends to vigorously defend its position. The Labor Court has imposed a gag order on the parties to the lawsuit.

### Item 1A. Risk Factors

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

### Item 6.Exhibits

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

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.

SIGNATURE

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: November 15, 2010 | /s/Uri Nissani<br>Uri Nissani<br>Chief Executive Officer and President |