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DEFENSE INDUSTRIES INTERNATIONAL INC  
Form 10QSB  
November 15, 2004

U.S. SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-QSB

- Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2004
- Transition report under Section 13 or 15(d) of the Exchange Act for the transition period from \_\_\_ to \_\_\_

Commission file number: 1-9009

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

NEVADA  
(State of Incorporation)

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

INDUSTRIAL ZONE EREZ, P.O. BOX 779, ASHKELON 78101, ISRAEL  
(Address of Principal Executive Offices)

(011) 972-7-689-1611  
(Issuer's Telephone Number, Including Area Code)

-----  
(Former Name, Former Address and Former Fiscal Year,  
if Changed Since Last Report)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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

APPLICABLE ONLY TO CORPORATE ISSUERS

As of November 12, 2004 the Issuer had 25,350,000 shares of Common Stock, \$.0001 par value per share, outstanding.

Transitional Small Business Disclosure Format (check one):

Yes  No

DEFENSE INDUSTRIES INTERNATIONAL, INC. AND SUBSIDIARIES

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## DEFENSE INDUSTRIES INTERNATIONAL, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS

### PART I - FINANCIAL INFORMATION

#### ITEM 1.

#### ASSETS

	September 30, 2004 (Unaudited) -----	December 31, 2003 -----
CURRENT ASSETS		
Cash and cash equivalents	\$ 581,861	\$ 784,026
Trade accounts receivable, net of allowance for doubtful accounts of \$89,084 and \$68,345, respectively	2,915,028	1,912,747

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Trade accounts receivable - related parties, net	391,899	322,373
Inventory	2,324,532	2,115,825
Investment in marketable securities	697,949	704,046
Deferred taxes	47,969	45,353
Other assets	464,882	422,489
	-----	-----
Total Current Assets	7,424,120	6,306,859
	-----	-----
PROPERTY, PLANT AND EQUIPMENT, NET	1,607,466	1,662,902
	-----	-----
OTHER ASSETS		
Deposits for the severance of employer-employee relations	431,590	437,963
Deferred taxes, long-term	45,610	232,713
Intangible assets	32,630	41,105
	-----	-----
Total Other Assets	509,830	711,781
	-----	-----
TOTAL ASSETS	\$9,541,416	\$8,681,542
	=====	=====

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

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DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

LIABILITIES AND SHAREHOLDERS' EQUITY

		September 30, 2004 (Unaudited)
		-----
CURRENT LIABILITIES		
Trade accounts payable		\$ 754,801
Short-term debt		498,673
Current portion of long-term debt		414,400
Accrued expenses		499,467
Other liabilities		515,317
		-----
Total Current Liabilities		2,682,658
		-----
LONG-TERM LIABILITIES		
Long-term portion of debt		803,572
Provision for the severance of employer-employee relations		299,641

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Minority interest	883,562
	-----
Total long-term Liabilities	1,986,775
	-----
TOTAL LIABILITIES	4,669,433
	-----
COMMITMENTS AND CONTINGENCIES	
SHAREHOLDERS' EQUITY	
Preferred stock, \$.0001 par value, 50,000,000 shares authorized, none issued and outstanding	--
Common stock, \$.0001 par value, 250,000,000 shares authorized, 25,350,000 issued and outstanding	2,535
Additional paid-in capital	1,711,450
Retained earnings	3,449,523
Accumulated other comprehensive loss	(291,525)
	-----
Total Shareholders' Equity	4,871,983
	-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 9,541,416
	=====

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

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DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND OTHER  
COMPREHENSIVE INCOME (LOSS)  
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003  
(UNAUDITED)

	For the Three Months Ended September 30, 2004	For the Three Months Ended September 30, 2003	Fo Mo
	-----	-----	-----
NET REVENUES	\$ 3,181,111	\$ 1,960,300	\$
COST OF SALES	2,027,699	1,464,340	
	-----	-----	
GROSS PROFIT	1,153,412	495,960	
	-----	-----	

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OPERATING EXPENSES			
Selling	222,231	210,417	
General and administrative	367,941	335,160	
	-----	-----	
TOTAL OPERATING EXPENSES	590,172	545,577	
	-----	-----	
INCOME FROM OPERATIONS	563,240	(49,617)	
	-----	-----	
OTHER INCOME (EXPENSE)			
Financial (expense), net	(47,787)	(42,699)	
Other income (expense) - net	(39,947)	71,275	
	-----	-----	
Total Other Income (Expense)	(87,734)	28,576	
	-----	-----	
INCOME (EXPENSE) BEFORE INCOME TAXES	475,506	(21,041)	
Less: Income tax expense (benefit)	212,583	(59,827)	
	-----	-----	
INCOME BEFORE MINORITY INTEREST	262,923	38,786	
Minority interest (income) loss	(13,515)	2,102	
	-----	-----	
NET INCOME	\$ 249,408	\$ 40,888	\$
	=====	=====	=====
OTHER COMPREHENSIVE INCOME (LOSS)			
Foreign currency translation gain (loss), net of minority interest portion	6,275	83,692	
Unrealized gain (loss) on available-for-sale securities	-	(109,730)	
	-----	-----	
Other comprehensive income (loss) before tax	6,275	(26,038)	
Income tax (expense) benefit related to items of other comprehensive income	(2,196)	9,374	
	-----	-----	
TOTAL OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX	4,079	(16,664)	
	-----	-----	
COMPREHENSIVE INCOME	\$ 253,487	\$ 24,224	\$
	=====	=====	=====
Net income per share - basic and diluted	\$ 0.01	\$ -	\$
	=====	=====	=====
Weighted average number of shares outstanding during the period - basic and diluted	25,350,000	25,350,000	
	=====	=====	

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

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	For The Nine Months Ended September 30, 2004 -----	For The Nine Months Ended September 30, 2003 -----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	\$ 681,742	\$ 142,604
Adjustments to reconcile net income to net cash provided by used in operating activities:		
Depreciation and amortization	211,125	222,187
Provision for doubtful accounts	13,470	7,064
Net realized and unrealized gain on marketable securities	(17,950)	(97,290)
Decrease (increase) in deferred taxes	184,487	(11,240)
Gain on sale of property, plant and equipment	(1,109)	---
Stock issued for services	---	43,000
Minority interest in income of subsidiary	39,413	5,082
CHANGES IN OPERATING ASSETS AND LIABILITIES:		
Decrease (increase) in deposits for employee severance	6,373	(48,578)
Increase in trade accounts receivable	(1,085,278)	(201,870)
Increase in other assets	(42,393)	(117,697)
Increase in inventory	(208,707)	(759,943)
Decrease in trade accounts payable	24,241	106,170
Increase in accrued expenses	227,364	3,352
Increase (decrease) in other liabilities	183,906	(88,740)
Increase (decrease) in provision for the severance of employer-employee relations	9,068	(21,353)
	-----	-----
Net Cash Provided By (Used In) Operating Activities	225,752	(817,252)
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(161,077)	(66,128)
Proceeds from sale of marketable securities	201,948	781,685
Proceeds from sale of property, plant and equipment	1,109	---
Purchases of marketable securities	(194,086)	(759,366)
Funds advanced on behalf of shareholder	---	380,986
	-----	-----
Net Cash (Used In) Provided By Investing Activities	(152,106)	337,177
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Short-term debt, net	(220,969)	252,335
Payments on long-term debt	(373,821)	(268,489)
Proceeds from long term loans	401,598	---
	-----	-----
Net Cash Used In Financing Activities	(193,192)	(16,154)
	-----	-----
EFFECT OF CHANGES IN EXCHANGE RATES ON CASH	(82,619)	138,937
	-----	-----
NET DECREASE IN CASH AND CASH EQUIVALENTS	(202,165)	(357,292)
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	784,026	831,820
	-----	-----
CASH AND CASH EQUIVALENTS - END OF PERIOD	\$ 581,861	\$ 474,528
	=====	=====

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INTEREST PAID	\$ 97,039	\$ 147,308
	=====	=====
TAXES PAID	\$ 137,781	\$ 112,895
	=====	=====

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

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DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF SEPTEMBER 30, 2004  
(UNAUDITED)

NOTE 1 BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

(A) BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements are presented in United States dollars under accounting principles generally accepted in the United States of America.

(B) PRINCIPLES OF CONSOLIDATION

The condensed consolidated financial statements include the accounts of Defense Industries International, Inc. and its wholly owned subsidiaries, Export Erez, USA, Inc., Export Erez, Ltd., Mayotex, Ltd. and Dragonwear Trading Ltd. and its 76% owned subsidiary Achidatex Nazareth Elite (collectively, the "Company"). The minority interest represents the minority shareholders' proportionate share of Achidatex.

All intercompany accounts and transactions have been eliminated in consolidation.

(C) USE OF ESTIMATES

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that effect the reported amounts of assets and liabilities and disclose the nature of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

(D) PER SHARE DATA

Basic net income per common share is computed based on the weighted average number of common shares outstanding during the period. Diluted net income per common share is computed based on the weighted average number of common shares and common stock equivalents outstanding during the period. There were no common stock equivalents outstanding during the periods presented. Accordingly, a reconciliation between basic and diluted earnings per share is not presented.

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## (E) INTERIM CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements as of and for the three and nine months ended September 30, 2004 and 2003 are unaudited. In the opinion of management, such condensed consolidated financial statements include all adjustments (consisting only of normal recurring accruals) necessary for the fair presentation of the consolidated financial position and the consolidated results of operations. The consolidated results of operations for the nine months ended September 30, 2004 and 2003 are not necessarily indicative of the results to be expected for the full year. The consolidated balance sheet information as of December 31, 2003 was derived from the audited consolidated financial statements included in the Company's Annual Report Form 10-KSB. The interim condensed consolidated financial statements should be read in conjunction with that report.

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DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF SEPTEMBER 30, 2004  
(UNAUDITED)

## (F) RECENT ACCOUNTING PRONOUNCEMENTS

In March 2004, the U.S. Securities and Exchange Commission's Office of the Chief Accountant and the Division of Corporate Finance released Staff Accounting bulletin ("SAB") No. 105, "Loan Commitments Accounted for as Derivative Instruments". This bulletin contains specific guidance on the inputs to a valuation-recognition model to measure loan commitments accounted for at fair value, and requires that fair-value measurement include only differences between the guaranteed interest rate in the loan commitment and market interest rate, excluding any expected future cash flows related to the customer relationship or loan servicing. In addition, SAB105 requires the disclosure of the accounting policy for loan commitments, including methods and assumptions used to estimate the fair value of loan commitments, and any associated hedging strategies. SAB 105 is effective for derivative instruments entered into subsequent to March 31, 2004 and should also be applied to existing instruments as appropriate. The Company has not yet completed its evaluation of SAB 105, but does not anticipate a material impact on the consolidated financial statements.

## NOTE 2 INVENTORY

Inventory consisted of the following:

	September 30, 2004	December 31, 2003
	-----	-----
Raw materials	\$1,447,014	\$1,175,453
Work in process	638,614	796,100
Finished goods	238,904	144,272
	-----	-----
	\$2,324,532	\$2,115,825
	=====	=====



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## NOTE 3 LONG-TERM LOANS

On May 31, 2004, the Company executed two promissory notes with a financial institution, each for \$88,948 for aggregate proceeds of \$177,896. Payments on the notes are due monthly through January 2009. Interest on the notes is also due monthly and accrues at LIBOR plus 1.2%. As of September 30, 2004, the balance of the notes was \$171,271 of which \$33,199 was short-term.

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DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF SEPTEMBER 30, 2004  
(UNAUDITED)

On August 6, 2004, the Company executed another promissory note with a financial institution for aggregate proceeds of \$223,110. Payments on the note are due monthly through September 2009. Interest on the note is also due monthly and accrues at LIBOR plus 1.25%. As of September 30, 2004, the balance of the note was \$220,023 of which \$48,727 was short-term.

## NOTE 4 SEGMENT INFORMATION AND CONCENTRATIONS

The Company has two strategic business units: the civilian market and the military market. The military market is further broken down between local and export sales in order to better analyze trends in sales and profit margins. The Company does not allocate assets between segments because several assets are used in more than one segment and any allocation would be impractical.

### (A) SALES AND INCOME FROM OPERATIONS:

	Civilian Local -----	Military Local -----	Military Export -----	Consolidated -----
September 30, 2004				
Net sales	\$1,194,140	\$1,489,255	\$7,070,520	\$9,753,915
Income from operations	176,851	277,123	855,087	1,309,061
September 30, 2003				
Net sales	\$1,923,639	\$2,155,768	\$3,001,295	\$7,080,702
Income from operations	73,140	89,664	153,270	316,074

### (B) SINGLE CUSTOMERS EXCEEDING 10% OF SALES:

For the Nine Months Ended September 30,	For the Nine Months Ended September 30,
---	---

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	2004 -----	2003 -----
Sales		
Customer A (Military Local)	\$ ---	\$1,484,357
Customer B (Military Export)	\$3,973,159	\$ ---

## NOTE 5 COMMITMENTS AND CONTINGENCIES

As part of its current plans for the West Bank, the Israeli Government has determined to remove Israeli residents from the Erez Industrial Zone, where one of the Company's subsidiaries is currently located. The Company intends to move the operations of its subsidiary to a local governmental recognized development zone. Companies located in development zones are entitled to significant governmental benefits.

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DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF SEPTEMBER 30, 2004  
(UNAUDITED)

The Company is currently negotiating a lease of approximately 15,000 square foot space in an industrial building in Shderot, a local governmental recognized development zone, which is owned by Mr. Fostbinder, the Company's Chief Executive Officer and Chairman of its board of directors. In the event the Company enters into such a lease, this space will accommodate part of the operations of the subsidiary currently located in the Erez Industrial Zone, and the remainder of its operations will be relocated to the Company's facilities in the Nazareth Elite industrial area, in accordance with a sub lease agreement with one of the Company's subsidiaries.

The cost of relocating these operations is indeterminable at this time. The Company does not believe the relocation will materially impact its consolidated financial statements.

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DEFENSE INDUSTRIES INTERNATIONAL, INC.  
AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
AS OF SEPTEMBER 30, 2004  
(UNAUDITED)

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

THIS INFORMATION 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

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RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2003 CONTAINED IN OUR 2003 ANNUAL REPORT ON FORM 10-KSB. 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

### CRITICAL ACCOUNTING POLICIES

We have identified the following policies as critical to the understanding of our condensed consolidated financial statements. The preparation of our condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of sales and expenses during the reporting periods. Our condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America.

REVENUES AND REVENUE RECOGNITION. Revenues from sales of products are recognized under the completed contract method upon shipment to customers. The contracts are short term, generally under two months. We provide a warranty on goods ranging from three to four years. Our policy is to consider the establishment of a reserve for warranty expenses. Based upon historical experience of no warranty claims, we have not established a reserve at September 30, 2004. If we change any of our assumptions with regard to our recognition of revenues under the completed contract method of revenue recognition, or if there is a change with respect to warranties expenses, our financial position and results of operations may change materially.

FOREIGN CURRENCY TRANSLATION AND TRANSACTIONS. The functional currency of Export Erez, Ltd., Mayotex Ltd., and Achidatex Nazareth Elite is the New Israeli Shekel, or NIS. The functional currency of Dragonwear Trading Ltd. is the Cyprus Pound, or CYP. The financial statements of Dragonwear are translated into NIS. The financial statements for all of these entities are then translated into U.S. dollars from NIS at period-end exchange rates as to assets and liabilities and average exchange rates as to revenues and expenses. Capital accounts are translated at their historical exchange rates when the capital transactions occurred. Foreign currency transaction gains or losses from transactions denominated in currencies other than NIS are recognized in net income in the period the gain or loss occurs. Any change in exchange rates may have a material impact on our financial position and results of operations.

INVENTORIES. Inventories are valued at the lower of cost or market value using the first-in first-out method. The cost includes expenses of freight-in transportation. The specific identification method is used for finished goods since all orders are custom orders for customers. Inventories write-offs and write-down provisions are provided to cover risks arising from slow-moving items or technological obsolescence. Any change in our assumptions with respect to the need to write-off or write-down the value of our inventories may have a material affect on our financial position or results of operations.

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PROPERTY, PLANT AND EQUIPMENT. Fixed assets are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of three to twenty-five years. These long-lived assets are generally evaluated on an individual basis in making a determination as to whether such assets are impaired. Periodically, we review our long-lived assets for impairment based on estimated future non-discounted cash flows attributed to the assets. In the event such cash flows are not expected to be sufficient to recover the recorded value of the assets, the assets are written down to their estimated fair values. The use of different assumptions with respect to the expected cash flows from our assets and other economic variables may lead to different conclusions regarding the recoverability of our assets' carrying values and to the potential need to record an impairment loss for our long - lived assets.

### OVERVIEW

Defense Industries International, Inc. is a manufacturer and global provider of military and civilian protective personal 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 principal products include body armor, bulletproof clothing and combat vests, bomb disposal suits, battle pouches and combat harness units, flak jackets, ballistic helmets, dust protectors, padded coats, sleeping bags, weapons straps and belts, dry storage units, liquid logistics products, ceramic ballistic plates, ballistic wall coverings, tents, vehicle covers and lightweight vehicle armor kits for trucks and vans. Our recently introduced minefield protection shoes are now being evaluated by governmental authorities. Products under development include stab-resistant solutions and polyethylene ballistic plates. We are continuing to upgrade our lightweight vehicle armor kits.

Our strategic objective is to be a leading global provider of military and civilian personal protective equipment and supplies. We intend to realize our strategic objective through the following:

- o CAPITALIZE ON EXPOSURE TO MILITARY PROBLEMS. We believe that the events of September 11, 2001, the subsequent "War on Terrorism", the increasing likelihood of military conflicts abroad, and recent actual events where lives have been saved due to the performance of armor systems, are all likely to result in additional interest in our products.
  
- o EXPAND DISTRIBUTION, NETWORKS AND PRODUCT OFFERINGS. We expect to continue to leverage our distribution network by expanding our range of branded law enforcement equipment through the acquisition of niche defensive security products manufacturers and by investing in the development of new and enhanced products which complement our existing offerings. A broader product line will strengthen our relationships with distributors and enhance our brand appeal with military, law enforcement and other end users.
  
- o PURSUE STRATEGIC ACQUISITIONS. We intend to selectively pursue strategic acquisitions that complement and/or expand our product offerings, provide access to new geographic markets, and provide

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additional distribution channels and new customer relations.

### OTHER MATERIAL CONSIDERATIONS

As part of its current plans for the West Bank, the Israeli Government has determined to remove Israeli residents from the Erez Industrial Zone, where one of our subsidiaries is currently located. We intend to move the operations of our subsidiary to a local governmental recognized development zone. Companies located in development zones are entitled to significant governmental benefits.

We are currently negotiating a lease of approximately 15,000 square foot space in an industrial building in Shderot, a local governmental recognized development zone, which is owned by Mr. Fostbinder, our Chief Executive Officer and Chairman of the board of directors. In the event we enter such a lease, this space will accommodate part of the operations of our subsidiary currently located in the Erez Industrial Zone, and the remainder of its operations will be relocated to our facilities in the Nazareth Elite industrial area, in accordance with a sub lease agreement with one of our other subsidiaries.

We, together with the majority of the businesses located in Erez Industrial Zone, have agreed to engage a leading local law firm to negotiate the terms of our compensation with the Israeli Government. We believe that at the minimum we will be compensated for the actual expenses incurred in connection with the subsidiary relocation.

THREE MONTHS ENDED SEPTEMBER 30, 2004 COMPARED WITH THREE MONTHS ENDED SEPTEMBER 30, 2003

### RESULTS OF OPERATIONS

NET REVENUES AND GROSS PROFIT MARGIN. Net Revenues for the three months ended September 30, 2004 increased to \$3,181,111 from \$1,960,300 in the same period in 2003, an increase of 62.3%. This increase was due to increased export military sales including, sales of our recently introduced new products: ballistic plates, blankets and lightweight vehicle armor kits. This increase in net revenues was partially offset by the continued weakness in sales to the local market.

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The following table sets forth the breakdown of sales by segment for the three months ended September 30, 2004 and 2003.

	Three Months Ended September 30,	
	2004	2003
	-----	-----
Sales to the local civilian market	\$ 654,945	\$ 717,952
Sales to the local military market	359,091	659,134
Export military sales	2,167,075	583,214
	-----	-----
Total	\$3,181,111	\$1,960,300

The trend of increased export sales is expected to continue into the fourth

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quarter. This expectation is based, among other things, on the fact that we have broadened our export customers basis.

We anticipate that our total sales in the fourth quarter will exceed our sales results in the same period in 2003.

Gross profit for the three months ended September 30, 2004 was \$1,153,412 compared to \$495,960 for the same period in 2003. This increase in gross profit is primarily attributable to the increase in overall sales.

Our gross profit margin for the three months ended September 30, 2004 was 36.3% compared to 25.3% for the same period in 2003. This increase is attributable to the increase in overseas sales which in this quarter were characterized by higher margins compared to the margins obtained on local sales. The relatively high margins were offset by: (i) the approximately 6% increase in the ratio between the Euro (which is the currency used for the majority of our raw material purchases) and the U.S. dollar (which is the principal currency for our sales); and (ii) the increased local competition arising from the decrease in the local market size. We do not anticipate any major change to our gross margin percentage during the remainder of 2004.

Our cost of sales for the three months ended September 30, 2004 was \$2,027,699 compared to \$1,464,340 for the same the same period in 2003. This increase is a result of the increase in sales.

GENERAL AND ADMINISTRATIVE EXPENSES AND SELLING EXPENSES. General and administrative expenses for three months ended September 30, 2004 increased slightly to \$367,941 from \$335,160 for the same period in 2003. Selling expenses for the three months ended September 30, 2004 were \$222,231 compared to \$210,417 for the same period in 2003. This increase is primarily due to payment of a higher rate of commissions on export sales transactions. We anticipate no material change in our general and administrative expenses, and a moderate increase in our selling expenses in the fourth quarter.

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INCOME TAX EXPENSE. Our income tax expense for the three months ended September 30, 2004 was \$212,583 as compared to a tax benefit of \$59,827 for the comparable period in 2003. Our effective tax rate was 44.7% in the 2004 period.

FINANCIAL EXPENSES. We had financial expenses, net of \$47,787 for the three month ended September 30, 2004 as compared to \$42,699 for the same period in 2003. The increase is attributable to a change in the US currency exchange rate which resulted in a decrease of our income from foreign currency deposits.

OTHER INCOME (EXPENSE), NET. We had other expenses, net for the three months ended September 30, 2004 of \$39,947 as compared to other income of \$71,275 for the same period in 2003. The decrease in other income, net is attributable to losses from our marketable securities.

MINORITY INTEREST. Minority interest in the profits and losses of one of our consolidated subsidiaries represents the minority shareholders' share of the profits or losses in such majority owned subsidiary. For the three months ended September 30, 2004, we recognized and recorded minority share in our profit of \$13,515 compared to minority share in our loss of \$2,102 for the same period in 2003.

NINE MONTHS ENDED SEPTEMBER 30, 2004 COMPARED WITH NINE MONTHS ENDED SEPTEMBER 30, 2003

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## RESULTS OF OPERATIONS

NET REVENUES AND GROSS PROFIT MARGIN. Net Revenues for the nine months ended September 30, 2004 increased to \$9,753,915 from \$7,080,702 in the same period in 2003, an increase of 37.8%. This increase was due to increased export military sales including, sales of our recently introduced new products: ballistic plates, blankets and lightweight vehicle armor kits. This increase in net revenues was partially offset by the continued weakness in sales to the local market.

The following table sets forth the breakdown of sales by market for the nine months ended September 30, 2004 and 2003.

	Nine Months Ended September30,	
	2004	2003
	-----	-----
Sales to the local civilian market	\$1,194,140	\$1,923,639
Sales to the local military market	1,489,255	2,155,768
Export military sales	7,070,520	3,001,295
	-----	-----
Total	\$9,753,915	\$7,080,702

Gross profit for the nine months ended September 30, 2004 was \$2,974,178 compared to \$1,937,976 for the same period in 2003. This increase in gross profit is primarily attributable to the increase in overall sales.

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Gross profit margin for the nine months ended September 30, 2004 was 30.5% compared to 27.4% for the same period in 2003.

Our cost of sales for the nine months ended September 30, 2004 increased to \$6,779,737 compared to \$5,142,726 for the same the same period in 2003, due to the increase in overall sales .

GENERAL AND ADMINISTRATIVE EXPENSES AND SELLING EXPENSES. General and administrative expenses for nine months ended September 30, 2004 were \$1,051,530 compared to \$1,029,214 for the same period in 2003. This slight increase is a result of the growth in our activities. Selling expenses for the nine months ended September 30, 2004 were \$613,587 compared to \$592,688 for the same period in 2003.

INCOME TAX EXPENSE. Our income tax expense for the nine months ended September 30, 2004 was \$496,284 as compared to \$65,086 for the comparable period in 2003. Our effective tax rate was 40.8% in the 2004 period compared to 30.6% in 2003. This increase in the effective tax rate was attributable to tax imposed on our company due to cancellation of a tax benefit accrued in the previous year (\$49,951).

FINANCIAL EXPENSES. We had financial expenses, net of \$110,582 for the nine

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month ended September 30, 2004 as compared to financial expenses, net of \$200,592 for the same period in 2003. The decrease is attributable to a decrease in prevailing interest rates in Israel and to the reduction in our bank liabilities.

OTHER INCOME (EXPENSE), NET. We had other income, net for the nine months ended September 30, 2004 of \$18,960 as compared to \$97,290 for the same period in 2003. The decrease in other income, net is attributable to the decrease in profits from our marketable securities.

MINORITY INTEREST. Minority interest in the profits and losses of one of our consolidated subsidiaries represents the minority shareholders' share of the profits or losses in such majority owned subsidiary. For the nine months ended September 30, 2004, we recognized and recorded a minority share in our profit of \$39,413 compared to minority share in our profit of \$5,082 for the same period in 2003.

### LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2004, we had \$581,861 in cash and cash equivalents and our working capital was \$4,741,462. Our current activities are financed by short and long-term bank loans offset by short-term deposits. Our decision to incur additional short-term debt was based on our consideration of the prevailing yields on our deposits, which are generally in foreign currency generated from receipts from overseas sales, compared to the cost of short-term loans.

Net cash provided by operating activities was \$225,752 for the nine months ended September 30, 2004. This was primarily attributable to our net income of \$681,742 and a \$411,270 increase in other liabilities, non-cash activities of \$395,612, prepaid payments by customers, accrued employees expenses, accrued taxes expenses and other accrued expenses, which was offset by among other things by a \$1,085,278 increase in trade accounts receivable, a \$24,241 decrease in trade accounts payable and a \$208,707 increase in inventory.

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The increase in accounts receivable at September 30, 2004 from December 31, 2003, was primarily the result of increased level of export sales. The increase in inventory at September 30, 2004 compared to December 31, 2003 was also due to the increased level of sales and our forecast of future sales.

Net cash used for investing activities was \$152,106 for the nine months ended September 30, 2004. During the nine months ended September 30, 2004, \$7,862 of net cash was provided from sales and purchase of marketable securities and \$161,077 was used to purchase property, plant and equipment.

Net cash used for financing activities was \$193,192 for the nine months ended September 30, 2004. During the nine months ended September 30, 2004, we increased our long term debt by \$27,777, net.

During the remainder of 2004 and into 2005, we plan to increase our research and development efforts, primarily with respect to stab-resistant solutions, mine-protective shoes, floatable ballistic vests, ballistic protection based on ceramic glass, ballistic concrete reinforcement, and modified ballistic wall coverings. We estimate total research and development expenses for the remainder of 2004 will be approximately \$50,000 and will increase to \$350,000 in 2005. We plan to finance our future research and development through an equity offering or other financing. If we are unsuccessful in securing sufficient funds, we will fund our research and development in 2005 at a slower pace of development, from



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our working capital and cash flow.

We believe that our existing capital resources are sufficient to fund our operations through 2005.

### NEW ACCOUNTING PRONOUNCEMENT

In March 2004, the U.S. Securities and Exchange Commission's Office of the Chief Accountant and the Division of Corporate Finance released Staff Accounting bulletin ("SAB") No. 105, "Loan Commitments Accounted for as Derivative Instruments". This bulletin contains specific guidance on the inputs to a valuation-recognition model to measure loan commitments accounted for at fair value, and requires that fair-value measurement include only differences between the guaranteed interest rate in the loan commitment and market interest rate, excluding any expected future cash flows related to the customer relationship or loan servicing. In addition, SAB105 requires the disclosure of the accounting policy for loan commitments, including methods and assumptions used to estimate the fair value of loan commitments, and any associated hedging strategies. SAB 105 is effective for derivative instruments entered into subsequent to March 31, 2004 and should also be applied to existing instruments as appropriate. We have not yet completed our evaluation of SAB 105, but do not anticipate a material impact on the consolidated financial statements.

### MARKET RISK

At September 30, 2004 and December 31, 2003, we held cash and cash equivalents in the aggregate amount of \$581,861 and \$784,026, respectively. Most of these amounts were deposited with Israeli banks. Under Israeli law, the Bank of Israel insures all bank deposits without limits on the amount. Therefore, we do not anticipate losses in respect to these items.

Our exposure from export sales are managed by the receipt of letters of credit or advance payments from our overseas customers or limited open accounts based on previous experience with a specific customer. The majority of our local sales are made to government institutions and private industry in Israel. Consequently, we believe the exposure to credit risks relating to trade receivables is limited.

We perform ongoing credit evaluations of our customers and generally do not require collateral. An appropriate allowance for doubtful accounts is included in trade accounts receivable.

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### FOREIGN CURRENCY EXCHANGE RISK

We develop products in Israel and sell them in South America, Asia and several European countries. 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 with respect to our sales is mitigated, and we expect it will continue to be mitigated, through salaries, materials and support operations, in which part of these costs are denominated in NIS.

During 2004, the NIS devaluated approximately 2.35% against the U.S. dollar. Among the factors contributing to the devaluation are the low interest rate for US investments compared to the higher interest rate for Israeli investments. The inflation in Israel was approximately 1.19% for the nine months

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ended September 30, 2004 compared to an annual deflation of 1.9% in 2003.

Since most of our sales are quoted in U.S. dollars, and a portion of our expenses are incurred in NIS, our results may be adversely affected by a change in the rate of inflation in Israel or if such change in the rate of inflation is not offset, or is offset on a lagging basis, by a corresponding devaluation of the NIS against the U.S. dollar and other foreign currencies.

We did not enter into any foreign exchange contracts in 2003 or the first nine months of 2004.

### CONTRACTUAL OBLIGATIONS

The following table summarizes our contractual obligations and commercial commitments as of September 30, 2004.

Contractual Obligations -----	Payments due by Period -----			
	Total -----	less than 1 year -----	2 -3 years -----	4 -5 years -----
Long-term debt obligations	\$1,217,973	\$ 414,400	\$ 564,064	\$ 234,231
Capital (finance) lease obligations	--	--	--	--
Operating lease obligations	98,275	92,875	5,400	--
Purchase obligations	--	--	--	--
Other long-term liabilities reflected on the Company's balance sheet under U.S. GAAP	--	--	--	--
Total	\$1,316,248	\$ 507,275	\$ 569,464	\$ 234,231

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### CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION AND RISK FACTORS

THIS REPORT CONTAINS FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995. WORDS SUCH AS "ANTICIPATE," "EXPECT," "INTEND," "PLAN," "BELIEVE," "SEEK," "OUTLOOK" AND "ESTIMATE" AS WELL AS SIMILAR WORDS AND PHRASES SIGNIFY FORWARD-LOOKING STATEMENTS. OUR FORWARD-LOOKING STATEMENTS ARE NOT GUARANTEES OF FUTURE RESULTS AND CONDITIONS AND IMPORTANT FACTORS, RISKS AND UNCERTAINTIES MAY CAUSE OUR ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE EXPRESSED IN OUR FORWARD-LOOKING STATEMENTS. THESE UNCERTAINTIES AND OTHER FACTORS INCLUDE, BUT ARE NOT LIMITED TO, THE FOLLOWING:

- o Our products are used in applications that are inherently risky and could give rise to product liability and other claims arising from the design, manufacture or sale of such goods. If we are found to be liable in such claim we may be required to pay substantial damages and our insurance costs may increase significantly. Moreover, our insurance coverage may not be sufficient to cover the payment of any potential claim. As a result of such claim, insurance coverage will may not be available for us. The inability to obtain product liability coverage would prohibit us from bidding for orders from certain governmental customers.

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- o Our failure or inability to comply with extensive government regulation to which we are subject could materially restrict our operations and subject us to substantial penalties.
- o Our significant international operations subject us to financial and regulatory risks.
- o Currency exchange rate fluctuations in the world markets in which we conduct business could have a material adverse effect on our business, results of operations and financial condition.
- o Reduction in military budgets worldwide may cause a reduction in our revenues.
- o Sales of our products are subject to governmental procurement procedures and practices; termination, reduction or modification of contracts with our customers, and especially with the government of Israel, or a substantial decrease in our customers' budgets may adversely affect on us.
- o The loss of one or more of our key customers would result in a loss of a significant amount of our revenues.
- o Our markets are highly competitive. Inability to compete effectively will adversely affect us.
- o Limited sources for some of our raw materials may significantly curtail our manufacturing operations.
- o Our resources may be insufficient to manage the demands imposed by any future growth.
- o Technological advances, the introduction of new products, and new design and manufacturing techniques could adversely affect our operations unless we are able to adapt to the resulting change in conditions.

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- o We may need to raise additional capital in the future, which may not be available to us.
- o Conditions in Israel affect our operations and may limit our ability to produce and sell our products, which could decrease our revenues.
- o The economic conditions in Israel have not been stable in recent years.
- o Some of our directors, officers and employees are obligated to perform annual military reserve duty in Israel. We cannot assess the potential impact of these obligations on our business.
- o Our shares of common stock are thinly traded.
- o We are subject to the penny stock rules. These rules may adversely effect trading in our common shares.
- o We do not intend to pay dividends.

ITEM 3. CONTROLS AND PROCEDURES

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Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we carried out an evaluation of the effectiveness of the design and operation of our company's disclosure controls and procedures pursuant to Rule 13a-14 of the Securities Exchange Act of 1934. Based upon that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

There have been no significant changes in our internal controls or other factors which could significantly affect internal controls subsequent to the date we carried out the evaluation.

### PART II - OTHER INFORMATION

#### DEFENSE INDUSTRIES INTERNATIONAL, INC. AND SUBSIDIARIES

##### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SHAREHOLDERS

None.

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##### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

###### (A) EXHIBITS

31.1 Certification by Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification by Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification by Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification by Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

###### (B) REPORTS ON FORM 8-K FILED DURING THE LAST QUARTER OF THE PERIOD COVERED BY THIS REPORT:

None

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### SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

DEFENSE INDUSTRIES INTERNATIONAL, INC.  
(Registrant)

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/S/ Joseph Postbinder  
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Name: Joseph Postbinder  
Chief Executive Officer

/S/ Tsippy Moldovan  
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Name: Tsippy Moldovan  
Chief Financial Officer

Date: November 15, 2004