

DEFENSE INDUSTRIES INTERNATIONAL INC  
Form 10QSB  
August 12, 2004

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

June 30,  
2004                      December 31,

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	(Unaudited)	2003
	-----	-----
CURRENT ASSETS		
Cash and cash equivalents	\$ 808,790	\$ 784,026
Trade accounts receivable, net of allowance for doubtful accounts of \$81,586 and \$68,345 respectively	2,507,755	1,912,747
Trade accounts receivable - related parties, net	334,092	322,373
Inventory	2,202,635	2,115,825
Investment in marketable securities	708,989	704,046
Deferred taxes	45,874	45,353
Other assets	413,039	422,489
	-----	-----
Total Current Assets	7,021,174	6,306,859
	-----	-----
PROPERTY, PLANT AND EQUIPMENT, NET	1,645,069	1,662,902
	-----	-----
OTHER ASSETS		
Deposits for the severance of employer-employee relations	432,404	437,963
Deferred taxes, long-term	233,903	232,713
Intangible assets	35,023	41,105
	-----	-----
Total Other Assets	701,330	711,781
	-----	-----
TOTAL ASSETS	\$9,367,573	\$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

	June 30, 2004	Decem
	(Unaudited)	20
	-----	-----
CURRENT LIABILITIES		
Trade accounts payable	\$ 636,926	\$ 7
Short-term debt	765,657	7
Current portion of long-term debt	413,030	4
Other liabilities	1,085,030	6

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Total Current Liabilities	2,900,643	2,5
LONG-TERM LIABILITIES		
Long-term portion of debt	707,394	7
Provision for the severance of employer-employee relations	281,349	2
Minority interest	868,611	8
Total long-term Liabilities	1,857,354	1,8
TOTAL LIABILITIES	4,757,997	4,4
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	1,7
Retained earnings	3,200,115	2,7
Accumulated other comprehensive loss	(304,524)	(2
Total Shareholders' Equity	4,609,576	4,2
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 9,367,573	\$ 8,6

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 SIX MONTHS ENDED JUNE 30, 2004 AND 2003  
(UNAUDITED)

	For the Three Months Ended June 30, 2004	For the Three Months Ended June 30, 2003	For the Si Months Ended June 30, 2004
	-----	-----	-----
NET REVENUES	\$ 2,826,725	\$ 1,952,258	\$ 6,572,80
COST OF SALES	1,972,198	1,404,574	4,752,03

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GROSS PROFIT	854,527	547,684	1,820,76
OPERATING EXPENSES			
Selling	270,437	193,595	391,35
General and administrative	376,892	370,705	683,58
Total Operating Expenses	647,329	564,300	1,074,94
INCOME FROM OPERATIONS	207,198	(16,616)	745,82
OTHER INCOME (EXPENSE)			
Financial (expense), net	(38,313)	(87,140)	(62,79)
Other income - net	31,709	26,015	58,90
Total Other Income (Expense)	(6,604)	(61,125)	(3,88)
INCOME BEFORE INCOME TAXES	200,594	(77,741)	741,93
Less: Income tax (Expense) benefit	(89,363)	4,334	(283,70)
INCOME BEFORE MINORITY INTEREST	111,231	(73,407)	458,23
Minority interest loss (income)	(28,121)	1,012	(25,89)
NET INCOME (LOSS)	\$ 83,110	\$ (72,395)	\$ 432,33
OTHER COMPREHENSIVE INCOME (LOSS)			
Foreign currency translation gain (loss), net of minority interest portion	29,588	71,689	(88,89)
Unrealized gain on available-for-sale securities	---	118,060	--
Other comprehensive income (loss) before tax	29,588	189,749	(88,89)
Income tax (expense) benefit related to items of other comprehensive income	(11,541)	(68,310)	31,11
TOTAL OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX	18,047	121,439	(57,78)
COMPREHENSIVE INCOME	\$ 101,157	\$ 49,044	\$ 374,55
Net income per share - basic and diluted	\$ ---	\$ ---	\$ 0.0
Weighted average number of shares outstanding during the period - basic and diluted	25,350,000	25,350,000	25,350,00

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 CASH FLOWS  
FOR THE SIX MONTHS ENDED JUNE 30, 2004 AND 2003  
(UNAUDITED)

	For The Six Months Ended June 30, 2004	For The Si Months Ende June 30, 20
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	\$ 432,334	\$ 101,717
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	145,557	146,785
Provision for doubtful accounts	3,411	---
Net realized and unrealized gain on marketable securities	(59,024)	(26,015)
Stock issued for services	---	43,000
Minority interest in income of subsidiary	25,898	7,184
Decrease (increase) in deposits for employee severance	5,559	(71,974)
(Increase) decrease in deferred taxes	(1,711)	107,543
Increase in trade accounts receivable	(610,139)	(312,930)
Decrease (increase) in other assets	9,450	(54,576)
Increase in inventory	(86,810)	(390,553)
Decrease in trade accounts payable	(93,634)	(182,815)
Increase (decrease) in other liabilities	481,516	(111,683)
(Decrease) increase in provision for the severance of employer-employee relations	(9,224)	46,406
	-----	-----
Net Cash Provided By (Used in) Operating Activities	243,183	(697,911)
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(131,906)	(52,187)
Proceeds from sale of marketable securities	146,419	183,839
Purchases of marketable securities	(110,804)	(204,743)
Funds advanced on behalf of shareholder	---	380,986
	-----	-----
Net Cash (Used in) Provided By Investing Activities	(96,291)	307,895
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from short-term debt, net	46,015	339,171
Payments on long-term debt	(243,720)	(74,102)
Proceeds from long term loans	177,896	---
	-----	-----
Net Cash (Used In) Provided By Financing Activities	(19,809)	265,069
	-----	-----
EFFECT OF CHANGES IN EXCHANGE RATES ON CASH	(102,319)	64,795
	-----	-----
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	24,764	(60,152)
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	784,026	831,820
	-----	-----

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CASH AND CASH EQUIVALENTS - END OF PERIOD	\$ 808,790	\$ 771,668
	=====	=====
INTEREST PAID	\$ 71,341	\$ 97,292
	=====	=====
TAXES PAID	\$ 72,257	\$ 101,149
	=====	=====

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  
(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

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were no common stock equivalents outstanding during the periods presented. Accordingly, a reconciliation between basic and diluted earnings per share is not presented.

### (E) INTERIM CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements as of and for the three and six months ended June 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 six months ended June 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  
(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 financial statements.

### NOTE 2 INVENTORY

Inventory consisted of the following:

	June 30, 2004	December 31, 2003
	-----	-----
Raw materials	\$1,317,051	\$1,175,453
Work in process	598,416	796,100
Finished goods	287,168	144,272
	-----	-----

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\$2,202,635      \$2,115,825  
 =====

NOTE 3 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.

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DEFENSE INDUSTRIES INTERNATIONAL, INC.  
 AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 (UNAUDITED)

(A) SALES AND INCOME FROM OPERATIONS:

	Civilian Local -----	Military Local -----	Military Export -----	Consolidated -----
June 30, 2004				
Net Sales	\$ 539,195	\$1,130,164	\$4,903,445	\$6,572,804
Income from operations	86,306	156,254	503,261	745,821
June 30, 2003				
Net Sales	\$1,205,687	\$1,496,634	\$2,418,081	\$5,120,402
Income from operations	76,252	95,563	193,877	365,692

(B) SINGLE CUSTOMERS EXCEEDING 10% OF SALES:

	For the Six Months Ended June 30, 2004 -----	For the Six Months Ended June 30, 2003 -----
Sales		
Customer A (Military Local)	\$ -	\$1,103,142
Customer B (Military Export)	\$2,822,264	\$ 642,235

NOTE 4 DEBT

On May 31, 2004, the Company executed two promissory notes with a financial



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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% annually.

### NOTE 5 COMMITMENTS AND CONTINGENCIES

There presently exists the possibility that the Israel Government will decide to evacuate the Erez Industrial Zone as part of a proposed plan to evacuate the entire Gaza Strip. The Company has begun to search for alternative locations to conduct its operations should this event occur. The Company believes that it will be able to quickly locate a suitable alternative location to conduct its operations, if and when an evacuation of the Gaza Strip occurs. If needed, the Company can shift the major part of its operation in the Erez Industrial Zone to its Achidatex subsidiary. The Company, along with other companies, is in the process of forming a group to retain counsel to represent the group for negotiations with the Israel Government regarding this matter. The Company believes that, at a minimum, it will be compensated for the actual expenses incurred in connection with the potential relocation.

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### 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 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

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experience of no warranty claims, we have not established a reserve at June 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.

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**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.

**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.

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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.

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- 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 additional distribution channels and new customer relations.

### OTHER MATERIAL CONSIDERATIONS

The Israeli Government is considering the removal of Israeli residents from the Erez Industrial Zone as part of its current plans for the West Bank, but has not made any decisions as to the actual evacuation of the zone as of the date of this report. Nevertheless, if evacuation is mandated we would be required to relocate the activities of one of our subsidiaries. The operations would likely be moved to a local governmental recognized development zone. Companies located in development zones are entitled to significant governmental benefits.

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, if and when such an event takes place. We believe that at the minimum we would be compensated for the actual expenses incurred in connection with the subsidiary relocation.

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

### RESULTS OF OPERATIONS

NET REVENUES AND GROSS PROFIT MARGIN. Net Revenues for the three months ended June 30, 2004 were \$2,826,725 compared to \$1,952,258 for the same period in 2003, an increase of 44.8%. This increase was due to increased export military sales. The increase in the export business is partially attributable to the sales of our ballistic plates, blankets and lightweight vehicle armor kits that were recently introduced as new product offerings. 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 June 30, 2004 and 2003.

	Three Months Ended June 30,	
	2004	2003
Sales to the local civilian market	\$ 282,108	\$ 784,155
Sales to the local military market	688,147	497,887
Export military sales	1,856,470	670,216

The trend of increased export sales is expected to continue into the third quarter. We anticipate that our total sales in the third quarter will exceed our sales the same quarter in 2003.

Gross profit for the three months ended June 30, 2004 was \$854,527 compared to \$547,684 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 June 30, 2004 was 30.2% compared to 28.0% 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 local sales. The relatively high margins were offset by: (i) the approximately 5% 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 shrinkage in the market. 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 June 30, 2004 was \$1,972,198 compared to \$1,404,547 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 June 30, 2004 increased slightly to \$376,892 from \$370,705 for the same period in 2003. Selling expenses for the three months ended June 30, 2004 were \$270,437 compared to \$193,595 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 or selling expenses in the third quarter.

INCOME TAX EXPENSE. Our income tax expense (benefit) for the three months ended June 30, 2004 was \$89,363 as compared to (\$4,333) for the comparable period in 2003. Our effective tax rate was 44.5% in the 2004 period.

FINANCIAL EXPENSES. We had financial expenses, net of \$38,313 for the three months ended June 30, 2004 as compared to \$87,140 for the same period in 2003. The decrease is attributable to a decrease in financing expenditures due to a decrease in prevailing interest rates in Israel.

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OTHER INCOME (EXPENSE), NET. We had other income, net for the three months ended June 30, 2004 of \$31,709 as compared to other income of \$26,015 for the same period in 2003. The increase in other income, net is attributable to 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 three months ended June 30, 2004, we recognized and recorded minority share in our profit of \$28,121 compared to minority share in our loss of \$1,012 for the same period in 2003.

SIX MONTHS ENDED JUNE 30, 2004 COMPARED WITH SIX MONTHS ENDED JUNE 30, 2003

## RESULTS OF OPERATIONS

NET REVENUES AND GROSS PROFIT MARGIN. Net Revenues for the six months ended June 30, 2004 were \$6,572,804 compared to \$5,120,402 for the same period in 2003, an increase of 28.4%. This increase resulted from an increase in our export military sales. The increase in the export business is partially attributable to our sales of ballistic plates, blankets and lightweight vehicle armor kits that were recently introduced as new product offerings. This increase in export sales was partially offset by the continued weakness of sales to the local market.

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

	Six Months Ended June 30,	
	2004	2003
Sales to the local civilian market	\$ 539,195	\$1,205,687
Sales to the local military market	1,130,164	1,496,634
Export military sales	4,903,445	2,418,081

Gross profit for the six months ended June 30, 2004 was \$1,820,766 compared to \$1,442,016 for the same period in 2003. This increase in gross profit is primarily attributable to the increase in export sales.

Gross profit margin for the six months ended June 30, 2004 was 27.7% compared to 28.2% for the same period in 2003.

Our cost of sales for the six months ended June 30, 2004 increased to \$4,752,038 compared to \$3,678,386 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 six months ended June 30, 2004 were \$683,589 compared to \$694,053 for the same period in 2003, as a result of our recently implemented budget policy. Selling expenses for the six months ended June 30, 2004 were \$391,356 compared to \$382,271 for the same period in 2003.

INCOME TAX EXPENSE. Our income tax expense for the six months ended June 30, 2004 was \$283,701 as compared to \$124,913 for the comparable period in 2003. Our effective tax rate was 38.2% in the 2004 period compared to 53.4% in 2003. This decrease in the effective tax rate was due to lower levels of non-deductible expenses for taxes.

FINANCIAL EXPENSES. We had financial expenses, net of \$62,795 for the six months ended June 30, 2004 as compared to financial expenses, net of \$157,893 for the same period in 2003. The decrease is attributable to decrease in financing expenditures due to a decrease in prevailing interest rates in Israel.

OTHER INCOME (EXPENSE), NET. We had other income, net for the six months ended June 30, 2004 of \$58,907 as compared to \$26,015 for the same period in 2003. The increase in other income, net is attributable to 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 six months ended June 30, 2004, we recognized and recorded minority share in our profit of \$25,898 compared to minority share in our profit of \$7,184 for the same period in 2003.

#### LIQUIDITY AND CAPITAL RESOURCES

As of June 30, 2004, we had \$808,790 in cash and cash equivalents and our working capital was \$4,120,531. 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 \$243,183 for the six months ended June 30, 2004. This was primarily attributable to our net income of \$432,334 and a \$481,516 increase in other liabilities, prepaid payments by customers, accrued employees expenses, accrued taxes expenses and other accrued expenses, which was offset among other things by a \$610,139 increase in trade accounts receivable, a \$93,634 decrease in trade accounts payable and a \$86,810 increase in inventory.

The increase in accounts receivable at June 30, 2004 from December 31, 2003, was primarily the result of the increased level of export sales. The increase in inventory at June 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 \$96,291 for the six months ended June 30, 2004. During the six months ended June 30, 2004, \$35,615 of net cash was provided from sales and purchases of marketable securities and \$131,906 was used to purchase property, plant and equipment.

Net cash used for financing activities was \$19,809 for the six months ended June 30, 2004, compared to net cash provided by financing activities of \$265,069 for the six months ended June 30, 2003. During the 2004 period we made \$243,720 in payments on our long term debt that was substantially offset by net proceeds from short term debt and long term loans. In the 2003 period we incurred \$339,171 in short term debt and made \$74,102 payments on our long term debt.

During the remainder of 2004 and 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 \$250,000 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 from our working capital and cash flow, at a slower pace of development.

We believe that we have sufficient funds to fund our operations during the remainder of 2004.

#### MARKET RISK

At June 30, 2004 and December 31, 2003, we held cash and cash equivalents in the aggregate amount of \$808,790 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.

#### 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 revalued approximately 9.4% against the U.S. dollar. Among the factors contributing to the revaluation are the low interest rate for US\$ investments compared to the higher interest rate for NIS investments. The inflation in Israel was approximately 1.4% for the six month ended June 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

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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 six months of 2004.

### CONTRACTUAL OBLIGATIONS

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

Contractual Obligations	Payments due by Period			
	Total	less than 1 year	2-3 years	4-5 years
Long-term debt obligations	\$1,120,424	\$ 413,030	\$ 529,250	\$ 178,144
Capital (finance) lease obligations	--	--	--	--
Operating lease obligations	127,400	116,600	10,800	--
Purchase obligations	--	--	--	--
Other long-term liabilities reflected on the Company's balance sheet under U.S. GAAP	--	--	--	--
Total	\$1,247,824	\$ 529,630	\$ 540,050	\$ 178,144

### 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:

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- 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.
- 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.



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- 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.
- 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.

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- 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

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.

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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.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

### PART II - OTHER INFORMATION

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

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

None.

##### 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.

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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

### 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)

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

By: /S/ Tsippy Moldovan

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Tsippy Moldovan  
Chief Financial Officer

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EXHIBIT 31.1

CERTIFICATION PURSUANT TO SECTION 302(A)  
OF THE SARBANES-OXLEY ACT OF 2002

I, Joseph Postbinder, certify that:

1. I have reviewed this quarterly report on 10-QSB of Defense Industries International, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) [Paragraph omitted pursuant to SEC Release Nos. 33-8238 and 34-47986]
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - (a) All significant deficiencies and material weaknesses in the design or

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operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 12, 2004

\_\_\_\_\_\*  
Joseph Postbinder  
Chief Executive Officer

\* The originally executed copy of this Certification will be maintained at the Company's offices and will be made available for inspection upon request.

EXHIBIT 31.2

### CERTIFICATION PURSUANT TO SECTION 302(A) OF THE SARBANES-OXLEY ACT OF 2002 I,

I, Tsippy Moldovan, certify that:

1. I have reviewed this quarterly report on 10-QSB of Defense Industries International, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) [Paragraph omitted pursuant to SEC Release Nos. 33-8238 and 34-47986]
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 12, 2004

\_\_\_\_\_\*  
Tsippy Moldovan  
Chief Financial Officer

\* The originally executed copy of this Certification will be maintained at the Company's offices and will be made available for inspection upon request.

EXHIBIT 99.3

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Defense Industries International, Inc. (the "Company") on Form 10-QSB for the period ending June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Joseph Postbinder, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

\_\_\_\_\_\*  
Joseph Postbinder  
Chief Executive Officer  
August 12, 2004

\* The originally executed copy of this Certification will be maintained at the Company's offices and will be made available for inspection upon request.

EXHIBIT 99.4

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002

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In connection with the Quarterly Report of Defense Industries International, Inc. (the "Company") on Form 10-QSB for the period ending June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Tsippy Moldovan, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

\_\_\_\_\_\*  
Tsippy Moldovan  
Chief Financial Officer  
August 12, 2004

\* The originally executed copy of this Certification will be maintained at the Company's offices and will be made available for inspection upon request.