

DEFENSE INDUSTRIES INTERNATIONAL INC
Form 10-Q
November 21, 2011

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

FORM 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2011

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

Commission file number: 0-30105

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

Nevada
(State or Other Jurisdiction of
Incorporation or Organization)

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

12 Hamefalsim Street, Petach Tikva 49514, Israel
(Address of Principal Executive Offices)
(011) 972-3-7168383
(Registrant's Telephone Number, Including Area Code)
N/A
(Former Name, Former Address and Former Fiscal Year,
if Changed Since Last Report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is large accelerated filer, an accelerated filer, or a non-accelerated filer. See of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

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Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if smaller reporting
company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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

DEFENSE INDUSTRIES INTERNATIONAL, INC. AND SUBSIDIARIES

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SIGNATURES

PART I - FINANCIAL INFORMATION:

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

ASSETS	September 30, 2011 (Unaudited)	December 31, 2010
CURRENT ASSETS		
Cash and cash equivalents	\$1,026,957	\$3,502,461
Trading securities	201,152	1,894,864
Accounts receivable, net of allowance for doubtful accounts of \$ 354,294, and \$368,477, respectively	2,707,113	2,324,985
Inventories	4,442,467	4,402,517
Deferred taxes	260,115	191,318
Other current assets	1,160,357	398,297
Total Current Assets	9,798,161	12,714,442
PROPERTY, PLANT AND EQUIPMENT, NET	1,987,097	1,864,346
INVESTMENT AND LOANS TO ASSOCIATED COMPANIES	1,259,459	1,274,991
OTHER ASSETS		
Funds in respect of employee rights upon retirement	765,616	881,184
Intangible assets, net	1,279,198	1,300,445
Deferred taxes	33,918	22,155
Total Other Assets	2,078,732	2,203,784
TOTAL ASSETS	\$15,123,449	\$18,057,563

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

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

LIABILITIES AND EQUITY

	September 30, 2011 (Unaudited)	December 31, 2010
CURRENT LIABILITIES		
Accounts payable	\$ 2,634,816	\$ 1,519,545
Accounts payable – related parties	14,324	156,753
Short-term debt	908,243	1,299,546
Other current liabilities	2,078,178	1,674,027
Total Current Liabilities	5,635,561	4,649,871
LONG-TERM LIABILITIES		
Long-term portion of debt	448,140	240,945
Long-term portion of minimum royalty payment to the Government of Israel	446,015	466,500
Deferred tax liability	253,696	261,866
Liability for employee rights upon retirement	833,177	967,309
Total Long-Term Liabilities	1,981,028	1,936,620
TOTAL LIABILITIES	7,616,589	6,586,491
COMMITMENTS AND CONTINGENCIES	-	-
EQUITY		
Preferred stock, \$0.0001 par value, 50,000,000 shares authorized, none issued and outstanding		
Common stock, \$0.0001 par value, 250,000,000 shares authorized, 29,200,535 shares issued and		
28,150,535 shares outstanding at September 30, 2011 and December 31, 2010	2,920	2,920
Additional paid-in capital	2,997,370	2,997,370
Treasury stock (1,050,000 shares at cost)	(252,000)	(252,000)
Retained earnings	4,141,200	7,603,276
Accumulated other comprehensive income	617,370	1,119,506
Total Equity	7,506,860	11,471,072
TOTAL LIABILITIES AND EQUITY	\$ 15,123,449	\$ 18,057,563

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

DEFENSE INDUSTRIES INTERNATIONAL, INC. AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE NINE AND THREE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010
(UNAUDITED)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2011	2010	2011	2010
NET REVENUES	\$3,815,920	\$6,581,429	\$12,002,697	\$12,462,974
COST OF SALES	3,418,660	4,865,555	9,696,945	9,974,941
GROSS PROFIT	397,260	1,715,874	2,305,752	2,488,033
OPERATING EXPENSES				
Selling	399,843	460,788	1,829,851	793,295
General and administrative	577,282	631,357	2,817,965	2,031,652
Impairment of Isorad	587,318	---	587,318	---
Total Operating Expenses	1,564,443	1,092,145	5,235,134	2,824,947
INCOME (LOSS) FROM OPERATIONS	(1,167,183)	623,729	(2,929,382)	(336,914)
OTHER (EXPENSES) INCOME				
Financial expenses	(289,045)	(330,727)	(502,884)	(216,905)
Financial income	6,436	17,857	7,359	55,715
Other income (expenses), net	13,678	10,483	(71,614)	100,694
Total Other (Expenses) Income	(268,931)	(302,387)	(567,139)	(60,496)
INCOME (LOSS) BEFORE INCOME TAXES	(1,436,114)	321,342	(3,496,521)	(397,410)
Income Tax (expenses) benefit	(17,222)	3,313	6,059	(4,671)
LOSS BEFORE SHARE IN PROFIT OF ASSOCIATED COMPANY	(1,453,336)	324,655	(3,490,462)	(402,081)
Share in profit of associated company	(9,188)	----	28,386	----
NET INCOME (LOSS)	\$(1,462,524)	\$324,655	\$(3,462,076)	\$(402,081)
Net loss attributable to controlling interest	\$(1,462,524)	\$324,655	\$(3,462,076)	\$(402,081)
Net income (loss) per share attributable to controlling interest - basic and diluted	\$(0.052)	\$0.012	\$(0.123)	\$(0.014)
Weighted average number of shares outstanding - basic and diluted	28,150,535	28,150,535	28,150,535	28,150,535

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

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010 (UNAUDITED)

	Common Stock		Treasury Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Comprehensive Income (Loss)	Total Comprehensive Income (Loss)
	Shares	Dollars	Shares	Dollars					
Balance as of January 1, 2011	29,200,535	\$2,920	1,050,000	\$(252,000)	\$2,997,370	\$7,603,276	\$1,119,506		\$11,400,000
Comprehensive loss:									
Net loss	-	-	-	-	-	(3,462,076)	-	(3,462,076)	(3,462,076)
Foreign currency translation gain	-	-	-	-	-	-	(502,136)	(502,136)	(502,136)
Total comprehensive loss								(3,964,212)	(3,964,212)
Balance as of September 30, 2011	29,200,535	\$2,920	1,050,000	\$(252,000)	\$2,997,370	\$4,141,200	\$617,370		7,500,000
Balance as of January 1, 2010	29,200,535	\$2,920	1,050,000	\$(252,000)	\$2,997,370	\$10,176,352	\$358,745		\$13,784,887
Comprehensive loss:									
Net loss	-	-	-	-	-	(402,081)	-	(402,081)	(402,081)
Foreign currency translation gain	-	-	-	-	-	-	401,577	401,577	401,577
Total comprehensive loss								\$(504)	\$(504)
Balance as of September 30,	29,200,535	\$2,920	1,050,000	\$(252,000)	\$2,997,370	\$9,774,271	\$760,322		\$13,779,863

2010

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

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DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010 (UNAUDITED)

	Common Stock		Treasury Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Comprehensive Income Loss	Total Com Shareh Eq
	Shares	Dollars	Shares	Dollars					
Balance as of July 1, 2011	29,200,535	\$2,920	1,050,000	\$(252,000)	\$2,997,370	\$5,603,724	\$1,448,258		\$9,80
Comprehensive loss:									
Net loss	-	-	-	-	-	(1,462,524)		(1,462,524)	(1,40
Foreign currency translation gain	-	-	-	-	-	-	(830,888)	(830,888)	(830
Total comprehensive loss								\$(2,293,412)	
Balance as of September 30, 2011	29,200,535	\$2,920	1,050,000	\$(252,000)	\$2,997,370	\$4,141,200	\$617,370		\$7,50
Balance as of July 1, 2010	29,200,535	\$2,920	1,050,000	\$(252,000)	\$2,997,370	\$9,449,616	\$26,907		\$12,2
Common stock issued to acquire Rizzo Inc.									
	-								
Comprehensive Income:									
Net Income						324,655		\$324,655	324,
Foreign currency translation gain	-	-	-	-	-	-	733,415	733,415	733,
								\$1,058,070	

Total
comprehensive
loss

Balance as of
September 30,

2010	29,200,535	\$2,920	1,050,000	\$(252,000)	\$2,997,370	\$9,774,271	\$760,322		13,2
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The accompanying notes are an integral part of the condensed consolidated financial statements.

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DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010 (UNAUDITED)

For the Nine Months
Ended September 30,
2011 2010

CASH FLOWS FROM OPERATING ACTIVITIES:

Net loss	\$(3,462,076)	\$(402,081)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	527,802	425,163
Gain from sale of property, plant and equipment	---	1,829
Provision for doubtful accounts	(2,321)	(14,642)
Deferred taxes	(84,479)	2,556
Net unrealized gain on trading securities	22,167	(53,966)
Gain from the disposal of Dragonwear Trading Ltd.	---	(14,001)
Gain from settlement of long- term note	---	(8,968)
Penalty for existing Isorad agreement	150,000	---
Accrued interest and exchange rate differences of long-term debt	(83,933)	479
Accrued interest and exchange rate differences on refundable deposits for the purchase of a business	---	(15,320)
Impairment of Isorad	587,318	
Equity Gains	(28,386)	---
Changes in assets and liabilities		
Decrease in accounts receivable	(354,289)	(912,700)
Increase in inventories	(62,276)	(189,693)
Decrease in trading securities	1,588,337	419,346
Decrease in related parties accounts	(136,484)	(425,233)
Increase in other current assets	(772,226)	(272,625)
Increase (decrease) in funds in respect of employee rights upon retirement	76,874	(63,255)
Increase in accounts payable	998,795	936,561
Increase (decrease) in other current liabilities	11,668	(261,004)
(Decrease) increase in liability for employee rights upon retirement	(90,297)	86,225
Net cash used in Operating Activities	(1,113,806)	(761,329)

CASH FLOWS FROM INVESTING ACTIVITIES:

Purchases of property, plant and equipment	(760,186)	(174,239)
Proceeds from sale of property, plant and equipment	---	6,891
Purchase of the Philcar business (a)	(235,502)	---
Refundable deposits for purchase of a business	---	(13,782)
Net cash used in Investing Activities	(995,688)	(181,130)

CASH FLOWS FROM FINANCING ACTIVITIES:

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(Reduction) increase in Short-term debt, net	(525,362)	232,736
Proceeds from long-term debt	317,664	124,794
Repayment of long-term debt	(214,521)	(224,877)
Redemption of related party creditors	14,233	-
Net cash (used in) provided by Financing Activities	(407,986)	132,653
EFFECT OF CHANGES IN EXCHANGE RATES ON CASH AND CASH EQUIVALENTS		
	41,976	127,433
NET DECREASE IN CASH AND CASH EQUIVALENTS	(2,475,504)	(682,373)
CASH AND CASH EQUIVALENTS – BEGINNING OF PERIOD	3,502,461	3,783,631
CASH AND CASH EQUIVALENTS – END OF PERIOD	\$1,026,957	\$3,101,258
INTEREST PAID	\$105,545	\$36,567
TAXES PAID	\$60,850	\$134,414

(a) Purchase of the Philcar business (see also Note 2):

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

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

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

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010 (UNAUDITED)

NOTE 1 BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

- A. The accompanying unaudited interim consolidated financial statements as of September 30, 2011 and for the nine month period then ended (the “interim financial statements”) were prepared in a condensed form in accordance with the instructions for Form 10-Q and, therefore, do not include all disclosures necessary for a complete presentation of financial condition, results of operations, changes in equity, cash flows and all the data and notes which are required when preparing annual financial statements, in conformity with generally accepted accounting principles accepted in the United States of America.
- B. The accounting principles used in the presentation of the interim financial statements are consistent with those principles used in the presentation of the latest annual financial statements. All significant accounting policies have been applied consistently with the year ended December 31, 2010.
- C. The preparation of the interim financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates. In the opinion of management, all adjustments considered necessary for fair presentation of the interim financial statements have been included. The results of operations for the nine month period ended September 30, 2011, are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. The interim financial statements should be read in conjunction with the Company’s annual financial statements as of December 31, 2010 and for the year then ended and the accompanying notes thereto.

D. Principles of Consolidation

The interim financial statements include the accounts of Defense Industries International, Inc., its wholly owned subsidiaries, Export Erez USA, Inc., Rizzo Inc. (doing business as Owen Mills Company), Export Erez, Ltd. (“Export Erez”), Mayotex, Ltd. (“Mayotex”), Mayosar Technologies Ltd. (“Mayosar”), Philcar Ltd. (“Philcar”), and Achidatex Nazareth Elite (1977) Ltd. (“Achidatex”). In addition, the Company holds 82% of the issued and outstanding share capital of Isorad IR Optics Ltd. (“Optics”).

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

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010 (UNAUDITED)

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

E. Per share data

Basic net income per share of common stock is computed based on the weighted average number of shares of common stock outstanding during the period. Diluted net income per share of common stock is computed based on the weighted average number of shares of common stock and common stock equivalents outstanding during the period. For each of the nine month periods ended September 30, 2011 and 2010 common stock equivalents to purchase 202,500 shares of common stock were not included in diluted income (loss) per share because their effect is anti-dilutive.

F. Fair value

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

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

- Level 1 Quoted prices in active markets for identical assets or liabilities;
- Level 2 Quoted prices in active markets for similar assets and liabilities and inputs that are observable for the asset or liability; or
- Level 3 Unobservable inputs, such as discounted cash flow models or valuations.

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

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

In addition to the assets and liabilities described above, our financial instruments also include cash, accounts receivable, other receivables, accounts payable, accounts payable to related parties, accrued expenses and other payables. The fair value of these financial instruments was not materially different from their carrying value at September 30, 2011 and December 31, 2010 due to the short-term maturity of these instruments.

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010 (UNAUDITED)

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

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

With the exception of those pronouncements stated below, there have been no recent accounting pronouncements or changes in accounting pronouncements during the nine months ended September 30, 2011, as compared to the recent accounting pronouncements described in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, that are of material significance, or have potential material significance, to the Company.

In June 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-05 for the presentation of comprehensive income thereby amending ASC220, Comprehensive Income. The amendment requires that all non-owner changes in stockholder's equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendment is effective in fiscal years beginning after December 15, 2011 and should be applied retrospectively. These amendments will not impact the presentation of our financial statements upon adoption.

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

In September 2011, the FASB issued ASU No. 2011-08, "Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment" ("ASU 2011-08"). ASU 2011-08 is intended to simplify how entities, both public and nonpublic, test goodwill for impairment. ASU 2011-08 permits an entity to first assess qualitative factors to determine whether it is "more likely than not" that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50%. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Although early adoption is permitted, the Company will adopt ASU 2011-08 as of January 1, 2012. Based on the Company's evaluation of this ASU, the adoption of ASU 2011-08 will not have a material impact on the Company's consolidated condensed financial statements.

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010 (UNAUDITED)

NOTE 2 BUSINESS COMBINATION AND CERTAIN TRANSACTIONS

1. On December 21, 2008, Mayosar, through its wholly owned subsidiary, Optics, entered into an agreement (the "Isorad Agreement") to purchase the Germanium Crystals Business of Isorad Ltd. ("Isorad"), an Israeli governmental company. The Isorad Agreement provided for the purchase of certain know-how, equipment, inventories and production activities of Germanium Crystals for lenses used in infra-red night vision system applications. After a period of uncertainty, in August 2010, Mayosar, Optics and Isorad executed an addendum to the 2008 agreement, according to which the parties confirmed the validity of the Isorad Agreement under certain conditions. On December 19, 2010 (the "Effective Date"), the Isorad Agreement was approved and became effective. Pursuant to the Isorad Agreement, Optics is to pay annual royalties to Isorad of 3% out of sales for a period of 15 years commencing the Effective Date of the Isorad Agreement, with a minimum of approximately \$133,000, payable on an annual basis during the first 18 months or until the date of completion of the transfer of the site of the Germanium Crystals Business, whichever is earlier (this payment includes a reimbursement of costs for the usage of the site and equipment in this initial period), and approximately \$53,000 per year during the years following the above initial period. Isorad also has the right to acquire 5% of the share capital of Optics on a fully diluted basis for a nominal value during an original 24-month period beginning on the Effective Date. Such right was extended until January 1, 2012. In the event of an allotment of shares representing 5% of Optics' share capital to Isorad upon the exercise by Isorad of its option, Optics will issue additional shares of Optics to Mayotex on a pro rata basis, in order for Mayotex to retain an 82% interest in Optics' share capital.

Management performed a purchase price allocation for the purchase of Isorad IR based on the fair value of the assets acquired and liabilities assumed at the date of acquisition, and concluded upon the advice of an independent valuator that no intangible assets should be recognized and the excess purchase price over the fair value of the net assets purchased should be allocated to goodwill at the date of acquisition.

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

Cash payment to Isorad (in the form of a deposit paid in January 2009)	\$698,570
Minimum guaranteed royalty payments	750,000
Total consideration	1,448,570
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Current assets (including cash and cash equivalents of \$82,947)	196,539
Property and equipment	152,284
Goodwill	1,267,000
Accounts payable and other current liabilities	(92,253)
Deferred income taxes liabilities	(75,000)
Total identifiable net assets acquired	\$1,448,570

DEFENSE INDUSTRIES INTERNATIONAL, INC.
AND SUBSIDIARY COMPANIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010 (UNAUDITED)

NOTE 2 BUSINESS COMBINATION AND CERTAIN TRANSACTIONS (Continued)

Management has identified certain changes in circumstance, including a reduction in the volume of operations of Isorad IR and a decrease in sales following the acquisition as triggering events for applying a goodwill impairment test that would, more likely than not, reduce the fair value of Isorad IR below the booked amount, based on the provisions of ASC 350-20-35-28.

Management applied the Net Realized Value (NRV) approach to estimate the fair value of Isorad IR and recognized impairment losses of \$549,933 and \$ 141,312 for goodwill and fixed assets, respectively. Additionally, we wrote off certain current assets of Isorad IR in aggregate amount of \$ 72,299.

The Companies are in the process of signing a second addendum to the Isorad agreement that will provide that the royalty payment will be postponed to a period that will start on January, 1, 2012 and that at the end of 2012, Isorad could under certain circumstances, determine to end the relationship between the parties, subject to a final payment of approximately \$150,000.

Management is of the opinion that under the circumstances, including the recognition of impairment losses for long lived assets and goodwill, it is more likely than not that the Company will determine to make a final payment of approximately \$150,000. Accordingly, the Company made a provision for such amount in our financial statements.

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

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

Fixed assets	\$22,205
Inventory	1,830
Customer lists and backlog	28,445

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

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

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NOTE 2 BUSINESS COMBINATION AND CERTAIN TRANSACTIONS (Continued)

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

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

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

Amortization cost for the five months ended September 30, 2011 for the backlog was \$15,000.

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

The pro forma information is as follows:

	For the nine Months ended September 30, 2011 Unaudited	For the nine Months ended September 30, 2010 Unaudited	For the three Months ended September 30, 2011 Unaudited	For the three Months ended September 30, 2010
Net revenues	12,144,965	13,069,135	3,815,920	6,805,458
Net loss	(3,727,151)	(801,851)	(1,469,246)	(175,289)
Basic net loss per share	(0.132)	(0.028)	(0.052)	(0.006)
Diluted net loss per share	(0.132)	(0.028)	(0.052)	(0.006)

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NOTE 2 BUSINESS COMBINATION AND CERTAIN TRANSACTIONS (Continued)

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

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

The consideration to be paid by Achidatex is NIS 42 million (approximately \$12.3 million) together with V.A.T. as required by law and 10% of the issued and outstanding share capital of the Company (2,815,053 shares of common stock). The consideration is to be paid as follows: (i) NIS 9 million (approximately \$2.6 million) to be paid to Rabintex in installments; (ii) NIS 14.5 million (approximately \$4.25 million) to be paid directly to the Banks; (iii) NIS 6.5 million (approximately \$1.9 million) to be paid to the accounts of Rabintex at the Banks for the purchase of real estate; and (iv) Achidatex agreed to take all action reasonably necessary to enable the collection of the accounts receivable under a project in Italy for the Italian army. Payment is to be guaranteed by a NIS 15 million (approximately \$4.4 million) lien on the personal protection activity assets purchased, including a floating lien on the inventory purchased in the framework of the Agreement, and a writ of guarantee from the Company's Export-Erez and Mayotex Ltd. subsidiaries. As of September 30, 2011 not all of the conditions to closing that are mentioned above had been met.

NOTE 3

INVENTORIES

Inventories of:

	September 30, 2011	December 31, 2010
Raw materials	\$ 2,388,246	\$ 3,030,442
Work in progress	646,491	607,328
Finished goods	1,407,730	764,747
	\$ 4,442,467	\$ 4,402,517

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NOTE 4 SEGMENT INFORMATION AND CONCENTRATIONS

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

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

A. Sales and income from operations:

	Civilian		Military		Consolidated
	Local	Export	Local	Export	
For the nine months ended September 30, 2011					
Revenue from sales	\$ 2,412,137	\$ 2,457,051	\$ 2,231,993	\$ 4,901,516	\$ 12,002,697
Gross Profits	496,719	794,314	201,277	813,442	2,305,752
Corporate unallocated costs					5,235,134
Loss from operations					(2,929,382)
For the three months ended September 30, 2011:					
Revenue from sales	\$ 1,025,398	\$ 492,425	\$ 662,398	\$ 1,635,699	\$ 3,815,920
Gross Profits	3,229	252,460	1,447	140,124	397,260
Corporate unallocated costs					1,564,443
Loss from operations					(1,167,183)
For the nine months ended September 30, 2010					
Revenue from sales	\$ 2,996,771	\$ 1,096,859	\$ 3,805,094	\$ 4,564,250	\$ 12,462,974
Gross Profits	531,011	282,657	767,714	906,651	2,488,033
Corporate unallocated costs					2,824,947
Income (Loss) from operations					(336,914)
For the three months ended September 30, 2010:					
Revenue from sales	\$ 1,311,624	\$ 488,141	\$ 1,129,326	\$ 3,652,338	\$ 6,581,429
Gross Profits	301,491	199,868	409,906	804,609	1,715,874
Corporate unallocated costs					1,092,145
Income from operations					623,729

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NOTE 4 SEGMENT INFORMATION AND CONCENTRATIONS (Continued)

B. Geographic Areas – revenues:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Israel	\$ 1,687,796	\$ 2,440,950	\$ 4,644,130	\$ 6,801,865
South America	185,558	2,825,282	1,645,554	3,292,725
North America	537,336	488,175	2,534,886	1,093,918
Europe and Asia	175,374	190,230	691,154	635,413
Africa	1,229,856	636,792	2,486,973	