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

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED June 30, 2010 .**

Commission file number: 0-23336

AROTECH CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**95-4302784**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1229 Oak Valley Drive, Ann Arbor, Michigan	**48108**
(Address of principal executive offices)	(Zip Code)

(800) 281-0356
(Registrant's telephone number, including area code)

(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, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer: ☐	Accelerated filer: ☐
Non-accelerated filer: ☐ (Do not check if a 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 ☒

The number of shares outstanding of the issuer's common stock as of August 10, 2010 was 14,739,912.

SEC 1296 (04-09)

Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

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ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

C ONDENSED CONSOLIDATED BALANCE SHEETS
(U.S. Dollars)

	June 30, 2010	December 31, 2009
	(Unaudited)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 1,777,853	$ 1,901,525
Restricted collateral deposits	1,896,825	1,997,165
Trade receivables (net of allowance for doubtful accounts in the amount of $42,000 as of June 30, 2010 and $47,000 as of December 31, 2009)	13,728,977	14,010,974
Unbilled receivables	6,870,457	4,142,107
Other accounts receivable and prepaid expenses	3,740,824	2,825,202
Inventories	10,976,276	12,335,037
Total current assets	38,991,212	37,212,010
LONG TERM ASSETS:		
Deferred tax assets	47,184	41,405
Severance pay fund	3,632,120	3,447,884
Other long term receivables	439,627	395,456
Property and equipment, net	4,339,902	4,624,833
Investment in affiliated company	67,018	67,018
Other intangible assets, net	5,321,749	6,025,600
Goodwill	32,110,454	32,303,673
Total long term assets	45,958,054	46,905,869
Total assets	$ 84,949,266	$ 84,117,879

The accompanying notes are an integral part of the Interim Condensed Consolidated Financial Statements.

CONDENSED CONSOLIDATED BALANCE SHEETS
(U.S. Dollars, except share data)

	June 30, 2010 (Unaudited)	December 31, 2009
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	$ 5,467,297	$ 5,149,243
Other accounts payable and accrued expenses	5,027,004	6,239,436
Current portion of capitalized leases	48,271	45,911
Current portion of long term debt	1,902,730	1,902,097
Short term bank credit	4,074,890	4,074,890
Deferred revenues	5,828,713	4,434,093
Total current liabilities	22,348,905	21,845,670
LONG TERM LIABILITIES:		
Accrued severance pay	5,320,500	4,985,011
Long term portion of capitalized leases	27,230	52,021
Long term debt	1,412,483	2,270,152
Deferred tax liability	3,269,999	2,990,000
Other long term liabilities	360,189	555,220
Total long term liabilities	10,390,401	10,852,404
STOCKHOLDERS' EQUITY:		
Share capital –		
Common stock – $0.01 par value each;		
Authorized: 50,000,000 shares as of June 30, 2010 and December 31, 2009; Issued and outstanding: 14,739,912 shares and 14,405,948 shares as of June 30, 2010 and December 31, 2009, respectively	147,400	144,060
Preferred shares – $0.01 par value each;		
Authorized: 1,000,000 shares as of June 30, 2010 and December 31, 2009; No shares issued and outstanding as of June 30, 2010 and December 31, 2009	–	–
Additional paid-in capital	221,149,861	220,481,911
Accumulated deficit	(169,336,476)	(169,788,022)
Notes receivable from stockholders	(954,647)	(954,647)
Accumulated other comprehensive income	1,203,822	1,536,503
Total stockholders' equity	52,209,960	51,419,805
Total liabilities and stockholders' equity	$ 84,949,266	$ 84,117,879

The accompanying notes are an integral part of the Interim Condensed Consolidated Financial Statements.

C ONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(U.S. Dollars, except share data)

	Six months ended June 30,		Three months ended June 30,	
	2010	2009	2010	2009
Revenues	$ 40,054,254	$ 36,127,412	$ 18,903,860	$ 16,035,190
Cost of revenues, exclusive of amortization of intangibles	28,610,458	26,595,444	13,283,807	11,763,982
Research and development	1,578,497	735,575	764,016	403,687
Selling and marketing expenses	2,597,294	2,317,455	1,436,635	1,171,363
General and administrative expenses	5,871,919	5,548,527	2,918,322	2,781,858
Amortization of intangible assets	838,906	746,626	417,258	374,029
Total operating costs and expenses	39,497,074	35,943,627	18,820,038	16,494,919
Operating profit (loss)	557,180	183,785	83,822	(459,729)
Other income	61,218	51,650	37,758	1,819
Allowance for settlements	500,000	–	500,000	–
Financial expenses, net	(207,710)	(1,099,492)	(64,460)	(126,414)
Total other income (expenses)	353,508	(1,047,842)	473,298	(124,595)
Income (loss) before income tax expenses	910,688	(864,057)	557,120	(584,324)
Income tax expenses	(459,140)	(468,644)	(197,120)	(272,354)
Net income (loss)	$ 451,548	$ (1,332,701)	$ 360,000	$ (856,678)
Basic net income (loss) per share	$ 0.03	$ (0.10)	$ 0.03	$ (0.06)
Diluted net income (loss) per share	$ 0.03	$ (0.10)	$ 0.02	$ (0.06)
Weighted average number of shares used in computing basic net income/loss per share	13,944,492	13,802,821	14,013,658	14,028,757
Weighted average number of shares used in computing diluted net income/loss per share	14,547,232	13,802,821	14,616,398	14,028,757

The accompanying notes are an integral part of the Interim Condensed Consolidated Financial Statements.

CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED)

(U.S. Dollars)

	Six months ended June 30, 2010	Six months ended June 30, 2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 451,548	$ (1,332,701)
Adjustments required to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	622,345	623,834
Amortization of intangible assets and capitalized software costs	838,906	746,626
Amortization of debt discount	96,000	147,103
Compensation related to shares issued to employees, consultants and directors	302,096	212,009
Adjustment to value of warrants and imbedded features on the senior convertible notes	(195,647)	479,289
Deferred tax expense	274,220	286,820
Changes in operating assets and liabilities:		
Severance pay, net	151,253	(188,105)
Trade receivables	281,997	3,907,438
Other accounts receivable and prepaid expenses	(959,793)	98,456
Inventories	1,358,761	(1,685,906)
Unbilled receivables	(2,728,350)	2,147,209
Deferred revenues	1,394,620	(909,413)
Trade payables	318,054	(3,170,639)
Accounts payable and accrued expenses	(1,234,249)	(1,181,672)
Net cash provided by (used in) operating activities	971,761	180,348
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment net of investment grants received from the State of Israel	(337,414)	(91,300)
Additions of capitalized software development	(231,516)	(17,193)
Investment in affiliated company	–	33,969
Restricted cash	100,340	86,696
Net cash provided by (used in) investing activities	(468,590)	12,172
FORWARD	$ 503,171	$ 192,520

The accompanying notes are an integral part of the Interim Condensed Consolidated Financial Statements.

CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED)
(U.S. Dollars)

	Six months ended June 30,	
	2010	**2009**
FORWARD	$ 503,171	$ 192,520
CASH FLOWS FROM FINANCING ACTIVITIES:		
Long term loans	(527,389)	(936,193)
Short term bank credit	–	(150,000)
Treasury stock purchased	(56,453)	(258,596)
Net cash provided by (used in) financing activities	(583,842)	(1,344,789)
DECREASE IN CASH AND CASH EQUIVALENTS	(80,671)	(1,152,269)
CASH EROSION DUE TO EXCHANGE RATE DIFFERENCES	(43,001)	(18,836)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	1,901,525	4,301,359
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	$ 1,777,853	$ 3,130,254
SUPPLEMENTARY INFORMATION ON NON-CASH TRANSACTIONS:		
Interest paid during the period	$ 289,839	$ 348,054
Taxes on income paid during the period	$ 85,147	$ 113,149
Note conversion to common stock	$ 425,647	$ –
Stock issued in lieu of funding severance fund	$ –	$ 440,000

The accompanying notes are an integral part of the Interim Condensed Consolidated Financial Statements.

N OTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1: BASIS OF PRESENTATION

a. Company:

Arotech Corporation ("Arotech") and its wholly-owned subsidiaries (the "Company") provide defense and security products for the military, law enforcement and homeland security markets, including multimedia interactive simulators/trainers, lightweight vehicle armoring, and advanced zinc-air and lithium batteries and chargers. The Company operates primarily through its wholly-owned subsidiaries FAAC Incorporated ("FAAC"), based in Ann Arbor, Michigan and Royal Oak, Michigan; MDT Protective Industries, Ltd. ("MDT"), based in Lod, Israel; MDT Armor Corporation ("MDT Armor"), based in Auburn, Alabama; Electric Fuel Battery Corporation ("EFB"), based in Auburn, Alabama; Electric Fuel Ltd. ("EFL"), based in Beit Shemesh, Israel; and Epsilor Electronic Industries, Ltd. ("Epsilor"), based in Dimona, Israel. The Company's former subsidiaries Armour of America Incorporated ("AoA") and Realtime Technologies, Inc. ("RTI") have been merged into MDT Armor and FAAC, respectively.

b. Basis of presentation:

The accompanying interim condensed consolidated financial statements have been prepared by Arotech Corporation in accordance with generally accepted accounting principles for interim financial information, with the instructions to Form 10-Q and with Article 10 of Regulation S-X, and include the accounts of Arotech Corporation and its subsidiaries. Certain information and footnote disclosures, normally included in complete financial statements prepared in accordance with generally accepted accounting principles, have been condensed or omitted. In the opinion of the Company, the unaudited financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of its financial position at June 30, 2010, its operating results for the six- and three-month periods ended June 30, 2010 and 2009, and its cash flow for the six-month periods ended June 30, 2010 and 2009.

The results of operations for the six and three months ended June 30, 2010 are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year ending December 31, 2010.

The balance sheet at December 31, 2009 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. These condensed consolidated financial statements should be read in conjunction with the audited financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

c. Accounting for stock-based compensation:

For the six months ended June 30, 2010 and 2009 the compensation expense recorded related to stock options and restricted shares was $302,096 and $212,009, respectively, of which $0 and $18,023, respectively, was for stock options and $302,096 and $193,986, respectively, was for restricted shares. The remaining total compensation cost related to non-vested stock options and restricted share awards not yet recognized in the income statement as of June 30, 2010 was

$334,000, all of which was for restricted shares. The weighted average period over which this compensation cost is expected to be recognized is approximately one and one-half years. Income tax expense was not impacted since the Company is in a net operating loss position. There were no new options issued in the first six months of 2010 and no options were exercised in the first six months of 2010. The Company's directors received their annual restricted stock grants on April 1, 2010 in accordance with the terms of the directors' stock compensation plan.

On April 12, 2010, the Company's executive officers were granted restricted stock and restricted stock units totaling 290,000 shares at a deemed grant price of $1.67 per share (the closing price on the date of grant) as authorized by the Company's compensation committee. An additional 170,000 shares of either restricted stock or restricted stock units were issued with the same terms to other employees. These shares will vest 50% at the end of 2010 (with 2/3 of such vesting being subject to the achievement of certain performance criteria) and 50% at the end of 2011 (with 2/3 of such vesting being subject to the achievement of certain performance criteria), and will be expensed over the vesting period. No compensation cost has been recorded for the quarter ended June 30, 2010 related to the performance portion of these restricted awards as it is not yet considered probable the criteria will be met.

d. Reclassification:

Certain comparative data in these financial statements may have been reclassified to conform to the current year's presentation.

e. Anti-dilutive shares for EPS calculation

All outstanding stock options and warrants have been excluded from the calculation of the diluted net loss per common share because all such securities are anti-dilutive for the periods presented and the Company has excluded any restricted stock that will never vest under the current program. The total weighted average number of shares excluded from the calculations of diluted net income (loss) per share for the six-month periods ended June 30, 2010 and 2009 were 778,760 and 906,305, respectively.

NOTE 2: INVENTORIES

Inventories are stated at the lower of cost or market value. Cost is determined using the average cost method or the FIFO method. The Company periodically evaluates the quantities on hand relative to current and historical selling prices and historical and projected sales volume. Based on these evaluations, provisions are made in each period to write down inventory to its net realizable value. Inventory write-offs are provided to cover risks arising from slow-moving items, technological obsolescence, excess inventories, and for market prices lower than cost. Inventories are composed of the following:

	June 30, 2010	December 31, 2009
	(Unaudited)	
Raw materials	$ 8,137,053	$ 7,479,672
Work-in-progress	2,166,179	3,943,073
Finished goods	673,044	912,292
Total:	$ 10,976,276	$ 12,335,037

NOTE 3: IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

For information about previous new accounting pronouncements and the potential impact on the Company's Consolidated Financial Statements, see Note 2 of the Notes to Consolidated Financial Statements in the Company's 2009 Form 10-K and Notes 6 and 8 below.

NOTE 4: SEGMENT INFORMATION

a. General:

The Company and its subsidiaries operate primarily in three business segments and follow the requirements of FASB ASC 280-10.

The Company's reportable operating segments have been determined in accordance with the Company's internal management structure, which is organized based on operating activities. The accounting policies of the operating segments are the same as those used by the Company in the preparation of its annual financial statement. The Company evaluates performance based upon two primary factors, one is the segment's operating income and the other is the segment's contribution to the Company's future strategic growth.

b. The following is information about reported segment revenues, income (losses) and total assets for the six and three months ended June 30, 2010 and 2009:

	Training and Simulation	Armor	Battery and Power Systems	All Others	Total
Six months ended June 30, 2010					
Revenues from outside customers	$ 20,067,950	$ 11,098,163	$ 8,888,141	$ –	$ 40,054,254
Depreciation and amortization expenses (1)	(776,934)	(6,676)	(254,620)	(88,280)	(1,126,510)
Direct expenses (2)	(16,276,292)	(11,028,547)	(8,690,676)	(2,272,971)	(38,268,486)
Segment income (loss)	3,014,724	62,940	(57,155)	(2,361,251)	659,258
Financial income (expense)	–	(65,752)	(291,498)	149,540	(207,710)
Income (loss) from continuing operations	$ 3,014,724	$ (2,812)	$ (348,653)	$ (2,211,711)	$ 451,548
Segment assets (3)	$ 46,860,622	$ 11,508,079	$ 23,530,636	$ 3,049,929	$ 84,949,266
Six months ended June 30, 2009					
Revenues from outside customers	$ 21,304,763	$ 6,441,692	$ 8,380,957	$ –	$ 36,127,412
Depreciation and amortization expenses (1)	(677,370)	(88,740)	(505,323)	(99,027)	(1,370,460)
Direct expenses (2)	(17,910,521)	(7,075,326)	(7,668,992)	(2,335,322)	(34,990,161)
Segment income (loss)	2,716,872	(722,374)	206,642	(2,434,349)	(233,209)
Financial expense	–	(95,902)	(192,706)	(810,884)	(1,099,492)
Income (loss) from continuing operations	$ 2,716,872	$ (818,276)	$ 13,936	$ (3,245,233)	$ (1,332,701)
Segment assets (3)	$ 44,974,286	$ 11,077,850	$ 23,116,763	$ 3,546,706	$ 82,715,605
Three months ended June 30, 2010					
Revenues from outside customers	$ 10,422,409	$ 4,546,342	$ 3,935,109	$ –	$ 18,903,860
Depreciation and amortization expenses (1)	(384,758)	39,341	(754)	(44,032)	(390,203)
Direct expenses (2)	(8,263,151)	(4,836,204)	(4,113,807)	(876,035)	(18,089,197)
Segment income (loss)	1,774,500	(250,521)	(179,452)	(920,067)	424,460
Financial income (expense)	–	(32,662)	(285,432)	253,634	(64,460)
Income (loss) from continuing operations	$ 1,774,500	$ (283,183)	$ (464,884)	$ (666,433)	$ 360,000

		Training and Simulation		Armor		Battery and Power Systems		All Others		Total
Three months ended June 30, 2009										
Revenues from outside customers	$	9,842,912	$	1,723,974	$	4,468,304	$	–	$	16,035,190
Depreciation and amortization expenses (1)		(339,722)		(44,626)		(248,400)		(49,339)		(682,087)
Direct expenses (2)		(8,143,462)		(2,582,587)		(4,183,005)		(1,174,313)		(16,083,367)
Segment income (loss)		1,359,728		(903,239)		36,899		(1,223,652)		(730,264)
Financial income (expense)		–		32,043		160,346		(318,803)		(126,414)
Income (loss) from continuing operations	$	1,359,728	$	(871,196)	$	197,245	$	(1,542,455)	$	(856,678)

(1) Includes depreciation of property and equipment and amortization expenses of intangible assets.

(2) Including, *inter alia*, sales and marketing, general and administrative and tax expenses.

(3) Out of those amounts, goodwill in our Training and Simulation, Armor and Battery and Power Systems Divisions stood at $24,435,641, $1,772,668 and $5,902,145, respectively, as of June 30, 2010 and $24,435,641, $1,757,041 and $5,835,880, respectively, as of June 30, 2009. Subsequent to the 2004 purchase of AoA, the Company recorded an impairment charge in 2005 to fully impair related goodwill ($10.5 million) and intangible assets ($2.6 million). Additionally, due to an earnout on the same transaction, the Company recorded an additional $316,000 in goodwill in 2007 and immediately recorded an impairment of $316,000. The Company has not recorded any other goodwill impairment charges.

NOTE 5: COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) for the six and three months ended June 30, 2010 and 2009 is summarized below:

	Six Months Ended June 30,				Three Months Ended June 30,			
		2010		2009		2010		2009
Net income (loss)	$	451,548	$	(1,332,701)	$	360,000	$	(856,678)
Foreign currency translation		(332,681)		(360,916)		499,381		738,013
Total comprehensive income (loss)	$	118,867	$	(1,693,617)	$	859,381	$	(118,665)

NOTE 6: CONVERTIBLE NOTES AND DETACHABLE WARRANTS

a. 10% Senior Convertible Notes due August 15, 2011

Pursuant to the terms of a Securities Purchase Agreement dated August 14, 2008, the Company issued and sold to a group of institutional investors 10% senior convertible notes in the aggregate principal amount of $5.0 million due August 15, 2011. These notes are convertible at any time prior to August 15, 2011 at a conversion price of $2.24 per share. As part of our analysis of the convertible debt and related warrants, we reviewed and followed the guidance of FASB ASC 718-10, ASC 815-40-15, ASC 470-20-30 and ASC 105-10-05.

As part of the securities purchase agreement, the Company issued to the purchasers of its 10% senior convertible notes due August 15, 2011, warrants to purchase an aggregate of 558,036 shares of common stock at any time prior to August 15, 2011 at a price of $2.24 per share. The warrants were classified in 2008 as equity based on relative fair value. The relative fair value of these warrants was determined in 2008 using the Black-Scholes pricing model, assuming a risk-free interest rate of 2.78%, a volatility factor 75%, dividend yields of 0% and a contractual life of 3.0 years.

On June 30, 2010, the Company revalued its warrants, their embedded conversion options and their embedded put options and recorded a reduction of approximately $148,000 in the second quarter of 2010 as a credit to financial expense. The approximate year-to-date financial expense associated with this transaction is $196,000. The table below lists the variables used in the Black-Scholes calculation and the resulting values:

Variables	December 31, 2009	June 30, 2010
Stock price	$ 1.70	$ 1.46
Risk free interest rate	1.70%	1.00%
Volatility	79.85%	77.76%
Dividend yield	0.00%	0.00%
Contractual life	1.6 years	1.1 years

Values	December 31, 2009	June 30, 2010
Warrants	$ 298,570	$ 155,616
Conversion option	88,156	39,510
Puts	7,370	3,323
Total value	$ 394,096	$ 198,449
Change in value – charged to financial expense		$ 195,647

Principal payments are due on the convertible notes as follows:

Year	Amount
2010	$ 909,090
2011	1,363,640
	$ 2,272,730

NOTE 7: FINANCING ACTIVITIES

Loan to DEI Services Corporation

Concurrent with the Securities Purchase Agreement dated August 14, 2008, the Company purchased a $2,500,000 Senior Subordinated Convertible Note from an unaffiliated company, DEI Services Corporation (“DEI”). This 10% Senior Subordinated Convertible Note (the “DEI Note”) was due December 31, 2009. The DEI Note is convertible at maturity at the Company’s option into such number of shares of DEI’s common stock, no par value per share, as shall be equal at the time of conversion to twelve percent (12%) of DEI’s outstanding common stock.

In the third quarter of 2009 DEI repaid a portion of their internal shareholder loans, which was a violation of the DEI Note covenants with the Company. Because of this, the Company agreed in October of 2009 to amend the DEI Note to provide that the interest rate on the DEI Note would be increased to 15% and would be payable through the payment date. In the event that the DEI Note is not paid in full at maturity, the DEI Note will be convertible into a minimum of 20% of DEI’s then outstanding common stock, or more under certain circumstances.

In November 2009, DEI brought in a new investor that was prepared to provide DEI with additional working capital, but only if the Company agreed to step aside and accept a $500,000 discount on the DEI Note and waive its associated rights of first refusal and conversion. In view of the possibility that DEI would seek an extension of the DEI Note, the Company decided to enable DEI to bring in the new investor and thereby be able to pay the DEI Note on time, albeit at a discount. The Company accordingly wrote down the value of the DEI Note in the third quarter of 2009 by $500,000, to $2.0 million and charged the associated expense to allowance for settlements on the statement of operations. When the new investor's investment did not close, the Company retained all its rights under the DEI Note, including its right to be paid the full amount of the DEI Note and its conversion option and right of first refusal.

On August 10, 2010, DEI repaid the entire $2.5 million principal amount, along with all outstanding earned and unpaid interest. Inasmuch as the Company had previously established an allowance of $500,000 in the fourth quarter of 2009 based on the expectation that the DEI Note would not be fully collected, the Company recognized in the second quarter of 2010 the difference between the $2.0 million book value of the DEI Note and the $2.5 million that was actually collected as a recovery under allowance for settlements in the Company's financial statements. Additionally, the Company accrued unpaid interest on the DEI note through June 30, 2010 in the amount of $140,000 which was booked as a reduction of financial expenses. This transaction extinguished the Company's conversion options and rights of first refusal with respect to DEI.

NOTE 8: FAIR VALUE MEASUREMENT

The carrying value of short term assets and liabilities in the accompanying condensed consolidated balance sheets for cash and cash equivalents, restricted collateral deposits, trade receivables, unbilled receivables, inventories, prepaid and other assets, trade payables, accrued expenses, deferred revenues and other liabilities as of June 30, 2010 and December 31, 2009, approximate fair value because of the short maturity of these instruments. The carrying amounts of long term debt approximates the estimated fair values at June 30, 2010, based upon the Company's ability to acquire similar debt at similar maturities.

NOTE 9: COMMON STOCK REPURCHASE PROGRAM

In February of 2009, the Company authorized, for a period of one year, the repurchase in the open market or in privately negotiated transactions of up to $1.0 million of its common stock. This program was subsequently extended to August 2011. Pursuant to this plan, the Company through June 30, 2010 had repurchased 482,097 shares of its common stock for $619,605 ($609,823 net of commissions), all of which was purchased after April 1, 2009. At June 30, 2010, the Company had remaining authorization for the repurchase of up to $390,177 in shares of its common stock. The repurchase program is subject to the discretion of the Company's management.

NOTE 10: SUBSEQUENT EVENTS

See update to DEI Note in Note 7 above.

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

This report contains forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements involve inherent risks and uncertainties. When used in this discussion, the words "believes," "anticipated," "expects," "estimates" and similar expressions are intended to identify such forward-looking statements. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We undertake no obligation to publicly release the result of any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors including, but not limited to, those set forth elsewhere in this report. Please see "Risk Factors" in our Annual Report on Form 10-K and in our other filings with the Securities and Exchange Commission.

Arotech™ is a trademark and Electric Fuel® is a registered trademark of Arotech Corporation. All company and product names mentioned may be trademarks or registered trademarks of their respective holders. Unless the context requires otherwise, all references to us refer collectively to Arotech Corporation and its subsidiaries.

We make available through our internet website free of charge our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, amendments to such reports and other filings made by us with the SEC, as soon as practicable after we electronically file such reports and filings with the SEC. Our website address is www.arotech.com. The information contained in this website is not incorporated by reference in this report.

The following discussion and analysis should be read in conjunction with the interim financial statements and notes thereto appearing elsewhere in this Quarterly Report. We have rounded amounts reported here to the nearest thousand, unless such amounts are more than 1.0 million, in which event we have rounded such amounts to the nearest hundred thousand.

Executive Summary

We are a defense and security products and services company, engaged in three business areas: interactive simulation for military, law enforcement and commercial markets (***Training and Simulation Division***); high-level armoring for military, paramilitary and commercial vehicles (***Armor Division***); and batteries and charging systems for the military (***Battery and Power Systems Division***).

Overview of Results of Operations

Acquisitions

In acquisition of subsidiaries, part of the purchase price is allocated to intangible assets and goodwill. Amortization of intangible assets related to acquisition of subsidiaries is recorded based on the estimated expected life of the assets. Accordingly, for a period of time following an acquisition, we incur a non-cash charge related to amortization of intangible assets in the amount of a fraction (based on the useful life of the intangible assets) of the amount recorded as intangible assets. Such amortization charges continued during the first six months of 2010. We are required to review intangible assets and goodwill for impairment at least annually or whenever events or changes in circumstances indicate that carrying amount of the assets may not be recoverable. If we determine, through the impairment review process, that goodwill has been impaired, we must record the impairment charge in our statement of operations.

In the case of goodwill, the assets recorded as goodwill are not amortized; instead, we are required to perform an annual impairment review. If we determine, through the impairment review process, that goodwill has been impaired, we must record the impairment charge in our statement of operations.

Financings and Issuances of Warrants

The non-cash charges that relate to our financings occurred in connection with our issuance of convertible securities with warrants, and in connection with our repricing of certain warrants and grants of new warrants. When we issue convertible securities, we record a discount for a beneficial conversion feature that is amortized ratably over the life of the debenture.

During the third quarter of 2008 and pursuant to the terms of a Securities Purchase Agreement dated August 14, 2008, we issued and sold to a group of institutional investors 10% senior convertible notes in the aggregate principal amount of $5.0 million due August 15, 2011. These notes are convertible at any time prior to August 15, 2011 at a conversion price of $2.24 per share. As part of our analysis of the convertible debt and related warrants, we reviewed and followed the guidance of FASB ASC 718-10, ASC 815-40-15, ASC 470-20-30 and ASC 105-10-05.

As part of the securities purchase agreement, we issued to the purchasers of our 10% senior convertible notes due August 15, 2011, warrants to purchase an aggregate of 558,036 shares of common stock at any time prior to August 15, 2011 at a price of $2.24 per share. The warrants were classified in 2008 as equity based on relative fair value. The relative fair value of these warrants was determined in 2008 using the Black-Scholes pricing model, assuming a risk-free interest rate of 2.78%, a volatility factor 75%, dividend yields of 0% and a contractual life of 3.0 years.

In connection with the original accounting for these convertible notes, we recorded a deferred debt discount on the balance sheet of $412,000 in 2008. The beneficial conversion feature and the discount arising from fair value allocation of the warrants according to FASB ASC 470-20-25 is being amortized from the date of issuance to the stated redemption date – August 15, 2011.

On January 1, 2009 we adopted FASB ASC 815-40-15, “Determining Whether an Instrument is Indexed to an Entity’s Own Stock.” FASB ASC 815-40-15 requires us to re-evaluate the warrants issued with the convertible notes and to also re-evaluate the embedded conversion option and embedded put options within the notes to determine if the previous accounting for these items would change. Upon this re-evaluation, we were required to reclassify the warrants along with the value of the embedded conversion feature from equity to a derivative liability. The embedded put options remained classified as derivative liabilities. The Company again used the Black-Scholes valuation model to determine the value of the warrants, the value of the embedded conversion feature and the value of the embedded put options associated with the convertible notes as of January 1, 2009. In accordance with the guidance of FASB ASC 815-40-15, a cumulative adjustment increasing January 1, 2009 retained earnings by $1,287,000 was made in the first quarter of 2009 to reflect this new accounting. We re-valued this amount in the second quarter of 2009 based on a revised valuation of the derivative liability. This resulted in a debt discount balance in the amount of approximately $325,000, which is included in Long Term Debt on the balance sheet, and a revised cumulative adjustment to retained earnings of $471,000.

On June 30, 2010, we revalued these warrants, their embedded conversion option and their embedded put options and recorded a reduction of approximately $148,000 in the second quarter as a credit to financial expense. The year to date financial expense associated with this transaction is approximately $196,000. The table below lists the variables used in the Black-Scholes calculation and the resulting values.

Variables	December 31, 2009	June 30, 2010
Stock price	$ 1.70	$ 1.46
Risk free interest rate	1.70%	1.00%
Volatility	79.85%	77.76%
Dividend yield	0.00%	0.00%
Contractual life	1.6 years	1.1 years

Values	December 31, 2009	June 30, 2010
Warrants	$ 298,570	$ 155,616
Conversion option	88,156	39,510
Puts	7,370	3,323
Total value	$ 394,096	$ 198,449
Change in value – charged to financial expense		$ 195,647

Remaining principal payments are due on the convertible notes as follows:

Year	Amount
2010	$ 909,090
2011	1,363,640
	$ 2,272,730

Concurrent with the Securities Purchase Agreement dated August 14, 2008, we purchased a $2,500,000 Senior Subordinated Convertible Note from an unaffiliated company, DEI Services Corporation ("DEI"). This 10% Senior Subordinated Convertible Note (the "DEI Note") was due December 31, 2009. The DEI Note is convertible at maturity at our option into such number of shares of DEI's common stock, no par value per share, as shall be equal at the time of conversion to twelve percent (12%) of DEI's outstanding common stock.

Interest on the outstanding principal amount of the DEI Note commenced accruing on the issuance date and was payable quarterly, in arrears. We discontinued accruing interest on the DEI Note due to the default on the DEI Note recorded in the third quarter of 2009. The final payment was due on December 31, 2009; however, interest income had not been accrued until received during the default period. Interest on the DEI Note will be recognized as a reduction of financial expenses. Related fees and costs will be recorded as general and administrative expense.

In November 2009, DEI brought in a new investor that was prepared to provide DEI with additional working capital, but only if we agreed to step aside and accept a $500,000 discount on the DEI Note and waive our associated rights of first refusal and conversion. In view of the possibility that DEI would seek an extension of the DEI Note, we decided to enable DEI to bring in the new investor and thereby be able to pay the DEI Note on time, albeit at a discount. We accordingly wrote down the value of the DEI Note in the third quarter of 2009 by $500,000, to $2.0 million and charged the associated expense to allowance for settlements on the statement of operations. When the new investor's investment did not close, we retained all our rights under the DEI Note, including our right to be paid the full amount of the DEI Note and our conversion option and right of first refusal.

On August 10, 2010, DEI repaid the entire $2.5 million principal amount, along with all outstanding earned and unpaid interest. Inasmuch as we had previously established an allowance of $500,000 in the fourth quarter of 2009 based on the expectation that the DEI Note would not be fully collected, we recognized in the second quarter of 2010 the difference between the $2.0 million book value of the DEI Note and the $2.5 million that was actually collected as a recovery under allowance for settlements on our financial statements. Additionally, we accrued unpaid interest on the note through June 30, 2010 in the amount of $140,000 which was booked as a reduction of financial expenses. This transaction extinguished our conversion options and rights of first refusal with DEI.

Restricted Shares and Options

In accordance with FASB ASC 505-50, we incurred, for the six months ended June 30, 2010 and 2009, compensation expense related to stock options and restricted shares of approximately $302,000 and $212,000, respectively, of which $0 and $18,000, respectively, was for stock options and $302,000 and $194,000, respectively, was for restricted shares. Our directors received their annual restricted stock grants on April 1, 2010 in accordance with the terms of the directors' stock compensation plan.

On April 12, 2010, our executive officers were granted restricted stock and restricted stock units totaling 290,000 shares at a deemed grant price of $1.67 per share (the closing price on the date of grant) as authorized by our compensation committee. An additional 170,000 shares of either restricted stock or restricted stock units were issued with the same terms to other employees. These shares will vest 50% at the end of 2010 (with 2/3 of such vesting being subject to the achievement of certain performance criteria) and 50% at the end of 2011 (with 2/3 of such vesting being subject to the achievement of certain performance criteria), and will be expensed over the vesting period. No compensation cost has been recorded for the quarter ended June 30, 2010 related to the performance portion of these restricted awards as it is not yet considered probable that the criteria will be met.

Overview of Operating Performance and Backlog

Overall, our income before income tax expenses for the six months ended June 30, 2010 was $911,000 on revenues of $40.1 million, compared to a loss before income tax expenses of $864,000 on revenues of $36.1 million during the six months ended June 30, 2009. Our overall backlog as of June 30, 2010 totaled $40.4 million.

In our Training and Simulation Division, revenues decreased from approximately $21.3 million in the first six months of 2009 to $20.1 million in the first six months of 2010. As of June 30, 2010, our backlog for our Training and Simulation Division totaled $18.6 million.

In our Armor Division, revenues increased from $6.4 million during the first six months of 2009 to $11.1 million during the first six months of 2010. As of June 30, 2010, our backlog for our Armor Division totaled $8.7 million.

In our Battery and Power Systems Division, revenues increased from approximately $8.4 million in the first six months of 2009 to approximately $8.9 million in the first six months of 2010. As of June 30, 2010, our backlog for our Battery and Power Systems Division totaled $13.1 million.

Common Stock Repurchase Program

In February of 2009, we authorized, for a period of one year, the repurchase in the open market or in privately negotiated transactions of up to $1 million of our common stock. Pursuant to this plan, through June 30, 2010 we have repurchased 482,097 shares of our common stock for $619,605 ($609,823 net of commissions), all of which was purchased after April 1, 2009. At June 30, 2010, we had remaining authorization for the repurchase of up to $390,177 in shares of our common stock. The repurchase program is subject to the discretion of our management.

Recent Developments

See the update to the discussion of the DEI Note in “Overview of Results of Operations – Acquisitions – Financings and Issuance of Warrants,” above.

Functional Currency

We consider the United States dollar to be the currency of the primary economic environment in which we and our Israeli subsidiary EFL operate and, therefore, both we and EFL have adopted and are using the United States dollar as our functional currency. Transactions and balances originally denominated in U.S. dollars are presented at the original amounts. Gains and losses arising from non-dollar transactions and balances are included in net income.

The majority of financial transactions of our Israeli subsidiaries MDT and Epsilor is in New Israel Shekels (“NIS”) and a substantial portion of MDT’s and Epsilor’s costs is incurred in NIS. Management believes that the NIS is the functional currency of MDT and Epsilor. Accordingly, the financial statements of MDT and Epsilor have been translated into U.S. dollars. All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. Statement of operations amounts have been translated using the average exchange rate for the period. The resulting translation adjustments are reported as a component of accumulated other comprehensive income (loss) in stockholders' equity.

Results of Operations

Three months ended June 30, 2010 compared to the three months ended June 30, 2009.

Revenues. Revenues for the three months ended June 30, 2010 totaled $18.9 million, compared to $16.0 million in the comparable period in 2009, an increase of $2.9 million, or 17.9%. In the second quarter of 2010, revenues were $10.4 million for the Training and Simulation Division (compared to $9.8 million in the second quarter of 2009, an increase of $579,000, or 5.9%, due primarily to a simulation contract with the state of California); $4.5 million for the Armor Division (compared to $1.7 million in the second quarter of 2009, an increase of $2.8 million, or 163.7%, due primarily to increased production of the David vehicle); and $3.9 million for the Battery and Power Systems Division (compared to $4.5 million in the second quarter of 2009, a decrease of $533,000, or 11.9%, due primarily to decreased orders for our battery and charger products).

Cost of revenues. Cost of revenues totaled $13.3 million during the second quarter of 2010, compared to $11.8 million in the second quarter of 2009, an increase of $1.5 million, or 12.9%, due primarily to increased production in our Armor and Battery and Power Systems divisions.

Direct expenses were $8.3 million for the Training and Simulation Division (compared to $8.1 million in the second quarter of 2009,an increase of $120,000, or 1.5%, due primarily to the increase in revenue for the quarter); $4.8 million for the Armor Division (compared to $2.6 million in the second quarter of 2009, an increase of $2.2 million, or 87.3%, due primarily to increased production of the David vehicle offset to some extent by improved operating efficiencies); and $4.1 million for the Battery and Power Systems Division (compared to $4.2 million in the second quarter of 2009, a decrease of $69,000, or 1.7%, due primarily to decreased material costs for our battery and charger products).

Amortization of intangible assets. Amortization of intangible assets totaled $417,000 in the second quarter of 2010, compared to $374,000 in the second quarter of 2009, an increase of $43,000, or 11.6%, due primarily to the increase in amortization of capitalized software in our Training and Simulation Division.

Research and development expenses. Research and development expenses for the second quarter of 2010 were $764,000, compared to $404,000 during the second quarter of 2009, an increase of $360,000, or 89.3%. This increase was primarily due to the development of new vehicles in the Armor Division along with increases in new product development in the other divisions. In particular, the Armor Division has invested a significant amount of resources to develop our new Tiger vehicle, which has been displayed in trade shows in both Europe and the United States.

***Selling and marketing expenses*.** Selling and marketing expenses for the second quarter of 2010 were $1.4 million, compared to $1.2 million in the second quarter of 2009, an increase of $265,000, or 22.6%, due primarily to increased expenses in the Armor Division related to the newly-developed Tiger vehicle.

General and administrative expenses. General and administrative expenses for the second quarter of 2010 were $2.9 million, compared to $2.8 million in the second quarter of 2009, an increase of $136,000, or 4.9%. This increase was due primarily to an increase in severance and social benefit expenses in Israel along with increased professional fees in connection with regulatory compliance work in our Armor Division.

Allowance for settlements. In the second quarter of 2010 we recorded a positive adjustment in the amount of $500,000 to reflect the reversal of the allowance booked in the third quarter of 2009 relating to the DEI Note, which was paid in full in the third quarter of 2010, prior to our filing of our financial statements.

***Financial expense, net*.** Financial expenses totaled $64,000 in the second quarter of 2010, compared to $126,000 in the second quarter of 2009, a decrease of $62,000, or 49.0%, due primarily to the $140,000 accrued interest income relating to the DEI Note booked in the quarter, offset to some extent by an increase in currency exchange expenses and a decrease in warrant and debt discount expenses compared to 2009.

Income taxes. With respect to some of our subsidiaries that operated at a net income during 2010, we were able to offset federal taxes against our accumulated loss carry forward. We recorded a total of $197,000 in tax expense in the second quarter of 2010, compared to $272,000 in tax expense in the second quarter of 2009, a decrease of $75,000, or 27.6%, mainly concerning state and local taxes. This amount includes the required adjustment of taxes due to the deduction of goodwill “naked” credits for U.S. federal taxes, which totaled $140,000 in non-cash expenses in the second quarter of 2009 and 2010 (“naked” credits occur when deferred tax liabilities that are created by indefinite-lived assets such as goodwill cannot be used as a source of taxable income to support the realization of deferred tax assets). This adjustment is required under current accounting regulations.

Net income. Due to the factors cited above, we went from a net loss of $(857,000) in the second quarter of 2009 to a net income of $360,000 in the second quarter of 2010, an improvement of $1.2 million.

Six months ended June 30, 2010 compared to the six months ended June 30, 2009.

Revenues. Revenues for the six months ended June 30, 2010 totaled $40.1 million, compared to $36.1 million in the comparable period in 2009, an increase of $3.9 million, or 10.9%. In the first six months of 2010, revenues were $20.1 million for the Training and Simulation Division (compared to $21.3 million in the first six months of 2009, a decrease of $1.2 million, or 5.8%, due primarily to a simulation contract with the military that concluded in 2009); $11.1 million for the Armor Division (compared to $6.4 million in the first six months of 2009, an increase of $4.7 million, or 72.3%, due primarily to increased production of the David vehicle); and $8.9 million for the Battery and Power Systems Division (compared to $8.4 million in the first six months of

2009, an increase of $507,000, or 6.1%, due primarily to increased orders for our battery and charger products).

Cost of revenues. Cost of revenues totaled $28.6 million during the first six months of 2010, compared to $26.6 million in the first six months of 2009, an increase of $2.0 million, or 7.6%, due primarily to increased production in our Armor and Battery and Power Systems divisions.

Direct expenses were $16.3 million for the Training and Simulation Division (compared to $17.9 million in the first six months of 2009, a decrease of $1.6 million, or 9.1%, due primarily to the reduction in revenue for the period); $11.0 million for the Armor Division (compared to $7.1 million in the first six months of 2009, an increase of $3.9 million, or 55.9%, due primarily to increased production of the David vehicle and improved operating efficiencies); and $8.7 million for the Battery and Power Systems Division (compared to $7.7 million in the first six months of 2009, an increase of $1.0 million, or 13.3%, due primarily to increased orders for our battery and charger products).

Amortization of intangible assets. Amortization of intangible assets totaled $839,000 in the first six months of 2010, compared to $747,000 in the first six months of 2009, an increase of $92,000, or 12.4%, due primarily to the increase in amortization of capitalized software in our Training and Simulation Division.

Research and development expenses. Research and development expenses for the first six months of 2010 were $1.6 million, compared to $736,000 during the first six months of 2009, an increase of $843,000, or 114.6%. This increase was primarily due to the development of new vehicles in the Armor Division along with increases in new product development in the other divisions. In particular, the Armor division has invested a significant amount of resources to develop our new Tiger vehicle, which has been displayed in trade shows in both Europe and the United States.

Selling and marketing expenses. Selling and marketing expenses for the first six months of 2010 were $2.6 million, compared to $2.3 million in the first six months of 2009, an increase of $280,000, or 12.1%, due primarily to increased expenses in the Armor Division for expenses related to the newly-developed Tiger vehicle.

General and administrative expenses. General and administrative expenses for the first six months of 2010 were $5.8 million, compared to $5.5 million in the first six months of 2009, an increase of $323,000, or 5.8%, due primarily to an increase in professional fees in connection with regulatory compliance work in our Armor Division.

Allowance for settlements. In the second quarter of 2010 we recorded a positive adjustment in the amount of $500,000 to reflect the reversal of the allowance booked in the third quarter of 2009 relating to the DEI Note, which was paid in full in the third quarter of 2010, prior to our filing of our financial statements.

Financial expenses, net. Financial expenses totaled $208,000 in the first six months of 2010, compared to $1.1 million in the first six months of 2009, a decrease of $892,000, or 81.1%, due primarily to the $140,000 accrued interest income relating to the DEI Note booked in the second quarter of 2010 and a decrease in warrant and debt discount expense from 2009, offset by an increase in currency exchange expenses.

Income taxes. With respect to some of our subsidiaries that operated at a net income during 2010, we were able to offset federal taxes against our accumulated loss carry forward. We recorded a total of $459,000 in tax expense in the first six months of 2010, compared to $469,000 in tax expense in the first six months of 2009, a decrease of $10,000, or 2.0%, mainly concerning state and local taxes along. This amount includes the required adjustment of taxes due to the deduction of goodwill "naked" credits for U.S. federal taxes, which totaled $280,000 in non-cash expenses in the first six months of 2009 and 2010 ("naked" credits occur when deferred tax liabilities that are created by indefinite-lived assets such as goodwill cannot be used as a source of taxable income to support the realization of deferred tax assets).

Net income. Due to the factors cited above, we went from a net loss of $(1.3) million in the first half of 2009 to a net income of $452,000 in the first half of 2010, an improvement of $1.8 million.

Liquidity and Capital Resources

As of June 30, 2010, we had $1.8 million in cash and $1.9 million in restricted cash, as compared to December 31, 2009, when we had $1.9 million in cash and $2.0 million in restricted cash.

We used available funds in the six months ended June 30, 2010 primarily for sales and marketing, continued research and development expenditures, and other working capital needs. We purchased approximately $337,000 of fixed assets during the six months ended June 30, 2010. Our net fixed assets amounted to $4.3 million at quarter end.

Net cash provided by operating activities from continuing operations for the six months ended June 30, 2010 and 2009 was $972,000 and $180,000, respectively, an improvement of $791,000. This increase in cash provided was primarily the result of changes in operating assets and liabilities.

Net cash (used in)/provided by investing activities for the six months ended June 30, 2010 and 2009 was $(469,000) and $12,000, a decrease of $481,000. This decrease was primarily the result of purchases of property and equipment and increases in capitalized research and development.

Net cash used in financing activities for the six months ended June 30, 2010 and 2009 was $(584,000) and $(1.3) million, respectively, a decrease of $761,000, primarily due to a decrease in cash used in the repayment of long term debt due to the conversion to common shares of a portion of the quarterly principal payment by one of the holders of our senior convertible notes in the second quarter.

As of June 30, 2010, we had approximately $4.1 million in bank debt and $3.3 million in long-term debt outstanding. This is in comparison to $4.1 million in bank debt and $4.2 million in long-term debt outstanding as of December 31, 2009.

Subject to all of the reservations regarding “forward-looking statements” set forth above, we believe that our present cash position, anticipated cash flows from operations and lines of credit should be sufficient to satisfy our current estimated cash requirements through the remainder of the year.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Interest Rate Risk

It is our policy not to enter into interest rate derivative financial instruments, except for hedging of foreign currency exposures discussed below. We do not currently have any significant interest rate exposure.

Foreign Currency Exchange Rate Risk

Since a significant part of our sales and expenses are denominated in U.S. dollars, we have experienced only insignificant foreign exchange gains and losses to date, and do not expect to incur significant gains and losses in 2010. Certain of our research, development and production activities are carried out by our Israeli subsidiary, EFL, at its facility in Beit Shemesh, and accordingly we have sales and expenses in NIS. Additionally, our MDT and Epsilor subsidiaries operate primarily in NIS. However, the majority of our sales are made outside Israel in U.S. dollars, and a substantial portion of our costs are incurred in U.S. dollars. Therefore, our functional currency is the U.S. dollar.

While we conduct our business primarily in U.S. dollars, some of our agreements are denominated in foreign currencies, which could have an adverse effect on the revenues that we incur in foreign currencies. We do not hold or issue derivative financial instruments for trading or speculative purposes.

ITEM 4T. CONTROLS AND PROCEDURES.

As of the end of the period covered by this report, an evaluation was carried out by the Company's management, with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that these disclosure controls and procedures were effective as of the end of the period covered by this report. In addition, no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS.

Class Action Litigation

In May 2007, two purported class action complaints (the “Class Action Complaint”) were filed in the United States District Court for the Eastern District of New York against us and certain of our officers and directors. These two cases were consolidated in June 2007. In January 2010, we reached an agreement with lead plaintiffs to settle the Class Action Complaint. This agreement, providing for settlement of all claims for a monetary payment of $2.9 million funded entirely from insurance proceeds, was approved by the District Court on June 23, 2010, and accordingly the lawsuit was dismissed with prejudice, and we and all our current and former officers and directors named in the complaint have received a full and complete release of all claims asserted against us and them in the litigation, as well as any related claims that could have been asserted.

Additionally, on May 6, 2009 a purported shareholders derivative complaint (the “Derivative Complaint”) was filed in the United States District Court for the Eastern District of New York against us and certain of our officers and directors. The Derivative Complaint is based on the same facts as the class action litigation currently pending against us in the same district, and primarily relates to our acquisition of Armour of America in 2005 and certain public statements made by us with respect to our business and prospects during the Period. The Derivative Complaint seeks an unspecified amount of damages. We moved for dismissal of the Derivative Complaint in March of 2010.

Although the ultimate outcome of this matter cannot be determined with certainty, we believe that the allegations stated in the Derivative Complaint are without merit and we and our officers and directors named in the Derivative Complaint intend to defend ourselves vigorously against such allegations.

NAVAIR Litigation

In December 2004, AoA filed an action in the United States Court of Federal Claims against the United States Naval Air Systems Command (NAVAIR), seeking approximately $2.2 million in damages for NAVAIR’s alleged improper termination of a contract for the design, test and manufacture of a lightweight armor replacement system for the United States Marine Corps CH-46E rotor helicopter. NAVAIR, in its answer, counterclaimed for approximately $2.1 million in alleged reprocurement and administrative costs (subsequently revised to approximately $1.5 million). Trial in this matter has concluded and closing briefs and certain supplemental briefs have been filed, but no decision has yet been rendered.

Based on the trial results and subsequent inquiries, we, after consultation with our litigation counsel handling this case and with an outside firm with particular expertise in government contract litigation, formed a conclusion that it would be appropriate and prudent to take a allowance against an adverse decision in this case, in the amount of one-half of the amount of NAVAIR’s counterclaim. Based on the legal advice received by management, our management deemed a loss of $750,000 in this case to be a probable outcome as determined under GAAP and recorded a related charge as part of our financial statements for 2009.

ITEM 1A. RISK FACTORS.

For information regarding our risk factors, please refer to Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2009. We do not believe that there have been any material changes in the risk factors disclosed in the Annual Report on Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

In February of 2009, we authorized, for a period of one year, the repurchase in the open market or in privately negotiated transactions of up to $1 million of our common stock. Through June 30, 2010, we repurchased 482,097 shares of its common stock for $619,605 ($609,823 net of commissions), all of which was purchased after April 1, 2009. The following table shows information relating to the repurchase of our common stock during the three months ended June 30, 2010:

Period	Total Number of Shares Purchased	Average Price Paid Per Share[1]	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans
April 1, 2010 through April 30, 2010	–	$ –	–	$ 436,386
May 1, 2010 through May 31, 2010	16,439	$ 1.58	16,439	$ 410,397
June 1, 2010 through June 30, 2010	12,800	$ 1.55	12,800	$ 390,177
TOTAL THIS QUARTER	29,239		29,239	

[1]Average price paid per share includes commissions and is rounded to the nearest two decimal places.

The repurchase program is subject to management's discretion.

ITEM 6. E XHIBITS.

The following documents are filed as exhibits to this report:

Exhibit Number	Description
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNA TURES

Pursuant to the requirements 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.

Dated: August 12, 2010

AROTECH CORPORATION

By: /s/ Robert S. Ehrlich
Name: Robert S. Ehrlich
Title: Chairman and CEO
(Principal Executive Officer)

By: /s/ Thomas J. Paup
Name: Thomas J. Paup
Title: Vice President – Finance and CFO
(Principal Financial Officer)

Exhibit 31.1

CERTIFICATION

I, Robert S. Ehrlich, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Arotech Corporation;

2. Based on my knowledge, this quarterly 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 quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;

4. The registrant's other certifying officer 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 we 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 quarterly report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this quarterly report based on such evaluation; and

(c) disclosed in this quarterly 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 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 officer 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 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 controls over financial reporting.

Dated: August 12, 2010

/s/ Robert S. Ehrlich
Robert S. Ehrlich, Chairman and CEO
(Principal Executive Officer)

A signed original of this written statement required by Section 302 has been provided to Arotech Corporation and will be retained by Arotech Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

The foregoing certification is being furnished solely pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) and is not being filed as part of the Form 10-Q or as a separate disclosure document.

Exhibit 31.2

CERTIFICATION

I, Thomas J. Paup, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Arotech Corporation;

2. Based on my knowledge, this quarterly 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 quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;

4. The registrant's other certifying officer 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 we 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 quarterly report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this quarterly report based on such evaluation; and

(c) disclosed in this quarterly 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 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 officer 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 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 controls over financial reporting.

Dated: August 12, 2010

/s/ Thomas J. Paup
Thomas J. Paup, Vice President – Finance and CFO
(Principal Financial Officer)

A signed original of this written statement required by Section 302 has been provided to Arotech Corporation and will be retained by Arotech Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

The foregoing certification is being furnished solely pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) and is not being filed as part of the Form 10-Q or as a separate disclosure document.

Exhibit 32.1

WRITTEN STATEMENT

In connection with the Quarterly Report of Arotech Corporation (the "Company") on Form 10-Q for the quarterly period ended June 30, 2010 filed with the Securities and Exchange Commission (the "Report"), I, Robert S. Ehrlich, Chairman and Chief Executive Officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that to my knowledge, the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Report fairly presents, in all material respects, the consolidated financial condition of the Company and its subsidiaries as of the dates presented and the consolidated results of operations of the Company and its subsidiaries for the periods presented.

Dated: August 12, 2010

/s/ Robert S. Ehrlich
Robert S. Ehrlich, Chairman and CEO
(Principal Executive Officer)

A signed original of this written statement required by Section 906 has been provided to Arotech Corporation and will be retained by Arotech Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

The foregoing certification is being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) and is not being filed as part of the Form 10-Q or as a separate disclosure document.

Exhibit 32.2

WRITTEN STATEMENT

In connection with the Quarterly Report of Arotech Corporation (the "Company") on Form 10-Q for the quarterly period ended June 30, 2010 filed with the Securities and Exchange Commission (the "Report"), I, Thomas J. Paup, Vice President – Finance and Chief Financial Officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that to my knowledge, the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Report fairly presents, in all material respects, the consolidated financial condition of the Company and its subsidiaries as of the dates presented and the consolidated results of operations of the Company and its subsidiaries for the periods presented.

Dated: August 12, 2010

/s/ Thomas J. Paup
Thomas J. Paup, Vice President – Finance and CFO
(Principal Financial Officer)

A signed original of this written statement required by Section 906 has been provided to Arotech Corporation and will be retained by Arotech Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

The foregoing certification is being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) and is not being filed as part of the Form 10-Q or as a separate disclosure document.