SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2003.

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____.

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.)
632 Broadway, New York, New York	10012
(Address of principal executive offices)	(Zip Code)

(646) 654-2107

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
None	Not applicable

Securities registered pursuant to Section 12(g) of the Act: Common Stock, $0.01 par value

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 [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (ss. 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes [ ] No [X]

The aggregate market value of the registrant's voting stock held by non-affiliates of the registrant as of June 30, 2003 was approximately $31,017,725 (based on the last sale price of such stock on such date as reported by The Nasdaq National Market).

(Applicable only to corporate registrants) Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: 62,312,796 as of 3/23/04

Documents incorporated by reference: None

PRELIMINARY NOTE

This annual report contains historical information and forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to our business, financial condition and results of operations. The words "estimate," "project," "intend," "expect" and similar expressions are intended to identify forward-looking statements. These forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those contemplated in such forward-looking statements. Further, we operate in an industry sector where securities values may be volatile and may be influenced by economic and other factors beyond our control. In the context of the forward-looking information provided in this annual report and in other reports, please refer to the discussions of risk factors detailed in, as well as the other information contained in, our other filings with the Securities and Exchange Commission.

Electric Fuel(R) is a registered trademark and Arotech(TM) is a trademark of Arotech Corporation, formerly known as Electric Fuel Corporation. All company and product names mentioned may be trademarks or registered trademarks of their respective holders. Unless otherwise indicated, "we," "us," "our" and similar terms refer to Arotech and its subsidiaries.

PART I

ITEM 1. BUSINESS

General

We are a defense and security products and services company, engaged in three business areas: interactive simulation for military, law enforcement and commercial markets; batteries and charging systems for the military; and high-level armoring for military, paramilitary and commercial vehicles. Until September 17, 2003, we were known as Electric Fuel Corporation. We operate primarily as a holding company, through our various subsidiaries, which are organized into three divisions. Our divisions and subsidiaries are as follows:

>> We develop, manufacture and market advanced hi-tech multimedia and interactive digital solutions for use-of-force and driving training of military, law enforcement and security personnel, as well as offering security consulting and other services (our Simulation, Training and Consulting Division), consisting of:

- IES Interactive Training, Inc., located in Littleton, Colorado, which provides specialized "use of force" training for police, security personnel and the military ("IES");
- FAAC Incorporated, located in Ann Arbor, Michigan, which provides simulators, systems engineering and software products to the United States military, government and private industry ("FAAC"); and
- Arocon Security Corporation, located in New York, New York, which provides security consulting and other services, focusing on protecting life, assets and operations with minimum hindrance to personal freedom and daily activities ("Arocon").

>> We manufacture and sell Zinc-Air and lithium batteries for defense and security products and other military applications and we pioneer advancements in Zinc-Air technology for electric vehicles (our Battery and Power Systems Division), consisting of:

- Electric Fuel Battery Corporation, located in Auburn, Alabama, which manufactures and sells Zinc-Air fuel cells, batteries and chargers for the military, focusing on applications that demand high energy and light weight ("EFB");
- Epsilor Electronic Industries, Ltd., located in Dimona, Israel (in Israel's Negev desert area), which develops and sells rechargeable and primary lithium batteries and smart chargers to the military and to private industry in the Middle East, Europe and Asia ("Epsilor"); and
- Electric Fuel (E.F.L.) Ltd., located in Beit Shemesh, Israel, which produces water-activated lifejacket lights for commercial aviation and marine applications, and which conducts our Electric Vehicle effort, focusing on obtaining and implementing demonstration projects in the U.S. and Europe, and on building broad industry partnerships that can lead to eventual commercialization of our Zinc-Air energy system for electric vehicles ("EFL").

>> We utilize sophisticated lightweight materials and advanced engineering processes to armor vehicles (our Armored Vehicle Division), consisting of:

- MDT Protective Industries, Ltd., located in Lod, Israel, which specialize in using state-of-the-art lightweight ceramic materials, special ballistic glass and advanced engineering processes to fully armor vans and cars, and is a leading supplier to the Israeli military, Israeli special forces and special services ("MDT"), of which we own 75.5%; and
- MDT Armor Corporation, located in Auburn, Alabama, which conducts MDT's United States activities ("MDT Armor"), of which we own 88%.

We acquired FAAC and Epsilor in early 2004. Prior to the acquisition of FAAC and Epsilor, we were organized into two divisions: Defense and Security Products (consisting of IES, MDT, MDT Armor and Arocon), and Electric Fuel Batteries (consisting of EFL and EFB). We have reported our results of operations for 2003 and 2002 in accordance with these earlier divisions, and our financial results for 2003 and 2002 do not include the activities of FAAC or Epsilor.

Background

We began work in 1990 on the research, development and

commercialization of an advanced Zinc-Air battery system for powering electric vehicles, work that continues to this day, under the name "Electric Fuel Corporation"; we changed our name to Arotech Corporation in September 2003. Beginning in 1998, we also began to apply our Zinc-Air fuel cell technology to the defense industry, by receiving and performing a series of contracts from the U.S. Army's Communications-Electronics Command (CECOM) to develop and evaluate advanced primary Zinc-Air fuel cell packs. This effort culminated in 2002 in our receipt of a National Stock Number, a Department of Defense catalog number assigned to products authorized for use by the U.S. military, and our subsequent receipt in 2002 and 2003 of a total of $9.3 million in delivery orders for our newly designated BA-8180/U military batteries.

We further enhanced our capabilities in the defense industry through our purchase in the third quarter of 2002 of IES and MDT. In the first quarter of 2004, we added two new subsidiaries, with their business lines, to our company: FAAC and Epsilor.

Between 1998 and 2002, we were also engaged in the design, development and commercialization of our proprietary Zinc-Air fuel cell technology for portable consumer electronic devices such as cellular telephones, PDAs, digital cameras and camcorders. In October 2002, we discontinued retail sales of our consumer battery products because of the high costs associated with consumer marketing and low volume manufacturing.

We were incorporated in Delaware in 1990 under the name "Electric Fuel Corporation," and we changed our name to "Arotech Corporation" on September 17, 2003. Unless the context requires otherwise, all references to us refer collectively to Arotech Corporation and Arotech's wholly-owned Israeli subsidiaries, EFL and Epsilor; its majority-owned Israeli subsidiaries, MDT and MDT Armor; and its wholly-owned United States subsidiaries, EFB, IES, Arocon and FAAC.

For financial information concerning the business segments in which we operate, see Note 15 of the Notes to the Consolidated Financial Statements. For financial information about geographic areas in which we engage in business, see Note 15.c of the Notes to the Consolidated Financial Statements.

Simulation, Training and Consulting Division

USE-OF-FORCE TRAINING

Through our wholly-owned subsidiary, IES Interactive Training, Inc., we provide specialized "use of force" training for police, security personnel and the military. We offer products and services that allow organizations to train their personnel in safe, productive, and realistic environments. We believe that our training systems offer more functionality, greater flexibility, unprecedented realism and a wider variety of user interface options than competing products. Our systems are sold to corporations, government agencies, military and law enforcement professionals around the world. The simulators are currently used by some of the worlds leading training academies and law enforcement agencies, including (in the United States) the FBI, the Secret Service, the Bureau of Alcohol, Tobacco and Firearms, the Customs Service, the Federal Protective Service, the Border Patrol, the Bureau of Engraving and Printing, the Coast Guard, the Federal Law Enforcement Training Centers, the Department of Health and Human Services, the California Department of Corrections, NASA, police departments in Texas (Houston), Michigan (Detroit), D.C., California (Fresno and the California Highway Patrol), Massachusetts (Brookline), Virginia (Newport News and the State Police Academy), Arizona (Maricopa County), universities and nuclear power plants, as well as international users such as the Israeli Defense Forces, the German National Police, the Royal Thailand Army, the Hong Kong Police, the Russian Security Police, and over 500 other training departments worldwide.

Our interactive training systems vary from the powerful Range 3000 use-of-force simulator system to the multi-faceted A2Z Classroom Training system. The Range 3000 line of simulators addresses the entire use of force training continuum in law enforcement, allowing the trainee to use posture, verbalization, soft hand skills, impact weapons, chemical spray, low-light electronic weapons and lethal force in a scenario based classroom environment. The A2Z Classroom Trainer provides the trainer with real time electronic feedback from every student through wireless handheld keypads. The combination of interactivity and instant response assures that learning takes place in less time with higher retention.

VEHICLE SIMULATORS

Through our wholly-owned subsidiary, FAAC Corporation, we provide simulators, systems engineering and software products to the United States military, government and private industry. FAAC's fully interactive driver-training systems feature state-of-the-art vehicle simulator technology enabling training in situation awareness, risk analysis and decision making, emergency reaction and avoidance procedures, and conscientious equipment operation. FAAC has an installed base of 179 simulators that have successfully trained over 80,000 drivers. FAAC's customer base includes all branches of the Department of Defense, state and local governments, and commercial entities.

We believe that FAAC is the premier developer of validated, high fidelity analytical models and simulations of tactical air and land warfare for all branches of the Department of Defense and its related industrial

contractors. Simulations developed by FAAC are found in systems ranging from instrumented air combat and maneuver ranges (such as Top Gun) to full task training devices such as the F-18 Weapon Tactics Trainer.

FAAC supplies on-board software to support weapon launch decisions for the F-15, F-18, and Joint Strike Fighter fighter aircraft. Pilots benefit by having highly accurate presentations of their weapon's capabilities, including susceptibility to target defensive reactions. FAAC designed and developed an Instructor operator station, mission operator station and real-time, database driven electronic combat environment for the special operational forces aircrew training system. The special operational forces aircrew training system provides a full range of aircrew training, including initial qualification, mission qualification, continuation, and upgrade training, as well as combat mission rehearsal.

SECURITY CONSULTING

Arocon Security Corporation focuses on protecting life, assets and operations with minimum hindrance to personal freedom and daily activities. Arocon Security, which provides security consulting and other services, has signed an agreement with Rafael Armament Development Authority Ltd., Israel's leading defense research and development company, to market and implement certain of Rafael's security products and technology in the United States.

Battery and Power Systems Division

ZINC-AIR FUEL CELLS, BATTERIES AND CHARGERS FOR THE MILITARY

We have been engaged in research and development in the field of Zinc-Air electrochemistry and battery design for over ten years, as a result of which we have developed our current Zinc-Air technology and its applications. We have successfully applied our technology to our high-energy battery packs for military and security applications. We have also applied our technology to the development of a refuelable Zinc-Air fuel cell for powering zero-emission electric vehicles. Through these efforts, we have sought to position ourselves as a world leader in the application of Zinc-Air technology to innovative primary and refuelable power sources.

Our primary existing battery product for the military and defense sectors is a 12/24 volt, 800 watt-hour battery pack for battlefield power, which is based on our Zinc-Air fuel cell technology, weighs only six pounds and has approximately twice the energy capacity per pound of the U.S. Army's standard lithium-sulfur dioxide battery packs - the BA-8180/U battery, which offer extended-use portable power using our commercial Zinc-Air cell technology. Our BA-8180/U battery has received a National Stock Number (a Department of Defense catalog number assigned to products authorized for use by the U.S. military), making our batteries available for purchase by all units of the U.S. Armed Forces.

We believe that our Zinc-Air batteries provide the highest energy and power density combination available today in the defense market, making them particularly appropriate where long missions are required and low weight is important.

LITHIUM BATTERIES AND CHARGING SYSTEMS FOR THE MILITARY

Recent developments and improvements in lithium rechargeable batteries have caused the US military, as well as armies worldwide, to shift many battery-operated devices to cost-effective rechargeable batteries. Non-rechargeable batteries continue to be the leading source of energy in war and during limited conflicts. For more than ten years, our wholly-owned subsidiary Epsilor Electronic Industries, Ltd. has developed and sold rechargeable and primary lithium batteries and smart chargers to the military, and to private industry in the Middle East, Europe and Asia.

ELECTRIC VEHICLE

Our electric vehicle effort, conducted through our subsidiary Electric Fuel Battery Corporation, continues to focus on finding a strategic partner that can lead the way to eventual commercialization of the Zinc-Air energy system. Our all-electric bus, powered by our Zinc-Air fuel cell technology, has demonstrated a world-record 127-mile range under rigorous urban conditions.

LIFEJACKET LIGHTS

We produce water-activated lifejacket lights for commercial aviation and marine applications based on our patented water-activated magnesium-cuprous chloride battery technology. We intend to continue to work with original equipment manufacturers (OEMs), distributors and end-user companies to expand our market share in the aviation and marine segments. We presently sell five products in the safety products group, three for use with marine life jackets and two for use with aviation life vests. All five products are certified under applicable international marine and aviation safety regulations.

Armored Vehicle Division

Through our majority-owned MDT Protective Industries Ltd. and MDT Armor Corporation subsidiaries, we specialize in using state-of-the-art lightweight ceramic materials, special ballistic glass and advanced engineering processes to fully armor vans and cars. MDT is a leading supplier to the Israeli military, Israeli special forces and special services. MDT's products are proven in intensive battlefield situations and under actual terrorist attack conditions, and are designed to meet the demanding requirements of governmental and private sector customers worldwide.

Facilities

Our principal executive offices are located at 632 Broadway, New York, New York 10012, and our telephone number at our executive offices is (646) 654-2107. Beginning April 15, 2004, we will move to new headquarters located at 250 West 57th Street, Suite 310, New York, New York 10107, and our new telephone number will be (212) 258-3222. Our corporate website is www.arotech.com. Our periodic reports to the Securities Exchange Commission, as well as recent filings relating to transactions in our securities by our executive officers and directors, that have been filed with the Securities and Exchange Commission in EDGAR format are made available through hyperlinks located on the investor relations page of our website, at http://www.arotech.com/compro/investor.html, as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. Reference to our websites does not constitute incorporation of any of the information thereon or linked thereto into this annual report.

The offices and facilities of our three of our principal subsidiaries, EFL, MDT and Epsilor, are located in Israel (in Beit Shemesh, Lod and Dimona, respectively, all of which are within Israel's pre-1967 borders). Most of our senior management is located at EFL's facilities. IES's offices and facilities are located in Littleton, Colorado, FAAC's offices and facilities are located in Ann Arbor, Michigan, and the offices and facilities of EFB and MDT Armor are located in Auburn, Alabama.

Simulation, Training and Consulting Division

Use-of-Force Training

We conduct our interactive training activities through our subsidiary IES Interactive Training, Inc. ("IES"), a Delaware corporation based in Littleton, Colorado. IES is a leading provider of interactive, multimedia, fully digital training simulators for law enforcement, security, military and similar applications. With a customer base of over 500 customers in over twenty countries around the world, IES is a leader in the supply of simulation training products to military, law enforcement and corporate client communities. We believe, based on our general knowledge of the size of the interactive use-of-force market, our specific knowledge of the extent of our sales, and discussions we have held with customers at trade shows, etc., that IES provides more than 35% of the worldwide market for government and military judgment training simulators.

INTRODUCTION

IES offers consumers the following interactive training products and services:

>> Range 3000 - providing use of force simulation for military and law enforcement. We believe that the Range 3000 is the most technologically advanced judgment training simulator in the world.

>> A2Z Classroom Trainer - a state-of-the-art computer based training (CBT) system that allows students to interact with realistic interactive scenarios projected life-size in the classroom.

>> Range FDU (Firearms Diagnostic Unit) - a unique combination of training and interactive technologies that give instructors a first-person perspective of what trainees are seeing and doing when firing a weapon.

>> Summit Training International - providing relevant, cost-effective professional training services and interactive courseware for law enforcement, corrections and corporate clients.

>> IES Studio Productions - providing cutting edge multimedia video services for law enforcement, military and security agencies, utilizing the newest equipment to create the training services required by the most demanding authorities.

Our products feature state of the art all digital video formats, ultra-advanced laser-based lane detection for optimal accuracy and performance, customer-based authoring of training scenarios, and 95% COTS (commercial off-the-shelf)-based system.

IES's revenues during 2001, 2002 and 2003 were approximately $3.5 million, $5.1 million and $8.0 million, respectively.

PRODUCTS

Below is a description of each of the core products and services in the IES line.

Range 3000 "Use of Force" Simulator

We believe that the Range 3000, which IES launched in late 2002, combines the most powerful operational hardware and software available, and

delivers performance unobtainable by any competing product presently on the market.

The Range 3000 simulator allows training with respect to the full "Use of Force" continuum. Training can be done on an individual basis, or as many as four members of a team can participate simultaneously and be scored and recorded individually. Topics of training include (but are not limited to):

>> Officer's Presence and Demeanor - Picture-on-picture digital recordings of the trainee's actions allows visual review of the trainee's reaction, body language and weapons handling during the course of the scenario, which then can be played back for debriefing of the trainee's actions.

>> Verbalization - Correct phrases, timing, manner and sequence of an officer's dialogue is integrated within the platform of the system, allowing the situation to escalate or de-escalate through the officer's own words in the context of the scenario and in conjunction with the trainer.

>> Less-Than-Lethal Training - Training in the use of non-lethal devices such as Taser, OC (pepper spray), batons and other devices can be used with the video training scenarios with appropriate reactions of each.

>> Soft Hand Tactics - Low level physical control tactics with the use of additional equipment such as take-down dummies can be used.

>> Firearms Training and Basic Marksmanship - Either utilizing laser based training weapons or in conjunction with a live-fire screen, the use of "Live Ammunition" training can be employed on the system.

The interactive training scenarios are projected either through single or multiple screens and projectors, allowing IES to immerse a trainee in true-to-life training scenarios and incorporating one or all the above training issues in the "Use of Force" continuum.

A2Z Classroom Trainer

The A2Z is a state-of-the-art Computer Based Training (CBT) system that allows students to interact with realistic interactive scenarios projected life-size in the classroom.

Using individual hand-held keypads, the students can answer true/false or multiple choice questions. Based on the student's performance, the scenario will branch and unfold to a virtually unlimited variety of different possible outcomes of the student's actions. The system logs and automatically scores each and every trainee's response and answer. At the end of the scenario, the system displays a session results summary from which the trainer can debrief the class.

The advanced A2Z Courseware Authoring Tools allow the trainer easily to create complete customized interactive courses and scenarios.

The Authoring Tools harness advances in digital video and multimedia, allowing the trainer to capture video and graphics from any source. The A2Z allows the trainer to combine his or her insight, experience and skills to recreate a realistic learning environment. The A2Z Training System is based on the well-known PC-Pentium technology and Windows XPTM operated. The menu and mouse operation make the A2Z user-friendly.

The individual keypads are connected "wirelessly." The system is completely portable and may be setup within a matter of minutes.

Key advantages:

>> Provides repeatable training to a standard based on established policy

>> Quick dissemination and reinforcement of correct behavior and policies

>> Helps reduces liability

>> More efficient than "traditional and redundant" role-playing methods

>> Realistic scenarios instead of outdated "play-acting"

>> Interactive training of up to 250 students simultaneously with wireless keypads

>> Easy Self-Authoring of interactive training content

>> PC-Pentium platform facilitates low cost of ownership

>> Easy to use Windows XP-based software

>> Easy to deploy in any classroom

Range FDU

The Range FDU (firearm diagnostics unit) is a unique combination of

training and interactive technologies that give instructors a first-person perspective of what trainees are seeing and doing when firing a weapon. The Range FDU is the only firearms training technology of its kind.

With the Range FDU, firearms instructors can see the trainees' actual sight alignment to the target as well as measure trigger pressure against proper trigger pressure graphs, making corrective instruction simple and effective. In addition, the Range FDU records a trainee's recoil control, grip and stance - allowing the instructor to playback the information in slow motion or real time to better analyze the trainee's actions and more accurately diagnose any deficiencies.

The Range FDU also has the ability to record the firearm instruction session to either DVD or VHS, allowing both the trainee and the instructor to review it at a later time. Trainees now have a diagnostic tool that they can learn from, even after their training has been completed. In addition, instructors can build a library for each trainee to record progress.

The Range FDU provides the following benefits:

>> Fall of shot feedback

>> Trigger pressure analysis

>> Recoil control, grip and stance assessment

>> Sight alignment

>> Sight picture analysis and target reacquisition

Summit Training International

Summit Training International (STI) is a wholly-owned subsidiary of IES Interactive Training. STI provides relevant, cost-effective professional training seminars, consulting services, and interactive courseware for law enforcement, corrections, and corporate clients. STI's emphasis and goal is to create a "total training" environment designed to address the cutting edge issues faced today. STI provides conferences throughout the United States, and develops courseware dealing with these important topics. The incorporation of IES Interactive Systems creates an intense learning environment and adds to the realism of the trainee's experience.

Conferences

STI has provided conferences throughout the United States, on such topics as:

>> Recruiting and Retention of Law Enforcement and Corrections Personnel

>> Ethics and Integrity

>> Issues of Hate Crimes

>> Traffic Stops and Use of Force

>> Community and Corporate Partnerships for Public Safety

>> Creating a Safe School Environment

In addition to these national and regional conferences, STI designs and produces training to address specific department issues. STI has a distinguished cadre of instructors that allows adaptation of programs to make them specifically focused for a more intense learning experience. The A2Z Classroom Trainer is incorporated into the "live" presentation creating a stimulating interactive training experience.

Courseware

STI develops courseware for use exclusively with IES's interactive systems. Courses are designed to addresses specific department issues, and can be customized to fit each agency's needs. These courses are available in boxed sets that provide the customer with a turn-key training session. The A2Z Classroom Trainer and the Range 3000 XP-4 are used to deliver the curriculum and create a virtual world that the trainees respond and react to. Strategic

relationships with high profile companies such as H&K Firearms, and Taser International, provide customers with training that deals with cutting edge issues facing law enforcement today. The incorporation of STI's courseware library along with simulation systems allows training to remain consistent and effective, giving customers more value for their training dollar.

IES Studio Productions

IES Studio Productions, a division of IES, provides multimedia video services for law enforcement, military and security agencies, and others. IES Studio Productions creates interactive courseware and interactive scenarios for the Range 3000, Video Training Scenarios and all types of video production services. With the latest in media equipment, IES Studio Productions provides all media and marketing services to IES Interactive Training in-house.

MARKETING

IES markets its products and services to domestic and international law enforcement, military and other federal agencies and to various companies that serve them, through attendance and presentations at conferences, exhibits at trade shows, seminars at law enforcement academies and government agencies, through its web pages on the Internet, and to its compiled database of prospect and customer names. IES's salespeople are also its marketing team. We believe that this is effective for several reasons: (1) customers appreciate talking directly with salespeople who can answer a wide range of technical questions about methods and features, (2) our salespeople benefit from direct customer contact through gaining an appreciation for the environment and problems of the customer, and (3) the relationships we build through peer-to-peer contact are useful in the military, police and federal agency market.

IES also uses its web pages on the Internet for such activities as providing product information and software updates.

IES markets augmentative and alternative law enforcement products through a network of employee representatives and independent resellers. These products include but are not limited to products manufactured by:

>> Bristlecone Products

>> Airmunitions Inc.

>> Taser Inc.

>> ASP Inc.

>> H&K Training Centers

At the present time IES has six sales representatives based in Denver, eight domestic independent distributors, and fifteen independent resellers / representatives overseas. IES also has three inside sales/support persons who answer telephone inquiries on IES's 800 line and Internet, and who can also provide technical support. Additional outside salespersons and independent dealers and resellers are being actively recruited at this time.

IES typically participates in over thirty industry conferences annually, held throughout the United States and in other countries, that are attended by our potential customers and their respective purchasing and budgeting decision makers. A significant percentage of IES's sales of products, both software and hardware, are sold through leads developed at these shows.

IES and others in the industry demonstrate their products at these conferences and present technical papers that describe the application of their technologies and the effectiveness of their products. IES also advertises in selected publications of interest to potential customers.

CUSTOMERS

Most of IES's customers are law enforcement agencies, both in the United States (federal, state and local) and worldwide. Purchasers of IES products have included (in the United States) the FBI, the Secret Service, the Bureau of Alcohol, Tobacco and Firearms, the Customs Service, the Federal Protective Service, the Border Patrol, the Bureau of Engraving and Printing, the Coast Guard, the Federal Law Enforcement Training Centers, the Department of Health and Human Services, the California Department of Corrections, NASA, police departments in Texas (Houston), Michigan (Detroit), D.C., California (Fresno and the California Highway Patrol), Massachusetts (Brookline), Virginia (Newport News and the State Police Academy), Arizona (Maricopa County), universities and nuclear power plants, as well as international users such as the Israeli Defense Forces, the German National Police, the Royal Thailand Army, the Hong Kong Police, the Russian Security Police, and over 500 other training departments worldwide.

The mix of customers has historically been approximately 40% city and state agencies, 30% federal agencies, and 30% international. During 2003, IES's order from the German National Police accounted for 16% of our revenues on a consolidated basis.

COMPETITION

IES competes against a number of established companies that provide similar products and services, many of which have financial, technical, marketing, sales, manufacturing, distribution and other resources significantly greater than ours. There are also companies whose products do not compete directly, but are sometimes closely related. Firearms Training Systems, Inc., Advanced Interactive Systems, Inc., and LaserShot Inc. are IES's main competitors.

We believe the key factors in our competing successfully in this field will be our ability to develop simulation software and related products and services to effectively train law enforcement and military to today's standards, our ability to develop and maintain a proprietary technologically advanced hardware, and our ability to develop and maintain relationships with departments and government agencies.

Vehicle Simulators

Through our wholly-owned subsidiary, FAAC Corporation, we provide simulators, systems engineering and software products to the United States military, government and private industry. FAAC's fully interactive

driver-training systems feature state-of-the-art vehicle simulator technology enabling training in situation awareness, risk analysis and decision making, emergency reaction and avoidance procedures, and conscientious equipment operation. FAAC has an installed base of over 179 simulators that have successfully trained over 80,000 drivers. FAAC's customer base includes all branches of the U.S. Department of Defense, state and local governments, and commercial entities.

INTRODUCTION

Based in Ann Arbor, Michigan, FAAC is a premier developer of validated, high fidelity analytical models and simulations of tactical air and land warfare for all branches of the Department of Defense and its related industrial contractors. Simulations developed by FAAC are found in systems ranging from instrumented air combat and maneuver ranges (such as Top Gun) to full task training devices such as the F-18 Weapon Tactics Trainer. FAAC is also the leading supplier of wheeled vehicle simulators to the U.S. Armed Forces for mission-critical vehicle training. Management believes that FAAC has held a 100% market share in U.S. military wheeled simulators since 1999 and holds a market share in excess of 50% in commercial wheeled vehicle simulators.

Simulators are cost-effective solutions, enabling users to reduce overall aircraft and ground vehicle usage, vehicle maintenance costs, fuel costs, repairs, and spares expenditures. For example, FAAC's Medium Tactical Vehicle Replacement (MTVR) simulators have reduced total driver training time by 35%. Many customers have reduced actual "behind-the-wheel" time by up to 50% while still maintaining or improving safety. Additionally, for customers with multiple simulators, the corresponding increase in the student to instructor ratio has reduced instructor cost per student.

The implementation of FAAC simulators has led to measurable benefits. North American Van Lines, one of FAAC's earliest vehicle simulator customers, has shown a 22% reduction in preventable accidents since it began using FAAC's simulators. The German Army, one of FAAC's earliest Military Vehicle customers, showed better driver testing scores in 14 of 18 driver skills compared to classroom and live driver training results. Additionally, the New York City Transit Authority documented a 43% reduction in preventable accidents over its first six months of use and has reduced its driver hiring and training "washout" by 50%.

Simulators can produce more drastic situations than can traditional training, which inherently produces drivers that are more skilled in diverse driving conditions. For example, while many first-time drivers will learn to drive during the summer months, they are not trained to drive in wintry conditions. Simulators can produce these and other situations, such as a tire blowout or having to react to a driver cutting off the trainee, effectively preparing the driver for adverse conditions.

FAAC supplies on-board software to support weapon launch decisions for the F-15, F-18, and Joint Strike Fighter fighter aircraft. Pilots benefit by having highly accurate presentations of their weapon's capabilities, including susceptibility to target defensive reactions. FAAC designed and developed an Instructor operator station, mission operator station and real-time, database driven electronic combat environment for the special operational forces aircrew training system. The special operational forces aircrew training system provides a full range of aircrew training, including initial qualification, mission qualification, continuation, and upgrade training, as well as combat mission rehearsal.

FAAC operates in two primary business areas: Vehicle Simulations, which focuses on the development and delivery of complete driving simulations for a wide range of vehicle types - such as trucks, automobiles, buses, fire trucks, police cars, ambulances, airport ground vehicles, and military vehicles - for commercial, governmental and foreign customers; and Military Operations, which conducts tactical air and land combat analysis and develops analytical models, simulations, and "turnkey" training systems for the U.S. military. In 2003, Vehicle Simulations accounted for approximately 75% of FAAC's revenues, and Military Operations accounted for approximately 25% of FAAC's revenues.

FAAC's revenues during 2001, 2002 and 2003 were approximately $12.2 million, $15.2 million and $9.8 million, respectively.

PRODUCT LINES

Below is a description of FAAC's products and product lines.

Vehicle Simulations

Military Vehicles

Military Vehicles is FAAC's largest business segment. Military vehicle simulators are highly realistic vehicle simulators that include variable reactive traffic and road conditions, the capacity to customize driving conditions to be geography-specific, and training in hazardous and emergency conditions. FAAC has several large contracts and task orders in the Military Vehicles business, including (i) the MTVR contract to develop vehicle simulators and related training services for the U.S. Marine Corps; (ii) a series of scheduled General Services Administration purchases of simulators with the U.S. Army to supply 78 simulators for 25 training sites; and (iii) a two-year contract with the U.S. Navy Seabees to supply eight simulators for three

training sites. Management estimates that FAAC's software trained 9,000 soldiers at four sites in 2002.

FAAC's military vehicle simulators provide complete training capabilities based on integrated, effective simulation solutions to military vehicle operators in the U.S. Armed Forces. FAAC's flagship military vehicle simulation product is its MTVR Operator Driver Simulator, developed for the USMC. The MTVR ODS concept is centered on a pod of up to six Student Training Stations (STS) and a single controlling Instructor Operator Station (IOS). The STS realistically simulates the form, fit, and feel of the MTVR vehicle. The high-fidelity version of the STS consists of a modified production cab unit mounted on a full six-degree-of-freedom motion platform. The STS provides over an 180-degree field of view into a realistically depicted virtual world, simulating a variety of on-road and off-road conditions. The IOS is the main simulation control point supporting the instructor's role in simulator training. The IOS initializes and configures the attached STS, conducts training scenarios, assesses student performance, and maintains scenarios and approved curriculum.

FAAC's software solution provides a complete operator training curriculum based upon integrated simulation training. Military vehicle simulators enable students to learn proper operational techniques under all terrain, weather, road, and traffic conditions. Instructors can use simulators as the primary instructional device, quantitatively evaluating student performance under controlled, repeatable scenarios. This monitoring, combined with the ability to create hazardous and potentially dangerous situations without risk to man or material, results in well-trained students at significantly less cost than through the use of traditional training techniques. In addition to standard on-road driver training, FAAC's military vehicle simulators can provide training in such tasks as:

>> Off-road driving on severe slopes, including muddy or swampy terrain;

>> Night vision goggle and blackout conditions;

>> Convoy training; and

>> The use of the Central Tire Inflation System in response to changing terrain.

In addition to simulation systems, FAAC offers on-site operator and maintenance staff, train-the-trainer courses, curriculum development, scenario development, system maintenance, software upgrades, and warranty packages to its U.S. Armed Forces customers.

Commercial Vehicles

Commercial Vehicles is FAAC's second largest business segment. The Commercial Vehicles business is comprised of technology similar to that of the Military Vehicles product line and also is customized to reflect the specific vehicle being simulated. FAAC serves four primary customer bases in the Commercial Vehicles business: transit, municipal, airport, and corporate customers.

Transit

Transit customers represent an attractive customer base as they generally have access to their own funds, which often exempts them from the lengthy and complex process of requesting funds from a governing body. FAAC has provided simulators to ten leading transit authorities, including the New York City Transit Authority, Washington, D.C. Metro, and Dallas Area Rapid Transit.

Municipal

FAAC targets municipal customers in police departments, hospitals, fire departments, and departments of transportation for sales of its municipal product. FAAC's customers include the Mexico Department of Education, California Department of Transportation, and the Fire Department of New York. FAAC is developing an industry advisory group focusing on the municipal market to identify and address customer needs. Additionally, FAAC has developed a simulator module to extend the simulation once police, fire, or emergency medical service personnel reach the incident location. FAAC management believes that this represents another of FAAC's bases of differentiation over its competition.

Airport

FAAC was a pioneer in providing simulation software to airports to facilitate training personnel in adverse conditions, including the Detroit and Toronto airports.

Corporate

FAAC targets corporate fleets and "for-hire" haulers as customers of the corporate simulator product. These customers use simulators to train personnel effectively as well as to avoid the brand damage that could be associated with poor driver performance. To date, FAAC has provided simulators to customers such as Schlumberger Oil Services, Kramer Entertainment, and North American Van Lines.

Military Operations

FAAC provides air combat range software, missile launch envelope decision support software, the SimBuilder(TM) simulation software product, and Weapon System Trainer software through the Military Operations business line.

Air Combat Range Software

FAAC serves the U.S. Air Force Air Combat Training System and U.S. Navy Tactical Aircrew Training System with its air combat training range software. Air combat training ranges allow pilots to train and evaluate new tactics in a controlled airborne environment. Air "battles" are extremely realistic, with FAAC software determining the outcome of weapon engagements based on launch conditions and the target aircraft defensive reactions.

Missile Launch Envelope Software

Onboard weapon decision-making software enables pilots to assimilate the complex information presented to them in F-15 and F-18 fighter aircraft. FAAC provides its missile launch envelope software to the U.S. Navy and Air Force through its subcontracting relationships with Boeing.

Weapon System Trainer Software

FAAC has successfully transitioned software from U.S. Navy Tactical Aircrew Training Systems to over 15 Weapon Systems Trainers built by prime contractors such as L-3, Boeing, Northrop Grumman, and Lockheed Martin.

SIMBuilder(TM)

The SimBuilder(TM) simulation software product is designed to provide weapons simulation models for use in training environments for launched weapons. This software enables foreign end-users to use weapons simulation models similar to the U.S. military without classified U.S. weapons data. Militaries of Canada, Taiwan, and Singapore currently use SimBuilders(TM).

MARKETING

The sales and marketing effort at FAAC focuses on developing new business opportunities as well as generating follow-on sales of simulators and upgrades. FAAC currently employs four dedicated sales representatives who focus on Commercial Vehicles, Military Operations, and Military Vehicles opportunities. Furthermore, two additional FAAC employees spend a significant portion of their time in sales. Various members of senior management serve as effective sales representatives in the generation of municipal, military, and corporate business. FAAC also retains the services of four independent consultants who act as marketing agents on FAAC's behalf. These representatives are largely commission-based agents who focus on particular products and/or regions (such as airport customers, Texas, California, and Eglin Air Force Base). Finally, FAAC has four customers that have agreements wherein the companies support FAAC marketing efforts and market FAAC products themselves in exchange for commissions and/or free upgrade services.

FAAC's sales representatives are salaried employees with minimal commission-based revenue. Independent consultants generally do not receive a base salary and receive 5% to 10% commissions on the amount of business that they generate each year. The majority of FAAC's sales representatives have engineering backgrounds that they leverage to anticipate the technical needs of FAAC's dynamic customer base and targeted markets. Additionally, the program manager and service department assist FAAC in gaining repeat business.

Developing a pipeline of follow-on work is one of the tasks for all program managers. FAAC has a long history of repeat and follow-on work with programs such as F-15 and F-18 ZAP (over 20 contracts with Boeing), the U.S. Navy Tactical Aircrew Training System (a series of 6 sequential contracts over the last 25 years), and F-18 Weapon Tactics Trainer (series of 20 contracts with the simulator manufacturer).

FAAC also aggressively pursues several marketing initiatives to complement its experienced sales force. FAAC's most successful marketing strategy includes the formation of industry advisory groups. Such advisory groups, which consist of simulation users within select industries, conduct regular seminars to educate transit and similar agencies on the benefits and challenges of simulation-based training, as well as to share training concepts, curriculums, and experiences. These sessions not only serve as excellent sales and marketing tools to generate orders but also have created significant goodwill with customers. FAAC management believes that these industry advisory groups have proven to be particularly successful in cooperative industries, such as transit, where users are self-funded and do not compete with one another.

CUSTOMERS

FAAC has long-term relationships, many of over ten years' duration, with the U.S. Air Force, U.S. Navy, U.S. Army, and most major Department of Defense training and simulation prime contractors and related subcontractors. The quality of FAAC's customer relationships is illustrated by the multiple program contract awards it has earned with many of its customers. For example, under a series of 20 subcontracts over 15 years, FAAC has provided the tactical environment and F-18 weapons and avionics models for the F/A-18 Weapons Tactics Trainer. FAAC has served as a subcontractor for the F/A-18 WTT through three distinct prime contractor tenures.

COMPETITION

FAAC's technical excellence, superior product reliability, and high customer satisfaction have enabled FAAC to develop market leadership and an attractive competitive position. Several potential competitors in the military segment are large, diversified defense and aerospace conglomerates who do not focus on FAAC's specific niches. As such, FAAC is able to serve certain large military contracts through strategic agreements with these organizations or can compete directly with these organizations based on FAAC's strength in developing higher quality software solutions. In commercial market applications, FAAC competes against smaller, less sophisticated software companies.

FAAC differentiates itself from its competition on several bases:

>> Leading Technology - Management believes that FAAC offers better-developed, more dynamic software than its competitors. Additionally, FAAC incorporates leading graphics and motion-cueing technologies in its systems to provide customers with the most realistic simulation experience on the market.

>> Long History in the Simulation Software Business - As a market leader in the simulation software business for more than thirty years, FAAC's professionals understand customer requirements and operating environments. Thus, FAAC builds its software to meet and exceed demanding customers' expectations.

>> Low-Cost Research and Development Capabilities for New Products - FAAC's customers benefit from government and commercial funding of research and development and the low cost of subsequent adaptation. As such, internally funded new product development costs have been less than $100,000 per year since 1999.

>> Service Reputation - FAAC is known for providing better service than the competition, a characteristic that drives new business within FAAC's chosen markets.

>> Standardized Development Processes - FAAC generally delivers its products to the market more quickly than its competition and at higher quality due to its standardized development processes.

Below is a description of FAAC's competition organized by product lines.

Vehicle Simulations

Military Vehicles

FAAC has been the sole provider of wheeled vehicle simulation solutions to the U.S. military since 1999. FAAC's devotion to developing realistic, comprehensive products for a wide range of vehicle types positions it as the preferred simulation provider within this market niche. FAAC's strategy of identifying a training need, isolating government funds, and then developing a customized training solution has led to considerable successes. This approach, which differs from the "build first and market later" strategy employed by a number of FAAC's competitors, effectively identifies market opportunities and provides a better product to the military customer. Diversified defense companies and commercial simulation providers have attempted to enter the military wheeled vehicle market but have been unsuccessful thus far. Although FAAC's management believes that market penetration by these companies is ultimately inevitable, FAAC's established brand, understanding of customer requirements, and engineering expertise provide FAAC with a competitive advantage in this market segment. FAAC's primary competitors for military vehicle simulation solutions include Lockheed Martin Corporation's Information & Technology Services Group, Raydon Corporation, and the Cubic Defense Applications division of Cubic Corporation.

Commercial Vehicles

A handful of simulation product and service companies currently compete with FAAC's targeted commercial driving simulator markets. However, FAAC's marketing and development of selected commercial market segments has positioned FAAC as a leading provider of commercial simulation solutions. Competition within each market segment varies, but the following companies generally participate in selected driving simulator market opportunities: GE Capital I-Sim (a subsidiary of GE Capital Commercial Equipment Financing), Doron Precision Systems, Lockheed-Martin Corporation's LMIS Division, Global SIM, and USADriveSafe, Inc.

Military Operations

Currently no significant competitors participate in the market for FAAC's tactical environment software, and there are essentially no independent competitors that exist in the market for FAAC's decision support software. Competition for software to support tactical environment requirements in aircraft weapon systems trainers comes from the manufacturers of the simulators themselves and from a handful of companies who produce tactical environment software. FAAC's primary competitors for training range software, decision support software, and weapons system trainer software solutions include Lockheed Martin Corporation, L-3 Communications Holdings, Raytheon Company, Science

Applications International Corporation, Dynetics, Inc., and Georgia Tech Research Institute.

Security Consulting

Arocon Security Corporation focuses on protecting life, assets and operations with minimum hindrance to personal freedom and daily activities. Arocon Security, which provides security consulting and other services, has signed an agreement with Rafael Armament Development Authority Ltd., Israel's leading defense research and development company, to market and implement certain of Rafael's security products and technology in the United States.

Battery and Power Systems Division

Zinc-Air Fuel Cells, Batteries and Chargers for the Military

We base our strategy in the field of Zinc-Air military batteries on the development and commercialization of our next-generation Zinc-Air fuel cell technology, as applied in our batteries that we produce for the U.S. Army's Communications and Electronics Command (CECOM). We will continue to seek new applications for our technology in defense projects, wherever synergistic technology and business benefits may exist. We intend to continue to develop our battery products for defense agencies, and plan to sell our products either directly to such agencies or through prime contractors.

Since 1998 we have received and performed a series of contracts from CECOM to develop and evaluate advanced primary Zinc-Air fuel cell packs. Pursuant to these contracts, we developed and began selling in 2002 a 12/24 volt, 800 watt-hour battery pack for battlefield power, which is based on our Zinc-Air fuel cell technology, weighs only six pounds and has approximately twice the energy capacity per pound of the U.S. Army's standard lithium-sulfur dioxide battery packs - the BA-8180/U battery.

In the second half of 2002, our five-year program with CECOM to develop a Zinc-Air battery for battlefield power culminated in the assignment of a National Stock Number and a $2.5 million delivery order for the newly designated BA-8180/U battery. Subsequent to this initial $2.5 million delivery order, we received in 2003 an additional $6.8 million in follow-on orders from the Army.

Our batteries have been used in both Afghanistan (Operation Enduring Freedom) and in Iraq (Operation Iraqi Freedom). The significant contribution that our batteries made to both these endeavors was recognized by General Tommy R. Franks, then the Commander of United States Central Command (USCENTCOM), who said in a letter to EFB dated July 3, 2003, "Your efforts in managing and supplying zinc-air batteries were seen as nothing less than spectacular. The long hours, hard work, and personal sacrifices made in support of these operations have ensured our War Fighters had the necessary resources to successfully conduct their missions without interruption."

Our Zinc-Air fuel cells, batteries and chargers for the military are manufactured through our Electric Fuel Battery Corporation subsidiary. In 2003, EFB's facilities were granted ISO 9001 "Top Quality Standard" certification.

PRODUCTS

Zinc-Air Power Packs

BA-8180/U

Electric Fuel Zinc-Air power packs are lightweight, low-cost primary Zinc-Air batteries with up to twice the energy capacity per pound of primary lithium (LiSO2) battery packs, which are the most popular batteries used in the US military today. Zinc-Air batteries are inherently safe in storage, transportation, use, and disposal.

The BA-8180/U is a 12/24 volt, 800 watt-hour battery pack approximately the size and weight of a notebook computer. The battery is based on a new generation of lightweight, 30 ampere-hour cells developed by us over the last five years with partial funding by CECOM. Each BA-8180/U battery pack contains 24 cells.

The battery has specific energy of up to 350 Wh/kg, which is substantially higher than that of any competing disposable battery available to the defense and security industries. By way of comparison, the BA-5590, a popular LiSO2 battery pack, has only 175 Wh/kg. Specific energy, or energy capacity per unit of weight, translates into longer operating times for battery-powered electronic equipment, and greater portability as well. Because of lower cost per watt-hour, the BA-8180/U can provide substantial cost savings to the Army when deployed for longer missions, even for applications that are not man-portable.

CECOM has assigned a National Stock Number (NSN) to our Zinc-Air battery, making it possible to order and stock the battery for use by the Armed Forces. CECOM also assigned the designation BA-8180/U to our Zinc-Air battery, the first time an official US Army battery designation was ever assigned to a Zinc-Air battery.

Based on extensive contacts with the US and foreign military agencies, we believe that a significant market exists for the BA-8180/U both in the US Armed Forces and abroad.

8140/U

The BA-8140/U is a new product, presently being field tested and at its initial procurement stages. The BA-8140/U is a smaller version of our 8180/U, which we developed at the request of CECOM. It is approximately half the size, weight and capacity of our 8180/U, and is appropriate for smaller hand-held communications devices.

Adapters

The BA-8180/U is a battery, but in order to connect it to a specific piece of equipment, an adapter must be used. In order to provide compatibility between the BA-8180/U and various items of military equipment, we supply various types of electrical interface adapters for the BA-8180/U, including equipment-specific adapters for the AN/PRC-119 SINCGARS and SINCGARS ASIP tactical radio sets, and a generic interface for items of equipment that were designed to interface with a BA-5590 or equivalent battery. Each of the three interfaces was also assigned a national stock number (NSN) by CECOM. In addition, we are in the process of adding more electrical interfaces for the BA-8180/U. These will address various applications, including other radios, night vision, missile launchers and chemical detectors.

Hybrids

We have also developed interface adapters for other items of equipment which require higher power than the BA-8180/U can provide by itself. For example, we have developed a hybrid battery system comprising a BA-8180/U battery pack and two small rechargeable lead-acid packs. Even with the weight of the lead-acid batteries, this hybrid system powers a satellite communications terminal for significantly longer than an equivalent weight of BA-5590 LiSO2 battery packs. We have also developed experimental hybrid systems incorporating other rechargeable technologies, such as lithium-ion batteries and ultracapacitors.

Forward Field Chargers

One of the initial goals to develop high energy density and power density Zinc-Air was to deploy them as forward field chargers. It was envisioned that a man portable power pack would be required by the dismounted soldier to charge the range of rechargeable batteries now proliferating the military. A high efficiency forward field charger has been developed which enables either a BB-390/U (NiMH) or a BB-2590/U (Li-ion) to receive multiple charges from a single BA-8180/U.

Other Zinc-Air Products

A fourth generation of Zinc-Air products has been developed for applications where volume is critical, and/or where the power to energy ratio needs to be significantly higher than that of the BA-8180/U. These "Gen4" Zinc-Air products consist of an air cathode folded around a zinc electrode. Gen4 was originally developed for the Marine Corps Dragon Eye UAV, which requires up to 200 W from a battery that fits into its sleek fuselage and which weighs less than one kilogram. Along the way, it was recognized that the Gen4 design could be applied to other battery missions requiring high power as well as energy density, such as Land Warrior and Objective Force Warrior soldier systems, where up to 300 Wh of energy are required of a 24 hour battery that must be worn conformably, at minimal weight. For these systems the battery currently limits functionality, and Gen4 zinc-air may be the enabling technology.

We are currently under contract with the U.S. military and an Israeli security agency, to demonstrate the feasibility of Zinc-Air batteries for both unmanned aerial vehicles (UAV) and micro-air vehicles (MAV) platforms, respectively. Short-term development goals include the optimization and integration of cell components for performance and manufacturability. System-level objectives include refinement of battery envelope design and vehicle interfaces, and continued actual flight testing. During 2003, our Zinc-Air battery successfully powered a Dragon Eye unmanned drone and an MAV in test flights, outperforming a competing technology, a high-performance lithium-ion polymer battery.

UAVs

Man-portable UAVs are considered to be an increasingly important battlefield tool for reconnaissance and surveillance of enemy positions. At present, power sources available to the military provide only marginally adequate operating times for these UAVs. For example, the Marine Corps' DragonEye system, operating off primary lithium batteries, can run for 30 to 60 minutes. We expect to achieve a cruise time of at least two hours using an equivalent weight of Zinc-Air cells. Our Zinc-Air battery successfully powered a Dragon Eye unmanned drone in a test flight in June 2003.

MAVs

Development of electrically propelled MAVs has been hampered by the lack of a satisfactory battery solution. Achievement of our development targets will enable a Zinc-Air battery to power a typical 5-oz. MAV for as long as 30 minutes. Our Zinc-Air battery successfully powered an MAV in a test flight in June 2003, outperforming a competing technology, a high-performance lithium-ion polymer battery.

MARKETS/APPLICATIONS

Being an external alternative to the popular lithium based BA-5590/U,

the BA-8180 can be used in many applications operated by the 5590. The BA-8180/U can be used for a variety of military applications, including:

>> Tactical radios

>> SIGINT systems

>> Training systems

>> SATCOM radios

>> Nightscope power

>> Guidance systems

>> Surveillance systems

>> Sensors

CUSTOMERS

EFB's principal customer during 2003 was the U.S. Army's Communications-Electronics Command (CECOM), sales to which accounted for approximately 27% of our revenues in 2003.

COMPETITION

The BA-8180/U is the only Zinc-Air battery to hold a US Army battery designation. It does, however, compete with other primary (disposable) batteries, and primarily lithium based batteries. In some cases, primarily in training missions, it will also compete with rechargeable batteries.

Zinc-Air batteries are inherently safer than primary lithium battery packs in storage, transportation, use, and disposal, and are more cost effective. They are lightweight, with up to twice the energy capacity per pound of primary lithium battery packs. Zinc-Air batteries for the military are also under development by Rayovac Corporation. Rayovac's military Zinc-Air batteries utilize cylindrical cells, rather than the prismatic cells that we developed. While cylindrical cells may provide higher specific power than our prismatic cells, we believe they will generally have lower energy densities and be more difficult to manufacture.

The most popular competing primary battery in use by the US Armed Forces is the BA-5590, which uses lithium-sulfur dioxide (LiSO2) cells. The largest suppliers of LiSO2 batteries to the US military are believed to be Saft America Inc and Eagle Picher Technologies LLC. The battery compartment of most military communications equipment, as well as other military equipment, is designed for the x90 family of batteries, of which the BA-5590 battery is the most commonly deployed. Another primary battery in this family is the BA-5390, which uses lithium-manganese dioxide (LiMnO2) cells. Suppliers of LiMnO2 batteries include Ultralife Batteries Inc., Saft and Eagle Picher.

Rechargeable batteries in the x90 family include lithium-ion and nickel-metal hydride batteries which may be used in training missions in order to save the higher costs associated with primary batteries. Because of the short usage time per charge cycle, rechargeable batteries are not considered suitable for use in combat.

Our BA-8180 does not fit inside the battery compartment of any military equipment, and therefore is connected externally using an interface adapter that we also sell to the Army. Our battery offers greatly extended mission time, along with lower total mission cost, and these significant advantages often greatly outweigh the slight inconvenience of fielding an external battery.

MANUFACTURING

EFB has established a battery factory at our new location in Auburn, Alabama, where we have leased 15,000 square feet of light industrial space from the city of Auburn. We also have production capabilities for some battery components at the facility of EFL in Beit Shemesh, Israel. Both the facilities in Auburn and those in Beit Shemesh have received ISO 9001 "Top Quality Standard" certification.

Lithium Batteries and Charging Systems for the Military

We sell lithium batteries and charging systems to the military through our subsidiary Epsilor Electronic Industries, Ltd., an Israeli corporation established in 1985 that we purchased early in 2004.

Epsilor specializes in the design and manufacture of primary and rechargeable batteries, related electronic circuits and associated chargers for military applications. Epsilor has experience in working with government agencies, the military and large corporations. Epsilor's technical team has significant expertise in the fields of electrochemistry, electronics, software and battery design, production, packaging and testing.

PRODUCTS

Epsilor currently produces over 50 different products in the following categories:

>> Primary batteries;

>> Rechargeable batteries;

>> Smart chargers;

>> State of charge indicators; and

>> Control and monitoring battery circuits

Epsilor's batteries are based on commercially-available battery cells that we purchase from several leading suppliers, with proprietary energy management circuitry and software. Epsilor's battery packs are designed to withstand harsh environments, and have a track record of years of service in armies worldwide.

Epsilor produces a wide range of primary batteries based on the following chemistries: lithium sulfur dioxide, lithium thionyl chloride, lithium manganese dioxide and alkaline. The rechargeable battery chemistries that Epsilor employs are: nickel cadmium, nickel metal hydride and lithium-ion. Epsilor manufactures single and multi-channel smart chargers for nickel cadmium, nickel metal hydride and lithium-ion batteries.

Epsilor has designed a number of sophisticated state of charge indicators. These are employed in Epsilor's products and are also sold as components to other battery pack manufacturers. Epsilor also develops and manufactures control systems for high rate primary battery-packs and monitoring systems for rechargeable battery-packs.

MARKETS/APPLICATIONS

Epsilor's target markets are military and security entities seeking high-end solutions for their power source needs. By their nature, the sell-in cycles are long and the resultant entry barriers are high. This is due to the high cost of developing custom designs and the long period needed to qualify any product for military use.

Epsilor's present customers include:

>> Armed forces in the Middle East and Asia;

>> Military original equipment manufacturers (OEMs); and

>> Various battery manufacturers.

COMPETITION

Epsilor's main competitors are Bren-tronics Inc. in the United States, which controls much of the U.S. rechargeable market, and AEA Battery Systems (a wholly owned subsidiary of AEA Technology plc) in the United Kingdom, which has the majority of the English military market. On the primary end of the market there are a host of players who include the cell manufacturers themselves, including Saft S.A. and Ultralife Batteries, Inc.

It should be noted that a number of OEMs, such as Motorola, have internal engineering groups that can develop competitive products in-house. However, on many occasions they outsource such activities in order to stabilize their staffing level.

MARKETING

Epsilor markets to its existing customers through direct sales. To generate new customers and applications, Epsilor relies on its working relationship with a selection of OEMs, with the intent of having these OEMs design Epsilor products into their equipment, thereby creating a market with a high entry barrier.

MANUFACTURING

Epsilor has developed and built battery production lines for military batteries and chargers which have been ISO-9001 certified since 1994. We believe that Epsilor's 19,000 square foot facility in Dimona, Israel has the necessary capabilities and operations to support its production cycle.

Electric Vehicles

We believe that electric buses represent a particularly important market for electric vehicles in the United States. Transit buses powered by diesel engines operate in large urban areas where congestion is a fact of life and traffic is largely stop-and-go. As a result, they are the leading contributor to inner city toxic emissions, and are a major factor for those U.S. cities that have been designated as in "non-attainment" with respect to air quality standards. Moreover, the U.S. Environmental Protection Agency has identified particulate emissions from diesel engine emissions as a carcinogen. Electric Fuel-powered full-size vehicles, capable of clean, long-range, high-speed travel, could fulfill the needs of transit operators in all weather conditions, with fast, cost-effective refueling. An all-electric, full-size bus powered by the Electric Fuel system can provide to transit authorities a full day's operating range for both heavy duty city and suburban routes in all weather conditions.

THE ELECTRIC FUEL ZINC-AIR ENERGY SYSTEM FOR ELECTRIC VEHICLES

The Electric Fuel Zinc-Air Energy System consists of:

>> an in-vehicle, Zinc-Air fuel cell unit consisting of a series of Zinc-Air cells and refuelable zinc-fuel anode cassettes;

>> a battery exchange unit for fast vehicle turn-around that is equivalent to the time needed to refuel a diesel bus;

>> an automated battery refueling system for mechanically replacing depleted zinc-fuel cassettes with charged cassettes; and

>> a regeneration system for electrochemical recycling and mechanical repacking of the discharged fuel cassettes.

With its proprietary high-power air cathode and zinc anode technologies, our Zinc-Air fuel cell delivers a unique combination of high-energy density and high-power density, which together power electric vehicles with speed, acceleration, driving range and driver convenience similar to that of conventionally powered vehicles.

THE DEPARTMENT OF TRANSPORTATION-FEDERAL TRANSIT ADMINISTRATION ZINC-AIR ALL ELECTRIC TRANSIT BUS PROGRAM

In the United States, our Zinc-Air technology is the focus of a Zinc-Air All Electric Bus demonstration program the costs and expenditures of which are 50% offset by subcontracting fees paid by the U.S. Department of Transportation's Federal Transit Administration (FTA). The test program is designed to prove that an all-electric bus can meet these and all other Los Angeles and New York Municipal Transit Authority mass transit requirements including requirements relating to performance, speed, acceleration and hill climbing.

The bus used in the program, which includes General Electric and the Regional Transportation Commission of Southern Nevada (RTC) as project partners, is a standard 40-foot (12.2 meter) transit bus manufactured by NovaBus Corporation. It has a capacity of 40 seated and 37 standing passengers and a gross vehicle weight of 39,500 lbs. (17,955 kg.). The all-electric hybrid system consists of an Electric Fuel Zinc-Air fuel cell as the primary energy source, an auxiliary battery to provide supplementary power and recuperation of energy when braking. Ultracapacitors enhance this supplementary power, providing faster throughput and higher current in both directions than the auxiliary battery can supply on its own. The vehicle draws cruising energy from the Zinc-Air fuel cell, and supplementary power for acceleration, merging into traffic and hill climbing, from the auxiliary battery and ultracapacitors.

During Phase II of performance testing, our bus was driven a record-breaking 127 miles, more than 100 of them under the rigorous stop-and-go diving conditions of the Society of Automotive Engineers' Central Business District cycle with a full passenger load. We demonstrated our bus in a public demonstration in Las Vegas, Nevada in November 2001, and in Washington, D.C., on Capitol Hill, with the participation of certain members of the United States Senate, in March 2002. We have now completed Phase III of the project, which focused on installation, testing and commissioning of new generation advanced ultracapacitors and associated interface controls, and culminated in a performance evaluation test in Schenectady and Albany, New York, with the participation of New York Assembly Speaker Sheldon Silver, in November 2003.

Phase IV of the program, which we began in October 2003, is a $1.5 million cost-shared program (half of which is funded by the FTA and the remainder by the program partners, including us) that will explore steps necessary for commercializing the all-electric zinc-air/ultracapacitor hybrid bus. It will focus on continued optimization of the propulsion system developed in previous phases, on additional vehicle and system testing, including testing alternative advanced auxiliary battery technologies, and on evaluating alternative zinc anodes, which are more commercially available in North America.

COMPETITION

We believe that our products must be available at a price that is competitive with alternative technologies, particularly those intended for use in zero or low-emission vehicles. Besides other battery technologies, these include hydrogen fuel cells, "hybrid systems" that combine an internal combustion engine and battery technologies, and use of regular or low-pollution fuels such as gasoline, diesel, compressed natural gas, liquefied natural gas, ethanol and methanol. Other alternative technologies presently use costly components, including use of flywheels and catalytic removal of pollutants. These various technologies are at differing stages of development and any one of them, or a new technology, may prove to be more cost effective, or otherwise more readily acceptable by consumers, than the Electric Fuel Zinc-Air Energy System for electric vehicles. In addition, the California Air Resource Board has expressed to us concerns about the costs associated with the Zinc-Air regeneration infrastructure as compared to battery technologies that use electrical recharging.

An area of increased development has been that of hydrogen fuel cell powered vehicles, spearheaded by the Ballard Corporation's solid polymer electrolyte hydrogen-air fuel cell program. Major automobile companies have made significant investments in this technology. We believe that vehicles based on hydrogen fuel cells are many years away from commercialization, with significant

issues of hydrogen production and storage. We feel that storing hydrogen in containers on board vehicles may be risky and involves major investments in infrastructure for highly-pressurized hydrogen, and that using methanol for making hydrogen on board vehicles is highly complex, costly and risky. We also believe that competing Zinc-Air technologies, such as those offered by Metallic Power (Carlsbad, California) and Powerzinc Electric (City of Industry, California), are at a much earlier stage of development, not just in terms of size and number of cells, modules and demonstrations in electric vehicles, but also in terms of the scale of development effort. We are not aware of a competing Zinc-Air development effort that could yield a product that is superior to ours in terms of vehicle performance or life-cycle cost.

Lifejacket Lights

In 1996, we began to produce and market lifejacket lights built with our patented magnesium-cuprous chloride batteries, which are activated by immersion in water (water-activated batteries), for the aviation and marine safety and emergency markets. At present we have a product line consisting of five lifejacket light models, three for use with marine life jackets and two for use with aviation life vests, all of which work in both freshwater and seawater. Each of our lifejacket lights is certified for use by relevant governmental agencies under various U.S. and international regulations. We manufacture, assemble and package all our lifejacket lights in our factory in Beit Shemesh, Israel.

MARKETING

We market our marine safety products through our own network of distributors in Europe, the United States, Asia and Oceania. We market our lights to the commercial aviation industry in the United States exclusively through The Burkett Company of Houston, Texas, which receives a commission on sales.

COMPETITION

Two of the largest manufacturers of aviation and marine safety products, including TSO and SOLAS-approved lifejacket lights, are ACR Electronics Inc. of Hollywood, Florida, and Pains Wessex McMurdo Ltd. of England. Other significant competitors in the marine market include Daniamant Aps of Denmark, and SIC of Italy.

Armored Vehicle Division

MDT Protective Industries and MDT Armor

INTRODUCTION

MDT Protective Industries Ltd. was established in Israel in 1989 as one of Israel's first car armoring companies, and is Israel's leader in lightweight armoring of vehicles, ranging from light tactical vehicles to passenger vehicles. With two production lines, MDT specializes in using state-of-the-art lightweight ceramic materials, special ballistic glass and advanced engineering processes to fully armor vans and cars. MDT is a leading supplier to the Israeli military, Israeli special forces and special services. MDT's products have been proven in intensive battlefield situations and under actual terrorist attack conditions, and are designed to meet the demanding requirements of governmental and private sector customers worldwide.

MDT has acquired many years of battlefield experience in Israel. MDT's vehicles have provided proven life-saving protection for their passengers in incidents of rock throwing, handgun and assault rifle attack at point-blank range, roadside bombings and suicide bombings. In fact, to our knowledge an MDT-armored vehicle has never experienced bullet penetration into a vehicle cabin under attack. MDT also uses its technology to protect vehicles against vandalism.

In 2003, MDT Armor established operations in a new facility in Auburn, Alabama. Soon thereafter, the United States General Services Administration (GSA) awarded a five-year contract to MDT Armor for vehicle armoring, establishing a pricing schedule for armoring of GM Suburban and Toyota Land Cruiser SUVs and of GM Savana/Express passenger vans. With this contract, these armored vehicles became available for purchase directly by all federal agencies beginning December 1, 2003.

MDT's revenues during 2001, 2002 and 2003 were approximately $6.8 million, $6.4 million and $3.4 million, respectively.

THE ARMORING PROCESS

Armoring a vehicle involves much more than just adding "armor plates." It includes professional and secure installation of a variety of armor components - inside doors, dashboards, and all other areas of passenger and engine compartments. MDT uses overlapping sections to ensure protection from all angles, and installs armored glass in the windshield and windows. MDT has developed certain unique features, such as new window operation mechanisms that can raise windows rapidly despite their increased weight, gun ports, run-flat tires, and more. MDT developed the majority of the materials that it uses in-house, or in conjunction with Israeli companies specializing in protective materials.

In order to armor a vehicle, MDT first disassembles the vehicle and removes the interior paneling, passenger seats, doors, windows, etc. MDT then fortifies the entire body of the vehicle, including the roof, motor and other critical components, and reinforces the door hinges. MDT achieves firewall protection from frontal assault with carefully designed overlapping armor. Options, such as air-conditioning, seating modifications and run-flat tires, are also available. MDT fixes the armoring into the shell of the vehicle, ensuring that the installation and finishing is according to the standards set for that particular model. MDT then reassembles the vehicle as close to its original appearance as possible.

Once MDT has ensured full vehicle protection, it places a premium on retaining the original vehicle's look and feel to the extent possible, including enabling full serviceability of the vehicle, thereby rendering the armoring process "invisible." MDT works with its customers to understand their requirements, and together with the customer develops an optimized armoring solution. A flexible design-to-cost process helps evaluate tradeoffs between heavy and light materials and various levels of protection.

By working within the vehicle manufacturer's specifications, MDT maintains stability, handling, center-of-gravity and overall integrity. MDT's methods minimize impact on payload, and do not obstruct the driver's or passengers' views. In most cases all the original warranties provided by the manufacturer are still in effect.

ARMORING MATERIALS

MDT offers a variety of armoring materials, optimized to the customer's requirements. MDT uses ballistic steel, composite materials (including Kevlar(R), Dyneema(R) and composite armor steel) as well as special ceramics developed by MDT, together with special armored glass. MDT uses advanced engineering techniques and "light" composite materials, and avoids, to the extent possible, using traditional "heavy" materials such as armored steel because of the added weight, which impairs the driving performance and handling of the vehicle.

All materials used by MDT meet not only international ballistic standards, but also the far more stringent requirements set down by the Israeli military, the Israeli Ministries of Defense and Transport, and the Israel Standards Institute. MDT's factory has also been granted the ISO 9002 quality standards award.

PRODUCTS AND SERVICES

MDT armors a variety of vehicles for both commercial and military markets. At present, MDT offers armoring for approximately thirty different models of motor vehicles.

In the military market, MDT armors:

>> troop and personnel carriers (such as vehicles in the Mercedes-Benz Vario and Sprinter lines);

>> front-line police and military vehicles;

>> command vehicles (such as the Land Rover Defender 4x4);

>> specialty vehicles.

In the commercial market, MDT armors:

>> sports utility vehicles (such as the GM Suburban, the Toyota Land Cruiser and the Land Rover Defender);

>> passenger vans (such as the Chevrolet Savana, the General Motors Vandura and the Ford Econoline).

SALES AND MARKETING

Most of MDT's business has historically come from Israel, although MDT has armored vehicles under contracts from companies in Yugoslavia, Mexico, Colombia, South Africa and Singapore, and MDT recently received a $5.5 million order from the United States. MDT's principal customer at present is the Israeli Ministry of Defense. Other customers include Israeli government ministries and agencies, private companies, medical services and private clients.

MDT markets its vehicle armoring through Israeli vehicle importers, both pursuant to marketing agreements and otherwise, and directly to private customers. Most sales are through vehicle importers.

MDT holds exclusive armoring contracts with Israel's sole General Motors and Chevrolet distributors. This means that these distributors will continue to honor the original vehicle warranty on armored versions of vehicles sold by them only if the armoring was done by MDT.

CUSTOMERS

MDT's principal customer during 2003 was the Israeli Ministry of Defense, sales to which accounted for approximately 17% of our consolidated revenues in 2003.

COMPETITION

The global armored car industry is highly fragmented. Major suppliers

include both vehicle manufacturers and aftermarket specialists. As a highly labor-intensive process, vehicle armoring is numerically dominated by relatively small businesses. Industry estimates place the number of companies doing vehicle armoring in the range of around 500 suppliers globally. While certain large companies may armor several hundred cars annually, most of these companies are smaller operations that may armor in the range of five to fifty cars per year. In 2002, MDT armored over 130 vehicles against weapons and explosives, and another approximately 300 vehicles against vandalism.

Among vehicle manufacturers, Mercedes-Benz has the largest vehicle-armoring market share, estimated at around 7% of the global market. Among aftermarket specialists, the largest share of the vehicle-armoring market is held by O'Gara-Hess & Eisenhardt. Other aftermarket specialists include International Armoring Corp. Lasco, Texas Armoring and Chicago Armor (Moloney). Many of these companies have financial, technical, marketing, sales, manufacturing, distribution and other resources significantly greater than ours.

We believes the key factors in our competing successfully in this field will be our ability to penetrate new military and paramilitary markets outside of Israel, particularly in North and South America and in Europe.

Backlog

We generally sell our products under standard purchase orders. Orders constituting our backlog are subject to changes in delivery schedules and are typically cancelable by our customers until a specified time prior to the scheduled delivery date. Accordingly, our backlog is not necessarily an accurate indication of future sales. As of December 31, 2003 and 2002, our backlog for the following years was approximately $17.2 million and $7.2 million, respectively, divided among our product lines as follows (backlog for product lines acquired after December 31, 2003 is given as it stood at such date in the books of the seller, prior to the acquisition):

<TABLE>
<CAPTION>

Division	Product Line	2003	2002
<S>		<C>	<C>
Simulation, Training and Consulting Division	Use-of-force training.....	$ 334,000	$ 2,690,000
	Vehicle simulators*.....	6,206,000	-
	Security consulting.....	60,000	-
Battery and Power Systems Division	Zinc-Air batteries for the military.....	5,250,000	2,700,000
	Lithium batteries for the military*.....	3,800,000	-
	Electric vehicle.....	436,000	420,000
	Water-activated batteries.....	144,000	300,000
Armored Vehicle Division	Car armoring.....	931,000	1,040,000
	TOTAL:.....	$ 17,161,000	$ 7,150,000

</TABLE>

* Not owned at December 31, 2002.

Patents and Trade Secrets

We rely on certain proprietary technology and seek to protect our interests through a combination of patents, trademarks, copyrights, know-how, trade secrets and security measures, including confidentiality agreements. Our policy generally is to secure protection for significant innovations to the fullest extent practicable. Further, we seek to expand and improve the technological base and individual features of our products through ongoing research and development programs.

We rely on the laws of unfair competition and trade secrets to protect our proprietary rights. We attempt to protect our trade secrets and other proprietary information through confidentiality and non-disclosure agreements with customers, suppliers, employees and consultants, and through other security measures. However, we may be unable to detect the unauthorized use of, or take appropriate steps to enforce our intellectual property rights. Effective trade secret protection may not be available in every country in which we offer or intend to offer our products and services to the same extent as in the United States. Failure to adequately protect our intellectual property could harm or even destroy our brands and impair our ability to compete effectively. Further, enforcing our intellectual property rights could result in the expenditure of significant financial and managerial resources and may not prove successful. Although we intend to protect our rights vigorously, there can be no assurance that these measures will be successful.

Research and Development

Research and development is conducted by IES in Denver, Colorado; by FAAC in Ann Arbor, Michigan; by MDT in Lod, Israel; by EFB in Auburn, Alabama; by Epsilor in Dimona, Israel; and by EFB and EFL in Beit Shemesh, Israel. During the years ended December 31, 2003, 2002 and 2001, our gross research and product development expenditures were approximately $1.1 million, $2.2 million and $4.2 million, respectively, including research and development in discontinued operations. During these periods, the Office of the Chief Scientist of the Israel Ministry of Industry and Trade (the "Chief Scientist") participated in our research and development efforts relating to our consumer battery business, thereby reducing our gross research and product development expenditures in the amounts of approximately $26,000, $49,000 and $705,000 for the years 2003, 2002 and 2001, respectively.

EFL has certain contingent royalty obligations to Chief Scientist and the Israel-U.S. Binational Industrial Research and Development Foundation (BIRD, which apply (in respect of continuing operations) only to our Electric Vehicle program. As of December 31, 2003, our total outstanding contingent liability in this connection was approximately $10.1 million.

Employees

As of February 29, 2004, we had 219 full-time employees worldwide. Of these employees, 4 hold doctoral degrees and 20 hold other advanced degrees. Of the total, 52 employees were engaged in product research and development, 125 were engaged in production and operations, 12 were engaged in marketing and sales, and 30 were engaged in general and administrative functions. Our success will depend in large part on our ability to attract and retain skilled and experienced employees.

We and our employees are not parties to any collective bargaining agreements. However, as certain of our employees are located in Israel and employed by EFL, MDT or Epsilor, certain provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) and the Coordination Bureau of Economic Organizations (including the Manufacturers' Association of Israel) are applicable to EFL's, MDT's and Epsilor's employees by order (the "Extension Order") of the Israeli Ministry of Labor and Welfare. These provisions principally concern the length of the work day and the work week, minimum wages for workers, contributions to a pension fund, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay and other conditions of employment, including certain automatic salary adjustments based on changes in the Israeli CPI.

Israeli law generally requires severance pay upon the retirement or death of an employee or termination of employment without due cause; additionally, some of our senior employees have special severance arrangements, certain of which are described under "Item 11. Executive Compensation - Employment Contracts," below. We currently fund our ongoing severance obligations by making monthly payments to approved severance funds or insurance policies. In addition, Israeli employees and employers are required to pay specified sums to the National Insurance Institute, which is similar to the United States Social Security Administration. Since January 1, 1995, such amounts also include payments for national health insurance. The payments to the National Insurance Institute are approximately 15.6% of wages, of which the employee contributes approximately 62% and the employer contributes approximately 38%. The majority of the permanent employees of EFL, about a quarter of the permanent employees of MDT, and one of the permanent employees of Epsilor, are covered by "managers' insurance," which provides life and pension insurance coverage with customary benefits to employees, including retirement and severance benefits. We contribute 14.33% to 15.83% (depending on the employee) of base wages to such plans and the permanent employees contribute 5% of their base wages.

In 1993, an Israeli court held that companies that are subject to the Extension Order are required to make pension contributions exclusively through contributions to Mivtachim Social Institute of Employees Ltd., a pension fund managed by the Histadrut. We subsequently reached an agreement with Mivtachim with respect to providing coverage to certain production employees and bringing ourselves into conformity with the court decision. The agreement does not materially increase our pension costs or otherwise materially adversely affect its operations. Mivtachim has agreed not to assert any claim against us with respect to any of our past practices relating to this matter. Although the arrangement does not bind employees with respect to instituting claims relating to any nonconformity by us, we believe that the likelihood of the assertion of claims by employees is low and that any potential claims by employees against us, if successful, would not result in any material liability to us.

ITEM 2. PROPERTIES

Our New York headquarters, constituting approximately 4,000 square feet, is located in New York City and subleased on a month-to-month basis. Beginning April 15, 2004, we will move to new corporate headquarters consisting of approximately 1,100 square feet, at 250 West 57th Street in New York City, pursuant to an agreement of lease expiring in June 2009. Under the terms of this lease, we have an option to request an increase in our leased space of at least 50%, and the failure to provide such increased space in the same building would enable us to terminate the lease without penalty.

The Auburn, Alabama research and manufacturing facility, constituting approximately 15,000 square feet, is leased from the City of Auburn through July 2004, with an option to extend the lease for an additional 1 1/2 years at the same rent and for another three years thereafter at a 10% rent increase. We also have an option to expand to 30,000 square feet, and we have free use of this additional space through mid-2004.

Our management and administrative facilities and research, development and production facilities for the manufacture and assembly of our Survivor Locator Lights, constituting approximately 18,300 square feet, are located in Beit Shemesh, Israel, located between Jerusalem and Tel-Aviv (within Israel's pre-1967 borders). The lease for these facilities in Israel expires on December 31, 2007; we have the ability to terminate the lease every two years upon three months' written notice. Moreover, we may terminate the lease at any time upon twelve months written notice.

Our Epsilor subsidiary rents approximately 19,000 square feet of factory, office and warehouse space in Dimona, Israel, in Israel's Negev desert (within Israel's pre-1967 borders), on a month-to-month basis.

Our IES subsidiary rents approximately 8,900 square feet of office and warehouse space in Littleton, Colorado, approximately ten miles outside of Denver, pursuant to a lease expiring in September 2005, with an option to extend the lease for an additional five years, or until September 2010. IES also holds an option under certain circumstances to rent an additional 3,200 square feet of contiguous space.

Our FAAC subsidiary rents approximately 17,800 square feet of office and warehouse space in Ann Arbor, Michigan, pursuant to a lease expiring in February 2005, with an option to extend the lease for an additional five years, or until February 2010.

Our MDT subsidiary rents approximately 20,000 square feet of office space in Lod, Israel, near Ben-Gurion International airport (within Israel's pre-1967 borders) pursuant to a lease renewable on an annual basis.

We believe that our existing facilities are adequate to meet our current and foreseeable future needs.

ITEM 3. LEGAL PROCEEDINGS

As of the date of this filing, there were no material pending legal proceedings against us.

In October 2003, I.E.S. Group, the parent company of IES Electronics Industries Ltd., the seller from which we purchased the assets of our IES subsidiary in 2002, filed a lawsuit in Tel-Aviv District Court against us and certain of our past and present officers. The complaint alleged breaches by us of certain of our agreements with IES Electronics Industries Ltd. and claims monetary damages in the amount of approximately $3 million.

On February 4, 2004, we entered into an agreement settling this litigation. Pursuant to the terms of the settlement agreement, in addition to agreeing to dismiss their lawsuit with prejudice, IES Electronics agreed (i) to cancel our $450,000 debt to them that had been due on December 31, 2003, and (ii) to transfer to us title to certain certificates of deposit in the approximate principal amount of $112,000. In consideration of the foregoing, we issued to IES Electronics (i) 450,000 shares of our common stock, and (ii) five-year warrants to purchase up to an additional 450,000 shares of our common stock at a purchase price of $1.91 per share.

The foregoing description of our settlement agreement with IES Electronics is qualified in its entirety by reference to the summary of the settlement agreement filed as an exhibit to our Current Report on Form 8-K that we filed with the SEC on February 5, 2004.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Since February 1994, our common stock has been traded on the Nasdaq National Market. Our Nasdaq ticker symbol is currently "ARTX"; prior to February 2003, our Nasdaq ticker symbol was "EFCX." The following table sets forth, for the periods indicated, the range of high and low closing prices of our common stock on the Nasdaq National Market System:

Year Ended December 31, 2003	High	Low
Fourth Quarter	$ 2.86	$ 1.28
Third Quarter	$ 1.62	$ 0.81
Second Quarter	$ 1.19	$ 0.49
First Quarter	$ 0.66	$ 0.43
Year Ended December 31, 2002		
Fourth Quarter	$ 1.06	$ 0.61
Third Quarter	$ 1.59	$ 0.83
Second Quarter	$ 1.68	$ 0.73
First Quarter	$ 2.20	$ 1.42

As of February 29, 2004 we had approximately 300 holders of record of our common stock.

Dividends

We have never paid any cash dividends on our common stock. The Board of Directors presently intends to retain all earnings for use in our business. Any future determination as to payment of dividends will depend upon our financial condition and results of operations and such other factors as the Board of Directors deems relevant.

Recent Sales of Unregistered Securities

Sale of Debentures

Pursuant to the terms of a Securities Purchase Agreement dated September 30, 2003 (the "Purchase Agreement") by and between Arotech Corporation and six institutional investors (the "Debenture Holders"), we issued and sold to the Debenture Holders (i) an aggregate principal amount of $5,000,000 in 8% secured convertible debentures due September 30, 2006, convertible into shares of our common stock at any time after January 1, 2004 at a conversion price of $1.15 per share, and (ii) three-year warrants to purchase up to an aggregate of 1,250,000 shares of our common stock at any time after January 1, 2004 at an exercise price of $1.4375 per share.

The Debenture Holders also had the right, at their option, at any time prior to September 30, 2006, to purchase up to an additional $6,000,000 in debentures (the "Additional Debentures") convertible into shares of our common stock at any time after January 1, 2004 at a conversion price of $1.45 per share, and to receive warrants to purchase up to an aggregate of 1,500,000 shares of our common stock at any time after January 1, 2004 (the "Additional Warrants") at an exercise price of $1.8125 per share. The Debenture Holders exercised this right pursuant to Amendment and Exercise Agreements dated December 10, 2003.

We also granted to the Debenture Holders supplemental warrants to purchase up to an aggregate of 1,038,000 shares of our common stock (the "Supplemental Warrants" and, together with the Additional Warrants, the "Warrants") at an exercise price of $2.20 per share (the closing price of our common stock on December 10, 2003 was $1.70 per share) and, on December 18, 2003, we issued to the Debenture Holders the Additional Debentures and the Warrants.

As of February 29, 2004, we had $7,225,000 principal amount of Debentures outstanding.

Under the terms of the Purchase Agreement, we granted the Debenture Holders a first position security interest in the stock of MDT Armor Corporation, the assets of our IES Interactive Training, Inc. subsidiary, the stock of our subsidiaries, and in any stock that we acquire in future Acquisitions (as defined in the Purchase Agreement).

The foregoing description of our agreement with the Debenture Holders is qualified in its entirety by reference to the agreements with the Debenture Holders filed as exhibits to our Current Report on Form 8-K that we filed with the SEC on December 23, 2003.

We issued the above securities in reliance on the exemption from registration provided by Section 4(2) of the Securities Act as transactions by an issuer not involving a public offering. The issuance of these securities was without the use of an underwriter, and the shares of common stock were issued with restrictive legends permitting transfer thereof only upon registration or an exemption under the Act.

Issuance of Warrants in Connection with an Offering of Registered Shares

Pursuant to the terms of a Securities Purchase Agreement dated January 7, 2004 (the "SPA") by and between us and several institutional investors (the "Investors"), we issued and sold to the Investors registered stock off of our effective shelf registration statement, and three-year warrants to purchase up to an aggregate of 9,840,426 shares of our common stock at any time beginning six months after closing (the "Warrants") at an exercise price per share equal to $1.88. The common stock underlying the Warrants was not registered.

The foregoing description of our agreement with the Investors is qualified in its entirety by reference to the agreements with the Investors filed as exhibits to our Current Report on Form 8-K that we filed with the SEC on January 9, 2004.

We issued the Warrants in reliance on the exemption from registration provided by Section 4(2) of the Securities Act as transactions by an issuer not involving a public offering. The issuance of these securities was without the use of an underwriter, and the Warrants were issued with restrictive legends permitting transfer thereof and of the shares underlying the Warrants only upon registration or an exemption under the Act.

Issuance of Shares to a Consultant

Under the terms of an independent contractor agreement between us and InteSec Group LLC, we pay InteSec a commission in stock of 5% of the military battery sales that InteSec brings to us from U.S. and NATO defense, security and military entities and U.S. defense contractors. Pursuant to the terms of this agreement, in February 2004, we issued 74,215 shares to InteSec.

We issued the above securities in reliance on the exemption from registration provided by Section 4(2) of the Securities Act as transactions by an issuer not involving a public offering. The issuance of these securities was without the use of an underwriter, and the shares of common stock were issued with restrictive legends permitting transfer thereof only upon registration or an exemption under the Act.

ITEM 6. SELECTED FINANCIAL DATA

The selected financial information set forth below with respect to the consolidated financial statements for each of the five fiscal years in the period ended December 31, 2003, and with respect to the balance sheets at the end of each such fiscal year has been derived from our consolidated financial statements audited by Kost, Forer, Gabbay & Kassierer, independent certified public accountants in Israel and a member firm of Ernst & Young Global.

The results of operations, including revenue, operating expenses, and financial income of the consumer battery segment for the years ended December 31, 2003, 2002, 2001, 2000 and 1999 have been reclassified in the accompanying statements of operations as discontinued operations. Our balance sheets at December 31, 2003, 2002, 2001, 2000 and 1999 give effect the assets of the consumer battery business as discontinued operations within current assets and liabilities. Thus, the financial information presented herein includes only continuing operations.

The financial information set forth below is qualified by and should be read in conjunction with the Consolidated Financial Statements contained in Item 8 of this Report and the notes thereto and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations," below.

<TABLE>
<CAPTION>

	Year Ended December 31,				
	1999	2000	2001	2002	2003
	(dollars in thousands, except per share data)				
Statement of Operations Data:					
<S>	<C>	<C>	<C>	<C>	<C>
Revenues	$ 2,422	$ 1,490	$ 2,094	$ 6,407	$ 17,326
Research and development expenses and costs of revenues	3,867	1,985	2,448	5,108	12,141
Selling, general and administrative expenses and amortization of intangible assets	2,754	3,434	3,934	5,982	10,594
Operating loss	(4,198)	(3,929)	(4,288)	(4,683)	(5,409)
Financial income (expenses), net	190	544	263	100	(3,470)
Loss before minority interest in loss (earnings) of subsidiary and tax expenses	(4,008)	(3,385)	(4,026)	(4,583)	(8,879)
Taxes on income	(6)	-	-	-	(396)
Minority interest in loss (earnings) of subsidiary	-	-	-	(355)	157
Loss from continuing operations	(4,014)	(3,385)	(4,026)	(4,938)	(9,118)
Income (loss) from discontinued operations	(2,902)	(8,596)	(13,261)	(13,566)	110
Net loss for the period	(6,916)	(11,981)	(17,287)	(18,504)	(9,008)
Deemed dividend to certain shareholders of common stock	-	-	(1,197)	-	-
Net loss attributable to shareholders of common stock	$ (6,916)	$ (11,981)	$ (18,483)	$ (18,504)	$ (9,008)
Basic and diluted net loss per share from continuing operations	$ (0.28)	$ (0.18)	$ (0.21)	$ (0.15)	$ (0.23)
Loss per share for combined operations	$ (0.48)	$ (0.62)	$ (0.76)	$ (0.57)	$ (0.23)
Weighted average number of common shares used in computing basic and diluted net loss per share (in thousands)	14,334	19,243	24,200	32,382	38,890

	As At December 31,				
	1999	2000	2001	2002	2003
Balance Sheet Data:					
Cash, cash equivalents, investments in marketable debt securities and restricted collateral deposits	$ 2,556	$ 11,596	$ 12,672	$ 2,091	$ 14,391
Receivables and other assets*	5,215	13,771	11,515	7,895	8,898
Property and equipment, net of depreciation	2,258	2,289	2,221	2,555	2,293
Goodwill and other intangible assets, net	-	-	-	7,522	7,440
Total assets	$ 10,029	$ 27,656	$ 26,408	$ 20,063	$ 33,022
Current liabilities*	$ 3,427	$ 4,787	$ 3,874	$ 7,272	$ 6,860
Long-term liabilities	2,360	2,791	3,126	3,753	4,118
Stockholders' equity	4,242	20,078	19,408	9,038	22,044
Total liabilities and stockholders equity*	$ 10,029	$ 27,656	$ 26,408	$ 20,063	$ 33,022

</TABLE>

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* Includes assets and liabilities, as applicable, from discontinued operations.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS

OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that 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," below, and in our other filings with the Securities and Exchange Commission.

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements contained in Item 8 of this report, and the notes thereto. 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.

General

We are a defense and security products and services company, engaged in three business areas: interactive simulation for military, law enforcement and commercial markets; batteries and charging systems for the military; and high-level armoring for military, paramilitary and commercial vehicles. Until September 17, 2003, we were known as Electric Fuel Corporation. We operate in three business units:

>> we develop, manufacture and market advanced hi-tech multimedia and interactive digital solutions for use-of-force and driving training of military, law enforcement and security personnel, as well as offering security consulting and other services (our Simulation, Training and Consulting Division);

>> we manufacture and sell Zinc-Air and lithium batteries for defense and security products and other military applications and we pioneer advancements in Zinc-Air battery technology for electric vehicles (our Battery and Power Systems Division); and

>> we utilize sophisticated lightweight materials and advanced engineering processes to armor vehicles (our Armored Vehicle Division).

Early in 2004, we acquired two new businesses: FAAC Corporation, located in Ann Arbor, Michigan, which provides simulators, systems engineering and software products to the United States military, government and private industry (which we have placed in our Simulation, Training and Consulting Division), and Epsilor Electronic Industries, Ltd., located in Dimona, Israel, which develops and sells rechargeable and primary lithium batteries and smart chargers to the military and to private industry in the Middle East, Europe and Asia (which we have placed in our Battery and Power Systems Division). Prior to the acquisition of FAAC and Epsilor, we were organized into two divisions: Defense and Security Products (consisting of IES, MDT, MDT Armor and Arocon), and Electric Fuel Batteries (consisting of EFL and EFB). We have reported our results of operations for 2003 and 2002 in accordance with these earlier divisions, and our financial results for 2003 and 2002 do not include the activities of FAAC or Epsilor.

Critical Accounting Policies

The preparation of financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, we evaluate our estimates and judgments, including those related to revenue recognition, allowance for bad debts, inventory, impairment of intangible assets and goodwill. We base our estimates and judgments on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Under different assumptions or conditions, actual results may differ from these estimates.

We believe the following critical accounting policies, among others, affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition and Bad Debt

We generate revenues primarily from sales of multimedia and interactive digital training systems and use-of-force simulators specifically targeted for law enforcement and firearms training and from service contracts related to such sales; from providing lightweight armoring services of vehicles; from sale of zinc-air battery products for defense applications; and, to a lesser extent, from development services and long-term arrangements subcontracted by the U.S government. We recognize revenues in respect of products when, among other things, we have delivered the goods being purchased and we believe

collectibility to be reasonably assured. We do not grant a right of return to our customers. We perform ongoing credit evaluations of our customers' financial condition and we require collateral as deemed necessary. We make judgments as to our ability to collect outstanding receivables and provide allowances for a portion of such receivables when and if collection becomes doubtful. Provisions are made based upon a specific review of all significant outstanding receivables. In determining the provision, we analyze our historical collection experience and current economic trends. If the historical data we use to calculate the allowance provided for doubtful accounts does not reflect the future ability to collect outstanding receivables, additional provisions for doubtful accounts may be needed and the future results of operations could be materially affected.

Revenues from development services are recognized using contract accounting on a percentage of completion method, based on completion of agreed-upon milestones and in accordance with the "Output Method" or based on the time and material basis. Provisions for estimated losses on uncompleted contracts are recognized in the period in which the likelihood of such losses is determined.

The complexity of the estimation process and the issues related to the assumptions, risks and uncertainties inherent with the application of the percentage of completion method of accounting affect the amounts of revenue and related expenses reported in our consolidated financial statements.

Inventories

Our policy for valuation of inventory and commitments to purchase inventory, including the determination of obsolete or excess inventory, requires us to perform a detailed assessment of inventory at each balance sheet date, which includes a review of, among other factors, an estimate of future demand for products within specific time horizons, valuation of existing inventory, as well as product lifecycle and product development plans. The estimates of future demand that we use in the valuation of inventory are the basis for our revenue forecast, which is also used for our short-term manufacturing plans. Inventory reserves are also provided to cover risks arising from slow-moving items. We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based on assumptions about future demand and market conditions. We may be required to record additional inventory write-down if actual market conditions are less favorable than those projected by our management. For fiscal 2003, no significant changes were made to the underlying assumptions related to estimates of inventory valuation or the methodology applied.

Goodwill

Our business acquisitions typically result in the recognition of goodwill and other intangible assets, which affect the amount of current and future period charges and amortization expenses. The determination of value of these components of a business combination, as well as associated asset useful lives, requires our management to make various estimates and assumptions. Estimates using different, but each reasonable, assumptions could produce significantly different results. We test goodwill for possible impairment on an annual basis and at any other time if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Such impairment loss is measured by comparing the recoverable amount of an asset with its carrying value. The determination of the value of goodwill requires our management to make assumptions regarding estimated future cash flows and other factors to determine the fair value of a respective asset. If these estimates or the related assumptions change in the future, we could be required to record impairment charges. Any material change in our valuation of assets in the future and any consequent adjustment for impairment could have a material adverse impact on our future reported financial results.

Impairment of long-lived assets and intangibles

Long-lived assets and certain identifiable intangibles are reviewed for impairment in accordance with Statement of Financial Accounting Standard No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of the carrying amount of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less selling costs. As of December 31, 2003, no impairment losses have been identified.

The determination of the value of such long-lived and intangible assets requires management to make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. These estimates have been based on our business plans for the entities acquired. If these estimates or the related assumptions change in the future, we could be required to record impairment charges. Any material change in our valuation of assets in the future and any consequent adjustment for impairment could have a material adverse impact on our future reported financial results.

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 loss in shareholders' equity.

Executive Summary

The following executive summary includes, where appropriate, discussion of our two new subsidiaries, FAAC Incorporated and Epsilor Electronic Industries, Ltd., that we purchased early in 2004. The results of these subsidiaries are not included in our results of operations for 2003 and 2002, but are included in this discussion to the extent that they are relevant to our anticipated financial condition and results of operations going forward.

Divisions and Subsidiaries

We operate primarily as a holding company, through our various subsidiaries, which we have organized into three divisions. Our divisions and subsidiaries (all 100% owned, unless otherwise noted) are as follows:

>> Our Simulation, Training and Consulting Division, consisting of:

- IES Interactive Training, Inc., located in Littleton, Colorado, which provides specialized "use of force" training for police, security personnel and the military ("IES");
- FAAC Incorporated, located in Ann Arbor, Michigan, which provides simulators, systems engineering and software products to the United States military, government and private industry ("FAAC"); and

- Arocon Security Corporation, located in New York, New York, which provides security consulting and other services, focusing on protecting life, assets and operations with minimum hindrance to personal freedom and daily activities ("Arocon").

>> Our Battery and Power Systems Division, consisting of:

- Electric Fuel Battery Corporation, located in Auburn, Alabama, which manufactures and sells Zinc-Air fuel sells, batteries and chargers for the military, focusing on applications that demand high energy and light weight ("EFB");
- Epsilor Electronic Industries, Ltd., located in Dimona, Israel (in Israel's Negev desert area), which develops and sells rechargeable and primary lithium batteries and smart chargers to the military and to private industry in the Middle East, Europe and Asia ("Epsilor"); and
- Electric Fuel (E.F.L.) Ltd., located in Beit Shemesh, Israel, which produces water-activated lifejacket lights for commercial aviation and marine applications, and which conducts our Electric Vehicle effort, focusing on obtaining and implementing demonstration projects in the U.S. and Europe, and on building broad industry partnerships that can lead to eventual commercialization of our Zinc-Air energy system for electric vehicles ("EFL").

>> Our Armored Vehicle Division, consisting of:

- MDT Protective Industries, Ltd., located in Lod, Israel, which specializes in using state-of-the-art lightweight ceramic materials, special ballistic glass and advanced engineering processes to fully armor vans and cars, and is a leading supplier to the Israeli military, Israeli special forces and special services ("MDT") (75.5% owned); and
- MDT Armor Corporation, located in Auburn, Alabama, which conducts MDT's United States activities ("MDT Armor") (88% owned).

Prior to the acquisition of FAAC and Epsilor, we were organized into two divisions: Defense and Security Products (consisting of IES, MDT, MDT Armor

and Arocon), and Electric Fuel Batteries (consisting of EFL and EFB). We have reported our results of operations for 2003 and 2002 in accordance with these earlier divisions.

Overview of Results of Operations

We incurred significant operating losses for the years ended December 31, 2003, 2002 and 2001. While we expect to continue to derive revenues from the sale of products that we manufacture and the services that we provide, there can be no assurance that we will be able to achieve or maintain profitability on a consistent basis.

During 2003, we substantially increased our revenues and reduced our operating loss, from $18.5 million in 2002 to $9.0 million in 2003. This was achieved through a combination of cost-cutting measures and increased revenues, particularly from the sale of Zinc-Air batteries to the military and from sales of interactive training systems by IES. We believe that our new acquisitions, FAAC and Epsilor, will contribute to our goal of achieving profitability.

We regard moving the company to a positive cash flow situation on a consistent basis to be an important goal, and we are focused on achieving that goal for the second half of 2004 and beyond. In this connection, we note that most of our business lines historically have had weaker first halves than second halves, and weaker first quarters than second quarters. We expect this to be the case for 2004 as well.

A portion of our operating loss during 2003 arose as a result of non-cash charges. These charges were primarily related to our acquisitions and to our raising capital. Because we anticipate continuing these activities during 2004, we expect to continue to incur such non-cash charges in the future.

Non-cash charges related to acquisitions arise when the purchase price for an acquired company exceeds the company's book value. In such a circumstance, a portion of the excess of the purchase price is recorded as goodwill, and a portion as intangible assets. 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. Intangible assets are amortized in accordance with their useful life. Accordingly, for a period of time following an acquisition, we incur a non-cash charge in the amount of a fraction (based on the useful life of the intangible assets) of the amount recorded as intangible assets. Such non-cash charges will continue during 2004; additionally, our acquisitions of FAAC and Epsilor will result in our incurring similar non-cash charges beginning in 2004.

As a result of the application of the above accounting rule, we incurred non-cash charges in the amount of $865,000 during 2003. See "Critical Accounting Policies - Goodwill," above.

The non-cash charges that relate to our financings occurred in connection with our sale of convertible debentures with warrants, and in connection with our repricing of certain warrants and grants of new warrants. When we issue convertible debentures, we record an expense for a beneficial conversion feature that is amortized ratably over the life of the debenture. When a debenture is converted, however, the entire remaining unamortized beneficial conversion feature expense is immediately recognized in the quarter in which the debenture is converted. Similarly, when we issue warrants in connection with convertible debentures, we record an expense for financial expenses that is amortized ratably over the term of the warrant; when the warrant is exercised, the entire remaining unamortized financial expense is immediately recognized in the quarter in which the warrant is exercised. As and to the extent that our remaining convertible debentures and warrants are converted and exercised, we would incur similar non-cash charges going forward.

As a result of the application of the above accounting rule, we incurred non-cash charges in the amount of $3.4 million during 2003.

Additionally, in an effort to improve our cash situation and our shareholders' equity, and in order to reduce the number of our outstanding warrants, during 2003 we induced holders of certain of our warrants to exercise their warrants by lowering the exercise price of the warrants to approximately market value in exchange for immediate exercise of such warrants, and by issuing to such investors a lower number of new warrants at a higher exercise price. Under such circumstances, accounting rules require us to record a compensation expense in an amount determined based upon the fair value of the new warrants (using a Black-Scholes pricing model). As and to the extent that we engage in similar warrant repricings and issuances in the future, we would incur similar non-cash charges.

As a result of the application of the above accounting rule, we incurred non-cash charges in the amount of $388,000 during 2003.

We also incurred a non-cash charge in the amount of $839,000 during 2003 arising out of the shares and warrants we granted to IES Electronics in connection with the settlement of our litigation with them, as a result of and expense in an amount determined based upon the fair value of these warrants (using a Black-Scholes pricing model). This charge is not expected to recur.

Overview of Financial Condition and Operating Performance

We shut down our money-losing consumer battery operations and began acquiring new businesses in the defense and security field in 2002. Since then, we have concentrated on eliminating our operating deficit and moving Arotech to cash-flow positive operations. In order to do this, we have focused on acquiring businesses with strong revenues and profitable operations.

In our Defense and Security Products Division, MDT experienced a slowdown in revenues during 2003 because MDT's primary customer, the Israel Defense Forces, reduced orders as a result of cuts in that portion of its budget that it can spend in Israel. We noted this trend in 2003 and began to work on reversing it by opening production facilities for MDT Armor in Auburn, Alabama. As of December 31, 2003, our backlog for MDT totaled $931,000, most of which was from orders from customers other than the Israel Defense Forces.

IES had record sales in 2003; IES sales have grown from $3.5 million in 2001 (before we owned it) to more than $8.0 million in 2003. We attribute this to a number of substantial orders, such as orders from the German Police and from the United States Department of Health and Human Services. Since sales of new IES simulation systems (as opposed to upgrades and add-ons) have a very long sales cycle, it is difficult to predict what sales will be like in 2004. As of December 31, 2003, our backlog for IES totaled $334,000.

In our Electric Fuel Batteries Division, EFB had its first sales in 2003. These sales were almost exclusively from the United States Army, which continues to use our BA-8180 Zinc-Air battery for its CECOM division. We believe the war in Iraq had a substantial positive effect on our sales in 2003. However, we are hopeful that since the war came at a time when we were just beginning the introduction of our batteries to the Army, much of the falloff in use of our products that would normally be expected to occur at the war's end (which is not presently anticipated to occur in the immediate future) will be offset by growing acceptance of our batteries by soldiers in the field and their supply officers. As of December 31, 2003, our backlog for EFB totaled $5.3 million.

We do not anticipate a substantial change in our revenues from EFL, either from the water-activated battery line or from the electric vehicle. In this connection, we have begun an effort to find external financing for development of our electric vehicle in the form of a partnership or joint venture, but there can be no assurance that we will succeed in this effort, and we do not anticipate that our electric vehicle program will provide significant revenues in 2004.

We anticipate that our acquisitions of Epsilor and FAAC, which occurred in January 2004, will add to our revenues, our gross profit and our cash flow in 2004.

Results of Operations

Preliminary Note

Results for the years ended December 31, 2003 and 2002 include the results of IES and MDT for such periods as a result of our acquisitions of these companies early in the third quarter of 2002. However, the results of IES and MDT were not included in our operating results for the full year ended December 31, 2002. Accordingly, the following year-to-year comparisons should not necessarily be relied upon as indications of future performance.

In addition, results are net of the operations of the retail consumer battery products, which operations were discontinued in the third quarter of 2002.

Following is a table summarizing our results of operations for the years ended December 31, 2003 and 2002, after which we present a narrative discussion and analysis:

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	Year Ended December 31,	
	2003	2002
Revenues:		
<S>	<C>	<C>
Defense and Security Products	$ 11,457,741	$ 4,724,443
Electric Fuel Batteries	5,868,899	1,682,296
All other	-	-
	$ 17,326,641	$ 6,406,739
Cost of revenues:		
Defense and Security Products	$ 6,566,252	$ 2,380,387
Electric Fuel Batteries	4,521,588	2,041,361
All other	-	-
	$ 11,087,840	$ 4,421,748
Research and development expenses.:		
Defense and Security Products	$ 216,800	$ 175,796
Electric Fuel Batteries	836,608	510,123
All other	-	-
	$ 1,053,408	$ 685,919
Sales and marketing expenses:		

Defense and Security Products	$ 2,418,017	$ 636,066
Electric Fuel Batteries	926,872	673,601
All other	187,747	-
	$ 3,532,636	$ 1,309,669

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	Year Ended December 31,	
	2003	2002
General and administrative expenses:		
<S>	<C>	<C>
Defense and Security Products	$ 1,519,458	$ 833,610
Electric Fuel Batteries	188,655	89,945
All other	4,488,666	3,099,548
	$ 6,196,779	$ 4,023,103
Financial expense (income):		
Defense and Security Products	$ (139,668)	$ (4,556)
Electric Fuel Batteries	7,936	-
All other	3,602,191	(95,895)
	$ 3,470,459	$ (100,451)
Tax expenses:		
Defense and Security Products	$ 393,303	$ -
Electric Fuel Batteries	-	-
All other	2,890	-
	$ 396,193	$ -
Amortization of intangible assets:		
Defense and Security Products	$ 864,910	$ 649,543
Electric Fuel Batteries	-	-
All other	-	-
	$ 864,910	$ 649,543
Minority interest in loss (profit) of subsidiaries:		
Defense and Security Products	$ 156,900	$ (355,360)
Electric Fuel Batteries	-	-
All other	-	-
	$ 156,900	$ (355,360)
Net loss from continuing operations:		
Defense and Security Products	$ 224,431	$ 301,765
Electric Fuel Batteries	612,760	1,632,734
All other	8,281,493	3,003,653
	$ 9,118,684	$ 4,938,152
Net loss (profit) from discontinued operations:		
Defense and Security Products	$ -	$ -
Electric Fuel Batteries	(110,410)	13,566,206
All other	-	-
	$ (110,410)	$ 13,566,206
Net loss:		
Defense and Security Products	$ 224,431	$ 301,765
Electric Fuel Batteries	502,350	15,198,940
All other	8,281,493	3,003,653
	$ 9,008,274	$ 18,504,358

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Fiscal Year 2003 compared to Fiscal Year 2002

Revenues. During 2003, we (through our subsidiaries) recognized revenues as follows:

>> IES recognized revenues from the sale of interactive use-of-force training systems and from the provision of warranty services in connection with such systems;

>> MDT recognized revenues from payments under vehicle armoring contracts and for service and repair of armored vehicles;

>> EFB recognized revenues from the sale of batteries and adapters to the military, and under certain development contracts with the U.S. Army;

>> Arocon recognized revenues under consulting agreements; and

>> EFL recognized revenues from the sale of lifejacket lights and from subcontracting fees received in connection with Phase III of the United States Department of Transportation (DOT) electric bus program, which began in October 2002 and was

completed in March 2004. Phase IV of the DOT program, which began in October 2003, did not result in any revenues during 2003.

Revenues from continuing operations for the year ended December 31, 2003 totaled $17.3 million, compared to $6.4 million for 2002, an increase of $10.9 million, or 170%. This increase was primarily the result of increased sales attributable to IES and EFB, as well as the inclusion of IES and MDT in our results for the full year of 2003 but only part of 2002.

In 2003, revenues were $11.5 million for the Defense and Security Products Division (compared to $4.7 million in 2002, an increase of $6.7 million, or 143%, due primarily to increased sales on the part of IES, as well as the inclusion of IES and MDT in our results for the full year of 2003 but only part of 2002), and $5.9 million for the Electric Fuel Batteries Division (compared to $1.7 million in the comparable period in 2002, an increase of $4.2 million, or 249%, due primarily to increased sales to the U.S. Army on the part of EFB).

Cost of revenues and gross profit. Cost of revenues totaled $11.1 million during 2003, compared to $4.4 million in 2002, an increase of $6.7 million, or 151%, due to increased cost of goods sold, particularly by IES and EFB, as well as the inclusion of IES and MDT in our results for the full year of 2003 but only part of 2002.

Direct expenses for our two divisions during 2003 were $10.9 million for the Defense and Security Products Division (compared to $4.4 million in 2002, an increase of $6.5 million, or 150%, due primarily to increased sales attributable to IES, as well as the inclusion of IES and MDT in our results for the full year of 2003 but only part of 2002), and $5.9 million for the Electric Fuel Batteries Division (compared to $3.1 million in the comparable period in 2002, an increase of $2.9 million, or 94%, due primarily to increased sales on the part of EFB to the U.S. Army).

Gross profit was $6.2 million during 2003, compared to $2.0 million during 2002, an increase of $4.3 million, or 214%. This increase was the direct result of all factors presented above, most notably the increased sales of IES and EFB, as well as the inclusion of IES and MDT in our results for the full year of 2003 but only part of 2002. In 2003, IES contributed $4.1 million to our gross profit, EFB contributed $1.6 million, and MDT contributed $833,000.

Research and development expenses. Research and development expenses for 2003 were $1.1 million, compared to $686,000 in 2002, an increase of $367,000, or 54%. This increase was primarily because certain research and development personnel who had worked on the discontinued consumer battery operations during 2002 (the expenses of which are not reflected in the 2002 number above) were reassigned to military battery research and development in 2003.

Sales and marketing expenses. Sales and marketing expenses for 2003 were $3.5 million, compared to $1.3 million in 2002, an increase of $2.2 million, or 170%. This increase was primarily attributable to the following factors:

- The inclusion of the sales and marketing expenses of IES and MDT in our results for the full year of 2003 but only part of 2002;
- An increase in IES's sales activity during 2003, which resulted in both increased sales and increased sales and marketing expenses during 2003; and
- We incurred expenses for consultants in the amount of $810,000 in connection with our CECOM battery program with the U.S. Army and $345,000 in connection with our security consulting business.

General and administrative expenses. General and administrative expenses for 2003 were $6.2 million, compared to $4.0 million in 2002, an increase of $2.2 million, or 54%. This increase was primarily attributable to the following factors:

- The inclusion of the general and administrative expenses of IES and MDT in our results for the full year of 2003 but only part of 2002;
- Expenses in 2003 in connection with a litigation settlement agreement, in the amount of $864,000, that were not present in 2002;
- Expenses in 2003 in connection with warrant repricings, in the amount of $388,000, that were not present in 2002;
- Legal and consulting expenses in 2003 in connection with our convertible debentures, in the amount of $484,000, that were not present in 2002; and
- Expenses in 2003 in connection with the start-up of our security consulting business in the United States and with the beginning of operations of MDT Armor, in the amount of 250,000, that were not present in 2002.

Financial income (expense). Financial expense totaled approximately $3.5 million in 2003 compared to financial income of $100,000 in 2002, an

increase of $3.6 million. This increase was due primarily to amortization of compensation related to the issuance of convertible debentures issued in December 2002 and during 2003 in the amount of $3.4 million, and interest expenses related to those debentures in the amount of $376,000.

Tax expenses. We and our Israeli subsidiary EFL incurred net operating losses during 2003 and 2002 and, accordingly, we were not required to make any provision for income taxes. MDT and IES had taxable income, and accordingly we were required to make provision for income taxes in the amount of $396,000 in 2003. We were able to offset IES's federal taxes against our loss carryforwards. In 2002 we did not accrue any tax expenses due to our belief that we would be able to utilize our loss carryforwards against MDT's taxable income, estimation was revised in 2003. Of the amount accrued in 2003, approximately $352,000 was accrued on account of income in 2002.

Amortization of intangible assets and in-process research and development. Amortization of intangible assets totaled $865,000 in 2003, compared to $649,000 in 2002, an increase of $215,000, or 33%, resulting from amortization of these assets subsequent to our acquisition of IES and MDT in 2002. Of this $215,000 increase, $169,000 was attributable to IES and $46,000 was attributable to MDT.

Loss from continuing operations. Due to the factors cited above, we reported a net loss from continuing operations of $9.1 million in 2003, compared to a net loss of $4.9 million in 2002, an increase of $4.2 million, or 85%.

Profit (loss) from discontinued operations. In the third quarter of 2002, we decided to discontinue operations relating to the retail sales of our consumer battery products. Accordingly, all revenues and expenses related to this segment have been presented in our consolidated statements of operations for the years ended December 31, 2003 and 2002 in an item entitled "Loss from discontinued operations."

Profit from discontinued operations in 2003 was $110,000, compared to a net loss of $13.6 million in 2002, a decrease of $13.7 million. This decrease was the result of the elimination of the losses from these discontinued operations beginning with the fourth quarter of 2002. The profit from discontinued operations was primarily from cancellation of past accruals made unnecessary by the closing of the discontinued operations.

Net loss. Due to the factors cited above, we reported a net loss of $9.0 million in 2003, compared to a net loss of $18.5 million in 2002, a decrease of $9.5 million, or 51%.

Fiscal Year 2002 compared to Fiscal Year 2001

Revenues. Revenues from continuing operations for the year ended December 31, 2002 totaled $6.4 million, compared to $2.1 million for 2001, an increase of $4.3 million, or 206%. This increase was primarily the result of the inclusion of IES and MDT in our results in 2002.

During 2002, we recognized revenues from the sale of interactive use-of-force training systems (through our IES subsidiary), from payments under vehicle armoring contracts (through our MDT subsidiary), and from the sale of lifejacket lights, as well as under contracts with the U.S. Army's CECOM for deliveries of batteries and for design and procurement of production tooling and equipment. We also recognized revenues from subcontracting fees received in connection with Phase II of the United States Department of Transportation (DOT) program, which began in the fourth quarter of 2001 and was completed in July 2002, and Phase III of the DOT program, which began in October 2002. We participate in this program as a member of a consortium seeking to demonstrate the ability of the Electric Fuel battery system to power a full-size, all-electric transit bus. The total program cost of Phase II was $2.7 million, 50% of which was covered by the DOT subcontracting fees. Subcontracting fees cover less than all of the expenses and expenditures associated with our participation in the program. In 2001, we derived revenues principally from the sale of lifejacket lights, under contracts with the U.S. Army's CECOM for deliveries of batteries and for design and procurement of production tooling and equipment and from subcontracting fees received in connection with the DOT program.

In 2002, revenues were $4.7 million for the Defense and Security Products Division (compared to $0 in 2001), due to the inclusion of IES and MDT in our 2002 results, and $1.7 million for the Electric Fuel Batteries Division (compared to $2.1 million in the comparable period in 2001, a decrease of $411,000, or 20%), due primarily to $471,000 in revenues from a German consortium project relating to our electric vehicle that were included in 2001 but that did not exist in 2002. Of the $4.7 million increase in Defense and Security Products revenues, $2.0 million was attributable to the inclusion of IES in our results in 2002 and $2.7 million was attributable to the inclusion of MDT in our results in 2002.

Cost of revenues and gross profit. Cost of revenues totaled $4.4 million during 2002, compared to $2.0 million in 2001, an increase of $2.4 million, or 122%, due to the inclusion of IES and MDT in our 2002 results.

Direct expenses for our two divisions during 2002 were $4.4 million for the Defense and Security Products Division (compared to $0 in 2001), due to the inclusion of IES and MDT in our 2002 results, and $3.1 million for the Electric Fuel Batteries Division (compared to $2.3 million in the comparable period in

2001, an increase of $767,000, or 33%), due primarily to the following factors:

- We began to ramp up production at our CECOM facility in Alabama in anticipation of the CECOM order that we received in December 2002; and

- We wrote off certain disqualified CECOM inventory in the amount of $116,000.

Of the $4.4 million increase in Defense and Security Products direct expenses, $2.1 million was attributable to the inclusion of IES in our results in 2002 and $2.3 million was attributable to the inclusion of MDT in our results in 2002.

Gross profit was $2.0 million during 2002, compared to $101,000 during 2001, an increase of $1.9 million. This increase was the direct result of all factors presented above, most notably the inclusion of IES and MDT in our 2002 results. In 2002, IES contributed $1.3 million to our gross profit, and MDT contributed $1.1 million, which was offset by a gross loss of $360,000 in our other divisions.

Research and development expenses. Research and development expenses for 2002 were $686,000, compared to $456,000 in 2001, an increase of $230,000, or 50%. This increase was primarily the result of the inclusion of IES, which accounted for $130,000 of the increase, in our 2002 results.

Sales and marketing expenses. Sales and marketing expenses for 2002 were $1.3 million, compared to $106,000 in 2001, an increase of $1.2 million, or 1,136%. This increase was primarily attributable to the following factors:

- We had sales and marketing expenses in 2002 related to IES of $572,000, which we did not have in 2001;

- We had sales and marketing expenses in 2002 related to MDT of $63,000, which we did not have in 2001; and

- We incurred expenses for consultants, primarily lobbyists, in the amount of $128,000 in connection with our Electric Vehicle program and $441,000 in connection with our CECOM battery program with the U.S. Army.

General and administrative expenses. General and administrative expenses for 2002 were $4.0 million compared to $3.8 million in 2001, an increase of $196,000, or 5%. This increase was primarily attributable to the inclusion of IES and MDT in our results beginning with the third quarter, which increased general and administrative expenses by approximately $839,000. This increase was offset by a decrease in general and administrative expenses of $643,000, resulting from:

- the dismissal of our litigation with Electrofuel Inc., which resulted in a decrease in litigation-related legal expenses; and

- the settlement of our dispute with a former employee on terms that resulted in a savings to us over the amount that we had set aside on our books.

Financial income. Financial income, net of interest expenses and exchange differentials, totaled approximately $100,000 in 2002 compared to $263,000 in 2001, a decrease of $163,000, or 62%. This decrease was due primarily to lower interest rates and lower balances of invested funds as a result of our use of the proceeds of private placements of our securities.

Income taxes. We and our Israeli subsidiary EFL incurred net operating losses during 2002 and 2001 and, accordingly, we were not required to make any provision for income taxes. MDT had taxable income, but we may use EFL's losses to offset MDT's income, and accordingly MDT has made no provision for income taxes.

Amortization of intangible assets. Amortization of intangible assets totaled $649,000 in 2002, compared to $0 in 2001, due to the inclusion of IES and MDT in our 2002 results. Of this $649,000 increase, $551,000 was attributable to the inclusion of IES in our results in 2002 and $98,000 was attributable to the inclusion of MDT in our results in 2002.

Loss from continuing operations. Due to the factors cited above, we reported a net loss from continuing operations of $4.9 million in 2002, compared to a net loss of $4.0 million in 2001, an increase of $913,000, or 22%.

Loss from discontinued operations. In the third quarter of 2002, we decided to discontinue operations relating to the retail sales of our consumer battery products. Accordingly, all revenues and expenses related to this segment have been presented in our consolidated statements of operations for the year ended December 31, 2002 in an item entitled "Loss from discontinued operations."

Loss from discontinued operations in 2002 was $13.6 million, compared to $13.3 million in 2001, an increase of $306,000, or 2%. This increase was the result of a write-off of fixed inventory and assets in the amount of $7.1 million in connection with our discontinuation of the operations relating to the retail sales of our consumer battery products at the end of the third quarter of 2002, which was not entirely offset by the elimination of the losses from these discontinued operations beginning with the fourth quarter of 2002.

Net loss. Due to the factors cited above, we reported a net loss of $18.5 million in 2002, compared to a net loss of $17.3 million in 2001, an increase of $1.2 million, or 7%.

Liquidity and Capital Resources

As of December 31, 2003, we had cash and cash equivalents of approximately $13.7 million, compared with $1.5 million as of December 31, 2002, an increase of $12.2 million, or 839%. The increase in cash was primarily the result of sales of our securities during 2003. In January 2004, we raised an additional $17.8 million, net of expenses, through additional sales of our securities. As of February 29, 2004, our cash totaled approximately $4.2 million, not including approximately $9.1 million held in restricted deposits to fund future obligations in connection with such acquisitions, primarily as a result of our use of cash for the Epsilor and FAAC acquisitions.

We used available funds in 2003 primarily for working capital needs. We increased our investment in fixed assets by $585,000 during the year ended December 31, 2003, primarily in the Electric Fuel Batteries Division. Our fixed assets amounted to $2.3 million as at year end.

Net cash used in operating activities from continuing operations for 2003 and 2002 was $3.0 million and $3.5 million, respectively, a decrease of $465,000, or 13%. This decrease was primarily the result of changes in operating assets and liabilities, such as accounts payable and inventory.

Net cash used in investing activities for 2003 and 2002 was $1.8 million and $5.4 million, respectively, a decrease of $3.6 million, or 66%. This decrease was primarily the result of our investment in the acquisition of IES and MDT in 2002.

Net cash provided by financing activities for 2003 and 2002 was $17.4 million and $3.1 million, respectively, an increase of $14.3 million, or 464%. This increase was primarily the result of higher amounts of funds raised through sales of our securities in 2003 compared to 2002.

During 2003, certain of our employees exercised options under our registered employee stock option plan. The proceeds to us from the exercised options were approximately $434,000.

On September 30, 2003 we issued and sold to various institutional investors an aggregate $5,000,000 principal amount of 8% Secured Convertible Debentures due September 30, 2006, as more fully described in the Current Report on Form 8-K that we filed with the Securities and Exchange Commission on October 3, 2003.

On December 18, 2002 we issued and sold to various institutional investors an aggregate $6,000,000 principal amount of 8% Secured Convertible Debentures due December 31, 2006, as more fully described under "Item 5. Market For Registrant's Common Equity and Related Stockholder Matters - Recent Sales of Unregistered Securities," above.

We have approximately $10.5 million in long term debt outstanding, of which $8.4 million was convertible debt, and approximately $6.9 million in short-term debt.

We believe that our present cash position and anticipated cash flows from operations should be sufficient to satisfy our current estimated cash requirements through the next year. Over the long term, we will need to become profitable, at least on a cash-flow basis, and maintain that profitability in order to avoid future capital requirements. Additionally, we would need to raise additional capital in order to fund any future acquisitions.

Our current debt agreements grant to our investors a right of first refusal on any future financings, except for underwritten public offerings in excess of $30 million. We do not believe that this covenant will materially limit our ability to undertake future financings.

Effective Corporate Tax Rate

Arotech and EFL have incurred net operating losses or had earnings arising from tax-exempt income during the years ended December 31, 2001, 2002 and 2003 and accordingly no provision for income taxes was required. Taxes in these entities paid in 2001, 2002 and 2003 are primarily composed of United States federal alternative minimum taxes.

As of December 31, 2003, we had U.S. net operating loss carry forwards of approximately $17.0 million that are available to offset future taxable income, expiring primarily in 2015, and foreign net operating and capital loss carry forwards of approximately $84.0 million, which are available indefinitely to offset future taxable income.

Contractual Obligations

The following table lists our contractual obligations and commitments as of December 31, 2003:

<TABLE>
<CAPTION>
Contractual Obligations	Payment Due by Period
</TABLE>

	Total	Less Than 1 Year	1-3 Years	3-5 Years	More than 5 Years
<S>	<C>	<C>	<C>	<C>	<C>
Long-term debt*.....	$ 8,525,000	$ -	$ 8,525,000	$ -	$ -
Short-term debt.....	$ 190,849	$ 190,849	$ -	$ -	$ -
Operating lease obligations...	$ 590,778	$ 393,512	$ 197,266	$ -	$ -
Severance obligations.....	$ 1,749,391	$ 183,056	$ 1,387,738	$ -	$ 178,597

</TABLE>

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* Includes convertible debentures in the gross amount of $8,375,000. Unamortized financial expenses related to the beneficial conversion feature of these convertible debentures amounted to $7,493,056 at year end.

RISK FACTORS

The following factors, among others, could cause actual results to differ materially from those contained in forward-looking statements made in this Report and presented elsewhere by management from time to time.

Business-Related Risks

We have had a history of losses and may incur future losses.

We were incorporated in 1990 and began our operations in 1991. We have funded our operations principally from funds raised in each of the initial public offering of our common stock in February 1994; through subsequent public and private offerings of our common stock and equity and debt securities convertible into shares of our common stock; research contracts and supply contracts; funds received under research and development grants from the Government of Israel; and sales of products that we and our subsidiaries manufacture. We have incurred significant operating losses since our inception. Additionally, as of December 31, 2003, we had an accumulated deficit of approximately $110.0 million. There can be no assurance that we will ever be able to maintain profitability consistently or that our business will continue to exist.

Our existing indebtedness may adversely affect our ability to obtain additional funds and may increase our vulnerability to economic or business downturns.

Our indebtedness aggregated approximately $8.7 million as of December 31, 2003. Accordingly, we are subject to the risks associated with indebtedness, including:

- we must dedicate a portion of our cash flows from operations to pay debt service costs and, as a result, we have less funds available for operations, future acquisitions of consumer receivable portfolios, and other purposes;
- it may be more difficult and expensive to obtain additional funds through financings, if available at all;
- we are more vulnerable to economic downturns and fluctuations in interest rates, less able to withstand competitive pressures and less flexible in reacting to changes in our industry and general economic conditions; and
- if we default under any of our existing debt instruments or if our creditors demand payment of a portion or all of our indebtedness, we may not have sufficient funds to make such payments.

The occurrence of any of these events could materially adversely affect our results of operations and financial condition and adversely affect our stock price.

The agreements governing the terms of our debentures contain numerous affirmative and negative covenants that limit the discretion of our management with respect to certain business matters and place restrictions on us, including obligations on our part to preserve and maintain our assets and restrictions on our ability to incur or guarantee debt, to merge with or sell our assets to another company, and to make significant capital expenditures without the consent of the debenture holders. Our ability to comply with these and other provisions of such agreements may be affected by changes in economic or business conditions or other events beyond our control.

Failure to comply with the terms of our debentures could result in a default that could have material adverse consequences for us.

A failure to comply with the obligations contained in our debenture agreements could result in an event of default under such agreements which could result in an acceleration of the debentures and the acceleration of debt under other instruments evidencing indebtedness that may contain cross-acceleration or cross-default provisions. If the indebtedness under the debentures or other indebtedness were to be accelerated, there can be no assurance that our assets would be sufficient to repay in full such indebtedness.

We have pledged a substantial portion of our assets to secure our

borrowings.

Our debentures are secured by a substantial portion of our assets. If we default under the indebtedness secured by our assets, those assets would be available to the secured creditors to satisfy our obligations to the secured creditors, which could materially adversely affect our results of operations and financial condition and adversely affect our stock price.

We need significant amounts of capital to operate and grow our business.

We require substantial funds to market our products and develop and market new products. To the extent that we are unable to fully fund our operations through profitable sales of our products and services, we may continue to seek additional funding, including through the issuance of equity or debt securities. However, there can be no assurance that we will obtain any such additional financing in a timely manner or on acceptable terms. If additional funds are raised by issuing equity securities, stockholders may incur further dilution. If additional funding is not secured, we will have to modify, reduce, defer or eliminate parts of our anticipated future commitments and/or programs.

We may not be successful in operating a new business.

Prior to the acquisitions of IES and MDT in 2002 and the acquisitions of FAAC and Epsilor early in 2004, our primary business was the marketing and sale of products based on primary and refuelable Zinc-Air fuel cell technology and advancements in battery technology for defense and security products and other military applications, electric vehicles and consumer electronics. As a result of our acquisitions, a substantial component of our business is the marketing and sale of hi-tech multimedia and interactive training solutions and sophisticated lightweight materials and advanced engineering processes used to armor vehicles. These are new businesses for us and our management group has limited experience operating these types of businesses. Although we have retained our acquired companies' management personnel, we cannot assure that such personnel will continue to work for us or that we will be successful in managing this new business. If we are unable to successfully operate these new businesses, our business, financial condition and results of operations could be materially impaired.

Our acquisition strategy involves various risks.

Part of our strategy is to grow through the acquisition of companies that will complement our existing operations or provide us with an entry into markets we do not currently serve. Growth through acquisitions involves substantial risks, including the risk of improper valuation of the acquired business and the risk of inadequate integration. There can be no assurance that suitable acquisition candidates will be available, that we will be able to acquire or manage profitably such additional companies or that future acquisitions will produce returns that justify our investments therein. In addition, we may compete for acquisition and expansion opportunities with companies that have significantly greater resources than we do. Furthermore, acquisitions could disrupt our ongoing business, distract the attention of our senior managers, make it difficult to maintain our operational standards, controls and procedures and subject us to contingent and latent risks that are different, in nature and magnitude, than the risks we currently face.

We may finance future acquisitions with cash from operations or additional debt or equity financings. There can be no assurance that we will be able to generate internal cash or obtain financing from external sources or that, if available, such financing will be on terms acceptable to us. The issuance of additional common stock to finance acquisitions may result in substantial dilution to our stockholders. Any debt financing may significantly increase our leverage and may involve restrictive covenants which limit our operations.

We may not successfully integrate our new acquisitions.

In light of our recent acquisitions of IES, MDT, FAAC and Epsilor, our success will depend in part on our ability to manage the combined operations of these companies and to integrate the operations and personnel of these companies along with our other subsidiaries and divisions into a single organizational structure. There can be no assurance that we will be able to effectively integrate the operations of our subsidiaries and divisions and our newly-acquired businesses into a single organizational structure. Integration of these operations could also place additional pressures on our management as well as on our key technical resources. The failure to successfully manage this integration could have an adverse material effect on us.

If we are successful in acquiring additional businesses, we may experience a period of rapid growth that could place significant additional demands on, and require us to expand, our management, resources and management information systems. Our failure to manage any such rapid growth effectively could have a material adverse effect on our financial condition, results of operations and cash flows.

If we are unable to manage our growth, our operating results will be impaired.

We are currently experiencing a period of growth and development activity which could place a significant strain on our personnel and resources. Our activity has resulted in increased levels of responsibility for both existing and new management personnel. Many of our management personnel have had limited or no experience in managing growing companies. We have sought to manage our current and anticipated growth through the recruitment of additional management and technical personnel and the implementation of internal systems

and controls. However, our failure to manage growth effectively could adversely affect our results of operations.

A significant portion of our business is dependent on government contracts.

Many of the customers of IES and FAAC to date have been in the public sector of the U.S., including the federal, state and local governments, and in the public sectors of a number of other countries, and most of MDT's customers have been in the public sector in Israel, in particular the Ministry of Defense. Additionally, all of EFB's sales to date of battery products for the military and defense sectors have been in the public sector in the United States. A significant decrease in the overall level or allocation of defense spending or law enforcement in the U.S. or other countries could have a material adverse effect on our future results of operations and financial condition. MDT has already experienced a slowdown in orders from the Ministry of Defense due to budget constraints and a requirement of U.S. aid to Israel that a substantial proportion of such aid be spent in the U.S., where MDT has only recently opened a factory in operation.

Sales to public sector customers are subject to a multiplicity of detailed regulatory requirements and public policies as well as to changes in training and purchasing priorities. Contracts with public sector customers may be conditioned upon the continuing availability of public funds, which in turn depends upon lengthy and complex budgetary procedures, and may be subject to certain pricing constraints. Moreover, U.S. government contracts and those of many international government customers may generally be terminated for a variety of factors when it is in the best interests of the government and contractors may be suspended or debarred for misconduct at the discretion of the government. There can be no assurance that these factors or others unique to government contracts or the loss or suspension of necessary regulatory licenses will not have a material adverse effect on our future results of operations and financial condition.

Our U.S. government contracts may be terminated at any time and may contain other unfavorable provisions.

The U.S. government typically can terminate or modify any of its contracts with us either for its convenience or if we default by failing to perform under the terms of the applicable contract. A termination arising out of our default could expose us to liability and have a material adverse effect on our ability to re-compete for future contracts and orders. Our U.S. government contracts contain provisions that allow the U.S. government to unilaterally suspend us from receiving new contracts pending resolution of alleged violations of procurement laws or regulations, reduce the value of existing contracts, issue modifications to a contract and control and potentially prohibit the export of our products, services and associated materials.

A negative audit by the U.S. government could adversely affect our business, and we might not be reimbursed by the government for costs that we have expended on our contracts.

Government agencies routinely audit government contracts. These agencies review a contractor's performance on its contract, pricing practices, cost structure and compliance with applicable laws, regulations and standards. If we are audited, we will not be reimbursed for any costs found to be improperly allocated to a specific contract, while we would be required to refund any improper costs for which we had already been reimbursed. Therefore, an audit could result in a substantial adjustment to our revenues. If a government audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeitures of profits, suspension of payments, fines and suspension or debarment from doing business with United States government agencies. We could suffer serious reputational harm if allegations of impropriety were made against us. A governmental determination of impropriety or illegality, or an allegation of impropriety, could have a material adverse effect on our business, financial condition or results of operations.

We may be liable for penalties under a variety of procurement rules and regulations, and changes in government regulations could adversely impact our revenues, operating expenses and profitability.

Our defense and commercial businesses must comply with and are affected by various government regulations that impact our operating costs, profit margins and our internal organization and operation of our businesses. Among the most significant regulations are the following:

- the U.S. Federal Acquisition Regulations, which regulate the formation, administration and performance of government contracts;
- the U.S. Truth in Negotiations Act, which requires certification and disclosure of all cost and pricing data in connection with contract negotiations; and

- the U.S. Cost Accounting Standards, which impose accounting requirements that govern our right to reimbursement under certain cost-based government contracts.

These regulations affect how we and our customers do business and, in some instances, impose added costs on our businesses. Any changes in applicable

laws could adversely affect the financial performance of the business affected by the changed regulations. With respect to U.S. government contracts, any failure to comply with applicable laws could result in contract termination, price or fee reductions or suspension or debarment from contracting with the U.S. government.

Our operating margins may decline under our fixed-price contracts if we fail to estimate accurately the time and resources necessary to satisfy our obligations.

Some of our contracts are fixed-price contracts under which we bear the risk of any cost overruns. Our profits are adversely affected if our costs under these contracts exceed the assumptions that we used in bidding for the contract. In 2003, approximately 36% of our revenues were derived from fixed-price contracts for both defense and non-defense related government contracts. Often, we are required to fix the price for a contract before we finalize the project specifications, which increases the risk that we will mis-price these contracts. The complexity of many of our engagements makes accurately estimating our time and resources more difficult.

If we are unable to retain our contracts with the U.S. government and subcontracts under U.S. government prime contracts in the competitive rebidding process, our revenues may suffer.

Upon expiration of a U.S. government contract or subcontract under a U.S. government prime contract, if the government customer requires further services of the type provided in the contract, there is frequently a competitive rebidding process. We cannot guarantee that we, or if we are a subcontractor that the prime contractor, will win any particular bid, or that we will be able to replace business lost upon expiration or completion of a contract. Further, all U.S. government contracts are subject to protest by competitors. The termination of several of our significant contracts or nonrenewal of several of our significant contracts, could result in significant revenue shortfalls.

We cannot assure you of market acceptance of our electric vehicle technology.

Our batteries for the defense industry and a signal light powered by water-activated batteries for use in life jackets and other rescue apparatus are the only commercial Zinc-Air battery products we currently have available for sale. Significant resources will be required to develop and produce additional products utilizing this technology on a commercial scale. Additional development will be necessary in order to commercialize our technology and each of the components of the Electric Fuel System for electric vehicles. We cannot assure you that we will be able to successfully develop, engineer or commercialize our Zinc-Air energy system. The likelihood of our future success must be considered in light of the risks, expenses, difficulties and delays frequently encountered in connection with the operation and development of a relatively early stage business and with development activities generally.

We believe that public pressure and government initiatives are important factors in creating an electric vehicle market. However, there can be no assurance that there will be sufficient public pressure or that further legislation or other governmental initiatives will be enacted, or that current legislation will not be repealed, amended, or have its implementation delayed. In addition, we are subject to the risk that even if an electric fuel vehicle market develops, a different form of zero emission or low emission vehicle will dominate the market. In addition, we cannot assure you that other solutions to the problem of containing emissions created by internal combustion engines will not be invented, developed and produced. Any other solution could achieve greater market acceptance than electric vehicles. The failure of a significant market for electric vehicles to develop would have a material adverse effect on our ability to commercialize this aspect of our technology. Even if a significant market for electric vehicles develops, there can be no assurance that our technology will be commercially competitive within that market.

Some of the components of our electric vehicle technology and our products pose potential safety risks which could create potential liability exposure for us.

Some of the components of our electric vehicle technology and our products contain elements that are known to pose potential safety risks. Also, because electric vehicle batteries contain large amounts of electrical energy, they may cause injuries if not handled properly. In addition to these risks, and there can be no assurance that accidents in our facilities will not occur. Any accident, whether occasioned by the use of all or any part of our products or technology or by our manufacturing operations, could adversely affect commercial acceptance of our products and could result in significant production delays or claims for damages resulting from injuries. Any of these occurrences would materially adversely affect our operations and financial condition.

We may face product liability claims.

In the event that our products, including the products manufactured by MDT, fail to perform as specified, users of these products may assert claims for substantial amounts. These claims could have a materially adverse effect on our financial condition and results of operations. There is no assurance that the amount of the general product liability insurance that we maintain will be sufficient to cover potential claims or that the present amount of insurance can be maintained at the present level of cost, or at all.

Our fields of business are highly competitive.

The competition to develop defense and security products and electric

vehicle battery systems, and to obtain funding for the development of these products, is, and is expected to remain, intense.

Our defense and security products compete with other manufacturers of specialized training systems, including Firearms Training Systems, Inc., a producer of interactive simulation systems designed to provide training in the handling and use of small and supporting arms. In addition, we compete with manufacturers and developers of armor for cars and vans, including O'Gara-Hess & Eisenhardt, a division of Armor Holdings, Inc.

Our battery technology competes with other battery technologies, as well as other Zinc-Air technologies. The competition in this area of our business consists of development stage companies, major international companies and consortia of such companies, including battery manufacturers, automobile manufacturers, energy production and transportation companies, consumer goods companies and defense contractors. Many of our competitors have financial, technical, marketing, sales, manufacturing, distribution and other resources significantly greater than ours.

Various battery technologies are being considered for use in electric vehicles and defense and safety products by other manufacturers and developers, including the following: lead-acid, nickel-cadmium, nickel-iron, nickel-zinc, nickel-metal hydride, sodium-sulfur, sodium-nickel chloride, zinc-bromine, lithium-ion, lithium-polymer, lithium-iron sulfide, primary lithium, rechargeable alkaline and Zinc-Air.

If we are unable to compete successfully in each of our operating areas, especially in the defense and security products area of our business, our business and results of operations could be materially adversely affected.

Our business is dependent on proprietary rights that may be difficult to protect and could affect our ability to compete effectively.

Our ability to compete effectively will depend on our ability to maintain the proprietary nature of our technology and manufacturing processes through a combination of patent and trade secret protection, non-disclosure agreements and licensing arrangements.

Litigation, or participation in administrative proceedings, may be necessary to protect our proprietary rights. This type of litigation can be costly and time consuming and could divert company resources and management attention to defend our rights, and this could harm us even if we were to be successful in the litigation. In the absence of patent protection, and despite our reliance upon our proprietary confidential information, our competitors may be able to use innovations similar to those used by us to design and manufacture products directly competitive with our products. In addition, no assurance can be given that others will not obtain patents that we will need to license or design around. To the extent any of our products are covered by third-party patents, we could need to acquire a license under such patents to develop and market our products.

Despite our efforts to safeguard and maintain our proprietary rights, we may not be successful in doing so. In addition, competition is intense, and there can be no assurance that our competitors will not independently develop or patent technologies that are substantially equivalent or superior to our technology. Moreover, in the event of patent litigation, we cannot assure you that a court would determine that we were the first creator of inventions covered by our issued patents or pending patent applications or that we were the first to file patent applications for those inventions. If existing or future third-party patents containing broad claims were upheld by the courts or if we were found to infringe third party patents, we may not be able to obtain the required licenses from the holders of such patents on acceptable terms, if at all. Failure to obtain these licenses could cause delays in the introduction of our products or necessitate costly attempts to design around such patents, or could foreclose the development, manufacture or sale of our products. We could also incur substantial costs in defending ourselves in patent infringement suits brought by others and in prosecuting patent infringement suits against infringers.

We also rely on trade secrets and proprietary know-how that we seek to protect, in part, through non-disclosure and confidentiality agreements with our customers, employees, consultants, and entities with which we maintain strategic relationships. We cannot assure you that these agreements will not be breached, that we would have adequate remedies for any breach or that our trade secrets will not otherwise become known or be independently developed by competitors.

We are dependent on key personnel and our business would suffer if we fail to retain them.

We are highly dependent on the presidents of our IES and FAAC subsidiaries and the general managers of our MDT and Epsilor subsidiaries, and the loss of the services of one or more of these persons could adversely affect us. We are especially dependent on the services of our Chairman, President and Chief Executive Officer, Robert S. Ehrlich. The loss of Mr. Ehrlich could have a material adverse effect on us. We are party to an employment agreement with Mr. Ehrlich, which agreement expires at the end of 2005. We do not have key-man life insurance on Mr. Ehrlich.

There are risks involved with the international nature of our business.

A significant portion of our sales are made to customers located outside the U.S., primarily in Europe and Asia. In 2003, 2002 and 2001, without taking account of revenues derived from discontinued operations, 42%, 56% and 49%, respectively, of our revenues, were derived from sales to customers located outside the U.S. We expect that our international customers will continue to account for a substantial portion of our revenues in the near future. Sales to international customers may be subject to political and economic risks, including political instability, currency controls, exchange rate fluctuations, foreign taxes, longer payment cycles and changes in import/export regulations and tariff rates. In addition, various forms of protectionist trade legislation have been and in the future may be proposed in the U.S. and certain other countries. Any resulting changes in current tariff structures or other trade and monetary policies could adversely affect our sales to international customers.

Investors should not purchase our common stock with the expectation of receiving cash dividends.

We currently intend to retain any future earnings for funding growth and, as a result, do not expect to pay any cash dividends in the foreseeable future.

Market-Related Risks

The price of our common stock is volatile.

The market price of our common stock has been volatile in the past and may change rapidly in the future. The following factors, among others, may cause significant volatility in our stock price:

- Announcements by us, our competitors or our customers;
- The introduction of new or enhanced products and services by us or our competitors;

- Changes in the perceived ability to commercialize our technology compared to that of our competitors;
- Rumors relating to our competitors or us;
- Actual or anticipated fluctuations in our operating results; and
- General market or economic conditions.

If our shares were to be delisted, our stock price might decline further and we might be unable to raise additional capital.

One of the continued listing standards for our stock on the Nasdaq National Market is the maintenance of a $1.00 bid price. Our stock price has periodically traded below $1.00 in the recent past. If our bid price were to go and remain below $1.00 for 30 consecutive business days, Nasdaq could notify us of our failure to meet the continued listing standards, after which we would have 180 calendar days to correct such failure or be delisted from the Nasdaq National Market.

Although we would have the opportunity to appeal any potential delisting, there can be no assurances that this appeal would be resolved favorably. As a result, there can be no assurance that our common stock will remain listed on the Nasdaq National Market. If our common stock were to be delisted from the Nasdaq National Market, we might apply to be listed on the Nasdaq SmallCap market; however, there can be no assurance that we would be approved for listing on the Nasdaq SmallCap market, which has the same $1.00 minimum bid and other similar requirements as the Nasdaq National Market. If we were to move to the Nasdaq SmallCap market, current Nasdaq regulations would give us the opportunity to obtain an additional 180-day grace period and an additional 90-day grace period after that if we meet certain net income, stockholders' equity or market capitalization criteria. While our stock would continue to trade on the over-the-counter bulletin board following any delisting from the Nasdaq, any such delisting of our common stock could have an adverse effect on the market price of, and the efficiency of the trading market for, our common stock. Also, if in the future we were to determine that we need to seek additional equity capital, it could have an adverse effect on our ability to raise capital in the public equity markets.

In addition, if we fail to maintain Nasdaq listing for our securities, and no other exclusion from the definition of a "penny stock" under the Securities Exchange Act of 1934, as amended, is available, then any broker engaging in a transaction in our securities would be required to provide any customer with a risk disclosure document, disclosure of market quotations, if any, disclosure of the compensation of the broker-dealer and its salesperson in the transaction and monthly account statements showing the market values of our securities held in the customer's account. The bid and offer quotation and compensation information must be provided prior to effecting the transaction and must be contained on the customer's confirmation. If brokers become subject to the "penny stock" rules when engaging in transactions in our securities, they would become less willing to engage in transactions, thereby making it more difficult for our stockholders to dispose of their shares.

A substantial number of our shares are available for sale in the public market and sales of those shares could adversely affect our stock price.

Sales of a substantial number of shares of common stock into the public market, or the perception that those sales could occur, could adversely affect our stock price or could impair our ability to obtain capital through an offering of equity securities. As of February 29, 2004, we had 59,904,449 shares of common stock issued and outstanding. Of these shares, most are freely transferable without restriction under the Securities Act of 1933, and a substantial portion of the remaining shares may be sold subject to the volume restrictions, manner-of-sale provisions and other conditions of Rule 144 under the Securities Act of 1933.

In connection with a stock purchase agreement dated September 30, 1996 between Leon S. Gross and us, we also entered into a registration rights agreement with Mr. Gross dated September 30, 1996, providing registration rights with respect to the shares of common stock issued to Mr. Gross in connection with the offering. These rights include the right to make two demands for the registration of the shares of our common stock owned by Mr. Gross. In addition, Mr. Gross was granted unlimited rights to "piggyback" on registration statements that we file for the sale of our common stock. Mr. Gross presently owns 3,482,534 shares, of which 1,538,462 have never been registered.

Exercise of our warrants, options and convertible debt could adversely affect our stock price and will be dilutive.

As of February 29, 2004, there were outstanding warrants to purchase a total of 19,302,156 shares of our common stock at a weighted average exercise price of $1.85 per share, options to purchase a total of 9,627,212 shares of our common stock at a weighted average exercise price of $1.48 per share, of which 6,477,440 were vested, at a weighted average exercise price of $1.67 per share, and outstanding debentures convertible into a total of 5,203,149 shares of our common stock at a weighted average conversion price of $1.39 per share. Holders of our options, warrants and convertible debt will probably exercise or convert them only at a time when the price of our common stock is higher than their respective exercise or conversion prices. Accordingly, we may be required to issue shares of our common stock at a price substantially lower than the market price of our stock. This could adversely affect our stock price. In addition, if and when these shares are issued, the percentage of our common stock that existing stockholders own will be diluted.

Our certificate of incorporation and bylaws and Delaware law contain provisions that could discourage a takeover.

Provisions of our amended and restated certificate of incorporation may have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from attempting to acquire, control of us. These provisions could limit the price that certain investors might be willing to pay in the future for shares of our common stock. These provisions:

- divide our board of directors into three classes serving staggered three-year terms;

- only permit removal of directors by stockholders "for cause," and require the affirmative vote of at least 85% of the outstanding common stock to so remove; and

- allow us to issue preferred stock without any vote or further action by the stockholders.

The classification system of electing directors and the removal provision may tend to discourage a third-party from making a tender offer or otherwise attempting to obtain control of us and may maintain the incumbency of our board of directors, as the classification of the board of directors increases the difficulty of replacing a majority of the directors. These provisions may have the effect of deferring hostile takeovers, delaying changes in our control or management, or may make it more difficult for stockholders to take certain corporate actions. The amendment of any of these provisions would require approval by holders of at least 85% of the outstanding common stock.

Israel-Related Risks

A significant portion of our operations takes place in Israel, and we could be adversely affected by the economic, political and military conditions in that region.

The offices and facilities of three of our subsidiaries, EFL, MDT and Epsilor, are located in Israel (in Beit Shemesh, Lod and Dimona, respectively, all of which are within Israel's pre-1967 borders). Most of our senior management is located at EFL's facilities. Although we expect that most of our sales will be made to customers outside Israel, we are nonetheless directly affected by economic, political and military conditions in that country. Accordingly, any major hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could have a material adverse effect on our operations. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors and a state of hostility, varying in degree and intensity, has led to security and economic problems for Israel.

Historically, Arab states have boycotted any direct trade with Israel and to varying degrees have imposed a secondary boycott on any company carrying on trade with or doing business in Israel. Although in October 1994, the states comprising the Gulf Cooperation Council (Saudi Arabia, the United Arab Emirates, Kuwait, Dubai, Bahrain and Oman) announced that they would no longer adhere to the secondary boycott against Israel, and Israel has entered into certain agreements with Egypt, Jordan, the Palestine Liberation Organization and the

Palestinian Authority, Israel has not entered into any peace arrangement with Syria or Lebanon. Moreover, since September 2000, there has been a significant deterioration in Israel's relationship with the Palestinian Authority, and a significant increase in terror and violence. Efforts to resolve the problem have failed to result in an agreeable solution. Continued hostilities between the Palestinian community and Israel and any failure to settle the conflict may have a material adverse effect on our business and us. Moreover, the current political and security situation in the region has already had an adverse effect on the economy of Israel, which in turn may have an adverse effect on us.

Some of our employees are currently obligated to perform annual reserve duty in the Israel Defense Forces and are subject to being called for active military duty at any time. No assessment can be made of the full impact of such requirements on us in the future, particularly if emergency circumstances occur, and no prediction can be made as to the effect on us of any expansion of these obligations. However, further deterioration of hostilities with the Palestinian community into a full-scale conflict might require more widespread military reserve service by some of our employees, which could have a material adverse effect on our business.

Service of process and enforcement of civil liabilities on us and our officers may be difficult to obtain.

We are organized under the laws of the State of Delaware and will be subject to service of process in the United States. However, approximately 35% of our assets are located outside the United States. In addition, two of our directors and all of our executive officers are residents of Israel and a portion of the assets of such directors and executive officers are located outside the United States.

There is doubt as to the enforceability of civil liabilities under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, in original actions instituted in Israel. As a result, it may not be possible for investors to enforce or effect service of process upon these directors and executive officers or to judgments of U.S. courts predicated upon the civil liability provisions of U.S. laws against our assets, as well as the assets of these directors and executive officers. In addition, awards of punitive damages in actions brought in the U.S. or elsewhere may be unenforceable in Israel.

Exchange rate fluctuations between the U.S. dollar and the Israeli NIS may negatively affect our earnings.

Although a substantial majority of our revenues and a substantial portion of our expenses are denominated in U.S. dollars, a portion of our costs, including personnel and facilities-related expenses, is incurred in New Israeli Shekels (NIS). Inflation in Israel will have the effect of increasing the dollar cost of our operations in Israel, unless it is offset on a timely basis by a devaluation of the NIS relative to the dollar. In 2003, the inflation adjusted NIS appreciated against the dollar, which raised the dollar cost of our Israeli operations.

Some of our agreements are governed by Israeli law.

Israeli law governs some of our agreements, such as our lease agreements on our subsidiaries' premises in Israel, and the agreements pursuant to which we purchased IES, MDT and Epsilor. While Israeli law differs in certain respects from American law, we do not believe that these differences materially adversely affect our rights or remedies under these agreements.

ITEM 7A. 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 2004. Our research, development and production activities are primarily carried out by our Israeli subsidiary, EFL, at its facility in Beit Shemesh, and accordingly we have sales and expenses in New Israeli Shekels. Additionally, our MDT and Epsilor subsidiaries operate primarily in New Israeli Shekels. 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. Please see "Impact of Inflation and Currency Fluctuations," above and Note 2.b to the Notes to the Consolidated Financial Statements.

While we conduct our business primarily in U.S. dollars, some of our agreements are denominated in foreign currencies. Specifically, at the end of 2003 our IES contract with the German National Police, which accounted for 16% of our revenues on a consolidated basis in 2003, was denominated in Euros. Thus, we are exposed to market risk, primarily related to fluctuations in the value of the Euro. Therefore, due to the volatility in the exchange rate of the Euro versus the U.S. dollar, we decided to hedge part of the risk of a devaluation of

the U.S dollar, which could have an adverse effect on the revenues that we incur in IES. During the year 2003 we hedged revenues derived from the German National Police in order to protect against a decrease in value of forecasted foreign currency cash flows resulting from revenues payments denominated in Euro. We do not hold or issue derivative financial instruments for trading or speculative purposes

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

During the fourth quarter of 2003, our management, including the principal executive officer and principal financial officer, evaluated our disclosure controls and procedures related to the recording, processing, summarization, and reporting of information in our periodic reports that we file with the SEC. These disclosure controls and procedures have been designed to ensure that material information relating to us, including our subsidiaries, is made known to our management, including these officers, by other of our employees, and that this information is recorded, processed, summarized, evaluated, and reported, as applicable, within the time periods specified in the SEC's rules and forms. Due to the inherent limitations of control systems, not all misstatements may be detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. Our controls and procedures can only provide reasonable, not absolute, assurance that the above objectives have been met.

As of December 31, 2003, these officers concluded that the design of the disclosure controls and procedures provides reasonable assurance that they can accomplish their objectives. We intend to continually strive to improve our disclosure controls and procedures to enhance the quality of our financial reporting.

There have been no changes in our internal control over financial reporting that occurred during our last fiscal quarter to which this Annual Report on Form 10-K relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Executive Officers, Directors and Significant Employees

Executive Officers and Directors

Our executive officers and directors and their ages as of February 29, 2004 were as follows:

<TABLE>
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Name	Age	Position
<S>	<C>	
Robert S. Ehrlich	65	Chairman of the Board, President and Chief Executive Officer
Steven Esses	40	Executive Vice President, Chief Operating Officer and Director
Avihai Shen	36	Vice President - Finance and Chief Financial Officer
Dr. Jay M. Eastman	57	Director
Jack E. Rosenfeld	64	Director
Lawrence M. Miller	57	Director
</TABLE>

Bert W. Wasserman.....	71	Director
Edward J. Borey	53	Director

</TABLE>

Our by-laws provide for a board of directors of one or more directors. There are currently seven directors. Under the terms of our certificate of incorporation, the board of directors is composed of three classes of similar size, each elected in a different year, so that only one-third of the board of directors is elected in any single year. Dr. Eastman and Mr. Esses are designated Class I directors and have been elected for a term expiring in 2006 and until their successors are elected and qualified; Messrs. Rosenfeld and Miller are designated Class II directors elected for a term expiring in 2005 and until their successors are elected and qualified; and Mr. Ehrlich is designated a Class III director elected for a term that expires in 2004 and until his successor is elected and qualified. Mr. Bert W. Wasserman and Mr. Edward J. Borey have been appointed to the Board (in February 2003 and December 2003, respectively) and proposed for election to the Board as Class III directors at the next annual meeting of the shareholders in June 2004, along with Mr. Ehrlich. A majority of the Board is "independent" under relevant SEC and Nasdaq regulations.

Robert S. Ehrlich has been our Chairman of the Board since January 1993 and our President and Chief Executive Officer since October 2002. From May 1991 until January 1993, Mr. Ehrlich was our Vice Chairman of the Board, and from May 1991 until October 2002 he was our Chief Financial Officer. Mr. Ehrlich was a director of Eldat, Ltd., an Israeli manufacturer of electronic shelf labels, from June 1999 to July 2003. From 1987 to June 2003, Mr. Ehrlich served as a director of PSC Inc. ("PSCX"), a manufacturer and marketer of laser diode bar code scanners, and, between April 1997 and June 2003, Mr. Ehrlich was the chairman of the board of PSCX. PSCX filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code in November 2002; its pre-negotiated plan of reorganization was confirmed by the Bankruptcy Court in June 2003. Mr. Ehrlich received a B.S. and J.D. from Columbia University in New York, New York.

Steven Esses has been a director since July 2002 and our Executive Vice President since January 2003 and Chief Operating Officer since February 2003. From 2000 till 2002, Mr. Esses was a principal with Stillwater Capital Partners, Inc., a New York-based investment research and advisory company (hedge fund) specializing in alternative investment strategies. During this time, Mr. Esses also acted as an independent consultant to new and existing businesses in the areas of finance and business development. From 1995 to 2000, Mr. Esses founded Dunkin' Donuts in Israel and held the position of Managing Director and CEO. Prior thereto, he was Director of Retail Jewelry Franchises with Hamilton Jewelry, and before that he served as Executive Director of Operations for the Conway Organization, a major off-price retailer with 17 locations.

Avihai Shen has been our Vice President - Finance since September 1999 and our Chief Financial Officer since October 2002, and served as our corporate Secretary from September 1999 to December 2000. Mr. Shen was the CFO of Commtouch Software Ltd., an internet company based in California that develops e-mail solutions, from 1996 to early 1999, and worked previously at Ernst and Young in Israel. Mr. Shen is a certified public accountant and has a B.A. in Economics from Bar-Ilan University in Israel and an M.B.A. from the Hebrew University of Jerusalem.

Dr. Jay M. Eastman has been one of our directors since October 1993. Since November 1991, Dr. Eastman has served as President and Chief Executive Officer of Lucid, Inc., which is developing laser technology applications for medical diagnosis and treatment. Dr. Eastman has served as a director of PSCX since April 1996 and served as Senior Vice President of Strategic Planning from December 1995 through October 1997. PSCX filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code in November 2002; its pre-negotiated plan of reorganization was confirmed by the Bankruptcy Court in June 2003. Dr. Eastman is also a director of Dimension Technologies, Inc., a developer and manufacturer of 3D displays for computer and video displays, and Centennial Technologies Inc., a manufacturer of PCMCIA cards. From 1981 until January 1983, Dr. Eastman was Director of the University of Rochester's Laboratory for Laser Energetics, where he was a member of the staff from September 1975 to 1981. Dr. Eastman holds a B.S. and a Ph.D. in Optics from the University of Rochester in New York.

Jack E. Rosenfeld has been one of our directors since October 1993. Mr. Rosenfeld is also a director of Maurice Corporation and a director of PSCX. PSCX filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code in November 2002; its pre-negotiated plan of reorganization was confirmed by the Bankruptcy Court in June 2003. Since April 1998, Mr. Rosenfeld has been President and Chief Executive Officer of Potpourri Collection Inc., a specialty catalog direct marketer. Mr. Rosenfeld was President and Chief Executive Officer of Hanover Direct, Inc., formerly Horn & Hardart Co., which operates a direct mail marketing business, from September 1990 until December 1995, and had been President and Chief Executive Officer of its direct marketing subsidiary, since May 1988. Mr. Rosenfeld holds a B.A. from Cornell University in Ithaca, New York and an LL.B. from Harvard University in Cambridge, Massachusetts.

Lawrence M. Miller was elected to the board of directors in November 1996. Mr. Miller has been a senior partner in the Washington D.C. law firm of Schwartz, Woods and Miller since 1990. He served from August 1993 through May 1996 as a member of the board of directors of The Phoenix Resource Companies, Inc., a publicly traded energy exploration and production company, and as a member of the Audit and Compensation Committee of that board. That company was merged into Apache Corporation in May 1996. Mr. Miller holds a B.A. from Dickinson College in Carlisle, Pennsylvania and a J.D. with honors from George Washington University in Washington, D.C. He is a member of the District of

Columbia bar.

Bert W. Wasserman was added to the board in February 2003. Mr. Wasserman served as Executive Vice President and Chief Financial Officer of Time Warner, Inc. from 1990 until his retirement in 1995 and served on the Board of Directors of Time Warner, Inc. and its predecessor company, Warner Communications, Inc. from 1981 to 1995. He joined Warner Communications, Inc. in 1966 and had been an officer of that company since 1970. Mr. Wasserman is director of several investment companies in the Dreyfus Family of Funds. He is also a director of Malibu Entertainment, Inc., Lillian Vernon Corporation, InforMedix, Inc. and PSCX. PSCX filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code in November 2002; its pre-negotiated plan of reorganization was confirmed by the Bankruptcy Court in June 2003. Mr. Wasserman is a certified public accountant; he holds a B.A. from Baruch College in New York City, of whose Board of Trustees he has served as Vice President and President, and an LL.B from Brooklyn Law School.

Edward J. Borey was added to the board in December 2003. From December 2000 to September 2003, Mr. Borey served as President, Chief Executive Officer and a director of PSCX. PSCX filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code in November 2002; its pre-negotiated plan of reorganization was confirmed by the Bankruptcy Court in June 2003. Prior to joining the Company, Mr. Borey was President and CEO of TranSenda (May 2000 to December 2000). Previously, Mr. Borey held senior positions in the automated data collection industry. At Intermec Technologies Corporation (1995-1999), he was Executive Vice President and Chief Operating Officer and also Senior Vice President/General Manager of the Intermec Media subsidiary. Currently, Mr. Borey serves as a Board member at Centura Software, recently renamed MBrane, and he is on the Advisory Board of TranSenda Software and NextRx. Mr. Borey holds a B.S. in Economics from the State University of New York, College of Oswego; an M.A. in Public Administration from the University of Oklahoma; and an M.B.A. in Finance from Santa Clara University.

Committees of the Board of Directors

Our board of directors has an Audit Committee, a Compensation Committee, a Nominating Committee and an Executive Committee.

Created in December 1993, the purpose of the Audit Committee is to review with management and our independent auditors the scope and results of the annual audit, the nature of any other services provided by the independent auditors, changes in the accounting principles applied to the presentation of our financial statements, and any comments by the independent auditors on our policies and procedures with respect to internal accounting, auditing and financial controls. The Audit Committee was established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. In addition, the Audit Committee is charged with the responsibility for making decisions on the engagement of independent auditors. As required by law, the Audit Committee operates pursuant to a charter. The Audit Committee consists of Messrs. Wasserman (Chair), Miller and Rosenfeld. We have determined that Mr. Wasserman qualifies as an "audit committee financial expert" under applicable SEC and Nasdaq regulations. Mr. Wasserman, as well as all the other members of the Audit Committee, is "independent," as independence is defined in Rule 4200(a)(15) of the National Association of Securities Dealers' listing standards and under Item 7(d)(3)(iv) of Schedule 14A of the proxy rules under the Exchange Act.

The Compensation Committee, also created in December 1993, recommends annual compensation arrangements for the Chief Executive Officer and Chief Financial Officer and reviews annual compensation arrangements for all officers and significant employees. The Compensation Committee consists of Dr. Eastman (Chair) and Messrs. Wasserman and Rosenfeld, all of whom are independent non-employee directors.

The Executive Committee, created in July 2001, exercises the powers of the Board during the intervals between meetings of the Board, in the management of the property, business and affairs of the Company (except with respect to certain extraordinary transactions). The Executive Committee consists of Messrs. Ehrlich (Chair), Miller and Esses.

The Nominating Committee, created in March 2003, identifies and proposes candidates to serve as members of the Board of Directors. Proposed nominees for membership on the Board of Directors submitted in writing by stockholders to the Secretary of the Company will be brought to the attention of the Nominating Committee. The Nominating Committee consists of Mr. Miller (Chair), Dr. Eastman and Mr. Rosenfeld, all of whom are independent non-employee directors.

Code of Ethics

We have adopted a Code of Ethics, as required by Nasdaq listing standards and the rules of the SEC, that applies to our principal executive officer, our principal financial officer, and our principal accounting officer, as well as a more general code of conduct that applies to our other employees. The Code of Ethics is publicly available through a hyperlink located on the investor relations page of our website, at http://www.arotech.com/compro/investor.html. If we make substantive amendments to the Code of Ethics or grant any waiver, including any implicit waiver, that applies to anyone subject to the Code of Ethics, we will disclose the nature of such amendment or waiver on the website or in a report on Form 8-K in accordance

with applicable Nasdaq and SEC rules

Voting Agreements

Messrs. Gross, Ehrlich and Yehuda Harats are parties to a Voting Rights Agreement dated September 30, 1996, as amended, pursuant to which each of the parties agrees to vote the shares of our common stock held by that person in favor of the election of Messrs. Ehrlich, Harats and Miller until the earlier of December 28, 2004 or our fifth annual meeting of stockholders after December 28, 1999. Mr. Harats resigned as a director in 2002; however, we believe that Mr. Harats must continue to comply with the terms of this agreement.

Director Compensation

Non-employee members of our board of directors are paid $2,500 (plus expenses) for each board of directors meeting attended, $2,000 (plus expenses) for each meeting of the audit committee of the board of directors attended, and $1,000 (plus expenses) for each meeting of all other committees of the board of directors attended. In addition, we have adopted a Non-Employee Director Stock Option Plan pursuant to which non-employee directors receive an initial grant of options to purchase 25,000 shares of our common stock upon the effective date of such plan or upon the date of his or her election as a director. Thereafter, non-employee directors will receive options to purchase 10,000 shares of our common stock for each year of service on the board. All such options are granted at fair market value and vest ratably over three years from the date of the grant. At our next annual meeting of shareholders in June 2004, we will propose increasing these stock option grants to 40,000 shares of our common stock upon the effective date of such plan or upon the date of a director's election as a director and 25,000 shares of our common stock for each year of service on the board.

Significant Employees

Our significant employees as of February 29, 2004, and their ages as of December 31, 2003, are as follows:

<TABLE>
<CAPTION>

Name	Age	Position
<S>	<C>	
Jonathan Whartman	49	Senior Vice President
Dr. Neal Naimer	45	Vice President and Chief Technology Officer
Yoel Gilon	51	Vice President - Electric Vehicle Technologies
Yaakov Har-Oz	46	Vice President, General Counsel and Secretary
Danny Waldner	32	Controller
Greg Otte	44	President, IES Interactive Training, Inc.
Alan G. Jordan	50	President and CEO, FAAC Incorporated
Yosef Bar	61	General Manager, MDT Protective Industries
Hezy Aspis	53	General Manager, Epsilor Electronics Industries, Ltd.
Arik Arad	51	Chairman, IES Interactive Training, Inc. and President, Arocon Security Corporation

</TABLE>

Jonathan Whartman has been Senior Vice President since December 2000, and Vice President of Marketing from 1994 to December 2000. From 1991 until 1994, Mr. Whartman was our Director of Special Projects. Mr. Whartman was also Director of Marketing of Amtec from its inception in 1989 through the merger of Amtec into Arotech. Before joining Amtec, Mr. Whartman was Manager of Program Management at Luz, Program Manager for desk-top publishing at ITT Qume in San Jose, California from 1986 to 1987, and Marketing Director at Kidron Digital Systems, an Israeli computer developer, from 1982 to 1986. Mr. Whartman holds a B.A. in Economics and an M.B.A. from the Hebrew University, Jerusalem, Israel.

Dr. Neal Naimer has been a Vice President since June 1997 and our Chief Technology Officer since December 2002. Dr. Naimer was previously Director of Electrode Engineering of our Air Electrode development program. From 1987 to 1989, he was the Manager of the Chemical Vapor Deposition (Thin Films) Group at Intel Electronics in Jerusalem, and was Project Manager of the photo voltaic IR detector development program at Tadiran Semiconductor Devices in Jerusalem from 1984 to 1987. Dr. Naimer was educated at University College of London, England, where he received his B.Sc. in Chemical Engineering and a Ph.D. in Chemical Engineering.

Yoel Gilon has been our Vice President - Electric Vehicle Technologies since 2001; prior to that, he served as Director of Electric Vehicle Technologies at our Beit Shemesh facility since joining us in 1994. From 1991 to 1994, Mr. Gilon was Project Development Manager at Ormat Industries. Previously, Mr. Gilon was Vice President of System Engineering Development at Luz Industries. Mr. Gilon holds a B.Sc. in Mathematics and Physics and a M.Sc. in Mathematics from the Hebrew University of Jerusalem. He also holds a B.A. in Fine Arts from the Bezalel Academy in Jerusalem.

Yaakov Har-Oz has served as our Vice President and General Counsel since October 2000 and as our corporate Secretary since December 2000. From 1994 until October 2000, Mr. Har-Oz was a partner in the Jerusalem law firm of Ben-Ze'ev, Hacohen & Co. Prior to moving to Israel in 1993, he was an administrative law judge and in private law practice in New York. Mr. Har-Oz holds a B.A. from Brandeis University in Waltham, Massachusetts and a J.D. from

Vanderbilt Law School (where he was an editor of the law review) in Nashville, Tennessee. He is a member of the New York bar and the Israel Chamber of Advocates.

Danny Waldner has served as our Controller since March 2000 and as our chief accounting officer since October 2002. Prior thereto, Mr. Waldner was an accountant at KPMG in Israel from 1996 to 2000. Mr. Waldner is a Certified Public Accountant and holds a B.A. in Accounting and Business Administration and an M.B.A. from the Rishon Lezion College of Administration in Israel.

Greg Otte has served as IES's President since January 2001. From 1994 to 2001, Mr. Otte was in charge of IES's North American marketing efforts. Prior to this, he was responsible for sales, product placement and national contracts with Tuxall Uniform & Equipment, a national supplier of law enforcement equipment. Mr. Otte holds a bachelor's degree in Marketing from the University of Colorado.

Alan G. Jordan started at First Ann Arbor Corporation, the predecessor of FAAC, in 1978 as a junior engineer. He subsequently was promoted to section head, program manager, group head, director of operations, vice president, and finally president, which position he has held for more than the past five years. Prior to joining FAAC, Mr. Jordan was an engineer in the U.S. Navy civil service. Mr. Jordan maintains Department of Defense "secret" clearance. Mr. Jordan holds a bachelor's degree in Systems Science from Michigan State University.

Yosef Bar established MDT Protective Industries in 1989 as one of the first bulletproofing companies in Israel. Under the direction of Mr. Bar, MDT moved from its initial emphasis on vandalism protection to bulletproofing not just windshields but the entire vehicle, as a result of which MDT became Israel's leader in the state-of-the art lightweight armoring of vehicles, ranging from light tactical vehicles to passenger vehicles. Mr. Bar served in the Israel Defense Forces, reaching the rank of Lieutenant Colonel of the paratroop regiment with over 1,000 jumps to his credit. He also participated in several anti-terrorism courses.

Hezy Aspis has headed Epsilor Electronic Industries, Ltd. since 1991. Prior to this, he was an engineer with Tadiran Batteries Ltd., Israel's leading lithium battery manufacturer. Mr. Aspis holds a B.Sc. in electric engineering from the Technion Israel Institute of Technology in Haifa, Israel, and an M.B.A. from Tel-Aviv University in Israel.

Arik Arad has served as IES's Chairman since August 2003 and as Chairman of Arocon Security Consulting since September 2003. Mr. Arad has served in the military, law enforcement and private-sector security business, servicing clientele from among the Fortune 500(TM) companies. In that capacity, Mr. Arad has participated in the process of reassessing security requirements, security design, security implementation, security training programs and proactive security follow-up. Mr. Arad has been exposed to issues pertinent to companies whose worldwide operations pose potential for terrorist activity. He has also gained worldwide experience in securing major airports, shopping centers and other high profile facilities. Mr. Arad served as a Lieutenant Colonel in the Israel Defense Forces. Mr. Arad is a graduate of the International Seminar Management Program (ISMP) of the Harvard Business School and holds a B.Sc. in psychology and political sciences from the Haifa University in Israel.

Section 16(a) Beneficial Ownership Reporting Compliance

Under the securities laws of the United States, our directors, certain of our officers and any persons holding more than ten percent of our common stock are required to report their ownership of our common stock and any changes in that ownership to the Securities and Exchange Commission. Specific due dates for these reports have been established and we are required to report any failure to file by these dates during 2003. We are not aware of any instances during 2003, not previously disclosed by us, where such "reporting persons" failed to file the required reports on or before the specified dates, except as follows:

(i) Mr. Borey was required to report his holdings of our securities in a Form 3 that should have been filed on or prior to December 15, 2003 in connection with his becoming a director on December 4, 2003. Additionally, Mr. Borey was required to file a Form 4 on or prior to January 2, 2004 in connection with his receipt of 35,000 stock options on December 30, 2003. He reported his holdings and this transaction in a Form 5 filed on February 17, 2004.

(ii) Mr. Eastman was required to file a Form 4 on or prior to January 2, 2004 in connection with his receipt of 10,000 stock options on December 30, 2003. He reported this transaction in a Form 5 filed on February 17, 2004.

(iii) Mr. Ehrlich was required to file a Form 4 on or prior to March 17, 2003 in connection with his receipt of 1,500,000 stock options on March 14, 2003. He reported this transaction in a Form 4 filed on August 11, 2003.

(iv) Mr. Ehrlich was required to file a Form 4 on or prior to June 30, 2003 in connection with his receipt of 500,000 stock options on June 26, 2003. He reported this transaction in a Form 4 filed on August 11, 2003.

(v) Mr. Ehrlich was required to file a Form 4 on or prior to January 27, 2004 in connection with his receipt of 35,000 stock options on January 25, 2004. He reported this transaction in a Form 5 filed on February 17, 2004.

(vi) Mr. Esses was required to file a Form 4 on or prior to February 26, 2003 in connection with his receipt of 600,000 stock options on February 24, 2003. He reported this transaction in a Form 4 filed on August 8, 2003.

(vii) Mr. Esses was required to file a Form 4 on or prior to July 11, 2003 in connection with his receipt of 100,000 stock options on July 9, 2003, and a Form 4 on or prior to October 15, 2003 in connection with his receipt of 335,000 stock options on October 13, 2003. He reported these transactions in a Form 5 filed on February 17, 2004 (as amended on February 24, 2004).

(viii) Mr. Miller was required to file a Form 4 on or prior to January 2, 2004 in connection with his receipt of 10,000 stock options on December 30, 2003. He reported this transaction in a Form 5 filed on February 17, 2004.

(ix) Mr. Rosenfeld was required to file a Form 4 on or prior to January 2, 2004 in connection with his receipt of 10,000 stock options on December 30, 2003. He reported this transaction in a Form 5 filed on February 18, 2004 (after the required filing date of February 17, 2004, due to a technical delay in filing with the EDGAR system).

(x) Mr. Shen was required to file a Form 4 on or prior to February 26, 2003 in connection with his receipt of 120,000 stock options on February 24, 2003. He reported this transaction in a Form 4 filed on August 11, 2003.

(xi) Mr. Shen was required to file a Form 4 on or prior to July 11, 2003 in connection with his receipt of 120,000 stock options on July 9, 2003, and a Form 4 on or prior to October 15, 2003 in connection with his receipt of 333,750 stock options on October 13, 2003. He reported these transactions in a Form 5 filed on February 17, 2004 (as amended on February 24, 2004).

(xii) Mr. Wasserman was required to report his holdings of our securities in a Form 3 that should have been filed on or prior to March 6, 2003 in connection with his becoming a director on February 24, 2003. Additionally, Mr. Wasserman was required to file a Form 4 on or prior to January 2, 2004 in connection with his receipt of 10,000 stock options on December 30, 2003. He reported his holdings and this transaction in a Form 5 filed on February 19, 2004 (after the required filing date of February 17, 2004, due to a technical delay in filing with the EDGAR system).

ITEM 11. EXECUTIVE COMPENSATION

Cash and Other Compensation

General

Our Chief Executive Officer and the other highest paid executive officers (of which there were two) who were compensated at a rate of more than $100,000 in salary and bonuses during the year ended December 31, 2003 (collectively, the "Named Executive Officers") are Israeli residents, and thus certain elements of the compensation that we pay them is structured as is customary in Israel.

During 2002, 2001 and 2000, compensation to our Named Executive Officers took several forms:

>> cash salary;

>> bonus, some of which was paid in cash in the year in which it was earned and some of which was accrued in the year in which it was earned but paid in cash in a subsequent year;

>> cash reimbursement for taxes paid by the Named Executive Officer and reimbursed by us in accordance with Israeli tax regulations;

>> accruals (but not cash payments) in respect of contractual termination compensation in excess of the Israeli statutory minimum;

>> accruals (but not cash payments) in respect of pension plans, which consist of a savings plan, life insurance and statutory severance pay benefits, and a continuing education fund (as is customary in Israel);

>> stock options, including options issued in exchange for a waiver of salary under the "options-for-salary" program discussed in more detail below; and

>> other benefits, primarily consisting of annual statutory holiday pay.

The specific amounts of each form of compensation paid to each Named Executive Officer appear in the summary compensation table and the notes thereto appearing under "Summary Compensation Table," below.

Summary Compensation Table

The following table, which should be read in conjunction with the explanations provided above, shows the compensation that we paid (or accrued), in connection with services rendered for 2003, 2002 and 2001, to our Named Executive Officers.

SUMMARY COMPENSATION TABLE(1)

<TABLE>
<CAPTION>

		Annual Compensation			Long Term Compensation	Compensation		
Name and Principal Position	Year	Salary	Bonus	Tax Reimburse-ment	Securities Underlying Options	Changes in Accruals for Sick Days, Vacation Days, and Termination Compensation	Payment to Pension and Education Funds	Others
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Robert S. Ehrlich	2003	259,989	$99,750(2)	$ 27,211	2,035,000	$ 80,713(3)	$ 48,228	$ 678
Chairman of the Board,	2002	$202,962	$99,750	$ 15,232	262,500(4)	$ 170,691(5)	$ 22,256	$ 654
President, Chief Executive Officer and director	2001	$211,644	$84,000	$ 17,201	521,000(6)	$ 229,800(7)	$ 52,841	$ 87,113(8)
Steven Esses								
Executive Vice President,	2003	$ 0	$ 0	$ 0	$1,035,000	$ 0	$ 0	$ 0
Chief Operating Officer	2002	$ 0	$ 0	$ 0	0	$ 0	$ 0	$120,480(9)
and director*	2001	$ 0	$ 0	$ 0	0	$ 0	$ 0	$ 0
Avihai Shen								
Vice President - Finance	2003	$123,988	$ 0	$ 8,653	608,750	$ 6,471(10)	$ 23,133	$ 463
and Chief Financial	2002	$ 93,641	$ 0	$ 18,857	48,935	$ 9,847(11)	$ 20,394	$ 6,894(12)
Officer	2001	$ 82,019	$ 0	$ 8,804	43,749	$ 1,629(13)	$ 15,956	$ 674

</TABLE>

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* Mr. Esses became an officer in January 2003. His compensation as an officer during 2003 consisted solely of stock options. Prior to January 2003, Mr. Esses was a director (from July 2002), in which position he received certain compensation as a consultant, in addition to the stock options and per-meeting fees payable to directors generally (which is not reflected above).

(1) We paid the amounts reported for each named executive officer in U.S. dollars and/or New Israeli Shekels (NIS). We have translated amounts paid in NIS into U.S. dollars at the exchange rate of NIS into U.S. dollars at the time of payment or accrual.

(2) We paid Mr. Ehrlich $67,370 during 2003 in satisfaction of the remainder of bonuses from 2002 to which he was entitled according to his contract. Additionally, we accrued $99,750 for Mr. Ehrlich in satisfaction of the 2003 bonus to which he was entitled according to his contract.

(3) Of this amount, $92,075 represents our accrual for severance pay that would be payable to Mr. Ehrlich upon a "change of control" or upon the occurrence of certain other events; $3,451 represents the increase of the accrual for sick leave and vacation redeemable by Mr. Ehrlich; and $(14,813) represents the decrease of our accrual for severance pay that would be payable to Mr. Ehrlich under the laws of the State of Israel if we were to terminate his employment.

(4) Of this amount, 262,500 options were in exchange for a total of $105,000 in salary waived by Mr. Ehrlich during 2002 pursuant to the options-for-salary program instituted by us beginning in May 2001. See "Options-for-Salary Program," below.

(5) Of this amount, $109,935 represents our accrual for severance pay that would be payable to Mr. Ehrlich upon a "change of control" or upon the occurrence of certain other events; $17,571 represents the increase of the accrual for sick leave and vacation redeemable by Mr. Ehrlich; and $43,725 represents the increase of our accrual for severance pay that would be payable to Mr. Ehrlich under the laws of the State of Israel if we were to terminate his employment.

(6) Of this amount, 80,000 options were in exchange for a total of $32,000 in salary waived by Mr. Ehrlich during 2001 pursuant to the options-for-salary program instituted by us beginning in May 2001. See "Options-for-Salary Program," below.

(7) Of this amount, $172,360 represents our accrual for severance pay that

would be payable to Mr. Ehrlich upon a "change of control" or upon the occurrence of certain other events; $50,548 represents the increase of the accrual for sick leave and vacation redeemable by Mr. Ehrlich; and $6,892 represents the increase of our accrual for severance pay that would be payable to Mr. Ehrlich under the laws of the State of Israel if we were to terminate his employment.

(8) Of this amount, $86,434 represents benefit imputed to Mr. Ehrlich upon the purchase by us of certain of his shares for treasury, and $679 represents other benefits that we paid to Mr. Ehrlich in 2001. See "Item 13. Certain Relationships and Related Transactions - Officer Loans," below.

(9) Represents consulting fees paid in 2002.

(10) Of this amount, $8,369 represents the increase of the accrual for vacation redeemable by Mr. Shen; and $(1,628) represents the decrease of our accrual for severance pay that would be payable to Mr. Shen under the laws of the State of Israel if we were to terminate his employment.

(11) Of this amount, $1,062 represents the increase of the accrual for vacation redeemable by Mr. Shen; and $8,785 represents the increase of our accrual for severance pay that would be payable to Mr. Shen under the laws of the State of Israel if we were to terminate his employment.

(12) Of this amount, $6,500 represents the value of shares issued to Mr. Shen as a stock bonus and $394 represents other benefits that we paid to Mr. Shen in 2002.

(13) Of this amount, $(1.099) represents the decrease of the accrual for vacation redeemable by Mr. Shen; and $2,728 represents the increase of our accrual for severance pay that would be payable to Mr. Shen under the laws of the State of Israel if we were to terminate his employment.

Executive Loans

In 1999, 2000 and 2002, we extended certain loans to our Named Executive Officers. These loans are summarized in the following table, and are further described under "Item 13. Certain Relationships and Related Transactions - - Officer Loans," below.

<TABLE>
<CAPTION>

Name of Borrower	Date of Loan	Original Principal Amount of Loan	Amount Outstanding as of 12/31/03	Terms of Loan
<S>	<C>	<C>	<C>	<C>
Robert S. Ehrlich.....	12/28/99	$ 167,975	$ 201,570	Ten-year non-recourse loan to purchase our stock, secured by the shares of stock purchased.
Robert S. Ehrlich.....	02/09/00	$ 789,991	$ 657,146	Twenty-five-year non-recourse loan to purchase our stock, secured by the shares of stock purchased.
Robert S. Ehrlich.....	10/06/02	$ 36,500	$ 37,810	Twenty-five-year non-recourse loan to purchase our stock, secured by the shares of stock purchased.

</TABLE>

Options-for-Salary Program

Between May 2001 and December 2002, we conducted an options-for-salary program designed to conserve our cash and to offer incentives to employees to remain with us despite lower cash compensation. Under this program, most of our salaried employees permanently waived a portion of their salaries in exchange for options to purchase shares of our common stock, at a ratio of options to purchase 2.5 shares of our stock for each dollar in salary waived. Social benefits (such as pension) and contractual bonuses for such employees continued to be calculated based on their salaries prior to reduction. The options-for-salary program was ended on December 31, 2002.

During 2001, options were accrued quarterly in advance, but since no employees requested the grant of their options during the third quarter, all grants were deferred to the beginning of the fourth quarter, during the month of October. During 2002, options were accrued quarterly in advance for the Named Executive Officers, and annually in advance for other employees.

During 2001, in exchange for waiver of $265,597 in salary, our employees other than the Named Executive Officers received a total of 663,992 options, which options were granted based on the lowest closing price of our common stock during the month of October 2001 ($1.30). Named Executive Officers, in exchange for waiver of $40,699 in salary, received a total of 101,747 options during 2001, which options were granted based on the lowest closing prices of our common stock during the month of October 2001 ($1.30), as set forth in the table below.

During 2002, in exchange for waiver of $364,209 in salary, our employees other than the Named Executive Officers received a total of 910,522

options, which options were granted based on the lowest closing price of our common stock during the month of December 2002 ($0.61). Named Executive Officers, in exchange for waiver of $119,774 in salary, received a total of 299,435 options during 2002, which options were granted based on the lowest closing prices of our common stock during each quarter of 2002, as set forth in the table below.

Following is a table setting forth the number of options that we issued to each of our Named Executive Officers under the options-for-salary program during each fiscal quarter in which the program was in effect, and the range of trading prices for our common stock during each such fiscal quarter:

<TABLE>
<CAPTION>

Named Executive Officer	Fiscal Quarter Ended	Amount of Salary Waived	Number of Options Accrued	Number of Options Issued	Average Exercise Price	Low Trading Price During Quarter	High Trading Price During Quarter	Closing Price on Last Day of Quarter
<S>	<C>	<C>	<C>	<C>		<C>	<C>	<C>
Robert S. Ehrlich.....	06/30/01	$ 8,000	20,000	0	-	$2.18	$4.20	$2.54
	09/30/01	$ 12,000	30,000	0	-	$1.10	$3.05	$1.48
	12/31/01	$ 12,000	30,000	80,000	$1.30	$1.30	$2.48	$1.66
	03/31/02	$ 26,250	65,625	65,625	$1.42	$1.35	$2.41	$1.55
	06/30/02	$ 26,250	65,625	65,625	$0.73	$0.73	$1.79	$0.91
	09/30/02	$ 26,250	65,625	65,625	$0.85	$0.79	$1.70	$1.05
	12/31/02	$ 26,250	65,625	65,625	$0.61	$0.61	$1.17	$0.64
Avihai Shen.....	06/30/01	$ 2,174	5,435	0	-	$2.18	$4.20	$2.54
	09/30/01	$ 3,262	8,153	0	-	$1.10	$3.05	$1.48
	12/31/01	$ 3,262	8,153	21,741	$1.30	$1.30	$2.48	$1.66
	03/31/02	$ 3,262	8,153	8,153	$1.42	$1.35	$2.41	$1.55
	06/30/02	$ 3,262	8,153	8,153	$0.73	$0.73	$1.79	$0.91
	09/30/02	$ 3,262	12,476	12,476	$0.85	$0.79	$1.70	$1.05
	12/31/02	$ 3,262	8,153	8,153	$0.61	$0.61	$1.17	$0.64

</TABLE>

Stock Options

The table below sets forth information with respect to stock options granted to the Named Executive Officers for the fiscal year 2003.

OPTION GRANTS IN LAST FISCAL YEAR

<TABLE>
<CAPTION>

	INDIVIDUAL GRANTS				POTENTIAL REALIZABLE VALUE OF ASSUMED ANNUAL RATES OF STOCK PRICE APPRECIATION FOR OPTION TERM(1)	
NAME	NUMBER OF SECURITIES UNDERLYING OPTIONS GRANTED	% OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN FISCAL YEAR	EXERCISE OR BASE PRICE ($/SH)	EXPIRATION DATE	5% ($)	10% ($)
<S>	<C>	<C>	<C>	<C> <C>	<C>	<C>
Robert S. Ehrlich.....	1,500,000	27%	$0.46	03/14/08	$ 190,634	$ 421,252
	500,000	9%	$0.85	06/26/08	$ 111,894	$ 247,257
	35,000	6%	$0.42	01/25/13	$ 9,245	$ 23,428
Steven Esses.....	600,000	11%	$0.43	02/24/08	$ 71,281	$ 157,512
	100,000	2%	$0.85	07/09/13	$ 53,456	$ 135,468
	300,000	5%	$1.28	12/31/08	$ 106,092	$ 234,436
	35,000	1%	$1.28	01/31/13	$ 28,174	$ 71,400
Avihai Shen.....	120,000	2%	$0.43	02/24/08	$ 14,256	$ 31,503
	120,000	2%	$0.85	07/09/13	$ 64,147	$ 162,562
	333,750	6%	$1.28	07/09/13	$ 268,664	$ 680,847
	35,000	1%	$0.42	01/25/13	$ 9,245	$ 23,429

</TABLE>

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(1) The potential realizable value illustrates value that might be realized upon exercise of the options immediately prior to the expiration of their terms, assuming the specified compounded rates of appreciation of the market price per share from the date of grant to the end of the option term. Actual gains, if any, on stock option exercise are dependent upon a number of factors, including the future performance of the common stock and the timing of option exercises, as well as the executive officer's continued employment through the vesting period. The gains shown are net of the option exercise price, but do not include deductions for taxes and other expenses payable upon the exercise of the option or for sale of underlying shares of common stock. The 5% and 10% rates of appreciation are mandated by the rules of the Securities and Exchange Commission and do not represent our estimate or projection of future increases in the price of our stock. There can be no assurance that the amounts reflected in this table will be achieved, and unless the market price of our common stock appreciates over the option term, no value will be realized from the option grants made to the executive officers.

The table below sets forth information for the Named Executive Officers with respect to aggregated option exercises during fiscal 2003 and fiscal 2003 year-end option values.

Aggregated Option Exercises and Fiscal Year-End Option Values

<TABLE>
<CAPTION>

Name	Shares cquired on A Exercise	Value Realized	Number of Securities Underlying Unexercised Options at Fiscal Year End		Value of Unexercised In-the-Money Options at Fiscal-Year-End(1)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
<S>		<C>	<C>	<C>	<C>	<C>
Robert S. Ehrlich....	-	$ -	1,905,667	1,000,000	$ 1,826,171	$ 1,185,000
Steven Esses.....	99,860	$ 183,215	416,807	518,333	$ 317,362	$ 655,733
Avihai Shen.....	75,000	$ 143,500	217,304	421,100	$ 119,283	$ 286,046

</TABLE>

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(1) Options that are "in-the-money" are options for which the fair market value of the underlying securities on December 31, 2003 ($1.82) exceeds the exercise or base price of the option.

Employment Contracts

Mr. Ehrlich is party to an employment agreement with us effective as of January 1, 2000. The term of this employment agreement, as extended, expires on December 31, 2005, and is extended automatically for additional terms of two years each unless either Mr. Ehrlich or we terminate the agreement sooner.

The employment agreement provides for a base salary of $20,000 per month, as adjusted annually for Israeli inflation and devaluation of the Israeli shekel against the U.S. dollar, if any. Additionally, the board may at its discretion raise Mr. Ehrlich's base salary. In January 2002, the board raised Mr. Ehrlich's base salary to $23,750 per month effective January 1, 2002; Mr. Ehrlich has elected to waive this increase in his salary and to receive options instead, under our salary for options program.

The employment agreement provides that if the results we actually attain in a given year are at least 80% of the amount we budgeted at the beginning of the year, we will pay a bonus, on a sliding scale, in an amount equal to a minimum of 35% of Mr. Ehrlich's annual base salary then in effect, up to a maximum of 90% of his annual base salary then in effect if the results we actually attain for the year in question are 120% or more of the amount we budgeted at the beginning of the year.

The employment agreement also contains various benefits customary in Israel for senior executives (please see "Item 1. Business - Employees," above), tax and financial planning expenses and an automobile, and contain confidentiality and non-competition covenants. Pursuant to the employment agreements, we granted Mr. Ehrlich demand and "piggyback" registration rights covering shares of our common stock held by him.

We can terminate Mr. Ehrlich's employment agreement in the event of death or disability or for "Cause" (defined as conviction of certain crimes, willful failure to carry out directives of our board of directors or gross negligence or willful misconduct). Mr. Ehrlich has the right to terminate his employment upon a change in our control or for "Good Reason," which is defined to include adverse changes in employment status or compensation, our insolvency, material breaches and certain other events. Additionally, Mr. Ehrlich may retire (after age 68) or terminate his agreement for any reason upon 150 days' notice. Upon termination of employment, the employment agreement provides for payment of all accrued and unpaid compensation, and (unless we have terminated the agreement for Cause or Mr. Ehrlich has terminated the agreement without Good Reason and without giving us 150 days' notice of termination) bonuses due for the year in which employment is terminated and severance pay in the amount of three years' base salary (or, in the case of termination by Mr. Ehrlich on 150 days' notice, a lump sum payment of $520,000). Furthermore, certain benefits will continue and all outstanding options will be fully vested.

Mr. Esses is not a party to an employment agreement with us. Mr. Shen has signed our standard employee employment agreement, described below.

Other employees (including Mr. Shen) have entered into individual employment agreements with us. These agreements govern the basic terms of the individual's employment, such as salary, vacation, overtime pay, severance arrangements and pension plans. Subject to Israeli law, which restricts a company's right to relocate an employee to a work site farther than sixty kilometers from his or her regular work site, we have retained the right to transfer certain employees to other locations and/or positions provided that such transfers do not result in a decrease in salary or benefits. All of these agreements also contain provisions governing the confidentiality of information and ownership of intellectual property learned or created during the course of the employee's tenure with us. Under the terms of these provisions, employees must keep confidential all information regarding our operations (other than information which is already publicly available) received or learned by the employee during the course of employment. This provision remains in force for five years after the employee has left our service. Further, intellectual property created during the course of the employment relationship belongs to us.

A number of the individual employment agreements, but not all, contain non-competition provisions which restrict the employee's rights to compete against us or work for an enterprise which competes against us. Such provisions remain in force for a period of two years after the employee has left our service.

Under the laws of Israel, an employee of ours who has been dismissed from service, died in service, retired from service upon attaining retirement age, or left due to poor health, maternity or certain other reasons, is entitled to severance pay at the rate of one month's salary for each year of service. We currently fund this obligation by making monthly payments to approved private provident funds and by its accrual for severance pay in the consolidated financial statements. See Note 2.r of the Notes to the Consolidated Financial Statements.

Compensation Committee Interlocks and Insider Participation

The Compensation Committee of our board of directors for the 2003 fiscal year consisted until May 8, 2003 of Dr. Jay M. Eastman, Jack E. Rosenfeld and Lawrence M. Miller; thereafter, the Compensation Committee consisted of Dr. Jay M. Eastman, Jack E. Rosenfeld and Bert W. Wasserman. None of the members has served as our officers or employees.

Robert S. Ehrlich, our Chairman and Chief Financial Officer, serves as Chairman and a director of PSCX, for which Dr. Eastman serves as director and member of the Executive and Strategic Planning Committees and Mr. Rosenfeld serves as director and member of the Executive Compensation Committees.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Security Ownership of Certain Beneficial Owners and Management

The following table sets forth information regarding the security ownership, as of March 23, 2004, of those persons owning of record or known by us to own beneficially more than 5% of our common stock and of each of our Named Executive Officers and directors, and the shares of common stock held by all of our directors and executive officers as a group.

<TABLE>
<CAPTION>

Name and Address of Beneficial Owner(1)	Shares Beneficially Owned(2)(3)	Percentage of Total Shares Outstanding(3)
<S>	<C>	<C>
Leon S. Gross	3,482,534(4)(13)	5.6%
Robert S. Ehrlich	2,284,213(5)(13)	3.6%
Steven Esses	663,475(6)	1.1%
Avihai Shen	267,804(7)	*
Dr. Jay M. Eastman	85,001(8)	*
Jack E. Rosenfeld	87,001(9)	*
Lawrence M. Miller	539,080(10)	*
Bert W. Wasserman	8,334(11)	*
Edward J. Borey	40,334(12)	*
All of our directors and executive officers as a group (10 persons**)	7,519,535(14)	11.5%

</TABLE>

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* Less than one percent.

** Includes 3,482,534 shares owned by Mr. Leon Gross that are subject to the Voting Rights Agreement described in footnote 9, below. Also includes 508,924 shares held of record by Mr. Yehuda Harats that are subject to the Voting Rights Agreement described in footnote 9, below.

(1) The address of each named beneficial owner other than Leon Gross is in care of Arotech Corporation, 632 Broadway, New York, New York 10012.

(2) Unless otherwise indicated in these footnotes, each of the persons or entities named in the table has sole voting and sole investment power with respect to all shares shown as beneficially owned by that person, subject to applicable community property laws.

(3) For purposes of determining beneficial ownership of our common stock, owners of options exercisable within sixty days are considered to be the beneficial owners of the shares of common stock for which such securities are exercisable. The percentage ownership of the outstanding common stock reported herein is based on the assumption (expressly required by the applicable rules of the Securities and Exchange Commission) that only the person whose ownership is being reported has converted his options into shares of common stock.

(4) Includes 447,165 shares held by Leon S. Gross and Lawrence M. Miller as co-trustees of the Rose Gross Charitable Foundation. Mr. Gross's address is c/o Enterprises Inc., River Park House, 3600 Conshohocken Avenue, Philadelphia, Pennsylvania 19131.

(5) Includes 50,000 shares held by Mr. Ehrlich's wife (in which shares Mr. Ehrlich disclaims beneficial ownership), 161,381 shares held in Mr. Ehrlich's pension plan, 3,000 shares held by children sharing the same household (in which shares Mr. Ehrlich disclaims beneficial ownership), and 1,905,667 shares issuable upon exercise of options exercisable within 60 days.

(6) Consists of 663,475 shares issuable upon exercise of options exercisable within 60 days.

(7) Includes 257,304 shares issuable upon exercise of options exercisable within 60 days.

(8) Consists of 85,001 shares issuable upon exercise of options exercisable within 60 days.

(9) Includes 85,001 shares issuable upon exercise of options exercisable within 60 days.

(10) Includes 447,165 shares held by Leon S. Gross and Lawrence M. Miller as co-trustees of the Rose Gross Charitable Foundation, and 80,001 shares issuable upon exercise of options exercisable within 60 days.

(11) Consists of 8,334 shares issuable upon exercise of options exercisable within 60 days.

(12) Includes 8,334 shares issuable upon exercise of options exercisable within 60 days.

(13) Messrs. Ehrlich, Leon Gross and Yehuda Harats are parties to a Voting Rights Agreement pursuant to which each of the parties agrees to vote the shares of our common stock held by that person in favor of the election of Messrs. Ehrlich, Harats and Miller until the earlier of December 28, 2004 or our fifth annual meeting of stockholders after December 28, 1999. Mr. Harats resigned as a director in 2002; however, we believe that Mr. Harats must continue to comply with the terms of this agreement. As of February 19, 2004, 4,370,004 shares of our common stock were subject to this Voting Rights Agreement.

(14) Includes 3,093,117 shares issuable upon exercise of options exercisable within 60 days.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table sets forth certain information, as of December 31, 2003, with respect to our 1991, 1993, 1995 and 1998 stock option plans, as well as any other stock options and warrants previously issued by us (including individual compensation arrangements) as compensation for goods and services:

Equity Compensation Plan Information

<TABLE>
<CAPTION>

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)(1)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)(1)
<S>	<C>	<C>	<C>
Equity compensation plans approved by security holders.....	6,150,677	$1.38	(352,708)
Equity compensation plans not approved by security holders(2)(3).....	3,481,236	$1.65	(299,374)

</TABLE>

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(1) Numbers in parenthesis in column (c), which are included in the number in column (a), indicate options that have been conditionally granted pending expansion of certain of our stock option plans at our next annual meeting of stockholders.

(2) In October 1998, the Board of Directors adopted the 1998 Non-Executive Stock Option and Restricted Stock Purchase Plan, which under Delaware law did not require shareholder approval since directors and executive officers were ineligible to participate in it. Participation in the 1998 Plan is limited to those of our employees and consultants who are neither executive officers nor otherwise subject to Section 16 of the Securities Exchange Act of 1934, as amended, or Section 162(m) of the Internal Revenue Code of 1986, as amended. The 1998 Plan is administered by the Compensation Committee of our Board of Directors, which determined the conditions of grant. Options issued under the 1998 Plan generally expire no more than ten years from the date of grant, and incentive options issued under the 1998 Plan may be granted only at exercise prices equal to the fair market value of our common stock on

the date the option is granted. A total of 4,750,000 shares of our common stock were originally subject to the 1998 Plan, of which 3,181,862 options are outstanding, 1,568,138 options have been exercised, and 299,374 options have been conditionally granted pending expansion of this stock option plan at our next annual meeting of stockholders.

(3) For a description of the material features of grants of options and warrants other than options granted under our employee stock option plans, please see Note 11.g.2 of the Notes to the Consolidated Financial Statements.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Voting Agreements

Pursuant to a securities purchase agreement dated December 28, 1999 between a group of purchasers, including Mr. Gross, and us, Mr. Gross agreed that for a period of five years, neither he nor his "affiliates" (as such term is defined in the Securities Act) directly or indirectly or in conjunction with or through any "associate" (as such term is defined in Rule 12b-2 of the Exchange Act), will (i) solicit proxies with respect to any capital stock or other voting securities of ours under any circumstances, or become a "participant" in any "election contest" relating to the election of our directors (as such terms are used in Rule 14a-11 of Regulation 14A of the Exchange Act); (ii) make an offer for the acquisition of substantially all of our assets or capital stock or induce or assist any other person to make such an offer; or (iii) form or join any "group" within the meaning of Section 13(d)(3) of the Exchange Act with respect to any of our capital stock or other voting securities for the purpose of accomplishing the actions referred to in clauses (i) and (ii) above, other than pursuant to the voting rights agreement described below.

Pursuant to a voting rights agreement dated September 30, 1996 and as amended December 10, 1997 and December 28, 1999, between Mr. Gross, Robert S. Ehrlich, Yehuda Harats and us, Lawrence M. Miller, Mr. Gross's advisor, is entitled to be nominated to serve on our board of directors so long as Mr. Gross, his heirs or assigns retain at least 1,375,000 shares of common stock. In addition, under the voting rights agreement, Mr. Gross and Messrs. Ehrlich and Harats agreed to vote and take all necessary action so that Messrs. Ehrlich, Harats and Miller shall serve as members of the board of directors until the earlier of December 28, 2004 or our fifth annual meeting of stockholders after December 28, 1999. Mr. Harats resigned as a director in 2002; however, we believe that Mr. Harats must continue to comply with the terms of this agreement. As of February 19, 2004, 4,370,004 shares of our common stock were subject to this Voting Rights Agreement.

Officer Loans

On December 3, 1999, Robert S. Ehrlich purchased 125,000 shares of our common stock out of our treasury at the closing price of the common stock on December 2, 1999. Payment was rendered by Mr. Ehrlich in the form of non-recourse promissory notes due in 2009 in the amount of $167,975 each, secured by the shares of common stock purchased and other shares of common stock previously held by him. As of December 31, 2003, the aggregate amount outstanding pursuant to this promissory note was $201,570.

On February 9, 2000, Mr. Ehrlich exercised 131,665 stock options. Mr. Ehrlich and Harats paid the exercise price of the stock options and certain taxes that we paid on his behalf by giving us a non-recourse promissory note due in 2025 in the amount of $789,991, secured by the shares of our common stock acquired through the exercise of the options and certain compensation due to Mr. Ehrlich upon termination. As of December 31, 2003, the aggregate amount outstanding pursuant to this promissory note was $657,146.

On June 10, 2002, Mr. Ehrlich exercised 50,000 stock options. Mr. Ehrlich paid the exercise price of the stock options by giving us a non-recourse promissory note due in 2012 in the amount of $36,500, secured by the shares of our common stock acquired through the exercise of the options. As of December 31, 2003, the aggregate amount outstanding pursuant to this promissory note was $37,810.

Director Consulting Agreements

Beginning in February 2002, Mr. Steven Esses, who became one of our directors in July 2002, entered into an oral consulting arrangement with us, whereby he performed periodic financial and other consulting for us. We paid Mr. Esses a total of $120,480 in consulting fees in 2002. Beginning in July 2002, when Mr. Esses became a director, this consulting arrangement ceased.

Beginning in January 2004, Mr. Edward J. Borey, who became one of our directors in December 2003, entered into a consulting agreement with us pursuant to which he agreed to aid us in identifying potential acquisition candidates in exchange for transaction fees in respect of acquisitions in which he plays a "critical role" (as determined by us in our sole and absolute discretion) in identifying and/or initiating and/or negotiating the transaction in the amount of (i) 1.5% of the value of the transaction up to $10,000,000, plus (ii) 1.0% of the value of the transaction in excess of $10,000,000 and up to $50,000,000, plus (iii) 0.5% of the value of the transaction in excess of $50,000,000. We also agreed to issue to Mr. Borey, at par value, a total of 32,000 shares of our

common stock, the value of which is to be deducted from any transaction fees paid.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

In accordance with the requirements of the Sarbanes-Oxley Act of 2002 and the Audit Committee's charter, all audit and audit-related work and all non-audit work performed by our independent accountants, Kost, Forer, Gabbay & Kassierer, is approved in advance by the Audit Committee, including the proposed fees for such work. The Audit Committee is informed of each service actually rendered.

>> Audit Fees. Audit fees billed or expected to be billed to us by Kost, Forer, Gabbay & Kassierer for the audit of the financial statements included in our Annual Report on Form 10-K, and reviews of the financial statements included in our Quarterly Reports on Form 10-Q, for the years ended December 31, 2002 and 2003 totaled approximately $151,375 and $177,000, respectively.

>> Audit-Related Fees. Kost, Forer, Gabbay & Kassierer billed us $383 and $34,500 for the fiscal years ended December 31, 2002 and 2003, respectively, for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements and are not reported under the caption "Audit Fees," above.

>> Tax Fees. Kost, Forer, Gabbay & Kassierer billed us an aggregate of $12,000 and $24,320 for the fiscal years ended December 31, 2002 and 2003, respectively, for tax services, principally advice regarding the preparation of income tax returns.

>> Other Matters. The Audit Committee of the Board of Directors has considered whether the provision of the Audit-Related Fees, Tax Fees and all other fees are compatible with maintaining the independence of our principal accountant.

Applicable law and regulations provide an exemption that permits certain services to be provided by our outside auditors even if they are not pre-approved. We have not relied on this exemption at any time since the Sarbanes-Oxley Act was enacted.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) The following documents are filed as part of this report:

(1) Financial Statements - See Index to Financial Statements on page 66 above.

(2) Financial Statements Schedules - Schedule II - Valuation and Qualifying Accounts. All schedules other than those listed above are omitted because of the absence of conditions under which they are required or because the required information is presented in the financial statements or related notes thereto.

(3) Exhibits - The following Exhibits are either filed herewith or have previously been filed with the Securities and Exchange Commission and are referred to and incorporated herein by reference to such filings:

Exhibit No.	Description
(8)3.1	Amended and Restated Certificate of Incorporation
(15)3.1.1	Amendment to our Amended and Restated Certificate of Incorporation
(24)3.1.2	Amendment to our Amended and Restated Certificate of Incorporation
**3.1.3	Amendment to our Amended and Restated Certificate of Incorporation
(2)3.2	Amended and Restated By-Laws
(1)4	Specimen Certificate for shares of common stock, $.01 par value
+ (6)10.6	Amended and Restated 1993 Stock Option and Restricted Stock Purchase Plan dated November 11, 1996
+ (1)10.7.1	Form of Management Employment Agreements
+ * (1) 10.7.2	General Employee Agreements
* (1)10.8	Office of Chief Scientist documents

	(2)10.8.1	Letter from the Office of Chief Scientist to us dated January 4, 1995
+	(3)10.12	Amended and Restated 1995 Non-Employee Director Stock Option Plan
	(4)10.14	Stock Purchase Agreement between us and Leon S. Gross ("Gross") dated September 30, 1996
	(4)10.15	Registration Rights Agreement between us and Gross dated September 30, 1996
	(4)10.16	Voting Rights Agreement between us, Gross, Robert S. Ehrlich and Yehuda Harats dated September 30, 1996
+	(5)10.20	Amended and Restated Employment Agreement dated as of October 1, 1996 between us, EFL and Robert S. Ehrlich
+	(15)10.20.1	Second Amended and Restated Employment Agreement, effective as of January 1, 2000 between us, EFL and Robert S. Ehrlich
+	(15)10.20.2	Letter dated January 12, 2001 amending the Second Amended and Restated Employment Agreement, effective as of January 1, 2000 between us, EFL and Robert S. Ehrlich
	(6)10.25	Amendment No. 1 to the Voting Rights Agreement between us, Gross, Robert S. Ehrlich, and Yehuda Harats dated December 10, 1997

Exhibit No.	Description
(6)10.26	Amendment No. 2 to the Registration Rights Agreement between us, Gross, Robert S. Ehrlich and Yehuda Harats dated December 10, 1997
(7)10.27	1998 Non-Executive Stock Option and Restricted Stock Purchase Plan
(10)10.31	Form of Warrant dated December 28, 1999
(10)10.32	Amendment No. 1 to Voting Rights Agreement dated December 28, 1999, by and between us, Leon S. Gross, Robert S. Ehrlich, Yehuda Harats and the Purchasers listed on Exhibit A to the Securities Purchase Agreement dated December 28, 1999
(12)10.35.1	Promissory Note dated January 3, 1993, from Robert S. Ehrlich to us
(12)10.35.2	Amendment dated April 1, 1998, to Promissory Note dated January 3, 1993 between Robert S. Ehrlich and us
(12)10.37	Promissory Note dated December 3, 1999, from Robert S. Ehrlich to us
(12)10.39	Promissory Note dated February 9, 2000, from Robert S. Ehrlich to us
(14)10.48	Series A Stock Purchase Warrant issued to Capital Ventures International dated November 17, 2000
(14)10.49	Series B Stock Purchase Warrant issued to Capital Ventures International dated November 17, 2000
(14)10.50	Stock Purchase Warrant issued to Josephthal & Co., Inc. dated November 17, 2000
(15)10.52	Promissory Note dated January 12, 2001, from Robert S. Ehrlich to us
(15)10.54	Agreement of Lease dated December 5, 2000 between us as tenant and Renaissance 632 Broadway LLC as landlord
(16)10.55	Series C Stock Purchase Warrant issued to Capital Ventures International dated May 3, 2001
(17)10.56	Form of Common Stock Purchase Warrant dated May 8, 2001
(23)10.63	Securities Purchase Agreement dated December 31, 2002 between us and the Investors
(23)10.64	Form of 9% Secured Convertible Debenture due June 30, 2005
(23)10.65	Form of Warrant dated December 31, 2002
(23)10.66	Form of Security Agreement dated December 31, 2002
(23)10.67	Form of Intellectual Property Security Agreement dated December 31, 2002
+(24)10.68	Settlement Agreement and Release between us and Yehuda Harats dated December 31, 2002
(24)10.69.1	Commercial lease agreement between Commerce Square Associates

	L.L.C. and I.E.S. Electronics Industries U.S.A., Inc. dated September 24, 1997
(24)10.69.2	Amendment to Commercial lease agreement between Commerce Square Associates L.L.C. and I.E.S. Electronics Industries U.S.A., Inc. dated as of May 1, 2000
(24)10.70	Agreement of Lease dated December 6, 2000 between Janet Nissim et al. and M.D.T. Protection (2000) Ltd. [English summary of Hebrew original]
(24)10.71	Agreement of Lease dated August 22, 2001 between Aviod Building and Earthworks Company Ltd. et al. and M.D.T. Protective Industries Ltd. [English summary of Hebrew original]

Exhibit No.	Description
**10.72	Promissory Note dated July 1, 2002 from Robert S. Ehrlich to us
(25)10.73	Securities Purchase Agreement dated September 30, 2003 between us and the Investors named therein
(25)10.74	Form of 8% Secured Convertible Debenture due September 30, 2006
(25)10.75	Form of Warrant dated September 30, 2003
(25)10.76	Form of Security Agreement dated September 30, 2003
(25)10.77	Form of Intellectual Property Security Agreement dated September 30, 2003
(26)1010.78	Form of Amendment and Exercise Agreement dated December 10, 2003
(26)10.79	Form of Supplemental Warrant dated December 18, 2003
(27)10.80	Stock Purchase and Sale Agreement dated January 7, 2004 between us and the shareholders of FAAC Incorporated
(27)10.81	Securities Purchase Agreement dated January 7, 2004 between us and the Investors named therein
(27)10.82	Registration Rights Agreement dated January 7, 2004 between us and the Investors named therein
(27)10.83	Form of Warrant dated January __, 2004
(28)10.84	Share Purchase Agreement dated January __, 2004 between us and the shareholders of Epsilor Electronics Industries, Ltd.
(28)10.85	Management Agreement dated January __, 2004 among us, Office Line Ltd. and Hezy Aspis
*(29)10.86	Settlement Agreement between us and I.E.S. Electronics Industries, Ltd. dated February 4, 2004
+**10.86	Consulting agreement dated January 1, 2004 between us and Edward J. Borey
**10.87	Lease dated April 8, 1997, between AMR Holdings, L.L.C. and FAAC Incorporated
**10.88	Lease dated as of March 22, 2004 between us and Fisk Building Associates L.L.C.
**14	Code of Ethics
**21	List of Subsidiaries of the Registrant
**23	Consent of Kost, Forer, Gabbay & Kassierer
**31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
**31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
**32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
**32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

- ----------
 * English translation or summary from original Hebrew
** Filed herewith
 + Includes management contracts and compensation plans and arrangements

(1) Incorporated by reference to our Registration Statement on Form S-1

(Registration No. 33-73256), which became effective on February 23, 1994

(2) Incorporated by reference to our Registration Statement on Form S-1 (Registration No. 33-97944), which became effective on February 5, 1996

(3) Incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 1995

(4) Incorporated by reference to our Current Report on Form 8-K dated October 4, 1996

(5) Incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 1996, as amended

(6) Incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 1997, as amended

(7) Incorporated by reference to our Registration Statement on Form S-8 (Registration No. 333- 74197), which became effective on March 10, 1998

(8) Incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 1998

(9) [Intentionally omitted]

(10) Incorporated by reference to our Current Report on Form 8-K filed January 7, 2000

(11) [Intentionally omitted]

(12) Incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 1999

(13) [Intentionally omitted]

(14) Incorporated by reference to our Current Report on Form 8-K filed November 17, 2000

(15) Incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2000

(16) Incorporated by reference to our Current Report on Form 8-K filed May 7, 2001 (EDGAR Film No. 1623996)

(17) Incorporated by reference to our Current Report on Form 8-K filed May 7, 2001 (EDGAR Film No. 1623989)

(18) [Intentionally omitted]

(19) [Intentionally omitted]

(20) [Intentionally omitted]

(21) [Intentionally omitted]

(22) [Intentionally omitted]

(23) Incorporated by reference to our Current Report on Form 8-K filed January 6, 2003

(24) Incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2002

(25) Incorporated by reference to our Current Report on Form 8-K filed October 3, 2003

(26) Incorporated by reference to our Current Report on Form 8-K filed December 23, 2003

(27) Incorporated by reference to our Current Report on Form 8-K filed January 9, 2004

(28) Incorporated by reference to our Current Report on Form 8-K filed February 4, 2004

(29) Incorporated by reference to our Current Report on Form 8-K filed February 5, 2004 (b) Reports on Form 8-K.

The following reports on Form 8-K were filed during the fourth quarter of 2003 and thereafter:

<TABLE>
<CAPTION>

Date Filed	Item Reported
<S>	<C>
October 3, 2003.....	Item 5 - Other Events and Regulation FD Disclosure; and Item 7 - Financial Statements, Pro Forma Financial Information and Exhibits
November 3, 2003.....	Item 7 - Financial Statements, Pro Forma Financial Information and Exhibits; and Item 12 - Results of Operations and Financial Condition
December 23, 2003.....	Item 5 - Other Events and Regulation FD Disclosure; and Item 7 - Financial Statements, Pro Forma Financial Information and Exhibits
	Item 2 - Acquisition or Disposition of Assets; 5 - Other Events and Regulation FD

<TABLE>
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January 9, 2004.....	Item 5 - Other Events and Regulation FD Disclosure; and Item 7 - Financial Statements, Pro Forma Financial Information and Exhibits
January 15, 2004.....	Item 7 - Financial Statements, Pro Forma Financial Information and Exhibits; and Item 12 - Results of Operations and Financial Condition
January 21, 2004.....	Item 5 - Other Events and Regulation FD Disclosure; and Item 7 - Financial Statements, Pro Forma Financial Information and Exhibits
February 4, 2004.....	Item 2 - Acquisition or Disposition of Assets; and Item 7 - Financial Statements, Pro Forma Financial Information and Exhibits
February 5, 2004.....	Item 5 - Other Events and Regulation FD Disclosure; and Item 7 - Financial Statements, Pro Forma Financial Information and Exhibits
March 9, 2004.....	Item 7 -Financial Statements, Pro Forma Financial Information and Exhibits (amendment)
March 9, 2004.....	Item 5 - Other Events and Regulation FD Disclosure; and Item 7 - Financial Statements, Pro Forma Financial Information and Exhibits
</TABLE>

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on March 30 , 2004.

AROTECH CORPORATION

By: /s/ Robert S. Ehrlich
Name: Robert S. Ehrlich
Title: Chairman, President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<TABLE>
<CAPTION>
Signature	Title	Date
<S>	<C>	<C>
/s/ Robert S. Ehrlich Robert S. Ehrlich	Chairman, President, Chief Executive Officer and Director (Principal Executive Officer)	March 30 , 2004
/s/ Avihai Shen Avihai Shen	Vice President - Finance (Principal Financial Officer)	March 30 , 2004
/s/ Danny Waldner Danny Waldner	Controller (Principal Accounting Officer)	March 30 , 2004
/s/ Steven Steven Esses	Esses Executive Vice President, Chief Operating Officer and Director	March 30 , 2004
/s/ Jay M. Eastman Dr. Jay M. Eastman	Director	March 30 , 2004
/s/ Lawrence M. Miller Lawrence M. Miller	Director	March 30 , 2004
/s/ Jack E. Rosenfeld Jack E. Rosenfeld	Director	March 30 , 2004
/s/ Bert W. Wasserman Bert W. Wasserman	Director	March 30 , 2004
/s/ Edward J. Borey Edward J. Borey	Director	March 21 , 2004
</TABLE>

ELECTRIC FUEL CORPORATION AND ITS SUBSIDIARIES

AROTECH CORPORATION AND ITS SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2003
IN U.S. DOLLARS
INDEX

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Consolidated Statements of Operations	5
Statements of Changes in Shareholders' Equity	6 - 8
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REPORT OF INDEPENDENT AUDITORS

To the Shareholders of

AROTECH CORPORATION

We have audited the accompanying consolidated balance sheets of Arotech Corporation (formerly known as Electric Fuel Corporation) (the "Company") and its subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2003. Our audits also included the financial statement schedule listed in Item 15(a)(2) of the Company's 10-K. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2003 and 2002, and the consolidated results of their operations and cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States. Additionally, in our opinion the related financial statement schedule, when considered in relation to the basic financial statements and schedule taken as a whole, present fairly in all material respects the information set forth therein.

Tel Aviv, Israel
March 9, 2004

KOST, FORER, GABBAY & KASSIERER
A Member of Ernst & Young Global

AROTECH CORPORATION AND ITS SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
- ---

In U.S. dollars

<TABLE>

	December 31,	
	2003	2002
ASSETS		
CURRENT ASSETS:		
<S>	<C>	<C>
Cash and cash equivalents	$ 13,685,125	$ 1,457,526
Restricted collateral deposit and other restricted cash	706,180	633,339
Trade receivables (net of allowance for doubtful accounts in the amounts of $61,282 and $40,636 as of December 31, 2003 and 2002, respectively)	4,706,423	3,776,195
Other accounts receivable and prepaid expenses	1,187,371	1,032,311
Inventories	1,914,748	1,711,479
Assets of discontinued operations	66,068	349,774
Total current assets	22,265,915	8,960,624
SEVERANCE PAY FUND	1,023,342	1,025,071
PROPERTY AND EQUIPMENT, NET	2,292,741	2,555,249
GOODWILL	5,064,555	4,954,981
</TABLE>

OTHER Intangible Assets, NET	2,375,195	2,567,457
	$ 33,021,748	$ 20,063,382

</TABLE>

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

AROTECH CORPORATION AND ITS SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
- ---
In U.S. dollars

<TABLE>
<CAPTION>

	December 31,	
	2003	2002
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
<S>	<C>	<C>
Short term bank loans	$ 40,849	$ 108,659
Trade payables	1,967,448	2,900,117
Other accounts payable and accrued expenses	4,321,347	2,009,109
Current portion of promissory note	150,000	1,200,000
Liabilities of discontinued operations	380,108	1,053,798
Total current liabilities	6,859,752	7,271,683
LONG TERM LIABILITIES		
Accrued severance pay	2,814,492	2,994,233
Convertible debenture	881,944	-
Deferred warranty revenue	220,143	-
Promissory note	150,000	516,793
Total long-term liabilities	4,066,579	3,511,026
COMMITMENTS AND CONTINGENT LIABILITIES		
MINORITY INTEREST	51,290	243,172
SHAREHOLDERS' EQUITY:		
Share capital -		
Common stock - $0.01 par value each; Authorized: 100,000,000 shares as of December 31, 2002 and 2001; Issued: 47,972,407 shares and 35,701,594 shares as of December 31, 2003 and 2002, respectively; Outstanding - 47,417,074 shares and 35,146,261 shares as of December 31, 2003 and 2002, respectively	479,726	357,017
Preferred shares - $0.01 par value each; Authorized: 1,000,000 shares as of December 31, 2003 and 2002; No shares issued and outstanding as of December 31, 2003 and 2002		-
Additional paid-in capital	135,891,316	114,082,584
Accumulated deficit	(109,681,893)	(100,673,619)
Deferred stock compensation	(8,464)	(12,000)
Treasury stock, at cost (common stock - 555,333 shares as of December 31, 2003 and 2002)	(3,537,106)	(3,537,106)
Notes receivable from shareholders	(1,203,881)	(1,177,589)
Accumulated other comprehensive loss	104,429	(1,786)
Total shareholders' equity	22,044,127	9,037,501
	$ 33,021,748	$ 20,063,382

</TABLE>

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

AROTECH CORPORATION AND ITS SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
- ---
In U.S. dollars

<TABLE>
<CAPTION>

	Year ended December 31,		
	2003	2002	2001
Revenues:			
<S>	<C>	<C>	<C>

Products	$ 16,918,480	$ 5,944,370	$ 1,670,634
Services	408,161	462,369	422,998
Total revenues	17,326,641	6,406,739	2,093,632
Cost of revenues	11,087,840	4,421,748	1,992,636
Gross profit	6,238,801	1,984,991	100,996
Operating expenses:			
Research and development, net	1,053,408	685,919	455,845
Selling and marketing expenses	3,532,636	1,309,669	105,977
General and administrative expenses	6,196,779	4,023,103	3,827,544
Amortization of intangible assets	864,910	623,543	-
In-process research and development write-off	-	26,000	-
Total operating costs and expenses	11,647,733	6,668,234	4,389,366
Operating loss	(5,408,932)	(4,683,243)	(4,288,370)
Financial income (expenses), net	(3,470,459)	100,451	262,581
Loss before minority interest in loss (earnings) of a subsidiary and tax expenses	(8,879,391)	(4,582,792)	(4,025,789)
Tax expenses	(396,193)	-	-
Minority interest in loss (earnings) of a subsidiary	156,900	(355,360)	-
Loss from continuing operations	(9,118,684)	(4,938,152)	(4,025,789)
Income (loss) from discontinued operations (including loss on disposal of $4,446,684 during 2002)	110,410	(13,566,206)	(13,260,999)
Net loss	$ (9,008,274)	$ (18,504,358)	$ (17,286,788)
Deemed dividend to certain shareholders of common stock	$ -	$ -	$ (1,196,667)
Net loss attributable to shareholders of common stock	$ (9,008,274)	$ (18,504,358)	$ (18,483,455)
Basic and diluted net loss per share from continuing operations	$ (0.23)	$ (0.15)	$ (0.21)
Basic and diluted net loss per share from discontinued operations	$ 0.00	$ (0.42)	$ (0.55)
Basic and diluted net loss per share	$ (0.23)	$ (0.57)	$ (0.76)
Weighted average number of shares used in computing basic and diluted net loss per share	38,890,174	32,381,502	24,200,184

</TABLE>

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

AROTECH CORPORATION AND ITS SUBSIDIARIES
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
In U.S. dollars

<TABLE>
<CAPTION>

	COMMON STOCK SHARES	COMMON STOCK AMOUNT	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED DEFICIT	DEFERRED STOCK COMPENSATION	TREASURY STOCK
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Balance as of January 1, 2001	21,422,691	$ 214,227	$89,091,790	$ 64,882,473)	$ (17,240)	$ (37,731)
Repurchase of common shares from shareholders and repayment of the related interest and principal of notes from shareholders	-	-	228,674	-	-	(3,499,375)
Issuance of shares to investors, net	6,740,359	67,405	14,325,941	-	-	-
Retirement of shares	(3,000)	(30)	(17,970)	-	-	-
Issuance of shares to service providers	346,121	3,461	536,916	-	-	-
Exercise of options	219,965	2,200	512,089	-	-	-
Exercise of warrants	333,333	3,333	836,667	-	-	-
Deferred stock compensation	-	-	18,000	-	(18,000)	-
Amortization of deferred stock compensation	-	-	(6,193)	-	17,240	-

Stock compensation related to options issued to consultants	-	-	139,291	-	-	-
Stock compensation related to options to consultants repriced	-	-	21,704	-	-	-
Comprehensive loss:						
Net loss	-	-	-	(17,286,788)	-	-
Total comprehensive loss						
Balance as of December 31, 2001	29,059,469	$ 290,596	$105,686,909	$(82,169,261)	$ (18,000)	$ (3,537,106)

<CAPTION>

	TOTAL COMPREHENSIVE LOSS	NOTES RECEIVABLE FROM SHAREHOLDERS	TOTAL SHAREHOLDERS EQUITY
<S>		<C>	<C>
Balance as of January 1, 2001		$ (4,290,204)	$ 20,078,369
Repurchase of common shares from shareholders and repayment of the related interest and principal of notes from shareholders		3,470,431	199,730
Issuance of shares to investors, net		-	14,393,346
Retirement of shares		18,000	-
Issuance of shares to service providers		-	540,377
Exercise of options		(43,308)	470,981
Exercise of warrants	-	-	840,000
Deferred stock compensation		-	-
Amortization of deferred stock compensation		-	11,047
Stock compensation related to options issued to consultants		-	139,291
Stock compensation related to options to consultants repriced		-	21,704
Comprehensive loss:			
Net loss	(17,286,788)	-	(17,286,788)
Total comprehensive loss	$(17,286,788)		
Balance as of December 31, 2001		$ (845,081)	$ 19,408,057

</TABLE>

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

AROTECH CORPORATION AND ITS SUBSIDIARIES
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
In U.S. dollars

<TABLE>
<CAPTION>

	COMMON STOCK SHARES	COMMON STOCK AMOUNT	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED DEFICIT	DEFERRED STOCK COMPENSATION	TREASURY STOCK
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Balance as of January 1, 2002	29,059,469	$290,596	$105,686,909	$(82,169,261)	$(18,000)	$(3,537,106)
Adjustment of notes from shareholders						
Repayment of notes from employees	-	-	-	-	-	-
Issuance of shares to investors	2,041,176	20,412	3,209,588			
Issuance of shares to service providers	368,468	3,685	539,068			
Issuance of shares to lender in respect of prepaid interest expenses	387,301	3,873	232,377	-	-	-
Exercise of options by employees	191,542	1,915	184,435			
Amortization of deferred stock compensation					6,000	
Stock compensation related to options issued to employees	13,000	130	12,870			
Issuance of shares in respect of acquisition	3,640,638	36,406	4,056,600			
Accrued interest on notes						

receivable			160,737			
Other comprehensive loss						
Foreign currency translation adjustment						
Net loss				(18,504,358)		
Total comprehensive loss						
Balance as of December 31, 2002	35,701,594	$ 357,017	$114,082,584	$(100,673,619)	$ (12,000)	$(3,537,106)

<CAPTION>

	TOTAL COMPREHENSIVE LOSS	NOTES RECEIVABLE FROM SHAREHOLDERS		TOTAL SHAREHOLDERS EQUITY
<S>		<C>	<C>	
Balance as of January 1, 2002		$(845,081)	-	$19,408,057
Adjustment of notes from shareholders		(178,579)		(178,579)
Repayment of notes from employees		43,308		43,308
Issuance of shares to investors				3,230,000
Issuance of shares to service providers				542,753
Issuance of shares to lender in respect of prepaid interest expenses		-		236,250
Exercise of options by employees		(36,500)		149,850
Amortization of deferred stock compensation				6,000
Stock compensation related to options issued to employees				13,000
Issuance of shares in respect of acquisition				4,093,006
Accrued interest on notes receivable		(160,737)		-
Other comprehensive loss				
Foreign currency translation adjustment	(1,786)		(1,786)	(1,786)
Net loss	(18,504,358)			(18,504,358)
Total comprehensive loss	$ (18,506,144)			
Balance as of December 31, 2002		$(1,177,589)	$ (1,786)	$ 9,037,501

</TABLE>

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

AROTECH CORPORATION AND ITS SUBSIDIARIES
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
In U.S. dollars

<TABLE>
<CAPTION>

	COMMON STOCK		ADDITIONAL PAID-IN		DEFERRED STOCK	TREASURY
	SHARES	AMOUNT	CAPITAL	ACCUMULATED DEFICIT	COMPENSATION	STOCK
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Balance as of January 1, 2003	35,701,594	$ 357,017	$114,082,584	$(100,673,619)	$ (12,000)	$(3,537,106)
Compensation related to warrants issued to the holders of convertible debentures			5,157,500			
Compensation related to beneficial conversion feature of convertible debentures			5,695,543			
Issuance of shares on conversion of convertible debentures	6,969,605	69,696	6,064,981			
Issuance of shares on exercise of warrants	3,682,997	36,831	3,259,422			
Issuance of shares to consultants	223,600	2,236	159,711			
Compensation related to warrants and options issued to consultants and investors			418,162			
Compensation related to non-recourse loan granted to shareholder			38,500			
Deferred stock compensation			4,750		(4,750)	
Amortization of deferred stock						

compensation						8,286
Exercise of options by employees	689,640	6,896	426,668			
Exercise of options by consultants	15,000	150	7,200			
Conversion of convertible promissory note	563,971	5,640	438,720			
Increase in investment in subsidiary against common stock issuance	126,000	1,260	120,960			
Accrued interest on notes receivable from shareholders			16,615			
Other comprehensive loss - foreign currency translation adjustment						
Net loss				(9,008,274)		
Balance as of December 31, 2003	47,972,407	$ 479,726	$135,891,316	$(109,681,893)	$ (8,464)	$(3,537,106)

<CAPTION>

	TOTAL COMPREHENSIVE LOSS	NOTES RECEIVABLE FROM SHAREHOLDERS	ACCUMULATED OTHER COM-PREHENSIVE LOSS	TOTAL SHAREHOLDERS' EQUITY
<S>	<C>	<C>	<C>	<C>
Balance as of January 1, 2003	$(1,177,589)	$ (1,786)		$ 9,037,501
Compensation related to warrants issued to the holders of convertible debentures				5,157,500
Compensation related to beneficial conversion feature of convertible debentures				5,695,543
Issuance of shares on conversion of convertible debentures	(9,677)			6,125,000
Issuance of shares on exercise of warrants				3,296,253
Issuance of shares to consultants				161,947
Compensation related to warrants and options issued to consultants and investors				418,162
Compensation related to non-recourse loan granted to shareholder				38,500
Deferred stock compensation				-
Amortization of deferred stock compensation				8,286
Exercise of options by employees				433,564
Exercise of options by consultants				7,350
Conversion of convertible promissory note				444,360
Increase in investment in subsidiary against common stock issuance				122,220
Accrued interest on notes receivable from shareholders	(16,615)			-
Other comprehensive loss - foreign currency translation adjustment		106,215	106,215	106,215
Net loss			(9,008,274)	(9,008,274)
			(8,902,059)	
Balance as of December 31, 2003	$(1,203,881)	$ 104,429		$ 22,044,127

</TABLO>

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

AROTECH CORPORATION AND ITS SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
- ---
In U.S. dollars

<TABLE>
<CAPTION>

	Year ended December 31,		
	2003	2002	2001

Cash flows from operating activities:			
<S>	<C>	<C>	<C>
Net loss	(9,008,274)	(18,504,358)	(17,286,788)
Less loss (profit) for the period from discontinued operations	(110,410)	13,566,206	13,260,999
Adjustments required to reconcile net loss to net cash used in operating activities:			
Minority interest in earnings (loss) of subsidiary	(156,900)	355,360	-
Depreciation	730,159	473,739	530,013
Amortization of intangible assets	864,910	623,543	-
In-process research and development write-off	-	26,000	-
Accrued severance pay, net	3,693	(357,808)	530,777
Amortization of deferred stock compensation	8,286	6,000	17,240
Impairment and write-off of loans to shareholders	(12,519)	542,317	206,005
Compensation expenses related to repurchase of treasury stock		-	228,674
Write-off of inventories	96,350	116,008	-
Impairment of fixed assets	68,945	-	-
Amortization of compensation related to beneficial conversion feature and warrants issued to holders of convertible debentures	3,359,987	-	-
Amortization of deferred expenses related to convertible debenture issuance	483,713	-	-
Amortization of prepaid financial expenses	236,250	-	-
Amortization of capitalized research and development projects	14,401	-	-
Stock-based compensation related to repricing of warrants granted to investors and the grant of new warrants	388,403	-	-
Stock-based compensation related to repricing of warrants granted to consultants	29,759	-	-
Stock-based compensation related to shares issued to consultants	161,947	-	-
Stock-based compensation related to non-recourse note granted to stockholder	38,500	-	-
Compensation expenses related to shares issued to employees	-	13,000	-
Accrued interest on notes receivable from shareholders	-	-	36,940
Interest accrued on promissory notes due to acquisition	(66,793)	29,829	-
Interest accrued on restricted collateral deposit	-	(3,213)	-
Capital (gain) loss from sale of property and equipment	(11,504)	(4,444)	815
Decrease (increase) in trade receivables	(820,137)	389,516	(452,425)
Decrease in other accounts receivable and prepaid expenses	40,520	257,218	616,040
Increase in inventories	(193,222)	(520,408)	(128,897)
Decrease in trade payables	(986,022)	(62,536)	(301,075)
Increase (decrease) in other accounts payable and accrued expenses	1,827,668	(423,664)	286,511
Net cash used in operating activities from continuing operations (reconciled from continuing operations)	(3,012,290)	(3,477,695)	(2,455,171)
Net cash used in operating activities from discontinued operations (reconciled from discontinued operations)	(313,454)	(5,456,912)	(10,894,660)
Net cash used in operating activities	(3,325,744)	(8,934,607)	(13,349,831)

</TABLE>

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

AROTECH CORPORATION AND ITS SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

In U.S. dollars

<TABLE>
<CAPTION>

	Year ended December 31,		
	2003	2002	2001
Cash flows from investing activities:			
<S>	<C>	<C>	<C>
Purchase of property and equipment	(580,949)	(275,540)	(513,746)
Increase in capitalized research and development projects	(209,616)	-	-
Payment to suppliers for purchase of property and equipment from previous year	-	(39,336)	(43,883)
Loans granted to shareholders	(13,737)	(4,529)	-
Repayment of loans granted to shareholders	9,280	-	-
Proceeds from sale of property and equipment	16,753	8,199	40,217
Acquisition of IES (1)	-	(2,958,083)	-
Acquisition of MDT (2)	-	(1,201,843)	-
Repayment of promissory note related to acquisition of subsidiary	(750,000)	-	-
Purchase of intangible assets and inventory	(196,331)	-	-
Increase in restricted cash	(72,840)	(595,341)	-
Net cash used in discontinued operations (purchase of property and equipment)	-	(290,650)	(761,555)
Net cash used in investing activities	(1,797,440)	(5,357,123)	(1,278,967)
Cash flows from financing activities:			

Proceeds from issuance of shares, net	(6,900)	3,230,000	14,393,346
Proceeds from exercise of options to employees and consultants	440,914	113,350	470,981
Proceeds from exercise of warrants	3,296,254	-	840,000
Proceeds from the sale of convertible debentures, net	13,708,662	-	-
Payment of interest and principal on notes receivable from shareholders	-	43,308	-
Profit distribution to minority	-	(412,231)	-
Increase (decrease) in short term bank credit	(74,158)	108,659	-
Payment on capital lease obligation	(4,427)	(5,584)	-
Net cash provided by financing activities	17,360,345	3,077,502	15,704,327
Increase (decrease) in cash and cash equivalents	12,237,161	(11,214,228)	1,075,529
Cash erosion due to exchange rate differences	(9,562)	-	-
Cash and cash equivalents at the beginning of the year	1,457,526	12,671,754	11,596,225
Cash and cash equivalents at the end of the year	$ 13,685,125	$ 1,457,526	$ 12,671,754
Supplementary information on non-cash transactions:			
Purchase of property and equipment against trade payables	$ -	$ -	$ 39,336
Purchase of treasury stock in respect of notes receivable from shareholders	$ -	$ -	$ 3,499,375
Retirement of shares issued under notes receivables	$ -	$ -	$ 18,000
Issuance of shares to consultants in respect of prepaid interest expenses	$ -	$ 236,250	$ -
Exercise of options against notes receivable	$ -	$ 36,500	$ 43,308
Purchase of intangible assets against note receivable	$ 300,000	$ -	$ -
Increase of investment in subsidiary against issuance of shares of common stock	$ 123,480	$ -	$ -
Conversion of promissory note to shares of common stock	$ 450,000	$ -	$ -
Conversion of convertible debenture to shares of common stock	$ 6,125,000	$ -	$ -
Benefit due to convertible debentures and warrants	$ 10,853,043	$ -	$ -
Supplemental disclosure of cash flows activities:			
Cash paid during the year for:			
Interest	$ 39,412	$ 10,640	$ 19,106

</TABLE>

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

AROTECH CORPORATION AND ITS SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Cont.)

In U.S. dollars

(1) In July 2002, the Company acquired substantially all of the assets of I.E.S. Electronics Industries U.S.A., Inc. ("IES"). The net fair value of the assets acquired and the liabilities assumed, at the date of acquisition, was as follows:

Working capital, excluding cash and cash equivalents	$ 1,233,000
Property and equipment, net	396,776
Capital lease obligation	(15,526)
Technology	1,515,000
Existing contracts	46,000
Covenants not to compete	99,000
In process research and development	26,000
Customer list	527,000
Trademarks	439,000
Goodwill	4,032,726
	8,298,976
Issuance of shares	(3,653,929)
Issuance of promissory note	(1,686,964)
	$ 2,958,083

(2) In July 2002, the Company acquired 51% of the outstanding ordinary shares of MDT Protective Industries Ltd. ("MDT"). The fair value of the assets acquired and liabilities assumed was as follows:

Working capital, excluding cash and cash and cash equivalents	$ 350,085
Property, and equipment, net	139,623
Minority rights	(300,043)
Technology	280,000
Customer base	285,000

In U.S. dollars

Goodwill	886,255
	1,640,920
Issuance of shares	(439,077)
	$ 1,201,843

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

NOTE 1: - GENERAL

a. Arotech Corporation, f/k/a Electric Fuel Corporation ("Arotech" or the "Company") and its subsidiaries are engaged in the development, manufacture and marketing of defense and security products, including advanced hi-tech multimedia and interactive digital solutions for training of military, law enforcement and security personnel and sophisticated lightweight materials and advanced engineering processes to armor vehicles, and in the design, development and commercialization of its proprietary zinc-air battery technology for electric vehicles and defense applications. The Company is primarily operating through Electric Fuel Ltd. ("EFL") a wholly-owned Israeli subsidiary; IES Interactive Training, Inc. ("IES"), a wholly-owned U.S. subsidiary; Arocon Security Corporation, a wholly-owned U.S. subsidiary; Electric Fuel Battery Corporation, a wholly-owned U.S. subsidiary; MDT Protective Industries ("MDT"), an Israeli subsidiary in which the Company has a 75.5% interest; and MDT Armor Corporation, a U.S. subsidiary in which the Company has an 88% interest. The Company's production and research and development operations are primarily located in Israel and in the United States.

b. Acquisition of IES:

In August 2, 2002, the Company entered into an asset purchase agreement among I.E.S. Electronics Industries U.S.A., Inc. ("IES"), its direct and certain of its indirect shareholders, and its wholly-owned Israeli subsidiary, EFL, pursuant to the terms of which it acquired substantially all the assets, subject to substantially all the liabilities, of IES, a developer, manufacturer and marketer of advanced hi-tech multimedia and interactive digital solutions for training of military, law enforcement and security personnel. The Company intends to continue to use the assets purchased in the conduct of the business formerly conducted by IES (the "Business"). The acquisition has been accounted under the purchase method of accounting. Accordingly, all assets and liabilities were acquired as at the values on such date, and the Company consolidated IES's results with its own commencing at such date.

The assets purchased consisted of the current assets, property and equipment, and other intangible assets used by IES in the conduct of the Business. The consideration for the assets and liabilities purchased consisted of (i) cash and promissory notes in an aggregate amount of $4,800,000 ($3,000,000 in cash and $1,800,000 in promissory notes, which was recorded at its fair value in the amount of $1,686,964) (see Note 9), and (ii) the issuance, with registration rights, of a total of 3,250,000 shares of our common stock, $.01 par value per share, having a value of approximately $3,653,929, which shares are the subject of a voting agreement on the part of IES and certain of its affiliated companies. The value of 3,250,000 shares issued was determined based on the average market price of Arotech's Common stock over the period including two days before and after the terms of the acquisition were agreed to and announced. The total consideration of $8,354,893 (including $14,000 of transaction costs) was determined based upon arm's-length negotiations between the Company and IES and IES's shareholders.

NOTE 1: - GENERAL (Cont.)

Based upon a valuation of tangible and intangible assets acquired, Arotech has allocated the total cost of the acquisition to IES's assets as follows:

Tangible assets acquired	$ 2,856,951
Intangible assets	
Technology (four year useful life)	1,515,000
Existing contracts (one year useful life)	46,000
Covenants not to compete (five year useful life)	99,000
In process research and development	26,000
Customer list (seven year useful life)	527,000
Trademarks (indefinite useful life)	439,000
Goodwill	4,032,726

In U.S. dollars

Liabilities assumed	(1,186,784)
Total consideration	$ 8,354,893

In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill arising from acquisitions will not be amortized. In lieu of amortization, Arotech is required to perform an annual impairment review. If Arotech determines, through the impairment review process, that goodwill has been impaired, it will record the impairment charge in its statement of operations. Arotech will also assess the impairment of goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

The value assigned to the tangible, intangibles assets and liabilities was determined as follows:

1. To determine the value of the Company's net current assets, property and equipment, and net liabilities; the Cost Approach was used, which requires that the assets and liabilities in question be restated to their market values. Per estimation made by the independent appraisal the book values for the current assets and liabilities were reasonable proxies for their market values.

2. The amount of the excess cost attributable to technology of Range 2000, 3000 and A2Z Systems is $1,515,000 and was determined using the Income Approach.

3. The value assigned to purchased in-process technology relates to two projects "Black Box" and A2Z trainer. The estimated fair value of the acquired in-process research and development platforms that had not yet reached technological feasibility and had no alternative future use amounted to $26,000. Technological feasibility or commercial viability of these projects was established at the acquisition date. These products were considered to have no alternative future use other than the technological indications for which they were in development. Accordingly, these amounts were immediately expensed in the consolidated statement of operations on the acquisition date in accordance with FASB Interpretation No. 4, "Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method." The estimated fair values of these platforms were determined using discounted cash flow models. Projects were estimated to be 4% complete; estimated costs to completion of these platforms were approximately $200,000 and $25,000, respectively, and discount rate of 25% was used.

NOTE 1: - GENERAL (Cont.)

4. The value assigned to the customer list is amounted to $527,000. Management states that its customers have generally been very loyal to IES's products; most present customers are expected to purchase add-ons or up-grades to their IES simulator systems in the future, and some will purchase additional warranties for the systems they possess. Independent appraisal has therefore valued the Company's customer list using the Income Approach.

5. The value assigned to the trademarks amounted to $439,000 and was determined based on the Cost Approach. In doing so, it is assumed that historical expenditures for advertising are a reasonable proxy for the future benefits expected from the Trademarks and Trade names.

6. Value of IES's Covenant Not to Compete (CNC) was valued at the amount of $99,000. One of IES's intangible assets is its covenant not to compete. Asset Purchase Agreement precludes the former parent company, and its principals and key employees from competing with IES for five years from the Valuation Date. According to management, among the individuals covered by the CNC are the original developers of the Range 2000 and A2Z systems. Estimated CNC's value was determined using the Income Approach. The estimated value of the CNC is the sum of the present value of the cash flows that would be lost if the CNC was not in place. Specifically, the value of the CNC is calculated as the difference between the projected cash flows if the former parent company or its principals were to start competing immediately and the projected cash flows if those parties start competing after five years, when the CNC expires.

In September 2003, the Company's IES subsidiary purchased selected assets of Bristlecone Corporation. The assets purchased consisted of inventories, customer lists, and certain other assets (including intangible assets such as intellectual property and customer lists), including the name "Bristlecone Training Products" and the patents for the Heads Up Display (HUD) and a remote trigger device, used by Bristlecone in connection with its designing and manufacturing firearms training devices, for a total consideration of $183,688 in cash and $300,000 in promissory notes, payable in four equal semi-annual payments of $75,000 each, to become due and payable on March 1, 2004, August 31, 2004, February 28, 2005 and August 31, 2005. The acquired patents are used in the IES's Range FDU (firearm diagnostics unit).

The purchase consideration was estimated as follows:

In U.S. dollars

NOTE 1: - GENERAL (Cont.)

	U.S. Dollars
Cash consideration	$ 33,668
	$183,688
Present value of promissory notes	289,333
Transaction expenses	12,643
Total consideration	$485,664

Based upon a valuation of tangible and intangible assets acquired, the Company has allocated the total cost of the acquisition of Bristlecone's assets as follows:

	U.S. Dollars
Tangible assets acquired	$ 33,668
	$ 33,668
Intangible assets	
Technology and patents	436,746
Customer list	15,250
Total consideration	$485,664

The Company believes that the acquisition of Bristlecone is not material to its business.

c. Acquisition of MDT:

On July 1, 2002, the Company entered into a stock purchase agreement with all of the shareholders of M.D.T. Protective Industries Ltd. ("MDT"), pursuant to the terms of which the Company purchased 51% of the issued and outstanding shares of MDT, a privately-held Israeli company that specializes in using sophisticated lightweight materials and advanced engineering processes to armor vehicles. The Company also entered into certain other ancillary agreements with MDT and its shareholders and other affiliated companies. The Acquisition was accounted under the purchase method accounting and results of MDT's operations have been included in the consolidated financial statements since that date. The total consideration of $1,767,877 for the shares purchased consisted of (i) cash in the aggregate amount of 5,814,000 New Israeli Shekels ($1,231,780), and (ii) the issuance, with registration rights, of an aggregate of 390,638 shares of our common stock, $0.01 par value per share, having a value of approximately $439,077. The value of 390,638 shares issued was determined based on the average market price of Arotech's Common stock over the period including two days before and after the terms of the acquisition were agreed to and announced.

Based upon a valuation of tangible and intangible assets acquired, Arotech has allocated the total cost of the acquisition to MDT's assets as follows:

Tangible assets acquired	$ 1,337,048
Intangible assets	
Technology (five year weighted average useful life)	280,000
Customer base (five year weighted average useful life)	285,000
Goodwill	886,255
Liabilities assumed	(1,020,426)
Total consideration	$ 1,767,877

In U.S. dollars

NOTE 1: - GENERAL (Cont.)

In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill arising from acquisitions will not be amortized. In lieu of amortization, Arotech is required to perform an annual impairment review. If Arotech determines, through the impairment review process, that goodwill has been impaired, it will record the impairment charge in its statement of operations. Arotech will also assess the impairment of goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

The value assigned to the tangible, intangibles assets and liabilities was

In U.S. dollars

determined as follows:

1. To determine the value of the Company's net current assets, net property, and equipment and net liabilities; the Cost Approach was used, which requires that the assets and liabilities in question be restated to their market values. Per estimation made by the independent appraisal the book values for the current assets and liabilities were reasonable proxies for their market values.

2. The amount of the excess cost attributable to technology of optimal bulletproofing material and power mechanism for bulletproofed windows is $280,000 and was determined using the Income Approach.

3. The value assigned to the customer base is amounted to $285,000. Independent appraisal has valued the Company's customer base using the Income Approach. The valuation of the customers' base derives mostly from relations with customers with no contracts. Most of the customers of MDT are from defense sector and usually have longstanding relationships and tend to reorder from the Company.

In September 2003, the Company increased its holdings in both of its vehicle armoring subsidiaries. The Company now holds 88% of MDT Armor Corporation (compared to 76% before this transaction) and 75.5% of MDT Protective Industries Ltd. (compared to 51% before this transaction). The Company acquired the additional stake in MDT from AGA Means of Protection and Commerce Ltd. in exchange for the issuance to AGA of 126,000 shares of its common stock, valued at $0.98 per share based on the closing price of the Company's common stock on the closing date of September 4, 2003, or a total of $123,480. Of this amount, a total of $75,941 was allocated to intangible assets. The Company did not obtain a valuation due to the immaterial nature of this acquisition.

d. Pro forma results:

The following unaudited proforma information does not purport to represent what the Company's results of operations would have been had the acquisitions occurred on January 1, 2001 and 2002, nor does it purport to represent the results of operations of the Company for any future period.

NOTE 1: - GENERAL (Cont.)

<TABLE>
<CAPTION>

	Year ended December 31,	
	2002	2001
<S>	<C>	<C>
Revenues	$12,997,289	$12,369,749
Net loss from continuing operations	$(6,103,771)	$(5,757,675)
Basic and diluted net loss per share for continuing operations	$ (0.18)	$ (0.21)
Weighted average number of shares of common stock in computation of basic and diluted net loss per share	34,495,185	27,840,822

</TABLE>

The amount of the excess cost attributable to in-process research and development of IES and MDT in the amount of $26,000 has not been included in the pro forma information, as it does not represent a continuing expense.

e. Discontinued operations:

In September 2002, the Company committed to a plan to discontinue the operations of its retail sales of consumer battery products. The Company ceased the operation and disposed of all assets related to this segment by an abandonment. The operations and cash flows of consumer battery business have been eliminated from the operations of the entity as a result of the disposal transactions. The Company has no intent of continuing its activity in the consumer battery business. The Company's plan of discontinuance involved (i) termination of all employees whose time was substantially devoted to the consumer battery line and who could not be used elsewhere in the Company's operations, including payment of all statutory and contractual severance sums, by the end of the fourth quarter of 2002, and (ii) disposal of the raw materials, equipment and inventory used exclusively in the consumer battery business, since the Company has no reasonable expectation of being able to sell such raw materials, equipment or inventory for any sum substantially greater than the cost of disposal or shipping, by the end of the first quarter of 2003. The Company had previously reported its consumer battery business as a separate segment (Consumer Batteries) as called for by Statement of Financial Standards No. 131, "Disclosures About Segments of an Enterprise and Related Information" ("SFAS No. 131").

The results of operations including revenue, operating expenses, other income and expense of the retail sales of consumer battery products business unit for

2002 and 2001 have been reclassified in the accompanying statements of operations as a discontinued operation. The Company's balance sheets at December 31, 2002 and 2001 reflect the net liabilities of the retail sales of consumer battery products business as net liabilities and net assets of discontinued operation within current liabilities and current assets.

At December 31, 2002, the estimated net losses associated with the disposition of the retail sales of consumer battery products business were approximately $13,566,206 for 2002. These losses included approximately $6,508,222 in losses from operations for the period from January 1, 2002 through the measurement date of December 31, 2002 and $7,057,684, reflecting a write-down of inventory and net property and equipment of the retail sales of consumer battery products business, as follows:

NOTE 1: - GENERAL (Cont.)

	December 31, 2002
Write-off of inventories	$ 2,611,000
Impairment of property and equipment	4,446,684
	$ 7,057,684

As a result of the discontinuance of consumer battery segment, the Company ceased to use property and equipment related to this segment. In accordance with Statement of Financial Accounting Standard No. 144 "Accounting for the Impairment or Disposal of Long- Lived Assets" ("SFAS No. 144") such assets was considered to be impaired, the impairment to be recognized was measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

Obligations to employees for severance and other benefits resulting from the discontinuation have been reflected in the financial statements on an accrual basis.

Summary operating results from the discontinued operation for the years ended December 31, 2003, 2002 and 2001 are as follows:

<TABLE>
<CAPTION>

	Year Ended December 31,		
	2003	2002	2001
<S>	<C>	<C>	<C>
Revenues	$ 117,267	$ 1,100,442	$ 1,939,256
Cost of sales (1)	-	(5,293,120)	(5,060,966)
Gross profit (loss)	117,267	(4,192,678)	(3,121,710)
Operating expenses, net	6,857	4,926,844	10,139,289
Impairment of fixed assets	-	4,446,684	-
Operating profit (loss)	$ 110,410	$ (13,566,206)	$ (13,260,999)

</TABLE>

(1) Including write-off of inventory in the amount of $0, $2,611,000 and $441,000 for the years ended December 31, 2003, 2002 and 2001.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP").

a. Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

b. Financial statements in U.S. dollars:

A majority of the revenues of the Company and most of its subsidiaries is generated in U.S. dollars. In addition, a substantial portion of the Company's and most of its subsidiaries costs are incurred in U.S. dollars ("dollar").

In U.S. dollars

Management believes that the dollar is the primary currency of the economic environment in which the Company and most of its subsidiaries operate. Thus, the functional and reporting currency of the Company and most of its subsidiaries is the dollar. Accordingly, monetary accounts maintained in currencies other than the U.S. dollar are remeasured into U.S. dollars in accordance with Statement of Financial Accounting Standards No. 52 "Foreign Currency Translation" ("SFAS No. 52"). All transaction, gains and losses from the remeasured monetary balance sheet items are reflected in the consolidated statements of operations as financial income or expenses, as appropriate.

The majority of financial transactions of MDT is in New Israel Shekel ("NIS") and a substantial portion of MDT's costs is incurred in NIS. Management believes that the NIS is the functional currency of MDT. Accordingly, the financial statements of MDT 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 has been translated using the weighted average exchange rate for the period. The resulting translation adjustments are reported as a component of accumulated other comprehensive loss in shareholders' equity

c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its wholly and majority owned subsidiaries. Intercompany balances and transactions have been eliminated upon consolidation.

d. Cash equivalents:

Cash equivalents are short-term highly liquid investments that are readily convertible to cash with maturities of three months or less when acquired.

e. Inventories:

Inventories are stated at the lower of cost or market value. Inventory write-offs and write-down provisions are provided to cover risks arising from slow-moving items or technological obsolescence and for market prices lower than cost. The Company periodically evaluates the quantities on hand relative to current and historical selling prices and historical and projected sales volume. Based on this evaluation, provisions are made to write inventory down to its market value. In 2003, the Company wrote off $96,350 of obsolete inventory, which has been included in the cost of revenues.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Cost is determined as follows:

Raw and packaging materials - by the average cost method.

Work in progress - represents the cost of manufacturing with the addition of allocable indirect manufacturing cost.

Finished products - on the basis of direct manufacturing costs with the addition of allocable indirect manufacturing costs.

f. Property and equipment:

Property and equipment are stated at cost net of accumulated depreciation and investment grants (no investment grants were received during 2003, 2002 and 2001).

Depreciation is calculated by the straight-line method over the estimated useful lives of the assets, at the following annual rates:

	%
Computers and related equipment	33
Motor vehicles	15
Office furniture and equipment	6 - 10
Machinery, equipment and installation	10 - 25 (mainly 10)
Leasehold improvements	Over the term of the lease

g. Goodwill:

Goodwill represents the excess of cost over the fair value of the net assets of businesses acquired. Under Statement of Financial Accounting Standard No. 142, "Goodwill and Other Intangible Assets" ("SFAS No, 142") goodwill acquired in a business combination on or after July 1, 2001, is not amortized.

SFAS No. 142 requires goodwill to be tested for impairment on adoption of the Statement and at least annually thereafter or between annual tests in certain circumstances, and written down when impaired, rather than being amortized as previous accounting standards required. Goodwill is tested for impairment by comparing the fair value of the Company's reportable units with their carrying value. Fair value is determined using discounted cash flows, market multiples and market capitalization. Significant estimates used in the methodologies include estimates of future cash flows, future short-term and long-term growth rates, weighted average cost of capital and estimates of market multiples for

the reportable units.

h. Other intangible assets:

Intangible assets acquired in a business combination that are subject to amortization are amortized over their useful life using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with SFAS No. 142. Intangible assets are amortized over their useful life (See Note 1b. and c).

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

i. Impairment of indefinite-lived intangible asset

The acquired IES trademark is deemed to have an indefinite useful life because it is expected to contribute to cash flows indefinitely. Therefore, the trademark will not be amortized until its useful life is no longer indefinite. The trademark is tested annually for impairment in accordance FAS 142.

j. Impairment of long-lived assets:

The Company and its subsidiaries' long-lived assets and certain identifiable intangibles are reviewed for impairment in accordance with Statement of Financial Accounting Standard No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144") whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of the carrying amount of assets to be held and used is measured by a comparison of the carrying amount of the assets to the future undiscounted cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. As of December 31, 2003 no impairment losses have been identified.

k. Revenue recognition:

The Company generates revenues primarily from sales of multimedia and interactive digital training systems and use-of-force simulators specifically targeted for law enforcement and firearms training and from service contracts related to such sales (through IES), from providing lightweight armoring services of vehicles (through MDT), and from sale of zinc-air battery products for defense applications. To a lesser extent, revenues are generated from development services and long-term arrangements subcontracted by the U.S Government.

Revenues from products, training and simulation systems are recognized in accordance with SEC Staff Accounting Bulletin No. 104, "Revenue Recognition" ("SAB No. 104") when persuasive evidence of an agreement exists, delivery has occurred, the fee is fixed or determinable, collectability is probably, and no further obligation remains.

The Company does not grant a right of return to its customers.

Revenues from long-term agreements, subcontracted by the U.S. government, are recorded on a cost-sharing basis, when services are rendered and products delivered, as prescribed in the related agreements. Provisions for estimated losses are recognized in the period in which the likelihood of such losses is determined. As of December 31, 2003, no such estimated losses were identified.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Deferred warranty revenues includes unearned amounts received from customers, but not recognized as revenues.

Revenues from development services are recognized based on Statement of Position No. 81-1 "Accounting for Performance of Construction - Type and Certain Production - Type Contracts" ("SOP 81-1"), using contract accounting on a percentage of completion method, based on completion of agreed-upon milestones and in accordance with the "Output Method" or based on the time and material basis. Provisions for estimated losses on uncompleted contracts are recognized in the period in which the likelihood of such losses is determined. As of December 31, 2003, no such estimated losses were identified.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Revenues from lightweight armoring services of vehicles are recorded when services are rendered and vehicle is delivered and no additional obligations exists.

Revenues from products not delivered upon customers' request due to lack of storage space at the customers' facilities during the integration are recognized when the criteria of Staff Accounting Bulletin No. 104 ("SAB No. 104") for bill-and-hold transactions are met.

l. Research and development cost:

Research and development costs, net of grants received, are charged to the statements of operations as incurred.

Significant software development costs incurred by the Company's subsidiaries between completion of the working model and the point at which the product is ready for general release, are capitalized.

Capitalized software costs are amortized by using the straight-line method over the estimated useful life of the product (three to five years). The Company assesses the recoverability of this intangible asset on a regular basis by determining whether the amortization of the asset over its remaining life can be recovered through future gross revenues from the specific software product sold. Based on its most recent analyses, management believes that no impairment of capitalized software development costs exists as of December 31, 2003.

m. Royalty-bearing grants:

Royalty-bearing grants from the Office of the Chief Scientist ("OCS") of the Israeli Ministry of Industry and Trade and from the Israel-U.S. Bi-national Industrial Research and Development Foundation ("BIRD-F") for funding approved research and development projects are recognized at the time the Company is entitled to such grants on the basis of the costs incurred, and included as a deduction of research and development costs.

n. Income taxes:

The Company and its subsidiaries account for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). This Statement prescribes the use of the liability method, whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

o. Concentrations of credit risk:

Financial instruments that potentially subject the Company and its subsidiaries to concentrations of credit risk consist principally of cash and cash equivalents, restricted collateral deposit and other restricted cash and trade receivables. Cash and cash equivalents are invested in U.S. dollar deposits with major Israeli and U.S. banks. Such deposits in the U.S. may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Company's investments are financially sound and, accordingly, minimal credit risk exists with respect to these investments.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The trade receivables of the Company and its subsidiaries are mainly derived from sales to customers located primarily in the United States, Europe and Israel. Management believes that credit risks are moderated by the diversity of its end customers and geographical sales areas. The Company performs ongoing credit evaluations of its customers' financial condition. An allowance for doubtful accounts is determined with respect to those accounts that the Company has determined to be doubtful of collection.

The Company and its subsidiaries had no off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

p. Basic and diluted net loss per share:

Basic net loss per share is computed based on the weighted average number of shares of common stock outstanding during each year. Diluted net loss per share is computed based on the weighted average number of shares of common stock outstanding during each year, plus dilutive potential shares of common stock considered outstanding during the year, in accordance with Statement of Financial Standards No. 128, "Earnings Per Share" ("SFAS No. 128").

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 all periods presented. The total weighted average number

In U.S. dollars

of shares related to the outstanding options and warrants excluded from the calculations of diluted net loss per share was 22,194,211 and 4,394,803 and 3,170,334 for the years ended December 31, 2003, 2002 and 2001, respectively.

q. Accounting for stock-based compensation:

The Company has elected to follow Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB No. 25") and Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation" ("FIN No. 44") in accounting for its employee stock option plans. Under APB No. 25, when the exercise price of the Company's share options is less than the market price of the underlying shares on the date of grant, compensation expense is recognized. Under Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), pro-forma information regarding net income and net income per share is required, and has been determined as if the Company had accounted for its employee stock options under the fair value method of SFAS No. 123.

The Company applies SFAS No. 123 and Emerging Issue Task Force No. 96-18 "Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services" ("EITF 96-18") with respect to options issued to non-employees. SFAS No. 123 requires use of an option valuation model to measure the fair value of the options at the grant date.

The fair value for the options to employees was estimated at the date of grant, using the Black-Scholes Option Valuation Model, with the following weighted-average assumptions: risk-free interest rates of 2.54%, 3.5% and 3.5-4.5% for 2003, 2002 and 2001, respectively; a dividend yield of 0.0% for each of those years; a volatility factor of the expected market price of the common stock of 0.67 for 2003, 0.64 for 2002 and 0.82 for 2001; and a weighted-average expected life of the option of 5 years for 2003, 2002 and 2001.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The following table illustrates the effect on net income and earnings per share, assuming that the Company had applied the fair value recognition provision of SFAS No. 123 on its stock-based employee compensation:

<TABLE>
<CAPTION>

	Year ended December 31,		
	2003	2002	2001
<S>	<C>	<C>	<C>
Net loss as reported	$ (9,008,274)	$(18,504,358)	$(18,483,455)
Add: Stock-based compensation expenses included in reported net loss	8,286	6,000	17,240
Deduct: Stock-based compensation expenses determined under fair value method for all awards	(1,237,558)	(2,072,903)	(2,906,386)
	$(10,237,546)	$(20,571,261)	$ 21,372,601
Loss per share:			
Basic and diluted, as reported	$ (0.23)	$ (0.57)	$ (0.76)
Diluted, pro forma	$ (0.26)	$ (0.64)	$ (0.88)

</TABLE>

r. Fair value of financial instruments:

The following methods and assumptions were used by the Company and its subsidiaries in estimating their fair value disclosures for financial instruments:

The carrying amounts of cash and cash equivalents, restricted collateral deposit and other restricted cash, trade receivables, short-term bank credit, and trade payables approximate their fair value due to the short-term maturity of such instruments.

Long-terms liabilities are estimated by discounting the future cash flows using current interest rates for loans or similar terms and maturities. The carrying amount of the long-term liabilities approximates their fair value.

s. Severance pay:

The Company's liability for severance pay is calculated pursuant to Israeli severance pay law based on the most recent salary of the employees multiplied by the number of years of employment as of the balance sheet date. Employees are entitled to one month's salary for each year of employment, or a portion thereof. The Company's liability for all of its employees is fully provided by monthly deposits with severance pay funds, insurance policies and by an accrual. The value of these policies is recorded as an asset in the Company's balance sheet.

In addition and according to certain employment agreements, the Company is obligated to provide for a special severance pay in addition to amounts due to

certain employees pursuant to Israeli severance pay law. The Company has made a provision for this special severance pay in accordance with Statement of Financial Accounting Standard No. 106, "Employer's Accounting for Post Retirement Benefits Other than Pensions" ("SFAS No. 106"). As of December 31, 2003 and 2002, the accumulated severance pay in that regard amounted to $ 1,699,260 and $1,630,366, respectively.

NOTE 2: - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The deposited funds include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israeli severance pay law or labor agreements. The value of the deposited funds is based on the cash surrendered value of these policies and includes immaterial profits.

Severance expenses for the year ended December 31, 2003 amounted to $ 219,857 as compared to severance income and expenses for the years ended December 31, 2002 and 2001, which amounted to $338,574 and $653,885, respectively.

t. Advertising costs:

The Company and its subsidiaries expense advertising costs as incurred. Advertising expense for the years ended December 31, 2003, 2002 and 2001 was approximately $34,732, $294,599 and $1,676,280 respectively.

NOTE 3:- RESTRICTED COLLATERAL DEPOSIT AND OTHER RESTRICTED CASH

The restricted collateral deposit is invested in a $706,180 certificate of deposit that is used to secure certain real property lease arrangements, and a currency hedging arrangement to protect the Company against change in the euro versus the dollar in connection with IES's contract with the German police, which is denominated in euros; a portion was also on deposit with an arbitrator in connection with the Company's litigation with IES Electronic Industries, Ltd.

	December 31, 2003
IES Deposit	$ 450,000
Forward Deal	205,489
Property Lease	41,412
Other	9,279
	$ 706,180

NOTE 4: - OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

	December 31,	
	2003	2002
Government authorities	$ 65,402	$ 348,660
Employees	246,004	23,959
Prepaid expenses	551,010	591,008
Other	324,955	68,684
	$ 1,187,371	$ 1,032,311

NOTE 5:- INVENTORIES

	December 31,	
	2003	2002
Raw and packaging materials	$ 657,677	$ 893,666
Work in progress	634,221	296,692
Finished products	622,850	521,121
	$ 1,914,748	$ 1,711,479

NOTE 6:- PROPERTY AND EQUIPMENT, NET

a. Composition of property and equipment is as follows:

In U.S. dollars

<TABLE>
<CAPTION>

		December 31,	
		2003	2002
Cost:			
<S>		<C>	<C>
	Computers and related equipment	$ 1,015,836	$ 815,759
	Motor vehicles	288,852	335,286
	Office furniture and equipment	402,726	519,092
	Machinery, equipment and installations	4,866,904	4,715,182
	Leasehold improvements	882,047	442,482
	Demo inventory	150,996	154,689
		7,607,361	6,982,490
Accumulated depreciation:			
	Computers and related equipment	753,593	669,258
	Motor vehicles	95,434	39,281
	Office furniture and equipment	173,301	255,829
	Machinery, equipment and installations	3,637,111	3,106,389
	Leasehold improvements	655,181	356,484
		5,314,620	4,427,241
Depreciated cost		$ 2,292,741	$ 2,555,249

</TABLE>

b. Depreciation expense amounted to $730,159, $473,739 and $530,013, for the years ended December 31, 2003, 2002 and 2001, respectively.

As for liens, see Note 10.d.

NOTE 7: - OTHER INTANGIBLE ASSETS, NET

a.

	Year ended December 31,	
	2003	2002
Cost:		
Technology	$ 2,231,746	$ 1,795,000
Capitalized research and development	209,615	--
Existing contracts	46,000	46,000
Covenants not to compete	99,000	99,000
Customer list	827,250	812,000
	3,413,611	2,752,000
Exchange differences	25,438	--
Less - accumulated amortization	(1,502,854)	623,543
Amortized cost	1,936,195	2,128,457
Trademarks	439,000	439,000
	$ 2,375,195	$ 2,567,457

b. Amortization expenses amounted to $879,311 for the year ended December 31, 2003.

c. Estimated amortization expenses for the years ended:

Year ended December 31,	
2004	$ 552,443
2005	541,466
2006	366,421
2007	244,734
2008 and forward	231,131
	$ 1,936,195

In U.S. dollars

NOTE 8: - PROMISSORY NOTES

In connection with the acquisition discussed in Note 1b, the Company issued promissory notes in the face amount of an aggregate of $1,800,000, one of which was a note for $400,000 that was convertible into an aggregate of 200,000 shares of the Company's common stock. The Company has accounted for these notes in accordance with Accounting Principles Board Opinion No. 21, "Interest on Receivables and Payables," and recorded the notes at its present value in the amount of $1,686,964. In December 2002, the terms of these promissory notes were amended to (i) extinguish the $1,000,000 note due at the end of June 2003 in exchange for prepayment of $750,000, (ii) amend the $400,000 note due at the end of December 2003 to be a $450,000 note, and (iii) amend the convertible $400,000 note due at the end of June 2004 to be a $450,000 note convertible at $0.75 as to $150,000, at $0.80 as to $150,000, and at $0.85 as to $150,000. In accordance with EITF 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments," the terms of the promissory notes are not treated as changed or modified when the cash flow effect on a present value basis is less than 10% and therefore the Company did not record any compensation related to these changes. The $450,000 note due at the end of June 2004 was converted into an aggregate of 563,971 shares of common stock in August 2003. With reference to the $450,000 note due at the end of December 2003, see Note 17.f.

NOTE 9: - OTHER ACCOUNTS PAYABLE AND ACCRUED EXPENSES

	December 31,	
	2003	2002
Employees and payroll accruals	$ 1,232,608	$ 615,292
Accrued vacation pay	216,768	137,179
Accrued expenses	842,760	342,793
Minority balance	149,441	289,451
Government authorities	357,095	497,428
Deferred warranty revenues	40,936	95,831
Litigation settlement accrual(1)	1,313,642	-
Other	168,097	31,135
	$ 4,321,347	$ 2,009,109

(1) See Note 17.f.

NOTE 10: - COMMITMENTS AND CONTINGENT LIABILITIES

a. Royalty commitments:

1. Under EFL's research and development agreements with the Office of the Chief Scientist ("OCS"), and pursuant to applicable laws, EFL is required to pay royalties at the rate of 3%-3.5% of net sales of products developed with funds provided by the OCS, up to an amount equal to 100% of research and development grants received from the OCS (linked to the U.S. dollars. Amounts due in respect of projects approved after year 1999 also bear interest of the Libor rate). EFL is obligated to pay royalties only on sales of products in respect of which OCS participated in their development. Should the project fail, EFL will not be obligated to pay any royalties.

Royalties paid or accrued for the years ended December 31, 2003, 2002 and 2001, to the OCS amounted to $435, $32,801 and $75,791, respectively.

As of December 31, 2003, the total contingent liability to the OCS was approximately $10,057,000. The Company regards the probability of this contingency coming to pass in any material amount to be low.

2. EFL, in cooperation with a U.S. participant, has received approval from the BIRD-F for 50% funding of a project for the development of a hybrid propulsion system for transit buses. The maximum approved cost of the project is approximately $1.8 million, and the Company's share in the project costs is anticipated to amount to approximately $1.1 million, which will be reimbursed by BIRD-F at the aforementioned rate of 50%. Royalties at rates of 2.5%-5% of sales are payable up to a maximum of 150% of the grant received, linked to the U.S. Consumer Price Index. Accelerated royalties are due under certain circumstances.

EFL is obligated to pay royalties only on sales of products in respect of which BIRD-F participated in their development. Should the project fail, EFL will not be obligated to pay any royalties.

No royalties were paid or accrued to the BIRD-F in each of the three years in the period ended December 31, 2003.

In U.S. dollars

NOTE 10: - COMMITMENTS AND CONTINGENT LIABILITIES(Cont.)

As of December 31, 2003, the total contingent liability to pay BIRD-F (150%) was approximately $772,000. The Company regards the probability of this contingency coming to pass in any material amount to be low.

b. Lease commitments:

The Company and its subsidiaries rent their facilities under various operating lease agreements, which expire on various dates, the latest of which is in 2005. The minimum rental payments under non-cancelable operating leases are as follows:

Year ended December 31,	
2004	$ 393,512
2005	197,266
	$ 590,778

Total rent expenses for the years ended December 31, 2003, 2002 and 2001, were approximately $484,361, $629,101 and $456,701, respectively.

c. Guarantees:

The Company obtained bank guarantees in the amount of $51,082 in connection with (i) a lease agreement of one of the Company's subsidiaries, (ii) a sales obligation to a customer of one of the Company's subsidiaries, and (iii) obligations of one of the Company's subsidiaries to the Israeli customs authorities.

d. Liens:

As security for compliance with the terms related to the investment grants from the state of Israel, EFL has registered floating liens on all of its assets, in favor of the State of Israel.

The Company has granted to the holders of its 8% secured convertible debentures a first position security interest in (i) the shares of MDT Armor Corporation, (ii) the assets of its IES Interactive Training, Inc. subsidiary, (iii) the shares of all of its subsidiaries, and (iv) any shares that the Company acquires in future Acquisitions (as defined in the securities purchase agreement).

EFL has granted to its former CEO a security interest in certain of its property located in Beit Shemesh, Israel, to secure sums due to him pursuant to the terms of the settlement agreement with him.

NOTE 11: - SHAREHOLDERS' EQUITY

a. Shareholders' rights:

The Company's shares confer upon the holders the right to receive notice to participate and vote in the general meetings of the Company and right to receive dividends, if and when declared.

b. Issuance of common stock to investors:

1. In May 2001, the Company issued a total of 4,045,454 shares of its common stock to a group of institutional investors at a price of $2.75 per share, or a total purchase price of $11,125,000. (See also Note 11.f.1 and 11.f.2.)

2. On November 21, 2001, the Company issued a total of 1,503,759 shares of its common stock at a purchase price of $1.33 per share, or a total purchase price of $2,000,000, to a single institutional investor.

3. On December 5, 2001, the Company issued a total of 1,190,476 shares of its common stock at a purchase price of $1.68 per share, or a total purchase price of $2,000,000, to a single institutional investor.

4. On January 18, 2002, the Company issued a total of 441,176 shares of its common stock at a purchase price of $1.70 per share, or a total purchase price of $750,000, to an investor (see also Note 11.f.3).

5. On January 24, 2002, the Company issued a total of 1,600,000 shares of its common stock at a purchase price of $1.55 per share, or a total purchase price of $2,480,000, to a group of investors.

c. Issuance of common stock to service providers and employees:

1. On June 17, 2001 the Company issued a consultant a total of 8,550 shares of its common stock in compensation for services rendered by such consultant for the Company for preparation of certain video point-of-purchase and sales demonstration materials. At the issuance date the fair value of these shares was determined both by the value of the shares issued as reflected by fair market price at the issuance date and by the value of the services provided and amounted to $15,488 in accordance with EITF 96-18. In accordance with EITF 00-18, the Company recorded this compensation expense as marketing expenses in

the amount of $15,488.

2. On September 17, 2001 the Company issued to selling and marketing consultants a total of 337,571 shares of its common stock in compensation for distribution services rendered by such consultant. At the issuance date the fair value of these shares was determined both by the value of the shares issued as reflected by fair market price at the issuance date and by the value of the services provided and amounted to $524,889 in accordance with EITF 96-18 and in accordance with EITF 00-18. The Company recorded this compensation expense as marketing expenses in the amount of $524,889.

3. On February 15, 2002 and September 10, 2002, the Company issued 318,468 and 50,000 shares, respectively, of common stock at par consideration to a consultant for providing business development and marketing services in the United Kingdom. At the issuance date, the fair value of these shares was determined both by the value of the shares issued as reflected by fair market price at the issuance date and by the value of the services provided and amounted to $394,698 and $63,000, respectively, in accordance with EITF 96-18. In accordance with EITF 00-18, the Company recorded this compensation expense of $394,698 and $63,000, respectively, during the year 2002 and included this amount in marketing expenses.

NOTE 11: - SHAREHOLDERS' EQUITY (Cont.)

4. On September 10, 2002, the Company issued an aggregate of 13,000 shares of common stock at par consideration to two of its employees as stock bonuses. At the issuance date, the fair value of these shares was determined by the fair market value of the shares issued as reflected by fair market price at the issuance date in accordance with APB No. 25. In accordance with APB No. 25, the Company recorded this compensation expense of $13,000 during the year 2002 and included this amount in general and administrative expenses.

5. In July 2003, the Company issued 215,294 shares of common stock to a consultant as commissions on battery orders. At the issuance date, the fair value of these shares was determined both by the value of the shares issued as reflected by fair market price at the issuance date and by the value of the services provided and amounted to $154,331 in accordance with EITF 96-18. In accordance with EITF 00-18, the Company recorded this compensation expense of $154,331 during the year 2003 and included this amount in marketing expenses.

6. In November 2003, the Company issued 8,306 shares of common stock to a consultant as commissions on battery orders. At the issuance date, the fair value of these shares was determined by the fair market value of the shares issued as reflected by fair market price at the issuance date and by the value of the services provided and amounted to $7,616 in accordance with EITF 96-18. In accordance with EITF 96-18, the Company recorded this compensation expense of $7,616 during the year 2003 and included this amount in marketing expenses.

d. Issuance of shares to lenders

As part of the securities purchase agreement on December 31, 2002 (see Note 16.a), the Company issued 387,301 shares at par as consideration to lenders for the first nine months of interest expenses. At the issuance date, the fair value of these shares was determined both by the value of the shares issued as reflected by fair market price at the issuance date and by the value of the interest and amounted to $236,250 in accordance with APB 14. During 2003 the company recorded this amount as financial expenses.

e. Issuance of notes receivable:

1. As part of its purchase of the assets of IES Interactive Training, Inc. (see Note 1.b.), the Company issued a $450,000 convertible promissory note (see Note 8). This note was converted into an aggregate of 563,971 shares of common stock in August 2003.

f. Warrants:

1. As part of an investment agreement in November 2000, the Company issued warrants to purchase an additional 1,000,000 shares of common stock to the investor, with exercise prices of $11.31 for 333,333 of these warrants and $12.56 per share for 666,667 of these warrants. In addition, the Company issued warrants to purchase 150,000 shares of common stock, with exercise prices of $9.63 for 50,000 of these warrants and $12.56 per share for 100,000 of these warrants to an investment banker involved in this agreement. Out of these warrants issued to the investor, 666,667 warrants expire on November 17, 2005 and 333,333 warrants were to expire on August 17, 2001.

NOTE 11: - SHAREHOLDERS' EQUITY (Cont.)

As part of the transaction in May 2001 (see Note 11.b.1), the Company repriced these warrants in the following manner:

>> Of the 1,000,000 warrants granted to the investor, the exercise price of 666,667 warrants was reduced from $12.56 to $3.50 and of 333,333 warrants was reduced from $11.31 to $2.52. In addition, the 333,333 warrants that were to expire on August 17, 2001, were immediately exercised for a total consideration of $840,000.

>> Moreover, the Company issued to this investor an additional warrant to purchase 250,000 shares of common stock at an exercise price of $3.08 per share, to expire on May 3, 2006.

>> Of the 150,000 warrants granted to the investment banker the exercise price of 100,000 warrants was reduced from $12.56 to $3.08 and of 50,000 warrants was reduced from $9.63 to $3.08. In addition, the 50,000 warrants that were to expire on August 17, 2001 were extended to November 17, 2005.

As a result of the aforesaid modifications, including the repricing of the warrants to the investors and to the investment banker and the additional grant of warrants to the investor, the Company has recorded a deemed dividend in the amount of $1,196,667, to reflect the additional benefit created for these certain investors. The fair value of the repriced warrants was calculated as a difference measured between (1) the fair value of the modified warrant determined in accordance with the provisions of SFAS No. 123, and (2) the value of the old warrant immediately before its terms are modified, determined based on the shorter of (a) its remaining expected life or (b) the expected life of the modified option. The deemed dividend increased the loss applicable to common stockholders in the calculation of basic and diluted net loss per share for the year ended December 31, 2001, without any effect on total shareholder's equity.

2. As part of the investment agreement in May 2001 (see Note 11.b.1), the Company issued to the investors a total of 2,696,971 warrants (the "May 2001 Warrants") to purchase shares of common stock at a price of $3.22 per share; these warrants are exercisable by the holder at any time after November 8, 2001 and will expire on May 8, 2006. The Company also issued to a financial consultant that provided investment banking services concurrently with this transaction a total of 125,000 warrants to purchase shares of common stock at a price of $3.22 per share; these warrants are exercisable by the holder at any time and will expire on June 12, 2006. In addition the Company paid approximately $562,000 in cash, which was recorded as deduction from additional paid in capital.

In June 2003, the Company adjusted the purchase price of 1,357,577 of the May 2001 Warrants to $0.82 per share in exchange for immediate exercise of these warrants, and issued to the holders of these exercised warrants new warrants to purchase a total of 905,052 shares of common stock at a purchase price of $1.45 per share (the "June 2003 Warrants"). The June 2003 Warrants were originally exercisable at any time from and after December 31, 2003 to June 30, 2008; however, in September 2003, the exercise period of 638,385 of these June 2003 Warrants was adjusted to make them exercisable at any time from and after December 31, 2004 to June 30, 2009. As a result the company recorded during 2003 an expense of $244,810 and included this amount in general and administrative expenses.

NOTE 11: - SHAREHOLDERS' EQUITY (Cont.)

In addition, with respect to an additional 387,879 May 2001 Warrants, in December 2003 the Company adjusted the purchase price to $1.60 per share in exchange for immediate exercise of these warrants, and issued to the holders of these exercised warrants new warrants to purchase a total of 193,940 shares of common stock at a purchase price of $2.25 per share .As a result the company recorded during 2003 an expense of $74,384 and included this amount in general and administrative expenses.

Additionally, in October 2003 the Company granted to three of these investors additional new warrants to purchase a total of 150,000 shares of common stock at a purchase price of $1.20 per share. As a result the company recorded during 2003 an expense of $69,209 and included this amount in general and administrative expenses.

3. As part of the investment agreement in January 2002 (see Note 11.b.4), the Company, in January 2002, issued to a financial consultant that provided investment banking services concurrently with this transaction a warrants to acquire (i) 150,000 shares of common stock at an exercise price of $1.68 per share, and (ii) 119,000 shares of common stock at an exercise price of $2.25 per share; these warrants are exercisable by the holder at any time and will expire on January 4, 2007.

4. As part of the securities purchase agreement on December 31, 2002 (see Note 16.a), the Company issued to the purchasers of its 9% secured convertible debentures due June 30, 2005, warrants, as follows: (i) Series A Warrants to purchase an aggregate of 1,166,700 shares of common stock at any time prior to December 31, 2007 at a price of $0.84 per share; (ii) Series B Warrants to purchase an aggregate of 1,166,700 shares of common stock at any time prior to December 31, 2007 at a price of $0.89 per share; and (iii) Series C Warrants to purchase an aggregate of 1,166,700 shares of common stock at any time prior to December 31, 2007 at a price of $0.93 per share. The exercise price of these warrants was adjusted to $0.64 per share in April 2003.

In connection with these warrants, the Company recorded a deferred debt discount of $1,290,000, which will be amortized ratably over the life of the convertible debentures (3 years), unless these warrants are exercised, in which case any remaining financial expense will be taken in the quarter in which the exercise occurs. This transaction was accounted according to APB No. 14 "Accounting for Convertible debt and Debt Issued with Stock Purchase Warrants" and Emerging Issue Task Force No. 00-27 "Application of Issue No. 98-5 to Certain Convertible Instruments" ("EITF 00-27"). The fair value of these warrants was determined using Black-Scholes pricing model, assuming a risk-free interest rate of 3.5%, a volatility factor 64%, dividend yields of 0% and a contractual life of 5 years.

During 2003, an aggregate of 1,500,042 shares were issued pursuant to exercises of these warrants.

During 2003, the Company recorded an expense of $847,714, of which $423,857 was attributable to amortization of the convertible debentures over their term and $423,857 was attributable to accelerated amortization due to the exercise of warrants. Those expenses were included in the financial expenses.

5. As part of the securities purchase agreement on September 30, 2003 (see Note 16.b), the Company issued to the purchasers of its 8% secured convertible debentures due September 30, 2006, warrants to purchase an aggregate of 1,250,000 shares of common stock at any time prior to September 30, 2006 at a price of $1.4375 per share.

NOTE 11: - SHAREHOLDERS' EQUITY (Cont.)

In connection with these warrants, the Company recorded a deferred debt discount of $1,025,000, which will be amortized ratably over the life of the convertible debentures (3 years). This transaction was accounted according to APB No. 14 "Accounting for Convertible debt and Debt Issued with Stock Purchase Warrants" and Emerging Issue Task Force No. 00-27 "Application of Issue No. 98-5 to Certain Convertible Instruments" ("EITF 00-27"). The fair value of these warrants was determined using Black-Scholes pricing model, assuming a risk-free interest rate of 1.95%, a volatility factor 98%, dividend yields of 0% and a contractual life of 3 years.

During 2003, an aggregate of 437,500 shares were issued pursuant to exercises of these warrants.

During 2003 the Company recorded an expense of $414,676, of which $78,512 was attributable to amortization of the debt discount over their term and $336,164 was attributable to amortization due to accelerated exercise of warrants. Those expenses were included in the financial expenses.

6. As a further part of the securities purchase agreement on September 30, 2003 (see Note 16.c), the Company issued to the purchasers of its 8% secured convertible debentures due December 31, 2006, warrants to purchase an aggregate of 1,500,000 shares of common stock at any time prior to December 31, 2006 at a price of $1.8125 per share. Additionally, the Company issued to the investors supplemental warrants to purchase an aggregate of 1,038,000 shares of common stock at any time prior to December 31, 2006 at a price of $2.20 per share.

In connection with these warrants, the Company will record financial expenses of $ 1,545,000 and $1,297,500 for the additional and the supplemental warrants referred to above, respectively, which will be amortized ratably over the life of the convertible debentures (3 years). This transaction was accounted according to APB No. 14 "Accounting for Convertible debt and Debt Issued with Stock Purchase Warrants" and Emerging Issue Task Force No. 00-27 "Application of Issue No. 98-5 to Certain Convertible Instruments" ("EITF 00-27"). The fair value of these warrants was determined using Black-Scholes pricing model, assuming a risk-free interest rate of 2.45%, a volatility factor 98%, dividend yields of 0% and a contractual life of 3 years.

During 2003 the Company recorded an expense of $53,440 for amortization of these debt discounts over their term, which is included in financial expenses.

g. Stock option plans:

1. Options to employees and others (except consultants)

a. The Company has adopted the following stock option plans, whereby options may be granted for purchase of shares of the Company's common stock. Under the terms of the employee plans, the Board of Directors or the designated committee grants options and determines the vesting period and the exercise terms.

1) 1991 Employee Option Plan - 2,115,600 shares reserved for issuance, of which 53,592 were available for future grants to employees as of December 31, 2003.

2) 1993 Employee Option Plan - as amended, 6,200,000 shares reserved for issuance, of which no shares were available for future grants to employees as of December 31, 2003.

In U.S. dollars

NOTE 11: - SHAREHOLDERS' EQUITY (Cont.)

3) 1998 Employee Option Plan - as amended, 4,750,000 shares reserved for issuance, of which no shares were available for future grants to employees and consultants as of December 31, 2003.

4) 1995 Non-Employee Director Plan - 1,000,000 shares reserved for issuance, of which 600,000 were available for future grants to directors as of December 31, 2003.

b. Under these plans, options generally expire no later than 10 years from the date of grant. Each option can be exercised to purchase one share, conferring the same rights as the other common shares. Options that are cancelled or forfeited before expiration become available for future grants. The options generally vest over a three-year period (33.3% per annum).

c. A summary of the status of the Company's plans and other share options (except for options granted to consultants) granted as of December 31, 2003, 2002 and 2001, and changes during the years ended on those dates, is presented below:

<TABLE>
<CAPTION>

	2003		2002		2001	
	Amount	Weighted average exercise price	Amount	Weighted average exercise price	Amount	Weighted average exercise price
		$		$		$
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Options outstanding at beginning of year	5,260,366	$ 2.26	4,240,228	$ 2.74	2,624,225	$ 3.82
Changes during year:						
Granted (1) (2)	5,264,260	$ 0.71	1,634,567	$ 0.87	2,172,314	$ 1.55
Exercised (3)	689,640	$ 0.64	(191,542)	$ 1.29	(159,965)	$ 1.31
Forfeited or cancelled	(816,675)	$ 3.51	(422,887)	$ 1.92	(396,346)	$ 4.11
Options outstanding at end of year	9,018,311	$ 1.37	5,260,366	$ 2.26	4,240,228	$ 2.74
Options exercisable at end of year	5,826,539	$ 1.70	4,675,443	$ 2.26	2,643,987	$ 2.75

</TABLE>

(1) Includes 2,035,000, 481,435 and 1,189,749 options granted to related parties in 2003, 2002 and 2001, respectively.

(3) The Company recorded deferred stock compensation for options issued with an exercise price below the fair value of the common stock in the amount of $4,750, $0 and $18,000 as of December 31, 2003, 2002 and 2001, respectively. Deferred stock compensation is amortized and recorded as compensation expenses ratably over the vesting period of the option. The stock compensation expense that has been charged in the consolidated statements of operations in respect of options to employees and directors in 2003, 2002 and 2001, was $8,286, $6,000 and $17,240, respectively.

(3) In June 2002 and December 2001, the employees exercised 100,000 and 33,314, respectively, options for which the exercise price was not paid at the exercise date. The Company recorded the owed amount of $73,000 and $43,308, respectively, as "Note receivable from shareholders" in the statement of shareholders' equity. In accordance with EITF 95-16, since the original option grant did not permit the exercise of the options through loans, and due to the Company's history of granting non-recourse loans, this postponement in payments of the exercise price resulted in a variable plan accounting. However, the Company did not record any compensation due to the decrease in the market value of the Company's shares during 2001 and 2002. During the year 2002 the notes in the amount of $43,308 were entirely repaid and note at the amount of $36,500 was forgiven and appropriate compensation was recorded. During the year 2003, the company recorded compensation in amount of $38,500 due to increase in the market value of the company's shares.

NOTE 11: - SHAREHOLDERS' EQUITY (Cont.)

d. The options outstanding as of December 31, 2003 have been separated into ranges of exercise price, as follows:

<TABLE>
<CAPTION>

Total options outstanding	Exercisable options outstanding

Range of exercise prices	Amount outstanding at December 31, 2003	Weighted average remaining contractual life	Weighted average exercise price	Amount exercisable at December 31, 2003	Weighted average exercise price
$		Years	$		$
<S>	<C>	<C>	<C>	<C>	<C>
0.01-2.00	7,773,767	7.48	0.90	4,584,740	0.98
2.01-4.00	314,544	3.56	3.07	314,544	3.07
4.01-6.00	885,000	6.28	4.60	882,255	4.60
6.01-8.00	35,000	2.05	7.73	35,000	7.73
8.01	10,000	3.75	9.06	10,000	9.06
	9,018,311	7.20	1.37	5,826,539	1.70

</TABLE>

Weighted-average fair values and exercise prices of options on dates of grant are as follows:

<TABLE>
<CAPTION>

	Equals market price			Exceeds market price			Less than market price		
	Year ended December 31,			Year ended December 31,			Year ended December 31,		
	2003	2002	2001	2003	2002	2001	2003	2002	2001
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Weighted average exercise prices	$ 0.950	$ 1.265	$ 1.579	$ -	$ -	$ 1.466	$ -	$ 0.755	$ 1.300
Weighted average fair value on grant date	0 $ 0.73	0 $ 0.56	0 $ 0.50	$ -	$ -	0 $ 0.56	$ -	0 $ 0.25	$ 0.790

</TABLE>

2. Options issued to consultants:

a. The Company's outstanding options to consultants as of December 31, 2003, are as follows:

<TABLE>
<CAPTION>

	2003		2002		2001	
	Amount	Weighted average exercise price	Amount	Weighted average exercise price	Amount	Weighted average exercise price
		$		$		$
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Options outstanding at beginning of year	245,786	$ 5.55	245,786	$ 5.55	175,786	$ 6.57
Changes during year:						
Granted (1)	83,115	$ 0.99	-	-	130,000	$ 6.02
Exercised	(15,000)	$ 0.49	-	-	(60,000)	$ 5.13
Repriced (2):						
Old exercise price	-	-	-	-	(56,821)	$ 9.44
New exercise price	-	-	-	-	56,821	$ 4.78
Options outstanding at end of year	313,901	$ 4.59	245,786	$ 5.55	245,786	$ 5.55
Options exercisable at end of year	193,901	$ 3.46	125,786	$ 6.42	125,786	$ 6.42

</TABLE>

(1) 120,000 options out of 130,000 options granted in 2001 to the Company's selling and marketing consultants are subject to the achievement of the targets specified in the agreements with these consultants. The measurement date for these options has not yet occurred, as these targets have not been met, in accordance with EITF 96-18. When the targets is achieved the Company will record appropriate compensation upon the fair value at the same date at which the targets is achieved

NOTE 11: - SHAREHOLDERS' EQUITY (Cont.)

(2) During the year 2001 the Company repriced 56,821 options to its service providers. The fair value of repriced warrants was calculated as a difference measured between (1) the fair value of the modified warrants determined in accordance with the provisions of SFAS 123, and (2) the value of the old warrant immediately before its terms were modified, determined based on the shorter of (a) its remaining expected life or (b) the expected life of the modified option. As a result of the repricing, the Company has recorded an additional compensation at the amount of $21,704, and included this amount in marketing expenses.

b. The Company accounted for its options to consultants under the fair value method of SFAS No. 123 and EITF 96-18. The fair value for these options was estimated using a Black-Scholes option-pricing model with the following weighted-average assumptions:

<TABLE>
<CAPTION>

	2003	2002	2001
<S>	<C>	<C>	
Dividend yield	0%	-	0%
Expected volatility	78%	-	82%
Risk-free interest	2.3%	-	3.5-4.5%
Contractual life of up to	10 years	-	10 years

</TABLE>

c. In connection with the grant of stock options to consultants, the Company recorded stock compensation expenses totaling $29,759, $0 and $139,291 for the years ended December 31, 2003, 2002 and 2001, respectively, and included these amounts in marketing and general and administrative expenses.

3. Dividends:

In the event that cash dividends are declared in the future, such dividends will be paid in U.S. dollars. The Company does not intend to pay cash dividends in the foreseeable future.

4. Treasury Stock:

Treasury stock is the Company's common stock that has been issued and subsequently reacquired. The acquisition of common stock is accounted for under the cost method, and presented as reduction of stockholders' equity.

h. Issuances in connection with acquisitions:

In September 2003, the Company acquired an additional 12% interest in MDT Armor Corporation and an additional 24.5% interest in MDT Protective Industries Ltd. in exchange for the issuance to AGA Means of Protection and Commerce Ltd. of 126,000 shares of its common stock.

In U.S. dollars

NOTE 12: - INCOME TAXES

a. Taxation of U.S. parent company (Arotech):

As of December 31, 2003, Arotech has operating loss carryforwards for U.S. federal income tax purposes of approximately $17.0 million, which are available to offset future taxable income, if any, expiring in 2010 through 2022. Utilization of U.S net operating losses may be subject to substantial annual limitations due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating loses before utilization.

b. Israeli subsidiary (EFL):

1. Tax benefits under the Law for the Encouragement of Capital Investments, 1959 (the "Investments Law"):

A small part of EFL's manufacturing facility has been granted "Approved Enterprise" status under the Investments Law, and is entitled to investment grants from the State of Israel of 38% on property and equipment located in Jerusalem, and 10% on property and equipment located in its plant in Beit Shemesh, and to reduced tax rates on income arising from the "Approved Enterprise," as detailed below.

The approved investment program is in the amount of approximately $500,000. EFL effectively operated the program during 1993, and is entitled to the tax benefits available under the Investments Law. EFL is entitled to additional tax benefits as a "foreign investment company," as defined by the Investments Law.

The tax-exempt income attributable to the "Approved Enterprise" can be distributed to shareholders without subjecting the Company to taxes only upon the complete liquidation of the Company. If these retained tax-exempt profits are distributed in a manner other than in the complete liquidation of the Company they would be taxed at the corporate tax rate applicable to such profits as if the Company had not elected the alternative system of benefits, currently between 25% for an "Approved Enterprise." As of December 31, 2003, the accumulated deficit of the Company does not include tax-exempt profits earned by the Company's "Approved Enterprise."

The entitlement to the above benefits is conditional upon the Company's fulfilling the conditions stipulated by the Investments Law, regulations published thereunder and the instruments of approval for the specific investments in "approved enterprises." In the event of failure to comply with these conditions, the benefits may be canceled and the Company may be required to refund the amount of the benefits, in whole or in part, including interest. As of December 31, 2003, according to the Company's management, the Company has fulfilled all conditions.

The main tax benefits available to EFL are:

a) Reduced tax rates:

During the period of benefits (seven to ten years), commencing in the first year in which EFL earns taxable income from the "Approved Enterprise," a reduced corporate tax rate of between 10% and 25% (depending on the percentage of foreign ownership, based on present ownership percentages of 15%) will apply, instead of the regular tax rates.

In U.S. dollars

NOTE 12: - INCOME TAXES(Cont.)

The period of tax benefits, detailed above, is subject to limits of 12 years from the commencement of production, or 14 years from the approval date, whichever is earlier. Hence, the first program will expire in the year 2004. The benefits have not yet been utilized since the Company has no taxable income, since its incorporation.

b) Accelerated depreciation:

EFL is entitled to claim accelerated depreciation in respect of machinery and equipment used by the "Approved Enterprise" for the first five years of operation of these assets.

Income from sources other than the "Approved Enterprise" during the benefit period will be subject to tax at the regular corporate tax rate of 36%.

2. Measurement of results for tax purposes under the Income Tax Law (Inflationary Adjustments), 1985

Results for tax purposes are measured in real terms of earnings in NIS after certain adjustments for increases in the Consumer Price Index. As explained in Note 2b, the financial statements are presented in U.S. dollars. The difference between the annual change in the Israeli consumer price index and in the NIS/dollar exchange rate causes a difference between taxable income and the income before taxes shown in the financial statements. In accordance with paragraph 9(f) of SFAS No. 109, EFL has not provided deferred income taxes on this difference between the reporting currency and the tax bases of assets and liabilities.

3. Tax benefits under the Law for the Encouragement of Industry (Taxation), 1969:

EFL is an "industrial company," as defined by this law and, as such, is entitled to certain tax benefits, mainly accelerated depreciation, as prescribed by regulations published under the inflationary adjustments law, the right to claim public issuance expenses and amortization of know-how, patents and certain other intangible property rights as deductions for tax purposes.

4. Tax rates applicable to income from other sources:

Income from sources other than the "Approved Enterprise," is taxed at the regular rate of 36%.

5. Tax loss carryforwards:

As of December 31, 2003, EFL has operating and capital loss carryforwards for Israeli tax purposes of approximately $84.0 million, which are available, indefinitely, to offset future taxable income.

In U.S. dollars

NOTE 12: - INCOME TAXES(Cont.)

c. Deferred income taxes:

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and amounts used for income tax purposes. Significant components of the

In U.S. dollars

Company's deferred tax assets resulting from tax loss carryforward are as follows:

	December 31,	
	2003	2002
Operating loss carryforward	$33,958,434	$ 29,257,118
Reserve and allowance	843,453	303,204
Net deferred tax asset before valuation allowance	34,801,887	29,560,322
Valuation allowance	(34,801,887)	(29,560,322)
	$ -	$ -

The Company and its subsidiaries provided valuation allowances in respect of deferred tax assets resulting from tax loss carryforwards and other temporary differences. Management currently believes that it is more likely than not that the deferred tax regarding the loss carryforwards and other temporary differences will not be realized. The change in the valuation allowance as of December 31, 2003 was $5,241,565.

d. Loss from continuing operations before taxes on income and minority interest in loss (earnings) of a subsidiary:

	Year ended December 31		
	2003	2002	2001
Domestic	$ (7,181,774)	$ (5,250,633)	$ (5,828,828)
Foreign	(1,697,617)	(13,254,195)	(11,457,960)
	$ (8,879,391)	$ (18,504,358)	$ (17,286,788)

e. Taxes on income were comprised of the following:

	Year ended December 31		
	2003	2002	2001
Current taxes	$ 44,102	$ -	$ -
Taxes in respect of prior years	352,091	-	-
	$ 396,193	$ -	$ -
Domestic	$ 33,020	$ -	$ -
Foreign	363,173	-	-
	$ 396,193	$ -	$ -

NOTE 12: - INCOME TAXES(Cont.)

f. A reconciliation between the theoretical tax expense, assuming all income is taxed at the statutory tax rate applicable to income of the Company and the actual tax expense as reported in the Statement of Operations, is as follows:

	Year ended December 31,		
	2003	2002	2001
Loss from continuing operations before taxes, as reported in the consolidated statements of income	$ (8,879,391)	$ (4,582,792)	$ (4,025,789)

Statutory tax rate	35%	35%	35%
Theoretical tax income on the above amount at the U.S. statutory tax rate	$ (3,107,787)	$ (1,603,977)	$ (1,409,026)
Deferred taxes on losses for which valuation allowance was not provided	1,178,215	1,603,977	1,409,026
Non-deductible expenses	1,940,019	-	-
State taxes	33,020	-	-
Other	635	-	-
Taxes in respect of prior years due to change in estimates	352,091	-	-
Actual tax expense	$ 396,193	$ -	$ -

</TABLE>

NOTE 13: - SELECTED STATEMENTS OF OPERATIONS DATA

Financial income (expenses), net:

<TABLE>
<CAPTION>

	Year ended December 31,		
	2003	2002	2001
Financial expenses:			
<S>	<C>	<C>	<C>
Interest, bank charges and fees	$ (355,111)	$ (89,271)	$ (49,246)
Amortization of compensation related to beneficial convertible feature of convertible debenture and warrants issued to the holders of convertible debenture	(3,359,987)	-	-
Foreign currency translation differences	115,538	15,202	(16,003)
	(3,599,560)	(74,069)	(65,249)
Financial income:			
Interest	129,101	174,520	327,830
Total	$ (3,470,459)	$ 100,451	$ 262,581

</TABLE>

In U.S. dollars

NOTE 14: - RELATED PARTY DISCLOSURES

<TABLE>
<CAPTION>

	Year ended December 31,		
	2003	2002	2001
Transactions:			
<S>	<C>	<C>	
Reimbursement of general and administrative expenses	-	$ 36,000	$ 23,850
Financial income (expenses), net from notes receivable and loan holders	-	$ (7,309)	$ (36,940)

</TABLE>

NOTE 15: - SEGMENT INFORMATION

a. General:

The Company and its subsidiaries operate primarily in two business segments (see Note 1a for a brief description of the Company's business) and follow the requirements of SFAS No. 131.

The Company previously managed its business in three reportable segments organized on the basis of differences in its related products and services. With the discontinuance of Consumer Batteries segment (see Note 1.e-Discontinued Operation) and acquiring two subsidiaries (see Notes 1.b.and c.), two reportable segments remain: Electric Fuel Batteries, and Defense and Security Products. As a result the Company reclassified information previously reported in order to comply with new segment reporting.

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 described in the summary of significant accounting policies. The Company evaluates performance based upon two primary factors, one is the segment's operating income and the other is based on the segment's contribution

In U.S. dollars

to the Company's future strategic growth.

b. The following is information about reported segment gains, losses and assets:

<TABLE>
<CAPTION>

	Batteries	Defense and Security Products	All Other	Total
2003				
<S>	<C>	<C>	<C>	<C>
Revenues from outside customers	$ 5,868,899	$ 11,457,742	$ -	$ 17,326,641
Depreciation expense and amortization	(527,775)	(927,665)	(139,630)	(1,595,070)
Direct expenses (1)	(5,945,948)	(10,892,933)	(4,539,674)	(21,378,555)
Segment gross loss	(604,824)	(362,856)	(4,679,304)	(5,646,984)
Financial income (in deduction of minority rights)	-	-	-	(3,471,700)
Net loss from continuing operation				(9,118,684)
Segment assets (2)	2,128,062	1,628,562	450,864	4,207,488
Expenditures for segment assets	247,989	208,497	124,463	580,949
2002				
Revenues from outside customers	$ 1,682,296	$ 4,724,443	$ -	$ 6,406,739
Depreciation expense and amortization	(252,514)	(676,753)	(194,014)	(1,123,281)
Direct expenses (1)	(3,062,548)	(4,353,770)	(2,905,743)	(10,322,061)
Segment gross loss	$ (1,632,766)	$ (306,080)	$ (3,099,757)	(5,038,603)
Financial income				100,451
Net loss from continuing operation				$ 4,938,152
Segment assets (2)	$ 2,007,291	$ 1,683,825	$ 575,612	$ 4,266,728
Expenditures for segment assets	$ 246,664	$ 58,954	$ 70,486	$ 376,104

</TABLE>

NOTE 15: - SEGMENT INFORMATION(Cont.)

<TABLE>
<CAPTION>

	Batteries	Defense and Security Products	All Other	Total
2001				
<S>	<C>	<C>	<C>	<C>
Revenues from outside customers	$ 2,093,632	$ -	$ -	$2,093,632
Depreciation expense	(304,438)	-	(225,577)	(530,015)
Direct expenses (1)	(2,295,501)	-	(3,556,486)	(5,851,987)
Segment gross loss	$ (506,307)	$ -	$ (3,782,063)	(4,288,370)
Financial income net				262,581
Net loss from continuing operations				$ (4,025,789)
Segment assets (2)	$ 2,044,257	$ 1,175,521	$ 702,915	$ 2,744,172
Expenditures for segment assets	$ 229,099	$ 229,099	$ 323,985	$ 553,084

</TABLE>

(1) Including sales and marketing, general and administrative expenses.

(2) Including property and equipment and inventory.

c. Summary information about geographic areas:

The following presents total revenues according to end customers location for the years ended December 31, 2003, 2002 and 2001, and long-lived assets as of December 31, 2003, 2002 and 2001:

<TABLE>
<CAPTION>

	2003	2002	2001

	Total revenues	Long-lived assets	Total revenues	Long-lived assets	Total revenues	Long-lived assets
	U.S. dollars					
<S>	<C>	<C>	<C>	<C>	<C>	
U.S.A.	$10,099,652	$6,778,050	$ 2,787,250	$ 6,710,367	$ 1,057,939	$ 60,531
Germany	2,836,725	-	38,160	-	526,766	-
England	29,095	-	47,696	-	36,648	-
Thailand	95,434	-	291,200	-	-	-
Israel	3,576,139	2,954,441	2,799,365	3,367,320	13,773	2,160,275
Other	689,596	-	443,068	-	458,506	-
	$17,326,641	$ 9,732,491	$ 6,406,739	$ 10,077,687	$ 2,093,632	$ 2,220,806

</TABLE>

In U.S. dollars

NOTE 15: - SEGMENT INFORMATION(Cont.)

d. Revenues from major customers:

<TABLE>
<CAPTION>

	Year ended December 31,		
	2003	2002	2001
		%	
Electric Fuel Batteries:			
<S>			<C>
Customer A	-	-	22%
Customer B	2%	7%	20%
Customer C	1%	2%	13%
Customer D	27%	8%	12%
Defense and Security Products:			
Customer A	17%	43%	-
Customer B	16%	-	-

e. Revenues from major products:

	Year ended December 31,		
	2003	2002	2001
EV	$ 408,161	$ 460,562	$ 894,045
WAB	703,084	647,896	951,598
Military batteries	4,757,116	573,839	247,989
Car armoring	3,435,715	2,744,382	-
Interactive use-of-force training	7,961,302	1,980,060	-
Other	61,263	-	-
Total	$17,326,641	$6,406,749	$2,093,632

</TABLE>

NOTE 16: - CONVERTIBLE DEBENTURES

a. 9% Secured Convertible Debentures due June 30, 2005

Pursuant to the terms of a Securities Purchase Agreement dated December 31, 2002, the Company issued and sold to a group of institutional investors an aggregate principal amount of 9% secured convertible debentures in the amount of $3.5 million due June 30, 2005. These debentures are convertible at any time prior to June 30, 2005 at a conversion price of $0.75 per share, or a maximum aggregate of 4,666,667 shares of common stock (see also Note 11.f.4). The conversion price of these debentures was adjusted to $0.64 per share in April 2003. In accordance with EITF 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments," the terms of convertible debentures are not treated as changed or modified when the cash flow effect on a present value basis is less than 10%, and therefore the Company did not record any compensation related to the change in the conversion price of the convertible debentures.

During 2003, an aggregate of $2,350,000 in 9% secured convertible debentures was converted into an aggregate of 3,671,875 shares of common stock.

In determining whether the convertible debentures include a beneficial conversion feature in accordance with EITF 98-5 "Accounting for Convertible Securities with Beneficial Conversion Features or Continently Adjustable Conversion Ratios" and EITF 00-27, the total proceeds were allocated to the convertible debentures and the detachable warrants based on their relative fair values. In connection with these convertible debentures, the Company will record financial expenses of $600,000 with respect to the beneficial conversion feature. The $600,000 is amortized from the date of issuance to the stated redemption date - June 30, 2005 - as financial expenses.

NOTE 16: - CONVERTIBLE DEBENTURES(Cont.)

During 2003 the Company recorded an expense of $481,714, of which $174,000 was attributable to amortization of the beneficial conversion feature of the convertible debenture over its term and $307,714 was attributable to amortization due to conversion of the convertible debenture into shares.

b. 8% Secured Convertible Debentures due September 30, 2006

Pursuant to the terms of a Securities Purchase Agreement dated September 30, 2003, the Company issued and sold to a group of institutional investors an aggregate principal amount of 8% secured convertible debentures in the amount of $5.0 million due September 30, 2006. These debentures are convertible at any time prior to September 30, 2006 at a conversion price of $1.15 per share, or a maximum aggregate of 4,347,826 shares of common stock (see also Note 11.f.5).

During 2003, an aggregate of $3,775,000 in 8% secured convertible debentures was converted into an aggregate of 3,282,608 shares of common stock.

In determining whether the convertible debentures include a beneficial conversion option in accordance with EITF 98-5 "Accounting for Convertible Securities with Beneficial Conversion Features or Continently Adjustable Conversion Ratios" and EITF 00-27, the total proceeds were allocated to the convertible debentures and the detachable warrants based on their relative fair values. In connection with these convertible debentures, the Company will record financial expenses of $1,938,043 with respect to the beneficial conversion feature. The $1,938,043 is amortized from the date of issuance to the stated redemption date - September 30, 2006 - as financial expenses.

During 2003 the Company recorded an expense of $1,503,080, of which $134,646 was attributable to amortization of the beneficial conversion feature of the convertible debenture over its term and $1,368,434 was attributable to amortization due to conversion of the convertible debenture into shares.

c. 8% Secured Convertible Debentures due December 31, 2006

Pursuant to the terms of a Securities Purchase Agreement dated September 30, 2003, the Company issued and sold to a group of institutional investors an aggregate principal amount of 8% secured convertible debentures in the amount of $6.0 million due December 31, 2006. These debentures are convertible at any time prior to December 31, 2006 at a conversion price of $1.45 per share, or a maximum aggregate of 4,137,931 shares of common stock (see also Note 11.f.6).

NOTE 16: - CONVERTIBLE DEBENTURES(Cont.)

In determining whether the convertible debentures include a beneficial conversion option in accordance with EITF 98-5 "Accounting for Convertible Securities with Beneficial Conversion Features or Continently Adjustable Conversion Ratios" and EITF 00-27, the total proceeds were allocated to the convertible debentures and the detachable warrants based on their relative fair values. In connection with these convertible debentures, the Company will record financial expenses of $3,157,500 with respect to the beneficial conversion feature. The $3,157,500 is amortized from the date of issuance to the stated redemption date - December 31, 2006 - as financial expenses.

During 2003 the Company recorded an expense of $59,362, which represents the amortization of the beneficial conversion feature of the convertible debenture over its term.

NOTE 17: - SUBSEQUENT EVENTS (UNAUDITED)

a. Debenture conversion:

In January 2004, a total of $1,150,000 principal amount of 9% debentures was converted into an aggregate of 1,796,875 shares of common stock at a conversion price of $0.64 per share.

b. Issuance of common stock to investors:

In January 2004, the Company issued to a group of investors an aggregate of 9,840,426 shares of common stock at a price of $1.88 per share, or a total purchase price of $18,500,000. (See also Note 17.c.)

c. Issuance of warrants to investors:

As part of the investment agreement in January 2004 (see Note 17.b.), the Company issued to a group of investors warrants to purchase an aggregate of

In U.S. dollars

9,840,426 shares of common stock at a price of $1.88 per share. These warrants are exercisable by the holder at any time after August 12, 2004 and will expire on January 12, 2007.

d. Acquisition of FAAC Incorporated:

In January 2004, the Company purchased all of the outstanding stock of FAAC Incorporated, a Michigan corporation ("FAAC"), from FAAC's existing shareholders. The assets acquired through the purchase of all of FAAC's outstanding stock consisted of all of FAAC's assets, including FAAC's current assets, property and equipment, and other assets (including intangible assets such as goodwill, intellectual property and contractual rights). The consideration for the assets purchased consisted of (i) cash in the amount of $12,000,000, and (ii) the issuance of $2,000,000 in Arotech stock, plus an earn-out based on 2004 net pretax profit, with an additional earn-out on the 2005 net profit from certain specific and limited programs.

e. Acquisition of Epsilor Electronic Industries, Ltd.:

In January 2004, the Company purchased all of the outstanding stock of Epsilor Electronic Industries, Ltd., an Israeli corporation ("Epsilor"), from Epsilor's existing shareholders. The assets acquired through the purchase of all of

NOTE 17: - SUBSEQUENT EVENTS (UNAUDITED)(Cont.)

Epsilor's outstanding stock consisted of all of Epsilor's assets, including Epsilor's current assets, property and equipment, and other assets (including intangible assets such as goodwill, intellectual property and contractual rights). The consideration for the assets purchased will consist of (i) cash in the amount of $7,000,000, and (ii) a series of three $1,000,000 promissory notes, due on the first, second and third anniversaries of the Agreement under the circumstances set forth in the acquisition agreement.

f. Settlement of litigation:

On February 4, 2004, the Company entered into an agreement settling the litigation brought against it in the Tel-Aviv, Israel district court by I.E.S. Electronics Industries, Ltd. ("IES Electronics") and certain of its affiliates in connection with the Company's purchase of the assets of its IES Interactive Training, Inc. subsidiary from IES Electronics in August 2002. The litigation had sought monetary damages in the amount of approximately $3 million. Pursuant to the terms of the settlement agreement, in addition to agreeing to dismiss their lawsuit with prejudice, IES Electronics agreed (i) to cancel the Company's $450,000 debt to them that had been due on December 31, 2003, and (ii) to transfer to the Company title to certain certificates of deposit in the approximate principal amount of $112,000. The parties also agreed to exchange mutual releases. In consideration of the foregoing, the Company issued to IES Electronics (i) 450,000 shares of common stock, and (ii) five-year warrants to purchase up to an additional 450,000 shares of common stock at a purchase price of $1.91 per share.

In respect of the above settlement, the Company recorded in 2003 an expense of $838,714, representing the fair value of the warrants and shares over the remaining balance of the Company's debt to IES Electronics as carried in the Company books at December 31, 2003, less the $112,000 certificate of deposit that was transferred to the Company's name as noted above.

- - - - - - - -

SUPPLEMENTARY FINANCIAL DATA

Quarterly Financial Data (unaudited) for the two years ended December 31, 2003

<TABLE>
<CAPTION>

	Quarter Ended			
2003	March 31	June 30	September 30	December 31
<S>	<C>	<C>	<C>	<C>
Net revenue	$ 4,033,453	$ 3,493,135	$ 5,705,898	$ 4,094,155
Gross profit	$ 1,399,734	$ 1,013,965	$ 2,453,575	$ 1,371,527
Net loss from continuing operations	$ (1,291,122)	$ (2,640,920)	$ 77,093	$ (5,263,735)
Net loss from discontinued operations	$ (95,961)	$ 179,127	$ (2,285)	$ 29,529
Net loss for the period	$ (1,387,083)	$ (2,461,793)	$ 74,808	$ (5,234,206)
Net loss per share - basic and diluted	$ (0.04)	$ (0.07)	$ 0.00	$ (0.12)
Shares used in per share calculation	34,758,960	36,209,872	40,371,940	43,604,830

	Quarter Ended			
2002	March 31	June 30	September 30	December 31
Net revenue	$ 570,545	$ 425,053	$ 3,262,711	$ 2,148,430

Gross profit	$ 186,917	$ 48,807	$ 1,593,770	$ 155,497
Net loss from continuing operations	$ (990,097)	$ (1,005,877)	$ (923,122)	$ (2,019,054)
Net loss from discontinued operations	$ (2,324,109)	$ (1,654,108)	$ (8,716,422)	$ (871,567)
Net loss for the period	$ (3,314,208)	$ (2,659,985)	$ (9,369,544)	$ (2,890,621)
Net loss per share - basic and diluted	$ (0.11)	$ (0.09)	$ (0.29)	$ (0.08)
Shares used in per share calculation	30,149,210	30,963,919	33,441,137	34,758,048

</TABLE>

FINANCIAL STATEMENT SCHEDULE

Arotech Corporation and Subsidiaries

Schedule II - Valuation and Qualifying Accounts

For the Years Ended December 31, 2003, 2002 and 2001

<TABLE>
<CAPTION>

Description	Balance at beginning of period	Additions charged to costs and expenses	Balance at end of period
<S>	<C>		
Year ended December 31, 2003			
Allowance for doubtful accounts	$ 40,636	$ 20,646	$ 61,282
Valuation allowance for deferred taxes	29,560,322	5,241,565	34,801,887
Totals	$ 29,600,958	$ 5,262,211	$ 34,863,169
Year ended December 31, 2002			
Allowance for doubtful accounts	$ 39,153	$ 1,483	$ 40,636
Valuation allowance for deferred taxes	12,640,103	16,920,219	29,560,322
Totals	$ 12,679,256	$ 16,921,702	$ 29,600,958
Year ended December 31, 2001			
Allowance for doubtful accounts	$ 13,600	$ 25,553	$ 39,153
Valuation allowance for deferred taxes	8,987,750	3,652,353	12,640,103
Totals	$ 9,001,350	$ 3,677,906	$ 12,679,256

</TABLE>

EXHIBIT INDEX

<TABLE>
<CAPTION>

Exhibit Number	Description
<S>	<C>
3.1.3	Amendment to our Amended and Restated Certificate of Incorporation
10.72	Promissory Note dated July 1, 2002 from Robert S. Ehrlich to us
10.86	Consulting agreement dated January 1, 2004 between us and Edward J. Borey
10.87	Lease dated April 8, 1997, between AMR Holdings, L.L.C. and FAAC Incorporated
10.88	Lease dated as of March 22, 2004 between us and Fisk Building Associates L.L.C.
14	Code of Ethics
21	List of Subsidiaries of the Registrant
23	Consent of Kost, Forer, Gabbay & Kassierer
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	Written Statement of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Written Statement of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

</TABLE>

Exhibit 3.1.3

STATE OF DELAWARE

CERTIFICATE OF AMENDMENT

OF THE

AMENDED AND RESTATED

CERTIFICATE OF INCORPORATION

OF

ELECTRIC FUEL CORPORATION

Adopted in accordance with the provisions of
Section 242 of the General Corporation Law
of the State of Delaware

The undersigned, being respectively the Chairman and Secretary of Electric Fuel Corporation, a corporation existing under the laws of the State of Delaware (the "Corporation"), hereby certify as follows:

FIRST: The certificate of incorporation of the Corporation, as heretofore amended and restated (the "Certificate of Incorporation"), is hereby amended as follows:

By striking out Article ONE of the Certificate of Incorporation as it now exists and inserting in lieu and instead thereof a new Article ONE, reading in its entirety as follows:

ONE: The name of this corporation is Arotech Corporation.

SECOND: This amendment has been duly adopted at a meeting of the Board of Directors of the Corporation and at a meeting of the stockholders of the Corporation duly called and held, pursuant to notice in accordance with Section 222 of the General Corporation Law, by the vote of the holders of a majority of the outstanding stock of the Corporation entitled to vote thereon in accordance with the provisions of Section 242 of the General Corporation Law.

THIRD: The capital of the Corporation shall not be reduced under or by reason of this amendment.

IN WITNESS WHEREOF, the undersigned have executed this Certificate this 16th day of September, 2003.

Robert S. Ehrlich, Chairman and CEO

ATTEST:

Yaakov Har-Oz, Secretary

Exhibit 10.72

PROMISSORY NOTE

$36,500.00 New York, New York
July 1, 2002

FOR VALUE RECEIVED, Robert S. Ehrlich ("Maker") hereby promises to pay to the order of Electric Fuel Corporation ("EFC"), at 632 Broadway, New York, New York, or at such other place as may be designated in writing by EFC or any subsequent holder of this Note ("Holder"), the principal sum of Thirty-Six Thousand Five Hundred Dollars ($36,500.00), on July 1, 2012, together with simple interest from the date hereof on the principal amount from time to time unpaid at a per annum rate equal to the lesser of (i) 5.75%, and (ii) 1% over the then-current Federal Fund Rate, until the principal sum is paid in full. Interest will accrue on the loan until maturity.

All payments hereunder shall be made in United States Dollars only. Maker may prepay this Note at any time and from time to time without premium or penalty.

Maker will bear no personal liability on the principal and accrued interest of this Note.

In the event that the Maker files or has filed against the Maker any petition under any bankruptcy or insolvency law or for the appointment of a receiver or makes a general assignment for the benefit of creditors, then the entire unpaid principal of this note, together with accrued interest thereon, shall automatically become immediately due and payable. No failure by the holder to take action with respect to any default hereunder shall affect its subsequent rights to take action with respect to the same or any other default. In the event of default the Maker agrees to pay all reasonable costs of collection, including reasonable attorneys' fees, to the extent allowed by law.

This Note shall be secured by a pledge to EFC of 50,000 shares (the "Pledged Shares") of EFC's common stock, $0.01 par value, acquired with this note.

The recourse under this note shall only be to the Pledged Shares. EFC shall have all rights of a secured party under the Uniform Commercial Code as in effect in the State of New York, including without limitation all remedies available thereunder to a secured party in the event of a default in the performance of the obligation secured, with respect to the Pledged Shares, and Maker will take all actions reasonably requested by EFC to perfect such security interest, including without limitation delivering to EFC the stock certificate or certificates representing the Pledged Shares, together with stock powers duly endorsed in blank. EFC shall release its security interest in the Pledged Shares when all principal and interest owed hereunder have been paid in full. Notwithstanding the foregoing, EFC shall sell Pledged Shares per Maker's instructions from time to time, provided that with respect to any and each such sale EFC may withhold from the proceeds of such sale that percentage of the original principal and accrued but unpaid interest under this Note as the Pledges Shares sold shall bear to the original 50,000 Pledged Shares (so that if, for example, Maker instructs EFC to sell 14,000 Pledged Shares, EFC shall be entitled to withhold from the proceeds of such sale 28% of the original principal amount and accrued but unpaid interest under this Note).

The Maker hereby waives presentment, demand, notice of nonpayment, protest and all other demands, notices and defenses (other than payment) in connection with the delivery, acceptance, performance and enforcement of this note.

This Note shall be deemed to have been made under and shall in all respects be governed by the internal laws of the State of New York without reference to conflicts of laws. Maker consents to the exclusive jurisdiction of the courts in New York, New York with respect to any and all suits brought in connection with this Agreement, and waives any right to object to the personal or subject matter jurisdiction of such court and waives any right to move dismissal based on

grounds of forum non conveniens.

IN WITNESS WHEREOF, the undersigned has duly executed and delivered this Note as of the 1st day of July, 2002.

Robert S. Ehrlich

Exhibit 10.86

[AROTECH LOGO]

Arotech Corporation

632 Broadway, Suite 1200
New York, New York 10012
Tel: (646) 654-2107 Fax: (646) 654-2187
http://www.arotech.com
Writer's direct dial: +972-2-990-6612
Writer's direct fax: +972-2-990-6688
Writer's e-mail: ehrlich@arotech.com

Robert S. Ehrlich
Chairman, President and Chief Executive Officer

January 1, 2004

Mr. Edward J. Borey Mukilteo, Washington 98275-1125

Dear Ed:

Re: Consulting Agreement

The following confirms our understanding with regard to the terms and conditions of your retention by Arotech Corporation (you will hereinafter be referred to as the "Consultant" and Arotech Corporation will hereinafter be referred to as the "Company").

1. Retention of Consultant; Scope of Duties and Services.

(a) The Company hereby engages the Consultant and the Consultant hereby accepts such engagement and agrees to provide the Company with the such services as may be requested from time to time with the agreement of the parties hereto. The Consultant agrees that the services provided by him must be satisfactory to and approved by the Company, and that he will promptly remedy any deficiency at no additional cost or expense to the Company.

(b) The parties hereto agree that the services to be provided by the Consultant hereunder shall be as an independent consultant, and not as employee or agent. The parties further agree that any personnel of, or retained by, the Consultant who perform services hereunder are not and shall not be deemed to employees, agents or representatives of the Company. This Agreement shall not be construed to create the relationship of principal or agent, joint venturers, co-partners or any relationship other than that of independent Consultant and client, and the existence of any such other relationship is hereby expressly denied by the Company and the Consultant. Neither the Consultant nor any of his agents, employees, or representatives shall have any power or authority to bind the Company or to assume or to create any obligation or responsibility, expressed or implied, on behalf of or in the name of the Company.

(c) The Consultant acknowledges and agrees that he has the sole responsibility to pay any and all taxes due on fees received by him from the Company and to pay or withhold (as appropriate) all applicable social security, income withholding and other payroll or related taxes with respect to his employees, agents and other personnel who may perform services hereunder, and the Consultant shall file or cause to be filed all tax returns and all reports and keep all records which may be required by any law or regulation of the country or countries to whose laws he is subject or any state or municipality or governmental subdivision with respect to his activities and the activities of any of personnel working for him.

(d) The Consultant acknowledges that as a director of the Company, he owes the Company the highest fiduciary duty, and he will therefore (i) refrain from participating in the discussion or voting in any meeting of the Company's Board of Directors (the "Board") on any issue relating to this agreement or the scope of his consulting work with the Company, including without limitation any discussion of proposed acquisitions by the Company, whether or not such acquisition falls within the scope of his consulting work with the Company, and (ii) promptly disclose to the Board any conflict of interest or potential conflict of interest that he might have in connection with this Agreement on any other issue that may come before the Board. Furthermore, the Consultant acknowledges that as a result of this Agreement he will not be an "Independent Director" under applicable SEC and Nasdaq regulations and accordingly will be ineligible to sit on the Audit Committee or any other independent committee of the Board.

2. Term.

(a) The term of this Agreement shall commence on and as of the date hereof and shall continue for a period of one year unless sooner terminated as hereinafter provided. Notwithstanding the foregoing, all of the rights and remedies of the parties hereto under the terms of this Agreement and in law and in equity shall be preserved even after the termination or expiration of this Agreement.

(b) This Agreement may be terminated by either party for "cause" immediately following written notice thereof specifying the reasons for such termination. In the event that this Agreement is terminated by the Company for cause, the Consultant shall forfeit all rights to compensation for his services hereunder.

(c) As used in this Agreement, "cause" shall mean fraud, dishonesty, gross negligence or willful misconduct.

3. Fees and Expenses; Record Keeping.

(a) For all services rendered by the Consultant under this Agreement, the Company shall compensate the Consultant as follows:

- 32,000 shares of the Company's common stock, to be issued at par value, to be held by the Company in escrow and released in 8,000 share installments at the end of each of the next four fiscal quarters;

- Transaction fees in respect of acquisitions in which the Consultant plays a "critical role" (as determined by the Company in its sole and absolute discretion) in identifying and/or initiating and/or negotiating the transaction in the amount of (i) 1.5% of the value of the transaction up to $10,000,000, plus (ii) 1.0% of the value of the transaction in excess of $10,000,000 and up to $50,000,000, plus, (iii) 0.5% of the value of the transaction in excess of $50,000,000, minus (iv) the value of any common stock released from escrow as noted in the preceding paragraph, based on its value on the date of its release from escrow;

- Additional fees for services rendered in connection with acquisitions not identified or initiated by the Consultant, in amounts to be negotiated on a case-by-case basis between the Consultant and the Company;

provided, however, that the Company shall not be obligated to continue such payments in the event that this Agreement is terminated by the Company for cause (as defined in Section 2(c) above).

(b) The Consultant will be reimbursed for travel and lodging and other expenses pre-approved by the CEO of the Company. This pre-approval can be in the form of an email from the CEO of the Company to the Consultant upon appropriate e-mail request from the Consultant. The Consultant shall bear and be responsible

for all other costs and expenses incurred by him in performing his duties hereunder.

(c) The Consultant shall maintain complete and accurate accounting records to substantiate any charges for disbursements and any other expenses which are payable by the Company (if any). Such records shall include but not be limited to proper and adequate receipts, time and attendance records, payroll records and job summaries, and the Consultant shall retain such records for a period of three (3) years from the last date of payment hereunder.

4. Warranties.

(a) The Consultant warrants that all services provided by him hereunder will be rendered in a competent and professional manner and that such services will conform in all respects to (i) generally-accepted industry and professional standards then applicable to such services and products, (ii) all applicable laws, rules, regulations and professional codes, and (iii) any specifications and requirements applicable to the services and any products contracted for hereunder (including a delivery timetable) which may be set forth in an agreement between the Company and a third party or parties. The Company shall have the right to extend the Consultant's warranties herein to third parties and the Consultant shall be liable thereon to the same extent as if such warranties were originally made to such third parties.

(b) The warranties contained herein shall survive the termination and expiration of this Agreement regardless of the reasons therefor.

5. Confidential Information; Return of Materials; Inventions.

(a) In the course of his retention by the Company hereunder, the Consultant will have access to, and become familiar with, "Confidential Information" (as hereinafter defined) of the Company. The Consultant shall at all times hereinafter maintain in the strictest confidence all such Confidential Information and shall not divulge any Confidential Information to any person, firm or corporation without the prior written consent of the Company. For purposes hereof, "Confidential Information" shall mean all information in any and all medium which is confidential by its nature including, without limitation, data, technology, know-how, inventions, discoveries, designs, processes, formulations, models and/or trade and business secrets relating to any line of business in which the Company's marketing and business plans relating to current, planned or nascent products.

(b) The Consultant shall not use Confidential Information for, or in connection with, the development, manufacture or use of any product or for any other purpose whatsoever except as and to the extent necessary for him to perform his obligations under this Agreement.

(c) Notwithstanding the foregoing, Confidential Information shall not include information which the Consultant can evidence to the Company by appropriate documentation: (i) is in, or enters the public domain otherwise than by reason of breach hereof by the Consultant; (ii) is known by the Consultant at the time of disclosure thereof by the Company; or (iii) is rightfully transmitted or disclosed to the Consultant by a third party which owes no obligation of confidentiality with respect to such information.

(d) All Confidential Information made available to, or received by, the Consultant shall remain the property of the Company, and no license or other rights in or to the Confidential Information is granted hereby.

(e) All files, records, documents, drawings, specifications, equipment, and similar items relating to the business of the Company, whether prepared by the Consultant or otherwise coming into his possession, and whether classified as Confidential Information or not, shall remain the exclusive property of the Company. Upon termination or expiration of this Agreement, or upon request by the Company, the Consultant shall promptly turn over to the Company all such files, records, reports, analyses, documents, and other material of any kind concerning the Company which the Consultant obtained, received or prepared pursuant to this Agreement.

(f) Confidential Information shall not include information brought to the Company by the Consultant, where the Company does not subsequently utilize such information in the ordinary course of its business (including as a result of changes to its business).

(g) The provisions of this Section shall survive the termination of this Agreement. The Consultant acknowledges that the provisions set forth in this Section of this Agreement are fair and reasonable.

6. Miscellaneous.

(a) This Agreement shall inure to the benefit of the Company and its successors and assigns.

(b) This Agreement shall be subject to, governed by and construed in accordance with, the laws of the State of New York without regard to conflicts of law provisions and principles of that State, and the courts located in Manhattan, New York shall have exclusive jurisdiction of any dispute hereunder.

(c) This Agreement contains the entire agreement between the Consultant and the Company with respect to all matters relating to the Consultant's retention by the Company and will supersede and replace all prior agreements, written or oral, between the parties relating to the terms or conditions of Consultant's retention.

(d) Neither the Consultant nor the Company will be deemed to have made any representation, warranty, covenant or agreement except for those expressly set forth herein.

[AROTECH LOGO]

If the foregoing satisfactorily reflects the mutual understanding between you and the Company, kindly sign and return to the Company the enclosed copy of this letter. On behalf of the Company, I want to take this opportunity to state that we look forward to our working relationship with you.

Very truly yours,

AROTECH CORPORATION

By: _____
Robert S. Ehrlich
Chairman, President and CEO

ACCEPTED AND AGREED:

- _____
Edward J. Borey

Exhibit 10.87

LEASE AGREEMENT

VALLEY RANCH BUSINESS PARK
Ann Arbor, Michigan

THIS LEASE is made as of the 8th day of April, 1997, by and between AMR HOLDINGS, L.L.C., a Michigan limited liability corporation, the address of which is 1174 Oak Valley Drive, Ann Arbor, Michigan, as Lessor, and FAAC Corp., a Michigan corporation, the current address of which is 825 Victors Way, Ann Arbor, Michigan, as Lessee.

IN CONSIDERATION OF the rents to be paid and the mutual covenants, promises and agreements herein set forth, Lessor and Lessee agree as follows:

LESSOR hereby leases unto Lessee Lot 9 situated in the Township of Pittsfield, County of Washtenaw, State of Michigan, in a single story office/industrial building located at Valley Ranch Business Park (the "Building"), which development is shown on the site plan marked Exhibit "A".

TO HAVE AND TO HOLD for a term of Eighty Four (84) months from and after the commencement of the term as hereinafter provided.

SECTION 1
Construction of Building

Section 1.01: Lessor agrees, prior to commencement of the term of this Lease, to complete construction of the Leased Premises and related improvements on the site in accordance with the plans enumerated on Exhibit "C", attached hereto and made a part hereof, which shall be deemed part of the Building referred to above. The Leased Premises shall consist of an exterior approximately 13,704 square feet on one (1) floor. No minor change from such plans which may be necessary during construction shall affect, change, or invalidate this Lease. If Lessor shall be in good faith delayed in construction by any labor dispute, strike, lockout, fire, unavailability of material, weather, or casualty or any other cause beyond its reasonable control, then the period of delay necessarily caused thereby shall be added to the time limit provided for such construction.

SECTION 2 Possession and Commencement of Term

Section 2.01: Except as herein provided, Lessor shall deliver possession of the Leased Premises to Lessee on or before December 1, 1997. The Leased Premises shall be deemed ready for Lessee's occupancy when Lessor shall have substantially completed construction of said Leased Premises pursuant to the plans on Exhibit "A" and receive a temporary Certificate of Occupancy from the Township of Pittsfield. By occupying the Leased Premises, Lessee will be deemed to have accepted the Leased Premises and acknowledged that they are in the condition called for hereunder. Upon occupying the Leased Premises, the Lessee will provide the Lessor with a completed punchlist. The Lessor will complete the items not completed according to the term hereunder, in no later than 30 days. The rentals herein reserved and the term of this Lease shall commence on the date when the premises are delivered to Lessee as required hereunder. Lessor will require its contractors to cooperate with Lessee's installers of equipment trade fixtures, furnishings, and decorations attached to the real estate improvements to the maximum extent possible, but delay of or interference with construction caused by such installers shall not postpone the commencement of the term or the obligation to commence paying rent.

Section 2.02: In the event Lessor fails to deliver the Leased Premises on the commencement date because the Leased Premises are not then ready for occupancy, or because the previous occupant of said Leased Premises is holding over, or for any other cause whatsoever, except as provided in Section 1.01, Lessor shall not be liable to Lessee for damages, as a result of Lessor's delay in delivering such promises, and Lessee shall have no right to terminate the Lease or contest the validity of the Lease, and the commencement date of the _Lease shall be postponed until such time as the leased premises are ready for Lessee's occupancy, and the termination date of this Lease shall be extended for a period

equivalent to the period of such postponement, provided such postponed

termination date shall occur on the last day of a calendar month; if not, then such termination date shall be extended by an additional period so as to fall on the last day of such calendar month in which it would otherwise occur.
Section 2.03: On the commencement date, or within fifteen (15) days thereafter upon request by Lessor, Lessee shall execute a written instrument confirming the commencement date and the termination date of the Lease, that the Lease is in full force and effect, the rent is paid currently without any offset or defense thereto, the amount of rent, if any, paid in advance, and that there are no uncured defaults by Lessor, or stating those claimed by Lessee, provided that, such facts are accurate and ascertainable.

SECTION 3
Basic Rental

Section 3.01: In consideration of the leasing aforesaid, Lessee hereby covenants and agrees to pay Lessor, at such place as Lessor may hereafter from time to time designate in writing, a minimum net rental payable monthly in advance on the first day of each and every month in equal monthly installments as follows: Months 1 - 84 = $12.48 per square foot NNN, or $14,252.16 per month Receipt of Seven Thousand and 00/xx ($7,000.00) Dollars, representing a Security Deposit is hereby acknowledged. The rental payments shall be made by Lessee at the office of Lessor without any prior demand. therefore and without any deductions or set-offs whatsoever.

Section 3.02: Lessor and Lessee intend that the minimum net rental shall be net to Lessor, so that this Lease shall yield, net, to Lessor, not less than the minimum net rent specified in Section 3.01 hereof during the term of this Lease, and that all costs, expenses, and charges of every kind and nature relating to the Leased Premises which may be attributable to, or become due during the term of this Lease, shall be paid by Lessee, and that Lessor shall be indemnified and held harmless by Lessee from and against the same. Provided, however, that if the Lease term shall commence on a day other than the first day of a calendar month, then the rental for such month shall be prorated upon a daily basis based upon a thirty (30) day calendar month.

SECTION 4
Taxes, Assessments and Utilities

Section 4.01: Lessee agrees to pay Lessor its proportionate share of all taxes and assessments which have been or may be levied or assessed by any lawful authority, for any calendar year during the term hereof, against the land and Leased Premises presently and/or at any time during the term of this Lease comprising the Building. Lessee's proportionate share shall be equal to the product obtained by multiplying such taxes and assessments by a fraction, the numerator of which shall be the number of square feet of floor area in the Leased Premises, and the denominator of which shall be the total number of square feet of constructed leasable floor area in the Building. Any tax and/or assessment of any kind or nature presently or hereafter imposed by the State of Michigan or any political subdivision thereof or any governmental authority having jurisdiction there over upon, against or with respect to the rentals payable by tenants in the Building to Lessor or on the income of Lessor derived from the Building or with respect to the Lessor's, or the individuals or entities which form the Lessor herein, ownership of the land and buildings presently and/or at any time during the term of this Lease comprising the Building, either by way of substitution for all or any part of the taxes and assessments levied or assessed against such land and such buildings, shall be deemed to constitute a tax and/or assessment against such land and such buildings for the purpose of this Section, and Lessee shall be obligated to pay its proportionate share thereof as provided herein. In addition, Lessee shall also be obligated to pay any sales tax imposed by any governmental authority on the payments by Lessee or on the receipt by Lessor of any and all payments from Lessee. If the sales tax is separately assessed, then Lessee shall pay that amount imposed on the individual payments of Lessee; if the sales tax is not separately assessed, the Lessee shall pay its proportionate share monthly as provided herein.

Section 4.02: Lessee's share of all of the aforesaid taxes and assessments levied or assessed for or during the term hereof, as determined by Lessor, shall be paid in monthly installments on or before the first day of each calendar

month, in advance, in an amount estimated by Lessor, provided, that in the event Lessor is required under any mortgage covering the land and improvements leased to Lessee to escrow real estate taxes, Lessor may, but shall not be obligated to, use the amount required to be so escrowed as a basis for its estimate of the monthly installments due from Lessee hereunder. Upon receipt of all tax bills and assessment bills attributable to any calendar year during the term hereof, Lessor shall furnish Lessee with a written statement of the actual amount of Lessee's share of the taxes and assessments for such year. In the event no tax bill is available, Lessor will compute the amount of such tax. If the total amount paid by Lessee under this Section for any such year, as shown on such statement, Lessee shall pay to Lessor the difference between the amount paid by Lessee and the actual amount due, such deficiency to be paid within thirty (30) days after demand therefore by Lessor, and if the total amount paid by Lessee hereunder for such calendar year shall exceed such actual amount due from Lessee for such calendar year, such excess shall be credited against the next installment of taxes and assessments due from Lessee to Lessor hereunder. All amounts due hereunder shall be payable to Lessor at the place where the fixed annual rental is payable. For the calendar years in which this Lease commences and terminates, the provisions of this Section shall apply, and Lessee's liability for its proportionate share of any taxes and assessments for such years shall be subject to a pro rata adjustment based on the number of days of said calendar years during which the term of this Lease is in effect A copy of a tax bill or assessment bill submitted by Lessor to Lessee shall at all times be sufficient evidence of the amount of taxes and/or assessments assessed or levied against the property to which such bill relates. Prior to or at the commencement of the term of this Lease and from time to time thereafter throughout the term hereof; Lessor shall notify Lessee, in writing, or Lessor's estimate of Lessee's monthly installments due hereunder. Lessors and Lessee's obligations under this Section shall survive the expiration of the term of this Lease.

Section 4.03: Lessee also agrees to pay all charges made against the Leased Premises for gas, heat, electricity, and all other utilities separately metered during the continuance of this Lease as the same shall become due.

Section 4.04: In the event any or all of the foregoing utilities are to be paid from an escrowed fund required to be established by Lessor or its financial institution under the terms of any financing, the Lessor shall notify Lessee and Lessee shall be required to include with the additional monthly payments referred to in Section 4.02 a monthly amount to satisfy the estimated monthly utility costs. If the utilities, when due, exceed the total amount then in the utility escrow, then the Lessee shall, upon demand, pay any deficiency to Lessor. If such payments by Lessee, over the term of the Lease, exceed the amount of utilities paid from the escrow, such excess shall be refunded by Lessor to Lessee at the expiration of the Lease term, or when such excess is refunded by the financial institution to Lessor, whichever first occurs. The utility escrow shall be adjusted as often as necessary to provide sufficient funds to pay current utilities.

SECTION 5
Use of Premises

Section 5.01: It is understood and agreed between the parties, that the Leased Premises, during the continuance of this Lease, shall be used and occupied for office, research and storage use only and for no other purpose without the prior written consent of Lessor. Lessee agrees that it will not use or permit any person to use the Leased Premises or any part thereof for any use or purpose in violation of the laws of the United States, the State of Michigan, the ordinances or other regulations of the Township of Pittsfield or of any other lawful authorities. During the original term or any extended term, the Lessee will keep the Leased Premises and every part thereof and the area adjacent to the Leased Premises (including service areas), orderly, neat, safe, and clean and free from rubbish and dirt, and at all times shall store all trash, garbage, or any other material solely within the leased premises and Lessor shall arrange for the regular pickup of such trash and garbage at Lessee's expense. Lessee shall not bum any trash or garbage at any time in or about the building. If Lessor shall provided any services or facilities for such pickup, then Lessee shall be obligated to use the same and shall pay a proportionate share of the actual cost thereof within ten (10) days after being billed therefor. Lessee shall not store or leave any material outside of the building at any time. All signs and advertising displayed in and about the Leased Premises shall be such

only as to advertise the business carried on upon the Leased Premises, and

Lessor shall control the location, character, and size thereof. No signs shall be displayed except as approved in writing by the Lessor, and no awning shall be installed or used on the exterior of said building unless approved in writing by the Lessor.

SECTION 6
Operation and Maintenance of Common Areas

Section 6.01: Lessor agrees, at Lessors sole cost and expense, to construct the building and hard surface, to properly drain, landscape, and light a parking area or parking areas, all substantially as shown on Exhibit "A". Lessor further agrees to cause to be operated, managed, and maintained during the term of this Lease, all parking areas, roads, sidewalks, landscaping, drainage, and common area lighting facilities in the Building. The manner in which such areas and facilities shall be maintained and operated, and the expenditures therefore, shall be at the sole discretion of the Lessor, and the use of such areas and facilities shall be subject to such reasonable regulations as Lessor shall make from time to time.

Section 6.02: Lessee agrees to pay to Lessor in the manner hereinafter provided, but not more often than once each month, Lessee's proportionate share of all costs and expenses of every kind and nature paid or incurred by Lessor in operating, equipping, policing and protecting, lighting, insuring, repairing, replacing, and maintaining the common areas of the Building. Such costs and expenses shall include, but not be limited to, illumination and maintenance of the Building signs, cleaning, lighting, line painting and landscaping, premiums liability and property insurance. Any utilities furnished or supplied to common areas of the Building which are not separately metered shall be considered a cost to maintain the common areas and shall be included as part of such cost. For the purpose hereof, any charges for utilities contained in the foregoing costs and expenses shall be at the same rates as the rates for comparable service from the applicable utility company serving the area in which the Building is located. The proportionate share to be paid by Lessee shall be computed on the basis that the total number of square feet of floor area in the Leased Premises bears to the total number of square feet of the Building. .
Lessee's proportionate share of such costs and expenses for each lease year and partial lease year shall be paid in monthly installments on the first day of each month, in advance, in an amount established by Lessor. Within one hundred eighty (180) days after the end of each lease year or partial lease year, Lessor shall furnish Lessee with a statement of the actual amount of Lessee's proportionate share of such costs and expenses for such period. If the total amount paid by Lessee under this Section for any calendar year shall be less than the actual amount due from Lessee for such year as shown on such statement, Lessee shall pay to lessor the difference between the amount paid by Lessee and the actual amount due, such deficiency to be paid within thirty (30) days after the furnishing of each such statement, and if the total amount paid by Lessee hereunder for any such calendar year shall exceed such actual amount due from Lessee for such calendar year, such excess shall be credited against the installment due from Lessee to Lessor under this Section 6.02.

SECTION 7
Maintenance and Repairs of Leased Premises

Section 7.01: Lessor shall keep and maintain the foundation, exterior walls, and roof of the Building in which the Leased Premises are located and the structural portions of the Leased Premises which were originally installed by Lessor, exclusive of door, door frames, door checks, windows, and exclusive of window frames located in exterior building walls, in good repair, except that Lessor shall not be called upon to make any such repairs occasioned by the act or negligence of Lessee, its agents, employees, invitees, licensees, or contractors, except to the extent that Lessor is reimbursed therefore under any policy of insurance permitting waiver of subrogation in advance of loss. Lessor shall not be called upon to make any other improvements or repairs of any kind upon said premises and appurtenances, except as may be required under Section 11 and 12 hereof.

Section 7.02: Except as provided in Section 7.01 of this Lease, Lessee shall keep and maintain in good order, condition and repair (including replacement of parts and equipment if necessary) the Leased Premises and every part thereof and any and all appurtenances thereto wherever located, including, but without

limitation, the exterior and interior portion of all doors, door checks,

windows, plate windows, store front, all plumbing and sewage facilities within the Leased Premises, including free flow up to the main sewer line, fixtures, heating and air conditioning, and electrical systems (whether or not located in the Leased Premises), sprinkler system, walls, floors, and ceilings. The plumbing and sewage facilities shall not be used for any other purpose than that for which they are constructed, and no foreign substance of any kind shall be introduced therein. Lessee hereby agrees to be responsible for any expenses incurred in connection with any breakage, stoppage, or damage resulting from a violation of this provision by Lessee, its agents, employees, invitees, licensees, or contractors.

Lessor shall be responsible for all costs, as long as such costs are not due to the negligence of Lessee, related to the following: (1) replacement of the main electrical distribution panel if such panel cannot be repaired but rather needs complete replacement; (2) the roof-top H.V. A.C. units, if such components cannot be repaired but rather such H.V.AC. units need complete replacement, and (3) if the underground sewer or water system shall burst or break. Lessee shall keep and maintain the Leased Premises in a clean, sanitary, and safe condition in accordance with the laws of the State of Michigan and in accordance with all direction, rules, and regulations of the health office, fire marshall, building inspector, or other proper officials of the governmental agencies having jurisdiction, at the sole cost and expense of Lessee, and Lessee shall comply with all requirements of law, ordinance, and otherwise, affecting said Leased Premises. If Lessee refuses or neglects to commence or complete repairs required by Section 7.02 hereof promptly and adequately, Lessor may, but shall not be required to do so, make all or any part of said repairs, and Lessee shall pay the cost thereof to Lessor upon demand, non-payment of which shall entitle Lessor to exercise any remedy available to it in the event of the non-payment by Lessee of rental or any other charge due to Lessor under this Lease. At the time of the expiration of the tenancy created herein, Lessee shall surrender the premises in good condition, reasonable wear and tear, loss by fire, or other unavoidable casualty excepted.

Lessee, at its own expense, shall maintain fire extinguishers and other fire protection devices as may be required from time to time by any agency having jurisdiction thereof and the insurance underwriters insuring the building in which the Leased Premises are located.

Section 7.03: All damages or injury done to the Leased Premises by the Lessee, or by any person who may be in or upon the Leased Premises with the consent, invitation or license of the Lessee, shall be repaired and paid for by the Lessee.

SECTION 8
Alterations

Section 8.01: Lessee agrees that the Leased Premises shall not be altered, improved, or changed without the written consent of Lessor, and that unless otherwise provided by written agreement, all alterations, improvements, and changes which may be desired by the Lessee and so consented to by the Lessor shall be done either by or under the direction of the. Lessor, but at the cost of Lessee. All alterations, additions, and improvements made in or to the Building or the Leased Premises, except movable office furniture put in at the expense of the Lessee and removable without defacing or injuring the building or Leased Premises, shall, unless otherwise provided by written agreement, be the property of Lessor and remain upon and be surrendered with the Leased Premises; provided, however, the Lessor will designate by written notice to Lessee those alterations, additions, and improvements which shall be removed by Lessee at the expiration or termination of the Lease, and Lessee shall promptly remove the same and repair any damage to the Leased Premises caused by such removal.

SECTION 9
Liens

Section 9.01: Lessee shall keep the Leased Premises free from any and all liens arising out of any work performed, materials furnished, or obligations incurred by or for Lessee, and agrees to bond against or discharge any mechanic's or material-men's lien within ten (10) days after written request therefore by Lessor. Lessee shall reimburse Lessor for any and all costs and expenses which may be incurred by Lessor by reason of the filing of any such liens and/or the removal of same, such reimbursement to be made within ten (10) days after receipt by Lessee from Lessor of a statement setting forth the amount of such costs and expenses. The failure of Lessee to pay any such amount to Lessor

within said ten (10) day period shall carry with it the same consequences as failure to pay any installment of rental.

SECTION 10
Insurance and Indemnity

Section 10.01: Lessee shall, during the entire term hereof, keep in full force and effect a policy of public liability and property damage insurance with respect to the Leased Premises, and the business operated by Lessee and any subtenants of Lessee in the Leased Premises, including steam boiler insurance if applicable, in which the limits of public liability shall be not less than One Million Dollars ($1,000,000.00) per occurrence, and in which the limit of property damage liability shall be not less than Five Hundred Thousand Dollars ($500,000.00). The policy shall name Lessor, any other parties in interest designed by Lessor, and Lessee as insured, and shall contain a clause that the insurer will not cancel or change the insurance without first giving the Lessor thirty (30) days prior written notice. Such insurance may be furnished by Lessee under any blanket policy carried by it or under a separate policy therefor. The insurance shall be with an insurance company approved by Lessor and a copy of the paid-up policy evidencing such insurance or a certificate of insurer certifying to the issuance of such policy shall be delivered to Lessor prior to commencement of Lease Term and upon renewals not less than thirty (30) days prior to the expiration of such coverage.

Section 10.02: Lessor agrees, during the term hereof, to carry insurance against fire, vandalism, malicious mischief, and such other perils as are from time to time included in a standard extended coverage endorsement and, at Lessor's option, special extended coverage endorsements including rental interruption insurance equal to twelve (12) full months of rental and tax obligations, insuring the improvements of the Building in an amount determined solely by Lessor, but not less than one hundred percent (100%) of the full replacement cost, if available, and with or without deductible, at the option of Lessor. Lessee agrees, from time to time, to pay Lessor, Lessee's proportionate share of the cost of such insurance, such payment to be made within ten (10) days after receipt of a written statement from Lessor setting forth such cost. The proportionate share to be paid by Lessee shall be computed on the basis that the total number of square feet of floor area in the Leased Premises bears to the total number of square feet of constructed leasable floor area in the Building. Lessee shall not carry any stock of goods or do anything in or about said Leased Premises which will in any way tend to increase the insurance rates on said Leased Premises and/or the Building of which they are a part. If Lessee installs any electrical equipment that overloads the lines in the Leased Premises, Lessee shall, at its own expense, make whatever changes are necessary to comply with the requirements of the insurance underwriters and governmental authorities having jurisdiction.

Section 10.03: Lessee covenants to indemnify Lessor, and save it harmless (except for loss or damage resulting from the negligence of Lessor, its agents,` or employees) from and against any and all claims, action, damages, liability, and expense, including attorney's fees, in connection with loss of life, personal injury, and/or damage to property arising from or out of any occurrence in, upon, or at the Leased Premises or the occupancy or use by Lessee of the Leased Premises or any part thereof, or arising from or out of Lessee's failure to comply with Section 7.02 hereof, or occasioned wholly or in part by any actor omission of Lessee, its agents, contractors, employees, servants, customers, or licensees. For the purpose hereof, the Leased Premises shall include the service areas adjoining the same and the loading platform area allocated to the use of Lessee. In case Lessor shall, without fault on its part, be made a party to any litigation commenced by or against Lessee, then Lessee shall protect and hold Lessor harmless, and shall pay all costs, expenses, and reasonable attorneys' fees incurred or paid by Lessor in connection with such litigation. Lessee shall also pay all of Lessor's costs, expenses, and reasonable attorneys' fees that may be incurred by Lessor in enforcing the Lessee's covenants and agreements in this Lease.

SECTION 11
Destruction of Leased Premises

Section 11.01: In the event the Leased Premises shall be partially or totally destroyed by fire or other casualty insured under the insurance carried by

Lessor pursuant to Section 10.02 of this Lease, as to become partially or totally untenantable, the damage to the Leased Premises shall promptly be repaired by Lessor, to the extent of any proceeds received from any insurance, unless Lessor shall elect not to rebuild as hereinafter provided, and a just and proportionate part of the fixed minimum rental and all other charges shall be abated, annually, until so repaired. The obligation of Lessor hereunder shall be limited to reconstruction of the Leased Premises in accordance with the initial plans and specifications for the construction of the Leased Premises. In no event shall Lessor be required to repair or replace Lessee's merchandise, trade fixtures, furnishings, or equipment If more than thirty-five (35%) percent of the Leased Premises or more than thirty-five (35%) of the floor area of the Building in which the Leased Premises are located shall be destroyed by fire or other casualty, then Lessor may elect either to repair or rebuild the Leased Premises or the Building of which the Leased Premises are a part, as the case may be, or to terminate this Lease by giving written notice to Lessee of its election to so terminate, such notice to be given within sixty (60) days after the occurrence of such damage or destruction. If Lessor elects to restore the Leased Premises, Lessor shall do so within one hundred eighty (180) days after giving notice to Lessee of such election. If Lessor fails to tender possession to Lessee after the one hundred eighty (160) days, Lessee shall have the option of terminating this Lease by sending notice on the one hundred eightieth (180th) day to Lessor. Such notice shall inform Lessor of Lessee's election to terminate.

Section 11.02: Each party hereto does hereby remise, release, and discharge the other party hereto and any officer, agent, employee, or representative of such party, of and from any liability whatsoever hereafter arising from loss, damage, or injury caused by fire or other casualty from which insurance (permitting waiver of liability and containing a waiver of subrogation) is carried by the injured party at the time of such loss, damage, or injury to the extent of any recovery by the injured party under such insurance.

SECTION 12
Eminent Domain

Section 12.01: In the event, during the term of this Lease, proceedings shall be instituted under the power of eminent domain which shall result in the taking of any part of the Leased Premises or the floor area of the Building in which the Leased Premises are a part, or the taking of a material portion of the parking area so that the number of spaces is thereby reduced to such an extent that Lessee's business is significantly and adversely affected, and which shall result in an eviction total or partial of the Lessee therefrom, then at the time of such eviction, this Lease shall be void and the term above demised shall cease and terminate; and if Lessee shall thereafter continue in possession of the Leased Premises or any part thereof, it shall be a Lease from month to month and for no longer term, anything in this instrument to the contrary notwithstanding. If there is only a partial taking, not including a portion of the Building but reducing the parking to the extent described in the previous sentence, the Lessor shall restore the parking to the extent necessary to permit Lessee to continue the use of the premises and there shall be no reduction in the monthly rental. Provided, further, that the whole of any award for any portion of the Building taken by reason of said condemnation proceedings shall be the sole property of, and be payable to, the Lessor, and provided, further, that the whole of any award for loss of business and for removal and relocation expenses in any condemnation proceedings shall be the sole property of, and be payable to, the Lessee. It is further agreed that in any such condemnation proceedings, the Lessor and Lessee shall each seek its own award at its own expense.

SECTION 13
Assignment

Section 13.01: Lessee shall not assign or sublet the Leased Premises or any part thereof without first obtaining the Lessor's written consent, except that the Lessee may, without Lessors consent, assign or sublet all or any of the part of the premises to wholly or substantially owned subsidiaries of the Lessee, for a use permitted pursuant to Section 5.01 hereof, and provided that Lessee is not at such time in default hereunder, and provided further that such successor shall execute an instrument in writing assuming all of the obligations and liabilities to the Lessor, and provided further that such assignment or subletting shall not operate to release Lessee from any of its obligations under

the Lease.

SECTION 14
Inspection of Premises

Section 14.01: Lessee agrees to permit Lessor and the authorized representatives of Lessor to enter the Leased Premises at all reasonable times during business hours for the purpose of inspecting the same.

SECTION 15
Fixtures and Equipment

Section 15.01: All fixtures and equipment paid for by the Lessor and all fixtures and equipment which may be paid for and placed on the Leased Premises by the Lessee from time to time, but which are so incorporated and affixed to the Building that their removal would involve damage or structural change to the Building, shall be and remain the property of the Lessor.
Section 15.02: All furnishings, equipment, and fixtures other than those specified in Section 15.01, which are paid for and placed on the Leased Premises by Lessee from time to time (other than those which are replacements for fixtures originally paid for by Lessor) shall remain the property of the Lessee.

SECTION 16
Notice or Demands

Section 16.01: All notices to or demands upon Lessor or Lessee desired or required to be given under any of the provisions hereof shall be in writing. Any notices or demands from Lessor to Lessee shall be deemed to have been duly and sufficiently given if a copy thereof has been mailed by United States mail in an envelope properly stamped and addressed to Lessee, at the address of the Leased Premises, or at such other address as Lessee may have last furnished in writing to Lessor for such purpose, and any notices or demands from Lessee to Lessor shall be deemed to have been duly and sufficiently given if mailed by United States mail in an envelope properly stamped and addressed to Lessor at the address last furnished by written notice from Lessor to Lessee. The effective date of such notice shall be one (1) business day following the delivery of the same to the United States Post Office for mailing.

SECTION 17
Bankruptcy

Section 17.01: Lessee covenants and agrees that if any one or more of the following events occur, namely: (a) Lessee shall be adjudged a bankrupt or insolvent or trustee shall be appointed for Lessee after a petition has been filed for Lessee's reorganization or arrangement under the Federal Bankruptcy Laws, as now or hereafter amended, or under the laws of any State, and any such adjudication or appointment shall not have been vacated or stayed or set aside within thirty (30) days from the date of the entry or granted thereof; or (b) Lessee shall file, or consent to any petition in bankruptcy or arrangement under the Federal Bankruptcy Laws, as not or hereafter amended, or under the laws of any State; or 8 A decree or order appointing a receiver of the property of Lessee shall be made and such decree or order shall not have been vacated, stayed or set aside within thirty (30) days from the date of the entry or granted thereof, or Lessee shall apply for or consent to the appointment of a receiver for Lessee; or (d) Lessee shall make any assignment for the benefit or credits; then it.shall be lawful for Lessor, at his election, to declare a default as hereinafter defined and the term of the Lease ended.

SECTION 18
Default, Re-entry, and Damages

Section 18.01: In case any rent or other payments required to be made by Lessee shall be due and remain unpaid for more than ten (10) days after due, or if default be made in any of the other covenants, agreements, stipulations, or conditions herein contained and such default shall continue for a period of thirty (30) days after written notice of such default, or if the leased premises shall be deserted, or vacated, or if Lessee is declared bankrupt or insolvent as

detailed in Section 17.01 herein, Lessor, in addition to other rights or remedies it may have, shall have the immediate right of re-entry and may remove all persons and property from the Leased Premises pursuant to applicable Michigan law, such property may be removed and stored in any other place in the

Building in which the Leased Premises are situated, or in any other place, for the account of, and at the expense and at the risk of Lessee. Lessee hereby waives all claims for damages which may be caused by the re-entry of Lessor and taking possession of the Leased Premises or removing or storing of furniture and property as herein provided, and will hold Lessor harmless from any and all losses, costs, or damages occasioned Lessor thereby, and no such re-entry shall be considered or construed to be a forcible entry.

Section 18.02: Should Lessor elect to re-enter as herein provided, or should it take possession pursuant to legal proceedings or pursuant to any notice provided for by law, it may either terminate this lease or it may, from time to time, without terminating this Lease, re-let the Leased Premises or any part thereof for such term or terms and at such rental or rentals and upon such other terms and conditions as Lessor, in its sole discretion, may deem advisable, with the right to make alterations and repairs to the Leased Premises. Rentals received by Lessor from such re-letting shall be applied as follows: First, to the payment of any indebtedness, other than rent due hereunder from Lessee to Lessor, including all damages sustained by Lessor as a result of the default of Lessee; Second, to the payment of rent or other payments required of Lessee for taxes, insurance, or utilities due and unpaid hereunder,

Third, to the payment of any other sum specified in Section 3.02 hereof;

Fourth, to the payment of any cost of such re-letting;

Fifth, to the payment of the cost of any alterations or repairs to the Leased Premises; and the residue, if any, shall be held by Lessor and applied in payment of further rent, as the same may become due and payable hereunder. Should such rentals received from such re-letting during any month be less than the amount agreed to be paid that month by Lessee hereunder, the Lessee shall pay such deficiency to Lessor. Such deficiency shall be calculated and paid monthly.

No such re-entry or taking possession of the Leased Premises by Lessor shall be construed as an election on its part to terminate this Lease unless a written notice of such intention be given to Lessee or unless the termination thereof be decreed by a court of competent jurisdiction. Notwithstanding any such re-letting without termination, Lessor may, at any time thereafter, elect to terminate this Lease for such previous breach. Should Lessor, at any time, terminate this Lease for any breach, in addition to any other remedy, it may recover, from Lessee all damages it may incur by reason of such breach, including the cost of recovering the Leased Premises, and including the worth at the time of such termination of the excess, if any, of the amount of rent and other payments required of Lessee hereunder and charges equivalent to rent reserved in this Lease for the remainder of the stated term, over the then reasonable rental value of the premises for the remainder of the stated term.

SECTION 19
Surrender of Premises on Termination

Section 19.01: Whenever this Lease shall be terminated, whether by lapse of time, forfeiture, or in any other way, Lessee will yield and deliver up the Leased Premises, including the Building and improvements thereon and the fixtures and equipment belonging to lessor therein contained, peaceably to Lessor in as good repair as when taken, except for reasonable and normal wear and tear.

SECTION 20
Performance by Lessor of the Covenants of Lessee

Section 20.01: Should Lessee at any time fail to do any of the things required to be done by it under the provisions of this Lease, Lessor, at its option and in addition to any and all other rights and remedies of Lessor in such event, may (but shall not be required to) do the same or cause the same to be done, and the reasonable amount of any money expended by Lessor in connection therewith shall be due from Lessee to Lessor as additional rent on or before the next rental due date, bearing interest at the rate of one and one half (1.5%) percent per month from the date of payment until the repayment thereof to Lessor by Lessee. On default of such payment, Lessor shall have the same remedies as on default in the payment of rent.

SECTION 21

Rights to Mortgage

Section 21.01: Lessor reserves the right to subject and subordinate this Lease, at all times, to the lien of any mortgage or mortgages now or hereafter placed upon Lessor's interest in the said Leased Premises and on the land and Buildings of which the said Leased Premises are a part or upon any Buildings hereafter placed upon the land of which the Leased Premises form a part. Lessee covenants and agreed to execute and deliver, upon demand, such further instrument or instruments subordinating this Lease to the lien of any such mortgage or mortgages as shall be desired by Lessor and any mortgagees or proposed mortgage, and hereby irrevocably appoints Lessor the attorney-in-fact of Lessee to execute in compliance with this Section 21.01 and deliver any such instrument or instruments for and in the name of Lessee. Lessor acknowledges that Lessee shall be permitted to remain in possession of the Premises under the terms of this Lease as long as Lessee is not in default under the terms of this Lease or any subordination.

SECTION 22
Covenants of Quiet Enjoyment

Section 22.01: Lessor covenants and agrees to and with Lessee that, at all times when Lessee is not in default under the terms of and during the term of this Lease, Lessee's quiet and peaceable enjoyment of the Leased Premises shall not be disturbed or interfered with by Lessor or any person claiming by, through, or under Lessor.

SECTION 23
Security Deposit

Section 23.01: Pursuant to Section 3.01 hereof, Lessee shall deposit the sum of Seven Thousand and 00/xx Dollars ($7,000.00) which Lessor agrees to retain as security for the faithful performance of all of the covenants, conditions, and agreements of this Lease, but in no event shall the Lessor be obliged to apply the same upon rents or other charges in arrears, or upon damages for the Lessee's failure to perform the said covenants, conditions, and agreements; the Lessor may so apply the security at its option; and the Lessor's right to the possession of the premises for nonpayment of rent or for any other reason shall not in any event be affected by reason of the fact that the Lessor holds this security. The said sum, if not applied toward the payment of rent or other charges in arrears, or toward the payment of damages suffered by Lessor by reason of the Lessee's breach of the covenants, conditions, and agreements of this Lease, shall be returned to the Lessee when this Lease is terminated, according to these terms, and in no event is the said security to be returned until the Lessee has vacated the premises, delivered possession to the Lessor, and Lessor has inspected said premises.

In the event that the Lessor repossesses itself of the said premises because of the Lessee's default or because of the Lessee's failure to carry out the covenants, conditions, and agreements of the Lease, the Lessor may apply the said security upon all damages suffered to the date of said repossession and may retain the said security to apply upon such damages as may be suffered or shall accrue thereafter by reason of the Lessee's default or breach. The Lessor shall not be obliged to keep the said security as a separate fund, but may mix the said security with its own funds and there shall be paid no interest on said security deposit.

SECTION 24
Holding Over

Section 24.01: In the event of Lessee herein holding over after the termination. of this Lease, thereafter the tenancy shall be from month to month in the absence of a written agreement to the contrary subject to all the conditions, provisions and obligations of this Lease insofar as the same are applicable to a month to month tenancy, but at a monthly rental of one hundred percent (125%) of the monthly rental stipulated in Section 3.

SECTION 25
Remedies Not Exclusive; Waiver

Section 25.01: Each and every of the rights, remedies, and benefits provided by this Lease shall be cumulative, and shall not be exclusive of any other of said rights, remedies and benefits, or of any other rights, remedies, and benefits

allowed by law.

Section 25.02: One or more waivers of any covenant or condition by Lessor shall not be construed as a waiver of a further or subsequent breach of the same covenant of condition, and the consent or approval by Lessor to or of any act by Lessee requiring Lessors consent or approval shall not be deemed to waive or render unnecessary Lessors consent or approval to or of any subsequent similar act by Lessee.

SECTION 26
Right to Show Premises

Section 26.01: The Lessee hereby agrees that, for a period commencing one hundred eighty (180) days prior to the termination of this Lease, the Lessor may show the Leased Premises and building to prospective Lessees, and one hundred eighty (180) days prior to the termination of this Lease, Lessor may display about said Leased Premises the usual and ordinary "For Lease" signs.

SECTION 27
Lessee's Property

Section 27.01: Lessee shall be responsible for and shall pay before delinquency all municipal, county, state, and federal taxes assessed during the term of this Lease against any lease-hold interest or personal property of any kind, owned by or placed in, upon, or about the leased premises by the Lessee.

Section 27.02: The Lessor shall not be responsible or liable to the Lessee for any loss or damage that may be occasioned by or through the acts or omissions of persons occupying adjoining premises, or any part of the Leased Premises adjacent to or connected with the Leased Premises hereby leased, or any part of the Building of which the Leased Premises are a part, or for any loss or damage resulting to the Lessee or its property from bursting, stoppage, or leaking of water, gas, sewer, or steam pipes, or for any damage or loss of property on or within the Leased Premises from any cause whatsoever.

SECTION 28
Renewal Option

Section 28.01: The Lessee will have one five year option to renew this Lease, if at the time of renewal, the Lessee is not in default under the terms of this Lease, the Lessee can exercise this option in a written notification to the Lessor 8 months before the termination of this Lessee, with the understanding that all terms of this Lease will remain except that the monthly rental rate will be renegotiated. The new rate will not exceed 125% of the original rate. Additionally, the Lessee will receive a $5 per square foot allowance for tenant improvements upon exercising the option.

SECTION 29
Future Expansion

Section 29.01: During the term of this Lease, the Lessee has the option of requesting an expansion of up to 5,000 square feet as shown on Exhibit (degree)A". The Lessor is obligated to build the expansion according to Lessee requirement's, so long as both Lessor and Lessee agree on the cost and method of payment of such said improvements. Costs will be based on true expenses plus ten percent (10%) profit. The method of payment will use a twenty (20) year amortization calculation for shell costs and an amortization calculation equal to the actual remaining term for the leasehold improvement costs.

SECTION 30
Miscellaneous

Section 28.01: This Lease shall be governed by and construed in accordance with the laws of the State of Michigan. If any provisions of this Lease or the application thereof to any person or circumstances shall, to any extent, be invalid or unenforceable, the remainder of this Lease shall not be affected thereby, and each provision of the Lease shall be valid and enforceable to the fullest extent permitted by the law.

Section 28.02: The captions of this Lease are for convenience only, and are not to be construed as part of this Lease, and shall not be construed as defining or limiting, in any way, the scope of intent of the provisions hereof.

Section 28.03: Whenever herein the singular member is used, the same shall include the plural, and the masculine gender shall include the feminine and neuter genders.

Section 28.04: This Lease shall constitute the entire agreement of the parties hereto; all prior agreements between the parties, whether written or oral, are merged herein and shall be of no force and effect. This lease cannot be changed, modified, or discharged orally, but only by an agreement in writing, signed by the party against whom enforcement of the change, modification, or discharge is sought.

Section 28.05: If Lessor shall fail to perform any covenant, term, or condition of this Lease upon Lessors part to be performed, and if as a consequence of such default Lessee shall recover a money judgment against Lessor, such judgment shall be satisfied only out of the proceeds of sale received upon execution of such judgment and levie thereon against the right, title, and interest of Lessor in the Building and property of which the Leased Premises are a part and out of the rents or other income from such property receivable by Lessor, and neither Lessor nor any of the members comprising. the limited liability corporation which is the Lessor herein shall be liable for any deficiency.

Section 28.06: In the event any proceedings are brought for the foreclosure of or in the event of exercise of the power of sale under any mortgage made by Lessor covering the leased premises, Lessee shall, at the option and request of Purchaser, attom to the Purchaser upon any such foreclosure or sale and recognize such Purchaser as the Lessor under this Lease.

Section 28.07: In the event of any transfer or transfers of Lessor's interest in the Premises, the transferor shall be automatically relieved of any and all obligations and liabilities on the part of Lessor accruing from and after the date of such transfer. Lessor acknowledges that the obligation of the Lessor under this Lease shall be transferred to the party receiving the interest of Lessor.

Section 28.08: All rights and liabilities herein given to or imposed upon the respective parties hereto shall extend to and bind the several respective heirs, executors, administrators, successors, and assigns of the said parties; and if there shall be more than one Lessee, they shall all be bound jointly and severally by the terms, covenants, and agreements herein. No rights, however, shall inure to the benefit of any assignee of Lessee unless the assignment to such assignee has been approved by Lessor, in writing, as provided in Section 13.01 hereof.

Section 28.09: This agreement shall inure to the benefit of and be binding upon the parties hereto, their respective heirs, administrators, executors, representatives, successors, and permitted assigns.

Section 28.10: No payment by Lessee or receipt by Lessor of a lesser amount than the monthly rent herein stipulated shall be deemed to be other than on account of the earliest stipulated rent, nor shall any endorsement or statement on any check or any letter accompanying any check or payment as rent be deemed an accord and satisfaction, and Lessor shall accept such check or payment without prejudice to Lessor's right to recover the balance of such rent or pursue and other remedy in this Lease.

Section 28.11: The submission of this Lease for examination does not constitute a reservation of or option for the Leased Premises. This Lease shall become effective only upon execution and delivery thereof by Lessor to Lessee.

SECTION 29
Environmental

Section 29.01: Lessee shall neither generate, store, discharge nor bury any toxic or hazardous waste or substance or material or any chemicals or substances which are either toxic or hazardous at or upon the Leased Premises and Building, as the terms "toxic" or "hazardous" are defined under all currently existing or future applicable federal, state or local environmental laws, Lessor and Lessee understand and acknowledge, however, that Lessee may utilize certain substances or materials in the Leased Premises incidental to its operations which are or may be classified as hazardous or toxic substances, such as cleaning solvents, degreasing agents, adhesives, greases, oils and lubricants, and the like. All

such substances may be utilized and stored in proper containers only temporarily on the Leased Premises and shall be properly disposed of and transported off the Leased Premises in compliance with all applicable environmental and other laws and ordinances.

All other substances which are non-toxic or non-hazardous shall be stored in proper containers. No substances or materials shall be stored outside of the Building which constitutes the Leased Premises without Landlord's prior written approval. Tenant shall forever indemnify and hold harmless and defend Landlord, its successors and assigns and any mortgagee from and against all loss, damage, claim and expense, including attorney's fees, incurred in connection with the generation, burial, storage or disposal by Tenant of said hazardous or toxic substances upon the Premises, and such indemnification shall survive the expiration or termination of this Lease or any extensions.

IN WITNESS WHEREOF, the Lessor and Lessee have executed this Lease as of the date set forth at the outset hereof.

WITNESS: LESSOR:
AMR HOLDINGS, L.L.C.
a Michigan Lim Limited Liability Corporation

LESSEE:
FAAC Corp.
A Michigan Corporation

Exhibit 10.88

AGREEMENT OF LEASE

FISK BUILDING ASSOCIATES L.L.C., Landlord

and

AROTECH CORPORATION, Tenant

Premises: The Fisk Building - Suite 310
250 West 57th Street
New York, New York

Date: As of March 22, 2004

LEASE made as of the 22nd day of March, 2004, between FISK BUILDING ASSOCIATES L.L.C., a New York limited liability company, with an address at 250 West 57th Street, New York, New York 10107, hereinafter referred to as "Landlord", and AROTECH CORPORATION, a Delaware corporation, with an address at 250 West 57th Street, New York, New York 10107, hereinafter referred to as "Tenant".

WITNESSETH:

Landlord hereby leases to Tenant and Tenant hereby hires from Landlord those certain premises known as Suites 310, described on Exhibit A annexed hereto and made part hereof (said premises are hereinafter referred to as the "demised premises" or the "premises"), in the building known as 250 West 57th Street ("the building"), in the County of New York, City of New York, for a term to commence on the 15th day of April, 2004, and to expire on the 30th day of June, 2009, or until such term shall sooner end as herein provided, both dates inclusive, upon the terms and conditions hereinafter provided.

Landlord and Tenant covenant and agree:

1. PURPOSE

Tenant shall use and occupy the demised premises only for general and executive offices relating to Tenant's technology business, and for no other purpose. Without limiting the generality of the foregoing, it is expressly understood that no portion of the demised premises shall be used as, by or for (a) retail operations of any retail or branch bank, trust company, savings bank, industrial bank, savings and loan association, credit union or personal loan operation, or (b) a public stenographer or typist, (c) barber shop, beauty shop, beauty parlor or shop, (d) telephone or telegraph agency, (e) telephone or secretarial service, (f) messenger service, (g) travel or tourist agency, (h) employment agency, (i) restaurant or bar, (j) commercial document reproduction or offset printing service, (k) public vending machines, (l) retail, wholesale or discount shop for sale of books, magazines, audio or video tapes, CD ROM, DVD ROM or other devices for the recording or transmitting of audio or visual

signals, images, music or speech, electronic equipment and accessories or any other merchandise, (m) retail service shop, (n) labor union, (o) school or classroom, (p) governmental or quasi-governmental bureau, department or agency, including an autonomous governmental corporation, embassy or consular office of any country or other quasi-autonomous or sovereign organization, (q) an advertising agency, (r) a firm whose principal business is real estate brokerage, (s) a company engaged in the business of renting office or desk space or (t) any person, organization, association, corporation, company, partnership entity or other agency immune from service or suit in the courts of the State of New York or the assets of which may be exempt from execution by Landlord in any action for damages. Tenant shall not affix any sign to any window or exterior surface of the demised premises nor install or place any sign within the demised premises that may be seen from the outside.

2. RENT

Tenant agrees to pay each of the types of rent set forth in this Article 2, as herein provided, at the office of Landlord or such other place as Landlord may designate, payable in United States legal tender by good and sufficient check drawn on a bank having a branch in the Borough of Manhattan, City of New York, and without any notice (except as specifically set forth herein), set off or deduction whatsoever. Any sum other than fixed annual rent payable under this lease shall be deemed additional rent and due on demand unless otherwise specifically provided. Landlord shall have the same rights and remedies hereunder with respect to Tenant's non-payment of additional rent as it has with respect to Tenant's non-payment of fixed annual rent.

A. Fixed Annual Rent: There is herein reserved to Landlord for the entire term of this lease fixed annual rent equal to the aggregate amount of the sums hereinafter set forth. Fixed annual rent shall be paid in advance as follows: Commencing on April 15, 2004, and on the first day of each month thereafter throughout the term of this lease, Tenant shall pay to Landlord, without notice, deduction, set off or reduction (except as specifically set forth herein), monthly payments of fixed annual rent equal to one-twelfth (1/12th) of each of the following annual amount (except that the first month and a half of fixed annual rent (including electricity), in the amount of $4,045.02, is being paid upon the execution hereof):

April 15, 2004 through April 30, 2005: Forty-Three Thousand Two Hundred and 00/100 ($43,200.00) Dollars per annum ($3,600.00 per month);

May 1, 2005 through April 30, 2006: Forty-Four Thousand Six Hundred Ninety-Six and 00/100 ($44,696.00) Dollars per annum ($3,708.00 per month);

May 1, 2006 through April 30, 2007: Forty-Five Thousand Eight Hundred Thirty and 88/100 ($45,830.88) Dollars per annum ($3,819.24 per month);

May 1, 2007 through April 30, 2008: Forty-Seven Thousand Two Hundred Five and 81/100 ($47,205.81) Dollars per annum ($3,933.82) per month); and

May 1, 2008 through June 30, 2009: Forty-Eight Thousand Six Hundred Twenty-One and 98/100 ($48,621.98) Dollars per annum ($4,051.83 per month).

If and so long as Tenant is not in default of any obligation on its part to be performed hereunder, Tenant shall receive a rent credit of Ten Thousand Eight Hundred and 00/100 ($10,800.00) Dollars, to be applied in three (3) equal monthly installments of Three Thousand Six Hundred and 00/100 ($3,600.00) Dollars each against the third, fifteenth and twenty-eighth monthly installments of fixed annual rent (without electricity) payable hereunder (i.e. June, 2004; May, 2005; and May, 2006).

B. Tax Escalation: Tenant shall pay to Landlord, as additional rent, tax escalation in accordance with this paragraph B:

(i) Definitions: For the purpose of this Article, the following definitions shall apply:

(a) The term "base tax year" as hereinafter set forth for the determination of real estate tax escalation, shall mean the New York City real estate tax year commencing July 1, 2004 and ending June 30, 2005.

(b) The term "The Percentage", for purposes of computing tax escalation, shall mean .227 percent (.227%).

(c) The term "the building project" shall mean the aggregate combined parcel of land on a portion on which the building is constructed and the building.

(d) The term "comparative year" shall mean the twelve (12) months following the base tax year, and each subsequent period of twelve (12) months (or such other period of twelve (12) months occurring during the term of this lease as hereafter may be duly adopted as the tax year for real estate tax purposes by the City of New York).

(e) The term "real estate taxes" shall mean the total of all taxes and special or other assessments levied, assessed or imposed at any time by any governmental authority upon or against the building project, and also any tax or assessment levied, assessed or imposed at any time by any governmental authority in connection with the receipt of income or rents from said building project to the extent that same shall be in lieu of all or a portion of any of the aforesaid taxes or assessments, or additions or increases thereof, upon or against said building project. If, due to a future change in the method of taxation or in the taxing authority, or for any other reason, a franchise, income, transit, profit or other tax or governmental imposition, however designated, shall be levied against landlord in substitution in whole or in part for the real estate taxes, or in lieu of additions to or increases of said real estate taxes, then such franchise, income, transit, profit or other tax or governmental imposition shall be deemed to be included within the definition of "real estate taxes" for the purposes hereof. As to special assessments which are payable over a period of time extending beyond the term of this lease, only a pro rata portion thereof covering the portion of the term of this lease unexpired at the time of the imposition of such assessment, shall be included in "real estate taxes." If by law, any

assessment may be paid in installments, then, for the purposes hereof (a) such assessment shall be deemed to have been payable in the maximum number of installments permitted by law and (b) there shall be included in real estate taxes, for each comparative year in which such installments may be paid, the installments of such assessment so becoming payable during such comparative year, together with interest payable during such comparative year.

(f) Where more than one assessment is imposed by the City of New York for any tax year, whether denominated an "actual assessment" or "transitional assessment" or otherwise, then the phrases herein "assessed value" and "assessments" shall mean whichever of the actual, transitional or other assessment is designated by the City of New York as the taxable assessment for that tax year.

(g) The phrase "real estate taxes payable during the base tax year" shall mean that amount obtained by multiplying the assessed value of the land and buildings of the building project for the base tax year by the tax rate for the base tax year for each $100 of such assessed value.

(ii) (a) In the event that the real estate taxes payable for any comparative year shall exceed the amount of the real estate taxes payable during the base tax year, Tenant shall pay to

Landlord, as additional rent for such comparative year, an amount equal to The Percentage of the excess. Before or after the start of each comparative year, Landlord shall furnish to Tenant a statement of the real estate taxes payable for such comparative year, and a statement of the real estate taxes payable during the base tax year. If the real estate taxes payable for such comparative year exceed the real estate taxes payable during the base tax year, additional rent for such comparative year, in an amount equal to The Percentage of the excess, shall be due from Tenant to Landlord, and such additional rent shall be payable by Tenant to Landlord within ten (10) days after receipt of the aforesaid statement. The benefit of any discount for any earlier payment or prepayment of real estate taxes shall accrue solely to the benefit of Landlord, and such discount shall not be subtracted from the real estate taxes payable for any comparative year.

Additionally, Tenant shall pay to Landlord, on demand, a sum equal to The Percentage of any business improvement district assessment payable by the building project.

(b) Should the real estate taxes payable during the base tax year be reduced by final determination of legal proceedings, settlement or otherwise, then, the real estate taxes payable during the base tax year shall be correspondingly revised, the additional rent theretofore paid or payable hereunder for all comparative years shall be recomputed on the basis of such reduction, and Tenant shall pay to Landlord as additional rent, within ten (10) days after being billed therefor, any deficiency between the amount of such additional rent as theretofore computed and the amount thereof due as the result of such recomputations. Should the real estate taxes payable during the base tax year be increased by such final determination of legal proceedings, settlement or otherwise, then appropriate recomputation and adjustment also shall be made.

(c) As long as Tenant is a tenant and is not in default of any material obligation hereunder, if Tenant shall have made a payment of additional rent under this paragraph, Landlord shall receive a refund of any portion of the real estate taxes payable for any comparative year after the base tax year on which such payment of additional rent shall have been based, as a result of a reduction of such real estate taxes by final determination of legal proceedings, settlement or otherwise, Landlord shall promptly after receiving the refund pay to Tenant The Percentage of the refund less The Percentage of expenses (including attorneys' and appraisers' fees) incurred by Landlord in connection with any such application or proceeding. If prior to the payment of taxes for any comparative year, Landlord shall have obtained a reduction of that comparative year's assessed valuation of the building project, and therefore of said taxes, then the term "real estate taxes" for that comparative year shall be deemed to include the amount of Landlord's expenses in obtaining such reduction in assessed valuation, including attorneys' and appraisers' fees.

(d) The statement of the real estate taxes to be furnished by Landlord as provided above shall be certified by Landlord and shall constitute a final determination as between Landlord and Tenant of the real estate taxes for the Periods represented thereby, unless Tenant within thirty (30) days after they are furnished shall give a written notice to Landlord that it disputes their accuracy or their appropriateness, which notice shall specify the particular respects in which the statement is inaccurate or inappropriate. If Tenant shall so dispute said statement then, pending the resolution of such dispute, Tenant shall pay the additional rent to Landlord in accordance

with the statement furnished by Landlord.

(e) In no event shall the fixed annual rent under this lease (exclusive of the additional rents under this Article) be reduced by virtue of this Article.

(f) If the commencement date of the term of this lease is not the first day of the first comparative year, then the additional rent due hereunder for such first comparative year shall be a proportionate share of said additional rent for the entire comparative year, said proportionate share to be based upon the length of time that the lease term will be in existence during such first comparative year. Upon the date of any expiration or termination of this lease (except termination because of Tenant's default) whether the same be the date hereinabove set forth for the expiration of the term or any prior or subsequent date, a proportionate share of said additional rent for the comparative year during which such expiration or termination occurs shall immediately become due and payable by Tenant to Landlord, if it was not theretofore already billed and paid. The said proportionate share shall be based upon the length of time that this lease shall have been in existence during such comparative year. Landlord shall promptly cause statements of said additional rent for that comparative year to be prepared and furnished to Tenant. Landlord and Tenant shall thereupon make appropriate adjustments of amounts then owing.

(g) Landlord's and Tenant's obligations to make the adjustments referred to in subdivision (f) above shall survive any expiration or termination of this lease.

(h) Any delay or failure of Landlord in billing any tax escalation hereinabove provided shall not constitute a waiver of or in any way impair the continuing obligation of Tenant to pay such tax escalation hereunder.

C. Failure to Bill: Landlord's failure to bill on a timely basis all or any portion of any amount payable pursuant to this lease for any period during the term hereof shall neither constitute a waiver of Landlord's right to ultimately collect such amount or to bill Tenant at any subsequent time retroactively for the entire amount so un-billed. Landlord's failure to render an Escalation Statement with respect to any comparative year shall not prejudice Landlord's right to thereafter render an Escalation Statement with respect thereto or with respect to any subsequent comparative year. Tenant's obligation to pay any fixed annual rent and additional rent shall survive the expiration or earlier termination of this lease.

D. No Right to Apply Security: Tenant shall not have the right to apply any security deposited to assure Tenant's faithful performance of Tenant's obligation hereunder to the payment of any installment of fixed annual rent or additional rent.

E. No Reduction in Fixed Annual Rent: In no event shall the fixed annual rent under this lease be reduced by virtue of any decrease in the amount of any additional rent payment under this Article or any other provision of this lease. If Landlord receives from Tenant any payment less than the sum of the fixed annual rent and additional rent then due and owing pursuant to this lease, Tenant hereby waives its right, if any, to designate the items to which such payment shall be applied and agrees that Landlord in its sole discretion may apply such payment in whole or in part to any fixed annual rent, additional rent or to any combination thereof then due and payable hereunder. Unless Landlord shall otherwise expressly agree in writing, acceptance of any portion of the fixed annual rent or additional rent from anyone other than Tenant shall not relieve Tenant of any of its other obligations under this lease, including the obligation to pay other fixed annual rent and additional rent, and Landlord shall have the right at any time, upon notice to Tenant, to require Tenant (rather than someone other than Tenant) to pay the fixed annual rent and additional rent payable hereunder directly to Landlord. Furthermore, such

acceptance of fixed annual rent and additional rent shall not be deemed to constitute Landlord's consent to an assignment of this lease or a subletting or other occupancy of the demised premises by anyone other than Tenant, nor a waiver of any of Landlord's right or Tenant's obligations under this lease.

F. Partial Comparative Year: If the commencement date of the term of this lease is not the first day of the first comparative year commencing prior to the date hereof, then the additional rent due under any paragraph of this Article for the first comparative year (as defined in the relevant paragraph) shall be a proportionate share of said additional rent for the entire comparative year, said proportionate share to be based upon the length of time that the Lease term will be in existence during such first comparative year. Upon the date of any expiration or termination of this lease (except termination because of Tenant's default) whether the same be the date herein above set forth for the expiration of the term or any prior or subsequent date, a proportionate share of said additional rent for such comparative year during which such expiration or termination occurs shall immediately become due and payable by Tenant to Landlord, if it was not theretofore already billed and paid. The said proportionate share shall be based upon the length of time that this lease shall have been in existence during such comparative year. Landlord shall, as soon as reasonably practicable, compute the additional rent due from Tenant, as aforesaid, which computations shall either be based on that comparative year's actual figures or be an estimate based upon the most recent statements theretofore prepared by Landlord and furnished to Tenant as may be required under any paragraph above. If an estimate is used, then Landlord shall cause statements to be prepared on the basis of the comparative year's actual figures promptly after they are available, and thereupon, Landlord and Tenant shall make appropriate adjustments of any estimated payments theretofore made.

G. Survival of Obligations: Landlord's and Tenant's obligation to make the adjustments and payments referred to in the preceding paragraphs of this Article shall survive any expiration or termination of this lease.

H. No Waiver: Any delay or failure of Landlord in billing any tax escalation hereinabove provided shall not constitute a waiver of or in any way impair the continuing obligation of Tenant to pay the same hereunder.

3. ELECTRICITY

Tenant agrees that Landlord may furnish electricity to the demised premises on, at Landlord's option, a "rent inclusion" basis or on a "submetering" basis. Electricity and electric service, as used herein, shall mean any element affecting the generation, transmission, and/or redistribution of electricity, including but not limited to, services which facilitate the distribution of service.

A. Rent Inclusion: (i) If and so long as Landlord provides electricity to the demised premises on a rent inclusion basis, Tenant agrees that the fixed annual rent shall be increased by the amount of the Electricity Rent Inclusion Factor ("ERIF"), as hereinafter defined. Tenant acknowledges and agrees (a) that the fixed annual rent herein above set forth in this lease does not yet, but is to include an ERIF of $3.20 per rentable square foot per annum to compensate Landlord for electrical wiring and other installations necessary for, and for its obtaining and making available to Tenant the redistribution of, electric current as an additional service; and (b) that said ERIF, which shall be subject to periodic adjustments as hereinafter provided, has been partially based upon an estimate of Tenant's connected electrical load, which shall be deemed to be the demand (KW), and hours of use thereof, which shall be deemed to be the energy (KWH), for ordinary lighting and light office equipment and the operation of typical small business machines, including copying machines, personal computers and peripheral equipment such as printers, telephone switching equipment, facsimile transmission machines (such lighting, machines and equipment are hereinafter called "Ordinary Equipment") during ordinary business hours ("ordinary business hours" shall be deemed to mean forty-five (45) hours per week, 8:00 a.m. to 5:00 p.m., Mondays through Fridays, including holidays), with Landlord providing an average connected load of 4 1/2 watts of electricity for all purposes per rentable square foot. Any installation and use of equipment other than Ordinary Equipment and/or any connected load and/or any energy usage by Tenant in excess of the foregoing shall result in adjustment of the ERIF as hereinafter provided. For purposes of this lease the rentable square foot area of the demised premises shall be deemed to be 1,128 rentable square feet.

(ii) If the cost to Landlord of electricity shall have been,

or shall be, increased subsequent to May 1, 1996 (whether such change occurs prior to or during the term of this lease), (a) by change in Landlord's electric

rates or service classifications, or electricity charges, including changes in market prices, or (b) by any increase in fuel adjustments or (c) by charges of any kind, or (d) by taxes, imposed or which may be imposed on Landlord's electricity purchases, or on Landlord's electricity redistribution, or (e) by virtue of any other cause, then (x) the ERIF, which is a portion of the fixed annual rent, shall be changed in the same percentage as any such change in cost due to changes in electric rates, service classifications, or market prices and, also, (y) Tenant's payment obligation, for electricity redistribution, shall change from time to time so as to reflect any such increase in any of the items listed in (b) through (e) of this paragraph. Sales taxes collectible by Landlord under applicable law in connection with the sale or re-distribution of electricity to Tenant shall be paid by Tenant to Landlord as additional rent when billed. Any such percentage change in Landlord's cost due to changes in electric rates, service classifications or market prices shall be computed by the application of the average consumption (energy and demand) of electricity for the entire building for the twelve (12) full months immediately prior to the rate and/or service classification and/or market price change, or any changed methods of or rules on billing for same, on a consistent basis to the new rate and/or service classification and/or market price and to the immediately prior existing rate and/or service classification and/or market price. If the average consumption of electricity for the entire building for said prior twelve (12) months cannot reasonably be applied and used with respect to changed methods of or rules on billing, then the percentage increase shall be computed by the use of the average consumption (energy and demand) for the entire building for the first three (3) months after such change, projected to a full twelve (12) months, so as to reflect the different seasons; and that same consumption, so projected, shall be applied to the rate and/or service classification and/or market price which existed immediately prior to the change. The parties agree that a reputable, independent electrical consultant, selected by Landlord ("Landlord's electrical consultant"), shall determine the percentage change for the changes in the ERIF due to Landlord's changed costs, and that Landlord's electrical consultant may from time to time make surveys in the demised premises of the electrical equipment and fixtures and the use of current. If any such survey shall reflect a connected load in the demised premises in excess of 4 1/2 watts of electricity for all purposes per rentable square foot and/or energy usage in excess of ordinary business hours (each such excess is hereinafter called "excess electricity") then the connected load and/or the hours of use portion(s) of the then existing ERIF shall each be increased by an amount which is equal to the product derived from multiplying the then existing ERIF by a fraction, the numerator of which is the excess electricity (i.e., excess connected load and/or excess usage) and the denominator of which is the connected load and/or the energy usage which was the basis for the computation of the then existing ERIF. Such fractions shall be determined by Landlord's electrical consultant. The fixed annual rent shall then be appropriately adjusted, effective as of the date of any such change in connected load and/or usage, as disclosed by said survey. If such survey shall disclose installation and use of other than Ordinary Equipment, then effective as of the date of said survey, there shall be added to the ERIF portion of the fixed annual rent (computed and fixed as hereinbefore described) an additional amount equal to what would be paid under the SC-4 Rate I Service Classification in effect on the date of this lease (and not the time-of-day rate schedule) for such load and usage of electricity, with the connected electrical load deemed to be demand (KW) and the hours of use thereof deemed to be the energy (KWH), as hereinbefore provided, (which addition to the ERIF shall be increased by all electricity cost increases of Landlord, as herein above provided, from May 1, 1996 through the date of billing).

(iii) In no event, whether because of surveys or for any other reason, is the originally specified per rentable square foot ERIF portion of the fixed annual rent (plus any net increase thereof, but not decrease, by virtue of all electric rate or service classification changes subsequent to May 1, 1996) to be reduced.

B. Submetering: If and so long as Landlord provides electricity to the demised premises on a submetering basis, Tenant covenants and agrees to purchase the same from Landlord or Landlord's designated agent at charges, terms and rates set, from time to time, during the term of this lease by Landlord but not

less than those specified in the service classification in effect on the date of this lease pursuant to which Landlord then purchased electric current from the public utility corporation serving the part of the city where the building is located; provided, however, said charges shall be increased in the same percentage as any percentage increase in the billing to Landlord for electricity for the entire building, (a) by reason of increase in Landlord's electric rates or service classifications, subsequent to January 1, 1970, and so as to reflect any increase in Landlord's electric charges, including changes in market prices for electricity from utilities and/or other providers, or (b) by fuel adjustment, or (c) by taxes or charges of any kind imposed or which may be imposed on Landlord's electricity purchases, or on Landlord's electricity redistribution, or (d) by virtue of any other cause subsequent to January 1, 1970. Sales taxes collectible by Landlord under applicable law in connection with the sale or re-distribution of electricity to Tenant shall be paid by Tenant to Landlord as additional rent when billed. Any such percentage increase in Landlord's billing for electricity due to changes in rates or service

classifications or market prices shall be computed by the application of the average consumption (energy and demand) of electricity for the entire building for the twelve (12) full months immediately prior to the rate and/or service classification change, or any changed methods of or rules on billing for same, on a consistent basis to the new rate and/or service classification and to the service classification in effect on January 1, 1970. If the average consumption of electricity for the entire building for said prior twelve (12) months cannot reasonably be applied and used with respect to changed methods of or rules on billing, then the percentage increase shall be computed by the use of the average consumption (energy and demand) for the entire building for the first three (3) months after such change, projected to a full twelve (12) months; and that same consumption, so projected, shall be applied to the service classification in effect on January 1, 1970. Where more than one meter measures the service of Tenant in the building, the service rendered through each meter may be computed and billed separately in accordance with the rates herein. Bills therefor shall be rendered at such times as Landlord may elect and the amount, as computed from a meter, shall be deemed to be, and be paid as, additional rent. In the event that such bills are not paid within five (5) days after the same are rendered, Landlord may, without further notice, discontinue the service of electric current to the demised premises without releasing Tenant from any liability under this lease and without Landlord or Landlord's agent incurring any liability for any damage or loss sustained by Tenant by such discontinuance of service. If any tax is imposed upon Landlord's receipt from the sale or resale of electrical energy or gas or telephone service to Tenant by any Federal, State or Municipal Authority, Tenant covenants and agrees that where permitted by law, Tenant's pro rata (based on consumption or estimated consumption) share of such taxes shall be passed on to, and included in the bill of, and paid by, Tenant to Landlord.

C. General Conditions: (i) The determinations by Landlord's electrical consultant shall be binding and conclusive on Landlord and on Tenant from and after the delivery of a copy of each such relevant determination to Landlord and Tenant, unless, within fifteen (15) days after delivery thereof, Tenant disputes such determination. If Tenant so disputes the determination, it shall, at its own expense, obtain from a reputable, independent electrical consultant its own determinations in accordance with the provisions of this Article. Tenant's consultant and Landlord's consultant then shall seek to agree. If they cannot agree within thirty (30) days, they shall choose a third reputable electrical consultant, whose cost shall be shared equally by the parties, to make similar determinations which shall be controlling. (If they cannot agree on such third consultant within ten (10) days, then either party may apply to the Supreme Court in the County of New York for such appointment.) However, pending such controlling determinations, Tenant shall pay to Landlord the amount of additional rent or ERIF in accordance with the determinations of Landlord's electrical consultant. If the controlling determinations differ from Landlord's electrical consultant, then the parties shall promptly make adjustment for any deficiency owed by Tenant or overage paid by Tenant.

(ii) At the option of Landlord, Tenant agrees to purchase from Landlord or its agents all lamps and bulbs used in the demised premises and to pay for the cost of installation thereof. If all or part of the submetering additional rent or the ERIF payable in accordance with this Article becomes uncollectible or reduced or refunded by virtue of any law, order or regulation,

the parties agree that, at Landlord's option, in lieu of submetering additional rent or ERIF, and in consideration of Tenant's use of the building's electrical distribution system and receipt of redistributed electricity and payment by Landlord of consultants' fees and other redistribution costs, the fixed annual rental rate(s) to be paid under this lease shall be increased by an "alternative charge" which shall be a sum equal to $3.20 per rentable square foot of the demised premises per year, changed in the same percentage as any increases in the cost to Landlord for electricity for the entire building subsequent to May 1, 1996 because of electric rate or service classification or market price changes, as hereinabove provided.

(iii) Landlord shall not be liable to Tenant for any loss or damage or expense which Tenant may sustain or incur if either the quantity or character of electric service is changed or is no longer available or suitable for Tenant's requirements. Tenant covenants and agrees that at all times its use of electric current shall never exceed the capacity of existing feeders to the building or the risers or wiring installation. Tenant agrees not to connect any additional electrical equipment to the building electric distribution system which shall increase consumption or demand beyond the capacity and rating of the electrical system directly servicing the demised premises without the Landlord's prior written consent, which shall not be unreasonably withheld. Any riser or risers to supply Tenant's electrical requirements, upon written request of Tenant, will be installed by Landlord, at the sole cost and expense of Tenant, if, in Landlord's sole judgment, the same are necessary and will not cause permanent damage or injury to the building or demised premises or cause or create a dangerous or hazardous condition or entail excessive or unreasonable alterations, repairs or expense or interfere with or disturb other tenants or occupants. In addition to the installation of such riser or risers, Landlord will also at the sole cost and expense of Tenant, install all other equipment

proper and necessary in connection therewith subject to the aforesaid terms and conditions. The parties acknowledge that they understand that it is anticipated that electric rates, charges, etc., may be changed by virtue of time-of-day rates, or other methods of billing, electricity purchases and the redistribution thereof, and fluctuations in the market price of electricity, and that the references in the foregoing paragraphs to changes in methods of or rules on billing are intended to include any such changes. Anything herein above to the contrary notwithstanding, in no event is the submetering additional rent or ERIF, or any "alternative charge", to be less than an amount equal to the total of Landlord's payments to public utilities and/or others for the electricity consumed by Tenant (and any taxes on Landlord's purchase of the same or on redistribution of same) plus five (5%) percent for transmission line loss, plus fifteen (15%) percent for other redistribution costs. Landlord reserves the right, at any time upon thirty (30) days' written notice, to change its furnishing of electricity to Tenant from a rent inclusion basis to a submetering basis, or vice versa. Landlord reserves the right to terminate the furnishing of electricity on a rent inclusion, submetering, or any other basis at any time, upon thirty (30) days' written notice to Tenant, in which event Tenant may make application directly to the public utility and/or other providers for Tenant's entire separate supply of electric current and Landlord shall permit its wires and conduits, to the extent available and safely capable, to be used for such purpose and only to the extent of Tenant's then authorized connected load. Any meters, risers or other equipment or connections necessary to furnish electricity on a submetering basis or to enable Tenant to obtain electric current directly from such utility shall be installed at Tenant's sole cost and expense. Only rigid conduit or electricity metal tubing (EMT) will be allowed. Landlord, upon the expiration of the aforesaid thirty (30) days' written notice to Tenant may discontinue furnishing the electric current but this lease shall otherwise remain in full force and effect. If Tenant was provided electricity on a rent inclusion basis when it was so discontinued, then commencing when Tenant receives such direct service and as long as Tenant shall continue to receive such service, the fixed annual rental rate payable under this lease shall be reduced by the amount of the ERIF which was payable immediately prior to such discontinuance of electricity on a rent inclusion basis.

(iv) Alternative Service Providers: Landlord on the date hereof obtains electric service for the building from Consolidated Edison Company. Notwithstanding anything herein set forth to the contrary, if permitted by law, Landlord may contract separately with Consolidated Edison Company and/or one or more other providers ("Alternative Service Providers") to provide one or more of the component services which together make up the entire package of

electric service (e.g., transmission, generation, distribution and ancillary services) to the building. If Landlord elects to contract with any Alternative Service Provider, Tenant shall cooperate with Landlord and each such Alternative Service Provider to effect any change to the method or means of providing and distributing electricity service to the demised premises or any other portion of the building by reason of such change in the provision of electricity. Such cooperation shall include but not be limited to providing Landlord or any such Alternative Service Provider and any other person unimpeded access to the demised premises and to all wiring, conduit, lines, feeders, cable and risers, electricity panel boxes and any other component of the electrical distribution system within or adjacent to the demised premises. Landlord shall not be liable to Tenant for any loss or damage or expense which Tenant may sustain or incur if such change shall interfere with Tenant's business or either the quantity or character of electric service is changed, interrupted or is no longer available or suitable for Tenant's requirements by reason of such change in the provision of electric service nor shall any such interference, change, interruption, unavailability or unsuitability constitute an actual or constructive eviction of Tenant.

4. ASSIGNMENT

A. Tenant, for itself, its heirs, distributees, executors, administrators, legal representatives, successors and assigns, expressly covenants that it shall not assign, mortgage or encumber this lease, nor underlet, or suffer or permit the demised premises or any part thereof to be used or occupied by others, without the prior written consent of Landlord in each instance. The transfer of a majority of the issued and outstanding capital stock of any corporate tenant or subtenant of this lease or a majority of the total interests in any partnership tenant or subtenant or any other form of entity or organization, however accomplished, and whether in a single transaction or in a series of transactions, and the conversion of a tenant or subtenant entity to either a limited liability company or a limited liability partnership, shall be deemed on assignment of this lease or of such sublease. The merger or consolidation of a tenant or subtenant, whether a corporation, partnership, limited liability company or other form of entity or organization, where the net worth of the resulting or surviving corporation, partnership, limited liability company or other form of entity or organization, is less than the net worth of Tenant or subtenant immediately prior to such merger or consolidation shall be deemed an assignment of this lease or of such sublease. If this lease be assigned, or if the demised premises or any part thereof be underlet or occupied by anybody other than Tenant, Landlord may, after default

by Tenant, collect rent from the assignee, undertenant or occupant, and apply the net amount collected to the rent herein reserved, but no assignment, underletting, occupancy or collection shall be deemed a waiver of the provisions hereof, the acceptance of the assignee, undertenant or occupant as tenant, or a release of Tenant from the further performance by Tenant of covenants on the part of Tenant herein contained. The consent by Landlord to an assignment or underletting shall not in any way be construed to relieve Tenant from obtaining the express consent in writing of Landlord to any further assignment or underletting. In no event shall any permitted subtenant assign or encumber its sublease or further sublet all or any portion of its sublet space, or otherwise suffer or permit the sublet space or any part thereof to be used or occupied by others, without Landlord's prior written consent in each instance. A modification, amendment or extension of a sublease shall be deemed a sublease. If any lien is filed against the demised premises or the building of which the same form a part for brokerage services claimed to have been performed for Tenant, whether or not actually performed, the same shall be discharged by Tenant within ten (10) days thereafter, at Tenant's expense, by filing the bond required by law, or otherwise, and paying any other necessary sums, and Tenant agrees to indemnify Landlord and its agents and hold them harmless from and against any and all claims, losses or liability resulting from such lien for brokerage services rendered. For the purposes of this Article, an "interest" shall mean a right to participate, directly or indirectly, through one or more intermediaries, nominees, trustees or agents, in any of the profits, losses, dividends, distributions, income, gain, losses or capital of any entity or other organization.

B. (i) If Tenant desires to assign this lease or to sublet all or any portion of the demised premises, it shall first submit in writing to Landlord

the documents described in paragraph C below, and shall offer in writing, (a) with respect to a prospective assignment, to assign this lease to Landlord without any payment of moneys or other consideration therefor, or, (b) with respect to a prospective subletting, to sublet to Landlord the portion of the demised premises involved ("Leaseback Area") for the term specified by Tenant in its proposed sublease or, at Landlord's option, for the balance of the term of the Lease less one (1) day, and at the lower of (x) Tenant's proposed subrental and (y) at the same rate of fixed rent and additional rent, and otherwise on the same terms, covenants and conditions (including provisions relating to escalation rents), as are contained herein and as are allocable and applicable to the portion of the demised premises to be covered by such subletting. The offer shall specify the date when the Leaseback Area will be made available to Landlord, which date shall be in no event earlier than forty-five (45) days nor later than one hundred eighty (180) days following the acceptance of the offer. If an offer of sublease is made, and if the proposed sublease will result in all or substantially all of the demised premises being sublet, then Landlord shall have the option to extend the term of its proposed sublease for the balance of the term of this lease less one (1) day.

(ii) Landlord shall have a period of thirty (30) days from the receipt of such offer (and all documents required under paragraph C below) to either accept or reject the same. If Landlord shall accept such offer (a) Tenant shall then execute and deliver to Landlord, or to anyone designated or named by Landlord, an assignment or sublease, as the case may be, in either case in a form reasonably satisfactory to Landlord's counsel; and (b) if the proposed transaction is a sublease and Landlord accepts such offer, Tenant, on demand, shall pay to Landlord or its managing agent (as Landlord shall elect) an amount equal to the brokerage commissions and any work contribution which would have been incurred by Tenant but for Landlord's accepting such offer.

(iii) If a sublease is so made it shall expressly:

(a) permit Landlord to make further subleases of all or any part of the Leaseback Area and (at no cost or expense to Tenant) to make and authorize any and all changes, alterations, installations and improvements in such space as necessary;

(b) provide that Tenant will at all times permit reasonably appropriate means of ingress to and egress from the Leaseback Area;

(c) negate any intention that the estate created under such sublease be merged with any other estate held by either of the parties;

(d) provide that Landlord shall accept the Leaseback Area "as is" except that Landlord, at Tenant's expense, shall perform all such work and make all such alterations as may be required

physically to separate the Leaseback Area from the remainder of the demised premises and to permit lawful occupancy;

(e) provide that at the expiration of the term of such sublease Tenant will accept the Leaseback Area in its then existing condition, subject to the obligations of Landlord to make such repairs thereto as may be necessary to preserve the Leaseback Area in good order and condition, ordinary wear and tear excepted;

(f) provide that Landlord shall indemnify and save Tenant harmless from all obligations under this lease as to the Leaseback Area during the period of time it is so sublet, except for fixed annual rent and additional rent, if any, due under the within Lease, which are in excess of the rents and additional sums due under such sublease.

(iv) Subject to the foregoing, performance by Landlord, or its designee, under a sublease of the Leaseback Area shall be deemed performance by Tenant of any similar obligation under

this lease and any default under any such sublease shall not give rise to a default under a similar obligation contained in this lease, nor shall Tenant be liable for any default under this lease or deemed to be in default hereunder if such default is occasioned by or arises from any act or omission of the subtenant under such sublease or is occasioned by or arises from any act or omission of any occupant holding under or pursuant to any such sublease.

C. If Tenant requests Landlord's consent to a specific assignment or subletting, it shall submit in writing to Landlord (i) the name and address of the proposed assignee or subtenant, (ii) a duly executed counterpart of the proposed agreement of assignment or sublease, (iii) reasonably satisfactory information as to the nature and character of the business of the proposed assignee or subtenant, and as to the nature of its proposed use of the space, and (iv) banking, financial or other credit information relating to the proposed assignee or subtenant reasonably sufficient to enable Landlord to determine the financial responsibility and character of the proposed assignee or subtenant.

D. If Landlord shall not have accepted Tenant's offer, as provided in paragraph B, then Landlord will, subject to paragraph F below, not unreasonably withhold or delay its consent to Tenant's request for consent to such specific assignment or subletting, where Tenant will not move the conduct of its business to another building in New York City. Any consent of Landlord under this Article shall be subject to the terms of this Article and the effectiveness of any assignment or sublease under this Article shall be conditioned upon there being no default by Tenant, beyond any grace period, under any of the terms, covenants and conditions of this lease at the time that Landlord's consent to any such subletting or assignment is requested and on the date of the commencement of the term of any proposed sublease or the effective date of any proposed assignment.

E. Tenant understands and agrees that no assignment or subletting shall be effective unless and until Tenant, upon receiving any necessary Landlord's written consent (and unless it was theretofore delivered to Landlord) causes a duly executed copy of the sublease or assignment to be delivered to Landlord within ten (10) days after execution thereof. Any such sublease shall provide that the subtenant shall comply with all applicable terms and conditions of this lease to be performed by Tenant hereunder. Any such assignment of lease shall contain an assumption by the assignee of all of the terms, covenants and conditions of this lease to be performed by Tenant.

F. Anything herein contained to the contrary notwithstanding:

(i) Tenant shall not advertise (but may list with brokers) its space for assignment or subletting at a rental rate lower than the greater of the then building rental rate for such space or the rental rate then being paid by Tenant to Landlord.

(ii) The transfer of outstanding capital stock of any corporate tenant, for purposes of this Article, shall not include sale of such stock by persons other than those deemed "insiders" within the meaning of the Securities Exchange Act of 1934 as amended, and which sale is effected through "over-the-counter market" or through any recognized stock exchange.

(iii) No assignment or subletting shall be made:

(a) To any person or entity which shall at that time be a tenant, subtenant or other occupant (or an affiliate thereof) of any part of the building of which the demised premises form a part, or who dealt with Landlord or Landlord's agent (directly or through a broker) with respect to space in the building during the twelve (12) months immediately preceding Tenant's request for Landlord's consent;

(b) By the legal representatives of Tenant or by any person to whom Tenant's interest under this lease passes by operation of law, except in compliance with the provisions of this Article;

(c) To any person or entity for the conduct of a business which is not in keeping with the standards and the general character of the building of which the demised premises form a part.

(iv) Tenant shall retain the building's managing agent as Tenant's broker in connection with any assignment or subletting, except in connection with a transaction described in paragraph G or paragraph H.

(v) The listing of any names other than that of Tenant, whether on the doors of the demised premises or on the building directory shall not be construed as consent to the occupancy or subletting of all or any portion of the demised premises or to an assignment of this lease.

G. Anything herein above contained to the contrary notwithstanding, the offer back to Landlord provisions of paragraph B above shall not apply to, and Landlord will not unreasonably withhold or delay its consent to an assignment of this lease, or sublease of all or part of the demised premises, to the parent of Tenant or to a wholly-owned subsidiary of Tenant or of said parent of Tenant, provided the net worth of the transferee or subtenant, after such transaction, is equal to or greater than the greater of Tenant's net worth on the date hereof or immediately prior to such transaction, and provided, also, that any such transaction complies with the other provisions of this Article.

H. Anything herein above contained to the contrary notwithstanding, the offer back to Landlord provisions of paragraph B above shall not apply to, and Landlord will not unreasonably withhold or delay its consent to an assignment of this lease, or sublease of all or part of the demised premises, to any corporation (a) to which substantially all the assets of Tenant are transferred or (b) into which Tenant may be merged or consolidated, provided that the net worth, experience and reputation of such transferee or of the resulting or surviving corporation, as the case may be, is equal to or greater than the net worth, experience and reputation of Tenant and of any guarantor of this lease immediately prior to such transfer, and provided, also, that any such transaction complies with the other provisions of this Article.

I. No consent from Landlord shall be necessary under paragraphs G and H above where (a) reasonably satisfactory proof is delivered to Landlord that the net worth and other provisions of paragraphs G or H, as the case may be, and the other provisions of this Article, have been satisfied and (b) Tenant, in a writing reasonably satisfactory to Landlord's attorneys, agrees to remain primarily liable jointly and severally with any transferee or assignee, for the obligations of Tenant under this lease.

J. If Landlord shall not have accepted any required Tenant's offer and/or Tenant effects any assignment or subletting, then Tenant thereafter shall pay to Landlord a sum equal to (i) any rent or other consideration paid to Tenant by any subtenant which (after deducting the costs of Tenant, if any, in effecting the subletting, including reasonable alteration costs, commissions and legal fees) is in excess of the rent allocable strictly on a per square foot basis, without regard to any other allocation of value, by dividing aggregate consideration by the rentable square feet of the area so sublet) to the subleased space which is then being paid by Tenant to Landlord pursuant to the terms hereof, and (ii) any other profit or gain (after deducting any necessary expenses incurred) realized by Tenant from any such subletting or assignment. All sums payable hereunder by Tenant shall be payable to Landlord as additional rent upon receipt thereof by Tenant.

K. Each subletting pursuant to this Article shall be subject to all of the covenants, agreements, terms, provisions and conditions contained in this lease. Notwithstanding any such subletting to any subtenant and/or acceptance of

rent or additional rent by Landlord from any subtenant, Tenant shall and will remain fully liable for the payment of the fixed annual rent and additional rent due and to become due hereunder and for the performance of all the covenants, agreements, terms, provisions and conditions contained in this lease on the part of Tenant to be observed and performed and for all the acts and omissions of any licensee, subtenant, or any other person claiming under or through any subtenant that shall be in violation of any of the obligations of this lease, and any such violation shall be deemed to be a violation by Tenant. Tenant further agrees

that, notwithstanding any such subletting, no further subletting (including, without limitation, any extensions or renewals of any initial sublettings) of the demised premises by Tenant, or any person claiming through or under Tenant shall, or will be, made, except upon compliance with, and subject to, the provisions of this Article.

L. Any assignment or transfer shall be made only if, and shall not be effective until, the assignee shall execute, acknowledge and deliver to Landlord an agreement, in form and substance reasonably satisfactory to Landlord, whereby the assignee shall assume all of the obligations of this lease on the part or Tenant to be performed or observed and whereby the assignee shall agree that the provisions contained herein shall, notwithstanding such assignment or transfer, continue to be binding upon it in respect of all future assignments and transfers. The original named Tenant covenants that, notwithstanding any assignment or transfer whether or not in violation of the provisions hereof, and notwithstanding the acceptance of fixed annual rent and/or additional rent by Landlord from an assignee, transferee or any other party, the original named Tenant shall remain fully liable for the payment of the fixed annual rent and additional rent and for the other obligations of this lease on the part of Tenant to be performed or observed.

M. If Landlord shall decline to give consent to any proposed assignment or sublease, or if Landlord shall exercise Landlord's option under paragraph B of this Article, Tenant shall indemnify, defend and hold Landlord harmless from and against any and all losses, liabilities, costs and expenses (including reasonable attorneys' fees) resulting from any claims that may be made against Landlord by the proposed assignee or subtenant or by any brokers or other persons claiming a commission or similar compensation in connection with the proposed assignment or sublease. This provision shall survive the expiration or sooner termination of this lease.

N. The joint and several liability of Tenant and any immediate or remote successor in interest to Tenant, and the due performance of the obligations of this lease on Tenant's part to be performed or observed, shall not be discharged, released or impaired in any respect by any agreement or stipulation made by Landlord extending the time of, or modifying any of the obligations of, this lease, or by any waiver or failure of Landlord to enforce any of the obligations of this lease.

5. DEFAULT

Landlord may terminate this lease on three (3) days' notice: (a) if fixed annual rent or additional rent or any other payment due hereunder is not paid within five (5) business days after written notice from Landlord; or (b) if Tenant shall have failed to cure a default in the performance of any covenant of this lease (except the payment of rent), or any rule or regulation hereinafter set forth, within five (5) business days after written notice thereof from Landlord, or if default cannot be completely cured in such time, if Tenant shall not promptly proceed to cure such default within said five (5) business days, or shall not complete the curing of such default with due diligence; or (c) when and to the extent permitted by law, if a petition in bankruptcy shall be filed by or against Tenant or if Tenant shall make a general assignment for the benefit of creditors, or receive the benefit of any insolvency or reorganization act; or (d) if a receiver or trustee is appointed for any portion of Tenant's property and such appointment is not vacated within twenty (20) business days; or (e) if an execution or attachment shall be issued under which the premises shall be taken or occupied or attempted to be taken or occupied by anyone other than Tenant; or (f) if the premises become and remain vacant or deserted for a period over ten (10) business days; or (g) if Tenant shall default beyond any grace period under any other lease between Tenant and Landlord; or (h) if Tenant shall fail to move into or take possession of the premises within fifteen (15) business days after commencement of the term of this lease. Notwithstanding anything herein to the contrary set forth, Tenant shall not commit waste or cause any damage to any portion of the building irrespective of whether within or without the demised premises. The willful infliction of damage on any property or the interference with the quiet enjoyment by any other occupant of the building shall be deemed to be a conditional limitation of the term of this lease. Tenant shall not create any nuisance or other disturbance within the building.

At the expiration of the three (3) day notice period, this lease and any rights of renewal or extension thereof shall terminate as completely as if that were the date originally fixed for the expiration of the term of this lease; but Tenant shall remain liable as hereinafter provided.

6. RE-LETTING, ETC.

If Landlord shall re-enter the premises on the default of Tenant, by summary proceedings or otherwise: (a) Landlord may re-let the premises or any part thereof as Tenant's agent, in the name of Landlord, or otherwise, for a term shorter or longer than the balance of the term of this lease, and may grant concessions or free rent; (b) Tenant shall pay Landlord any deficiency between the rent herein reserved and the net amount of any rents collected by Landlord for the remaining term of this lease, through such re-letting. Such deficiency shall become due and payable monthly, as it is determined. Landlord shall have no obligation to re-let the premises, and its failure or refusal to do so, or failure to collect rent on re-letting, shall not affect Tenant's liability hereunder. In computing the net amount of rents collected through such re-letting, Landlord may deduct all expenses incurred in obtaining possession or re-letting the premises, including legal expenses and fees, brokerage fees, the cost of restoring the premises to good order, and the cost of all alterations and decorations deemed necessary by Landlord to effect re-letting. In no event shall Tenant be entitled to a credit or repayment for rerental income which exceed the sums payable to Tenant hereunder or which covers a period after the original term of this lease; (c) Tenant hereby expressly waives any right of redemption granted by any present or future law. "Re-enter" and "re-entry" as used in this lease are not restricted to their technical legal meaning. In the event of a breach or threatened breach of any of the covenants or provisions hereof Landlord shall have the right of injunction. Mention herein of any particular remedy shall not preclude Landlord from any other available remedy; and (d) Landlord shall recover as liquidated damages, in addition to accrued rent and other charges, if Landlord's re-entry is the result of Tenant's bankruptcy, insolvency, or reorganization, the full rental for the maximum period allowed by any act relating to bankruptcy, insolvency or reorganization.

If Landlord re-enters the premises for any cause, or if Tenant abandons or vacates the premises, and after the expiration of the term of this lease, any property left in the premises by Tenant shall be deemed to have been abandoned by Tenant, and Landlord shall have the right to retain or dispose of such property in any manner without any obligation to account therefor to Tenant. If Tenant shall at any time default hereunder, and if Landlord shall institute an action or summary proceeding against Tenant based upon such default, then Tenant will reimburse Landlord for the legal expenses and fees thereby incurred by Landlord.

7. LANDLORD MAY CURE DEFAULTS

If Tenant shall default in performing any covenant or condition of this lease, Landlord may perform the same for the account of Tenant, and if Landlord, in connection therewith, or in connection with any default by Tenant, makes any expenditures or incurs any obligations for the payment of money, including but not limited to attorneys' fees and disbursements, such sums so paid or obligations incurred shall be deemed to be additional rent hereunder, and shall be paid by Tenant to Landlord together with interest at an annual rate equal to the average of all prime rates published from time to time in The Wall Street Journal (Eastern Edition) plus three (3%) percent calculated from the date of each expenditure by Landlord, within five (5) days of rendition of any bill or statement therefor, and if Tenant's lease term shall have expired at the time of the making of such expenditures or incurring such obligations, such sums shall be recoverable by Landlord as damages.

8. ALTERATIONS

A. Tenant shall make no decoration, alteration, addition or improvement ("alteration") in the premises, without the prior written consent of Landlord, and then only by contractors or mechanics and in such manner and with such materials as shall be approved by Landlord. All alterations, additions or improvements to the premises, including window and central air conditioning equipment and duct work, if any, and fixtures, equipment and built-ins, except movable office furniture and equipment installed at the expense of Tenant, shall, unless Landlord elects otherwise in writing, become the property of Landlord, and shall be surrendered with the premises at the expiration or sooner termination of the term of this lease. Any such alterations, additions and

improvements which Landlord shall designate, shall be removed by Tenant and any damage repaired, at Tenant's expense prior to the expiration of the term of this lease.

B. Anything in this Article to the contrary notwithstanding, Landlord shall not unreasonably withhold or delay approval of written requests of Tenant to make nonstructural interior alterations in the demised premises, provided that such alterations do not affect utility services or plumbing and electrical lines or other systems of the building. All alterations shall be performed in accordance with the following conditions:

(i) All alterations requiring the submission of plans to any governmental agency (including the department of buildings of the City of New York) shall be performed in accordance with plans and specifications first submitted to Landlord for its prior written approval. Landlord shall be given, in writing, a good description of all other alterations.

(ii) All alterations shall be done in a good and workmanlike manner. Tenant shall, prior to the commencement of any such alterations, at its sole cost and expense, obtain and exhibit to Landlord any governmental permit required in connection with such alterations.

(iii) All alterations shall be done in compliance with all other applicable provisions of this lease, all building regulations (including specifications for construction material and finishes criteria adopted by Landlord for the building) and with all applicable laws, ordinances, directions, rules and regulations of governmental authorities having jurisdiction, including, without limitation, the Americans with Disabilities Act of 1990, as amended, New York City Local Law No. 5/73 and New York City Local Law No. 58/87 and similar present or future laws, and regulations issued pursuant thereto, and also New York City Local Law No. 76 and similar present or future laws, and regulations issued pursuant thereto, on abatement, storage, transportation and disposal of asbestos, which work, if required, shall be effected at Tenant's sole cost and expense, by contractors and consultants approved by Landlord and in strict compliance with the aforesaid rules and regulations and with Landlord's rules and regulations thereon. Notwithstanding anything to the contrary herein contained, Tenant agrees not to penetrate or disrupt the structural columns of the building located within the demised premises or any area within three feet of any such structural column, in connection with any alteration performed for or on behalf of Tenant.

(iv) All work shall be performed with union labor having the proper jurisdictional qualifications by contractors and subcontractors approved by Landlord.

(v) Tenant shall keep the building and the demised premises free and clear of all liens for any work or material claimed to have been furnished to Tenant or to the demised premises.

(vi) All work to be performed by Tenant shall be done in a manner which will not interfere with or disturb other tenants and occupants of the building. No demolition or core drilling or welding shall be permitted between the hours of 7:00 a.m. and 6:00 p.m. on Mondays through Fridays.

(vii) All alterations or other work and installations in and for the demised premises, which shall be consented to by Landlord as provided herein, including without limitation, Tenant's Initial Installations (as hereinafter defined), if any, and any further changes in or additions to the demised premises after said initial work has been completed, shall, at Landlord's option, be effected on Tenant's behalf by Landlord, its agents or contractors, and Tenant shall pay to Landlord, as additional rent promptly when billed, all costs for such work, including labor, materials and general conditions, plus, for supervising and coordinating such work (regardless of whether Landlord, its agents or contractors perform such work), ten percent (10%) of the cost of such work (including overhead) for profit plus ten percent (10%) of the cost of such work for overhead.

(viii) Notwithstanding anything herein set forth to the contrary, within thirty (30) days after final completion of any alteration, Tenant shall

deliver to the Landlord final record drawings of the alteration including, as may be pertinent to the work performed, a reflected ceiling plan, mechanical and electrical drawings, partition plan and any other drawings which may be required to indicate accurately the layout and systems of the demised premises. Tenant shall require its architect to load and maintain such record plans on a CADD system.

9. LIENS

Prior to commencement of its work in the demised premises, Tenant shall obtain and deliver to Landlord a written letter of authorization, in form reasonably satisfactory to Landlord's counsel, signed by architects, engineers, designers and consultants to become involved in such work, which shall confirm that any of their drawings or plans are to be removed from any filing with governmental authorities, on request of Landlord, in the event that said architect, engineer or designer thereafter no longer is providing services with respect to the demised premises. With respect to contractors, subcontractors, materialmen and laborers, and architects, engineers and designers, for all work or materials to be furnished to Tenant at the premises, Tenant agrees to obtain and deliver to Landlord written and unconditional waivers of mechanics liens upon the premises or the building, after payments to the contractors, their subcontractors and vendors, Tenant's architects, engineers, designers and consultants, subject to any then applicable provisions of the Lien law. Notwithstanding the foregoing, Tenant at its expense shall cause any lien filed against the premises or the building, for work or materials claimed to have been furnished to Tenant, to be discharged of record within thirty (30) days after notice thereof.

10. REPAIRS

Tenant shall take good care of the premises and the fixtures and appurtenances therein, and shall make all repairs necessary to keep them in good working order and condition, including structural repairs when those are necessitated by the act, omission or negligence of Tenant or its agents, employees or invitees. The exterior walls of the building, the windows and the portions of all window sills outside same and areas above any hung ceiling are not part of the premises demised by this lease, and Landlord hereby reserves all rights to such parts of the building. Landlord shall replace, at the expense of Tenant, any plate glass and other glass damaged or broken from any cause whatsoever in and about the demised premises. Landlord may insure, and keep insured, at Tenant's expense, all plate and other glass in the demised premises for and in the name of Landlord. Bills for the premium therefor shall be rendered by Landlord to Tenant at such times as Landlord may elect and shall be due from and payable by Tenant when rendered and the amount thereof shall be deemed to be and paid as additional rent.

11. DESTRUCTION

If the premises shall be partially damaged by fire or other casualty, the damage shall be repaired at the expense of Landlord, but without prejudice to the rights of subrogation, if any, of Landlord's insurer. Landlord shall not be required to repair or restore any of Tenant's property or any alteration or leasehold improvement made by or for Tenant at Tenant's expense. Tenant shall give Landlord prompt notice of any damage or destruction to the premises. The rent shall abate in proportion to the portion of the premises not usable by Tenant. Landlord shall not be liable to Tenant for any delay in restoring the premises, Tenant's sole remedy being the right to an abatement of rent, as above provided. If (i) the premises are rendered wholly untenantable by fire or other casualty and if Landlord shall decide not to restore the premises, (ii) the premises are rendered wholly untenantable by fire or other casualty during the last twenty-four (24) months of the term hereof, or (iii) if the building shall be so damaged that Landlord shall decide to demolish it or to rebuild it (whether or not the premises have been damaged), Landlord may within ninety (90) days after such fire or other cause give written notice to Tenant of its election that the term of this lease shall automatically expire no less than ten (10) days after such notice is given. Tenant hereby expressly waives the provisions of Section 227 of the Real Property Law and agrees that the foregoing provisions of this Article shall govern and control in lieu thereof.

12. END OF TERM.

Tenant shall surrender the premises to Landlord at the expiration or sooner termination of this lease in good order and condition, except for reasonable wear and tear and damage by fire or other casualty, and Tenant shall remove all of its property. Tenant agrees that any personal property remaining in the demised premises following the expiration of the term of this lease (or such earlier date as of which the term hereof may have been terminated) shall for all purposes be deemed conveyed to and to be the property of Landlord who shall be free to dispose of such property, at Tenant's cost, in any manner Landlord deems desirable. Landlord may retain or assign any salvage or other residual value of such property. In consideration of Landlord's disposing of such property, Tenant shall reimburse Landlord or pay to Landlord any cost which Landlord may incur in disposing of such property within ten (10) days after

demand therefor. Tenant shall indemnify and save Landlord harmless against all costs, claims, loss or liability resulting from delay by Tenant in so surrendering the premises, including, without limitation, any claims made by any succeeding tenant founded on such delay. Additionally, the parties recognize and agree that other damage to Landlord resulting from any failure by Tenant timely to surrender the premises will be substantial, will exceed the amount of monthly rent theretofore payable hereunder, and will be impossible of accurate measurement. Tenant therefore agrees that if possession of the premises is not surrendered to Landlord within one (1) day after the expiration or sooner termination of the term of this lease, then Tenant will pay Landlord as liquidated damages for each month and for each portion of any month during which Tenant holds over in the premises after expiration or termination of the term of this lease, a sum equal to three times the average rent and additional rent which was payable per month under this lease during the last six months of the term thereof. The aforesaid obligations shall survive the expiration or sooner termination of the term of this lease. Anything in this lease to the contrary notwithstanding, the acceptance of any rent shall not preclude Landlord from commencing and prosecuting a holdover or summary eviction proceeding, and the preceding sentence shall be deemed to be an agreement expressly "providing otherwise" within the meaning of Section 232-c of the Real Property Law of the State of New York and any successor law of like import. Tenant expressly waives, for itself and for any person claiming through or under the Tenant, any rights which the Tenant or any such Person may have under the provisions of Section 2201 of the New York Civil Practice Law and Rules and of any successor law of like import then in force in connection with any holdover summary proceedings which the Landlord may institute. Tenant's obligations under this paragraph shall survive the expiration or sooner termination of the term of this lease. At any time during the term of this lease, Landlord may exhibit the premises to prospective purchasers or mortgagees of Landlord's interest therein. During the last year of the term of this lease, Landlord may exhibit the premises to prospective tenants.

13. SUBORDINATION AND ESTOPPEL, ETC.

A. This lease and Tenant's rights hereunder are and shall be subject and subordinate to any and all master leases of the building project, ground or underlying leases and to all mortgages, building loan agreements, leasehold mortgages, spreader and consolidation agreements and other similar documents and instruments (individually, a "Superior Interest" and collectively, "Superior Interests"), which may now or hereafter affect such leases or the real property of which the premises form a part and to all renewals, modifications, consolidations, replacements, extensions, assignments, spreaders, consolidations and refinancings thereof and to all advances made or hereafter made thereunder. This Article shall be self-operative and no further instrument of subordination shall be necessary. In confirmation of such subordination, Tenant shall within ten (10) days after written request execute any instrument in recordable form that Landlord or the holder of any Superior Interest may request. Tenant hereby appoints Landlord as Tenant's irrevocable attorney-in-fact to execute any document of subordination on behalf of Tenant. The foregoing power of attorney is a power coupled with an interest and not revocable during the term of this lease. In the event that the Master Lease or any other ground or underlying lease is terminated, or any mortgage foreclosed, this lease shall not terminate or be terminable by Tenant unless Tenant was specifically named in any termination or foreclosure judgment or final order for the purposes of terminating this lease or the interest of Tenant in the premises.

B. Any holder of a Superior Interest may elect that this lease shall have priority over such Superior Interest and, upon notification by such holder of a Superior Interest to Tenant, this lease shall be deemed to have priority over such Superior Interest, whether this lease is dated prior to or subsequent to the date of such Superior Interest. In the event that any master lease or any other ground or underlying lease is terminated as aforesaid, or if the interests of Landlord under this lease are transferred by reason of or assigned in lieu of foreclosure or other proceedings for enforcement of any mortgage, or if the holder of any mortgage acquires a lease in substitution therefor, or if the holder of any Superior Interest shall otherwise succeed to Landlord's estate in the lease or the building, or the rights of Landlord under this lease, then Tenant will, at the option to be exercised in writing by the lessor under any such master lease or other ground or underlying lease, the holder of any other Superior Interest or such purchaser, assignee or lessee, as the case may be, (i) attorn to it and will perform for its benefit all the terms, covenants and conditions of this lease on the Tenant's part to be performed with the same force and effect as if said lessor, mortgagee or such purchaser, assignee or lessee, were the landlord originally named in this lease, or (ii) enter into a new lease with said lessor, mortgagee or such purchaser, assignee or lessee, as landlord, for the remaining term of this lease and otherwise on the same terms, conditions and rentals as herein provided. The foregoing provisions shall inure to the benefit of any such successor landlord, shall apply notwithstanding that, as a matter of law, this lease may terminate upon the termination of any Superior Interest, shall be self-operative upon any such request and no further

instrument shall be required to give effect to said provisions; provided, however, that upon request of any such successor landlord, Tenant shall promptly execute and deliver, from time to time, any instrument in recordable form that any successor landlord may reasonably request to evidence and confirm the foregoing provisions of this paragraph, in form and content reasonably satisfactory to each such successor landlord, acknowledging such attornment and setting forth the terms and conditions of its tenancy. Upon such attornment, this lease shall continue in full force and effect as a direct lease between such successor landlord and Tenant upon all of the then executory terms of this lease except that such successor landlord shall not be: (a) liable for any previous act or omission or negligence of any prior landlord under this lease (including, without limitation, Landlord); (b) subject to any counterclaim, demand, defense, deficiency, credit or offset which Tenant might have against any prior landlord under this lease (including, without limitation, Landlord); (c) bound by any modification, amendment, cancellation or surrender of this lease or by any prepayment of more than one month's rent or additional rent, unless such modification, cancellation, surrender or prepayment shall have been approved in writing by the successor landlord; (d) bound by any security deposit, cleaning deposit or other prepaid charge which Tenant might have paid in advance to any prior landlord under this lease (including, without limitation, Landlord), unless such payments have been received by the successor landlord; and (e) bound by any agreement of any landlord under the lease (including, without limitation, Landlord) with respect to the completion of any improvements affecting the premises, the building, the land or any part thereof or for the payment or reimbursement to Tenant of any contribution to the cost of the completion of any such improvements.

C. If the then current term of any master, ground or other underlying lease to which this lease is subordinate shall expire prior to the date set forth herein for the expiration of this lease, then, unless (i) the term of such underlying or other lease shall have been extended, which extension Landlord may arbitrarily decline to enter into or (ii) the holder of any Superior Interest shall elect, in writing, to have Tenant attorn to it, the term of this lease shall expire on the date of the expiration of any master, ground or other underlying lease to which this lease is subordinate, notwithstanding the later termination date herein above set forth. If any such master, ground or other underlying lease is renewed or if the holder of any Superior Interest shall elect, in writing, to have Tenant attorn to it, then the term of this lease shall expire as herein above set forth and, Tenant shall attorn to the holder of such Superior Interest on the terms and conditions set forth in paragraph B above for attornment.

D. From time to time, Tenant, on ten (10) days' prior written request by Landlord, will deliver to Landlord and the holder of any Superior Interest a statement in writing certifying that this lease is unmodified and is in full

force and effect (or if there have been modifications, that the same is in full force and effect as modified and stating the modifications) and the dates to which the rent and other charges have been paid, stating the date of expiration of the term hereof and whether any renewal options exists (and if so, the terms thereof), stating whether any defense or counterclaim to the payment of any rent exists, whether any allowance or work is due to Tenant from Landlord, stating whether or not the Landlord is in default in performance of any covenant, agreement or condition contained in this lease and, if so, specifying each such default of which Tenant may have knowledge and containing such other information as the holder of any Superior Interest may request. If Tenant shall fail to deliver such a statement within such ten (10) day period, Landlord is hereby appointed the true and lawful attorney-in-fact of Tenant, coupled with an interest, for the purpose of executing and delivering such statement on behalf of Tenant. Nothing contained herein will be deemed to impair any right, privilege or option of the holder of any Superior Interest. If, in connection with obtaining, continuing or renewing financing or refinancing for the building and/or the land, the lender shall request reasonable modifications to this lease as a condition to such financing or refinancing, Tenant will not unreasonably withhold, delay or defer its consent thereto, provided that such modifications do not materially and adversely increase the obligations of Tenant hereunder (except, perhaps, to the extent that Tenant may be required to give notices of any defaults by Landlord to such lender with the granting of such additional time for such curing as may be required for such lender to get possession of the said building and/or land) or materially and adversely affect the leasehold interest hereby created or the rights of Tenant thereunder. If any act or omission by Landlord shall give Tenant the right, immediately or after the lapse of time, to cancel or terminate this lease or to claim a partial or total eviction, Tenant shall not exercise any such right until: (a) it shall have given written notice of such act or omission to each holder of any Superior Interest of which it has written notice, and (b) a reasonable period for remedying such act or omission shall have elapsed following such notice (which reasonable period shall be equal to the period to which Landlord would be entitled under this lease to effect such remedy, plus an additional thirty (30) day period), provided such holder or lessor shall, with reasonable diligence, give Tenant notice of its intention to remedy such act or omission and shall commence and continue to act upon such intention.

14. CONDEMNATION

A. In the event that the whole of the demised premises shall be lawfully condemned or taken in any manner for any public or quasi-public use or purpose, this lease and the term and estate hereby granted shall forthwith cease and terminate as of the date of vesting of title (hereinafter referred to as the "date of taking"), and Tenant shall have no claim against Landlord for, or make any claim for, the value of any unexpired term of this lease, and the rent and additional rent shall be apportioned as of such date.

B. In the event that any part of the demised premises shall be so condemned or taken, then this lease shall be and remain unaffected by such condemnation or taking, except that the rent and additional rent allocable to the part so taken shall be apportioned as of the date of taking, provided, however, that Tenant may elect to cancel this lease in the event more than twenty-five (25%) percent of the demised premises should be so condemned or taken, provided such notice of election is given by Tenant to Landlord not later than thirty (30) days after the date when title shall vest in the condemning authority. Landlord shall promptly give Tenant copies of any notice received from the condemning authority as to vesting. Upon the giving of such notice, this lease shall terminate on the thirtieth day following the date of such notice and the rent and additional rent shall be apportioned as of such termination date. Upon such partial taking and this lease continuing in force as to any part of the demised premises, the rent and additional rent shall be diminished by an amount representing the part of said rent and additional rent properly applicable to the portion or portions of the demised premises which may be so condemned or taken. If as a result of the partial taking (and this lease continuing in force as to the part of the demised premises not so taken), any part of the demised premises not taken is damaged, Landlord agrees with reasonable promptness to commence the work necessary to restore the damaged portion to the condition existing immediately prior to the taking (subject to paragraph D below), and prosecute the same with reasonable diligence to its completion. In the event Landlord and Tenant are unable to agree as to the

amount by which the rent and additional rent shall be diminished, the matter shall be determined by arbitration in New York City.

C. Nothing herein provided shall preclude Tenant from appearing, claiming, proving and receiving in the condemnation proceeding, Tenant's moving expenses, and the value of Tenant's fixtures, or Tenant's alterations, installations and improvements which do not become part of the building, or property of Landlord; or, in the case of temporary taking, so long as rent hereunder is paid to Landlord, Tenant may make a claim for rental value and damages to the demised premises (which are of a nature that Tenant is obligated hereunder to repair same) or damages to Tenant's furniture and fixtures.

D. In the event that only a part of the demised premises shall be so taken and Tenant shall not have elected to cancel this lease as above provided, the entire award for a partial taking shall be paid to Landlord, and Landlord, at Landlord's own expense, shall to the extent of the net proceeds (after deducting reasonable expenses including attorneys' and appraisers' fees) of the award restore the unaffected part of the building to substantially the same condition and tenability as existed prior to the taking.

E. Until said unaffected portion is restored, Tenant shall be entitled to a proportionate abatement of rent for that portion of the premises which is being restored and is not usable until the completion of the restoration or until the said portion of the premises is used by Tenant, whichever occurs sooner. Said unaffected portion shall be restored within a reasonable time but not more than six (6) months after the taking; provided, however, if Landlord is delayed by strike, lockout, the elements, or other causes beyond Landlord's control, the time for completion shall be extended for a period equivalent to the delay. Should Landlord fail to complete the restoration within the said six (6) months or the time as extended, Tenant may elect to cancel this lease and the term hereby granted provided such notice of election is given by Tenant to Landlord not later than thirty (30) days after the end of said six (6) months of time or the time as extended.

15. REQUIREMENTS OF LAW

A. Tenant at its expense shall comply with all laws, orders and regulations of any governmental authority having or asserting jurisdiction over the demised premises, which shall impose any violation, order or duty upon Landlord or Tenant with respect to the premises or the use or occupancy thereof including, without limitation, compliance in the demised premises with New York City Local Law No. 5/73, and all City, State and Federal laws, rules and

regulations on the disabled or handicapped, on fire safety and on hazardous materials. The foregoing shall not require Tenant to do structural work but shall require Tenant to perform work, including asbestos abatement and abatement of any other hazardous or toxic material that may become necessary by reason of any Tenant installation, alteration, improvement or work.

B. Tenant shall require every person engaged by him to clean any window in the premises from the outside, to use the equipment and safety devices required by Section 202 of the Labor Law and the rules of any governmental authority having or asserting jurisdiction.

C. Tenant at its expense shall comply with all requirements of the New York Board of Fire Underwriters, or any other similar body affecting the premises and shall not use the premises in a manner which shall increase the rate of fire insurance of Landlord or of any other tenant, over that in effect prior to this lease. If Tenant's use of the premises increases the fire insurance rate, Tenant shall reimburse Landlord for all such increased costs. That the premises are being used for the purpose set forth in Article 1 hereof shall not relieve Tenant from the foregoing duties, obligations and expenses.

16. CERTIFICATE OF OCCUPANCY

Tenant will at no time use or occupy the premises in violation of any certificate of occupancy issued for or statute governing the use of the building. The statement in this lease of the nature of the business to be conducted by Tenant shall not be deemed to constitute a representation or guaranty by Landlord that such use is lawful or permissible in the premises

under the certificate of occupancy for the building or any such statute.

17. POSSESSION

If Landlord shall be unable to give possession of the premises on the commencement date of the term because of the retention of possession of any occupant thereof, alteration or construction work, or for any other reason, except as hereinafter provided, Landlord shall not be subject to any liability for such failure. In such event, this lease shall stay in full force and effect, without extension of its term. However, the rent hereunder shall not commence until the demised premises are available for occupancy by Tenant. If delay in possession is due to work, changes or decorations being made by or for Tenant, or is otherwise caused by Tenant, there shall be no rent abatement and the rent shall commence on the date specified in this lease. If permission is given to Tenant to occupy the demised premises or other premises prior to the date specified as the commencement of the term, such occupancy shall be deemed to be pursuant to the terms of this lease, except that the parties shall separately agree as to the obligation of Tenant to pay rent for such occupancy. The provisions of this Article are intended to constitute an "express provision to the contrary" within the meaning of Section 223(a), New York Real Property Law.

18. QUIET ENJOYMENT

Landlord covenants that if Tenant pays the rent and additional rent and performs all of Tenant's other obligations under this lease, Tenant may peaceably and quietly enjoy the demised premises, subject to the terms, covenants and conditions of this lease and to the Master Lease and other Superior Interests.

19. RIGHT OF ENTRY

Tenant shall permit Landlord to erect and maintain pipes and conduits in and through the demised premises. Landlord or its agents shall have the right to enter or pass through the demised premises at all times, by master key, by reasonable force or otherwise, to examine the same, to exhibit the space to prospective tenants, purchasers, investors and lenders, and to make such repairs, installations, alterations or additions as to the building or the demised premises as may be required by law or as Landlord may deem necessary or desirable, and to take into and store within and upon the demised premises all material that may be used in connection with any such repair, installation, alteration or addition work. Such entry, storage and work in connection with any such repair, installation, alteration or addition shall not constitute an eviction (whether actual or constructive) of Tenant in whole or in part or breach of the covenant of quiet enjoyment, shall not be grounds for any abatement of rent, and shall not impose any liability on Landlord to Tenant by reason of inconvenience or injury to Tenant's business or to the demised

premises. Landlord shall have the right at any time, without the same constituting an actual or constructive eviction, and without incurring any liability to Tenant, to change the arrangement and/or location of entrances or passageways, windows, corridors, elevators, stairs, toilets, or other public parts of the building, and to change the name or number by which the building is known.

20. VAULT SPACE

Anything contained in any plan or blueprint to the contrary notwithstanding, no vault or other space not within the building property line is demised hereunder. Any use of such space by Tenant shall be deemed to be pursuant to a license, revocable at will by Landlord, without diminution of the rent payable hereunder. If Tenant shall use such vault space, any fees, taxes or charges made by any governmental authority for such space shall be paid by Tenant.

21. INDEMNITY

Tenant shall defend, indemnify and hold harmless Landlord, its agents, officers, directors, shareholders, partners, principals, employees and tenants in common (whether disclosed or undisclosed) (hereinafter collectively the "Landlord Parties") from and against any and all claims, demands, liability,

losses, damages, costs and expenses (including reasonable attorneys' fees and disbursements) arising from or in connection with: (a) any breach or default by Tenant in the full and prompt payment and performance of Tenant's obligations hereunder; (b) the use or occupancy or manner of use or occupancy of the demised premises by Tenant or any person claiming under or through Tenant; (c) any act, omission or negligence of Tenant or any of its subtenants, assignees or licensees or its or their partners, principals, directors, officers, agents, invitees, employees, guests, customers or contractors during the term hereof; (d) any accident, injury or damage occurring in or about the demised premises during the term hereof; (e) the performance by Tenant of any alteration in the demised premises including, without limitation, Tenant's failure to obtain any permit, authorization or license or failure to pay in full any contractor, subcontractor or materialmen performing work on such alteration; and (f) mechanics lien filed, claimed or asserted in connection with any alteration or any other work, labor, services or materials done for or supplied to, or claimed to have been done for or supplied to, or claimed to have been done for or supplied to Tenant, or any person claiming through or under Tenant. If any claim, action or proceeding is brought against any of the Landlord Parties for a matter covered by this indemnity, Tenant, upon notice from the indemnified person or entity, shall defend such claim, action or proceeding with counsel reasonably satisfactory to Landlord and the indemnified person or entity. The provisions of this Article shall survive the expiration or sooner termination of this lease.

22. LANDLORD'S LIABILITY

This lease and the obligations of Tenant hereunder shall in no way be affected because Landlord is unable to fulfill any of its obligations or to supply any service (e.g., heat, electricity, air conditioning (if Landlord is obligated hereunder to furnish the same), elevators, water), by reason of strike or other cause not within Landlord's control. Landlord shall have the right, without incurring any liability to Tenant, to stop any service because of accident or emergency, or for repairs, alterations or improvements, necessary or desirable in the judgment of Landlord to the building or the demised premises, until such repairs, alterations or improvements shall have been completed. Landlord shall not be liable to Tenant or anyone else, for any loss or damage to person, property or business, unless due to the negligence of Landlord nor shall Landlord be liable for any latent defect in the demised premises or the building. Landlord or its agents shall not be liable for any damage to property of Tenant or of others entrusted to employees of the building nor for the loss of or damage to any property of Tenant by theft or otherwise. Landlord or its agents shall not be liable for any injury or damage to persons or property resulting from fire, explosion, falling ceilings, falling plaster, steam, gas, electricity, water, rain or snow or leaks from any part of said building or from the pipes, appliances or plumbing works or from the roof, street or subsurface or from any other place or by dampness or by any other cause or whatsoever nature, including but not limited to the making or repairs and improvements, unless caused by or due to the negligence of Landlord, its agents, servants or employees; nor shall Landlord or its agents be liable for any such damage caused by other tenants or persons in said building or caused by operations in construction of any private, public or quasi public work; nor shall Landlord be liable for any latent defect in the demised premises or in the building. Tenant shall give immediate notice to Landlord in case of fire or accidents in the demised premises or in the building or of defects therein or in any fixtures or equipment. TENANT AGREES TO LOOK SOLELY TO LANDLORD'S ESTATE AND INTEREST IN THE

LAND AND BUILDING, OR THE LEASE OF THE BUILDING OR OF THE LAND AND BUILDING, AND THE DEMISED PREMISES, FOR THE SATISFACTION OF ANY RIGHT OR REMEDY OF TENANT FOR THE COLLECTION OF A JUDGMENT (OR OTHER JUDICIAL PROCESS) REQUIRING THE PAYMENT OF MONEY BY LANDLORD, IN THE EVENT OF ANY LIABILITY BY LANDLORD, AND NO OTHER PROPERTY OR ASSETS OF LANDLORD SHALL BE SUBJECT TO LEVY, EXECUTION OR OTHER ENFORCEMENT PROCEDURE FOR THE SATISFACTION OF TENANT'S REMEDIES UNDER OR WITH RESPECT TO THIS LEASE, THE RELATIONSHIP OF LANDLORD AND TENANT HEREUNDER, OR TENANT'S USE AND OCCUPANCY OF THE DEMISED PREMISES OR ANY OTHER LIABILITY OF LANDLORD TO TENANT (EXCEPT FOR NEGLIGENCE, IN WHICH CASE TENANT MAY ALSO LOOK TO THE PROCEEDS OF ANY INSURANCE CARRIED BY LANDLORD AND NOT PAYABLE UNDER INSURANCE TO BE MAINTAINED BY TENANT PURSUANT TO THE TERMS HEREOF). IN NO EVENT SHALL TENANT BE ENTITLED TO MAKE, NOR SHALL TENANT MAKE, ANY CLAIM, AND TENANT HEREBY WAIVES ANY CLAIM, FOR MONEY DAMAGES (NOR SHALL TENANT CLAIM ANY MONEY DAMAGES BY WAY OF SET-OFF, COUNTERCLAIM OR DEFENSE) BASED UPON ANY CLAIM OR

ASSERTION BY TENANT THAT LANDLORD HAS UNREASONABLY WITHHELD OR UNREASONABLY DELAYED ITS CONSENT OR APPROVAL TO A PROPOSED ASSIGNMENT OR SUBLETTING AS PROVIDED FOR IN THIS LEASE. TENANT'S SOLE REMEDY SHALL BE AN ACTION OR PROCEEDING TO ENFORCE ANY SUCH PROVISION, OR FOR SPECIFIC PERFORMANCE, INJUNCTION OR DECLARATORY JUDGMENT.

23. CONDITION OF PREMISES

Tenant expressly acknowledges that it has inspected the demised premises and is fully familiar with the physical condition thereof. Tenant agrees to accept the demised premises in their "as is" condition. Tenant acknowledges that Landlord (i) has made no representation respecting the physical condition of the demised premises, including the existence or non-existence of any hazardous substances, any defects or other matters concerning their physical condition and (ii) shall have no obligation to do any work in and to the demised premises in order to make them suitable and ready for occupancy and use by Tenant.

24. SERVICES

Landlord shall provide no services, except as specifically set forth in this lease. Tenant acknowledges that it has been advised that the cleaning contractor for the building may be a subdivision or affiliate of Landlord. Tenant agrees to employ said contractor, or such other contractor as Landlord may from time to time designate, for any waxing, polishing and other maintenance work in or to the demised premises and Tenant's furniture, fixtures and equipment, provided that the prices charged by said contractor are comparable to the prices charged by other contractors for the same work. Tenant agrees that it shall not employ any other cleaning and maintenance contractor, nor any individual, firm or organization for such purpose without Landlord's prior written consent. If Landlord and Tenant cannot agree on whether the prices being charged by the contractor designated by the Landlord are comparable to those charged by other contractors, Landlord and Tenant shall each obtain two bona fide bids for such work from reputable contractors, and the average of the four bids thus obtained shall be the standard of comparison. Landlord shall not be obligated to provide cleaning services in excess of the specifications set forth in Exhibit B annexed hereto and made part hereof.

25. JURY WAIVER, DAMAGES

THE PARTIES HERETO HEREBY WAIVE TO THE FULLEST EXTENT PERMITTED BY LAW, TRIAL BY JURY IN ANY ACTION, PROCEEDING OR COUNTERCLAIM BROUGHT BY EITHER OF SUCH PARTIES AGAINST THE OTHER WITH RESPECT TO ANY MATTER WHATSOEVER ARISING OUT OF OR IN ANY WAY CONNECTED WITH THIS LEASE, THE RELATIONSHIP OF LANDLORD AND TENANT, TENANT'S USE OR OCCUPANCY OF THE DEMISED PREMISES, OR FOR THE ENFORCEMENT OF ANY REMEDY WHETHER PURSUANT TO STATUTE, IN CONTRACT OR TORT, AND IRRESPECTIVE OF THE NATURE OR BASIS OF THE CLAIM INCLUDING BREACH OF AN OBLIGATION TO MAKE ANY PAYMENT, FRAUD, DECEIT, MISREPRESENTATION OF FACT, FAILURE TO PERFORM ANY ACT, NEGLIGENCE, MISCONDUCT OF ANY NATURE OR VIOLATION OF

STATUTE, RULE, REGULATION OR ORDINANCE. IF LANDLORD COMMENCES AGAINST TENANT ANY SUMMARY PROCEEDING OR OTHER ACTION TO RECOVER POSSESSION OF THE DEMISED PREMISES OR TO RECOVER ANY RENT, TENANT SHALL NOT INTERPOSE ANY COUNTERCLAIM OF WHATEVER NATURE OR DESCRIPTION IN ANY SUCH PROCEEDING OR ACTION. NO DAMAGES SHALL BE AWARDED AND TENANT HEREBY WAIVES ANY CLAIM FOR DAMAGES (WHETHER ACTUAL, COMPENSATORY, CONSEQUENTIAL, SPECIAL OR PUNITIVE) IN ANY ACTION OR PROCEEDING (WHETHER JUDICIAL OR AN ARBITRATION) RELATING TO LANDLORD'S WITHHOLDING, DELAYING OR CONDITIONING ANY CONSENT OR APPROVAL OR THE REASONABLENESS OF ANY SUCH WITHHOLDING, DELAY OR CONDITION.

26. NO WAIVER, ETC.

No act or omission of Landlord or its agents shall constitute an actual or constructive partial or total eviction or give rise to a right of Tenant to terminate this Lease or receive an abatement of any portion of its rent, or to be relieved of any other obligation hereunder or to be compensated for any loss or injury suffered by it, except as otherwise explicitly set forth herein. In the event that any payment herein provided for by Tenant to Landlord shall become overdue for a period in excess of ten (10) days, then at Landlord's option a "late charge" shall become due and payable to Landlord, as additional

rent, from the date it was due until payment is made at the following rates: for individual and partnership Tenants, said late charge shall be computed at the maximum legal rate of interest; for corporate or governmental entity Tenants the late charge shall be computed at two (2%) percent per month unless there is an applicable maximum legal rate of interest which then shall be used. No act or omission of Landlord or its agents shall constitute acceptance of a surrender of the demised premises, except a writing signed by Landlord. The delivery of keys to Landlord or its agents shall not constitute a termination of this lease or a surrender of the demised premises. Acceptance by Landlord of less than the rent herein provided shall at Landlord's option be deemed on account of earliest rent remaining unpaid. No endorsement on any check, or letter accompanying rent, shall be deemed an accord and satisfaction, and such check may be cashed without prejudice to Landlord. No waiver of any provision of this lease shall be effective, unless such waiver be in writing signed by Landlord. This lease contains the entire agreement between the parties, and no modification thereof shall be binding unless in writing and signed by the party concerned. Tenant shall comply with the rules and regulations set forth in the Rider attached hereto and made a part hereof, and any reasonable modifications thereof or additions thereto. Landlord shall not be liable to Tenant for the violation of such rules and regulations by any other tenant. Failure of Landlord to enforce any provision of this lease, or any rule or regulation, shall not be construed as the waiver of any subsequent violation of a provision of this lease, or any rule or regulation. This lease shall not be affected by nor shall Landlord in any way be liable for the closing, darkening or bricking up of windows in the demised premises, for any reason, including as the result of construction on any property of which the demised premises are not a part or by Landlord's own acts.

27. OCCUPANCY AND USE BY TENANT

A. Tenant acknowledges that its continued occupancy of the demised premises, and the regular conduct of its business therein, are of utmost importance to the Landlord in the renewal of other leases in the building, in the renting of vacant space in the building, in the providing of electricity, air conditioning, steam and other services to the tenants in the building, and in the maintenance of the character and quality of the tenants in the building. Tenant therefore covenants and agrees that it will occupy the entire demised premises, and will conduct its business therein in the regular and usual manner, throughout the term of this lease. Tenant acknowledges that Landlord is executing this lease in reliance upon these covenants, and that these covenants are a material element of consideration inducing the Landlord to execute this lease. Tenant further agrees that if it vacates the demised premises or fails to so conduct its business therein, at any time during the term of this lease, without the prior written consent of the Landlord, then all rent and additional rent reserved in this lease from the date of such breach to the expiration date of this lease shall become immediately due and payable to Landlord.

B. The parties recognize and agree that the damage to Landlord resulting from any breach of the covenants in paragraph A hereof will be extremely substantial, will be far greater than the rent payable for the balance of the term of this lease, and will be impossible of accurate measurement. The parties therefore agree that in the event of a breach or threatened breach of the said covenants, in addition to all of Landlord's other rights and remedies, at law or in equity or otherwise, Landlord shall have the right of injunction to

preserve Tenant's occupancy and use. The words "become vacant or deserted" as used elsewhere in this lease shall include Tenant's failure to occupy or use as by this Article required.

C. If Tenant breaches either of the covenants in paragraph A above, and this lease shall be terminated because of such default, then, in addition to Landlord's right of reentry, restoration, preparation for and rerental, and anything elsewhere in this lease to the contrary notwithstanding, Landlord shall retain its right to judgement on and collection of Tenant's aforesaid obligation to make a single payment to Landlord of a sum equal to the total of all rent and additional rent reserved for the remainder of the original term of this lease, subject to future credit or repayment to Tenant in the event of any rerenting of the demised premises by Landlord, after first deducting from rerental income all expenses incurred by Landlord in reducing to judgment or otherwise collecting Tenant's aforesaid obligation, and in obtaining possession of restoring, preparing for and re-letting the demised premises. In no event shall Tenant be

entitled to a credit or repayment for rerental income which exceeds the sums payable by Tenant hereunder or which covers a period after the original term of this lease.

D. Tenant shall not obstruct or permit the obstruction of the light, halls, areas, roof, stairway or entrances to the building, and will not affix, erect or inscribe any signs, projections, awnings, signals or advertisements of any kind to any part of the demised premises including the inside or outside of the windows or doors thereof and will not paint the outside of the doors thereof or the inside or outside of the windows thereof unless and until the style, size, color, construction and location thereof have been approved in writing by Landlord. Landlord shall have the right to withdraw such approval at any time and to require Tenant to remove any such signs, projections, awnings, signals or advertisements. Landlord also reserves to itself the sole right to designate the person, firm or corporation which shall do the work of lettering and erecting of any and all signs to be affixed to the demised premises or the building. In the event that said work is done by Tenant through any person, firm or corporation, other than that designated by Landlord, Landlord is hereby given the right to remove said signs without being liable to Tenant by reason thereof and to charge the cost of so doing to Tenant as additional rent payable on the first day of the next following month, or at Landlord's option, on the first day of any subsequent month.

28. NOTICES

Any bill, notice or demand from Landlord to Tenant, may be delivered personally at the demised premises or sent by registered or certified mail. Such bill, notice or demand shall be deemed to have been given at the time of delivery or mailing. Any notice from Tenant to Landlord must be in writing and sent by registered or certified mail to the last address designated in writing by Landlord and shall be deemed to have been given when received.

29. WATER

Tenant shall pay the amount of Landlord's cost for all water used by Tenant for any purpose other than ordinary lavatory uses, and any sewer rent or tax based thereon. Landlord may install a water meter to measure Tenant's water consumption for all purposes and Tenant agrees to pay for the installation and maintenance thereof and for water consumed as shown on said meter. If water is made available to Tenant in the building or the demised premises through a meter which also supplies other premises, or without a meter, then Tenant shall pay to Landlord a reasonable charge per month for water.

30. SPRINKLER SYSTEM

If there shall be a "sprinkler system" in the demised premises for any period during this lease, Tenant shall pay a reasonable charge per month, for sprinkler supervisory service. If such sprinkler system is damaged by any act or omission of Tenant or its agents, employees, licensees or visitors, Tenant shall restore the system to good working condition at its own expense. If the New York Board of Fire Underwriters, the New York Fire Insurance Exchange, the Insurance Services Office or any governmental authority requires the installation or any alteration to a sprinkler system by reason of Tenant's occupancy or use of the demised premises, including any alteration necessary to obtain the full allowance for a sprinkler system in the fire insurance rate of Landlord, or for any other reason, Tenant shall make such installation or alteration promptly, and at its own expense.

31. HEAT, AIR-CONDITIONING, ELEVATOR, ETC.

A. Landlord shall provide elevator service during all usual business hours including Saturdays until 1 P.M., except on Sundays, State holidays, Federal holidays, or Building Service Employees Union Contract holidays; provided, however, at least one (1) passenger or freight elevator shall be available on a call basis at all times. Landlord shall furnish heat to the demised premises during the same hours on the same days in the cold season in each year. Landlord shall cause the demised premises to be kept clean in accordance with the cleaning specifications set forth on Exhibit B annexed hereto and made part hereof, provided they are kept in order by Tenant. Landlord, its cleaning contractor and their employees shall have after-hours

access to the demised premises and the use of Tenant's light, power and water in the demised premises as may be reasonably required for the purpose of cleaning the demised premises. Landlord may remove Tenant's extraordinary refuse from the building and Tenant shall pay the cost thereof. If the elevators in the building are manually operated, Landlord may convert to automatic elevators at any time, without in any way affecting Tenant's obligations hereunder.

B. During the term of this lease, Tenant may use any air-conditioning equipment located in the demised premises. Landlord shall at Tenant's expense, inspect, maintain, repair and replace as necessary any such equipment and shall bill Tenant for each such repair and replacement work performed by or on behalf of Landlord at rates that are competitive in the market and Tenant shall pay the same upon demand as additional rent hereunder. All such equipment is and shall remain the property of Landlord. Tenant shall not abuse or use any such equipment, except in accordance with the instructions that may accompany such equipment and the design and performance specifications therefor. Tenant shall reimburse Landlord upon demand for any damage to such equipment caused by Tenant or any invitee of Tenant and for any replacement equipment made necessary by reason of Tenant's breach of the covenant contained in the preceding sentence. This obligation shall survive the expiration or earlier termination of the term hereof. Notwithstanding the preceding provisions of this paragraph, if air-conditioning is provided to the demised premises by means of a central system or package or other units that also provide air-conditioning to any portion of the building other than the demised premises, Landlord shall maintain, repair and replace the same as hereinabove provided but the charges therefor shall be prorated among all persons who are the recipients of such service based upon the ratio of rentable square feet leased to each such recipient of service and the aggregate rentable square feet serviced by such equipment. For the purposes of this paragraph, rentable square feet shall be determined pursuant to standards then being applied throughout the building by Landlord for new leases. In any case where Landlord is providing air-conditioning or if Landlord is providing chilled water or condensor water for air-conditioning units serving only the demised premises, Landlord shall supply such service between May 15, and October 15, each year throughout the term and Tenant shall reimburse Landlord, in accordance with Article 3 of this lease, for electricity consumed by the equipment.

C. In no event shall Landlord be required to furnish heat, air-conditioning or ventilation during hours other than those as set forth in paragraphs A or B above, as applicable; provided, however, that Landlord shall provide after-hours air-conditioning or after-hours heating at Landlord's then existing schedule of rates for overtime air-conditioning and after-hours heating for tenants in the Building, provided that Tenant shall give notice to Landlord, requesting such after-hours air-conditioning or heating, prior to 3:00 p.m. in the case of after hours service on weekdays and prior to 1:00 p.m. on Fridays in the case of after-hours service on weekends.

D. Tenant shall be permitted access to the demised premises on a twenty-four hour per day, seven day a week basis, subject to emergencies, requirements of law and the provisions of this lease.

32. SECURITY DEPOSIT

A. Tenant has deposited with Landlord the sum of $7,200.00 as security for the performance by Tenant of the terms of this lease. Landlord may use any part of the security to satisfy any default of Tenant and any expenses arising from such default, including but not limited to any damages or rent deficiency before or after re-entry by Landlord. Tenant shall, upon demand, deposit with Landlord the full amount so used, in order that Landlord shall have the full security deposit on hand at all times during the term of this lease. If Tenant shall comply fully with the terms of this lease, the security shall be returned to Tenant after the date fixed as the end of this lease. In the event of a sale or Lease of the building containing the demised premises, Landlord may transfer the security to the purchaser or tenant, and Landlord shall thereupon be released from all liability for the return of the security. This provision shall

apply to every transfer or assignment of the security to a new Landlord. Tenant shall no legal power to assign or encumber the security herein described.

B. Landlord may, in its sole discretion, hold such security in an

interest-bearing savings account, in which case Tenant shall be entitled to the interest earned thereon annually, less the maximum administrative fee allowed by law to which Landlord shall be entitled under law.

C. It is agreed that in the event Tenant defaults in respect of any of the terms, provisions and conditions of this lease, including, but not limited to, the payment of fixed annual rent and additional rent, Landlord may use, apply or retain the whole or any part of the security so deposited to the extent required for the payment of any fixed annual rent and additional rent or any other sum as to which Tenant is in default or for any sum which Landlord may expend or may be required to expend by reason of Tenant's default in respect of any of the terms, covenants and conditions of this lease, including, but not limited to, any damages or deficiency in the reletting of the demised premises, whether such damages or deficiency accrued before or after summary proceedings or other re-entry by Landlord. In the event that Tenant shall fully and faithfully comply with all of the terms, provisions, covenants and conditions of this lease, the security deposit shall be returned to Tenant after the date fixed as the end of the Lease and after delivery of entire possession of the demised premises to Landlord in the condition required hereunder. In the event of a sale of the land and building or leasing of the building, Landlord shall have the right to transfer the security to the vendee or lessee and Landlord shall thereupon be released by Tenant from all liability for the return of such security; and Tenant agrees to look solely to the new owner for the return of said security, and it is agreed that the provisions hereof shall apply to every transfer or assignment made of the security to a new owner. Tenant further covenants that it shall not assign or encumber or attempt to assign or encumber the monies or the letter to credit deposited herein as security and that neither Landlord nor its successors or assigns shall be bound be any such assignment, encumbrance, attempted assignment or attempted encumbrance. In the event Landlord applies or retains any portion or all of the security deposited, Tenant shall forthwith restore the amount so applied or retained so that at all times the amount deposited shall be the amount herein above then required to be maintained as the security deposit, exclusive of accrued interest.

33. RENT CONTROL

In the event the fixed annual rent or additional rent or any part thereof provided to be paid by Tenant under the provisions of this lease during the demised term shall become uncollectible or shall be reduced or required to be reduced or refunded by virtue of any Federal, State, County or City law, order or regulation, or by any direction of a public officer or body pursuant to law, or the orders, rules, codes or regulations of any organization or entity formed pursuant to law, whether such organization or entity be public or private, then Landlord, at its option, may at anytime thereafter terminate this lease, by not less than thirty (30) days' written notice to Tenant, on a date set forth in said notice, in which event this lease and the term hereof shall terminate and come to an end on the date fixed in said notice as if the said date were the date originally fixed herein for the termination of the demised term. Landlord shall not have the right so to terminate this lease if Tenant within such period of thirty (30) days shall in writing lawfully agree that the rentals herein reserved are a reasonable rental and agree to continue to pay said rentals, and if such agreement by Tenant shall then be legally enforceable by Landlord.

34. SHORING

Tenant shall permit any person authorized to make an excavation on land adjacent to the building containing the demised premises to do any work within the demised premises necessary to preserve the wall of the building from injury or damage, and Tenant shall have no claim against Landlord for damages or abatement of rent by reason thereof.

35. EFFECT OF CONVEYANCE, ETC.

If the building containing the demised premises shall be sold, transferred or leased, or the lease thereof transferred or sold, Landlord shall be relieved of all future obligations and liabilities hereunder and the purchaser, transferee or tenant of the building shall be deemed to have assumed and agreed to perform all such obligations and liabilities of Landlord hereunder. In the event of such sale, transfer or lease, Landlord shall also be

relieved of all existing obligations and liabilities hereunder, provided that the purchaser, transferee or tenant of the building assumes in writing such obligations and liabilities.

36. RIGHTS OF SUCCESSORS AND ASSIGNS

This lease shall bind and inure to the benefit of the heirs, executors, administrators, successors, and, except as otherwise provided herein, the assigns of the parties hereto. If any provision of any Article of this lease or the application thereof to any person or circumstances shall, to any extent, be invalid or unenforceable, the remainder of that Article, or the application of such provision to persons or circumstances other than those as to which it is held invalid or unenforceable, shall not be affected thereby, and each provision of said Article and of this lease shall be valid and be enforced to the fullest extent permitted by law.

37. CAPTIONS

The captions herein are inserted only for convenience, and are in no way to be construed as a part of this lease or as a limitation of the scope of any provision of this lease.

38. LEASE SUBMISSION

Landlord and Tenant agree that this lease is submitted to Tenant on the understanding that it shall not be considered an offer and shall not bind Landlord in any way unless and until (i) Tenant has duly executed and delivered duplicate originals thereof to Landlord and (ii) Landlord has executed and delivered one of said originals to Tenant.

39. ELEVATORS AND LOADING

A. There shall be no major loading or unloading in the building between 7:30 a.m. and 6:00 p.m. or on any Saturday, Sunday or holiday. Tenant acknowledges it has been advised that the freight elevators servicing the building can be used from 7:30 a.m. to 4:45 p.m. on business days only for less than truck load deliveries which will not unreasonably interfere with use of the freight elevator by or on behalf of Landlord and the other tenants of the building.

B. It is the intention of Landlord to maintain in the building, operatorless automatic control elevators. However, Landlord may, at its option, maintain in the building either manually operated elevators or operatorless automatic control elevators or part one and part the other, and Landlord shall have the right from time to time during said term, to change, in whole or in part, from one to the other without notice to Tenant and without in any way constituting an eviction of Tenant or affecting the obligations of Tenant hereunder or incurring any liability to Tenant hereunder.

40. BROKERAGE

Tenant represents and warrants that it neither consulted nor negotiated with any broker or finder with regard to the demised premises other than Cushman & Wakefield, Inc. and Manhattan Office Space (Jeff Zegarac). Tenant agrees to indemnify, defend and save Landlord harmless from and against any claims for fees or commissions from anyone other than Cushman & Wakefield, Inc. and Manhattan Office Space (Jeff Zegarac) with whom Tenant has dealt in connection with the demised premises or this lease. Landlord agrees to pay any commission or fee owing to the aforesaid Cushman & Wakefield, Inc. and Manhattan Office Space (Jeff Zegarac) pursuant to separate agreements with them. Nothing in this Article 40 shall be construed to be a third party beneficiary contract.

41. ARBITRATION

In each case specified in this lease in which resort to arbitration shall be required, such arbitration (unless otherwise specifically provided in other Sections of this Lease) shall be in Manhattan in accordance with the Commercial Arbitration Rules of the American Arbitration Association and the provisions of this lease, and judgment upon the award rendered by the arbitrators may be entered in any court having jurisdiction thereof.

42. INSURANCE

The following requirements (collectively, the "Insurance Requirements") shall be complied with by Tenant at all times during the term hereof:

A. At all times during the term hereof, Tenant shall maintain, at Tenant's expense, the following insurance coverage:

(i) all risk property insurance, including theft and, if applicable, boiler and machinery coverage, written at replacement cost value in an adequate amount to avoid coinsurance and a replacement cost endorsement insuring Tenant's trade fixtures, furnishings, equipment and all items of personal property of Tenant and including property of Tenant's customers or clients, as the case may be, located in the demised premises;

(ii) broad form commercial general liability insurance written on a per occurrence basis with a per occurrence limit of not less than $2,000,000 and with other limits reasonably satisfactory to Landlord;

(iii) business interruption insurance covering risk of loss due to the occurrence of any of the hazards covered by the insurance to be maintained by Tenant described in paragraph A(i) with coverage in a face amount of not less than the aggregate amount, for a period of 12 months following the insured-against peril, of 100% of all fixed annual rent and additional rent to be paid by Tenant under this Lease;

(iv) worker's compensation insurance and employer's liability coverage in statutory limits, and New York State disability insurance as required by law, covering all employees; and

(v) such other coverage as Landlord may reasonably require with respect to the demised premises, its use and occupancy and the conduct or operation of business therein.

Landlord may, from time to time, but not more frequently than once every year, adjust the minimum limits set forth above.

B. All insurance policies to be maintained as set forth above (i) shall be issued by companies of recognized responsibility, licensed and admitted to do business in the State of New York, reasonably acceptable to Landlord, and maintaining a rating of A-/XII or better in Best's Insurance Reports-Property-Casualty (or an equivalent rating in any successor index adopted by Best's or its successor), (ii) shall provide that they may not be canceled or modified unless Landlord and all additional insureds and loss payees thereunder are given at least thirty (30) days prior written notice of such cancellation or modification, (iii) shall name, as additional insureds, Landlord, the managing agent of the building and any other person or entity whose name and address shall have been furnished to Tenant and (iv) shall be primary and non-contributory in all respects. All policies providing fire and extended coverage property insurance coverage pursuant to paragraph A(i) shall name Landlord as loss payee with respect to improvements and alterations, and shall name Tenant as loss payee with respect to Tenant's property.

C. Prior to the commencement date of the term hereof, Tenant shall deliver to Landlord certificates of insurance for the insurance coverage required by paragraph A and, if required by Landlord, copies of the policies therefore, in each case in form and providing for deductibles reasonably satisfactory to Landlord. Tenant shall procure and pay for renewals of such insurance from time to time before the expiration thereof, and Tenant shall deliver to Landlord certificates of renewal at least thirty (30) days before the expiration of any existing policy. If Tenant fails to procure or maintain any insurance required by this Lease and to pay all premiums and charges therefor, Landlord may (but shall not be obligated to) pay the same, and Tenant shall reimburse Landlord, within twenty (20) days after demand, for all such sums paid

by Landlord. Any such payment shall not cure or waive any default by Tenant in the performance of its obligations hereunder, nor shall the foregoing right of Landlord to make such payment in any way limit, reduce, diminish or impair the rights of Landlord under the terms of this Lease or at law or in equity arising

as a result of any such default.

D. Tenant shall not carry separate or additional insurance, concurrent in form or contributing in the event of any loss or damage with any insurance required to be obtained by Tenant under this Lease unless the parties required by paragraph B above to be named as additional insureds or loss payees thereunder are so named. Tenant may carry any insurance coverage required of it hereunder pursuant to blanket policies of insurance so long as the coverage afforded Landlord and the other additional insureds or loss payees thereunder, as the case may be, shall not be less than the coverage that would be provided by direct policies.

E. Tenant agrees to include, if obtainable at no additional cost, in its fire insurance policy or policies on its furniture, furnishings, fixtures and other property removable by Tenant under the provisions of its lease of space in the building appropriate clauses pursuant to which the insurance company or companies (i) waive the right of subrogation against Landlord and/or any tenant of space in the building with respect to losses payable under such policy or policies and/or (ii) agree that such policy or policies shall not be invalidated should the insured waive in writing prior to a loss any or all right of recovery against any party for losses covered by such policy or policies. But should any additional premium be exacted for any such clause or clauses, Tenant shall be released from the obligation hereby imposed unless Landlord or the other tenants shall agree to pay such additional premium.

43. CHANGE OF LOCATION

A. Tenant covenants and agrees that Landlord shall have the absolute and unqualified right, upon notice to Tenant, to designate as the demised premises that part of any other floor in the building that approximately corresponds to the premises demised hereunder; provided, however, that (a) such substituted space (hereinafter called "Substituted Space") shall be substantially the equivalent in the appearance of the demised premises upon completion of Landlord's work, if any, to make the Substitute Space ready for Tenant's occupancy and (b) Landlord shall move Tenant to the Substituted Space at Landlord's cost. Such notice shall specify and designate the Substituted Space so substituted for the demised premises. Notwithstanding such substitution of space, this lease and all the terms, provisions, covenants and conditions contained in this lease shall remain and continue in full force and effect, except that the demised premises shall be and be deemed to be such substituted space, with the same force and effect as if the Substituted Space were originally specified in this lease as the premises demised hereunder.

B. In the event of the substitution of space as provided in paragraph A above, Tenant, upon three (3) months' prior written notice given by Landlord to Tenant, shall move to the Substituted Space at Landlord's expense, and upon failure of Tenant to so move to the Substituted Space, Landlord may, as Tenant's agent, remove Tenant from the demised premises to the Substituted Space. Failure of Tenant to move to the Substituted Space pursuant to this Article shall be deemed a substantial breach of this lease.

C. Following such substitution of space (pursuant to this Article) if any, Landlord and Tenant shall, promptly at the request of either party, execute and deliver an agreement in recordable form setting forth such substitution of space and the effective date thereof.

44. LATE CHARGES

If Tenant shall fail to pay all or any part of any installment of fixed annual rent or additional rent for more than ten (10) days after the same shall have become due and payable, Tenant shall pay, upon demand, as additional rent hereunder to Landlord a late charge of four ($.04) cents for each dollar of the amount of such fixed annual rent or additional rent which shall not have been paid to Landlord within such ten (10) days after becoming due and payable. Tenant acknowledges that the payment of rent after the date when first due shall result in loss and injury to Landlord the exact amount of which is not susceptible of reasonable calculation and that the aforesaid amount of late charge represents a reasonable estimate of such losses and injury under the circumstances, especially after taking into account the grace period hereby afforded Tenant before such late charge is to be imposed. The late charge payable pursuant to this Article 44 shall be without prejudice to any of Landlord's rights and remedies hereunder at law and equity for non-payment or

late payment of rent or other sums and in addition to any such rights and remedies, including the right to institute and prosecute a proceeding under Article 7 of the Real Property Actions and Proceedings Law. No failure by Landlord to insist upon the strict performance by Tenant of Tenant's obligation to pay late charges as provided in this Article shall constitute a waiver by Landlord of its right to enforce the provisions of this Article in any instance thereafter occurring. The provisions of this Article shall not be construed in any way to extend the grace periods or notice periods provided for elsewhere in this lease.

45. ENVIRONMENTAL COMPLIANCE

A. (i) Tenant shall comply with all federal, state and local environmental protection and regulatory laws applicable to the demised premises.

(ii) Tenant shall not use, generate, manufacture, store or dispose of any hazardous substance on, under or about the demised premises or the building nor transport any hazardous substance thereto. Tenant shall immediately advise the Landlord, in writing of any and all enforcement, clean-up, remediation, removal or other governmental or regulatory actions instituted, completed or threatened pursuant to any applicable laws relating to any hazardous substances; and all claims, made or threatened by any person (including a governmental authority) against the demised premises, Tenant or Landlord relating to any damage, injury, costs, remedial action or cost recovery compensation arising out of or due to the existence of any hazardous substance in or about the demised premises or the building.

B. Tenant shall defend, indemnify and hold Landlord harmless from and against all actions, causes of action, claims, lawsuits, administrative proceedings, hearings, judgments, awards, fines, penalties, costs (including legal, engineers', experts', investigatory and consulting fees), damages, remediation activities and clean-up costs, liens, and all other liabilities incurred by Landlord whenever incurred, arising out of any Tenant's act or failure to act resulting in (i) the existence or presence (or alleged existence or presence) on or about the building of any hazardous substance or the release of any hazardous substance into the environment; (ii) any personal injury or property damage resulting from any hazardous substance in or about the building; (iii) the violation of any federal, state or municipal environmental protection or regulatory law; or (iv) the commencement or prosecution of any judicial or administrative procedure arising out of any claims under any federal, state or municipal environmental protection or regulatory law or common law cause of action in which Landlord is named a party or in which it may intervene. The obligations of Tenant under this paragraph B shall survive the expiration or earlier termination of the term hereof.

C. "Hazardous substance" means any hazardous substance as defined in the Comprehensive Environmental Response, Compensation and Liability Act of 1980, 42 U.S.C. ss.ss. 9601 et seq., as amended by the Superfund Amendments and Reauthorization Act of 1986; hazardous waste as defined in the Resource Conservation and Recovery Act of 1976, 42 U.S.C. ss.ss. 6901 et seq., as any of the foregoing may be amended or superseded; oil; petroleum product, derivative, compound or mixture; mineral, including asbestos; chemical; gas; medical waste; polychlorinated biphenyls (pcb's); methane; radon; radioactive material; volatile hydrocarbons; or other material, whether naturally occurring, man-made or the by-product of any process, which is toxic, harmful or hazardous or acutely hazardous to the environment or public health or safety; or any other substance the existence of which on or at any property would be the basis for a claim for damages, clean-up costs or remediation costs, fine, penalty or lien under any federal, state or municipal environmental protection or regulatory law or applicable common law.

46. LEASE FULLY NEGOTIATED

In construing this lease, it shall be deemed to be a document fully negotiated and drafted jointly by counsel to Landlord and counsel to Tenant and the authorship of any term or provision hereof shall not be deemed germane to its meaning. The existence or non-existence in any prior draft hereof of any term or provision whether included herein or not shall not be relevant to the establishment of the intent of the parties hereto or the meaning of any term or provision hereof and may not be used as evidence to establish any such intent or meaning.

47. SMOKING RESTRICTIONS

Landlord hereby prohibits all smoking of cigarettes, cigars, other tobacco products or any other substances and the use of pipes and other paraphernalia for such purposes within the building and the premises. Without limiting Landlord's rights under the preceding sentence, Tenant shall enforce within the demised premises all applicable laws, rules and regulations regarding smoking.

48. ADDITIONAL DEFINITIONS

The term "real estate taxes" shall, in addition to the items referred to in Article 2, include assessments, impositions and levies imposed by business special tax districts. "Business days" shall mean all days, except Saturdays, Sundays, and all days celebrated as holidays under union contracts applicable to the building. The words "herein," "hereof," "hereto," "hereunder" and similar words shall be interpreted as being references to this lease as a whole and not merely the clause, paragraph, Section or Article in which such word appears. The term "demised premises" is used interchangeably with the term "premises". The words "shall" and "will" are interchangeable, each imposing a mandatory obligation upon the party to whom such verb applies. The words ""include" and "including" shall be interpreted to mean "including, without limitation." The word "control" and the variations thereof used in this lease shall have the meanings ascribed to them under the Securities Act of 1933, as amended, and the regulations promulgated under it. Wherever appropriate in this lease, personal pronouns shall be deemed to include the other genders and the singular or plural of any defined term or other word shall, as the context may require, be deemed to include, as the case may be, either the singular or the plural. All Article and paragraph and subsection references set forth herein shall, unless the context otherwise specifically requires, be deemed references to the Articles, paragraphs and subsections of this lease. Wherever herein Tenant is required to comply with laws, orders and regulations of any governmental authority having or asserting jurisdiction over the demised premises, such laws, orders and regulations shall include, as and where applicable to the demised premises: the Americans with Disabilities Act of 1990, Local Law 5/1973, Local Laws 16/1984, and 16/1987, Local Law 58/1987, Local Law 76/1985 and Local Law 80/1985, as each may be amended and any successor statutes of like or similar import. References to Landlord as having no liability to Tenant or being without liability to Tenant shall mean that, except as otherwise provided in this lease, Tenant is not entitled to terminate this lease, or to claim actual or constructive eviction, partial or total, or to receive any abatement or diminution of rent, or to be relieved in any manner of any of its other obligations hereunder, or to be compensated for loss or injury suffered or to enforce any other kind of liability whatsoever against Landlord under or with respect to this lease or with respect to tenant's use or occupancy of the demised premises.

50. SUBSTITUTE LEASE

If Tenant shall consummate a lease with Landlord in the building for vacant space at least fifty percent (50%) larger than the premises demised hereunder, Tenant shall have the right to cancel this lease but such cancellation right shall be effective only upon strict compliance with the following terms and conditions:

(a) Tenant shall notify Landlord within five (5) days after consummating such new lease of its intention to cancel this lease. The cancellation date shall be either: (i) within ninety (90) days of the effective date of the new lease for larger space; or (ii) any April 30 or October 31, during the remaining period the term of this lease.

(b) It is understood and agreed that the aforesaid cancellation right is conditioned upon Tenant's not being in default under any of the terms, covenants and conditions of this lease, beyond any grace period, at the date of delivery of any such cancellation notice and on the cancellation date. Notwithstanding any such cancellation by Tenant hereunder, Tenant shall remain liable to cure any default under any of the terms, covenants and conditions of this lease existing on the cancellation date. Such liability of Tenant shall survive any such cancellation.

(c) Tenant shall vacate the premises demised hereunder and surrender possession thereof to Landlord, in broom clean condition and otherwise in accordance with all terms, conditions and covenants of this lease on or prior to the cancellation date.

IN WITNESS WHEREOF, Landlord and Tenant have executed this lease as of the day and year first above written.

LANDLORD:

FISK BUILDING ASSOCIATES L.L.C.

By: Cushman & Wakefield, Inc., as Agent

By: _____

Name:

Title:

TENANT:

AROTECH CORPORATION

By: _____

Name:

Title:

EXHIBIT A

to lease

between

Fisk Building Associates L.L.C., Landlord

and

Arotech Corporation, Tenant

Diagram of Demised Premises

EXHIBIT B

to lease

between

Fisk Building Associates L.L.C., Landlord

and

Arotech Corporation, Tenant

Cleaning Schedule

1. General

All flooring swept nightly.
All carpeted areas and rugs carpet-swept nightly and vacuum cleaned weekly.
Wastepaper baskets and ashtrays emptied nightly (excluding kitchen and kitchenette areas and all so-called "wet" garbage) and damp dusted when necessary.
All baseboards, chair rails and trim dusted nightly.
All water fountains washed clean nightly.

2. Lavatories (other than Tenant's private and executive lavatories)

All flooring swept and washed nightly.
All basins, bowls, urinals and toilet seats (both sides) washed nightly. All partitions, tile walls, dispensers and receptacles dusted nightly.
Paper towel and sanitary disposal receptacles emptied and cleaned nightly (and replenished at Tenant's expense).

3. High Dusting - Office Area

Do all high dusting approximately once a month, including the following:

Dust all pictures, frames, charts, graphs and panel wall hangings not reached in nightly cleaning.
Dust all vertical surfaces such as walls, partitions, ventilating louvres and other surfaces not reached in nightly cleaning.
Dust all lighting fixtures (exterior only).
Dust all overhead pipes, sprinklers, etc.
Dust all Venetian blinds and window frames approximately once every two months.

4. Periodic Cleaning - Office Area

Wipe clean all interior metal as necessary.
Dust all door louvres and other ventilating louvres within reach weekly.

5. Periodic Cleaning - Lavatories (other than Tenant's private and executive lavatories)

Machine-scrub flooring when necessary.
Wash all partitions, tile walls and enamel surfaces monthly with proper disinfectant when necessary.
Dust exterior of lighting fixtures monthly.

6. Windows

Clean outside windows, when necessary, approximately 2 times a year, weather and scaffold conditions permitting.

SCHEDULE A

RULES AND REGULATIONS REFERRED TO IN THIS LEASE

1. No animals, birds, bicycles or vehicles shall be brought into or kept in the premises. The premises shall not be used for manufacturing or commercial repairing or for sale or display or merchandise or as a lodging

place, or for any immoral or illegal purpose, nor shall the premises be used for a public stenographer or typist; barber or beauty shop; telephone, secretarial or messenger service; employment, travel or tourist agency; school or classroom; commercial document reproduction; or for any business other than specifically provided for in the tenant's lease. Tenant shall not cause or permit in the premises any disturbing noises which may interfere with occupants of this or neighboring building, any cooking or objectionable odors, or any nuisance of any kind, or any inflammable or explosive fluid, chemical or substance. Canvassing, soliciting and peddling in the building are prohibited, and each tenant shall cooperate so as to prevent the same.

2. The toilet rooms and other water apparatus shall not be used for any purposes other than those, for which they were constructed, and no sweepings, rags, ink, chemicals or other unsuitable substances shall be thrown therein. Tenant shall not throw anything out of doors, windows or skylights or into hallways, stairways or elevators, nor place food or objects on outside windowsills. Tenant shall not obstruct or cover the halls, stairways and elevators, or use them for any purpose other than ingress and egress to or from tenant's premises, nor shall skylights, windows, doors and transoms that reflect or admit light into the building be covered or obstructed n any way.

3. Tenant shall not place a load upon any floor of the premises in excess of the load per square foot, which such floor was designed to carry and which is allowed by law. Landlord reserves the right to prescribe the weight and position of all safes in the premises. Business machines and mechanical equipment shall be placed and maintained by tenant, at tenant's expense, only with Landlord's consent and in settings approved by Landlord to control weight, vibration, noise and annoyance. Smoking or carrying lighted cigars, pipes or cigarettes in the elevators of the building is prohibited. If the premises are on the ground floor of the building the tenant thereof at its expense shall keep the sidewalks and curb in front of the premises clean and free from ice, snow, dirt and rubbish.

4. Tenant shall not move any heavy or bulky materials into or out of the building without Landlord's prior written consent, and then only during such hours and in such manner as landlord shall approve. If any material or equipment requires special handling, tenant shall employ only persons holding a Master Rigger's License to do such work, and all such work shall comply with all legal requirements. Landlord reserves the right to inspect all freight to be brought into the building, and to exclude any freight which violates any rule, regulation or other provision of this lease.

5. No sign, advertisement, notice or thing shall be inscribed, painted or affixed on any part of the building, without the prior written consent of Landlord. Landlord may remove anything installed in violation of this provision, and Tenant shall pay the cost of such removal. Interior signs on doors and directories shall be inscribed or affixed by Landlord at Tenant's expense. Landlord shall control the color, size, style and location of all signs, advertisement and notices. No advertising of any kind by Tenant shall refer to the building, unless first approved in writing by Landlord.

6. No article shall be fastened to, or holes drilled or nails or screws driven into, the ceilings, walls, doors or other portions of the premises, nor shall any part of the premises be painted, papered or otherwise covered, or in any way marked or broken, without the prior written consent of Landlord.

7. No existing locks shall be changed, nor shall any additional locks or bolts of any kind be placed upon any door or window by Tenant, without the prior written consent of Landlord. At the termination of this lease, Tenant shall deliver to Landlord all keys for any portion of the premises or building. Before leaving the premises at any time, Tenant shall close all windows and close and lock all doors.

8. No Tenant shall purchase or obtain for use in the premises any spring water, ice, towels, food, bootblacking, barbering, or other such services furnished by any company or person not approved by Landlord. Any necessary exterminating work in the premises shall be done at Tenant's expenses, at such times, in such manner and by such company as Landlord shall require. Landlord reserves the right to exclude from the building, from 6:00 p.m. to 8:00 a.m., and at all hours on Sunday and legal holidays, all persons who do not present a pass to the building signed by Landlord. Landlord will

furnish passes to all persons reasonably designated by Tenant. Tenant shall be responsible for the acts of all persons to whom passes are issued at Tenant's request.

9. Whenever Tenant shall submit to Landlord any plan, agreement or other document for Landlord's consent or approval, Tenant agrees to pay Landlord as additional rent, on demand, and administrative fee equal to the sum of the reasonable fees of any architect, engineer or attorney employed by Landlord review said plan, agreement or document and Landlord's administrative costs for same.

10. The use in the demised premises of auxiliary heating devices, such as portable electric heaters, heat lamps or other devices whose principal function at the time of operation is to produce space heating, is prohibited.

In case of any conflict or inconsistency between any provisions of this lease and any of the rules and regulations as originally or as hereafter adopted, the provisions of this lease shall control.

Exhibit 14

CODE OF ETHICS

FOR

SENIOR FINANCIAL OFFICERS

OF

AROTECH CORPORATION

1. PURPOSE.

The Board of Directors (the "Board") of Arotech Corporation (the "Company") has adopted the following Code of Ethics (the "Code") to apply to the Company's Chief Executive Officer; Chief Financial Officer; Chief Accounting Officer; Controller; and Treasurer (the "Senior Financial Officers"). This Code is intended to focus Senior Financial Officers on areas of ethical risk, provide guidance to help them recognize and deal with ethical issues, provide mechanisms to report unethical conduct, foster a culture of honesty and accountability, deter wrongdoing and promote fair and accurate disclosure and financial reporting.

No code or policy can anticipate every situation that may arise. Accordingly, this Code is intended to serve as a source of guiding principles. Senior Financial Officers are encouraged to bring questions about particular circumstances that may involve one or more of the provisions of this Code to the attention of the Chair of the Audit Committee, who may consult with inside or outside legal counsel as appropriate.

2. INTRODUCTION

Each Senior Financial Officer is expected to adhere to a high standard of ethical conduct. The good name of the Company depends on the way Senior Financial Officers conduct business and the way the public perceives that conduct. Unethical actions, or the appearance of unethical actions, are not acceptable. Senior Financial Officers are expected to be guided by the following principles in carrying out their responsibilities.

- Loyalty. Senior Financial Officers should not be, or appear to be, subject to influences, interests or relationships that conflict with the best interests of the Company.

- Compliance with Applicable Laws. Senior Financial Officers are expected to comply with all laws, rules and regulations applicable to the Company's activities.

- Observance of Ethical Standards. Senior Financial Officers must adhere to high ethical standards in the conduct of their duties. These include honesty and fairness.

3. INTEGRITY OF RECORDS AND FINANCIAL REPORTING.

Senior Financial Officers are responsible for the accurate and reliable preparation and maintenance of the Company's financial records. Accurate and reliable preparation of financial records is of critical importance to proper management decisions and the fulfillment of the Company's financial, legal and

reporting obligations. Diligence in accurately preparing and maintaining the Company's records allows the Company to fulfill its reporting obligations and to provide stockholders, governmental authorities and the general public with full, fair, accurate, timely and understandable disclosure. Senior Financial Officers are responsible for establishing and maintaining adequate disclosure controls and procedures, and internal controls and procedures, including procedures that are designed to enable the Company to: (a) accurately document and account for transactions on the books and records of the Company; and (b) maintain reports,

vouchers, bills, invoices, payroll and service records, business measurement and performance records and other essential data with care and honesty.

Senior Financial Officers shall immediately bring to the attention of the Audit Committee any information they may have concerning:

(a) Defects, deficiencies, or discrepancies related to the design or operation of internal controls which may affect the Company's ability to accurately record, process, summarize, report and disclose its financial data or

(b) Any fraud, whether or not material, that involves management or other employees who have roles in the Company's financial reporting, disclosures or internal controls.

4. CONFLICT OF INTEREST.

Senior Financial Officers must avoid any conflicts of interest between themselves and the Company. Any situation that involves, or may involve, a conflict of interest with the Company, should be disclosed promptly to the Chair of the Audit Committee, who may consult with inside or outside legal counsel as appropriate.

A "conflict of interest" can occur when an individual's personal interest is adverse to - or may appear to be adverse to - the interests of the Company as a whole. Conflicts of interest also arise when an individual, or a member of his or her family, receives improper personal benefits as a result of his or her position with the Company.

This Code does not attempt to describe all possible conflicts of interest which could develop. Some of the more common conflicts from which Senior Financial Officers must refrain, however, are set forth below:

- Improper conduct and activities. Senior Financial Officers may not engage in any conduct or activities that are inconsistent with the Company's best interests or that disrupt or impair the Company's relationship with any person or entity with which the Company has, or proposes to enter into, a business or contractual relationship.

- Compensation from non-Company sources. Senior Financial Officers may not accept compensation for services performed for the Company from any source other than the Company.

- Gifts. Senior Financial Officers and members of their immediate families may not accept gifts from persons or entities where any such gift is being made in order to influence their actions in their position with the Company, or where acceptance of the gifts could create the appearance of a conflict of interest.

- Personal use of Company assets. Senior Financial Officers may not use Company assets, labor or information for personal use, other than incidental personal use, unless approved by the Chair of the Audit Committee or as part of a compensation or expense reimbursement program.

- Financial Interests in other Businesses. Senior Financial Officers should avoid having an ownership interest in any other enterprises, such as a customer, supplier or competitor, if that interest compromises the officer's loyalty to the Company.

5. CORPORATE OPPORTUNITIES.

Senior Financial Officers are prohibited from: (a) taking for themselves personally opportunities related to the Company's business without first presenting those opportunities to the Company and obtaining approval from the Board; (b) using the Company's property, information, or position for personal gain; or (c) competing with the Company for business opportunities.

6. CONFIDENTIALITY.

Senior Financial Officers should maintain the confidentiality of information entrusted to them by the Company and any other confidential information about the Company, its business or finances, customers or suppliers, that comes to them, from whatever source, except when disclosure is authorized or legally mandated. For purposes of this Code, "confidential information" includes all non-public information relating to the Company, its business or finances, customers or suppliers.

7. COMPLIANCE WITH LAWS, RULES AND REGULATIONS.

Senior Financial Officers shall comply with laws, rules and regulations applicable to the Company, including insider trading laws, and all other Company policies. Transactions in Company securities are governed by the Company's Insider Trading Policy.

8. ENCOURAGING THE REPORTING OF ANY ILLEGAL OR UNETHICAL BEHAVIOR.

Senior Financial Officers must promote ethical behavior and create a culture of ethical compliance. Senior Financial Officers should foster an environment in which the Company: (a) encourages employees to talk to supervisors, managers and other appropriate personnel when in doubt about the best course of action in a particular situation; (b) encourages employees to report violations of laws, rules and regulations to appropriate personnel; and (c) informs employees that the Company will not allow retaliation for reports made in good faith.

9. CONCLUSION.

Senior Financial Officers should communicate any suspected violations of this Code promptly to the Chair of the Audit Committee. The Board or a person or persons designated by the Board will investigate violations, and appropriate disciplinary action will be taken in the event of any violation of the Code, up to and including termination. Only the Audit Committee may grant any waivers of this policy.

Exhibit 21

SUBSIDIARIES OF THE REGISTRANT

Name of Subsidiary	Jurisdiction	Percentage Ownership
Arocon Security Corporation	Delaware	100.0%
Electric Fuel (E.F.L.) Ltd.	Israel	100.0%
Electric Fuel Battery Corporation	Delaware	100.0%
Electric Fuel Transportation Corp.	Delaware	100.0%
Epsilor Electronic Industries, Ltd.	Israel	100.0%
FAAC Incorporated	Michigan	100.0%
IES Interactive Training, Inc.	Delaware	100.0%
MDT Armor Corporation	Israel	88.0%
MDT Protective Industries, Ltd.	Israel	75.5%

Exhibit 23

CONSENT OF INDEPENDENT AUDITORS

We consent to the reference to our firm under the caption "Selected financial data" and to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 33-81044, 333-19753, 333-59902, 333-74197 and 333-86728) (pertaining to the 1991 Qualified Stock Option Plan, the Amended and Restated 1993 Stock Option and Restricted Stock Purchase Plan, the 1995 Amended and Restated Non-Employee Director Stock Option Plan and the 1998 Non-Executive Employee Stock Option and Restricted Stock Purchase Plan) and Form S-3 (Nos. 333-95361, 333-33986, 333-37630, 333-45818, 333-49628, 333-59346, 333-63514, 333-99559, 333-99673, 333-106420, 333-110729, and 333-112611) of our report dated March 9, 2004 with respect to the consolidated financial statements and schedule of Arotech Corporation (f/k/a Electric Fuel Corporation) for each of the three years included in the period ended December 31, 2003 included in this Annual Report (Form 10-K) for the year ended December 31, 2003.

/s/ Kost, Forer, Gabbay & Kassierer

Kost, Forer, Gabbay & Kassierer
A Member of Ernst & Young Global

Tel-Aviv, Israel
March 30, 2004

Exhibit 31.1

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Robert S. Ehrlich, certify that:

1. I have reviewed this annual report on Form 10-K of Arotech Corporation;

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

3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual 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 control 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 annual report is being prepared;

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

   (c) disclosed in this annual report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of this 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.

Date: March 30, 2004

/s/ Robert S. Ehrlich

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

Exhibit 31.2

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Avihai Shen, certify that:

1. I have reviewed this annual report on Form 10-K of Arotech Corporation;

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

3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual 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 control 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 annual report is being prepared;

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

   (c) disclosed in this annual report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of this 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.

Date: March 30, 2004

/s/ Avihai Shen

Avihai Shen, Vice President - Finance and CFO
(Principal Financial Officer)

Exhibit 32.1

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

In connection with the Annual Report of Arotech Corporation (the "Company") on Form 10-K for the year ended December 31, 2003 filed with the Securities and Exchange Commission (the "Report"), I, Robert S. Ehrlich, Chairman, President 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 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 financial condition and results of operations of the Company.

By: /s/ Robert S. Ehrlich

Robert S. Ehrlich, Chairman, President and CEO
(Chief Executive Officer)

Date: March 30, 2004

Exhibit 32.2

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

In connection with the Annual Report of Arotech Corporation (the "Company") on Form 10-K for the year ended December 31, 2003 filed with the Securities and Exchange Commission (the "Report"), I, Avihai Shen, 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 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 financial condition and results of operations of the Company.

By: /s/ Avihai Shen

Avihai Shen, Vice President - Finance and CFO
(Chief Financial Officer)

Date: March 30, 2004