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

FORM 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED June 30, 2005 .

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.)
354 Industry Drive, Auburn, Alabama	**36830**
(Address of principal executive offices)	(Zip Code)

(334) 502-9001
(Registrant's telephone number, including area code)

(Former address, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes☒ No☐

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of shares outstanding of the issuer's common stock as of August 12, 2005 was 89,770,108.

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AROTECH CORPORATION

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AROTECH CORPORATION

ITEM 1. INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

CONSOLIDATED BALANCE SHEETS

(U.S. Dollars)

ASSETS	June 30, 2005 (Unaudited)	December 31, 2004
CURRENT ASSETS:		
Cash and cash equivalents	$ 4,193,924	$ 6,734,512
Restricted collateral deposits and restricted held to maturity securities	962,552	6,962,110
Available-for-sale marketable securities	35,413	135,568
Trade receivables (net of allowance for doubtful accounts in the amount of $82,324 and $55,394 as of June 30, 2005 and December 31, 2004, respectively)	7,455,971	8,266,880
Unbilled receivables	2,396,078	2,881,468
Other accounts receivable and prepaid expenses	1,642,882	1,339,393
Inventories	8,550,596	7,277,301
Total current assets	25,237,416	33,597,232
SEVERANCE PAY FUND	2,024,120	1,980,047
PROPERTY AND EQUIPMENT, NET	4,328,008	4,600,691
RESTRICTED DEPOSITS	3,000,000	4,000,000
INVESTMENT IN AFFILIATED COMPANY	112,500	-
GOODWILL	37,503,181	39,745,516
OTHER INTANGIBLE ASSETS, NET	12,089,170	14,368,701
	$ 84,294,395	$ 98,292,187

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

AROTECH CORPORATION

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

	June 30, 2005	December 31, 2004
	(Unaudited)	
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	$ 4,390,506	$ 6,177,546
Other accounts payable and accrued expenses	4,385,712	5,818,188
Current portion of promissory notes due to purchase of subsidiaries	7,946,797	13,585,325
Short-term bank loans and current portion of long-term loans	1,267,155	181,352
Deferred revenues	1,205,811	618,229
Liabilities of discontinued operations	200,000	-
Total current liabilities	19,395,981	26,380,640
LONG TERM LIABILITIES		
Accrued severance pay	3,545,341	3,422,951
Convertible debenture	2,544,251	1,754,803
Deferred revenues	125,673	163,781
Long-term note	-	20,891
Long-term portion of promissory note due to purchase of subsidiaries	-	980,296
Total long-term liabilities	6,215,265	6,342,722
MINORITY INTEREST	168,910	95,842
SHAREHOLDERS' EQUITY:		
Share capital -		
Common stock - $0.01 par value each;		
Authorized: 250,000,000 shares as of June 30, 2005 and December 31, 2004; Issued: 90,325,441 shares as of June 30, 2005 and 80,637,002 shares as of December 31, 2004; Outstanding - 89,770,108 shares as of June 30, 2005 and 80,081,669 shares as of December 31, 2004	903,256	806,370
Preferred shares - $0.01 par value each;		
Authorized: 1,000,000 shares as of June 30, 2005 and December 31, 2004; No shares issued and outstanding as of June 30, 2005 and December 31, 2004	-	-
Additional paid-in capital	190,588,710	189,266,103
Deferred stock compensation	(860,924)	(1,258,295)
Accumulated deficit	(127,032,567)	(118,953,553)
Treasury stock, at cost (common stock - 555,333 shares as of June 30, 2005 and December 31, 2004)	(3,537,106)	(3,537,106)
Notes receivable from stockholders	(1,237,984)	(1,222,871)
Accumulated other comprehensive income (loss)	(309,146)	372,335
Total shareholders' equity	58,514,239	65,472,983
	$ 84,294,395	$ 98,292,187

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

AROTECH CORPORATION

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

	Six months ended June 30,		Three months ended June 30,	
	2005	**2004**	**2005**	**2004**
Revenues	$ 22,624,355	$ 17,110,502	$ 12,236,910	$ 9,928,248
Cost of revenues	14,981,150	11,131,967	8,609,276	6,574,747
Gross profit	7,643,205	5,978,535	3,627,634	3,353,501
Operating expenses:				
Research and development	898,504	871,627	483,826	408,121
Selling and marketing	2,222,692	2,140,696	1,063,873	1,119,611
General and administrative	6,720,816	5,460,070	3,364,406	3,371,934
Amortization of intangible assets	1,646,241	992,025	823,153	496,013
Impairment of goodwill and other intangible assets	2,389,129	-	2,389,129	-
Total operating costs and expenses	13,877,382	9,464,418	8,124,387	5,395,679
Operating loss	(6,234,177)	(3,485,883)	(4,496,753)	(2,042,178)
Financial expenses, net	(1,306,466)	(3,231,356)	(837,608)	(2,152,811)
Loss before income taxes	(7,540,643)	(6,717,239)	(5,334,361)	(4,194,989)
Income tax expenses	(267,218)	(170,065)	(49,954)	(174,972)
Loss before minority interest in earnings of a subsidiary	(7,807,861)	(6,887,304)	(5,384,315)	(4,369,961)
Minority interest in earnings of a subsidiary	(71,153)	(26,708)	(38,199)	(26,162)
Loss from continuing operations	(7,879,014)	(6,914,012)	(5,422,514)	(4,396,123)
Loss from discontinued operations	(200,000)	-	(200,000)	-
Net loss	(8,079,014)	(6,914,012)	(5,622,514)	(4,396,123)
Deemed dividend to certain stockholders	-	(1,163,000)	-	-
Net loss attributable to common stockholders	$ (8,079,014)	$ (8,077,012)	$ (5,622,514)	$ (4,396,123)
Basic and diluted net loss per share from continuing operations	$ (0.10)	$ (0.11)	$ (0.07)	$ (0.07)
Basic and diluted net loss per share from discontinued operation	$ (0.00)	$ -	$ (0.00)	$ -
Basic and diluted net loss per share	$ (0.10)	$ (0.13)	$ (0.07)	$ (0.07)
Weighted average number of shares used in computing basic and diluted net loss per share	80,441,575	62,035,532	80,780,149	64,490,090

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

AROTECH CORPORATION
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(U.S. Dollars, except share data)

	Common Stock									
	Shares	**Amount**	**Additional paid-in capital**	**Deferred stock compensation**	**Accumulated deficit**	**Treasury stock**	**Notes receivable from shareholders**	**Accumulated other comprehensive income (loss)**	**Total comprehensive loss**	**Total**
BALANCE AT JANUARY 1, 2005 - NOTE 1	80,637,001	$806,370	$189,266,103	$ (1,258,295)	$(118,953,553)	$(3,537,106)	$ (1,222,871)	$ 372,335	$ -	$65,472,983
CHANGES DURING THE SIX-MONTH PERIOD ENDED JUNE 30, 2005							-			
Issuance of shares	9,539,962	95,401	1,179,924	-	-	-	-	-	-	1,275,325
Issuance of shares to consultants	72,653	727	88,636	-	-	-	-	-	-	89,363
Issuance of shares to employees	10,000	100	(100)	-	-	-	-	-	-	-
Compensation related to non-recourse loan granted to shareholder	-	-	(28,500)	-	-	-	-	-	-	(28,500)
Exercise of options by employees	15,825	158	17,034	-	-	-	-	-	-	17,192
Deferred stock compensation related to restricted stock	50,000	500	50,500	(51,000)	-	-	-	-	-	-
Amortization of deferred stock compensation	-	-	-	448,371	-	-	-	-	-	448,371
Interest accrued on notes receivable from shareholders	-	-	15,113	-	-	-	(15,113)	-	-	-
Other comprehensive loss - foreign currency translation adjustment	-	-	-	-	-	-	-	(678,921)	(678,921)	(678,921)
Other comprehensive loss - unrealized gain on available for sale marketable securities	-	-	-	-	-	-	-	(2,560)	(2,560)	(2,560)
Net loss	-	-	-	-	(8,079,014)	-	-	-	(8,079,014)	(8,079,014)
Total comprehensive loss	-	-	-	-	-	-	-	-	$ (8,760,495)	-
BALANCE AT JUNE 30, 2005 - UNAUDITED	90,325,441	$903,256	$190,588,710	$ (860,924)	$(127,032,567)	$(3,537,106)	$ (1,237,984)	$ (309,146)		$58,514,239

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

AROTECH CORPORATION

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

	Six months ended June 30,	
	2005	**2004**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss for the period before deemed dividend to certain stockholders of common stock	$ (8,079,014)	$ (6,914,012)
Less loss for the period from discontinued operations	200,000	-
Adjustments required to reconcile net loss to net cash used in operating activities:		
Depreciation	613,368	518,332
Amortization of intangible assets	1,646,241	992,025
Impairment of goodwill and other intangible assets	2,389,129	-
Amortization of compensation related to warrants issued to the holders of convertible debentures and beneficial conversion feature	789,448	2,939,617
Amortization of deferred expenses related to convertible debenture issuance	24,256	160,414
Amortization of capitalized research and development projects	64,084	18,326
Stock based compensation due to options granted to employees and directors	177,633	362,161
Amortization of deferred stock based compensation due to shares issued employees	270,738	53,200
Stock based compensation related to non-recourse note granted to stockholder	(28,500)	13,500
Stock based compensation related to shares granted and to be granted to consultants and shares granted as a donation	98,010	-
Write-off of inventory	-	112,395
Earnings to minority	71,153	26,708
Markdown (Markup) of loans to stockholders	-	(32,397)
Interest expenses accrued on promissory notes issued to purchase of subsidiary	284,140	14,668
Interest accrued on restricted securities and certificates of deposit due within one year	-	(101,569)
Interest accrued on long-term loans	-	382
Capital (gain) loss from sale of marketable securities	2,693	(4,103)
Amortization of premium related to restricted securities	42,234	89,743
Capital gain from sale of property and equipment	-	(5,744)
Accrued severance pay, net	10,711	(436,974)
Decrease (increase) in deferred tax assets	64,595	(16,453)
Changes in operating asset and liability items:		
Decrease in trade receivables	661,953	2,439,972
Decrease (increase) in unbilled receivables	485,390	(270,927)
Decrease in notes receivable	32,850	154,952
Increase in other accounts receivable and prepaid expenses	(184,965)	(675,608)
Increase in inventories	(1,230,866)	(3,742,621)
Increase (decrease) in trade payables	(1,676,572)	987,471
Increase in deferred revenues	549,474	2,749,306
Decrease in accounts payable and accruals	(1,209,465)	(548,134)
Net cash used in operating activities from continuing operations (reconciled from continuing operations)	(3,931,282)	(1,115,370)
Net cash used in operating activities from discontinued operations (reconciled from discontinued operations)	-	(105,407)
Net cash used in operating activities	(3,931,282)	(1,220,777)

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

AROTECH CORPORATION

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

	Six months ended June 30,	
	2005	2004
CASH FLOWS FROM INVESTING ACTIVITIES:		
Repayment of promissory note related to purchase of subsidiary	(7,055,937)	(75,000)
Proceeds from sale of marketable securities	92,519	90,016
Investment in marketable securities	-	(89,204)
Investment in subsidiary[1]	-	(7,190,777)
Investment in subsidiary[2]	-	(12,125,953)
Payment of transactions expenses in related to previous year investment in subsidiary	(12,945)	-
Investment in affiliated company	(112,500)	-
Purchase of property and equipment	(534,678)	(636,775)
Increase in capitalized research and development projects	(56,109)	(153,357)
Proceeds from sale of property and equipment	-	59,036
Decrease in demo inventories, net	-	11,201
Repayment of loan granted to stockholder	-	32,397
Decrease (increase) in restricted securities and deposits, net	6,667,886	(9,792,408)
Net cash used in investing activities	(1,011,764)	(29,870,824)
FORWARD	$ (4,943,046)	$ (31,091,601)

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

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

	Six months ended June 30,	
	2005	**2004**
FORWARD	$ (4,943,046)	$ (31,091,601)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase (decrease) in short-term credit from banks	1,117,477	(165,245)
Proceeds from issuance of share capital, net	1,275,325	17,741,739
Proceeds from exercise of options	17,192	1,089,815
Proceeds from exercise of warrants	-	3,893,823
Payment on capital lease obligation	-	(1,550)
Repayment of long-term loans	(44,471)	(28,192)
Net cash provided by financing activities	2,365,523	22,530,390
DECREASE IN CASH AND CASH EQUIVALENTS	(2,577,523)	(8,561,211)
CASH EROSION DUE TO EXCHANGE RATE DIFFERENCES	36,935	(4,208)
BALANCE OF CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	6,734,512	13,685,125
BALANCE OF CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	$ 4,193,924	$ 5,119,706
SUPPLEMENTARY INFORMATION ON NON-CASH TRANSACTIONS:		
Investment in subsidiary against promissory note	$ -	$ 2,940,985
Issuance of shares and warrants against accrued expenses	$ 56,577	$ 1,310,394
Exercise of convertible debentures against shares	$ -	$ 3,112,500
Accrual for earnout in respect of subsidiary acquisition	$ 152,973	$ -
Shares issuance in regard to subsidiary acquisition	$ 82,645	$ -
SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFOR--MATION - CASH PAID DURING THE PERIOD FOR:		
Interest	$ (209,580)	$ (273,836)

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

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

(1) In January 2004, the Company acquired substantially all of the outstanding ordinary shares of Epsilor Electronic Industries, Ltd. ("Epsilor"). 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 (unaudited)	$ (849,992)
Property and equipment (unaudited)	709,847
Intangible assets and goodwill (unaudited)	10,284,407
	10,144,262
Issuance of promissory note (unaudited)	(2,940,985)
Issuance of shares in respect to transaction costs	(12,500)
	$ 7,190,777

(2) In January 2004, the Company acquired all of the outstanding common stock of FAAC Incorporated ("FAAC"). The net fair value of the assets acquired was as follows:

Working capital, excluding cash and cash equivalents (unaudited)	$ 1,796,791
Property and equipment (unaudited)	263,669
Intangible assets and goodwill (unaudited)	25,507,646
	27,568,106
Accrual for earn out payment	(13,435,325)
Issuance of shares, net (unaudited)	(2,006,828)
	$ 12,125,953

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

AROTECH CORPORATION
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1: BASIS OF PRESENTATION

a. Company:

Arotech Corporation ("Arotech" or the "Company"), and its subsidiaries provide defense and security products for the military, law enforcement and homeland security markets, including advanced zinc-air and lithium batteries and chargers, multimedia interactive simulators/trainers and lightweight vehicle armoring. The Company is primarily operating through IES Interactive Training, Inc. ("IES"), a wholly-owned subsidiary based in Littleton, Colorado; FAAC Corporation, a wholly-owned subsidiary based in Ann Arbor, Michigan, and FAAC's 80%-owned United Kingdom subsidiary FAAC Limited; Electric Fuel Battery Corporation, a wholly-owned subsidiary based in Auburn, Alabama; Electric Fuel Ltd. ("EFL") a wholly-owned subsidiary based in Beit Shemesh, Israel; Epsilor Electronic Industries, Ltd., a wholly-owned subsidiary located in Dimona, Israel; MDT Protective Industries, Ltd. ("MDT"), a majority-owned subsidiary based in Lod, Israel; MDT Armor Corporation, a majority-owned subsidiary based in Auburn, Alabama; and Armour of America, Incorporated, a wholly-owned subsidiary based in Los Angeles, California.

b. Basis of presentation:

The accompanying interim consolidated financial statements have been prepared by Arotech Corporation in accordance with generally accepted accounting principles for interim financial information, with the instructions to Form 10-Q and with Article 10 of Regulation S-X, and include the accounts of Arotech Corporation and its subsidiaries. Certain information and footnote disclosures, normally included in complete financial statements prepared in accordance with generally accepted accounting principles, have been condensed or omitted. In the opinion of the Company, the unaudited financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of its financial position at June 30, 2005 and its operating results and cash flows for the six- and three-month periods ended June 30, 2005 and 2004.

The results of operations for the six months ended June 30, 2005 are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year ending December 31, 2005.

The balance sheet at December 31, 2004 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. These consolidated financial statements should be read in conjunction with the audited financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004.

c. Accounting for stock-based compensation:

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation" in accounting for its employee stock option plans. Under APB No. 25, when the exercise price of the Company's stock options is less than the market price of the underlying shares on the date of grant, compensation expense is recognized.

The Company adopted the disclosure provisions of Statement of Financial Accounting Standard No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," which amended certain provisions of Statement of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation." The Company continues to apply the provisions of APB No. 25 in accounting for stock-based compensation.

Under Statement of Financial Accounting Standard No. 123, pro forma information regarding net loss and net loss 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 fair value for these options is amortized over their vesting period and estimated at the date of grant using a Black-Scholes Option Valuation Model with the following weighted-average assumptions for the six and three months ended June 30, 2005 and 2004:

	Six months ended June 30,		Three months ended June 30,	
	2005	2004	2005	2004
	(Unaudited)			
Risk free interest	3.7	3.81	3.7	3.81
Dividend yields	0.0%	0.0%	0.0%	0.0%
Volatility	0.76	0.817	0.76	0.817
Expected life	3 years	5 years	3 years	5 years

Pro forma information under SFAS No. 123:

	Six months ended June 30,		Three months ended June 30,	
	2005	2004	2005	2004
	Unaudited (U.S. Dollars, except per share data)			
Net loss as reported	$ (8,079,014)	$ (8,077,012)	(5,622,514)	$ (4,396,123)
Add - stock-based compensation expense determined under APB 25	$ 448,371	$ 415,361	$ 232,739	$ 415,361
Deduct - stock based compensation expense determined under fair value method for all awards	(851,391)	(859,600)	(401,799)	(649,317)
Pro forma net loss	$ (8,482,034)	$ (8,521,251)	$ (5,791,574)	$ (4,630,079)
Loss per share:	$ (0.11)	$ (0.14)	$ (0.07)	$ (0.07)
Net income (loss) as reported	$ (0.10)	$ (0.13)	$ (0.07)	$ (0.07)

NOTE 2: INVENTORIES

Inventories are stated at the lower of cost or market value. Cost is determined using the average cost method. The Company periodically evaluates the quantities on hand relative to current and historical selling prices and historical and projected sales volume. Based on these evaluations, provisions are made in each period to write down inventory to its net realizable value. Inventory write-offs are provided to cover risks arising from slow-moving items, technological obsolescence, excess inventories, and for market prices lower than cost. In the six months ended June 30, 2005 the Company did not write off any inventory. Inventories are composed of the following:

	June 30, 2005	December 31, 2004
	(Unaudited)	
Raw materials	$ 4,330,620	$ 4,087,650
Work-in-progress	3,210,003	1,877,889
Finished goods	1,009,973	1,311,762
	$ 8,550,596	$ 7,277,301

NOTE 3: IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123 (revised 2004), "Share-Based Payment," which is a revision of FASB Statement No. 123, "Accounting for Stock-Based Compensation." Statement 123(R) supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and amends FASB Statement No. 95, "Statement of Cash Flows." Generally, the approach in Statement 123(R) is similar to the approach described in Statement 123. However, Statement 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

Statement 123(R) must be adopted no later than January 1, 2006. Early adoption will be permitted in periods in which financial statements have not yet been issued. The Company expects to adopt Statement 123(R) on the first interim period beginning after January 1, 2006.

Statement 123(R) permits public companies to adopt its requirements using one of two methods:

1. A "modified prospective" method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of Statement 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of Statement 123 for all awards granted to employees prior to the effective date of Statement 123(R) that remain unvested on the effective date.

2. A "modified retrospective" method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under Statement 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

The Company is still in the process of evaluating the method it will use.

As permitted by Statement 123, the Company currently accounts for share-based payments to employees using Opinion 25's intrinsic value method and, as such, generally recognizes no compensation cost for employee stock options. Accordingly, the adoption of Statement 123(R)'s fair value method will have a significant impact on our result of operations, although it will have no impact on our overall financial position. The impact of adoption of Statement 123(R) cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, had the Company adopted Statement 123(R) in prior periods, the impact of that standard would have approximated the impact of Statement 123 as described in the disclosure of pro forma net income and earnings per share in Note 1.c. above to the Company's consolidated financial statements. Statement 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature.

In March 2005, the SEC staff issued Staff Accounting Bulletin No. 107 (SAB 107) to give guidance on implementation of SFAS 123(R), which the Company plans to consider in implementing SFAS 123(R).

In May 2005, the FASB issued Statement of Financial Accounting Standard No. 154 ("FAS 154"), "Accounting Changes and Error Corrections," a replacement of APB No. 20,"Accounting Changes" and FAS No. 3, "Reporting Accounting Changes in Interim Financial Statements." FAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. APB Opinion 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. FAS 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. FAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company is currently assessing the impact of FAS 154 on its results of operations, financial condition and liquidity.

NOTE 4: SEGMENT INFORMATION

a. General:

The Company and its subsidiaries operate primarily in three business segments and follow the requirements of SFAS No. 131.

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

b. The following is information about reported segment revenues, income (losses) and assets for the six and three months ended June 30, 2005 and 2004:

	Simulation and Security	Battery and Power Systems	Armor	All Others	Total
Six months ended June 30, 2005					
Revenues from outside customers	$ 9,639,071	$ 5,060,971	$ 7,924,313	$ -	$ 22,624,355
Depreciation , amortization and impairment expenses [1]	(806,350)	(454,840)	(3,378,631)	(73,000)	(4,712,821)
Direct expenses [2]	(8,491,590)	(5,062,577)	(7,750,259)	(3,178,029)	(24,482,455)
Segment income (loss)	$ 341,131	$ (456,446)	$ (3,204,577)	$ (3,251,029)	(6,570,921)
Financial income (after deduction of minority interest)					(1,308,093)
Loss from continuing operations					$ (7,879,014)
Segment assets [3], [4]	32,558,188	12,567,167	16,582,452	763,148	62,470,955
Six months ended June 30, 2004					
Revenues from outside customers	$ 7,224,644	$ 5,132,390	$ 4,753,468	$ -	$ 17,110,502
Depreciation , amortization and impairment expenses [1]	(808,243)	(563,991)	(59,123)	(79,000)	(1,510,357)
Direct expenses [2]	(6,937,321)	(5,077,918)	(4,404,993)	(2,860,981)	(19,281,213)
Segment income (loss)	$ (520,920)	$ (509,519)	$ 289,352	$ (2,939,981)	(3,681,068)
Financial expenses (after deduction of minority interest)					(3,232,944)
Loss from continuing operations					$ (6,914,012)
Segment assets[3], [4]	18,569,441	13,114,218	5,424,216	501,931	37,609,806
Three months ended June 30, 2005					
Revenues from outside customers	$ 5,523,421	$ 2,054,832	$ 4,658,657	$ -	$ 12,236,910
Depreciation , amortization and impairment expenses [1]	(403,690)	(232,140)	(2,887,083)	(38,000)	(3,560,913)
Direct expenses [2]	(4,983,466)	(2,305,587)	(4,434,210)	(1,536,132)	(13,259,395)
Segment income (loss)	$ 136,265	$ (482,895)	$ (2,662,636)	$ (1,574,132)	(4,583,398)
Financial income (after deduction of minority interest)					(839,116)
Loss from continuing operations					$ (5,422,514)
Three months ended June 30, 2004					
Revenues from outside customers	$ 4,012,561	$ 2,626,768	$ 3,288,919	$ -	$ 9,928,248
Depreciation , amortization and impairment expenses [1]	(423,142)	(281,121)	(29,673)	(44,000)	(777,936)
Direct expenses [2]	(3,769,830)	(2,613,958)	(3,022,974)	(1,987,442)	(11,394,204)
Segment income (loss)	$ (180,411)	$ (268,311)	$ 236,272	$ (2,180,969)	(2,243,892)
Financial expenses (after deduction of minority interest)					(2,152,231)
Loss from continuing operations					$ (4,396,123)

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[1] Includes depreciation of property and equipment, amortization expenses of intangible assets and impairment of goodwill and other intangible assets.

[2] Including sales and marketing, general and administrative and tax expenses.

[3] Consisting of property and equipment, inventory and intangible assets.

[4] Out of those amounts, goodwill in our Simulation and Security, Battery and Power Systems and Armor divisions stood at $23,001,305, $5,000,178 and $9,501,699 as of June 30, 2005, respectively, and $8,509,016 , $4,806,249 and $1,006,801 as of June 30, 2004, respectively.

NOTE 5: CONVERTIBLE DEBENTURES AND DETACHABLE WARRANTS

a. 8% Secured Convertible Debentures due September 30, 2006 and issued in September 2003

Pursuant to the terms of a Securities Purchase Agreement dated September 30, 2003, the Company, in September 2003, 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.

As part of the Securities Purchase Agreement dated September 30, 2003, 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.

As of June 30, 2005, principal amount of $150,000 remained outstanding under these convertible debentures.

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 three years.

In connection with these convertible debentures, the Company will recognize financial expenses of $2,963,043 with respect to the beneficial conversion feature, which is being amortized from the date of issuance to the stated redemption date - September 30, 2006 - as financial expenses.

During the six months ended June 30, 2005 the Company recorded an expense of $14,680, which was attributable to amortization of debt discount and beneficial conversion feature related to the convertible debenture over its term. These expenses were included in the financial expenses.

b. 8% Secured Convertible Debentures due September 30, 2006 and issued in December 2003

Pursuant to the terms of a Securities Purchase Agreement dated September 30, 2003, the Company, in December 2003, 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 September 30, 2006. These debentures are convertible at any time prior to September 30, 2006 at a conversion price of $1.45 per share.

As of June 30, 2005, principal amount of $4,387,500 remained outstanding under these convertible debentures.

As a further part of the Securities Purchase Agreement dated September 30, 2003, the Company issued to the purchasers of its 8% secured convertible debentures due September 30, 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 June 18, 2009 at a price of $2.20 per share.

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 the warrants granted in respect of convertible debentures 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 three years.

In connection with these convertible debentures, the Company will recognize financial expenses of $6,000,000 with respect to the beneficial conversion feature, which is being amortized from the date of issuance to the stated redemption date - September 30, 2006 - as financial expenses.

During the six months ended June 30, 2005 the Company recorded an expense of $774,768, which was attributable to amortization of the beneficial conversion feature of the convertible debenture over its term. These expenses were included in the financial expenses.

NOTE 6: IMPAIRMENT OF GOODWILL AND OTHER INTANGIBLE ASSETS

SFAS No. 142 requires goodwill to be tested for impairment on adoption of the Statement, at least annually thereafter, and 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. 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.

The Company performed the required annual impairment test of goodwill, based on management's projections and using expected future discounted operating cash flows. As of June 30, 2005, the Company identified in AoA an impairment of goodwill in the amount of $2,043,129.

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 June 30, 2005 the Company identified an impairment of backlog previously identified with the AoA acquisition and as a result has recorded an impairment loss in the amount of $346,000.

NOTE 7: CONTINGENT LIABILITIES

In 2000 and 2001, the Company sold consumer cellphone batteries and chargers to a major department store chain. Subsequent to these sales, in late 2001, one of the Company's employees signed an agreement with the department store chain to price-protect the goods previously sold, with such price protection "to be debited from current open invoices." The department store chain has recently claimed to the Company that the Company owes them approximately $517,000, primarily in respect of this price protection. The Company contends that employee who signed the price protection had no authority, actual or apparent, to do so, and that in any event the clear meaning of the language in the price protection is that the department store chain may deduct the price protection from sums they owe the Company, not that the Company is obligated to return sums previously paid. Settlement discussions are currently taking place. Although it is difficult at this early stage to come to any conclusions, the Company estimates that its liability in this matter will not exceed $200,000. The Company has recorded an appropriate provision in respect of this amount. These expenses were included in loss from discontinued operations.

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

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

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

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

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

Executive Summary

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 and Security Division***, consisting of:
  - 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

- IES Interactive Training, Inc., located in Littleton, Colorado, which provides specialized “use of force” training for police, security personnel and the military (“IES”).

➢ Our ***Armor Division***, consisting of:

- Armour of America, located in Los Angeles, California, which manufacturers ballistic and fragmentation armor kits for rotary and fixed wing aircraft, marine armor, personnel armor, military vehicles and architectural applications, including both the LEGUARD Tactical Leg Armor and the Armourfloat Ballistic Floatation Device, which is a unique vest that is certified by the U.S. Coast Guard (“AoA”);

- 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 SUVs, 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).

➢ Our ***Battery and Power Systems Division***, consisting of:

- 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”);

- 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”); 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”).

Overview of Results of Operations

We incurred significant operating losses for the years ended December 31, 2003 and 2004 and for the first six months of 2005. While we expect to continue to derive revenues from the sale of products that our subsidiaries manufacture and the services that they provide, there can be no assurance that we will be able to achieve or maintain profitability on a consistent basis.

Between 2002 and 2004, we substantially increased our revenues and reduced our net loss, from $18.5 million in 2002 to $9.2 million in 2003 to $9.0 million in 2004. 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 products manufactured by the subsidiaries we acquired in 2002 and 2004.

We succeeded during 2004 in moving Arotech to a positive cash flow situation, for the first time in our history. We are focused on continuing this success in 2005 (although we had negative cash flow during the first six months of 2005) and beyond, and ultimately on achieving profitability. 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 2005 as well.

A portion of our operating loss during the first six months of 2005 arose as a result of non-cash charges. These charges were primarily related to our acquisitions made in the previous year and to our raising capital through convertible debenture in the prior years. Because we anticipate continuing these activities, 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. Our acquisitions of FAAC, Epsilor and AoA resulted in our incurring such non-cash charges during the first six months of 2005.

As a result of the application of the above accounting rule, we incurred non-cash charges related to amortization of intangible assets in the amount of $1.6 million and an additional $2.4 million related to impairment of goodwill and other intangible assets during the first six months of 2005.

The non-cash charges that relate to our financings arise when we sell convertible debentures and warrants. When we issue convertible debentures, we might 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 discount that is amortized ratably over the term of the convertible debentures; when the convertible debentures are converted, the entire remaining unamortized financial expense is immediately recognized in the quarter in which the conversion occurs. As and to the extent that our remaining convertible debentures are converted, 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 related to our financings in the amount of $789,000 during the first six months of 2005.

Additionally, in an effort to improve our cash situation and our shareholders' equity, we have periodically induced holders of certain of our warrants to exercise their warrants by lowering the exercise price of the warrants in exchange for immediate exercise of such warrants, and by issuing to such investors new warrants. Under such circumstances, we record a deemed dividend 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 recorded a deemed dividend related to warrants repricing in amount of $0 and $1,163,000 during the first six months of 2005 and 2004, respectively.

In addition, we incurred non-cash charges in the amount of $420,000 during the first six months of 2005 in connection with options and shares granted to employees.

Overview of Operating Performance and Backlog

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 Simulation and Security Division, revenues grew from approximately $7.2 million in the first six months of 2004 to $9.6 million in the first six months of 2005. As of June 30, 2005, our backlog for our Simulation and Security Division totaled $12.0 million, most of which was attributable to FAAC.

In our Battery and Power Systems Division, revenues decreased from approximately $5.13 million in the first six months of 2004 to approximately $5.06 million in the first six months of 2005. As of June 30, 2005, our backlog for our Battery and Power Systems Division totaled $2.9 million.

In our Armor Division, revenues grew from $4.8 million during the first six months of 2004 to $7.9 million during the first six months of 2005, due primarily to increased revenues of MDT Armor as a result of new orders in connection with the war in Iraq and the inclusion of AoA in our results. As of June 30, 2005, our backlog for our Armor Division totaled $4.1 million.

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 loss.

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.

Results of Operations

Preliminary Note

Results for the three and six months ended June 30, 2005 include the results of AoA for such period as a result of our acquisition of AoA in August 2004. The results of AoA were not included in our operating results for the three and six months ended June 30, 2004. Accordingly, the following period-to-period comparisons should not necessarily be relied upon as indications of future performance.

Three months ended June 30, 2005 compared to the three months ended June 30, 2004.

Revenues. During the three months ended June 30, 2005, we (through our subsidiaries) recognized revenues as follows:

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

- MDT, MDT Armor and AoA recognized revenues from payments under vehicle armoring contracts, for service and repair of armored vehicles, and on sale of armoring products;

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

- EFL recognized revenues from the sale of lifejacket lights and from subcontracting fees received in connection with Phase IV of the United States Department of Transportation (DOT) electric bus program.

Revenues for the three months ended June 30, 2005 totaled $12.2 million, compared to $9.9 million in the comparable period in 2004, an increase of $2.3 million, or 23.3%. This increase was primarily attributable to the following factors:

- Increased revenues from our Armor Division, particularly by revenues generated by AoA ($1.6 million in the second quarter of 2005 that were not present in the corresponding period of 2004.

- Increased revenues from our Simulation and Security division, particularly FAAC.

These revenues were offset to some extent by

- Decreased revenues from our EFB subsidiary.

In the second quarter of 2005, revenues were $5.5 million for the Simulation and Security Division (compared to $4.0 million in the second quarter of 2004, an increase of $1.5 million, or 37.7%, due primarily to increased sales of FAAC); $2.1 million for the Battery and Power Systems Division (compared to $2.6 million in the second quarter of 2004, a decrease of $572,000, or 21.8%, due primarily to decreased sales of EFB.); and $4.7 million for the Armor Division (compared to $3.3 million in the second quarter of 2004, an increase of $1.4 million, or 41.6%, due primarily to the added revenues of AoA).

Cost of revenues and gross profit. Cost of revenues totaled $8.6 million during the second quarter of 2005, compared to $6.6 million in the second quarter of 2004, an increase of $2.0 million, or 30.9%, due primarily to increased sales in all divisions.

Direct expenses for our three divisions during the second quarter of 2005 were $5.0 million for the Simulation and Security Division (compared to $3.8 million in the second quarter of 2004, an increase of $1.2 million, or 32.2%, due primarily to increased sales of FAAC); $2.3 million for the Battery and Power Systems Division (compared to $2.6 million in the second quarter of 2004, a decrease of $308,000, or 11.8%, due primarily to decreased sales of EFB; and $4.4 million for the Armor Division (compared to $3.0 million in the second quarter of 2004, an increase of $1.4 million, or 46.7%, due primarily to the added revenues of AoA).

Gross profit was $3.6 million during the second quarter of 2005, compared to $3.4 million during the second quarter of 2004, an increase of $274,000, or 8.2%. This increase was the direct result of all factors presented above, most notably the presence of AoA in our results and the increase in simulation revenues.

Research and development expenses. Research and development expenses for the second quarter of 2005 were $484,000, compared to $408,000 during the second quarter of 2004, an increase of $76,000, or 18.0%, due primarily to the added expenses of AoA.

Sales and marketing expenses. Sales and marketing expenses for the second quarter of 2005 were $1.1 million, compared to $1.1 million the second quarter of 2004.

General and administrative expenses. General and administrative expenses for the second quarter of 2005 were $3.4 million compared to $3.4 million in the second quarter of 2004, a decrease of $8,000.

Financial expenses, net. Financial income, net of financial expenses and exchange differentials, totaled approximately $838,000 in the second quarter of 2005 compared to $2.2 million in the second quarter of 2004. The difference was due primarily to decrease in amortization of debt discount related to the issuance of convertible debenture.

Income taxes. We and certain of our subsidiaries incurred net operating losses during the six months ended June 30, 2005 and, accordingly, we were not required to make any provision for income taxes. With respect to some of our subsidiaries that operated at a net profit during 2005, we were able to offset federal taxes against our accumulated loss carry forward. We recorded a total of $50,000 in tax expenses in the second quarter of 2005, mainly in respect to state taxes. We recorded a total of $175,000 in tax expenses in the second quarter of 2004 with respect to certain of our subsidiaries that operated at a net profit during 2004, and we were not able to offset their taxes against our loss carry forward and with respect to state taxes.

Amortization of intangible assets. Amortization of intangible assets totaled $823,000 in the second quarter of 2005, compared to $496,000 the second quarter of 2004, an increase of $327,000, or 66.0%, due primarily to amortization of intangible assets related to our subsidiary, AoA, that we acquired in August 2004.

Impairment of goodwill and other intangibles assets. Current accounting standards require us to test goodwill for impairment at least annually, and between annual tests in certain circumstances; when we determine goodwill is impaired, it must be written down, rather than being amortized as previous accounting standards required. Goodwill is tested for impairment by comparing the fair value of our reportable units with their carrying value. Fair value is determined using discounted cash flows. 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.

We performed the required annual impairment test of goodwill, based on our management's projections and using expected future discounted operating cash flows. As of June 30, 2005, we identified in AoA an impairment of goodwill in the amount of $2,043,129.

Our and our subsidiaries' long-lived assets and certain identifiable intangibles are reviewed for impairment in accordance with current accounting standards 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 June 30, 2005 we identified an impairment of backlog previously identified with the AoA acquisition and as a result we recorded an impairment loss in the amount of $346,000.

Loss from continuing operations. Due to the factors cited above, we reported a loss from continuing operations of $5.4 million in the second quarter of 2005, compared to $4.4 million in the second quarter of 2004, an increase of $1.0 million, or 23.3%.

Loss from discontinued operations. Net loss from discontinued operations for the second quarter of 2005 was $200,000 compared to $0 in the second quarter of 2004. This is because during the second quarter of 2005 we took an accrual for a litigation contingency related to the discontinued operations (see Note 7 to the notes to unaudited financial statements).

Net loss attributable to common stockholders. Due to the factors cited above, we reported a net loss of $5.6 million in the second quarter of 2005, compared to a net loss of $4.4 million the second quarter of 2004, an increase of $1.2 million, or 27.9%.

Six months ended June 30, 2005 compared to the three months ended June 30, 2004.

Revenues. During the six months ended June 30, 2005, we (through our subsidiaries) recognized revenues as follows:

- IES and FAAC recognized revenues from the sale of interactive use-of-force training systems and from the provision of maintenance services in connection with such systems;
- MDT, MDT Armor and AoA recognized revenues from payments under vehicle armoring contracts, for service and repair of armored vehicles, and on sale of armoring products;
- EFB and Epsilor recognized revenues from the sale of batteries, chargers and adapters to the military, and under certain development contracts with the U.S. Army; and
- EFL recognized revenues from the sale of lifejacket lights and from subcontracting fees received in connection with Phase IV of the United States Department of Transportation (DOT) electric bus program.

Revenues for the six months ended June 30, 2005 totaled $22.6 million, compared to $17.1 million in the comparable period in 2004, an increase of $5.5 million, or 32.2%. This increase was primarily attributable to the following factors:

- Increased revenues from our Armor Division, particularly MDT Armor and revenues generated by AoA ($2.3 million) in the first half of 2005 that were not present in the corresponding period of 2004.
- Increased revenues from our Simulation and Security division, particularly FAAC.

These revenues were offset to some extent by

- Decreased U.S. Army Communications Electronics Command (CECOM) revenues from our EFB subsidiary.

In the first half of 2005, revenues were $9.6 million for the Simulation and Security Division (compared to $7.2 million in the first half of 2004, an increase of $2.4 million, or 33.4%, due primarily to increased sales of FAAC); $5.1 million for the Battery and Power Systems Division (compared to $5.1 million in the first half of 2004, a decrease of $71,000, or 1.4%, due primarily to decreased CECOM revenues from our EFB subsidiary); and $7.9 million for the Armor Division (compared to $4.8 million in the first half of 2004, an increase of $3.2 million, or 66.7%, due primarily to the added revenues of AoA).

Cost of revenues and gross profit. Cost of revenues totaled $15.0 million during the first half of 2005, compared to $11.1 million in the first half of 2004, an increase of $3.8 million, or 34.6%, due primarily to increased sales in all divisions.

Direct expenses for our three divisions during the first half of 2005 were $8.5 million for the Simulation and Security Division (compared to $6.9 million in the first half of 2004, an increase of $1.6 million, or 22.4%, due primarily to increased sales of FAAC); $5.1 million for the Battery and Power Systems Division (compared to $5.1 million in the first half of 2004, a decrease of $15,000.; and $7.8 million for the Armor Division (compared to $4.4 million in the first half of 2004, an increase of $3.3 million, or 76.0%, due primarily to the added revenues of AoA)

Gross profit was $7.6 million during the first half of 2005, compared to $6.0 million during the first half of 2004, an increase of $1.7 million, or 27.8%. This increase was the direct result of all factors presented above, most notably the presence of AoA in our results and the increase in simulation revenues.

Research and development expenses. Research and development expenses for the first half of 2005 were $899,000, compared to $872,000 during the first half of 2004, an increase of $27,000, or 3.1%.

Sales and marketing expenses. Sales and marketing expenses for the first half of 2005 were $2.2 million, compared to $2.1 million the first half of 2004, an increase of $82,000, or 3.8%. This increase was primarily attributable to the inclusion of the sales and marketing expenses of AoA in our results for 2005.

General and administrative expenses. General and administrative expenses for the first half of 2005 were $6.7 million, compared to $5.5 million in the first half of 2004, an increase of $1.3 million, or 23.0%. This increase was primarily attributable to the following factors:

- The inclusion of the general and administrative expenses of AoA in our results for 2005;

- Increases in general and administrative expenses in our FAAC subsidiary due to legal expenses, employee relocation, accounting, incentive pay accruals, etc. ; and

- Increase in other general and administrative expenses such as Sarbanes-Oxley compliance and additional auditing expenses.

Financial expenses, net. Financial income, net of financial expenses and exchange differentials, totaled approximately $1.3 million in the first half of 2005 compared to $3.2 million in the first half of 2004. The difference was due primarily to decrease in amortization of debt discount related to the issuance of convertible debenture.

Income taxes. We and certain of our subsidiaries incurred accumulated net operating losses during the six months ended June 30, 2005 and, accordingly, we were not required to make any provision for income taxes. With respect to some of our subsidiaries that operated at a net profit during 2005, we were able to offset federal taxes against our accumulated loss carry forward. We recorded a total of $267,000 in tax expenses in the first half of 2005, with respect to certain of our subsidiaries that operated at a net profit during 2005 and we are not able to offset their taxes against our loss carry forward and with respect to state taxes. We recorded a total of $170,000 in tax income in the first half of 2004 with respect to certain of our subsidiaries that operated at a net profit during 2004, and we were not able to offset their taxes against our loss carry forward and with respect to state taxes.

Amortization of intangible assets. Amortization of intangible assets totaled $1.6 million in the first half of 2005, compared to $1.0 million the first half of 2004, an increase of $654,000, or 65.9%, due primarily to amortization of intangible assets related to our subsidiary, AoA, that we acquired in August 2004.

Impairment of goodwill and other intangibles assets. Current accounting standards require us to test goodwill for impairment at least annually, and between annual tests in certain circumstances; when we determine goodwill is impaired, it must be written down, rather than being amortized as previous accounting standards required. Goodwill is tested for impairment by comparing the fair value of our reportable units with their carrying value. Fair value is determined using discounted cash flows. 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.

We performed the required annual impairment test of goodwill, based on our management's projections and using expected future discounted operating cash flows. As of June 30, 2005, we identified in AoA an impairment of goodwill in the amount of $2,043,129.

Our and our subsidiaries' long-lived assets and certain identifiable intangibles are reviewed for impairment in accordance with current accounting standards 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 June 30, 2005 we identified an impairment of backlog previously identified with the AoA acquisition and as a result we recorded an impairment loss in the amount of $346,000.

Loss from continuing operations. Due to the factors cited above, we reported a loss from continuing operations of $7.9 million in the first half of 2005, compared to $6.9 million in the first half of 2004, an increase of $965,000, or 14.0%.

Loss from discontinued operations. Net loss from discontinued operations for the first half of 2005 was $200,000 compared to $0 in the first half of 2004. This is because during the second quarter of 2005 we took an accrual for a litigation contingency related to the discontinued operations (see Note 7 to the notes to unaudited financial statements).

Net loss before deemed dividend to certain stockholders of common stock. Due to the factors cited above, we reported a net loss of $8.1 million in the first half of 2005, compared to a net loss of $6.9 million in the first half of 2004, an increase of $1.2 million, or 16.8%.

Net loss attributable to common stockholders. Due to the factors cited above and the deemed dividend recorded during the first six months of 2004, net loss attributable to common stockholders remained steady at $8.1 million.

Liquidity and Capital Resources

As of June 30, 2005, we had $4.2 million in cash, $963,000 in restricted collateral securities and cash deposits due within one year, $3.0 million in long-term restricted securities and deposits, and $35,000 in marketable securities, as compared to at December 31, 2004, when we had $6.7 million in cash, $7.0 million in restricted collateral securities and restricted held-to-maturity securities due within one year, $4.0 million in long-term restricted deposits, and $136,000 in available-for-sale marketable securities. The decrease in cash was primarily the result of working capital needed in all of our segments.

We used available funds in the second quarter of 2005 primarily for sales and marketing, continued research and development expenditures, and other working capital needs. We increased our investment in fixed assets during the six months ended June 30, 2005 by $535,000 over the investment as at December 31, 2004, primarily in the Battery and Power Systems Division and in the Simulation and Security Division. Our net fixed assets amounted to $4.3 million at quarter end.

Net cash used in operating activities from continuing operations for the six months ended June 30, 2005 and 2004 was $3.9 million and $1.1 million, respectively, an increase of $2.8 million. This increase was primarily the result of decrease in trade payables and other account payables.

Net cash used in investing activities for the six months ended June 30, 2005 and 2004 was $1.0 million and $29.9 million, respectively, a decrease of $28.9 million. This decrease was primarily the result of our investment in the acquisition of FAAC and Epsilor in 2004.

Net cash provided by financing activities for the six months ended June 30, 2005 and 2004 was $2.4 million and $22.5 million, respectively. This decrease was primarily the result of lower amounts of funds raised through sales of our securities in 2005 compared to 2004.

As of June 30, 2005, we had (based on the contractual amount of the debt and not on the book value of the debt, without taking into consideration trade payables, other payables and accrued severance pay) approximately $13.8 million in long term bank and certificated debt outstanding, of which $4.5 million was convertible debt, and approximately $9.2 million in short-term debt (which including short-term bank credit, current portion of long-term loan and liabilities due to subsidiaries acquisitions, in the amount of $7.9 million).

Based on our internal forecasts, we believe that our present cash position and anticipated cash flows from operations, loans and financings should be sufficient to satisfy our current estimated cash requirements through the next twelve months. This belief is based on certain assumptions that our management and our subsidiaries managers believes to be reasonable, some of which are subject to the risk factors detailed below. In this connection, we note that from time to time our working capital needs are partially dependent on our subsidiaries' lines of credit. In the event that we are unable to continue to make use of our subsidiaries' lines of credit for working capital on economically feasible terms, our business, operating results and financial condition could be adversely affected.

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.

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 or exercisable 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 net losses since our inception. Additionally, as of June 30, 2005, we had an accumulated deficit of approximately $127.0 million. There can be no assurance that we will ever be able to achieve or 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 bank and certificated indebtedness (short and long term) aggregated approximately $13.8 million as of June 30, 2005 (not including trade payables, other account payables and accrued severance pay). 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 future cash flow or assets would be sufficient to repay in full such indebtedness.

Failure to comply with the earnout provisions of our acquisition agreements could have material adverse consequences for us.

A failure to comply with the obligations contained in our acquisition agreements to make the earnout payments required under such agreements could result in actions for damages, a possible right of rescission on the part of the sellers, and the acceleration of debt under instruments evidencing indebtedness that may contain cross-acceleration or cross-default provisions. If we are unable to raise capital in order to pay the earnout provisions of our acquisition agreements, there can be no assurance that our future cash flow or assets would be sufficient to pay such obligations.

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, on acceptable terms, or at all. 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.

Any inability to continue to make use from time to time of our subsidiaries' current working capital lines of credit could have an adverse effect on our ability to do business.

From time to time our working capital needs are partially dependent on our subsidiaries' lines of credit. In the event that we are unable to continue to make use of our subsidiaries' lines of credit for working capital on economically feasible terms, our business, operating results and financial condition could be adversely affected.

We may not be successful in operating new businesses.

Prior to the acquisitions of IES and MDT in 2002 and the acquisitions of FAAC and Epsilor in January 2004 and AoA in August 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 relatively 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 these new businesses. 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 officers, 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 acquisitions.

In light of our acquisitions of IES, MDT, FAAC, Epsilor and AoA, 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 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.

As a result of our acquisitions, we are currently experiencing a period of significant 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 and reduction or reallocation of defense or law enforcement spending could reduce our revenues.

Many of the customers of IES, FAAC and AoA 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 or law enforcement spending in the U.S. or other countries could reduce our revenues and 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.

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 reduce our revenues and 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. 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.

The loss of, or a significant reduction in, U.S. military business would have a material adverse effect on us.

U.S. military contracts account for a significant portion of our business. The U.S. military funds these contracts in annual increments. These contracts require subsequent authorization and appropriation that may not occur or that may be greater than or less than the total amount of the contract. Changes in the U.S. military's budget, spending allocations and the timing of such spending could adversely affect our ability to receive future contracts. None of our contracts with the U.S. military has a minimum purchase commitment, and the U.S. military generally has the right to cancel its contracts unilaterally without prior notice. We manufacture for the U.S. aircraft and land vehicle armor systems, protective equipment for military personnel and other technologies used to protect soldiers in a variety of life-threatening or catastrophic situations, and batteries for communications devices. The loss of, or a significant reduction in, U.S. military business for our aircraft and land vehicle armor systems, other protective equipment, or batteries could have a material adverse effect on our business, financial condition, results of operations and liquidity.

A reduction of U.S. force levels in Iraq may affect our results of operations.

Since the invasion of Iraq by the U.S. and other forces in March 2003, we have received steadily increasing orders from the U.S. military for armoring of vehicles and military batteries. These orders are the result, in substantial part, from the particular combat situations encountered by the U.S. military in Iraq. We cannot be certain, therefore, to what degree the U.S. military would continue placing orders for our products if the U.S. military were to reduce its force levels or withdraw completely from Iraq. A significant reduction in orders from the U.S. military could have a material adverse effect on our business, financial condition, results of operations and liquidity.

There are limited sources for some of our raw materials, which may significantly curtail our manufacturing operations.

The raw materials that we use in manufacturing our armor products include Kevlar®, a patented product of E.I. du Pont de Nemours Co., Inc. We purchase Kevlar in the form of woven cloth from various independent weaving companies. In the event Du Pont and/or these independent weaving companies were to cease, for any reason, to produce or sell Kevlar to us, we might be unable to replace it with a material of like weight and strength, or at all. Thus, if our supply of Kevlar were materially reduced or cut off or if there were a material increase in the price of Kevlar, our manufacturing operations could be adversely affected and our costs increased, and our business, financial condition and results of operations could be materially adversely affected.

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

Some of the components of our products contain elements that are known to pose potential safety risks. In addition to these risks, 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. In the event that our products, including the products manufactured by MDT and AoA, 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.

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.

Many of our competitors have financial, technical, marketing, sales, manufacturing, distribution and other resources significantly greater than ours. 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. 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, FAAC and AoA 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 2007. 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 2004, 2003 and 2002, without taking account of revenues derived from discontinued operations, 19%, 42% and 56%, 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;
- The issuance of our securities, including warrants, in connection with financings and acquisitions; 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 traded below $1.00 in the 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.

Our management has determined that we have material weaknesses in our internal controls. If we fail to achieve and maintain effective internal controls in accordance with Section 404 of the Sarbanes-Oxley Act, we may not be able to accurately report our financial results.

We have, with our auditors' concurrence, identified significant deficiencies that constitute material weaknesses under standards established by the Public Company Accounting Oversight Board (PCAOB). A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our auditors have reported to us that at December 31, 2004, we had material weaknesses for inadequate controls related to the financial statement close process, convertible debentures and share capital processes as it applies to non-routine and highly complex financial transactions. The material weaknesses arise from insufficient staff with technical accounting expertise to independently apply our accounting policies, as they relate to non-routine and highly complex transactions, in accordance with U.S. generally accepted accounting principles.

As a public company, we will have significant requirements for enhanced financial reporting and internal controls. The process of designing and implementing effective internal controls is a continuous effort that requires us to anticipate and react to changes in our business and the economic and regulatory environments and to expend significant resources to maintain a system of internal controls that is adequate to satisfy our reporting obligations as a public company. We cannot assure you that the measures we have taken or will take to remediate any material weaknesses or that we will implement and maintain adequate controls over our financial processes and reporting in the future as we continue our rapid growth. If we are unable to establish appropriate internal financial reporting controls and procedures, it could cause us to fail to meet our reporting obligations, result in material mis-statements in our financial statements, harm our operating results, cause investors to lose confidence in our reported financial information and have a negative effect on the market price for shares of our common stock.

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 June 30, 2005, we had 90,325,441 shares of common stock issued and 89,770,108 shares of common stock 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.

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

As of June 30, 2005, there were outstanding warrants to purchase a total of 16,961,463 shares of our common stock at a weighted average exercise price of $1.55 per share, options to purchase a total of 9,495,361 shares of our common stock at a weighted average exercise price of $1.28 per share, of which 7,300,810 were vested, at a weighted average exercise price of $1.34 per share, and outstanding debentures convertible into a total of 3,156,298 shares of our common stock at a weighted average conversion price of $1.44 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.

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 22% of our assets are located outside the United States. In addition, two of our directors and most 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 2005, the inflation adjusted NIS depreciated against the dollar.

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 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Interest Rate Risk

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

Foreign Currency Exchange Rate Risk

Since a significant part of our sales and expenses are denominated in U.S. dollars, we have experienced only insignificant foreign exchange gains and losses to date, and do not expect to incur significant gains and losses in 2005. Certain of our research, development and production activities are carried out by our Israeli subsidiary, EFL, at its facility in Beit Shemesh, and accordingly we have sales and expenses in NIS. Additionally, our MDT and Epsilor subsidiaries operate primarily in NIS. However, the majority of our sales are made outside Israel in U.S. dollars, and a substantial portion of our costs are incurred in U.S. dollars. Therefore, our functional currency is the U.S. dollar.

While we conduct our business primarily in U.S. dollars, some of our agreements are denominated in foreign currencies, and we occasionally 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 foreign currencies. We do not hold or issue derivative financial instruments for trading or speculative purposes

ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

As of June 30, 2005, 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 are intended 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. Any system of controls and procedures, no matter how well designed and operated, can at best provide only reasonable assurance that the objective of the system are met and management necessarily is required to apply its judgment in evaluating the cost benefit relationship of possible controls and procedures. 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 are intended to provide only reasonable, not absolute, assurance that the above objectives have been met.

Based on their evaluation, our principal executive officer and principal financial officer concluded that our controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) were not effective as of June 30, 2005.

Our management has not completed implementation of the changes it believes are required to remediate the previously reported material weaknesses for inadequate controls related to the financial statement close process, convertible debentures and share capital processes as it applies to non-routine and highly complex financial transactions. The material weaknesses arise from insufficient staff with technical accounting expertise to independently apply our accounting policies, as they relate to non-routine and highly complex transactions, in accordance with U.S. generally accepted accounting principles. Management has identified that due to the reasons described above, we did not consistently follow established internal control over financial reporting procedures related to the analysis, documentation and review of selection of the appropriate accounting treatment for non-routine and highly complex transactions. Because of these material weaknesses, we have concluded that we did not maintain effective internal control over financial reporting as of June 30, 2005, based on the criteria set forth by the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission in *Internal Control - Integrated Framework*.

In light of the material weakness described above, our management performed additional analyses and other post-closing procedures to ensure our consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States (U.S. GAAP). Accordingly, management believes that the consolidated financial statements included in this report fairly present in all material respects our financial position, results of operations and cash flows for the periods presented.

Management's Response to the Material Weaknesses

In response to the material weaknesses described above, we have undertaken to take the following initiatives with respect to our internal controls and procedures that we believe are reasonably likely to improve and materially affect our internal control over financial reporting. We anticipate that remediation will be continuing throughout fiscal 2005, during which we expect to continue pursuing appropriate corrective actions, including the following:

- Preparing appropriate written documentation of our financial control procedures (currently in process);
- Adding additional qualified staff to our finance department (currently in process);
- Scheduling training for accounting staff to heighten awareness of generally accepted accounting principles applicable to complex transactions (not yet begun);
- Strengthening our internal review procedures in conjunction with our ongoing work to enhance our internal controls so as to enable us to identify and adjust items proactively (currently in process);
- Engaging an outside accounting firm to support our Sarbanes-Oxley Section 404 compliance activities and to provide technical expertise in the selection and application of generally accepted accounting principles related to complex transactions to identify areas that require control or process improvements and to consult with us on the appropriate accounting treatment applicable to complex transactions (done); and

- Implementing the recommendations of our outside accounting consultants (currently in process).

Our management and Audit Committee will monitor closely the implementation of our remediation plan. The effectiveness of the steps we intend to implement is subject to continued management review, as well as Audit Committee oversight, and we may make additional changes to our internal control over financial reporting.

Changes in Internal Controls Over Financial Reporting

Except as noted above, there have been no changes in our internal control over financial reporting that occurred during our last fiscal quarter to which this Quarterly Report on Form 10-Q relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

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

Issuance of Restricted Stock to Certain Employees

In June 2005, we granted a total of 50,000 shares of our common stock as stock bonuses to two employees of FAAC. Under the terms of this grant, the sale or other transfer of these shares is restricted, 50% for a period of one year from the date of grant and 50% for a period of two years from the date of grant, and such shares automatically return to us if the employees leave our employ during such restricted periods under certain circumstances (generally, resignation without good cause or dismissal with good cause).

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

We held our 2005 Annual Meeting of Stockholders on July 11, 2005. At that meeting, the stockholders voted on the following matters with the following results:

1. *Fixing the number of Class II Directors at three:*

	Votes For	Votes Against	Abstentions	Shares Not Voting
	72,447,641	685,128	0	0

2. *Election of Class II Directors:*

	Votes For	Votes Against	Abstentions	Shares Not Voting
Jack E. Rosenfeld	70,902,042	1,545,599	0	0
Lawrence M. Miller	71,152,372	1,295,269	0	0
Seymour Jones	71,066,345	1,381,296	0	0

(Directors whose terms of office continued after the meeting were Robert S. Ehrlich, Dr. Jay M. Eastman, Steven Esses, Bert W. Wasserman and Edward J. Borey)

ITEM 6. EXHIBITS.

The following documents are filed as exhibits to this report:

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

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: August 15, 2005

AROTECH CORPORATION

By: /s/ Robert S. Ehrlich

Name: Robert S. Ehrlich
Title: Chairman, President and CEO
(Principal Executive Officer)

By: /s/ Avihai Shen

Name: Avihai Shen
Title: Vice President - Finance
(Principal Financial Officer)

AROTECH CORPORATION

EXHIBIT INDEX

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Exhibit 31.1

CERTIFICATION

I, Robert S. Ehrlich, certify that:

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

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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 quarterly report is being prepared;

(b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

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

(d) disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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

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

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

Dated: August 15, 2005

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

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

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

Exhibit 31.2

CERTIFICATION

I, Avihai Shen, certify that:

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

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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 quarterly report is being prepared;

(b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

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

(d) disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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

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

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

Dated: August 15, 2005

/s/ Avihai Shen
Avihai Shen, Vice President - Finance
(Principal Financial Officer)

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

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

Exhibit 32.1

WRITTEN STATEMENT

In connection with the Quarterly Report of Arotech Corporation (the "Company") on Form 10-Q for the quarterly period ended June 30, 2005 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 to my knowledge, the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Report fairly presents, in all material respects, the consolidated financial condition of the Company and its subsidiaries as of the dates presented and the consolidated results of operations of the Company and its subsidiaries for the periods presented.

Dated: August 15, 2005

By: /s/ Robert S. Ehrlich
Robert S. Ehrlich, Chairman, President and CEO
(Chief Executive Officer)

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

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

Exhibit 32.2

WRITTEN STATEMENT

In connection with the Quarterly Report of Arotech Corporation (the “Company”) on Form 10-Q for the quarterly period ended June 30, 2005 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 to my knowledge, the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Report fairly presents, in all material respects, the consolidated financial condition of the Company and its subsidiaries as of the dates presented and the consolidated results of operations of the Company and its subsidiaries for the periods presented.

Dated: August 15, 2005

By: /s/ Avihai Shen
Avihai Shen, Vice President - Finance
(Chief Financial Officer)

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

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