

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED September 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 [X] No |_|

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes [X] No |_|

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

Yes |_| No [X]

APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of shares outstanding of the issuer's common stock as of November 14, 2005 was 90,204,708.

AROTECH CORPORATION

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<C>

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AROTECH CORPORATION

ITEM 1. INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

CONSOLIDATED BALANCE SHEETS
(U.S. Dollars)

<TABLE>
<CAPTION>

	September 30, 2005	December 31, 2004
	-----	-----
ASSETS	(Unaudited)	
CURRENT ASSETS:		
<S>	<C>	<C>
Cash and cash equivalents	\$ 11,232,180	\$ 6,734,512
Restricted collateral deposits	2,328,908	6,962,110
Available-for-sale marketable securities	35,775	135,568
Trade receivables (net of allowance for doubtful accounts in the amount of \$46,475 and \$55,394 as of September 30, 2005 and December 31, 2004, respectively)	9,120,855	8,266,880
Unbilled receivables	2,052,482	2,881,468
Other accounts receivable and prepaid expenses	2,527,075	1,339,393
Inventories	8,572,203	7,277,301
	-----	-----
Total current assets	35,869,478	33,597,232
	-----	-----
SEVERANCE PAY FUND	2,015,184	1,980,047
PROPERTY AND EQUIPMENT, NET	4,172,889	4,600,691
RESTRICTED DEPOSITS	4,021,441	4,000,000
INVESTMENT IN AFFILIATED COMPANY	112,500	--
GOODWILL	28,961,782	39,745,516
OTHER INTANGIBLE ASSETS, NET	11,695,813	14,368,701
	-----	-----
	\$ 86,849,087	\$ 98,292,187
	=====	=====

</TABLE>

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

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

<TABLE>
<CAPTION>

	September 30, 2005	December
	-----	-----
	(Unaudited)	
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
<S>	<C>	<C>
Trade payables	\$ 5,112,744	\$
6,177,546		
Other accounts payable and accrued expenses	5,533,640	
5,818,188		
Current portion of promissory notes due to purchase of subsidiaries ...	1,498,488	
13,585,325		
Short-term bank loans and current portion of long-term loans	1,211,587	
181,352		
Deferred revenues	1,271,497	

618,229		
Liability in connection with issuance of warrants	422,034	
--		
Current portion of convertible debentures	10,061,329	
--		
Liabilities of discontinued operation (see Note 8)	200,000	
--		
-----	-----	-----
Total current liabilities	25,311,319	
26,380,640		
LONG TERM LIABILITIES		
Accrued severance pay	3,519,907	
3,422,951		
Convertible debenture	9,962,155	
1,754,803		
Deferred revenues	--	
163,781		
Long-term note	--	
20,891		
Long-term portion of promissory note due to purchase of subsidiaries ..	--	
980,296		
-----	-----	-----
Total long-term liabilities	13,482,062	
6,342,722		
MINORITY INTEREST	114,731	
95,842		
SHAREHOLDERS' EQUITY:		
Share capital -		
Common stock - \$0.01 par value each;		
Authorized: 250,000,000 shares as of September 30, 2005 and December		
31, 2004; Issued: 90,760,041 shares as of September 30, 2005 and		
80,637,002 shares as of December 31, 2004; Outstanding - 90,204,708		
shares as of September 30, 2005 and 80,081,669 shares as of		
December 31, 2004	907,602	
806,370		
Preferred shares - \$0.01 par value each;		
Authorized: 1,000,000 shares as of September 30, 2005 and December		
31, 2004; No shares issued and outstanding as of September 30, 2005		
and December 31, 2004	--	
--		
Additional paid-in capital	193,669,329	
189,266,103		
Deferred stock compensation	(633,943)	
(1,258,295)		
Accumulated deficit	(139,741,499)	
(118,953,553)		
Treasury stock, at cost (common stock - 555,333 shares as of September		
30, 2005 and December 31, 2004)	(3,537,106)	
(3,537,106)		
Notes receivable from stockholders	(2,363,243)	
(1,222,871)		
Accumulated other comprehensive income (loss)	(360,165)	
372,335		
-----	-----	-----
Total shareholders' equity	47,940,975	
65,472,983		
-----	-----	-----
	\$ 86,849,087	\$
98,292,187	=====	
=====		

</TABLE>

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

<TABLE>
<CAPTION>

	Nine months ended September 30,		Three months ended September	
30,				

	2005	2004	2005	2004

<S>	<C>	<C>	<C>	<C>
Revenues	\$ 33,814,030	\$ 33,383,023	\$ 11,189,675	\$ 16,272,521
Cost of revenues	23,414,434	22,680,921	8,433,283	11,548,948

Gross profit	10,399,596	10,702,102	2,756,392	4,723,573
Operating expenses:				
Research and development	1,245,452	1,302,774	346,948	431,147
Selling and marketing	3,241,179	3,435,183	1,018,486	1,294,487
General and administrative	10,874,309	7,571,923	4,031,477	2,111,853
Amortization of intangible assets	2,346,083	1,731,425	699,843	739,400
Impairment of goodwill and other intangible assets	11,052,606	--	8,663,478	-
-				

Total operating costs and expenses	28,759,629	14,041,305	14,760,232	4,576,887

Operating income (loss)	(18,360,033)	(3,339,203)	(12,003,840)	146,686
Other income	160,652	--	38,636	-
-				
Financial income (expenses), net	(2,056,518)	(2,126,079)	(750,052)	1,105,276

Income (loss) before income taxes	(20,255,899)	(5,465,282)	(12,715,256)	1,251,962
Income tax expenses	(314,760)	(286,525)	(47,542)	
(116,460)				

Income (loss) before minority interest in earnings of a subsidiary	(20,570,659)	(5,751,807)	(12,762,798)	1,135,502
Minority interest in loss (earnings) of a subsidiary	(17,287)	(35,365)	53,866	
(8,657)				

Income (loss) from continuing operations	(20,587,946)	(5,787,172)	(12,708,932)	1,126,845
Income (loss) from discontinued operations (see Note 8)	(200,000)	--	--	-
-				

Net loss	(20,787,946)	(5,787,172)	(12,708,932)	1,126,845
Deemed dividend to certain stockholders	--	(3,328,952)	--	
(2,165,952)				

Net loss attributable to common stockholders	\$ (20,787,946)	\$ (9,116,124)	\$ (12,708,932)	\$
(1,039,107)				
=====				
Basic and diluted net loss per share from continuing operations	\$ (0.25)	\$ (0.14)	\$ (0.15)	\$
(0.01)				
=====				
Basic and diluted net loss per share from discontinued operation	\$ 0.00	\$ 0.00	\$ 0.00	\$
0.00				
=====				
Basic and diluted net loss per share	\$ (0.26)	\$ (0.14)	\$ (0.15)	\$
(0.01)				
=====				
Weighted average number of shares used in computing basic and diluted net loss per share .	81,122,481	67,072,069	82,475,778	76,744,251

=====
</TABLE>

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)

<TABLE>
<CAPTION>

	Common Stock		Additional paid-in capital	Deferred stock compensation	Accumulated deficit
	Shares	Amount			
<S>	<C>	<C>	<C>	<C>	<C>
BALANCE AT JANUARY 1, 2005 - NOTE 1	80,637,001	\$806,370	\$ 189,266,103	\$(1,258,295)	\$(118,953,553)
CHANGES DURING THE NINE-MONTH PERIOD ENDED SEPTEMBER 30, 2005					
Issuance of shares, net	9,539,962	95,401	3,892,835	--	--
Shares issued to consultant ..	507,253	5,073	516,200	--	--
Compensation related to non-recourse loan granted to shareholder	--	--	(28,500)	--	--
Employee options exercise	15,825	158	17,034	--	--
Shares issued to employees ...	10,000	100	(100)	--	--
Deferred stock compensation related to options and restricted stock	50,000	500	50,500	(51,000)	--
Amortization of deferred stock compensation	--	--	--	606,152	--
Cancellation of deferred stock compensation	--	--	(69,200)	69,200	--
Interest accrued on notes receivable from shareholders	--	--	24,457	--	--
Other comprehensive loss - foreign currency translation adjustment	--	--	--	--	--
Other comprehensive loss - unrealized gain on available for sale marketable securities	--	--	--	--	--
Net loss	--	--	--	--	(20,787,946)
Total comprehensive loss	--	--	--	--	--
BALANCE AT SEPTEMBER 30, 2005 - UNAUDITED	90,760,041	\$907,602	\$ 193,669,329	\$(633,943)	\$(139,741,499)

<CAPTION>

	Treasury stock	Notes receivable from shareholders	Accumulated other comprehensive income (loss)	Total comprehensive loss	Total
<S>	<C>	<C>	<C>	<C>	<C>
BALANCE AT JANUARY 1, 2005 - NOTE 1	\$(3,537,106)	\$(1,222,871)	\$ 372,335	\$ --	\$ 65,472,983
CHANGES DURING THE NINE-MONTH PERIOD ENDED SEPTEMBER 30, 2005					
Issuance of shares, net	--	(1,115,915)	--	--	2,872,321
Shares issued to consultant ..	--	--	--	--	521,273
Compensation related to non-recourse loan granted to shareholder	--	--	--	--	(28,500)
Employee options exercise	--	--	--	--	17,192
Shares issued to employees ...	--	--	--	--	--

Deferred stock compensation related to options and restricted stock	--	--	--	--	--
Amortization of deferred stock compensation	--	--	--	--	606,152
Cancellation of deferred stock compensation	--	--	--	--	--
Interest accrued on notes receivable from shareholders	--	(24,457)	--	--	--
Other comprehensive loss - foreign currency translation adjustment	--	--	(730,501)	(730,501)	(730,501)
Other comprehensive loss - unrealized gain on available for sale marketable securities	--	--	(1,999)	(1,999)	(1,999)
Net loss	--	--	--	(20,787,946)	(20,787,946)
Total comprehensive loss	--	--	--	\$ (21,520,446)	--
BALANCE AT SEPTEMBER 30, 2005 - UNAUDITED	\$ (3,537,106)	\$ (2,363,243)	\$ (360,165)	--	\$ 47,940,975
	=====	=====	=====	=====	=====

</TABLE>

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

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

<TABLE>
<CAPTION>

September 30,	Nine months ended	
-----	-----	-----
2004	2005	2004
-----	-----	-----
<S>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss for the period before deemed dividend to certain stockholders of common stock . (5,787,172)	\$ (20,787,946)	\$
Less loss for the period from discontinued operations (see Note 8)	200,000	
--		
Adjustments required to reconcile net loss to net cash used in operating activities:		
Depreciation	940,529	
834,637		
Amortization of intangible assets	2,346,083	
1,703,936		
Impairment of goodwill and other intangible assets	11,052,606	
--		
Amortization of subsidiary purchase price allocated to inventory	--	
586,325		
Amortization of compensation related to warrants issued to the holders of convertible debentures and beneficial conversion feature	1,190,715	
3,454,676		
Amortization of deferred expenses related to convertible debenture issuance	36,384	
176,771		
Amortization of capitalized research and development projects	94,419	
27,489		
Adjustment of liability in connection to warrants granted	--	
(1,829,025)		
Stock based compensation due to options granted to employees and directors	219,966	
481,494		
Amortization of deferred stock based compensation due to shares issued employees	386,186	
108,654		
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	533,501	
--		
Write-off and write-down of inventories	647,614	
67,951		
Write-off of fixed assets	32,367	
Earnings to minority	17,288	
35,363		
Markdown (Markup) of loans to stockholders	--	

(32,397)	Interest expenses accrued on promissory notes issued to purchase of subsidiary	517,923
36,385	Interest accrued on restricted securities and certificates of deposit due within one year	--
(184,374)	Capital (gain) loss from sale of marketable securities	2,694
(4,114)	Amortization of premium related to restricted securities	42,234
146,105	Capital gain from sale of property and equipment	4,517
(5,744)	Accrued severance pay, net	(60,693)
(474,575)	Decrease (increase) in deferred tax assets	75,078
(16,499)	Changes in operating asset and liability items:	
	Decrease in trade receivables	(1,026,422)
725,593	Decrease (increase) in unbilled receivables	828,986
(1,259,720)	Decrease in notes receivable	46,527
283,078	Increase in other accounts receivable and prepaid expenses	(52,558)
(447,270)	Increase in inventories	(1,908,500)
(2,895,083)	Increase (decrease) in trade payables	(944,996)
955,347	Increase in deferred revenues	489,488
2,092,736		
</TABLE>		

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

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

<TABLE>			
<CAPTION>			
September 30,		Nine months ended	
-----		-----	
		2005	
2004		-----	---

<S>		<C>	<C>
Increase (decrease) in accounts payable and accruals	202,891	(51,983)	
-----		-----	---
Net cash used in operating activities from continuing operations (reconciled from	(1,030,042)	(5,156,493)	
continuing operations)		-----	---

Net cash used in operating activities from discontinued operations (reconciled from discontinued operations)	(211,628)	--	
-----		-----	---
Net cash used in operating activities	(1,241,670)	(5,156,493)	
-----		-----	---
CASH FLOWS FROM INVESTING ACTIVITIES:			
Repayment of promissory note related to purchase of subsidiary	(1,150,000)	(14,120,602)	
Proceeds from sale of marketable securities	812	92,036	
Investment in subsidiary(1)	(7,190,777)	--	
Investment in subsidiary(2)	(12,129,103)	--	
Investment in subsidiary(3)	(17,302,167)	--	
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	(761,003)	
(1,121,991)		
Increase in capitalized research and development projects	(181,342)	
(304,108)		
Proceeds from sale of property and equipment	13,000	
93,786		
Decrease in demo inventories, net	--	
(26,970)		
Repayment of loan granted to stockholder	--	
32,397		
Decrease (increase) in restricted securities and deposits, net	4,278,671	
(13,111,519)		
-----		-----
-----		-----
Net cash used in investing activities	(10,804,685)	
(52,209,640)		
-----		-----
-----		-----
FORWARD	\$ (15,961,178)	
\$(53,451,310)		
-----		-----
-----		-----

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

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

<TABLE>
<CAPTION>

	Nine months ended September 30,	
	2005	2004
	-----	-----
<S>	<C>	<C>
FORWARD	\$ (15,961,178)	\$ (53,451,310)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase (decrease) in short-term credit from banks	1,079,583	(419,085)
Proceeds from issuance of convertible debentures, net	16,511,372	--
Proceeds from issuance of share capital, net	2,872,321	24,319,890
Proceeds from exercise of options	17,192	1,094,156
Proceeds from exercise of warrants	--	19,387,651
Payment on capital lease obligation	--	(2,888)
Repayment of long-term loans	(61,460)	(42,529)
	-----	-----
Net cash provided by financing activities	20,419,008	44,337,195
	-----	-----
DECREASE IN CASH AND CASH EQUIVALENTS	4,457,830	(9,114,115)
CASH EROSION DUE TO EXCHANGE RATE DIFFERENCES	39,838	2,865
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	\$ 11,232,180	\$ 4,573,875
	=====	=====
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
	=====	=====
Exercise of options and warrants against notes receivables	\$ 1,115,915	\$ 6,100
	=====	=====
Issuance expenses against accounts payable	\$ 70,181	\$ 155,002
	=====	=====
Purchase of property and equipment against accounts payable	\$ --	\$ 32,841
	=====	=====
Liability in connection to warrants granted	\$ 422,034	\$ 10,841,020
	=====	=====
Accrual for earnout in respect of subsidiary acquisition	\$ 535,546	\$ --

SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION - CASH PAID DURING THE PERIOD FOR:

Interest	\$ (813,976)	\$ (404,503)
----------------	--------------	--------------

</TABLE>

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 Epsilon Electronic Industries, Ltd. ("Epsilon"). 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)	(2,003,678)

	\$ 12,129,103
	=====

(3) In August 2004, the Company acquired all of the outstanding common stock of Armour of America, Incorporated ("AoA"). The net fair value of the assets acquired was as follows:

Working capital, excluding cash and cash equivalents (unaudited)	\$ 3,219,728
Property and equipment (unaudited)	997,148
Intangible assets and goodwill (unaudited)	13,085,291

	\$17,302,167
	=====

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; Epsilon 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 September 30, 2005, its operating results for the nine- and three-month periods ended September 30, 2005 and 2004 and its cash flow for the nine month periods ended September 30, 2005 and 2004.

The results of operations for the nine months ended September 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.

AROTECH CORPORATION

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 nine and three months ended September 30, 2005 and 2004:

<TABLE>
<CAPTION>

	Nine months ended September 30,		Three months ended September 30,	
	2005	2004	2005	2004

(Unaudited)

<S>	<C>	<C>		<C>
Risk free interest	3.70	3.38	--	3.38
Dividend yields	0.0%	0.0%	--	0.0%
Volatility	0.76	0.817	--	0.817
Expected life	3 years	5 years	--	5 years

</TABLE>

Pro forma information under SFAS No. 123:

<TABLE>
<CAPTION>

	Nine months ended September 30,	Three months ended September 30,
--	---------------------------------	----------------------------------

	2005	2004	2005	2004
	-----	-----	-----	-----
	Unaudited (U.S. Dollars, except per share data)			
<S>	<C>	<C>	<C>	<C>
Net loss as reported	\$ (20,787,946)	\$ (9,116,124)	\$ (12,708,932)	\$ (1,039,107)
	=====	=====	=====	=====
Add - stock-based compensation expense .. determined under APB 25	606,152	536,958	157,781	174,787
Deduct - stock based compensation expense determined under fair value method for all awards	(1,464,734)	(1,605,146)	(613,343)	
(745,546)				
	=====	=====	=====	=====
Pro forma net loss	\$ (21,646,528)	\$ (10,184,312)	\$ (13,164,494)	\$ (1,609,866)
	=====	=====	=====	=====
Loss per share as reported	\$ (0.26)	\$ (0.14)	\$ (0.15)	\$
(0.01)				
	=====	=====	=====	=====
Pro forma loss per share	\$ (0.27)	\$ (0.15)	\$ (0.16)	\$
(0.02)				
	=====	=====	=====	=====

</TABLE>

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 nine months ended September 30, 2005 wrote off and wrote down inventory in the amount of \$647,614. Inventories are composed of the following:

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	September 30, 2005	December 31, 2004
	-----	-----
	(Unaudited)	
Raw materials	\$ 3,962,580	\$ 4,087,650
Work-in-progress	3,217,213	1,877,889
Finished goods	1,392,410	1,311,762
	-----	-----
	\$ 8,572,203	\$ 7,277,301
	=====	=====

NOTE 3: IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payments" ("SFAS 123(R)"), which is a revision of FASB No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). Generally, the approach in SFAS 123(R) is similar to the approach described in Statement 123. However, SFAS 123 permitted, but not required, share-based payments to employees to be recognized based on their fair values while SFAS 123(R) requires all share-based payments to employees to be recognized based on their fair values. SFAS 123(R) also revises, clarifies and expands guidance in several areas, including measuring fair value, classifying an award as equity or as a liability and attributing compensation cost to reporting periods. The new standard will be effective for the Company in the first interim period beginning after December 15, 2005.

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.

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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 nine and three months ended September 30, 2005 and 2004:

<TABLE>
<CAPTION>

Total	Simulation and Security	Battery and Power Systems	Armor	All Others

Nine months ended September 30, 2005				
<S>	<C>	<C>	<C>	<C>
<C>				
Revenues from outside customers	\$ 16,794,959	\$ 7,600,090	\$ 9,418,981	\$ --
33,814,030				
Depreciation , amortization and impairment expenses (1)	(1,203,691)	(690,604)	(12,429,841)	(109,500)
(14,433,636)				
Direct expenses (2)	(14,485,473)	(7,441,305)	(10,645,962)	(5,337,448)
(37,910,188)				

Segment income (loss)	\$ 1,105,795	\$ (531,819)	\$ (13,656,822)	\$ (5,446,948)
(18,529,794)				
=====				
Financial income (after deduction of ..				
(2,058,152)				
minority interest)				

Loss from continuing operations
 \$(20,587,946)

Segment assets (3), (4)	\$ 32,458,316	\$ 14,898,075	\$ 5,326,840	\$ 719,456	\$
53,402,687					

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<TABLE>
 <CAPTION>

	Simulation and Security	Battery and Power Systems	Armor	All Others	
Total					

Nine months ended September 30, 2004					
<S>	<C>	<C>	<C>	<C>	
<C>					
Revenues from outside customers	\$ 13,258,943	\$ 8,046,095	\$ 12,077,985	\$ --	\$
33,383,023					
Depreciation expenses and amortization (1)	(1,225,248)	(855,797)	(941,342)	(130,000)	
(3,152,387)					
Direct expenses (2)	(11,947,426)	(7,476,476)	(10,650,363)	(3,818,306)	
(33,892,571)					

Segment gross profit (loss)	\$ 86,269	\$ (286,178)	\$ 486,280	\$ (3,948,306)	
(3,661,935)					
=====					
Financial expenses (after deduction of ..					
(2,125,237)					
minority interest)					-

Net loss from continuing operations					\$
(5,787,172)					
=====					
Segment assets (3)	\$ 18,393,997	\$ 12,914,008	\$ 20,367,854	\$ 698,516	\$
52,374,375					
=====					

Three months ended September 30, 2005					
Revenues from outside customers	\$ 7,155,887	\$ 2,539,120	\$ 1,494,668	\$ --	\$
11,189,675					
Depreciation , amortization and impairment					
expenses (1)	(397,341)	(235,764)	(9,051,210)	(36,500)	
(9,720,815)					
Direct expenses (2)	(5,993,882)	(2,378,728)	(2,895,703)	(2,159,420)	
(13,427,733)					

Segment income (loss)	\$ 764,664	\$ (75,372)	\$ (10,452,245)	\$ (2,195,920)	
(11,958,873)					
=====					
Financial income (after deduction of ..					
(750,059)					
minority interest)					-

Loss from continuing operations					
\$(12,708,932)					
=====					

Three months ended September 30, 2004					
Revenues from outside customers	\$ 6,034,299	\$ 2,913,705	\$ 7,324,517	\$ --	\$
16,272,521					
Depreciation expenses and amortization (1)	(417,005)	(291,806)	(882,219)	(51,000)	
(1,642,030)					
Direct expenses (1)	(5,010,108)	(2,398,561)	(6,245,370)	(957,319)	
(14,611,358)					

Segment gross profit (loss)	\$ 607,186	\$ 223,338	\$ 196,928	\$ (1,008,319)	
19,133					
=====					

Financial income (after deduction of ..
1,107,712
minority interest)

Net income from continuing operations
1,126,845

-

\$

=====

</TABLE>

- - - - -

- 1) Includes depreciation of property and equipment, amortization expenses of intangible assets and impairment of goodwill and other intangible assets.
- (2) Including, inter alia, 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, \$4,974,078 and \$986,399 as of September 30, 2005, respectively, and \$8,559,016, \$4,974,517 and \$11,445,232 as of September 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.

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As of September 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 nine months ended September 30, 2005, the Company recorded an expense of \$22,142, 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 September 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.

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During the nine months ended September 30, 2005, the Company recorded an expense of \$1,168,573, 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: CONVERTIBLE NOTES AND DETACHABLE WARRANTS

Pursuant to the terms of a Securities Purchase Agreement dated September 29, 2005 (the "Purchase Agreement") by and between the Company and certain institutional investors, the Company issued and sold to the investors an aggregate of \$17.5 million principal amount of senior secured notes having a final maturity date of March 31, 2008.

Under the terms of the Purchase Agreement, the Company granted the investors (i) a second position security interest in the stock of MDT Armor Corporation, IES Interactive Training, Inc. and M.D.T. Protective Industries, Ltd. (junior to the security interest of the holders of the Company's 8% secured convertible debentures due September 30, 2006) and in the assets of FAAC Incorporated (junior to a bank that extends to FAAC Incorporated a \$5 million line of credit) and in any stock that the Company acquires in future acquisitions, and (ii) a first position security interest in the assets of all of the Company's other active United States subsidiaries. The Company's active United States subsidiaries are also acting as guarantors of the Company's obligations under the Notes.

As of September 30, 2005, principal amount of \$17.5 million remained outstanding under these convertible notes.

The Notes are convertible at the investors' option at a fixed conversion price of \$1.00. The Notes bear interest at a rate equal to six month LIBOR plus 6% per annum, subject to a floor of 10% and a cap of 12.5%. The Company will repay the principal amount of the Notes over a period of two and one-half years, with the principal amount being amortized in twelve payments payable at the Company's option in cash and/or stock, provided certain conditions are met. In the event the Company elects to make such payments in stock, the price used to determine the number of shares to be issued will be calculated using an 8% discount to the average trading price of our common stock during 17 of the 20 consecutive trading days ending two days before the payment date. The Company is obligated under Nasdaq rules, to solicit the approval of its stockholders to such stock payments at a special meeting of its stockholders to be held on or before December 14, 2005.

As a further part of the Securities Purchase Agreement dated September 29, 2005, the Company issued warrants, which are not exercisable for the six month period following closing, to purchase up to 5,250,000 shares of common stock (30% warrant coverage) at an exercise price of \$1.10 per share. These warrants are exercisable until the one-year anniversary of the effective date of the registration statement registering the shares of common stock underlying the warrants.

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 3.87%, a volatility factor 53%, dividend yields of 0% and a contractual life of one year.

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In connection with these convertible notes, the Company will recognize financial expenses of \$422,034 with respect to the beneficial compensation related to the warrants issued to the holders of the convertible debenture, which is being amortized from the date of issuance to the stated redemption date - March 31, 2008 - as financial expenses.

During the nine months ended September 30, 2005, the Company did not record any expense in connection with the foregoing issuance.

NOTE 7: 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 (a component of the Company's Armor Division) an impairment of goodwill in the amount of \$2,043,129. As of September 30, 2005, the Company performed another impairment test in AoA in response to several factors, including without limitation the reduced sales in AoA during the third quarter of 2005, the fact that since the last impairment test AoA received no substantial new orders and therefore failed to meet its projections, the decision of the General Manager of AoA and his new supervisor to leave the employ of AoA and the Company, respectively, and general uncertainty about the market for AoA's products in general and AoA's business in particular; specifically, the delay or loss of several potential orders, decisions by customers to utilize methods of armor not produced by AoA (hard armor instead of soft armor), and the change in U.S. military priorities from acquiring new armor to funding the ground forces in Iraq and Afghanistan. As a result of this impairment test, the Company identified an additional impairment of goodwill in AoA in the amount of \$8,510,533.

In connection with the Company's acquisition of AoA, the Company has a contingent earnout obligation in an amount equal to the revenues realized by the Company from certain specific programs that were identified by the Company and the former shareholder of AoA as appropriate targets for revenue increases. The earnout provides that if AoA receives certain types of orders from certain specific customers prior to December 31, 2006 ("Additional Orders"), then upon shipment of goods in connection with such Additional Orders, the former shareholder of AoA will be paid an earnout based on revenues, up to a maximum of an additional \$6 million. To date, AoA has not accrued any liability in respect of such earnout obligation.

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 recorded an impairment loss in the amount of \$346,000. As a result of the additional impairment test performed in connection with preparation of the third quarter financial statements, the Company recorded an additional impairment in the amount of \$152,944 as of September 30, 2005 in respect of trademarks and a covenant not to compete previously identified with respect to the AoA acquisition.

NOTE 8: CONTINGENT LIABILITIES

In 2000 and 2001, the Company sold consumer cellphone batteries and chargers (an operation that was discontinued in the third quarter of 2002) 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 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 have terminated. 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.

In connection with the Company's acquisition of FAAC, the Company has a contingent earnout obligation in an amount equal to the net income realized by the Company from certain specific programs that were identified by the Company and the former shareholders of FAAC as appropriate targets for revenue increases in 2005. Through September 30, 2005, the Company had accrued an amount of \$382,572 in respect of such earnout obligation against FAAC's goodwill. Although one of the former shareholders of FAAC has indicated to the Company his belief that the specific programs identified include more orders than those with respect to which the Company has made accrual in respect of this earnout obligation, the Company believes there is no basis for this claim.

In connection with the Company's acquisition of AoA, the Company has a contingent earnout obligation in an amount equal to the revenues realized by the Company from certain specific programs that were identified by the Company and the former shareholder of AoA as appropriate targets for revenue increases. The earnout provides that if AoA receives certain types of orders from certain specific customers prior to December 31, 2006 ("Additional Orders"), then upon shipment of goods in connection with such Additional Orders, the former shareholder of AoA will be paid an earnout based on revenues, up to a maximum of an additional \$6 million. To date, AoA has not accrued any liability in respect of such earnout obligation.

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

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

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

Executive Summary

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:
 - o 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

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- o 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:

- o Armour of America, located in Los Angeles, California, which manufactures 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");
- o 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
- o 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:

- o Epsilon 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 ("Epsilon");
- o Electric Fuel Battery Corporation, located in Auburn, Alabama, which manufactures and sells Zinc-Air fuel cells, batteries and chargers for the military, focusing on applications that demand high energy and light weight ("EFB"); and
- o 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").

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Overview of Results of Operations

We incurred significant operating losses for the years ended December 31, 2003 and 2004 and for the first nine 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.

While we succeeded during 2004 in moving Arotech to positive EBITDA for the first time in our history, we are doubtful that we will be able to continue this success in 2005, since we had substantial negative EBITDA during the first nine months of 2005. While we believe the fourth quarter of 2005 will be stronger than the first three quarters, we do not believe that it will be sufficiently strong to move us to positive EBITDA for 2005.

A portion of our operating loss during the first nine months of 2005 arose as a result of non-cash charges. These charges were primarily related to

acquisitions made in the previous year and to raising capital through convertible debenture in the prior years.

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, Epsilon and AoA resulted in our incurring such non-cash charges during the first nine 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 \$2.3 million and an additional \$11.6 million related to impairment of goodwill and other intangible assets during the first nine months of 2005.

The non-cash charges that relate to our financings arise when we sell convertible debentures or notes and warrants. When we issue convertible debentures or notes, we record an expense for a beneficial conversion feature that is amortized ratably over the life of the debenture or note. When a debenture or note is converted, however, the entire remaining unamortized beneficial conversion feature expense is immediately recognized in the quarter in which the debenture or note is converted. Similarly, when we issue warrants in connection with convertible debentures or notes, we record an expense for financial expenses that is amortized ratably over the term of the convertible debentures or notes; when the convertible debentures or notes 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 or notes are converted, we would incur similar non-cash charges going forward.

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As a result of the application of the above accounting rule, we incurred non-cash charges related to our financings in the amount of \$1.2 million during the first nine 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 \$3.3 million during the first nine months of 2005 and 2004, respectively.

In addition, we incurred non-cash charges in the amount of \$606,000 during the first nine months of 2005 in connection with options and shares granted to employees and \$534,000 in connection with shares granted to consultants and as a donation.

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 our Simulation and Security Division, revenues grew from approximately \$13.3 million in the first nine months of 2004 to \$16.8 million in the first nine months of 2005. As of September 30, 2005, our backlog for our Simulation and Security Division totaled \$15.6 million, most of which was attributable to FAAC.

In our Battery and Power Systems Division, revenues decreased from approximately \$8.0 million in the first nine months of 2004 to approximately \$7.6 million in the first nine months of 2005. As of September 30, 2005, our backlog for our Battery and Power Systems Division totaled \$6.1 million.

In our Armor Division, revenues decreased from \$12.1 million during the first nine months of 2004 to \$9.4 million during the first nine months of 2005.

As of September 30, 2005, our backlog for our Armor Division totaled \$6.0 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 income.

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The majority of financial transactions of our Israeli subsidiaries MDT and Epsilon, is in New Israel Shekels ("NIS") and a substantial portion of MDT's and Epsilon's costs is incurred in NIS. Management believes that the NIS is the functional currency of MDT and Epsilon. Accordingly, the financial statements of MDT and Epsilon 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 nine months ended September 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 full period of the three and nine months ended September 30, 2004. Accordingly, the following period-to-period comparisons should not necessarily be relied upon as indications of future performance.

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

Revenues. During the three months ended September 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 Epsilon 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 September 30, 2005 totaled \$11.2 million, compared to \$16.3 million in the comparable period in 2004, a decrease of \$5.1 million, or 31.2%. This decrease was primarily attributable to decreased revenues from our Armor Division (\$1.5 million in the third quarter of 2005 compared to \$7.3 million in the comparable period in 2004), primarily as a result of low revenues of AoA and decreased revenues of MDT Armor. These decreased revenues were offset to some extent by increased revenues from our Simulation and Security Division (\$7.2 million in the third quarter of 2005 compared to \$6.0 million in the comparable period in 2004).

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In the third quarter of 2005, revenues were \$7.2 million for the Simulation and Security Division (compared to \$6.0 million in the third quarter of 2004, an increase of \$1.1 million, or 18.6%, due primarily to increased sales of FAAC); \$2.5 million for the Battery and Power Systems Division (compared to \$2.9 million in the third quarter of 2004, a decrease of \$375,000, or 12.9%, due primarily to decreased sales of Epsilon); and \$1.5 million for the Armor Division (compared to \$7.3 million in the third quarter of 2004, a decrease of \$5.8 million, or 79.6%, due primarily to the decreased revenues of MDT Armor).

Cost of revenues and gross profit. Cost of revenues totaled \$8.4 million during the third quarter of 2005, compared to \$11.5 million in the third quarter of 2004, a decrease of \$3.1 million, or 27.0%, due primarily to decreased sales in our Armor Division.

Direct expenses for our three divisions during the third quarter of 2005 were \$6.0 million for the Simulation and Security Division (compared to \$5.0 million in the third quarter of 2004, an increase of \$984,000, or 19.6%, due primarily to increased sales of FAAC); \$2.4 million for the Battery and Power Systems Division (compared to \$2.4 million in the third quarter of 2004, a decrease of \$20,000, or 0.8%, due primarily to decreased sales of Epsilon); and \$2.9 million for the Armor Division (compared to \$6.2 million in the third quarter of 2004, a decrease of \$3.3 million or 53.6%, due primarily to the decreased revenues of MDT Armor, offset to some extent by an inventory write-off and write-down in the amount of \$647,000 in the Armor Division, primarily in AoA).

Gross profit was \$2.8 million during the third quarter of 2005, compared to \$4.7 million during the third quarter of 2004, a decrease of \$2.0 million, or 39.9%. This decrease was the direct result of all factors presented above, most notably the decrease in revenues from our Armor Division and the write-off of inventory referred to above, offset to some extent by increased revenues from our Simulation and Security Division.

Research and development expenses. Research and development expenses for the third quarter of 2005 were \$347,000, compared to \$431,000 during the third quarter of 2004, a decrease of \$84,000, or 20.0%. This decrease was primarily attributable to allocating research and development expenses to the cost of revenues due to research and development contracts in the Battery and Power Systems Division.

Sales and marketing expenses. Sales and marketing expenses for the third quarter of 2005 were \$1.0 million, compared to \$1.3 million the third quarter of 2004, a decrease of \$276,000, or 21.3%. This decrease was primarily attributable to the decrease in sales commissions.

General and administrative expenses. General and administrative expenses for the third quarter of 2005 were \$4.0 million compared to \$2.1 million in the third quarter of 2004, an increase of \$1.9 million, or 90.9%. This increase was primarily attributable to the following factors:

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- >> Costs related to abandoned acquisition activities;
- >> The presence of AoA's general and administrative expenses for three full months in 2005 in comparison to only half of the comparable period in 2004; and
- >> Increase in other general and administrative expenses such as auditing and legal expenses.

Financial income (expenses), net. Financial expenses, net totaled approximately \$750,000 in the third quarter of 2005 compared to financial income, net of \$1.1 million in the third quarter of 2004. The difference was due primarily to an adjustment of liability in the amount of \$1.8 million in 2004 created in connection with warrants issued to investors, not present in 2005.

Income taxes. We and certain of our subsidiaries incurred net operating losses during the three months ended September 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 \$48,000 in tax expenses in the third quarter of 2005, mainly in respect of state taxes. We recorded a total of \$116,000 in tax expenses in the third 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 \$700,000 in the third quarter of 2005, compared to \$739,000 the third quarter of 2004, a decrease of \$39,000, or 5.3%.

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 in the third quarter an impairment test of goodwill, based on our management's projections and using expected future discounted operating cash flows. As of September 30, 2005, we identified in AoA an impairment of goodwill in the amount of \$8.5 million.

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 September 30, 2005 we identified an impairment of other intangible assets, such as customer list, trademark, etc. previously identified with the AoA acquisition and as a result we recorded an impairment loss in the amount of \$153,000.

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Loss from continuing operations. Due to the factors cited above, we reported a loss from continuing operations of \$12.7 million in the third quarter of 2005, compared to income of \$1.1 million in the third quarter of 2004.

Net loss attributable to common stockholders. Due to the factors cited above, we reported a net loss of \$12.7 million in the third quarter of 2005, compared to a net loss of \$1.0 million in the third quarter of 2004, an increase of \$11.7 million.

Nine months ended September 30, 2005 compared to the nine months ended September 30, 2004.

Revenues. During the nine months ended September 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 Epsilon 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 nine months ended September 30, 2005 totaled \$33.8 million, compared to \$33.4 million in the comparable period in 2004, an increase of \$431,000, or 1.3%. This increase was primarily attributable to increased revenues of \$3.5 million from our Simulation and Security Division, particularly FAAC. These revenues were offset to some extent by decreased revenues in our Armor and Battery and Power Systems Divisions.

In the first nine months of 2005, revenues were \$16.8 million for the Simulation and Security Division (compared to \$13.3 million in the first nine months of 2004, an increase of \$3.5 million, or 26.7%, due primarily to increased sales of FAAC); \$7.6 million for the Battery and Power Systems Division (compared to \$8.0 million in the first nine months of 2004, a decrease of \$446,000, or 5.5%, due primarily to decreased revenues from our Epsilon subsidiary); and \$9.4 million for the Armor Division (compared to \$12.1 million in the first nine months of 2004, a decrease of \$2.7 million, or 22.0%, due primarily to the decreased revenues from MDT and MDT Armor, offset to some extent by the inclusion of AoA's revenues for all nine months in 2005 but only the latter half of the third quarter in 2004).

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Cost of revenues and gross profit. Cost of revenues totaled \$23.4 million during the first nine months of 2005, compared to \$22.7 million in the first nine months of 2004, an increase of \$734,000, or 3.2%, due primarily to

increased sales and the write-off and write-down of inventory in our Armor Division in the amount of \$648,000 in 2005.

Direct expenses for our three divisions during the first nine months of 2005 were \$14.5 million for the Simulation and Security Division (compared to \$11.9 million in the first nine months of 2004, an increase of \$2.5 million, or 21.2%, due primarily to increased sales of FAAC); \$7.4 million for the Battery and Power Systems Division (compared to \$7.5 million in the first nine months of 2004, a decrease of \$35,000, due primarily to decreased revenues from Epsilon and lower margins in 2004 as a result of a different product mix); and \$10.6 million for the Armor Division (compared to \$10.7 million in the first nine months of 2004, a decrease of \$4,000, due primarily to lower margins in 2004 as a result of a different product mix).

Gross profit was \$10.4 million during the first nine months of 2005, compared to \$10.7 million during the first nine months of 2004, a decrease of \$303,000, or 2.1%. This decrease was the direct result of all factors presented above, most notably the decrease in revenues and margins from MDT Armor and Epsilon and the write-off and write-down of inventory, primarily in AoA, which were not entirely offset by the increase in simulation revenues.

Research and development expenses. Research and development expenses for the first nine months of 2005 were \$1.2 million, compared to \$1.3 million during the first nine months of 2004, a decrease of \$57,000, or 4.4%. This decrease was primarily attributable to allocating research and development expenses to the cost of revenues due to research and development contracts in the Battery and Power Systems Division.

Sales and marketing expenses. Sales and marketing expenses for the first nine months of 2005 were \$3.2 million, compared to \$3.4 million the first nine months of 2004, a decrease of \$194,000, or 5.6%. This decrease was primarily attributable to our decreased in sales commissions in the Battery and Power Systems Division.

General and administrative expenses. General and administrative expenses for the first nine months of 2005 were \$10.9 million, compared to \$7.6 million in the first nine months of 2004, an increase of \$3.3 million, or 43.6%. This increase was primarily attributable to the following factors:

- >> The inclusion of the general and administrative expenses of AoA in our results for the entire nine months of 2005;
- >> Increases in general and administrative expenses in our FAAC subsidiary due to legal expenses, employee relocation, accounting, incentive pay accruals, etc.;
- >> Increase in other general and administrative expenses such as auditing and legal expenses and higher liability insurance premiums; and
- >> Increase in costs related to abandoned acquisition activities.

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Financial expenses, net. Financial expenses, net of financial income and exchange differentials, totaled approximately \$2.1 million in the first nine months of 2005 compared to \$2.1 million in the first nine months of 2004.

Income taxes. We and certain of our subsidiaries incurred accumulated net operating losses during the nine months ended September 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 \$315,000 in tax expenses in the first nine months 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 \$287,000 in tax expense in the first nine months 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 \$2.3 million in the first nine months of 2005, compared to \$1.7 million the first nine months of 2004, an increase of \$615,000, or 35.5%, 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 \$2.0 million. As of September 30, 2005, we performed another impairment test in AoA in response to several factors, including without limitation the reduced sales in AoA during the third quarter of 2005, the fact that since the last impairment test AoA received no substantial new orders and therefore failed to meet its projections, the decision of the General Manager of AoA and his new supervisor to leave the employ of AoA and us, respectively, and general uncertainty about the market for AoA's products in general and AoA's business in particular; specifically, the delay or loss of several potential orders, decisions by customers to utilize methods of armor not produced by AoA (hard armor instead of soft armor), and the change in U.S. military priorities from acquiring new armor to funding the ground forces in Iraq and Afghanistan. As a result of this impairment test, we identified an additional impairment of goodwill and other intangible assets such as backlog, customer list, certifications and trademarks in AoA in the amount of \$8.5 million.

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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 recorded an impairment loss in the amount of \$346,000. As a result of the additional impairment test performed in connection with preparation of the third quarter financial statements, we recorded an additional impairment in the amount of \$153,000 as of September 30, 2005.

Loss from continuing operations. Due to the factors cited above, we reported a loss from continuing operations of \$20.6 million in the first nine months of 2005, compared to \$5.8 million in the first nine months of 2004, an increase of \$14.8 million, or 255.8%.

Loss from discontinued operations. Net loss from discontinued operations for the first nine months of 2005 was \$200,000 compared to \$0 in the first nine months of 2004. This is because during the second quarter of 2005 we took an accrual for a litigation contingency related to the discontinued operations.

Net loss before deemed dividend to certain stockholders of common stock. Due to the factors cited above, we reported a net loss of \$20.8 million in the first nine months of 2005, compared to a net loss of \$5.8 million in the first nine months of 2004, an increase of \$15.0 million, or 259.2%.

Net loss attributable to common stockholders. Due to the factors cited above, we reported a net loss of \$20.8 million in the first nine months of 2005, compared to a net loss of \$9.1 million in the first nine months of 2004, an increase of \$11.7 million, or 128.0%.

Liquidity and Capital Resources

As of September 30, 2005, we had \$11.2 million in cash, \$2.3 million in restricted collateral securities and cash deposits due within one year, \$4.2 million in long-term restricted securities and deposits, and \$36,000 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 increase in cash was primarily the result of the sale of convertible debentures, which was completed in September 2005.

We used available funds in the third 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 three months ended September 30, 2005 by \$226,000 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 \$4.2 million at quarter end.

Net cash used in operating activities from continuing operations for the nine months ended September 30, 2005 and 2004 was \$5.2 million and \$1.0 million, respectively, an increase of \$4.1 million. This increase was primarily the result of increased loss in 2005 and an increase in trade receivables and decrease in trade payables and other account payables.

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Net cash used in investing activities for the nine months ended September 30, 2005 and 2004 was \$10.8 million and \$52.2 million, a decrease of \$41.4 million. This decrease was primarily the result of our investment in the acquisition of FAAC, Epsilor and AoA in the first nine months of 2004.

Net cash provided by financing activities for the nine months ended September 30, 2005 and 2004 was \$20.4 million and \$44.3 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 September 30, 2005, we had (based on the contractual amount of the debt and not on the accounting valuation of the debt) approximately \$10.2 million in long term bank and certificated debt outstanding, all of which was convertible debt, and approximately \$14.5 million in short-term debt (which including short-term bank credit, current portion of long-term loan and convertible debentures in an amount of \$11.8 million, and liabilities due to subsidiaries acquisitions, in the amount of \$1.5 million).

Based on our internal forecasts, we believe that our present cash position and anticipated cash flows from operations should be sufficient to satisfy our current estimated cash requirements through the next twelve months. This belief is based on certain earnout and other assumptions that our management and our subsidiaries managers believes to be reasonable, some of which are subject to the risk factors detailed below, including without limitation our ability to refinance, restructure or convert to equity our \$4.5 million in 8% secured convertible debentures due September 30, 2006 and our ability to make principal payments on our secured convertible notes in shares. 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.

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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 September 30, 2005, we had an accumulated deficit of approximately \$139.7 million. In an effort to reduce operating expenses and maximize available resources, we intend to consolidate certain of our subsidiaries, shift personnel and reassign responsibilities. We have also substantially reduced senior employee salaries, cut directors' fees, and taken a variety of other measures to limit spending and will continue to assess our internal processes to seek additional cost-structure improvements. Although we believe that such steps will help to reduce our operating expenses and maximize our available resources, 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 \$24.7 million as of September 30, 2005 (not including trade payables, other account payables and accrued severance pay). In addition, we may incur additional indebtedness in the future. Accordingly, we are subject to the risks associated with indebtedness, including:

- o 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;
- o it may be more difficult and expensive to obtain additional funds through financings, if available at all;
- o 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
- o 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 and notes 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.

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

A failure to comply with the obligations contained in the agreements governing our indebtedness could result in an event of default under such agreements which could result in an acceleration of the debentures and notes 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, notes 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.

We may not generate sufficient cash flow to service all of our debt obligations.

Our ability to make payments on and to refinance our indebtedness and to fund our operations depends on our ability to generate cash in the future. Our future operating performance is subject to market conditions and business factors that are beyond our control. Consequently, we cannot assure you that we will generate sufficient cash flow to pay the principal and interest on our debt. If our cash flows and capital resources are insufficient to allow us to make scheduled payments on our debt, we may have to reduce or delay capital expenditures, sell assets, seek additional capital or restructure or refinance our debt. We cannot assure you that the terms of our debt will allow for these alternative measures or that such measures would satisfy our scheduled debt service obligations. In addition, in the event that we are required to dispose of material assets or restructure or refinance our debt to meet our debt obligations, we cannot assure you as to the terms of any such transaction or how quickly such transaction could be completed. Our ability to refinance our indebtedness or obtain additional financing will depend on, among other things:

- o our financial condition at the time;
- o restrictions in the agreements governing our other indebtedness; and
- o other factors, including the condition of the financial markets and our industry.

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

We require substantial funds to operate our business, including to market our products and develop and market new products and to pay our outstanding debt as it comes due. To the extent that we are unable to fully fund our operations, including repaying our outstanding debt, through profitable sales of our products and services, we will need to seek additional funding, including through the issuance of equity or debt securities. In addition, based on our internal forecasts and the assumptions described under "Liquidity and Capital Resources" in our Management's Discussion and Analysis of Financial Condition and Results of Operations, we believe that our present cash position and anticipated cash flows from operations should be sufficient to satisfy our current estimated cash requirements through the next twelve months. However, in the event our internal forecasts and other assumptions prove to be incorrect, we may need to seek additional funding. There can be no assurance that we will obtain any such additional financing in a timely manner, on acceptable terms, or at all. Moreover, the issuance by us of additional debt or equity is severely restricted by the terms of our existing indebtedness. If additional funds are raised by issuing equity securities or convertible debt securities, stockholders may incur further dilution. If we incur additional indebtedness, we may be subject to affirmative and negative covenants that may restrict our ability to operate or finance our business. If additional funding is not secured, we will have to modify, reduce, defer or eliminate parts of our present and anticipated future commitments and/or programs.

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The payment by us of our secured convertible notes in stock or the conversion of such notes by the holders could result in substantial numbers of additional shares being issued, with the number of such shares increasing if and to the extent our market price declines, diluting the ownership percentage of our existing stockholders.

In September 2005, we issued \$17.5 million in secured convertible notes due March 31, 2008. The Notes are convertible at the option of the holders at a fixed conversion price of \$1.00. We will repay the principal amount of the notes over the next two and one-half years, with the principal amount being amortized in twelve payments payable at our option in cash and/or stock, provided certain conditions are met; the failure to meet such conditions could make us unable to pay our notes, causing us to default. If the price of our common stock is above \$1.00, the holders of our notes will presumably convert their notes to stock when payments are due, or before, resulting in the issuance of up to an additional 17.5 million shares of common stock.

In the event we elect to make payments of principal on our convertible notes in stock, either because our cash position at the time makes it necessary or we otherwise deem it advisable, the price used to determine the number of shares to be issued will be calculated using an 8% discount to the average trading price of our common stock during 17 of the 20 consecutive trading days ending two days before the payment date. Accordingly, the lower the market price of our common stock at the time at which we make payments of principal in stock, the greater the number of shares we will be obliged to issue and the greater the dilution to our existing stockholders.

In either case, the issuance of the additional shares of our common stock could adversely affect the market price of our common stock.

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

Our debentures and notes 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.

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.

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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 Epsilon 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 earnings will decline if we write off additional goodwill and other intangible assets.

As of December 31, 2004, we have recorded goodwill of \$39.7 million. On January 1, 2002, we adopted SFAS No. 142, "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 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 projections and using expected future discounted operating cash flows. As of September 30, 2005, we identified in AoA an impairment of goodwill in the amount of \$11.6 million.

Our and our 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," 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 September 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.

We will continue to assess the fair value of our goodwill annually or earlier if events occur or circumstances change that would more likely than not reduce the fair value of our goodwill below its carrying value. These events or circumstances would include a significant change in business climate, including a significant, sustained decline in an entity's market value, legal factors, operating performance indicators, competition, sale or disposition of a significant portion of the business, or other factors. If we determine that significant impairment has occurred, we would be required to write off the impaired portion of goodwill. Impairment charges could have a material adverse effect on our financial condition and results

We may consider acquisitions in the future to grow our business, and such activity could subject us to various risks.

We may consider acquiring 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 in such companies. 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, increase our expenses, 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 prior acquisitions.

In light of our acquisitions of IES, MDT, FAAC, Epsilon 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 has placed 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.

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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.

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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:

- o the U.S. Federal Acquisition Regulations, which regulate the formation, administration and performance of government contracts;
- o the U.S. Truth in Negotiations Act, which requires certification and disclosure of all cost and pricing data in connection with contract negotiations; and
- o 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. In the event we fail to estimate our time and resources accurately, our expenses will increase and our profitability, if any, under such contracts will decrease.

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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 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(R), 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.

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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.

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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.

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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 Epsilon 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:

- o announcements by us, our competitors or our customers;
- o the introduction of new or enhanced products and services by us or our competitors;
- o changes in the perceived ability to commercialize our technology compared to that of our competitors;
- o rumors relating to our competitors or us;
- o actual or anticipated fluctuations in our operating results;

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- o the issuance of our securities, including warrants, in connection with financings and acquisitions; and
- o 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 Stock Market (both the Nasdaq National Market, on which our stock is currently listed, and the Nasdaq Capital Market (formerly known as the Nasdaq SmallCap Market)) is the maintenance of a \$1.00 bid price. Our stock price is currently below \$1.00, and has been so since August 15, 2005. On September 27, 2005, we received a notice from Nasdaq to the effect that our common stock does not satisfy the minimum bid price rule (Nasdaq Marketplace Rule 4350(a)(5)), and that in accordance with the rules of the Nasdaq National Market, we will be provided 180 calendar days, or until March 27, 2006, to regain compliance with the Nasdaq's minimum bid price rule or be delisted from 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 Capital Market if we then met the initial listing standards of the Nasdaq Capital Market (other than the \$1.00 minimum bid standard). If we were to move to the Nasdaq Capital Market, current Nasdaq regulations would give us the opportunity to obtain an additional 180-day grace period (until September 23, 2006) if we meet certain net income, stockholders' equity or market capitalization criteria; if at the end of that period we had not yet achieved compliance with the minimum bid price rule, we would be subject to delisting from the Nasdaq Capital 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 Stock Market.

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. Trading volume of over-the-counter

bulletin board stocks has been historically lower and more volatile than stocks traded on an exchange or the Nasdaq Stock Market. As a result, holders of our securities could find it more difficult to sell their securities. 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.

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Additionally, delisting from the Nasdaq Stock Market would constitute an event of default under certain of our debt instruments.

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 misstatements 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 October 31, 2005, we had 90,204,708 shares of common stock issued and outstanding (prior to cancellation of 3,479,464 shares returned to us in connection with the FAAC earnout). Of these shares, most are freely transferable without restriction under the Securities Act of 1933 or pursuant to effective resale registration statements, 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.

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

As of October 31, 2005, there were outstanding warrants to purchase a total of 22,211,463 shares of our common stock at a weighted average exercise price of \$1.44 per share, options to purchase a total of 9,661,647 shares of our common stock at a weighted average exercise price of \$1.32 per share, of which 7,707,830 were vested, at a weighted average exercise price of \$1.33 per share, and outstanding debentures and notes convertible into a total of 20,656,298 shares of our common stock at a weighted average conversion price of \$1.07 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:

- o divide our board of directors into three classes serving staggered three-year terms;
- o 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
- o 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 Epsilon, 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.

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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 Epsilon. 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 Epsilon 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 September 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.

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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 September 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 September 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:

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- >> 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).

Additionally, we believe that our substantial diminution of acquisition activity will enable our current accounting staff to maintain better internal control over financial reporting.

Our management and Audit Committee have monitored and will continue to 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.

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PART II

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

Issuance of Restricted Stock to Certain Service Providers

In August 2005, pursuant to the terms of agreements between us and Artemis Equity LLC, we issued an aggregate of 425,000 shares of our common stock as part of the fee arrangements in connection with investment banking, financial consulting and investor relations services that Artemis rendered to us.

In August 2005, pursuant to the terms of an agreement between us and RK Equity Advisors, LLC, we issued 9,600 shares of our common stock as part of the fee arrangements in connection with investor relations services that RK Equity rendered to us.

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

ITEM 6. EXHIBITS.

The following documents are filed as exhibits to this report:

Exhibit Number	Description
10.1.....	Securities Purchase Agreement dated September 29, 2005 between the Company and certain investors (incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on September 30, 2005)
10.2.....	Form of Note due March 31, 2008 (incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on September 30, 2005)
10.3.....	Form of Warrant (incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on September 30, 2005)
10.4.....	Form of Guaranty (incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on September 30, 2005)
10.5.....	Form of Security Agreement (incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on September 30, 2005)
10.6.....	Form of Intellectual Property Security Agreement (incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on September 30, 2005)

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10.7.....Registration Rights Agreement dated September 29, 2003

- between the Company and the Investors (incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on September 30, 2005)
- 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

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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: November 14, 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)

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EXHIBIT INDEX

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

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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: November 14, 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.

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: November 14, 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.

WRITTEN STATEMENT

In connection with the Quarterly Report of Arotech Corporation (the "Company") on Form 10-Q for the quarterly period ended September 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: November 14, 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.

WRITTEN STATEMENT

In connection with the Quarterly Report of Arotech Corporation (the "Company") on Form 10-Q for the quarterly period ended September 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: November 14, 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.