

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED March 31, 2013.

Commission file number: 0-23336

AROTECH CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

1229 Oak Valley Drive, Ann Arbor, Michigan

(Address of principal executive offices)

95-4302784

(I.R.S. Employer
Identification No.)

48108

(Zip Code)

(800) 281-0356

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer:

Non-accelerated filer:

(Do not check if a smaller reporting company)

Accelerated filer:

Smaller reporting company:

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares outstanding of the issuer's common stock as of May 1, 2013 was 16,251,773.

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ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)
(U.S. Dollars)

	<u>March 31,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 377,812	\$ 1,580,627
Restricted collateral deposits	489,253	186,306
Trade receivables	14,329,246	9,639,709
Unbilled receivables	12,480,827	13,374,004
Other accounts receivable and prepaid expenses	1,027,490	1,178,780
Inventories	10,461,815	10,033,525
Discontinued operations – short term	122,310	389,272
<i>Total current assets</i>	<u>39,288,753</u>	<u>36,382,223</u>
LONG TERM ASSETS:		
Severance pay fund	4,603,249	4,177,488
Other long term receivables	56,441	55,156
Property and equipment, net	5,070,771	4,464,580
Other intangible assets, net	1,953,037	2,238,273
Goodwill	30,705,052	30,562,298
<i>Total long term assets</i>	<u>42,388,550</u>	<u>41,497,795</u>
<i>Total assets</i>	<u>\$ 81,677,303</u>	<u>\$ 77,880,018</u>

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

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

	<u>March 31,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	\$ 8,307,264	\$ 7,156,327
Other accounts payable and accrued expenses	3,637,849	4,252,910
Current portion of long term debt	334,063	888,839
Short term bank credit	11,991,501	9,787,779
Deferred revenues	4,540,544	3,798,086
Discontinued operations – short term	100,407	588,592
<i>Total current liabilities</i>	28,911,628	26,472,533
LONG TERM LIABILITIES:		
Accrued severance pay	6,627,879	6,133,042
Long term portion of debt	1,003,750	992,917
Deferred tax liability	5,069,646	4,920,021
Other long-term liabilities	26,507	27,590
Discontinued operations – long term	902,774	912,813
<i>Total long-term liabilities</i>	13,630,556	12,986,383
STOCKHOLDERS' EQUITY:		
Share capital –		
Common stock – \$0.01 par value each; Authorized: 50,000,000 shares as of March 31, 2013 and December 31, 2012; Issued and outstanding: 16,174,187 shares and 16,151,298 shares as of March 31, 2013 and December 31, 2012, respectively	161,742	161,513
Preferred shares – \$0.01 par value each; Authorized: 1,000,000 shares as of March 31, 2013 and December 31, 2012; No shares issued or outstanding as of March 31, 2013 and December 31, 2012	–	–
Additional paid-in capital	223,279,772	223,181,705
Accumulated deficit	(184,844,878)	(185,248,923)
Notes receivable from stockholders	(908,054)	(908,054)
Accumulated other comprehensive income	1,446,537	1,234,861
<i>Total stockholders' equity</i>	39,135,119	38,421,102
<i>Total liabilities and stockholders' equity</i>	\$ 81,677,303	\$ 77,880,018

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

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

	Three months ended March 31,	
	2013	2012
Revenues	\$ 22,053,131	\$ 16,107,708
Cost of revenues	16,776,967	11,819,066
Research and development expenses	533,385	591,153
Selling and marketing expenses	1,237,006	1,284,894
General and administrative expenses	2,387,811	3,000,606
Amortization of intangible assets	276,494	301,371
Total operating costs and expenses	<u>21,211,663</u>	<u>16,997,090</u>
Operating income (loss)	<u>841,468</u>	<u>(889,382)</u>
Other income	1,233	192
Financial expense, net	(189,137)	(36,836)
Total other expense	<u>(187,904)</u>	<u>(36,644)</u>
Income (loss) from continuing operations before income tax expense	<u>653,564</u>	<u>(926,026)</u>
Income tax expense	174,777	197,577
Income (loss) from continuing operations	478,787	(1,123,603)
Income (loss) from discontinued operations, net of income tax	(74,743)	64,160
Net income (loss)	<u>404,044</u>	<u>(1,059,443)</u>
Other comprehensive income, net of income tax		
Foreign currency translation adjustment	211,676	167,075
Comprehensive income (loss)	<u>\$ 615,720</u>	<u>\$ (892,368)</u>
Basic net income/loss per share – continuing operations	\$ 0.03	\$ (0.08)
Basic net income/loss per share – discontinued operations	–	0.01
Basic net income/loss per share	<u>\$ 0.03</u>	<u>\$ (0.07)</u>
Diluted net income/loss per share – continuing operations	\$ 0.03	\$ (0.08)
Diluted net income/loss per share – discontinued operations	–	0.01
Diluted net income/loss per share	<u>\$ 0.03</u>	<u>\$ (0.07)</u>
Weighted average number of shares used in computing basic net income/loss per share	<u>15,569,153</u>	<u>14,654,803</u>
Weighted average number of shares used in computing diluted net income/loss per share	<u>16,171,893</u>	<u>14,654,803</u>

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

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

	Three months ended March 31,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 404,044	\$ (1,059,443)
<i>Adjustments required to reconcile net income (loss) to net cash (used in) provided by operating activities:</i>		
Depreciation	294,762	273,007
Amortization of intangible assets	276,494	301,371
Stock based compensation	98,295	63,203
Deferred tax provision	149,625	149,625
Changes in continuing operating assets and liabilities:		
Severance pay, net	69,076	43,877
Trade receivables	(4,689,537)	4,417,875
Other accounts receivable and prepaid expenses	150,005	177,523
Inventories	(428,290)	(344,719)
Unbilled receivables	893,177	(2,558,355)
Deferred revenues	742,458	(574,116)
Trade payables	1,150,937	(1,683,114)
Other accounts payable and accrued expenses	(616,141)	91,249
Discontinued operations	(323,725)	598,458
<i>Net cash provided by (used in) operating activities</i>	<u>(1,828,820)</u>	<u>(103,559)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(900,953)	(302,876)
Additions to capitalized software development	(3,675)	-
Decrease (increase) in restricted collateral deposits	(302,947)	1,581,377
Discontinued operations	44,827	54,553
<i>Net cash provided by (used in) investing activities</i>	<u>\$ (1,162,748)</u>	<u>\$ 1,333,054</u>

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

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

	Three months ended March 31,	
	2013	2012
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of long term debt	\$ (543,943)	\$ (31,071)
Change in short term bank credit	2,203,722	(1,202,964)
Discontinued operations	(9,298)	(331,711)
<i>Net cash provided by (used in) financing activities</i>	<u>1,650,481</u>	<u>(1,565,746)</u>
DECREASE IN CASH AND CASH EQUIVALENTS	<u>(1,341,087)</u>	<u>(336,251)</u>
CASH ACCRETION (EROSION) DUE TO EXCHANGE RATE DIFFERENCES	81,339	(13,566)
NET CHANGE IN CASH AND EQUIVALENTS – DISCONTINUED OPERATIONS	56,933	(250,392)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	<u>1,580,627</u>	<u>2,324,163</u>
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	<u>\$ 377,812</u>	<u>\$ 1,723,954</u>
SUPPLEMENTARY INFORMATION ON NON-CASH TRANSACTIONS:		
Interest paid during the period	\$ 73,871	\$ 64,216
Taxes paid on income during the period	\$ 10,500	\$ –

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

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**NOTE 1: BASIS OF PRESENTATION**

a. Company:

Arotech Corporation (“Arotech”) and its wholly-owned subsidiaries (the “Company”) provide defense and security products for the military, law enforcement and homeland security markets, including advanced zinc-air and lithium batteries and chargers, and multimedia interactive simulators/trainers. The Company operates primarily through its wholly-owned subsidiaries FAAC Incorporated (“FAAC”), based in Ann Arbor, Michigan with locations in Royal Oak, Michigan and Orlando, Florida; Electric Fuel Battery Corporation (“EFB”), based in Auburn, Alabama; and Epsilon-Electric Fuel Ltd. (“Epsilon-EFL”), based in Dimona, Israel with a location in Beit Shemesh, Israel. EFB and Epsilon-EFL form the Company’s Battery and Power Systems Division. IES Interactive Training (“IES”) and Realtime Technologies (“RTI”) were merged with FAAC in 2007 and 2010, respectively, to create Arotech’s Training and Simulation Division. Pursuant to a management decision in the fourth quarter of 2011 and sale in 2012, the Company’s Armor Division, consisting of M.D.T. Protective Industries, Ltd. (“MDT”), based in Lod, Israel, and MDT Armor Corporation (“MDT Armor”), based in Auburn, Alabama, along with the trade name of Armour of America Incorporated (“AoA”), were sold in June 2012 and are reflected as discontinued operations for all periods presented.

b. Basis of presentation:

The accompanying interim condensed consolidated financial statements have been prepared by Arotech Corporation in accordance with generally accepted accounting principles for interim financial information, with the instructions to Form 10-Q and with Article 10 of Regulation S-X, and include the accounts of Arotech Corporation and its subsidiaries. Certain information and footnote disclosures, normally included in complete financial statements prepared in accordance with generally accepted accounting principles, have been condensed or omitted. In the opinion of the Company, the unaudited financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of its financial position at March 31, 2013, its operating results for the three-month periods ended March 31, 2013 and 2012, and its cash flows for the three-month periods ended March 31, 2013 and 2012.

The results of operations for the three months ended March 31, 2013 are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year ending December 31, 2013.

The balance sheet at December 31, 2012 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. These condensed consolidated financial statements should be read in conjunction with the audited financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

c. Accounting for stock-based compensation:

For the three months ended March 31, 2013 and 2012 the compensation expense recorded related to restricted stock units and restricted shares was \$98,295 and \$63,203, respectively. The remaining total compensation cost related to share awards not yet recognized in the income statement as of March 31, 2013 was \$308,626 all of which was for restricted stock units and restricted shares that vest on longevity rather than performance. The weighted average period over which this compensation cost is expected to be recognized is approximately one and one-half years. Income tax expense was not impacted since the Company is in a net operating loss position. There were no new options issued in the first three months of 2013. The Company’s directors received their annual restricted stock grants on April 3, 2013 in accordance with the terms of the directors’ stock compensation plan.

d. Reclassification:

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

e. Anti-dilutive shares for EPS calculation

All outstanding stock options and contingent, non-vested restricted stock have been excluded from the calculation of the basic net income (loss) per common share because all such securities are anti-dilutive for the periods presented and the Company has excluded any restricted stock or restricted stock units that will never vest under the current program. The total weighted average number of shares related to outstanding options and restricted stock excluded from the calculations of basic net income (loss) per share for the three-month periods ended March 31, 2013 and 2012 were 614,968 and 667,693, respectively.

f. Discontinued operations

In December 2011, the Company's Board of Directors approved management's plan to sell the Armor Division. On March 8, 2012, the Company signed a non-binding letter of intent to sell the division to an Israeli public company. The sale of the assets was completed in June 2012 at a cash purchase price of \$50,000. Unless otherwise indicated, discontinued operations are not included in the Company's reported results.

Unless otherwise noted, amounts and disclosures throughout the Notes to Consolidated Financial Statements relate to the Company's continuing operations. The assets and liabilities of the discontinued operation after impairment and the revenues and expenses of the discontinued operation are shown below.

ASSETS AND LIABILITIES – DISCONTINUED (UNAUDITED)	March 31, 2013	December 31, 2012
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 49,615	\$ 106,548
Restricted collateral deposits	–	44,827
Trade receivables	40,961	164,824
Other accounts receivable and prepaid expenses	31,734	73,073
<i>Total current assets</i>	<u>122,310</u>	<u>389,272</u>
<i>Total assets</i>	<u>\$ 122,310</u>	<u>\$ 389,272</u>
LIABILITIES		
CURRENT LIABILITIES:		
Trade payables	\$ –	\$ 75,862
Other accounts payable and accrued expenses	40,379	453,443
Current portion of long term debt	60,028	59,287
<i>Total current liabilities</i>	<u>100,407</u>	<u>588,592</u>
LONG TERM LIABILITIES		
Long term debt (building mortgage)	902,774	912,813
<i>Total long-term liabilities</i>	<u>902,774</u>	<u>912,813</u>
<i>Total liabilities</i>	<u>\$ 1,003,181</u>	<u>\$ 1,501,405</u>

REVENUE AND EXPENSES – DISCONTINUED (UNAUDITED)

	Three months ended March 31,	
	2013	2012
Revenues	\$ 1,954	\$ 4,009,561
Cost of revenues, exclusive of amortization of intangibles	(2,303)	3,472,323
Research and development expenses	–	50,358
Selling and marketing expenses	–	183,080
General and administrative expenses	81,939	246,403
Total operating costs and expenses	<u>79,636</u>	<u>3,952,164</u>
Operating income (loss)	<u>(77,682)</u>	<u>57,397</u>
Other income	27,986	21,281
Financial (income) expense, net	(24,047)	(14,518)
Total other income	<u>3,939</u>	<u>6,763</u>
Income (loss) before income tax	<u>(73,743)</u>	<u>64,160</u>
Income tax expense	1,000	–
Net income (loss)	<u>\$ (74,743)</u>	<u>\$ 64,160</u>

NOTE 2: INVENTORIES

Inventories are stated at the lower of cost or market value. Cost is determined using the average cost method or the FIFO method. The Company periodically evaluates the quantities on hand relative to current and historical selling prices and historical and projected sales volume. Based on these evaluations, provisions are made in each period to write down inventory to its net realizable value. Inventory write-offs are provided to cover risks arising from slow-moving items, technological obsolescence, excess inventories, and for market prices lower than cost. Inventories in continuing business segments decreased, from December 31, 2012, \$275,447 in the Training and Simulation Division and increased \$703,737 in the Battery Division for the product required to fulfill the current backlog. Inventories are composed of the following:

	March 31, 2013	December 31, 2012
	(Unaudited)	(Unaudited)
Raw and packaging materials	\$ 7,813,653	\$ 7,455,426
Work in progress	500,696	363,415
Finished products	2,147,466	2,214,684
Total:	<u>\$ 10,461,815</u>	<u>\$ 10,033,525</u>

NOTE 3: IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

For information about previous new accounting pronouncements and the potential impact on the Company's Consolidated Financial Statements, see Note 2 of the Notes to Consolidated Financial Statements in the Company's 2012 Form 10-K.

NOTE 4: SEGMENT INFORMATION

a. The Company and its subsidiaries operate primarily in two continuing business segments and follow the requirements of FASB ASC 280-10. Additionally, the two segments are also treated by the Company as reporting units for goodwill purposes under FASB ASC 350-20-35. The goodwill amounts associated with each of these reporting units was determined and valued when the specific businesses in the reportable segment were purchased.

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

b. The following is information about reported segment revenues, income (losses) and total assets for the three months ended March 31, 2013 and 2012:

	Training and Simulation Division	Battery and Power Systems Division	Corporate Expenses	Discontinued	Total Company
Three months ended March 31, 2013					
Revenues from outside customers	\$ 15,679,191	\$ 6,373,940	\$ –	\$ –	\$ 22,053,131
Depreciation, amortization and impairment expenses ⁽¹⁾	(243,994)	(319,742)	(7,520)	–	(571,256)
Direct expenses ⁽²⁾	(13,426,464)	(6,097,049)	(1,115,661)	–	(20,639,174)
Segment net income (loss)	\$ 2,008,733	\$ (42,851)	\$ (1,123,181)	\$ –	\$ 842,701
Financial income (expense)	(6,939)	(61,440)	(120,758)	–	(189,137)
Income tax expense	25,152	–	149,625	–	174,777
Net income (loss) continuing operations	\$ 1,976,642	\$ (104,291)	\$ (1,393,564)	\$ –	\$ 478,787
Net income discontinued operations	–	–	–	(74,743)	(74,743)
Net income (loss)	\$ 1,976,642	\$ (104,291)	\$ (1,393,564)	\$ (74,743)	\$ 404,044
Segment assets ⁽³⁾	\$ 53,321,818	\$ 27,685,266	\$ 547,909	\$ 122,310	\$ 81,677,303
Additions to long-lived assets	\$ 31,604	\$ 873,024	\$ –	\$ –	\$ 904,628
Three months ended March 31, 2012					
Revenues from outside customers	\$ 10,933,538	\$ 5,174,170	\$ –	\$ –	\$ 16,107,708
Depreciation, amortization and impairment expenses ⁽¹⁾	(279,763)	(279,251)	(15,364)	–	(574,378)
Direct expenses ⁽²⁾	(10,072,542)	(4,574,425)	(1,775,553)	–	(16,422,520)
Segment net income (loss)	\$ 581,233	\$ 320,494	\$ (1,790,917)	\$ –	\$ (889,190)
Financial income (expense)	(13,455)	57,670	(81,051)	–	(36,836)
Income tax expense	47,952	–	149,625	–	197,577
Net income (loss) continuing operations	\$ 519,826	\$ 378,164	\$ (2,021,593)	\$ –	\$ (1,123,603)
Net income discontinued operations	–	–	–	64,160	64,160
Net income (loss)	\$ 519,826	\$ 378,164	\$ (2,021,593)	\$ 64,160	\$ (1,059,443)
Segment assets ⁽³⁾	\$ 44,708,798	\$ 25,275,405	\$ 875,500	\$ 5,154,002	\$ 76,013,705
Additions to long-lived assets	\$ 161,429	\$ 141,447	\$ –	\$ –	\$ 302,876

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

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

(3) Out of those amounts, goodwill in the Company's Training and Simulation and Battery and Power Systems Divisions totaled \$24,435,640 and \$6,269,412, respectively, as of March 31, 2013 and \$24,435,640 and \$6,156,343, respectively, as of March 31, 2012.

NOTE 5: FAIR VALUE MEASUREMENT

The carrying value of short term assets and liabilities in the accompanying condensed consolidated balance sheets for cash and cash equivalents, restricted collateral deposits, trade receivables, unbilled receivables, inventories, prepaid and other assets, trade payables, accrued expenses, deferred revenues and other liabilities as of March 31, 2013 and December 31, 2012, approximate fair value because of the short maturity of these instruments. The carrying amounts of long term debt approximates the estimated fair values at March 31, 2013, based upon the Company's ability to acquire similar debt at similar maturities.

NOTE 6: COMMON STOCK REPURCHASE PROGRAM

In February 2009, the Company's Board of Directors authorized the repurchase in the open market or in privately negotiated transactions of up to \$1.0 million of the Company's common stock. Through March 31, 2013, the Company repurchased 638,611 shares for a total of \$869,931. The repurchase program, which expires on August 13, 2013, is subject to management's discretion.

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

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

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

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

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

Executive Summary

We are a defense and security products and services company, engaged in two business areas: interactive simulation for military, law enforcement and commercial markets; and batteries and charging systems for the military. We operate in two business units:

- We develop, manufacture and market advanced high-tech multimedia and interactive digital solutions for use-of-force training and driving training of military, law enforcement, security and other personnel (our **Training and Simulation Division**); and
- We manufacture and sell lithium and Zinc-Air batteries for defense and security products, including our Soldier Wearable Integrated Power Equipment System (SWIPES)™ power hubs, and other military applications (our **Battery and Power Systems Division**).

Between 2002 and December 2011, we were also engaged in the production of armored vehicles and aviation armor, through our Armor Division. In December 2011, our Board of Directors approved management's plan to sell our Armor Division in order to focus on the more profitable and growth-oriented aspects of our business. We completed the sale of our Armor Division in June 2012.

The discontinuation of the Armor Division for accounting purposes resulted in a one-time, pre-tax charge during the fourth quarter of 2011 of approximately \$3.9 million, reflecting an impairment of goodwill and intangibles (\$1.8 million), an impairment of other long-lived assets (\$1.5 million), a write-off of a joint venture investment (\$269,000), and costs associated with change of control provisions and other non-statutory severance expenses (\$302,000). Almost all these charges are non-cash impacting items. In 2012, an additional pre-tax adjustment of approximately \$829,000 was recorded to reflect a loss upon the sale.

Overview of Results of Operations*Acquisitions*

In the acquisition of subsidiaries, part of the purchase price is allocated to intangible assets and goodwill. Amortization of definite-lived intangible assets related to acquisition of subsidiaries is recorded based on the estimated expected life of the assets. Accordingly, for a period of time following an acquisition, we incur a non-cash charge related to amortization of definite-lived intangible assets in the amount of a fraction (based on the useful life of the definite-lived intangible assets) of the amount recorded as intangible assets. Such amortization charges continued during the first three months of 2013. We are required to review long-lived intangible assets and goodwill for impairment at least annually or whenever events or changes in circumstances indicate that carrying amount of the assets may not be recoverable. If we determine, through the impairment review process, that the carrying amount of these assets has been impaired, we must record the impairment charge in our statement of operations.

We incurred non-cash charges for amortization of intangible assets in the first three months of 2013 and 2012 in the amount of \$276,000 and \$301,000, respectively.

Restricted Shares, Restricted Stock Units and Options

In accordance with FASB ASC 505-50, we incurred, for the three months ended March 31, 2013 and 2012, compensation expense related to restricted stock units and restricted shares of approximately \$98,000 and \$63,000, respectively. Our directors received their annual restricted stock grants on April 3, 2013 in accordance with the terms of the directors' stock compensation plan.

Overview of Operating Performance and Backlog

Overall, our pre-tax income from continuing operations for the three months ended March 31, 2013 was \$654,000 on revenues of \$22.1 million, compared to a loss of \$926,000 on revenues of \$16.1 million during the three months ended March 31, 2012. Our overall backlog for the first quarter of 2013 totaled \$76.3 million.

In our Training and Simulation Division, revenues increased from approximately \$10.9 million in the first three months of 2012 to \$15.7 million in the first three months of 2013. As of March 31, 2013, our backlog for our Training and Simulation Division totaled \$59.8 million compared to \$67.9 million in the first quarter of 2012.

In our Battery and Power Systems Division, revenues increased from approximately \$5.2 million in the first three months of 2012 to approximately \$6.4 million in the first three months of 2013. As of March 31, 2013, our backlog for our Battery and Power Systems Division totaled \$16.5 million compared to \$9.4 million in the first quarter of 2012.

The table below details the percentage of total recognized revenue by type of arrangement for the three months ended March 31, 2013 and 2012:

Type of Revenue	Three months ended March 31,	
	2013	2012
Sale of products	95.7%	96.1%
Maintenance and support agreements	2.8%	3.2%
Long term research and development contracts	1.5%	0.7%
Total	<u>100.0%</u>	<u>100.0%</u>

Functional Currency

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

The majority of financial transactions of Epsilon is in New Israeli Shekels (“NIS”) and a substantial portion of Epsilon’s costs is incurred in NIS. Management believes that the NIS is the functional currency of Epsilon. Accordingly, the financial statements of 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 stockholders’ equity.

Results of Operations

Three months ended March 31, 2013 compared to the three months ended March 31, 2012.

Revenues. Revenues for the three months ended March 31, 2013 totaled \$22.1 million, compared to \$16.1 million in the comparable period in 2012, an increase of \$6.0 million, or 36.9%. In the first quarter of 2013, revenues were \$15.7 million for the Training and Simulation Division (compared to \$10.9 million in the first quarter of 2012, an increase of \$4.8 million, or 43.4%, due primarily to several new, significant contracts); and \$6.4 million for the Battery and Power Systems Division (compared to \$5.2 million in the first quarter of 2012, an increase of \$1.2 million, or 23.2%, due primarily to increased sales in the U.S.).

Cost of revenues. Cost of revenues totaled \$16.8 million during the first quarter of 2013, compared to \$11.8 million in the first quarter of 2012, an increase of \$5.0 million, or 41.9%, due primarily to the increased revenue in our divisions and the higher costs associated with our VCTS and our battery systems. Cost of revenues were \$11.4 million for the Training and Simulation Division (compared to \$7.9 million in the first quarter of 2012, an increase of \$3.5 million, or 44.5%, due primarily to several new, significant contracts); and \$5.4 million for the Battery and Power Systems Division (compared to \$3.9 million in the first quarter of 2012, an increase of \$1.5 million, or 36.8%, due primarily to increased sales in the U.S.).

Research and development expenses. Research and development expenses for the first quarter of 2013 were \$533,000, compared to \$591,000 during the first quarter of 2012, a decrease of \$58,000, or 9.8%, due primarily to reduced spending in our Training and Simulation Division offset by increased spending in the Battery and Power Systems Division for continuing research on new battery products in Israel.

Selling and marketing expenses. Selling and marketing expenses for the first quarter of 2013 were \$1.2 million, compared to \$1.3 million in the first quarter of 2012, a decrease of \$48,000, or 3.7%.

General and administrative expenses. General and administrative expenses for the first quarter of 2013 were \$2.4 million, compared to \$3.0 million in the first quarter of 2012, a decrease of \$613,000, or 20.4%, due primarily to a reduction of \$728,000 in corporate consulting and legal expenses related to transactional activities. We have continued with our initiative to reduce general and administrative expense in all categories.

Amortization of intangible assets. Amortization of intangible assets totaled \$276,000 in the first quarter of 2013, compared to \$301,000 in the first quarter of 2012, a decrease of \$25,000, or 8.3%, due primarily to decreased charges for fully amortized capitalized software in our Training and Simulation Division.

Financial expense, net. Financial expense totaled \$189,000 in the first quarter of 2013, compared to financial expense of \$37,000 in the first quarter of 2012, an increase of \$152,000, due primarily to an increase in corporate interest and bank charges of \$40,000.

Income taxes. We recorded \$175,000 in tax expense in the first quarter of 2013, compared to \$198,000 in tax expense in the first quarter of 2012, a decrease of \$23,000, or 11.5%. This amount includes the required adjustment of taxes due to the deduction of goodwill “naked” credits for U.S. federal taxes, which totaled \$150,000 in non-cash expenses in the both the first quarter of 2013 and 2012.

Net income. Due to the factors cited above, we went from a net loss of \$(1.1) million in the first quarter of 2012 to a net income of \$479,000 in the first quarter of 2013, an improvement of \$1.6 million.

Liquidity and Capital Resources

As of March 31, 2013, we had \$378,000 in cash and \$489,000 in restricted collateral deposits, as compared to December 31, 2012, when we had \$1.6 million in cash and \$186,000 in restricted collateral deposits. We have experienced fluctuations in available cash in the previous twelve months due to the funding requirements of our larger contracts. These fluctuations have not had a significant impact on our operations, due in part to the increase in our credit facility that was negotiated with our primary bank in 2012. We ended the quarter with \$1.1 million in available, unused bank lines of credit with our main bank as of March 31, 2013, under a \$15.0 million credit facility under our FAAC subsidiary, described below. Our cash position has improved in the thirty days following the end of the quarter primarily due to the collection of milestone payments for the VCTS program.

We and FAAC maintain a \$15.0 million credit facility with FAAC's primary bank, which is secured by Arotech's assets and the assets of our other domestic subsidiaries and guaranteed by Arotech and our other domestic subsidiaries, at a rate of LIBOR plus 375 basis points. This credit facility expires May 31, 2015. The credit agreement contains certain covenants, including minimum Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA"), quarterly Maximum Increase in Net Advance to Affiliates of less than 90% of EBITDA and an annual Fixed Charge Coverage Ratio of not less than 1.1 to 1.0. At the end of the first quarter of 2013 and as of the filing date of this report, we met all required current covenants. The credit agreement carries an interest rate of 30 day LIBOR plus 375 basis points and an unused line of credit fee of 0.35%.

We used available funds in the three months ended March 31, 2013 primarily for working capital and investment in fixed assets. We purchased approximately \$901,000 of fixed assets during the three months ended March 31, 2013. Our net fixed assets amounted to \$5.1 million at quarter end.

Net cash used in operating activities for the three months ended March 31, 2013 and 2012 was \$1.8 million and \$104,000, respectively, an increase of \$1.7 million. This difference was due primarily to the increased working capital funding requirements for our major projects at both the Simulation and Training Division and Battery and Power Systems Division. The timing of cash inflows and outflows has impacted us due to the substantial purchases of products to fulfill these contracts. Additionally, the increases in working capital were offset by a profit from continuing operations.

Net cash provided by (used in) investing activities for the three months ended March 31, 2013 and 2012 was \$(1.2) million and \$1.3 million, a net change of \$2.5 million. This difference was due primarily to the change in restricted collateral deposits offset by the purchase of capital assets.

Net cash provided by (used in) financing activities for the three months ended March 31, 2013 and 2012 was \$1.7 million and \$(1.6) million, respectively, net change of \$3.3 million. The change in 2013 of cash used in financing activities was due primarily to changes in short term borrowing under our primary line of credit.

As of March 31, 2013, we had approximately \$12.0 million in short-term bank debt and \$1.3 million in long-term debt outstanding. This is in comparison to \$9.8 million in short-term bank debt and \$1.9 million in long-term debt outstanding as of December 31, 2012.

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Interest Rate Risk

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

Foreign Currency Exchange Rate Risk

Since a significant part of our sales and expenses are denominated in U.S. dollars, we have experienced only minor foreign exchange gains and losses to date, and do not expect to incur significant gains and losses in 2013. Certain of our research, development and production activities are carried out by our Israeli subsidiary, Epsilon-EFL, at its facility in Beit Shemesh, and accordingly we have sales and expenses in NIS. Additionally, our Epsilon-EFL subsidiary operates primarily in NIS. However, the majority of our sales are made outside Israel in U.S. dollars, and a substantial portion of our costs are incurred in U.S. dollars. Therefore, our functional currency is the U.S. dollar.

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

ITEM 4. CONTROLS AND PROCEDURES.

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

PART II**ITEM 1A. RISK FACTORS.**

For information regarding our risk factors, please refer to Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2012. We do not believe that there have been any material changes in the risk factors disclosed in the Annual Report on Form 10-K.

ITEM 5. OTHER INFORMATION,*Annual Shareholders Meeting*

We held our 2012 Annual Meeting of Stockholders on August 13, 2012. In our Annual Report on Form 10-K for the year ended December 31, 2012, we announced that our 2013 Annual Meeting of Stockholders would be held on Monday, June 24, 2013 commencing at 9:00 a.m., eastern daylight time, by webcast. However, after reconsidering, we have decided in favor of an in-person meeting, and accordingly our 2013 Annual Meeting of Stockholders will be held on Monday, October 21, 2013 commencing at 10:00 a.m., local time, at the offices of Lowenstein Sandler P.C., 1251 Avenue of the Americas, 17th Floor, New York, New York.

In light of the foregoing and in accordance with Rules 14a-5(f) and 14a-8(e)(2) under the Securities Exchange Act of 1934, as amended, we will consider stockholder proposals submitted in connection with our 2013 Annual Meeting to have been submitted in a timely fashion if such proposals are received by us at our principal offices no later than June 23, 2013. If a proposal is received after June 23, 2013, the proxies designated by the Board of Directors of the Company will have discretionary authority to vote on the proposal under circumstances consistent with the proxy rules of the Securities and Exchange Commission.

We expect to mail our Notice of Internet Availability of Proxy Materials and Notice of the 2013 Annual Meeting on or about August 30, 2013, at which date our Proxy Statement and Annual Report will be available on an Internet site to be designated in the Notice of Internet Availability of Proxy Materials. Stockholders will also be given instructions on how to elect to receive printed proxy materials by mail.

New Executive Employment Agreements and Succession Plan

On May 13, 2013, we entered into new amended and restated employment agreements with our senior executive officers – Robert S. Ehrlich, Steven Esses and Thomas J. Paup. As further described below, the amended and restated agreements involve extensions in term until the end of December 2015 and, with respect to Messrs. Ehrlich and Esses, that beginning in October 2014, Mr. Ehrlich will cease to be our Chief Executive Officer and will serve as Chairman of the Board only, and Mr. Esses will become our President and Chief Executive Officer. Mr. Ehrlich's agreement also provides for a salary reduction and for us to begin payout of his earned severance.

Employment Agreement with Robert S. Ehrlich

On May 13, 2013, we entered into a new amended and restated employment agreement with our Chairman and Chief Executive Officer, Robert S. Ehrlich (the "Ehrlich Employment Agreement"). The term of the Ehrlich Employment Agreement is effective May 1, 2013 and expires on December 31, 2015. The Ehrlich Employment Agreement provides that Mr. Ehrlich will serve as our Chairman of the Board and Chief Executive Officer until September 30, 2014, and thereafter as our Chairman of the Board.

The Ehrlich Employment Agreement provides for a monthly base salary of NIS 122,050 (approximately \$34,150 per month based on the exchange rate on May 1, 2013), as adjusted annually for Israeli inflation (but with no retroactive inflation adjustment for 2013 in respect of inflation during 2012). Additionally, the board may at its discretion raise Mr. Ehrlich's base salary.

The Ehrlich Employment Agreement provides that we will pay an annual bonus, on a sliding scale, in an amount equal to 25% of Mr. Ehrlich's annual base salary then in effect if the results we actually attain for the year in question are 100% or more of the amount we budgeted at the beginning of the year, up to a maximum of 75% of his annual base salary then in effect if the results we actually attain for the year in question are 120% or more of the amount we budgeted at the beginning of the year. Budget targets in the past have included combinations of revenues, EBITDA, backlog, and/or other factors.

The Ehrlich Employment Agreement also contains certain benefits customary in Israel for senior executives, tax and financial planning expenses, and contains confidentiality and non-competition covenants.

We can terminate Mr. Ehrlich's employment agreement in the event of death or disability or for "Cause" (defined as conviction of certain crimes, willful failure to carry out directives of our board of directors or gross negligence or willful misconduct). Mr. Ehrlich has the right to terminate his employment upon a change in our control or for "Good Reason," which is defined to include adverse changes in employment status or compensation, our insolvency, material breaches and certain other events.

Upon termination of employment, the Ehrlich Employment Agreement provides for payment of all accrued and unpaid compensation and benefits (including under most circumstances Israeli statutory severance), and (unless we have terminated the agreement for Cause or Mr. Ehrlich has terminated the agreement without Good Reason) bonuses (to the extent earned) due for the year in which employment is terminated. Furthermore, in respect of any termination by us other than termination for Cause or termination of the agreement due to Mr. Ehrlich's death or disability, or by Mr. Ehrlich other than for Good Reason, all outstanding options and all restricted shares will be fully vested. Restricted shares that have vested prior to the date of termination are not forfeited under any circumstances, including termination for Cause.

The Ehrlich Employment Agreement further provides that Mr. Ehrlich's severance payment of \$1,625,400, which has been fully earned, shall be paid to him as follows:

- (i) By immediate transfer to Mr. Ehrlich of the shares of our common stock issued to him (but since held by us) in April 2009, which we and Mr. Ehrlich then agreed would be valued at \$240,000, irrespective of any changes in the market value of the shares.
- (ii) By immediate transfer to Mr. Ehrlich of \$774,377 in cash, which is the amount in Mr. Ehrlich's Rabbi Trust established by trust agreement dated December 23, 2003.
- (iii) The remaining \$611,023 of the severance payment will be paid to Mr. Ehrlich in 30 equal monthly installments of \$20,367.43 each on or before the last day of each calendar month by wire transfer to an account to be specified in writing by Mr. Ehrlich, beginning with the calendar month of May 2013 through and including the calendar month of October 2015.

The foregoing description of the Ehrlich Employment Agreement is qualified in its entirety by the terms of the Ehrlich Employment Agreement, which is filed herewith as Exhibit 10.1 and incorporated herein by reference.

Employment Agreement with Steven Esses and Consulting Agreement with Sampen Corporation

On May 13, 2013, we entered into a new amended and restated employment agreement with our President, Steven Esses (the "Esses Employment Agreement"). The term of the Esses Employment Agreement is effective May 1, 2013 and expires on December 31, 2015. The Esses Employment Agreement provides that Mr. Esses will serve as our President until September 30, 2014, and thereafter as our President and Chief Executive Officer.

The Esses Employment Agreement provides for a monthly base salary of NIS 74,515 (approximately \$20,775 per month at the rate of exchange in effect on May 1, 2013), as adjusted for Israeli inflation (but with no retroactive inflation adjustment for 2013 in respect of inflation during 2012). Additionally, the board may at its discretion raise Mr. Esses's base salary.

The Esses Employment Agreement provides that if the results we actually attain in a given year are at least 100% of the amount we budgeted at the beginning of the year, we will pay a bonus, on a sliding scale, in an amount equal to a minimum of 25% of Mr. Esses's annual base salary then in effect, up to a maximum of 75% of his annual base salary then in effect if the results we actually attain for the year in question are 120% or more of the amount we budgeted at the beginning of the year. Budget targets in the past have included combinations of revenues, EBITDA, backlog, and/or other factors.

The Esses Employment Agreement also contains various benefits customary in Israel for senior executives, tax and financial planning expenses and an automobile, and contains confidentiality and non-competition covenants.

We can terminate Mr. Esses's employment agreement in the event of death or disability or for "Cause" (defined as conviction of certain crimes, willful failure to carry out directives of our board of directors or gross negligence or willful misconduct). Mr. Esses has the right to terminate his employment upon a change in our control or for "Good Reason," which is defined to include adverse changes in employment status or compensation, our insolvency, material breaches and certain other events. Additionally, Mr. Esses may retire (after age 65), retire early (after age 55) or terminate his agreement for any reason upon 150 days' notice.

Upon termination of employment, the Esses Employment Agreement provides for payment of all accrued and unpaid compensation (including under most circumstances Israeli statutory severance), and (unless we have terminated the agreement for Cause or Mr. Esses has terminated the agreement without Good Reason and without giving us 150 days' notice of termination) bonuses (to the extent earned) due for the year in which employment is terminated (in an amount of not less than 20% of base salary) and severance pay equal to the greater of (i) twenty-four (24) times monthly salary, and (ii) NIS 3,144,000 (approximately \$876,500 at the rate of exchange in effect on May 1, 2013). Furthermore, Mr. Esses will receive, in respect of all benefits, an additional sum in the amount of (i) \$75,000, in the case of termination due to disability, Good Reason, death, or non-renewal, or (ii) \$150,000, in the case of termination due to early retirement, retirement, change of control or change of location. Additionally, in respect of any termination due to a change of control or a change in the primary location from which Mr. Esses shall have conducted his business activities during the 60 days prior to such change, all outstanding options and all restricted shares will be fully vested. Restricted shares that have vested prior to the date of termination are not forfeited under any circumstances, including termination for Cause.

We also entered into a new agreement with Sampen Corporation. Sampen is a New York corporation owned by members of Mr. Esses's immediate family, and Mr. Esses is an employee of both ours and of Sampen.

Pursuant to the terms of our new agreement with Sampen, Sampen provides one of its employees to us for such employee to serve as our President until September 20, 2014, and as our President and Chief Executive Officer thereafter. We pay Sampen \$8,960 per month, plus an annual bonus, on a sliding scale, in an amount equal to a minimum of 25% of Sampen's annual base compensation then in effect if the results we actually attain for the year in question are 100% or more of the amount we budgeted at the beginning of the year, up to a maximum of 75% of its annual base compensation then in effect if the results we actually attain for the year in question are 120% or more of the amount we budgeted at the beginning of the year. We also pay Sampen, to cover the cost of our use of Sampen's offices as an ancillary New York office and the attendant expenses and insurance costs, an amount equal to 16% of each monthly payment of base compensation.

The foregoing descriptions of the Esses Employment Agreement and the Sampen Consulting Agreement are qualified in their entirety by the terms of the Esses Employment Agreement and the Sampen Consulting Agreement, which are filed herewith as Exhibits 10.2 and 10.3, respectively, and incorporated herein by reference.

Employment Agreement with Thomas J. Paup

On May 13, 2013, we entered into a new amended and restated employment agreement with our Vice President – Finance and Chief Financial Officer, Thomas J. Paup (the "Paup Employment Agreement"). The term of the Paup Employment Agreement is effective May 1, 2013 and expires on December 31, 2015. The Paup Employment Agreement provides that Mr. Paup will serve as our Senior Vice President – Finance and Chief Financial Officer.

Under the terms of the Paup Employment Agreement, Mr. Paup is entitled to receive a base salary of \$201,400 per annum, as adjusted annually for inflation (but with no retroactive inflation adjustment for 2013 in respect of inflation during 2012).

The Paup Employment Agreement provides that if the results we actually attain in a given year are at least 100% of the amount we budgeted at the beginning of the year, we will pay a bonus, on a sliding scale, in an amount equal to a minimum of 16.5% of Mr. Paup's annual base salary then in effect, up to a maximum of 50% of his annual base salary then in effect if the results we actually attain for the year in question are 120% or more of the amount we budgeted at the beginning of the year. Budget targets in the past have included combinations of revenues, EBITDA, backlog, and/or other factors.

The Paup Employment Agreement provides that if we terminate his agreement other than for cause (defined as conviction of certain crimes, willful failure to carry out directives of our board of directors or gross negligence or willful misconduct), we must pay Mr. Paup severance in an amount of twelve times his monthly salary.

The foregoing description of the Paup Employment Agreement is qualified in its entirety by the terms of the Paup Employment Agreement, which is filed herewith as Exhibit 10.4 and incorporated herein by reference.

ITEM 6. EXHIBITS.

The following documents are filed as exhibits to this report:

Exhibit Number	Description
10.1	<u>Sixth Amended and Restated Employment Agreement, dated May 13, 2013 and effective as of May 1, 2013, between us, Epsilor-EFL and Robert S. Ehrlich</u>
10.2	<u>Third Amended and Restated Employment Agreement, dated May 13, 2013 and effective as of May 1, 2013, between us, Epsilor-EFL and Steven Esses</u>
10.3	<u>Amended and Restated Consulting Agreement, dated May 13, 2013 and effective as of May 1, 2013, between us and Sampen Corporation</u>
10.4	<u>Third Amended and Restated Employment Agreement, dated May 13, 2013 and effective as of May 1, 2013, between us and Thomas J. Paup</u>
31.1	<u>Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2	<u>Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
32.1	<u>Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
32.2	<u>Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>

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: May 15, 2013

AROTECH CORPORATION

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

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

SIXTH AMENDED AND RESTATED EMPLOYMENT AGREEMENT

THIS AGREEMENT (“Agreement”) is signed on the 13th day of May, 2013, effective as of the 1st day of May, 2013, by and among Arotech Corporation, a Delaware corporation (“Arotech”), and Epsilon-Electric Fuel Ltd., an Israeli company (“Epsilon-EFL” and together with Arotech, the “Companies”), and Mr. Robert S. Ehrlich, Israel I.D. Number 303673487 (the “Executive”).

WHEREAS, the Companies and the Executive entered into an Amended and Restated Employment Agreement dated as of October 1, 1996, a Second Amended and Restated Employment Agreement dated as of January 1, 2000, as extended, a Third Amended and Restated Employment Agreement effective as of January 1, 2005, a Fourth Amended and Restated Employment Agreement effective as of January 1, 2007, and a Fifth Amended and Restated Employment Agreement effective as of January 1, 2012 (together, the “Original Agreement”) formalizing the terms of the Executive’s employment with the Companies;

WHEREAS, the Companies and the Executive now wish to make certain changes to the conditions of the Executive’s employment, including (i) by reducing the Executive’s compensation, extending the Executive’s employment, and providing for the Executive’s succession in the position of Chief Executive Officer of the Company, and (ii) in consideration of the foregoing, and in view of the fact that the Executive has already reached an age at which it would be reasonable for him to retire if he so desired, by providing for immediate payment of the majority of the Retirement Payment (as defined in the Original Agreement) and payment during the term of this Agreement of the remainder of the Retirement Payment, and to amend and restate the Original Agreement in its entirety in accordance with the terms of this Agreement;

WHEREAS, the form, terms and provisions of this Agreement have been approved by the Board of Directors of both of the Companies, and unanimously approved by the independent directors of the Board of Directors of Arotech;

NOW, THEREFORE, in consideration of the respective agreements of the parties contained herein, the parties agree as follows:

1. Term.

The term of the Executive’s employment under this Agreement shall be for the period commencing on May 1, 2013, and ending on December 31, 2015 (the “Term”).

2. Employment.

- (a) The Executive shall be employed as the Chairman of the Board and Chief Executive Officer of Arotech until September 30, 2014, and thereafter shall be employed as Chairman of the Board of the Company. The Executive shall perform the duties, undertake the responsibilities and exercise the authority customarily performed, undertaken and exercised by persons situated in a similar executive capacity in publicly-held United States corporations and their Israeli subsidiaries. The Executive shall exercise his authority in a reasonable manner and shall report to the Board of Directors of each Company (each a “Board”).
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- (b) Excluding periods of vacation and sick leave to which the Executive shall be entitled, the Executive agrees to devote the attention and time to the businesses and affairs of the Companies required to discharge the responsibilities assigned to the Executive hereunder. The Executive's duties shall be in the nature of management duties that demand a special level of loyalty and accordingly the Israeli Law of Work Hours and Rest, 5711 - 1951 shall not apply to this Agreement.
- (c) While the Executive is employed by the Companies hereunder, Arotech shall use its best efforts to cause the Executive to be elected to, and if so elected the Executive shall serve on, the Board of Arotech as a member of such Board, and shall cause the Executive to be elected to, and the Executive shall serve on, the Board of Epsilon-EFL as a member of such Board. For the avoidance of doubt, even if the Executive is not elected to either position, it will not affect any of his rights and responsibilities under this Agreement and he will continue to serve and be employed as a senior officer of the Company.
- (d) Each Company will use its reasonable best efforts to obtain, and to keep in place at all times that the Executive is a director or officer of either Company, a directors and officers liability policy covering the Executive in an amount and otherwise containing terms and conditions consistent with past practices.
- (e) The Executive agrees to serve on the board of directors of such subsidiaries of the Companies as the Board may reasonably request.

3. Base Salary, Bonus, Retirement Payment and Financial Planning Allowance.

- (a) The Companies agree to pay or cause to be paid to the Executive a monthly base salary at the rate of NIS 122,050 per month, or such larger amount as the Board may in its sole discretion determine following a review which shall be conducted by the Board by not later than March 31 of each year (beginning with March 31, 2014), such larger amount to take effect retroactively to the January 1 immediately preceding such review (hereinafter referred to as the "Base Salary"). Notwithstanding such review, on each anniversary of the effective date of this Agreement, the Base Salary shall be adjusted upward in an amount equal to the official anticipated net Israeli inflation rate as published by the Israeli Central Bureau of Statistics in the month of December immediately preceding such anniversary, in each case for the year immediately following such anniversary (the "CPI Adjustment"). For the avoidance of doubt, it is understood by the parties that the monthly base salary stated above shall be not adjusted for 2013, retroactive to January 1, 2013, in respect of the CPI Adjustment for inflation during 2012.
- (b) The Companies agree to pay or cause to be paid to the Executive, in a single lump-sum payment in cash on each anniversary of this Agreement or as soon thereafter as may be possible in order to determine the relevant results of the Companies (but in no event later than May 31 of each year), an annual bonus (if and to the extent earned according to the criteria below), as follows:
 - (i) If, as of such anniversary, the Company shall have attained 100% of the Company's Budgeted Number (as defined below) for the year preceding such anniversary, then Executive's bonus shall be equal to 25% of Executive's gross annual Base Salary as then in effect for the year preceding such anniversary;

- (ii) If, as of such anniversary, the Companies shall have attained 120% of the Companies' Budgeted Number (as defined below) for the year preceding such anniversary, then Executive's bonus shall be equal to 75% of Executive's annual Base Salary as then in effect for the year preceding such anniversary;
- (iii) If, as of such anniversary, the Companies shall have attained more than 100% but less than 120% of the Companies' Budgeted Number (as defined below), then Executive's bonus shall be calculated as follows:

$$B = (S \times 25\%) + (N-100)/20 \times (S \times 50\%)$$

Where:

B = The amount of Executive's annual bonus, as a percentage of Executive's Base Salary; and

N = The percentage of the Budgeted Number (as defined below) that was attained by the Companies in the immediately preceding fiscal year; *provided, however*, that N is more than 100 and less than 120;

S = Executive's Base Salary.

For the purposes of this Section 3(b), the Budgeted Number shall be the budgeted results of the Companies as mutually agreed by the Boards and Executive prior to the end of each fiscal year for the fiscal year designated in such budget.

- (c) In addition, the Companies shall pay Executive an amount of up to \$10,000, against invoices or receipts, on each anniversary of this Agreement to cover Executive's tax and financial planning expenses.
- (d) The Companies agree to pay to the Executive the Retirement Payment (as defined under Section 7(b)(ii) of the Original Agreement), consisting of the following elements, less taxes and other customary withholdings, if any, as follows:
 - (i) By transfer to the Executive of share certificate AC 0563 n/o "Ella Benita Advocate as trustee for Robert S. Ehrlich" in the amount of 328,767 shares of Arotech common stock (the "Shares") upon the signing of this Agreement (it having been previously agreed between the parties by letter dated April 19, 2009 that the issuance and now the transfer of the Shares to the Executive would be a credit against the Retirement Payment in the amount of \$240,000, irrespective of any changes in the market value of the Shares).
 - (ii) \$774,377 of the Retirement Payment shall be paid to the Executive in cash upon the signing of this Agreement, said payment to be equal to and withdrawn from the principal of the Executive's Rabbi Trust established by trust agreement dated December 23, 2003

- (iii) The remaining \$611,023 of the Retirement Payment will be paid to the Executive in 30 equal monthly installments of \$20,367.43 each on or before the last day of each calendar month by wire transfer to an account to be specified in writing by the Executive, beginning with the calendar month of May 2013 through and including the calendar month of October 2015.

4. Employee Benefits.

The Executive shall be entitled to the following benefits:

- (a) Manager's Insurance. The Executive and the Companies agree that notwithstanding any prior practice or custom, the Executive will not receive manager's insurance benefits, including without limitation disability and life insurance.
- (b) Education Fund (Keren Hishtalmut). The Companies will contribute to an education fund of the Executive's choice an amount equal to 7.5% of each monthly payment of the Base Salary (up to the maximum amount of the Base Salary as to which contributions to an education fund may be made without any tax being due on such contribution by the Executive (the "Education Fund Maximum")), and will deduct from each monthly payment of the Base Salary and contribute to such education fund an additional amount equal to 2.5% of each such monthly payment of the Base Salary (up to an amount equal to 1/3 of the Education Fund Maximum). Upon the termination of the Executive's employment with the Companies for whatever reason, including without limitation termination for Cause or the resignation by the Executive, the right to receive any amounts in such fund shall be automatically assigned to the Executive.
- (c) Vacation. The Executive shall be entitled to an annual vacation at full pay equal to 24 work days.
- Vacation days may be accumulated and may, at the Executive's option or automatically upon termination, be converted into cash payments in an amount equal to the proportionate part of the Base Salary for such days; *provided, however*, that if the Executive accumulates more than two (2) times his then current annual entitlement of vacation days, such excess shall be automatically converted into the right to receive such a cash payment in respect of such excess. Payments to which the Executive is entitled pursuant to this Section 4(c) shall be made promptly after the Executive's request therefor.
- (d) Sick Leave. The Executive shall be entitled to up to 30 days of fully paid sick leave annually *provided, however*, that the Executive shall not be entitled to sick leave payment to the extent he is already covered by manager's insurance. Sick leave may be accumulated and at the conclusion of this Agreement for all reasons other than Cause, up to 30 days of accumulated but unused sick leave shall be converted into a cash payment to the Executive in an amount equal to the proportionate part of the Base Salary for such days.

- (e) Automobile. The Executive and the Companies agree that notwithstanding any prior practice or custom, the Companies shall not provide the Executive with an automobile. The Company will continue to pay the maintenance and fuel expenses for the Executive's personal automobile as it has in the past.
- (f) Recuperation Payments (D'mai Havra-ah). The Executive shall be entitled to Recuperation Payments as required by law.
- (g) Benefit Plans. The Executive shall be entitled to participate in all stock-based incentive, bonus, benefit or other similar plans offered by either of the Companies, including without limitation Arotech's 2009 Equity Incentive Plan, in accordance with the terms thereof and as determined by the Boards from time to time.

5. Expenses.

The Executive shall be entitled to receive prompt reimbursement of all expenses reasonably incurred by him in connection with the performance of his duties hereunder. Without limiting the generality of the foregoing, the Companies shall pay all of the Executive's expenses in the use of telephones for the Companies' businesses. The Executive shall be entitled to receive room, board and travel reimbursement in connection with the performance of his duties other than at the principal executive office of either Company, as is customary for senior executives in publicly-held United States and Israeli companies. All expense reimbursements made under this Section shall be tax-effected such that the amount of reimbursement received by the Executive net of any taxes and withholdings (including such amounts in respect of payments pursuant to this sentence) equals the expense incurred.

6. Termination.

The Executive's employment hereunder shall and/or may be terminated under the following circumstances:

- (a) Death. This Agreement shall terminate upon the death of the Executive.
- (b) Disability. The Companies may terminate the Executive's employment after having established the Executive's Disability. For purposes of this Agreement, "Disability" means a physical or mental infirmity which impairs the Executive's ability to substantially perform his duties under this Agreement which continues for a period of at least one hundred and eighty (180) consecutive days.
- (c) Cause. The Companies may terminate the Executive's employment for Cause. For purposes of this Agreement, termination for "Cause" shall mean and include: (i) conviction for fraud, crimes of moral turpitude or other conduct which reflects on the Companies in a material and adverse manner; (ii) a willful failure to carry out a material directive of either of the Boards, *provided* that such directive concerned matters within the scope of the Executive's duties, was in conformity with Sections 2(a) and 2(b) hereof, would not give the Executive Good Reason to terminate this Agreement and was capable of being reasonably and lawfully performed; (iii) conviction in a court of competent jurisdiction for embezzlement of funds of the Companies; and (iv) reckless or willful misconduct that is materially harmful to either of the Companies; *provided, however*, that the Companies may not terminate the Executive for Cause unless they have given the Executive (i) written notice of the basis for the proposed termination given not more than thirty (30) days after the Companies have obtained knowledge of such basis ("Companies' Notice of Termination") and (ii) a period of at least thirty (30) days after the Executive's receipt of such notice in which to cure such basis.

- (d) Good Reason. The Executive may terminate his employment under this Agreement for Good Reason. For purposes of this Agreement, "Good Reason" shall mean the occurrence of any of the events or conditions described in subsections (i) through (viii) hereof:
- (i) a change in the Executive's status, title, position or responsibilities which, in the Executive's reasonable judgment, represents a reduction or demotion in the Executive's status, title, position or responsibilities as in effect immediately prior thereto (except for the change in responsibilities and title contemplated by Section 2(a) above), or in the composition of a majority of the Board of Directors;
 - (ii) a reduction in the Executive's Base Salary;
 - (iii) the failure by the Companies to continue in effect any material compensation or benefit plan in which the Executive is participating;
 - (iv) the insolvency or the filing (by any party, including the Companies) of a petition for the winding-up of either of the Companies;
 - (v) any material breach by the Companies of any provision of this Agreement;
 - (vi) any purported termination of the Executive's employment for Cause by the Companies which does not comply with the terms of Section 6(c) of this Agreement;
 - (vii) any movement of either Company's principal executive offices from the Jerusalem/Tel Aviv area of Israel; and
 - (viii) any movement of the location where the Executive is generally to render his services to the Companies hereunder from the Jerusalem/Tel Aviv area of Israel;

provided, however, that the Executive may not terminate his employment under this Agreement for Good Reason unless he has given the Companies (i) written notice of the basis for the proposed termination not more than thirty (30) days after the Executive has obtained knowledge of such basis ("Executive's Notice of Termination") and (ii) a period of at least thirty (30) days after the Companies' receipt of such notice in which to cure such basis.

- (e) Termination Date, Etc. "Termination Date" shall mean in the case of the Executive's death, his date of death, or in all other cases, the date specified in the Notice of Termination subject to the following:
- (i) if the Executive's employment is terminated by the Companies for Cause or due to Disability, the date specified in the Companies' Notice of Termination shall be at least thirty (30) days from the date the Notice of Termination is given to the Executive, *provided* that in the case of Disability the Executive shall not have returned to the full-time performance of his duties during such period of at least thirty (30) days;

- (ii) if the Executive's employment is terminated for Good Reason, the Termination Date specified in the Executive's Notice of Termination shall not be more than sixty (60) days from the date the Notice of Termination is given to the Companies.

7. Compensation upon Termination.

Upon termination of the Executive's employment hereunder, the Executive shall be entitled to the following benefits:

- (a) If the Executive's employment is terminated by the Companies for Cause, or if the Executive's employment is terminated by the Executive other than with Good Reason, then the Companies shall pay the Executive all amounts of Base Salary and the employee benefits specified in clauses (a), (b) and (c) of Section 4 of this Agreement earned or accrued hereunder through the Termination Date but not paid as of the Termination Date (collectively, "Accrued Compensation").
- (b) If the Executive's employment by the Companies shall be terminated (1) due to Disability, (2) by the Executive for Good Reason, (3) by the Executive's death, or (4) by this Agreement coming to the end of the Term, then the Executive shall be entitled to the benefits provided below (in addition to and not instead of whatever other benefits he may be entitled to by reason of operation of law):
 - (i) The Companies shall pay the Executive (a) all Accrued Compensation, (b) a bonus at the rate that would otherwise be payable pursuant to the provisions of Section 3(b) above for the year in which the Termination Date occurs (based on the Company's actual results during the full year in which the Termination Date occurs), of Executive's annual Base Salary as of the Termination Date, *pro rated* based on the number of days in such year which occurred prior to the Termination Date and paid at the time and in the manner specified in Section 3(b) above, (c) the amounts referred to in Section 4(d) above, to the extent earned or accrued hereunder through the Termination Date but unpaid as of the Termination Date, and (d) in the case of termination by the Executive for Good Reason, or termination by the Companies without Cause, all Base Salary that the Executive would have been paid through the end of the Term but for the termination.
 - (ii) For thirty-six (36) months after the Executive ceases to be an officer of either of the Companies, the Companies shall at their expense continue to provide the Executive with a cellular telephone, an e-mail account, and an office if the Company or any of its subsidiaries otherwise maintains office space in Beit Shemesh, Israel, or if not then a home office allowance of \$1,000 per month. The Executive will also be authorized in his discretion to hire a secretary at a salary of no more than \$2,000 per month. The Executive will be solely responsible for any taxes levied on the above benefits.

- (c) The Companies may procure life insurance on the Executive in order to secure the payment of its obligations arising in the event of termination under Section 6(a) hereof. Such insurance shall be payable to the Company, which shall remain primarily liable for the payment of all such obligations to the Executive.
- (d) All stock options and restricted stock that are unvested shall vest on termination (except for Termination for Cause). In the event of termination due to any reason except for Termination for Cause, the Executive's stock options shall be extended for a period of the earlier of (x) the expiration date thereof, and (y) two years after such termination.
- (e) The Companies and the Executive agree that the Executive currently holds 200,000 unvested restricted shares of Arotech common stock (the "Restricted Stock"). Of these shares, 100,000 shares are scheduled to vest on December 31, 2013 (33,334 on the basis of time only and 66,666 on the basis of performance criteria); 33,334 shares are scheduled to vest on June 30, 2013 (on the basis of time only); 33,333 shares are scheduled to vest on June 30, 2014 (on the basis of time only); and 33,333 shares are scheduled to vest on June 30, 2015 (on the basis of time only). It is agreed that on termination (except Termination for Cause), any of the Executive's remaining unvested Restricted Shares shall immediately become unrestricted and freely tradable (subject to applicable securities laws).

As a condition to receiving the payments described in this Section 7, the Executive shall execute and deliver to the Companies a release in the form attached hereto as Exhibit A.

8. Confidentiality; Proprietary Rights; Competitive Activity.

- (a) Confidentiality. Executive recognizes and acknowledges that the technology, developments, designs, inventions, improvements, data, methods, trade secrets and works of authorship which the Companies own, plan or develop, including without limitation the specifications, documentation and other information relating to the Companies' zinc-air battery systems, and businesses and equipment related thereto (in each case whether for their own use or for use by their clients) are confidential and are the property of the Companies. Executive also recognizes that the Companies' technology, customer lists, supplier lists, proposals and procedures are confidential and are the property of the Companies. Executive further recognizes and acknowledges that in order to enable the Companies to perform services for their clients, those clients may furnish to the Companies confidential information concerning their business affairs, property, methods of operation or other data. All of these materials and information will be referred to below as "Proprietary Information"; *provided, however*, that such information shall not include any information known generally to the public (other than as a result of unauthorized disclosure by the Executive).

- (b) Non-Disclosure. Executive agrees that, except as directed by the Companies, and in the ordinary course of the Companies' businesses, Executive will not during Executive's employment with the Companies and thereafter, disclose to any person or entity or use, directly or indirectly for Executive's own benefit or the benefit of others, any Proprietary Information, or permit any person to examine or make copies of any documents which may contain or be derived from Proprietary Information; *provided, however*, that the Executive's duties under this Section 8(b) shall not extend to (i) any disclosure that may be required by law in connection with any judicial or administrative proceeding or inquiry or (ii) any disclosure which may be reasonably required in connection with any actions or proceedings to enforce the Executive's rights under this Agreement. Executive agrees that the provisions of this paragraph shall survive the termination of this Agreement and Executive's employment by the Companies.
 - (c) Competitive Activity. The Executive undertakes not, directly or indirectly (whether as owner, partner, consultant, employee or otherwise) at any time, during and for sixty (60) months following termination of his employment with the Companies, to engage in or contribute his knowledge to any work or activity that involves a product, process, service or development which is then directly (in any material manner) competitive with the Companies' businesses as then constituted. Notwithstanding the foregoing, the Executive shall be permitted to engage in the aforementioned proposed work or activity if the Companies furnishes him with written consent to that effect signed by an authorized officer of each Company.
 - (d) No Solicitation. During the period specified in 8(c) hereof, Executive will not solicit or encourage any customer or supplier of either Company or of any group, division or subsidiary of either Company, to terminate its relationship with either Company or any such group, division or subsidiary, and Executive will not, directly or indirectly, recruit or otherwise seek to induce any employee of either Company or any such group, division or subsidiary to terminate his or her employment or violate any agreement with or duty to either Company or any such group, division or subsidiary.
 - (e) Equitable Relief. The Executive agrees that violations of the material covenants in this Section 8 will cause the Companies irreparable injuries and agrees that the Companies may enforce said covenants by seeking injunctive or other equitable relief (in addition to any other remedies the Companies may have at law for damages or otherwise) from a court of competent jurisdiction. In the event such court declares these covenants to be too broad to be specifically enforced, the covenants shall be enforced to the largest extent as may be allowed by such court for the Companies' protection. Executive further agrees that no breach by the Companies of, or other failure by the Companies under this Agreement shall relieve the Executive of any obligations under Sections 8(a) and 8(b) hereof.
9. Successors and Assigns.
- (a) This Agreement shall be binding upon and shall inure to the benefit of each Company, its successors and assigns and the Companies shall require any successor or assign to expressly assume and agree to perform this Agreement in the same manner and to the same extent that the Companies would be required to perform it if no such succession or assignment had taken place. The term the "Companies" as used herein shall include such successors and assigns. The term "successors and assigns" as used herein shall mean a corporation or other entity acquiring all or substantially all the assets and business of either Company (including this Agreement) whether by operations of law or otherwise.

- (b) Subject to Section 16 hereof, neither this Agreement nor any right or interest hereunder shall be assignable or transferable by the Executive, his beneficiaries or legal representatives, except by will or by the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by the Executive's legal personal representative.

10. Notice.

For the purposes of this Agreement, notices and all other communications provided for in the Agreement shall be in writing and shall be deemed to have been duly given when personally delivered or sent by registered mail, postage prepaid, addressed to the respective addresses set forth below or last given by each party to the other. All notices and communications shall be deemed to have been received on the date of delivery thereof or on the eighth business day after the mailing thereof, except that notice of change of address shall be effective only upon receipt.

The initial addresses of the parties for purposes of this Agreement shall be as follows:

The Companies: Arotech Corporation
1229 Oak Valley Drive
Ann Arbor, Michigan 48108
Attention: Steven Esses

and Epsilon-Electric Fuel Ltd.
Western Industrial Park
P.O. Box 461
Beit Shemesh 99054
Israel

The Executive: Robert S. Ehrlich
21 Nahal Sorek
Ramat Beit Shemesh
Israel

11. Miscellaneous.

No provision of this Agreement may be modified, waived or discharged unless such waiver, modification or discharge is agreed to in writing and signed by the Executive and the Companies. No waiver by either party hereto at any time of any breach by the other party hereto of, or compliance with, any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time. No agreement or representations, oral or otherwise, express or implied, with respect to the subject matter hereof have been made by either party which are not expressly set forth in this Agreement.

12. Governing Law; Venue.

This Agreement shall be governed by and construed and enforced in accordance with the laws of Israel without application of any conflicts of laws principles which would cause the application of the domestic substantive laws of any other jurisdiction. Each of the Executive and the Companies hereby irrevocably waives any objection it may now or hereafter have to the laying of venue in the courts of the State of Israel for any legal suit or action instituted by any party to the Agreement against any other with respect to the subject matter hereof.

13. Severability.

The provisions of this Agreement shall be deemed severable, and the invalidity or unenforceability of any provision shall not affect the validity or enforceability of the other provisions hereof.

14. Entire Agreement.

This Agreement constitutes the entire agreement between the parties hereto and supersedes all prior agreements, understandings and arrangements, oral or written, between the parties hereto with respect to the subject matter hereof including, without limitation the Original Agreement.

15. Joint and Several Obligations.

The obligations and liabilities of each Company hereunder shall be joint and several with the obligations and liabilities of the other Company hereunder.

16. Registration Rights.

- (a) If Arotech at any time proposes to register any of its securities under the Securities Act of 1933, as from time to time in effect (together with the rules and regulations thereunder, all as from time to time in effect, the "Securities Act"), for its own account or for the account of any holder of its securities, on a form which would permit registration of Common Stock of Arotech at the time held or obtainable upon the exercise of options, warrants or rights, or the conversion of convertible securities, at the time held by the Executive ("Registrable Securities"), for sale to the public under the Securities Act, Arotech will each such time give notice to the Executive of its intention to do so. Such notice shall describe such securities and specify the form, manner and other relevant aspects of such proposed registration. The Executive may, by written response delivered to Arotech within 15 days after the giving of any such notice, request that all or a specified part of the Registrable Securities be included in such registration. Arotech will thereupon use its best efforts as part of its filing of such form to effect the registration under the Securities Act of all Registrable Securities which Arotech has been so requested to register by the Executive, to the extent required to permit the disposition (in accordance with the intended methods thereof as aforesaid) of the Registrable Securities to be so registered.
- (b) The Executive may, by notice to Arotech specifying the intended method or methods of disposition, given at any time and from time to time after Arotech has registered any shares of its Common Stock under the Securities Act, request that Arotech effect the registration under the Securities Act of all or a specified part of the Registrable Securities; *provided, however*, that Arotech shall not be required to effect a registration pursuant to this Section 16(b) unless such registration may be effected on a Form S-3 (or any successor or similar Form); and *provided, further*, that each registration pursuant to this Section 16(b) shall cover a number of Registrable Shares equal to not less than 2% of the aggregate number of shares of Arotech Common Stock then outstanding. Arotech will then use its best efforts to effect the registration as promptly as practicable under the Securities Act of the Registrable Securities which Arotech has been requested to register by the Executive pursuant to the Section 16(b).

- (c) Notwithstanding the provisions of Section 16(b), in the event that Executive has requested pursuant to Section 16(b) that Arotech effect a registration of securities, and (i) the Board of Arotech determines that it would be seriously detrimental to Arotech to effect a registration pursuant to Section 16(b), or (ii) the Board of Arotech determines in good faith that (A) Arotech is in possession of material, non-public information concerning an acquisition, merger, recapitalization, consolidation, reorganization or other material transaction by or of Arotech or concerning pending or threatened litigation and (B) disclosure of such information would jeopardize any such transaction or litigation or otherwise materially harm Arotech, then Arotech shall promptly notify Executive of the occurrence of any of the events described in the foregoing clauses (i) or (ii). Upon the occurrence of any of the events described in clauses (i) or (ii) hereof, Arotech shall be allowed to defer a registration of securities pursuant to Section 16(b) above, and if a registration statement had already been filed at such time, Executive shall not dispose of his Registrable Securities under such registration statement until it is so advised in writing by Arotech that the registration of securities under 16(b) may be effected or resumed. Notwithstanding the foregoing, any such deferment or prohibition on disposition shall not be in effect for more than 90 days in any 12 months period.
- (d) Arotech shall not be obligated to effect any registration of Registrable Securities under Section 16(a) hereof incidental to the registration of any of its securities in connection with mergers, acquisitions, exchange offers, dividend reinvestment plans or stock option or other employee benefit plans.
- (e) Arotech hereby agrees to pay, or cause to be paid, all legal, accounting, printing and other expenses (other than the fees and expenses of the Executive's own counsel and other than underwriting discounts and commissions attributable to the Registrable Securities) in connection with each registration of Registrable Securities pursuant to this Section 16.
- (f) In connection with each registration of Registrable Securities pursuant to this Section 16, Arotech and the Executive will enter into such agreements, containing such terms and conditions, as are customary in connection with public offerings, such agreements to contain, without limitation, customary indemnification provisions, representations and warranties and opinions and other documents to be delivered in connection therewith, and to be, if requested, with underwriters.
- (g) The provisions of this Section 16 shall be subject to any agreement entered into by Arotech, in good faith, with any underwriter of Arotech's securities or any person or entity providing financing to Arotech, in each case containing reasonable limitations on the Executive's rights and Arotech's obligations hereunder.
- (h) The provisions of this Section 16 shall survive the termination of the other provisions of this Agreement. The rights of the Executive under this Section 16 are assignable, in whole or in part, by the Executive to any person or other entity acquiring securities of Arotech from the Executive.

- (i) Notwithstanding anything in the foregoing to the contrary, the Executive shall not demand a registration during the 180 days following an underwritten public offering of the Common Stock of the Company.
- (j) Without the prior written consent of the underwriters managing any public offering, for a period beginning ten days immediately preceding the effective date of any registration statement filed by the Company under the Securities Act of 1933, as amended, and ending on the earlier of (i) 180 days after the effective date of such registration statement and (ii) the end of the shortest period generally applicable to any "affiliate" (as defined in the Securities Act of 1933, as amended) of Arotech who is a selling shareholder pursuant to such registration statement or who is otherwise subject to a lockup provision, the Executive (whether or not a selling shareholder pursuant to such registration statement) shall not sell or otherwise transfer any securities of Arotech except pursuant to such registration statement.

17. Taxes.

All sums referred to herein are gross, not net.

18. Currency.

All U.S. dollar amounts payable under this Agreement shall, at the Company's option, be paid either in U.S. dollars or in New Israeli Shekels at the rate of exchange on the date prior to the day of payment as published by the Bank of Israel.

IN WITNESS WHEREOF, the Companies have caused this Agreement to be executed by its duly authorized officer and the Executive has executed this Agreement as of the day and year first above written.

AROTECH CORPORATION

By: /s/ Steven Esses
Its: President

EPSILOR-ELECTRIC FUEL LTD.

By: /s/ Ronen Badichi
Its: General Manager

/s/ Robert S. Ehrlich
Executive

Exhibit A

FORM OF MUTUAL RELEASE

This mutual release is executed and delivered by and between the undersigned employee of Arotech Corporation, a Delaware corporation ("Arotech") and Epsilon-Electric Fuel Ltd. ("Epsilon-EFL") and the undersigned's successors, assigns, executors, estates and personal representatives (collectively, the "Executive"), on the one hand, and Arotech and Epsilon-EFL and each of their respective affiliates, agents, successors and assigns (collectively, the "Companies"), on the other hand. For and in consideration of the Executive receiving the compensation referred to in Section 7 of the Sixth Amended and Restated Employment Agreement dated May 13, 2013 and other good and valuable consideration, the adequacy and receipt of which are hereby acknowledged by the Executive and the Companies, the Executive hereby remises, releases and forever discharges the Companies, and the Companies hereby remise, release and forever discharge the Executive, of and from any and all manner of action and actions, cause and causes of actions, suits, debts, dues, sums of money, accounts, reckonings, bonds, bills, covenants, contracts, controversies, executions, claims and demands of any kind and nature whatsoever in law or in equity, known or unknown, against the other party which ever existed prior to the date hereof, or may ever have on and after the date hereof with respect to matters arising, and dealings with the other party occurring, prior to the date hereof; *provided, however*, that nothing contained herein shall be construed to release the Executive from any obligations to the Companies pursuant to the Employment Agreement nor to release the Companies from any of their obligations to the Executive pursuant to the Employment Agreement.

IN WITNESS WHEREOF, the Executive and the Companies have each caused this Release to be executed as of _____.

EXECUTIVE

Name: Robert S. Ehrlich

AROTECH CORPORATION

By: _____
Title:

EPSILON-ELECTRIC FUEL LTD.

By: _____
Title:

THIRD AMENDED AND RESTATED EMPLOYMENT AGREEMENT

THIS AGREEMENT ("Agreement") is signed on the 13th day of May, 2013, effective as of the 1st day of May, 2013, by and between Epsilon-Electric Fuel Ltd., an Israeli corporation ("Epsilon"), Arotech Corporation, a Delaware corporation ("Arotech" and, together with Epsilon, the "Company") and Mr. Steven Esses (the "Executive").

WHEREAS, the Executive has worked for the Company since October 2002; and

WHEREAS, Epsilon and the Executive entered into an Employment Agreement effective as of January 1, 2005, as amended and restated effective as of January 1, 2008 and January 1, 2012 (the "Original Agreement"); and

WHEREAS, the Company and the Executive now wish to extend the Executive's employment and to amend and restate the Original Agreement in its entirety in accordance with the terms of this Agreement; and

WHEREAS, Arotech wishes to join this Agreement;

NOW, THEREFORE, in consideration of the respective agreements of the parties contained herein, the parties agree as follows:

1. Term.

The term of the Executive's employment under this Agreement shall be for the period commencing May 1, 2013 and ending on December 31, 2015 (the "Term"). The provisions of this Agreement shall apply to the relationship between the parties hereto retroactively as if this Agreement were signed on the commencement of the Term.

2. Employment.

- (a) The Executive shall be employed as President of the Company until September 30, 2014, and thereafter shall be employed as President and Chief Executive Officer of the Company. The Executive shall perform the duties, undertake the responsibilities and exercise the authority customarily performed, undertaken and exercised by persons situated in a similar executive capacity in Israeli subsidiaries of publicly-held corporations. The Executive shall exercise his authority in a reasonable manner and shall report to the Chairman (the "Chairman") of the Board of Directors (the "Board") of Arotech until September 30, 2014, and thereafter to the Board.
- (b) Excluding periods of vacation and sick leave to which the Executive shall be entitled, the Executive agrees to devote the attention and time to the businesses and affairs of the Company required to discharge the responsibilities assigned to the Executive hereunder. The Company acknowledges that the Executive is a director of multiple non-profit organizations. In addition, the Company acknowledges that the Executive is involved in certain investment activities which, together with the above mentioned positions, will consume a portion of his time. The Company consents to these other positions and activities so long as these do not interfere in any material manner with the Executive's performance of his duties hereunder and do not constitute a violation of Section 8 hereof.
-

- (c) While the Executive is employed by the Company hereunder, the Company shall use its best efforts to cause the Executive to be elected to the Board of Directors of the Company (the "Board") and on the board of directors of such of the Company's affiliates as the Board shall determine, as a member of such Board(s).
- (d) The Company will use its reasonable best efforts to obtain, and to keep in place at all times that the Executive is a director or officer of the Company, a directors and officers liability policy covering the Executive in an amount and otherwise containing terms and conditions consistent with past practices.
- (e) The Executive agrees to serve on the Board and on the board of directors of such affiliates of the Company as the Board may request.
- (f) The Executive shall be required to travel on a periodic basis. Air travel shall be business class.

3. Base Salary, Bonus and Financial Planning Allowance

- (a) Base Salary. The Company agrees to pay or cause to be paid to the Executive, for his services to the Company during the Term, a base salary (the "Base Salary") to be paid by Epsilon at the rate of NIS 74,515 per month, as adjusted upward annually each January (beginning with January 2014) in an amount equal to the official anticipated net Israeli inflation rate as published by the Israeli Central Bureau of Statistics in the month of December prior to such adjustment (the "CPI Adjustment").
- (b) Bonus. The Company agrees to pay or cause to be paid to the Executive, in a single lump-sum payment in cash on each anniversary of this Agreement or as soon thereafter as may be possible in order to determine the relevant results of the Company (but in no event later than May 31 of each year), an annual bonus (if and to the extent earned according to the criteria below), as follows:
 - (i) If, as of such anniversary, the Company shall have attained 100% of the Company's Budgeted Number (as defined below) for the year preceding such anniversary, then Executive's bonus shall be equal to 25% of Executive's gross annual Base Salary as then in effect for the year preceding such anniversary;
 - (ii) If, as of such anniversary, the Company shall have attained 120% of the Company's Budgeted Number (as defined below) for the year preceding such anniversary, then Executive's bonus shall be equal to 75% of Executive's gross annual Base Salary as then in effect for the year preceding such anniversary;
 - (iii) If, as of such anniversary, the Company shall have attained more than 100% but less than 120% of the Company's Budgeted Number (as defined below), then Executive's bonus shall be calculated as follows:

$$B = (S \times 25\%) + (N-100)/20 \times (S \times 50\%)$$

Where:

B = The amount of Executive's annual bonus, as a percentage of Executive's gross annual Base Salary; and

N = The percentage of the Budgeted Number (as defined below) that was attained by the Company in the immediately preceding fiscal year *provided, however*, that N is more than 100 and less than 120;

S = Executive's gross annual Base Salary.

For the purposes of this Section 3(b), the Budgeted Number shall be the budgeted results of the Company as agreed by the Board prior to the end of each fiscal year for the fiscal year designated in such budget, and may include targets for any or all of the following factors: (i) revenues; (ii) cash flow, and (iii) EBITDA. In the event that some but not all targets are reached, the Compensation Committee shall make a determination as to what percentage of the Budgeted Number was attained.

- (c) Equity Grants. The Executive will receive annual stock option or restricted stock bonus grants in respect of the common stock of the Company's parent corporation, Arotech Corporation ("Arotech"), in amounts to be determined based on the recommendation of the Chairman and the decision of the Compensation Committee of Arotech.
- (d) Tax Planning Reimbursement. The Company shall pay Executive an amount of up to NIS 45,000 on each anniversary of this Agreement to cover Executive's legal, tax and financial planning expenses, against invoices or receipts; any excess in any given year may be used by the Executive to fund supplemental health or life insurance policies, if any. Any amounts not used in a given year shall roll over to future years, but amounts unused at notice of termination of this Agreement shall expire. Legal expenses may not be used to finance legal advice or litigation against the interests of the Company.

4. Employee Benefits.

The Executive shall be entitled to the following benefits:

- (a) Life and Disability Insurance. The Company will pay to an insurance company of the Executive's choice, as premiums for life and disability insurance for the Executive, an amount equal to 13.33% of each monthly payment of the Base Salary together with 2.5% of the Base Salary for disability, and will deduct from each monthly payment of the Base Salary and pay to such insurance company an amount equal to 5% of each monthly payment of the Base Salary, which shall constitute the Executive's contribution to such premiums. Upon the termination of the Executive's employment with the Company for whatever reason, including without limitation termination for Cause or the resignation by the Executive, the right to receive the life and disability insurance benefits shall be automatically assigned to the Executive. At the Executive's option, in lieu of providing life and disability insurance, the Company shall pay the amount it would otherwise pay for such insurance to the trust referred to in Section 7(b)(ii) hereof.

- (b) Education Fund. The Company will contribute to an education fund of the Executive's choice an amount equal to 7.5% of each monthly payment of the Base Salary, and will deduct from each monthly payment of the Base Salary and contribute to such education fund an additional amount equal to 2.5% of each such monthly payment of the Base Salary. Additionally, the Company will pay a supplementary amount to the education fund in the amount of 20% of the Base Salary. Upon the termination of the Executive's employment with the Company for whatever reason, including without limitation termination for Cause or the resignation by the Executive, the right to receive any amounts in such fund shall be automatically assigned to the Executive. All education fund contributions or imputed income made under this Section in excess of the statutory exemption shall be tax-effected such that the amount of contribution net of any taxes and withholding (including such amounts in respect of payments pursuant to this sentence) equals the percentages specified herein.
- (c) Vacation. The Executive shall be entitled to an annual vacation at full pay equal to 24 work days. Vacation days may be accumulated and may, at the Executive's option or automatically upon termination, be converted into cash payments in an amount equal to the proportionate part of the Base Salary for such days; *provided, however*, that if the Executive accumulates more than two (2) times his then current annual entitlement of vacation days, such excess shall be automatically converted into the right to receive such a cash payment in respect of such excess. Payments to which the Executive is entitled pursuant to this Section 4(c) shall be made promptly after the Executive's request therefor.
- (d) Sick Leave. The Executive shall be entitled to a maximum aggregate of 30 days of fully paid sick leave (inclusive of days accrued under the Original Agreement), accruing at the rate of 2.5 days per month; *provided, however*, that the Executive shall not be entitled to sick leave payment to the extent he is already covered by manager's insurance. Sick leave may be accumulated and may, at the Executive's option, be converted into cash payments in an amount equal to the proportionate part of the Base Salary for such days. Payments to which the Executive is entitled pursuant to this Section 4(d) shall be made promptly after the Executive's request therefor.
- (e) Automobile. Every three years, the Company shall make a new automobile available to the Executive during the term of this Agreement. Such automobile shall be of a high quality comparable to, but not less than, that of a 2012 model Honda Legend, and shall be subject to the approval of the Executive, which shall not be unreasonably withheld. The Executive shall be entitled to use the automobile for his personal and business needs, so long as he does not allow anyone who would not be covered by the Company's insurance to drive it. The Company shall pay all expenses of maintaining and operating the automobile. All expense reimbursements or imputed income made under this Section shall be tax-effected such that the amount of reimbursement received by the Executive net of any taxes and withholdings (including such amounts in respect of payments pursuant to this sentence) equals the expense incurred.
- (f) Benefit Plans. The Executive shall be entitled to participate in all incentive, bonus, benefit or other similar plans offered by the Company, including without limitation the Company's 2009 Equity Incentive Plan, in accordance with the terms thereof and as determined by the Board from time to time.

(g) Medical Insurance. The Executive shall be entitled to obtain, at Company expense of up to \$12,000 per year, medical insurance for himself and his family.

5. Expenses.

The Executive shall be entitled to receive prompt reimbursement of all expenses reasonably incurred by him in connection with the performance of his duties hereunder. Without limiting the generality of the foregoing, the Company shall pay all of the Executive's expenses in the use of Internet and telephones for the Company's businesses. The Executive shall be entitled to receive room, board and travel reimbursement in connection with the performance of his duties other than at the principal executive office of the Company, as is customary for senior executives of publicly-held companies. All expense reimbursements made under this Section shall be tax-effected such that the amount of reimbursement received by the Executive net of any taxes and withholdings (including such amounts in respect of payments pursuant to this sentence) equals the expense incurred.

6. Termination.

The Executive's employment hereunder shall and/or may be terminated under the following circumstances:

(a) Death. This Agreement shall terminate upon the death of the Executive.

(b) Disability. The Company may terminate the Executive's employment after having established the Executive's Disability. For purposes of this Agreement, "Disability" means a physical or mental infirmity which impairs the Executive's ability to substantially perform his duties under this Agreement which continues for a period of at least one hundred and eighty (180) consecutive days.

(c) Cause. The Company may terminate the Executive's employment for Cause. For purposes of this Agreement, termination for "Cause" shall mean and include: (i) conviction for fraud, crimes of moral turpitude or other conduct which reflects on the Company in a material and adverse manner; (ii) a willful failure to carry out a material directive of the Board, *provided* that such directive concerned matters within the scope of the Executive's duties, was in conformity with Sections 2(a) and 2(b) hereof, would not give the Executive Good Reason to terminate this Agreement and was capable of being reasonably and lawfully performed; (iii) conviction in a court of competent jurisdiction for embezzlement of funds of the Company; and (iv) reckless or willful misconduct that is materially harmful to the Company; *provided, however*, that the Company may not terminate the Executive for Cause unless they have given the Executive written notice of the basis for the proposed termination ("Company's Notice of Termination").

(d) Good Reason. The Executive may terminate his employment under this Agreement for Good Reason. For purposes of this Agreement, "Good Reason" shall mean the occurrence of any of the events or conditions described in subsections (i) through (vi) hereof:

- (i) (1) a change in the Executive's status, title, position or responsibilities (except for the change in responsibilities and title contemplated by Section 2(a) above) which, in the Executive's reasonable judgment, represents a reduction or demotion in the Executive's status, title, position or responsibilities as in effect immediately prior thereto, or (2) a change in the primary location from which the Executive shall have conducted his business activities during the 60 days prior to such change, or (3) a change in the composition of a majority of the Board of Directors, or (4) the failure to promote the Executive to the position of President and Chief Executive Officer on or before October 1, 2014;
- (ii) a reduction in the Executive's Base Salary;
- (iii) the failure by the Company to continue the Executive as a participant in any material compensation or benefit plan in which the other senior executives of the Company are participating unless agreed to by the Executive;
- (iv) the insolvency or the filing (by any party, including the Company) of a petition for the winding-up of the Company or of Arotech;
- (v) any material breach by the Company of any provision of this Agreement;
- (vi) any purported termination of the Executive's employment for Cause by the Company which does not comply with the terms of Section 6(c) of this Agreement;

provided, however, that the Executive may not terminate his employment under this Agreement for Good Reason unless he has given the Company (i) written notice of the basis for the proposed termination not more than thirty (30) days after the Executive has obtained knowledge of such basis ("Executive's Notice of Termination") and (ii) a period of at least thirty (30) days after the Company's receipt of such notice in which to cure such basis.

- (e) Termination Date, Etc. "Termination Date" shall mean in the case of the Executive's death, his date of death, or in all other cases, the date specified in the Notice of Termination subject to the following:
 - (i) if the Executive's employment is terminated by the Company for Cause or due to Disability, the date specified in the Company's Notice of Termination shall be at least thirty (30) days from the date the Notice of Termination is given to the Executive, *provided* that in the case of Disability the Executive shall not have returned to the full-time performance of his duties during such period of at least thirty (30) days;
 - (ii) if the Executive's employment is terminated for Good Reason, the Termination Date specified in the Executive's Notice of Termination shall not be more than sixty (60) days from the date the Notice of Termination is given to the Company.

- (f) Retirement. At any time during the period beginning (i) 150 days prior to his 65th birthday (“Retirement”) or (ii) from 150 days prior to his 55th birthday until 150 days prior to his 65th birthday (“Early Retirement”), the Executive may retire from his positions with the Companies by giving to the Companies written Notice of Retirement specifying the Retirement Date, which Retirement Date shall be at least one hundred and fifty (150) days from the date of such Notice of Retirement.
 - (g) Termination Without Cause. Termination other than as set forth above shall constitute termination “Without Cause.”
7. Compensation upon Termination.

Upon termination of the Executive’s employment hereunder, in addition to any severance sums due to the Executive by operation of law, the Executive shall be entitled to the following benefits:

- (a) If the Executive’s employment is terminated by the Company for Cause or if the Executive’s employment is terminated by the Executive Without Cause, then the Company shall pay the Executive all amounts of Base Salary and the employee benefits specified in clauses (a), (b) and (c) of Section 4 of this Agreement earned or accrued hereunder through the Termination Date but not paid as of the Termination Date (collectively, “Accrued Compensation”).
- (b) If the Executive’s employment by the Company shall be terminated (1) due to Disability, (2) by the Executive for Good Reason, (3) by the Executive’s death, (4) due to this Agreement coming to the end of the Term and not being extended or immediately succeeded by a new substantially similar employment agreement (“Non-Renewal”), (5) due to Retirement or Early Retirement, or (6) by the Company Without Cause, then the Executive shall be entitled to the additional benefits provided below, which, in the case of death, Disability, Retirement or Early Retirement, shall be in lieu of any further salary for periods subsequent to the Termination Date):
 - (i) The Company shall pay the Executive (a) all Accrued Compensation, (b) a bonus at a rate of the higher of (i) 20%, or (ii) the rate that would otherwise be payable pursuant to the provisions of Section 3(b) above for the year in which the Termination Date occurs, of Executive’s annual Base Salary as of the Termination Date, *pro rated* based on the number of days in such year which occurred prior to the Termination Date, (c) the amounts referred to in Sections 4(d) and (e) above, to the extent earned or accrued hereunder through the Termination Date but unpaid as of the Termination Date, and (d) in the case of termination by the Executive for Good Reason, or termination by the Companies without Cause, all Base Salary that the Executive would have been paid through the end of the Term but for the termination;

- (ii) The Company shall pay into a trust to be established pursuant to a separate trust agreement or shall purchase a certificate of deposit registered in the Executive's name but held by the Company (the "Trust") as termination pay and in lieu of any further salary for periods subsequent to the Termination Date (except as provided in Section 7(b)(i) above), an amount equal to the higher of (i) twenty-four (24) times the monthly Base Salary at the highest rate in effect at any time within the ninety (90) day period ending on the Termination Date, and (ii) NIS 3,144,000 (the "Base Termination Pay"). Base Termination Pay will vest and be funded into the Trust as provided in Section 7(b)(iv) below. The parties agree, pursuant to the terms of the letter between the parties dated April 19, 2009, that the payment of \$200,000 of the Base Termination Pay shall be accomplished by transfer to the Executive of share certificate AC 0564 n/o "Ella Benita Advocate as trustee for Steven Esses" in the amount of 273,973 shares of Arotech common stock (the "Shares") (it having been previously agreed between the parties that the issuance and now the transfer of the Shares to the Executive would be a credit against the Base Termination Pay in the amount of \$200,000, irrespective of any changes of any changes in the market value of the Shares).
- (iii) The Company shall pay to the Executive, in respect of all benefits, an additional sum in the amount of (i) \$75,000, in the case of Termination due to Disability, the Executive's death, or Non-Renewal, or (ii) \$150,000, in the case of Termination due to Early Retirement, Retirement, or Good Reason. Additionally, the Company shall transfer to the Executive title to the Honda Legend currently in the possession of the Executive, upon payment by the Executive to the Company, in advance, of all taxes that the Company in good faith believes will be due and owing as a result of the transfer of such title.
- (iv) In the event of a termination by the Company without Cause or by the Executive due to Good Reason, all of the Executive's stock options, whether or not they have yet vested, shall immediately vest and shall be extended for a period of the later of (x) the expiration date thereof, and (y) the second anniversary of such termination, and all of the Executive's restricted stock shall immediately become unrestricted and freely tradable (subject to applicable securities laws). In the event of termination due to any other reason except for Termination for Cause, the Executive's then-vested stock options shall be extended for a period of the earlier of (x) the expiration date thereof, and (y) two years after such termination.

Such sums are intended to be in addition to any severance sums due to the Executive by operation of law (in respect of which the Company hereby acknowledges that the Executive's employment with the Company began in October 2002), and any such sums paid to the Executive as a result of statutory or other legal requirements ("Statutory Severance Pay") shall not be deducted from the sums above. Such sums are not intended to be in lieu of amounts payable pursuant to any separate agreements entered into contemporaneously with or subsequent to the date of this Agreement.

In addition to the foregoing sums, the Company will pay to the Executive pursuant to this subsection (b) an additional payment in cash equal to the amount, if any, by which that portion of the Statutory Severance Pay that shall be payable in respect of the Employee's employment during the period of this Agreement is less than it would have been had the Statutory Severance Pay in respect of such period been calculated on the basis of a Base Salary of NIS 131,000 per month from October 2002.

As a condition to receiving the payments described in this Section 7, the Executive shall execute and deliver to the Company a release in the form attached hereto as Exhibit A.

- (c) If the Executive's employment by the Company shall be terminated by the Executive for the reason specified in Section 6(d)(i)(3) above, then in addition to the sums otherwise payable hereunder, the Executive shall be paid an amount equal to the product of (x) NIS 20,645, multiplied by (y) the number (which need not be a whole number) of months between January 1, 2013 and the date of such termination, which result shall be multiplied by (z) 1.16.

8. Confidentiality; Proprietary Rights; Competitive Activity.

- (a) Confidentiality. Executive recognizes and acknowledges that the technology, developments, designs, inventions, improvements, data, methods, trade secrets and works of authorship which the Company owns, plans or develops, including without limitation the specifications, documentation and other information relating to the Company's zinc-air battery systems, and businesses and equipment related thereto (in each case whether for their own use or for use by their clients) are confidential and are the property of the Company. Executive also recognizes that the Company's technology, customer lists, supplier lists, proposals and procedures are confidential and are the property of the Company. Executive further recognizes and acknowledges that in order to enable the Company to perform services for its clients, those clients may furnish to the Company confidential information concerning their business affairs, property, methods of operation or other data. All of these materials and information will be referred to below as "Proprietary Information"; *provided, however*, that such information shall not include any information known generally to the public (other than as a result of unauthorized disclosure by the Executive).
- (b) Non-Disclosure. Executive agrees that, except as directed by the Company, and in the ordinary course of the Company's business, Executive will not during Executive's employment with the Company and thereafter, disclose to any person or entity or use, directly or indirectly for Executive's own benefit or the benefit of others, any Proprietary Information, or permit any person to examine or make copies of any documents which may contain or be derived from Proprietary Information; *provided, however*, that the Executive's duties under this Section 8(b) shall not extend to (i) any disclosure that may be required by law in connection with any judicial or administrative proceeding or inquiry or (ii) any disclosure which may be reasonably required in connection with any actions or proceedings to enforce the Executive's rights under this Agreement. Executive agrees that the provisions of this paragraph shall survive the termination of this Agreement and Executive's employment by the Company.

- (c) Competitive Activity. The Executive undertakes not, directly or indirectly (whether as owner, partner, consultant, employee or otherwise) at any time, during and for twelve (12) months following termination of his employment with the Company, to engage in or contribute his knowledge to any work or activity that involves a product, process, service or development which is then directly (in any material manner) competitive with any business that the Company has conducted during the term of this Agreement or any extension hereof on which the Executive worked or with respect to which the Executive had access to Proprietary Information while with the Company. Notwithstanding the foregoing, the Executive shall be permitted to engage in the aforementioned proposed work or activity if the Company furnishes him with written consent to that effect signed by an authorized officer of the Company.
 - (d) No Solicitation. During the period specified in 8(c) hereof, Executive will not solicit or encourage any customer or supplier of the Company or of any group, division or subsidiary of the Company, to terminate its relationship with the Company or any such group, division or subsidiary, and Executive will not, directly or indirectly, recruit or otherwise seek to induce any employee of the Company or any such group, division or subsidiary to terminate his or her employment or violate any agreement with or duty to the Company or any such group, division or subsidiary.
 - (e) Equitable Relief. The Executive agrees that violations of the material covenants in this Section 8 will cause the Company irreparable injuries and agrees that the Company may enforce said covenants by seeking injunctive or other equitable relief (in addition to any other remedies the Company may have at law for damages or otherwise) from a court of competent jurisdiction. In the event such court declares these covenants to be too broad to be specifically enforced, the covenants shall be enforced to the largest extent as may be allowed by such court for the Company's protection. Executive further agrees that no breach by the Company of, or other failure by the Company under this Agreement shall relieve the Executive of any obligations under Sections 8(a) and 8(b) hereof.
9. Successors and Assigns.
- (a) This Agreement shall be binding upon and shall inure to the benefit of the Company, its successors and assigns and the Company shall require any successor or assign to expressly assume and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform it if no such succession or assignment had taken place. The term the "Company" as used herein shall include such successors and assigns. The term "successors and assigns" as used herein shall mean a corporation or other entity acquiring all or substantially all the assets and business of the Company (including this Agreement) whether by operations of law or otherwise.
 - (b) Neither this Agreement nor any right or interest hereunder shall be assignable or transferable by the Executive, his beneficiaries or legal representatives, except by will or by the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by the Executive's legal personal representative.
 - (c) Nothing to the contrary in the foregoing notwithstanding, the Executive may assign this Agreement to any company of which he is a "control person" within the meaning of the Securities Exchange Act of 1934, *provided*, that the Executive shall continue to be obligated to fulfill the duties set forth in Section 2 above, and *provided, further*, that the Executive shall continue to be bound by the terms and provisions of Section 8 of this Agreement notwithstanding any such assignment.

10. Notice.

For the purposes of this Agreement, notices and all other communications provided for in the Agreement shall be in writing and shall be deemed to have been duly given when personally delivered or sent by registered mail, postage prepaid, addressed to the respective addresses set forth below or last given by each party to the other. All notices and communications shall be deemed to have been received on the date of delivery thereof or on the eighth business day after the mailing thereof, except that notice of change of address shall be effective only upon receipt.

The initial addresses of the parties for purposes of this Agreement shall be as follows:

The Company: Arotech Corporation and Epsilor-Electric Fuel Ltd.
 c/o Epsilor-Electric Fuel Ltd.
 One HaSolela Street, Western Industrial Park
 Beit Shemesh 99054, Israel

The Executive: Steven Esses
 Koresh 13
 Efrat, Israel

11. Miscellaneous.

No provision of this Agreement may be modified, waived or discharged unless such waiver, modification or discharge is agreed to in writing and signed by the Executive and the Company. No waiver by either party hereto at any time of any breach by the other party hereto of, or compliance with, any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time. No agreement or representations, oral or otherwise, express or implied, with respect to the subject matter hereof have been made by either party which are not expressly set forth in this Agreement.

12. Governing Law; Arbitration; Venue.

This Agreement shall be governed by and construed and enforced in accordance with the laws of Israel without application of any conflicts of laws principles which would cause the application of the domestic substantive laws of any other jurisdiction. All disputes under this Agreement that cannot be resolved by the parties shall be submitted to arbitration under the rules and regulations of the Israel Institute of Commercial Arbitration. Either party may invoke this paragraph after providing 30 (thirty) days written notice to the other party. All costs of arbitration shall be divided equally between the parties. The arbitrator(s) shall award to the prevailing party, if any, as determined by the arbitrator(s), all of its costs and fees. "Costs and Fees" means all reasonable pre-award expenses of the arbitration, including arbitration fees, administrative fees, travel expenses, out-of-pocket expenses such as copying and telephone, court costs, witness fees and reasonable attorneys' fees. In the event that notwithstanding the foregoing arbitration provision there is nevertheless litigation in respect of this Agreement, each of the Executive and the Company hereby irrevocably waives any objection it may now or hereafter have to the laying of venue in the courts of the State of Israel, City of Tel-Aviv-Yafo, for any legal suit or action instituted by any party to the Agreement against any other with respect to the subject matter hereof.

13. Severability.

The provisions of this Agreement shall be deemed severable, and the invalidity or unenforceability of any provision shall not affect the validity or enforceability of the other provisions hereof.

14. Entire Agreement.

This Agreement constitutes the entire agreement between the parties hereto and supersedes all prior agreements, understandings and arrangements, oral or written, between the parties hereto with respect to the subject matter hereof including.

15. Registration Rights.

- (a) If the Company at any time proposes to register any of its securities under the Securities Act of 1933, as from time to time in effect (together with the rules and regulations thereunder, all as from time to time in effect, the "Securities Act"), for its own account or for the account of any holder of its securities, on a form which would permit registration of Common Stock of the Company at the time held or obtainable upon the exercise of options, warrants or rights, or the conversion of convertible securities, at the time held by the Executive ("Registrable Securities"), for sale to the public under the Securities Act, the Company will each such time give notice to the Executive of its intention to do so. Such notice shall describe such securities and specify the form, manner and other relevant aspects of such proposed registration. The Executive may, by written response delivered to the Company within 15 days after the giving of any such notice, request that all or a specified part of the Registrable Securities be included in such registration. the Company will thereupon use its best efforts as part of its filing of such form to effect the registration under the Securities Act of all Registrable Securities which the Company has been so requested to register by the Executive, to the extent required to permit the disposition (in accordance with the intended methods thereof as aforesaid) of the Registrable Securities to be so registered.
- (b) The Executive may, by notice to the Company specifying the intended method or methods of disposition, given at any time and from time to time after the Company has registered any shares of its Common Stock under the Securities Act, request that the Company effect the registration under the Securities Act of all or a specified part of the Registrable Securities; *provided, however*, that the Company shall not be required to effect a registration pursuant to this Section 15(b) unless such registration may be effected on a Form S-3 (or any successor or similar Form); and *provided, further*, that each registration pursuant to this Section 15(b) shall cover a number of Registrable Shares equal to not less than 2% of the aggregate number of shares of the Company Common Stock then outstanding. the Company will then use its best efforts to effect the registration as promptly as practicable under the Securities Act of the Registrable Securities which the Company has been requested to register by the Executive pursuant to the Section 15(b).

- (c) Notwithstanding the provisions of Section 15(b), in the event that Executive has requested pursuant to Section 15(b) that the Company effect a registration of securities, and (i) the Board determines that it would be seriously detrimental to the Company to effect a registration pursuant to Section 15(b), or (ii) the Board determines in good faith that (A) the Company is in possession of material, non-public information concerning an acquisition, merger, recapitalization, consolidation, reorganization or other material transaction by or of the Company or concerning pending or threatened litigation and (B) disclosure of such information would jeopardize any such transaction or litigation or otherwise materially harm the Company, then the Company shall promptly notify Executive of the occurrence of any of the events described in the foregoing clauses (i) or (ii). Upon the occurrence of any of the events described in clauses (i) or (ii) hereof, the Company shall be allowed to defer a registration of securities pursuant to Section 15(b) above, and if a registration statement had already been filed at such time, Executive shall not dispose of his Registrable Securities under such registration statement until it is so advised in writing by the Company that the registration of securities under 15(b) may be effected or resumed. Notwithstanding the foregoing, any such deferment or prohibition on disposition shall not be in effect for more than 90 days in any 12 months period.
- (d) The Company shall not be obligated to effect any registration of Registrable Securities under Section 15(a) hereof incidental to the registration of any of its securities in connection with mergers, acquisitions, exchange offers, dividend reinvestment plans or stock option or other employee benefit plans.
- (e) The Company hereby agrees to pay, or cause to be paid, all legal, accounting, printing and other expenses (other than the fees and expenses of the Executive's own counsel and other than underwriting discounts and commissions attributable to the Registrable Securities) in connection with each registration of Registrable Securities pursuant to this Section 15.
- (f) In connection with each registration of Registrable Securities pursuant to this Section 15, the Company and the Executive will enter into such agreements, containing such terms and conditions, as are customary in connection with public offerings, such agreements to contain, without limitation, customary indemnification provisions, representations and warranties and opinions and other documents to be delivered in connection therewith, and to be, if requested, with underwriters.
- (g) The provisions of this Section 15 shall be subject to any agreement entered into by the Company, in good faith, with any underwriter of the Company's securities or any person or entity providing financing to the Company, in each case containing reasonable limitations on the Executive's rights and the Company's obligations hereunder.
- (h) The provisions of this Section 15 shall survive the termination of the other provisions of this Agreement. The rights of the Executive under this Section 16 are assignable, in whole or in part, by the Executive to any person or other entity acquiring securities of the Company from the Executive.

- (i) Notwithstanding anything in the foregoing to the contrary, the Executive shall not demand a registration during the 180 days following an underwritten public offering of the Common Stock of the Company.
- (j) Without the prior written consent of the underwriters managing any public offering, for a period beginning ten days immediately preceding the effective date of any registration statement filed by the Company under the Securities Act of 1933, as amended, and ending on the earlier of (i) 180 days after the effective date of such registration statement and (ii) the end of the shortest period generally applicable to any "affiliate" (as defined in the Securities Act of 1933, as amended) of the Company who is a selling shareholder pursuant to such registration statement or who is otherwise subject to a lockup provision, the Executive (whether or not a selling shareholder pursuant to such registration statement) shall not sell or otherwise transfer any securities of the Company except pursuant to such registration statement.

16. Taxes.

All sums referred to herein are gross, not net.

17. Currency.

All U.S. dollar amounts payable under this Agreement shall, at the Company's option, be paid either in U.S. dollars or in New Israeli Shekels at the rate of exchange on the date prior to the day of payment as published by the Bank of Israel.

IN WITNESS WHEREOF, the Company has caused this Amended and Restated Agreement to be executed by its duly authorized officer and the Executive has executed this Amended and Restated Agreement as of the effective date first above written.

Epsilon-Electric Fuel Ltd.

By: /s/ Ronen Badichi
Name: Ronen Badichi
Title: General Manager

/s/ Steven Esses
Steven Esses

Arotech Corporation

By: /s/ Robert S. Ehrlich
Name: Robert S. Ehrlich
Title: Chairman and CEO

FORM OF MUTUAL RELEASE

This mutual release is executed and delivered by and between the undersigned employee of Epsilon-Electric Fuel Ltd., an Israeli corporation ("Epsilon"), Arotech Corporation, a Delaware corporation ("Arotech" and, together with Epsilon, the "Company") and the undersigned's successors, assigns, executors, estates and personal representatives (collectively, the "Executive"), on the one hand, and the Company and its affiliates, agents, successors and assigns (collectively, the "Company"), on the other hand. For and in consideration of the Executive receiving the compensation referred to in Section 7 of the Second Amended and Restated Employment Agreement dated May 13, 2013 and other good and valuable consideration, the adequacy and receipt of which are hereby acknowledged by the Executive and the Company, the Executive hereby remises, releases and forever discharges the Company, and the Company hereby remises, releases and forever discharges the Executive, of and from any and all manner of action and actions, cause and causes of actions, suits, debts, dues, sums of money, accounts, reckonings, bonds, bills, covenants, contracts, controversies, executions, claims and demands of any kind and nature whatsoever in law or in equity, known or unknown, against the other party which ever existed prior to the date hereof, or may ever have on and after the date hereof with respect to matters arising, and dealings with the other party occurring, prior to the date hereof; *provided, however*, that nothing contained herein shall be construed to release the Executive from any obligations to the Company pursuant to the Employment Agreement nor to release the Company from any of its obligations to the Executive pursuant to the Employment Agreement.

IN WITNESS WHEREOF, the Executive and the Company have each caused this Release to be executed as of _____.

Epsilon-Electric Fuel Ltd.

By: _____
Name:
Title:

Steven Esses

**Arotech Corporation**

1229 Oak Valley Drive
Ann Arbor, Michigan 48108
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Writer's direct fax: +972-2-990-6688
Writer's e-mail: ehrlich@arotech.com

Robert S. Ehrlich
Chairman and Chief Executive Officer

May 13, 2013

Sampen Corporation
1133 East 22nd Street
Brooklyn, New York 11210

Re: Amended and Restated Consulting Agreement

Gentlemen:

The following confirms our understanding with regard to the terms and conditions of the retention by Arotech Corporation (the "Company") of Sampen Corporation ("Sampen"). This letter replaces and supersedes the agreement between us dated March 30, 2005.

1. Retention of Consultant; Scope of Duties and Services.

(a) Effective May 1, 2013, the Company hereby engages Sampen, and Sampen hereby accepts such engagement and agrees to provide the Company with the services set forth herein.

(b) Sampen shall provide to the Company the services of one of its employees, subject to the Company's approval of such employee (which the Company may withhold for any reason or for no reason), for such employee to serve as (i) until September 30, 2014, President of the Company, and (ii) from October 1, 2014, President and Chief Executive Officer of the Company. Sampen shall give written notice to the Company in advance if it wishes to provide a different employee to the Company, and such change shall be subject to the Company's approval (which the Company may withhold for any reason or for no reason). The individual provided by Sampen, as such individual may change from time to time, shall be referred to herein as the "Executive." The Executive shall perform the duties, undertake the responsibilities and exercise the authority customarily performed, undertaken and exercised by persons situated in a similar executive capacity in publicly-held United States corporations. The Executive shall exercise his authority in a reasonable manner and shall report to the Chairman of the Board of Directors of the Company (the "Chairman").

(c) While Sampen is providing services to the Company hereunder, the Company shall use its best efforts to cause the Executive to be elected to the Board of Directors of the Company (the "Board") and on the board of directors of such of the Company's subsidiaries as the Chairman shall determine, as a member of such Board(s). The Company will use its reasonable best efforts to obtain, and to keep in place at all times that the Executive is a director or officer of the Company, a directors and officers liability policy covering the Executive in an amount and otherwise containing terms and conditions consistent with past practices.



(d) The parties hereto agree that the services to be provided by Sampen hereunder shall be as an independent consultant, and not as employee or agent. The parties further agree that any personnel of, or retained by, Sampen who perform services hereunder are not and shall not be deemed to employees, agents or representatives of the Company. This Agreement shall not be construed to create the relationship of principal or agent, joint venturers, co-partners or any relationship other than that of independent Consultant and client, and the existence of any such other relationship is hereby expressly denied by the Company and Sampen.

(e) Sampen acknowledges and agrees that it has the sole responsibility to pay any and all taxes due on fees received by it from the Company and to pay or withhold (as appropriate) all applicable social security, income withholding and other payroll or related taxes with respect to its employees (including without limitation the Executive), agents and other personnel who may perform services hereunder, and Sampen shall file or cause to be filed all tax returns and all reports and keep all records which may be required by any law or regulation of the country or countries to whose laws it is subject or any state or municipality or governmental subdivision with respect to its activities and the activities of any of personnel working for it.

(f) Sampen shall allow the Company to use Sampen's offices as an ancillary New York office for the Company, for meetings, mail and package deliveries, fax receptions, etc., the expenses of which shall be covered by the payment referred to in Section 3(b)(i) below. Additionally, Sampen shall be entitled to receive prompt reimbursement of all other expenses reasonably incurred by it or by the Executive in connection with the performance of its duties hereunder. Without limiting the generality of the foregoing, the Company shall pay all expenses in the use of telephones by Sampen and its employees for the Company's businesses. Sampen shall be entitled to reimbursement of the Executive's expenses and to receive room, board and travel reimbursement in connection with the performance by the Executive of Sampen's duties other than at the principal executive office of the Company, as is customary for senior executives in publicly-held United States companies. All expense reimbursements made under this Section shall be tax-effected such that the amount of reimbursement received by Sampen net of any taxes and withholdings (including such amounts in respect of payments pursuant to this sentence) equals the expense incurred. Except as otherwise specifically set forth above or elsewhere in this Agreement, Sampen shall bear and be responsible for all costs and expenses incurred by it or its employees (including the Executive) in performing its duties hereunder.

(g) Sampen's employees, including the Executive, shall be required to travel on a periodic basis. Air travel shall be business class.

2. Term.

(a) The term of this Agreement shall commence on and as of May 1, 2013 and shall continue until December 31, 2015, unless sooner terminated as hereinafter provided (the "Initial Term"). Notwithstanding the foregoing, all of the rights and remedies of the parties hereto under the terms of this Agreement and in law and in equity shall be preserved even after the termination or expiration of this Agreement.



(b) The Initial Term shall be automatically extended for additional two-year periods (each, an "Additional Term") unless either party provides written notice to the other of its desire to terminate the Agreement which notice shall be given at least ninety (90) days prior to the expiration date of the Initial Term or Additional Term of this Agreement.

(c) This Agreement may be terminated by the Company prior to the end of the Initial Term or any Additional Term under the following circumstances:

- (i) Upon the death of the Executive, unless Sampen provides a new individual who is acceptable to the Company to serve in that position.
- (ii) Upon the Disability of the Executive, unless Sampen provides a new individual who is acceptable to the Company to serve in that position. For purposes of this Agreement, "Disability" means a physical or mental infirmity which impairs the Executive's ability to substantially perform Sampen's duties under this Agreement which continues for a period of at least one hundred and eighty (180) consecutive days.
- (iii) For "Cause," which shall mean and include: (i) conviction for fraud, crimes of moral turpitude or other conduct which reflects on the Company in a material and adverse manner; (ii) a willful failure to carry out a material directive of the Board, *provided* that such directive concerned matters within the scope of Sampen's duties, was in conformity with Section 1(b) hereof, would not give Sampen Good Reason to terminate this Agreement and was capable of being reasonably and lawfully performed; (iii) conviction in a court of competent jurisdiction for embezzlement of funds of the Company; and (iv) reckless or willful misconduct that is materially harmful to the Company; *provided, however*, that the Company may not terminate Sampen for Cause unless it has given Sampen written notice of the basis for the proposed termination ("Company's Notice of Termination").

(d) This Agreement may be terminated by Sampen prior to the end of the Initial Term or any Additional Term under the following circumstances:

- (i) For "Good Reason," which shall mean and include:
 - (A) a change (1) in the Executive's status, title, position or responsibilities which, in Sampen's reasonable judgment, represents a reduction or demotion in the Executive's status, title, position or responsibilities as in effect immediately prior thereto, or (2) in the primary location from which Sampen shall have conducted its business activities under this Agreement during the 60 days prior to such change;
 - (B) a reduction in Sampen's Base Payment (as hereinafter defined);



- (C) the insolvency or the filing (by any party, including the Company) of a petition for the winding-up of the Company;
- (D) any material breach by the Company of any provision of this Agreement; and
- (E) any purported termination of this Agreement for Cause by the Company which does not comply with the terms of Section 2(c)(iii) of this Agreement;

provided, however, that Sampen may not terminate this Agreement for Good Reason unless it has given the Company (i) written notice of the basis for the proposed termination not more than thirty (30) days after Sampen has obtained knowledge of such basis (“Sampen’s Notice of Termination”) and (ii) a period of at least thirty (30) days after the Company’s receipt of such notice in which to cure such basis.

- (ii) if there is a “Change in Control” in Arotech. For purposes of this Agreement, a “Change in Control” shall mean any of the following events:
 - (A) The dissolution or liquidation of the Company;
 - (B) A merger, consolidation, reorganization or similar transaction involving the Company (a) in which the Company is not the surviving corporation or other surviving entity, or (b) that results in the Company becoming a subsidiary of another corporation (a “Transaction”);
 - (C) A sale or other disposition of all or substantially all of the assets of the Company to another corporation or other entity, as determined in accordance with the applicable law of the State of Delaware;
 - (D) Any other transaction (including a merger, consolidation, reorganization or similar transaction) that results in any corporation or other entity beneficially owning (within the meaning of Rule 13d-3 promulgated under the Securities Exchange Act of 1934, as amended) immediately following the consummation of such transaction (a) in the case of voting securities acquired other than directly from the Company, more than 20% of the voting securities of the Company, or (b) in the case of voting securities acquired directly from the Company, more than 50% of the voting securities of the Company; or

(E) The members of the Board of Directors of the Company on the date of this letter (the “Incumbent Board Members”) ceasing for any reason to constitute (a) at any time prior to the consummation of a Transaction, a majority of the Board, or (b) at any time following the consummation of a Transaction, a majority of the board of directors or other governing body of the corporation or other entity whose voting securities are issued to existing stockholders of the Company in such Transaction; *provided, however*, that any individual becoming a member of the Board or of such board of directors or other governing body, as the case may be, subsequent to the date of this Agreement whose appointment or nomination for election was approved by a vote of at least a majority of the Incumbent Board Members shall be deemed to be an Incumbent Board Member for purposes of this clause (v), but excluding, for such purposes, any such individual whose initial assumption of office occurs as a result of an actual or threatened election contest with respect to the election or removal of directors (or other members of any such governing body) or other actual or threatened solicitation of proxies or contests by or on behalf of a person other than the Board or such board of directors or other governing body, as the case may be.

Sampen shall give to the Company a Sampen’s Notice of Termination if Sampen desires to terminate this Agreement because there has been a Change in Control, such notice to specify the date of such termination which shall be not less than thirty (30) days after such notice is received by the Company. Any such notice, to be effective with respect to any Change in Control, must be sent no later than six (6) months after such Change in Control.

(iii) if there is a “Change of Location.” For purposes of this Agreement, a “Change of Location” shall mean a change of more than 100 kilometers in the primary location from which the business activities of the Executive shall have been conducted during the 60 days prior to such change.

(e) “Termination Date” shall mean in the case of the Executive’s death (or the death of any other Executive Sampen offers as a successor), the date of such death, or in all other cases, the date specified in the Notice of Termination subject to the following:

(i) If this Agreement is terminated by the Company for Cause or due to Disability, the date specified in the Company’s Notice of Termination shall be at least thirty (30) days from the date the Notice of Termination is given to Sampen, *provided* that in the case of Disability the Executive shall not have returned to the full-time performance of its duties during such period of at least thirty (30) days assuming Sampen cannot provide a substitute Executive acceptable to the Company; and

(ii) If this Agreement is terminated for Good Reason, or because there has been a Change in Control, the Termination Date specified in Sampen’s Notice of Termination shall not be more than sixty (60) days from the date the Notice of Termination is given to the Company.



(f) Upon Termination, the Company shall pay Sampen all amounts of Base Payment and the benefits specified in clauses 3(b)(i), (ii) and (iii) of this Agreement earned or accrued hereunder through the Termination Date but not paid as of the Termination Date.

3. Compensation; Benefits.

(a) For the services rendered by Sampen under this Agreement, the Company shall compensate Sampen as follows:

(i) A base payment at the rate of US \$8,960 per month, or such larger amount as the Compensation Committee of the Board (the "Compensation Committee") may in its sole discretion determine following a review which shall be conducted by the Board and the Compensation Committee by not later than March 31 of each year, such larger amount to take effect retroactively to the January 1 immediately preceding such review (hereinafter referred to as the "Base Payment"). Such Base Payment shall be payable in equal monthly installments.

(ii) On each anniversary of this Agreement or as soon thereafter as may be possible in order to determine the relevant results of the Company, (but in no event later than May 31 of each year), in a single lump-sum payment in cash, an annual bonus (if and to the extent earned according to the criteria below), as follows:

(A) If, as of such anniversary, Arotech shall have attained 100% of Arotech's Budgeted Number (as defined below) for the year preceding such anniversary, then Sampen's bonus shall be equal to 25% of Sampen's gross annual Base Payment as then in effect for the year preceding such anniversary;

(B) If, as of such anniversary, Arotech shall have attained 120% of Arotech's Budgeted Number (as defined below) for the year preceding such anniversary, then Sampen's bonus shall be equal to 75% of Sampen's gross annual Base Payment as then in effect for the year preceding such anniversary;

(C) If, as of such anniversary, Arotech shall have attained more than 100% but less than 120% of Arotech's Budgeted Number (as defined below), then Sampen's bonus shall be calculated as follows:

$$B = (S \times 25\%) + (N-100)/20 \times (S \times 50\%)$$

Where:



- B = The amount of Sampen's annual bonus, as a percentage of Sampen's gross annual Base Payment; and
- N = The percentage of the Budgeted Number (as defined below) that was attained by Arotech in the immediately preceding fiscal year; *provided, however*, that N is more than 100 and less than 120;
- S = Sampen's gross annual Base Payment.

For the purposes of this Section 3(a)(ii), the Budgeted Number shall be the budgeted results of Arotech as agreed by the Board of Arotech prior to the end of each fiscal year for the fiscal year designated in such budget, and may include targets for any or all of the following factors: (i) revenues; (ii) cash flow, and (iii) EBITDA. In the event that some but not all targets are reached, the Compensation Committee shall make a determination as to what percentage of the Budgeted Number was attained.

(b) It being in the Company's interest that the Company have an additional office in the New York area and that the Executive be provided with certain benefits, including without limitation vacation and sick leave, the Company and Sampen agree that the Executive will be provided with the following benefits:

- (i) The Company will pay Sampen, to cover the cost of the Company's use of Sampen's office as an ancillary Company office and insurance, an amount equal to 16% of each monthly payment of the Base Payment.
- (ii) The Company agrees that Sampen shall provide the Executive with an annual vacation at full pay equal to 24 work days. Vacation days may be accumulated and may, at the Executive's option or automatically upon termination, be converted into cash payments in an amount equal to the proportionate part of the Base Payment for such days; *provided, however*, that if the Executive accumulates more than two (2) times its then current annual entitlement of vacation days, such excess shall be automatically converted into the right to receive such a cash payment in respect of such excess. Payments to which Sampen is entitled pursuant to this Section 3(b)(ii) shall be made promptly after Sampen's request therefore.
- (iii) Sampen shall provide the Executive with a maximum aggregate of 30 days of fully paid sick leave, accruing at the rate of 2.5 days per month. Sick leave may be accumulated and may, at Sampen's option, be converted into cash payments in an amount equal to the proportionate part of the Base Payment for such days. Payments to which Sampen is entitled pursuant to this Section 3(b)(iii) shall be made promptly after Sampen's request therefor.



4. Warranties.

(a) Sampen warrants that all services provided by him hereunder will be rendered in a competent and professional manner and that such services will conform in all respects to (i) generally-accepted industry and professional standards then applicable to such services and products, (ii) all applicable laws, rules, regulations and professional codes, and (iii) any specifications and requirements applicable to the services and any products contracted for hereunder (including a delivery timetable) which may be set forth in an agreement between the Company and a third party or parties. The Company shall have the right to extend Sampen's warranties herein to third parties and Sampen shall be liable thereon to the same extent as if such warranties were originally made to such third parties.

(b) The warranties contained herein shall survive the termination and expiration of this Agreement regardless of the reasons therefor.

5. Confidential Information; Return of Materials; Inventions.

(a) In the course of his retention by the Company hereunder, Sampen will have access to, and become familiar with, "Confidential Information" (as hereinafter defined) of the Company. Sampen shall at all times hereinafter maintain in the strictest confidence all such Confidential Information and shall not divulge any Confidential Information to any person, firm or corporation without the prior written consent of the Company. For purposes hereof, "Confidential Information" shall mean all information in any and all medium which is confidential by its nature including, without limitation, data, technology, know-how, inventions, discoveries, designs, processes, formulations, models and/or trade and business secrets relating to any line of business in which the Company's marketing and business plans relating to current, planned or nascent products.

(b) Sampen shall not use Confidential Information for, or in connection with, the development, manufacture or use of any product or for any other purpose whatsoever except as and to the extent necessary for him to perform his obligations under this Agreement. Sampen shall assure that none of its employees uses such Confidential Information other than as permitted in this Agreement.

(c) Notwithstanding the foregoing, Confidential Information shall not include information which Sampen can evidence to the Company by appropriate documentation: (i) is in, or enters the public domain otherwise than by reason of breach hereof by Sampen; (ii) is known by Sampen at the time of disclosure thereof by the Company; or (iii) is rightfully transmitted or disclosed to Sampen by a third party which owes no obligation of confidentiality with respect to such information.

(d) All Confidential Information made available to, or received by, Sampen or its employees shall remain the property of the Company, and no license or other rights in or to the Confidential Information is granted hereby.



(e) All files, records, documents, drawings, specifications, equipment, and similar items relating to the business of the Company, whether prepared by Sampen or otherwise coming into his possession, and whether classified as Confidential Information or not, shall remain the exclusive property of the Company. Upon termination or expiration of this Agreement, or upon request by the Company, Sampen shall promptly turn over to the Company all such files, records, reports, analyses, documents, and other material of any kind concerning the Company which Sampen obtained, received or prepared pursuant to this Agreement.

(f) Confidential Information shall not include information brought to the Company by Sampen, where the Company does not subsequently utilize such information in the ordinary course of its business (including as a result of changes to its business).

(g) Sampen undertakes not, directly or indirectly (whether as owner, partner, consultant, employee or otherwise) at any time, during and for twelve (12) months following termination of this Agreement, to engage in or contribute its knowledge to any work or activity that involves a product, process, service or development which is then directly (in any material manner) competitive with any business that the Company has conducted during the term of this Agreement or any extension hereof on which Sampen worked or with respect to which Sampen had access to Proprietary Information while with the Company. Notwithstanding the foregoing, Sampen shall be permitted to engage in the aforementioned proposed work or activity if the Company furnishes it with written consent to that effect signed by an authorized officer of the Company.

(h) During the period specified in 5(g) hereof, Sampen will not solicit or encourage any customer or supplier of the Company or of any group, division or subsidiary of the Company, to terminate its relationship with the Company or any such group, division or subsidiary, and Sampen will not, directly or indirectly, recruit or otherwise seek to induce any employee of the Company or any such group, division or subsidiary to terminate his or her employment or violate any agreement with or duty to the Company or any such group, division or subsidiary.

(i) Sampen agrees that violations of the material covenants in this Section 5 will cause the Company irreparable injuries and agrees that the Company may enforce said covenants by seeking injunctive or other equitable relief (in addition to any other remedies the Company may have at law for damages or otherwise) from a court of competent jurisdiction. In the event such court declares these covenants to be too broad to be specifically enforced, the covenants shall be enforced to the largest extent as may be allowed by such court for the Company's protection. Sampen further agrees that no breach by the Company of, or other failure by the Company under this Agreement shall relieve Sampen of any obligations under Sections 5(g) and 5(h) hereof.

(j) The provisions of this Section shall survive the termination of this Agreement. Sampen acknowledges that the provisions set forth in this Section of this Agreement are fair and reasonable, and Sampen agrees to cause its employees to comply with the above provisions.

6. Miscellaneous.

(a) This Agreement shall inure to the benefit of the Company and its successors and assigns.



(b) This Agreement shall be subject to, governed by and construed in accordance with, the laws of the State of Michigan without regard to conflicts of law provisions and principles of that State, and the state and federal courts located in Washtenaw County, Michigan shall have exclusive jurisdiction and venue in respect of any dispute hereunder.

(c) No provision of this Agreement may be modified, waived or discharged unless such waiver, modification or discharge is agreed to in writing and signed by Sampen and the Company. No waiver by either party hereto at any time of any breach by the other party hereto of, or compliance with, any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time. No agreement or representations, oral or otherwise, express or implied, with respect to the subject matter hereof have been made by either party which are not expressly set forth in this Agreement.

(d) Neither Sampen nor the Company will be deemed to have made any representation, warranty, covenant or agreement except for those expressly set forth herein.

(e) This Agreement shall be binding upon and shall inure to the benefit of the Company, its successors and assigns and the Company shall require any successor or assign to expressly assume and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform it if no such succession or assignment had taken place. The term the "Company" as used herein shall include such successors and assigns. The term "successors and assigns" as used herein shall mean a corporation or other entity acquiring all or substantially all the assets and business of the Company (including this Agreement) whether by operations of law or otherwise.

(f) Neither this Agreement nor any right or interest hereunder shall be assignable or transferable by Sampen or its legal representatives, except by will or by the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by Sampen's legal representative.

(g) Nothing to the contrary in the foregoing notwithstanding, Sampen may assign this Agreement to any company of which it is a "control person" within the meaning of the Securities Exchange Act of 1934, *provided*, that Sampen shall continue to be obligated to fulfill the duties set forth in Section 1 above, and *provided, further*, that Sampen shall continue to be bound by the terms and provisions of Section 5 of this Agreement notwithstanding any such assignment.

If the foregoing satisfactorily reflects the mutual understanding between you and the Company, kindly sign and return to the Company the enclosed copy of this letter. On behalf of the Company, I want to take this opportunity to state that we look forward to our working relationship with you.

Very truly yours,

AROTECH CORPORATION

By: /s/ Robert S. Ehrlich
Robert S. Ehrlich
Chairman and Chief Executive Officer

ACCEPTED AND AGREED:

SAMPEN CORPORATION

By: /s/ Morris Esses
Morris Esses
President

THIRD AMENDED AND RESTATED EMPLOYMENT AGREEMENT

THIS AGREEMENT is signed on the 13th day of May, 2013, effective as of the 1st day of May, 2013, by and between **Arotech Corporation**, a Delaware corporation with offices at 1229 Oak Valley Drive, Ann Arbor, Michigan 48108 (the "Company"), and **Thomas J. Paup**, an individual residing at 4716 Lohr Road, Ann Arbor, Michigan 46108 (the "Employee").

WITNESSETH:

WHEREAS, the Company and the Employee entered into an Employment Agreement dated as of December 30, 2005, as amended and restated effective as of January 1, 2008 and January 1, 2012 (the "Original Agreement"); and

WHEREAS, the Company and the Employee now wish to further extend the Employee's employment and to amend and restate the Original Agreement in its entirety in accordance with the terms of this Agreement;

NOW, THEREFORE, the parties hereto do hereby agree as follows:

1. Title and Duties.

(a) The Employee will serve as Senior Vice President – Finance and Chief Financial Officer of the Company, except that the Company may, from time to time, change the title and/or duties of the Employee in such manner as shall not unduly prejudice the rights of the Employee hereunder. The Employee will report to the President of the Company or to such other person as shall be designated, from time to time, by the Board of Directors of the Company.

(b) The Employee shall not during the term hereof undertake or accept any other employment or occupation, whether paid or unpaid *provided, however*, that the Employee may continue to work up to eight (8) evenings per month as a Finance Instructor at Eastern Michigan University. The Employee acknowledges and agrees that, although ordinary working hours are expected to be Monday through Friday, 8 a.m. to 5 p.m., under certain circumstances the performance of his duties hereunder may require additional time and/or domestic and international travel. The Employee acknowledges that this is a managerial position, and that accordingly overtime hours will be worked as needed, without additional compensation.

(c) The Employee's place of work will be in Ann Arbor, Michigan, or at such other place as the Company may from time to time specify, provided that the employment of the Employee on a permanent basis at a place which is located more than fifty (50) miles from Ann Arbor, Michigan shall be done only with the Employee's prior consent.

2. Compensation and Benefits.

(a) The Company shall pay the Employee, as compensation for all of the employment services provided by him hereunder during the term of this Agreement, an annualized base salary of two hundred one thousand four hundred dollars (\$201,400) (the "Base Salary"). The Base Salary will be paid semi-monthly in arrears on the fifteenth and final day of each month. The Base Salary will, effective March 31 of each year beginning March 31, 2014, be adjusted annually, retroactive to January 1 of that year, in accordance with the change in the Consumer Price Index for Urban Wage Earners and Clerical Workers in Detroit-Ann Arbor-Flint, Michigan (All Items), as reported by the Bureau of Labor Statistics of the United States Department of Labor, during the previous year (the "CPI Adjustment"). For the avoidance of doubt, it is understood by the parties that, as soon as practicable, the Base Salary stated above shall be adjusted for 2014, retroactive to January 1, 2014, in respect of the CPI Adjustment for inflation during 2013. Additionally, the Base Salary may be increased from time to time, effective January 1 of each year beginning January 1, 2015, in accordance with the Company's procedures, and in the Company's sole discretion, based on the Employee's performance during the prior year.

(b) The Company agrees to pay or cause to be paid to the Employee, in a single lump-sum payment in cash on each March 31 following the first anniversary of this Agreement, or as soon thereafter as may be possible in order to determine the relevant results of the Company (but in no event later than May 31 of each year), an annual bonus (if and to the extent earned according to the criteria below), as follows:

(i) If, as of such anniversary, the Company shall have attained 100% of the Company's Budgeted Number (as defined below) for the year preceding such anniversary, then Employee's bonus shall be equal to 16.5% of Employee's gross annual Base Salary as then in effect for the year preceding such anniversary;

(ii) If, as of such anniversary, the Company shall have attained 120% of the Company's Budgeted Number (as defined below) for the year preceding such anniversary, then Employee's bonus shall be equal to 50% of Employee's gross annual Base Salary as then in effect for the year preceding such anniversary;

(iii) If, as of such anniversary, the Company shall have attained more than 100% but less than 120% of the Company's Budgeted Number (as defined below), then Employee's bonus shall be calculated as follows:

$$B = (S \times 16.5\%) + (N-100)/20 \times (S \times 33.5\%)$$

Where:

B = The amount of Employee's annual bonus; and

N = The percentage of the Budgeted Number (as defined below) that was attained by the Company in the immediately preceding fiscal year; *provided, however*, that N is more than 100 and less than 120;

S = Employee's gross annual Base Salary.

For the purposes of this Section 2(b), the Budgeted Number shall be the budgeted results of the Company as agreed by the Board prior to the end of each fiscal year for the fiscal year designated in such budget, and may include targets for any or all of the following factors: (i) revenues; (ii) cash flow, and (iii) EBITDA. In the event that some but not all targets are reached, the Compensation Committee shall make a determination as to what percentage of the Budgeted Number was attained.

(c) The Employee shall be entitled to a paid annual vacation of twenty (20) business days with respect to, and during, each twelve (12) month period of his employment hereunder, provided that up to five days of the unused portion of any such vacation, in respect to any year, may be carried forward only to the next year, with the remainder being redeemed by the Company for cash. Upon termination Employee shall be paid for all accrued but unused vacation. Any vacation days taken by Employee in advance of their actual accrual shall be considered an advance on wages and deducted from any wages owing at termination. Timing of vacations will be cleared in advance with the Company.

(d) The Employee shall be entitled to paid sick leave of ten (10) days with respect to, and during, each twelve (12) month period of his employment hereunder.

(e) The Company shall provide the Employee and his family with medical insurance and related insurance benefits in accordance with its policies from time to time for all employees generally.

(f) The Company shall reimburse the Employee's work-related expenses, against proper receipts, subject to and in accordance with policies adopted, from time to time, by the Company.

3. Confidential Information; Return of Materials; Inventions; on-Solicitation.

(a) In the course of his employment by the Company hereunder, the Employee will have access to, and become familiar with, "Confidential Information" (as hereinafter defined) of the Company. The Employee shall at all times hereinafter maintain in the strictest confidence all such Confidential Information and shall not divulge any Confidential Information to any person, firm or corporation without the prior written consent of the Company. For purposes hereof, "Confidential Information" shall mean all information in any and all media which is confidential by its nature including, without limitation, data, technology, know-how, inventions, discoveries, designs, processes, formulations, models, customer lists and contact people, prices and any other trade and business secrets relating to any line of business in which the Company's marketing and business plans relating to current, planned or nascent products.

(b) The Employee shall not use Confidential Information for, or in connection with, the development, manufacture or use of any product or for any other purpose whatsoever except as and to the extent necessary for him to perform his obligations under this Agreement.

(c) Notwithstanding the foregoing, Confidential Information shall not include information which the Employee can evidence to the Company by appropriate documentation is in, or enters, the public domain otherwise than by reason of breach hereof by the Employee.

(d) All Confidential Information made available to, or received by, the Employee shall remain the property of the Company, and no license or other rights in or to the Confidential Information is granted hereby.

(e) All files, records, documents, drawings, specifications, equipment, and similar items relating to the business of the Company, whether prepared by the Employee or otherwise coming into his possession, and whether classified as Confidential Information or not, shall remain the exclusive property of the Company. Upon termination or expiration of this Agreement, or upon request by the Company at any time, the Employee shall promptly turn over to the Company all such files, records, reports, analyses, documents, and other material of any kind and in any medium concerning the Company which the Employee obtained, received or prepared pursuant to this Agreement without retaining any copies thereof in any medium.

(f) Commencing on the date hereof and ending two (2) years after the termination of this Agreement (irrespective of the reason for such termination), the Employee shall not solicit nor in any manner encourage other employees of the Company to leave its employ. The Employee further agrees that during that two (2) year period he will not offer, or cause to be offered, employment to any person who was employed by the Company at any time during the three months prior to the termination of this Agreement.

(g) The Employee acknowledges that the provisions set forth in Section 3 of this Agreement are fair and reasonable. The Employee further acknowledges that the Company will be irreparably harmed if the Employee's obligations under this Section 3 are not specifically enforced and that the Company would not have an adequate remedy at law in the event of an actual or threatened violation by the Employee of the Employee's obligations. Therefore, and in addition to any and all other remedies to which it may be entitled, the Company shall be entitled to an injunction or any appropriate decree of specific performance for any actual or threatened violations or breach by the Employee without the necessity of the Company showing actual damages or that monetary damages would not afford an adequate remedy, and without posting a bond.

(h) The provisions of this Section 3 shall survive the expiration or termination of this Agreement regardless of the reasons therefor. Furthermore, the period of time during which the restrictions set forth in subsection (f) above shall be in effect shall be extended by the length of time during which the Employee is in breach of any of the terms of such subsection.

4. Prohibition on Trading While in Possession of Material Non-Public Information.

(a) The Employee acknowledges that the Company is a publicly-listed company, and that the Employee is a "person having a duty of trust or confidence" as defined in Rule 10b5-2 promulgated under the United States Securities Exchange Act of 1934, as amended, and that the Employee is accordingly prohibited from trading in shares of the Company on the basis of material non-public information. The Employee covenants and agrees that the Employee will not trade in, or, without the express consent of the Company, exercise any option to purchase securities of the Company (the "Arotech Shares") (1) until at least two Trading Days (a "Trading Day" being a day on which the U.S. Financial markets are open for trading) have passed since such material information was released to the public, and (2) during the period beginning on the eleventh calendar day of the third month of each fiscal quarter and ending at the close of the second Trading Day following the release of quarterly or annual financial results. The Employee understands and acknowledges that the most appropriate time to trade in Arotech Shares is the period beginning on the third Trading Day and ending on the twelfth Trading Day following the release of quarterly or financial information, provided that during such period the Employee possesses no other material non-public information which is not disclosed in such release.

(b) If at any time the Employee is working on securities matters regarding the Company, or is aware that the Company is offering or selling its own securities or is involved in a tender offer situation, the Employee shall consult with the General Counsel of the Company before trading in Arotech Shares.

(c) The provisions of this Section 4 shall survive the expiration or termination of this Agreement regardless of the reasons therefor.

5. Term and Termination. This Agreement shall be for a period from May 1, 2013 until December 31, 2015 (the "Term"). This Agreement may be terminated at any time, as follows:

(a) This Agreement shall terminate upon the death or incapacitation of the Employee. For purposes hereof, the Employee shall be deemed to be incapacitated if he is unable to perform his duties hereunder, as evidenced by a certificate(s) to that effect, signed by a doctor reasonably satisfactory to the Company, for a continuous period of one hundred fifty (150) days or for shorter periods aggregating more than two hundred (200) days in any period of twelve (12) consecutive months.

(b) The Company shall have the right to terminate this Agreement and the employment relationship hereunder for cause, at any time, by informing the Employee that such termination is for and cause and by further informing the Employee of the acts or omissions constituting cause. In such event, this Agreement and the employment relationship between the Company and the Employee shall be terminated as of the time Employee is informed that such termination is for cause. For purposes hereof, "cause" shall mean: (1) a breach of trust by the Employee, including, for example, but without limitation, commission of an act of moral turpitude, theft, embezzlement, self-dealing or insider trading; (2) the unauthorized disclosure by the Employee of confidential information of or relating to the Company; (3) a material breach by the Employee of this Agreement; or (4) any act of, or omission by, the Employee which, in the reasonable judgment of the Company, amounts to a serious failure by the Employee to perform his responsibilities or functions or in the exercise of his authority, which failure, in the reasonable judgment of the Company, rises to a level of gross nonfeasance, misfeasance or malfeasance.

(c) Upon termination of this Agreement other than for the reasons set forth in subsection (b) above, including without limitation by this Agreement coming to the end of the Term and not being extended or immediately succeeded by a new substantially similar employment agreement ("Non-Renewal"), the Company shall pay the Employee as severance pay an amount equal to twelve (12) times the monthly Base Salary at the highest rate in effect at any time within the ninety (90) day period ending on the Termination Date.

6. Miscellaneous.

(a) All notices and other communications required or permitted under this Agreement shall be in writing and shall be sent by facsimile transmission to the other party at the fax number set forth below, with a copy sent by first class mail or express courier to said party at the address set forth below, or to such other fax number and/or address as a party may hereinafter designate by notice to the other. Notices shall be effective on the date they are sent by facsimile transmission if the facsimile transmission report confirms receipt by the receiving fax.

(b) This Agreement shall be subject to, governed by and construed in accordance with, the laws of the State of Michigan without regard to conflicts of law provisions and principles of that State, and the courts located in Washtenaw County, Michigan shall have exclusive jurisdiction and venue of any dispute hereunder.

(c) This Agreement contains the entire agreement between the Employee and the Company with respect to all matters relating to the Employee's employment with the Company and will supersede and replace all prior agreements and understandings, written or oral, between the parties relating to the subject matter hereof. This Agreement may be amended, modified, or supplemented only by a written instrument signed by both of the parties hereto. No waiver or failure to act by either party with respect to any breach or default hereunder, whether or not the other party has notice thereof, shall be deemed to be a waiver with respect to any subsequent breach or default, whether of similar or different nature.

(d) If any provision of this Agreement, under all the then relevant circumstances, is held to be invalid, illegal or unenforceable, the other provisions shall remain in full force and effect, and the relevant provision shall automatically be modified by substituting for the unenforceable provision an enforceable provision which most closely approximates the intent and economic effect of the invalid provision.

(e) This Agreement shall inure to the benefit of the Company and its successors and assigns.

(f) The headings contained in this Agreement are intended solely for ease of reference and shall be given no effect in the construction or interpretation of this Agreement.

IN WITNESS WHEREOF, the parties hereto have duly executed this Agreement as of the effective date set forth above:

Arotech Corporation

/s/ Thomas J. Paup
Thomas J. Paup

By: /s/ Robert S. Ehrlich
Name: Robert S. Ehrlich
Title: Chairman and CEO

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 controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - (b) 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: May 15, 2013

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

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

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

CERTIFICATION

I, Thomas J. Paup, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Arotech Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) 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 controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - (b) 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: May 15, 2013

/s/ Thomas J. Paup

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

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

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

WRITTEN STATEMENT

In connection with the Quarterly Report of Arotech Corporation (the "Company") on Form 10-Q for the quarterly period ended March 31, 2013 filed with the Securities and Exchange Commission (the "Report"), I, Robert S. Ehrlich, Chairman and Chief Executive Officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that to my knowledge, the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Report fairly presents, in all material respects, the consolidated financial condition of the Company and its subsidiaries as of the dates presented and the consolidated results of operations of the Company and its subsidiaries for the periods presented.

Dated: May 15, 2013

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

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

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

WRITTEN STATEMENT

In connection with the Quarterly Report of Arotech Corporation (the "Company") on Form 10-Q for the quarterly period ended March 31, 2013 filed with the Securities and Exchange Commission (the "Report"), I, Thomas J. Paup, Vice President – Finance and Chief Financial Officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that to my knowledge, the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Report fairly presents, in all material respects, the consolidated financial condition of the Company and its subsidiaries as of the dates presented and the consolidated results of operations of the Company and its subsidiaries for the periods presented.

Dated: May 15, 2013

/s/ Thomas J. Paup

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

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

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