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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

**T QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED September 30, 2014 .**

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)

95-4302784

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

1229 Oak Valley Drive, Ann Arbor, Michigan

(Address of principal executive offices)

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:

Accelerated filer:

Non-accelerated filer:

Smaller reporting company:

(Do not check if a 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 November 4, 2014 was 24,444,063.

SEC 1296 (01-12)

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PART I**ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)****CONDENSED CONSOLIDATED BALANCE SHEETS**
(U.S. Dollars)

| | September 30, | December 31, |
|--|-----------------------|----------------------|
| | 2014 | 2013 |
| | <u> </u> | <u> </u> |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 10,802,643 | \$ 5,821,325 |
| Restricted collateral deposits | 241,613 | 498,495 |
| Trade receivables | 14,911,644 | 12,362,871 |
| Unbilled receivables | 19,036,156 | 8,463,920 |
| Other accounts receivable and prepaid expenses | 1,544,692 | 1,379,621 |
| Inventories | 10,711,913 | 10,074,766 |
| <i>Total current assets</i> | <u>57,248,661</u> | <u>38,600,998</u> |
| LONG TERM ASSETS: | | |
| Israeli statutory and contractual severance pay fund | 4,900,528 | 4,968,811 |
| Other long term receivables | 84,247 | 73,979 |
| Property and equipment, net | 6,114,138 | 4,926,949 |
| Other intangible assets, net | 12,396,306 | 1,059,151 |
| Goodwill | 45,730,986 | 31,024,754 |
| <i>Total long term assets</i> | <u>69,226,205</u> | <u>42,053,644</u> |
| <i>Total assets</i> | <u>\$ 126,474,866</u> | <u>\$ 80,654,642</u> |

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

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

| | <u>September 30,</u> <u>2014</u> | <u>December 31,</u> <u>2013</u> |
|--|-------------------------------------|------------------------------------|
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Trade payables | \$ 4,803,969 | \$ 5,107,208 |
| Other accounts payable and accrued expenses | 8,532,938 | 6,012,041 |
| Current portion of long term debt | 4,340,729 | 95,382 |
| Short term bank credit | 2,782,213 | – |
| Deferred revenues | 6,300,162 | 7,020,079 |
| <i>Total current liabilities</i> | <u>26,760,011</u> | <u>18,234,710</u> |
| LONG TERM LIABILITIES: | | |
| Accrued Israeli statutory and contractual severance pay | 7,141,535 | 7,020,060 |
| Long term portion of debt | 18,357,684 | 1,830,348 |
| Deferred tax liability | 5,966,690 | 5,518,521 |
| Other long-term liabilities | 2,438,046 | 74,027 |
| <i>Total long-term liabilities</i> | <u>33,903,955</u> | <u>14,442,956</u> |
| <i>Total liabilities</i> | <u>60,663,966</u> | <u>32,677,666</u> |
| STOCKHOLDERS' EQUITY: | | |
| Share capital – | | |
| Common stock – \$0.01 par value each; | | |
| Authorized: 50,000,000 shares as of September 30, 2014 and December 31, 2013; Issued and outstanding: 24,317,211 shares and 20,163,163 shares as of September 30, 2014 and December 31, 2013, respectively | 243,172 | 201,632 |
| Preferred shares – \$0.01 par value each; | | |
| Authorized: 1,000,000 shares as of September 30, 2014 and December 31, 2013; No shares issued or outstanding as of September 30, 2014 and December 31, 2013 | – | – |
| Additional paid-in capital | 245,183,160 | 229,917,341 |
| Accumulated deficit | (179,921,267) | (183,096,572) |
| Notes receivable from stockholders | (908,054) | (908,054) |
| Accumulated other comprehensive income | 1,213,889 | 1,862,629 |
| <i>Total stockholders' equity</i> | <u>65,810,900</u> | <u>47,976,976</u> |
| <i>Total liabilities and stockholders' equity</i> | <u>\$ 126,474,866</u> | <u>\$ 80,654,642</u> |

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

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

| | Nine months ended September 30, | | Three months ended September 30, | |
|---|------------------------------------|---------------------|-------------------------------------|---------------------|
| | 2014 | 2013 | 2014 | 2013 |
| Revenues | \$ 74,995,339 | \$ 67,637,517 | \$ 24,783,353 | \$ 23,187,544 |
| Cost of revenues | 49,682,017 | 49,681,174 | 16,775,556 | 16,816,012 |
| Research and development expenses | 2,857,144 | 1,935,958 | 925,186 | 807,788 |
| Selling and marketing expenses | 4,180,519 | 3,849,483 | 1,202,966 | 1,229,225 |
| General and administrative expenses | 11,606,038 | 7,539,580 | 3,799,772 | 2,685,522 |
| Amortization of intangible assets | 1,828,635 | 821,097 | 867,452 | 270,985 |
| Total operating costs and expenses | <u>70,154,353</u> | <u>63,827,292</u> | <u>23,570,932</u> | <u>21,809,532</u> |
| Operating income | 4,840,986 | 3,810,225 | 1,212,421 | 1,378,012 |
| Other income, net | 288,252 | 261,222 | 58,831 | (7,460) |
| Financial expense, net | (1,098,755) | (475,448) | (416,107) | (172,569) |
| Total other expense | (810,503) | (214,226) | (357,276) | (180,029) |
| Income from continuing operations before income tax expense | <u>4,030,483</u> | <u>3,595,999</u> | <u>855,145</u> | <u>1,197,983</u> |
| Income tax expense | 855,178 | 765,962 | 476,617 | 337,060 |
| Income from continuing operations | 3,175,305 | 2,830,037 | 378,528 | 860,923 |
| Income (loss) from discontinued operations, net of income tax | – | (87,278) | – | 652 |
| Net income | <u>3,175,305</u> | <u>2,742,759</u> | <u>378,528</u> | <u>861,575</u> |
| Other comprehensive income, net of \$0 income tax | | | | |
| Foreign currency translation adjustment | (648,740) | 472,767 | (749,849) | 202,844 |
| Comprehensive income (loss) | <u>\$ 2,526,565</u> | <u>\$ 3,215,526</u> | <u>\$ (371,321)</u> | <u>\$ 1,064,419</u> |
| Income (loss) per share of common stock: | | | | |
| Basic – continuing operations | \$ 0.15 | \$ 0.18 | \$ 0.02 | \$ 0.05 |
| Basic – discontinued operations | \$ – | \$ (0.01) | \$ – | \$ – |
| Basic net income per share | <u>\$ 0.15</u> | <u>\$ 0.17</u> | <u>\$ 0.02</u> | <u>\$ 0.05</u> |
| Diluted – continuing operations | \$ 0.15 | \$ 0.18 | \$ 0.02 | \$ 0.05 |
| Diluted – discontinued operations | \$ – | \$ (0.01) | \$ – | \$ – |
| Diluted net income per share | <u>\$ 0.15</u> | <u>\$ 0.17</u> | <u>\$ 0.02</u> | <u>\$ 0.05</u> |
| Weighted average number of shares used in computing basic net income/loss per share | <u>20,998,023</u> | <u>15,521,974</u> | <u>23,137,808</u> | <u>15,951,602</u> |
| Weighted average number of shares used in computing diluted net income/loss per share | <u>21,600,763</u> | <u>16,124,714</u> | <u>23,740,548</u> | <u>16,554,342</u> |

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

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

| | Nine months ended September 30, | |
|---|------------------------------------|-----------------------|
| | 2014 | 2013 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 3,175,305 | \$ 2,742,759 |
| <i>Adjustments required to reconcile net income to net cash provided by (used in) operating activities:</i> | | |
| Depreciation | 1,116,599 | 867,008 |
| Amortization of intangible assets | 1,828,635 | 821,097 |
| Stock based compensation | 393,187 | 394,135 |
| Capital loss from sale of property and equipment | 5,039 | – |
| Deferred tax provision | 448,169 | 448,875 |
| <i>Changes in operating assets and liabilities:</i> | | |
| Severance pay fund | 189,758 | 106,933 |
| Trade receivables | 154,201 | (4,181,183) |
| Other accounts receivable and prepaid expenses | 132,593 | (272,511) |
| Inventories | (90,303) | (509,479) |
| Unbilled receivables | (761,405) | 5,615,419 |
| Deferred revenues | (719,917) | 1,344,493 |
| Trade payables | (3,111,745) | (1,265,849) |
| Other accounts payable and accrued expenses | (291,197) | 326,579 |
| Discontinued operations | – | (308,835) |
| <i>Net cash provided by (used in) operating activities</i> | <u>2,468,919</u> | <u>6,129,441</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Acquisition of UEC(1) | (29,113,655) | – |
| Purchase of property and equipment | (1,298,505) | (1,296,896) |
| Additions to capitalized software development | (65,790) | (3,675) |
| Decrease (increase) in restricted collateral deposits | 256,882 | (341,305) |
| Discontinued operations | – | 44,827 |
| <i>Net cash provided by (used in) investing activities</i> | <u>\$ (30,221,068)</u> | <u>\$ (1,597,049)</u> |

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

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

| | Nine months ended September 30, | |
|---|------------------------------------|--------------|
| | 2014 | 2013 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Repayment of long term debt | \$ (1,727,317) | \$ (850,507) |
| Proceeds from long term debt | 22,500,000 | – |
| Changes in short term bank credit | 1,511,903 | (6,071,231) |
| Proceeds from sale of common stock, net | 10,698,173 | 5,461,999 |
| Discontinued operations | – | (49,636) |
| <i>Net cash provided by (used in) financing activities</i> | 32,982,759 | (1,509,375) |
| INCREASE IN CASH AND CASH EQUIVALENTS | 5,230,610 | 3,023,017 |
| CASH DIFFERENCES DUE TO EXCHANGE RATE CHANGES | (249,292) | 193,692 |
| NET CHANGE IN CASH AND EQUIVALENTS – DISCONTINUED OPERATIONS | – | 66,192 |
| CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD | 5,821,325 | 1,580,627 |
| CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD | \$ 10,802,643 | \$ 4,863,528 |
| SUPPLEMENTARY INFORMATION ON NON-CASH TRANSACTIONS: | | |
| Common stock issued in acquisition of UEC | \$ 4,216,000 | \$ – |
| Interest paid during the period | \$ 606,997 | \$ 326,345 |
| Taxes paid on income during the period | \$ 249,374 | \$ 136,294 |

(1) On April 1, 2014, the Company acquired all of the outstanding membership interests of UEC Electronics, LLC (“UEC”). The cash portion of the transaction is summarized as follows:

| | |
|---|----------------------|
| New long term debt | \$ 22,500,000 |
| Cash | 5,500,000 |
| Net working capital adjustment (paid in May 2014) | 1,206,245 |
| Cash acquired | (92,590) |
| Total | \$ 29,113,655 |

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 advanced battery and simulation solutions, including innovative energy management and power distribution technologies, turnkey interactive multimedia simulators/trainers, and world-class product design and manufacturing services for the aerospace, defense, law enforcement and homeland security markets. 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; Epsilon-Electric Fuel Ltd. (“Epsilon-EFL”), based in Dimona, Israel with a location in Beit Shemesh, Israel; and UEC Electronics, LLC (“UEC”), based in Hanahan, South Carolina (see also Note 2). EFB, Epsilon-EFL and UEC form the Company’s Battery and Power Systems Division. IES Interactive Training (MILO Range) and Realtime Technologies 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., based in Lod, Israel, and MDT Armor Corporation, based in Auburn, Alabama, along with the trade name of Armour of America Incorporated, are reflected as discontinued operations.

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 September 30, 2014, its operating results for the nine- and three month periods ended September 30, 2014 and 2013, and its cash flows for the nine month periods ended September 30, 2014 and 2013.

The results of operations for the nine- and three months ended September 30, 2014 are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year ending December 31, 2014.

The balance sheet at December 31, 2013 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, 2013.

c. Accounting for stock-based compensation:

For the nine months ended September 30, 2014 and 2013 the compensation expense recorded related to restricted stock units and restricted shares was \$393,187 and \$394,135, respectively. The remaining total compensation cost related to share awards not yet recognized in the statements of comprehensive income as of September 30, 2014 was \$269,151. 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 nine months of 2014 and there are no outstanding issued options. The Company’s directors received their annual restricted stock grants on April 1, 2014 in accordance with the terms of the directors’ stock compensation plan, along with a special one-time additional grant on August 12, 2014.

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 contingent restricted stock shares have been excluded from the calculation of the basic net income 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 the outstanding contingent shares excluded from the calculations of basic net income per share for the three and nine-month periods ended September 30, 2014 and 2013 were 602,740 and 611,700, respectively.

f. Contingencies

The Company is from time to time involved in legal proceedings and other claims. The Company is required to assess the likelihood of any adverse judgments or outcomes to these matters, as well as potential ranges of probable losses. The Company has not made any material changes in the accounting methodology used to establish its self-insured liabilities during the past three fiscal years.

A determination of the amount of reserves required, if any, for any contingencies is made after careful analysis of each individual issue. The required reserves may change due to future developments in each matter or changes in approach, such as a change in the settlement strategy in dealing with any contingencies, which may result in higher net loss.

g. Certain relationships and related transactions

Officer loans: On February 9, 2000, one of the Company's officers exercised 9,404 stock options. This officer paid the exercise price of the stock options and certain taxes that the Company paid on his behalf by giving the Company a non-recourse promissory note due in 2025 in the amount of \$329,163, bearing annual interest at 1% over the then-current federal funds rate announced from time to time by the Wall Street Journal, secured by the shares of the Company's common stock acquired through the exercise of the options and certain compensation due to this officer upon termination. As of September 30, 2014, the aggregate amount outstanding pursuant to this promissory note was \$908,054.

Consulting agreement with Sampen Corporation: The Company has an amended and restated consulting agreement with Sampen Corporation that it executed in May 2013. Sampen is a New York corporation owned by members of the immediate family of one of the Company's officers, and this officer is an employee of both the Company and of Sampen. The term of this consulting agreement is until December 31, 2015.

Pursuant to the terms of the Company's agreement with Sampen, Sampen provides one of its employees to the Company for such employee to serve as (i) until September 30, 2014, the Company's President, and (ii) from October 1, 2014, as the Company's President and Chief Executive Officer. The Company pays 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 the Company actually attains for the year in question are 100% or more of the amount the Company budgeted at the beginning of the year, up to a maximum of 75% of Sampen's annual base compensation then in effect if the results the Company actually attains for the year in question are 120% or more of the amount the Company budgeted at the beginning of the year. The Company also pays Sampen, to cover the cost of the Company's 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.

h. Change in SEC filing status

On June 30, 2014, the Company exceeded the \$75.0 million public float threshold to trigger accelerated filer status with the SEC beginning in 2015. Consequently, as of January 1, 2015 the Company will no longer be a Smaller Reporting Company (SRC) and the Company's auditors will accordingly have to provide an auditor attestation on the Company's internal controls to be included in the Company's Form 10-K for the year ending December 31, 2014. Such Form 10-K will continue to provide scaled SRC-level disclosures; the accelerated filer disclosures will commence in the Company's Form 10-Q for the quarter ending March 31, 2015.

i. 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.

The revenues and expenses of the discontinued operation are shown below.

| REVENUES AND EXPENSES – DISCONTINUED | Nine months ended September 30, | |
|--|---------------------------------|-------------|
| | 2014 | 2013 |
| Revenues | \$ – | \$ 1,992 |
| Cost of revenues, exclusive of amortization of intangibles | – | (2,458) |
| Selling and marketing expenses | – | 1,340 |
| General and administrative expenses | – | 116,163 |
| Total operating costs and expenses | – | 115,045 |
| Operating loss | – | (113,053) |
| Other income | – | 83,957 |
| Financial income, net | – | (57,182) |
| Total other income (expense) | – | 26,775 |
| Loss before income tax | – | (86,278) |
| Income tax expense | – | 1,000 |
| Net loss | \$ – | \$ (87,278) |

NOTE 2: ACQUISITION OF UEC

In April 2014, the Company entered into a stock purchase agreement pursuant to the terms of which the Company purchased all of the outstanding membership interests of UEC Electronics, LLC (“UEC”) from the seller of UEC, a company owned by UEC’s two top managers (the “Acquisition”). UEC develops and manufactures electronic components and subsystems primarily for military, aerospace and industrial customers. The Company’s management considered the purchase of UEC to be an accretive addition to the Battery and Power Systems Division.

The Acquisition was accounted for under the acquisition method accounting. Accordingly, all assets and liabilities acquired, along with the potential \$5.5 million earn out (with an estimated fair value of \$4.5 million at the acquisition date) were recorded at their estimated fair market values as of the date of acquisition. The liability for the earn out was recorded in other accounts payable and accrued expenses (\$2.2 million) and other long-term liabilities (\$2.3 million). The fair value measurements were based on significant inputs that were not observable in the market which are Level 3 inputs in the fair value hierarchy. The results of UEC’s operations have been included in the consolidated financial statements commencing on the date of acquisition. The total consideration of \$36.7 million for the membership interests purchased consisted of (i) cash in the amount of \$28,000,000, (ii) 775,000 shares of the Company’s common stock, valued at \$4,216,000, and (iii) contingent consideration with an estimated fair value of \$4.5 million.

Based upon an outside valuation of tangible and intangible assets acquired, the Company has allocated the total cost of the Acquisition to UEC’s net assets as follows (unaudited):

| | |
|--|---------------|
| Tangible assets acquired | \$ 14,471,492 |
| Less: Net working capital adjustment | (1,206,245) |
| Intangible assets | |
| Customer relationships | 7,400,000 |
| Contracts in place (backlog) | 2,100,000 |
| Technology | 1,700,000 |
| IPR&D | 1,500,000 |
| Management contract | 400,000 |
| Goodwill (intangibles that did not qualify for separate recognition) | 15,105,680 |
| Total asset value | 41,470,927 |
| Less: liabilities assumed | (4,754,927) |
| Net fair value of assets acquired | \$ 36,716,000 |

These fair value measurements are provisional based on third-party valuations that are currently under review and are subject to refinement for up to one year after the acquisition date based on additional information that may be obtained by the Company that existed as of the acquisition date.

Intangible assets in the amount of \$13.1 million have a weighted-average useful life of approximately five years.

In accordance with FASB ASC 350, “Goodwill and Other Intangible Assets,” goodwill arising from acquisitions will not be amortized but is deductible for tax purposes. In lieu of amortization, the Company is required to perform an annual impairment test. If the Company determines, through the impairment review process, that goodwill has been impaired, it will record the impairment charge in its statement of operations. The Company will also assess the impairment of goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

NOTE 3: PRO FORMA FINANCIAL INFORMATION

In April 2014, the Company acquired UEC, as more fully described in “Note 2 – Acquisition of UEC,” above (the “Acquisition”). The following summary pro forma information includes the effects of the Acquisition on the operating results of the Company. The pro forma data for the nine months ended September 30, 2014 and 2013 are presented as if the Acquisition had been completed on January 1, 2013. This pro forma financial information does not purport to be indicative of the results of operations that would have occurred had the Acquisition taken place at the beginning of the period, nor do they purport to be indicative of the results of operations that will be obtained in the future.

PRO-FORMA FINANCIAL INFORMATION

| | Three Months Ended September | | Nine Months Ended September | |
|--|-------------------------------------|-------------|------------------------------------|-------------|
| | 30, | | 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| Total revenues | \$ 24,783,353 | 31,357,624 | 87,546,334 | 89,215,428 |
| Income – continuing operations before income tax | 855,145 | 1,540,383 | 6,716,086 | 2,355,090 |
| Net income | \$ 378,528 | 1,203,975 | 5,860,908 | 1,501,850 |
| Basic net income per share | \$ 0.02 | 0.07 | 0.28 | 0.09 |
| Diluted net income per share | \$ 0.02 | 0.07 | 0.27 | 0.09 |
| Weighted average number of shares used in computing basic net income per share | 23,137,808 | 16,726,602 | 21,256,356 | 16,296,974 |
| Weighted average number of shares used in computing diluted net income per share | 23,740,548 | 17,329,342 | 21,859,096 | 16,899,714 |

Pro forma results presented above reflect: (1) amortization relating to fair value estimates of intangible assets; (2) elimination of UEC expenses that were not part of the transaction; and (3) incremental interest expense on new long term debt incurred in connection with the transaction as though the transaction occurred as of January 1, 2013.

Additionally, acquisition related expenses of approximately \$940,000 recognized as general and administrative expenses in the three and nine months ended September 30, 2014 are reflected in the pro forma results above as though they were recognized during the three months ended March 31, 2013 and have been removed from the pro forma results for the three and nine months ended September 30, 2014.

NOTE 4: 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 increased, from December 31, 2013, \$342,000 in the Training and Simulation Division and \$295,000 in the Battery and Power Systems Division for the product required to fulfill the current backlog. Inventories are composed of the following:

| | September 30, | December 31, |
|-----------------------------|----------------------|---------------------|
| | 2014 | 2013 |
| Raw and packaging materials | \$ 8,207,597 | \$ 6,761,876 |
| Work in progress | 1,580,896 | 666,386 |
| Finished products | 923,420 | 2,646,504 |
| Total: | \$ 10,711,913 | \$ 10,074,766 |

NOTE 5: IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In August 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2014-15, ("ASU 2014-15"), "Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern". ASU 2014-15 requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued and provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. ASU 2014-15 applies to all entities and is effective for annual and interim reporting periods ending after December 15, 2016, with early adoption permitted. The Company does not expect that the adoption of this standard will have a material effect on its financial statements.

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09 completes the joint effort by the FASB and International Accounting Standards Board (IASB) to improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and International Financial Reporting Standards (IFRS). ASU 2014-09 applies to all companies that enter into contracts with customers to transfer goods or services. ASU 2014-09 is effective for public entities for interim and annual reporting periods beginning after December 15, 2016. Early application is not permitted and entities have the choice to apply ASU 2014-09 either retrospectively to each reporting period presented or by recognizing the cumulative effect of applying ASU 2014-09 at the date of initial application and not adjusting comparative information. The Company is currently evaluating the requirements of ASU 2014-09 and has not yet determined its impact on the Company's consolidated financial statements.

In April 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360)." ASU 2014-08 amends the requirements for reporting discontinued operations and requires additional disclosures about discontinued operations. Under the new guidance, only disposals representing a strategic shift in operations or that have a major effect on the Company's operations and financial results should be presented as discontinued operations. ASU 2014-08 also requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income and expenses of discontinued operations. This new accounting guidance is effective for annual periods beginning after December 15, 2014. We have determined that the adoption of these changes will need to be considered in the Company's financial condition or results of operations in the event the Company initiates any of the transactions described above.

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 2013 Form 10-K.

NOTE 6: 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 impairment testing 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 statements. 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 nine and three months ended September 30, 2014 and 2013:

| | <u>Training and Simulation Division</u> | <u>Battery and Power Systems Division</u> | <u>Corporate Expenses</u> | <u>Discontinued</u> | <u>Total Company</u> |
|---|---|---|-------------------------------|---------------------|--------------------------|
| Nine months ended September 30, 2014 | | | | | |
| Revenues from outside customers | \$ 41,877,991 | \$ 33,117,348 | \$ — | \$ — | \$ 74,995,339 |
| Depreciation and amortization expense(1) | (558,081) | (2,372,141) | (15,012) | — | (2,945,234) |
| Direct expenses(2) | <u>(32,886,293)</u> | <u>(28,229,098)</u> | <u>(5,805,476)</u> | — | <u>(66,920,867)</u> |
| Segment net income (loss) | \$ 8,433,617 | \$ 2,516,109 | \$ (5,820,488) | \$ — | \$ 5,129,238 |
| Financial expense | (32,157) | (130,987) | (935,611) | — | (1,098,755) |
| Income tax expense | (101,570) | (13,810) | (739,798) | — | (855,178) |
| Net income (loss) | <u>\$ 8,299,890</u> | <u>\$ 2,371,312</u> | <u>\$ (7,495,897)</u> | <u>\$ —</u> | <u>\$ 3,175,305</u> |
| Segment assets(3) | \$ 59,172,772 | \$ 66,906,744 | \$ 395,350 | \$ — | \$ 126,474,866 |
| Additions to long-lived assets | <u>\$ 728,556</u> | <u>\$ 29,848,785</u> | <u>\$ 2,956</u> | <u>\$ —</u> | <u>\$ 30,580,297</u> |

| | | | | | |
|---|---------------------|---------------------|-----------------------|--------------------|---------------------|
| Nine months ended September 30, 2013 | | | | | |
| Revenues from outside customers | \$ 48,141,162 | \$ 19,496,355 | \$ — | \$ — | \$ 67,637,517 |
| Depreciation and amortization expense(1) | (714,621) | (952,453) | (21,031) | — | (1,688,105) |
| Direct expenses(2) | <u>(39,909,351)</u> | <u>(18,104,604)</u> | <u>(3,864,010)</u> | — | <u>(61,877,965)</u> |
| Segment net income (loss) | \$ 7,517,190 | \$ 439,298 | \$ (3,885,041) | \$ — | \$ 4,071,447 |
| Financial expense | (28,801) | (96,431) | (350,216) | — | (475,448) |
| Income tax expense | (231,186) | (85,901) | (448,875) | — | (765,962) |
| Net income (loss) continuing operations | \$ 7,257,203 | \$ 256,966 | \$ (4,684,132) | \$ — | \$ 2,830,037 |
| Net loss discontinued operations | — | — | — | (87,278) | (87,278) |
| Net income (loss) | <u>\$ 7,257,203</u> | <u>\$ 256,966</u> | <u>\$ (4,684,132)</u> | <u>\$ (87,278)</u> | <u>\$ 2,742,759</u> |
| Segment assets(3) | \$ 53,793,396 | \$ 26,791,215 | \$ 335,623 | \$ 71,655 | \$ 80,991,889 |
| Additions to long-lived assets | <u>\$ 92,243</u> | <u>\$ 1,208,328</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 1,300,571</u> |

| | <u>Training and Simulation Division</u> | <u>Battery and Power Systems Division</u> | <u>Corporate Expenses</u> | <u>Discontinued</u> | <u>Total Company</u> |
|--|---|---|-------------------------------|---------------------|--------------------------|
| Three months ended September 30, 2014 | | | | | |
| Revenues from outside customers | \$ 13,000,538 | \$ 11,782,815 | \$ — | \$ — | \$ 24,783,353 |
| Depreciation and amortization expense(1) | (191,066) | (1,094,069) | (4,574) | — | (1,289,709) |
| Direct expenses(2) | <u>(10,147,054)</u> | <u>(10,493,007)</u> | <u>(1,582,331)</u> | — | <u>(22,222,392)</u> |
| Segment net income (loss) | \$ 2,662,418 | \$ 195,739 | \$ (1,586,905) | \$ — | \$ 1,271,252 |
| Financial expense | (14,712) | (118,055) | (283,340) | — | (416,107) |
| Income tax expense | (36,059) | (10) | (440,548) | — | (476,617) |
| Net income (loss) | <u>\$ 2,611,647</u> | <u>\$ 77,674</u> | <u>\$ (2,310,793)</u> | <u>\$ —</u> | <u>\$ 378,528</u> |
| Three months ended September 30, 2013 | | | | | |
| Revenues from outside customers | \$ 17,667,054 | \$ 5,520,490 | \$ — | \$ — | \$ 23,187,544 |
| Depreciation and amortization expense(1) | (229,542) | (318,535) | (7,011) | — | (555,088) |
| Direct expenses(2) | <u>(14,334,738)</u> | <u>(5,406,581)</u> | <u>(1,520,585)</u> | — | <u>(21,261,904)</u> |
| Segment net income (loss) | \$ 3,102,774 | \$ (204,626) | \$ (1,527,596) | \$ — | \$ 1,370,552 |
| Financial expense | (11,216) | (61,453) | (99,900) | — | (172,569) |
| Income tax expense | (175,534) | (11,901) | (149,625) | — | (337,060) |
| Net income (loss) continuing operations | \$ 2,916,024 | \$ (277,980) | \$ (1,777,121) | \$ — | \$ 860,923 |
| Net loss discontinued operations | — | — | — | 652 | 652 |
| Net income (loss) | <u>\$ 2,916,024</u> | <u>\$ (277,980)</u> | <u>\$ (1,777,121)</u> | <u>\$ 652</u> | <u>\$ 861,575</u> |

(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 \$24,435,641 and \$21,295,345, respectively, as of September 30, 2014 and \$24,435,641 and \$6,466,161, respectively, as of September 30, 2013.

NOTE 7: 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 September 30, 2014 and December 31, 2013, approximate fair value because of the short maturity of these instruments. The carrying amounts of long term debt approximates the estimated fair values at September 30, 2014, based upon the Company's ability to acquire similar debt at similar maturities

NOTE 8: BANK FINANCING

The Company's FAAC subsidiary has a \$15.0 million line of credit (the "Line of Credit") with Fifth Third Bank (the "Bank") at a rate of LIBOR plus 3.75%, secured by the assets and receivables of FAAC and by the assets and receivables of the Company and of the Company's subsidiary EFB. Additionally, the Company and EFB are guarantors of the Line of Credit.

On April 1, 2014, pursuant to an Amended and Restated Credit Agreement (the "Amended Credit Agreement"), the parties to the original credit agreement (the "Original Credit Agreement") agreed to amend the Line of Credit to add two term loans to it: an \$18.0 million 61-month senior term loan at a 2014 interest rate of 3.75% over LIBOR, and a \$4.5 million 61-month B term loan at a 2014 interest rate of 5.5% over LIBOR. Pursuant to a joinder agreement that took effect upon the Company's acquisition of UEC (the "Joinder Agreement"), UEC became a party to the Amended Credit Agreement as a co-borrower with FAAC, and provided a guaranty and security substantially identical to that granted by the Company and EFB. The Company, FAAC and EFB also entered into a patent and trademark security agreement with the Bank; upon effectiveness of the Joinder Agreement, UEC executed a substantially identical agreement.

Certain covenants contained in the Original Credit Agreement have been modified in the Amended Credit Agreement. Commencing with the fiscal quarter ending September 30, 2014, the Company's "Fixed Charge Coverage Ratio," determined on a combined basis with UEC and otherwise computed in the same manner as under the Original Credit Agreement, has been raised to 1.25 to 1 from 1.10 to 1. "Net Advances to Affiliates" as defined in the Original Credit Agreement are now defined with reference to FAAC or UEC, as the case may be, and may not increase by more than \$5,500,000 on a combined basis for both borrowers in any calendar year over a "Base Amount" to be determined by mutual agreement of FAAC and the Bank.

In addition, two new covenants have been added in the Amended Credit Agreement. First, UEC's earnings before interest, taxes, depreciation and amortization with certain add-backs ("EBITDA"), computed on a stand-alone basis, may not be less than \$4,500,000 for any trailing twelve-month period ending at the end of a fiscal quarter (a "Test Period") beginning with the Test Period ending September 30, 2014 and each succeeding fiscal quarter thereafter. Second, the ratio of "Combined Funded Indebtedness" (defined as all indebtedness (a) in respect of money borrowed, (b) evidenced by a note, debenture or other like written obligation to pay money, (c) in respect of rent or hire of property under leases or lease arrangements which under GAAP are required to be capitalized or (d) in respect of obligations under conditional sales or other title retention agreements, all as determined on a combined basis for FAAC and UEC) to "Combined Adjusted EBITDA" (defined as EBITDA of FAAC and UEC computed on a combined basis) may not exceed (a) 2.25 to 1.0 for the Test Period ending September 30, 2014 or any Test Period ending as of the end of any fiscal quarter thereafter prior to the fiscal quarter ending March 31, 2015 or (b) 2.00 to 1.0 for the Test Period ending March 31, 2015 or any Test Period ending as of the end of any fiscal quarter thereafter.

Pursuant to the requirements of the Amended Credit Agreement, the Company was required to deliver an Interest Rate Swap agreement fixing the interest rate of 1.37% on approximately \$9.0 million of the outstanding term loans associated with the acquisition of UEC. Accordingly, in April 2014, the Company entered into an interest rate swap for a notional amount of \$9 million. The expiration date of this interest rate swap is April 1, 2019. The unrealized \$41,000 expense to date associated with this derivative has been charged to Financial Expenses and will be adjusted through Financial Expense and other accounts payable and accrued expenses as the swap matures.

NOTE 9: COMMON STOCK REPURCHASE PROGRAM

In February 2009, the Company's Board of Directors authorized the repurchase of up to \$1.0 million of the Company's common stock. Through September 30, 2014, the Company repurchased 638,611 shares for a total of \$869,931. The repurchase program was extended in August 2014 for an additional year and the authorization expanded to repurchase up to \$2.0 million of the Company's common stock. The program, which expires on August 11, 2015, is subject to management's discretion.

NOTE 10: COMMON STOCK OFFERING

In July 2014, the Company sold 2,860,000 shares of common stock in a public offering for an aggregate of \$10.0 million (before underwriting discounts, commission and expenses of the offering). The following day, the Company sold an additional 429,000 shares in this public offering for an aggregate of \$1.5 million (before underwriting discounts, commission and expenses of the offering).

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 provide advanced battery solutions, innovative energy management and power distribution technologies and world-class product design and manufacturing services for the aerospace, defense, law enforcement and homeland security markets, 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.

Our results for the first three months of 2014 do not include the results of UEC Electronics, LLC, a South Carolina limited liability company that we purchased on April 1, 2014. See "Recent Developments – Acquisition of UEC Electronics, LLC," below.

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 nine months of 2014. 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 comprehensive income.

We incurred non-cash charges for amortization of intangible assets in the first nine months of 2014 and 2013 in the amount of \$1,828,634 and \$821,097, respectively.

Restricted Shares, Restricted Stock Units and Options

In accordance with FASB ASC 505-50, we incurred, for the nine months ended September 30, 2014 and 2013, compensation expense related to restricted stock units and restricted shares of approximately \$393,000 and \$394,000, respectively. Our directors received their annual restricted stock grants on April 1, 2014 in accordance with the terms of the directors' stock compensation plan.

Overview of Operating Performance and Backlog

Overall, our income from continuing operations before income tax expense for the nine months ended September 30, 2014 was \$4.0 million on revenues of \$75.0 million, compared to \$3.6 million on revenues of \$67.6 million during the nine months ended September 30, 2013. As of September 30, 2014, our overall backlog totaled \$74.1 million compared to \$74.4 million in the third quarter of 2013.

In our Training and Simulation Division, revenues decreased from approximately \$48.1 million in the first nine months of 2013 to \$41.9 million in the first nine months of 2014. As of September 30, 2014, our backlog for our Training and Simulation Division totaled \$50.8 million compared to \$58.9 million in the third quarter of 2013.

In our Battery and Power Systems Division, revenues increased from approximately \$19.5 million in the first nine months of 2013 to approximately \$33.1 million in the first nine months of 2014. As of September 30, 2014, our backlog for our Battery and Power Systems Division totaled \$23.4 million, including backlog related to our UEC acquisition, compared to \$15.5 million in the third quarter of 2013, which does not include any acquisition-related backlog.

The table below details the percentage of total recognized revenue by type of arrangement for the nine months ended September 30, 2014 and 2013:

| Type of Revenue | Nine months ended September 30, | |
|--|---------------------------------|--------|
| | 2014 | 2013 |
| Sale of products | 94.8% | 95.4% |
| Maintenance and support agreements | 3.5% | 3.1% |
| Long term research and development contracts | 1.7% | 1.5% |
| Total | 100.0% | 100.0% |

Recent Developments

Common Stock Offering

In July 2014, we sold 2,860,000 shares of our common stock in a public offering for an aggregate of \$10.0 million (before underwriting discounts, commission and expenses of the offering). The following day, we sold an additional 429,000 shares in this public offering for an aggregate of \$1.5 million (before underwriting discounts, commission and expenses of the offering).

Acquisition of UEC Electronics, LLC

On April 1, 2014, we entered into and consummated a Membership Interest Purchase Agreement (the “Agreement”) to purchase all of the membership interests of UEC Electronics, LLC, a South Carolina limited liability company (“UEC”), from the seller of UEC (the “Seller”), a company principally owned by UEC’s two top managers (together with the Seller, the “Sellers”). UEC management will stay with UEC and will continue to manage UEC as a wholly-owned subsidiary of ours. We considered the purchase of UEC to be an accretive addition to our Battery and Power Systems Division.

UEC develops and manufactures electronic components and subsystems primarily for military, aerospace and industrial customers. UEC specializes in core, proprietary engineering capabilities in highly-demanded solution areas, including: (i) hybrid power generation systems, (ii) smart power subsystems for military vehicles and dismounted applications, and (iii) aircraft and missile systems support for cutting-edge weapons and communications technologies.

The initial acquisition price of UEC was \$28 million plus 775,000 shares of our common stock, as well as a potential earn-out of up to \$5.5 million over the next two calendar years, which earn-out is payable in cash or shares of our common stock at our option. The liability for the earn out was recorded in other accounts payable and accrued expenses (\$2.2 million) and other long-term liabilities (\$2.3 million). On April 1, 2014, the closing price of our common stock on the Nasdaq Global Market was \$5.44 per share, causing the common stock issued in the acquisition to be valued for accounting purposes at \$4.2 million, subject to potential reduction to reflect the fact that the stock being issued in the acquisition is unregistered and not freely tradable. The source of the cash used was \$22.5 provided by the financing transaction described below and \$5.5 million of our working capital. The amount of consideration was determined based upon arm’s-length negotiations between ourselves and the Sellers.

Bank Financing

Our FAAC subsidiary has a \$15.0 million line of credit (the “Line of Credit”) with Fifth Third Bank (the “Bank”) at a rate of LIBOR plus 3.5%, secured by the assets and receivables of FAAC and by the assets and receivables of us and of our subsidiary EFB. Additionally, we and EFB are guarantors of the Line of Credit.

On April 1, 2014, pursuant to an Amended and Restated Credit Agreement (the “Amended Credit Agreement”), the parties to the original credit agreement (the “Original Credit Agreement”) agreed to amend the Line of Credit to add two term loans to it: an \$18.0 million 61-month senior term loan at a 2014 interest rate of 3.75% over LIBOR, and a \$4.5 million 61-month B term loan at a 2014 interest rate of 5.5% over LIBOR. Pursuant to a joinder agreement that took effect upon our acquisition of UEC (the “Joinder Agreement”), UEC became a party to the Amended Credit Agreement as a co-borrower with FAAC, and provided a guaranty and security substantially identical to that granted by us and EFB. We, FAAC, and EFB also entered into a patent and trademark security agreement with the Bank; upon effectiveness of the Joinder Agreement, UEC executed a substantially identical agreement.

Certain covenants contained in the Original Credit Agreement have been modified in the Amended Credit Agreement. Commencing with the fiscal quarter ending September 30, 2014, our “Fixed Charge Coverage Ratio,” determined on a combined basis with UEC and otherwise computed in the same manner as under the Original Credit Agreement, has been raised to 1.25 to 1 from 1.10 to 1. “Net Advances to Affiliates” as defined in the Original Credit Agreement are now defined with reference to FAAC or UEC, as the case may be, and may not increase by more than \$5,500,000 on a combined basis for both borrowers in any calendar year over a “Base Amount” to be determined by mutual agreement of FAAC and the bank.

In addition, two new covenants have been added in the Amended Credit Agreement. First, UEC’s earnings before interest, taxes, depreciation and amortization with certain add-backs (“EBITDA”), computed on a stand-alone basis, may not be less than \$4,500,000 for any trailing twelve-month period ending at the end of a fiscal quarter (a “Test Period”) beginning with the Test Period ending September 30, 2014 and each succeeding fiscal quarter thereafter. Second, the ratio of “Combined Funded Indebtedness” (defined as all indebtedness (a) in respect of money borrowed, (b) evidenced by a note, debenture or other like written obligation to pay money, (c) in respect of rent or hire of property under leases or lease arrangements which under GAAP are required to be capitalized or (d) in respect of obligations under conditional sales or other title retention agreements, all as determined on a combined basis for FAAC and UEC) to “Combined Adjusted EBITDA” (defined as EBITDA of FAAC and UEC computed on a combined basis) may not exceed (a) 2.25 to 1.0 for the Test Period ending September 30, 2014 or any Test Period ending as of the end of any fiscal quarter thereafter prior to the fiscal quarter ending March 31, 2015 or (b) 2.00 to 1.0 for the Test Period ending March 31, 2015 or any Test Period ending as of the end of any fiscal quarter thereafter. We were in compliance with all covenant requirements for the period ended September 30, 2014.

Pursuant to the requirements of the Amended Credit Agreement, we were required to deliver an Interest Rate Swap agreement fixing the interest rate of 1.37% on approximately \$9.0 million of the outstanding term loans associated with the acquisition of UEC. Accordingly, in April 2014, we entered into an interest rate swap for a notional amount of \$9.0 million. The expiration date of this interest rate swap is April 1, 2019. The net unrealized \$41,000 expense to date associated with this derivative has been charged to Financial Expenses and will be adjusted through Financial Expense as the swap matures.

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 comprehensive income amounts have been translated using the average exchange rate for the period. The resulting translation adjustments are reported as a component of accumulated other comprehensive income/loss in stockholders' equity.

Results of Operations

Preliminary Note

Results for the three and nine months ended September 30, 2014 include the results of UEC for such period as a result of our acquisition of this company on April 1, 2014. The results of UEC were not included in our operating results for the three and nine months ended September 30, 2013. Accordingly, the following period-to-period comparisons should not necessarily be relied upon as indications of future performance.

Three months ended September 30, 2014 compared to the three months ended September 30, 2013.

Revenues. Revenues for the three months ended September 30, 2014 totaled \$24.8 million, compared to \$23.2 million in the comparable period in 2013, an increase of \$1.6 million, or 6.9%. In the third quarter of 2014, revenues were \$13.0 million for the Training and Simulation Division (compared to \$17.7 million in the third quarter of 2013, a decrease of \$4.7 million, or 26.4%, due primarily to the wind down of the first phase of our VCTS program (revenue in this program will increase due to the second phase of our VCTS program, which commenced in the third quarter of 2014)); and \$11.8 million for the Battery and Power Systems Division (compared to \$5.5 million in the third quarter of 2013, an increase of \$6.3 million, or 113.4%, due primarily to revenue generated by our new UEC subsidiary, offset by reduced revenue in our other U.S. subsidiary).

Cost of revenues. Cost of revenues totaled \$16.8 million during the third quarter of 2014, compared to \$16.8 million in the third quarter of 2013, a decrease of \$40,000, or 0.2%, due primarily to the product mix of the reporting units, which included products sold at a somewhat higher margin. Cost of revenues was \$7.9 million for the Training and Simulation Division (compared to \$12.4 million in the third quarter of 2013, a decrease of \$4.5 million, or 36%, also due primarily to lower revenues and the product mix); and \$8.9 million for the Battery and Power Systems Division (compared to \$4.4 million in the third quarter of 2013, an increase of \$4.4 million, or 99.2%, due primarily to the increased revenue associated with our new UEC subsidiary, offset by the reduced product sales in our other U.S. subsidiary).

Research and development expenses. Research and development expenses for the third quarter of 2014 were \$925,000, compared to \$808,000 during the third quarter of 2013, an increase of \$117,000, or 14.5%, due primarily to continuing research on training systems and battery technologies for new products.

Selling and marketing expenses. Selling and marketing expenses for the third quarter of 2014 were \$1.2 million, compared to \$1.2 million in the third quarter of 2013, a decrease of \$26,000, or 2.2%.

General and administrative expenses. General and administrative expenses for the third quarter of 2014 were \$3.8 million, compared to \$2.7 million in the third quarter of 2013, an increase of \$1.1 million, or 41.5%, due primarily to expenses related to our addition of a new subsidiary.

Amortization of intangible assets. Amortization of intangible assets totaled \$867,000 in the third quarter of 2014, compared to \$271,000 in the third quarter of 2013, an increase of \$596,000, or 220.1%, due primarily to the additional \$811,000 in amortization expenses relating to our acquisition of UEC, offset by fully amortized acquisition related intangibles relating to other subsidiaries in our Battery and Power Systems Division.

Other income. Other income totaled \$59,000 in the third quarter of 2014, compared to other expense of \$7,000 in the third quarter of 2013, an increase of \$66,000, or 888.6%, due primarily to the insurance proceeds (related to a fire in our Israeli offices in 2012) received in our Battery and Power Systems Division.

Financial expense, net. Financial expense totaled \$416,000 in the third quarter of 2014, compared to financial expense of \$173,000 in the third quarter of 2013, an increase of \$244,000, due primarily to increased long term debt interest relating to our acquisition of UEC.

Income taxes. We recorded \$477,000 in tax expense in the third quarter of 2014, compared to \$337,000 in tax expense in the third quarter of 2013, an increase of \$140,000, or 41.4%. This expense includes “naked” credits (“naked” credits occur when deferred tax liabilities that are created by indefinite-lived assets such as goodwill cannot be used as a source of taxable income to support the realization of deferred tax assets). This 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 both the third quarter of 2014 and 2013. Additionally, taxes have increased due to our improved results.

Net income. Due to the factors cited above, we went from a net income of \$861,000 in the third quarter of 2013 to a net income of \$379,000 in the third quarter of 2014, a reduction of \$482,000 or 56.0%.

Nine months ended September 30, 2014 compared to the nine months ended September 30, 2013.

Revenues. Revenues for the nine months ended September 30, 2014 totaled \$75.0 million, compared to \$67.6 million in the comparable period in 2013, an increase of \$7.4 million, or 10.9%. In the first nine months of 2014, revenues were \$41.9 million for the Training and Simulation Division (compared to \$48.1 million in the first nine months of 2013, a decrease of \$6.2 million, or 13.0%, due primarily to the wind down of the first phase of our VCTS program (revenue in this program will increase due to the second phase of our VCTS program, which commenced in the third quarter of 2014); and \$33.1 million for the Battery and Power Systems Division (compared to \$19.5 million in the first nine months of 2013, an increase of \$13.6 million, or 69.9%, due primarily to revenue generated by our new UEC subsidiary, offset by reduced revenue in our other U.S. subsidiary).

Cost of revenues. Cost of revenues totaled \$49.7 million during the first nine months of 2014, compared to \$49.7 million in the first nine months of 2013, due primarily to the product mix of the reporting units, which included products sold at a higher margin. Cost of revenues were \$25.6 million for the Training and Simulation Division (compared to \$33.8 million in the first nine months of 2013, a decrease of \$8.2 million, or 24.3%, due primarily to lower revenue and the product mix) and \$24.1 million for the Battery and Power Systems Division (compared to \$15.9 million in the first nine months of 2013, an increase of \$8.2 million, or 51.8%, due primarily to revenue generated by our new UEC subsidiary, offset by reduced revenue in our other U.S. subsidiary).

Research and development expenses. Research and development expenses for the first nine months of 2014 were \$2.9 million, compared to \$1.9 million during the first nine months of 2013, an increase of \$921,000, or 47.6%, due primarily to continuing research on training systems and battery technologies for new products.

Selling and marketing expenses. Selling and marketing expenses for the first nine months of 2014 were \$4.2 million, compared to \$3.9 million in the first nine months of 2013, an increase of \$331,000, or 8.6%, due primarily to due primarily to increased trade show representation and the sales efforts of both divisions, including additional expenses related to our addition of a new subsidiary.

General and administrative expenses. General and administrative expenses for the first nine months of 2014 were \$11.6 million, compared to \$7.5 million in the first nine months of 2013, an increase of \$4.1 million, or 53.9%, due primarily to \$1.1 million in one-time, acquisition related expenses, along with increased corporate salary and benefit expenses and the additional, normally occurring expenses related to our addition of a new subsidiary.

Amortization of intangible assets. Amortization of intangible assets totaled \$1.8 million in the first nine months of 2014, compared to \$821,000 in the first nine months of 2013, an increase of \$1.0 million, or 122.7%, due primarily to the additional \$1.6 million in amortization expenses relating to our acquisition of UEC, offset by fully amortized acquisition related intangibles relating to other subsidiaries in our Simulation and Battery and Power Systems Divisions.

Other income. Other income totaled \$288,000 in the first nine months of 2014, compared to other income of \$261,000 in the first nine months of 2013, an increase of \$27,000, or 10.3%, due primarily to the insurance proceeds (related to a fire in our Israeli offices in 2012) received in our Battery and Power Systems Division.

Financial expense, net. Financial expense totaled \$1.1 million in the first nine months of 2014, compared to financial expense of \$475,000 in the first nine months of 2013, an increase of \$623,000, or 131.1%, due primarily to increased long term interest and bank financing fees relating to our acquisition of UEC, offset by a decrease in corporate interest and bank charges in the second quarter of 2014.

Income taxes. We recorded \$855,000 in tax expense in the first nine months of 2014, compared to \$766,000 in tax expense in the first nine months of 2013, an increase of \$89,000, or 11.6%, mainly concerning “naked” credits (“naked” credits occur when deferred tax liabilities that are created by indefinite-lived assets such as goodwill cannot be used as a source of taxable income to support the realization of deferred tax assets). This amount includes the required adjustment of taxes due to the deduction of goodwill “naked” credits for U.S. federal taxes, which totaled \$449,000 in non-cash expenses in both the first nine months of 2014 and 2013. Additionally, taxes have increased due to our improved results.

Net income. Due to the factors cited above, we went from a net income of \$2.8 million in the first nine months of 2013 to a net income of \$3.2 million in the first nine months of 2014, an improvement of \$345,000 or 12.2%.

Liquidity and Capital Resources

As of September 30, 2014, we had \$10.8 million in cash and \$242,000 in restricted collateral deposits, as compared to December 31, 2013, when we had \$5.8 million in cash and \$498,000 in restricted collateral deposits. We also had \$7.7 million in available, unused bank lines of credit with our main bank as of September 30, 2014, under a \$15.0 million credit facility under our FAAC subsidiary, described on page 15 above, under Bank Financing.

We were in compliance with all covenant requirements for the period ended September 30, 2014.

We used available funds in the nine months ended September 30, 2014 primarily for working capital needs, the acquisition of UEC and investment in fixed assets. We purchased approximately \$1.3 million of fixed assets during the nine months ended September 30, 2014 along with \$1.0 million in net fixed assets purchased in the acquisition of UEC. Our net fixed assets amounted to \$6.1 million at quarter end.

Net cash provided by (used in) operating activities for the nine months ended September 30, 2014 and 2013 was \$2.5 million and \$6.1 million, respectively, a net change of \$3.6 million. This difference was due primarily an increase in net income of \$433,000 plus a change of \$1.3 million in non-cash charges offset by \$(5.4) million in working capital needs for 2014 versus the same period in 2013.

Net cash used in investing activities for the nine months ended September 30, 2014 and 2013 was \$30.2 million and \$1.6 million, respectively, a net change of \$28.6 million. This difference was due to the \$29.1 million acquisition of our UEC subsidiary.

Net cash provided by (used in) financing activities for the nine months ended September 30, 2014 and 2013 was \$33.0 million and \$(1.5) million, respectively, a net change of \$34.5 million. The increase in 2014 of cash provided by financing activities was due to the \$22.5 million in new long term debt associated with the acquisition of UEC and proceeds from the recent stock offering in the amount of \$10.7 million as compared to the stock offering proceeds of \$5.5 million in 2013. Additionally, there were net borrowings of short term bank credit in the amount of \$1.5 million along with the repayment of an additional \$1.7 million in long term debt in 2014.

As of September 30, 2014, we had approximately \$2.8 million in short-term bank debt under our credit facility and \$22.7 million in long-term loans outstanding, which included \$4.3 million in current debt and \$18.4 million in long term debt. This is in comparison to December 31, 2013, when we had no short-term bank debt under our credit facility and \$1.9 million in long-term loans outstanding, which included \$95,000 in current debt and \$1.8 million in long term debt.

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.

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 2014. 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 our 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 Exhibit 99.3 to our Current Report on Form 8-K filed on April 1, 2014, as modified by Item 1A of our Form 10-Q for the quarterly period ended June 30, 2014. We do not believe that there have been any material changes in the risk factors disclosed therein.

ITEM 5. OTHER INFORMATION,

New Employment Agreement with Steven Esses and Consulting Agreement with Sampen Corporation

On November 14, 2014, we entered into a new amended and restated employment agreement with our President and CEO, Steven Esses (the "Esses Employment Agreement"). As further described below, the amended and restated agreement involve an extension in term until the end of December 2017 and an increase in salary to take account of the fact that Mr. Esses is now serving as our President and Chief Executive Officer. The term of the Esses Employment Agreement is effective October 1, 2014 and expires on December 31, 2017. The Esses Employment Agreement provides that Mr. Esses will serve as our President and Chief Executive Officer.

The Esses Employment Agreement provides for a monthly base salary of NIS 105,000 (approximately \$27,666 per month at the rate of exchange in effect on November 10, 2014), as adjusted for Israeli inflation (but with no retroactive inflation adjustment for 2015 in respect of inflation during 2014) in an amount of not less than 3.5%. Additionally, the board may at its discretion raise Mr. Esses's base salary. Mr. Esses also receives a retention bonus in the amount of 125,000 shares of restricted stock, vesting (contingent on continued employment) in three equal tranches on each of December 31, 2015, 2016 and 2017.

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 110% 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 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 and severance pay equal to the greater of (i) twenty-four (24) times monthly salary, and (ii) NIS 4,430,250 (approximately \$1,167,296 at the rate of exchange in effect on November 10, 2014). In addition, upon retirement or early retirement, Mr. Esses receives a further payment of up to \$250,000. 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 or in the event of his death or disability, 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 and Chief Executive Officer. 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 110% 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 10.1 and 10.2, respectively, and incorporated herein by reference.

ITEM 6. EXHIBITS.

The following documents are filed as exhibits to this report:

| Exhibit Number | Description |
|-----------------------|--|
| 10.1 | <u>Fourth Amended and Restated Employment Agreement, dated November 14, 2014 and effective as of October 1, 2014, between us, Epsilon-EFL and Steven Esses</u> |
| 10.2 | <u>Second Amended and Restated Consulting Agreement, dated November 14, 2014 and effective as of October 1, 2014, between us and Sampen Corporation</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: November 14, 2014

AROTECH CORPORATION

By: /s/ Steven Esses
Name: Steven Esses
Title: President and CEO
(Principal Executive Officer)

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

FOURTH AMENDED AND RESTATED EMPLOYMENT AGREEMENT

THIS AGREEMENT (“Agreement”) is signed on the 14th day of November, 2014, effective as of the 1st day of October, 2014, by and between Epsilor-Electric Fuel Ltd., an Israeli corporation (“Epsilor”), Arotech Corporation, a Delaware corporation (“Arotech” and, together with Epsilor, the “Company”) and Mr. Steven Esses (the “Executive”).

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

WHEREAS, Epsilor and the Executive entered into an Employment Agreement effective as of January 1, 2005, as amended and restated effective as of January 1, 2008, January 1, 2012 and (with Arotech) May 13, 2013 (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;

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 October 1, 2014 and ending on December 31, 2017 (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 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 Board of Directors (the “Board”) of Arotech.
 - (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 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. The Executive shall have an additional travel allowance of up to \$5,000 per year to cover the additional expenses of family members of the Executive traveling with him. 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.

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 105,000 per month. 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, but in no event shall such upward adjustment be in amount of less than 3.5% (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 2014 or 2015, retroactive to January 1, 2014 or January 1, 2015, in respect of the CPI Adjustment for inflation during 2013 or 2014.
- (b) Bonus. The Company hereby grants to the Executive a retention bonus of 125,000 shares of restricted stock, vesting in three equal tranches, on December 31, 2015, December 31, 2016, and December 31, 2017. Additionally, 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 110% 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 110% of the Company's Budgeted Number (as defined below), then Executive's bonus shall be calculated as follows:

$$B = (S \times 25\%) + (N-100)/10 \times (S \times 50\%)$$

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 110;

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 of Arotech's Board of Directors (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 Arotech, in amounts to be determined based on the recommendation of the Chairman and the decision of the Compensation Committee.
- (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) 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.
- (f) 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 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;

- (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 or Disability, (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 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 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) 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 4,430,250 (the "Base Termination Pay"). The parties agree, notwithstanding the terms of the letter between the parties dated April 19, 2009, that the 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") shall be accomplished at any time upon the Executive's request, and that the amount of Base Termination Pay due to the Executive shall not be reduced by \$200,000 in respect of the issuance of the Shares or the transfer of the Shares to the Executive, notwithstanding that it had been previously agreed between the parties that the issuance and the transfer of the Shares to the Executive would be a credit against the Base Termination Pay in the amount of \$200,000.

- (iii) Upon Retirement or Early Retirement in accordance with the provisions of this Agreement, the Executive shall be entitled to receive a retirement benefit payment (the "Retirement Payment") as follows:
 - (A) For any Retirement or Early Retirement taking place after completion of the first year of this Agreement, the sum of \$175,000;
 - (B) For any Retirement or Early Retirement taking place after completion of the second year of this Agreement, the sum of \$200,000; and
 - (C) For any Retirement or Early Retirement taking place after completion of the third year of this Agreement, the sum of \$250,000.
- (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.
- (iv) In the event of a termination by the Company without Cause or by the Executive due to Good Reason, or in the event of the Executive's death or Disability, 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 136,675 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) The rights (but not the obligations) of the Executive under this Agreement are assignable, in whole or in part, by the Executive to any person or other entity. 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 Epsilon-Electric Fuel Ltd.
 c/o Epsilon-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.

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 Fourth Amended and Restated Employment Agreement dated November 14, 2014 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

By: _____
Name:
Title:



Arotech Corporation

1229 Oak Valley Drive
Ann Arbor, Michigan 48108
Tel: (800) 281-0356 Fax: (734) 761-5368
<http://www.arotech.com>
Nasdaq National Market: ARTX
Writer's direct dial: +972-2-990-6612
Writer's direct fax: +972-2-990-6688
Writer's e-mail: ehrlich@arotech.com

Robert S. Ehrlich
Executive Chairman

November 14, 2014

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

Re: Second 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 amended and restated agreement between us dated May 13, 2013.

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

(a) Effective October 1, 2014, 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 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 October 1, 2014 and shall continue until December 31, 2017, 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 110% 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 110% of Arotech's Budgeted Number (as defined below), then Sampen's bonus shall be calculated as follows:

$$B = (S \times 25\%) + (N-100)/10 \times (S \times 50\%)$$

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 110;

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
Executive Chairman

ACCEPTED AND AGREED:

SAMPEN CORPORATION

By: /s/ Morris Esses
Morris Esses
President

CERTIFICATION

I, Steven Esses, 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: November 14, 2014

/s/ Steven Esses

Steven Esses, President and CEO
(Principal Executive Officer)

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

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

CERTIFICATION

I, 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: November 14, 2014

/s/ Thomas J. Paup

Thomas J. Paup, Senior 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 September 30, 2014 filed with the Securities and Exchange Commission (the "Report"), I, Steven Esses, President and Chief Executive Officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that to my knowledge, the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Report fairly presents, in all material respects, the consolidated financial condition of the Company and its subsidiaries as of the dates presented and the consolidated results of operations of the Company and its subsidiaries for the periods presented.

Dated: November 14, 2014

/s/ Steven Esses

Steven Esses, President 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 September 30, 2014 filed with the Securities and Exchange Commission (the "Report"), I, Thomas J. Paup, Senior Vice President – Finance and Chief Financial Officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that to my knowledge, the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Report fairly presents, in all material respects, the consolidated financial condition of the Company and its subsidiaries as of the dates presented and the consolidated results of operations of the Company and its subsidiaries for the periods presented.

Dated: November 14, 2014

/s/ Thomas J. Paup

Thomas J. Paup, Senior 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.

