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FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2014 .**

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

Commission File Number: 0-23336

AROTECH CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	**95-4302784**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1229 Oak Valley Drive, Ann Arbor, Michigan	**48108**
(Address of principal executive offices)	(Zip Code)

(800) 281-0356
(Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock, $0.01 par value	**The Nasdaq Stock Market LLC**

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.**Yes** ☐ **No** ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.**Yes** ☐ **No** ☒

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

Indicate by check mark whether the registrant is large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions 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: ☒

EXPLANATORY NOTE

The registrant met the "accelerated filer" requirements as of the end of its 2014 fiscal year pursuant to Rule 12b-2 of the Securities Exchange Act of 1934, as amended. However, pursuant to Rule 12b-2 and SEC Release No. 33-8876, the registrant (as a smaller reporting company transitioning to the larger reporting company system based on its public float as of June 30, 2014) is not required to satisfy the larger reporting company requirements until its first quarterly report on Form 10-Q for the 2015 fiscal year and thus is eligible to check the "Smaller Reporting Company" box on the cover of this Form 10-K.

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

The aggregate market value of the registrant's voting stock held by non-affiliates of the registrant as of June 30, 2014 was approximately $81,031,929 (based on the last sale price of such stock on such date as reported by The Nasdaq Global Market and assuming, for the purpose of this calculation only, that all of the registrant's directors and executive officers are affiliates).

(Applicable only to corporate registrants) Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: **24,568,351 as of 3/13/2015**

Documents incorporated by reference: **None**

SEC 1673 (01-12)

Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

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PRELIMINARY NOTE

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

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

As of December 31, 2014, we became an accelerated filer. We elected to provide the optional scaled disclosure allowed for smaller reporting companies in this Form 10-K to provide us with sufficient time to transition into the fuller reporting standard.

PART I

ITEM 1. BUSINESS

General

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 power systems and batteries for the military, commercial and medical markets. We have organized our business into two divisions, as follows:

- 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, emergency services and other personnel through our ***Training and Simulation Division***:

  We provide simulators, systems engineering support and software products for military operations and vehicle driving trainings to the United States military, government, municipalities and private industry; and

  We provide specialized "use-of-force" training simulators and systems for police, security personnel and the military under the trade name MILO Range™ ("MILO Range").

- 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, homeland security and medical 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 through our ***Power Systems Division***:

  We provide high-end electronics engineering and design services, system integration services, rapid prototyping, and vertically-integrated production services for military, aerospace, and industrial customers, 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;

  We develop and sell rechargeable and primary lithium batteries and smart chargers to the military and medical markets and to private defense industry in the Middle East, Europe and Asia under our Epsilor nameplate;

  We develop, manufacture and market primary Zinc-Air batteries, rechargeable batteries and battery chargers for the military, focusing on applications that demand high energy and light weight, such custom portable power systems like our Soldier Wearable Integrated Power Equipment System (SWIPES™) power hub product; and

  We produce water-activated lifejacket lights for commercial aviation and marine applications under our Electric Fuel nameplate.

Background

We were incorporated in Delaware in 1990 under the name "Electric Fuel Corporation," and we changed our name to "Arotech Corporation" on September 17, 2003. We operate through our various subsidiaries (all of which are 100% owned by us):

- FAAC Incorporated, a Michigan corporation located in Ann Arbor, Michigan (Training and Simulation Division);
- Epsilor-Electric Fuel Ltd., an Israeli corporation located in Beit Shemesh, Israel (between Jerusalem and Tel-Aviv) and in Dimona, Israel (in Israel's Negev desert area) (Power Systems Division);
- UEC Electronics, LLC, a South Carolina limited liability company located in Hanahan, South Carolina (Power Systems Division); and
- Electric Fuel Battery Corporation, a Delaware corporation in the process of being relocated from Auburn, Alabama to UEC's facilities in Hanahan, South Carolina (Power Systems Division).

Unless the context requires otherwise, all references to us refer collectively to Arotech Corporation and its subsidiaries.

Our results for 2013 and 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.

For financial information concerning the business segments in which we operate, see Note 16.b. of the Notes to the Consolidated Financial Statements. For financial information about geographic areas in which we engage in business, see Note 16.c. of the Notes to the Consolidated Financial Statements.

Facilities

Our principal executive offices are located at 1229 Oak Valley Drive, Ann Arbor, Michigan 48108, and our toll-free telephone number at our executive offices is (800) 281-0356. Our corporate website is www.arotech.com. Our periodic reports, as well as recent filings relating to transactions in our securities by our executive officers and directors, that have been filed with the Securities and Exchange Commission in EDGAR format are made available through hyperlinks located on the investor relations page of our website, at http://ir.stockpr.com/arotech/all-sec-filings , as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. Reference to our websites does not constitute incorporation of any of the information thereon or linked thereto into this annual report.

The offices and facilities of our Power Systems Division are located in Hanahan, South Carolina, in Auburn, Alabama (in the process of being relocated to Hanahan, South Carolina), and in Israel (in Beit Shemesh and Dimona, both of which are within Israel's pre-1967 borders). Most of the members of our senior management work extensively out of our facilities in Beit Shemesh; our financial operations are conducted primarily from our principal executive offices in Ann Arbor, Michigan, which is the headquarters of our Simulation Division; the Simulation Division also maintains offices in Royal Oak, Michigan and in Orlando, Florida.

Training and Simulation Division

Our Training and Simulation Division develops, manufactures and markets an extensive array of trainers and simulators that provide interactive and situational training for military, law enforcement and commercial customers. Our simulators safely and economically train people, from municipal rail and bus drivers to military convoy crews, to respond immediately and appropriately in threatening and dangerous situations while under extreme pressure. During 2014 and 2013, revenues from our Training and Simulation Division were approximately $56.4 million and $63.4 million, respectively.

The Training and Simulation Division concentrates on three different product areas:

- Our *Vehicle Simulation* group provides high fidelity vehicle simulators for use in operator training;
- Our *Air Warfare Simulations* group provides weapon simulations used to train military pilots in the effective use of air launched weapons; and
- Our *Use of Force* group provides training products focused on the proper employment of hand carried weapons and is marketed under our MILO Range nameplate.

Vehicle Simulation

We provide simulators, systems engineering support and software products focused on training vehicle operators for cars and trucks. We provide these products to the United States military, government, municipalities, and private industry. Our fully interactive driver-training systems feature state-of-the-art vehicle simulator technology enabling training in situation awareness, risk analysis and decision making, emergency reaction and avoidance procedures, and proper equipment operation techniques. We also offer simulation software applications, consulting services, and custom software and hardware development services primarily for use by the automobile industry and universities engaged in the study of vehicle performance or operator/vehicle interactions. Our simulators have successfully trained hundreds of thousands of drivers.

Our Vehicle Simulation group focuses on the development and delivery of complete driving simulations for a wide range of vehicle types – such as trucks, automobiles, subway trains, buses, fire trucks, police cars, ambulances, airport ground vehicles, and military vehicles. Additionally, we are a prime contractor in respect of the U.S. Army's Virtual Clearance Training Suite (VCTS) program. In 2014, our Vehicle Simulations group accounted for approximately 42.0% of our Training and Simulation Division's revenues.

We believe that we have held a dominant market share in U.S. military wheeled vehicle operator driver training simulators since 1999 and that we are currently one of three significant participants in the U.S. municipal wheeled vehicle simulators market.

Air Warfare Simulations

In the area of Air Warfare Simulations, we believe we are a premier developer of validated, high fidelity analytical models and simulations of tactical air and land warfare systems for all branches of the Department of Defense and its related industrial contractors. Our simulations are found in systems ranging from instrumented air combat and maneuver training ranges (such as Top Gun), full task training devices such as the F-18 Weapon Tactics Trainer, and in the on-board computer of many fighter jet aircraft. We supply on-board software to support weapon launch decisions for the F-15, F-16, F-18, F-22 and Joint Strike Fighter (JSF) fighter aircraft. Two of our key Air Warfare Simulations programs are the VCTS and our trainer for Air National Guard boom operators. VCTS trains route clearance teams on techniques to detect and neutralize improvised explosive devices (IEDs). Our trainer for Air National Guard Boom Operators trains the boom operators for the performance of in-flight refueling. Boom operators control the equipment on a specially designed, refueling aircraft that passes fuel to other aircrafts in midair. We recently commenced production of this trainer and expect to start generate revenue from these trainers in 2015. In 2014, our Air Warfare Simulations group accounted for 35.0% of our Training and Simulation Division's revenues.

Use-of-Force

We are a leading provider of interactive, multimedia, fully digital use-of-force training simulators for law enforcement, security, military and similar applications. With a large customer base spread over twenty countries around the world, we are a leader in the supply of simulation training products to law enforcement, governmental, and commercial clients. We conduct our interactive training activities and market our interactive training products, such as the MILO Range (Interactive Use-of-Force and Firearms Training), the MILO Classroom Trainer (a state-of-the-art Computer Based Training (CBT) system that allows students to interact with realistic interactive scenarios projected life-size in the classroom), and the MILO Range FDU (firearm diagnostics unit), using our MILO Range nameplate. In 2014, our Use-of-Force group accounted for 16.0% of our Training and Simulation Division's revenues.

Warranty

We typically offer a one to two year warranty for most of our products. Additionally, we sell extended warranties to our existing customers. In 2014, warranty revenue accounted for 7.0% of our Training and Simulation Division's revenues.

Marketing and Customers

We market our Simulation Division products to all branches of the U.S. military, federal and local government, municipal transportation departments, and public safety groups. Municipalities throughout the U.S. are using our vehicle simulators and use-of-force products, and our penetration in Asia, Europe and the Americas continues through the use of commissioned sales agents and regional distributors.

We have long-term relationships, many of over ten years' duration, with the U.S. Air Force, U.S. Navy, U.S. Army, U.S. Marine Corps, Department of Homeland Security, and most major Department of Defense training and simulation prime contractors and related subcontractors. The quality of our customer relationships is illustrated by the multiple program contract awards we have earned from many of our customers.

Competition

Our technical excellence, superior product reliability, high customer satisfaction and warranty services have enabled us to develop market leadership and attractive competitive positions in each of our product areas.

Vehicle Simulators

Several potential competitors in this segment are large, diversified defense and aerospace conglomerates, such as L-3 Communications and Leidos, who do not focus on our specific niches. As such, we are able to provide service on certain large military contracts through strategic agreements with these organizations or can compete directly with these organizations based on our strength in developing higher quality software solutions. In municipal market applications, we compete against smaller, less sophisticated software companies, such as Boron and Simulation Technology. Many of our competitors have financial, technical, marketing, sales, manufacturing, distribution and other resources significantly greater than ours.

Air Warfare Simulations

Currently no significant competitors participate in the markets we serve around our weapon simulation niche. Our nearly 45-year history in this space provides us with a library of resources that would require substantial investment by a competitor to offer a comparable product. The companies that have the potential to compete with us if they chose are the companies that now subcontract this work to us: Boeing Company (NYSE: BA) (“Boeing”), Raytheon Company (NYSE: RTN) (“Raytheon”), and Cubic Corporation (NYSE: CUB) (“Cubic”).

Use of Force

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

Power Systems Division

Our Power Systems Division develops and provides sophisticated portable energy solutions for diverse applications, including military equipment carried by soldiers, hybrid energy generation/storage in austere environments, power management and power distribution, and clean, stable power for tactical vehicles, unmanned vehicles and medical devices, all of which are designed to complex and demanding customer specifications. During 2014 and 2013, revenues from our Power Systems Division were approximately $47.2 million and $25.1 million, respectively. Revenues in 2013 and the first quarter of 2014 did not include the results of UEC, which we did not own until April 2014. On a *pro forma* basis, assuming we had owned all components of our Power Systems Division since January 1, 2013, Power Systems Division revenues in 2014 and 2013 would have been approximately $59.7 million and $57.6 million, respectively.

Electronics Engineering and Design Services for the Military

Introduction

We design, engineer, and manufacture proprietary electronics, spanning components and sub-assemblies, for a broad range of end use systems in multiple markets to include aerospace, defense, industrial and medical. We specialize in electronic/electromechanical systems, subsystems, and component level requirements, which include circuit card assemblies and wire and cable assemblies. Our products range from complex integrated assemblies up through multi-rack functional systems and test equipment.

We specialize 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. Our unique brand of comprehensive service is highly sought-after by customer agencies such as the Marine Corps Systems Command (“MARCORSYSCOM”), Space and Naval Warfare Systems Command (“SPAWAR”), and Tank Automotive Command (“TACOM”), as well as large prime contractors such as Raytheon, Boeing, Lockheed Martin Corporation (NYSE: LMT) (“Lockheed Martin”), and BAE Systems plc (LON: BA) (“BEA”). Our key program areas in this field include the following:

- We supply the United States Marine Corps (USMC) with its program of record Ground Renewable Expeditionary Energy Network Systems (GREENS), a renewable power generation, intelligent energy storage and distribution system for troops serving in austere environments. GREENS is the only DoD Program of Record for renewable power generation. We are currently launching a commercial version of this product, targeting both domestic and international markets.

- We supply the USMC with Mobile Electric Hybrid Power Sources (MEHPS), a product that incorporates both solar collection and high density battery technologies to intelligently reduce run time and optimize efficiency of tactical generators. This single system is scalable to 3.5kW, 7kW and 10.5kW output making it an ideal solution for multiple military missions.

- We have designed and continue to refine a proprietary Distributed Power Control and Management System (DPCMS) that replaces electrical systems on aging tactical vehicles. This enables vehicles that have already exceeded the OEM’s recommended life to be refurbished and to take advantage of new automotive communication protocols J-1939. These refurbishments permit aging tactical vehicle fleets to function as a new vehicle, without the cost implications of replacing it with a new vehicle. This system has been successfully tested on two Light Armored Vehicles by the USMC.

- We have developed significant expertise and past performance qualifications in the area of solutions for Command, Control, Communications, Computers Intelligence. Surveillance and Reconnaissance (C4ISSR), providing these solutions to, among others, SPAWAR and Raytheon.

Competition

Our main competitors for renewable energy and power management systems products and services are ZeroBase Energy, LLC, a provider of hybrid and renewable power systems, Energy Technologies, Inc., a provider of power systems, EnerDel, Inc., a provider of compact lithium-ion-powered batteries for transportation, utility grid and industrial electronics markets, and Solar Stik, Inc., a provider of portable and custom power solutions, as well as companies that compete on proposals to Raytheon, including Celestica Inc. (NYSE: CLS), Ducommun Incorporated (NYSE: DCO), Sanmina-SCI Corporation (Nasdaq: SANM), Jabil Circuit, Inc., a supplier of manufacturing services for circuit board assemblies, and Woven Electronics Corporation, an electronics parts supplier.

We believe the fact that we have full-service engineering coupled with state-of-the-art manufacturing provides us with an advantage over most of our competitors, enabling us to customize solutions for customers, quickly develop prototype and first-article units, and move into full-rate production before many of our competitors are beyond the requirements definition phase. Few in the industry have both the agility and capabilities required to offer this advantage. As a manufacturer, we build our own cable harnesses, circuit cards, and integrated complex assemblies, which enables us to control our own supply chain and program schedules. These combined capabilities have resulted in lower costs and shorter lead times, both very important discriminators for our customers in this current fiscal environment.

Marketing and Customers

We market to a diverse array of customers. The renewable and hybrid energy market prior to 2015 has been primarily focused on the U.S. Department of Defense. After having achieved significant success we are modifying products to better meet commercial/industrial demands. We are refocusing marketing efforts internationally on the heels of our tremendously successful GREENS and MEHPS. Specific efforts include attendance at international trade shows, marketing videos, establishing networks within the U.S. commercial service, an increase in social media engagement and technical brochures of products.

Over ninety percent of revenues are attributed to existing customers with new requirements or referrals of new customers from our existing customer base. This fantastic customer loyalty is closely tied to our technical solutions, our on-time delivery and quality of product metrics (consistently 98% or greater).

Manufacturing

Our four AS9100 and ISO 9001 registered facilities are located in the tri-county area of Charleston, South Carolina. All facilities are well equipped with state of the art design tools and automated manufacturing equipment to support our customers' design, testing, and production needs.

Lithium Batteries and Charging Systems for Military, Industrial and Medical Markets

We sell lithium batteries and charging systems, including the SWIPES™ power hubs we produce for the Army's Soldier Warrior program, to the military, industrial and medical markets.

We specialize in the design and manufacture of primary and rechargeable batteries, related electronic circuits and associated chargers for military applications. We have experience in working with government agencies, the military and large corporations. Our technical team has significant expertise in the fields of electrochemistry, electronics, software and battery design, production, packaging and testing. We also specialize in custom products that must meet the highest possible military, industrial and medical specifications.

Our SWIPES™ power hub utilizes the MOLLE (Modular Lightweight Load-carrying Equipment) vest and integrates force protection electronics and communications equipment with an advanced battery. The system utilizes a modular power distribution system that is powered by BA-8180/U, BA-8140/U Zinc-Air batteries or the LI-145, BB-2590 rechargeable batteries for direct power of equipment, allowing for extended mission times without the burden of power source swaps or charging due to their high energy density, and reducing battery weight soldiers carry by up to 30%. The batteries continuously charge the secondary batteries inside various devices, such as two way radios, GPS units and shot detection systems. The SWIPES™ product allows for individual tailoring by the warfighter and is designed to accept new applications as they become available. The SWIPES™ power hub was recognized by the U.S Army Research, Development and Engineering Command as one of the U.S. Army's ten greatest inventions of 2010.

Customers

The principal customers for our lithium batteries during 2014 were the Israel Ministry of Defense, Elbit, Air Cruisers, Aeronautics, and Thales. The principal customer for our SWIPES™ power hub during 2014 was the U.S. Army.

Competition

There are a limited number of players globally that are a one-stop-shop for high-end custom portable power. Our main competitors are Bren-Tronics, Ultralife, Enersys, Palladium Energy, SAFT, Electrochem, RRC Power Solutions and Inspired Energy,

Manufacturing

Our US manufacturing facility for batteries and chargers is in the process of being moved from Auburn, Alabama to Hanahan, South Carolina, in the Charleston area. In parallel we have manufacturing facilities in Beit Shemesh and Dimona, both located in Israel.

Zinc-Air Batteries and Chargers for the Military

Introduction

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

Our batteries have been used in both Afghanistan (Operation Enduring Freedom) and in Iraq (Operation Iraqi Freedom). Our BA-8180/U Zinc-Air battery was recognized by the U.S Army Research, Development and Engineering Command as one of the U.S. Army's ten greatest inventions of 2003.

Our manufacturing facilities for Zinc-Air batteries, rechargeable batteries and battery chargers for the military have been granted ISO 9001 "Top Quality Standard" certification.

Markets/Applications

As an external alternative to the popular lithium based BA-5590/U, the BA-8180/U can be used in many applications operated by the BA-5590/U. The BA-8180/U can be used for a variety of military applications.

Customers

The principal customers for our Zinc-Air batteries during 2014 were the U.S. Army's Communications-Electronics Command (CECOM) and the Defense Logistics Agency (DLA). In addition, we continue to further penetrate Special Forces and other specific U.S. military units with direct sales.

Competition

The BA-8180/U is the only Zinc-Air battery to hold a U.S. Army battery designation and a National Stock Number (NSN). (An NSN is a Department of Defense catalog number assigned to products authorized for use by the U.S. military. With an NSN, any active, reserve or associated military personnel may purchase these products up to defined limits without need for a requisition or similar purchasing documentation.) The BA-8180/U competes with other primary (disposable) batteries, and primarily lithium based batteries. In some cases, it will also compete with rechargeable batteries.

Zinc-Air batteries have many advantages over primary lithium battery packs. Zinc-Air batteries are inherently safer than primary lithium battery packs in storage, transportation, use, and disposal. They are also more cost-effective than primary lithium batteries. They are lightweight, with up to twice the energy density of primary lithium battery packs. Zinc-Air batteries for the military are also under development by Spectrum Brands Holdings, Inc. (NYSE: SPB), the successor to Rayovac Corporation ("Rayovac"). Rayovac's military Zinc-Air batteries utilize cylindrical cells, rather than the prismatic cells that we developed. While cylindrical cells may provide higher specific power than our prismatic cells, we believe they will generally have lower energy densities and may be more difficult to manufacture.

The most popular competing primary battery in use by the US Armed Forces is the BA-5590/U, which uses lithium-sulfur dioxide ($LiSO_2$) cells. The largest suppliers of LiSO2 batteries to the US military are believed to be Saft America Inc.(EPA: SAFT) ("Saft") and Eagle Picher Technologies LLC, a provider of integrated power solutions ("Eagle Picher"). The battery compartment of most military communications equipment, as well as other military equipment, is designed for the XX90 family of batteries, of which the BA-5590/U battery is the most commonly deployed. Another primary battery in this family is the BA-5390/U, which uses lithium-manganese dioxide (LiMnO2) cells. Suppliers of LiMnO2 batteries include Ultralife Batteries Inc., Saft and Eagle Picher.

Rechargeable batteries in the XX90 family include lithium-ion (BB-2590/U) and nickel-metal hydride (BB-390/U) batteries which may be used in training missions in order to save the higher costs associated with primary batteries. These rechargeable batteries have also become more prevalent in combat use as their energy densities improve, their availability expands and their State-of-Charge Indicator (SOCI) technologies become more reliable.

Our BA-8180/U does not fit inside the XX90 battery compartment of any military equipment, and therefore is connected externally using an interface adapter that we also sell to the Army. We believe that the greatly extended mission time and lower total mission cost provided by our BA-8180/U often greatly outweigh the slight inconvenience of fielding an external battery.

Manufacturing

Our facilities for Zinc-Air military batteries and chargers are in the process of being moved from Auburn, Alabama to Hanahan, South Carolina, in the Charleston area.

Lifejacket Lights

Products

We have a product line consisting of seven lifejacket light models. Five of these models are for use with marine life jackets and two are for use with aviation life vests. All of our lifejacket lights work in both freshwater and seawater. Each of our lifejacket lights is certified for use by relevant governmental agencies under various U.S. and international regulations, including the U.S. Federal Aviation Administration's Technical Standard Order ("TSO") and the International Convention for the Safety of Life at Sea ("SOLAS"). We manufacture, assemble and package all our lifejacket lights in our factory in Beit Shemesh, Israel.

Marketing

We market our marine safety products through our own network of distributors in Europe, the United States, Asia and Oceania. We market our lights to the commercial aviation industry through an independent company that receives a commission on sales.

Competition

Our primary competitor in the field of aviation safety products, including TSO -approved lifejacket lights, is ACR Electronics Inc. of Hollywood, Florida. Other significant competitors in the marine market include Daniamant Aps of Denmark and England, a provider of survivor location lights, and Alcares ApS of Denmark, a manufacturer of marine emergency lights.

Flow Battery

We are engaged in preliminary research and development of an iron flow battery for grid storage.

Electricity generation can be highly variable, especially if the supply is generated from intermittent, renewable sources such as the sun or wind. A flow battery can store a substantial amount of grid power produced by renewables and return it to the grid as needed, providing a buffer between the supply and demand of electricity. For example, in a solar power station, more power might be generated in the mid-day sun than is needed. The excess power could be stored in the flow battery during the day and used on demand without the need to generate additional electricity at that time.

Flow battery plants can help minimize the necessity of building new fuel-based power plants to address momentary peak demand. It can do this by using stored energy during times of peak demand and collecting energy at trough times, reducing the need to scale fuel-based energy production. This becomes even more crucial as more renewables come on line with their highly variable output. We believe this would be an integral part of the initiative to modernize the electrical power grid.

According to the Boston Consulting Group, the grid storage market is estimated to exceed $400 billion by 2030. This represents a global storage capacity of 430 giga-watts. To give some perspective, grid storage currently approximates 100 giga-watts, so the market is expected to more than quadruple in only 16 years.

Preliminary research and development into the iron flow battery has yielded what we believe to be promising results in lab tests, and we have filed a patent application covering our new technology. We are currently in our next stage of development, wherein we hope to demonstrate a lab-scale pilot battery, complete with a unique membrane and an in-house manufactured anode. We are working to complete this stage of the project, at which point we would move to the next stage: demonstrating a 20kW/100kWh pilot battery (approximately the size of a shipping container).

Backlog

We generally sell our products under standard purchase orders. Orders constituting our backlog are subject to changes in delivery schedules and are typically cancelable by our customers until a specified time prior to the scheduled delivery date. Accordingly, our backlog is not necessarily an accurate indication of future sales. As of December 31, 2014 and 2013, our funded backlog for the following year was approximately $69.9 million and $58.0 million, respectively, divided between our divisions as follows:

Division	2014	2013
Training and Simulation Division	$ 45,731,000	$ 45,892,000
Power Systems Division	24,175,000	12,067,000
TOAL:	$ 69,906,000	$ 57,959,000

Major Customers

During 2014 and 2013, including both of our divisions, various branches of the United States military accounted for approximately 56% and 55% of our revenues. See “Item 1A. Risk Factors – Risks Related to Government Contracts,” below.

Patents and Trade Secrets

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

Our intellectual property portfolio includes two issued U.S. patents, which expire between 2020 and 2030. We also have two patent applications pending for examination in foreign jurisdictions.

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

Research and Development

During the years ended December 31, 2014 and 2013, our research and product development expenses were approximately $3.3 million and $3.0 million, respectively. Not included in these figures is research and development where the costs were underwritten by customers or charged directly to projects as non-recovered engineering costs.

Employees

As of December 31, 2014, we had approximately 531 total employees worldwide, the majority of whom were full-time employees. Our success will depend in large part on our ability to attract and retain skilled and experienced employees.

With respect to those of our employees who are Israeli residents, Israeli law generally requires severance pay upon the retirement or death of an employee or termination of employment without due cause; additionally, some of our senior employees have special severance arrangements, certain of which are described under “Item 11. Executive Compensation – Employment Contracts,” below. We currently partially fund our ongoing severance obligations by making monthly payments to approved severance funds or insurance policies.

Regulatory Matters

Our businesses are heavily regulated in most of our markets. We deal with numerous U.S. government agencies and entities, including, but not limited to, branches of the U.S. military and the Department of Homeland Security. Similar government authorities exist in our international markets. We are also subject to export regulations. For additional information related to export regulations, see Item 1A, entitled “Risk Factors – We may not be able to receive or retain the necessary licenses or authorizations required for us to export or re-export….”

Government Contracts

The U.S. government, and other governments, may terminate any of our government contracts at their convenience, as well as for default, based on our failure to meet specified performance requirements. If any of our U.S. government contracts were to be terminated for convenience, we generally would be entitled to receive payment for work completed and allowable termination or cancellation costs. If any of our government contracts were to be terminated for default, generally the U.S. government would pay only for the work that has been accepted and can require us to pay the difference between the original contract price and the cost to re-procure the contract items, net of the work accepted from the original contract. The U.S. government can also hold us liable for damages resulting from the default. For additional information related to government contracts, see Item 1A. “Risk Factors – Risks Related to Government Contracts.”

Environmental

We are subject to various federal, state, local and non-U.S. laws and regulations relating to environmental protection, including the discharge, treatment, storage, disposal and remediation of hazardous substances and wastes. We continually assess our compliance status and management of environmental matters to ensure our operations are in substantial compliance with all applicable environmental laws and regulations. Investigation, remediation, operation and maintenance costs associated with environmental compliance and management of sites are a normal, recurring part of our operations. These costs often are allowable costs under our contracts with the U.S. government. It is reasonably possible that continued environmental compliance could have a material impact on our results of operations, financial condition or cash flows if additional work requirements or more stringent clean-up standards are imposed by regulators, new areas of soil and groundwater contamination are discovered and/or expansions of work scope are prompted by the results of investigations.

ITEM 1A. RISK FACTORS

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

Business-Related Risks

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

We were incorporated in 1990 and began our operations in 1991. We have funded our operations principally from funds raised in public and private offerings of our common stock and equity and debt securities convertible or exercisable into shares of our common stock; research contracts and supply contracts; funds received under research and development grants from the Government of Israel; and sales of products that we and our subsidiaries manufacture. We have incurred significant net losses since our inception. Additionally, as of December 31, 2014, we had an accumulated deficit (including discontinued operations) of approximately $179.6 million. In an effort to reduce operating expenses and maximize available resources, we have consolidated certain of our subsidiaries, shifted personnel and reassigned responsibilities. We have also taken a variety of other measures to limit spending and will continue to assess our internal processes to seek additional cost-structure improvements. Although we believe that such steps have helped to reduce our operating expenses and maximize our available resources and enabled us to operate at a net profit in the recent past, there can be no assurance that we will be able to maintain profitability consistently or that our business will continue to exist.

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

We require substantial funds to operate our business, including marketing our products and developing and marketing new products. To the extent that we are unable to fully fund our operations, including repaying our outstanding debt, through profitable sales of our products and services, we will need to seek additional funding, including through the issuance of equity or debt securities. In addition, based on our internal forecasts, the assumptions described under “Liquidity and Capital Resources” below, and subject to the other risk factors described herein, we believe that our present cash position and anticipated cash flows from operations and lines of credit should be sufficient to satisfy our current estimated cash requirements for 2015. However, in the event our internal forecasts and other assumptions regarding our liquidity prove to be incorrect, we may need to seek additional funding. There can be no assurance that we will obtain any such additional financing in a timely manner, on acceptable terms, or at all. If additional funds are raised by issuing equity securities or convertible debt securities, stockholders may incur further dilution. If we incur additional indebtedness, we may be subject to affirmative and negative covenants that may restrict our ability to operate or finance our business. If additional funding is not secured, we will have to modify, reduce, defer or eliminate parts of our present and anticipated future commitments and/or programs.

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

Our bank and other indebtedness (short and long term) totaled approximately $21.3 million as of December 31, 2014 (not including trade payables, other account payables, capital leases, and accrued severance pay), of which $33,000 was bank working capital lines of credit and approximately $19.3 million represents two term loans entered into to fund the UEC acquisition. In addition, we may incur additional indebtedness in the future. Accordingly, we are subject to the risks associated with significant indebtedness, including:

- we must dedicate a portion of our cash flows from operations to pay principal and interest and, as a result, we may have less funds available for operations and other purposes;

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

- we are more vulnerable to economic downturns and fluctuations in interest rates, less able to withstand competitive pressures and less flexible in reacting to changes in our industry and general economic conditions; and

- if we default under any of our existing debt instruments, including paying the outstanding principal when due, and if our creditors demand payment of a portion or all of our indebtedness, we may not have sufficient funds to make such payments.

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

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

In February 2013, our primary bank increased our credit line ("Line of Credit") by 50%, from $10.0 million to $15.0 million, and the expiration of the Line of Credit was extended to May 31, 2015. Additionally, in April 2014 we agreed with our bank to amend the Line of Credit to add two term loans to it: an $18.0 million 61-month senior term loan at an interest rate of 3.75% over LIBOR, and a $4.5 million 61-month B term loan at an interest rate of 5.5% over LIBOR along with extending the Line of Credit until May 2016.

Our amended and restated credit agreement contains certain financial covenants. Commencing with the fiscal quarter ending June 30, 2014, our "Fixed Charge Coverage Ratio", determined on a combined basis with UEC and otherwise computed in the same manner as under the previous version of the credit agreement (the "Original Credit Agreement"), has been raised to 1.25-to-1 from 1.10-to-1. "Net Advances to Affiliates" are now defined with reference to FAAC or UEC, as the case may be, and may not increase by more than $5.5 million on a combined basis for both borrowers in any calendar year over a "Base Amount" to be determined by mutual agreement of Arotech and the bank.

In addition, 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 $4.5 million 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.

A failure to comply with the obligations contained in the agreements governing our indebtedness could result in an event of default under such agreements which could result in an acceleration of debt under other instruments evidencing indebtedness that contain cross-acceleration or cross-default provisions. If our indebtedness were to be accelerated, there can be no assurance that our future cash flow or assets would be sufficient to repay in full such indebtedness. We were in compliance with all debt covenants as of December 31, 2014.

We may not be successful in operating our electronics engineering and design services for the military business, which is a new business for us.

The business of electronics engineering and design services for the military is a new business for us and our management group has limited experience operating this particular type of business. Although we have retained UEC's management personnel, we cannot assure that such personnel will continue to work for us or that we will be successful in managing this new business. Additionally, we may not be able to successfully integrate the operations and personnel of UEC into our business, and we may not realize any anticipated benefits of such acquisition. If we are unable to successfully operate this new business, our business, financial condition and results of operations could be materially impaired.

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

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

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

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

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

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

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

Our earnings may decline if we write off additional goodwill and other intangible assets.

As of December 31, 2014, we had recorded goodwill of $45.4 million. Any future impairment of goodwill or other intangible assets may have a significant impact on earnings. Goodwill is not amortized, but is tested for impairment at the reporting unit level. Goodwill is required to be tested for impairment annually and between annual tests if events or circumstances indicate that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, which, in the Power Systems Division in 2014, was a six percent margin. There are numerous risks that may cause the fair value of a reporting unit to fall below its carrying amount, which could lead to the measurement and recognition of goodwill impairment. These risks include, but are not limited to, adverse changes in legal factors or the business climate, an adverse action or assessment by a regulator, a more-likely-than-not expectation that all or a significant portion of a reporting unit may be disposed of, a sustained decline in our market capitalization, significant negative variances between actual and expected financial results, and lowered expectations of future financial results.

Significant judgments inherent in these analyses include assumptions about appropriate sales growth rates, WACC and the amount of expected future net cash flows. The judgments and assumptions used in the estimate of fair value are generally consistent with the projections and assumptions that are used in current operating plans. Such assumptions are subject to change as a result of changing economic and competitive conditions. The determination of fair value is highly sensitive to differences between estimated and actual cash flows and changes in the related discount rate used to evaluate the fair value of the reporting units and trade name.

The goodwill of our Training and Simulation Division equaled $24.4 million and the goodwill of our Power Systems Division equaled $21.0 million at December 31, 2014. Based on the discounted cash flow valuation at December 31, 2014, an increase in the WACC or changes in other significant variables for the Power Systems Division could potentially result in impairment.

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

Some of the components of our products contain elements that are known to pose potential safety risks. In addition to these risks, there can be no assurance that accidents in our facilities will not occur. Any accident, whether occasioned by the use of all or any part of our products or technology or by our manufacturing operations, could adversely affect commercial acceptance of our products and could result in significant production delays or claims for damages resulting from injuries. Any of these occurrences would materially adversely affect our operations and financial condition. In the event that our products fail to perform as specified, users of these products may assert claims for substantial amounts. These claims could have a materially adverse effect on our financial condition and results of operations. There is no assurance that the amount of the general product liability insurance that we maintain will be sufficient to cover potential claims or that the present amount of insurance can be maintained at the present level of cost, or at all.

We are subject to the Dodd-Frank Wall Street Reform and Consumer Protection Act disclosure requirements regarding the use of "conflict minerals"

Beginning in 2014, the Dodd-Frank Wall Street Reform and Consumer Protection Act imposes new disclosure requirements regarding the use of "conflict minerals" mined from the Democratic Republic of Congo and adjoining countries in products, whether or not these products are manufactured by third parties. The definition of "conflict minerals" includes tin, tantalum, tungsten and gold, and their derivatives, some of which we use in the activities of our Power Systems Division. These new requirements could affect the pricing, sourcing and availability of minerals used in the manufacture of our products. There will be additional costs associated with complying with the disclosure requirements, such as costs related to determining the source of any conflict minerals used in our products. Our supply chain is complex and we may be unable to verify the origins for all metals used in our products. We may also encounter challenges with our customers and stockholders if we are unable to certify that our products are conflict free.

Our fields of business are highly competitive.

The competition to develop defense and security products and to obtain funding for the development of these products is, and is expected to remain, intense.

Our defense and security products compete with other manufacturers of specialized training systems.

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

Many of our competitors have financial, technical, marketing, sales, manufacturing, distribution and other resources significantly greater than ours. If we are unable to compete successfully in each of our operating areas, our business and results of operations could be materially adversely affected.

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

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

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

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

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

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

We are highly dependent on the managers of our Simulation Division and our Power Systems Division, and the loss of the services of any of these persons could adversely affect us. We are especially dependent on the services of our President and Chief Executive Officer, Steven Esses, and our Executive Chairman, Robert S. Ehrlich. The loss of either Mr. Esses or Mr. Ehrlich could have a material adverse effect on us. We are party to employment agreements with Mr. Esses and Mr. Ehrlich, both of which agreements expire at the end of 2017. We do not have key-man life insurance on either Mr. Esses or Mr. Ehrlich.

We face risks related to general domestic and global economic conditions.

In general, our operating results can be significantly affected by negative economic conditions, high labor, material and commodity costs and unforeseen changes in demand for our products and services. These risks are heightened as economic conditions globally have deteriorated significantly and may remain at recessionary levels for the foreseeable future. The current recessionary conditions could have a potentially significant negative impact on demand for our products and services, which may have a direct negative impact on our sales and profitability, as well as our ability to generate sufficient internal cash flows or access credit at reasonable rates to meet future operating expenses, service debt and fund capital expenditures.

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

A significant portion of our sales are made to customers located outside the U.S., primarily in Europe and Asia. In 2014 and 2013, 19.1% and 16.5%, respectively, of our revenues, were derived from sales to customers located outside the U.S. We expect that our international customers will continue to account for a substantial portion of our revenues in the near future. Sales to international customers may be subject to political and economic risks, including political instability, currency controls, exchange rate fluctuations, foreign taxes, longer payment cycles and changes in import/export regulations and tariff rates. In addition, various forms of protectionist trade legislation have been and in the future may be proposed in the U.S. and certain other countries. Any resulting changes in current tariff structures or other trade and monetary policies could adversely affect our sales to international customers. See also “Israel-Related Risks,” below.

Risks Related to Government Contracts

A significant portion of our business is dependent on government contracts and reduction or reallocation of defense or law enforcement spending could reduce our revenues.

Most of our customers to date have been in the public sector of the U.S., including the federal, state and local governments and the military, and in the public sectors of a number of other countries. A significant decrease in the overall level or allocation of defense or law enforcement spending in the U.S. or other countries could reduce our revenues and have a material adverse effect on our future results of operations and financial condition.

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

A decline in the U.S. Government defense budget, changes in budgetary priorities or timing of contract awards may adversely affect our future revenues and limit our growth prospects.

Revenues under contracts with the U.S. Department of Defense ("DoD"), either as a prime contractor or subcontractor to other contractors, represent a substantial portion of our total revenues. Our operating results could be adversely affected by spending caps or changes in the budgetary priorities of the U.S. Government or the DoD, as well as delays in program starts or the award of contracts or task orders under contracts.

An impasse in federal budget decision-making could lead to substantial delays or reductions in federal spending. For example, as a result of inability of the U.S. Government to reach agreement on budget reduction measures required by the Budget Control Act of 2011, sequestration triggered substantial automatic spending reductions beginning in January 2013, divided between defense and domestic spending over a nine-year period. As a result, U.S. Government funding for certain of our customers may be reduced, delayed or eliminated, which could significantly impact these customers' demand for our products and services and if so would have a material adverse effect on our business, results of operations and cash flows. While the future impact of sequestration is uncertain, these automatic across-the-board budget cuts in sequestration could have significant negative consequences to our business and industry.

In years when Congress does not complete its budget process before the end of its fiscal year (September 30), government operations are funded through a continuing resolution (CR) that temporarily funds federal agencies. Recent CRs have generally provided funding at the levels provided in the previous fiscal year and have not authorized new spending initiatives. When the federal government operates under a CR, delays can occur in the procurement of products and services. Historically, such delays have not had a material effect on our business; however, should sequestration not be alleviated, it could continue to have significant consequences to our business and our industry.

Additionally, our business could be affected if the demand for and priority of funding for combat operations overseas decreases, which may reduce the demand for our services on contracts supporting some operations and maintenance activities in the Department of Defense or if we experience an increase in set-asides for small businesses, which could result in our inability to compete directly for prime contracts.

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

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

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

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

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

- the U.S. Federal Acquisition Regulations, which regulate the formation, administration and performance of government contracts;
- the U.S. Truth in Negotiations Act, which requires certification and disclosure of all cost and pricing data in connection with contract negotiations; and
- the U.S. Cost Accounting Standards, which impose accounting requirements that govern our right to reimbursement under certain cost-based government contracts.

These regulations affect how we and our customers do business and, in some instances, impose added costs on our businesses. Any changes in applicable laws could adversely affect the financial performance of the business affected by the changed regulations. With respect to U.S. government contracts, any failure to comply with applicable laws could result in contract termination, price or fee reductions or suspension or debarment from contracting with the U.S. government.

We may not be able to receive or retain the necessary licenses or authorizations required for us to export or re-export our products, technical data or services, or to transfer technology from foreign sources (including our own subsidiaries) and to work collaboratively with them. Denials of such licenses and authorizations could have a material adverse effect on our business and results of operations.

U.S. regulations concerning export controls require us to screen potential customers, destinations, and technology to ensure that sensitive equipment, technology and services are not exported in violation of U.S. policy or diverted to improper uses or users.

In order for us to export certain products, technical data or services, we are required to obtain licenses from the U.S. government, often on a transaction-by-transaction basis. These licenses are generally required for the export of the military versions of our products and technical data and for defense services. We cannot be sure of our ability to obtain the U.S. government licenses or other approvals required to export our products, technical data and services for sales to foreign governments, foreign commercial customers or foreign destinations.

In addition, in order for us to obtain certain technical know-how from foreign vendors and to collaborate on improvements on such technology with foreign vendors, including at times our own foreign subsidiaries, we may need to obtain U.S. government approval for such collaboration through manufacturing license or technical assistance agreements approved by U.S. government export control agencies.

The U.S. government has the right, without notice, to revoke or suspend export licenses and authorizations for reasons of foreign policy, issues over which we have no control.

Failure to receive required licenses or authorizations would hinder our ability to export our products, data and services and to use some advanced technology from foreign sources. This could have a material adverse effect on our business, results of operations and financial condition.

Our failure to comply with export control rules could have a material adverse effect on our business.

Our failure to comply with these rules could expose us to significant criminal or civil enforcement action by the U.S. government, and a conviction could result in denial of export privileges, as well as contractual suspension or debarment under U.S. government contracts, either of which could have a material adverse effect on our business, results of operations and financial condition.

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

Some of our contracts are fixed-price contracts under which we bear the risk of any cost overruns. Our profits are adversely affected if our costs under these contracts exceed the assumptions that we used in bidding for the contract. Often, we are required to fix the price for a contract before we finalize the project specifications, which increases the risk that we will misprice these contracts. The complexity of many of our engagements makes accurately estimating our time and resources more difficult. In the event we fail to estimate our time and resources accurately, our expenses will increase and our profitability, if any, under such contracts will decrease.

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

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

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

U.S. military contracts account for a significant portion of our business. The U.S. military funds these contracts in annual increments. These contracts require subsequent authorization and appropriation that may not occur or that may be greater than or less than the total amount of the contract. Changes in the U.S. military's budget, spending allocations and the timing of such spending could adversely affect our ability to receive future contracts. None of our contracts with the U.S. military has a minimum purchase commitment, and the U.S. military generally has the right to cancel its contracts unilaterally without prior notice. The loss of, or a significant reduction in, U.S. military business could have a material adverse effect on our business, financial condition, results of operations and liquidity.

Market-Related Risks

The price of our common stock is volatile.

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

- announcements by us, our competitors or our customers;
- the introduction of new or enhanced products and services by us or our competitors;
- changes in the perceived ability to commercialize our technology compared to that of our competitors;
- rumors relating to our competitors or us;
- actual or anticipated fluctuations in our operating results;
- the issuance of our securities, including warrants, in connection with financings and acquisitions; and
- general market or economic conditions.

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

One of the continued listing standards for our stock on the Nasdaq Stock Market (both the Nasdaq Global Market, on which our stock is currently listed, and the Nasdaq Capital Market) is the maintenance of a $1.00 bid price. Our stock price has periodically traded below $1.00 in the past. If our bid price were to decrease and remain below $1.00 for 30 consecutive business days, Nasdaq could notify us of our failure to meet the continued listing standards, after which we would have 180 calendar days to correct such failure or be delisted from the Nasdaq Global Market. Although we would have the opportunity to appeal any potential delisting, there can be no assurances that this appeal would be resolved favorably. As a result, there can be no assurance that our common stock will remain listed on the Nasdaq Global Market. If our common stock were to be delisted from the Nasdaq Global Market, we might apply to be listed on the Nasdaq Capital Market if we then met the initial listing standards of the Nasdaq Capital Market (other than the $1.00 minimum bid standard). If we were to move to the Nasdaq Capital Market, current Nasdaq regulations would give us the opportunity to obtain an additional 180-day grace period if we meet certain net income, stockholders' equity or market capitalization criteria; if at the end of that period we had not yet achieved compliance with the minimum bid price rule, we would be subject to delisting from the Nasdaq Capital Market. Although we would have the opportunity to appeal any potential delisting, there can be no assurances that this appeal would be resolved favorably. In addition, we may be unable to satisfy the other continued listing requirements. As a result, there can be no assurance that our common stock will remain listed on the Nasdaq Stock Market.

While our stock would continue to trade on the over-the-counter bulletin board following any delisting from the Nasdaq, any such delisting of our common stock could have an adverse effect on the market price of, and the efficiency of the trading market for, our common stock. Trading volume of over-the-counter bulletin board stocks has been historically lower and more volatile than stocks traded on an exchange or the Nasdaq Stock Market. As a result, holders of our securities could find it more difficult to sell their securities. Also, if in the future we were to determine that we need to seek additional equity capital, it could have an adverse effect on our ability to raise capital in the public equity markets.

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

Changes in internal controls or accounting guidance could cause volatility in our stock price

Guidance regarding implementation and interpretation of the provisions of Section 404 of the Sarbanes-Oxley Act continues to be issued by the standards-setting community. Smaller reporting companies have been granted permanent exemption from having to obtain an auditors' report on the effectiveness of their internal control over financial reporting. We became an accelerated filer as of December 31, 2014 and are subject to an audit of our internal controls. As a result of the ongoing interpretation of new guidance and the audit testing that may be required to be completed in the future, our internal controls over financial reporting may include an unidentified material weakness that would result in our receiving an adverse opinion on our internal controls over financial reporting from our independent registered public accounting firm. This could result in significant additional expenditures responding to the Section 404 internal control audit, heightened regulatory scrutiny and potentially an adverse effect to the price of our stock.

In addition, due to increased regulatory scrutiny surrounding publicly traded companies, the possibility exists that a restatement of past financial results could be necessitated by an alternative interpretation of present accounting guidance and practice. Although management does not currently anticipate that this will occur, a potential result of such interpretation could be an adverse effect on our stock price.

Failure to maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act could have a material adverse effect on our business and stock price.

During the course of testing our disclosure controls and procedures and internal control over financial reporting, we may identify and disclose material weaknesses or significant deficiencies in internal control over financial reporting that will have to be remedied. Implementing any appropriate changes to our internal control may require specific compliance training of our directors, officers and employees, entail substantial costs to modify our existing accounting systems, and take a significant period of time to complete. Such changes may not, however, be effective in maintaining the adequacy of our internal control over financial reporting, and any failure to maintain that adequacy or inability to produce accurate financial statements on a timely basis could result in our financial statements being unreliable, increase our operating costs and materially impair our ability to operate our business.

Failure to achieve and maintain effective internal control over financial reporting could result in a loss of investor confidence in our financial reports and could have a material adverse effect on our stock price. Additionally, failure to maintain effective internal control over our financial reporting could result in government investigation or sanctions by regulatory authorities.

Compliance with public company obligations, including the securities laws and regulations, is costly and requires significant management resources, and we may fail to comply. We are now an "accelerated filer," and beginning with our Form 10-Q for the quarter ending March 31, 2015 will no longer qualify to report under smaller reporting company disclosure rules, and as a result will be subject to more comprehensive disclosure obligations, with increased compliance costs.

The federal securities laws and regulations, including the corporate governance and other requirements of the Sarbanes-Oxley Act of 2002, impose complex and continually changing regulatory requirements on our operations and reporting. Because the aggregate market value of our public float was in excess of $75 million as of June 30, 2014, we became an "accelerated filer" as of the end of our 2014 fiscal year. As a result, pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, our independent registered public accounting firm auditing our financial statements is now required to attest to and report on the effectiveness of our internal control over financial reporting. The auditor attestation requirement applies to us for the first time with respect to this Annual Report on Form 10-K. In addition, beginning with our Form 10-Q for our first quarter of fiscal 2015, we will be required to satisfy all of the larger reporting company disclosure requirements. These requirements will increase our legal compliance obligations and costs, which could harm our results of operations and divert management's attention from business operations.

Relatively speaking, we are a small company with limited resources. There can be no assurances that we will be able to comply with the added "accelerated filer" requirements by applicable deadlines and to maintain compliance in the future. If our independent registered public accounting firm is unable to provide us with an unqualified report as to the effectiveness of our internal control over financial reporting for future year ends, investors could lose confidence in the reliability of our financial reporting.

We do not anticipate paying cash dividends.

We currently intend to retain any future earnings for funding growth and, as a result, do not expect to pay any cash dividends in the foreseeable future. Additionally, our ability to declare dividends, should we decide to do so, is restricted by the terms of our debt agreements.

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

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

- divide our board of directors into three classes serving staggered three-year terms;
- only permit removal of directors by stockholders "for cause," and require the affirmative vote of at least 85% of the outstanding common stock to so remove; and
- allow us to issue preferred stock without any vote or further action by the stockholders.

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

Israel-Related Risks

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

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

Historically, Arab states have boycotted any direct trade with Israel and to varying degrees have imposed a secondary boycott on any company carrying on trade with or doing business in Israel. Although in October 1994, the states comprising the Gulf Cooperation Council (Saudi Arabia, the United Arab Emirates, Kuwait, Dubai, Bahrain and Oman) announced that they would no longer adhere to the secondary boycott against Israel, and Israel has entered into certain agreements with Egypt, Jordan, the Palestine Liberation Organization and the Palestinian Authority, Israel has not entered into any peace arrangement with Syria or Lebanon. Moreover, since September 2000, there has been a significant deterioration in Israel's relationship with the Palestinian Authority. Efforts to resolve the problem have failed to result in an agreeable solution.

In July and August of 2006, Israel was involved in a full-scale armed conflict with Hezbollah, a Lebanese Islamist Shiite militia group and political party, in southern Lebanon, which involved missile strikes against civilian targets in northern Israel that resulted in economic losses. On August 14, 2006, a ceasefire was declared relating to that armed conflict, although it is uncertain whether or not the ceasefire will continue to hold.

Israel withdrew unilaterally from the Gaza Strip and certain areas in northern Samaria in 2005. Thereafter Hamas, an Islamist terrorist group responsible for many attacks, including missile strikes against Israeli civilian targets, won the majority of the seats in the Parliament of the Palestinian Authority in January 2006 and took control of the entire Gaza Strip, by force, in June 2007. Since then, Hamas and other Palestinian movements have launched thousands of missiles from the Gaza strip into civilian targets in southern Israel. In late 2008, a sharp increase in rocket fire from Gaza on Israel's western Negev region, extending as far as 25 miles into Israeli territory and disrupting most day-to-day civilian activity in the proximity of the border with the Gaza Strip, prompted the Israeli government to launch military operations against Hamas that lasted approximately three weeks. Israel declared a unilateral ceasefire in January 2009, which substantially diminished the frequency of, but did not eliminate, Hamas rocket attacks against Israeli cities. In November 2012, following an increase in rocket attacks and hostile activity originating from the Gaza Strip, the Israeli government launched an air attack on Hamas. Rockets were fired into Israel extending as far as Tel Aviv and Jerusalem. After seven days, a ceasefire was agreed to by Israel and Hamas. This was followed by a period of relative calm that continued until July 2014, when rocket attacks resumed, and Israel began experiencing another round of armed conflict with Hamas in the Gaza Strip, with missiles reaching throughout Israel and Israeli ground forces engaged in operations within the Gaza Strip. The landing of one rocket about a mile from Israel's primary international airport on July 22, 2014 caused the Federal Aviation Administration to prohibit landings of U.S.-based carriers into Ben Gurion International Airport for a period of approximately 48 hours. A ceasefire was agreed to in August 2014.

Our Israeli production facilities in the cities of Beit Shemesh and Dimona, are located approximately 27 miles and 38 miles, respectively, from the nearest point of the border with the Gaza Strip. There can be no assurance that Hamas will not begin to use on a more frequent basis longer-range missiles capable of reaching our facilities, which could result in a significant disruption of the Israel-based portion of our business. Additionally, recent political events, including political uprisings, social unrest and regime change, in various countries in the Middle East and North Africa have weakened the stability of those countries, which could result in extremists coming to power, including in countries with which Israel has signed peace treaties that may not be respected by extremists. In addition, Iran has threatened to attack Israel, and Israel is reported to be considering a pre-emptive attack on Iran, which is widely believed to be developing nuclear weapons. Iran is also believed to have a strong influence among extremist groups in the region, such as Hamas in Gaza and Hezbollah in Lebanon. These situations may potentially escalate in the future to more violent events which may affect Israel and us. Any major hostilities involving Israel, including as a result of the military conflicts between the Fatah and Hamas in Gaza Strip, Judea and Samaria, or the interruption or curtailment of trade between Israel and its present trading partners could have a material adverse effect on our business, operating results and financial condition.

In addition to the foregoing, since the end of 2010, numerous acts of protest and civil unrest have taken place in several countries in the Middle East and North Africa, many of which involved significant violence. The civil unrest in Egypt, which borders Israel, resulted in significant changes to the country's government. In Syria, also bordering Israel, large and violent protests against the government are taking place. The ultimate effect of these developments on the political and security situation in the Middle East and on Israel's position within the region is not clear at this time.

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

We are organized under the laws of the State of Delaware and will be subject to service of process in the United States. However, approximately 17.9% of our assets are located outside the United States. In addition, two of our directors and some of our executive officers are residents of Israel and a portion of the assets of such directors and executive officers are located outside the United States.

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

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

Although a substantial majority of our revenues and a substantial portion of our expenses are denominated in U.S. dollars, a portion of our costs, including personnel and facilities-related expenses, is incurred in New Israeli Shekels (NIS). Inflation in Israel will have the effect of increasing the dollar cost of our operations in Israel, unless it is offset on a timely basis by a devaluation of the NIS relative to the dollar. In 2014, the inflation-adjusted NIS depreciated against the dollar.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our primary executive offices are located in the offices of our Simulation Division, consisting of approximately 17,300 square feet of office and warehouse space in Ann Arbor, Michigan, pursuant to a lease expiring in July 2018. We have also leased 17,200 square feet of office and warehouse space adjacent to our main offices pursuant to a lease beginning in June 2006 and expiring in July 2018. Additionally, pursuant to a lease expiring in October 2015, we are leasing approximately 10,000 square feet of office and lab space in Orlando, Florida.

We also lease approximately 5,500 square feet in Royal Oak, Michigan pursuant to a lease terminating in November 2018.

In August 2011, we purchased 40,000 square feet of office and warehouse space in Ann Arbor, Michigan, approximately three miles from the mail location of our Simulation Division, where we began to consolidate certain of our operations beginning in 2011. Subsequently, in December 2012, we subleased 7,000 square feet of surplus space of the purchased building to a non-profit organization as office space for a term of 10 years with an option to terminate the sublease with a one year prior notice in May 2018.

Our Power Systems Division operates out of facilities in Hanahan, South Carolina, constituting approximately 72,000 square feet, which are leased from the former owners of UEC through the end of 2024. We also have 30,000 square feet of leased facilities in Auburn, Alabama through the end of April 2015 and we are in the process of consolidating all operations of our Power Systems Division to Hanahan, South Carolina.

Our management and administrative facilities and research, development and production facilities for the manufacture and assembly of our Survivor Locator Lights, constituting approximately 21,000 square feet, are located in Beit Shemesh, Israel, located between Jerusalem and Tel-Aviv (within Israel's pre-1967 borders). The lease for these facilities in Israel expires on December 31, 2017. Most of the members of our senior management, including our Chief Executive Officer and our President, work extensively out of our Beit Shemesh facility. Our Chief Financial Officer works out of our Ann Arbor, Michigan facility.

Our Power Systems Division also maintains approximately 23,000 square feet of factory, office and warehouse space in Dimona, Israel, in Israel's Negev desert (within Israel's pre-1967 borders), on a month-to-month basis.

In March 2007, we purchased 16,700 square feet of space for the now discontinued Armor Division in Auburn, Alabama for approximately $1.1 million pursuant to a seller-financed secured purchase money mortgage. Half of the mortgage is payable over ten years in equal monthly installments based on a 20-year amortization of the full principal amount, and the remaining half is payable at the end of ten years in a balloon payment. The building was leased to a third party and was listed for sale with a local real estate agent. Additionally, the carrying value of this property was written down to zero as part of the 2011 Armor Division impairment. On February 9, 2015, we sold the building to the current tenant for $925,000. On that same date, the existing mortgage and existing building lease were terminated which ended any obligation we had for this property.

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

ITEM 3. LEGAL PROCEEDINGS

As of the date of this filing, there were no material pending legal proceedings against us, and there were no material legal proceedings active against us during 2014.

ITEM 4. MINE SAFETY DISCLOSURES

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the Nasdaq Global Market. Our Nasdaq ticker symbol is "ARTX." The following table sets forth, for the periods indicated, the range of high and low sales prices of our common stock on the Nasdaq Global Market System:

Year Ended December 31, 2014	High	Low
Fourth Quarter	$ 3.54	$ 2.02
Third Quarter	$ 4.73	$ 3.13
Second Quarter	$ 5.92	$ 2.96
First Quarter	$ 6.61	$ 2.40

Year Ended December 31, 2013	High	Low
Fourth Quarter	$ 3.91	$ 1.63
Third Quarter	$ 2.71	$ 1.32
Second Quarter	$ 1.93	$ 1.00
First Quarter	$ 1.31	$ 0.91

As of February 28, 2015, we had approximately 158 holders of record of our common stock.

Share Repurchase Program

Common Stock Repurchase Program

In February 2009, we authorized the repurchase in the open market or in privately negotiated transactions of up to $1.0 million of our common stock (increased to $2.0 million in August 2014). Pursuant to this plan, through September 30, 2014, we repurchased an aggregate of 638,611 shares of our common stock for an aggregate purchase price of $869,931 ($857,018 net of commissions). The following table shows information relating to the repurchase of our common stock during the three months ended December 31, 2014; through such date, 738,611 shares had been purchased for a total cost of $1,098,967 ($1,084,060 net of commissions):

Period	Total Number of Shares Purchased	Average Price Paid Per Share(1)	Total Number of Shares Purchased as Part of Plan	Maximum Approximate Dollar Value of Shares that May Yet be Purchased
October 1, 2014 through October 31, 2014	–	$ –	–	$ 1,142,982
November 1, 2014 through November 30, 2014	100,000	$ 2.27	738,611	$ 915,940
December 1, 2014 through December 31, 2014	–	$ –	–	$ 915,940
TOTAL THIS QUARTER	100,000	$	738,611	$

(1) Average price paid per share includes commissions and is rounded to the nearest two decimal places.

The repurchase program is subject to management's discretion, and expires August 11, 2015.

Dividends

We have never paid any cash dividends on our common stock. The Board of Directors presently intends to retain all earnings for use in our business. Any future determination as to payment of dividends will depend upon our financial condition and results of operations and such other factors as the Board of Directors deems relevant. Additionally, our ability to declare dividends should we decide to do so is restricted by the terms of our debt agreements.

ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve inherent risks and uncertainties. When used in this discussion, the words "believes," "anticipates," "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," above, and in our other filings with the Securities and Exchange Commission.

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements contained in Item 8 of this report, and the notes thereto. We have rounded amounts reported here to the nearest thousand, unless such amounts are more than $1.0 million, in which event we have rounded such amounts to the nearest hundred thousand.

General

We are a defense and security products and services company, engaged in two business areas: interactive simulation for military, law enforcement and commercial markets; and batteries and charging systems for the military, commercial and medical markets. 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, emergency services and other personnel through our ***Training and Simulation Division***.

- 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, homeland security markets, and we manufacture and sell lithium and Zinc-Air batteries, for defense and security products and other military applications through our ***Power Systems Division***.

Our results for 2013 and 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.

Critical Accounting Policies

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

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

Revenue Recognition

Significant management judgments and estimates must be made and used in connection with the recognition of revenue in any accounting period. Material differences in the amount of revenue in any given period may result if these judgments or estimates prove to be incorrect or if management's estimates change on the basis of development of the business or market conditions. Management judgments and estimates have been applied consistently and have been reliable historically.

A portion of our revenue is derived from license agreements that entail the customization of FAAC's simulators to the customer's specific requirements. Revenues from initial license fees for such arrangements are recognized in accordance with FASB ASC 605-35 based on the percentage of completion method over the period from signing of the license through to customer acceptance, as such simulators require significant modification or customization that takes time to complete. The percentage of completion is measured by monitoring progress using records of actual time incurred to date in the project compared with the total estimated project requirement, which corresponds to the costs related to earned revenues. Estimates of total project requirements are based on prior experience of customization, delivery and acceptance of the same or similar technology and are reviewed and updated regularly by management.

Similarly, UEC also uses percentage of completion for certain contracts. The percentage of completion is measured by monitoring progress using records of actual time incurred to date in the project compared with the total estimated project requirement, which corresponds to the costs related to earned revenues. Estimates of total project requirements are based on prior experience of customization, delivery and acceptance of the same or similar technology and are reviewed and updated regularly by management.

We believe that the use of the percentage of completion method is appropriate as we have the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, contracts executed include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged and the manner and terms of settlement. In all cases we expect to perform our contractual obligations and our licensees are expected to satisfy their obligations under the contract. The complexity of the estimation process and the issues related to the assumptions, risks and uncertainties inherent with the application of the percentage of completion method of accounting affect the amounts of revenue and related expenses reported in our consolidated financial statements. A number of internal and external factors can affect our estimates, including labor rates, utilization and specification and testing requirement changes.

We account for our other revenues from MILO Range simulators in accordance with the provisions of FASB ASC 985-605. We exercise judgment and use estimates in connection with the determination of the amount of software license and services revenues to be recognized in each accounting period.

Allowance for Doubtful Accounts

We make judgments as to our ability to collect outstanding receivables and provide allowances for the portion of receivables when collection becomes doubtful. If necessary, provisions are made based upon a specific review of all significant outstanding receivables. In determining the provision, we analyze our historical collection experience and current economic trends. We reassess these allowances each accounting period. Historically, our actual losses and credits have been consistent with these provisions with the exception of 2014, when we wrote off $305,000 in our Simulation Division for a bad debt with a foreign client. If actual payment experience with our customers is different than our estimates, adjustments to these allowances may be necessary resulting in additional charges to our statement of operations.

Accounting for Income Taxes

Significant judgment is required in determining our worldwide income tax expense provision. In the ordinary course of a global business, there are many transactions and calculations where the ultimate tax outcome is uncertain. Some of these uncertainties arise as a consequence of cost reimbursement arrangements among related entities, the process of identifying items of revenue and expense that qualify for preferential tax treatment and segregation of foreign and domestic income. Although we believe that our estimates are reasonable, the final tax outcome of these matters may be different than that which is reflected in our historical income tax provisions and accruals.

We have provided a valuation allowance on our net deferred income tax assets, which includes federal, state and foreign net operating loss carryforwards, because of the uncertainty regarding their realization. Our accounting for deferred taxes under FASB ASC 740-10, involves the evaluation of a number of factors concerning the realizability of our deferred tax assets. In concluding that a valuation allowance was required, we primarily considered such factors as our history of operating losses and expected future losses in certain jurisdictions and the nature of our deferred tax assets. We provide valuation allowances in respect of deferred tax assets resulting principally from the carryforward of tax losses. Management currently believes that it is more likely than not that our deferred tax assets in the U.S. and Israel will not be realized in the foreseeable future but as our results improve, this may change in future periods. We do not provide for U.S. federal income taxes on the undistributed earnings of our foreign subsidiaries because such earnings are re-invested and, in the opinion of management, will continue to be re-invested indefinitely.

We have indefinitely-lived intangible assets consisting of trademarks and goodwill. Pursuant to FASB ASC 350-10, these indefinitely-lived intangible assets are not amortized for financial reporting purposes. However, these assets are tax deductible, and therefore amortized over 15 years for tax purposes. As such, deferred income tax expense and a deferred tax liability arise as a result of the tax-deductibility of these indefinitely-lived intangible assets. The resulting deferred tax liability, which is expected to continue to increase over time, will have an indefinite life, resulting in what is referred to as a "naked tax credit." This deferred tax liability could remain on our balance sheet indefinitely for continuing operations unless there is an impairment of the related assets (for financial reporting purposes), or the business to which those assets relate were to be disposed of. Due to the fact that the aforementioned deferred tax liability could have an indefinite life, it should not be netted against our deferred tax assets (which primarily relate to net operating loss carryforwards) when determining the required valuation allowance. Doing so would result in the understatement of the valuation allowance and related deferred income tax expense.

We have adopted the provisions of the FASB ASC 740-10. FASB ASC 740-10 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken in a tax return. We must determine whether it is "more-likely-than-not" that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. Once it is determined that a position meets the more-likely-than-not recognition threshold, the position is measured to determine the amount of benefit to recognize in the financial statements. Uncertain tax positions require determinations and estimated liabilities to be made based on provisions of the tax law which may be subject to change or varying interpretation. If our determinations and estimates prove to be inaccurate, the resulting adjustments could be material to our future financial statements.

In addition, we operate within multiple taxing jurisdictions and may be subject to audits in these jurisdictions. These audits can involve complex issues that may require an extended period of time for resolution. In management's opinion, adequate provisions for income taxes have been made.

Inventories

Our policy for valuation of inventory and commitments to purchase inventory, including the determination of obsolete or excess inventory, requires us to perform a detailed assessment of inventory at each balance sheet date, which includes a review of, among other factors, an estimate of future demand for products within specific time horizons, valuation of existing inventory, as well as product lifecycle and product development plans. The estimates of future demand that we use in the valuation of inventory are the basis for our revenue forecast, which is also used for our short-term manufacturing plans. Inventory reserves are also provided to cover risks arising from slow-moving items. We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based on assumptions about future demand and market conditions. We may be required to record additional inventory write-down if actual market conditions are less favorable than those projected by our management. For fiscal 2014, no significant changes were made to the underlying assumptions related to estimates of inventory valuation or the methodology applied.

Goodwill

As of December 31, 2014, we had recorded goodwill of $45.4 million. We allocate goodwill acquired in a business combination to the appropriate reporting unit as of the acquisition date. Currently our reporting units are also our reportable segments and the associated goodwill was determined when the specific businesses in the reportable segments were purchased. Under FASB ASC 350-10, goodwill and intangible assets deemed to have indefinite lives are no longer amortized but are subject to annual impairment tests, and tests between annual tests in certain circumstances, based on estimated fair value in accordance with FASB ASC 350-10, and written down when impaired.

When testing goodwill for impairment we have the option of performing a qualitative assessment before calculating the fair value of a reporting unit. If the Company determines, on the basis of qualitative factors, that it is more likely than not that the fair value of the reporting unit is greater than the carrying amount, the two-step impairment test would not be required. If we cannot determine on the basis of qualitative factors that goodwill is not impaired, goodwill is then tested for impairment by using a discounted cash flow analysis. This type of analysis requires us to make assumptions and estimates regarding industry economic factors and the profitability of future business strategies. Significant estimates used in the methodologies include estimates of future cash flows, future short-term and long-term growth rates, weighted average cost of capital and estimates of market multiples for the reportable units. It is our policy to conduct impairment testing based on our current business strategy in light of present industry and economic conditions, as well as future expectations. In assessing the recoverability of our goodwill, we may be required to make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. This process is subjective and requires judgment at many points throughout the analysis. If our estimates or their related assumptions change in subsequent periods or if actual cash flows are below our estimates, we may be required to record impairment charges for these assets not previously recorded.

We completed our annual goodwill impairment review using the financial results as of the quarter ended December 31, 2014 using our forecasted plan developed in the fourth quarter.

Under certain circumstances we have the option of performing a qualitative assessment when testing goodwill for impairment. We determined that this qualitative assessment would be appropriate in the case of our Training and Simulation Division, but that with respect to our Power Systems Division, we determined that we were required to perform a quantitative analysis.

With respect to our Training and Simulation Division, we determined, using qualitative factors, that no goodwill was impaired.

Significant judgments inherent in these analyses include assumptions about appropriate sales growth rates, WACC and the amount of expected future net cash flows. The judgments and assumptions used in the estimate of fair value are generally consistent with the projections and assumptions that are used in current operating plans. Such assumptions are subject to change as a result of changing economic and competitive conditions. The determination of fair value is highly sensitive to differences between estimated and actual cash flows and changes in the related discount rate used to evaluate the fair value of the reporting units and trade name.

The goodwill of our Training and Simulation Division equaled $24.4 million and the goodwill of our Power Systems Division equaled $21.0 million at December 31, 2014. Based on the discounted cash flow valuation at December 31, 2014, an increase in the WACC or changes in other significant variables for the Power Systems Division could potentially result in impairment.

With respect to our Power Systems Division, we undertook the first step of the quantitative analysis, in which we computed a fair value of that reporting unit. The valuation for Power Systems Division exceeded the reporting unit's carrying value by over 6%; we will continue to monitor the actual results of the reporting unit versus the forecast used for the impairment review and reevaluate the goodwill as required. It should be noted that UEC was just acquired so its fair value and carrying value were the same when acquired in April 2014 and since UEC represents over 50% of the revenue of the Power Systems division, the excess of total fair value over carrying value is adversely impacted. Because we determined, with respect to our Power Systems Division, that the fair value was 6% greater than the carrying value of the unit at the measurement date, the second step of the quantitative impairment assessment was not required, and no goodwill was impaired.

We also consider our current market capitalization compared to the sum of the estimated fair values of its reporting units in conjunction with each impairment assessment. As part of this consideration, management recognizes that our market capitalization may not be an accurate representation of the sum of the reporting unit fair values for the following reasons:

- The long term horizon of the valuation process versus a short term valuation using current market conditions;
- The valuation by individual business segments versus the market share value based on our company as a wholeincluding unallocable corporate costs;
- The fact that our stock is thinly traded and widely dispersed with minimal institutional ownership, and thus not followed by major market analysts, leading management to conclude that the market in our securities was not acting as an informationally efficient reflection of all known information regarding us; and
- Control premiums reflected in the reporting unit fair values but not in our stock price.

As of the December 31, 2014 valuation date, our market capitalization was approximately $56.9 million, which did not, in management's view, suggest that the fair value estimates used in its impairment assessment required any adjustment.

Other Intangible Assets

Other intangible assets are amortized over the period during which benefits are expected to accrue, currently estimated at one to ten years.

The determination of the value of such intangible assets requires us to make assumptions regarding future business conditions and operating results in order to estimate future cash flows and other factors to determine the fair value of the respective assets. If these estimates or the related assumptions change in the future, we could be required to record additional impairment charges.

Impairment analysis triggering events include - A significant decrease in the market price of a long-lived asset, a significant adverse change in the extent or manner in which a long-lived asset is being used or in its physical condition, a significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset, a current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of the long lived asset, and a current expectation that, more likely than not, a long-lived asset will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

Contingencies

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

A determination of the amount of reserves required, if any, for any contingencies are 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.

If actual results are not consistent with our assumptions and judgments, we may be exposed to gains or losses that could be material.

Warranty Reserves

We typically offer a one to two year warranty for many of our products. The specific terms and conditions of those warranties vary depending upon the product sold and country in which we do business. We estimate the costs that may be incurred under our basic limited warranty, including parts and labor, and record warranty liability in the amount of such costs at the time product revenue is recognized. Factors that affect our warranty liability include the number of installed units, historical and anticipated rates of warranty claims, and cost per claim. We periodically assesses the adequacy of our reserves and adjust the amounts as necessary.

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 Epsilor is in New Israeli Shekels (“NIS”) and a substantial portion of Epsilor’s costs is incurred in NIS. Management believes that the NIS is the functional currency of Epsilor. Accordingly, the financial statements of Epsilor have been translated into U.S. dollars. All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. Statement of operations amounts have been translated using the average exchange rate for the period. The resulting translation adjustments are reported as a component of accumulated other comprehensive loss in stockholders’ equity.

Executive Summary

Overview of Results of Operations

We achieved profitability for the years ended December 31, 2014 and 2013. While we expect to continue to derive revenues from the sale of products that we manufacture and the services that we provide, there can be no assurance that we will be able to maintain profitability on a consistent basis.

A portion of our expenses during 2014 arose as a result of one-time expenses and non-cash charges. These charges were primarily related to our UEC acquisition, financings and stock-based awards to employees. To the extent that we continue certain of these activities during 2015, we would expect to continue to incur such expenses in the future.

Acquisitions

In acquisition of subsidiaries, part of the purchase price is allocated to intangible assets and goodwill. Amortization of 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 intangible assets in the amount of a fraction (based on the useful life of the intangible assets) of the amount recorded as intangible assets. Such amortization charges continued during 2014 and increased due to the UEC acquisition. We are required to review intangible assets for impairment 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 an intangible asset has been impaired, we must record the impairment charge in our statement of operations.

In the case of goodwill, the assets recorded as goodwill are not amortized; instead, we are required to perform an annual impairment review. If we determine, through the impairment review process, that goodwill has been impaired, we must record the impairment charge in our statement of operations.

We incurred non-cash charges for amortization of intangible assets in 2014 and 2013 in the amount of $2.7 million and $1.1 million, respectively.

Issuances of Restricted Shares and Restricted Stock Units.

During 2014 and 2013, we issued restricted shares and restricted stock units to certain of our employees and to our directors. Each restricted stock unit is equal to one share of Company stock and is redeemable only for stock. These shares were issued as stock bonuses or were the required annual grant to directors, and are restricted for a period of up to three years from the date of issuance. Relevant accounting rules provide that the aggregate amount of the difference between the purchase price of the restricted shares or restricted stock units (in this case, generally zero) and the market price of the shares on the date of grant is taken as a general and administrative expense, amortized over the life of the period of the restriction.

We incurred non-cash charges related to stock-based compensation in 2014 and 2013 in the amount of $1.4 million and $437,000, respectively.

Transition to Accelerated Filer Status.

We became an accelerated filer as of December 31, 2014 and are now subject to an audit of our internal controls. We expect our general and administrative expenses to reflect these new expenses going forward.

Overview of Operating Performance and Backlog

Overall, our pre-tax profit from continuing operations for 2014 was $4.5 million on revenues of $103.6 million, compared to a pre-tax profit of $3.3 million on revenues of $88.6 million during 2013. As of December 31, 2014, our overall backlog for continuing operations totaled $69.9 million compared to a backlog of $58.0 million as of December 31, 2013.

In our Training and Simulation Division, revenues decreased from approximately $63.4 million in 2013 to $56.4 million in 2014. This decrease was primarily due 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). As of December 31, 2014, our backlog for our Training and Simulation Division totaled $45.7 million compared to a backlog of $45.9 million as of December 31, 2013.

In our Power Systems Division, revenues increased from approximately $25.2 million in 2013 to approximately $47.2 million in 2014. This increase was primarily due to revenue associated with our new UEC subsidiary, offset by the reduced product sales in our other U.S. subsidiary. As of December 31, 2014, our backlog for our Power Systems Division totaled $24.2 million compared to a backlog of $12.1 million as of December 31, 2013.

Common Stock Repurchase Program

In February of 2009, we authorized the repurchase in the open market or in privately negotiated transactions of up to $1.0 million of our common stock (increased to $2.0 million in August 2014). Pursuant to this plan, through December 31, 2014 we have repurchased an aggregate of 738,611 shares of our common stock for an aggregate purchase price of $1,098,967 ($1,084,060 net of commissions), all of which was purchased after April 1, 2009. At December 31, 2014, we had remaining authorization for the repurchase of up to $915,940 in shares of our common stock. The repurchase program is subject to the discretion of our management.

Results of Operations

Summary

Following is a table summarizing our results of continuing operations for the years ended December 31, 2014 and 2013, after which we present a narrative discussion and analysis. Our results for 2013 and 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.

	Year Ended December 31,	
	2014	2013
Revenues:		
Training and Simulation Division	$ 56,404,498	$ 63,425,319
Power Systems Division	47,157,851	25,146,109
	$ 103,562,349	$ 88,571,428
Cost of revenues:		
Training and Simulation Division	$ 35,322,870	$ 44,257,129
Power Systems Division	35,531,867	20,223,011
	$ 70,854,737	$ 64,480,140
Research and development expenses:		
Training and Simulation Division	$ 1,571,295	$ 1,296,956
Power Systems Division	1,751,154	1,658,927
	$ 3,322,449	$ 2,955,883
Selling and marketing expenses:		
Training and Simulation Division	$ 4,800,580	$ 4,448,036
Power Systems Division	1,120,758	1,169,669
	$ 5,921,338	$ 5,617,705
General and administrative expenses:		
Training and Simulation Division	$ 4,340,145	$ 3,553,058
Power Systems Division	3,941,568	1,630,641
Corporate	8,979,645	5,703,260
	$ 17,261,358	$ 10,886,959
Amortization of intangible assets:		
Training and Simulation Division	$ 263,365	$ 581,886
Power Systems Division	2,433,375	509,240
	$ 2,696,740	$ 1,091,126
Operating income:		
Training and Simulation Division	$ 10,106,243	$ 9,288,254
Power Systems Division	2,379,129	(45,379)
Corporate	(8,979,645)	(5,703,260)
	$ 3,505,727	$ 3,539,615
Other income:		
Training and Simulation Division	$ 227,360	$ 4,761
Power Systems Division	211,676	253,600
Corporate	2,119,557	27,896
	$ 2,558,593	$ 286,347
Financial (expense) income:		
Training and Simulation Division	$ (50,975)	$ (44,146)
Power Systems Division	(215,453)	(30,733)
Corporate	(1,287,094)	(424,393)
	$ (1,553,522)	$ (499,272)
Income tax expense (benefit):		
Training and Simulation Division	$ 133,692	$ 319,225
Power Systems Division	(61,777)	134,995
Corporate	951,922	598,500
	$ 1,023,837	$ 1,052,720
Net income – continuing operations:		
Training and Simulation Division	$ 10,148,936	$ 8,929,644
Power Systems Division	2,437,129	42,493
Corporate	(9,099,104)	(6,698,167)
	$ 3,486,961	$ 2,273,970

Fiscal Year 2014 compared to Fiscal Year 2013

Revenues. During 2014, we recognized revenues as follows:

- **Training and Simulation Division** – We recognized revenues from the sale of air warfare simulators and vehicle simulators, interactive use-of-force training systems and from the provision of maintenance services in connection with such systems.

- **Power Systems Division** – We recognized revenues from sales of electronics engineering products and provision of design services for the military, as well as from the sale of batteries, chargers, adapters and power hub products to the military and commercial customers. We also recognized revenues from the sale of water-activated battery (WAB) lifejacket lights.

Revenues for 2014 totaled $103.6 million, compared to $88.6 million in 2013, an increase of $15.0 million, or 16.9%. In 2014, revenues were $56.4 million for the Training and Simulation Division (compared to $63.4 million in 2013, a decrease of $7.0 million, or 11.1%, 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 $47.2 million for the Power Systems Division (compared to $25.2 million in 2013, an increase of $22.0 million, or 87.5%, due primarily to $27.2 million in revenue generated by our new electronics engineering and design services for the military business, offset by reduced revenue in certain of our other businesses).

The table below details the percentage of total recognized revenue by type of arrangement for the years ended December 31, 2014 and 2013:

Type of Revenue	Year Ended December 31, 2014	2013
Sale of products	94.7 %	95.0 %
Maintenance and support agreements	3.8 %	3.3 %
Long term research and development contracts	1.5 %	1.7 %
Total	100.0 %	100.0 %

Cost of revenues. Cost of revenues totaled $70.8 million during 2014, compared to $64.5 million in 2013, an increase of $6.3 million, or 9.9%, due primarily to the product mix of the reporting units, which included products sold at a higher margin. Cost of revenues were $35.3 million for the Training and Simulation Division (compared to $44.3 million in 2013, a decrease of $9.0 million, or 20.2%, due primarily to lower revenue and a higher margin product mix) and $35.5 million for the Power Systems Division (compared to $20.2 million in 2013, an increase of $15.3 million, or 75.7%, due primarily to revenue generated by our electronics engineering and design services for the military business, offset by reduced revenue in certain our other businesses).

Research and development expenses. Research and development expenses for 2014 were $3.3 million, compared to $3.0 million during 2013, an increase of $367,000, or 12.4%, due primarily to continuing research on training systems and battery technologies for new products.

Selling and marketing expenses. Selling and marketing expenses for 2014 were $5.9 million, compared to $5.6 million in 2013, an increase of $304,000, or 5.4%, due primarily to increased trade show representation and the sales efforts of both divisions, including additional expenses related to our addition of a new line of business.

General and administrative expenses. General and administrative expenses for 2014 were $17.3 million, compared to $10.9 million in 2013, an increase of $6.4 million, or 56.9%, due primarily to our acquisition of UEC ($2.6 million) and $813,000 in one-time, acquisition related expenses, along with increased corporate salary and benefit expenses.

Amortization of intangible assets. Amortization of intangible assets totaled $2.7 million in 2014, compared to $1.1 million in 2013, an increase of $1.6 million, or 147.2%, due primarily to the additional $2.4 million in amortization expenses relating to our acquisition of UEC, offset by fully amortized acquisition related intangibles relating to other subsidiaries in our Training and Simulation and Power Systems Divisions.

Other income. Other income totaled $2.6 million in 2014, compared to other income of $286,000 in 2013, an increase of $2.3 million, or 793.4%, due primarily to a $2.0 million fair value adjustment of the potential 2015 earn-out due the previous owners of UEC. This adjustment was recorded due to reduction of the deemed purchase price of UEC as a result of potential payments to the seller that will not be earned because of changes in the expected timing of forecasted cash flows.

Financial expense, net. Financial expense totaled $1.6 million in 2014, compared to financial expense of $449,000 in 2013, an increase of $1.1 million, or 211.2%, 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 2014.

Income taxes. We recorded $1.0 million in tax expense in 2014, compared to $1.1 million in tax expense in 2013, a decrease of $30,000, or 2.7%, 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 $599,000 in non-cash expenses in 2014 and $599,000 in non-cash expenses in 2013. Additionally, overall taxes have increased due to our improved results.

Net income. Due to the factors cited above, we went from a net income from continuing operations of $2.3 million in 2013 to a net income of $3.5 million in 2014, an improvement of $1.2 million or 53.3%.

Liquidity and Capital Resources

As of December 31, 2014, we had $11.3 million in cash and $236,000 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 have experienced fluctuations in available cash in the previous twelve months due to the funding requirements of our larger contracts. These fluctuations have not had a significant impact on our operations, due in part to the increase in our credit facility that was negotiated with our primary bank in 2013. We also had $11.3 million in available, unused bank lines of credit with our main bank as of December 31, 2014, under a $15.0 million credit facility under our FAAC subsidiary, described below. As of December 31, 2014, we had no short-term bank debt with our primary bank.

We have a $15.0 million line of credit (the "Line of Credit") with our primary bank (the "Bank"), secured by the assets and receivables of FAAC and by the assets and receivables of Arotech and of our U.S. subsidiaries. Additionally, Arotech and certain of its subsidiaries 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 an interest rate of 3.75% over LIBOR, and a $4.5 million 61-month B term loan at an interest rate of 5.5% over LIBOR. The interest rate charged as of December 31, 2014 was 3.91% for term loan A and 5.66% for term loan B. Principal payments are made monthly for term loan A and quarterly for term loan B. Interest is paid monthly for both loans. 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 those 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" 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.

At the end of 2014 and as of the filing date of this report, we met all required current covenants.

We used available funds in 2014 primarily for investment in fixed assets and repayment of short term debt. We purchased approximately $2.1 million of property and equipment during 2014. Our net property and equipment amounted to $6.5 million as of December 31, 2014.

Net cash provided by operating activities for 2014 and 2013 was $7.4 million and $10.2 million, respectively, a net change of $2.8 million. This difference was due primarily to the profit from continuing operations and the changes in working capital. The timing of cash inflows and outflows has impacted us due to the substantial purchases of products to fulfill the contracts in the Simulation and Training Division and Power Systems Division.

Net cash used in investing activities for 2014 and 2013 was $31.3 million and $1.9 million, a net change of $29.4 million. This difference was due primarily to the $29.1 million acquisition of our UEC subsidiary.

Net cash provided by (used in) financing activities for 2014 and 2013 was $29.9 million and $(4.4 million), respectively, a change of $34.3 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 net proceeds from the recent stock offering in the amount of $10.7 million as compared to the stock offering proceeds of $6.3 million in 2013. Additionally, there were repayments of an additional $3.1 million in long term debt in 2014.

As of December 31, 2014, we had essentially no short-term bank debt and $21.3 million in long-term debt outstanding, as compared to December 31, 2013, when we had no short-term bank debt and $1.9 million in long-term debt outstanding for continuing operations, including current maturities.

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 availability under our lines of credit should be sufficient to satisfy our current estimated cash requirements through the next twelve months. In this connection, we note that from time to time our working capital needs are partially dependent on our subsidiaries’ lines of credit.

Effective Corporate Tax Rate

Certain of our subsidiaries incurred net operating losses during the years ended December 31, 2014 and 2013. With respect to some of our U.S. subsidiaries that operated at a net profit during 2014, we were able to offset federal taxes against our net operating loss carryforward. These subsidiaries are, however, subject to state taxes that cannot be offset against our net operating loss carryforward. We also set up a tax liability for the impact of the deductions taken for goodwill.

As of December 31, 2014, we had a U.S. net operating loss carryforward of approximately $35.0 million that is available to offset future taxable income under certain circumstances, expiring primarily from 2021 through 2032, and foreign net operating and loss carryforwards of approximately $85.1 million, which are available indefinitely to offset future taxable income under certain circumstances.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of December 31, 2014, our management, including the principal executive officer and principal financial officer, evaluated our disclosure controls and procedures related to the recording, processing, summarization, and reporting of information in our periodic reports that we file with the SEC. These disclosure controls and procedures are intended to ensure that material information relating to us, including our subsidiaries, is made known to our management, including these officers, by other of our employees, and that this information is recorded, processed, summarized, evaluated, and reported, as applicable, within the time periods specified in the SEC's rules and forms. Due to the inherent limitations of control systems, not all misstatements may be detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Any system of controls and procedures, no matter how well designed and operated, can at best provide only reasonable assurance that the objectives of the system are met and management necessarily is required to apply its judgment in evaluating the cost benefit relationship of possible controls and procedures. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. Our controls and procedures are intended to provide only reasonable, not absolute, assurance that the above objectives have been met.

Based on their evaluation as of December 31, 2014, our principal executive officer and principal financial officer were able to conclude that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) were effective.

We will continue to review and evaluate the design and effectiveness of our disclosure controls and procedures on an ongoing basis and to improve our controls and procedures over time and correct any deficiencies that we may discover in the future. Our goal is to ensure that our senior management has timely access to all material financial and non-financial information concerning our business. While we believe the present design of our disclosure controls and procedures is effective to achieve our goal, future events affecting our business may cause us to modify our disclosure controls and procedures.

Management's Report on Internal Control Over Financial Reporting

Our management, including our principal executive and financial officers, is responsible for establishing and maintaining adequate internal control over our financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Our management has evaluated the effectiveness of our internal controls as of the end of the period covered by this Annual Report on Form 10-K for the year ended December 31, 2014. In making our assessment of internal control over financial reporting, management used the criteria set forth by the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission in the 2013 *Internal Control – Integrated Framework.*

Our management concluded that our internal control over financial reporting was effective as of December 31, 2014.

Our internal control over financial reporting as of December 31, 2014 has been audited by BDO USA, LLP, an independent registered public accounting firm, as stated in their attestation report which appears herein.

Changes in Internal Controls Over Financial Reporting

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

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Arotech Corporation
Ann Arbor, Michigan

We have audited Arotech Corporation's internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Arotech Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in this Item 9A, Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Arotech Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on the COSO criteria

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Arotech Corporation as of December 31, 2014 and 2013, and the related consolidated statements of comprehensive income, changes in stockholders' equity and cash flows for the years then ended and our report dated March 20, 2015 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP
Grand Rapids, Michigan
March 20, 2015

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Executive Officers, Directors and Significant Employees

Executive Officers and Directors

Our executive officers and directors and their ages as of February 28, 2015 were as follows:

Name	Age	Position
Steven Esses	51	President, Chief Executive Officer and Director
Robert S. Ehrlich	77	Executive Chairman of the Board
Dr. Jay M. Eastman	66	Director
Seymour Jones	83	Director
Michael E. Marrus	51	Director
Richard Rudy	56	Director
Thomas J. Paup	66	Senior Vice President – Finance and Chief Financial Officer

Our by-laws provide for a board of directors of one or more directors. There are currently seven directors. Under the terms of our certificate of incorporation, the board of directors is composed of three classes of similar size, each elected in a different year, so that only one-third of the board of directors is elected in any single year. Dr. Eastman and Mr. Marrus are designated Class I directors and have been elected for a term expiring in 2015 or until their successors are elected and qualified; Prof. Jones and Mr. Rudy are designated Class II directors elected for a term expiring in 2017 or until their successors are elected and qualified; and Messrs. Esses and Ehrlich are designated Class III directors elected for a term that expires in 2016 or until their successors are elected and qualified. A majority of the Board is "independent" under relevant SEC and Nasdaq regulations.

Steven Esses has been our President and Chief Executive Officer since October 2014. He has been a director since July 2002, our Executive Vice President since January 2003, our Chief Operating Officer from February 2003 until February 2012 and our President since December 2005. From 2000 until 2002, Mr. Esses was a principal with Stillwater Capital Partners, Inc. ("Stillwater"), a New York-based investment research and advisory company specializing in alternative investment strategies. During this time, Mr. Esses also acted as an independent consultant to new and existing businesses in the areas of finance and business development. In 1995, Mr. Esses founded the Dunkin' Donuts franchise in Israel and was its Managing Director and CEO until 2005. Before founding Dunkin' Donuts Israel, Mr. Esses was the Director of Retail Jewelry Franchises with Hamilton Jewelry, and before that he served as Executive Director of Operations for the Conway Organization, a major off-price retailer with 17 locations.

Mr. Esses has been actively involved in the day-to-day management of companies since he was 22, when he co-founded a company that eventually went public. He has worked in retail and wholesale, in high-tech and low-tech, in a variety of industries. Throughout his career, he has been highly numbers-oriented, focusing on budgetary and fiscal matters and on building business value. We believe that Mr. Esses's background and experience make him appropriate to serve as one of our directors in light of our business and structure.

Robert S. Ehrlich has been our Executive Chairman of the Board since October 2014 and was our Chairman of the Board from January 1993. From October 2002 until September 2014, Mr. Ehrlich was our Chief Executive Officer. From May 1991 until January 1993, Mr. Ehrlich was our Vice Chairman of the Board, from May 1991 until October 2002 he was our Chief Financial Officer, and from October 2002 until December 2005, Mr. Ehrlich also held the title of President. From 1981 to 1991, Mr. Ehrlich served as Chairman of the Board and CEO of Fresenius USA, Inc. (NYSE: FRN), a manufacturer of medical devices. From 1987 to June 2003, Mr. Ehrlich served as a director of PSC Inc. (Nasdaq: PSCX), a manufacturer and marketer of laser diode bar code scanners, and, between April 1997 and June 2003, Mr. Ehrlich was the chairman of the board of PSCX. Mr. Ehrlich received a B.S. and J.D. from Columbia University in New York, New York.

Mr. Ehrlich has experience as an accountant, an attorney and as an investment banker. He has been involved with public companies since the late 1960s, both as an investment banker and as the chief financial officer and a director of Mattel (Nasdaq: MAT), where he was instrumental in helping to uncover fraudulent practices in the preparation of certain of that company's financial statements, and he continued to serve as a director of Mattel through the late 1980s. After leaving Mattel, Mr. Ehrlich founded his own boutique investment banking company and became a director of certain of the companies involved in his investment banking business. Mr. Ehrlich ultimately became the Chairman and CEO of Fresenius USA and of PSCX, prior to becoming our Chief Financial Officer in 1991 and our Chief Executive Officer in 2002. We believe that Mr. Ehrlich's background and experience make him appropriate to serve as one of our directors in light of our business and structure.

Dr. Jay M. Eastman has been one of our directors since October 1993. From November 1991 to December 2011, Dr. Eastman served as President and Chief Executive Officer of Lucid, Inc. (OTCQB: LCDX), a public company that is developing laser technology applications for medical diagnosis and treatment; since December 2011, Dr. Eastman has served as a director and Chief Science Officer of Lucid. Dr. Eastman served as Senior Vice President of Strategic Planning of PSCX from December 1995 through October 1997. Dr. Eastman is also a director of Dimension Technologies, Inc., a developer and manufacturer of 3D displays for computer and video displays, and of Chapman Instruments, Inc., a private manufacturer of precision surface metrology instruments. From 1981 until 1983, Dr. Eastman was the Director of the University of Rochester's Laboratory for Laser Energetics, where he was a member of the staff from 1975 to 1981. He holds, as inventor or co-inventor, 44 patents, and is a fellow of the Optical Society of America and the Society of Photo-Optical Instrumentation Engineers, as well as an honorary member of the Rochester Engineering Society. Dr. Eastman holds a B.S. and a Ph.D. in Optics from the University of Rochester in New York.

Dr. Eastman brings to our Board the unique perspective of a trained scientist who has also been deeply involved in the business world. Since many of our company's products are of a "high-tech" nature, Dr. Eastman's scientific background is extremely valuable to the Board. Additionally, Dr. Eastman brings to the Board his experiences as President and Chief Executive Officer of a high-tech company, as well as his experience as a director of other public companies. We believe that Dr. Eastman's background and experience make him appropriate to serve as one of our directors in light of our business and structure.

Seymour Jones has been one of our directors since August 2005. Mr. Jones has been a clinical professor of accounting at New York University Stern School of Business since September 1993. Professor Jones teaches courses in accounting, tax, forensic accounting and legal aspects of entrepreneurism. He is also the Associate Director of Ross Institute of Accounting Research at Stern School of Business. His primary research areas include audit committees, auditing, entrepreneurship, financial reporting, and fraud. Professor Jones is the principal author of numerous books including *Conflict of Interest*, *The Coopers & Lybrand Guide to Growing Your Business*, *The Emerging Business* and *The Bankers Guide to Audit Reports and Financial Statements*. From April 1974 to September 1995, Mr. Jones was a senior partner of the accounting firm of Coopers & Lybrand, a legacy firm of PricewaterhouseCoopers LLP ("PwC"). Professor Jones is a certified public accountant in New York State. Professor Jones received a B.A. in economics from City College, City University of New York, and an M.B.A. from NYU Stern.

Prof. Jones brings many years of experience as an audit partner at PwC with extensive financial accounting knowledge that is critical to our board of directors. Prof. Jones's experience with accounting principles, financial reporting rules and regulations, evaluating financial results and generally overseeing the financial reporting process of large public companies from an independent auditor's perspective and as a professor of accounting makes him an invaluable asset to our board of directors. We believe that Prof. Jones's background and experience make him appropriate to serve as one of our directors in light of our business and structure.

Michael E. Marrus has been one of our directors since October 2007. With 25 years of experience as an investment banker, Mr. Marrus has most recently been a Senior Managing Director at Dominick and Dominick, a wealth management and investment services firm, and a Managing Director of Merriman Capital, Inc., a financial services firm focused on growth companies. From 1998 to 2009, he was a Managing Director of C.E. Unterberg, Towbin & Co., an investment banking firm that was acquired by Collins Stewart plc. Prior to joining Unterberg, Towbin, Mr. Marrus was a Principal and founding member of Fieldstone Private Capital Group, an investment banking firm specializing in corporate, project and structured finance. Previously, he was employed at Bankers Trust Company, initially in the Private Equity and Merchant Banking Groups and subsequently in BT Securities, the securities affiliate of Bankers Trust. Mr. Marrus has an A.B. from Brown University and an M.B.A. from the Graduate School of Business, University of Chicago.

Mr. Marrus has been involved in mergers and acquisitions as an investment banker and has experience in company valuation in a wide range of industries, a critical skill set for us. We believe that Mr. Marrus's background and experience make him appropriate to serve as one of our directors in light of our business and structure.

Richard I. Rudy has been one of our directors since August 2014. Since January of 2012, Mr. Rudy has been a founder and partner of Advanced Energy Capital, LLC, a private investment management concern with a focus on energy-related investments. Prior to that, beginning in 1997, Mr. Rudy was a principal of Stillwater; before that, he was Chief Financial Officer and general counsel of the Conway Stores, a New York-based chain of discount apparel stores. Mr. Rudy received a B.S. (*summa cum laude*) in accounting from Brooklyn College and a J.D. from New York University School of Law.

Mr. Rudy has experience as a CFO, an attorney and a hedge fund principal, which positions him for all aspects of credit analysis and management. He spent several years at EF Hutton, a stock brokerage firm, and Drexel, Burnham & Lambert, formerly an investment banking firm focused on leveraged buyouts, advising high net worth clients with regard to alternatives to traditional equity and credit investments, including energy and real estate-related investments. Mr. Rudy spent several years in a variety of corporate financial/managerial capacities and was jointly responsible for founding and running a $1.3 billion investment advisor whose primary focus was credit and asset based lending. Over the last years he has spearheaded several energy-related transactions and has through Advanced Energy Capital and other vehicles, financed over $400 million in energy-related sales transactions. He has co-managed many investment funds and vehicles and has been featured at several alternative investment conferences around the world. He has served on the boards of directors of several privately held companies and charitable institutions. We believe that Mr. Rudy's background and experience make him appropriate to serve as one of our directors in light of our business and structure.

Thomas J. Paup has been our Vice President – Finance since December 2005 and our Chief Financial Officer since February 2006; in May 2013, Mr. Paup was promoted to Senior Vice President. Mr. Paup is currently also a Finance Lecturer at Eastern Michigan University. Mr. Paup was an Affiliated Partner with McMillan|Doolittle LLP, a retail consulting firm, from March 2002 until accepting this position with us, and prior thereto, he was an Executive in Residence and Finance Instructor at DePaul University's Kellstadt Graduate School of Business. Prior to his teaching experience, Mr. Paup spent over 25 years in the retail industry. Most recently, between 1997 and 2000, Mr. Paup was the Executive Vice President and Chief Financial Officer and member of the Board of Directors of Montgomery Ward and Company, formerly a private mail order and department store retailer. Mr. Paup brings a broad background of strategic and operational management experiences from the department store industry, where he served as CFO of Lord & Taylor, an upscale, specialty-retail department store chain, and Kaufmann's, a department store that merged into Macy's, Inc. ("Macy's"), and Controller of Bloomingdale's, an upscale chain of department stores owned by Macy's, and Robinson-May, formerly a chain of department stores. Mr. Paup holds an MBA in Finance and a BBS from Eastern Michigan University.

Board Leadership Structure

From October 2002 until October 2014, we operated under the traditional U.S. board leadership structure with our chief executive officer serving as chairman of the board. However, upon the retirement of Mr. Ehrlich as our CEO after thirteen years in that position, our board re-evaluated its leadership structure. Beginning in October 2014 with the appointment of Mr. Esses as our new CEO, the board determined that it would be preferable for Mr. Ehrlich to continue to head our Board of Directors as its Executive Chairman. We believe this board leadership structure is best for our company and our shareholders as Mr. Esses begins his service as CEO of our company.

We believe it is the chief executive officer's responsibility to run the company and the chairman's responsibility to run the board. As directors continue to have more oversight responsibilities than ever before, we believe it is beneficial to have a chairman whose sole job is leading the board. In making its decision to change the leadership structure and appoint a separate chairman, the board considered Mr. Ehrlich's long experience as our Chairman and as chairman of the board of other public companies, and the time that Mr. Esses will be required to devote to the CEO position in the current economic environment. By having Mr. Ehrlich serve as Executive Chairman of the Board, Mr. Esses will be able to focus his entire energy on running the company.

We believe our chief executive officer and our chairman have an excellent working relationship that has allowed Mr. Esses to make a good transition into the role of chief executive officer and will allow him to focus on growing our company in a difficult business environment. We believe this provides strong leadership for our board, while also positioning our CEO as the leader of the company in the eyes of our customers, employees and stockholders.

As part of our periodic board self-evaluation process, we evaluate our leadership structure to ensure that the board continues to believe that it provides the optimal structure for our company and stockholders. We recognize that different board leadership structures may be appropriate for companies in different situations. We believe our current leadership structure, with Mr. Esses serving as President and Chief Executive Officer and Mr. Ehrlich serving as Executive Chairman of the Board, is the optimal structure for our company at this time.

Our independent directors have not chosen to formally designate a lead independent director.

Committees of the Board of Directors

Our board of directors has an Audit Committee, a Compensation Committee, a Nominating Committee and an Executive and Finance Committee. The current composition of the various committees of the Board of Directors is as follows (the name of the chairman of each committee appears in italics):

Audit Committee	**Compensation Committee**	**Nominating Committee**	**Executive and Finance Committee**
Seymour Jones	*Jay M. Eastman*	*Michael Marrus*	*Robert S. Ehrlich*
Michael E. Marrus	Seymour Jones	Jay M. Eastman	Steven Esses
Richard I. Rudy	Richard I. Rudy	Richard I. Rudy	Michael E. Marrus

Audit Committee

The purpose of the Audit Committee is to review with management and our independent auditors the scope and results of the annual audit, the nature of any other services provided by the independent auditors, changes in the accounting principles applied to the presentation of our financial statements, and any comments by the independent auditors on our policies and procedures with respect to internal accounting, auditing and financial controls. The Audit Committee was established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. In addition, the Audit Committee is charged with the responsibility for making decisions on the engagement, compensation, retention and oversight of the work of our independent auditors. The Audit Committee consists of Prof. Jones (Chair) and Messrs. Marrus and Rudy. Each member of the Audit Committee is an "independent director," as that term is defined in Rule 4200(a)(15) of the listing standards and Marketplace Rules of the National Association of Securities Dealers (the "NASD") and the SEC's Rule 10A-3. All Audit Committee members possess the required by law, the level of financial literacy. We have determined that Prof. Jones qualifies as an "audit committee financial expert" under applicable SEC and Nasdaq regulations. As required by law, the Audit Committee operates pursuant to a charter, available through a hyperlink located on the investor relations page of our website, at http://content.stockpr.com/arotech/media/b7c6b7bc3ea4b17ef9af28aab2221d6d.pdf.

Compensation Committee

The duties of the Compensation Committee are to recommend compensation arrangements for our executive officers and review annual compensation arrangements for all other officers and significant employees.

The Compensation Committee consists of Dr. Eastman (Chair), Prof. Jones and Mr. Rudy. Each member of the Compensation Committee is an independent director as that term is defined in the NASD listing standards. The Compensation Committee operates under a formal charter that governs its duties, which charter is publicly available through a hyperlink located on the investor relations page of our website, at http://content.stockpr.com/arotech/media/249a9ac7cc90aa315f94037d49d2246e.pdf.

The Compensation Committee maintains compensation and incentive programs designed to motivate, retain and attract management and utilize various combinations of base salary, bonuses payable upon the achievement of specified goals, discretionary bonuses and grants of restricted stock. Our President and Chief Executive Officer, Mr. Steven Esses, our Executive Chairman, Mr. Robert S. Ehrlich, and our Chief Financial Officer, Mr. Thomas J. Paup, are all parties to employment agreements with us. The Compensation Committee reviews the compensation, both cash and stock, of our executive officers on an annual basis, while taking into account as well changes in compensation during previous years. Some of these components, such as salary, are generally fixed and do not vary based on our financial and other performance; some components, such as bonus, are in whole or in part dependent upon the achievement of certain goals jointly agreed upon by our management and the Compensation Committee; and some components, such as stock options and restricted stock, have a value that is dependent upon our stock price at the time of award and going forward. The Compensation Committee reviews the compensation, both cash and stock, of our executive officers on an annual basis, while taking into account as well changes in compensation during previous years.

The Compensation Committee performs an annual review of our executive officers' cash compensation and share and option holdings to determine whether they provide adequate compensation for the services they perform, as well as adequate incentives and motivation to our executive officers and whether they adequately compensate our executive officers relative to comparable officers in other companies.

Compensation Committee meetings typically have included, for all or a portion of some of the meetings, a representative of The Burke Group, Inc., a well-known consulting firm specializing in executive officer compensation, as well as preliminary discussion with our senior officers prior to our Compensation Committee deliberating without any members of management present. For compensation decisions, including decisions regarding the grant of equity compensation relating to executive officers (other than our Chairman and Chief Executive Officer), the Compensation Committee typically considers the recommendations of our Chairman and Chief Executive Officer.

Nominating Committee

The Nominating Committee identifies and proposes candidates to serve as members of the Board of Directors. Proposed nominees for membership on the Board of Directors submitted in writing by stockholders to Arotech's Secretary will be brought to the attention of the Nominating Committee. The Nominating Committee consists of Mr. Marrus (Chair), Dr. Eastman and Mr. Rudy. Each member of the Nominating Committee is an independent director as that term is defined in the NASD listing standards. The Nominating Committee makes recommendations to the Board of Directors regarding new directors to be selected for membership on the Board of Directors and its various committees. The Nominating Committee operates under a formal charter that governs its duties. The Nominating Committee's charter is publicly available through a hyperlink located on the investor relations page of our website, at http://content.stockpr.com/arotech/media/9db8a8bd53ecd3f2d895b23986e237c8.pdf.

Executive and Finance Committee

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

Code of Ethics

We have adopted a Code of Ethics, as required by Nasdaq listing standards and the rules of the SEC, that applies to our principal executive officer, our principal financial officer and our principal accounting officer. The Code of Ethics is publicly available through a hyperlink located on the investor relations page of our website, at http://content.stockpr.com/arotech/media/df40a6c92bcbf0b776162586acce0841.pdf. If we make substantive amendments to the Code of Ethics or grant any waiver, including any implicit waiver, that applies to anyone subject to the Code of Ethics, we will disclose the nature of such amendment or waiver on the website or in a report on Form 8-K in accordance with applicable Nasdaq and SEC rules.

Code of Conduct

We have adopted a general Code of Conduct, as required by Nasdaq listing standards and the rules of the SEC, that applies to all of our employees. The Code of Conduct is publicly available through a hyperlink located on the investor relations page of our website, at http://content.stockpr.com/arotech/media/5c5e3b052edfcf1e78084a414a4c37c1.pdf.

Whistleblower Policy

We have adopted a Whistleblower Policy, as required by Nasdaq listing standards, in order to ensure compliance with the provisions of the Sarbanes-Oxley Act of 2002. The Whistleblower Policy is publicly available through a hyperlink located on the investor relations page of our website, at http://content.stockpr.com/arotech/media/6a9edfc8a5cd8b55aa0c9f4a6aef0363.pdf. Employees with complaints about our compliance with applicable legal and regulatory requirements relating to accounting, auditing and internal control matters may submit their complaints in person, by mail or other written communication or by telephone to our Complaint Administrator. The Complaint Administrator can be contacted anonymously, by submitting the form located on our corporate website at http://www.arotech.com/contact/ethics-compliance. Complaints sent in this manner will automatically be stripped of all computer-encoded information identifying the originating e-mail address, and will then automatically be forwarded to the Complaint Administrator's regular e-mail address at Arotech.

Director Compensation

Non-employee members of our Board of Directors are entitled to a cash retainer of $8,000 (plus expenses) per quarter, plus $500 per quarter for each committee on which such outside directors serve ($1,000 per quarter for members of the Executive and Finance Committee). The Chairman of the Audit Committee receives an additional retainer of $1,500 per quarter, and the Chairman of the Compensation Committee receives an additional retainer of $1,000 per quarter. No per-meeting fees are paid. In addition, we have adopted a Non-Employee Director Equity Compensation Plan, pursuant to which non-employee directors receive an initial grant of a number of restricted shares having a fair market value on the date of grant equal to $25,000 upon their election as a director, and an annual grant on March 31 of each year of a number of restricted shares having a fair market value on the date of grant equal to $35,000. Each grant of restricted stock shall become free of restrictions in three equal installments on each of the first, second and third anniversaries of the grant, unless the director is removed from the Board of Directors for cause prior to such vesting. Restrictions lapse automatically in the event of a director being removed for service other than for cause, or being nominated as a director but failing to be elected, or death, disability or mandatory retirement. Furthermore, all restrictions lapse prior to the consummation of a merger or consolidation involving us, our liquidation or dissolution, any sale of substantially all of our assets or any other transaction or series of related transactions as a result of which a single person or several persons acting in concert own a majority of our then-outstanding common stock.

The following table shows the compensation earned or received by each of our non-officer directors for the year ended December 31, 2014:

DIRECTOR COMPENSATION

Name	Fees Earned or Paid in Cash	Stock Awards Granted 2014	Total	Stock Awards Vested(1) 2014
Dr. Jay M. Eastman	$ 33,000	$ 25,000	$ 58,000	$ 75,239 (2)
Seymour Jones	$ 36,000	$ 25,000	$ 61,000	$ 75,239 (3)
Michael E. Marrus	$ 31,500	$ 25,000	$ 56,500	$ 75,239 (4)
Arthur S. Leibowitz(7)	$ 29,000	$ 25,000	$ 54,000	$ 75,239 (5)
Richard I. Rudy	$ 9,500	$ 25,000	$ 34,500	$ – (6)

(1) This column reflects the 2014 compensation expense for stock based awards for the year ended December 31, 2014.
(2) As of December 31, 2014, Dr. Eastman held 20,820 unvested restricted shares of our common stock that were awarded in 2014.
(3) As of December 31, 2014, Prof. Jones held 20,820 unvested restricted shares of our common stock that were awarded in 2014.
(4) As of December 31, 2014, Mr. Marrus held 20,820 unvested restricted shares of our common stock that were awarded in 2014.
(5) As of December 31, 2014, Mr. Leibowitz held 20,820 unvested restricted shares of our common stock that were awarded in 2014.
(6) As of December 31, 2014, Mr. Rudy held 6,983 unvested restricted shares of our common stock that were awarded in 2014.
(7) This individual retired as a director effective August 11, 2014.

Significant Employees

Our significant employees as of February 28, 2015, and their ages as of December 31, 2014, are as follows:

Name	Age	Position
Dean Krutty	49	Senior Vice President, Operations – North America
Ronen Badichi	49	General Manager, Power Systems Division – Europe and Asia
Yaakov Har-Oz	57	Senior Vice President, General Counsel and Secretary
Norman E. Johnson	62	Corporate Controller, Chief Accounting Officer

Dean Krutty became President of the Simulation Division in January 2005, after having spent the prior thirteen years as a member of the FAAC management team, and was promoted to Arotech's Senior Vice President, Operations – North America in January 2015. He began his career at FAAC as an electrical engineer in FAAC's part task trainer division and served as FAAC's Director of Operations prior to becoming its President. He also has significant experience managing programs in the training and simulation industry. Mr. Krutty holds a B.S. in electrical engineering from the Michigan State University.

Ronen Badichi became the General Manager of Epsilor Electronic Industries in May 2005 and the General Manager of our Power Systems Division – Europe and Asia in December 2007. Prior to joining Epsilor, Mr. Badichi served since 1999 as the General Manager of Maoz Industries, a high end supplier of displays to the aviation industry. Prior thereto, Mr. Badichi was a project manager at BAE Systems (LON: BA) and served as the F-16 Avionics Integration manager in the Israeli Air Force, with the rank of Captain. Mr. Badichi holds a B.Sc. in Physics and Electro-Optic Engineering from the Lev Institute of Technology in Jerusalem.

Yaakov Har-Oz has served as our Vice President and General Counsel since October 2000 and as our corporate Secretary since December 2000; in December 2005 Mr. Har-Oz was promoted to Senior Vice President. From 1994 until October 2000, Mr. Har-Oz was a partner in the Jerusalem law firm of Ben-Ze'ev, Hacohen & Co. Prior to moving to Israel in 1993, he was an administrative law judge and in private law practice in New York. Mr. Har-Oz holds a B.A. from Brandeis University in Waltham, Massachusetts and a J.D. from Vanderbilt Law School (where he was an editor of the law review) in Nashville, Tennessee. He is a member of the New York bar and the Israel Chamber of Advocates.

Norman E. Johnson has served as our Controller and as our Chief Accounting Officer since August 2006. Prior to joining Arotech, Mr. Johnson was the Corporate Controller with Catuity Inc., a provider of loyalty and gift card solutions. Prior to Catuity, he was with the McCoig Group, a Detroit based holding company, and from March 2000 to August 2004 he was the Corporate Controller of Learning Care Group Inc., a provider of child care and educational services recently acquired by the private equity firm American Securities LLC. Mr. Johnson holds a B.S. in Accounting from Central Michigan University in Mt. Pleasant, Michigan.

Section 16(a) Beneficial Ownership Reporting Compliance

Under the securities laws of the United States, our directors, certain of our officers and any persons holding more than ten percent of our common stock are required to report their ownership of our common stock and any changes in that ownership to the Securities and Exchange Commission. Specific due dates for these reports have been established and we are required to report any failure to file by these dates during 2014. We are not aware of any instances during 2014, not previously disclosed by us, where such "reporting persons" failed to file the required reports on or before the specified dates.

ITEM 11. EXECUTIVE COMPENSATION

Cash and Other Compensation

Summary Compensation Table

The following table, which should be read in conjunction with the explanations provided below, shows the compensation that we paid (or accrued) to our executive officers during the fiscal years ended December 31, 2014 and 2013:

SUMMARY COMPENSATION TABLE(1)

Name and Principal Position	Year	Salary	Bonus(2)	Stock Awards Granted(3)	All Other Compensation	Total
Steven Esses	2014	$ 330,946 (4)	$ 374,600	$ 223,000	$ 516,356 (5)	$ 1,444,902
President, Chief Executive Officer and a director	2013	$ 273,437 (6)	$ 205,400	$ 273,750	$ 398,878 (7)	$ 1,151,465
Robert S. Ehrlich (8)	2014	$ 482,808	$ 361,250	$ 111,500	$ 64,385 (9)	$ 1,019,943
Executive Chairman of the Board and a director	2013	$ 444,356	$ 379,900	$ 365,000	$ 135,423 (10)	$ 1,324,679
Thomas J. Paup	2014	$ 225,000	$ 187,250	$ 133,800	$ 1,436 (11)	$ 547,486
Senior Vice President – Finance and Chief Financial Officer	2013	$ 201,400	$ 100,500	$ 273,750	$ – (11)	$ 575,650

(1) We paid the amounts reported for each named executive officer in U.S. dollars and/or New Israeli Shekels (NIS). We have translated amounts paid in NIS into U.S. dollars at the exchange rate of NIS into U.S. dollars at the time of payment or accrual, except that certain items are pursuant to corporate policy paid at a set exchange rate that may be higher than the actual exchange rate on the date of payment. The difference, which was a positive number in 2014 and 2013, has been reported under "Salary." The exchange rate differences for Mr. Ehrlich were $97,330 and $88,797 for 2014 and 2013, respectively. The exchange rate differences for Mr. Esses were $66,716 and $54,642 for 2014 and 2013, respectively.

(2) Bonuses are performance-based, against criteria established by the Compensation Committee of the Board of Directors and approved by the full Board of Directors. See "Employment Contracts," below.

(3) Reflects the value of awards of restricted stock or restricted stock units granted to our executive officers based on the compensation cost of their stock-based awards; see Note 13.b. of the Notes to Consolidated Financial Statements. The number of shares of restricted stock or restricted stock units received by our executive officers pursuant to such awards in 2014, vesting entirely after one year (dependent 33% on tenure and 67% on performance), was as follows: Mr. Esses, 100,000; Mr. Ehrlich, 50,000; and Mr. Paup, 60,000. The number of shares of restricted stock or restricted stock units received by our executive officers pursuant to such awards in 2013, vesting entirely after one year (dependent 33% on tenure and 67% on performance), was as follows: Mr. Esses, 75,000; Mr. Ehrlich, 100,000; and Mr. Paup, 75,000. All of these shares vested in 2014.

(4) Does not include approximately $124,723 that we paid in consulting fees to Sampen Corporation, a New York corporation owned by members of Steven Esses's immediate family, from which Mr. Esses receives a salary. See "Item 13. Certain Relationships and Related Transactions – Consulting Agreement with Sampen Corporation," below.
(5) Of this amount, $119,570 represents payments to Israeli pension and education funds; $378,207 represents the change in our accrual for severance pay that will be payable to Mr. Esses upon his leaving our employ other than if he is terminated for cause, such as a breach of trust; $37,460 represents sick pay redemption; $4,544 represents the change in sick pay accruals; $(18,460) represents the change of our accrual for vacation pay; $825 represents tax reimbursements; and $3,298 represents other normal or mandated Israeli benefits.
(6) Does not include approximately $148,723 that we paid in consulting fees to Sampen Corporation, a New York corporation owned by members of Steven Esses's immediate family, from which Mr. Esses receives a salary. See "Item 13. Certain Relationships and Related Transactions – Consulting Agreement with Sampen Corporation," below.
(7) Of this amount, $38,745represents payments to Israeli pension and education funds; $38,856 represents the change in our accrual for severance pay that will be payable to Mr. Esses upon his leaving our employ other than if he is terminated for cause, such as a breach of trust; $28,680 represents sick pay redemption; $214,559 represents the change in sick pay accruals; $8,687 represents the change of our accrual for vacation pay; $750 represents tax reimbursements; and $68,601 represents other normal or mandated Israeli benefits.
(8) Mr. Ehrlich was serving as our Chief Executive Officer until October 2014, at which time he became our Executive Chairman of the Board.
(9) Of this amount, $31,013 represents the change in our accrual for severance pay that will be payable to Mr. Ehrlich upon his leaving our employ other than if he is terminated for cause, such as a breach of trust; $29,112 represents the change of our accrual for vacation pay; $857 represents tax reimbursements, $44,609 represents vacation days redemption and $17,018 represents other normal or mandated Israeli benefits.
(10) Of this amount, $91,834 represents the change in our accrual for severance pay that will be payable to Mr. Ehrlich upon his leaving our employ other than if he is terminated for cause, such as a breach of trust; $32,205 represents the change of our accrual for vacation pay; $3,578 represents tax reimbursements and $7,806 represents other normal or mandated Israeli benefits.
(11) Represents the increase (decrease) in our accrual for Mr. Paup for accrued but unused vacation days.

Executive Loans

In 2000, we extended a loan to one of our Named Executive Officers. This loan is summarized in the following table, and is further described under "Item 13. Certain Relationships and Related Transactions – Officer Loan," below.

Name of Borrower	Date of Loan	Original Principal Amount of Loan	Amount Outstanding as of 12/31/2014	Terms of Loan
Robert S. Ehrlich	02/09/2000	$ 329,163	$ 452,995	Twenty-five-year non-recourse loan to purchase our stock, secured by the shares of stock purchased.

Plan-Based Awards

Grants of Restricted Stock or Restricted Stock Units

During 2014, the Compensation Committee approved the grant of a total of 210,000 shares of restricted stock or restricted stock units to our executive officers (in connection with their amended and restated employment agreements). The table below sets forth each equity award granted to our executive officers during the year ended December 31, 2014.

GRANTS OF PLAN-BASED AWARDS

Name	Grant Date	All Other Stock Awards: Number of Shares of Stocks	Grant Date Fair Value of Stock Awards (1)
Steven Esses(2)	12/15/2014	225,000	$ 560,500
Robert S. Ehrlich(2)	12/15/2014	50,000	$ 111,500
Thomas J. Paup(2)	12/15/2014	60,000	$ 133,800

(1)Reflects the aggregate market value of the shares of restricted stock or restricted stock units determined based on the closing price of our common stock on the Nasdaq Global Market on the date of grant.
(2)The restricted shares or restricted stock units vest on December 31, 2015 (dependent 33% on tenure and 67% on performance).

Stock Option Exercises and Vesting of Restricted Stock Awards

Our executive officers did not exercise any stock options during 2014. The following table presents awards of restricted stock or restricted stock units that vested during the year ended December 31, 2014.

STOCK VESTED

Name	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting(1) ($)
Steven Esses	75,000	$ 227,500
Robert S. Ehrlich	33,333	$ 148,665

(1)Reflects the aggregate market value of the shares of restricted stock or restricted stock units determined based on a per share price at vesting based on the closing price of our common stock on the Nasdaq Global Market.

Outstanding Equity Awards at Fiscal Year-End

The table below sets forth information for our executive officers with respect to option, restricted stock and restricted stock unit values at the end of the fiscal year ended December 31, 2014.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

	Stock Awards			
			Equity Incentive Plan Awards	
Name	Number of Shares that Have Not Vested (#)	Market Value of Shares that Have Not Vested(1) ($)	Number of Unearned Shares that Have Not Vested (#)	Market Value of Unearned Shares that Have Not Vested(1) ($)
Steven Esses	208,333 (2)	$ 483,333	116,667 (3)	$ 270,667
Robert S. Ehrlich	83,333 (4)	$ 193,333	100,000 (5)	$ 232,000
Thomas J. Paup	45,000 (6)	$ 104,400	90,000 (7)	$ 208,800

(1) Reflects the aggregate market value of the shares of restricted stock or restricted stock units determined based on a per share price at grant based on the closing price of our common stock on that day on the Nasdaq Global Market.
(2) 25,000 of these shares vest on January 1, 2015, 25,000 of these shares vest on June 30, 2015, 100,000 of these shares vest on December 31, 2015, 41,667 of these shares vest on December 31, 2016, and 41,666 of these shares vest on December 31, 2017, based solely on continued employment through such dates.
(3) 50,000 of these shares vest on January 1, 2015and 66,667 of these shares vest on December 31, 2016, based on continued employment through such dates and on achievement by us of certain performance criteria.
(4) 33,333 of these shares vest on January 1, 2015, 33,333 of these shares vest on June 30, 2015, and 16,667 of these shares vest on December 31, 2015, based solely on continued employment through such dates.
(5) 66,667 of these shares vest on January 1, 2015 and 33,333 of these shares vest on December 31, 2016, based on continued employment through such dates and on achievement by us of certain performance criteria.
(6) 25,000 of these shares vest on January 1, 2015, and 20,000 of these shares vest on December 31, 2015, based solely on continued employment through such dates.
(7) 50,000 of these shares vest on January 1, 2015, and 40,000 of these shares vest on December 31, 2016, based on continued employment through such dates and on achievement by us of certain performance criteria.

Employment Contracts

Steven Esses

Mr. Esses is party to an amended and restated employment agreement with us effective October 1, 2014. The term of this employment agreement expires on December 31, 2017. The employment agreement provides that Mr. Esses will serve as our President and Chief Executive Officer.

The 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 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. For 2013 and 2014, the Compensation Committee choose financial targets for determining eligibility for the above-referenced cash incentive bonus that are determined in part on the achievement of set budgetary forecast targets for adjusted EBITDA, a non-GAAP measurement, and in part on the achievement of other targets – in the case of 2013, targets for revenues and adjusted EBITDA, and in the case of 2014, targets for adjusted EBITDA. Bonus targets will be chosen for 2015 based upon future budgetary forecasts.

The 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 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.

A table describing the payments that would have been due to Mr. Esses under his employment agreement had Mr. Esses's employment with us been terminated at the end of 2014 under various circumstances appears under "Potential Payments and Benefits upon Termination of Employment – Steven Esses," below.

In April 2009, we, with the agreement of Mr. Esses, funded a portion of his severance security by means of issuing to him, in trust, restricted stock having a value (based on the closing price of our stock on the Nasdaq Stock Market on the date on which Mr. Esses and our board of directors agreed on this arrangement) of $200,000, a total of 273,973 shares. In Mr. Esses's new employment agreement, we agreed with him that these shares would still be restricted, but that the issuance of these shares to him would not reduce our severance obligations referred to above.

See also "Item 13. Certain Relationships and Related Transactions – Consulting Agreement with Sampen Corporation," below.

Robert S. Ehrlich

Mr. Ehrlich is party to an amended and restated employment agreement with us effective in January 2015. The term of this employment agreement expires on December 31, 2017. The employment agreement provides that Mr. Ehrlich will serve as our Executive Chairman of the Board.

The employment agreement provides for a monthly base salary of NIS 98,822 (approximately $25,236 at the rate of exchange in effect on December 24, 2014), as adjusted for Israeli inflation (but with no retroactive inflation adjustment for 2015 in respect of inflation during 2014). Additionally, the board may, at its discretion, raise Mr. Ehrlich's base salary.

The employment agreement also provides for an annual bonus divided into three tranches. The first tranche of the bonus is in an amount equaling between 20% and 50% of one-third of Mr. Ehrlich's gross annual Base Salary, and is awarded based on the achievement of acquisition and finance objectives during the previous fiscal year, such objectives to be set by the Compensation Committee after consultation with management. The second and third tranches are based on the results we actually attain in a given year, and are paid on a sliding scale, in an amount equal to a minimum of 20% of two-thirds of Mr. Ehrlich's annual base salary then in effect if the results we actually attain for the year in question are 100% of the amount we budgeted at the beginning of the year, up to a maximum of 50% of two-thirds 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. Mr. Ehrlich's previous employment agreement had a similar bonus provision (but with a lower (20%) threshold bonus). For 2013 and 2014, the Compensation Committee choose financial targets for determining eligibility for the above-referenced cash incentive bonus that are determined in part on the achievement of set budgetary forecast targets for adjusted EBITDA, a non-GAAP measurement, and in part on the achievement of other targets – in the case of 2013, targets for revenues and adjusted EBITDA, and in the case of 2014, targets for adjusted EBITDA. Bonus targets will be chosen for 2015 based upon future budgetary forecasts.

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

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

The employment agreement further notes that Mr. Ehrlich's severance payment of $1,625,400 under his prior agreement, which has been fully earned, has been paid to him (or that bank standing instructions have been issued with respect to such payment).

A table describing the payments that would have been due to Mr. Ehrlich under his employment agreement had Mr. Ehrlich's employment with us been terminated at the end of 2014 under various circumstances (pursuant to the terms of his then-current employment agreement) appears under "Potential Payments and Benefits upon Termination of Employment – Robert S. Ehrlich," below.

Thomas J. Paup

Mr. Paup is party to an amended and restated employment agreement with us executed in May 2013 and amended in January 2014, having a term running until December 31, 2015. The employment agreement provides that Mr. Paup will serve as our Senior Vice President – Finance and Chief Financial Officer. In January 2015, Mr. Paup's employment agreement was amended to, among other things, extend the term through March 31, 2017 and to increase the number of vacation days Mr. Paup receives annually from 20 to 40.

Under the terms of his employment agreement as amended, Mr. Paup is entitled to receive a base salary of $250,000, as adjusted annually for inflation (but with no retroactive inflation adjustment for 2013 in respect of inflation during 2012).

The employment agreement provides that if the results we actually attain in a given year are at least 90% of the amount we budgeted at the beginning of the year, we will pay a bonus, on a sliding scale, in an amount equal to a minimum of 16.5% of Mr. Paup's annual base salary then in effect, up to a maximum of 50% of his annual base salary then in effect if the results we actually attain for the year in question are 110% or more of the amount we budgeted at the beginning of the year. Mr. Paup's previous employment agreement had a similar bonus provision (but with a higher (20%) threshold bonus). For 2013 and 2014, the Compensation Committee choose financial targets for determining eligibility for the above-referenced cash incentive bonus that are determined in part on the achievement of set budgetary forecast targets for adjusted EBITDA, a non-GAAP measurement, and in part on the achievement of other targets – in the case of 2013, targets for revenues and adjusted EBITDA, and in the case of 2014, targets for adjusted EBITDA. Bonus targets will be chosen for 2015 based upon future budgetary forecasts.

Mr. Paup's employment agreement provides that if we terminate his agreement other than for cause (defined as conviction of certain crimes, willful failure to carry out directives of our board of directors or gross negligence or willful misconduct), we must pay Mr. Paup severance in an amount of twelve times his monthly salary. Restricted shares that have vested prior to the date of termination are not forfeited under any circumstances, including termination for Cause.

A table describing the payments that would have been due to Mr. Paup under his employment agreement had Mr. Paup's employment with us been terminated at the end of 2014 under various circumstances (pursuant to the terms of his then-current employment agreement) appears under "Potential Payments and Benefits upon Termination of Employment – Thomas J. Paup," below.

Others

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

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

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

Potential Payments and Benefits upon Termination of Employment

This section sets forth in tabular form quantitative disclosure regarding estimated payments and other benefits that would have been received by certain of our executive officers if their employment had terminated on December 31, 2014 (the last business day of the fiscal year), pursuant to the terms of their then-current employment agreements.

For a narrative description of the severance and change in control arrangements in the current employment contracts of Messrs. Esses, Ehrlich and Paup, see "– Employment Contracts," above. Each of Messrs. Esses and Ehrlich will be eligible to receive severance payments in excess of accrued but unpaid items only if he signs a general release of claims.

Steven Esses

The following table describes the potential payments and benefits upon employment termination for Steven Esses, our President and Chief Executive Officer, pursuant to applicable law and the terms of his then-current employment agreement with us, as if his employment had terminated on December 31, 2014 (the last business day of the fiscal year) under the various scenarios described in the column headings as explained in the footnotes below.

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See also "Item 13. Certain Relationships and Related Transactions – Consulting Agreement with Sampen Corporation," below.

STEVEN ESSES

Payments and Benefits	Non-Renewal(1)	Death or Disability(2)	Cause(3)	Good Reason(4)	Change of Control(5)	Retirement(6)	Early Retirement(7)	Other Employee Termination(8)
Accrued but unpaid(9):								
Base salary	$ 23,333	$ 23,333	$ 23,333	$ 23,333	$ 23,333	$ 23,333	$ 23,333	$ 23,333
Vacation	78,441	78,441	78,441	78,441	78,441	78,441	78,441	78,441
Sick leave(10)	218,197	218,197	218,197	218,197	218,197	218,197	218,197	218,197
Recuperation pay(11)	324	324	324	324	324	324	324	324
Benefits:								
Manager's insurance(12)	3,695	3,695	3,695	3,695	3,695	3,695	3,695	3,695
Continuing education fund(13)	1,750	1,750	1,750	1,750	1,750	1,750	1,750	1,750
Contractual severance	1,135,962	1,135,962		1,135,962	1,135,962	1,135,962	1,135,962	
Statutory severance(14)	430,779	430,779		430,779	430,779	430,779	430,779	
Benefits				75,000	150,000	150,000	150,000	
TOTAL:	$ 1,892,481	$ 1,892,481	$ 325,740	$ 1,967,481	$ 2,042,481	$ 2,042,481	$ 2,042,481	$ 325,740

(1)"Non-renewal" is defined in Mr. Esses's employment agreement as a decision, made with written notice of at least 90 days in advance of the effective date of such decision, by either us or Mr. Esses not to renew Mr. Esses's employment for an additional two-year term. Pursuant to the terms of Mr. Esses's employment agreement, in the absence of such notice, Mr. Esses's employment agreement automatically renews.

(2)"Disability" is defined in Mr. Esses's employment agreement as a physical or mental infirmity which impairs Mr. Esses's ability to substantially perform his duties and which continues for a period of at least 180 consecutive days.

(3)"Cause" is defined in Mr. Esses's employment agreement as (i) conviction for fraud, crimes of moral turpitude or other conduct which reflects on us in a material and adverse manner; (ii) a willful failure to carry out a material directive of our Chief Executive Officer, *provided* that such directive concerned matters within the scope of Mr. Esses's duties, would not give Mr. Esses "Good Reason" to terminate his agreement (see footnote 4 below) and was capable of being reasonably and lawfully performed; (iii) conviction in a court of competent jurisdiction for embezzlement of our funds; or (iv) reckless or willful misconduct that is materially harmful to us.

(4)"Good Reason" is defined in Mr. Esses's employment agreement as (i) (a) a change in Mr. Esses's status, title, position or responsibilities which, in Mr. Esses's reasonable judgment, represents a reduction or demotion in his status, title, position or responsibilities as in effect immediately prior thereto, (b) 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 (c) a change in the composition of a majority of the Board of Directors; or (ii) a reduction in Mr. Esses's base salary; (iii) the failure by us to continue in effect any material compensation or benefit plan in which Mr. Esses is participating; (iv) our insolvency or the filing (by any party, including us) of a petition for our winding-up; (v) any material breach by us of any provision of Mr. Esses's employment agreement; or (vi) any purported termination of Mr. Esses's employment for cause by us which does not comply with the terms of Mr. Esses's employment agreement.

(5)Represents additional payment due to Mr. Esses should he terminate his employment under the circumstances set forth in clause (i)(c) of footnote 4 above.

(6)"Retirement" is defined as Mr. Esses terminating his employment with us at age 65 or older on at least 150 days' prior notice.

(7)"Early Retirement" is defined as Mr. Esses terminating his employment with us at age 55 or older (up to age 65) on at least 150 days' prior notice.

(8)Any termination by Mr. Esses of his employment with us that does not fit into any of the prior categories, including but not limited to Mr. Esses terminating his employment with us, with or without notice, other than at the end of an employment term or renewal thereof, in circumstances that do not fit into any of the prior categories.

(9)Does not include a total of $9,000 in accrued but unpaid consulting fees due at December 31, 2014 to Sampen Corporation, a New York corporation owned by members of Steven Esses's immediate family, from which Mr. Esses receives a salary. See "Item 13. Certain Relationships and Related Transactions – Consulting Agreement with Sampen Corporation," below.

(10)Limited to an aggregate of 30 days.

(11)Pursuant to Israeli law and our customary practice, we pay Mr. Esses in July of each year the equivalent of six days' "recuperation pay" at the statutory rate of NIS 378 (approximately $97) per day.

(12)Payments to managers' insurance, a benefit customarily given to senior executives in Israel, come to a total of 15.83% of base salary, consisting of 8.33% for payments to a fund to secure payment of statutory severance obligations, 5% for pension and 2.5% for disability. The managers' insurance funds reflected in the table do not include the 8.33% payments to a fund to secure payment of statutory severance obligations with respect to amounts paid prior to December 31, 2013, which funds are reflected in the table under the "Statutory severance" heading.

(13)Pursuant to Israeli law, we must contribute an amount equal to 7.5% of Mr. Esses's base salary to a continuing education fund, up to the permissible tax-exempt salary ceiling according to the income tax regulations in effect from time to time. At December 31, 2014, the ceiling then in effect was NIS 15,712 (approximately $4,040). In Mr. Esses's case, we have customarily contributed to his continuing education fund in excess of the tax-exempt ceiling, and then reimbursed Mr. Esses for the tax. The sums in the table reflect this additional contribution and the resultant tax reimbursement.

(14)Under Israeli law, employees terminated other than for cause receive severance in the amount of one month's base salary for each year of work, at their salary rate at the date of termination.

Robert S. Ehrlich

The following table describes the potential payments and benefits upon employment termination for Robert S. Ehrlich, our Executive Chairman of the Board, pursuant to applicable law and the terms of his then-current employment agreement with us, as if his employment had terminated on December 31, 2014 (the last business day of the fiscal year) under the various scenarios described in the column headings as explained in the footnotes below.

ROBERT S. EHRLICH

Payments and Benefits	Death or Disability(1)	Cause(2)	Good Reason(3)	Other Employee Termination(4)
Accrued but unpaid:				
Base salary	$ 32,123	$ 32,123	$ 32,123	$ 32,123
Vacation	112,975	112,975	112,975	112,975
Recuperation pay(5)	405	405	405	405
Benefits:				
Continuing education fund(6)	2,409	2,409	2,409	2,409
Contractual severance	1,625,400	1,625,400	1,625,400	1,625,400
Statutory severance(7)	976,278		976,278	
TOTAL:	$ 2,749,590	$ 1,773,312	$ 2,749,590	$ 1,773,312

(1) "Disability" is defined in Mr. Ehrlich's employment agreement as a physical or mental infirmity which impairs Mr. Ehrlich's ability to substantially perform his duties and which continues for a period of at least 180 consecutive days.

(2) "Cause" is defined in Mr. Ehrlich's employment agreement as (i) conviction for fraud, crimes of moral turpitude or other conduct which reflects on us in a material and adverse manner; (ii) a willful failure to carry out a material directive of our Board of Directors, *provided* that such directive concerned matters within the scope of Mr. Ehrlich's duties, would not give Mr. Ehrlich "Good Reason" to terminate his agreement (see footnote 4 below) and was capable of being reasonably and lawfully performed; (iii) conviction in a court of competent jurisdiction for embezzlement of our funds; or (iv) reckless or willful misconduct that is materially harmful to us.

(3) "Good Reason" is defined in Mr. Ehrlich's employment agreement as (i) a change in Mr. Ehrlich's status, title, position or responsibilities which, in Mr. Ehrlich's reasonable judgment, represents a reduction or demotion in his status, title, position or responsibilities as in effect immediately prior thereto; (ii) a reduction in Mr. Ehrlich's base salary; (iii) the failure by us to continue in effect any material compensation or benefit plan in which Mr. Ehrlich is participating; (iv) our insolvency or the filing (by any party, including us) of a petition for our winding-up; (v) any material breach by us of any provision of Mr. Ehrlich's employment agreement; (vi) any purported termination of Mr. Ehrlich's employment for cause by us which does not comply with the terms of Mr. Ehrlich's employment agreement; or (vii) any movement of the location where Mr. Ehrlich is generally to render his services to us from the Jerusalem/Tel Aviv area of Israel.

(4) "Other Employee Termination" means a termination by Mr. Ehrlich of his employment other than for Good Reason.

(5) Pursuant to Israeli law and our customary practice, we pay Mr. Ehrlich in July of each year the equivalent of ten days' "recuperation pay" at the statutory rate of NIS 378 (approximately $97) per day.

(6) Pursuant to Israeli law, we must contribute an amount equal to 7.5% of Mr. Ehrlich's base salary to a continuing education fund, up to the permissible tax-exempt salary ceiling according to the income tax regulations in effect from time to time. At December 31, 2014, the ceiling then in effect was NIS 15,712 (approximately $4,040).

(7) Under Israeli law, employees terminated other than for cause receive severance in the amount of one month's base salary for each year of work, at their salary rate at the date of termination.

Thomas J. Paup

The following table describes the potential payments and benefits upon employment termination for Thomas J. Paup, our Senior Vice President – Finance and Chief Financial Officer, pursuant to applicable law and the terms of his then-current employment agreement with us, as if his employment had terminated on December 31, 2014 (the last business day of the fiscal year) under the various scenarios described in the column headings as explained in the footnotes below.

THOMAS J. PAUP

Payments and Benefits	Death or Disability(1)	Cause(2)	Non-Renewal(3)	Termination at Will(4)
Accrued but unpaid:				
Base salary	$ 225,000	$ 225,000	$ 225,000	$ 225,000
Vacation	12,500	12,500	12,500	12,500
Contractual severance	250,000		250,000	250,000
TOTAL:	$ 487,500	$ 237,500	$ 487,500	$ 487,500

(1) "Disability" is defined in Mr. Paup's employment agreement as a physical or mental infirmity which impairs Mr. Paup's ability to substantially perform his duties and which continues for a period of at least 180 consecutive days.
(2) "Cause" is defined in Mr. Paup's employment agreement as (i) a breach of trust by Mr. Paup, including, for example, but without limitation, commission of an act of moral turpitude, theft, embezzlement, self-dealing or insider trading; (ii) the unauthorized disclosure by Mr. Paup of confidential information of or relating to us; (iii) a material breach by Mr. Paup of his employment agreement; or (iv) any act of, or omission by, Mr. Paup which, in our reasonable judgment, amounts to a serious failure by Mr. Paup to perform his responsibilities or functions or in the exercise of his authority, which failure, in our reasonable judgment, rises to a level of gross nonfeasance, misfeasance or malfeasance.
(3) "Non-Renewal" is defined in Mr. Paup's employment agreement as the agreement coming to the end of the Term and not being extended or immediately succeeded by a new substantially similar employment agreement.
(4) "Termination at Will" is defined in Mr. Paup's employment agreement as Mr. Paup terminating his employment with us on written notice of at least 120 days in advance of the effective date of such termination.

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

Security Ownership of Certain Beneficial Owners and Management

The following table sets forth information regarding the security ownership, as of March 18, 2015, of those persons owning of record or known by us to own beneficially more than 5% of our common stock and of each of our Named Executive Officers and directors, and the shares of common stock held by all of our directors and executive officers as a group.

Name and Address of Beneficial Owner(1)	Shares Beneficially Owned(2)(3)	Percentage of Total Shares Outstanding(3)
Robert S. Ehrlich	1,225,643 (4)	5.0%
Steven Esses	1,171,480 (5)	4.8%
Thomas J. Paup	316,896 (6)	1.3%
Dr. Jay M. Eastman	79,329 (7)	*
Prof. Seymour Jones	79,329 (8)	*
Michael E. Marrus	82,619 (9)	*
Richard I. Rudy	6,983 (10)	*
All of our directors and executive officers as a group (7 persons)	2,962,279 (11)	12.0%

* Less than one percent.
(1) The address of each named beneficial owner is in care of Arotech Corporation, 1229 Oak Valley Drive, Ann Arbor, Michigan 48108.
(2) Unless otherwise indicated in these footnotes, each of the persons or entities named in the table has sole voting and sole investment power with respect to all shares shown as beneficially owned by that person, subject to applicable community property laws.

(3) Based on 24,568,351 shares of common stock outstanding as of March 18, 2015. For purposes of determining beneficial ownership of our common stock, owners of options exercisable or restricted stock that vests within 60 days of March 18, 2015 are considered to be the beneficial owners of the shares of common stock for which such securities are exercisable. The percentage ownership of the outstanding common stock reported herein is based on the assumption (expressly required by the applicable rules of the Securities and Exchange Commission) that only the person whose ownership is being reported has exercised his options for shares of common stock.

(4) Consists of 1,210,545 shares held directly by Mr. Ehrlich (including 83,333 unvested restricted shares, the vesting of 33,333 of which is subject to future performance criteria), 3,571 shares held by Mr. Ehrlich's wife (in which shares Mr. Ehrlich disclaims beneficial ownership), and 11,527 shares held in Mr. Ehrlich's pension plan.

(5) Consists of 1,171,480 shares held directly by Mr. Esses (including 250,000 unvested restricted shares, the vesting of 66,667 of which is subject to future performance criteria), and 273,973 shares issued to a trust and to be held in such trust until such time as Mr. Esses shall be entitled to payment of his severance package).

(6) Consists of 316,896 shares held directly by Mr. Paup. Does not include 60,000 restricted stock units, the vesting of 40,000 of which is subject to future performance criteria.

(7) Consists of 61,472 shares owned directly by Dr. Eastman, 9,146 shares of unvested restricted stock that vest within 60 days of March 18, 2015, and 8,711 unvested restricted shares.

(8) Consists of 61,472 shares owned directly by Prof. Jones, 9,146 shares of unvested restricted stock that vest within 60 days of March 18, 2015, and 8,711 unvested restricted shares.

(9) Consists of 64,762 shares owned directly by Mr. Marrus, 9,146 shares of unvested restricted stock that vest within 60 days of March 18, 2015, and 8,711 unvested restricted shares.

(10) Consists of 804 shares of unvested restricted stock that vest within 60 days of March 18, 2015 and 6,179 unvested restricted shares.

(11) Includes 28,242 shares of unvested restricted stock that vest within 60 days of March 18, 2015, 365,645 shares of unvested restricted stock (the vesting of 100,000 of which is subject to future performance criteria), and 273,973 shares of restricted stock held as part of a trust securing payment of severance. Does not include 60,000 unvested restricted stock units (the vesting of 40,000 of which is subject to future performance criteria).

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Officer Loans

On February 9, 2000, Mr. Ehrlich exercised stock options to purchase 9,404 shares of our common stock. At the time of exercise, Mr. Ehrlich was our Chief Financial Officer and Chairman of the Board of Directors. Currently, Mr. Ehrlich is our Executive Chairman of the Board of Directors. Mr. Ehrlich paid the exercise price of the stock options and certain taxes that we paid on his behalf by giving us a non-recourse promissory note due in 2025 in the amount of $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 our common stock acquired through the exercise of the options and certain compensation due to Mr. Ehrlich upon termination. As of December 31, 2014, the aggregate amount outstanding pursuant to this promissory note was $452,995. No payments of principal or interest were due or paid during the year ended December 31, 2014.

Consulting Agreement with Sampen Corporation

We have an amended and restated consulting agreement with Sampen Corporation that we executed in November 2014. Sampen is a New York corporation owned by members of Steven Esses's immediate family, and Mr. Esses is an employee of both the Company and of Sampen. The term of this consulting agreement is until December 31, 2017.

Pursuant to the terms of our 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.

Director Independence

For information related to director independence, see Item 10. "Directors, Executive Officers and Corporate Governance – (i) Executive Officers and Directors, (ii) Board Leadership Structure and (iii) Committees of the Board of Directors."

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

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

- *Audit Fees.* Audit fees billed or expected to be billed to us by BDO for the audit of the financial statements included in our Annual Report on Form 10-K, and reviews of the financial statements included in our Quarterly Reports on Form 10-Q, for the years ended December 31, 2014 and 2013 totaled approximately $552,000 and $343,000, respectively.

- *Audit-Related Fees*. BDO billed or expected to bill us $191,000 (principally consultation and due diligence related to mergers and acquisitions) and zero for the fiscal years ended December 31, 2014 and 2013, respectively, for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements.

- *Tax Fees.* BDO billed or expected to bill us $20,000 (including consultation related to mergers and acquisitions) and zero for the fiscal years ended December 31, 2014 and 2013, respectively, for tax services.

- *All Other Fees.* BDO billed or expected to bill us an aggregate of zero for both fiscal years ended December 31, 2014 and 2013 for permitted non-audit services.

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

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

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

(1) Financial Statements. See Index to Financial Statements on page 34 above and the financial pages following page 57 below.
(2) Financial Statements Schedules. All schedules are omitted because of the absence of conditions under which they are required or because the required information is presented in the financial statements or related notes thereto.
(3) Exhibits. The following Exhibits are either filed herewith or have previously been filed with the Securities and Exchange Commission and are referred to and incorporated herein by reference to such filings:

Exhibit No.	Description
(1)3.1	Amended and Restated Certificate of Incorporation
(3)3.1.1	Amendment to our Amended and Restated Certificate of Incorporation
(4)3.1.2	Amendment to our Amended and Restated Certificate of Incorporation
(6)3.1.3	Amendment to our Amended and Restated Certificate of Incorporation
(7)3.1.4	Amendment to our Amended and Restated Certificate of Incorporation
(8)3.1.5	Amendment to our Amended and Restated Certificate of Incorporation
(2)3.2	Amended and Restated By-Laws
(5)4.1	Specimen Certificate for shares of common stock, $0.01 par value
(3)10.1	Promissory Note dated February 9, 2000, from Robert S. Ehrlich to us
(5)10.2	Lease dated April 8, 1997, between AMR Holdings, L.L.C. and FAAC Incorporated
(6)10.3	Lease dated February 10, 2006 between Arbor Development Company LLC and FAAC Incorporated
*10.4	Lease dated October 31, 2014 between UEC Properties, LLC and UEC Electronics, LLC
(8)10.5	Membership Interest Purchase Agreement among, inter alia, Arotech Corporation, UEC Electronics, LLC and Ufkes Holdings, LLC dated April 1, 2014
(8)10.6	Amended and Restated Credit Agreement among Arotech Corporation, FAAC Incorporated and Fifth Third Bank dated March 31, 2014
(9)10.7	Joinder Agreement between UEC Electronics, LLC and Fifth Third Bank dated April 1, 2014
(9)10.8	Security Agreement between UEC Electronics, LLC and Fifth Third Bank dated April 1, 2014
(9)10.9	Guaranty from UEC Electronics, LLC to Fifth Third Bank dated April 1, 2014
(9)10.10	Patent and Trademark Security Agreement among Arotech Corporation, FAAC Incorporated, Electric Fuel Battery Corporation and Fifth Third Bank dated March 31, 2014 [a substantially identical agreement was executed by UEC Electronics, LLC]
†10.11 (10)	Fourth Amended and Restated Employment Agreement, dated November 14, 2014 and effective as of October 1, 2014, among us, Epsilor-EFL and Steven Esses
†10.12 (10)	Second Amended and Restated Consulting Agreement, dated November 14, 2014 and effective as of October 1, 2014, between us and Sampen Corporation
†10.13 (11)	Sixth Amended and Restated Employment Agreement, dated May 13, 2013 and effective as of May 1, 2013, among us, Epsilor-EFL and Robert S. Ehrlich
† (8)10.14	Third Amended and Restated Employment Agreement between us and Thomas J. Paup dated May 13, 2013 and effective as of May 1, 2013
†10.14.1 (12)	Amendment dated January 14, 2015 to Third Amended and Restated Employment Agreement, dated May 13, 2013 and effective as of May 1, 2013, between us and Thomas J. Paup

*21.1	List of Subsidiaries of the Registrant
*23.1	Consent of BDO USA, LLP
*31.1	Certification of Principal Executive Officer pursuant to Rule 13a -14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
*31.2	Certification of Principal Financial Officer pursuant to Rule 13a -14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
*32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
*32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
*101.INS	XBRL Instance Document
*101.SCH	XBRL Taxonomy Extension Schema Document
*101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
*101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
*101.LAB	XBRL Taxonomy Extension Label Linkbase Document
*101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith
† Includes management contracts and compensation plans and arrangements
(1) Incorporated by reference to our Registration Statement on Form S-1 (Registration No. 33-73256), which became effective on February 23, 1994
(2) Incorporated by reference to our Registration Statement on Form S-1 (Registration No. 33-97944), which became effective on February 5, 1996
(3) Incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2000
(4) Incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2003
(5) Incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2004
(6) Incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2005
(7) Incorporated by reference to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2006
(8) Incorporated by reference to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2013
(9) Incorporated by reference to our Current Report on Form 8-K filed April 1, 2014
(10) Incorporated by reference to our Quarterly Report on Form 10-Q for the quarter ended September 30, 2014
(11) Incorporated by reference to our Current Report on Form 8-K filed December 24, 2014
(12) Incorporated by reference to our Current Report on Form 8-K filed January 14, 2015

SIGNATURES

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

AROTECH CORPORATION

By: /s/ Steven Esses
Name: Steven Esses
Title: President and Chief Executive Officer

Date: March 20, 2015

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

Signature	**Title**	**Date**
/s/ Steven Esses Steven Esses	President, Chief Executive Officer and Director (Principal Executive Officer)	March 20, 2015
/s/ Thomas J. Paup Thomas J. Paup	Senior Vice President – Finance and Chief Financial Officer (Principal Financial Officer)	March 20, 2015
/s/ Norman E. Johnson Norman E. Johnson	Controller (Principal Accounting Officer)	March 20, 2015
/s/ Robert S. Ehrlich Robert S. Ehrlich	Executive Chairman of the Board and Director	March 20, 2015
/s/ Jay M. Eastman Dr. Jay M. Eastman	Director	March 20, 2015
Seymour Jones	Director	March __, 2015
Michael E. Marrus	Director	March __, 2015
/s/ Richard I. Rudy Richard I. Rudy	Director	March 20, 2015

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Arotech Corporation:
Ann Arbor, Michigan

We have audited the accompanying consolidated balance sheets of Arotech Corporation and subsidiaries (the "Company") as of December 31, 2014 and 2013 and the related consolidated statements of comprehensive income, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Arotech Corporation and subsidiaries at December 31, 2014 and 2013, and the results of its operations and its cash flows for the years then ended**,** in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Arotech Corporation's internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 20, 2015 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

Grand Rapids, Michigan
March 20, 2015

AROTECH CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

In U.S. dollars

	December 31, 2014	December 31, 2013
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 11,291,784	$ 5,821,325
Restricted collateral deposits	236,428	498,495
Trade receivables	17,595,811	12,362,871
Unbilled receivables	15,937,060	8,463,920
Other accounts receivable and prepaid expenses	1,155,548	1,379,621
Inventories	9,811,783	10,074,766
Total current assets	56,028,414	38,600,998
LONG TERM ASSETS:		
Contractual and Israeli statutory severance pay fund	4,961,918	4,968,811
Other long term receivables	23,482	73,979
Property and equipment, net	6,462,949	4,926,949
Other intangible assets, net	11,840,365	1,059,151
Goodwill	45,422,219	31,024,754
Total long term assets	68,710,933	42,053,644
Total assets	$ 124,739,347	$ 80,654,642

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

AROTECH CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

In U.S. dollars

	December 31, 2014	December 31, 2013
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	$ 6,772,082	$ 5,107,208
Other accounts payable and accrued expenses	9,105,214	6,012,041
Current portion of long term debt	4,380,730	95,382
Short term bank credit	33,238	–
Deferred revenues	7,826,178	7,020,079
Total current liabilities	28,117,442	18,234,710
LONG TERM LIABILITIES:		
Contractual and accrued Israeli statutory severance pay	7,051,630	7,020,060
Long term portion of debt	16,934,360	1,830,348
Deferred income tax liability	6,117,021	5,518,521
Other long term liabilities	163,446	74,027
Total long-term liabilities	30,266,457	14,442,956
Total liabilities	58,383,899	32,677,666
STOCKHOLDERS' EQUITY:		
Share capital –		
Common stock – $0.01 par value each; Authorized: 50,000,000 shares as of December 31, 2014 and 2013; Issued and outstanding: 24,533,121 shares and 20,163,163 shares as of December 31, 2014 and 2013, respectively	245,331	201,632
Preferred shares – $0.01 par value each; Authorized: 1,000,000 shares as of December 31, 2014 and 2013; No shares issued or outstanding as of December 31, 2014 and 2013	–	–
Additional paid-in capital	245,970,742	229,917,341
Accumulated deficit	(179,609,611)	(183,096,572)
Notes receivable from stockholders	(908,054)	(908,054)
Accumulated other comprehensive income	657,040	1,862,629
Total stockholders' equity	66,355,448	47,976,976
Total liabilities and stockholders' equity	$ 124,739,347	$ 80,654,642

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

AROTECH CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

In U.S. dollars

	December 31,	
	2014	**2013**
Revenues	$ 103,562,349	$ 88,571,428
Cost of revenues	70,854,737	64,480,140
Research and development expenses	3,322,449	2,955,883
Selling and marketing expenses	5,921,338	5,617,705
General and administrative expenses	17,261,358	10,886,959
Amortization of intangible assets	2,696,740	1,091,126
Total operating costs and expenses	100,056,622	85,031,813
Operating income	3,505,727	3,539,615
Other income, net	2,558,593	286,347
Financial expense, net	(1,553,522)	(499,272)
Total other income (expense)	1,005,071	(212,925)
Income from continuing operations before income tax expense	4,510,798	3,326,690
Income tax expense	1,023,837	1,052,720
Income from continuing operations	3,486,961	2,273,970
Loss from discontinued operations, net of income tax	–	(121,619)
Net income	3,486,961	2,152,351
Other comprehensive income, net of $0 income tax for both years		
Foreign currency translation adjustment	(1,205,589)	627,768
Comprehensive income	$ 2,281,372	$ 2,780,119
Income per share of common stock:		
Basic – continuing operations	$ 0.16	$ 0.14
Basic – discontinued operations	$ –	$ (0.01)
Basic net income per share	$ 0.16	$ 0.13
Diluted – continuing operations	$ 0.15	$ 0.13
Diluted – discontinued operations	$ –	$ (0.01)
Diluted net income per share	$ 0.15	$ 0.12
Weighted average number of shares used in computing basic net income per share	21,934,532	16,507,848
Weighted average number of shares used in computing diluted net income per share	22,537,272	17,110,588

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

AROTECH CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

In U.S. dollars

	Common stock		Additional paid-in capital	Accumulated deficit	Notes receivable from stockholders	Accumulated other comprehensive income (loss)	Total stockholders' equity
	Shares	Amount					
Balance as of January 1, 2014	20,163,163	$ 201,632	$ 229,917,341	$ (183,096,572)	$ (908,054)	$ 1,862,629	$ 47,976,976
Stock based compensation	–	–	1,411,970	–	–	–	1,411,970
Restricted stock issued	344,106	3,441	(3,441)	–	–	–	–
Sale of stock – public offering, net of offering costs	3,289,000	32,890	10,665,282	–	–	–	10,698,173
Purchase of treasury shares	(100,000)	(1,000)	(228,042)	–	–	–	(229,042)
Issuance of stock – acquisition	775,000	7,750	4,208,250	–	–	–	4,216,000
Restricted stock units vested	61,852	618	(618)	–	–	–	–
Foreign currency translation adjustment	–	–	–	–	–	(1,205,589)	(1,205,589)
Net income	–	–	–	3,486,961	–	–	3,486,961
Balance as of December 31, 2014	24,533,121	$ 245,331	$ 245,970,742	$ (179,609,611)	$ (908,054)	$ 657,040	$ 66,355,448

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

AROTECH CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (continued)

In U.S. dollars

	Common stock		Additional paid-in capital	Accumulated deficit	Notes receivable from stockholders	Accumulated other comprehensive income (loss)	Total stockholders' equity
	Shares	Amount					
Balance as of January 1, 2013	16,151,298	$ 161,513	$ 223,181,705	$ (185,248,923)	$ (908,054)	$ 1,234,861	$ 38,421,102
Stock based compensation	–	–	437,306	–	–	–	437,306
Sale of stock – public offering	3,942,856	39,429	6,299,020	–	–	–	6,338,449
Restricted stock issued	268,305	2,683	(2,683)	–	–	–	–
Restricted stock units vested	62,889	629	(629)	–	–	–	–
Restricted stock forfeitures	(262,185)	(2,622)	2,622	–	–	–	–
Foreign currency translation adjustment	–	–	–	–	–	627,768	627,768
Net income	–	–	–	2,152,351	–	–	2,152,351
Balance as of December 31, 2013	20,163,163	$ 201,632	$ 229,917,341	$ (183,096,572)	$ (908,054)	$ 1,862,629	$ 47,976,976

AROTECH CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

In U.S. dollars

	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 3,486,961	$ 2,152,351
Adjustments required to reconcile net income to net cash provided by operating activities:		
Depreciation	1,558,506	1,196,425
Amortization of intangible assets	2,696,740	1,091,126
Stock based compensation	1,411,970	437,306
Change in fair value of acquisition earn out liabilities	(2,000,000)	–
Capital loss from sale of property and equipment	12,809	16,418
Deferred tax provision	598,500	598,500
Changes in continuing operating assets and liabilities:		
Trade receivables	(2,529,966)	(2,723,162)
Unbilled receivables	2,337,691	4,910,084
Other accounts receivable and prepaid expenses	582,502	(219,664)
Inventories	809,827	(41,241)
Severance pay, net	38,463	95,695
Trade payables	(1,143,632)	(2,049,119)
Other accounts payable and accrued expenses	6,480	1,805,568
Deferred revenues	(464,211)	3,221,993
Discontinued operations	–	(291,410)
Net cash provided by (used in) operating activities	7,402,640	10,200,870
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of UEC[(1)]	(29,113,655)	–
Changes in restricted collateral deposits	262,067	(312,189)
Purchase of property and equipment	(2,122,886)	(1,701,110)
Additions to capitalized software development	(377,954)	(3,675)
Proceeds from sale of property and equipment	25,892	25,898
Discontinued operations	–	44,827
Net cash provided by (used in) investing activities	$ (31,326,536)	$ (1,946,249)

AROTECH CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

In U.S. dollars

	2014	2013
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of long term debt	$ (3,110,640)	$ (878,490)
Proceeds from long term debt	22,500,000	–
Change in short term bank credit	33,238	(9,787,779)
Purchase of treasury stock	(229,042)	–
Proceeds from sale of common stock, net of offering costs	10,698,173	6,338,449
Discontinued operations	–	(49,634)
Net cash provided by (used in) financing activities	29,891,729	(4,377,454)
INCREASE IN CASH AND CASH EQUIVALENTS	5,967,833	3,877,167
CASH DIFFERENCES DUE TO EXCHANGE RATE CHANGES	(497,374)	256,983
NET CHANGE IN CASH AND CASH EQUIVALENTS - DISCONTINUED	–	106,548
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR	5,821,325	1,580,627
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	$ 11,291,784	$ 5,821,325
SUPPLEMENTARY INFORMATION ON NON-CASH AND OTHER TRANSACTIONS:		
Interest paid during the year	$ 1,004,052	$ 420,505
Taxes on income paid during the year	$ 256,246	$ 93,004

(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:

Cash paid at closing	28,000,000
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 consolidated financial statements.

AROTECH CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In U.S. dollars

NOTE 1:– GENERAL

a. Corporate structure:

Arotech Corporation ("Arotech") and its wholly-owned subsidiaries (the "Company") provide defense and security products for the military, law enforcement, emergency services and homeland security markets, including advanced zinc-air and lithium batteries and chargers, and multimedia interactive simulators/trainers. The Company operates primarily through its wholly-owned subsidiaries FAAC Incorporated, a Michigan corporation located in Ann Arbor, Michigan (Training and Simulation Division) with locations in Royal Oak, Michigan and Orlando, Florida; Epsilor-Electric Fuel Ltd. ("Epsilor-EFL"), an Israeli corporation located in Beit Shemesh, Israel (between Jerusalem and Tel-Aviv) and in Dimona, Israel (in Israel's Negev desert area) (Power Systems Division); UEC Electronics, LLC ("UEC"), a South Carolina limited liability company located in Hanahan, South Carolina (Power Systems Division); and Electric Fuel Battery Corporation ("EFB"), a Delaware corporation in the process of being relocated from Auburn, Alabama to UEC's facilities in Hanahan, South Carolina (Power Systems 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 for all periods presented.

b. Impairment of goodwill and other long-lived assets:

Goodwill and indefinite-lived intangible assets are tested for impairment at least annually and between annual tests in certain circumstances, and written down when impaired. Goodwill is tested for impairment by comparing the fair value of the Company's reporting units with their carrying value. Both of the Company's reporting units have goodwill. Fair value is determined using discounted cash flows. Significant estimates used in the methodologies include estimates of future cash flows, future short-term and long-term growth rates and weighted average cost of capital.

When testing goodwill for impairment, the Company has the option of performing a qualitative assessment in order to determine whether it needs to calculate the fair value of a reporting unit. If the Company determines, on the basis of qualitative factors, that it is more likely than not that the fair value of the reporting unit is greater than the carrying amount, the two-step impairment test would not be required.

In December 2014 and 2013, the Company determined, using qualitative factors, that the goodwill for the Training and Simulation reporting unit was not impaired. In December 2014 and 2013, the Company completed the first step of the quantitative analysis of the goodwill in the Power Systems reporting unit, in which it computed a fair value of that reporting unit. Because the fair value was greater than the carrying value of the reporting unit at each measurement date, the second step of the quantitative impairment assessment was not required and no goodwill was impaired. Although the valuation for Power Systems reporting unit exceeded the reporting unit's carrying value by over 6% as of December 31, 2014, the Company will continue to monitor the actual results of the reporting unit versus the forecast used for the impairment review and reevaluate the goodwill if required.

The Company also considers its current market capitalization compared to the sum of the estimated fair values of its reporting units in conjunction with each impairment assessment. As part of this consideration, management recognizes that the market capitalization of the Company may not be an accurate representation of the sum of the reporting unit fair values for the following reasons:

- The long term horizon of the valuation process versus a short term valuation using current market conditions;
- The valuation by individual business segments versus the market share value based on the Company as a whole, including unallocated corporate costs;
- The Company's stock is thinly traded and widely dispersed with minimal institutional ownership, and thus not followed by major market analysts, leading management to conclude that the market in the Company's securities was not acting as an informationally efficient reflection of all known information regarding the Company and thereby serves to understate their value; and
- Control premiums reflected in the reporting unit fair values but not in the Company's stock price.

AROTECH CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In U.S. dollars

NOTE 1:– GENERAL (Cont.)

As of the December 31, 2014 valuation date, the Company's market capitalization was $56.9 million, which did not, in management's view, suggest that the fair value estimates used in its impairment assessment required any adjustment.

The Company's long-lived assets and amortizable identifiable intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of the carrying amount of assets to be held and used is measured by a comparison of the carrying amount of the assets to the future undiscounted cash flows expected to be generated by use of the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

c. Related parties

The Company has had a consulting agreement with Sampen Corporation since 2005. Sampen is a New York corporation owned by members of the immediate family of one of the Company's executive officers, and this executive officer is an employee of both the Company and of Sampen. In 2014, the term of this consulting agreement was extended until December 31, 2017, unless either Sampen or the Company terminates the agreement sooner.

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 our President and Chief Executive Officer of the Company. 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, up to a maximum of 75% of its annual base compensation then in effect if the results the Company actually attained for the year in question are 110% 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.

During the years ended December 31, 2014 and 2013, the Company incurred a total of $124,720 and $148,723, respectively, related to Sampen.

On February 9, 2000, Mr. Ehrlich, the Company's Executive Chairman of the Board, exercised 9,404 stock options. Mr. Ehrlich 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 Mr. Ehrlich upon termination. As of December 31, 2014 and 2013, the aggregate amount outstanding pursuant to this promissory note was $452,995. Additionally, there is a former employee with the same arrangement with an outstanding promissory note of $455,059.

On June 10, 2002, Mr. Ehrlich exercised 3,571 stock options. Mr. Ehrlich paid the exercise price of the stock options by giving the Company a non-recourse promissory note due in 2012 in the amount of $36,500, bearing simple annual interest at a rate equal to the lesser of (i) 5.75%, and (ii) 1% over the then-current federal funds rate announced from time to time, secured by the shares of the Company's common stock acquired through the exercise of the options. As of December 31, 2012, the aggregate amount outstanding pursuant to this promissory note was $46,593, which was not repaid and was charged to paid in capital in the fourth quarter of 2012. Pursuant to the terms of the note, the shares of stock securing the note were returned to the Company and retired in 2013 when the loan was not repaid.

d. Discontinued operations

In December 2011, the Company's Board of Directors approved management's plan to sell the Armor Division. 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 and amounts and disclosures throughout the Notes to Consolidated Financial Statements relate only to the Company's continuing operations.

In U.S. dollars

NOTE 1:– GENERAL (Cont.)

The operations in 2013 primarily represent the completion of certain contracts that were not assumed by the buyer of the Armor Division and include revenues of $2,009, operating costs of $118,323 and other costs of $62,067.

The Company retained the facility used by the Armor operations and currently leases it to the buyer of those operations under a three year operating lease for approximately $9,300 per month. As of December 31, 2014, the Company was marketing the facility for sale, and it had no recorded book value. The Company remained responsible for the outstanding mortgage on this facility, which was transferred to Arotech in 2013.

On February 10, 2015, the Company completed the sale of the building to the existing tenant for a price of $925,000. The existing mortgage was transferred to the purchaser.

NOTE 2:– SIGNIFICANT ACCOUNTING POLICIES

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

a. Use of estimates:

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

b. Financial statements in U.S. dollars:

A majority of the revenues of the Company is generated in U.S. dollars (“dollars”). In addition, a substantial portion of the Company’s costs are incurred in dollars. Management believes that the dollar is the primary currency of the economic environment in which the Company operates. Thus, the functional and reporting currency of the Company including most of its subsidiaries is the dollar. Accordingly, monetary accounts maintained in currencies other than dollars are remeasured into dollars, with resulting gains and losses reflected in the consolidated statements of comprehensive income as financial income or expenses, as appropriate.

The majority of transactions of Epsilor-EFL is in New Israel Shekels (“NIS”) and a substantial portion of Epsilor-EFL’s costs is incurred in NIS. Management believes that the NIS is the functional currency of Epsilor-EFL. Accordingly, the financial statements of Epsilor-EFL have been translated into 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 weighted average exchange rate for the period. The resulting translation adjustments are reported as a component of accumulated other comprehensive income (loss) in stockholders’ equity.

c. Principles of consolidation:

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

d. Cash equivalents:

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

In U.S. dollars

NOTE 2:– SIGNIFICANT ACCOUNTING POLICIES (Cont.)

e. Restricted collateral deposits:

Restricted collateral deposits are primarily invested in highly liquid deposits which are used as a security for the Company's performance guarantees at FAAC and Epsilor-EFL.

f. Marketable securities:

The Company determines the appropriate classification of its investments in debt and equity securities at the time of purchase and reevaluates such determinations at each balance sheet date. Investment in securities are classified as available-for-sale and stated at fair value, with unrealized gains and losses reported in accumulated other comprehensive income (loss), a separate component of stockholders' equity. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in the consolidated statements of comprehensive income. The Company did not hold any marketable securities at either December 31, 2014 or 2013.

g. Inventories:

Inventories are stated at the lower of cost or market value. Inventory write-offs and write-down provisions are provided to cover risks arising from slow-moving items or technological obsolescence and for market prices lower than cost. The Company periodically evaluates the quantities on hand relative to current and historical selling prices and historical and projected sales volume. Based on this evaluation, provisions are made to write inventory down to its market value. In 2014 and 2013, the Company wrote off approximately $509,000 and $186,000, respectively, of obsolete inventory, which has been included in the cost of revenues.

Cost is determined as follows:

Raw and packaging materials – by the average cost method or FIFO.

Work in progress – represents the cost of manufacturing with additions of allocable indirect and direct manufacturing costs.

Finished products – on the basis of direct manufacturing costs with additions of allocable indirect manufacturing costs.

h. Property and equipment:

Property and equipment are stated at cost net of accumulated depreciation and investment grants received from the State of Israel for investments in fixed assets under the Law for the Encouragement of Capital Investments, 5719-1959 (the "Investments Law"). The Company did not receive any investment grants in 2014 and 2013.

In U.S. dollars

NOTE 2:– SIGNIFICANT ACCOUNTING POLICIES (Cont.)

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

	Depreciable life (in years)
Computers and related equipment	3 to 5
Motor vehicles	5 to 7
Office furniture and equipment	3 to 5
Machinery, equipment and installations	5 to 10
Buildings	30
Land	Not depreciated
Leasehold improvements	Shorter of the term of the lease or the life of the asset
Demo inventory	5

i. Revenue recognition:

The Company is a defense and security products and services company, engaged in two business areas: interactive simulation for military, law enforcement and commercial markets; and power systems and batteries for the military, commercial and medical markets. During 2014 and 2013, the Company recognized revenues (i) from the sale and customization of interactive training systems and from the maintenance services in connection with such systems (Training and Simulation Division); (ii) from the sale of batteries, chargers and adapters, and under certain development contracts with the U.S. Army (Power Systems Division); and (iii) from the sale of lifejacket lights (Power Systems Division).

Revenues from certain products sold by the Power Systems Division are recognized when persuasive evidence of an agreement exists, delivery has occurred, the fee is fixed or determinable, collectability is probable, and no further obligation remains. Typically revenue is recognized, per the contract, when the transaction is entered into the U.S. Government's Wide Area Workflow system, which occurs after the products have been accepted at the plant or when shipped. Sales to other entities are recorded in accordance with the contract, either when shipped or delivered. Normally there are no further obligations that would preclude the recognition of revenue. Additionally, certain contracts are recognized using contract accounting on a percentage of completion method.

Revenues from contracts in the Training and Simulation Division and Power Systems Division that involve customization of the system to customer specifications are recognized using contract accounting on a percentage of completion method, in accordance with the "Input Method." The amount of revenue recognized is based on the percentage to completion achieved. The percentage to completion is measured by monitoring progress using records of actual time, materials and other costs incurred to date in the project compared to the total estimated project requirement. Estimates of total project requirements are based on prior experience of customization, delivery and acceptance of the same or similar technology and are reviewed and updated regularly by management. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are first determined, in the amount of the estimated loss on the entire contract. Normally there are no further obligations that would preclude the recognition of revenue.

In U.S. dollars

NOTE 2:– SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company believes that the use of the percentage of completion method is appropriate for certain contracts as the Company has the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, contracts executed include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged and the manner and the terms of settlement, including in cases of terminations for convenience. In all cases, the Company expects to perform its contractual obligations and its customers are expected to satisfy their obligations under the contract.

Revenues from products that do not require significant customization are recognized when persuasive evidence of an agreement exists, delivery has occurred, no significant obligations with regard to implementation remain, the fee is fixed or determinable and collectability is probable.

Maintenance and support revenue included in multiple element arrangements is deferred and recognized on a straight-line basis over the term of the maintenance and support services. Revenues from training are recognized when it is performed. The Vendor Specific Objective Evidence ("VSOE") of fair value of the maintenance, training and support services is determined based on the price charged when sold separately or when renewed.

Unbilled receivables include cost and gross profit earned in excess of billing.

Deferred revenues include unearned amounts received under maintenance and support services, customer prepayments and billing in excess of costs and estimated earnings on uncompleted contracts.

j. Trade receivables:

The Company records trade accounts receivable at net realizable value. This value includes an appropriate allowance for estimated uncollectible accounts to reflect any loss anticipated on the trade accounts receivable balances and charged to the provision for doubtful accounts. The Company calculates this allowance based on its history of write-offs, the level of past-due accounts based on the contractual terms of the receivables, and its relationships with, and the economic status of, its customers. During the years ended December 31, 2014 and 2013, the Company made no provisions or had any recoveries of doubtful accounts and had no reserves at either year end. The Company believes its exposure to concentrations of credit risk is limited due to the nature of its operations.

k. Warranty:

The Company typically offers a one to two year warranty for many of its products. The specific terms and conditions of those warranties vary depending upon the product sold and country in which the Company does business. The Company estimates the costs that may be incurred under its basic limited warranty, including parts and labor, and records deferred revenue in the amount of such costs at the time product revenue is recognized in the Training and Simulation Division. In the Power Systems Division, warranty costs are estimated, accrued and recorded on the balance sheet in deferred revenues. Factors that affect the Company's warranty liability include the number of installed units, historical and anticipated rates of warranty claims, and cost per claim. The Company periodically assesses the adequacy of its reserves and adjusts the amounts as necessary. (See Note 17.)

In U.S. dollars

NOTE 2:– SIGNIFICANT ACCOUNTING POLICIES (Cont.)

l. Research and development cost:

The Company capitalizes certain software development costs, subsequent to the establishment of technological feasibility. Based on the Company's product development process, technological feasibility is established upon the completion of a working model or a detailed program design. Research and development costs incurred in the process of developing product improvements or new products are generally charged to expenses as incurred. Significant costs incurred by the Company between completion of the working model or a detailed program design and the point at which the product is ready for general release have been capitalized. Capitalized software costs will be amortized by the greater of the amount computed using: (i) the ratio that current gross revenues from sales of the software bears to the total of current and anticipated future gross revenues from sales of that software, or (ii) the straight-line method over the estimated useful life of the product (one to three years). The Company assesses the net realizable value of this intangible asset on a regular basis by determining whether the amortization of the asset over its remaining life can be recovered through undiscounted future operating cash flows from the specific software product sold. Based on its most recent analyses, management believes that no impairment of capitalized software development costs exists as of December 31, 2014.

In 2014 and 2013, the Training and Simulation Division capitalized approximately $378,000 and $4,000, respectively, in software development costs that will be amortized on a straight-line method over 2 years, the useful life of the software.

m. Income taxes:

The Company accounts for income taxes under the asset and liability method, whereby deferred tax assets and liability account balances are determined based on tax credit carryforwards and differences between the financial reporting and the tax basis of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

The Company has adopted the provisions of the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") ASC 740-10, which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken in a tax return. The Company must determine whether it is "more-likely-than-not" that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. Once it is determined that a position meets the more-likely-than-not recognition threshold, the position is measured to determine the amount of benefit to recognize in the financial statements. Uncertain tax positions require determinations and estimated liabilities to be made based on provisions of the tax law which may be subject to change or varying interpretation. If the Company's determinations and estimates prove to be inaccurate, the resulting adjustments could be material to the Company's future financial statements.

n. Concentrations of credit risk:

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

The trade receivables of the Company are mainly derived from sales to customers located primarily in the United States and Israel along with the countries listed in footnote 16.c. Management believes that credit risks are moderated by the diversity of its end customers and geographical sales areas. The Company performs ongoing credit evaluations of its customers' financial condition. An allowance for doubtful accounts is determined with respect to those accounts that the Company has determined to be doubtful of collection.

In U.S. dollars

NOTE 2:– SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company had no off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other foreign currency hedging arrangements as of December 31, 2014 and 2013.

o. Basic and diluted net income per share:

Basic net income per share is computed based on the weighted average number of shares of common stock outstanding during each year. Diluted net income per share is computed based on the weighted average number of shares of common stock outstanding during each year, plus dilutive common stock equivalents related to outstanding stock options and non-vested restricted stock. The total weighted average number of shares related to the outstanding common stock equivalents excluded from the calculations of diluted net income per share was 602,740 and 611,700 for the years ended December 31, 2014 and 2013, respectively.

p. Accounting for stock-based compensation:

Stock-based awards to employees are recognized as compensation expense based on the calculated fair value on the date of grant. The costs are amortized over the vesting period.

The Company did not grant any stock options in 2014 or 2013. The Company typically uses a 5-10% forfeiture rate for restricted stock and restricted stock units and adjusts both forfeiture rates based on historical forfeitures. Each restricted stock unit is equal to one share of Company stock and is redeemable only for stock.

q. Fair value of financial instruments:

The following methods and assumptions were used by the Company in estimating their fair value disclosures for financial instruments using the required three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which may require the Company to develop its own assumptions.

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

The fair values of long-term promissory notes are estimated by discounting the future cash flows using current interest rates for loans of similar terms and maturities. The carrying amount of the long-term liabilities approximates their fair value (Level 3).

r. Severance pay:

The Company’s liability for severance pay for its Israeli employees is calculated pursuant to Israeli severance pay law based on the most recent salary of the employees multiplied by the number of years of employment as of the balance sheet date. Israeli employees are entitled to one month’s salary for each year of employment, or a portion thereof. The Company’s liability for all of its Israeli employees is fully provided for by monthly deposits into severance pay funds held by insurance companies on behalf of the employees, insurance policies and by accrual. The fair value of these funds, which are considered Level 2 fair value measurements, is recorded as an asset in the Company’s balance sheet.

In addition, according to certain employment agreements, the Company is obligated to provide for a special severance pay in addition to amounts due to certain employees pursuant to Israeli severance pay law. During the years ended December 31, 2014 and 2013, the Company had made provisions of $124,159 and $49,387, respectively, for this special severance pay. As of December 31, 2014 and 2013, the unfunded severance pay in that regard amounted to $1,441,390 and $1,317,231, respectively.

In U.S. dollars

NOTE 2:– SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Pursuant to the terms of the respective employment agreements between the Company and its Chief Executive Officer, its Chief Financial Officer and its Executive Chairman of the Board, funds to secure payment of their respective contractual severance amounts are to be deposited for their benefit in either Israel or the U.S., with payments to be made pursuant to an agreed-upon schedule. These funds continue to be owned by the Company, which benefits from all gains and bears the risk of all losses resulting from investments of these funds.

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

In April 2009, the Company, with the agreement of its then-Chairman and Chief Executive Officer and its then-President (now its Executive Chairman of the Board and its President and Chief Executive Officer, respectively), funded an additional portion of their severance security by means of issuing to them, in trust, restricted stock having a value (based on the closing price of the Company's stock on the Nasdaq Stock Market on the date on which the executives and the Company's board of directors agreed to this arrangement) of $440,000, a total of 602,740 shares. The Company agreed with the executives that the economic risk of gain or loss on these shares is to be borne by them. Should they leave the Company's employ under circumstances in which they are not entitled to their severance package (primarily, termination for Cause as defined in their employment agreement), these shares would be returned to the Company for cancellation and because of this, these shares were not included in the basic EPS calculation. In an agreement dated November 10, 2014 that was effective October 1, 2014, the contract with our current CEO was amended and his 273,973 shares are considered conditional restricted shares but without the previously-agreed reduction in his severance of $200,000.

Severance expenses for continuing operations for the years ended December 31, 2014 and 2013 amounted to $778,684 and $410,167, respectively.

s. Advertising costs:

The Company records advertising costs as incurred. Advertising expense for the years ended December 31, 2014 and 2013 was approximately $111,000 and $71,000, respectively.

t. New accounting pronouncements:

In August 2014, the FASB issued ASU No. 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 FASB issued 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 to improve financial reporting by creating similar revenue recognition guidance for U.S. GAAP and International Financial Reporting Standards. 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 or its adoption method.

In U.S. dollars

NOTE 2:– SIGNIFICANT ACCOUNTING POLICIES (Cont.)

In April 2014, the 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.

No other new accounting pronouncements issued or effective during 2014 have had or are expected to have a significant impact on the Company's consolidated financial statements.

u. Share repurchase:

In February 2009, the Company authorized the repurchase in the open market or in privately negotiated transactions of up to $1.0 million of the Company's common stock (increased to $2.0 million in August 2014). Pursuant to this plan, the Company repurchased an aggregate of 738,611 shares of its common stock through 2014 for an aggregate purchase price of $1,098,967 ($1,084,060 net of commissions). The repurchase program is subject to management's discretion, and expires August 11, 2015.

NOTE 3:– RESTRICTED COLLATERAL DEPOSITS

The following is a summary of restricted collateral deposits as of December 31, 2014 and 2013,

	December 31,	
	2014	2013
Deposits in connection with Epsilor/EFL projects	$ 90,286	$ 352,353
Deposits in connection with FAAC projects	146,142	146,142
Total restricted collateral deposits	$ 236,428	$ 498,495

NOTE 4:– OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES

The following is a summary of other accounts receivable and prepaid expenses as of December 31, 2014 and 2013:

	December 31,	
	2014	2013
Government authorities	$ 253,320	$ 187,707
Employees	81,150	69,283
Prepaid expenses	819,386	689,651
Other	1,692	432,980
Total	$ 1,155,548	$ 1,379,621

In U.S. dollars

NOTE 5:– INVENTORIES

The following is a summary of inventories as of December 31, 2014 and 2013:

	December 31, 2014	December 31, 2013
Raw and packaging materials	$ 8,195,623	$ 6,761,876
Work in progress	683,083	666,386
Finished products	933,077	2,646,504
Total	$ 9,811,783	$ 10,074,766

NOTE 6:– PROPERTY AND EQUIPMENT, NET

a. Composition of property and equipment is as follows:

	December 31, 2014	December 31, 2013
Cost:		
Computers and related equipment	$ 3,303,357	$ 2,370,067
Motor vehicles	624,562	440,470
Office furniture and equipment	1,590,124	1,116,884
Machinery, equipment and installations	7,678,040	6,480,993
Buildings	1,430,925	1,411,992
Land	300,000	300,000
Leasehold improvements	1,852,066	1,475,562
Demo inventory	2,286,159	1,657,928
	19,065,233	15,253,896
Accumulated depreciation:		
Computers and related equipment	2,661,174	1,966,293
Motor vehicles	295,298	245,329
Office furniture and equipment	1,175,897	958,116
Machinery, equipment and installations	5,675,452	4,731,881
Buildings	222,486	150,506
Leasehold improvements	1,097,739	889,495
Demo inventory	1,474,238	1,385,327
	12,602,284	10,326,947
Property and equipment, net	$ 6,462,949	$ 4,926,949

b. Depreciation expense amounted to $1,558,506 and $1,196,425 for the years ended December 31, 2014 and 2013, respectively.

As for liens, see Note 10.d.

In U.S. dollars

NOTE 7:– GOODWILL AND OTHER INTANGIBLE ASSETS, NET

a. Goodwill

The Company allocates goodwill acquired in a business combination to the appropriate reporting unit as of the acquisition date. Currently, the Company's reporting units are also its reportable segments and the associated goodwill was determined when the specific businesses in the reportable segments were purchased.

A summary of the goodwill by business segment is as follows:

	December 31, 2013	Additions	Adjustments (currency)	December 31, 2014
Training and Simulation Division	$ 24,435,641	$ –	$ –	$ 24,435,641
Power Systems Division	6,589,113	15,105,680	(708,215)	20,986,578
Total	$ 31,024,754	$ 15,105,680	$ (708,215)	$ 45,422,219

From December 31, 2012 to December 31, 2013, the only change in goodwill was a $462,456 increase due to Power Systems Division's goodwill due to currency adjustments.

b. Other intangible assets:

		December 31,			
		2014		2013	
	Original Useful life	Cost	Net book value	Cost	Net book value
Technology	4 - 8 years	$ 9,988,000	$ 2,988,500	$ 6,788,000	$ 94,714
Capitalized software costs	1 - 3 years	4,072,045	347,740	3,694,091	129,437
Trademarks	10 years	28,000	2,800	28,000	11,200
Backlog/customer relationship	1 - 10 years	2,844,000	1,440,200	744,000	24,800
Covenant not to compete	6 years	400,000	382,000	-	-
Customer list	2 - 10 years	14,173,645	5,880,125	6,773,645	-
		31,505,690	$ 11,041,365	18,027,736	$ 260,151
Less - accumulated amortization		(20,464,325)		(17,767,585)	
Amortized cost		11,041,365		260,151	
Trademarks (indefinite lives)		799,000		799,000	
Net book value		$ 11,840,365		$ 1,059,151	

Amortization expense amounted to $2,696,740 and $1,091,126 for the years ended December 31, 2014 and 2013, respectively, including amortization of capitalized software costs of $377,954 and $365,671, respectively.

In U.S. dollars

NOTE 7:– GOODWILL AND OTHER INTANGIBLE ASSETS, NET (Cont.)

c. Estimated amortization expenses, using both straight line and accelerated amortization methods, for the years shown is as follows:

Year ending December 31,		
2015	$	2,978,937
2016		2,580,303
2017		1,816,875
2018		1,266,750
2019		885,000
Thereafter		1,513,500
Total	$	11,041,365

Goodwill and other intangible assets are adjusted on a quarterly basis for any change due to currency fluctuations and any variation is included in the accumulated other comprehensive income on the consolidated balance sheets.

NOTE 8:– SHORT-TERM BANK CREDIT AND LOANS

The Company's FAAC subsidiary has a $15,000,000 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 Arotech and EFB. Additionally, Arotech 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 $18,000,000 61-month senior term loan at an interest rate of 3.75% over LIBOR, and a $4,500,000 61-month B term loan at a interest rate of 5.5% over LIBOR. The interest rate charged as of December 31, 2014 was 3.91% for term loan A and 5.66% for term loan B. Principal payments are made monthly for term loan A and quarterly for term loan B. Interest is paid monthly for both loans. 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 Arotech and EFB. Arotech, 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, FAAC'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. The Company was in compliance with all debt covenants as of December 31, 2014.

In U.S. dollars

NOTE 8:– SHORT-TERM BANK CREDIT AND LOANS (Cont.)

Pursuant to the requirements of the Amended Credit Agreement, the Company was required to enter an Interest Rate Swap agreement fixing the interest rate of 1.37% on approximately $9,000,000 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 $9,000,000. The expiration date of this interest rate swap is April 1, 2019. The unrealized $51,000 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:– OTHER ACCOUNTS PAYABLE AND ACCRUED EXPENSES

The following is a summary of other accounts payable and accrued expenses as of December 31, 2014 and 2013:

	December 31, 2014	December 31, 2013
Employees and payroll accruals	$ 4,254,140	$ 4,172,710
Accrued vacation pay	1,203,552	893,654
Accrued expenses	589,380	764,806
Government authorities	558,142	180,871
Earn-out liability	2,500,000	–
Total	$ 9,105,214	$ 6,012,041

NOTE 10:– COMMITMENTS AND CONTINGENT LIABILITIES

a. Royalty commitments:

Under Epsilor-EFL's research and development agreements with the Office of the Chief Scientist ("OCS"), and pursuant to applicable laws, Epsilor-EFL is required to pay royalties at the rate of 3%-3.5% of net sales of products developed with funds provided by the OCS, up to an amount equal to 100% of research and development grants received from the OCS. Amounts due in respect of projects approved after 1999 also bear interest at the LIBOR rate. Epsilor-EFL is obligated to pay royalties only on sales of products in respect of which OCS participated in their development. Should the project fail, Epsilor-EFL will not be obligated to pay any royalties or refund the grants. During 2014 and 2013, Epsilor-EFL received grants in the total amount of $177,918 and zero, respectively.

Royalties expensed for the years ended December 31, 2014 and 2013 to the OCS amounted to zero and $14,997, respectively.

b. Lease commitments:

The Company rents its facilities under various operating lease agreements, which expire on various dates through 2025. The minimum rental payments under non-cancelable operating leases are as follows:

December 31	Minimum rental payments
2015	$ 1,138,021
2016	1,063,403
2017	1,022,752
2018	527,579
2019	382,296
Thereafter	2,059,708
Total	$ 6,193,759

Total rent expenses for the years ended December 31, 2014 and 2013 were $1,366,192 and $887,796, respectively.

In U.S. dollars

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

c. Guarantees:

The Company obtained bank guarantees in the amount of $381,187 in connection with (i) obligations of one of the Company's subsidiaries to the Israeli customs authorities, and (ii) the obligation of one of the Company's subsidiaries to secure the return of products loaned to the Company from one of its customers.

d. Liens:

As security for compliance with the terms related to the investment grants from the State of Israel, Epsilor-EFL has registered floating liens (that is, liens that apply not only to assets owned at the time but also to after-acquired assets) on all of its assets, in favor of the State of Israel.

The Company has $385,000 in credit liens collateralized by the assets of the Company and guaranteed by the Company.

Epsilor-EFL has recorded a lien on all of its assets in favor of its banks to secure overdraft protection. In addition Epsilor-EFL has a specific pledge on assets in respect of which government guaranteed loans were given.

e. Litigation and other claims:

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

NOTE 11:– LONG TERM DEBT

a. Mortgage Note, Ann Arbor, Michigan:

In July 2011, the Training and Simulation Division purchased a building for $1,500,000 containing both office and lab space. The building was financed with a $1,100,000 mortgage loan that was obtained through the Company's primary bank. The note requires a payment (principal and interest) of approximately $8,000 per month at an interest rate of LIBOR plus 375 basis points per annum with a balloon payment due in May 2017. (See Note 8 for the relevant covenants.) In December 2012, FAAC leased surplus space of the purchased building to a non-profit organization for $6,300 per month as office space for a term of 10 years with an option to terminate the lease with a one year prior notice in May 2018.

b. Term loans A and B – UEC acquisition:

In April 2014, pursuant to the Amended Credit Agreement, the parties to the original credit agreement agreed to amend the Line of Credit to add two term loans to it: an $18,000,000 61-month senior term loan at an interest rate of 3.75% over LIBOR, and a $4,500,000 61-month B term loan at an interest rate of 5.5% over LIBOR. Arotech is also a guarantor of any sums due pursuant to the Amended and Restated Credit Agreement which are detailed in Note 8 above. Principal payments are made monthly for term loan A and quarterly for term loan B. Interest is paid monthly for both loans.

In U.S. dollars

NOTE 11:– LONG TERM DEBT (Cont.)

c. Mortgage Note, Auburn, Alabama:

In March 2007, the Company purchased space for the now-discontinued Armor Division in Auburn, Alabama for approximately $1,100,000 pursuant to a seller-financed secured purchase money mortgage. Half the mortgage is payable over ten years in equal monthly installments based on a 20-year amortization of the full principal amount, and the remaining half is payable at the end of ten years in a balloon payment. The note requires a payment (principal and interest) of approximately $9,300 per month at an interest rate of 8.0% per annum. In September 2013, the Company transferred the seller-financed mortgage to Arotech from the discontinued Armor Division. Until February 2015, the Company was leasing this building to the buyer of the Armor Division for approximately $9,300 per month under a three year lease expiring in June 2015. On February 9, 2015, the Company sold the building to the current tenant for $925,000. On that same date, the existing mortgage and existing building lease were terminated which ended any obligation the Company had for this property.

d. Minimum loan payments:

Minimum loan payments		December 31,
2015	$	4,380,730
2016		4,379,923
2017		5,908,150
2018		4,280,267
2019		2,366,020
Thereafter		–
Total	$	21,315,090

NOTE 12:– COSTS AND ESTIMATED EARNINGS ON UNCOMPLETED CONTRACTS

Billings in excess of costs generated under the percentage-of-completion method are recorded as deferred revenues until the revenue recognition criteria are met. Deferred revenues include unearned amounts received under maintenance and support services and customer deposits of $264,339 and $287,830 for 2014 and 2013, respectively, and billing in excess of costs and estimated earnings on uncompleted contracts.

The following is a summary of the costs and estimated earnings on uncompleted contracts as of December 31, 2014 and 2013. Open contracts are expected to be completed in the following year. The billings in excess of costs are included in the deferred revenue line of the balance sheet:

	Year ended December 31,			
		2014		**2013**
Costs incurred on uncompleted contracts	$	231,676,372	$	133,537,092
Estimated earnings		46,179,276		24,312,101
		277,855,648		157,849,193
Less billings to date		(265,026,596)		(152,849,352)
Total	$	12,829,052	$	4,999,841
Costs and estimated earnings in excess of billings	$	15,937,060	$	8,463,920
Billings in excess of costs and estimated earnings (included in deferred revenues)		(3,108,008)		(3,464,079)
Total	$	12,829,052	$	4,999,841

In U.S. dollars

NOTE 13:– STOCKHOLDERS' EQUITY

a. Stockholders' rights:

The Company's shares confer upon the holders the right to receive notice to participate and vote in the general meetings of the Company and right to receive dividends, if and when declared.

b. The Company has adopted the following stock award plans, whereby options may be granted for purchase of shares of the Company's common stock and where restricted shares and restricted stock units may be granted if approved by the Board of Directors. Each restricted stock unit is equal to one share of Company stock and is redeemable only for stock. Under the terms of the award plans, the Board of Directors or the designated committee grants options, restricted stock and restricted stock units. The Board of Directors or the designated committee also determines the vesting period and the exercise terms.

1. 2007 Non-Employee Director Equity Compensation Plan – 750,000 shares reserved for issuance, of which 344,050 were available for future grants to outside directors as of December 31, 2014.

2. 2009 Equity Incentive Plan – 5,000,000 shares reserved for issuance, of which 2,641,568 were available for future grants to employees and consultants as of December 31, 2014.

3. Under these plans, restricted shares and restricted stock units generally vest after one to three years or pursuant to defined performance criteria; in the event that employment is terminated within that period, unvested restricted shares and restricted stock units generally revert back to the Company.

4. Stock compensation expense is recorded ratably over the vesting period of the option or the restriction period of the restricted shares and restricted stock units. The stock compensation expense that has been charged in the consolidated statements of comprehensive income in respect of restricted shares and restricted stock units to employees and directors in 2014 and 2013 was $1,411,970 and $437,306, respectively. All stock options were fully vested as of December 31, 2102.

5. A summary of the status of the Company's plans and other share options, restricted shares and restricted stock units granted as of December 31, 2014 and 2013, and changes during the years ended on those dates, is presented below:

Stock Options:

	2014		2013	
	Amount	Weighted average exercise price	Amount	Weighted average exercise price
Options outstanding at beginning of year	8,960	$ 5.46	12,228	$ 5.46
Changes during year:				
Granted	–	$ –	–	$ –
Exercised	–	$ –	–	$ –
Forfeited	(8,960)	$ 5.46	(3,268)	$ 5.46
Options outstanding at end of year	–	$ –	8,960	$ 5.46
Options vested at end of year	–	$ –	8,960	$ 5.46

In U.S. dollars

NOTE 13:– STOCKHOLDERS' EQUITY (Cont.)

Restricted Shares and Restricted Stock Units:

	2014		2013	
	Shares	Weighted average fair value at grant date	Shares	Weighted average fair value at grant date
Non-vested at the beginning of the year	584,746	2.52	844,270	$ 1.30
Changes during year:				
Restricted stock granted	341,861	2.60	270,550	$ 2.94
Restricted units granted	163,175	2.48	110,180	$ 1.67
Vested	(166,110)	2.23	(434,732)	$ 1.22
Forfeited	(2,994)	3.65	(205,522)	$ 1.41
Non-vested at the end of the year	920,678	2.99	584,746	$ 2.52
Restricted shares vested at end of year	2,954,838	2.07	2,788,728	$ 1.85

6. The remaining total compensation cost related to non-vested restricted share and restricted stock unit awards not yet recognized (before applying a forfeiture rate) in the income statement as of December 31, 2014 was $708,057. The weighted average period over which this compensation cost is expected to be recognized is approximately one year.

7. On January 1, 2009, the Company adopted FASB ASC 260-45-28, Share-Based Payment Arrangements, which classifies unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) as participating securities and requires them to be included in the computation of earnings per share using the two class method. The Company has determined that the unvested restricted stock issued to our employees and directors are "participating securities" and as such, are included, net of estimated forfeitures, in the total shares used to calculate the Company's both the basic and diluted earnings per share.

NOTE 14:– INCOME TAXES

a. General:

As of December 31, 2014, Arotech has net operating loss ("NOL") carryforwards for U.S. federal income tax purposes of $35,000,000, which are available to offset future taxable income, if any, expiring in 2021 through 2032. Utilization of U.S. net operating losses is subject to substantial annual limitations due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

At December 31, 2014, the Company had net deferred tax assets before valuation allowance of $40.3 million. The deferred tax assets are primarily composed of federal, state and foreign tax NOL carryforwards. Due to uncertainties surrounding the Company's ability to generate future taxable income to realize these assets, a full valuation allowance has been established to offset its net deferred tax asset. Additionally, the future utilization of the Company's NOL carryforwards to offset future taxable income is subject to a substantial annual limitation as a result of IRC Section 382 changes that have occurred. Any carryforwards that will expire prior to utilization as a result of such limitations will be removed from deferred tax assets with a corresponding reduction of the valuation allowance.

In U.S. dollars

NOTE 14:– INCOME TAXES (Cont.)

The Company has indefinite-lived intangible assets consisting of trademarks and goodwill. These indefinitely-lived intangible assets are not amortized for financial reporting purposes. However, these assets are tax deductible, and therefore amortized over 15 years for tax purposes. As such, deferred income tax expense and a deferred tax liability arise as a result of the tax-deductibility of these indefinitely-lived intangible assets. The resulting deferred tax liability, which is expected to continue to increase over time, will have an indefinite life, resulting in what is referred to as a "naked tax credit." This deferred tax liability could remain on the Company's balance sheet indefinitely unless there is an impairment of the related assets (for financial reporting purposes), or the business to which those assets relate were to be disposed of. Due to the fact that the aforementioned deferred tax liability could have an indefinite life, it is not netted against the Company's deferred tax assets when determining the required valuation allowance. Doing so would result in the understatement of the valuation allowance and related deferred income tax expense.

The Company has also evaluated its income tax positions under FASB ASC 740-10 as of December 31, 2014 and the Company believes that it has no material uncertain tax positions and therefore has no uncertain tax position reserves and does not expect to provide for any such reserves. The Company does not believe that the unrecognized tax benefits will change within 12 months of this reporting date. It is the Company's policy that any assessed penalties and interest on uncertain tax positions would be charged to income tax expense.

The Company does not provide for U.S. federal income taxes on the undistributed earnings of its foreign subsidiaries because such earnings are re-invested and, in the opinion of management, will continue to be re-invested indefinitely.

The Company files income tax returns, including returns for its subsidiaries, with federal, state, local and foreign jurisdictions. The Company is no longer subject to IRS examination for periods prior to 2010, although carryforward losses that were generated prior to 2011 may still be adjusted by the IRS if they are used in a future period. Additionally, the Company is no longer subject to examination in Israel for periods prior to 2010.

The Company files consolidated tax returns for its U.S. entities.

b. Israeli subsidiary (Epsilor-EFL):

Epsilor-EFL's tax rate was 7.0% and 7.0% in 2014 and 2013, respectively, and will be reduced to 9% in 2015. In addition, dividends paid from the profits of Epsilor-EFL are subject to tax at the rate of 15% in the hands of their recipient and tax exempt on dividends paid to an Israeli company. As of December 31, 2014, there are no tax exempt profits earned by Epsilor–EFL by Israel law that will be distributed as a dividend, and accordingly, no deferred tax liability was recorded as of December 31, 2014. Furthermore, management has indicated that it has no intention of declaring any dividend.

On August 5, 2013, the Law for Change of National Priorities (Legislative Amendments for Achieving the Budgetary Goals for 2013-2014), 2013 (hereinafter - the 2013 Amendments) was published in Reshumot (the Israeli government official gazette), which enacts, among other things, the following amendments:

- Raising the corporate tax rate to 26.5% (instead of 25%) beginning in 2014 and thereafter.

- Commencing tax year 2014 and thereafter the tax rate on the income of preferred enterprises of a qualifying company in Development Zone A as stated in the Encouragement of Capital Investment Law, 1959 (hereinafter - the Encouragement Law) shall increase to 9% (instead of 7% in 2014 and 6% in 2015 and thereafter) and for companies located in zones other than Zone A the rate shall increase to 16% (instead of 12.5% in 2014 and 12% in 2015 and thereafter).

- In addition, the tax rate on dividends distributed on January 1, 2014 and thereafter originating from preferred income under the Encouragement Law will be raised to 20% (instead of 15%).

In U.S. dollars

NOTE 14:– INCOME TAXES (Cont.)

c. Merger of Epsilor and EFL:

On June 25, 2009, two of the Company’s Israeli subsidiaries, Epsilor and EFL, entered into a merger agreement pursuant to which EFL merged all of its assets and liabilities into Epsilor, with Epsilor the survivor of the merger (the “Merged Company”).

Through the merger date, EFL accumulated certain tax losses (the “EFL Loss”). 20% of the EFL Loss was cancelled and is not available to offset any future income. The remaining amount of the EFL Loss (the “Remaining Loss”) was absorbed into the Merged Company and is available to offset the Merged Company’s income after July 1, 2009; provided that for the 16 tax years following the merger, losses will not be available to offset the Merged Company’s income in excess of the lesser of (i) 6.25% of the original amount of the Remaining Loss, or (ii) 50% of the Merged Company’s total taxable income in that year prior to giving effect to the application of any of the EFL Loss.

As of December 31, 2014, the Merged Company has tax loss carryforwards, generated by EFL, of $85.1 million, which is available indefinitely to offset future taxable income.

d. Consolidated deferred income taxes:

Deferred income taxes reflect tax credit carryforwards and the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and amounts used for income tax purposes. Significant components of the Company’s deferred tax assets are as follows:

	December 31,	
	2014	**2013**
U.S. operating loss carryforward	$ 12,163,441	$ 15,836,153
Foreign operating loss carryforward	21,284,600	23,852,782
Total operating loss carryforward	33,448,041	39,688,935
Temporary differences:		
Compensation and benefits	2,438,804	2,321,718
Warranty reserves	1,743,409	1,165,515
Foreign temporary differences	711,222	445,129
All other temporary differences	1,979,413	2,321,650
Total temporary differences	6,872,848	6,254,012
Deferred tax asset before valuation allowance	40,320,889	45,942,947
Valuation allowance	(40,320,889)	(45,942,947)
Total deferred tax asset	$ –	$ –
Deferred tax liability – intangible assets	$ 6,117,021	$ 5,518,521

The Company provided valuation allowances for the deferred tax assets resulting from tax loss carryforwards and other temporary differences. Management currently believes that it is more likely than not that the deferred tax assets related to the operating loss carryforwards and other temporary differences will not be realized. The change in the valuation allowance during 2014 was $5.6 million).

AROTECH CORPORATION AND SUBSIDIARIES
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In U.S. dollars

NOTE 14:– INCOME TAXES (Cont.)

e. Income from continuing operations before taxes on income are as follows:

	Year ended December 31	
	2014	2013
Domestic	$ 4,455,370	$ 4,215,005
Foreign	55,428	(888,315)
	$ 4,510,798	$ 3,326,690

f. Taxes on income were comprised of the following:

	Year ended December 31	
	2014	2013
Current federal taxes	$ 183,758	$ 117,448
Current state and local taxes	316,444	210,299
Deferred taxes	598,500	598,500
Taxes in respect of prior years	(74,865)	126,473
Expense	$ 1,023,837	$ 1,052,720
Domestic	$ 1,098,702	$ 926,247
Foreign	(74,865)	126,473
Expense	$ 1,023,837	$ 1,052,720

g. A reconciliation between the theoretical tax expense, assuming all income is taxed at the U.S. federal statutory tax rate applicable to income of the Company and the actual tax expense as reported in the Statements of Comprehensive Income is as follows:

	Year ended December 31,	
	2014	2013
Income from continuing operations before taxes	$ 4,510,798	$ 3,326,690
Statutory tax rate	34 %	34 %
Theoretical income tax on the above amount at the U.S. statutory tax rate	$ 1,533,671	$ 1,131,075
Deferred taxes for which valuation allowance was provided	(949,966)	(797,899)
Non-deductible credits	66,720	67,928
State taxes, net of federal benefit	269,508	327,747
Foreign income in tax rates other than U.S. rate	(4,989)	79,948
Taxes in respect of prior years	(74,865)	126,473
Alternative minimum tax for which valuation allowance was not provided	183,758	117,448
Actual tax expense	$ 1,023,837	$ 1,052,720

In U.S. dollars

NOTE 15:– SELECTED STATEMENTS OF COMPREHENSIVE INCOME DATA

Financial income (expense), net:

	Year ended December 31, 2014	Year ended December 31, 2013
Financial expenses:		
Interest, bank charges and fees	$ (1,367,119)	$ (563,252)
Foreign currency transaction differences	(173,594)	(16,418)
Other	(12,809)	(37,205)
Total financial expenses	(1,553,522)	(616,875)
Financial income:		
Foreign currency transaction differences	–	117,603
Total financial income	–	117,603
Total financial expense, net	$ (1,553,522)	$ (499,272)

NOTE 16:– SEGMENT INFORMATION

a. General:

The Company operates in two continuing business segments (see Note 1.a. for a brief description of the Company's business).

The Company's reportable 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 reportable segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based on two primary factors: the segment's operating income and the segment's contribution to the Company's future strategic growth.

In U.S. dollars

NOTE 16:– SEGMENT INFORMATION (Cont.)

b. The following is information about reportable segment gains, losses and assets:

	Training and Simulation Division	Power Systems Division	Corporate Expenses	Discontinued operations	Total Company
2014					
Revenues from outside customers	$ 56,404,498	$ 47,157,851	$ –	$ –	$ 103,562,349
Depreciation and amortization expenses (1)	(756,939)	(3,477,855)	(20,452)	–	(4,255,246)
Direct expenses (2)	(45,313,956)	(41,089,191)	(6,839,636)	–	(93,242,783)
Segment net income (loss)	10,333,603	2,590,805	(6,860,088)	–	6,064,320
Financial expense	(50,975)	(215,453)	(1,287,094)	–	(1,553,522)
Income tax (expense) benefit	(133,692)	61,777	(951,922)	–	(1,023,837)
Net income (loss)	$ 10,148,936	$ 2,437,129	$ (9,099,104)	$ –	$ 3,486,961
Segment assets	$ 58,090,953	$ 65,781,686	$ 866,708	$ –	$ 124,739,347
Additions to long-lived assets (3)	$ 1,533,371	$ 29,159,805	$ 13,344	$ –	$ 30,706,520
2013					
Revenues from outside customers	$ 63,425,319	$ 25,146,109	$ –	$ –	$ 88,571,428
Depreciation and amortization expenses (1)	(988,893)	(1,272,399)	(26,259)	–	(2,287,551)
Direct expenses (2)	(53,143,411)	(23,665,489)	(5,649,015)	–	(82,457,915)
Segment net income (loss)	9,293,015	208,221	(5,675,274)	–	3,825,962
Financial expense	(44,146)	(30,733)	(424,393)	–	(499,272)
Income tax expense	(319,225)	(134,995)	(598,500)	–	(1,052,720)
Net income (loss) – continuing operations	8,929,644	42,493	(6,698,167)	–	2,273,970
Net loss – discontinued operations	–	–	–	(121,619)	(121,619)
Net income (loss)	$ 8,929,644	$ 42,493	$ (6,698,167)	$ (121,619)	$ 2,152,351
Segment assets	$ 53,424,900	$ 26,346,840	$ 882,902	$ –	$ 80,654,642
Additions to long-lived assets	$ 409,805	$ 1,294,980	$ –	$ –	$ 1,704,785

(1) Includes depreciation of property and equipment and amortization expenses of intangible assets.
(2) Including, *inter alia*, sales and marketing, general and administrative, research and development and other income.
(3) Includes intangible assets and all other long lived assets associated with the acquisition of UEC.

In U.S. dollars

NOTE 16:– SEGMENT INFORMATION (Cont.)

c. Summary information about geographic areas:

The following discloses total revenues according to the locations of the Company's end customers and long-lived assets as of and for the years ended December 31, 2014 and 2013:

	2014		2013	
	Total revenues	Long-lived assets	Total revenues	Long-lived assets
U.S.A.	$ 83,739,406	$ 55,970,370	$ 73,973,996	$ 28,506,630
Israel	11,428,427	7,755,163	9,109,921	8,504,224
Saudi Arabia	2,469,988	–	424,444	–
Korea	1,994,634	–	51,920	–
Germany	1,117,094	–	372,446	–
Canada	651,846	–	790,363	–
U.A.E.	518,634	–	–	–
Australia	459,153	–	–	–
China	305,800	–	203,563	–
Hong Kong	48,331	–	1,460,000	–
India	14,865	–	325,782	–
Mexico	2,300	–	94,595	–
Greece	–	–	249,500	–
Taiwan	–	–	231,267	–
Slovenia	–	–	191,163	–
Other	811,871	–	1,092,468	–
	$ 103,562,349	$ 63,725,533	$ 88,571,428	$ 37,010,854

d. Revenues from major customers (as a percentage of consolidated revenues):

Other than for sales to various branches of the United States Military, which accounted for 56% and 55% of consolidated continuing revenues for 2014 and 2013, respectively, no single customer accounted for more than 10% of revenues for either year.

e. Revenues from major products:

	Year ended December 31,	
	2014	2013
Simulators	$ 56,404,498	$ 63,425,319
Batteries and charging systems	42,930,497	21,073,942
Water activated batteries	4,227,354	4,072,167
Total	$ 103,562,349	$ 88,571,428

In U.S. dollars

NOTE 17:– WARRANTY

The following is a summary of the deferred warranty revenue in the Simulation Division included in total deferred revenue as of December 31, 2014 and 2013:

	Year ended December 31,	
	2014	2013
Balance at beginning of period	$ 3,206,369	$ 2,682,462
Deferred revenue	5,006,658	3,434,186
Revenue recognized	(3,912,425)	(2,910,279)
Balance at end of period	$ 4,300,602	$ 3,206,369

The following is a summary of the warranty liability in the Power Systems Division that is also included in deferred revenue as of December 31, 2014:

	Year ended December 31,	
	2014	2013
Balance acquired in UEC acquisition	$ 638,943	$ –
New reserves	44,670	–
Costs incurred	(297,411)	–
Balance at end of period	$ 386,202	$ –

NOTE 18:– ACQUISITION OF UEC ELECTRONICS, LLC

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 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 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) and then adjusted in the fourth quarter to $2.5 million in accrued expenses and zero in long term liabilities since the 2014 earn-out will be paid in April 2015 and the 2015 earn-out is no longer expected to be achieved. 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. Included in the Company's Consolidated Statements of Comprehensive Income for the year ended December 31, 2014 are net sales of approximately $27.2 million and income before provision for income taxes of approximately $5.0 million since the April 1, 2014 acquisition of UEC. The total consideration of $37.9 million, after the net working capital adjustment, for the membership interests purchased consisted of (i) cash in the amount of $29,206,245, (ii) 775,000 shares of the Company's common stock, valued at $4,216,000, and (iii) contingent consideration with an estimated fair value at April 1, 2014 of $4.5 million.

In U.S. dollars

NOTE 18:– ACQUISITION OF UEC ELECTRONICS, LLC (Cont.)

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

Tangible assets acquired:		
Cash:	$	92,590
Accounts receivable and unbilled revenues		12,513,805
Other current assets		854,776
Property and equipment, net		1,010,321
Intangible assets		
Customer list		7,400,000
Contracts in place (backlog)		2,100,000
Technology		3,200,000
Covenant not to compete.		400,000
Goodwill (intangibles that did not qualify for separate recognition)		15,105,680
Total asset value		42,677,172
Less: liabilities assumed		(4,754,927)
Net fair value of assets acquired	$	37,922,245

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.

Goodwill arising from acquisitions is not be amortized. 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 comprehensive income. The Company will also assess the impairment of goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. This goodwill is deductible for tax purposes.

In U.S. dollars

NOTE 18:– ACQUISITION OF UEC ELECTRONICS, LLC (Cont.)

Pro forma financial information

In April 2014, the Company acquired UEC, as more fully described 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 years ended December 31, 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 on January 1, 2013, nor do they purport to be indicative of the results of operations that will be obtained in the future.

	Year Ended December 31,	
	2014	2013
Revenues	$ 116,113,345	$ 120,854,708
Income – continuing operations before income tax	$ 8,050,164	$ 2,562,522
Net income	$ 7,026,327	$ 1,388,183
Basic net income per share	$ 0.32	$ 0.08
Diluted net income per share	$ 0.31	$ 0.08
Weighted average number of shares used in computing basic net income per share	22,127,751	17,282,848
Weighted average number of shares used in computing diluted net income per share	22,730,491	17,885,588

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 $813,000 recognized as general and administrative expenses in the year ended December 31, 2014 are reflected in the pro forma results above as though they were recognized during the year ended December 31, 2013 and have been removed from the pro forma results for the year ended December 31, 2014.

LEASE

THIS LEASE (this "**Lease**") made and entered into as of the 31st day of October, 2014 (the "**Effective Date**") between UEC Properties, LLC, a South Carolina limited liability company ("**Landlord**"), and UEC Electronics, LLC, a South Carolina limited liability company ("**Tenant**").

WITNESSETH:

In consideration of the mutual covenants and agreements contained herein, and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereto agree for themselves, their successors and assigns, as follows:

1. **PREMISES**. Landlord, in consideration of the rents, covenants, and agreements hereinafter reserved and contained to be paid and performed by Tenant, hereby demises and lets unto Tenant that certain land and improvements located in or near the City of Hanahan, Berkley County, South Carolina, commonly known as 5906 Howard Street, Hanahan, SC 29410 and buildings designated as 1 & 2 at 5914 and 5918 Howard Street, Hanahan, SC 29410 (the "**Premises**"), as more particularly described or shown in **EXHIBIT "A"** attached hereto and made a part hereof, together with all rights, appurtenances, easements, and privileges thereto, upon and subject to all of the terms and conditions set forth herein.

2. **TERM**.

(a) **Term.** This Lease shall be effective as of the Effective Date. The term ("**Term"**) of this Lease shall be for ten years commencing on January 1, 2015, (the "**Commencement Date**") and expiring at 11:59 p.m. on December 31, 2024 (the "**Termination Date**").

3. **TRIPLE NET LEASE**. THIS IS A TRIPLE NET LEASE AND LANDLORD SHALL NOT BE REQUIRED TO PAY ANY EXPENSE, TO PROVIDE ANY SERVICES, OR TO DO ANY ACT OR THING WITH RESPECT TO THE PREMISES, INCLUDING THE BUILDING, IMPROVEMENTS, OR ANY APPURTENANCES. THE RENT PAYABLE UNDER THIS LEASE SHALL BE PAID TO LANDLORD WITHOUT ANY CLAIM ON THE PART OF TENANT FOR DIMINUTION, SET-OFF OR ABATEMENT AND NOTHING SHALL SUSPEND, ABATE OR REDUCE ANY RENT TO BE PAID HEREUNDER. TENANT SHALL BE OBLIGATED TO PAY RENT IRRESPECTIVE OF ANY CLAIM TENANT MAY HAVE AGAINST LANDLORD; AND THIS COVENANT SHALL BE DEEMED INDEPENDENT OF ANY OTHER TERMS, CONDITIONS OR COVENANTS OF THIS LEASE.

4. **RENT AND OTHER SUMS TO BE PAID BY TENANT**.

(a) **Base Rent**. During the Term, Tenant shall pay to Landlord annual base rent, as increased each year (the "**Base Rent**") payable in equal monthly installments according to the following schedule:

Period	Monthly Rent	Annual Rent
Lease year 1	$28,862	$346,341
Lease year 2	$29,584	$355,000
Lease year 3	$30,323	$363,875
Lease year 4	$31,081	$372,971
Lease year 5	$31,858	$382,296
Lease year 6	$32,655	$391,853
Lease year 7	$33,471	$401,649
Lease year 8	$34,308	$411,691
Lease year 9	$35,166	$421,983
Lease year 10	$36,045	$432,532

Rent shall be paid to Landlord without demand and without setoff or reduction in equal monthly installments in advance on the first (1st) day of each month at the address of Landlord set forth in Section 32 hereof, or at such other address as Landlord may from time to time designate to Tenant by notice in the manner hereinafter provided. In the event the Commencement Date shall fall on a day other than the first day of a calendar month, the Base Rent shall be apportioned pro rata on a per diem basis for the period between the Commencement Date and the first day of the following calendar month (which pro rata payment shall be due and payable on the Commencement Date). No payment by Tenant or receipt by Landlord of rent hereunder shall be deemed to be other than on account of the amount due, and no endorsement or statement on any check or any letter accompanying any check or payment of rent shall be deemed an accord and satisfaction, and Landlord may accept such check as payment without prejudice to Landlord's right to recover the balance of such installment or payment of rent or pursue any other remedies available to Landlord.

(b) **Additional Rent**. Any amounts required to be paid by Tenant under this Lease (in addition to Base Rent) and/or any charges or expenses incurred by Landlord on behalf of Tenant under the terms of this Lease, including, without limitation, any expenses incurred for taxes, insurance, maintenance, repairs, replacements, damage to the Premises caused by Tenant or Tenant's employees, agents, contractors, licensees, or invitees, legal fees, cost of default remedies, owner's association dues and assessments, landscaping, utilities and other charges assessed against or attributed to the Premises which are the obligation of Tenant hereunder, shall be considered additional rent (herein, "**Additional Rent**") payable in the same manner and upon the same terms and conditions as Base Rent reserved hereunder except as expressly set forth herein to the contrary. Any failure on the part of Tenant to pay such Additional Rent when due shall entitle Landlord to the remedies available to it for non-payment of Base Rent, including, without limitation, late charges and Interest (as defined in Subsection 34(f)) thereon pursuant to Subsection 34(g) hereof. Base Rent and Additional Rent shall be deemed and are hereafter referred to occasionally as "**Rent**."

5. **USE OF PREMISES**. Tenant covenants and agrees that the Premises may be used for any lawful purpose (the "**Permitted Use**"). Tenant will permit no liens to attach or exist against the Premises, and shall not commit any waste. The Premises shall not be used for any illegal purposes, and Tenant shall not allow, suffer, or permit any unreasonable vibration, noise, odor, light or other effect to occur within or around the Premises that constitutes a nuisance or trespass for any neighbor of the Premises or their customers, agents, licensees or invitees. Upon notice by Landlord to Tenant that any of the aforesaid prohibited uses are occurring, Tenant agrees to promptly remove or control the same. Tenant shall not in any way violate any law, or ordinance from time to time affecting the Premises, or any restrictive covenant currently affecting the Premises, and shall not in any manner use the Premises so as to cause cancellation of, or prevent the use of the fire and extended coverage insurance policy required hereunder. Landlord makes no (and does hereby expressly disclaim any) covenant, representation or warranty as to the Permitted Use being allowed by or being in compliance with any applicable laws, rules, ordinances or restrictive covenants now or hereafter affecting the Premises, Tenant hereby expressly acknowledging and agreeing that Tenant shall conduct and rely solely on its own due diligence and investigation with respect to the compliance of the Permitted Use with all such applicable laws, rules, ordinances and restrictive covenants, and not on any such information provided by Landlord or any of its agents or employees.

6. **QUIET ENJOYMENT**. Tenant, upon paying the rents herein reserved and performing and observing all of the other terms, covenants, and conditions of this Lease on Tenant's part to be performed and observed, shall peaceably and quietly have, hold, and enjoy the Premises, during the Term, subject to the terms of this Lease and to any agreements and encumbrances which are superior to this Lease or to which this Lease may be subordinated.

7. **TAXES**.

(a) **Real Estate Taxes**. Tenant shall pay all real estate taxes and other impositions for the Premises, including any fees in lieu of taxes, both general and special, which may be levied or assessed by the taxing authorities against the land, buildings and all other improvements within or constituting the Premises. Tenant shall pay all such real estate taxes and assessments directly to the taxing authority including any fine, penalty, interest or cost that may be added thereto for non-payment thereof. Real estate taxes and other impositions shall mean all ad valorem taxes, water and sanitary taxes, assessments, liens, licenses and permit fees or any other taxes imposed, assessed or levied against the Premises, and all other charges, impositions or burdens of whatever kind and nature, whether or not particularized by name, and whether general or special, ordinary or extraordinary, foreseen or unforeseen, which at any time during the Term may be created, assessed, confirmed, adjudged, imposed or charged upon or with respect to the Premises or any improvements made thereto, or on any part of the foregoing or any appurtenances thereto, or directly upon this Lease or the rent payable hereunder or amounts payable by any subtenants or other occupants of the Premises, or upon this transaction or any documents to which Tenant is a party or successor-in-interest, or against Landlord because of Landlord's estate or interest herein, by any governmental authority, or under any law, including among others, all rental, sales, use, inventory or other similar taxes and any special tax bills and general, special or other assessments and liens or charges made on local or general improvements or any governmental or public power or authority whatsoever, but excluding income, franchise, capital gains, and estate and gift taxes.

(b) **<u>Personal Property Taxes and Assessments</u>**. The Tenant, at all times, shall be responsible for and shall pay, before delinquency, all municipal, county, state or federal taxes, including any fees in lieu of taxes, assessed against any leasehold interest or any fixtures, furnishings, equipment, stock and trade, or other personal property owned, installed or used on the Premises and billed to the Landlord or to the Premises, or any further improvements to the Premises by Tenant or by Landlord.

8 . **<u>UTILITIES</u>**. Tenant shall pay, prior to delinquency, all electricity, heat, water, sewer, trash removal, and all other utility charges and costs of any kind for utilities used or consumed at the Premises. Landlord is not responsible for any interruptions or curtailments in utility services except to the extent caused by the gross negligence or willful misconduct of Landlord, its employees, agents, servants, or contractors. Landlord hereby reserves the right to grant perpetual utility and/or other easements over, under, and across the Premises, to the applicable private, public, or governmental authorities for purposes of installing, constructing, reconstructing, using, operating, repairing, replacing, maintaining, relocating, and/or removing any utility lines and/or facilities, provided same do not unreasonably interfere with the conduct of Tenant's business. Tenant agrees, from time to time within ten (10) days of Landlord's request, to execute and deliver to Landlord any reasonable instruments presented to Tenant by Landlord which grant such utility and other easements over, across, and under the Premises, to any applicable private, public, or governmental authorities for the purposes described hereinabove.

9. **<u>INSURANCE REQUIRED OF TENANT</u>**.

(a) With respect to Tenant's performance under this Lease, and in addition to Tenant's obligation to indemnify, Tenant shall at its sole cost and expense:

(i) maintain the insurance coverages and limits required by this Section and any additional insurance and/or bonds required by law on or before the Effective Date or Tenant's entering the Premises for any purpose, and at all times during the Term;

(ii) procure the required insurance from an insurance company eligible to do business in the State of South Carolina and having and maintaining a Financial Strength Rating of "A-" or better and a Financial Size Category of "VII" or better, as rated in the A.M. Best Key Rating Guide for Property and Casualty Insurance Companies, except that, in the case of Workers' Compensation insurance, Tenant may procure insurance from the state fund of the State of South Carolina; and

(iii) deliver to Landlord, certificates of insurance stating the types of insurance and policy limits. Tenant shall provide or will endeavor to have the issuing insurance company provide at least thirty (30) days advance written notice of cancellation, non-renewal, or reduction in coverage, terms, or limits to Landlord. Tenant shall deliver such certificates:

1) On or before the Effective Date or Tenant's entering the Premises for any purpose; and

2) prior to expiration of any insurance policy required in this Section.

(b) The parties agree:

(i) the failure of Landlord to demand such certificate of insurance or failure of Landlord to identify a deficiency will not be construed as a waiver of Tenant's obligation to maintain the insurance required under this Lease;

(ii) that the insurance required under this Lease does not represent that coverage and limits will necessarily be adequate to protect Tenant, nor be deemed as a limitation on Tenant's liability to Landlord in this Lease;

(iii) Tenant may meet the required insurance coverages and limits with any combination of primary and Umbrella/Excess liability insurance; and

(iv) Tenant may not maintain a deductible that exceeds $5,000.00 on any liability and not more than $25,000.00 on any property policy without Landlord's prior written approval.

(c) The insurance required by this Section includes the following coverages:

(i) Workers' Compensation insurance with benefits afforded under the laws of the State of South Carolina and Employers Liability insurance with limits of at least:

$500,000.00 for Bodily Injury – each accident

$500,000.00 for Bodily Injury by disease – policy limits

$500,000.00 for Bodily Injury by disease – each employee

(ii) Commercial General Liability insurance written on Insurance Services Office (ISO) Form CG 00 01 12/07 or a substitute form providing equivalent coverage, covering liability arising from the Premises, operations, independent contractors, personal injury, products/completed operations, and liability assumed under an insured contract (including the tort liability of another assumed in a business contract) with limits of at least:

$3,000,000.00 General Aggregate limit (per location basis)
$1,000,000.00 each occurrence limit for all bodily injury or property damage incurred in any one (1) occurrence
$3,000,000.00 each occurrence limit for Personal Injury and Advertising Injury
$5,000,000.00 Products/Completed Operations Aggregate limit
$100,000.00 Damage to Rented Premises

(iii) The Commercial General Liability insurance policy must:

1) include Landlord and Landlord's lenders, if any, as Additional Insureds using the ISO Additional Insured-Managers or Lessors of Premises endorsement form CG 20 11 04/13, or an acceptable substitute providing equivalent coverage. Tenant shall provide a copy of the Additional Insured endorsement to Landlord. The Additional Insured endorsement may either be specific to Landlord or may be "blanket" or "automatic" addressing any person or entity as required by contract. A copy of the Additional Insured endorsement must be provided within sixty (60) days of execution of this Lease and within sixty (60) days of each Commercial General Liability policy renewal;

2) include a waiver of subrogation in favor of Landlord;

3) be primary and non-contributory with respect to any insurance or self-insurance that is maintained by Landlord; and

4) the policy aggregate must be provided on a per location basis.

(iv) Property insurance with limits equal to 90% replacement cost of Tenant's personal property, decorations, trade fixtures, furnishings, equipment, alterations and repairs, improvements and betterments, and other contents located or placed therein and shall include business interruption. The property insurance policy will include a waiver of subrogation in favor of Landlord.

(d) If Tenant fails to obtain and provide any or all of the aforesaid insurance, Landlord may, but shall not be required to, purchase such insurance on behalf of Tenant and recover the cost of such insurance as Additional Rent due under this Lease. Tenant agrees, as its own expense, to comply with all rules and regulations of the fire insurance rating organization having jurisdiction.

10. **LANDLORD'S INSURANCE**. Landlord shall maintain fire and casualty special form "all risk" insurance, with extended coverage, covering the buildings to be located upon the Premises equal to the full replacement cost thereof. Tenant shall pay or reimburse to Landlord the actual cost of insurance within fifteen (15) days after receipt of an invoice therefor. Such payment shall be deemed Additional Rent hereunder.

11. **WAIVER OF SUBROGATION**. Landlord and Tenant hereby release each other and each party's officers, directors, employees, and agents from liability or responsibility for any loss or damage to their respective property covered by insurance policies, or which would have been covered by insurance if the party had complied with the terms and provisions of this Lease. This release shall apply to Landlord and Tenant and anyone claiming through or under Landlord or Tenant, by way of subrogation or otherwise, even if the occurrence was caused by the fault or negligence of Landlord or Tenant or anyone under their control. Each of Landlord and Tenant shall cause any property damage insurance which it maintains in respect to the Premises, to contain a provision whereby the insurer waives any rights of subrogation against the other party.

12. **REPAIRS AND MAINTENANCE**. Throughout the Term, Tenant, at its sole expense, shall maintain all portions of the Premises in good condition, ordinary wear and tear excepted. Such maintenance shall include, without limitation, the building, parking areas, sidewalks, loading areas, thruways, methods of ingress and egress, electrical, lighting facilities and equipment, and all parkways, fences and signs located on Premises. Tenant will not suffer or permit any waste or neglect and will take such steps as often as may be necessary to keep the building, appurtenances, and other improvements on the Premises in a first-class and modern condition. Tenant shall also repair, replace and be responsible for the damage caused by stoppage, breakage, leakage, overflow, discharge or freezing of plumbing pipes, sewer lines or fixtures. Landlord shall have no obligation with respect to maintenance, repair and replacement of any improvements on the Premises, including, without limitation, repair, replacement and maintenance of the foundation, roofs, structural elements, exterior walls, and exterior windows of any such improvements.

If Tenant refuses or neglects to commence the necessary maintenance, repairs or replacements within thirty (30) days after the written demand by Landlord (other than in the case of emergency), Landlord may (but shall not be required to) make such maintenance, repairs or replacements without liability to Tenant for any loss or damage that may accrue to Tenant's stock, business, equipment, or fixtures by reason thereof, and if Landlord makes such maintenance, repairs or replacements, Tenant shall pay to Landlord, on demand, as Additional Rent, the cost thereof, plus interest at the rate set forth in Subsection 34(f) from the date Landlord pays for any such repairs.

Tenant shall, at its cost, contract with a service company (which Landlord, at its option, may reasonably designate or approve) for the quarterly maintenance of the heating, ventilating and air conditioning equipment serving the Premises. Tenant shall furnish a copy of the service contract to Landlord within ten (10) days after opening for business, and a copy of any subsequent contracts from time to time during the Term.

Tenant shall, at its cost, retain a licensed, bonded professional pest and termite control service (which Landlord, at its option, may reasonably designate or approve) to perform at the minimum annual inspections of the Premises, to keep the same free of infestation by insects, rodents and vermin, and shall promptly cause any corrective or extermination work reasonably recommended by such service to be performed. The Tenant shall provide the Landlord with a copy of the termite and pest control contract and annual renewals of the contract. Tenant agrees to initiate and carry out a program of regular maintenance and repair of the Premises, including the painting or refinishing of all areas of the interior and exterior thereof, so as to impede, to the extent possible, deterioration by ordinary wear and tear and to keep the same in attractive condition.

13. **ALTERATIONS**.

(a) Tenant agrees not to make alterations, changes, additions, or improvements to the Premises and/or or the improvements thereon costing in excess of $20,000 in the aggregate without the prior written consent of Landlord, which shall not be unreasonably withheld, delayed or conditioned. Tenant shall submit three complete sets of Tenant's plans and specifications which have been stamped/sealed by an architect or engineer licensed in the State of South Carolina (the "**Plans and Specifications**") to Landlord in conjunction with Tenant's request for Landlord's consent to Tenant's planned alterations of the Premises (the "**Tenant's Work**). If approved by Landlord, the Plans and Specifications shall be the final plans and specifications, and no material changes shall be made without Landlord's prior written consent. "**Material Changes**" shall include any change of the appearance of the improvements or re-engineered drawings of the improvements thereon. Landlord agrees to review and comment on the Plans and Specifications within fifteen (15) days after receipt; otherwise, such request and plans and specifications will be deemed approved by Landlord. If Landlord consents to Tenant's proposed alterations, changes, additions, or improvements and approves the Plans and Specifications, all work erected or performed shall be performed solely by Tenant at its sole cost and expense pursuant to the approved Plans and Specifications. Tenant agrees that no construction shall commence until Landlord approves said Plans and Specifications. Prior to commencement of construction, a pre-construction coordination conference shall be held at or near the Premises. Landlord's representative, Tenant's representative and Tenant's Contractor (as defined hereinafter), if any, shall attend such conference. Tenant shall be responsible for and agrees to obtain all building permits, other permits, utility services, and certificates of occupancy required in connection with the use and occupancy of the Premises.

(b) In the event Tenant engages the services of a contractor with regard to the Tenant's Work, Tenant and Tenant's contractor (the "**Contractor**") shall comply with the requirements set forth in this subsection (b). Tenant and Tenant's contractor shall enter into a construction contract in which the contractor agrees to perform the work, and Tenant shall provide an executed copy of such contract to Landlord. Said contract shall provide, among other things, as follows:

(i) That notwithstanding anything to the contrary, the Contractor will perform the work and furnish the materials required therefor on the sole credit of Tenant; that no lien for labor or materials will be filed or claimed by the Contractor against the Premises, that the Contractor will discharge any such lien filed or claims by any person or entity that furnishes labor or materials; and that the Contractor will indemnify and save Landlord harmless from any and all costs and expenses, including reasonable attorneys' fees, suffered, or incurred as a result of any such lien that may be filed or claimed in connection with or arising out of the work; and

(ii) That the Contractor shall furnish Tenant and Landlord with certificates of insurance setting forth the following coverages: (A) workmen's compensation insurance as required by the laws of the State of South Carolina or the United States; (B) bodily injury, including death, with limits of $1,000,000.00 per person and $3,000,000.00 per occurrence; (C) property damage, with limits of $500,000.00; (D) motor vehicle liability and property damage in the amounts set forth in (B) and (C); and (E) Builder's Risk Insurance in the full amount of the contract.

14. **DAMAGE OR DESTRUCTION**. If the building or other improvements upon the Premises are damaged by fire or other casualty, Landlord shall cause the damage to the physical structure of the building (excluding any tenant improvements or alterations therein) to be repaired or replaced without unreasonable delay; provided, however, if by reason of such casualty, Landlord, in its reasonable estimation, determines that the amount of time required to repair the damage using due diligence is in excess of 270 days (as measured from the issuance of the applicable building permits necessary for reconstruction), then either party shall have the right to terminate this Lease by giving written notice of termination to the other party hereto within thirty (30) days after the date of casualty; provided, however, in the event that the casualty giving rise to an election to terminate is caused by the negligence, misconduct or acts or omissions of Tenant or Tenant's invitees, Tenant shall have no right to terminate this Lease. Except as specifically set forth herein, in no event shall any such damage cause the abatement or rebate in the Rent then due or thereafter becoming due under the terms hereof. Notwithstanding the other provisions of this Section, in the event that there should be a casualty loss to the Premises during the last two (2) years of the Term, Landlord may, at its option, terminate this Lease by giving written notice thereof to Tenant within thirty (30) days after the date of the casualty and the Rent shall abate as of the date of such notice. Except as provided herein, Landlord shall have no obligation to rebuild or repair in case of fire or other casualty, and no termination under this Section shall affect any rights of Landlord or Tenant hereunder arising from the prior defaults of the other party. Tenant shall give Landlord immediate notice of any fire or other casualty in the Premises. Notwithstanding anything contained in this Section to the contrary, in no event shall Landlord be required to expend more funds in connection with repair or restoration than the amount received by Landlord from the proceeds of any insurance policies maintained by Landlord. Further, Landlord shall have no duty to restore, repair, replace or rebuild in the event that any lender of Landlord should require that insurance proceeds received as a result of the fire or other casualty be applied to payment of the mortgage debt, and, in such event, Landlord and Tenant shall each have the right to terminate this Lease immediately.

15. **CONDEMNATION**. If any substantial portion of the Premises is taken under the power of eminent domain (including any conveyance made in lieu thereof) or if such taking shall materially impair the normal operation of Tenant's business, then either party hereto shall have the right to terminate this Lease by giving written notice of such termination to the other party within thirty (30) days after such taking. If neither party elects to terminate this Lease, Landlord shall repair and restore the Premises to the best possible tenantable condition (but only to the extent of any condemnation proceeds made available to Landlord) and the Rent shall be proportionately and equitably reduced as of the date of the taking. All compensation awarded for any taking (or the proceeds of a private sale in lieu thereof) shall be the property of Landlord whether such award is for compensation for damages to the Landlord's or Tenant's interest, and Tenant hereby assigns all of its interest in any such award to Landlord; provided, however, Landlord shall not have any interest in any separate award made to Tenant for loss of business, moving expenses, its leasehold estate, or the taking of Tenant's trade fixtures or equipment if a separate award for such items is made to Tenant and such separate award does not reduce the award to Landlord.

16. **ASSIGNMENT OR SUBLETTING**. So long as Tenant is not in default under this Lease, Tenant may assign its interest in this Lease or sublet the entire Premises (but not a part thereof) to (i) a wholly owned corporation or controlled subsidiary of Tenant; or (ii) the parent corporation through which Tenant is authorized to operate its business. Tenant shall make no other assignment or subletting without the prior written consent of Landlord, and upon such terms and conditions as Landlord may approve. A change in ownership of Tenant shall be an assignment of this Lease for purposes of this Section. Any assignment or sublease shall not release or relieve Tenant from any obligations of this Lease. Tenant shall pay to Landlord, as Additional Rent, the sum of $3,000.00 to cover Landlord's administrative costs, overhead and counsel fees, plus all out-of-pocket expenses above such amount, in connection with such assignment or subletting consented to by Landlord and any and all additional costs and expenses incurred hereunder. Any assignee of Tenant shall assume Tenant's obligations hereunder and shall deliver to Landlord an assignment and assumption agreement in form satisfactory to Landlord within ten days after the effective date of the assignment. Notwithstanding the foregoing, regardless of Landlord's consent or the need under this Section to obtain Landlord's consent, no assignment or subletting shall release Tenant from this Lease. Acceptance of Rent from any other person shall not be deemed a waiver by Landlord of any provision of this Lease. Consent to one assignment or subletting shall not be deemed a consent to any subsequent assignment or subletting. In the event of any assignment or sublease involving rent in excess of the Base Rent or Additional Rent required under this Lease ("**Excess Rent**"), Landlord shall participate in the Excess Rent. Tenant shall promptly pay to Landlord, as additional rent, one hundred (100%) percent of all such Excess Rent collected from the assignee or subtenant, and shall supply Landlord with a true copy of each assignment or sublease, and in the case of the former, an originally executed assumption by the assignee of all of Tenant's obligations under this Lease.

17. **ORDINANCES**. Tenant shall at its own cost and expense promptly observe and comply with all laws, rules, orders, zoning ordinances, regulations, and requirements applicable to the Premises and all buildings and improvements thereon, or to repairs or alterations thereof, and shall also at its own cost and expense promptly comply with all laws, rules, orders, and regulations. If Tenant fails to comply with any of the foregoing requirements, Landlord may, at its option and after thirty (30) days' notice to Tenant of its intention to do so, comply with the same for the account of Tenant, and Tenant shall upon demand pay to Landlord the cost of such compliance including reasonable expenses, Interest, attorneys' fees, and costs incurred in connection therewith.

18. **FINANCING**. Tenant agrees that this Lease and all of Tenant's right, title, and interest in and to this Lease and the Premises is subject and subordinate to any mortgage, deed of trust, or other security instrument which Landlord may now or hereafter place upon all or any portion of the Premises (each, a "**Mortgage**") and to all renewals, modifications, amendments, and extensions thereof and to all the terms and provisions thereof. This provision is self-operative. Tenant agrees, however, to promptly execute any document or instrument which may be requested by Landlord or any mortgagee or lender holding a Mortgage (each, a "**Mortgagee**") evidencing such subordination. If any Mortgage is foreclosed (or in the event of a deed in lieu of foreclosure), then (a) Tenant shall, at any purchaser's (including any Mortgagee) at such foreclosure sale (or deed in lieu thereof) (the "**Purchaser**") election, attorn to such Purchaser and recognize such Purchaser as the "landlord" under this Lease pursuant to all the terms and provisions of this Lease, and Tenant will promptly execute any such documents and instruments as may be necessary or appropriate to evidence such attornment; and (b) Tenant waives the provisions of any statute or rule of law, now or hereafter in effect, that provides Tenant any right to terminate this Lease or to otherwise adversely affect Landlord's interest in this Lease upon any such foreclosure proceeding. Any Mortgagee shall also have the right, in such Mortgagee's discretion, to subordinate its Mortgage to this Lease. If Tenant, within fifteen (15) days after Landlord's demand, fails to execute and deliver any instrument or document required to be executed by Tenant pursuant to this Section 18, then Landlord is hereby authorized to execute same as attorney-in-fact for the Tenant, such power being coupled with an interest.

19. **ESTOPPEL CERTIFICATE & FINANCIAL STATEMENTS**. (a) Tenant shall, from time to time within ten (10) days after Landlord's demand, execute and deliver to Landlord and/or Landlord's designee an estoppel certificate in a form acceptable to Landlord and/or Landlord's designee certifying (a) that this Lease is unmodified and in full force and effect (or if there have been modifications, that this Lease is in full force and effect as so modified), (b) the dates to which rent and other charges payable under this Lease have been paid, (c) that Landlord is not in default under this Lease (or if Tenant alleges a default, then (i) stating the nature of such alleged default, and (ii) the date of notice provided to Landlord stating such default), and (d) such other matters as Landlord and/or such designee may require. If Tenant fails to execute and deliver to Landlord and/or Landlord's designee any such estoppel certificate within ten days after Landlord's demand, then Tenant shall be automatically deemed to have approved such estoppel certificate in the form submitted to Tenant and all the matters set forth therein.

(b) **Financial Statements**. Tenant shall furnish to Landlord within one hundred twenty (120) days after the close of each fiscal year a balance sheet, as well as a profit and loss statement and any other financial information or summaries that Tenant typically provides to its lenders or owners on Tenant for such fiscal year, certified by Tenant to be correct and accurate and prepared in accordance with generally accepted accounting principles consistently applied, and a quarterly profit and loss statement of Tenant. Landlord shall keep such information strictly confidential and not disclose such information to any other party other than its lender or potential lender.

20. **INDEMNITY; LIMITS OF LIABILITY**. Tenant agrees to indemnify, defend, and save Landlord, its agents, contractors, servants, and employees harmless from and against any and all liabilities, damages, claims and demands for, or in connection with, any accident, injury, or damage whatsoever caused to any person or property arising, directly or indirectly, out of the business conducted in or the use and/or occupancy of the Premises, or occurring in, on or about the Premises or any part thereof, or arising directly or indirectly, from any act or omission of Tenant or any concessionaire or sub-tenant or their respective licensees, servants, agents, employees, or contractors, and from and against any and all costs, expenses, and liabilities incurred in connection with any such claims and/or proceedings brought thereon, except to the extent caused by the willful misconduct or gross negligence of Landlord or any of its agents, contractors, servants, or any employees. If any action or proceeding shall be brought by or against Landlord, its agents, contractors, servants, or employees in connection with any such liability, claim, suit, cost, injury, death or damage, Tenant, on notice from Landlord shall defend such action or proceeding, at Tenant's expense, by or through attorneys reasonably satisfactory to Landlord. The provisions of this paragraph shall apply to all activities of Tenant, its agents, contractors, servants or employees with respect to the Premises, whether occurring before or after execution of this Lease. The insurance coverage maintained by Tenant pursuant to this Lease shall support insurable aspects of the foregoing indemnity; provided, however, Tenant's liability pursuant to such indemnity shall not be limited to the amount or coverage of such insurance. The foregoing indemnification provision and the obligations arising thereunder shall survive any expiration or termination of this Lease. Neither Landlord, its agents, contractors, servants or employees shall be liable in any manner to Tenant, its agents, contractors, servants or employees for any injury to or death of persons or for any loss of or damage to property, regardless of whether such loss or damage is occasioned by casualty, theft or any other cause of whatsoever nature, except to the extent such loss or damage caused by the willful misconduct or gross negligence of Landlord, its agents, contractors, servants or employees. In no event shall Landlord, its agents, contractors, servants and employees be liable in any manner to Tenant, its agents, contractors, servants or employees as the result of the acts or omissions of Tenant, its agents, contractors, servants and employees. All personal property upon the Premises shall be at the risk of Tenant only, and neither Landlord, its agents, contractors, servants or employees shall be liable for any damage thereto or theft thereof, except to the extent attributable to the willful misconduct or gross negligence of Landlord, its agents, contractors, servants or employees.

21. **LIENS**. Tenant will promptly, and in all events within thirty (30) days following the filing of same, remove and discharge, and shall indemnify, defend and hold Landlord harmless from and against any lien, charge, claim, security interest or encumbrance which may attach to, upon or against the Premises or any portion thereof, arising out of the possession, use, occupancy, construction, operation, supply, repair, or rebuilding by reason of the furnishing of labor, services, materials or equipment by a contractor or material supplier or anyone else who is entitled to mechanics' lien under applicable law (a "**Mechanics' Lien**"). Notwithstanding the foregoing, Tenant may reserve the right to contest the validity or amount of any such Mechanics' Lien in good faith, provided that, within thirty (30) days after the filing of such Mechanics' Lien, Tenant discharges said Mechanics' Lien of record or records a bond eliminating said Mechanics' Lien as an encumbrance against the Landlord's interest in the Premises. If Tenant fails to remove any Mechanics' Lien against Landlord's interest, Landlord may, in addition to any other right or remedy, but shall not be obligated to, take such action as Landlord shall reasonably determine to remove such Mechanics' Lien, and all costs and expenses incurred by Landlord, including, without limitation, amounts paid in good faith settlement of such Mechanics' Lien and attorneys' fees and costs, shall be paid by Tenant. Tenant's obligations pursuant to this Section shall survive the expiration or earlier termination of this Lease.

Nothing contained in this Lease shall be construed as the consent or request of Landlord, express or implied, for the performance of any labor or services or for the furnishing of any materials or equipment for any construction, alteration, addition, rehabilitation, repair or demolition of or to the Premises (or any part thereof). Notice is hereby given that Landlord will not be liable for any labor, services, materials or equipment furnished or to be furnished to Tenant, or anyone holding an interest in the Premises (or any part thereof) through or under Tenant, and that no construction or other liens for any such labor, services, materials or equipment shall attach to or affect the interest of Landlord in the Premises. Tenant agrees to indemnify, protect, defend and hold Landlord harmless from and against all Claims, paid or incurred by Landlord in connection with any such Mechanics' Lien.

22. **HAZARDOUS MATERIALS**.

(a) Throughout the Term, Tenant and Tenant's employees, agents, invitees, licensees, and contractors shall not cause, permit, or allow any substances, chemicals, materials, or pollutants (whether solid, liquid, or gaseous) deemed to be toxic or hazardous or the manufacture, storage, transport, or disposal of which is regulated, governed, restricted, or prohibited by any federal, state, or local agency or authority, or under any federal, state, or local law, ordinance, rule, or regulation related to the environment, health, or safety (collectively, "**Environmental Laws**"), including, without limitation, any oil, gasoline, petroleum, petroleum by-products, hazardous substances, toxic substances, hazardous waste, asbestos, or asbestos containing materials (collectively, "**Hazardous Materials**") to be handled, placed, stored, dumped, released, manufactured, used, transported, or located on, in, under, or about the Premises; provided, however, Tenant shall be permitted to use and otherwise handle minor quantities of such Hazardous Materials as are ordinarily and typically used and handled as part of the Permitted Use so long as such Hazardous Materials are used and handled in accordance with all Environmental Laws. Upon the expiration or earlier termination of this Lease, Tenant shall, at Tenant's sole cost and expense, remove all Hazardous Materials from the Premises except to the extent placed thereon by Landlord.

(b) Tenant shall give Landlord immediate written notice of any problem, spill, discharge, threatened discharge, or discovery of any Hazardous Materials or claim thereof. If such problem, spill, discharge, threatened discharge, or discovery was caused by Tenant or any of Tenant's employees, agents, contractors, invitees, guests, or licensees, then such notice shall include a description of measures proposed to be taken by Tenant to contain and/or remediate the release of such Hazardous Materials and any resultant damage to or impact on property, persons, and/or the environment (which term includes, without limitation, soil, surface water, or groundwater). Upon Landlord's approval and at Tenant's own cost and expense, Tenant shall promptly take all steps necessary to clean up and remediate any release of such Hazardous Materials, comply with all Environmental Laws, and otherwise report and/or coordinate with Landlord and all appropriate governmental agencies.

(c) Tenant shall indemnify, release, defend (with counsel reasonably acceptable to Landlord), and hold Landlord and Landlord's agents, affiliates, representatives, officers, and employees harmless from and against all Liabilities (as defined below) suffered by, incurred by, or assessed against Landlord and/or Landlord's agents, affiliates, representatives, officers, and employees, whether incurred as a result of legal action taken by any governmental entity or agency, taken by any private claimant or taken by Landlord, as a result of the presence, disturbance, discharge, release, removal, or cleanup of any Hazardous Materials on, in, upon, or about the Premises (except to the extent placed thereon by Landlord, its agents, servants, employees or contractors), and/or other off-site property if caused directly or indirectly, in whole or in part, by the acts or omissions of Tenant or Tenant's agents, employees, contractors, representatives, or invitees. Tenant's obligations and liabilities under this Section 22 shall survive the expiration or earlier termination of this Lease. "**Liabilities**" means all liabilities, expenses, demands, damages (including punitive, exemplary, and consequential damages), costs, losses, causes of action, claims, attorneys' fees, other professional fees, penalties, fines, assessments, and charges.

(d) Upon seven (7) days' advance notice, Tenant shall permit Landlord and its representatives access to the Premises, from time to time, to conduct an environmental assessment, investigation and sampling of the Premises, at Landlord's expense, except to the extent such assessment, investigation or sampling shows the presence of Hazardous Materials caused by Tenant's actions, in which case such audit shall be at Tenant's expense. Landlord shall cooperate with Tenant to ensure that such access causes the least amount of disruption to Tenant's operation on the Premises as possible and shall, at Landlord's sole expense, restore the Premises to its condition prior to such assessment.

23. **[INTENTIONALLY OMITTED]**

24. **TITLE AND CONDITION**. (a) The Premises are demised and let subject to (i) the existing state of title of any of the Premises, (ii) any state of facts which an accurate survey or physical inspection of the Premises might show, (iii) all requirements of law, including any existing violation of any thereof, and (iv) the condition of the Premises as of the Commencement Date, without representation or warranty by Landlord. Annexed hereto as Exhibit B is a title report reflecting the status of title as of the date hereof.

(b) LANDLORD LEASES AND WILL LEASE AND TENANT TAKES AND WILL TAKE THE PREMISES AS IS WHERE IS AND WITH ALL FAULTS. TENANT ACKNOWLEDGES THAT LANDLORD (WHETHER ACTING AS LANDLORD HEREUNDER OR IN ANY OTHER CAPACITY) HAS NOT MADE AND WILL NOT MAKE, NOR SHALL LANDLORD BE DEEMED TO HAVE MADE, ANY WARRANTY OR REPRESENTATION, EXPRESS OR IMPLIED, WITH RESPECT TO THE PREMISES, INCLUDING ANY WARRANTY OR REPRESENTATION AS TO (i) ITS FITNESS, DESIGN OR CONDITION FOR ANY PARTICULAR USE OR PURPOSE, (ii) THE QUALITY OF THE MATERIAL OR WORKMANSHIP THEREIN, (iii) THE EXISTENCE OF ANY DEFECT, LATENT OR PATENT, (iv) LANDLORD'S TITLE THERETO, (v) VALUE, (vi) COMPLIANCE WITH SPECIFICATIONS, (vii) LOCATION, (viii) USE, (ix) CONDITION, (x) MERCHANTABILITY, (xi) QUALITY, (xii) DESCRIPTION, (xiii) DURABILITY (xiv) OPERATION, (xv) THE EXISTENCE OF ANY HAZARDOUS SUBSTANCE, OR (xvi) COMPLIANCE OF THE PREMISES WITH ANY LAW OR LEGAL REQUIREMENT; AND ALL RISKS INCIDENT THERETO ARE TO BE BORNE BY TENANT. TENANT ACKNOWLEDGES THAT THE PREMISES ARE OF ITS SELECTION AND TO ITS SPECIFICATIONS AND THAT THE PREMISES HAVE BEEN INSPECTED BY TENANT AND ARE SATISFACTORY TO IT. IN THE EVENT OF ANY DEFECT OR DEFICIENCY IN ANY OF THE PREMISES OF ANY NATURE, WHETHER LATENT OR PATENT, LANDLORD SHALL NOT HAVE ANY RESPONSIBILITY OR LIABILITY WITH RESPECT THERETO OR FOR ANY INCIDENTAL OR CONSEQUENTIAL DAMAGES (INCLUDING STRICT LIABILITY IN TORT). THE PROVISIONS OF THIS SUBSECTION 24(b) HAVE BEEN NEGOTIATED, AND ARE INTENDED TO BE A COMPLETE EXCLUSION AND NEGATION OF ANY WARRANTIES BY LANDLORD, EXPRESS OR IMPLIED, WITH RESPECT TO ANY OF THE PREMISES, ARISING PURSUANT TO THE UNIFORM COMMERCIAL CODE OR ANY OTHER LAW NOW OR HEREAFTER IN EFFECT OR ARISING OTHERWISE.

25. **SIGNAGE**. Tenant shall fully comply with all applicable requirements of all jurisdictional regulatory requirements pertaining to signage and signage installation, including, but not limited to, the ordinances of the City of Hanahan, South Carolina, if applicable.

26. **TENANT'S FIXTURES**. Tenant shall have the right to install in the Premises trade fixtures required by Tenant or used by it in its business, and if installed by Tenant, to remove any or all such trade fixtures from time to time during and upon termination or expiration of this Lease, provided Tenant is not then in default under the terms of this Lease; provided, however, that prior to the expiration of the Term, Tenant shall remove said trade fixtures from the Premises and repair and restore any damage or injury to the Premises (to the condition in which the Premises existed prior to such installation) caused by the installation and/or removal thereof.

27. **DEFAULT**.

(a) Tenant shall be in default hereunder if (a) Tenant fails to pay when due Rent and any other sums due under this Lease; or (b) Tenant fails to observe and perform any of the other terms, covenants, and/or conditions of this Lease and such default shall continue for more than ten (10) days after notice from Landlord to Tenant. If the nature of a default under (b) above is such that it cannot reasonably be cured within the aforesaid cure period, and work thereon shall be commenced within said period and diligently prosecuted to completion within thirty (30) days after Landlord's notice to Tenant, then Landlord's rights under this Section shall be inapplicable.

(b) In the event of any default by Tenant, Landlord may (i) cure Tenant's default at Tenant's cost and expense, and/or (ii) re-enter the Premises and remove all persons and all or any property therefrom by any suitable action or proceeding at law, without being liable for any prosecution therefor or damages therefrom, and repossess and enjoy the Premises with all buildings, additions, alterations, and improvements, and Landlord may, at its option, repair, alter, remodel, and/or change the character of the improvements as it may deem fit, and/or (iii) at any time relet the Premises or any part or parts thereof, as the agent of Tenant or in Landlord's own right, and/or (iv) terminate this Lease upon not less than five (5) days' notice to Tenant. The exercise by Landlord of any right granted in this Section shall not relieve Tenant from the obligation to make all rental payments and to fulfill all other covenants required by this Lease at the time and in the manner provided herein and if Landlord so desires all current and future rent and other monetary obligations due hereunder less the fair rental value of the Premises (adjusted to reflect the present value of said obligation as of said date using the statutory judgment interest rate in making said calculation) shall become immediately due and payable. Tenant throughout the remaining Term hereof shall pay Landlord, no later than the last day of each month during the Term, the then current excess, if any, of the sum of the unpaid rentals and costs to Landlord resulting from such default by Tenant over the proceeds, if any, received by Landlord from such reletting, if any, but Landlord shall have no liability to account to Tenant for any excess. Landlord shall not be required to relet the Premises nor exercise any other right granted to Landlord hereunder, nor shall Landlord be under any obligation to minimize Tenant's loss as a result of Tenant's default. If Landlord attempts to relet, Landlord shall be the sole judge as to whether or not a proposed tenant is suitable and acceptable.

(c) In the event of a breach by Tenant of any of the covenants or provisions hereof, Landlord shall have, in addition to any other remedies which it may have, the right to invoke any other remedy allowed at law or in equity to enforce Landlord's rights or any of them, as if re-entry and other remedies were not herein provided. Tenant hereby waives its right to redeem in the event that it shall be dispossessed or this Lease terminated by reason of any default on its part. Tenant hereby agrees that notice to quit or surrender possession shall not be required in the event of Tenant's default.

(d) If Tenant shall at any time be in default hereunder, and if Landlord shall deem it necessary to engage attorneys to enforce its rights hereunder, the determination of such necessity to be in the sole discretion of Landlord, Landlord will be reimbursed by Tenant for its expenses incurred thereby, including but not limited to court costs and reasonable attorneys' fees.

(e) The failure of Landlord to insist upon strict performance of any of the terms, conditions, and covenants herein shall not be deemed to be a waiver of any rights or remedies that Landlord may have and shall not be deemed a waiver of any subsequent breach or default in the terms, conditions, and covenants herein contained except as may be expressly waived in writing.

(f) The maintenance of any action or proceeding to recover possession, or any installment or installments of Rent or any other moneys that may be due or become due from Tenant to Landlord, shall not preclude Landlord from thereafter instituting and maintaining subsequent actions or proceedings for the recovery of possession or of any other moneys that may be due or become due from Tenant. Any entry or reentry by Landlord shall not be deemed to absolve or discharge Tenant from liability hereunder.

(g) If at any time during the Term there shall be filed by or against Tenant or any successor tenant then in possession under this Lease, in any court pursuant to any statute either of the United States or of any state, a petition (i) in bankruptcy, (ii) alleging insolvency, (iii) for reorganization, (iv) for the appointment of a receiver, or (v) for any relief under the Bankruptcy Code, or if a similar type of proceeding shall be filed, then Landlord may terminate Tenant's rights under this Lease by notice in writing to Tenant, and thereupon Tenant shall immediately quit and surrender the Premises to Landlord, but Tenant shall continue to be liable for the payment of Rent and all other sums due hereunder.

28. **LANDLORD'S RIGHT TO INSPECT**. Upon reasonable prior notice to Tenant, Tenant agrees to permit Landlord to enter the Premises during Tenant's usual business hours to inspect the same and show same to prospective tenants or purchasers.

29. **SURRENDER**. Tenant agrees, at the termination of this Lease, whether by limitation, forfeiture, or otherwise, to quit, surrender, and deliver to Landlord possession of the Premises with all the buildings and improvements thereon free from any liens thereon, in good condition and repair, ordinary wear and tear alone excepted, all of which shall remain the property of Landlord. Tenant's obligation to observe or perform this covenant shall survive the expiration or other termination of this Lease.

30. **DEFINITION OF LANDLORD: LIABILITY OF LANDLORD LIMITED**. The term "Landlord" as used in this Lease means only the owner for the time being of the land which constitutes the Premises so that in the event of any assignment, transfer, or other conveyance of Landlord's rights under this Lease, Landlord shall be and hereby is entirely freed and relieved of all covenants and obligations of Landlord hereunder as to matters occurring subsequent to the date of said assignment, transfer, or conveyance, and it shall be deemed and construed without further agreement between the parties or their successors in interest, or between the parties and the purchaser at any such sale, or the successor to Landlord by reason of any assignment, transfer, or other conveyance of Landlord's interest in this Lease, that such purchaser or successor has assumed and agreed to perform all of Landlord's obligations hereunder. The preceding sentence shall also be applicable to all successor landlords. Notwithstanding anything to the contrary provided in this Lease, it is agreed that Landlord, its successors and assigns, shall have absolutely no personal or individual liability with respect to any of the terms, covenants, and conditions of this Lease, and Tenant hereby expressly agrees that it shall look solely to the equity of Landlord or its successor(s) in interest in the Premises for the satisfaction of each and every remedy of Tenant in the event of any breach by Landlord or by such successor in interest of any of the terms, covenants, and conditions of this Lease to be performed by Landlord, such exculpation of personal liability to be absolute and without any exception whatsoever. Tenant covenants that no execution shall be levied against Landlord, but only against the Premises, and all judgments shall be so indexed.

31. **BROKER**. The parties represent to each other that no broker or finder has brought the Premises to the attention of Tenant, or Tenant to the attention of Landlord, and that no broker or finder is entitled to a commission or other compensation in connection with this transaction. Each party agrees to indemnify the other party for all costs and expenses incurred, including reasonable attorneys' fees, as a result of the claim of any broker or finder, based on dealings with said party.

32. **NOTICES**. Whenever notice shall be given by either party to the other, notice shall be in writing addressed to the address of the party being notified at the address set forth below or to such other address as a party may from time to time designate by five days' notice to the other party. Notice may only be given by hand delivery (with receipt), facsimile, nationally recognized express service which documents receipt of its deliveries, or by postage paid certified or registered mail with return receipt requested. Each notice which is given, served, or sent in the manner specified in this Section 32 shall be deemed to have been given and received as of the date it is delivered or as of the date on which delivery is refused or unclaimed by the addressee upon presentation. Notice addresses are as follows:

LANDLORD:	**TENANT**:
For notices:	For notices
UEC Properties, LLC	UEC Electronics , LLC
3024 Jasper Blvd	5914 Howard Street
Sullivans Island, SC 29482	Hanahan, SC 29410
	Attention: Rick Winter - COO rickwinter@uec-electronics.com
For Rent payments:	
ACH to Bank Provided	

33. **HOLDING OVER**. Tenant may not remain upon the Premises after the day of expiration of the Term without Landlord's written approval. With Landlord's approval, Tenant shall become a tenant-at-will and any such holding over shall not constitute an extension of the Lease. During such holding over, Tenant shall pay 150% of the Rent in effect as of the expiration of the Term. If Tenant holds over without Landlord's written consent, Tenant shall also be a tenant at sufferance and shall pay 200% of the then-effective Rent until Tenant surrenders possession. Nothing contained herein shall be interpreted to grant permission to Tenant to holdover or to deprive Landlord of any rights and remedies with respect thereto. Such occupancy shall be subject to all the terms, covenants and conditions of this Lease.

34. **OTHER PROVISIONS**.

(a) **Entire Agreement**. This Lease contains the entire agreement of the parties and may not be amended, modified, released, or discharged, in whole or in part, except by an instrument in writing signed by the parties.

(b) **Captions**. The captions contained in this Lease are for convenience and reference only, and shall not be held to explain, modify, amplify, or aid in the interpretation, construction, or meanings of the provisions of this Lease to which they relate.

(c) **Provisions Severable**. If any provision of this Lease shall to any extent be invalid or unenforceable, the remainder of this Lease or the application of such provision or any portion thereof to any person or circumstances shall not be affected thereby, and each valid provision or portion thereof shall be enforceable to the fullest extent permitted by law.

(d) **Relationship of Parties**. Nothing contained in this Lease shall be construed to make the parties partners or joint venturers or to render either of said parties liable for the debts or obligations of the other, except as expressly provided in this Lease.

(e) **Successors**. Subject to the provisions of this Lease, the covenants, conditions, and agreements contained herein shall bind and inure to the benefit of Landlord and Tenant and their respective successors, heirs, and assigns.

(f) **Interest**. Whenever this Lease refers to "**Interest**" same shall be computed at a rate equal to 12% per annum. If, however, payment of Interest at such rate by Tenant (or by the tenant then in possession having succeeded to Tenant's interest in accordance with the terms of this Lease) should be unlawful, that is, violative of usury statutes or otherwise, then Interest shall, as against such party, be computed at the maximum contract rate payable by such party.

(g) **Late Payments**. Should Tenant fail to pay when due any installment of Rent or any other sum payable to Landlord under the terms of this Lease, then Interest shall accrue from and after the date on which any such sum was originally due, and such Interest together with a late charge of $200.00 to cover the extra expense in handling such delinquency shall be paid by Tenant to Landlord at the time of payment of the delinquent sum.

(h) **Applicable Law, Venue**. This Lease shall be governed, construed, and enforced in accordance with the laws of the State of South Carolina. Venue for any dispute shall be proper solely in Berkeley County, South Carolina. In addition, the parties agree to mandatorily refer any lawsuit, claim, and/or dispute resulting in litigation, to the Berkeley County Master-In-Equity for final disposition, or a Special Referee if the Master-In-Equity has a conflict of interest.

(i) **Waiver of Trial by Jury**. Landlord and Tenant hereby mutually, intentionally and knowingly waive any and all rights to trial by jury in any action, proceeding, claim, crossclaim, counterclaim, or third-party complaint brought by either party for any matters whatsoever arising out of, or in any way connected with, this Lease, the relationship of Landlord and Tenant, the Premises, any business thereon, pre-lease discussion or negotiations, or any other matter whatsoever between or involving the parties.

(j) **Force Majeure**. Neither Landlord nor Tenant shall be liable for any delay or failure to perform its nonmonetary obligations hereunder due to (and the time for performance of any covenant shall be deemed extended by the time last due to) any causes beyond its reasonable control, including, without limitation, fire, accident, act of the public enemy, war, rebellion, insurrection, sabotage, transportation delay, shortages of material, labor, energy or machinery, or act of God, act of government or the judiciary.

(k) **Option to Terminate**. Notwithstanding anything to the contrary contained in this Lease, and provided Tenant and Landlord are not in default of the Lease at the time the option to terminate herein is exercised, Tenant and Landlord shall have a one-time right to terminate the Lease as of December 31, 2019. In order to effect such a termination, tenant or Landlord shall provide the other party with written notice no later than December 31, 2018. If termination notice is provided by Landlord, Tenant shall receive rental abatement in the amount of $100,000.00 during the fifth year of the lease term. If Tenant elects to exercise the Option to Terminate the lease, Landlord shall receive a termination fee equal to $100,000.00 (due upon notice to terminate) payable by Tenant. If the option to terminate is exercised by either party, Tenant agrees to vacate the Premises on or before December 31, 2019.

(l) **Memorandum of Lease**. Promptly upon Tenant’s request, Landlord agrees to execute (and acknowledge) and deliver to Tenant a memorandum of this Lease in recordable form.

[SIGNATURES ON THE FOLLOWING PAGE]

IN WITNESS WHEREOF, the parties have executed this Lease under seal as of the Effective Date.

LANDLORD:

WITNESSES:

Name: ______________________________

UEC Properties, LLC,
a South Carolina limited liability company

By: ______________________________
Name: Philip J. Ufkes: ______________________________
Title: Managing Member

TENANT:

WITNESSES:

Name: ______________________________

Name: ______________________________

UEC Electronics, LLC,
a South Carolina limited liability company

By: ______________________________
Name: ______________________________
Title: ______________________________

EXHIBIT "A"

Premises

5914 & 5918 Howard Street

All that lot, piece or parcel of land, together with the buildings and improvements thereon, situate, lying and being in St. James Goose Creek Parish, Berkeley County, S.C., being enclosed and contained within the lines lettered "A" – "B" – "C" – "D" – "E" – "F" – "A" (legal description not closed on prior deed due to a scrivenors error) as shown on a plat entitled "PLAT OF TRACT OF LAND, LETTERED "A" – "B" – "C" – "D" – "E" – "F", LOCATED IN ST. JAMES GOOSE CREEK PARISH, BERKELEY COUNTY, S.C. ALSO A RAILROAD SIDING WITH 16 FEET RIGHT OF WAY, LETTERED "H" – "J" – "K" – "L" ALSO LOTS 1 AND 2 BLOCK C, AS SHOWN ON A PLAT OF PORT PARK SUBDIVISION…" prepared by Joseph Needle, CE dated October 16, 1961, and recorded in the RMC Office for Berkeley County, in Plat Cabinet M at page 155, reference hereby made to said plat for a more complete description thereof and butting and bounding as shown thereon.

This being the same property conveyed to UEC Properties, LLC by Paula Steinberg Farbman, Samuel Steinberg, Jack K. White, Louise J. Small, Dorothy M. Small, Robert L. White and Anna Lea P. Steinberg by deed dated May 29, 2001, and recorded in the ROD Office for Berkeley County on May 31, 2001, in Book 2276, page 72.

TMS: 265-15-06-028

5906 Howard Street

All those certain lots, pieces or parcels of land, with the buildings and improvements thereon, situate, lying and being in Port Park Subdivision, Berkeley County, South Carolina, designated as Lots 1 and 2, in Block C, on a plat of Port Park Subdivision made by J. O'Hear Sanders, Jr., CE dated January, 1949, and recorded in the Clerk of Court's office for Berkeley County in Plat Book F, page 53A and having such shape, metes, bounds and location as are shown thereon, to which reference is hereby craved for a fuller description.

This being the same property conveyed to UEC Properties, LLC by deed of Carolina Towing and Recovery, Inc. dated March 28, 2012, and recorded in the Berkeley County ROD Office on March 28, 2012, in Book 9386, pager 307.

TMS: 265-15-06-029

Exhibit 21.1

Subsidiaries of the Registrant

Name of Subsidiary	Jurisdiction	Percentage Ownership
Epsilor-Electric Fuel Ltd.	Israel	100.0%
Electric Fuel Battery Corporation	Delaware	100.0%
FAAC Incorporated	Michigan	100.0%
UEC Electronics, LLC	South Carolina	100.0%

Exhibit 23.1

Consent of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Arotech Corporation
Ann Arbor, Michigan:

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (Nos. 333-195141, 333-190808 and 333-153487) and Form S-8 (Nos. 333-160717, 333-146752, 333-124960, 333-86728 and 333-59902) of Arotech Corporation of our reports dated March 20, 2015, relating to the consolidated financial statements and the effectiveness of Arotech Corporation's internal control over financial reporting, which appear in this Form 10-K.

/s/ BDO USA, LLP

Grand Rapids, Michigan
March 20, 2015

Exhibit 31.1

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
(Pursuant to Rule 13a -14(a) or Rule 15d-14(a) of the
Securities Exchange Act of 1934, as amended,
as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002)

I, Steven Esses, certify that:

1. I have reviewed this annual report on Form 10-K of Arotech Corporation;

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

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

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and 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 annual 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 annual report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this annual report based on such evaluation; and

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

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

(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 control over financial reporting.

Date: March 20, 2015

/s/ Steven Esses
Steven Esses, President and CEO
(Principal Executive Officer)

Exhibit 31.2

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
(Pursuant to Rule 13a -14(a) or Rule 15d-14(a) of the
Securities Exchange Act of 1934, as amended,
as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002)

I, Thomas J. Paup, certify that:

1. I have reviewed this annual report on Form 10-K of Arotech Corporation;

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

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

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and 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 annual 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 annual report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this annual report based on such evaluation; and

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

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

(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 control over financial reporting.

Date: March 20, 2015

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

Exhibit 32.1

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Arotech Corporation (the "Company") on Form 10-K for the year ended December 31, 2014, as 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 the best of my knowledge, the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Steven Esses
Steven Esses
President and CEO
(Chief Executive Officer)

Date: March 20, 2015

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

This certification accompanies the Report to which it relates, is not deemed filed with the SEC and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, whether made before or after the date of the Report and irrespective of any general incorporation language contained in such filing.

Exhibit 32.2

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Arotech Corporation (the "Company") on Form 10-K for the year ended December 31, 2014, as filed with the Securities and Exchange Commission (the "Report"), I, Thomas J. Paup, Vice President – Finance and Chief Financial Officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that, to the best of my knowledge, the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Thomas J. Paup
Thomas J. Paup,
Senior Vice President – Finance and CFO
(Chief Financial Officer)

Date: March 20, 2015

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

This certification accompanies the Report to which it relates, is not deemed filed with the SEC and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, whether made before or after the date of the Report and irrespective of any general incorporation language contained in such filing.