

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

**T QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED September 30, 2015.**

**Commission file number: 0-23336**

**AROTECH CORPORATION**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**95-4302784**

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

**1229 Oak Valley Drive, Ann Arbor, Michigan**

(Address of principal executive offices)

**48108**

(Zip Code)

**(800) 281-0356**

(Registrant's telephone number, including area code)

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

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

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

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

Large accelerated filer:

Accelerated filer:

Non-accelerated filer:

Smaller reporting company:

(Do not check if a smaller reporting company)

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

The number of shares outstanding of the issuer's common stock as of November 6, 2015 was 24,697,335.

SEC 1296 (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.**

**TABLE OF CONTENTS**

<b>Item</b>	<b>Page</b>
<b>PART I - FINANCIAL INFORMATION</b>	
<a href="#">Item 1 – Financial Statements (Unaudited):</a>	
<a href="#">Condensed Consolidated Balance Sheets at September 30, 2015 and December 31, 2014</a>	3
<a href="#">Condensed Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2015 and 2014</a>	5
<a href="#">Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2015 and 2014</a>	6
<a href="#">Notes to the Interim Condensed Consolidated Financial Statements</a>	8
<a href="#">Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations</a>	16
<a href="#">Item 3 – Quantitative and Qualitative Disclosures about Market Risk</a>	20
<a href="#">Item 4 – Controls and Procedures</a>	20
<b>PART II - OTHER INFORMATION</b>	
<a href="#">Item 1A – Risk Factors</a>	21
<a href="#">Item 6 – Exhibits</a>	21
<a href="#">SIGNATURES</a>	22

---

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

	<b>September 30, 2015</b>	<b>December 31, 2014</b>
	(Unaudited)	
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 11,025,351	\$ 11,291,784
Restricted collateral deposits	235,645	236,428
Trade receivables	16,173,719	17,595,811
Unbilled receivables	10,701,463	15,937,060
Other accounts receivable and prepaid expenses	1,524,401	1,155,548
Inventories	9,974,354	9,811,783
<i><b>Total current assets</b></i>	<u>49,634,933</u>	<u>56,028,414</u>
<b>LONG TERM ASSETS:</b>		
Severance pay fund	5,232,979	4,961,918
Other long term receivables	23,278	23,482
Property and equipment, net	6,327,377	6,462,949
Other intangible assets, net	9,904,923	11,840,365
Goodwill	45,371,250	45,422,219
<i><b>Total long term assets</b></i>	<u>66,859,807</u>	<u>68,710,933</u>
<i><b>Total assets</b></i>	<u>\$ 116,494,740</u>	<u>\$ 124,739,347</u>

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

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

	<u>September 30,</u> <u>2015</u>	<u>December 31,</u> <u>2014</u>
	(Unaudited)	
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Trade payables	\$ 4,833,501	\$ 6,772,082
Other accounts payable and accrued expenses	5,093,817	9,105,214
Current portion of long term debt	4,355,436	4,380,730
Short term bank credit	5,760,000	33,238
Deferred revenues	5,204,867	7,826,178
<i>Total current liabilities</i>	<u>25,247,621</u>	<u>28,117,442</u>
<b>LONG TERM LIABILITIES:</b>		
Contractual and accrued Israeli statutory severance pay	7,406,330	7,051,630
Long term portion of debt	13,417,500	16,934,360
Deferred income tax liability	6,802,928	6,117,021
Other long term liabilities	239,219	163,446
<i>Total long-term liabilities</i>	<u>27,865,977</u>	<u>30,266,457</u>
<i>Total liabilities</i>	<u>53,113,598</u>	<u>58,383,899</u>
<b>STOCKHOLDERS' EQUITY:</b>		
Share capital –		
Common stock – \$0.01 par value each;		
Authorized: 50,000,000 shares as of September 30, 2015 and December 31, 2014;		
Issued and outstanding: 24,697,335 shares and 24,533,121 shares as of September 30, 2015 and December 31, 2014, respectively	246,974	245,331
Preferred shares – \$0.01 par value each;		
Authorized: 1,000,000 shares as of September 30, 2015 and December 31, 2014;		
No shares issued or outstanding as of September 30, 2015 and December 31, 2014	–	–
Additional paid-in capital	246,444,430	245,970,742
Accumulated deficit	(182,953,229)	(179,609,611)
Notes receivable from stockholders	(908,054)	(908,054)
Accumulated other comprehensive income	551,021	657,040
<i>Total stockholders' equity</i>	<u>63,381,142</u>	<u>66,355,448</u>
<i>Total liabilities and stockholders' equity</i>	<u>\$ 116,494,740</u>	<u>\$ 124,739,347</u>

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

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

	<b>Nine months ended September 30,</b>		<b>Three months ended September 30,</b>	
	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
Revenues	\$ 69,160,381	\$ 74,995,339	\$ 23,289,448	\$ 24,783,353
Cost of revenues	49,005,379	49,682,017	16,254,419	16,775,556
Research and development expenses	3,288,003	2,857,144	943,189	925,186
Selling and marketing expenses	3,810,662	4,180,519	1,187,872	1,202,966
General and administrative expenses	13,165,943	11,606,038	4,089,442	3,799,772
Amortization of intangible assets	2,286,384	1,828,635	720,117	867,452
Total operating costs and expenses	<u>71,556,371</u>	<u>70,154,353</u>	<u>23,195,039</u>	<u>23,570,932</u>
Operating income (loss)	<u>(2,395,990)</u>	<u>4,840,986</u>	<u>94,409</u>	<u>1,212,421</u>
Other income (expense)	839,772	288,252	(105,709)	58,831
Financial expense, net	<u>(887,771)</u>	<u>(1,098,755)</u>	<u>(316,766)</u>	<u>(416,107)</u>
Total other expense	<u>(47,999)</u>	<u>(810,503)</u>	<u>(422,475)</u>	<u>(357,276)</u>
Income (loss) before income tax expense	<u>(2,443,989)</u>	<u>4,030,483</u>	<u>(328,066)</u>	<u>855,145</u>
Income tax expense	899,629	855,178	289,905	476,617
Net income (loss)	<u>(3,343,618)</u>	<u>3,175,305</u>	<u>(617,971)</u>	<u>378,528</u>
Other comprehensive income, net of income tax:				
Foreign currency translation adjustment	<u>(106,019)</u>	<u>(648,740)</u>	<u>(489,365)</u>	<u>(749,849)</u>
Comprehensive income (loss)	<u>\$ (3,449,637)</u>	<u>\$ 2,526,565</u>	<u>\$ (1,107,336)</u>	<u>\$ (371,321)</u>
Basic net income (loss) per share	<u>\$ (0.14)</u>	<u>\$ 0.15</u>	<u>\$ (0.03)</u>	<u>\$ 0.02</u>
Diluted net income (loss) per share	<u>\$ (0.14)</u>	<u>\$ 0.15</u>	<u>\$ (0.03)</u>	<u>\$ 0.02</u>
Weighted average number of shares used in computing basic net income (loss) per share	<u>23,452,773</u>	<u>20,998,023</u>	<u>23,684,904</u>	<u>23,137,808</u>
Weighted average number of shares used in computing diluted net income (loss) per share	<u>23,452,773</u>	<u>21,600,763</u>	<u>23,684,904</u>	<u>23,740,548</u>

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

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

	<b>Nine months ended September 30,</b>	
	<b>2015</b>	<b>2014</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ (3,343,618)	\$ 3,175,305
<i>Adjustments required to reconcile net income (loss) to net cash provided by (used in) operating activities:</i>		
Amortization of intangible assets	2,286,384	1,828,635
Depreciation	1,376,036	1,116,599
Deferred tax provision	685,907	448,169
Stock based compensation	475,330	393,187
(Gain) loss on dispositions, net	(782,659)	5,039
<i>Changes in operating assets and liabilities:</i>		
Unbilled receivables	5,235,597	(761,405)
Trade receivables, net	1,422,092	154,201
Severance payable	83,639	189,758
Inventories, net	(162,571)	(90,303)
Other accounts receivable and prepaid expenses	(368,649)	132,593
Trade payables	(1,938,581)	(3,111,745)
Deferred revenues	(2,621,311)	(719,917)
Other accounts payable and accrued expenses	(3,935,623)	(291,197)
<b><i>Net cash provided by (used in) operating activities</i></b>	<b><u>(1,588,027)</u></b>	<b><u>2,468,919</u></b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from sale of property and equipment	895,000	–
Increase in restricted collateral deposits	783	256,882
Purchase of property and equipment	(1,352,805)	(1,298,505)
Acquisition of UEC	–	(29,113,655)
Additions to capitalized software	(350,942)	(65,790)
<b><i>Net cash used in investing activities</i></b>	<b><u>\$ (807,964)</u></b>	<b><u>\$ (30,221,068)</u></b>

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

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

	<b>Nine months ended September 30,</b>	
	<b>2015</b>	<b>2014</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repayment of long term debt	\$ (3,542,154)	\$ (1,727,317)
Change in short term bank credit	5,726,762	1,511,903
Proceeds from long term debt	–	22,500,000
Proceeds from sale of common stock, net	–	10,698,173
<i>Net cash provided by financing activities</i>	<u>2,184,608</u>	<u>32,982,759</u>
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(211,383)	5,230,610
<b>CASH DIFFERENCES DUE TO EXCHANGE RATE CHANGES</b>	(55,050)	(249,292)
<b>CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD</b>	11,291,784	5,821,325
<b>CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD</b>	<u>\$ 11,025,351</u>	<u>\$ 10,802,643</u>
<b>SUPPLEMENTARY INFORMATION ON NON-CASH TRANSACTIONS:</b>		
Common stock issued in acquisition of UEC	\$ –	\$ 4,216,000
<b>SUPPLEMENTARY CASH FLOW INFORMATION:</b>		
Interest paid during the period	\$ 746,681	\$ 606,997
Taxes paid on income during the period	594,652	249,374

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

**NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**NOTE 1: BASIS OF PRESENTATION**

a. Company:

Arotech Corporation (“Arotech”) and its wholly-owned subsidiaries (the “Company”) provide defense and security products for the military, law enforcement, 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; Epsilon-Electric Fuel Ltd. (“Epsilon-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 that has, as of April 30, 2015, been relocated from Auburn, Alabama to UEC’s facilities in Hanahan, South Carolina (Power Systems Division).

b. Basis of presentation:

The accompanying interim condensed consolidated financial statements have been prepared by Arotech Corporation in accordance with generally accepted accounting principles for interim financial information, with the instructions to Form 10-Q and with Article 10 of Regulation S-X, and include the accounts of Arotech Corporation and its subsidiaries. Certain information and footnote disclosures, normally included in complete financial statements prepared in accordance with generally accepted accounting principles, have been condensed or omitted. In the opinion of the Company, the unaudited financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of its financial position at September 30, 2015, its operating results for the nine- and three-month periods ended September 30, 2015 and 2014, and its cash flows for the nine-month periods ended September 30, 2015 and 2014.

The results of operations for the nine and three months ended September 30, 2015 are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year ending December 31, 2015.

The balance sheet at December 31, 2014 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. These condensed consolidated financial statements should be read in conjunction with the audited financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014.

c. 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.

As of our last annual impairment test as of December 31, 2014, the Company determined that the goodwill for both reporting units was not impaired. During 2015, the Power Systems reporting unit incurred losses from operations that were attributable to discrete events that management considers to be temporary in nature. Consistent with previous interim reporting periods, the Company monitors qualitative and quantitative factors, including internal projections, periodic forecasts, and actual results of the reporting unit. Based upon this interim review, the Company does not believe that the goodwill or our indefinite-lived intangible assets attributable to the Power Systems reporting unit are impaired.



The Company also periodically considers its current market capitalization compared to the sum of the estimated fair values of its reporting units in conjunction with each impairment assessment. Consistent with our last annual impairment test as of December 31, 2014, management does not believe that the market capitalization of the Company is 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 its value; and

d. Reclassification:

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

e. Contingencies

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

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

f. Certain relationships and related transactions

Officer loans: On February 9, 2000, one of the Company's officers exercised 9,404 stock options. This officer paid the exercise price of the stock options and certain taxes that the Company paid on his behalf by giving the Company a non-recourse promissory note due in 2025 in the amount of \$329,163, bearing annual interest at 1% over the then-current federal funds rate announced from time to time by the Wall Street Journal, secured by the shares of the Company's common stock acquired through the exercise of the options and certain compensation due to this officer upon termination. As of September 30, 2015 and December 31, 2014, 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.

Consulting agreement with Sampen Corporation: The Company has a second amended and restated consulting agreement with Sampen Corporation that it executed in November 2014. Sampen is a New York corporation owned by members of the immediate family of one of the Company's officers, and this officer is an employee of both the Company and of Sampen. The term of this consulting agreement is until December 31, 2017.

Pursuant to the terms of the Company's amended and restated agreement with Sampen, Sampen provides one of its employees to the Company for such employee to serve as the Company's President and Chief Executive Officer. The Company pays Sampen \$8,960 per month, plus an annual bonus, on a sliding scale, in an amount equal to a minimum of 25% of Sampen's annual base compensation then in effect if the results the Company actually attains for the year in question are 100% or more of the amount the Company budgeted at the beginning of the year, up to a maximum of 75% of Sampen's annual base compensation then in effect if the results the Company actually attains for the year in question are 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.

g. Accounting for stock-based compensation:

For the nine months ended September 30, 2015 and 2014 the compensation expense recorded related to restricted stock units and restricted shares was \$475,000 and \$393,000, respectively. The remaining total compensation cost related to share awards not yet recognized in the statements of comprehensive income as of September 30, 2015 was \$391,000. The weighted average period over which this compensation cost is expected to be recognized is approximately one and one-half years. Income tax expense was not impacted since the Company is in a net operating loss position. There were no new options issued in the first nine months of 2015 and there are no outstanding issued options. The Company's directors received their annual restricted stock grants on April 1, 2015 in accordance with the terms of the directors' stock compensation plan.

h. Anti-dilutive shares for EPS calculation

All contingent and non-vested restricted stock and non-vested restricted stock units have been excluded from the calculation of the basic earnings per common share because all such securities do not participate in losses for the periods presented and have been excluded from the calculation of diluted earnings per common share as the effect would be anti-dilutive. The Company has excluded any restricted stock or restricted stock units that will never vest under the current program. The total weighted average number of shares related to the outstanding options excluded from the calculations of basic and diluted net income per share for the nine-month periods ended September 30, 2015 and 2014 were 1,009,602 and none, respectively.

**NOTE 2: FAIR VALUE MEASUREMENT**

The carrying value of short term assets and liabilities in the accompanying condensed consolidated balance sheets for cash and cash equivalents, restricted collateral deposits, trade receivables, unbilled receivables, inventories, prepaid and other assets, trade payables, accrued expenses, deferred revenues and other liabilities as of September 30, 2015 and December 31, 2014, approximate fair value because of the short maturity of these instruments. The carrying amounts of long term debt approximates the estimated fair values at September 30, 2015, based upon the Company's ability to acquire similar debt at similar maturities.

**NOTE 3: INVENTORIES**

Inventories are stated at the lower of cost or market value. Cost is determined using the average cost method or the FIFO method. The Company periodically evaluates the quantities on hand relative to current and historical selling prices and historical and projected sales volume. Based on these evaluations, provisions are made in each period to write down inventory to its net realizable value. Inventory write-offs are provided to cover risks arising from slow-moving items, technological obsolescence, excess inventories, and for market prices lower than cost. Inventories in the Training and Simulation and Power Systems Divisions are as follows:

	<b>September 30, 2015</b>	<b>December 31, 2014</b>
	(Unaudited)	
Raw and packaging materials	\$ 7,844,765	\$ 8,195,623
Work in progress	1,105,125	683,083
Finished products	1,024,464	933,077
Total:	<u>\$ 9,974,354</u>	<u>\$ 9,811,783</u>

**NOTE 4: SEGMENT INFORMATION**

a. The Company and its subsidiaries operate primarily in two business segments and are also treated by the Company as reporting units for goodwill impairment testing purposes. The goodwill amounts associated with each of these reporting units was determined and valued when the specific businesses in the reportable segment were purchased.

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

b. The following is information about reported segment revenues, income (losses) and total assets for the nine and three months ended September 30, 2015 and 2014:

	<b>Training and Simulation Division</b>	<b>Power Systems Division</b>	<b>Corporate Expenses</b>	<b>Total Company</b>
<b>Nine months ended September 30, 2015</b>				
Revenues from customers	\$ 40,160,933	\$ 28,999,448	\$ –	\$ 69,160,381
Depreciation and amortization expense <sup>(1)</sup>	(640,842)	(3,002,255)	(19,323)	(3,662,420)
Direct expenses <sup>(2)</sup>	(32,671,082)	(30,925,166)	(3,457,931)	(67,054,179)
Segment net income (loss)	\$ 6,849,009	\$ (4,927,973)	\$ (3,477,254)	\$ (1,556,218)
Financial income (expense)	(42,851)	33,955	(878,875)	(887,771)
Income tax expense	(200,425)		(699,204)	(899,629)
Net income (loss)	\$ 6,605,733	\$ (4,894,018)	\$ (5,055,333)	\$ (3,343,618)
Segment assets <sup>(3)</sup>	\$ 58,050,229	\$ 58,058,399	\$ 386,112	\$ 116,494,740
Additions to long-lived assets	\$ 891,849	\$ 807,396	\$ 4,502	\$ 1,703,747
<b>Nine months ended September 30, 2014</b>				
Revenues from customers	\$ 41,877,991	\$ 33,117,348	\$ –	\$ 74,995,339
Depreciation and amortization expense <sup>(1)</sup>	(558,081)	(2,372,141)	(15,012)	(2,945,234)
Direct expenses <sup>(2)</sup>	(32,886,293)	(28,229,098)	(5,805,476)	(66,920,867)
Segment net income (loss)	\$ 8,433,617	\$ 2,516,109	\$ (5,820,488)	\$ 5,129,238
Financial income (expense)	(32,157)	(130,987)	(935,611)	(1,098,755)
Income tax expense	(101,570)	(13,810)	(739,798)	(855,178)
Net income (loss)	\$ 8,299,890	\$ 2,371,312	\$ (7,495,897)	\$ 3,175,305
Segment assets <sup>(3)</sup>	\$ 59,172,772	\$ 66,906,744	\$ 395,350	\$ 126,474,866
Additions to long-lived assets	\$ 728,556	\$ 29,848,785	\$ 2,956	\$ 30,580,297
<b>Three months ended September 30, 2015</b>				
Revenues from customers	\$ 13,838,250	\$ 9,451,198	\$ –	\$ 23,289,448
Depreciation and amortization expense <sup>(1)</sup>	(225,820)	(947,199)	(6,917)	(1,179,936)
Direct expenses <sup>(2)</sup>	(10,642,181)	(10,178,926)	(1,299,705)	(22,120,812)
Segment net income (loss)	\$ 2,970,249	\$ (1,674,927)	\$ (1,306,622)	\$ (11,300)
Financial income (expense)	(18,010)	19,791	(318,517)	(316,766)
Income tax expense	(21,949)		(267,956)	(289,905)
Net income (loss)	\$ 2,930,290	\$ (1,655,166)	\$ (1,893,095)	\$ (617,971)
<b>Three months ended September 30, 2014</b>				
Revenues from customers	\$ 13,000,538	\$ 11,782,815	\$ –	\$ 24,783,353
Depreciation and amortization expense <sup>(1)</sup>	(191,066)	(1,094,069)	(4,574)	(1,289,709)
Direct expenses <sup>(2)</sup>	(10,147,054)	(10,493,007)	(1,582,331)	(22,222,392)
Segment net income (loss)	\$ 2,662,418	\$ 195,739	\$ (1,586,905)	\$ 1,271,252
Financial expense	(14,712)	(118,055)	(283,340)	(416,107)
Income tax expense	(36,059)	(10)	(440,548)	(476,617)
Net income (loss)	\$ 2,611,647	\$ 77,674	\$ (2,310,793)	\$ 378,528

<sup>(1)</sup> Includes depreciation of property and equipment and amortization expenses of intangible assets.

<sup>(2)</sup> Including, *inter alia*, sales and marketing, general and administrative.

<sup>(3)</sup> Out of those amounts, goodwill in the Company's Training and Simulation and Power Systems Divisions totaled \$24,435,641 and \$20,935,609, respectively, as of September 30, 2015 and \$24,435,641 and \$21,295,345, respectively, as of September 30, 2014.

**NOTE 5: BANK FINANCING**

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

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

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

In addition, the Company also maintains a 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) less (e) cash held on account with the Bank 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.

Effective September 30, 2015, the requirement that the Company maintain a minimum fixed charge coverage ratio of 1.25 to 1.00 related to its Amended Credit Agreement was waived by Fifth Third Bank. As of September 30, 2015 and as of the date of this filing, the Company was in compliance with all of its bank covenants.

Pursuant to the requirements of the Amended Credit Agreement, the Company was required to deliver an Interest Rate Swap agreement fixing the interest rate of 1.37% on approximately \$9.0 million of the outstanding term loans associated with the acquisition of UEC. Accordingly, in April 2014, the Company entered into an interest rate swap for a notional amount of \$9.0 million. The expiration date of this interest rate swap is April 1, 2019. The fair value of the interest rate swap liability \$74,000 and \$51,000 at September 30, 2015 and December 31, 2014, respectively. The liability is included in accrued expenses and the change in fair value is recorded through financial expenses.

**NOTE 6: COMMON STOCK REPURCHASE PROGRAM**

In February 2009, the Company's Board of Directors authorized the repurchase in the open market or in privately negotiated transactions of up to \$1.0 million of the Company's common stock. The repurchase program was extended in August 2015 for an additional year and the authorization expanded repurchase up to \$2.0 million of the Company's common stock. Through September 30, 2015, the Company repurchased 738,611 shares for a total of \$1,084,060, net of commissions. There were no shares repurchased during the three months ended September 30, 2015. The repurchase program, which expires on August 10, 2016, is subject to management's discretion.

**NOTE 7: PRO FORMA FINANCIAL INFORMATION**

In April 2014, the Company entered into a membership interest 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 of 2014 to \$2.5 million in accrued expenses and zero in long term liabilities since the 2014 earn-out was 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 were 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 \$29.2 million, (ii) 775,000 shares of the Company's common stock, valued at \$4.2 million, and (iii) contingent consideration with an estimated fair value at April 1, 2014 of \$4.5 million.

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	<u>\$ 37,922,245</u>

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

## Pro forma financial information

The following pro forma data for the nine months ended September 30, 2014 is 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.

	<b>Nine Months Ended September 30, 2014</b>
Revenues	\$ 87,546,334
Income – before income tax	\$ 6,716,086
Net income	\$ 5,860,908
Basic net income per share	\$ 0.28
Diluted net income per share	\$ 0.27
Weighted average number of shares used in computing basic net income per share	21,256,356
Weighted average number of shares used in computing diluted net income per share	21,859,096

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.

**NOTE 8: SALE OF BUILDING**

In March 2007, the Company 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 was payable over ten years in equal monthly installments based on a 20-year amortization of the full principal amount, and the remaining half was 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, the Company sold the building to the current tenant for \$925,000, resulting in a gain, net of fees, of \$895,000 which was recorded in other income on the income statement. On that same date, the existing mortgage and existing building sub lease were terminated which ended any obligation the Company had for this property.

**NOTE 9: IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS**

In September 2015, the FASB issued ASU No. 2015-16, *Business Combination (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments*. This change eliminates the requirement to restate prior period financial statements for measurement period adjustments following a business combination and requires that the cumulative impact of a measurement period adjustment (including the impact on prior periods) be recognized in the reporting period in which the adjustment is identified. The prior period impact of the adjustment should be either presented separately on the face of the income statement or disclosed in the notes. The ASU is effective for financial statements issued for fiscal years beginning 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 April 2015, the FASB issued ASU No. 2015-03, *Simplifying the Presentation of Debt Issuance Costs (Topic 835-30)* and in August issued ASU 2015-15, *Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements*. These ASUs require the presentation of debt issuance costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of such costs is reported as interest expense. This change conforms the presentation with that of debt discounts. In the case of debt issuance costs associated with a line-of-credit arrangement, the SEC does not object to classifying these costs as an asset and amortizing the deferred issuance costs over the life of the line-of-credit arrangement. The ASU is effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2015; early adoption is permitted. The guidance is required to be applied retrospectively to all prior periods. The Company does not expect that the adoption of this standard will have a material effect on its financial statements.

In August 2015, the FASB issued ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*. This ASU formally deferred the implementation date of ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* from annual reporting periods beginning after December 15, 2016 to annual reporting periods beginning after December 15, 2017. The ASU 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. The Company is currently evaluating the requirements of ASU 2014-09 and has not yet determined its impact on the Company's consolidated financial statement or its adoption method.

In July 2015, the FASB issued ASU No. 2015-11, *Simplifying the Measurement of Inventory (Topic 330)*. ASU No. 2015-11 eliminates the notions of replacement cost and net realizable value less a normal profit margin. This change is intended to simplify the accounting for inventory. This ASU is effective for annual reporting periods beginning after December 15, 2016, and for interim periods within fiscal years beginning after December 15, 2017. Early adoption is permitted. The guidance is required to be applied prospectively and will be accounted for as a change in accounting principle. The Company does not expect that the adoption of this standard will have a material effect on its financial statements.

For information about previous new accounting pronouncements and the potential impact on the Company's Consolidated Financial Statements, see Note 2 of the Notes to Consolidated Financial Statements in the Company's 2014 Form 10-K.

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

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

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

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

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

### **Executive Summary**

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

For comparative purposes, the results for the nine-month period ended September 30, 2014, includes only six months of operations of UEC Electronics, LLC ("UEC"), a South Carolina-based company that we purchased on April 1, 2014.



**Overview of Results of Operations**

Revenues decreased \$5.9 million, down 7.9% to \$69.1 million during the nine months ended September 30, 2015 from \$75.0 million during the nine months ended September 30, 2014. For the three months ended September 30, 2015, revenues were down \$1.5 million or 6.0% to \$23.3 million from \$24.8 million during the three months ended September 30, 2014. The decrease in revenues is primarily attributable to delays in existing customer programs in our Power Systems Division.

Income from operations decreased \$7.2 million to a loss of \$2.4 million during the nine months ended September 30, 2015 from income of \$4.8 million during the nine months ended September 30, 2014. For the three months ended September 30, 2015, income from operations decreased \$1.1 million to \$94,000 from \$1.2 million for the three months ended September 30, 2014. Coupled with delays in existing customer programs, the Power Systems Division incurred incremental expenses related to the closure, move, and production of parts that were previously manufactured in Alabama that are now being produced in South Carolina as well as incremental amortization expense resulting from the acquisition of the UEC business.

Net income decreased \$6.5 million to a net loss of \$3.3 million for the nine months ended September 30, 2015 from net income of \$3.2 million for the nine months ended September 30, 2014. For the three months ended September 30, 2015, net income decreased \$997,000 to a net loss of \$617,000 from net income of \$379,000 for the three months ended September 30, 2014. In addition to those matters outlined above, for the nine month period ended September 30, 2015, other expense decreased \$763,000 to \$48,000 from \$811,000 for the nine months ended September 30, 2014. This is primarily due to income generated from the sale of the land and buildings associated with our former Armor business in Alabama.

**Overview of Operating Performance and Backlog**

Overall, our income (loss) from continuing operations before income tax expense for the nine months ended September 30, 2015 was (\$2.4) million on revenues of \$69.2 million, compared to \$4.0 million on revenues of \$75.0 million during the nine months ended September 30, 2014. As of September 30, 2015, our overall backlog totaled \$61.1 million compared to \$74.1 million in the third quarter of 2014.

In our Training and Simulation Division, revenues decreased from approximately \$41.9 million in the first nine months of 2014 to \$40.2 million in the first nine months of 2015. As of September 30, 2015, our backlog for our Training and Simulation Division totaled \$30.1 million compared to \$50.8 million in the third quarter of 2014.

In our Power Systems Division, revenues decreased from approximately \$33.1 million in the first nine months of 2014 to approximately \$29.0 million in the first nine months of 2015. As of September 30, 2015, our backlog for our Power Systems Division totaled \$31.0 million, compared to \$23.4 million in the third quarter of 2014.

The table below details the percentage of total recognized revenue by type of arrangement for the nine months ended September 30, 2015 and 2014:

Type of Revenue	Nine months ended September 30,	
	2015	2014
Sale of products	93.5%	94.8%
Maintenance and support agreements	5.5%	3.5%
Long term research and development contracts	1.0%	1.7%
Total	100.0%	100.0%

## Functional Currency

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

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

## Results of Operations

### *Three months ended September 30, 2015 compared to the three months ended September 30, 2014.*

**Revenues.** Revenues for the three months ended September 30, 2015 totaled \$23.3 million, compared to \$24.8 million in the comparable period in 2014, a decrease of \$1.5 million, or 6.0%. In the third quarter of 2015, revenues were \$13.8 million for the Training and Simulation Division (compared to \$13.0 million in the third quarter of 2014, an increase of \$838,000, or 6.4%, due primarily to the timing of contracts); and \$9.5 million for the Power Systems Division (compared to \$11.8 million in the third quarter of 2014, a decrease of \$2.3 million, or 19.8%, due primarily to delays on existing customer programs).

**Cost of revenues.** Cost of revenues totaled \$16.3 million during the third quarter of 2015, compared to \$16.8 million in the third quarter of 2014, a decrease of \$521,000, or 3.1%, due primarily to lower costs associated with decreased revenues. Cost of revenues was \$8.3 million for the Training and Simulation Division (compared to \$7.9 million in the third quarter of 2014, an increase of \$402,000, or 5.1%, due primarily to incremental costs associated with increased revenues); and \$7.9 million for the Power Systems Division (compared to \$8.9 million in the third quarter of 2014, a decrease of \$923,000, or 10.4%, due primarily to lower costs associated with decreased revenues and incremental costs incurred related to the closure and relocation of the EFB operations from Alabama to South Carolina).

**Research and development expenses.** Research and development expenses for the third quarter of 2015 were \$943,000, compared to \$848,000 during the third quarter of 2014, an increase of \$95,000, or 11.2%, due primarily to increased product development activities in our Power Systems Division.

**Selling and marketing expenses.** Selling and marketing expenses for the third quarter of 2015 were \$1.2 million, compared to \$1.2 million in the third quarter of 2014.

**General and administrative expenses.** General and administrative expenses for the third quarter of 2015 were \$4.1 million, compared to \$3.8 million in the third quarter of 2014, an increase of \$290,000, or 7.6%, due primarily to additional personnel costs and incremental costs associated with the transition our Alabama operations to South Carolina.

**Amortization of intangible assets.** Amortization of intangible assets totaled \$720,000 in the third quarter of 2015, compared to \$867,000 in the third quarter of 2014, a decrease of \$147,000, or 17.0%, due primarily to certain intangible assets related to the UEC acquisition that are subject to a short asset life.

**Other income (expense), net.** Other expense totaled (\$106,000) in the third quarter of 2015, compared to income of \$59,000 in the third quarter of 2014, a decrease of \$165,000, due primarily to an insurance settlement received in the third quarter of 2014.

**Financial expense, net.** Financial expense totaled \$317,000 in the third quarter of 2015, compared to financial expense of \$416,000 in the third quarter of 2014, a decrease of \$99,000, or 23.9%, due primarily to non-recurring bank charges incurred in the third quarter of 2014 related to our acquisition of UEC.

**Income taxes.** We recorded \$290,000 in tax expense in the third quarter of 2015, compared to \$477,000 in tax expense in the third quarter of 2014, a decrease of \$187,000, or 39.2% primarily due to lower alternative minimum tax resulting from lower profitability.

**Net loss.** Due to the factors cited above, we went from a net income of \$379,000 in the third quarter of 2014 to a net loss of \$618,000 in the third quarter of 2015, a decrease of \$997,000.

***Nine months ended September 30, 2015 compared to the nine months ended September 30, 2014.***

**Revenues.** Revenues for the nine months ended September 30, 2015 totaled \$69.2 million, compared to \$75.0 million in the first nine months of 2014, a decrease of \$5.8 million, or 7.8%. In the first nine months of 2015, revenues were \$40.2 million for the Training and Simulation Division (compared to \$41.9 million in the first nine months of 2014, a decrease of \$1.7 million, or 4.1%, due primarily to the timing of contracts); and \$29.0 million for the Power Systems Division (compared to \$33.1 million in the first nine months of 2014), a decrease of \$4.1 million or 12.4% due primarily to delays on existing customer programs).

**Cost of revenues.** Cost of revenues totaled \$49.0 million during the first nine months of 2015, compared to \$49.7 million in the first nine months of 2014, a decrease of \$677,000, or 1.4%, due primarily to lower costs associated with lower revenues. Cost of revenues were \$25.0 million for the Training and Simulation Division (compared to \$25.6 million in the first nine months of 2014, a decrease of \$608,000, or 2.4%, also due primarily to lower costs associated with lower revenues); and \$24.0 million for the Power Systems Division (compared to \$24.1 million in the first nine months of 2014) a decrease of \$69,000 or less than 1%, due primarily to lower costs associated with decreased revenues and incremental costs incurred related to the closure and relocation of the EFB operations from Alabama to South Carolina).

**Research and development expenses.** Research and development expenses for the first nine months of 2015 were \$3.3 million, compared to \$2.9 million during the first nine months of 2014, an increase of \$431,000, or 15.1%, due primarily to increased product development activities in our Power Systems Division.

**Selling and marketing expenses.** Selling and marketing expenses for the first nine months of 2015 were \$3.8 million, compared to \$4.2 million in the first nine months of 2014, a decrease of \$370,000, or 8.8%, due primarily to the reduction in headcount and marketing efforts associated with the EFB operation.

**General and administrative expenses.** General and administrative expenses for the first nine months of 2015 were \$13.2 million, compared to \$11.6 million in the first nine months of 2014, an increase of \$1.6 million, or 13.4%, due primarily to having had nine months of UEC operations in 2015 compared to six months in 2014.

**Amortization of intangible assets.** Amortization of intangible assets totaled \$2.3 million for the first nine months of 2015, compared to \$1.8 million for the first nine months of 2014, an increase of \$458,000, or 25.0%, due primarily to having nine months of amortization expense related to UEC intangible assets in 2015 compared to six months in 2014.

**Other income, net.** Other income totaled \$840,000 in the first nine months of 2015, compared to \$288,000 in the first nine months of 2014, an increase of \$552,000, due primarily to the sale of land and buildings associated with our former Armor business in Alabama.

**Financial expense, net.** Financial expense totaled \$888,000 in the first nine months of 2015, compared to financial expense of \$1.1 million in the first nine months of 2014, a decrease of \$212,000, or 19.2%, primarily due to non-recurring fees associated with the financing of the UEC acquisition in 2014.

**Income taxes.** We recorded \$900,000 in tax expense in the first nine months of 2015, compared to \$855,000 in tax expense in the first nine months of 2014, an increase of \$45,000, or 5.2%, primarily due to additional tax being generated in our Training and Simulation Division at the state and local level.

**Net loss.** Due to the factors cited above, we went from a net income of \$3.2 million in the first nine months of 2014 to a net loss of \$3.3 million in the first nine months of 2015, a difference of \$6.5 million.

## **Liquidity and Capital Resources**

As of September 30, 2015, we had \$11.0 million in cash and \$236,000 in restricted collateral deposits, as compared to December 31, 2014, when we had \$11.3 million in cash and \$236,000 in restricted collateral deposits. We also had \$6.6 million in available, unused bank lines of credit with our main bank as of September 30, 2015, under a \$15.0 million credit facility under our FAAC subsidiary.

We used available funds in the nine months ended September 30, 2015 primarily for working capital needs and investment in fixed assets. We purchased approximately \$1.4 million of fixed assets during the nine months ended September 30, 2015. Our net fixed assets amounted to \$6.3 million at quarter end.

Net cash provided by (used in) operating activities for the nine months ended September 30, 2015 and 2014 was (\$1.6) million and \$2.5 million, respectively, a net change of \$4.1 million. This difference was due primarily to the operating loss in the first nine months of 2015.

Net cash used in investing activities for the nine months ended September 30, 2015 and 2014 was \$808,000 and \$30.2 million, respectively, a net change of \$29.4 million. This difference was due primarily to the acquisition of UEC on April 1, 2014.

Net cash provided by financing activities for the nine months ended September 30, 2015 and 2014 was \$2.2 million and \$33.0 million, respectively, a net change of \$30.8 million. The difference primarily related to the financing of the acquisition of UEC.

As of September 30, 2015, we had approximately \$5.8 million in short-term bank debt under our credit facility and \$17.8 million in long-term loans outstanding, which included \$4.4 million in current debt and \$13.4 million in long term debt. This is in comparison to December 31, 2014, when we had a negligible amount of short-term bank debt and \$21.3 million in long-term debt outstanding.

Effective September 30, 2015, the requirement that the Company maintain a minimum fixed charge coverage ratio of 1.25 to 1.00 related to its Amended Credit Agreement was waived by Fifth Third Bank. As of September 30, 2015 and as of the date of this filing, the Company was in compliance with all of its bank covenants.

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

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

### **Foreign Currency Exchange Rate Risk**

Since a significant part of our sales and expenses are denominated in U.S. dollars, we have experienced only minor foreign exchange gains and losses to date, and do not expect to incur significant gains and losses in 2015. Certain of our research, development and production activities are carried out by our Israeli subsidiary, Epsilor-EFL, at its facility in Beit Shemesh, and accordingly we have sales and expenses in NIS. Additionally, our Epsilor-EFL subsidiary operates primarily in NIS. However, the majority of our sales are made outside Israel in U.S. dollars, and a substantial portion of our costs are incurred in U.S. dollars. Therefore, our functional currency is the U.S. dollar.

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

## **ITEM 4. CONTROLS AND PROCEDURES.**

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

**PART II**

**ITEM 1A. RISK FACTORS.**

For information regarding our risk factors, please refer to Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2014. We do not believe that there have been any material changes in the risk factors disclosed in the Annual Report on Form 10-K.

**ITEM 6. EXHIBITS.**

The following documents are filed as exhibits to this report:

<b>Exhibit Number</b>	<b>Description</b>
31.1	<a href="#"><u>Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u></a>
31.2	<a href="#"><u>Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u></a>
32.1	<a href="#"><u>Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u></a>
32.2	<a href="#"><u>Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u></a>
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 Presentation Linkbase Document

**SIGNATURES**

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

Dated: November 9, 2015

**AROTECH CORPORATION**

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

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



CERTIFICATION

I, Steven Esses, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Arotech Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this quarterly report based on such evaluation; and
  - (d) disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Dated: November 9, 2015

/s/ Steven Esses

---

Steven Esses, President and CEO  
(Principal Executive Officer)

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

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



**CERTIFICATION**

I, Thomas J. Paup, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Arotech Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this quarterly report based on such evaluation; and
  - (d) disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Dated: November 9, 2015

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

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

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

**WRITTEN STATEMENT**

In connection with the Quarterly Report of Arotech Corporation (the "Company") on Form 10-Q for the quarterly period ended September 30, 2015 filed with the Securities and Exchange Commission (the "Report"), I, Steven Esses, President and Chief Executive Officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that to my knowledge, the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Report fairly presents, in all material respects, the consolidated financial condition of the Company and its subsidiaries as of the dates presented and the consolidated results of operations of the Company and its subsidiaries for the periods presented.

Dated: November 9, 2015

/s/ Steven Esses

Steven Esses, President and CEO  
(Principal Executive Officer)

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

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

**WRITTEN STATEMENT**

In connection with the Quarterly Report of Arotech Corporation (the “Company”) on Form 10-Q for the quarterly period ended September 30, 2015 filed with the Securities and Exchange Commission (the “Report”), I, Thomas J. Paup, Senior Vice President – Finance and Chief Financial Officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that to my knowledge, the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Report fairly presents, in all material respects, the consolidated financial condition of the Company and its subsidiaries as of the dates presented and the consolidated results of operations of the Company and its subsidiaries for the periods presented.

Dated: November 9, 2015

/s/ Thomas J. Paup

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

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

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