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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED **September 30, 2016**.

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:

Non-accelerated filer:

(Do not check if a smaller reporting company)

Accelerated filer:

Smaller reporting company:

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

The number of shares outstanding of the issuer's common stock as of November 7, 2016 was 26,438,224.

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

	September 30, 2016	December 31, 2015
	(Unaudited)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 10,322,578	\$ 10,608,420
Restricted collateral deposits	235,292	89,985
Trade receivables	17,226,850	17,401,479
Unbilled receivables	11,709,032	12,132,484
Other accounts receivable and prepaid expenses	2,403,509	1,007,358
Inventories	10,569,742	9,607,836
Current assets of discontinued operations	40,000	–
<i>Total current assets</i>	<u>52,507,003</u>	<u>50,847,562</u>
LONG TERM ASSETS:		
Contractual and Israeli statutory severance pay fund	4,787,795	5,370,755
Other long term receivables	24,301	23,403
Property and equipment, net	6,010,908	6,385,238
Other intangible assets, net	7,197,744	9,334,730
Goodwill	45,627,221	45,463,027
Long term assets of discontinued operations	307,957	68,301
<i>Total long term assets</i>	<u>63,955,926</u>	<u>66,645,454</u>
<i>Total assets</i>	<u>\$ 116,462,929</u>	<u>\$ 117,493,016</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)

	September 30, 2016	December 31, 2015
	(Unaudited)	
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	\$ 4,693,744	\$ 5,914,042
Other accounts payable and accrued expenses	4,808,672	5,560,040
Current portion of long term debt	1,664,831	4,362,438
Short term bank credit	7,409,208	4,060,000
Deferred revenues	5,808,304	6,879,815
Current liabilities of discontinued operations	524,052	–
<i>Total current liabilities</i>	24,908,811	26,776,335
LONG TERM LIABILITIES:		
Contractual and accrued Israeli statutory severance pay	7,215,612	7,497,685
Long term portion of debt	9,164,244	11,856,522
Deferred income tax liability	7,639,489	7,031,564
Other long term liabilities	93,914	264,244
Long term liabilities of discontinued operations	55,678	19,295
<i>Total long-term liabilities</i>	24,168,937	26,669,310
<i>Total liabilities</i>	49,077,748	53,445,645
STOCKHOLDERS' EQUITY:		
Share capital –		
Common stock – \$0.01 par value each;		
Authorized: 50,000,000 shares as of September 30, 2016 and December 31, 2015;		
Issued and outstanding: 26,438,224 shares and 24,697,335 shares as of		
September 30, 2016 and December 31, 2015, respectively	264,382	246,973
Preferred shares – \$0.01 par value each;		
Authorized: 1,000,000 shares as of September 30, 2016 and December 31, 2015;		
No shares issued or outstanding as of September 30, 2016 and December 31, 2015	–	–
Additional paid-in capital	250,312,743	246,591,415
Accumulated deficit	(183,362,456)	(182,554,637)
Notes receivable from stockholders	(908,054)	(908,054)
Accumulated other comprehensive income	1,078,566	671,674
<i>Total stockholders' equity</i>	67,385,181	64,047,371
<i>Total liabilities and stockholders' equity</i>	\$ 116,462,929	\$ 117,493,016

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

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

	Nine Months ended September 30,		Three months ended September 30,	
	2016	2015	2016	2015
Revenues	\$ 71,486,478	\$ 69,160,381	\$ 24,300,120	\$ 23,289,448
Cost of revenues	48,933,171	49,005,379	16,436,276	16,254,419
Research and development expenses	2,367,964	2,697,121	752,847	680,414
Selling and marketing expenses	4,913,076	3,810,662	1,458,622	1,187,872
General and administrative expenses	11,149,640	12,270,493	3,122,853	4,089,442
Amortization of intangible assets	2,164,937	2,286,384	698,297	720,117
Total operating costs and expenses	<u>69,528,788</u>	<u>70,070,039</u>	<u>22,468,895</u>	<u>22,932,264</u>
Operating income (loss)	1,957,690	(909,658)	1,831,225	357,184
Other income (expense)	49,913	(55,678)	3,481	(105,709)
Financial expense, net	(769,328)	(887,771)	(227,474)	(316,766)
Total other expense	(719,415)	(943,449)	(223,993)	(422,475)
Income (loss) from continuing operations before income tax expense	1,238,275	(1,853,107)	1,607,232	(65,291)
Income tax expense	684,272	899,629	101,992	289,905
Income (loss) from continuing operations	554,003	(2,752,736)	1,505,240	(355,196)
Loss from discontinued operations	(1,361,787)	(590,882)	(869,302)	(262,775)
Net income (loss)	(807,784)	(3,343,618)	635,938	(617,971)
Other comprehensive income (loss), net of income tax:				
Foreign currency translation adjustment	406,892	(106,019)	344,837	(489,365)
Comprehensive income (loss)	<u>\$ (400,892)</u>	<u>\$ (3,449,637)</u>	<u>\$ 980,775</u>	<u>\$ (1,107,336)</u>
Income (loss) per share of common stock:				
Basic – continuing operations	\$ 0.02	\$ (0.12)	\$ 0.06	\$ (0.02)
Basic – discontinued operations	\$ (0.05)	\$ (0.02)	\$ (0.04)	\$ (0.01)
Basic net income (loss) per share	<u>\$ (0.03)</u>	<u>\$ (0.14)</u>	<u>\$ 0.02</u>	<u>\$ (0.03)</u>
Diluted – continuing operations	\$ 0.02	\$ (0.12)	\$ 0.06	\$ (0.02)
Diluted – discontinued operations	\$ (0.05)	\$ (0.02)	\$ (0.04)	\$ (0.01)
Diluted net income (loss) per share	<u>\$ (0.03)</u>	<u>\$ (0.14)</u>	<u>\$ 0.02</u>	<u>\$ (0.03)</u>
Weighted average number of shares used in computing basic net income (loss) per share	<u>26,125,819</u>	<u>23,452,773</u>	<u>26,215,049</u>	<u>23,684,904</u>
Weighted average number of shares used in computing diluted net income (loss) per share	<u>26,125,819</u>	<u>23,452,773</u>	<u>26,215,049</u>	<u>23,684,904</u>

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

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

	Nine months ended September 30,	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (807,784)	\$ (3,343,618)
<i>Adjustments required to reconcile net loss to net cash used in operating activities:</i>		
Amortization of intangible assets	2,164,937	2,286,384
Depreciation	1,322,595	1,376,036
Deferred tax provision	607,925	685,907
Stock based compensation	785,738	475,330
(Gain) on dispositions, net	–	(782,659)
<i>Changes in operating assets and liabilities:</i>		
Unbilled receivables	433,010	5,235,597
Trade receivables	372,779	1,422,092
Severance payable	436,682	83,639
Inventories	(819,411)	(162,571)
Other accounts receivable and prepaid expenses	(1,420,274)	(368,649)
Trade payables	(1,166,222)	(1,938,581)
Deferred revenues	(1,071,511)	(2,621,311)
Other accounts payable and accrued expenses	(341,418)	(3,935,623)
<i>Net cash provided by (used in) operating activities</i>	497,046	(1,588,027)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of property and equipment	–	895,000
Increase (decrease) in restricted collateral deposits	(139,192)	783
Purchase of property and equipment	(1,108,356)	(1,352,805)
Additions to capitalized software	(27,951)	(350,942)
<i>Net cash used in investing activities</i>	(1,275,499)	(807,964)

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

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

	Nine months ended September 30,	
	2016	2015
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of long term debt	\$ (16,380,225)	\$ (3,542,154)
Change in short term bank credit	3,349,208	5,726,762
Proceeds from long term debt	11,000,000	–
Proceeds from the issuance of common stock	2,952,999	–
<i>Net cash provided by financing activities</i>	921,982	2,184,608
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	143,529	(211,383)
CASH DIFFERENCES DUE TO EXCHANGE RATE CHANGES	(429,371)	(55,050)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	10,608,420	11,291,784
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	<u>\$ 10,322,578</u>	<u>\$ 11,025,351</u>
SUPPLEMENTARY CASH FLOW INFORMATION:		
Interest paid during the period	\$ 574,547	\$ 746,681
Taxes paid on income during the period	111,441	594,652

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) in Dimona, Israel (in Israel’s Negev desert area) and Sderot, Israel (near the Gaza Strip) (Power Systems Division); UEC Electronics, LLC (“UEC”), a South Carolina limited liability company located 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, 2016, its operating results for the nine and three month periods ended September 30, 2016 and 2015, and its cash flows for the nine-month periods ended September 30, 2016 and 2015. The results of operations for the nine and three months ended September 30, 2016 are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year ending December 31, 2016.

The balance sheet at December 31, 2015 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, 2015.

c. Asset Held for Sale and Discontinued Operations

In August 2016, the Board approved a strategic shift to discontinue the Flow Battery segment (“the segment”) with an effective date of August 31, 2016. The principal activities of the Flow Battery segment were research and development related and were focused on developing a commercial application based upon the Iron Flow Storage concept. In connection with the discontinuance of the operations, management has developed a plan to sell the assets to a third party for future development. Management believes that the Company will be able to execute the plan within the next 12 months.

The amounts presented in the condensed consolidated statement of comprehensive income as discontinued operations represent research and development and general and administrative expenses. As the Flow Battery segment is reported within the Epsilon-EFL legal entity and the legal entity has net operating loss carryforwards for which the Company has recorded a valuation allowance, there is no tax impact. Included in Flow Battery segment’s general and administrative expenses for the three month period ended September 30, 2016, is a contractual buyout associated with the termination of the Chairman of the Flow Battery segment of \$524,052.

The impact of the discontinued operations on operating and investing activities within the consolidated statement of cash flows for the nine months ended September 30, 2016 and 2015 was \$511,366 and \$11,186; and (\$230,587) and (\$22,075), respectively.

The assets and liabilities of the Flow Battery segment have been classified as held for sale as of September 30, 2016 and December 31, 2015. These amounts consist of the following carrying values in each major class.

	September 30, 2016	December 31, 2015
	(Unaudited)	
ASSETS		
Current Assets	\$ 40,000	\$ –
Property and equipment, net	262,317	55,032
Long-term assets	45,640	13,269
Total assets	\$ 347,957	\$ 68,301
LIABILITIES		
Other accounts payable and accrued expenses	\$ 524,052	\$ –
Long term liabilities	55,678	19,295
Total liabilities	\$ 579,730	\$ 19,295

Unless otherwise indicated, discontinued operations are not included in the reported results. The Notes to the Condensed Consolidated Financial Statements relate to the Company’s continuing operations.

d. 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. The Training and Simulation and the Power Systems reporting units have goodwill.

As of its last annual impairment test as of December 31, 2015, the Company determined that the goodwill for both reporting units was not impaired.

In concluding that goodwill for the Company’s Power Systems reporting unit was not impaired at December 31, 2015, the Company determined the fair value of the reporting unit using a discounted cash flow model (“DCF model”). The DCF model includes projections of future cash flows and assumptions in relation to future short-term and long-term growth rates and weighted average cost of capital (“WACC”). Inherent in the valuation at December 31, 2015, were key variables, including the WACC and the terminal growth rates of approximately 12% and 3%, respectively. With all other assumptions remaining constant, if either the WACC increased by 0.5% or the terminal growth rate decreased by 0.5%, the Company may have determined that proceeding to step 2 of the impairment analysis, as indicated in ASC 350-10, was necessary.

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 goodwill or its indefinite-lived intangible assets attributable to the Power Systems reporting unit are impaired.

e. Reclassification:

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

f. Contingencies

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

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

g. Certain relationships and related transactions

1. **Related party loans:** On February 9, 2000, one of the Company's former officers exercised 9,404 stock options. This former 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. As of September 30, 2016 and December 31, 2015, the aggregate amount outstanding pursuant to this promissory note was \$452,995. Additionally, there is another former employee with the same arrangement with an outstanding promissory note of \$455,059.

2. **Consulting agreement with Admiralty Partners:** On February 3, 2016, the Company entered into a consulting agreement with Admiralty Partners, a business controlled by a member of the Board of Directors, for a period of three years. In exchange, the Company will pay an annual fee equal to the difference between total accrued compensation of the Board member and \$125,000. The agreement can be terminated by either party upon sufficient written notice.

h. Accounting for stock-based compensation:

For the three months ended September 30, 2016 and 2015, the compensation expense recorded related to restricted stock units and restricted shares was \$137,252 and \$140,735, respectively. For the nine months ended September 30, 2016 and 2015, the compensation expense recorded related to restricted stock units and restricted shares was \$410,738 and \$475,330, respectively. The remaining total compensation cost related to share awards not yet recognized in the statements of comprehensive income as of September 30, 2016 was \$389,340. 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.

Additionally, on February 2, 2016, the Company and an investor (the "Investor") entered into a Stock Purchase Agreement (the "Investment Agreement") providing for the sale to the Investor of a total of 1,500,000 shares of the Company's common stock at a price valued at \$1.99 per share. As the Investor was also given the right to nominate a member of the Board of Directors pursuant to the terms of the Investment Agreement, and the shares were issued at a discount to the then market price, this resulted in additional stock compensation expense of \$375,000 recorded in general and administrative expenses in the condensed consolidated statement of comprehensive income.

i. Anti-dilutive shares for EPS calculation

When the Company reports a loss from continuing operations, all non-vested restricted stock and non-vested restricted stock units classified as participating are excluded from the calculation of the basic and diluted earnings per common share because all such securities are not contractually obligated to participate in losses. The total weighted average number of shares related to the outstanding non-vested stock and non-vested restricted stock units excluded from the calculations of basic and diluted net income per share for the three and nine month periods ended September 30, 2016 and 2015 were none and 1,009,602, respectively.

NOTE 2: FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS

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, and other assets, trade payables, accrued expenses, and other liabilities as of September 30, 2016 and December 31, 2015, approximate fair value because of the short maturity of these instruments. The carrying amounts of long term debt and contractual severance approximates the estimated fair values at September 30, 2016, based upon the Company's ability to acquire similar debt or fulfill similar obligations 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 at September 30, 2016 and December 31, 2015 were the following:

	September 30, 2016	December 31, 2015
	(Unaudited)	
Raw and packaging materials	\$ 9,255,796	\$ 8,184,476
Work in progress	665,412	760,585
Finished products	648,534	662,775
Total:	<u>\$ 10,569,742</u>	<u>\$ 9,607,836</u>

NOTE 4: SEGMENT INFORMATION

a. The Company and its subsidiaries operate primarily in two business segments. The two segments are also treated by the Company as reporting units for goodwill impairment evaluation purposes. The goodwill amounts associated with the Training and Simulation Division and the Power Systems Division were determined and valued when the specific businesses 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 or loss 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) from continuing operations and total assets for the nine and three months ended September 30, 2016 and 2015:

	Training and Simulation Division	Power Systems Division	Corporate Expenses	Total Company
Nine Months ended September 30, 2016				
Revenues from outside customers	\$ 36,519,124	\$ 34,967,354	\$ –	\$ 71,486,478
Depreciation, amortization and impairment expenses ⁽¹⁾	(825,178)	(2,649,545)	(12,809)	(3,487,532)
Direct expenses ⁽²⁾	<u>(29,218,054)</u>	<u>(32,217,155)</u>	<u>(4,556,134)</u>	<u>(65,991,343)</u>
Segment operating income (loss)	\$ 6,475,892	\$ 100,654	\$ (4,568,943)	\$ 2,007,603
Financial expense	(29,593)	(58,858)	(680,877)	(769,328)
Income tax benefit (expense)	51,285	(127,632)	(607,925)	(684,272)
Income (loss) from continuing operations	\$ 6,497,584	\$ (85,836)	\$ (5,857,745)	\$ 554,003
Segment assets ⁽³⁾	<u>\$ 46,650,797</u>	<u>\$ 61,131,101</u>	<u>\$ 8,681,031</u>	<u>\$ 116,462,929</u>
Additions to long-lived assets	<u>\$ 236,866</u>	<u>\$ 668,854</u>	<u>\$ –</u>	<u>\$ 905,720</u>
Nine Months ended September 30, 2015				
Revenues from outside customers	\$ 40,160,933	\$ 28,999,448	\$ –	\$ 69,160,381
Depreciation, amortization and impairment expenses ⁽¹⁾	(640,842)	(3,002,255)	(19,323)	(3,662,420)
Direct expenses ⁽²⁾	<u>(32,671,082)</u>	<u>(30,334,284)</u>	<u>(3,457,931)</u>	<u>(66,463,297)</u>
Segment operating income (loss)	\$ 6,849,009	\$ (4,337,091)	\$ (3,477,254)	\$ (965,336)
Financial income (expense)	(42,851)	33,955	(878,875)	(887,771)
Income tax expense	(200,425)	–	(699,204)	(899,629)
Income (loss) from continuing operations	\$ 6,605,733	\$ (4,303,136)	\$ (5,055,333)	\$ (2,752,736)
Segment assets ⁽³⁾⁽⁴⁾	<u>\$ 58,050,229</u>	<u>\$ 57,992,723</u>	<u>\$ 386,112</u>	<u>\$ 116,429,064</u>
Additions to long-lived assets	<u>\$ 891,849</u>	<u>\$ 785,321</u>	<u>\$ 4,502</u>	<u>\$ 1,681,672</u>

Three months ended September 30, 2016

Revenues from outside customers	\$ 11,871,987	\$ 12,428,133	\$ –	\$ 24,300,120
Depreciation, amortization and impairment expenses ⁽¹⁾	(276,151)	(874,163)	(2,552)	(1,152,866)
Direct expenses ⁽²⁾	(8,795,338)	(11,451,439)	(1,065,771)	(21,312,548)
Segment operating income (loss)	\$ 2,800,498	\$ 102,531	\$ (1,068,323)	\$ 1,834,706
Financial expense	(14,782)	(23,830)	(188,862)	(227,474)
Income tax benefit (expense)	144,915	(18,271)	(228,636)	(101,992)
Income (loss) from continuing operations	<u>\$ 2,930,631</u>	<u>\$ 60,430</u>	<u>\$ (1,485,821)</u>	<u>\$ 1,505,240</u>

Three months ended September 30, 2015

Revenues from outside customers	\$ 13,838,250	\$ 9,451,198	\$ –	\$ 23,289,448
Depreciation, amortization and impairment expenses ⁽¹⁾	(225,820)	(947,199)	(6,917)	(1,179,936)
Direct expenses ⁽²⁾	(10,642,181)	(9,916,151)	(1,299,705)	(21,858,037)
Segment operating income (loss)	\$ 2,970,249	\$ (1,412,152)	\$ (1,306,622)	\$ 251,475
Financial income (expense)	(18,010)	19,761	(318,517)	(316,766)
Income tax expense	(21,949)	–	(267,956)	(289,905)
Income (loss) from continuing operations	<u>\$ 2,930,290</u>	<u>\$ (1,392,391)</u>	<u>\$ (1,893,095)</u>	<u>\$ (355,196)</u>

- (1) Includes depreciation of property and equipment and amortization expenses of intangible assets.
- (2) Including, *inter alia*, sales and marketing, general and administrative.
- (3) Out of those amounts, goodwill in the Company’s Training and Simulation and Power Systems Divisions totaled \$24,435,641 and \$21,191,580, respectively, as of September 30, 2016 and \$24,435,641 and \$20,935,609, respectively, as of September 30, 2015.
- (4) Includes segment assets from continuing operations.

NOTE 5: BANK FINANCING

The Company maintains credit facilities with JPMorgan Chase Bank, N.A. (“Chase”), whereby Chase provides (i) a \$15,000,000 revolving credit facility (“Revolver”), (ii) a \$10,000,000 Term Loan (the “Term Loan”), and (iii) a \$1,000,000 Mortgage Loan (the “Mortgage Loan” and, together with the Revolver and the Term Loan, the “Credit Facilities”) in respect of certain property located in Ann Arbor, Michigan.

The maturity of the Revolver is March 11, 2021. The Revolver maintains an interest rate on a scale ranging from LIBOR plus 1.75% up to LIBOR plus 3.00%. The balance at September 30, 2016 and December 31, 2015 was \$7,409,208 and \$4,060,000, respectively.

The maturity of the Term Loan is March 11, 2021. The Term Loan maintains an interest rate on a scale ranging from LIBOR plus 2.0% up to LIBOR plus 3.25%. The repayment of the Term Loan will consist of 60 consecutive monthly payments of principal plus accrued interest based on annual principal reductions of 10% during the first year, 20% during the second through fourth years, and 30% during the fifth year. The balance at September 30, 2016 and December 31, 2015 was \$9,845,740 and \$15,316,046, respectively.

The maturity of the Mortgage Loan is March 11, 2021 and maintains an interest rate on a scale identical to the Term Loan. The monthly payments on the Mortgage Loan are \$5,555 in principal plus accrued interest, with a balloon payment due at the end of month 60. The balance at September 30, 2016 and December 31, 2015 was \$983,335 and \$902,914, respectively.

The Credit Facilities maintain certain reporting requirements, conditions precedent, affirmative covenants and financial covenants. The Company is required to maintain certain financial covenants that include a Maximum Debt to EBITDA ratio of 3.00 to 1.00 and a Minimum Fixed Charge Coverage Ratio of 1.20 to 1.00. The Company was in compliance with its covenants as of September 30, 2016.

The Credit Facilities are secured by the Company’s assets and the assets of the Company’s subsidiaries.

NOTE 6: SALE OF BUILDING

On February 9, 2015, the Company sold a building used for its now-discontinued Armor Division in Auburn, Alabama to the current tenant for \$925,000, resulting in a gain, net of fees, of \$895,000 which was recorded in general and administrative expenses on the condensed consolidated statement of comprehensive income. On that same date, the existing mortgage and existing building sublease were terminated which ended any obligation the Company had for this property.

NOTE 7: IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In August 2015, the Financial Accounting Standards Board (“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 has subsequently been enhanced and clarified for ease in the application of the standard. 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 February 2016, the FASB issued ASU No. 2016-02, *Leases*. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is currently evaluating the impact of its pending adoption of the new standard on its consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, *Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. The new standard introduces targeted amendments intended to simplify the accounting for stock compensation. Among other things, the ASU requires all excess tax benefits and tax deficiencies to be recognized as income tax expense or benefit in the income statement. The amendments are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The Company is currently evaluating the impact of its pending adoption of the new standard on its consolidated 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 2015 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," "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" 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. 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 are organized into two operational 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**.

Discontinued Operations

During the quarter ended September 30, 2016, the Board of Directors approved a plan to discontinue the Flow Battery segment. The discontinuance is a strategic shift that has and will have a major effect on the Company's operations and financial results; therefore, the results of the Flow Battery segment have been reclassified as discontinued operations for all periods presented.

The financial results of the Company are presented as continuing operations in the Consolidated Financial Statements for all periods presented. See Note 1 – Asset Held for Sale and Discontinued Operations. The loss from discontinued operations reported for the nine and three month periods ended September 30, 2016 and 2015 are \$1.4 million and \$591,000; and \$869,000 and \$263,000 respectively. The impact of the discontinued operations on operating and investing activities within the consolidated statement of cash flows for the nine months ended September 30, 2016 and 2015 was \$511,366 and \$11,186; and (\$230,587) and (\$22,075), respectively.

The absence of the losses from the Flow Battery segment is anticipated to improve financial results, liquidity, and loan covenants.

Overview of Pre-Tax Results of Continuing Operations

Through the first nine months of 2016 as compared to 2015, our revenues increased \$2.3 million to \$71.5 million. This was as a result of revenue growth in our Power Systems Division. For the first nine months of 2016, we reported income from continuing operations of \$1.2 million as compared to a loss from operations for the first nine months of 2015 of \$1.9 million. Included in the income from operations in 2016 is incremental stock compensation expense of \$375,000 related to a non-recurring issuance of common stock during the nine months ended September 30, 2016.

Included in the 2015 loss from operations of \$1.9 million was a non-recurring expense reduction of \$895,000 related to the sale of a building used in our former Armor Division, partially offset by non-recurring costs of \$803,000 related to the transition and move of our former Alabama operations to UEC based in South Carolina.

Excluding these significant non-recurring items, our income from operations improved \$3.6 million during the first nine months of 2016 as compared to 2015. This was primarily attributable to increased revenues and operating performance in our Power Systems Division.

Overview of Operating Performance and Backlog

Overall, our pre-tax income for the nine months ended September 30, 2016 was \$1.2 million on revenues of \$71.5 million, compared to pre-tax loss of \$1.9 million on revenues of \$69.2 million during the nine months ended September 30, 2015. Our overall backlog for the third quarter of 2016 totaled \$55.0 million, compared to \$61.1 million in the third quarter of 2015.

In our Training and Simulation Division, revenues for the nine months ended September 30, 2016 were \$36.5 million, compared to \$40.2 million in the first nine months of 2015. As of September 30, 2016, our backlog for our Training and Simulation Division totaled \$22.0 million, compared to \$30.1 million in the third quarter of 2015.

In our Power Systems Division, revenues for the nine months ended September 30, 2016 were \$35.0 million, compared to \$29.0 million in the first nine months of 2015. As of September 30, 2016, our backlog for our Power Systems Division totaled \$33.0 million, compared to \$31.0 million in the third quarter of 2015.

The table below details the percentage of total recognized revenue by type of arrangement for the nine months ended September 30, 2016 and 2015:

Type of Revenue	Nine Months ended September 30,	
	2016	2015
Sale of products	95.3%	93.5%
Maintenance and support agreements	4.4%	5.5%
Long term research and development contracts	0.3%	1.0%
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 are in New Israeli Shekels ("NIS") and a substantial portion of Epsilon's costs are 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 loss in stockholders' equity.

Results of Continuing Operations

Three months ended September 30, 2016 compared to the three months ended September 30, 2015.

Revenues. Revenues for the three months ended September 30, 2016 totaled \$24.3 million, compared to \$23.3 million in the comparable period in 2015, an increase of \$1.0 million, or 4.3%. In the third quarter of 2016, revenues were \$11.8 million for the Training and Simulation Division as compared to \$13.8 million in the third quarter of 2015, a decrease of \$2.0 million, or 14.2%, due primarily to lower revenues in our Vehicle Simulation product area; and \$12.4 million for the Power Systems Division, as compared to \$9.5 million in the third quarter of 2015, an increase of \$2.9 million, or 31.5%, due primarily to higher revenues generated both in the Israeli and U.S. operations of our Power Systems Division.

Cost of revenues. Cost of revenues totaled \$16.4 million during the third quarter of 2016 as compared to \$16.3 million in the third quarter of 2015, an increase of \$100,000, or 1.1%. Cost of revenues were \$6.1 million for the Training and Simulation Division as compared to \$8.3 million in the third quarter of 2015, a decrease of \$2.2 million, or 26.9%, due primarily to lower costs associated with lower Vehicle Simulation revenues; and \$10.4 million for the Power Systems Division as compared to \$7.9 million in the third quarter of 2015, an increase of \$2.5 million, or 30.4%, due primarily to higher costs associated with higher revenues.

Research and development expenses. Research and development expenses for the third quarter of 2016 were \$753,000 compared to \$680,000 during the third quarter of 2015, an increase of \$72,000, or 10.6%.

Selling and marketing expenses. Selling and marketing expenses for the third quarter of 2016 were \$1.5 million, compared to \$1.2 million in the third quarter of 2015, an increase of \$300,000, or 22.8%, due primarily to increased focus on selling and marketing activities in the U.S. operations of our Power Systems Division as well as increases in sales and marketing staff costs in our Training and Simulation Division.

General and administrative expenses. General and administrative expenses for the third quarter of 2016 were \$3.1 million, compared to \$4.1 million in the third quarter of 2015, a decrease of \$1.0 million, or 23.6%, due primarily to improved cost efficiencies in Corporate and in the U.S. operations of our Power Systems Division.

Amortization of intangible assets. Amortization of intangible assets totaled \$698,000 in the third quarter of 2016, compared to \$720,000 in the third quarter of 2015, a decrease of \$22,000, or 3.0%.

Financial expense, net. Financial expense totaled \$227,000 in the third quarter of 2016, compared to financial expense of \$317,000 in the third quarter of 2015, a decrease of \$90,000, or 28.2%, due primarily to less interest expense incurred as a result of less debt outstanding and more favorable interest rates in 2016 as compared to 2015.

Income taxes. We recorded \$102,000 in tax expense in the third quarter of 2016, compared to \$290,000 in tax expense in the third quarter of 2015, a decrease of \$188,000 or 64.8%. This expense also includes “naked” credits (“naked” credits occur when deferred tax liabilities that are created by indefinite-lived assets, such as goodwill, that cannot be used as a source of taxable income to support the realization of deferred tax assets). The naked tax credit expense was partially offset by lower state income taxes recorded in our Training and Simulation Division during the third quarter of 2016.

Income (loss) from continuing operations. Due to the factors cited above, we went from a loss from continuing operations of \$355,000 in the third quarter of 2015 to income from continuing operations of \$1.5 million in the third quarter of 2016, an improvement of \$1.9 million.

Nine months ended September 30, 2016 compared to the nine months ended September 30, 2015.

Revenues. Revenues for the nine months ended September 30, 2016 totaled \$71.5 million, compared to \$69.2 million in the comparable period in 2015, an increase of \$2.3 million, or 3.4%. In the first nine months of 2016, revenues were \$36.5 million for the Training and Simulation Division as compared to \$40.2 million in the first nine months of 2015, a decrease of \$3.6 million, or 9.1%, due primarily to lower revenues in our Vehicle Simulation product area; and \$35.0 million for the Power Systems Division, as compared to \$29.0 million in the first nine months of 2015, an increase of \$6.0 million, or 20.6%, due primarily to higher revenues generated by the Israeli and U.S. operations of our Power Systems Divisions.

Cost of revenues. Cost of revenues totaled \$48.9 million during the first nine months of 2016 as compared to \$49.0 million in the first nine months of 2015, a decrease of \$100,000, or less than 1.0%, due primarily to lower revenues in our Training and Simulation Division offset by increased spending in our Power Systems Division resulting from higher revenues. Cost of revenues was \$20.7 million for the Training and Simulation Division as compared to \$25.0 million in the first nine months of 2015, a decrease of \$4.3 million, or 17.1%, due primarily to lower costs associated with decreased revenues from our Vehicle Simulation product area; and \$28.3 million for the Power Systems Division as compared to \$24.0 million in the first nine months of 2015, an increase of \$4.3 million, or 17.5%, due primarily to higher revenues generated by our Israeli and U.S. operations of our Power Systems Division.

Research and development expenses. Research and development expenses for the first nine months of 2016 were \$2.4 million compared to \$2.7 million during the first nine months of 2015, a decrease of \$329,000, or 12.2%, due primarily to an increase in funding related to product development activities by our customers in our Power Systems Division.

Selling and marketing expenses. Selling and marketing expenses for the first nine months of 2016 were \$4.9 million, compared to \$3.8 million in the first nine months of 2015, an increase of \$1.1 million, or 28.9%, due primarily to increased focus on selling and marketing activities in the U.S. operations of our Power Systems Division as well as increases in sales and marketing staff costs in our Training and Simulation Division.

General and administrative expenses. General and administrative expenses for the first nine months of 2016 were \$11.1 million, compared to \$12.3 million in the first nine months of 2015, a decrease of \$1.2 million, or 9.1%, due primarily to improved cost efficiencies in Corporate and in the U.S. operations of our Power Systems Division.

Amortization of intangible assets. Amortization of intangible assets totaled \$2.2 million in the first nine months of 2016, compared to \$2.3 million in the first nine months of 2015, a decrease of \$100,000, or 5.3%, due primarily to higher amortization expense being recognized in 2015 pertaining to shorter lived intangible assets.

Financial expense, net. Financial expense totaled \$769,000 in the first nine months of 2016, compared to financial expense of \$888,000 in the first nine months of 2015, a decrease of \$119,000, or 13.3%, due primarily to less interest expense incurred as a result of less debt outstanding and lower interest rates in 2016 as compared to 2015.

Income taxes. We recorded \$684,000 in tax expense in the first nine months of 2016, compared to \$900,000 in tax expense in the first nine months of 2015, a decrease of \$216,000, or 23.9% primarily due to having less tax being generated at the state and local level in 2016 as compared to 2015. This expense also includes “naked” credits (“naked” credits occur when deferred tax liabilities that are created by indefinite-lived assets, such as goodwill, that cannot be used as a source of taxable income to support the realization of deferred tax assets).

Income (loss) from continuing operations. Due to the factors cited above, we went from a loss from continuing operations of \$2.8 million in the first nine months of 2015 to income from continuing operations of \$554,000 in the first nine months of 2016, a difference of \$3.4 million.

Liquidity and Capital Resources

As of September 30, 2016, we had \$10.3 million in cash and \$235,000 in restricted collateral deposits, as compared to December 31, 2015, when we had \$10.6 million in cash and \$90,000 in restricted collateral deposits. We also had \$7.6 million in available, unused bank lines of credit with our main bank as of September 30, 2016, under a \$15.0 million credit facility.

We maintain credit facilities with JPMorgan Chase Bank, N.A. (“Chase”), whereby Chase provides (i) a \$15,000,000 revolving credit facility (“Revolver”), (ii) a \$10,000,000 Term Loan (the “Term Loan”), and (iii) a \$1,000,000 Mortgage Loan (the “Mortgage Loan” and, together with the Revolver and the Term Loan, the “Credit Facilities”) in respect of certain property located in Ann Arbor, Michigan.

The maturity of the Revolver is March 11, 2021. The Revolver maintains an interest rate on a scale ranging from LIBOR plus 1.75% up to LIBOR plus 3.00%.

The maturity of the Term Loan is March 11, 2021. The Term Loan maintains an interest rate on a scale ranging from LIBOR plus 2.0% up to LIBOR plus 3.25%. The repayment of the Term Loan will consist of 60 consecutive monthly payments of principal plus accrued interest based on annual principal reductions of 10% during the first year, 20% during the second through fourth years, and 30% during the fifth year.

The maturity of the Mortgage Loan is March 11, 2021 and maintains an interest rate on a scale identical to the Term Loan. The monthly payments on the Mortgage Loan are \$5,555 in principal plus accrued interest, with a balloon payment due at the end of month 60.

The Credit Facilities maintain certain reporting requirements, conditions precedent, affirmative covenants and financial covenants. We are required to maintain certain financial covenants that include a Maximum Debt to EBITDA ratio of 3.00 to 1.00 and a Minimum Fixed Charge Coverage Ratio of 1.20 to 1.00. We were in compliance with our covenants as of September 30, 2016.

The Credit Facilities are secured by our assets and the assets of our subsidiaries.

We used available funds in the nine months ended September 30, 2016 primarily to improve our capital structure. We received \$3.0 million through the issuance of stock and paid \$5.4 million of long-term debt during the nine months ended September 30, 2016.

Net cash provided by operating activities for the nine months ended September 30, 2016 was \$500,000. Net cash used in operating activities for the nine months ended September 30, 2015 was \$1.6 million, representing a net change year over year of \$2.1 million. This difference was due primarily to improvements in operational results as well as working capital performance.

Net cash used in investing activities for the nine months ended September 30, 2016 was \$1.3 million. Net cash used in investing activities for the nine months ended September 30, 2015 was \$800,000, representing a net change year over year increase of \$500,000. This difference was due primarily to the non-recurring nature of the sale of the building of our former Armor Division during the nine months ended September 30, 2015, offset by lower capital expenditures of \$800,000.

Net cash provided by financing activities for the nine months ended September 30, 2016 was \$900,000. Net cash provided by financing activities for the nine months ended September 30, 2015 was \$2.2 million, representing a year over year net change of \$1.3 million. This change is attributable to a net decrease in cash used to pay long term debt and short term bank credit partially offset by proceeds from issuance of long term debt and common stock.

As of September 30, 2016, we had approximately \$7.4 million in short-term bank debt under our credit facility and \$10.8 million in long-term loans outstanding; which included \$1.7 million in current debt and \$9.1 million in long term debt. This is in comparison to December 31, 2015, when we had \$4.1 million in short-term bank debt under our credit facility and \$16.2 million in long-term debt outstanding, which included \$4.3 million in current debt and \$11.9 million in long term debt.

Subject to all of the reservations regarding “forward-looking statements” set forth above, we believe that our present cash position, anticipated cash flows from operations and lines of credit should be sufficient to satisfy our current estimated cash requirements through the next twelve months. In this connection, we note that from time to time our working capital needs are partially dependent on our and our subsidiaries’ lines of credit.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Interest Rate Risk

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

Foreign Currency Exchange Rate Risk

We conduct our business primarily in U.S. dollars. However, we operate one subsidiary based in Israel in NIS. This subsidiary conducts trading activities, including sales, purchasing, and research and development activities, in NIS. Since a significant part of our sales and expenses are denominated in U.S. dollars, we have historically experienced only minor foreign exchange gains and losses to date, and do not expect to incur significant gains and losses in 2016.

However, given that some of our agreements are denominated in foreign currencies, this 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 6. EXHIBITS.

The following documents are filed as exhibits to this report:

Exhibit Number	Description
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
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

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, 2016

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, 2016

/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, 2016

/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, 2016 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, 2016

/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, 2016 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, 2016

/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.