AROTECH CORP
Form 10-Q
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

T QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED June 30, 2013 .

Commission file number: 0-23336

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

| | |
|---|---|
| Delaware<br>(State or other jurisdiction of incorporation or organization) | 95-4302784<br>(I.R.S. Employer Identification No.) |
| 1229 Oak Valley Drive, Ann Arbor, Michigan<br>(Address of principal executive offices) | 48108<br>(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 T 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 T 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: T
(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 T

The number of shares outstanding of the issuer's common stock as of August 5, 2013 was 16,291,773.

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PART I

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

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

| | June 30, 2013 | December 31, 2012 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $953,295 | $1,580,627 |
| Restricted collateral deposits | 491,431 | 186,306 |
| Trade receivables | 19,628,085 | 9,639,709 |
| Unbilled receivables | 8,579,192 | 13,374,004 |
| Other accounts receivable and prepaid expenses | 1,003,018 | 1,178,780 |
| Inventories | 9,803,771 | 10,033,525 |
| Discontinued operations – short term | 77,761 | 389,272 |
| Total current assets | 40,536,553 | 36,382,223 |
| LONG TERM ASSETS: | | |
| Severance pay fund | 4,655,083 | 4,177,488 |
| Other long term receivables | 70,154 | 55,156 |
| Property and equipment, net | 5,153,389 | 4,464,580 |
| Other intangible assets, net | 1,655,551 | 2,238,273 |
| Goodwill | 30,757,037 | 30,562,298 |
| Total long term assets | 42,291,214 | 41,497,795 |
| Total assets | $82,827,767 | $77,880,018 |

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

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

| | June 30, 2013 | December 31, 2012 |
|---|---|---|
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Trade payables | $ 6,588,445 | $ 7,156,327 |
| Other accounts payable and accrued expenses | 3,911,854 | 4,252,910 |
| Current portion of long term debt | 55,000 | 888,839 |
| Short term bank credit | 10,215,170 | 9,787,779 |
| Deferred revenues | 7,428,171 | 3,798,086 |
| Discontinued operations – short term | 75,757 | 588,592 |
| Total current liabilities | 28,274,397 | 26,472,533 |
| LONG TERM LIABILITIES: | | |
| Accrued severance pay | 6,685,807 | 6,133,042 |
| Long term portion of debt | 990,000 | 992,917 |
| Deferred tax liability | 5,219,271 | 4,920,021 |
| Other long-term liabilities | 25,941 | 27,590 |
| Discontinued operations – long term | 892,926 | 912,813 |
| Total long-term liabilities | 13,813,945 | 12,986,383 |
| STOCKHOLDERS' EQUITY: | | |
| Share capital – | | |
| Common stock – $0.01 par value each; Authorized: 50,000,000 shares as of June 30, 2013 and December 31, 2012; Issued and outstanding: 16,291,773 shares and 16,151,298 shares as of June 30, 2013 and December 31, 2012, respectively | 162,918 | 161,513 |
| Preferred shares – $0.01 par value each; Authorized: 1,000,000 shares as of June 30, 2013 and December 31, 2012; No shares issued or outstanding as of June 30, 2013 and December 31, 2012 | – | – |
| Additional paid-in capital | 223,347,516 | 223,181,705 |
| Accumulated deficit | (183,367,739) | (185,248,923) |
| Notes receivable from stockholders | (908,054) | (908,054) |
| Accumulated other comprehensive income | 1,504,784 | 1,234,861 |
| Total stockholders' equity | 40,739,425 | 38,421,102 |
| Total liabilities and stockholders' equity | $ 82,827,767 | $ 77,880,018 |

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

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

| | Six months ended June 30, 2013 | Six months ended June 30, 2012 | Three months ended June 30, 2013 | Three months ended June 30, 2012 |
|---|---|---|---|---|
| Revenues | $44,449,973 | $36,480,838 | $22,396,842 | $20,373,130 |
| | | | | |
| Cost of revenues | 32,865,162 | 28,832,494 | 16,088,195 | 17,013,427 |
| Research and development expenses | 1,128,170 | 1,046,961 | 594,785 | 455,808 |
| Selling and marketing expenses | 2,620,258 | 2,613,194 | 1,383,252 | 1,328,301 |
| General and administrative expenses | 4,854,058 | 5,001,385 | 2,466,247 | 2,000,779 |
| Amortization of intangible assets | 550,112 | 601,305 | 273,618 | 299,934 |
| Total operating costs and expenses | 42,017,760 | 38,095,339 | 20,806,097 | 21,098,249 |
| | | | | |
| Operating income (loss) | 2,432,213 | (1,614,501) | 1,590,745 | (725,119) |
| | | | | |
| Other income | 268,682 | 753 | 267,449 | 561 |
| Financial expense, net | (302,879) | (379,000) | (113,742) | (342,164) |
| Total other expense | (34,197) | (378,247) | 153,707 | (341,603) |
| Income (loss) from continuing operations before income tax expense | 2,398,016 | (1,992,748) | 1,744,452 | (1,066,722) |
| | | | | |
| Income tax expense | 428,902 | 397,154 | 254,125 | 199,577 |
| Income (loss) from continuing operations | 1,969,114 | (2,389,902) | 1,490,327 | (1,266,299) |
| Loss from discontinued operations, net of income tax | (87,930) | (1,571,201) | (13,187) | (1,635,361) |
| Net income (loss) | 1,881,184 | (3,961,103) | 1,477,140 | (2,901,660) |
| | | | | |
| Other comprehensive income, net of income tax | | | | |
| Foreign currency translation adjustment | 269,923 | (171,511) | 58,247 | (338,586) |
| Comprehensive income (loss) | $2,151,107 | $(4,132,614) | $1,535,387 | $(3,240,246) |
| | | | | |
| Basic net income/loss per share – continuing operations | $0.13 | $(0.16) | $0.10 | $(0.09) |
| Basic net income/loss per share – discontinued operations | $(0.01) | $(0.11) | $0.00 | $(0.11) |
| Basic net income/loss per share | $0.12 | $(0.27) | $0.10 | $(0.20) |
| | | | | |
| Diluted net income/loss per share – continuing operations | $0.12 | $(0.16) | $0.09 | $(0.09) |
| Diluted net income/loss per share – discontinued operations | $(0.01) | $(0.11) | $0.00 | $(0.11) |
| Diluted net income/loss per share | $0.11 | $(0.27) | $0.09 | $(0.20) |
| Weighted average number of shares used in computing basic net income/loss per share | 15,472,667 | 14,691,577 | 15,554,199 | 14,728,352 |
| Weighted average number of shares used in computing diluted net income/loss per share | 16,075,407 | 14,691,577 | 16,146,939 | 14,728,352 |

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

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

| | Six months ended June 30, 2013 | 2012 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income (loss) | $1,881,184 | $(3,961,103) |
| Adjustments required to reconcile net income (loss) to net cash (used in) provided by operating activities: | | |
| Depreciation | 582,905 | 553,404 |
| Amortization of intangible assets | 550,112 | 601,305 |
| Stock based compensation | 167,215 | 118,574 |
| Deferred tax provision | 299,250 | 299,250 |
| Changes in continuing operating assets and liabilities: | | |
| Severance pay, net | 75,170 | 124,583 |
| Trade receivables | (9,988,376) | 561,722 |
| Other accounts receivable and prepaid expenses | 160,764 | 123,114 |
| Inventories | 229,754 | (873,220) |
| Unbilled receivables | 4,794,812 | (4,421,397) |
| Deferred revenues | 3,630,085 | (80,212) |
| Trade payables | (567,882) | 3,558,298 |
| Other accounts payable and accrued expenses | (342,702) | (350,763) |
| Discontinued operations | (284,934) | 178,263 |
| Net cash provided by (used in) operating activities | 1,187,357 | (3,568,182) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of property and equipment | (1,271,714) | (312,408) |
| Additions to capitalized software development | (3,675) | (159,616) |
| Decrease (increase) in restricted collateral deposits | (305,125) | 1,586,586 |
| Discontinued operations | 44,827 | 30,725 |
| Net cash provided by (used in) investing activities | $(1,535,687) | $1,145,287 |

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

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

| | Six months ended June 30, 2013 | 2012 |
|---|---|---|
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Repayment of current portion of long term debt | $(836,756) | $(13,907) |
| Changes in short term bank credit | 427,391 | 1,922,893 |
| Discontinued operations | (40,374) | (375,649) |
| Net cash provided by (used in) financing activities | (449,739) | 1,533,337 |
| DECREASE IN CASH AND CASH EQUIVALENTS | (798,069) | (889,558) |
| CASH ACCRETION DUE TO EXCHANGE RATE DIFFERENCES | 111,469 | 45,928 |
| NET CHANGE IN CASH AND EQUIVALENTS – DISCONTINUED OPERATIONS | 59,268 | (88,928) |
| CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD | 1,580,627 | 2,324,163 |
| CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD | $953,295 | $1,391,605 |
| SUPPLEMENTARY INFORMATION ON NON-CASH TRANSACTIONS: | | |
| Interest paid during the period | $217,649 | $155,752 |
| Taxes paid on income during the period | $95,900 | $– |

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

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

### NOTE 1: BASIS OF PRESENTATION

a. Company:

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

b. Basis of presentation:

The accompanying interim condensed consolidated financial statements have been prepared by Arotech Corporation in accordance with generally accepted accounting principles for interim financial information, with the instructions to Form 10-Q and with Article 10 of Regulation S-X, and include the accounts of Arotech Corporation and its subsidiaries. Certain information and footnote disclosures, normally included in complete financial statements prepared in accordance with generally accepted accounting principles, have been condensed or omitted. In the opinion of the Company, the unaudited financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of its financial position at June 30, 2013, its operating results for the six- and three-month periods ended June 30, 2013 and 2012, and its cash flows for the six- and three-month periods ended June 30, 2013 and 2012.

The results of operations for the six- and three months ended June 30, 2013 are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year ending December 31, 2013.

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

c. Accounting for stock-based compensation:

For the six months ended June 30, 2013 and 2012 the compensation expense recorded related to restricted stock units and restricted shares was $167,215 and $118,574, respectively. The remaining total compensation cost related to share awards not yet recognized in the income statement as of June 30, 2013 was $329,501, all of which was for restricted stock units and restricted shares that vest on longevity rather than performance. The weighted average period over which this compensation cost is expected to be recognized is approximately two years. Income tax expense was not impacted since the Company is in a net tax operating loss carryforward position. There were no new options issued in the first six months of 2013 and no options were exercised in the first six months of 2013. The Company’s directors received their annual restricted stock grants on April 3, 2013 in accordance with the terms of the directors' stock compensation plan.

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d. Reclassification:

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

e. Anti-dilutive shares for EPS calculation

All outstanding stock options and contingent, non-vested restricted stock have been excluded from the calculation of the basic net income (loss) per common share because all such securities are anti-dilutive for the periods presented and the Company has excluded any restricted stock or restricted stock units that will never vest under the current program. The total weighted average number of shares related to the outstanding options and warrants excluded from the calculations of basic net income (loss) per share for the six-month periods ended June 30, 2013 and 2012 were 614,754 and 667,693, respectively.

f. Discontinued operations

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

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

| ASSETS AND LIABILITIES – DISCONTINUED (unaudited) | June 30, 2013 | December 31, 2012 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $47,280 | $106,548 |
| Restricted collateral deposits | – | 44,827 |
| Trade receivables | – | 164,824 |
| Other accounts receivable and prepaid expenses | 30,481 | 73,073 |
| Total current assets | 77,761 | 389,272 |
| Total assets | $77,761 | $389,272 |
| LIABILITIES | | |
| CURRENT LIABILITIES: | | |
| Trade payables | $6,966 | $75,862 |
| Other accounts payable and accrued expenses | 29,991 | 453,443 |
| Current portion of long term debt | 38,800 | 59,287 |
| Total current liabilities | 75,757 | 588,592 |
| LONG TERM LIABILITIES | | |
| Long term debt (building mortgage) | 892,926 | 912,813 |
| Total long-term liabilities | 892,926 | 912,813 |
| Total liabilities | $968,683 | $1,501,405 |

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| REVENUE AND EXPENSES – DISCONTINUED (unaudited) | Six months ended June 30, 2013 | 2012 |
|---|---|---|
| Revenues | $1,977 | $5,375,503 |
| | | |
| Cost of revenues, exclusive of amortization of intangibles | (2,252) | 4,985,859 |
| Research and development expenses | – | 57,584 |
| Selling and marketing expenses | 1,330 | 302,218 |
| General and administrative expenses | 104,984 | 1,517,669 |
| Total operating costs and expenses | 104,062 | 6,863,330 |
| | | |
| Operating loss | (102,085) | (1,487,827) |
| | | |
| Other income | 55,971 | 53,392 |
| Financial income, net | (40,816) | (136,766) |
| Total other income (expense) | 15,155 | (83,374) |
| Income tax expense | 1,000 | – |
| Net loss | $(87,930) | $(1,571,201) |

NOTE 2: INVENTORIES

Inventories are stated at the lower of cost or market value. Cost is determined using the average cost method or the FIFO method. The Company periodically evaluates the quantities on hand relative to current and historical selling prices and historical and projected sales volume. Based on these evaluations, provisions are made in each period to write down inventory to its net realizable value. Inventory write-offs are provided to cover risks arising from slow-moving items, technological obsolescence, excess inventories, and for market prices lower than cost. In the second quarter of 2013, our Training and Simulation Division recorded an expense of $138,047 for obsolete inventory. Inventories in continuing business segments decreased in total, from December 31, 2012, a decrease of $(341,789) in the Training and Simulation Division offset by an increase of $112,035 in the Battery Division for the product required to fulfill the current backlog. Inventories are composed of the following:

| | June 30, 2013 (Unaudited) | December 31, 2012 |
|---|---|---|
| Raw and packaging materials | $ 7,366,631 | $ 7,455,426 |
| Work in progress | 310,547 | 363,415 |
| Finished products | 2,126,593 | 2,214,684 |
| Total: | $ 9,803,771 | $ 10,033,525 |

NOTE 3: IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

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

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NOTE 4: SEGMENT INFORMATION

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

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

b. The following is information about reported segment revenues, income (losses) and total assets for the six and three months ended June 30, 2013 and 2012:

| | Training and Simulation Division | Battery and Power Systems Division | Corporate Expenses | Discontinued | Total Company |
|---|---|---|---|---|---|
| Six months ended June 30, 2013 | | | | | |
| Revenues from outside customers | $30,474,108 | $13,975,865 | $– | $– | $44,449,973 |
| Depreciation, amortization and impairment expenses(1) | (485,079) | (633,918) | (14,020) | – | (1,133,017) |
| Direct expenses(2) | (25,574,613) | (12,698,023) | (2,343,425) | – | (40,616,061) |
| Segment net income (loss) | $4,414,416 | $643,924 | $(2,357,445) | $– | $2,700,895 |
| Financial expense, net | (17,585) | (34,978) | (250,316) | – | (302,879) |
| Income tax expense | (55,652) | (74,000) | (299,250) | – | (428,902) |
| Net income (loss) continuing operations | $4,341,179 | $534,946 | $(2,907,011) | $– | $1,969,114 |
| Net loss discontinued operations | – | – | – | (87,930) | (87,930) |
| Net income (loss) | $4,341,179 | $534,946 | $(2,907,011) | $(87,930) | $1,881,184 |
| Segment assets(3) | $54,349,090 | $28,270,758 | $130,158 | $77,761 | $82,827,767 |
| Additions to long-lived assets | $114,661 | $1,160,728 | $– | $– | $1,275,389 |
| Six months ended June 30, 2012 | | | | | |
| Revenues from outside customers | $27,400,605 | $9,080,233 | $– | $– | $36,480,838 |
| Depreciation, amortization and impairment expenses(1) | (566,370) | (561,843) | (26,496) | – | (1,154,709) |
| Direct expenses(2) | (25,176,638) | (8,874,885) | (2,888,354) | – | (36,939,877) |
| Segment net income (loss) | $1,657,597 | $(356,495) | $(2,914,850) | $– | $(1,613,748) |
| Financial expense, net | (20,580) | (78,156) | (280,264) | – | (379,000) |
| Income tax expense | (97,904) | – | (299,250) | – | (397,154) |
| Net income (loss) continuing operations | $1,539,113 | $(434,651) | $(3,494,364) | $– | $(2,389,902) |
| Net loss discontinued operations | – | – | – | (1,571,201) | (1,571,201) |
| Net income (loss) | $1,539,113 | $(434,651) | $(3,494,364) | $(1,571,201) | $(3,961,103) |
| Segment assets(3) | $52,396,629 | $23,269,717 | $208,262 | $2,989,645 | $78,864,253 |
| Additions to long-lived assets | $312,503 | $159,521 | $– | $– | $472,024 |

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| | Training and Simulation Division | Battery and Power Systems Division | Corporate Expenses | Discontinued | Total Company |
|---|---|---|---|---|---|
| Three months ended June 30, 2013 | | | | | |
| Revenues from outside customers | $14,794,917 | $7,601,925 | $– | $– | $22,396,842 |
| Depreciation, amortization and impairment expenses(1) | (241,084) | (314,176) | (6,501) | – | (561,761) |
| Direct expenses(2) | (12,148,150) | (6,600,975) | (1,227,762) | – | (19,976,887) |
| Segment net income (loss) | $2,405,683 | $686,774 | $(1,234,263) | $– | $1,858,194 |
| Financial income (expense), net | (10,646) | 26,463 | (129,559) | – | (113,742) |
| Income tax expense | (30,500) | (74,000) | (149,625) | – | (254,125) |
| Net income (loss) continuing operations | $2,364,537 | $639,237 | $(1,513,447) | $– | $1,490,327 |
| Net loss discontinued operations | – | – | – | (13,187) | (13,187) |
| Net income (loss) | $2,364,537 | $639,237 | $(1,513,447) | $(13,187) | $1,477,140 |
| Three months ended June 30, 2012 | | | | | |
| Revenues from outside customers | $16,467,067 | $3,906,063 | $– | $– | $20,373,130 |
| Depreciation, amortization and impairment expenses(1) | (286,607) | (282,592) | (11,132) | – | (580,331) |
| Direct expenses(2) | (15,104,097) | (4,300,458) | (1,112,802) | – | (20,517,357) |
| Segment net income (loss) | $1,076,363 | $(676,987) | $(1,123,934) | $– | $(724,558) |
| Financial expense, net | (7,125) | (135,826) | (199,213) | – | (342,164) |
| Income tax expense | (49,952) | – | (149,625) | – | (199,577) |
| Net income (loss) continuing operations | $1,019,286 | $(812,813) | $(1,472,772) | $– | $(1,266,299) |
| Net loss discontinued operations | – | – | – | (1,635,361) | (1,635,361) |
| Net income (loss) | $1,019,286 | $(812,813) | $(1,472,772) | $(1,635,361) | $(2,901,660) |

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

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

(3) Out of those amounts, goodwill in the Company's Training and Simulation and Battery and Power Systems Divisions totaled $24,435,641 and $6,321,396, respectively, as of June 30, 2013 and $24,435,641 and $5,829,929, respectively, as of June 30, 2012.

NOTE 5: FAIR VALUE MEASUREMENT

The carrying value of short term assets and liabilities in the accompanying condensed consolidated balance sheets for cash and cash equivalents, restricted collateral deposits, trade receivables, unbilled receivables, inventories, prepaid and other assets, trade payables, accrued expenses, deferred revenues and other liabilities as of June 30, 2013 and December 31, 2012, approximate fair value because of the short maturity of these instruments. The carrying amounts of long term debt approximates the estimated fair values at June 30, 2013, based upon the Company's ability to acquire similar debt at similar maturities

NOTE 6: COMMON STOCK REPURCHASE PROGRAM

In February 2009, the Company's Board of Directors authorized the repurchase in the open market or in privately negotiated transactions of up to $1.0 million of the Company's common stock. Through June 30, 2013, the Company repurchased 638,611 shares for a total of $869,931. The repurchase program, which expires on August 13, 2013, is subject to management's discretion.

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

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

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

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

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

### Executive Summary

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

- Ø we develop, manufacture and market advanced high-tech multimedia and interactive digital solutions for use-of-force training and operator training of military, law enforcement, security and other personnel (our Training and Simulation Division); and

- Ø we manufacture and sell lithium and Zinc-Air batteries for defense and security products, including our Soldier Wearable Integrated Power Equipment System (SWIPES)™ power hubs, along with other military and commercial applications (our Battery and Power Systems Division).

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

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

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Overview of Results of Operations

Acquisitions

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

We incurred non-cash charges for amortization of intangible assets in the first six months of 2013 and 2012 in the amount of approximately $550,000 and $601,000, respectively.

Restricted Shares, Restricted Stock Units and Options

In accordance with FASB ASC 505-50, we incurred, for the six months ended June 30, 2013 and 2012, compensation expense related to restricted stock units and restricted shares of approximately $167,000 and $119,000, respectively. Our directors received their annual restricted stock grants on April 3, 2013 in accordance with the terms of the directors' stock compensation plan.

Overview of Operating Performance and Backlog

Overall, our pre-tax income from continuing operations before income tax expense for the six months ended June 30, 2013 was $2.4 million on revenues of $44.4 million, compared to a loss of $2.0 million on revenues of $36.5 million during the six months ended June 30, 2012. As of June 30, 2013, our overall backlog totaled $65.7 million compared to $87.3 million in the second quarter of 2012.

In our Training and Simulation Division, revenues increased from approximately $27.4 million in the first six months of 2012 to $30.5 million in the first six months of 2013. As of June 30, 2013, our backlog for our Training and Simulation Division totaled $51.1 million compared to $78.7 million in the second quarter of 2012.

In our Battery and Power Systems Division, revenues increased from approximately $9.1 million in the first six months of 2012 to approximately $14.0 million in the first six months of 2013. As of June 30, 2013, our backlog for our Battery and Power Systems Division totaled $14.6 million compared to $8.6 million in the second quarter of 2012.

The table below details the percentage of total recognized revenue by type of arrangement for the six months ended June 30, 2013 and 2012:

| | Six months ended June 30, | | | |
|---|---|---|---|---|
| Type of Revenue | 2013 | | 2012 | |
| Sale of products | 93.8 | % | 96.7 | % |
| Maintenance and support agreements | 3.0 | % | 3.0 | % |
| Long term research and development contracts | 3.2 | % | 0.3 | % |
| 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.

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

Results of Operations

Three months ended June 30, 2013 compared to the three months ended June 30, 2012.

Revenues. Revenues for the three months ended June 30, 2013 totaled $22.4 million, compared to $20.4 million in the comparable period in 2012, an increase of $2.0 million, or 9.9%. In the second quarter of 2013, revenues were $14.8 million for the Training and Simulation Division (compared to $16.5 million in the second quarter of 2012, a decrease of $1.7 million, or 10.2%, due primarily to the timing of deliveries in 2012 related to our VCTS contract); and $7.6 million for the Battery and Power Systems Division (compared to $3.9 million in the second quarter of 2012, an increase of $3.7 million, or 94.6%, due primarily to increased sales in the U.S. of the SWIPES™ system).

Cost of revenues. Cost of revenues totaled $16.1 million during the second quarter of 2013, compared to $17.0 million in the second quarter of 2012, a decrease of $925,000, or 5.4%, due primarily to the decreased revenue in our Training and Simulation Division offset by the higher costs associated with increased revenues in our Battery and Power Systems Division. Cost of revenues were $10.0 million for the Training and Simulation Division (compared to $13.2 million in the second quarter of 2012, a decrease of $3.2 million, or 24.3%, due primarily to increased margins due to changes in estimated contract costs); and $6.1 million for the Battery and Power Systems Division (compared to $3.8 million in the second quarter of 2012, an increase of $2.3 million, or 60.0%, due primarily to increased sales of the SWIPES™ system).

Research and development expenses. Research and development expenses for the second quarter of 2013 were $595,000, compared to $456,000 during the second quarter of 2012, an increase of $139,000, or 30.5%, due primarily to a net increase in our Training and Simulation Division due to the capitalization of certain research and development expenses in 2012 along with increased spending in the Battery and Power Systems Division for continuing research on new battery products.

Selling and marketing expenses. Selling and marketing expenses for the second quarter of 2013 were $1.4 million, compared to $1.3 million in the second quarter of 2012, an increase of $55,000, or 4.1%, due primarily to increased staffing in our Battery and Power Systems Division.

General and administrative expenses. General and administrative expenses for the second quarter of 2013 were $2.5 million, compared to $2.0 million in the second quarter of 2012, an increase of $465,000, or 23.3%, due primarily to increased expenses in our Battery and Power Systems Division to accommodate the significant growth in this division.

Amortization of intangible assets. Amortization of intangible assets totaled $274,000 in the second quarter of 2013, compared to $300,000 in the second quarter of 2012, a decrease of $26,000, or 8.8%, due primarily to decreased charges for fully amortized capitalized software in our Training and Simulation Division.

Other income. Other income totaled $267,000 in the second quarter of 2013, compared to other income of less than $1,000 in the second quarter of 2012, an increase of $267,000, due primarily to insurance proceeds received in our Battery and Power Systems Division.

Financial expense, net. Financial expense totaled $114,000 in the second quarter of 2013, compared to financial expense of $342,000 in the second quarter of 2012, a decrease of $228,000, due primarily to exchange rate differences.

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Income taxes. We recorded $254,000 in tax expense in the second quarter of 2013, compared to $200,000 in tax expense in the second quarter of 2012, an increase of $54,000, or 27.3%, mainly concerning statutory Israeli taxes. This amount includes the required adjustment of taxes due to the deduction of goodwill “naked” credits (“naked” credits occur when deferred tax liabilities that are created by indefinite-lived assets such as goodwill cannot be used as a source of taxable income to support the realization of deferred tax assets) for U.S. federal taxes, which totaled $150,000 in both the second quarter of 2013 and 2012.

Net income. Due to the factors cited above, we went from a net loss of $1.3 million in the second quarter of 2012 to a net income of $1.5 million in the second quarter of 2013, an improvement of $2.8 million.

Six months ended June 30, 2013 compared to the six months ended June 30, 2012.

Revenues. Revenues for the six months ended June 30, 2013 totaled $44.4 million, compared to $36.5 million in the comparable period in 2012, an increase of $7.9 million, or 21.8%. In the first six months of 2013, revenues were $30.5 million for the Training and Simulation Division (compared to $27.4 million in the first six months of 2012, an increase of $3.1 million, or 11.2%, due primarily to several significant new contracts); and $14.0 million for the Battery and Power Systems Division (compared to $9.1 million in the first six months of 2012, an increase of $4.9 million, or 53.9%, due primarily to increased sales in the U.S. of the SWIPES™ system).

Cost of revenues. Cost of revenues totaled $32.9 million during the first six months of 2013, compared to $28.8 million in the first six months of 2012, an increase of $4.1 million, or 14.0%, due primarily to the improved margins and revenue in our divisions. Cost of revenues were $21.4 million for the Training and Simulation Division (compared to $21.1 million in the first six months of 2012, an increase of $310,000, or 1.5%, due to changes in estimated contract costs); and $11.4 million for the Battery and Power Systems Division (compared to $7.7 million in the first six months of 2012, an increase of $3.7 million, or 48.2%, due primarily to increased sales of the SWIPES™ system.

Research and development expenses. Research and development expenses for the first six months of 2013 were $1.1 million, compared to $1.0 million during the first six months of 2012, an increase of $81,000, or 7.8%, due primarily to increased spending in the Battery and Power Systems Division for continuing research on new battery products.

Selling and marketing expenses. Selling and marketing expenses for the first six months of 2013 were $2.6 million, compared to $2.6 million in the first six months of 2012, an increase of $7,000, or 0.3%.

General and administrative expenses. General and administrative expenses for the first six months of 2013 were $4.9 million, compared to $5.0 million in the first six months of 2012, a decrease of $147,000, or 2.9%, due primarily to a reduction of $557,000 in corporate consulting and legal expenses related to transactional activities offset by an increase of $363,000 in our Battery and Power Systems Division, due primarily to increased expenses to accommodate the significant growth in this division. We are continuing our initiative to reduce general and administrative expense in our corporate activities.

Amortization of intangible assets. Amortization of intangible assets totaled $550,000 in the first six months of 2013, compared to $601,000 in the first six months of 2012, a decrease of $51,000, or 8.5%, due primarily to decreased charges for fully amortized capitalized software in our Training and Simulation Division.

Other income. Other income totaled $269,000 in the first six months of 2013, compared to other income of $1,000 in the first six months of 2012, an increase of $268,000, due primarily to insurance proceeds received in our Battery and Power Systems Division.

Financial expense, net. Financial expense totaled $303,000 in the first six months of 2013, compared to financial expense of $379,000 in the first six months of 2012, a decrease of $76,000, due primarily to exchange rate differences.

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Income taxes. We recorded $429,000 in tax expense in the first six months of 2013, compared to $397,000 in tax expense in the first six months of 2012, an increase of $32,000, or 8.0%, mainly concerning statutory Israeli taxes. This amount includes the required adjustment of taxes due to the deduction of goodwill “naked” credits (“naked” credits occur when deferred tax liabilities that are created by indefinite-lived assets such as goodwill cannot be used as a source of taxable income to support the realization of deferred tax assets) for U.S. federal taxes, which totaled $299,000, in non-cash expenses in the both the first six months of 2013 and 2012.

Net income. Due to the factors cited above, we went from a net loss of $2.4 million in the first six months of 2012 to a net income of $2.0 million in the first six months of 2013, an improvement of $4.4 million.

Liquidity and Capital Resources

As of June 30, 2013, we had $953,000 in cash and $491,000 in restricted collateral deposits, as compared to December 31, 2012, when we had $1.6 million in cash and $186,000 in restricted collateral deposits. We have experienced fluctuations in available cash in the previous twelve months due to the funding requirements of our larger contracts. These fluctuations have not had a significant impact on our operations, due in part to the increase in our credit facility that was negotiated with our primary bank in 2012. We ended the quarter with $2.1 million in available, unused bank lines of credit with our main bank as of June 30, 2013, under a $15.0 million credit facility under our FAAC subsidiary, described below. Our cash position has improved in the thirty days following the end of the quarter.

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

We used available funds in the six months ended June 30, 2013 primarily for working capital, investment in fixed assets and repayment of short term debt. We purchased approximately $1.3 million of fixed assets during the six months ended June 30, 2013. Our net fixed assets amounted to $5.2 million at June 30, 2013.

Net cash provided by operating activities for the six months ended June 30, 2013 was $1.2 million and net cash used in operating activities for the six months ended June 30, 2012 was $3.6 million, a change of $4.8 million. This difference was due primarily to the profit from continuing operations along with changes in working capital. The timing of cash inflows and outflows has impacted us due to the substantial purchases of products to fulfill the contracts in the Simulation and Training Division and Battery and Power Systems Division.

Net cash used in investing activities for the six months ended June 30, 2013 was $1.5 million and net cash provided by investing activities for the six months ended 2012 was $1.1 million, a change of $2.6 million. This difference was due primarily to the purchase of capital equipment and changes in restricted collateral deposits.

Net cash used in financing activities for the six months ended June 30, 2013 was $450,000 and net cash provided by financing activities for the six months ended June 30, 2012 was $1.5 million, a change of $2.0 million. The change in 2013 of cash used in financing activities was due primarily to changes in short term borrowing under our primary line of credit along with the repayment of the short term portion of long term debt.

As of June 30, 2013, we had approximately $10.2 million in short-term bank debt and $1.0 million in long-term debt outstanding. This is in comparison to $9.8 million in short-term bank debt and $1.9 million in long-term debt outstanding as of December 31, 2012.

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

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

Interest Rate Risk

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

Foreign Currency Exchange Rate Risk

Since a significant part of our sales and expenses are denominated in U.S. dollars, we have experienced only minor foreign exchange gains and losses to date, and do not expect to incur significant gains and losses in 2013. Certain of our research, development and production activities are carried out by our Israeli subsidiary, 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.

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PART II

ITEM 1A. RISK FACTORS.

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

ITEM 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 |

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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: August 14, 2013

AROTECH CORPORATION

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

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