AROTECH CORP
Form 10-Q
August 14, 2008

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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, 2008 .

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 T No £

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

Large accelerated filer: £	Accelerated filer: £	Non-accelerated filer: £	Smaller reporting company: T

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 14, 2008 was 13,637,639.

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

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ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

CONDENSED CONSOLIDATED BALANCE SHEETS
(U.S. Dollars)

ASSETS	June 30, 2008 (Unaudited)	December 31, 2007
CURRENT ASSETS:		
Cash and cash equivalents	$ 1,714,056	$ 3,447,671
Restricted collateral deposits	179,194	320,454
Escrow receivable	–	1,479,826
Available-for-sale marketable securities	54,856	47,005
Trade receivables (net of allowance for doubtful accounts in the amount of zero as of June 30, 2008 and $25,000 as of December 31, 2007)	7,881,720	14,583,213
Unbilled receivables	3,257,644	3,271,594
Other accounts receivable and prepaid expenses	1,526,841	1,614,614
Inventories	12,555,330	7,887,820
Total current assets	27,169,641	32,652,197
SEVERANCE PAY FUND	3,207,355	2,815,040
DEFERRED TAX ASSETS	92,703	77,709
OTHER LONG-TERM RECEIVABLES	272,986	309,190
PROPERTY AND EQUIPMENT, NET	5,243,452	5,079,796
INVESTMENT IN AFFILIATED COMPANY	236,082	352,168
OTHER INTANGIBLE ASSETS, NET	8,097,347	7,837,076
GOODWILL	33,236,901	31,358,131
	$ 77,556,467	$ 80,481,307

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

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

	June 30, 2008 (Unaudited)	December 31, 2007
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	$ 5,414,414	$ 4,233,288
Other accounts payable and accrued expenses	3,790,503	4,889,729
Current portion of capitalized leases	80,573	67,543
Current portion of promissory notes due to purchase of subsidiaries	–	151,450
Current portion of long-term debt	56,515	103,844
Short term bank credit	2,308,350	4,557,890
Deferred revenues	2,287,632	2,903,166
Total current liabilities	13,937,987	16,906,910
Accrued severance pay	5,455,273	4,853,231
Long-term portion of capitalized leases	146,789	86,989
Long-term portion of long-term debt	1,061,806	1,088,498
Other long-term liabilities	150,513	110,255
Deferred taxes	1,020,000	1,020,000
Total long-term liabilities	7,834,381	7,158,973
MINORITY INTEREST	–	83,816
SHAREHOLDERS' EQUITY:		
Share capital –		
Common stock – $0.01 par value each;		
Authorized: 250,000,000 shares as of June 30, 2008 and December 31, 2007; Issued and outstanding: 13,637,639 and 13,544,819 shares as of June 30, 2008 and December 31, 2007, respectively	136,377	135,448
Preferred shares – $0.01 par value each;		
Authorized: 1,000,000 shares as of June 30, 2008 and December 31, 2007; No shares issued and outstanding as of June 30, 2008 and December 31, 2007	–	–
Additional paid-in capital	219,287,852	218,551,110
Accumulated deficit	(165,441,787)	(162,522,558)
Notes receivable from shareholders	(1,341,788)	(1,333,833)
Accumulated other comprehensive loss	3,143,445	1,501,441
Total shareholders' equity	55,784,099	56,331,608
	$ 77,556,467	$ 80,481,307

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

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

	Six months ended June 30,		Three months ended June 30,	
	2008	2007	2008	2007
Revenues	$ 25,857,582	$ 24,557,890	$ 12,607,006	$ 13,028,728
Cost of revenues, exclusive of amortization of intangibles	19,772,500	16,685,240	9,767,718	9,282,017
Research and development	832,872	922,255	225,778	424,170
Selling and marketing expenses	2,286,995	2,093,501	1,144,356	1,062,733
General and administrative expenses	6,825,780	6,349,404	3,293,320	2,625,114
Amortization of intangible assets	985,021	736,171	492,408	396,211
Escrow adjustment – credit	(1,448,074)	–	–	–
Total operating costs and expenses	29,255,094	26,786,571	14,923,580	13,790,245
Operating loss	(3,397,512)	(2,228,681)	(2,316,574)	(761,517)
Other income	659,149	69,118	122,777	57,174
Financial income (expenses), net	(52,952)	(626,813)	137,061	(502,733)
Loss before minority interest in earnings of a subsidiary, earnings from affiliated company and income tax expenses	(2,791,315)	(2,786,376)	(2,056,736)	(1,207,076)
Income tax credits (expenses)	(11,828)	(174,906)	108,106	(68,999)
Loss from affiliated company	(116,086)	(112,179)	–	(159,800)
Minority interest in earnings of subsidiaries	–	(110,330)	–	(49,674)
Net loss	$ (2,919,229)	$ (3,183,791)	$ (1,948,630)	$ (1,485,549)
Basic and diluted net loss per share	$ (0.23)	$ (0.28)	$ (0.15)	$ (0.13)
Weighted average number of shares used in computing basic and diluted net loss per share	12,591,575	11,301,183	12,604,715	11,380,845

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

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

	Six months ended June 30, 2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (2,919,229)	$ (3,183,791)
Adjustments required to reconcile net loss to net cash provided by (used in) operating activities:		
Minority interest in loss of subsidiary	–	110,330
Loss from affiliated company	116,086	112,179
Depreciation	609,921	1,183,948
Amortization of intangible assets, capitalized software costs and impairment of intangible assets	985,018	736,171
Accrued severance pay, net	209,727	92,742
Compensation related to shares issued to employees, consultants and directors	631,347	1,032,702
Amortization relating to warrants issued to the holders of convertible debentures and beneficial conversion feature	–	226,437
Amortization of deferred charges related to convertible debenture issuance	–	58,498
Capital loss from sale of property and equipment	–	3,232
Decrease in escrow receivable	1,479,826	–
Decrease (increase) in trade receivables	6,894,307	(1,481,220)
Decrease in other accounts receivable and prepaid expenses	24,309	267,866
Increase in deferred tax assets	(14,994)	(10,988)
Increase in inventories	(4,637,316)	(1,144,679)
Decrease in unbilled receivables	79,251	1,131,990
Decrease in deferred revenues	(615,534)	(2,735)
Increase in trade payables	1,170,166	2,243,515
Decrease in other accounts payable and accrued expenses	(1,173,626)	(1,840,175)
Net cash provided by (used in) operating activities	2,839,259	(452,990)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(664,555)	(511,183)
Acquisition of subsidiary, net of cash acquired	(1,026,273)	–
Acquisition of minority interest	(660,500)	–
Repayment of promissory notes related to acquisition of subsidiaries	(151,450)	(151,450)
Decrease in restricted cash	133,409	279,308
Net cash used in investing activities	(2,369,369)	(383,325)
FORWARD	$ 469,890	$ (836,315)

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

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

	Six months ended June 30, 2008	2007
FORWARD	$ 469,890	$ (836,315)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of options	–	37,642
Repayment of long-term loans	(74,021)	(29,373)
Decrease in short term bank credit	(2,249,540)	(118,092)
Net cash used in financing activities	(2,323,561)	(109,823)
DECREASE IN CASH AND CASH EQUIVALENTS	(1,853,671)	(946,138)
CASH ACCRETION (EROSION) DUE TO EXCHANGE RATE DIFFERENCES	120,056	(54,103)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	3,447,671	2,368,872
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	$ 1,714,056	$ 1,368,631
SUPPLEMENTARY INFORMATION ON NON-CASH TRANSACTIONS:		
Stock issued for acquisition	$ 100,000	$ –
Assets recorded for capital lease addition	$ 109,025	$ –
Assets recorded in association with seller financed debt	$ –	$ 1,115,000
Payment of principal installment of convertible debenture in shares	$ –	$ 1,458,333

The accompanying notes are an integral part of the 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" or the "Company"), and its wholly-owned subsidiaries provide defense and security products for the military, law enforcement and homeland security markets, including advanced zinc-air and lithium batteries and chargers, multimedia interactive simulators/trainers and lightweight vehicle armoring. The Company is primarily operating through its wholly-owned subsidiaries FAAC Corporation ("FAAC"), based in Ann Arbor, Michigan, and FAAC's subsidiary Realtime Technologies, Inc. ("RTI"), which is based in Royal Oak, Michigan; Electric Fuel Battery Corporation ("EFB"), based in Auburn, Alabama; Electric Fuel Ltd. ("EFL"), based in Beit Shemesh, Israel; Epsilor Electronic Industries, Ltd. ("Epsilor"), based in Dimona, Israel; MDT Protective Industries, Ltd. ("MDT"), based in Lod, Israel; MDT Armor Corporation ("MDT Armor"), based in Auburn, Alabama; and Armour of America, Incorporated ("AoA"), based in Auburn, Alabama.

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, 2008, its operating results for the three and six month periods ended June 30, 2008 and 2007, and its cash flow for the six-month periods ended June 30, 2008 and 2007.

The results of operations for the three and six months ended June 30, 2008 are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year ending December 31, 2008.

The balance sheet at December 31, 2007 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, 2007.

c. Accounting for stock-based compensation:

For the six months ended June 30, 2008 and 2007 the compensation expense recorded related to stock options and restricted shares was $631,347 and $1,032,702, respectively, of which $34,301 and $104,308, respectively, was for stock options and $597,046 and $928,394, respectively, was for restricted shares. The remaining total compensation cost related to non-vested stock options and restricted share awards not yet recognized in the income statement as of June 30, 2008 was $1,448,362, of which $57,599 was for stock options and $1,390,763 was for restricted shares. 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 operating loss position. There were no new options issued in the first six months of 2008 and no options were exercised in the first six months of 2008. The Company's directors received their annual restricted stock grants on April 1, 2008 in accordance with the terms of the directors' stock compensation plan.

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d. Reclassification:

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

e. Anti-dilutive shares for EPS calculation

All outstanding stock options, non-vested restricted stock and warrants have been excluded from the calculation of the diluted net loss per common share because all such securities are anti-dilutive for the periods presented. The total weighted average number of shares related to the outstanding options, restricted stock and warrants excluded from the calculations of diluted net loss per share for June 30, 2008 and 2007 were 1,500,886 and 1,763,594, respectively.

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. Inventories are composed of the following:

	June 30, 2008 (Unaudited)	December 31, 2007
Raw and packaging materials	$ 8,563,674	$ 6,043,170
Work-in-progress	3,532,450	1,583,790
Finished goods	459,206	260,860
	$ 12,555,330	$ 7,887,820

NOTE 3: IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141(R), Business Combinations, to further enhance the accounting and financial reporting related to business combinations. SFAS No. 141(R) establishes principles and requirements for how the acquirer in a business combination (1) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, (2) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and (3) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Therefore, the effects of the Corporation's adoption of SFAS No. 141(R) will depend upon the extent and magnitude of acquisitions after December 31, 2008.

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In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. The Statement does not require any new fair value measurements and was initially effective for the Corporation beginning January 1, 2008. In February 2008, the FASB issued FASB Staff Position (FSP) FAS 157-2. FSP FAS 157-2 defers the effective date of SFAS No. 157 until January 1, 2009 for nonfinancial assets and nonfinancial liabilities except those items recognized or disclosed at fair value on an annual or more frequently recurring basis. On January 1, 2008, we adopted the provisions of SFAS No. 157 for our financial assets and liabilities. The adoption of the standard did not have a material impact on our financial statements. We elected to defer the adoption of SFAS No. 157 for our non-financial assets and liabilities until January 1, 2009. We are currently evaluating the impact that the deferred provisions of this standard will have on our financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. This Statement permits entities to choose to measure eligible items at fair value at specified election dates. For items for which the fair value option has been elected, unrealized gains and losses are to be reported in earnings at each subsequent reporting date. The fair value option is irrevocable unless a new election date occurs, may be applied instrument by instrument, with a few exceptions, and applies only to entire instruments and not to portions of instruments. SFAS No. 159 provides an opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting. SFAS No. 159 was effective for the Corporation beginning January 1, 2008. The adoption of the standard did not have a material impact on the Company’s financial statements.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51, to create accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 establishes accounting and reporting standards that require (1) the ownership interest in subsidiaries held by parties other than the parent to be clearly identified and presented in the consolidated balance sheet within equity, but separate from the parent’s equity, (2) the amount of consolidated net income attributable to the parent and the noncontrolling interest to be clearly identified and presented on the face of the consolidated statement of income, (3) changes in a parent’s ownership interest while the parent retains its controlling financial interest in its subsidiary to be accounted for consistently, (4) when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary to be initially measured at fair value, and (5) entities to provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 applies to fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, and prohibits early adoption. Management has not completed its review of the new guidance; however, the effect of the Statement’s implementation is not expected to be material to the Corporation’s results of operations or financial position.

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In March 2008, the FASB issued SFAS No.161, Disclosures about Derivative Instruments and Hedging Activities. SFAS No.161 requires expanded disclosures regarding the location and amounts of derivative instruments in an entity's financial statements, how derivative instruments and related hedged items are accounted for under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and how derivative instruments and related hedged items affect an entity's financial position, operating results and cash flows. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008. Since SFAS No. 161 affects only disclosures, it is not expected to impact the Corporation's financial position or results of operations upon adoption.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." SFAS No. 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with generally accepted accounting principles in the United States for non-governmental entities. SFAS No. 162 is effective 60 days following approval by the SEC of the Public Company Accounting Oversight Board's amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." We do not expect that the adoption of SFAS No. 162 will impact the Company's financial position or results of operations.

NOTE 4: SEGMENT INFORMATION

a. General:

The Company and its subsidiaries operate primarily in three business segments and follow the requirements of SFAS No. 131.

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.

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b. The following is information about reported segment revenues, income (losses) and total assets for the six and three months ended June 30, 2008 and 2007:

	Training and Simulation	Battery and Power Systems	Armor	All Others	Total
Six months ended June 30, 2008					
Revenues from outside customers	$ 14,719,907	$ 5,317,521	$ 5,820,154	$ –	$ 25,857,582
Depreciation, amortization and impairment expenses (1)	(894,880)	(501,073)	(77,951)	(121,041)	(1,594,945)
Direct expenses (2)	(12,282,600)	(5,837,195)	(7,419,598)	(1,589,521)	(27,128,914)
Segment income (loss)	1,542,427	(1,020,747)	(1,677,395)	(1,710,562)	(2,866,277)
Financial income (expense)	11,056	30,772	7,224	(102,004)	(52,952)
Income (loss) from continuing operations	$ 1,553,483	$ (989,975)	$ (1,670,171)	$ (1,812,566)	$ (2,919,229)
Segment assets (3), (4)	$ 40,712,523	$ 24,196,236	$ 11,721,422	$ 926,286	$ 77,556,467
Six months ended June 30, 2007					
Revenues from outside customers	$ 9,395,747	$ 5,084,528	$ 10,077,615	$ –	$ 24,557,890
Depreciation, amortization and impairment expenses (1)	(995,700)	(479,786)	(326,455)	(118,178)	(1,920,119)
Direct expenses (2)	(8,081,468)	(4,718,414)	(8,456,540)	(3,938,327)	(25,194,749)
Segment income (loss)	318,579	(113,672)	1,294,620	(4,056,505)	(2,556,978)
Financial income (expense)	424	(53,436)	(4,313)	(569,488)	(626,813)
Income (loss) from continuing operations	$ 319,003	$ (167,108)	$ 1,290,307	$ (4,625,993)	$ (3,183,791)
Segment assets (3), (4)	$ 42,108,094	$ 18,477,947	$ 11,453,677	$ 2,520,941	$ 74,560,659
Three months ended June 30, 2008					
Revenues from outside customers	$ 7,185,310	$ 2,210,485	$ 3,211,211	$ –	$ 12,607,006
Depreciation, amortization and impairment expenses (1)	(445,561)	(300,211)	(48,908)	(108,048)	(902,728)
Direct income (expenses) (2)	(6,260,986)	(2,505,284)	(5,167,557)	143,858	(13,789,969)
Segment income (loss)	478,763	(595,010)	(2,005,254)	35,810	(2,085,691)
Financial income (expense)	116,720	29,848	29,418	(38,925)	137,061
Income (loss) from continuing operations	$ 595,483	$ (565,162)	$ (1,975,836)	$ (3,115)	$ (1,948,630)
Three months ended June 30, 2007					
Revenues from outside customers	$ 5,179,738	$ 2,545,396	$ 5,303,594	$ –	$ 13,028,728
Depreciation, amortization and impairment expenses (1)	(596,824)	(241,866)	(137,495)	(58,876)	(1,035,061)
Direct expenses (2)	(4,870,676)	(2,097,171)	(4,530,786)	(1,477,850)	(12,976,483)
Segment income (loss)	(287,762)	206,359	635,313	(1,536,726)	(982,816)
Financial expense	(24,369)	(41,601)	(19,424)	(417,339)	(502,733)
Income (loss) from continuing operations	$ (312,131)	$ 164,758	$ 615,889	$ (1,954,065)	$ (1,485,549)

(1) Includes depreciation of property and equipment, amortization expenses of intangible assets and impairment of goodwill and other intangible assets.

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

(3) Consisting of all assets.

(4) Out of those amounts, goodwill in our Training and Simulation, Battery and Power Systems and Armor Divisions stood at $24,424,030, $6,823,035 and $1,989,836, respectively, as of June 30, 2008 and $24,235,419, $5,413,210 and $1,066,596, respectively, as of June 30, 2007.

NOTE 5: COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) for the six and three months ended June 30, 2008 and 2007 is summarized below:

	Six Months Ended June 30,		Three Months Ended June 30,	
	2008	2007	2008	2007
Net loss	$ (2,919,229)	$ (3,183,791)	$ (1,948,630)	$ (1,485,549)
Foreign currency translation	1,642,004	(206,891)	699,777	(291,698)
Total comprehensive loss	$ (1,277,225)	$ (3,390,682)	$ (1,248,853)	$ (1,777,247)

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NOTE 6: ACQUISITIONS

Purchase of the Minority Interest in MDT Israel and MDT Armor

In January 2008, the Company purchased the minority shareholder’s 24.5% interest in MDT Protective Industries Ltd. (“MDT Israel”) and the 12.0% interest in MDT Armor Corporation (“MDT Armor”), as well as settling all outstanding disputes regarding severance payments, in exchange for a total of $1.0 million that was paid in cash. The purchase was treated as a step acquisition using the purchase method of accounting. The Company evaluated the purchase price and identified $607,100 in goodwill and workforce intangibles with an indefinite life. The Company also identified $53,400 as an intangible asset related to its customer list with a useful life of four years. The purchase price included a payment of $241,237 to the former president of MDT Israel as compensation for a right granted to him by MDT Armor that potentially would have given him the right to receive 5% of MDT Armor’s annual profit. The payment for this right was recorded as general and administrative expense in the first quarter.

Purchase of Realtime Technologies, Inc.

In February 2008 the Company’s FAAC subsidiary acquired all of the outstanding stock of Realtime Technologies, Inc. (RTI), a privately-owned corporation headquartered in Royal Oak, Michigan, for a total of $1,375,000, including $1,250,000 in cash, $100,000 in Company stock (54,348 shares) and approximately $25,000 in acquisition costs with a 2008 earnout (maximum of $250,000) based on 2008 net profit. RTI specializes in multi-body vehicle dynamics modeling and graphical simulation solutions. RTI’s product portfolio provides FAAC with the opportunity to economically add new features to the driver training products marketed by FAAC.

RTI’s operating results will be included in the Company’s Training and Simulation Division as of January 1, 2008 and the effect on operations is not expected to be material.

Listed below is the purchase price allocation:

Current assets acquired, net of liabilities	$	433,389
Technology and Patents - 7 year life		663,000
Trademark/Trade Names - 10 year life		28,000
Customer relationships - 10 year life		62,000
Goodwill - indefinite life(1)		188,611
Equity Value	$	1,375,000

(1) The full amount of the goodwill is expected to be deductible for U.S. tax purposes.

NOTE 7: ARBITRATION

In connection with the Company’s acquisition of AoA, the Company had a contingent earnout obligation in an amount equal to the revenues AoA realized from certain specific programs that were identified by the Company and the seller of AoA (“Seller”) as appropriate targets for revenue increases. As of December 31, 2006, the Company had reduced the $3.0 million escrow held by the Seller by approximately $1,520,000 for a putative claim against such escrow in respect of such earnout obligation.

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On March 20, 2007, the Company filed a Demand for Arbitration with the American Arbitration Association against the Seller. In February 2008, the arbitration panel issued a decision denying the Seller's counterclaims, granting the Seller's counterclaim for $70,000 in compensation, awarding the Company the entire $3.0 million escrow (less the $70,000 in compensation (with simple interest but without statutory penalties)), awarding the Company $135,000 in attorneys' fees, and interest of approximately $325,000. This award was paid to the Company in April 2008, and the time for the Seller to move to vacate or modify this award has now expired. In the first quarter of 2008, the Company adjusted the escrow receivable to reflect the updated amount of the escrow due to the arbitration panel's decision and final resolution of the remaining legal questions.

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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. 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," below, 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

Divisions and Subsidiaries

We are a defense and security products and services company, engaged in three business areas: interactive simulation for military, law enforcement and commercial markets; batteries and charging systems for the military; and high-level armoring for military, paramilitary and commercial vehicles. We operate in three business units:

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

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- Ø we provide aviation armor kits and we utilize sophisticated lightweight materials and advanced engineering processes to armor vehicles (our Armoring Division); and

- Ø we develop, manufacture and market primary Zinc-Air batteries, rechargeable batteries and battery chargers for defense and security products and other military applications (our Battery and Power Systems Division).

Recent Developments

AoA Arbitration

In connection with our acquisition of AoA, we had a contingent earnout obligation in an amount equal to the revenues AoA realized from certain specific programs that were identified by us and the seller of AoA (“Seller”) as appropriate targets for revenue increases. As of December 31, 2006, we had reduced the $3.0 million escrow held by the Seller by $1,520,000 for a putative claim against such escrow in respect of such earnout obligation.

On March 20, 2007, we filed a Demand for Arbitration with the American Arbitration Association against the Seller. In our demand, we sought the return of $3.0 million, plus interest, held in escrow by the Seller in connection with his sale of AoA to us in 2004. The Seller asserted counterclaims against us in the arbitration, alleging (i) that he is entitled to keep the $3.0 million, (ii) that he is entitled to an additional $3.0 million in post-sale earnout, and (iii) that he is entitled to $70,000 in compensation (plus interest and statutory penalties) wrongfully withheld by us when we constructively terminated his employment.

In February 2008, the arbitration panel issued a decision denying the Seller’s counterclaims (i) and (ii) above, granting the Seller’s counterclaim for $70,000 in compensation, awarding us the entire $3.0 million escrow (less the $70,000 in compensation (with simple interest but without statutory penalties)), awarding us $135,000 in attorneys’ fees, and interest of approximately $325,000. This award was paid to us in April 2008, and the time for the Seller to move to vacate or modify this award has now expired. In the first quarter of 2008, we adjusted the escrow receivable to reflect the updated amount of the escrow due to the arbitration panel’s decision and final resolution of the remaining legal questions.

Overview of Results of Operations

We incurred significant operating losses for the year ended December 31, 2007 and for the first six months of 2008. While we expect to continue to derive revenues from the sale of products that our subsidiaries manufacture and the services that they provide, there can be no assurance that we will be able to achieve or maintain profitability on a consistent basis.

A portion of our operating loss during 2007 and the first six months of 2008 arose as a result of non-cash charges. These charges were primarily related to our acquisitions, financings and issuances of restricted shares and options to employees. To the extent that we continue these activities during the remainder of 2008, we would expect to continue to incur such non-cash charges in the future.

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Acquisitions

In acquisition of subsidiaries, part of the purchase price is allocated to intangible assets and goodwill. Amortization of intangible assets related to acquisition of subsidiaries is recorded based on the estimated expected life of the assets. Accordingly, for a period of time following an acquisition, we incur a non-cash charge related to amortization of intangible assets in the amount of a fraction (based on the useful life of the intangible assets) of the amount recorded as intangible assets. Such amortization charges continued during 2008. We are required to review intangible assets for impairment whenever events or changes in circumstances indicate that carrying amount of the assets may not be recoverable. If we determine, through the impairment review process, that intangible asset 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 amount of $985,000 during the first six months of 2008.

In the case of goodwill, the assets recorded as goodwill are not amortized; instead, we are required to perform an annual impairment review. If we determine, through the impairment review process, that goodwill has been impaired, we must record the impairment charge in our statement of operations. The Company is currently performing its impairment review, which is done annually using the June 30 results. We expect to complete our review during the third quarter and as noted, will record impairment charges, if any, as determined in this review.

Financings and Issuances of Restricted Shares and Options

During 2006 and 2007, we issued options and restricted shares to certain employees along with restricted shares to our directors in 2007 and 2008. These options and shares were issued as bonuses, and generally vest over a period of two or three years from the date of issuance. Relevant accounting rules provide that the aggregate amount of the difference between the purchase price of the restricted shares (in this case, generally zero) and the market price of the shares on the date of grant is taken as a general and administrative expense, amortized over the life of the period of the restriction.

As a result of the application of the above accounting rules, we incurred, for the six months ended June 30, 2008 and 2007, compensation expense related to stock options and restricted shares of approximately $631,000 and $1.0 million, respectively, of which $34,000 and $104,000, respectively, was for stock options and $597,000 and $928,000, respectively, was for restricted shares.

Overview of Operating Performance and Backlog

Overall, our net loss before minority interest earnings, earnings from affiliated company and tax expenses for the six months ended June 30, 2008 was $2.8 million on revenues of $25.9 million, compared to a net loss of $2.8 million on revenues of $24.6 million during the six months ended June 30, 2007. As of June 30, 2008, our overall backlog totaled $51.6 million.

In our Training and Simulation Division, revenues increased from approximately $9.4 million in the first six months of 2007 to $14.7 million in the first six months of 2008. As of June 30, 2008, our backlog for our Training and Simulation Division totaled $20.5 million.

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In our Battery and Power Systems Division, revenues increased from approximately $5.1 million in the first six months of 2007 to approximately $5.3 million in the first six months of 2008. As of June 30, 2008, our backlog for our Battery and Power Systems Division totaled $12.7 million.

In our Armor Division, revenues decreased from $10.1 million during the first six months of 2007 to $5.8 million during the first six months of 2008. As of June 30, 2008, our backlog for our Armor Division totaled $18.4 million.

Functional Currency

We consider the United States dollar to be the currency of the primary economic environment in which we and our Israeli subsidiary 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 our Israeli subsidiaries MDT and Epsilor are in New Israel Shekels ("NIS") and a substantial portion of MDT's and Epsilor's costs is incurred in NIS. Management believes that the NIS is the functional currency of MDT and Epsilor. Accordingly, the financial statements of MDT and Epsilor have been translated into U.S. dollars. All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. Statement of operations amounts have been translated using the average exchange rate for the period. The resulting translation adjustments are reported as a component of accumulated other comprehensive loss in shareholders' equity.

Results of Operations

Three months ended June 30, 2008 compared to the three months ended June 30, 2007.

Revenues. During the three months ended June 30, 2008, we (through our subsidiaries) recognized revenues as follows:

- Ø FAAC and RTI recognized revenues from the sale of multimedia interactive simulators, interactive use-of-force training systems, and from the provision of maintenance services in connection with such systems.

- Ø MDT, MDT Armor and AoA recognized revenues from payments under vehicle armoring contracts, for service and repair of armored vehicles, and on the sale of armoring products.

- Ø EFB and Epsilor recognized revenues from the sale of batteries, chargers and adapters to the military, and under certain development contracts with the U.S. Army.

- Ø EFL recognized revenues from the sale of water-activated battery (WAB) lifejacket lights.

Revenues for the three months ended June 30, 2008 totaled $12.6 million, compared to $13.0 million in the comparable period in 2007, a decrease of $422,000, or 3.2%. In the second quarter of 2008, revenues were $7.2 million for the Training and Simulation Division (compared to $5.2 million in the second quarter of 2007, an increase of $2.0 million, or 38.7%, due primarily to increased sales of military vehicle simulators and use of force simulators); $2.2 million for the Battery and Power Systems Division (compared to $2.5 million in the second quarter of 2007, a decrease of $335,000, or 13.2%, due primarily to decreased sales of our battery products at Epsilor and EFB); and $3.2 million for the Armor Division (compared to $5.3 million in the second quarter of 2007, a decrease of $2.1 million, or 39.5%, due primarily to decreased revenues from MDT and MDT Armor, mostly in respect of the completion of orders for the "David" Armored Vehicle).

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Cost of revenues, exclusive of amortization of intangibles. Cost of revenues totaled $9.8 million during the second quarter of 2008, compared to $9.3 million in the second quarter of 2007, an increase of $486,000, or 5.2%, due primarily to increased sales in our Training and Simulation and our Battery and Power Systems divisions offset by erosion of the margin in our Battery Division and Armor Division.

Research and development. Research and development expenses for the second quarter of 2008 were $226,000, compared to $424,000 during the second quarter of 2007, a decrease of $198,000, or 46.8%. This decrease was primarily attributable to a general reduction of research and development in the Simulation and Battery Divisions, offset by an increase in research and development expenses in the Armor Division.

Selling and marketing expenses. Selling and marketing expenses for the second quarter of 2008 were $1.1 million, compared to $1.1 million in the second quarter of 2007, an increase of $82,000, or 7.7%. This increase was primarily attributable to additional expenses in our Battery and Armor Divisions, offset by slightly reduced expenses in our Simulation Division.

General and administrative expenses. General and administrative expenses for the second quarter of 2008 were $3.3 million, compared to $2.6 million in the second quarter of 2007, an increase of $668,000, or 25.5%. This increase was primarily attributable to additional expenses in our Simulation and Battery Divisions along with additional corporate expenses, offset by reduced expenses in our Armor Division.

Amortization of intangible assets. Amortization of intangible assets totaled $492,000 in the second quarter of 2008, compared to $396,000 in the second quarter of 2007, an increase of $96,000, or 24.3%, due primarily to an increase in amortization of capitalized technology in our Training and Simulation Division along with an increase in identified intangibles due to the acquisition of RTI.

Financial income (expenses), net. Financial income (expenses) totaled approximately $137,000 in the second quarter of 2008, compared to an expense of $(503,000) in the second quarter of 2007, an improvement of $640,000, or 127.3%. The difference was due primarily to reductions in debenture expenses, debenture interest, line of credit interest and currency fluctuations in payments made in 2008

Income tax credits (expenses). We and certain subsidiaries incurred net operating losses during the three months ended June 30, 2008 and accordingly, no provision for income taxes was recorded in this quarter. With respect to some of our subsidiaries that operated at a net profit during 2008, we were able to offset federal taxes against our accumulated loss carry forward. We recorded a total of $(108,000) in tax expense in the second quarter of 2008, compared to $69,000 in tax expense in the second quarter of 2007, a decrease of $177,000, or 256.7%, mainly concerning state and local taxes.

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Net loss. Due to the factors cited above, net loss increased from $1.5 million in the second quarter of 2007 to $1.9 million in the second quarter of 2008, an increase of $463,000, or 31.2%.

Six months ended June 30, 2008 compared to the six months ended June 30, 2007.

Revenues. During the six months ended June 30, 2008, we (through our subsidiaries) recognized revenues as follows:

- Ø FAAC and RTI recognized revenues from the sale of multimedia interactive simulators, interactive use-of-force training systems, and from the provision of maintenance services in connection with such systems.

- Ø MDT, MDT Armor and AoA recognized revenues from payments under vehicle armoring contracts, for service and repair of armored vehicles, and on the sale of armoring products.

- Ø EFB and Epsilor recognized revenues from the sale of batteries, chargers and adapters to the military, and under certain development contracts with the U.S. Army.

- Ø EFL recognized revenues from the sale of water-activated battery (WAB) lifejacket lights.

Revenues for the six months ended June 30, 2008 totaled $25.9 million, compared to $24.6 million in the comparable period in 2007, an increase of $1.3 million, or 5.3%. In the first six months of 2008, revenues were $14.7 million for the Training and Simulation Division (compared to $9.4 million in the first six months of 2007, an increase of $5.3 million, or 56.7%, due primarily to increased sales of military vehicle simulators and use of force simulators); $5.3 million for the Battery and Power Systems Division (compared to $5.1 million in the first six months of 2007, an increase of $233,000, or 4.6%, due primarily to increased sales of our battery products at Epsilor and EFB); and $5.8 million for the Armor Division (compared to $10.1 million in the first six months of 2007, a decrease of $4.3 million, or 42.2%, due primarily to decreased revenues from MDT and MDT Armor, mostly in respect of the completion of orders for the “David” Armored Vehicle due to the model changeover and unforeseen material shortages from our primary steel supplier).

Cost of revenues, exclusive of amortization of intangibles. Cost of revenues totaled $19.8 million during the first six months of 2008, compared to $16.7 million in the first six months of 2007, an increase of $3.1 million, or 18.5%, due primarily to increased sales in our Training and Simulation and our Battery and Power Systems Divisions along with erosion in margin in our Armor Division.

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Research and development. Research and development expenses for the first six months of 2008 were $833,000, compared to $922,000 during the first six months of 2007, a decrease of $89,000, or 9.7%. This decrease was primarily attributable to a general reduction of research and development in the Battery Division, offset by a small increase in research and development expenses in the Simulation and Armor Divisions.

Selling and marketing expenses. Selling and marketing expenses for the first six months of 2008 were $2.3 million, compared to $2.1 million in the first six months of 2007, an increase of $193,000, or 9.2%. This increase was primarily attributable to additional expenses in our Battery and Armor Divisions, offset by slightly reduced expenses in our Simulation Division.

General and administrative expenses. General and administrative expenses for the first six months of 2008 were $6.8 million, compared to $6.3 million in the first six months of 2007, an increase of $476,000, or 7.5%. This increase was primarily attributable to additional expenses in our Simulation and Battery Divisions, offset by reduced expenses in our Armor Division and in corporate.

Amortization of intangible assets. Amortization of intangible assets totaled $985,000 in the first six months of 2008, compared to $736,000 in the first six months of 2007, an increase of $249,000, or 33.8%, due primarily to an increase in amortization of capitalized technology in our Training and Simulation Division along with an increase in identified intangibles due to the acquisition of RTI.

Escrow adjustment – credit. The escrow adjustment – credit of $1.4 million represents the first quarter adjustment to operating expenses resulting from the completion of the escrow arbitration. This was a contingent earnout obligation that was identified by us when AoA was purchased.

Financial income (expenses), net. Financial income (expenses) totaled approximately $(53,000) in the first six months of 2008, compared to $(627,000) in the first six months of 2007, an improvement of $574,000, or 91.6%. The difference was due primarily to reductions in debenture expenses, debenture interest, line of credit interest and currency fluctuations in payments made in 2008

Income taxes. We and certain of our subsidiaries incurred net operating losses during the six months ended June 30, 2008 and accordingly, no provision for income taxes was recorded in this quarter. With respect to some of our subsidiaries that operated at a net profit during 2008, we were able to offset federal taxes against our accumulated loss carry forward. We recorded a total of $12,000 in tax expense in the first six months of 2008, compared to $175,000 in tax expense in the first six months of 2007, a decrease of $163,000, or 93.2%, mainly concerning state and local taxes.

Net loss. Due to the factors cited above, net loss decreased from $3.2 million in the first six months of 2007 to $2.9 million in the first six months of 2008, a decrease of $265,000, or 8.3%.

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Liquidity and Capital Resources

As of June 30, 2008, we had $1.7 million in cash, $179,000 in restricted collateral securities and restricted held-to-maturity securities due within one year, and $55,000 in available-for-sale marketable securities, as compared to December 31, 2007, when we had $3.4 million in cash, $320,000 in restricted collateral securities, $1.5 million in an escrow receivable and $47,000 in available-for-sale marketable securities.

We used available funds in the six months ended June 30, 2008 primarily for sales and marketing, continued research and development expenditures, and other working capital needs. We increased our investment in fixed assets during the six months ended June 30, 2008 by $665,000 over the investment as at December 31, 2007. Our net fixed assets amounted to $5.2 million at quarter end.

Net cash provided by (used in) operating activities from continuing operations for the six months ended June 30, 2008 and 2007 was $2.8 million and $(453,000), respectively, an increase of $3.3 million. This increase in cash used was primarily the result of changes in working capital.

Net cash provided by (used in) investing activities for the six months ended June 30, 2008 and 2007 was $2.4 million and $(383,000) an increase of $2.0 million. This increase was primarily the result of the RTI acquisition and the purchase of minority interest in MDT.

Net cash used in financing activities for the six months ended June 30, 2008 and 2007 was $(2.3) million and $(110,000), respectively, an increase of $2.2 million, primarily due to the reduction in short term bank debt.

As of June 30, 2008, we had approximately $2.3 million in bank debt outstanding compared to $4.6 million as of December 31, 2007.

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. In this connection, we note that from time to time our working capital needs are partially dependent on our subsidiaries’ lines of credit. In the event that we are unable to continue to make use of our subsidiaries’ lines of credit for working capital on economically feasible terms, our business, operating results and financial condition could be adversely affected.

Over the long term, we need to sustain profitability, at least on a cash-flow basis, to avoid future capital requirements. Additionally, we would need to raise additional capital in order to fund any future acquisitions.

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.

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Foreign Currency Exchange Rate Risk

Since a significant part of our sales and expenses are denominated in U.S. dollars, we have experienced only insignificant foreign exchange gains and losses to date, and do not expect to incur significant gains and losses in 2008. Certain of our research, development and production activities are carried out by our Israeli subsidiary, EFL, at its facility in Beit Shemesh, and accordingly we have sales and expenses in NIS. Additionally, our MDT and Epsilor subsidiaries operate 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, and we occasionally hedge part of the risk of a devaluation of the U.S dollar, 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 4T. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

As of June 30, 2008, our management, including the principal executive officer and principal financial officer, evaluated our disclosure controls and procedures related to the recording, processing, summarization, and reporting of information in our periodic reports that we file with the SEC. These disclosure controls and procedures are intended to ensure that material information relating to us, including our subsidiaries, is made known to our management, including these officers, by other of our employees, and that this information is recorded, processed, summarized, evaluated, and reported, as applicable, within the time periods specified in the SEC's rules and forms. Due to the inherent limitations of control systems, not all misstatements may be detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Any system of controls and procedures, no matter how well designed and operated, can at best provide only reasonable assurance that the objective of the system are met and management necessarily is required to apply its judgment in evaluating the cost benefit relationship of possible controls and procedures. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. Our controls and procedures are intended to provide only reasonable, not absolute, assurance that the above objectives have been met.

Based on their evaluations, our principal executive officer and principal financial officer were able to conclude that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) were effective as of June 30, 2008 to ensure that the information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

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Changes in Internal Controls Over Financial Reporting

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

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PART II

ITEM 1. LEGAL PROCEEDINGS.

Class Action Litigation

In May 2007, two purported class action complaints (the "Complaint") were filed in the United States District Court for the Eastern District of New York against us and certain of our officers and directors. These two cases were consolidated in June 2007. A similar case filed in the United States District Court for the Eastern District of Michigan in March 2007 was withdrawn by the plaintiff in June 2007. The Complaint seeks class status on behalf of all persons who purchased our securities between November 9, 2004 and November 14, 2005 (the "Period") and alleges violations by us and certain of our officers and directors of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, primarily related to our acquisition of Armour of America in 2005 and certain public statements made by us with respect to our business and prospects during the Period. The Complaint also alleges that we did not have adequate systems of internal operational or financial controls, and that our financial statements and reports were not prepared in accordance with GAAP and SEC rules. The Complaint seeks an unspecified amount of damages. A lead plaintiff has been named, and the plaintiff's consolidated amended complaint was filed in September 2007. Our motion to dismiss was filed in November 2007 and oral argument on the motion was heard on July 21, 2008. A decision on our motion is not expected until later in 2008.

Although the ultimate outcome of this matter cannot be determined with certainty, we believe that the allegations stated in the Complaint are without merit and we and our officers and directors named in the Complaint intend to defend ourselves vigorously against such allegations.

NAVAIR Litigation

In December 2004, AoA filed an action in the United States Court of Federal Claims against the United States Naval Air Systems Command (NAVAIR), seeking approximately $2.2 million in damages for NAVAIR's alleged improper termination of a contract for the design, test and manufacture of a lightweight armor replacement system for the United States Marine Corps CH-46E rotor helicopter. NAVAIR, in its answer, counterclaimed for approximately $2.1 million in alleged reprocurement and administrative costs. Trial in this matter has concluded, but no decision has yet been rendered. We are unable to make any prediction or assessment as to what the ultimate outcome of this case will be.

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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, 2007. We do not believe that there 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

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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, 2008

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: Vice President – Finance and CFO
(Principal Financial Officer)

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EXHIBIT INDEX

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