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

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**FORM 10-K**

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ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2017.

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

Commission File Number: 0-23336

**AROTECH CORPORATION**

(Exact name of registrant as specified in its charter)

Delaware

(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)

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

Title of each class  
**Common Stock, \$0.01 par value**

Name of each exchange on which registered  
**The Nasdaq Stock Market LLC**

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

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

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

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

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

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

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

Large accelerated filer:  Accelerated filer:   
Non-accelerated filer:  Smaller reporting company:   
(Do not check if a smaller reporting company)  
Emerging growth company:

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2017 was approximately \$93,817,930 (based on the last sale price of such stock on such date as reported by The Nasdaq Global Market and assuming, for the purpose of this calculation only, that all of the registrant's directors and executive officers are affiliates).

*(Applicable only to corporate registrants)* Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: **26,452,462 as of 3/14/2018**

Documents incorporated by reference: **None**

SEC 1673 (01-12)

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

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## **PRELIMINARY NOTE**

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

All company and product names mentioned may be trademarks or registered trademarks of their respective holders. Unless otherwise indicated, “we,” “us,” “our” and similar terms refer to Arotech Corporation and its subsidiaries.

### **PART I**

#### **ITEM 1. BUSINESS**

##### **General**

We are a defense and security company engaged in two business areas: interactive simulation, and mobile power systems.

- We develop, manufacture and market advanced high-tech multimedia and interactive digital solutions for engineering, use-of-force training and operator training of military, law enforcement, security, emergency services and other personnel through our *Training and Simulation Division*:
  - We provide interactive operator training systems featuring state-of-the-art vehicle simulator technology enabling training and research in situation awareness, risk analysis and decision-making, emergency reaction and avoidance procedures, conscientious equipment operation, and crew coordination;
  - We provide aircrew decision making support software, part-task aircraft simulators, and simulated weapon models to support military operations and aircrew training to the United States and foreign militaries;
  - Under the trade name MILO Range™, we provide specialized “use-of-force” and judgment skills training systems for police, security personnel and the military to train their personnel in safe, productive, and realistic environments; and
  - Under the trade name Realtime Technologies™ (“Realtime”), we provide consulting and development support for engineering and research simulation solutions.
- We provide advanced battery solutions, innovative energy management and power distribution technologies and world-class product design and manufacturing services for the aerospace, defense, law enforcement, and homeland security markets, and we manufacture and sell primary and rechargeable batteries, for defense and security products and medical and industrial applications through our *Power Systems Division*:
  - We provide high-end electronics engineering and design services, system integration services, rapid prototyping, and vertically-integrated production services for military, aerospace, and industrial customers, including: (i) hybrid power generation systems, (ii) smart power subsystems for military vehicles and dismounted applications, and (iii) aircraft and missile systems support for cutting-edge weapons and communications technologies;
  - We develop and sell rechargeable and primary batteries and smart chargers to the military and medical markets and to private defense industry in the Middle East, Europe and Asia under our Epsilon nameplate;
  - We develop, manufacture and market primary batteries, rechargeable batteries and battery chargers for the military, focusing on soldier system applications that demand high energy and light weight batteries with intelligent power management and distribution; and
  - We produce water-activated lifejacket lights for commercial aviation and marine applications under our Electric Fuel® nameplate.

## **Background**

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

- FAAC Incorporated (“FAAC”), a Michigan corporation located in Ann Arbor, Michigan (Training and Simulation Division);
- Epsilon-Electric Fuel Ltd. (“Epsilon-EFL”), an Israeli corporation with facilities located in Beit Shemesh, Israel (between Jerusalem and Tel-Aviv), Dimona, Israel (in Israel’s Negev desert area), and in Sderot, Israel (near the Gaza Strip) (Power Systems Division);
- UEC Electronics, LLC (“UEC”), a South Carolina limited liability company located in Hanahan, South Carolina (Power Systems Division); and
- Electric Fuel Battery Corporation (“EFB”), a Delaware corporation located in Hanahan, South Carolina (Power Systems Division).

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

For financial information concerning the business segments in which we operate, see Note 15.b. of the Notes to the Consolidated Financial Statements. For financial information about geographic areas in which we engage in business, see Note 15.c. of the Notes to the Consolidated Financial Statements.

## **Facilities**

Our principal executive offices are located at 1229 Oak Valley Drive, Ann Arbor, Michigan 48108, and our toll-free telephone number at our executive offices is (800) 281-0356. Our corporate website is [www.arotech.com](http://www.arotech.com). Our current reports on Form 8-K and our periodic reports on Form 10-Q and Form 10-K, including any amendments thereto, as well as recent filings relating to transactions in our securities by our executive officers and directors, that have been filed with the SEC in EDGAR format are made available through hyperlinks located on the investor relations page of our website, at <http://ir.arotech.com/all-sec-filings>, as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. Reference to our websites does not constitute incorporation of any of the information thereon or linked thereto into this annual report.

The offices and facilities of our Power Systems Division are located in Hanahan, South Carolina, and in Israel (in Beit Shemesh, Dimona and Sderot, all of which are within Israel’s pre-1967 borders). Our executive operations are conducted primarily from our principal executive offices in Ann Arbor, Michigan, which is the headquarters of our Training and Simulation Division. The Training and Simulation Division also maintains an office in Oviedo, Florida.

## **Training and Simulation Division**

Our Training and Simulation Division develops, manufactures and markets an extensive array of trainers and simulation based solutions that provide interactive and situational awareness and training for military, law enforcement, commercial, and research customers. Our simulators safely and economically train people, from transit bus/rail operators to public safety personnel to military convoy crews, to respond immediately and appropriately in threatening and dangerous situations while under extreme pressure. Our solutions provide pilots of U.S. fighter aircraft accurate weapon employment information. We provide tools and simulation solutions used in leading edge vehicular research. During 2017, 2016, and 2015, revenues from our Training and Simulation Division were approximately \$50.3 million, \$46.4 million, and \$54.6 million, respectively.

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

- Our *Vehicle Simulation* group provides high fidelity vehicle simulators for use in operator/crew training and research applications;
- Our *Air Warfare Simulations* group provides weapon simulations used to train military pilots, weapon employment information used in the effective use of air launched weapons, and part-task simulators to train aircrew; and
- Our *Use of Force* group provides training products focused on developing judgement skills necessary for the proper employment of various lethal and non-lethal options for public safety and military personnel.

### ***Vehicle Simulation***

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

Our Vehicle Simulation group focuses on the development and delivery of complete simulation solutions for a wide range of vehicle types and applications— such as trucks, automobiles, subway trains, buses, fire trucks, police cars, ambulances, airport ground vehicles, and military vehicles and encompasses both driver training and full crew coordination training. We are the prime contractor for the U.S. Army’s Virtual Clearance Training Suite (“VCTS”) program. VCTS trains route clearance teams on techniques to detect and neutralize improvised explosive devices. In 2017, 2016, and 2015, our Vehicle Simulations group accounted for approximately 27%, 37%, and 40%, respectively, of our Training and Simulation Division’s revenues. In 2017, 2016, and 2015, our Vehicle Simulations group accounted for 14%, 18%, and 23% of our consolidated revenues, respectively.

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

### ***Air Warfare Simulations***

In the area of Air Warfare Simulations, we believe we are a premier developer of validated, high fidelity analytical models and simulations of tactical air and land warfare systems for all branches of the U.S. Department of Defense (“DoD”) and its related industrial contractors. Our simulations are found in systems ranging from instrumented air combat and maneuver training ranges (such as Top Gun), full task training devices such as the F-18 Weapon Tactics Trainer, and in the on-board computer of many fighter jet aircraft. We supply on-board software to support weapon launch decisions for the F-15, F-16, F-18, F-22 and F-35 aircraft. Two of our key Air Warfare Simulations program areas are the Zone Acquisition Program (ZAP™) and our Combat Training System (CTS) weapon simulation solution. ZAP™ provides aircrew with weapon employment information using highly accurate high-speed weapon simulations embedded in the operational flight programs of all US fighter aircraft. CTS provides validated weapon simulations for use on combat training ranges and third party aircraft simulators. In 2017, 2016, and 2015, our Air Warfare Simulations group accounted for 38%, 35%, and 36%, respectively, of our Training and Simulation Division’s revenues. In 2017, 2016, and 2015, the Air Warfare Simulations group accounted for 19%, 18%, and 20% of our consolidated revenues, respectively.

### ***Use-of-Force***

We are a leading provider of interactive, multimedia, fully digital use-of-force training simulators for law enforcement, security, military and similar applications. With a large customer base spread over twenty countries around the world, we are a leader in the supply of simulation training products to law enforcement, governmental, and commercial clients. We conduct our interactive training activities and market our interactive training products, such as the MILO Range™ (interactive Use-of-Force and firearms training), the MILO Theater™ (an immersive training environment enabling trainees to experience up to 300 degrees of field of regard), and the MILO Response™ (judgement skills training for EMS personnel), using our MILO Range™ trade name. In 2017, 2016, and 2015, our Use-of-Force group accounted for 28%, 20%, and 15%, respectively, of our Training and Simulation Division’s revenues. In 2017, 2016, and 2015, the Use-of-Force group accounted for 14.3%, 9.8%, and 8.4% of our consolidated revenues, respectively.

### ***Warranty***

We typically offer a one to two year warranty for most of our products. Additionally, we sell extended warranties to our existing customers. In 2017, 2016, and 2015, warranty revenue accounted for 6%, 8%, and 9%, respectively, of our Training and Simulation Division’s revenues.

### ***Marketing and Customers***

We market our Training and Simulation Division products to all branches of the U.S. military, international militaries, federal and local governments, municipal transportation departments, research institutions, private organizations, and public safety groups. Municipalities throughout the U.S. and Mexico are using our vehicle simulators and use-of-force products, and our penetration in Asia, Europe and the Americas continues through the use of commissioned sales agents, regional distributors, and strategic corporate partnerships.

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

### **Competition**

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

#### *Vehicle Simulators*

Several potential competitors in this segment are large, diversified defense and aerospace conglomerates, such as L-3 Technologies, Inc. (NYSE: LLL) and Leidos Holdings, Inc. (NYSE: LDOS), who do not focus exclusively on our specific niches. As such, we are able to compete directly with these organizations based on our strength in developing higher quality software solutions or provide service on certain large military contracts through strategic agreements with these organizations. In municipal market applications, we compete against smaller, less sophisticated companies, such as Raydon Corporation and Doron Precision Systems, Inc. Many of our large business competitors have financial, technical, marketing, sales, manufacturing, distribution and other resources significantly greater than ours.

#### *Air Warfare Simulations*

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

#### *Use of Force*

We compete against a number of established companies that provide similar products and services, some of which have financial, technical, marketing, sales, manufacturing, distribution and other resources significantly greater than ours. There are also companies whose products do not compete directly, but are sometimes closely related to the products we offer. Cubic Corporation (NYSE: CUB), Meggitt PLC (LSE: MGT), VirTra, Inc. (OTCMKTS: VTSL.PK), Ti Training Corp., and Laser Shot, Inc. are our main competitors in this space.

### **Power Systems Division**

Our Power Systems Division develops and provides sophisticated portable power solutions for diverse applications, including military equipment carried by soldiers, hybrid energy generation/storage in austere environments, power management and power distribution, and clean, stable power for tactical vehicles, unmanned vehicles and medical devices, all of which are designed to complex and demanding customer specifications. During 2017, 2016, and 2015, revenues from our Power Systems Division were approximately \$48.5 million, \$46.6 million, and \$42.0 million, respectively.

### ***Electronics Engineering and Design Services for the Military***

#### *Introduction*

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

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In addition, we also specialize in core, proprietary engineering capabilities in highly-demanded solution areas, including: (i) hybrid power generation systems, (ii) smart power subsystems for military vehicles and dismounted applications, and (iii) aircraft and missile systems support for cutting-edge weapons and communications technologies. Our unique brand of comprehensive service is highly sought-after by customer agencies such as the Marine Corps Systems Command, Space and Naval Warfare Systems Command (“SPAWAR”), US Army Communications and Electronics Research & Development Command (“CERDEC”) and Tank Automotive Command, as well as large prime contractors such as Raytheon, Science Applications International Corporation (NYSE: SAIC) (“SAIC”), Boeing, Lockheed Martin Corporation (NYSE: LMT), and BAE Systems plc (LON: BA) (“BAE”). Our key program areas in this field include the following:

- We supply the United States Marine Corps (“USMC”) with its program of record Ground Renewable Expeditionary Energy Network Systems (“GREENS”), a renewable power generation, intelligent energy storage and distribution system for troops serving in austere environments. GREENS is the only DoD Program of Record for renewable power generation. We also offer a commercial (not-ITAR restricted) version of this product, targeting both domestic and international markets where clean, reliable power in austere, rugged environments is a critical need.
- We have supplied the USMC with Mobile Hybrid Expeditionary Energy System (“MHEES”), a product that incorporates both solar collection and high density battery technologies to intelligently reduce run time and optimize efficiency of tactical generators. This single system is scalable to 3.5kW, 7kW and 10.5kW output, making it an ideal solution for multiple military missions. During 2017, we delivered to the Marine Corps Systems Command the next-generation of MHEES, known as Mobile Electric Hybrid Power Sources (“MEHPS”). MEHPS is a modular, scalable system capable of delivering clean, reliable three-phase power in a 5kW dismounted configuration as well as a 10kW trailer mounted configuration. UEC will support government testing in 2018.
- We have designed and continue to refine a proprietary Distributed Power Control and Management System (DPCMS) that replaces electrical systems on aging tactical vehicles such as the Light Armored Vehicle (LAV) and Amphibious Assault Vehicle (AAV). This power management and distribution system enables vehicles that have already exceeded the OEM’s recommended life to be refurbished and to take advantage of new automotive communication protocol J-1939. These refurbishments permit aging tactical vehicle fleets to function as a new vehicle, without the cost implications of replacing it with a new vehicle. This system has been successfully tested on LAVs and AAVs by the USMC and UEC is currently under contract with the USMC to design and integrate the DPCMS system into multiple variants of the AAV.
- We have developed significant expertise and past performance qualifications in the area of solutions for Command, Control, Communications, Computers Intelligence, Surveillance and Reconnaissance (C4ISR), providing these solutions to, among others, SPAWAR and Raytheon.

### *Competition*

Our main competitors for renewable energy and power management systems and services are ZeroBase Energy, LLC, a provider of hybrid and renewable power systems, and Solar Stik, Inc., a provider of portable and custom power solutions. In the realm of contract design and manufacturing services, we compete with Sechan Electronics Inc., a provider of military electronic systems and subsystems, IEC Electronics Corp.(NYSE: IEC), a provider of electronic contract manufacturing services, Celestica Inc. (NYSE: CLS), Ducommun Incorporated (NYSE: DCO), Sanmina-SCI Corporation (Nasdaq: SANM), and Jabil Circuit, Inc. (NYSE: JBL), a supplier of manufacturing services for circuit board assemblies.

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

### *Marketing and Customers*

We market to a diverse array of customers. The renewable and hybrid energy market prior to 2015 had been primarily focused on the U.S. Department of Defense. We believe we have achieved significant success in this market; however, we are modifying our products to better meet commercial/industrial demands. In addition, we are refocusing marketing efforts internationally on the heels of our GREENS and MHEES programs. Specific efforts include exhibiting at international trade shows like DSEI and Eurosatory, establishing international sales channels, establishing networks within U.S. commercial markets, and an increase in outbound marketing efforts designed to drive potential customers to our solutions.

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Over 90% of revenues are attributed to existing customers with new requirements or referrals of new customers from our existing customer base. This customer loyalty is closely tied to our technical solutions, our on-time delivery and quality of product metrics (consistently 98% or greater).

### *Manufacturing*

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

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

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

We develop and produce high-end lithium batteries, both primary (disposable) and secondary (rechargeable), as well as "smart" chargers for the rechargeable batteries and electronic sub-assemblies. We market to the military, the medical, and the industrial markets. We believe we are among the few companies in the world with the capability to develop and manufacture complex portable power sources needed by high-end portables. We perform the development and manufacturing in-house with the exception of the electrochemical cells, which we purchase from suppliers. We have also begun to penetrate the "special" batteries market, meaning large format batteries (such as those used to power submarines) and high power batteries (such as those used in missile launchers and battle tank emergency startup units).

We have experience in working with government agencies, the military and large corporations. Our technical team has significant expertise in the fields of electrochemistry, electronics, software and battery design, production, packaging and testing. We also specialize in custom products that must meet the highest possible military, industrial and medical specifications.

Our SWIPES™ power hub utilizes the MOLLE (MODular Lightweight Load-carrying Equipment) vest and integrates force protection electronics and communications equipment with an advanced battery. The system utilizes a modular power distribution system that is powered by a conformal wearable battery allowing for extended mission times without the burden of power source swaps or charging due to their high energy density. It also reduces the battery weight soldiers carry by up to 30%. The batteries continuously charge the secondary batteries inside various devices, such as two way radios, GPS units and shot detection systems. In 2015 and 2016, US Army CERDEC awarded us with a development contract to expand the soldier system wearable capabilities through the development of super capacitor based Radio Power Adapters (RPA). These RPAs are expected to further reduce the weight that a soldier carries and allows for the next level of capability for integrated soldier systems.

### *Customers*

The principal customers for our lithium batteries during 2017 were the Israel Ministry of Defense, Elbit Systems Ltd. (Nasdaq: ESLT), Israel Aerospace Industries Ltd. (TASE: ARSP), and Rafael Advanced Defense Systems Ltd. The principal customer for our soldier power systems in 2017 was the U.S. Army, with interest also shown from the U.K. Ministry of Defence and the Australian Defence Force.

### *Competition*

There are a limited number of players globally that are a one-stop-shop for high-end custom portable power. Our main competitors are Bren-Tronics, Inc., Ultralife Corporation (Nasdaq: ULBI) ("Ultralife"), Inventus Power, Protonex Technology Corporation, Saft America Inc., Electrochem Solutions, Inc., RRC Power Solutions and Inspired Energy Plc (LSE: INSE).

### *Manufacturing*

Our U.S. manufacturing facility for batteries and chargers is located in Hanahan, South Carolina, in the Charleston area. In parallel, we have manufacturing facilities in Beit Shemesh, Dimona and Sderot, all located in Israel.

### ***Lifejacket Lights***

We are a world leader in the supply of water-activated lifejacket and survivor locator lights to the marine and aviation markets. Since 1996 we have offered a range of safety products used by the marine and aerospace industries, commercial airlines and military outfitters. Our lifejacket lights are certified by air and marine regulatory organizations, and are available through distributors worldwide.

### Products

We have a product line consisting of seven lifejacket light models. Five of these models are for use with marine lifejackets and two are for use with aviation lifejackets. The marine lifejacket lights come in two LED alkaline-powered models (a one-piece and a two-piece model), two LED lithium-powered models (a one-piece product and a two-piece product), and a two-piece lithium-powered incandescent mode. Both our aviation locator incandescent lights are powered by our patented magnesium copper chloride battery chemistry. All of our lifejacket lights work in both freshwater and seawater. Each of our lifejacket lights is certified for use by relevant governmental agencies under various U.S. and international regulations, including the U.S. Federal Aviation Administration's Technical Standard Order ("TSO"), the EU's Marine Equipment Directive 96/98/EC (MED), and the International Safety of Life at Sea (SOLAS) Convention. We manufacture, assemble and package all our lifejacket lights in our factory in Beit Shemesh, Israel.

### Marketing

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

### Competition

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

### Backlog

We generally sell our products under standard purchase orders. Orders constituting our backlog are subject to changes in delivery schedules and are typically cancelable by our customers until a specified time prior to the scheduled delivery date. Accordingly, our backlog is not necessarily an accurate indication of future sales. As of December 31, 2017, 2016, and 2015, our funded backlog was approximately \$61.1 million, \$55.4 million, and \$63.0 million, respectively, divided between our divisions as follows:

<b>Division</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
Training and Simulation Division	\$ 38,752,000	\$ 18,790,000	\$ 29,772,000
Power Systems Division	22,349,000	36,584,000	33,248,000
<b>TOTAL:</b>	<b>\$ 61,101,000</b>	<b>\$ 55,374,000</b>	<b>\$ 63,020,000</b>

### Major Customers

During 2017, 2016, and 2015, including both of our divisions, various branches of the United States military accounted for approximately 33%, 41% and 48% of our revenues. See "Item 1A. Risk Factors – Risks Related to Government Contracts," below.

### Patents and Trade Secrets

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

Our intellectual property portfolio includes four issued U.S. patents, which expire between 2018 and 2037. We also have various patent applications pending for examination in U.S. and foreign jurisdictions.

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

## **Research and Development**

During the years ended December 31, 2017, 2016, and 2015, our research and product development expenses were approximately \$3.0 million, \$2.7 million, and \$3.1 million, respectively. Not included in these figures are any costs pertaining to the Flow Battery segment that was discontinued on August 31, 2016, or any research and development where the costs were underwritten by customers or charged directly to projects as non-recovered engineering costs.

## **Employees**

As of December 31, 2017, we employed 489 total employees worldwide, substantially all of whom were full-time employees. Our success will depend in large part on our ability to attract and retain skilled and experienced employees.

With respect to those of our employees who are Israeli residents, Israeli law generally requires severance pay upon the retirement or death of an employee or termination of employment without due cause. We currently partially fund our ongoing severance obligations by making monthly payments to approved severance funds or insurance policies.

## **Raw Materials**

We are dependent on the availability of raw materials from our suppliers. The most important raw materials are lithium cells and zinc for our batteries. We purchase these raw materials from various suppliers. We believe alternative sources generally exist for the raw materials used for our batteries.

## **Regulatory Matters**

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

## **Government Contracts**

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

## **Environmental**

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

## ITEM 1A. RISK FACTORS

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

### Business-Related Risks

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

We have incurred significant net losses since our inception. As of December 31, 2017, we had an accumulated deficit of approximately \$181.6 million. In an effort to reduce operating expenses and maximize available resources, we have consolidated certain of our subsidiaries, shifted personnel and reassigned responsibilities. We have also taken a variety of other measures to limit spending and will continue to assess our internal processes to seek additional cost-structure improvements. Although we believe that such steps have helped to reduce our operating expenses and maximize our available resources and enabled us to operate at a net profit in the recent past, there can be no assurance that we will be able to maintain profitability consistently or that our business will continue to exist.

*Our existing indebtedness may adversely affect our ability to obtain additional funds and may increase our vulnerability to economic or business downturns. Failure to comply with the terms of our indebtedness could result in a default that could have material adverse consequences for us.*

Our bank and other indebtedness (short and long term) totaled approximately \$15.9 million as of December 31, 2017 (not including trade payables, other account payables, and accrued severance pay), of which \$5.1 million was bank working capital lines of credit and approximately \$7.7 million represents a term loan entered into to fund the UEC acquisition and a \$3.1 million mortgage on our property owned in Ann Arbor, Michigan. In addition, we may incur additional indebtedness in the future. Accordingly, we are subject to the risks associated with significant indebtedness, including:

- we must dedicate a portion of our cash flows from operations to pay principal and interest and, as a result, we may have less funds available for operations and other purposes;
- it may be more difficult and expensive to obtain additional funds through financings, if available at all;
- we are more vulnerable to economic downturns and fluctuations in interest rates, less able to withstand competitive pressures and less flexible in reacting to changes in our industry and general economic conditions; and
- if we default under any of our existing debt instruments, including paying the outstanding principal when due, and if our creditors demand payment of a portion or all of our indebtedness, we may not have sufficient funds to make such payments.

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

Furthermore, a failure to comply with the obligations contained in the agreements governing our indebtedness could result in an event of default under such agreements which could result in an acceleration of debt under other instruments evidencing indebtedness that contain cross-acceleration or cross-default provisions. If our indebtedness were to be accelerated, there can be no assurance that our future cash flow or assets would be sufficient to repay in full such indebtedness. In the past, we have received waivers that enabled us to avoid covenant violations that could have triggered a default on our indebtedness. There can be no assurance that any similar waivers will, if needed, be granted in the future.

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

The business of electronics engineering and design services for the military is a relatively new business for us and our management group has limited experience operating this particular type of business. We cannot assure that we will be successful in managing this new business. If we are unable to successfully operate this new business, our business, financial condition and results of operations could be materially impaired.

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

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

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

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

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

As of December 31, 2017, we had recorded goodwill of \$46.1 million. Any future impairment of goodwill or other intangible assets may have a significant impact on earnings. Goodwill is not amortized, but is tested for impairment at the reporting unit level. Goodwill is required to be tested for impairment annually and between annual tests if events or circumstances indicate that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. There are numerous risks that may cause the fair value of a reporting unit to fall below its carrying amount, which could lead to the measurement and recognition of goodwill impairment. These risks include, but are not limited to, adverse changes in legal factors or the business climate, an adverse action or assessment by a regulator, a more-likely-than-not expectation that all or a significant portion of a reporting unit may be disposed of, a sustained decline in our market capitalization, significant negative variances between actual and expected financial results, and lowered expectations of future financial results.

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

The goodwill of our Training and Simulation Division equaled \$24.4 million and the goodwill of our Power Systems Division equaled \$21.7 million at December 31, 2017. Based on the discounted cash flow valuation at December 31, 2017, an increase in the WACC or changes in other significant variables for the Power Systems Division could potentially result in impairment.

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

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

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

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

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

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

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

***Our business could be negatively impacted by cyber attacks and other security breaches.***

In the ordinary course of our business, we collect and store sensitive data, including intellectual property, our proprietary business information and that of our customers, suppliers and business partners, in our data centers and on our networks. As part of our business, we may face certain security threats, including threats to our information technology infrastructure, attempts to gain access to our proprietary, sensitive or classified information. Cybersecurity threats could evolve quickly and include, but not be limited to, computer viruses, attempts to access information and other electronic security breaches. Our information technology networks and related systems are critical to the operation of our business and essential to our ability to successfully perform day-to-day operations. In addition, our customers, suppliers, subcontractors and other third parties with whom we do business generally face similar security threats, and in some cases we must rely on the safeguards put in place by these parties to protect against security threats. We believe we have implemented appropriate measures and controls and have invested in resources to appropriately identify and monitor these threats and mitigate potential risks, including risks involving our customers and suppliers. However, such actions may not be sufficient to prevent cybersecurity breaches, disruptions to mission critical systems, the unauthorized release of sensitive information or corruption of data, or harm to facilities or personnel.

In addition, as a provider of products and services to government and commercial customers, our products and services may be the targets of cyber attacks that attempt to sabotage or otherwise disable such products and services, or our cybersecurity and other products and services ultimately may not be able to effectively detect, prevent, or protect against or otherwise mitigate losses from all cyber attacks. Furthermore, as a defense contractor with a security clearance we would be obligated to notify the Department of Defense of certain penetrations of protected networks.

The impact of these security threats and other disruptions, including cyber attacks and other security breaches, is difficult to predict. However, the cost and operational consequences of responding to breaches and implementing remediation measures could be significant and our insurance coverage may not cover all related costs. These threats and other events could also disrupt our operations, or the operations of our customers, suppliers, subcontractors and other third parties, could require significant management attention and resources, could result in the loss of business, regulatory actions and potential liability, and could negatively impact our reputation among our customers and the public, any one of which could have a negative impact on our financial condition, results of operations or liquidity.

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

A significant portion of our sales are made to customers located outside the U.S., primarily in Europe and Asia. In 2017, 2016, and 2015, 27.5%, 21.9%, and 19.5%, respectively, of our revenues, were derived from sales to customers located outside the U.S. We expect that our international customers will continue to account for a substantial portion of our revenues in the near future. Sales to international customers may be subject to political and economic risks, including political instability, currency controls, exchange rate fluctuations, foreign taxes, longer payment cycles and changes in import/export regulations and tariff rates. In addition, various forms of protectionist trade legislation have been and in the future may be proposed in the U.S. and certain other countries. Any resulting changes in current tariff structures or other trade and monetary policies could adversely affect our sales to international customers. See also “Israel-Related Risks,” below.

**Risks Related to Government Contracts**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Market-Related Risks**

***The price of our common stock is volatile.***

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

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

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

There can be no assurance that our common stock will remain listed on the Nasdaq Stock Market. While our stock would continue to trade on the over-the-counter bulletin board following any delisting from the Nasdaq, any such delisting of our common stock could have an adverse effect on the market price of, and the efficiency of the trading market for, our common stock. Trading volume of over-the-counter bulletin board stocks has been historically lower and more volatile than stocks traded on an exchange or the Nasdaq Stock Market. As a result, holders of our securities could find it more difficult to sell their securities. Also, if in the future we were to determine that we need to seek additional equity capital, any delisting could have an adverse effect on our ability to raise capital in the public equity markets.

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

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

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

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

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

***Compliance with public company obligations, including the securities laws and regulations, is costly and requires significant management resources, and we may fail to comply. We are an “accelerated filer,” and as a result are subject to more comprehensive disclosure obligations, with increased compliance costs.***

The federal securities laws and regulations, including the corporate governance and other requirements of the Sarbanes-Oxley Act of 2002, impose complex and continually changing regulatory requirements on our operations and reporting. Our legal compliance obligations and costs could harm our results of operations and divert management’s attention from business operations.

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

***We do not anticipate paying cash dividends.***

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

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

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

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

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

**Israel-Related Risks**

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

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

Israel withdrew unilaterally from the Gaza Strip and certain areas in northern Samaria in 2005. Thereafter Hamas, an Islamist terrorist group responsible for many attacks, including missile strikes against Israeli civilian targets, won the majority of the seats in the Parliament of the Palestinian Authority in January 2006 and took control of the entire Gaza Strip, by force, in June 2007. Since then, Hamas and other Palestinian movements have launched thousands of missiles from the Gaza strip into civilian targets in southern Israel.

Our Israeli production facilities in the cities of Beit Shemesh and Dimona, are located approximately 27 miles and 38 miles, respectively, from the nearest point of the border with the Gaza Strip. We also have a small production facility in Sderot, which is located 0.6 miles from the nearest point of the border with the Gaza Strip. There can be no assurance that Hamas will not begin to use on a more frequent basis longer-range missiles capable of reaching our facilities, which could result in a significant disruption of the Israel-based portion of our business. Additionally, recent political events, including political uprisings, social unrest and regime change, in various countries in the Middle East and North Africa have weakened the stability of those countries, which could result in extremists coming to power, including in countries with which Israel has signed peace treaties that may not be respected by extremists. In addition, Iran has threatened to attack Israel, and is widely believed to be developing nuclear weapons. Iran is also believed to have a strong influence among extremist groups in the region, such as Hamas in Gaza and Hezbollah in Lebanon. These situations may potentially escalate in the future to more violent events which may affect Israel and us. Any major hostilities involving Israel, including as a result of the military conflicts between the Fatah and Hamas in Gaza Strip, Judea and Samaria, or the interruption or curtailment of trade between Israel and its present trading partners could have a material adverse effect on our business, operating results and financial condition.

***Enforcement of civil liabilities against our Israeli assets may be difficult to obtain.***

We are organized under the laws of the State of Delaware and will be subject to service of process in the United States. However, approximately 24% of our assets are located outside the United States.

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

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

Although a substantial majority of our revenues and a substantial portion of our expenses are denominated in U.S. dollars, a portion of our costs, including personnel and facilities-related expenses, is incurred in New Israeli Shekels (NIS). Inflation in Israel will have the effect of increasing the dollar cost of our operations in Israel, unless it is offset on a timely basis by a devaluation of the NIS relative to the dollar. In 2017, the inflation-adjusted NIS appreciated against the dollar.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

Our primary administrative offices are located in the offices of our Training and Simulation Division, consisting of approximately 17,300 square feet of office and warehouse space in Ann Arbor, Michigan, pursuant to a lease expiring in July 2018. We own 57,200 square feet of office, production, and warehouse space near our administrative offices in Ann Arbor. We sublease 7,000 square feet of surplus space in this building for a term of five years with a five year option. The current sublessee has exercised their five year option to sublease this surplus space, which will expire January 31, 2023. Additionally, we also lease 10,000 square feet of office and lab space in Oviedo, Florida pursuant to a lease expiring in October 2019.

Our Power Systems Division operates out of facilities in Hanahan, South Carolina, constituting approximately 56,233 square feet, which are leased from the former owners of UEC through the end of 2019 with an option to renew through 2024. Our Power Systems Division also maintains approximately 23,000 square feet of factory, office and warehouse space in Dimona, Israel, in Israel's Negev desert (within Israel's pre-1967 borders), on a month-to-month basis. We also maintain approximately 2,300 square feet of factory, office and warehouse space in Sderot, Israel, located approximately 0.6 miles from the nearest point of the border with the Gaza Strip, pursuant to a lease expiring in April 2018.

Our research, development and production facilities for the manufacture and assembly of our Survivor Locator Lights, constituting approximately 21,000 square feet, are located in Beit Shemesh, Israel, located between Jerusalem and Tel-Aviv (within Israel's pre-1967 borders). Effective January 1, 2018, we entered into a new five-year lease for these facilities, with an option on our part to renew for an additional period of five years.

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

**ITEM 3. LEGAL PROCEEDINGS**

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

**ITEM 4. MINE SAFETY DISCLOSURES**

None.

## PART II

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

Information about our equity compensation plans may be found in Item 12 of this report which is hereby incorporated by reference.

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

<b>Year Ended December 31, 2017</b>	<b>High</b>	<b>Low</b>
Fourth Quarter	\$ 4.25	\$ 3.46
Third Quarter	\$ 4.35	\$ 3.05
Second Quarter	\$ 3.95	\$ 2.90
First Quarter	\$ 5.00	\$ 2.80

<b>Year Ended December 31, 2016</b>	<b>High</b>	<b>Low</b>
Fourth Quarter	\$ 4.35	\$ 2.25
Third Quarter	\$ 3.35	\$ 2.55
Second Quarter	\$ 4.13	\$ 2.35
First Quarter	\$ 2.88	\$ 1.92

As of February 28, 2018, we had approximately 131 registered holders of record of our common stock.

#### Dividends

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

#### Performance Graph

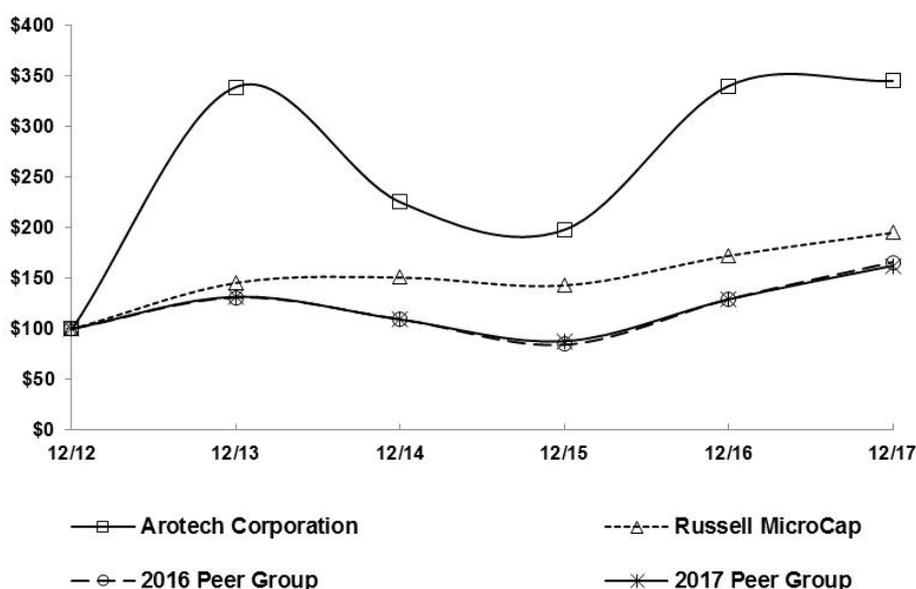
*The following performance graph and related information shall not be deemed "soliciting material" or to be "filed" with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933, as amended (the "Securities Act"), or the Exchange Act of 1934 as amended (the "Exchange Act"), except to the extent that we specifically incorporate it by reference into such filing.*

The following graph compares our cumulative total stockholder return for the past five years with the cumulative total return on the Russell Microcap Index (Broad Market Index) and a self-constructed peer group index (the "2017 Peer Group") consisting of two companies in the simulation and training space (Kratos Defense & Security Solutions, Inc. (Nasdaq: KTOS) and VirTra Systems, Inc. (OTC: VTSI)) and three companies in the power and defense space (Espey Mfg. & Electronics Corp. (NYSE: ESP), Highpower International, Inc. (Nasdaq: HPJ), and KVH Industries, Inc. (Nasdaq: KVHI), as well as our self-constructed peer group index last year (the "2016 Peer Group." Espey Mfg. & Electronics Corp. has been added to the 2017 Peer Group to replace API Technologies Corp., the securities of which no longer trade publicly. The market capitalization of the peer companies in the simulation and training space is roughly equivalent to that of the peer companies in the power and defense space, and we believe that all these companies are "microcap" companies that are fairly comparable to us.

The cumulative total stockholder return is based on \$100 invested in our common stock and in the respective indices on December 31, 2012, and assumes that all dividends were reinvested. The stock prices on the performance graph are not necessarily indicative of future price performance.

### COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\*

Among Arotech Corporation, the Russell MicroCap Index,  
2016 Peer Group and 2017 Peer Group



\*\$100 invested on 12/31/12 in stock or index, including reinvestment of dividends.  
Fiscal year ending December 31.

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	12/12	12/13	12/14	12/15	12/16	12/17
<b>Arotech Corporation</b>	<b>100.00</b>	<b>338.83</b>	<b>225.24</b>	<b>198.06</b>	<b>339.81</b>	<b>344.66</b>
<b>Russell MicroCap</b>	<b>100.00</b>	<b>145.62</b>	<b>150.93</b>	<b>143.15</b>	<b>172.30</b>	<b>194.99</b>
<b>2016 Peer Group</b>	<b>100.00</b>	<b>130.86</b>	<b>109.48</b>	<b>84.59</b>	<b>129.16</b>	<b>165.44</b>
<b>2017 Peer Group</b>	<b>100.00</b>	<b>131.63</b>	<b>109.10</b>	<b>87.63</b>	<b>128.98</b>	<b>162.29</b>

- (1) The 2017 Peer Group is comprised of the following companies: Kratos Defense & Security Solutions, Inc. (Nasdaq: KTOS), VirTra Systems, Inc. (OTC: VTSI), Espey Mfg. & Electronics Corp. (NYSE: ESP), Highpower International, Inc. (Nasdaq: HPJ), and KVH Industries, Inc. (Nasdaq: KVHI). The 2016 Peer Group is comprised of the following companies: Kratos Defense & Security Solutions, Inc. (Nasdaq: KTOS), VirTra Systems, Inc. (OTC: VTSI), Highpower International, Inc. (Nasdaq: HPJ), KVH Industries, Inc. (Nasdaq: KVHI), and API Technologies Corp., which no longer trades publicly. The returns of each company have been weighted according to their respective stock market capitalization for purposes of arriving at a peer group average.

#### ITEM 6. SELECTED FINANCIAL DATA

The selected financial information set forth below with respect to the consolidated statements of operations for each of the five fiscal years in the period ended December 31, 2017, and with respect to the consolidated balance sheets at the end of each such fiscal year has been derived from our consolidated financial statements audited by BDO USA, LLP, independent registered public accounting firm.

The financial information set forth below is qualified by and should be read in conjunction with the consolidated financial statements contained in Item 8 of this Report and the notes thereto and “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations,” below.

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The financial results of the Company are presented as continuing operations for all periods presented. The loss from discontinued operations reported for the years ended December 31, 2016 and 2015 was \$1.4 million and \$894,000, respectively.

	<b>Year Ended December 31,</b>				
	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>
	(dollars in thousands, except per share data)				
<b>Statement of Operations:</b>					
Revenues	\$ 98,723	\$ 92,975	\$ 96,574	\$ 103,562	\$ 88,571
Cost of revenues	\$ 71,083	\$ 64,825	\$ 68,457	\$ 70,855	\$ 64,479
Research and development expenses	\$ 3,041	\$ 2,723	\$ 3,075	\$ 2,926	\$ 2,956
Selling and marketing expenses	\$ 7,874	\$ 7,029	\$ 5,373	\$ 5,921	\$ 5,618
General and administrative expenses	\$ 11,624	\$ 15,308	\$ 16,339	\$ 17,261	\$ 10,887
Amortization of intangible assets	\$ 2,206	\$ 2,876	\$ 3,044	\$ 2,697	\$ 1,091
Total operating costs and expenses	\$ 95,828	\$ 92,761	\$ 96,288	\$ 99,660	\$ 85,031
Operating income	\$ 2,895	\$ 214	\$ 286	\$ 3,902	\$ 3,540
Other income (expense)	\$ (8)	\$ 65	\$ (24)	\$ 2,512	\$ 270
Financial expense, net	\$ (1,077)	\$ (975)	\$ (1,152)	\$ (1,507)	\$ (483)
Total other income (expense)	\$ (1,085)	\$ (910)	\$ (1,176)	\$ 1,005	\$ (213)
Income (loss) before income tax expense	\$ 1,810	\$ (696)	\$ (890)	\$ 4,907	\$ 3,327
Income tax (benefit) expense	\$ (2,024)	\$ 784	\$ 1,161	\$ 1,024	\$ 1,053
Income (loss) from continuing operations	\$ 3,834	\$ (1,480)	\$ (2,051)	\$ 3,883	\$ 2,274
Basic net income (loss) per share – continuing operations	\$ 0.15	\$ (0.06)	\$ (0.08)	\$ 0.18	\$ 0.13
Diluted net income (loss) per share – continuing operations	\$ 0.15	\$ (0.06)	\$ (0.08)	\$ 0.17	\$ 0.12
Weighted average number of shares used in computing basic net income (loss) per share	26,380,312	25,494,097	23,687,733	21,934,532	16,507,848
Weighted average number of shares used in computing diluted net income (loss) per share	26,380,312	25,494,097	23,687,733	22,537,272	17,110,588

	<b>As At December 31,</b>				
	<b>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>
	(dollars in thousands)				
<b>Balance Sheet Data:</b>					
Cash, cash equivalents, and restricted collateral deposits	\$ 5,489	\$ 7,400	\$ 10,698	\$ 11,528	\$ 6,320
Receivables and other assets	\$ 50,289	\$ 43,782	\$ 45,612	\$ 49,485	\$ 37,324
Property and equipment, net of depreciation	\$ 9,276	\$ 5,915	\$ 6,385	\$ 6,463	\$ 4,927
Goodwill and other intangible assets, net	\$ 51,344	\$ 52,313	\$ 54,798	\$ 57,263	\$ 32,084
Total assets	\$ 116,398	\$ 109,410	\$ 117,493	\$ 124,739	\$ 80,655
Current liabilities	\$ 26,319	\$ 23,761	\$ 26,777	\$ 28,117	\$ 18,235
Long-term liabilities	\$ 18,986	\$ 20,564	\$ 26,669	\$ 30,267	\$ 14,443
Stockholders' equity	\$ 71,093	\$ 65,085	\$ 64,047	\$ 66,355	\$ 47,977
Total liabilities and stockholders' equity	\$ 116,398	\$ 109,410	\$ 117,493	\$ 124,739	\$ 80,655

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

*The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve inherent risks and uncertainties. When used in this discussion, the words "believes," "anticipates," "expects," "estimates" and similar expressions are intended to identify such forward-looking statements. Such statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We undertake no obligation to publicly release the result of any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors including, but not limited to, those set forth elsewhere in this report. Please see "Risk Factors," above, and in our other filings with the Securities and Exchange Commission.*

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

### General

We are a defense and security company engaged in two business areas: interactive simulation, and batteries and charging systems.

- We develop, manufacture and market advanced high-tech multimedia and interactive digital solutions for engineering, use-of-force training and operator training of military, law enforcement, security, emergency services and other personnel through our ***Training and Simulation Division***.
- We provide advanced battery solutions, innovative energy management and power distribution technologies and world-class product design and manufacturing services for the aerospace, defense, law enforcement and homeland security markets, and we manufacture and sell primary rechargeable batteries, for defense and security products and medical and industrial applications through our ***Power Systems Division***.

### Federal Income Tax

The U.S. Tax Cuts and Jobs Act ("Tax Act") was enacted on December 22, 2017. The Tax Act makes broad complex changes to the U.S. tax code including, but not limited to, reducing the U.S. federal corporate tax rate from 35% to 21%, requiring companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred, and creating new taxes on certain foreign sourced earnings and additional limitations on the deductibility of interest.

The SEC issued Staff Accounting Bulletin No. 118 (SAB 118) in December, 2017, to provide guidance on accounting for the effects of the Tax Act. SAB 118 provides for a measurement period of up to one year from the Tax Act enactment date for companies to complete their assessment of and accounting for those effects of the Tax Act required under ASC 740 "Implementation Guidance on Accounting for Uncertainty in Income Taxes" to be reported in the period of enactment. Under SAB 118, a company must first reflect the income tax effects of the Tax Act for which the accounting is complete in the period of the date of enactment. To the extent the accounting for other income tax effects is incomplete, but a reasonable estimate can be determined, companies must record a provisional estimate to be included in their financial statements. For any income tax effect for which a reasonable estimate cannot be determined, an entity must continue to apply ASC 740 based on the provisions of the tax laws in effect immediately prior to the Tax Act being enacted until such time as a reasonable estimate can be determined.

We recorded a provisional deferred income tax benefit of \$3.2 million in the period ended December 31, 2017 related to the change in corporate tax rate from 35% to 21% as a result of the Tax Act. We require additional time to complete our analysis of the impacts of the Tax Act and therefore our accounting for the Tax Act is provisional but is a reasonable estimate based on available information. We will complete our analysis of and finalize our accounting for this provisional estimate during the one-year measurement period as prescribed by SAB 118.

For the year ended December 31, 2017, we were not required to record any provisional amounts for our foreign subsidiary due to the accumulated net loss position of our foreign subsidiary.

Beginning in 2018, the Tax Act provides a 100% deduction for dividends received from 10-percent owned foreign corporations by U.S. corporate shareholders, subject to a one-year holding period. Although dividend income is now exempt from U.S. federal tax in the hands of the U.S. corporate shareholders, companies must still apply the guidance of ASC 740-30-25-18 to account for the tax consequences of outside basis differences and other tax impacts of their investments in non-U.S. subsidiaries. While we have not accrued the Transition Tax on the deemed repatriated earnings that were previously indefinitely reinvested, we were unable to determine a reasonable estimate of the remaining tax liability, if any, under the Tax Act for its remaining outside basis.

The Tax Act limits net operating loss (“NOL”) deductions to 80 percent of taxable income for tax years beginning after December 31, 2017. The amendments disallow the carryback of NOLs but allow for the indefinite carryforward of NOLs, which would be considered an indefinite lived asset.

### ***Discontinued Operations***

During the quarter ended September 30, 2016, our Board of Directors approved a plan to discontinue the Flow Battery segment. The discontinuance was a strategic shift that had a major effect on our operations and financial results; therefore, the results of the Flow Battery segment were reclassified as discontinued operations as of and for the periods ended December 31, 2016 and 2015, respectively.

Our financial results are presented as continuing operations in the Consolidated Financial Statements for all periods presented. See Note 1 of the Notes to the Consolidated Financial Statements. The loss from discontinued operations reported for the year ended December 31, 2016 and 2015 was \$1.4 million and \$894,000, respectively. The impact of the discontinued operations on operating activities and on investing activities within the consolidated statement of cash flows for the two years ended December 31, 2016 and 2015 was (\$1.3 million), and (\$879,000); and (\$252,000), and (\$22,000), respectively.

During the quarter ended December 31, 2017, it was determined that we were not able to execute our plan to sell the assets associated with the Flow Battery segment. As a result, assets in the amount of \$270,000 have been reclassified on the consolidated balance sheet into property and equipment, which are being used in our operations and are therefore not considered to be impaired as of December 31, 2017.

### **Critical Accounting Policies**

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

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

### ***Revenue Recognition***

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

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

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

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

#### ***Allowance for Doubtful Accounts***

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

#### ***Accounting for Income Taxes***

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

The Tax Act was enacted on December 22, 2017. The Tax Act makes broad complex changes to the U.S. tax code including, but not limited to, reducing the U.S. federal corporate tax rate from 35% to 21%, requiring companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred, and creating new taxes on certain foreign sourced earnings and additional limitations on the deductibility of interest. The Tax Act is complex and requires interpretation of certain provisions to estimate the impact on our income tax expense. The estimates are based on the information available and our current interpretation of the Tax Act, and may change due to changes in interpretations and assumptions we make and additional guidance or context from the Internal Revenue Service, the U.S. Treasury Department, the Financial Accounting Standards Board or others regarding the Tax Act. Our accounting for the impacts of the Tax Act is provisional and our actual income tax benefit could differ from our estimates. Please refer to Note 13 to the "Consolidated Financial Statements" for additional information.

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

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

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

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

### ***Inventories***

Our policy for valuation of inventory and commitments to purchase inventory, including the determination of obsolete or excess inventory, requires us to perform a detailed assessment of inventory at each balance sheet date, which includes a review of, among other factors, an estimate of future demand for products within specific time horizons, valuation of existing inventory, as well as product lifecycle and product development plans. The estimates of future demand that we use in the valuation of inventory are the basis for our revenue forecast, which is also used for our short-term manufacturing plans. Inventory reserves are also provided to cover risks arising from slow-moving items. We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the net realizable value based on assumptions about future demand and market conditions. We may be required to record additional inventory write-down if actual market conditions are less favorable than those projected by our management. For fiscal 2017, no significant changes were made to the underlying assumptions related to estimates of inventory valuation or the methodology applied.

### ***Goodwill and Indefinite-Life Intangibles***

Certain business acquisitions have resulted in the recording of goodwill and indefinite-life intangible assets, primarily trademark assets, which are not amortized. At December 31, 2017 and 2016, we had goodwill of \$46.1 million and \$45.5 million, respectively. We primarily have trademark assets with a carrying value of \$799,000 as of December 31, 2017 and 2016, respectively.

Goodwill is tested for impairment at the reporting unit level, which is the operating segment or one level below the operating segment, also known as a component. Two or more components of an operating segment shall be aggregated into a single reporting unit if the components have similar economic characteristics, based on an assessment of various factors. We have determined that the Training and Simulation Division and the Power System Division segments are reporting units.

We perform our annual impairment assessment for goodwill and other indefinite-life intangible assets as of December 31 or more frequently if events or changes in circumstances indicate that the asset might be impaired.

We conduct a qualitative assessment by analyzing a variety of factors that could influence the fair value of the reporting unit or indefinite-life intangible, including, but not limited to: the results of prior quantitative assessments performed; changes in the carrying amount of the reporting unit or indefinite-life intangible; actual and projected revenue and operating margin; relevant market data for both us and our peer companies; industry outlooks; macroeconomic conditions; liquidity; changes in key personnel; and our competitive position. We use significant judgment to evaluate the totality of these events and factors to make the determination of whether it is more likely than not that the fair value of the reporting unit or indefinite-life intangible is less than its carrying value.

If we determine that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, we perform the impairment evaluation using the quantitative assessment. Under the quantitative assessment, the first step identifies whether there is a potential impairment by comparing the fair value of our reporting unit to the carrying amount, including goodwill. If the carrying amount of our reporting unit exceeds the fair value, then a test is performed to determine the implied fair value of goodwill. An impairment loss is recognized based on the amount that the carrying amount of goodwill exceeds the implied fair value. When measuring the fair value of its reporting units in the quantitative assessment, we use widely accepted valuation techniques, applying a combination of the income approach (discounted cash flows) and market approach (market multiples). When preparing discounted cash flow models under the income approach, we use internal forecasts to estimate future cash flows expected to be generated by the reporting units. To discount these cash flows, we use the expected cost of equity, determined by using a capital asset pricing model. We believe the discount rates used appropriately reflect the risks and uncertainties in the financial markets generally and specifically in our internally-developed forecasts. When using market multiples under the market approach, we apply comparable publicly traded companies' multiples (for example, earnings or revenues) to our reporting units' actual results.

The determination of fair value is highly sensitive to differences between estimated and actual cash flows and changes in the related discount rate used to evaluate fair value. Estimated cash flows are sensitive to changes in the economy among other things. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess.

However, estimates are inherently uncertain and represent only management's reasonable expectations regarding future developments. These estimates and the judgments and assumptions upon which the estimates are based will, in all likelihood, differ in some respects from actual future results. Should a significant or prolonged deterioration in economic conditions occur, such as declines in government spending; the inability to pass increases in the costs of raw materials on to customers; or a decline in comparable company market multiples, then key judgments and assumptions could be impacted.

For the years ended December 31, 2017 and 2016, respectively, we performed a qualitative assessment for our Training and Simulation reporting unit and we determined that it was more likely than not that the fair value of our reporting unit exceeded its carrying value. For our Power Systems reporting unit, we performed a quantitative assessment of goodwill for the purpose of determining whether an impairment existed at December 31, 2017 and 2016. As a result of our quantitative analysis, in which we computed the fair value of the Power Systems reporting unit, we concluded that the fair value of the reporting unit exceeded the reporting unit's carrying value by approximately 22% and 37%, respectively.

We also considered our current market capitalization compared to the sum of the estimated fair values of our reporting units in conjunction with each impairment assessment. As of the December 31, 2017 and 2016 valuation dates, our market capitalization was approximately \$92.1 and \$92.7 million, which did not, in our view, suggest that the fair value estimates used in our impairment assessment required any adjustment.

As a result of these analyses, we concluded that the goodwill recorded in relation to the Power Systems reporting unit was not impaired at December 31, 2017.

#### ***Other Intangible Assets***

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

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

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

### ***Contingencies***

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

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

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

### ***Warranty Reserves***

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

### ***Functional Currency***

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

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

**Results of Operations****Summary**

Following is a table summarizing our results of continuing operations for the years ended December 31, 2017, 2016 and 2015, after which we present a narrative discussion and analysis.

	<b>Year Ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
<b>Revenues:</b>			
Training and Simulation Division	\$ 50,254,324	\$ 46,358,794	\$ 54,617,611
Power Systems Division	48,468,354	46,616,958	41,956,336
	<u>\$ 98,722,678</u>	<u>\$ 92,975,752</u>	<u>\$ 96,573,947</u>
<b>Cost of revenues:</b>			
Training and Simulation Division	\$ 29,233,721	\$ 26,193,216	\$ 34,238,306
Power Systems Division	41,858,987	38,632,200	34,218,016
	<u>\$ 71,082,708</u>	<u>\$ 64,825,416</u>	<u>\$ 68,456,322</u>
<b>Research and development expenses:</b>			
Training and Simulation Division	\$ 2,544,164	\$ 2,030,485	\$ 1,766,667
Power Systems Division	496,966	692,480	1,308,695
	<u>\$ 3,041,130</u>	<u>\$ 2,722,965</u>	<u>\$ 3,075,362</u>
<b>Selling and marketing expenses:</b>			
Training and Simulation Division	\$ 6,204,037	\$ 5,517,682	\$ 4,796,288
Power Systems Division	1,670,327	1,511,408	577,133
	<u>\$ 7,874,364</u>	<u>\$ 7,029,090</u>	<u>\$ 5,373,421</u>
<b>General and administrative expenses:</b>			
Training and Simulation Division	\$ 4,235,512	\$ 4,556,990	\$ 4,610,586
Power Systems Division	3,847,728	4,011,769	6,859,143
Corporate	3,540,660	6,739,702	4,869,298
	<u>\$ 11,623,900</u>	<u>\$ 15,308,461</u>	<u>\$ 16,339,027</u>
<b>Amortization of intangible assets:</b>			
Training and Simulation Division	\$ 397,880	\$ 461,168	\$ 264,411
Power Systems Division	1,807,875	2,414,375	2,779,125
	<u>\$ 2,205,755</u>	<u>\$ 2,875,543</u>	<u>\$ 3,043,536</u>
<b>Operating income (loss):</b>			
Training and Simulation Division	\$ 7,649,010	\$ 7,599,253	\$ 8,941,353
Power Systems Division	(1,213,529)	(645,274)	(3,785,776)
Corporate	(3,540,660)	(6,739,702)	(4,869,298)
	<u>\$ 2,894,821</u>	<u>\$ 214,277</u>	<u>\$ 286,279</u>
<b>Other income (loss):</b>			
Training and Simulation Division	\$ (2,293)	\$ 9,430	\$ 51,349
Power Systems Division	(5,620)	47,673	(79,030)
Corporate	(243)	7,729	3,500
	<u>\$ (8,156)</u>	<u>\$ 64,832</u>	<u>\$ (24,181)</u>
<b>Financial (expense) income:</b>			
Training and Simulation Division	\$ (122,875)	\$ (41,397)	\$ (59,791)
Power Systems Division	(255,835)	(87,371)	21,432
Corporate	(697,949)	(846,495)	(1,113,762)
	<u>\$ (1,076,659)</u>	<u>\$ (975,263)</u>	<u>\$ (1,152,121)</u>
<b>Income tax (benefit) expense:</b>			
Training and Simulation Division	\$ 41,391	\$ (24,634)	\$ 233,106
Power Systems Division	195,592	(28,507)	-
Corporate	(2,261,113)	836,561	927,840
	<u>\$ (2,024,130)</u>	<u>\$ 783,420</u>	<u>\$ 1,160,946</u>
<b>Net income (loss) – continuing operations:</b>			
Training and Simulation Division	\$ 7,482,451	\$ 7,591,920	\$ 8,699,805
Power Systems Division	(1,670,576)	(656,465)	(3,843,374)
Corporate	(1,977,739)	(8,415,029)	(6,907,400)
	<u>\$ 3,834,136</u>	<u>\$ (1,479,574)</u>	<u>\$ (2,050,969)</u>

**Fiscal Year 2017 compared to Fiscal Year 2016**

**Revenues.** We recognized revenues as follows:

- **Training and Simulation Division** – We recognized revenues from the sale of air warfare simulators and vehicle simulators, interactive use-of-force training systems and from the provision of maintenance services in connection with such systems.
- **Power Systems Division** – We recognized revenues from sales of electronics engineering products and provision of design services for the military, as well as from the sale of batteries, chargers, adapters and power hub products to the military and commercial customers. We also recognized revenues from the sale of water-activated battery (“WAB”) lifejacket lights.

Revenues for 2017 totaled \$98.7 million, compared to \$93.0 million in 2016, an increase of \$5.7 million, or 6.2%, due primarily to higher revenues in both our divisions. In 2017, revenues were \$50.2 million for the Training and Simulation Division as compared to \$46.4 million in 2016, an increase of \$3.8 million, or 8.2%, due primarily to significant revenue growth in all product lines offset by a decline in revenues associated with the wind-down of the first phase of our VCTS program in preparation for the ramp up of the second phase of our VCTS program; and \$48.5 million for the Power Systems Division as compared to \$46.6 million in 2016, an increase of \$1.9 million, or 4.1%, due primarily to continued increases in key programs in Israel of \$4.1 million offset by a decline in revenues at UEC of \$2.2 million primarily attributable to the timing of contract awards and the receipt of material used in production of key programs.

The table below details the percentage of total recognized revenue by type of arrangement for the years ended December 31, 2017 and 2016:

Type of Revenue	Year Ended December 31,	
	2017	2016
Sale of products	96.2%	95.3%
Maintenance and support agreements	3.2%	4.3%
Long term research and development contracts	0.6%	0.4%
Total	100.0%	100.0%

**Cost of revenues.** Cost of revenues totaled \$71.1 million during 2017, compared to \$64.8 million in 2016, an increase of \$6.3 million, or 9.7%, due primarily to higher costs associated with higher revenues in both our divisions. Cost of revenues were \$29.2 million for the Training and Simulation Division as compared to \$26.2 million in 2016, an increase of \$3.0 million, or 11.5%, due primarily to higher costs associated with increased revenues, and \$41.9 million for the Power Systems Division as compared to \$38.6 million in 2016, an increase of \$3.3 million, or 8.5%, due primarily to higher costs associated with increased revenues.

**Research and development expenses.** Research and development expenses for 2017 were \$3.0 million, compared to \$2.7 million during 2016, an increase of \$318,000, or 11.7%, due primarily to increased development activities in our Vehicle Simulation product area offset by a decrease in research and development expense as key personnel were assigned to project-related development activities in our U.S. operations of our Power Systems Division.

**Selling and marketing expenses.** Selling and marketing expenses for 2017 were \$7.8 million, compared to \$7.0 million in 2016, an increase of \$845,000, or 12.0%, due primarily to increased selling and marketing efforts in our Vehicle Simulation product area as well as increased efforts in our use-of-force product areas.

**General and administrative expenses.** General and administrative expenses for 2017 were \$11.6 million, compared to \$15.3 million in 2016, a decrease of \$3.7 million or 24.1%. The decrease is primarily due to \$1.4 million in lower salaries and benefits, \$1.0 million non-recurring severance resulting from the 2016 separation of our former Chairman and Chief Executive Officer as well as a reduction in our stock compensation expense in the amount of \$480,000.

**Amortization of intangible assets.** Amortization of intangible assets totaled \$2.2 million in 2017, compared to \$2.9 million in 2016, a decrease of \$670,000, or 23.3%, due primarily to higher amortization expense recognized in 2016 pertaining to shorter lived intangible assets.

**Other income (expense), net.** Other expense totaled (\$8,000) in 2017, compared to income of \$65,000 in 2016, an increase in expense of \$73,000.

**Financial expense, net.** Financial expense totaled \$1.1 million in 2017, compared to financial expense of \$1.0 million in 2016, an increase of \$101,000, or 10.4%, due primarily to foreign exchange transactions.

**Income taxes.** We recorded a \$2.0 million tax benefit in 2017, compared to \$783,000 in tax expense in 2016, a decrease in tax expense of \$2.8 million, or 358.4%. The primary reason for the decrease in income tax expense is attributable to the re-measurement of our deferred tax liabilities associated with the change in the federal corporate income tax rate from 35% to 21% attributable to the Tax Act.

**Net income (loss).** Due to the factors cited above, we went from a net loss from continuing operations of (\$1.5) million in 2016 to a net income of \$3.8 million in 2017.

### **Fiscal Year 2016 compared to Fiscal Year 2015**

**Revenues.** We recognized revenues as follows:

- **Training and Simulation Division** – We recognized revenues from the sale of air warfare simulators and vehicle simulators, interactive use-of-force training systems and from the provision of maintenance services in connection with such systems.
- **Power Systems Division** – We recognized revenues from sales of electronics engineering products and provision of design services for the military, as well as from the sale of batteries, chargers, adapters and power hub products to the military and commercial customers. We also recognized revenues from the sale of water-activated battery (“WAB”) lifejacket lights.

Revenues for 2016 totaled \$93.0 million, compared to \$96.6 million in 2015, a decrease of \$3.6 million, or 3.7%, due primarily to lower revenues in our Training and Simulation Division. In 2016, revenues were \$46.4 million for the Training and Simulation Division as compared to \$54.6 million in 2015, a decrease of \$8.2 million, or 15.1%, due primarily to the timing of contracts; and \$46.6 million for the Power Systems Division as compared to \$42.0 million in 2015, an increase of \$4.6 million, or 11.1%, as noted above.

The table below details the percentage of total recognized revenue by type of arrangement for the years ended December 31, 2016 and 2015:

Type of Revenue	Year Ended December 31,	
	2016	2015
Sale of products	95.3%	94.1%
Maintenance and support agreements	4.3%	5.5%
Long term research and development contracts	0.4%	0.4%
Total	100.0%	100.0%

**Cost of revenues.** Cost of revenues totaled \$64.8 million during 2016, compared to \$68.5 million in 2015, a decrease of \$3.7 million, or 5.3%, due primarily to lower costs associated with lower revenues in our Training and Simulation Division. Cost of revenues were \$26.2 million for the Training and Simulation Division as compared to \$34.2 million in 2015, a decrease of \$8.0 million, or 23.5%, due primarily to lower costs associated with lower revenues and \$38.6 million for the Power Systems Division as compared to \$34.2 million in 2015, an increase of \$4.4 million, or 12.9%, due primarily to higher costs associated with increased revenues.

**Research and development expenses.** Research and development expenses for 2016 were \$2.7 million, compared to \$3.1 million during 2015, a decrease of \$352,000, or 11.5%, due primarily to an increase in funding related to product development activities by our customers in our Power Systems Division.

**Selling and marketing expenses.** Selling and marketing expenses for 2016 were \$7.0 million, compared to \$5.4 million in 2015, an increase of \$1.6 million, or 30.8%, due primarily to increased focus on selling and marketing activities in the U.S. operations of our Power Systems Division as well as increases in sales and marketing staff costs in our Training and Simulation Division.

**General and administrative expenses.** General and administrative expenses for 2016 were \$15.3 million, compared to \$16.3 million in 2015, a decrease of \$1.0 million, or 6.3%, due primarily to reductions in our general and administrative expenses within our Power Systems Division of \$2.0 million offset by increases in our Corporate Division related to the severance associated with the early termination agreement of our former Chief Executive Officer of approximately \$1.0 million.

**Amortization of intangible assets.** Amortization of intangible assets totaled \$2.9 million in 2016, compared to \$3.0 million in 2015, a decrease of \$168,000, or 5.5%, due primarily to higher amortization expense being recognized in 2015 pertaining to shorter lived intangible assets.

**Other income (expense), net.** Other income totaled \$65,000 in 2016, compared to other expense of (\$24,000) in 2015, an increase of \$89,000.

**Financial expense, net.** Financial expense totaled \$1.0 million in 2016, compared to financial expense of \$1.2 million in 2015, a decrease of \$177,000, or 15.4%, due primarily less interest expense based on less debt outstanding throughout the course of 2016.

**Income taxes.** We recorded \$783,000 in tax expense in 2016, compared to \$1.2 million in tax expense in 2015, a decrease of \$378,000, or 32.5%, primarily due to lower state and international tax obligations offset by annual tax expense recognized related to the “naked” tax credits previously described.

**Net income (loss).** Due to the factors cited above, we went from a net loss from continuing operations of (\$2.1) million in 2015 to a net loss of (\$1.5) million in 2016.

## Liquidity and Capital Resources

As of December 31, 2017, we had \$5.2 million in cash and \$284,000 in restricted collateral deposits, as compared to December 31, 2016, when we had \$7.1 million in cash and \$269,000 in restricted collateral deposits. We also had \$9.1 million in available, unused bank lines of credit as of December 31, 2017, under a \$15.0 million debt credit facility.

We used available funds in 2017 primarily for investment in fixed assets and repayment of long-term debt. We purchased land and a building for \$2.1 million previously leased by our Training and Simulation Division in Ann Arbor, Michigan and invested approximately \$2.6 million in capital projects during 2017. Our net property and equipment amounted to \$9.3 million as of December 31, 2017.

Net cash provided by operating activities for operations for 2017, 2016, and 2015 was \$1.9 million, \$2.6 million, and \$4.4 million, respectively. The decrease of \$737,000 in cash provided by operating activities for 2017 as compared to 2016 was primarily attributable to \$6.9 million of higher trade and unbilled receivables resulting from an increase in revenue during the fourth quarter of 2017 and a non-recurring severance payment of \$2.3 million paid to our former Chief Executive Officer. These amounts were partially offset by improved operating results, increase in our trade payables, other payables and deferred revenue of \$5.0 million and a \$2.1 million reduction in inventory as a result of an increase in fourth quarter revenues.

Net cash used in investing activities for 2017, 2016, and 2015 was (\$5.4) million, (\$2.1) million, and (\$1.4) million, an increase between 2017 and 2016 of \$3.3 million and between 2016 and 2015 of \$625,000. The net change in cash used in investing activities for 2017 as compared to 2016 was due primarily to the building purchase referred to above and \$1.2 million in other capital projects, including \$700,000 related to the implementation of an enterprise resource planning system within our Israel Power Systems unit.

Net cash provided by (used in) financing activities for 2017, 2016, and 2015 was \$2.4 million, (\$3.8) million, and (\$3.6) million, respectively, a change between 2017 and 2016 of \$6.2 million and between 2015 and 2014 of \$247,000. The increase in 2017 of cash used in financing activities was primarily due to proceeds associated with Term Loans B and C (described below) of \$2.2 million, an increase in the utilization of our line of credit of \$2.1 million, offset by payments on our long-term debt of \$1.8 million.

As of December 31, 2017, our line-of-credit and long-term bank debt, including current maturities, was \$5.1 million and \$10.8 million as compared to December 31, 2016, when we had \$3.0 million outstanding on our line of credit and \$10.5 million in long-term debt outstanding, including current maturities.

We maintain credit facilities with JPMorgan Chase Bank, N.A. (“Chase”), whereby Chase provides (i) a \$15,000,000 revolving credit facility (“Revolver”), (ii) a \$10,000,000 Term Loan (“Term Loan A”), (iii) a \$1,730,895 Mortgage Loan (“Term Loan B”) and (iv) a \$1,358,000 Mortgage Loan (“Term Loan C”); collectively referred to as the “Credit Facilities.”

The maturity of the Revolver is March 11, 2021. The Revolver maintains an interest rate on a scale ranging from LIBOR plus 1.75% up to LIBOR plus 3.00%. The effective interest rate for the revolver at December 31, 2017 was 5.0%.

The maturity of Term Loan A is March 11, 2021. This Term Loan maintains an interest rate on a scale ranging from LIBOR plus 2.0% up to LIBOR plus 3.25%. The repayment of this Term Loan consists of 60 consecutive monthly payments of principal plus accrued interest based on annual principal reductions of 10% during the first year, 20% during the second through fourth years, and 30% during the fifth year. The effective interest rate for this Term Loan at December 31, 2017 was 5.25%.

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During 2017, we purchased land and a building previously leased by our Training and Simulation Division in Ann Arbor, Michigan for \$2.2 million. As a result, we now have two Mortgage Loans (“Term Loans B and C”). The maturities of the Mortgage Loans are June 1, 2024 and maintain an interest rate on a scale identical to the Term Loan. The monthly payments on the Mortgage Loans are \$12,872 in principal plus accrued interest, with balloon payments due at the maturity date. The effective interest rate for the Mortgage Loans at December 31, 2017 was 5.25%.

The Credit Facilities maintain certain reporting requirements, conditions precedent, affirmative covenants and financial covenants. We are required to maintain certain financial covenants that include a Maximum Debt to EBITDA ratio of 3.00 to 1.00 and a Minimum Fixed Charge Coverage Ratio of 1.20 to 1.00. We were in compliance with our covenants at December 31, 2017.

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

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

#### Effective Corporate Tax Rate

Certain of our subsidiaries incurred net operating losses during the years ended December 31, 2016 and 2015. With respect to some of our U.S. subsidiaries that operated at a net profit during 2017, we were able to offset federal taxes against our net operating loss carryforward. These subsidiaries are, however, subject to state taxes that cannot be offset against our net operating loss carryforward. We also set up a tax liability for the impact of the deductions taken for goodwill.

As of December 31, 2017, we had a U.S. net operating loss carryforward of approximately \$40.7 million that is available to offset future taxable income under certain circumstances, expiring primarily from 2021 through 2032, and foreign net operating and loss carryforwards of approximately \$91.5 million, which are available indefinitely to offset future taxable income under certain circumstances.

#### Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to our stockholders.

#### Contractual Obligations

The following table lists our contractual obligations and commitments as of December 31, 2017, not including trade payables and other accounts payable:

Contractual Obligations	Payment Due by Period				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Bank obligations	\$ 15,910,000	\$ 7,340,000	\$ 5,045,000	\$ 1,299,000	\$ 2,226,000
Operating lease obligations	\$ 2,758,000	\$ 852,000	\$ 1,102,000	\$ 635,000	\$ 169,000
Severance obligations	\$ 4,710,000	\$ –	\$ –	\$ –	\$ 4,710,000

#### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not applicable.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

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

Not applicable.

**ITEM 9A. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

As of December 31, 2017, 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 reports that we file with the SEC. These disclosure controls and procedures are intended to ensure that information relating to us, including our subsidiaries, that is required to be disclosed in the reports that we file with the SEC 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 and to allow timely decisions regarding required disclosure. Due to the inherent limitations of control systems, not all misstatements may be detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Any system of controls and procedures, no matter how well designed and operated, can at best provide only reasonable assurance that the objectives of the system are met and management necessarily is required to apply its judgment in evaluating the cost benefit relationship of possible controls and procedures. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. Our controls and procedures are intended to provide only reasonable, not absolute, assurance that the above objectives have been met.

Based on their evaluation as of December 31, 2017, our principal executive officer and principal financial officer were able to conclude that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) were effective.

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

**Management's Report on Internal Control Over Financial Reporting**

Our management, including our principal executive and financial officers, is responsible for establishing and maintaining adequate internal control over our financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Our management has evaluated the effectiveness of our internal controls over financial reporting as of the end of the period covered by this Annual Report on Form 10-K for the year ended December 31, 2017. In making our assessment of internal control over financial reporting, management used the criteria set forth by the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission in the 2013 *Internal Control – Integrated Framework*.

Our management concluded that our internal control over financial reporting was effective as of December 31, 2017.

Our internal control over financial reporting as of December 31, 2017 has been audited by BDO USA, LLP, an independent registered public accounting firm, as stated in their attestation report which appears herein.

**Changes in Internal Control Over Financial Reporting**

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

## **Report of Independent Registered Public Accounting Firm**

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

### **Opinion on Internal Control over Financial Reporting**

We have audited Arotech Corporation's (the "Company's") internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO criteria"). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets of Arotech Corporation as of December 31, 2017 and 2016, the related consolidated statements of operations and comprehensive income (loss), changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2017, and the related notes and our report dated March 15, 2018, expressed an unqualified opinion thereon.

### **Basis for Opinion**

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

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

### **Definition and Limitations of Internal Control over Financial Reporting**

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

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

/s/ BDO USA, LLP

Grand Rapids, Michigan

March 15, 2018

### **ITEM 9B. OTHER INFORMATION**

None.

**PART III****ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE****Executive Officers, Directors and Significant Employees***Executive Officers and Directors*

Our executive officers and directors and their ages as of February 28, 2018 were as follows:

<b>Name</b>	<b>Age</b>	<b>Position</b>
Jon B. Kutler	61	Chairman of the Board
Michael E. Marrus	54	Director
Kenneth W. Cappell	65	Director
Lawrence F. Hagenbuch	51	Director
Adm. James J. Quinn (Ret.)	65	Director
Dean M. Krutty	53	President and Chief Executive Officer
Thomas J. Paup	69	Senior Vice President – Finance and Chief Financial Officer until March 31, 2018
Kelli L. Kellar	52	Vice President – Finance and Chief Financial Officer after March 31, 2018

Our by-laws provide for a board of directors of three or more directors. There are currently five directors. Under the terms of our certificate of incorporation, the board of directors is composed of three classes of similar size, each elected in a different year, so that only one-third of the board of directors is elected in any single year. Mr. Marrus and Mr. Kutler are designated Class I directors and have been elected for a term expiring in 2018 or until their successor is elected and qualified; Mr. Hagenbuch is designated a Class II director elected for a term expiring in 2020 or until his successors are elected and qualified; and Mr. Cappell and Adm. Quinn are designated Class III directors elected for a term that expires in 2019 or until their successors are elected and qualified. A majority of the Board is “independent” under relevant SEC and Nasdaq regulations.

*Directors and Executive Officers*

**Jon B. Kutler** has been one of our directors since February 2016 and our Chairman of the Board since May 2016. Mr. Kutler is currently chairman and CEO of Admiralty Partners, Inc. (“API”), a private equity investment firm, a position he has held for more than the past five years. After service in the U.S. Navy and nearly a decade on Wall Street, Mr. Kutler founded Quarterdeck Investment Partners, an international investment bank focused on the global aerospace and defense markets. He sold Quarterdeck to Jefferies & Company in 2002 to focus on private equity investments under API. He is a Trustee of the California Institute of Technology, where he serves as chairman of the Jet Propulsion Laboratory and as a member of the Technology Transfer Committee. From January 2011 until its sale in February 2016, Mr. Kutler served on the Board of Directors of TeleCommunication Systems, Inc. Mr. Kutler is a graduate of the United States Naval Academy and holds a Bachelor of Science degree in Naval Architecture. He received his Masters of Business Administration from Harvard University.

Mr. Kutler is a recognized investor, investment banker and expert in the aerospace and defense industries. He has been profiled in BusinessWeek, The New York Times, Fortune, Institutional Investor, The Los Angeles Times, Defense News, and Aviation Week & Space Technology, which have also featured his articles on consolidation, restructuring, and industry trends. He has also been a frequent commentator regarding industry issues on CNN, CNBC and Bloomberg Television. He has testified before Congressional committees, served as Chairman of the White House Small Business Task Force on Defense Conversion, and as a member of an advisory panel established by the Congressional Office of Technology Assessment to evaluate the status of the space launch vehicle industry. We believe that Mr. Kutler’s background and experience make him appropriate to serve as one of our directors in light of our business and structure.

**Michael E. Marrus** has been one of our directors since October 2007. Since September 2015, Mr. Marrus has been the managing director of The Special Equities Group, a Division of Chardan Capital Markets, LLC. Before that, Mr. Marrus was a Senior Managing Director at Dominick and Dominick, a wealth management and investment services firm, and a Managing Director of Merriman Capital, Inc., a financial services firm focused on growth companies. From 1998 to 2009, he was a Managing Director of C.E. Unterberg, Towbin & Co., an investment banking firm that was acquired by Collins Stewart plc. Prior to joining Unterberg, Towbin, Mr. Marrus was a Principal and founding member of Fieldstone Private Capital Group, an investment banking firm specializing in corporate, project and structured finance. Previously, he was employed at Bankers Trust Company, initially in the Private Equity and Merchant Banking Groups and subsequently in BT Securities, the securities affiliate of Bankers Trust. Mr. Marrus has an A.B. from Brown University and an MBA from the Graduate School of Business, University of Chicago.

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

**Kenneth W. Cappell** has been one of our directors since May 2015. Mr. Cappell has been an Adjunct Professor of Accounting at Baruch College since August 2015. Mr. Cappell held a similar role at Yeshiva University from August 2014 until his appointment at Baruch College. From 1987 until 2014, Mr. Cappell was a partner of PwC and its predecessor firms, first as an audit partner (through 2000), then as a regional leader of internal audit services (through 2010), and finally as a managing partner of strategic development for PwC's Risk Assurance practice (through his retirement in 2014). Mr. Cappell has worked with public companies in a variety of industries, including consumer and industrial products, financial services and entertainment. He has advised public company audit committees on diverse topics and has served as the *de facto* internal audit director at several companies. Mr. Cappell is a member of AICPA and the New York State Society of CPAs. He has served as a guest lecturer at the New York University Stern School of Business and Baruch College. Mr. Cappell has a B.A. in Economics from Yeshiva University and an MBA in Finance from NYU Stern.

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

**Lawrence F. Hagenbuch** has been one of our directors since March 2016. Mr. Hagenbuch is currently the Chief Operating Officer and Chief Financial Officer for J. Hilburn, Inc., a custom clothier for men. Mr. Hagenbuch has been with J. Hilburn since May 2010. Mr. Hagenbuch served on the board of directors of Remy International (Nasdaq: REMY) from November 2008 until that company's sale in November 2015, where he served on the audit and compensation committees. Mr. Hagenbuch has served in senior management positions for SunTx Capital Partners, Alix Partners, GE / GE Capital, and American National Can Group, Inc. Mr. Hagenbuch began his professional career in the United States Navy. Mr. Hagenbuch has extensive experience in supply chain, operational and profitability improvements, and through his background as a consultant and in senior management roles at various companies, he brings considerable experience in implementing lean manufacturing discipline and in creating innovative business and marketing strategies. Mr. Hagenbuch earned a B.S. in Mechanical and Materials Engineering from Vanderbilt University and an MBA from the Wharton School of the University of Pennsylvania.

Mr. Hagenbuch has extensive experience in supply chain, operational and profitability improvements, and through his background as a consultant and in senior management roles at various companies, he brings considerable experience in implementing lean manufacturing discipline and in creating innovative business and marketing strategies. We believe that Mr. Hagenbuch's background and experience make him appropriate to serve as one of our directors in light of our business and structure.

**Rear Admiral James J. Quinn**, USN (Ret.) has been one of our directors since May 2016. Adm. Quinn left the United States Navy in October 2003 after a 30-year career that included tours of duty as Director of Operations, Plans, Policy and Training with the Atlantic Fleet, a total of five commands (including command of a carrier group and of a nuclear-powered aircraft carrier), Senior Military Assistant to the Secretary of Defense, Commander of Naval Space Command, and the Naval Aide to two U.S. Presidents. After leaving the Navy, Adm. Quinn began a ten-year business career with Northrop Grumman Aerospace Systems, a division of Northrop Grumman Corporation ("NGC") (NYSE: NOC), where he served as Director of Navy-Marine Corps Programs & Corporate Lead Executive for the NGC Integrated Systems Sector from 2003 to 2004, Vice President of Business Development for the Military Space Systems Division of NGC from 2004 to 2009, Vice President of Business Development for the Strike & Surveillance Systems Division of NGC from 2009 to 2011, and Vice President of Business Development for the Unmanned Systems Division of NGC from 2012 until his retirement from NGC in 2013. Adm. Quinn holds a B.S. in Mathematics from the United States Naval Academy, and is a graduate of the Navy Nuclear Power Program. He received his wings and was designated a Naval Flight Officer at Naval Air Station Pensacola in 1975. Adm. Quinn is the recipient of the Defense Superior Service Medal, five Legions of Merit, two Bronze Stars, two Meritorious Service Medals, four Air Medals (two Individual with Combat "V"/2 Strike-Flight) and four Navy Commendation Medals (two with Combat "V").

Adm. Quinn's extraordinary record of service and experience, both military and business, give him experience that we believe to be an invaluable addition to our Board. Adm. Quinn's experience in both the military and civilian side of the defense sector is highly relevant to our business. We believe that Adm. Quinn's background and experience make him appropriate to serve as one of our directors in light of our business and structure.

**Dean M. Krutty** became our President and Chief Executive Officer in March 2018 after having served as our Acting Chief Executive Officer since January 2017. Mr. Krutty became President of our Training and Simulation Division in January 2005, after having spent the prior thirteen years as a member of the FAAC management team, and was promoted to Arotech’s Senior Vice President, Operations – North America in January 2015 and Executive Vice President, Operations – North America in June 2016. He began his career at FAAC as an electrical engineer in FAAC’s part task trainer division and served as FAAC’s Director of Operations prior to becoming its President. He also has significant experience managing programs in the training and simulation industry. Mr. Krutty holds a B.S. in electrical engineering from the Michigan State University.

**Thomas J. Paup** has been our Vice President – Finance since December 2005 and our Chief Financial Officer since February 2006, and in May 2013, Mr. Paup was promoted to Senior Vice President. Mr. Paup is currently also a Finance Lecturer at Eastern Michigan University. Mr. Paup was an Affiliated Partner with McMillan|Doolittle LLP, a retail consulting firm, from March 2002 until accepting this position with us, and prior thereto, he was an Executive in Residence and Finance Instructor at DePaul University’s Kellstadt Graduate School of Business. Prior to his teaching experience, Mr. Paup spent over 25 years in the retail industry. Most recently, between 1997 and 2000, Mr. Paup was the Executive Vice President and Chief Financial Officer and member of the Board of Directors of Montgomery Ward and Company, formerly a private mail order and department store retailer. Mr. Paup brings a broad background of strategic and operational management experiences from the department store industry, where he served as CFO of Lord & Taylor, an upscale, specialty-retail department store chain, and Kaufmann’s, a department store that merged into Macy’s, Inc. (“Macy’s”), and Controller of Bloomingdale’s, an upscale chain of department stores owned by Macy’s, and Robinson-May, formerly a chain of department stores. Mr. Paup holds an MBA in Finance and a BBS from Eastern Michigan University. Mr. Paup plans to retire on March 31, 2018.

**Kelli L. Kellar** has been our Vice President – Finance since January 2018. She is expected to take over as our Chief Financial Officer beginning on April 1, 2018. Ms. Kellar was Senior Manager of External Reporting, PP&E Reporting and IFRS Accounting with Fiat Chrysler Automobiles (NYSE: FCA), the world’s eighth-largest auto maker, from November 2013 until the end of 2017. From May 2009 until November 2013, Ms. Kellar was Vice President and controller of Silverpop Systems, Inc., a privately-held, international software development company. Since 1995 Ms. Kellar has held accounting and finance positions with both public and private companies, including serving as Chief Accounting Officer with Premier Exhibitions, Inc. (Nasdaq: PRXI), a provider of global museum-quality touring exhibitions, from 2007 to 2009. Ms. Kellar holds a B.Acc. and an M.S. in taxation from Florida International University.

#### ***Board Leadership Structure***

We do not have a policy regarding the advisability of separating the positions of chief executive officer and chairman of the board. Beginning in October 2014, the board determined that it would be preferable to separate the positions of chief executive officer and chairman. As part of our periodic board self-evaluation process, we evaluate our leadership structure to ensure that the board continues to believe that it provides the optimal structure for our company and stockholders. We recognize that different board leadership structures may be appropriate for companies in different situations. We continue to believe this board leadership structure to be best for our company and our stockholders at this time.

#### ***Committees of the Board of Directors***

Our board of directors has an Audit Committee, a Compensation Committee, and a Nominating Committee. In 2017 our board decided to dispense with having a standing Executive and Finance Committee in view of the streamlined size of the board. The current composition of the various committees of the Board of Directors is as follows (the name of the chairman of each committee appears in italics):

<b>Audit Committee</b>	<b>Compensation Committee</b>	<b>Nominating Committee</b>
<i>Kenneth W. Cappell</i>	<i>Michael E. Marrus</i>	<i>James J. Quinn</i>
Michael Marrus	Lawrence F. Hagenbuch	Lawrence F. Hagenbuch
James J. Quinn	Kenneth W. Cappell	

*Audit Committee*

The purpose of the Audit Committee is to review with management and our independent auditors the scope and results of the annual audit, the nature of any other services provided by the independent auditors, changes in the accounting principles applied to the presentation of our financial statements, and any comments by the independent auditors on our policies and procedures with respect to internal accounting, auditing and financial controls. The Audit Committee was established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. In addition, the Audit Committee is charged with the responsibility for making decisions on the engagement, compensation, retention and oversight of the work of our independent auditors. The Audit Committee also is responsible for the oversight and work of our internal audit department. The Audit Committee consists of Mr. Cappell (Chair) Mr. Marrus, and Adm. Quinn. Each member of the Audit Committee is an “independent director,” as that term is defined in Nasdaq Marketplace Rule 4200(a)(15) and the SEC’s Rule 10A-3. All Audit Committee members possess the level of financial literacy required by law. Our Board of Directors has determined that each of Mr. Cappell and Mr. Marrus qualifies as an “audit committee financial expert” under applicable SEC and Nasdaq regulations. As required by law, the Audit Committee operates pursuant to a charter that governs its duties, available through a hyperlink located on the investor relations page of our website at <http://content.equisolve.net/arotech/media/b7c6b7bc3ea4b17ef9af28aab2221d6d.pdf>.

*Compensation Committee*

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

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

The Compensation Committee maintains compensation and incentive programs designed to motivate, retain and attract management and utilize various combinations of base salary, bonuses payable upon the achievement of specified goals, discretionary bonuses and grants of restricted stock. Our Chief Executive Officer, Mr. Dean M. Krutty, and our Chief Financial Officer, Mr. Thomas J. Paup, are parties to employment agreements with us, as is Ms. Kellar, who will take over the position of Chief Financial Officer beginning April 1, 2018. The Compensation Committee reviews the compensation, both cash and stock, of our executive officers on an annual basis, while taking into account as well changes in compensation during previous years. Some of these components, such as salary, are generally fixed and do not vary based on our financial and other performance; some components, such as bonus, are in whole or in part dependent upon the achievement of certain goals jointly agreed upon by our management and the Compensation Committee; and some components, such as restricted stock, have a value that is dependent upon our stock price at the time of award and going forward. The Compensation Committee reviews the compensation, both cash and stock, of our executive officers on an annual basis, while taking into account as well changes in compensation during previous years.

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

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

*Nominating Committee*

The Nominating Committee identifies and proposes candidates to serve as members of the Board of Directors. Proposed nominees for membership on the Board of Directors submitted in writing by stockholders to Arotech’s Secretary will be brought to the attention of the Nominating Committee and will be evaluated in accordance with the same guidelines as other candidates are considered by the Nominating Committee. The Nominating Committee consists of Adm. Quinn (Chair) and Mr. Hagenbuch. Each member of the Nominating Committee is an independent director as that term is defined in the Nasdaq listing standards. The Nominating Committee makes recommendations to the Board of Directors regarding new directors to be selected for membership on the Board of Directors and its various committees. The Nominating Committee operates under a formal charter that governs its duties. The Nominating Committee’s charter is publicly available through a hyperlink located on the investor relations page of our website, at <http://content.equisolve.net/arotech/media/9db8a8bd53ecd3f2d895b23986e237e8.pdf>.

### ***Code of Ethics***

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

### ***Code of Conduct***

We have adopted a general Code of Conduct, as required by Nasdaq listing standards and the rules of the SEC, that applies to all of our employees. The Code of Conduct is publicly available through a hyperlink located on the investor relations page of our website, at <http://content.equisolve.net/arotech/media/5c5e3b052edfc1e78084a414a4c37c1.pdf>.

### ***Whistleblower Policy***

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

### ***Voting Agreements***

On February 2, 2016, we entered into a Stock Purchase Agreement with Admiralty Partners, Inc. ("API"), which was subsequently amended (as amended, the "API Agreement"). In connection with the API Agreement, API and Messrs. Robert S. Ehrlich (our former Executive Chairman) and the late Steven Esses (our former CEO) are parties to a Voting Agreement pursuant to which each of Messrs. Ehrlich and Esses agrees to vote the shares of our common stock held by him in favor of the election of a director nominee designated by API for so long as API holds at least 5% of our stock, and until July 31, 2017 API would with respect to the matters set forth in the API Agreement vote the shares of common stock beneficially owned by it at any meeting of our stockholders in accordance with the instructions of the our management. This obligation shall remain in effect for so long as API and its affiliates continue to beneficially own at least 750,000 shares of our common stock. On February 24, 2016, in connection with the API Agreement, Jon B. Kutler was appointed to our Board as a Class I director.

On March 25, 2016, we settled a threatened proxy contest with our then-largest stockholder, Ephraim Fields, by entering into a settlement agreement (the "Fields Agreement") in which we agreed to appoint a director selected by Mr. Fields to our Board as a Class II director, to serve until our 2017 Annual Meeting of Stockholders. Mr. Hagenbuch was appointed to the Board on that same date and as required by the Fields Agreement was named to the Compensation, Nominating, and Executive and Finance Committees (the last of which has since been disbanded). Pursuant to the terms of our settlement agreement with Mr. Fields, Mr. Fields agreed, among other things, to vote his shares in favor of our management's nominees at the 2016 Annual Meeting of Stockholders.

### ***Director Compensation***

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

The following table shows the compensation earned or received by each of our directors for the year ended December 31, 2017:

**DIRECTOR COMPENSATION**

Name	Fees Earned or Paid in Cash	Stock Awards Granted 2017(1)	Total
Jon B. Kutler	\$ 34,000	\$ 35,000	\$ 69,000 (2)
Michael E. Marrus	\$ 40,000	\$ 35,000	\$ 75,000 (3)
Kenneth W. Cappell	\$ 40,000	\$ 35,000	\$ 75,000 (4)
Lawrence F. Hagenbuch	\$ 38,000	\$ 35,000	\$ 73,000 (5)
James J. Quinn	\$ 35,000	\$ 35,000	\$ 70,000 (6)
Richard I. Rudy*	\$ 18,000	\$ –	\$ 18,000 (7)
Carol J. Battershell*	\$ 18,000	\$ –	\$ 18,000 (8)

- (1) This amount reflects the aggregate grant date fair value computed in accordance with FASB ASC Topic 718.
- (2) As of December 31, 2017, Mr. Kutler held 28,468 unvested restricted shares of our common stock.
- (3) As of December 31, 2017, Mr. Marrus held 25,472 unvested restricted shares of our common stock.
- (4) As of December 31, 2017, Mr. Cappell held 24,452 unvested restricted shares of our common stock.
- (5) As of December 31, 2017, Mr. Hagenbuch held 28,106 unvested restricted shares of our common stock.
- (6) As of December 31, 2017, Adm. Quinn held 16,296 unvested restricted shares of our common stock.
- (7) As of December 31, 2017, Mr. Rudy held no unvested restricted shares of our common stock.
- (8) As of December 31, 2017, Ms. Battershell held no unvested restricted shares of our common stock.
- \* This individual retired as a director effective March 27, 2017.

**Compensation Committee Interlocks and Insider Participation**

The Compensation Committee is composed entirely of directors who are not our current or former employees, each of whom meets the applicable definition of “independent” in the current rules of the under the listing standards of Nasdaq and SEC rules and regulations. None of the members of the compensation committee during fiscal 2017 (i) had any relationships requiring disclosure by us under the SEC’s rules requiring disclosure of related party transactions, or (ii) was an executive officer of a company of which one of our executive officers is a director. The Compensation Committee is responsible for establishing and administering our executive compensation policies. Our Compensation Committee does not have any interlocks with other public companies.

**Significant Employees**

Our significant employees as of February 28, 2018, and their ages as of December 31, 2017, are as follows:

Name	Age	Position
Kurt Flosky	49	President, Training and Simulation Division
Ronen Badichi	52	General Manager, Power Systems Division – Europe and Asia
David Modeen	50	President, Power Systems Division – United States
Yaakov Har-Oz	60	Senior Vice President, General Counsel and Secretary
Colin Gallagher	44	Corporate Controller, Chief Accounting Officer

**Kurt Flosky** has been President of our Training and Simulation Division since January 2015, after having spent the prior ten years serving as an Executive Vice President at FAAC, with ten additional years as a member of FAAC’s senior management team. He has been with FAAC since 1990 and has extensive experience in program management and business development within the training and simulation arena. Mr. Flosky holds a B.S. and an M.S in aerospace engineering from the University of Michigan.

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

**David Modeen** has been President of our Power Systems Division's U.S. operations since December, 2016, after serving as Director of Product Management since joining UEC in 2015. Prior to joining UEC, Mr. Modeen served as Director of Operations for IEC Electronics (NYSE: IEC), a contract manufacturing services company serving the military, industrial and medical markets. Before that, Mr. Modeen spent eleven years at Ultralife, where he served in several roles at the Vice President level. Mr. Modeen holds a B.S. in Mechanical Engineering from the University at Buffalo and an MBA from Rochester Institute of Technology.

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

**Colin Gallagher** has served as our Controller and as our Chief Accounting Officer since May 2015. Prior to joining Arotech, from 2013 to 2014, Mr. Gallagher was the Controller of DTE Energy Trading, a physical and financial gas and power marketing company. Prior to DTE, he was a Finance Director at Owens Corning (NYSE: OC) in Toledo Ohio, the world's largest manufacturer of fiberglass and related products. Before starting at Owens Corning, Mr. Gallagher spent twelve years at PwC in various positions, ending his career there as a Senior Manager in the public and private company sector. Mr. Gallagher is a certified public accountant. He holds a BBA from the Haworth College of Business at Western Michigan University in Kalamazoo, Michigan and an MBA from the Mendoza College of Business at the University of Notre Dame in South Bend, Indiana.

### **Section 16(a) Beneficial Ownership Reporting Compliance**

Under the securities laws of the United States, our directors, certain of our officers and any persons holding more than ten percent of our common stock are required to report their ownership of our common stock and any changes in that ownership to the Securities and Exchange Commission. Specific due dates for these reports have been established and we are required to report any failure to file by these dates. We are not aware of any instances during or prior to December 31, 2017, not previously disclosed by us, where such "reporting persons" failed to file the required reports on or before the specified dates except as follows:

- (i) Mr. Kutler was required to file a Form 4 on or prior to May 31, 2016 in connection with the purchase by an entity affiliated with him of 15,000 shares of our stock. He reported this transaction in a Form 5 filed on February 14, 2018.

## **ITEM 11. EXECUTIVE COMPENSATION**

### **Compensation Committee Report**

*Under the rules of the SEC, this Compensation Committee Report is not deemed to be incorporated by reference by any general statement incorporating this Annual Report by reference into any filings with the SEC.*

The Compensation Committee has reviewed and discussed the following Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K with management and, based on such review and discussions, the Compensation Committee recommended to the Board of Directors that the following Compensation Discussion and Analysis be included in this Annual Report on Form 10-K.

*Submitted by the Compensation Committee*

Michael E. Marrus, Chairman  
Lawrence F. Hagenbuch  
Kenneth W. Cappell

## Compensation Discussion and Analysis

### *Preliminary Note*

Pursuant to applicable SEC regulations, the information we present in this section relates to the chief executive officer, the chief financial officer, and the three additional most highly compensated “executive officers” (as this term is defined in the regulations promulgated under the Securities Exchange Act of 1934, as amended), as well as up to two additional persons meeting the above criteria but who were not employed by us at the end of the last fiscal year. We believe that in 2017 two individuals met these criteria, as follows (we refer to these individuals throughout this Compensation Discussion and Analysis as our “named executive officers”):

- Dean M. Krutty, our President and Chief Executive Officer; and
- Thomas J. Paup, our Senior Vice President – Finance and Chief Financial Officer.

### *Introduction*

In this section we present the principles underlying our executive officer compensation decisions and the most important factors that we believe are relevant to an analysis of these decisions. Our goal here is to provide qualitative information regarding the manner and context in which compensation is awarded to and earned by our named executive officers and to place in perspective the numerical and other quantitative data presented in the tables and other information that follow this section.

We have designed the compensation of our named executive officers in order to attract, as needed, individuals with the skills necessary for us to achieve our business plan, to reward those individuals fairly over time, and to retain those individuals who perform at or above our expectations.

Our named executive officers’ annual cash and stock compensation consists of several components, as follows:

- base salary;
- bonus, which is accrued in the year in which it is earned but is paid in cash in a subsequent year; and
- grants of restricted stock units, where the restricted stock units vest over a period of time or pursuant to the attainment of set performance goals and unvested restricted stock units are forfeited to us should the executive officer’s employment be terminated, provided that certain grants of restricted stock units provide for accelerated vesting under certain circumstances.

The Compensation Committee reviews the compensation, both cash and stock, of our named executive officers on an annual basis, while taking into account as well changes in compensation during previous years.

Some of these components, such as base salary, are generally fixed and do not vary based on our financial and other performance; some components, such as bonus, are in whole or in part dependent upon the achievement of certain goals jointly agreed upon by our management and the Compensation Committee; and some components, such as restricted stock units, have a value that is dependent upon our stock price at the time of award and going forward.

We compensate our named executive officers in these different ways in order to achieve different goals. Cash compensation, for example, provides our named executive officers with a guaranteed minimum base salary. We fix the base salary of each of our named executive officers at a level that we believe enables us to hire and retain individuals in a competitive environment and rewards satisfactory individual performance and a satisfactory level of contribution to our overall business goals. We also take into account the base salaries paid by similarly-situated companies and the base salaries of other private and public companies with which we believe we compete for talent. To this end, we utilize the services of an independent compensation consulting firm retained by the Compensation Committee, and our Compensation Committee consults with this firm periodically, and annually when we review named executive officer compensation.

Incentive bonus compensation is generally linked to the achievement of short-term operational, strategic or financial goals, and is intended to reward our named executive officers for their performance in reaching goals that are agreed in advance between our management and the Compensation Committee. We design the cash incentive bonuses for each of our named executive officers to focus the named executive officer on achieving key objectives within a yearly time horizon, as described in more detail below.

Grants of restricted stock units are intended to link our named executive officers’ longer-term compensation with the performance of our stock, which is an issue of vital importance to our stockholders. This encourages our named executive officers to remain with us, to act in ways intended to maximize stockholder value, and to penalize them if our stock fails to perform to expectations. These grants are intended to produce significant value for each named executive officer if we achieve our goals and if the named executive officer remains with us, provided that certain grants of restricted stock units provide for accelerated vesting under certain circumstances.

We view the three components of our named executive officer compensation as related but distinct. Although our Compensation Committee does review total compensation, we do not believe that compensation derived from one component of compensation should negate or reduce compensation from other components. We determine the appropriate level for each compensation component based in part, but not exclusively, on our view of internal equity and consistency, individual performance and other information we deem relevant, such as the data we receive from the consulting firm referred to above. Except as described below, our Compensation Committee has not adopted any formal or informal policies or guidelines for allocating compensation between long-term and currently paid out compensation, between cash and non-cash compensation, or among different forms of compensation. This is due to the small size of our named executive officer team and the need to tailor each named executive officer's award to attract and retain that named executive officer.

In addition, we provide our named executive officers with benefits that are generally available to our salaried employees.

Our Compensation Committee performs an annual review of our named executive officers' cash compensation and restricted stock holdings to determine whether they provide adequate compensation for the services they perform, as well as adequate incentives and motivation to our named executive officers and whether they adequately compensate our named executive officers relative to comparable officers in other companies. Our Compensation Committee's most recent review occurred in February and March 2018, and utilized data and assessments from our independent compensation consultant, The Burke Group, Inc., a well-known consulting firm specializing in named executive compensation. This review is described in more detail below.

Compensation Committee meetings typically have included, for all or a portion of some of the meetings, a representative of The Burke Group, as well as preliminary discussion with our Chief Executive Officer prior to our Compensation Committee deliberating without any members of management present. For compensation decisions, including decisions regarding the grant of equity compensation relating to named executive officers (other than our Chief Executive Officer), the Compensation Committee typically considers the recommendations of our Chief Executive Officer and our Chairman of the Board, if they are not the same person.

We account for the equity compensation expense for our employees under the rules of ASC 718, which requires us to estimate and record an expense for each award of equity compensation over the service period of the award. Accounting rules also require us to record cash compensation as an expense at the time the obligation is accrued. We structure cash incentive bonus compensation so that it is taxable to our employees at the time it is paid to them. It is not anticipated that the deduction of any compensation paid to any named executive officer will be limited by Section 162(m) of the Internal Revenue Code.

#### ***Benchmarking of Base Compensation and Equity Holdings***

At its February and March 2018 meetings, our Compensation Committee determined that our respective named executive officers' salaries, cash incentive bonuses and equity holdings were at or below the median of named executive officers with similar roles at public companies having comparable revenues and that no material changes should be made to the cash compensation levels of our named executive officers until our annual named executive officer performance reviews, which were conducted in the first quarter of 2018. This median was derived based on a report we obtained from The Burke Group in March 2018. The report compared our named executive officer compensation with the results of two surveys, involving companies in the aerospace and military/defense industry with revenues of between \$100 million and \$200 million, one from Willis Watson Data Services and one from the Economic Research Institute. Our Compensation Committee realizes that benchmarking our compensation against the compensation earned at comparable companies may not always be appropriate, but believes that engaging in a comparative analysis of our compensation practices is useful. In instances where a named executive officer is uniquely key to our success, the Compensation Committee may provide compensation above the median referred to above. The Committee's choice not to recommend to the Board of Directors immediate material changes to the compensation levels following its review of The Burke Group's report reflects our consideration of stockholders' interests in paying what is necessary, but not more than necessary, to achieve our corporate goals while conserving cash and equity as much as is practicable. We believe that our compensation levels are generally sufficient to retain our existing named executive officers and to hire new named executive officers when and as required.

#### ***Compensation Policies and Practices as They Relate to Risk Management***

In 2017, the Compensation Committee reviewed our compensation policies and practices and concluded that the mix and design of these policies and practices are not reasonably likely to encourage our employees to take excessive risks, and that our compensation policies and practices are not reasonably likely to have a material adverse effect on us. In connection with its evaluation, the Compensation Committee considered, among other things, the structure, philosophy and design characteristics of our primary incentive compensation plans and programs in light of our risk management and governance procedures, as well as other factors that may calibrate or balance potential risk-taking incentives. In particular, the Compensation Committee reviewed our compensation programs for certain design features that have been identified by experts as having the potential to encourage excessive risk-taking, including long term incentive compensation value that is driven entirely by increases in stock price, and low compensation levels exacerbated by performance-driven awards not paying out; including both annual bonus and long term incentive compensation, and noted that these are not substantial factors in our executives' compensation packages.

### ***Equity Compensation***

At the February and March 2018 meetings of the Compensation Committee, the Compensation Committee, in consultation with The Burke Group, analyzed the current restricted share holdings of our named executive officers and others, and found that the level of equity stake of our named executive officers was at market for companies of similar size and experience as a public company.

We do not have any program, plan or obligation that requires us to grant equity compensation to any named executive officer on specified dates. The authority to make equity grants to named executive officers rests with our Compensation Committee, although, as noted above, the Compensation Committee does consider the recommendations of our Chief Executive Officer in setting the compensation of our other named executive officers.

### ***Cash Incentive Bonuses***

Yearly cash incentive bonuses for our named executive officers are established as part of their respective individual employment agreements. Each of these employment agreements provides that the named executive officer will receive a cash incentive bonus determined in the discretion of our Board of Directors, with a target bonus amount specified for that named executive officer based on individualized objective and subjective criteria, pursuant to a specific formula. These bonus criteria are established by the Compensation Committee on an annual basis, and include specific objectives relating to the achievement of business and/or financial milestones. The target cash incentive bonus amount for each of our named executive officers is as follows:

<b>Name of Named Executive Officer</b>	<b>Title</b>	<b>Minimum Bonus</b>	<b>Maximum Bonus</b>
Dean M. Krutty	President and Chief Executive Officer	None	50% of annual base salary
Thomas J. Paup	Senior Vice President – Finance and Chief Financial Officer	None	50% of annual base salary

For 2017, the Compensation Committee chose financial targets for determining eligibility for the above-referenced cash incentive bonuses that are determined on the achievement of set budgetary forecast targets for Adjusted EBITDA, which is determined by taking net profit and adding back in interest expense (income), depreciation of fixed assets, taxes, and amortization of inventory adjustments and of intangible assets, capitalized software costs and technology impairment, as well as stock compensation expense, one-time transaction expenses and certain other non-cash expenses. The Compensation Committee determined that we did not achieve the financial performance criteria established by the Compensation Committee for the year ended December 31, 2017, and accordingly no cash incentive bonuses were paid in respect of the year ended December 31, 2017. Financial targets for 2018 were set in accordance with our 2018 budget forecast, and targets for determining eligibility for cash incentive bonuses will be determined partly on the achievement of set budgetary forecast targets for Adjusted EBITDA and partly based on the achievement of other qualitative objectives to be established at the discretion of the Compensation Committee of the Board.

### ***Severance and Change in Control Benefits***

Messrs. Krutty and Paup have a provision in their respective employment agreements providing for certain severance benefits in the event of termination or retirement. These severance provisions are described in the “Employment Agreements” section below, and certain estimates of these change of control benefits are provided in “Estimated Payments and Benefits upon Termination” below.

We believe the severance arrangements that we have with Messrs. Krutty and Paup are at or near the median of executive officers with similar roles at public companies having comparable revenues.

### ***Benefits***

Messrs. Krutty and Paup are eligible to participate in all of our employee benefit plans, such as medical, group life and disability insurance and our 401(k) plan, in each case on the same basis as our other U.S. employees.

### ***Perquisites***

Our use of perquisites as an element of compensation is limited and is largely based on historical practices and policies of our company. We do not view perquisites as a significant element of our comprehensive compensation structure, and while we believe that they can be used in conjunction with base salary to attract, motivate and retain individuals in a competitive environment, we are careful to review them periodically and to keep them at the lowest level possible consistent with industry practice.

**Effect of Stockholder Advisory Vote on Executive Compensation**

Of the 7,357,129 shares that voted (this number excludes the 84,434 shares that abstained from voting and 10,445,002 broker non-votes) on the advisory vote on executive compensation at the 2016 Annual Meeting, approximately 66% of the shares approved of our executive compensation policies and decisions. We have considered the results of this vote. From 2016 to 2017, the total amount of compensation paid to our executive officers decreased by approximately 71%. The committee and entire Board of Directors intend to continue careful review of the compensation programs and policies to assure that the compensation remains consistent with our philosophy and objectives as stated above and reflective of our financial performance.

**Cash and Other Compensation**

**Summary Compensation Table**

The following table, which should be read in conjunction with the explanations provided below, shows the compensation that we paid (or accrued) to our named executive officers during the fiscal years ended December 31, 2017, 2016, and 2015:

**SUMMARY COMPENSATION TABLE**

<b>Name and Principal Position</b>	<b>Year</b>	<b>Salary</b>	<b>Bonus(1)</b>	<b>Stock Awards (2)</b>	<b>All Other Compensation</b>	<b>Total</b>
Dean M. Krutty	2017	\$ 265,000	\$ –	\$ 87,500	\$ –	\$ 352,500
President and Chief Executive Officer	2016	\$ 255,000	\$ –	\$ 23,100	\$ –	\$ 278,100
Thomas J. Paup	2017	\$ 256,000	\$ –	\$ 70,000	\$ –	\$ 326,000
Senior Vice President – Finance and Chief Financial Officer	2016	\$ 250,000	\$ –	\$ 46,200	\$ –	\$ 296,200
	2015	\$ 250,000	\$ –	\$ 44,600	\$ –	\$ 294,600

- (1) Bonuses are performance-based, against criteria established by the Compensation Committee of the Board of Directors and approved by the full Board of Directors and represent cash awards for prior year company performance. See “Employment Contracts,” below.
- (2) Reflects the value of awards of restricted stock units granted to our named executive officers based on the compensation cost of their stock-based awards (the aggregate grant date fair value computed in accordance with FASB ASC Topic 718); see Note 12.b. of the Notes to Consolidated Financial Statements. The number of restricted stock units received by our named executive officers pursuant to such awards in 2017, vesting entirely after one year (dependent 33% on tenure and 67% on performance), was as follows: Mr. Krutty, 75,000; and Mr. Paup, 60,000. One-third of Mr. Krutty’s and Mr. Paup’s shares vested in 2017. The number of restricted stock units received by our named executive officers pursuant to such awards in 2016, vesting entirely after one year (dependent 33% on tenure and 67% on performance), was as follows: Mr. Krutty, 30,000; and Mr. Paup, 60,000. One-third of Mr. Krutty’s and Mr. Paup’s shares vested in 2016. No restricted stock units were issued in 2015.

**Plan-Based Awards**

**Grants of Restricted Stock Units**

During 2017, the Compensation Committee approved the grant of a total of 135,000 restricted stock units to our executive officers. The table below sets forth each equity award granted to our executive officers during the year ended December 31, 2017.

**GRANTS OF PLAN-BASED AWARDS**

<b>Name</b>	<b>Grant Date</b>	<b>All Other Stock Awards: Number of Shares of Stocks</b>	<b>Grant Date Fair Value of Stock Awards (1)</b>
Dean M. Krutty(2)	01/03/2017	75,000	\$ 262,500
Thomas J. Paup(2)	01/03/2017	60,000	\$ 210,000

- (1) Reflects the aggregate market value of restricted stock units determined based on a per share price at vesting based on the closing price of our common stock on the date of grant.
- (2) The restricted stock units vest on December 31, 2017 (dependent 33% on tenure and 67% on performance).

### *Vesting of Restricted Stock Awards*

The following table presents awards of restricted stock units that vested during the year ended December 31, 2017.

#### STOCK VESTED

Name	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting(1) (\$)
Dean M. Krutty	25,000	\$ 88,750
Thomas J. Paup	20,000	\$ 71,000

- (1) Reflects the aggregate market value of the restricted stock units determined based on a per share price at vesting based on the closing price of our common stock on the Nasdaq Global Market on December 29, 2017 (\$3.55), which was the last trading day of 2017.

### **Employment Contracts**

#### *Dean M. Krutty*

Mr. Krutty is party to an employment agreement with us executed in March 2017, with a term running, as extended, until December 31, 2018 (automatically extending for successive one-year terms unless either party gives 45 days' notice of intent not to extend). The employment agreement provides that Mr. Krutty will serve as our Executive Vice President – North American Operations, and will at the direction of the Board of Directors serve from time to time as acting Chief Executive Officer. Mr. Krutty is currently serving as our President and Chief Executive Officer.

Under the terms of his employment agreement as amended, Mr. Krutty is entitled to receive a base salary of \$265,000, as adjusted annually for inflation.

The employment agreement provides that if the results we actually attain in a given year are at least 100% of the amount we budgeted at the beginning of the year, we will pay a bonus, on a sliding scale, in an amount equal to a minimum of 20% of Mr. Krutty's annual base salary then in effect, up to a maximum of 50% of his annual base salary then in effect if the results we actually attain for the year in question are 110% or more of the amount we budgeted at the beginning of the year. Bonus targets were chosen for 2018 partly based upon 2018 budgetary forecasts and partly based on the achievement of other qualitative objectives to be established at the discretion of the Compensation Committee of the Board.

Mr. Krutty's employment agreement provides that if we fail to renew or we terminate his agreement other than for cause (defined as conviction of certain crimes, willful failure to carry out directives of our board of directors or gross negligence or willful misconduct) or if Mr. Krutty terminates his agreement under certain circumstances (reduction in salary or responsibilities (other than removing his function as acting CEO) or a change in control), we must pay Mr. Krutty severance in an amount of one year's salary. Restricted shares that have vested prior to the date of termination are not forfeited under any circumstances, including termination for Cause.

A table describing the payments that would have been due to Mr. Krutty under his employment agreement had Mr. Krutty's employment with us been terminated at the end of 2017 under various circumstances appears under "Potential Payments and Benefits upon Termination of Employment – Dean M. Krutty," below.

#### *Thomas J. Paup*

Mr. Paup is party to an amended and restated employment agreement with us executed in May 2013, as subsequently amended and extended, with a term running until March 31, 2018. The employment agreement provides that Mr. Paup will serve as our Senior Vice President – Finance and Chief Financial Officer.

Under the terms of his employment agreement as amended, Mr. Paup is entitled to receive a base salary of \$250,000, as adjusted annually for inflation.

The employment agreement provides that if the results we actually attain in a given year are at least 100% of the amount we budgeted at the beginning of the year, we will pay a bonus, on a sliding scale, in an amount equal to a minimum of 16.5% of Mr. Paup's annual base salary then in effect, up to a maximum of 50% of his annual base salary then in effect if the results we actually attain for the year in question are 110% or more of the amount we budgeted at the beginning of the year. For 2017, 2016, and 2015, the Compensation Committee chose financial targets for determining eligibility for the above-referenced cash incentive bonus that are determined on the achievement of set budgetary forecast targets for adjusted EBITDA, a non-GAAP measurement.

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

A table describing the payments that would have been due to Mr. Paup under his employment agreement had Mr. Paup's employment with us been terminated at the end of 2017 under various circumstances appears under "Potential Payments and Benefits upon Termination of Employment – Thomas J. Paup," below.

#### ***Kelli L. Kellar***

Ms. Kellar is party to an employment agreement with us effective in January 2018, with a term running until December 31, 2018. The employment agreement provides that Ms. Kellar will serve as our Vice President – Finance and, beginning in April 2018, as our Chief Financial Officer.

Under the terms of her employment agreement as amended, Ms. Kellar is entitled to receive a base salary of \$225,000, as adjusted annually for inflation.

The employment agreement provides that if the results we actually attain in a given year are at least 100% of the amount we budgeted at the beginning of the year, we will pay a bonus, on a sliding scale, in an amount equal to a minimum of 20% of Ms. Kellar's annual base salary then in effect, up to a maximum of 40% of her annual base salary then in effect if the results we actually attain for the year in question are 110% or more of the amount we budgeted at the beginning of the year. Bonus targets were chosen for 2018 based upon 2018 budgetary forecasts and partly based on the achievement of other qualitative objectives to be established at the discretion of the Compensation Committee of the Board.

Ms. Kellar's employment agreement provides that if we fail to renew or we terminate her agreement other than for cause (defined as conviction of certain crimes, willful failure to carry out directives of our board of directors or gross negligence or willful misconduct), we must pay Ms. Kellar severance in an amount of three times her monthly salary.

#### ***Others***

Other employees have entered into individual employment agreements with us. These agreements govern the basic terms of the individual's employment, such as salary, vacation, overtime pay, severance arrangements and pension plans. They also contain provisions governing the confidentiality of information and ownership of intellectual property learned or created during the course of the employee's tenure with us. Under the terms of these provisions, employees must keep confidential all information regarding our operations (other than information which is already publicly available) received or learned by the employee during the course of employment. This provision remains in force for five years after the employee has left our service. Further, intellectual property created during the course of the employment relationship belongs to us.

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

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

**Potential Payments and Benefits upon Termination of Employment**

This section sets forth in tabular form quantitative disclosure regarding estimated payments and other benefits that would have been received by certain of our executive officers if their employment had terminated on December 29, 2017 (the last business day of the fiscal year), pursuant to the terms of their then-current employment agreements. For a narrative description of the severance and change in control arrangements in the current employment contracts of Messrs. Krutty and Paup and Ms. Kellar, see “– Employment Contracts,” above.

**Dean M. Krutty**

The following table describes the potential payments and benefits upon employment termination for Dean M. Krutty, our President and Chief Executive Officer, pursuant to applicable law and the terms of his then-current employment agreement with us, as if his employment had terminated on December 29, 2017 (the last business day of the fiscal year) under the various scenarios described in the column headings as explained in the footnotes below.

<b>DEAN M. KRUTTY</b>			
<b>Payments and Benefits</b>	<b>Death or Incapacitation(1)</b>	<b>Cause(2)</b>	<b>Non- Renewal(3)</b>
Base salary	\$ –	\$ –	\$ –
Contractual severance	265,000	–	265,000
<b>TOTAL:</b>	<b>\$ 265,000</b>	<b>\$ –</b>	<b>\$ 265,000</b>

- (1) “Incapacitation” is defined in Mr. Krutty’s employment agreement as an inability to perform his duties under his agreement that continues for a period of at least 150 consecutive days or more than 200 days in any twelve-month period.
- (2) “Cause” is defined in Mr. Krutty’s employment agreement as (i) a breach of trust by Mr. Krutty, including, for example, but without limitation, commission of an act of moral turpitude, theft, embezzlement, self-dealing or insider trading; (ii) the intentional or grossly negligent disclosure by Mr. Krutty of confidential information of or relating to us; (iii) a material breach by Mr. Krutty of his employment agreement; (iv) failure in any material respect to follow the reasonable directives of our Board of Directors, or (v) any act of, or omission by, Mr. Krutty which, in our reasonable judgment, amounts to a serious failure by Mr. Krutty to perform his responsibilities or functions or in the exercise of his authority, which failure, in our reasonable judgment, rises to a level of gross nonfeasance, misfeasance or malfeasance.
- (3) “Non-Renewal” is defined in Mr. Krutty’s employment agreement as the agreement coming to the end of the Term and not being extended or immediately succeeded by a new substantially similar employment agreement.

**Thomas J. Paup**

The following table describes the potential payments and benefits upon employment termination for Thomas J. Paup, our Senior Vice President – Finance and Chief Financial Officer, pursuant to applicable law and the terms of his then-current employment agreement with us, as if his employment had terminated on December 29, 2017 (the last business day of the fiscal year) under the various scenarios described in the column headings as explained in the footnotes below.

<b>THOMAS J. PAUP</b>			
<b>Payments and Benefits</b>	<b>Death or Incapacitation(1)</b>	<b>Cause(2)</b>	<b>Non- Renewal(3)</b>
Accrued but unpaid:			
Base salary	\$ –	\$ –	\$ –
Contractual severance	263,000	–	263,000
<b>TOTAL:</b>	<b>\$ 263,000</b>	<b>\$ –</b>	<b>\$ 263,000</b>

- (1) “Incapacitation” is defined in Mr. Paup’s employment agreement as an inability to perform his duties under his agreement that continues for a period of at least 150 consecutive days or more than 200 days in any twelve-month period.
- (2) “Cause” is defined in Mr. Paup’s employment agreement as (i) a breach of trust by Mr. Paup, including, for example, but without limitation, commission of an act of moral turpitude, theft, embezzlement, self-dealing or insider trading; (ii) the unauthorized disclosure by Mr. Paup of confidential information of or relating to us; (iii) a material breach by Mr. Paup of his employment agreement; or (iv) any act of, or omission by, Mr. Paup which, in our reasonable judgment, amounts to a serious failure by Mr. Paup to perform his responsibilities or functions or in the exercise of his authority, which failure, in our reasonable judgment, rises to a level of gross nonfeasance, misfeasance or malfeasance.
- (3) “Non-Renewal” is defined in Mr. Paup’s employment agreement as the agreement coming to the end of the Term and not being extended or immediately succeeded by a new substantially similar employment agreement.

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

**Security Ownership of Certain Beneficial Owners and Management**

The following table sets forth information regarding the security ownership, as of February 28, 2018, of those persons owning of record or known by us to own beneficially more than 5% of our common stock and of each of our Named Executive Officers and directors, and the shares of common stock held by all of our current directors and executive officers as a group.

<b>Name and Address of Beneficial Owner(1)</b>	<b>Shares Beneficially Owned(2)(3)</b>	<b>Percentage of Total Shares Outstanding(3)</b>
Jon B. Kutler (includes 1,565,000 shares owned by Admiralty Partners, Inc.)	1,761,650 (4)	6.7%
Dean M. Krutty	118,972 (5)	*
Thomas J. Paup	343,946 (6)	1.3%
Michael E. Marrus	120,903 (7)	*
Kenneth W. Cappell	73,227 (8)	*
Lawrence F. Hagenbuch	40,327 (9)	*
James J. Quinn	18,513 (10)	*
All of our directors and executive officers as a group (7 persons)	<u>2,477,538</u> (11)	<u>9.4%</u>

\* Less than one percent.

(1) Unless otherwise indicated in these footnotes, the address of each named beneficial owner is in care of Arotech Corporation, 1229 Oak Valley Drive, Ann Arbor, Michigan 48108.

(2) Unless otherwise indicated in these footnotes, each of the persons or entities named in the table has sole voting and sole investment power with respect to all shares shown as beneficially owned by that person, subject to applicable community property laws.

(3) Based on 26,452,462 shares of common stock outstanding as of February 28, 2018. For purposes of determining beneficial ownership of our common stock, owners of options exercisable or restricted stock units that vest within 60 days of February 28, 2018 are considered to be the beneficial owners of the shares of common stock for which such securities are exercisable. The percentage ownership of the outstanding common stock reported herein is based on the assumption (expressly required by the applicable rules of the Securities and Exchange Commission) that only the person whose ownership is being reported has exercised his options for shares of common stock.

(4) Jon B. Kutler and his wife are directors of Admiralty Partners, Inc. (“API”), which owns 1,565,000 shares, or 6.5%, of our common stock. The principal place of business for API is 68-1052 Honoka’ope Way, Kamuela, Hawaii 96743. Mr. and Mrs. Kutler are also settlors and trustees of two trusts that between them own an additional 159,879 shares. Accordingly, Mr. and Ms. Kutler have shared voting and dispositive power with respect to 1,724,879 shares. Mr. and Mrs. Kutler disclaim beneficial ownership of these shares except to the extent of their respective voting and/or dispositive power. Mr. Kutler also holds 11,804 shares directly, 8,756 shares of unvested restricted stock that vest within 60 days of February 28, 2018, and 16,211 unvested restricted shares. API and Mr. Robert Ehrlich and the Estate of Steven Esses (as successor to Mr. Esses) are parties to a Voting Agreement pursuant to which Mr. Ehrlich and the Estate of Steven Esses agrees to vote the shares of our common stock held by them in favor of the election of a director nominee designated by API. This obligation shall remain in effect for so long as API and its affiliates continue to beneficially own at least 750,000 shares of our common stock. All information in this footnote and in the text to which this footnote relates other than information relating directly to Mr. Kutler is based on a Schedule 13D filed by API and certain of its related entities and persons, including Mr. Kutler, with the Securities and Exchange Commission on February 3, 2016, as amended on February 26, 2016, and Forms 3, 4, and 5 filed by Mr. Kutler.

(5) Consists of 118,972 shares held directly by Mr. Krutty. Does not include 75,000 restricted stock units, the vesting of 50,000 of which is subject to performance criteria.

(6) Consists of 343,946 shares held directly by Mr. Paup.

(7) Consists of 95,432 shares owned directly by Mr. Marrus, 12,761 shares of unvested restricted stock that vest within 60 days of February 28, 2018, and 12,710 unvested restricted shares.

(8) Consists of 48,775 shares owned directly by Mr. Cappell, 8,756 shares of unvested restricted stock that vest within 60 days of February 28, 2018, and 15,696 unvested restricted shares.

(9) Consists of 12,221 shares owned directly by Mr. Hagenbuch, 12,076 shares of unvested restricted stock that vest within 60 days of February 28, 2018, and 16,030 unvested restricted shares.

(10) Consists of 2,217 shares owned directly by Adm. Quinn, 3,955 shares of unvested restricted stock that vest within 60 days of February 28, 2018, and 12,341 unvested restricted shares.

(11) Includes 46,304 shares of unvested restricted stock that vest within 60 days of February 28, 2018 and 72,988 shares of unvested restricted stock. Does not include 75,000 unvested restricted stock units.

**Securities Authorized for Issuance Under Equity Compensation Plans**

The following table sets forth certain information, as of December 31, 2017, with respect to our 2009 and 2017 equity compensation plans, as well as any stock options previously issued by us (including individual compensation arrangements) as compensation for goods and services:

**EQUITY COMPENSATION PLAN INFORMATION**

<b>Plan Category</b>	<b>Number of securities to be issued upon exercise of outstanding options, war-rants and rights (a)</b>	<b>Weighted-average exercise price of outstanding options, warrants and rights (b)</b>	<b>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)</b>
Equity compensation plans approved by security holders	–	–	2,430,895

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

**Voting Agreements**

Please see “Item 10. Directors, Executive Officers and Corporate Governance – Executive Officers, Directors and Significant Employees – Voting Agreements,” above.

**Director Consulting Agreement**

In connection with the API Agreement described under “Item 10. Directors, Executive Officers and Corporate Governance – Executive Officers, Directors and Significant Employees – Voting Agreements,” above, we and Mr. Jon Kutler, who is now our Chairman of the Board, entered into a consulting agreement pursuant to which Mr. Kutler agreed to provide consulting services to us for a period of three years, unless terminated earlier. Under the terms of this agreement, Mr. Kutler will receive an annual fee for the three-year term of the consulting agreement equal to the difference between \$125,000 and the amount of cash and the value of any stock received by Mr. Kutler for serving on our Board.

**Director Independence**

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

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

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

- *Audit Fees.* Audit fees billed or expected to be billed to us by BDO for the audit of the financial statements included in our Annual Report on Form 10-K, and reviews of the financial statements included in our Quarterly Reports on Form 10-Q, for the years ended December 31, 2017 and 2016 totaled approximately \$507,000 and \$535,000, respectively.
- *Audit-Related Fees.* BDO billed or expected to bill us zero for the fiscal years ended December 31, 2017 and 2016, respectively, for other assurance and related services that are not directly related to the performance of the annual audit or review of our financial statements.
- *Tax Fees.* BDO billed or expected to bill us \$109,000 (including consultation related to mergers and acquisitions) and \$90,000 for the fiscal years ended December 31, 2017 and 2016, respectively, for tax services.
- *All Other Fees.* BDO billed or expected to bill us an aggregate of zero for both fiscal years ended December 31, 2017 and 2016 for permitted non-audit services.

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

**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

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

- (1) Financial Statements. See Index to Financial Statements on page 50 above and the financial pages following page 52 below.
- (2) Financial Statements Schedules. All schedules are omitted because of the absence of conditions under which they are required or because the required information is presented in the financial statements or related notes thereto.
- (3) Exhibits. The following Exhibits are either filed herewith or have previously been filed with the Securities and Exchange Commission and are referred to and incorporated herein by reference to such filings, along with hyperlinks to the applicable documents:

<b>Exhibit No.</b>	<b>Description</b>
* 3.1	<a href="#">Amended and Restated Certificate of Incorporation</a>
* 3.1.1	<a href="#">Amendment to Amended and Restated Certificate of Incorporation</a>
(1) 3.1.2	<a href="#">Amendment to Amended and Restated Certificate of Incorporation</a>
(2) 3.1.3	<a href="#">Amendment to Amended and Restated Certificate of Incorporation</a>
(3) 3.1.4	<a href="#">Amendment to Amended and Restated Certificate of Incorporation</a>
(4) 3.1.5	<a href="#">Amendment to Amended and Restated Certificate of Incorporation</a>
* 3.2	<a href="#">Amended and Restated By-Laws</a>
(5) 4.1	<a href="#">Specimen Certificate for shares of common stock, \$0.01 par value</a>
†(6) 10.1	<a href="#">Third Amended and Restated Employment Agreement between Arotech Corporation and Thomas J. Paup dated May 13, 2013 and effective as of May 1, 2013</a>
†(7) 10.1.1	<a href="#">Amendment dated January 13, 2015 to Third Amended and Restated Employment Agreement, dated May 13, 2013 and effective as of May 1, 2013, between Arotech Corporation and Thomas J. Paup</a>
†(8) 10.1.2	<a href="#">Amendment dated January 26, 2017 to Third Amended and Restated Employment Agreement, dated May 13, 2013 and effective as of May 1, 2013, between Arotech Corporation and Thomas J. Paup</a>
†(9) 10.2	<a href="#">Arotech Corporation 2007 Non-Employee Director Equity Compensation Plan</a>
†(10) 10.3	<a href="#">Arotech Corporation 2009 Equity Incentive Plan</a>
(11) 10.4	<a href="#">Stock Purchase Agreement dated as of February 2, 2016 between Arotech Corporation and Admiralty Partners, Inc.</a>
(12) 10.4.1	<a href="#">Amendment dated February 23, 2016 to Stock Purchase Agreement dated as of February 2, 2016 between Arotech Corporation and Admiralty Partners, Inc.</a>
(13) 10.4.2	<a href="#">Amendment dated March 25, 2016 to Stock Purchase Agreement dated as of February 2, 2016 between Arotech Corporation and Admiralty Partners, Inc.</a>
†(14) 10.5	<a href="#">Consulting Agreement dated February 2, 2016 between Arotech Corporation and Admiralty Partners, Inc.</a>
(14) 10.6	<a href="#">Registration Rights Agreement dated as of February 2, 2016 between Arotech Corporation and Admiralty Partners, Inc.</a>
(15) 10.7	<a href="#">Voting Agreement dated as of February 23, 2016 between Robert S. Ehrlich, Steven Esses, and Admiralty Partners, Inc.</a>
(16) 10.8	<a href="#">Credit Agreement between JPMorgan Chase Bank, N.A. and Arotech Corporation and certain of Arotech Corporation's subsidiaries dated March 11, 2016</a>
** 10.8.1	<a href="#">First amendment dated June 3, 2016 to Credit Agreement between JPMorgan Chase Bank, N.A. and Arotech Corporation and certain of Arotech Corporation's subsidiaries dated March 11, 2016</a>
** 10.8.2	<a href="#">Second amendment dated June 25, 2016 to Credit Agreement between JPMorgan Chase Bank, N.A. and Arotech Corporation and certain of Arotech Corporation's subsidiaries dated March 11, 2016</a>
** 10.8.3	<a href="#">Third amendment dated June 1, 2016 to Credit Agreement between JPMorgan Chase Bank, N.A. and Arotech Corporation and certain of Arotech Corporation's subsidiaries dated March 11, 2016</a>
** 10.8.4	<a href="#">Fourth amendment dated June 20, 2017 to Credit Agreement between JPMorgan Chase Bank, N.A. and Arotech Corporation and certain of Arotech Corporation's subsidiaries dated March 11, 2016</a>
(16) 10.9	<a href="#">Pledge and Security Agreement between JPMorgan Chase Bank, N.A. and Arotech Corporation and certain of Arotech Corporation's subsidiaries dated March 11, 2016</a>
(16) 10.10	<a href="#">Patent and Trademark Security Agreement between JPMorgan Chase Bank, N.A. and Arotech Corporation and certain of Arotech Corporation's subsidiaries dated March 11, 2016</a>
(17) 10.11	<a href="#">Settlement Agreement between Arotech Corporation and Ephraim Fields dated March 25, 2016</a>
(18) 10.12	<a href="#">Lease dated October 31, 2014 between UEC Properties, LLC and UEC Electronics, LLC</a>
†(19) 10.13	<a href="#">Employment Agreement between Arotech Corporation and Dean Krutty dated March 16, 2017 and effective as of January 1, 2017</a>
†** 10.13.1	<a href="#">Amendment dated August 30, 2017 to Employment Agreement between Arotech Corporation and Dean Krutty dated March 16, 2017 and effective as of January 1, 2017</a>
††(20) 10.14	<a href="#">Lease dated as of December 31, 2017 between Epsilon-Electric Fuel Ltd. and Industrial Buildings Company, Ltd.</a>

Exhibit No.	Description
†(21) 10.15	<a href="#">Employment Agreement between Arotech Corporation and Kelli L. Kellar effective as of January 8, 2018</a>
(22) 10.16	<a href="#">Arotech Corporation 2017 Non-Employee Director Equity Compensation Plan</a>
** 10.17	<a href="#">Purchase and Sale Agreement dated May 1, 2017 between FAAC Incorporated, and Oak Valley 1229, LLC</a>
** 21.1	<a href="#">List of Subsidiaries of Arotech Corporation</a>
** 23.1	<a href="#">Consent of BDO USA, LLP</a>
** 31.1	<a href="#">Certification of Principal Executive Officer pursuant to Rule 13a -14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</a>
** 31.2	<a href="#">Certification of Principal Financial Officer pursuant to Rule 13a -14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</a>
** 32.1	<a href="#">Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>
** 32.2	<a href="#">Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>
** 101.INS	XBRL Instance Document
** 101.SCH	XBRL Taxonomy Extension Schema Document
** 101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
** 101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
** 101.LAB	XBRL Taxonomy Extension Label Linkbase Document
** 101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
*	Previously-filed paper document being re-filed herewith in order to provide a hyperlink in compliance with amendments to Item 601 of Regulation S-K adopted by the Securities and Exchange Commission on March 1, 2017 and effective for filings after November 1, 2017
**	Filed herewith
†	Includes management contracts and compensation plans and arrangements
††	Summary of Hebrew original
(1)	Incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2000
(2)	Incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2003
(3)	Incorporated by reference to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2006
(4)	Incorporated by reference to our Current Report on Form 8-K filed June 9, 2009
(5)	Incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2004
(6)	Incorporated by reference to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2013
(7)	Incorporated by reference to our Current Report on Form 8-K filed January 14, 2015
(8)	Incorporated by reference to our Current Report on Form 8-K filed January 30, 2017
(9)	Incorporated by reference to our Registration Statement on Form S-8 (Registration No. 333-146752), which became effective on October 17, 2007
(10)	Incorporated by reference to our Registration Statement on Form S-8 (Registration No. 333-160717), which became effective on July 21, 2009
(11)	Incorporated by reference to our Current Report on Form 8-K filed February 3, 2016
(12)	Incorporated by reference to our Current Report on Form 8-K filed February 25, 2016
(13)	Incorporated by reference to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2016
(14)	Incorporated by reference to our Current Report on Form 8-K filed February 3, 2016
(15)	Incorporated by reference to our Current Report on Form 8-K filed February 25, 2016
(16)	Incorporated by reference to our Current Report on Form 8-K filed March 14, 2016
(17)	Incorporated by reference to our Current Report on Form 8-K filed March 28, 2016
(18)	Incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2014
(19)	Incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2016
(20)	Incorporated by reference to our Current Report on Form 8-K filed February 23, 2018
(21)	Incorporated by reference to our Current Report on Form 8-K filed January 8, 2018
(22)	Incorporated by reference to our Registration Statement on Form S-8 (Registration No. 333-222465), which became effective on January 8, 2018

**ITEM 16. FORM 10-K SUMMARY**

None.



## Report of Independent Registered Public Accounting Firm

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

### Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Arotech Corporation (the “Company”) as of December 31, 2017 and 2016, the related consolidated statements of operations and comprehensive income (loss), changes in stockholders’ equity and cash flows for each of the three years in the period ended December 31, 2017, and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2017 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) and our report dated March 15, 2018 expressed an unqualified opinion thereon.

### Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ BDO USA, LLP

We have served as the Company’s auditor since 2006.  
Grand Rapids, Michigan  
March 15, 2018

**AROTECH CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS**

In U.S. dollars

	December 31,	
	2017	2016
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 5,205,246	\$ 7,130,983
Restricted collateral deposits	283,508	268,980
Trade receivables	19,258,960	16,821,737
Unbilled receivables	16,094,515	10,981,577
Other accounts receivable and prepaid expenses	2,342,220	2,156,896
Inventories	8,654,878	10,318,021
<b>Total current assets</b>	<b>51,839,327</b>	<b>47,678,194</b>
<b>LONG TERM ASSETS:</b>		
Contractual and Israeli statutory severance pay fund	3,754,789	3,177,238
Other long term receivables	184,331	56,662
Property and equipment, net	9,276,088	5,915,240
Other intangible assets, net	5,205,605	6,823,346
Goodwill	46,138,036	45,489,517
Discontinued operations	-	270,139
<b>Total long term assets</b>	<b>64,558,849</b>	<b>61,732,142</b>
<b>Total assets</b>	<b>\$ 116,398,176</b>	<b>\$ 109,410,336</b>

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

**AROTECH CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS**

In U.S. dollars

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Trade payables	\$ 5,560,196	\$ 4,362,804
Other accounts payable and accrued expenses	6,640,154	5,597,558
Current portion of long term debt	2,248,043	1,828,840
Short term bank credit	5,092,088	2,973,032
Severance payable	–	2,577,472
Deferred revenues	6,778,313	6,421,271
<b>Total current liabilities</b>	<b>26,318,794</b>	<b>23,760,977</b>
<b>LONG TERM LIABILITIES:</b>		
Contractual and accrued Israeli statutory severance pay	4,709,807	3,891,710
Long term portion of debt	8,570,524	8,703,736
Deferred income tax liability	5,600,721	7,868,125
Other long term liabilities	105,112	100,742
<b>Total long-term liabilities</b>	<b>18,986,164</b>	<b>20,564,313</b>
<b>Total liabilities</b>	<b>45,304,958</b>	<b>44,325,290</b>
<b>STOCKHOLDERS' EQUITY:</b>		
Share capital –		
Common stock – \$0.01 par value each; Authorized: 50,000,000 shares as of December 31, 2017 and 2016; Issued and outstanding: 26,395,048 and 26,438,234 shares as of December 31, 2017 and 2016, respectively	263,951	264,382
Preferred shares – \$0.01 par value each; Authorized: 1,000,000 shares as of December 31, 2017 and 2016; No shares issued or outstanding as of December 31, 2017 and 2016	–	–
Additional paid-in capital	250,826,873	250,405,012
Accumulated deficit	(181,568,757)	(185,402,893)
Notes receivable from stockholders	(908,054)	(908,054)
Accumulated other comprehensive income	2,479,205	726,599
<b>Total stockholders' equity</b>	<b>71,093,218</b>	<b>65,085,046</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 116,398,176</b>	<b>\$ 109,410,336</b>

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

**AROTECH CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)****In U.S. dollars**

	<b>December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Revenues	\$ 98,722,678	\$ 92,975,752	\$ 96,573,947
Cost of revenues	71,082,708	64,825,416	68,456,322
Research and development expenses	3,041,130	2,722,965	3,075,362
Selling and marketing expenses	7,874,364	7,029,090	5,373,421
General and administrative expenses	11,623,900	15,308,461	16,339,027
Amortization of intangible assets	2,205,755	2,875,543	3,043,536
Total operating costs and expenses	<u>95,827,857</u>	<u>92,761,475</u>	<u>96,287,668</u>
Operating income	<u>2,894,821</u>	<u>214,277</u>	<u>286,279</u>
Other income (expense), net	(8,156)	64,832	(24,181)
Financial expense, net	(1,076,659)	(975,263)	(1,152,121)
Total other expense	(1,084,815)	(910,431)	(1,176,302)
Income (loss) from continuing operations before income tax (benefit) expense	<u>1,810,006</u>	<u>(696,154)</u>	<u>(890,023)</u>
Income tax (benefit) expense	<u>(2,024,130)</u>	<u>783,420</u>	<u>1,160,946</u>
Income (loss) from continuing operations	3,834,136	(1,479,574)	(2,050,969)
Loss from discontinued operations	–	(1,368,682)	(894,057)
Net income (loss)	3,834,136	(2,848,256)	(2,945,026)
Other comprehensive income (loss), net of \$0 income tax			
Foreign currency translation adjustment	1,752,606	54,925	14,634
Comprehensive income (loss)	<u>\$ 5,586,742</u>	<u>\$ (2,793,331)</u>	<u>\$ (2,930,392)</u>
Income (loss) per share of common stock:			
Basic – continuing operations	\$ 0.15	\$ (0.06)	\$ (0.08)
Basic – discontinued operations	\$ –	\$ (0.05)	\$ (0.04)
Basic net income (loss) per share	<u>\$ 0.15</u>	<u>\$ (0.11)</u>	<u>\$ (0.12)</u>
Diluted – continuing operations	\$ 0.15	\$ (0.06)	\$ (0.08)
Diluted – discontinued operations	\$ –	\$ (0.05)	\$ (0.04)
Diluted net income (loss) per share	<u>\$ 0.15</u>	<u>\$ (0.11)</u>	<u>\$ (0.12)</u>
Weighted average number of shares used in computing basic net income (loss) per share	<u>26,380,312</u>	<u>25,494,097</u>	<u>23,687,733</u>
Weighted average number of shares used in computing diluted net income (loss) per share	<u>26,380,312</u>	<u>25,494,097</u>	<u>23,687,733</u>

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

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

In U.S. dollars

	Common stock		Additional paid-in capital	Accumulated deficit	Notes receivable From stockholders	Accumulated other comprehensive income	Total stockholders' equity
	Shares	Amount					
Balance as of January 1, 2017	26,438,234	\$ 264,382	\$250,405,012	\$(185,402,893)	\$ (908,054)	\$ 726,599	\$ 65,085,046
Stock based compensation	–	–	421,430	–	–	–	421,430
Restricted stock issued	109,320	1,094	(1,094)	–	–	–	–
Restricted stock units vested	46,165	462	(462)	–	–	–	–
Restricted stock forfeitures	(198,671)	(1,987)	1,987	–	–	–	–
Foreign currency translation adjustment	–	–	–	–	–	1,752,606	1,752,606
Net Income	–	–	–	3,834,136	–	–	3,834,136
Balance as of December 31, 2017	<u>26,395,048</u>	<u>\$ 263,951</u>	<u>\$250,826,873</u>	<u>\$(181,568,757)</u>	<u>\$ (908,054)</u>	<u>\$ 2,479,205</u>	<u>\$ 71,093,218</u>

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

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

In U.S. dollars

	Common stock		Additional paid-in capital	Accumulated deficit	Notes receivable From stockholders	Accumulated other comprehensive income	Total stockholders' equity
	Shares	Amount					
Balance as of January 1, 2016	24,697,335	\$ 246,973	\$246,591,415	\$(182,554,637)	\$ (908,054)	\$ 671,674	\$ 64,047,371
Stock based compensation	—	—	878,007	—	—	—	878,007
Restricted stock issued	310,735	3,107	(3,107)	—	—	—	—
Sales of stock, net of offering costs	1,500,000	15,000	2,937,999	—	—	—	2,952,999
Restricted stock units vested	56,202	562	(562)	—	—	—	—
Restricted stock forfeitures	(126,038)	(1,260)	1,260	—	—	—	—
Foreign currency translation adjustment	—	—	—	—	—	54,925	54,925
Net loss	—	—	—	(2,848,256)	—	—	(2,848,256)
Balance as of December 31, 2016	<u>26,438,234</u>	<u>\$ 264,382</u>	<u>\$250,405,012</u>	<u>\$(185,402,893)</u>	<u>\$ (908,054)</u>	<u>\$ 726,599</u>	<u>\$ 65,085,046</u>

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

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

In U.S. dollars

	Common stock		Additional paid-in capital	Accumulated deficit	Notes receivable From stockholders	Accumulated other comprehensive income	Total stockholders' equity
	Shares	Amount					
Balance as of January 1, 2015	24,533,121	\$ 245,331	\$245,970,742	\$(179,609,611)	\$ (908,054)	\$ 657,040	\$ 66,355,448
Stock based compensation	–	–	622,315	–	–	–	622,315
Restricted stock issued	57,028	570	(570)	–	–	–	–
Restricted stock units vested	107,186	1,072	(1,072)	–	–	–	–
Foreign currency translation adjustment	–	–	–	–	–	14,634	14,634
Net loss	–	–	–	(2,945,026)	–	–	(2,945,026)
Balance as of December 31, 2015	<u>24,697,335</u>	<u>\$ 246,973</u>	<u>\$246,591,415</u>	<u>\$(182,554,637)</u>	<u>\$ (908,054)</u>	<u>\$ 671,674</u>	<u>\$ 64,047,371</u>

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

**AROTECH CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS****In U.S. dollars**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income (loss)	\$ 3,834,136	\$ (2,848,256)	\$ (2,945,026)
<i>Adjustments required to reconcile net income (loss) to net cash provided by operating activities:</i>			
Depreciation	1,835,308	1,789,041	1,851,982
Amortization of intangible assets	2,205,755	2,875,543	3,043,536
Stock based compensation	421,430	878,007	622,315
Loss (gain) from sale of property and equipment	5,651	8,680	(781,023)
Deferred tax expense	(2,267,404)	836,561	914,543
<i>Changes in operating assets and liabilities:</i>			
Trade receivables	(1,857,393)	659,468	194,332
Unbilled receivables	(5,085,759)	1,155,454	3,804,576
Other accounts receivable and prepaid expenses	(252,560)	(1,176,895)	148,269
Inventories	2,067,853	(652,391)	203,947
Severance pay, net	(1,894,037)	1,210,662	43,244
Trade payables	1,282,162	(1,532,471)	(858,040)
Other accounts payable and accrued expenses	1,252,630	(103,186)	(944,376)
Deferred revenues	357,041	(458,544)	(946,363)
<b><i>Net cash provided by operating activities</i></b>	<u>1,904,813</u>	<u>2,641,673</u>	<u>4,351,916</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Changes in restricted collateral deposits	14,033	(176,354)	146,443
Purchase of property and equipment	(4,824,493)	(1,555,788)	(2,002,104)
Additions to capitalized software development	(588,014)	(364,159)	(537,901)
Proceeds from sale of property and equipment	33,766	31,343	953,824
<b><i>Net cash used in investing activities</i></b>	<u>\$ (5,364,708)</u>	<u>\$ (2,064,958)</u>	<u>\$ (1,439,738)</u>

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

In U.S. dollars

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Repayment of long term debt	\$ (1,842,998)	\$ (16,682,823)	\$ (5,096,130)
Proceeds from long term debt	2,150,000	11,000,000	–
Change in short term bank credit, net	2,119,056	(1,086,968)	4,026,762
Payment of acquisition related earnout	–	–	(2,500,000)
Proceeds from sale of common stock, net of offering costs	–	2,952,999	–
<i>Net cash provided by (used in) financing activities</i>	<u>2,426,058</u>	<u>(3,816,792)</u>	<u>(3,569,368)</u>
<b>DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(1,033,837)</b>	<b>(3,240,077)</b>	<b>(657,190)</b>
<b>CASH DIFFERENCES DUE TO EXCHANGE RATE CHANGES</b>	<b>(891,900)</b>	<b>(237,360)</b>	<b>(26,174)</b>
<b>CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR</b>	<b>7,130,983</b>	<b>10,608,420</b>	<b>11,291,784</b>
<b>CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR</b>	<b><u>\$ 5,205,246</u></b>	<b><u>\$ 7,130,983</u></b>	<b><u>\$ 10,608,420</u></b>
<b>SUPPLEMENTARY CASH FLOW INFORMATION:</b>			
Interest paid during the year	\$ 765,941	\$ 712,558	\$ 1,084,710
Income tax paid during the year	169,584	221,654	679,055

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

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**In U.S. dollars**

**NOTE 1:– GENERAL**

a. Corporate structure:

Arotech Corporation (“Arotech”) and its wholly-owned subsidiaries (the “Company”) provide defense and security products for the military, law enforcement, emergency services and homeland security markets, including zinc-air and lithium batteries and chargers, and multimedia interactive simulators/trainers. The Company operates primarily through its wholly-owned subsidiaries FAAC Incorporated, a Michigan corporation located in Ann Arbor, Michigan (Training and Simulation Division) with a location in Orlando, Florida; Epsilon-Electric Fuel Ltd. (“Epsilon-EFL”), an Israeli corporation located in Beit Shemesh, Israel (between Jerusalem and Tel-Aviv), Dimona, Israel (in Israel’s Negev desert area) and Sderot, Israel (near the Gaza Strip) (Power Systems Division); UEC Electronics, LLC (“UEC”), a South Carolina limited liability company located in Hanahan, South Carolina (Power Systems Division).

b. Discontinued operations

Asset Held for Sale and Discontinued Operations

In August 2016, the Board approved a strategic shift to discontinue the Flow Battery segment (“the segment”) with an effective date of August 31, 2016. The principal activities of the Flow Battery segment were research and development related and were focused on developing a commercial application based upon the Iron Flow Storage concept. The assets of the Flow Battery segment of \$270,139 were classified as held for sale as of December 31, 2016. During the fourth quarter of 2017, it was determined that the Company was not able to execute its plan to sell the assets associated with the Flow Battery segment. As a result, assets in the amount of \$270,000 have been reclassified on the consolidated balance sheet into property and equipment, which are being used in operations and therefore not considered to be impaired as of December 31, 2017.

The amounts presented in the consolidated statements of comprehensive income as discontinued operations represented research and development and general and administrative expenses. As the Flow Battery segment was reported within the Epsilon-EFL legal entity and the legal entity has net operating loss carryforwards for which the Company has recorded a valuation allowance, there was no tax impact. Included in the Flow Battery segment’s general and administrative expenses for the year ended December 31, 2016, was a contractual buyout associated with the termination of the former Chairman of the Flow Battery segment of \$524,052.

The impact of the discontinued operations on operating and investing activities within the consolidated statements of cash flows for the year ended December 31, 2016, and 2015 was (\$1,337,751) and (\$879,428); and (\$252,064) and (\$22,075), respectively.

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

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**In U.S. dollars**

**NOTE 1:-- GENERAL (Cont.)**

c. Related parties

Note Receivable

Two former executives entered into non-recourse promissory notes whereby the Company provided the note to the executives and the executives in turn exercised stock options. The promissory notes originally accrued interest at an annual rate of 1% over the then federal funds rate. In 2008, the Company stopped accruing interest on the promissory notes. As of December 31, 2017 and 2016, the aggregate amount outstanding pursuant to this promissory note was \$908,054.

UEC Facility Headquarters

On October 31, 2014, the Company entered into a lease agreement with UEC Properties, LLC, a company controlled by the former owners of UEC, and now consultants and shareholders of the Company, for land and buildings that represent the headquarters of UEC Electronics. The lease term with UEC Properties commenced on January 1, 2015 and it extends for ten years, expiring on December 31, 2024. The 2017 monthly lease payment is \$30,325 and increases at a rate of 2.5% per year through the term of the lease. Lease expense recognized in 2017 and 2016 was \$364,000 and \$355,000, respectively. Upon written notice, the Company and UEC Properties, LLC, may elect to terminate the lease after five years.

Admiralty Partners

On February 2, 2016, the Company and Admiralty Partners (the "Investor") entered into a Stock Purchase Agreement (the "Investment Agreement") providing for the sale to the Investor of a total of 1,500,000 shares of the Company's common stock at a price valued at \$1.99 per share. As the Investor was also given the right to nominate a member of the Board of Directors pursuant to the terms of the Investment Agreement, and the shares were issued as a discount to the then market price, this resulted in additional stock compensation expense of \$375,000.

Subsequently, on February 3, 2016, the Company entered into a consulting agreement with the Investor for a period of three years. In exchange, the Company pays an annual fee equal to the difference between total accrued compensation of the Board member and \$125,000. The agreement can be terminated by either party upon sufficient written notice. Total compensation expense recognized in 2017 and 2016 was \$49,000 and \$27,000, respectively.

**NOTE 2:-- SIGNIFICANT ACCOUNTING POLICIES**

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

a. Principles of consolidation:

The consolidated financial statements include the accounts of Arotech and its wholly owned subsidiaries. Intercompany balances and transactions have been eliminated upon consolidation. The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

b. Financial Statements in U.S. Dollars:

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

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**In U.S. dollars**

**NOTE 2:– SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

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

c. Cash equivalents:

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

d. Restricted collateral deposits:

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

e. Inventories:

Inventory costs include material, labor, and manufacturing overhead costs, including depreciation and amortization expense associated with the manufacture and distribution of the Company’s products. Inventories are stated at lower of cost or net realizable value and expense estimates are made for excess and obsolete inventories. Based on this evaluation, provisions are made to write inventory down to its market value. In 2017, 2016, and 2015, the Company wrote off approximately \$407,000, \$359,000, and \$321,000, respectively, of obsolete inventory, which has been included in the cost of revenues. Cost is determined by first-in, first-out (“FIFO”) method.

f. Property and equipment:

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

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

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**In U.S. dollars**

**NOTE 2:– SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The Company tests long-lived asset groups for recoverability when changes in circumstances indicate the carrying value may not be recoverable, for example, when there are material adverse changes in projected revenues or expenses, significant underperformance relative to historical or projected operating results, or significant negative industry or economic trends. The Company also performs a test for recoverability when management has committed to a plan to sell or otherwise dispose of an asset group. The Company evaluates recoverability of an asset group by comparing its carrying value to the future net undiscounted cash flows that the Company expects will be generated by the asset group. If the comparison indicates that the carrying value of an asset group is not recoverable, the Company recognizes an impairment loss for the excess of carrying value over the estimated fair value. When the Company recognizes an impairment loss for assets to be held and used, the Company depreciates the adjusted carrying amount of those assets over their remaining useful life. No impairment losses were recognized for the year ended December 31, 2017.

g. Goodwill and Other Intangible Assets:

Certain business acquisitions have resulted in the recording of goodwill and indefinite-life intangible assets, primarily trademark assets, which are not amortized.

Goodwill is tested for impairment at the reporting unit level, which is the operating segment or one level below the operating segment, also known as a component. Two or more components of an operating segment shall be aggregated into a single reporting unit if the components have similar economic characteristics, based on an assessment of various factors. The Company has determined that the Training and Simulation Division and the Power System Division segments are separate reporting units.

The Company performs its annual impairment assessment for goodwill and other indefinite-life intangible assets as of December 31 or more frequently if events or changes in circumstances indicate that the asset might be impaired.

When testing goodwill for impairment, the Company may conduct a qualitative assessment by analyzing a variety of factors that could influence the fair value of the reporting unit or indefinite-life intangible, including, but not limited to: the results of prior quantitative assessments performed; changes in the carrying amount of the reporting unit or indefinite-life intangible; actual and projected revenue and operating margin; relevant market data for both the Company and its peer companies; industry outlooks; macroeconomic conditions; liquidity; changes in key personnel; and the Company's competitive position. The Company uses significant judgment to evaluate the totality of these events and factors to make the determination of whether it is more likely than not that the fair value of the reporting unit or indefinite-life intangible is less than its carrying value.

If the Company determines that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, it then performs the impairment evaluation using a quantitative assessment. Under the quantitative assessment, the first step identifies whether there is a potential impairment by comparing the fair value of a reporting unit to the carrying amount, including goodwill. If the carrying amount of a reporting unit exceeds the fair value, then a test is performed to determine the implied fair value of goodwill. An impairment loss is recognized based on the amount that the carrying amount of goodwill exceeds the implied fair value. When measuring the fair value of its reporting units in the quantitative assessment, the Company uses widely accepted valuation techniques, applying a combination of the income approach (discounted cash flows) and market approach (market multiples). When preparing discounted cash flow models under the income approach, the Company uses internal forecasts to estimate future cash flows expected to be generated by the reporting units. To discount these cash flows, the Company uses the expected cost of equity, determined by using a capital asset pricing model. The Company believes the discount rates used appropriately reflect the risks and uncertainties in the financial markets generally and specifically in the Company's internally-developed forecasts. When using market multiples under the market approach, the Company applies comparable publicly traded companies' multiples (e.g., earnings or revenues) to its reporting units' actual results.

h. Revenue recognition:

The Company is a defense and security products and services company, engaged in two business areas: interactive simulation for military, law enforcement and commercial markets; and power systems and batteries for the military, commercial and medical markets. During 2017, 2016, and 2015, the Company recognized revenues (i) from the sale and customization of interactive training systems and from the maintenance services in connection with such systems (Training and Simulation Division); (ii) from the sale of batteries, chargers and adapters, and under certain development contracts; and (iii) from the sale of lifejacket lights (Power Systems Division).

**AROTECH CORPORATION AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**In U.S. dollars**

**NOTE 2:– SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

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

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

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

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

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

i. Trade receivables

The Company records trade accounts receivable at net realizable value. This value includes an appropriate allowance for estimated uncollectible accounts to reflect any loss anticipated on the trade accounts receivable balances and charged to the provision for doubtful accounts. The Company calculates this allowance based on its history of write-offs, the level of past-due accounts based on the contractual terms of the receivables, and its relationships with, and the economic status of, its customers. During the years ended December 31, 2017 and 2016, the Company made no provisions or had any recoveries of doubtful accounts and had no reserves at either year end. The Company believes its exposure to concentrations of credit risk is limited due to the nature of its operations.

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

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

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**In U.S. dollars**

**NOTE 2:– SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

j. Warranty:

The Company typically offers a one to two year warranty for many of its products. The specific terms and conditions of those warranties vary depending upon the product sold and country in which the Company does business. The Company estimates the costs that may be incurred under its basic limited warranty, including parts and labor, and records deferred revenue in the amount of such costs at the time product revenue is recognized in the Training and Simulation Division. In the Power Systems Division, warranty costs are estimated, accrued and recorded on the balance sheet in deferred revenues. Factors that affect the Company's warranty liability include the number of installed units, historical and anticipated rates of warranty claims, and cost per claim. The Company periodically assesses the adequacy of its reserves and adjusts the amounts as necessary. (See Note 16.)

k. Research and development cost:

The Company capitalizes certain software development costs, subsequent to the establishment of technological feasibility. Based on the Company's product development process, technological feasibility is established upon the completion of a working model or a detailed program design. Research and development costs incurred in the process of developing product improvements or new products are generally charged to expenses as incurred. Significant costs incurred by the Company between completion of the working model or a detailed program design and the point at which the product is ready for general release have been capitalized. Capitalized software costs will be amortized by the greater of the amount computed using: (i) the ratio that current gross revenues from sales of the software bears to the total of current and anticipated future gross revenues from sales of that software, or (ii) the straight-line method over the estimated useful life of the product (one to three years). The Company assesses the net realizable value of this intangible asset on a regular basis by determining whether the amortization of the asset over its remaining life can be recovered through undiscounted future operating cash flows from the specific software product sold. Based on its most recent analyses, management believes that no impairment of capitalized software development costs exists as of December 31, 2017.

In 2017 and 2016, the Training and Simulation Division capitalized approximately \$588,000 and \$364,000, respectively, in software development costs that will be amortized on a straight-line method over 2 years, the useful life of the software.

l. Income taxes:

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

Accounting standards prescribe a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken in a tax return. The Company must determine whether it is "more-likely-than-not" that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. Once it is determined that a position meets the more-likely-than-not recognition threshold, the position is measured to determine the amount of benefit to recognize in the financial statements. Uncertain tax positions require determinations and estimated liabilities to be made based on provisions of the tax law which may be subject to change or varying interpretation. If the Company's determinations and estimates prove to be inaccurate, the resulting adjustments could be material to the Company's future financial statements. See Income Tax Footnote to the Consolidated Financial Statements for more information regarding income taxes (Note 13).

m. Concentrations of credit risk:

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

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**In U.S. dollars**

**NOTE 2:– SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

The trade receivables of the Company are mainly derived from sales to customers located primarily in the United States and Israel along with the countries listed in footnote 15.c. Management believes that credit risks are moderated by the diversity of its end customers and geographical sales areas. The Company performs ongoing credit evaluations of its customers' financial condition.

The Company had no off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other foreign currency hedging arrangements as of December 31, 2017 and 2016.

n. Basic and diluted net income per share:

Basic net income per share is computed based on the weighted average number of shares of common stock and participating securities outstanding during each year. Diluted net income per share includes the dilutive effect of additional potential common stock issuable under its share-based compensation plans, using the "treasury stock" method. Unvested restricted stock issued to its employees and directors are "participating securities" and as such, are included, net of estimated forfeitures, in the total shares used to calculate the Company's basic and diluted net income per share. In the event of a net loss, unvested restricted stock awards are excluded from the calculation of both basic and diluted net loss per share. The total weighted average number of shares related to the outstanding common stock equivalents excluded from the calculations of diluted net income per share were none, none, and 602,740 for the years ended December 31, 2017, 2016, and 2015, respectively.

o. Accounting for stock-based compensation:

Stock-based awards to employees are recognized as compensation expense based on the calculated fair value on the date of grant. The costs are amortized over the straight line vesting period. The Company granted restricted stock and restricted stock units in 2017, 2016, and 2015. The Company typically uses a 5-10% forfeiture rate for restricted stock and restricted stock units and adjusts both forfeiture rates based on historical forfeitures. Each restricted stock unit is equal to one share of Company stock and is redeemable only for stock.

p. Fair value of financial instruments:

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

The carrying amounts of cash and cash equivalents, restricted collateral deposits, trade and other receivables, short-term bank credit, and trade payables approximate their fair value due to the short-term maturity of such instruments (Level 1).

The fair values of long-term promissory notes are estimated by discounting the future cash flows using current interest rates for loans of similar terms and maturities. The carrying amount of the long-term debt and contractual severance approximates the estimated fair values at December 31, 2017, based upon the Company's ability to acquire similar debt or fulfill similar obligations at similar maturities (Level 3).

q. Severance pay:

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

In addition, according to certain employment agreements, the Company is obligated to provide for a special severance pay in addition to amounts due to certain employees pursuant to Israeli severance pay law. During the years ended December 31, 2017, 2016, and 2015, the Company had made provisions of \$106,000, \$1,022,000, and \$143,000, respectively, for this special severance pay.

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**In U.S. dollars**

**NOTE 2:– SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

As of December 31, 2017 and 2016 the unfunded severance pay amounted to \$142,000 and \$2,130,000, respectively. Severance expenses from continuing operations for the years ended December 31, 2017, 2016, and 2015, amounted to \$728,000, \$1,389,000, and \$625,000, respectively.

In December 2016, the Company and its former Chief Executive Officer (“former Executive”) signed an agreement whereby the Company and the former Executive agreed to early termination of the former Executive’s employment agreement. The additional expense and accrual, included above, related to this termination, were approximately \$925,000 and \$2,050,000, respectively.

r. Advertising costs:

The Company records advertising costs as incurred. Advertising expense for the years ended December 31, 2017, 2016, and 2015 was approximately \$94,000, \$72,000, and \$159,000, respectively.

s. New accounting pronouncements:

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers, as a new Topic, Accounting Standards Codification (“ASC”) 606. The new revenue recognition standard relates to revenue from contracts with customers, which, along with amendments issued in 2015 and 2016, will supersede nearly all current U.S. GAAP guidance on this topic and eliminate industry-specific guidance. The underlying principle is to use a five-step analysis of transactions to recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. Additionally, the new standard requires enhanced disclosures about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts, including revenue recognition policies to identify performance obligations, assets recognized from costs incurred to obtain and fulfill a contract, and significant judgments in measurement and recognition. The Company’s task force has reviewed significant contracts with customers and the promised goods and/or services associated with the revenue streams for each segment. The Company has evaluated the distinct performance obligations and the pattern of revenue recognition of these significant contracts in advance of the implementation of the standard. In our review of contracts in each revenue stream, the Company noted no material impact in the implementation of the standard.

The Company has determined the impact of adopting the standard on its control framework and notes minimal, insignificant changes to its system and other controls process. The standard, as amended, will be effective for annual periods beginning after December 15, 2017, including interim periods within that reporting period. The Company adopted the standard on a modified retrospective basis on January 1, 2018. The Company is finalizing the impact of topic 606 on the disclosures for its financial statement footnotes and expects the disclosures to be enhanced in the first quarter of 2018.

In February 2016, the FASB issued ASU No. 2016-02, Leases. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. Upon adoption, the Company expects that the ROU asset and lease liability will be recognized in the balance sheets in amounts that will be material.

In March 2016, the FASB issued ASU No. 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The new standard introduces targeted amendments intended to simplify the accounting for stock compensation. Among other things, the ASU requires all excess tax benefits and tax deficiencies to be recognized as income tax expense or benefit in the income statement. The amendments are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The adoption of this new standard was not material to the consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15 (Topic 230): Classification of Certain Cash Receipts and Cash Payments. The amendments provide guidance on eight specific cash flow issues for which the current accounting framework does not provide specific guidance. The amendments are effective for annual periods beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. The Company finalized its analysis and the adoption of this guidance will not have a material impact on its consolidated financial statements and its internal controls over financial reporting.

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****In U.S. dollars****NOTE 2:– SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

In January 2017, the FASB issued ASU No. 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The new standard simplifies the subsequent measurement of goodwill and eliminates Step 2 from the goodwill impairment test and requires businesses to perform its annual goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and recognizing an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The amendments are effective for annual periods beginning after December 15, 2019 with early adoption permitted for goodwill impairment tests performed on testing dates after January 1, 2017. The Company is currently evaluating the impact of its pending adoption of the new standard on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. The amendments provide a more robust framework to use in determining when a set of assets and activities is a business. The amendments are effective for annual periods beginning after December 15, 2017 with a limited scope of early adoption. The adoption of this new standard did not impact the Company and will apply for any future acquisitions.

In February 2018, the FASB issued ASU No. 2018-02, Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (“AOCI”). The accounting standard allows for the optional reclassification of stranded tax effects within accumulated other comprehensive income to retained earnings that arise due to the enactment of the Tax Cuts and Jobs Act of 2017 (the “Tax Act”). The amount of the reclassification would reflect the effect of the change in the U.S. federal corporate income tax rate on the gross deferred tax amounts and related valuation allowances, if any, at the date of enactment of the Tax Act and other income tax effects of the Tax Act on items remaining in accumulated other comprehensive income. The standard, will be effective for annual periods beginning after December 15, 2018, including interim periods within that reporting period with early adoption permitted. The Company is currently evaluating the impact of its pending adoption of the new standard on its consolidated financial statements.

u. Use of estimates:

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

v. Reclassification:

Prior period amounts are reclassified, when necessary, to conform to the current period presentation.

w. Business Combinations:

The Company recognizes the assets acquired and liabilities assumed in business combinations on the basis of their fair values at the date of acquisition. The Company assesses the fair value of assets, including intangible assets, using a variety of methods and each asset is measured at fair value from the perspective of a market participant. The method used to estimate the fair values of intangible assets incorporates significant assumptions regarding the estimates a market participant would make in order to evaluate an asset, including a market participant's use of the asset and the appropriate discount rates for a market participant. Assets recorded from the perspective of a market participant that are determined to not have economic use for us are expensed immediately. Any excess purchase price over the fair value of the net tangible and intangible assets acquired is allocated to goodwill. Transaction costs and restructuring costs associated with a business combination are expensed as incurred.

**NOTE 3:– RESTRICTED COLLATERAL DEPOSITS**

The following is a summary of restricted collateral deposits as of December 31, 2017 and 2016:

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
Deposits in connection with Epsilon/EFL projects	\$ 283,508	\$ 268,980
Total restricted collateral deposits	<u>\$ 283,508</u>	<u>\$ 268,980</u>

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

In U.S. dollars

**NOTE 4:– OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES**

The following is a summary of other accounts receivable and prepaid expenses as of December 31, 2017 and 2016:

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
Government authorities	\$ 733,360	\$ 877,670
Israeli statutory severance pay fund	–	455,172
Employees	67,504	60,296
Prepaid expenses	1,359,055	761,257
Other	182,301	2,501
Total	<u>\$ 2,342,220</u>	<u>\$ 2,156,896</u>

**NOTE 5:– INVENTORIES**

The following is a summary of inventories as of December 31, 2017 and 2016:

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
Raw and packaging materials	\$ 6,843,479	\$ 8,512,006
Work in progress	718,085	917,582
Finished products	1,093,314	888,433
Total	<u>\$ 8,654,878</u>	<u>\$ 10,318,021</u>

**NOTE 6:– PROPERTY AND EQUIPMENT, NET**

a. Composition of property and equipment is as follows:

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
Cost:		
Computers and related equipment	\$ 3,500,548	\$ 2,733,722
Motor vehicles	962,095	717,543
Office furniture and equipment	1,664,035	1,571,364
Machinery, equipment and installations	9,522,420	7,760,341
Buildings	4,344,803	1,716,924
Land	300,000	300,000
Leasehold improvements	1,959,587	2,172,253
Demo inventory	1,683,484	1,791,751
	<u>23,936,972</u>	<u>18,763,898</u>
Accumulated depreciation:		
Computers and related equipment	2,590,718	2,415,842
Motor vehicles	324,433	248,248
Office furniture and equipment	1,479,613	1,356,671
Machinery, equipment and installations	6,928,337	5,805,540
Buildings	729,051	408,194
Leasehold improvements	1,284,742	1,219,113
Demo inventory	1,323,990	1,395,050
	<u>14,660,884</u>	<u>12,848,658</u>
Property and equipment, net	<u>\$ 9,276,088</u>	<u>\$ 5,915,240</u>

b. Depreciation expense amounted to \$1,835,308, \$1,752,084, and \$1,851,982 for the years ended December 31, 2017, 2016 and 2015, respectively. In 2016, the Company had additional depreciation expense of \$36,957 in its discontinued operations.

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**In U.S. dollars****NOTE 7:– GOODWILL AND OTHER INTANGIBLE ASSETS, NET**

## a. Goodwill

Goodwill and indefinite lived assets are assessed annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. For the years ended December 31, 2017 and 2016, respectively, the Company performed a qualitative assessment for its Training and Simulation reporting unit and the Company determined that it was more likely than not that the fair values of its reporting unit exceeded its carrying value.

For its Power Systems reporting unit, the Company determined that it was necessary to perform a quantitative assessment of goodwill for the purpose of determining whether an impairment existed at December 31, 2017. When conducting this analysis, the Company engaged third party valuation experts with a detailed understanding of its Power Systems reporting unit to perform a valuation of the Power Systems reporting unit on a going concern basis. The Company prepared a discounted cash flow analysis over a five year period so as to derive a reasonable view of the cash flows that the Power Systems reporting unit are projected to generate from 2018-2022. As a result of its quantitative analysis, in which the Company computed the fair value of the Power Systems reporting unit, the Company concluded that the fair value of the reporting unit exceeded the reporting unit's carrying value by approximately 22%.

The Company also considered its current market capitalization compared to the sum of the estimated fair values of its reporting units in conjunction with each impairment assessment. As of the December 31, 2017 valuation date, its market capitalization was approximately \$92.1 million, which did not, in management's view, suggest that the fair value estimates used in its impairment assessment required any adjustment.

As a result of these analyses, the Company concluded that the goodwill recorded in relation to the Power Systems reporting unit was not impaired at December 31, 2017.

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

	<b>December 31, 2016</b>	<b>Additions</b>	<b>Adjustments (currency)</b>	<b>December 31, 2017</b>
Training and Simulation Division	\$ 24,435,641	\$ –	\$ –	\$ 24,435,641
Power Systems Division	21,053,876	–	648,519	21,702,395
<b>Total</b>	<b>\$ 45,489,517</b>	<b>\$ –</b>	<b>\$ 648,519</b>	<b>\$ 46,138,036</b>

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

In U.S. dollars

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

b. Other intangible assets:

	Original Useful life	December 31,			
		2017		2016	
		Cost	Net book value	Cost	Net book value
Technology	4 - 8 years	\$ 9,988,000	\$ 980,750	\$ 9,988,000	\$ 1,617,000
Capitalized software costs	1 - 3 years	5,562,119	741,355	4,974,105	542,220
Trademarks	10 years	28,000	–	28,000	2,800
Backlog/customer relationship	1 - 10 years	2,844,000	–	2,844,000	8,826
Covenant not to compete	6 years	400,000	76,000	400,000	172,000
Customer list	2 - 10 years	14,173,645	2,608,500	14,173,645	3,681,500
		32,995,764	\$ 4,406,605	32,407,750	\$ 6,024,346
Less - accumulated amortization		(28,589,159)		(26,383,404)	
Amortized cost		4,406,605		6,024,346	
Trademarks (indefinite lives)		799,000		799,000	
Net book value		\$ 5,205,605		\$ 6,823,346	

Amortization expense amounted to \$2,205,755, \$2,875,543, and \$3,043,536 for the years ended December 31, 2017, 2016 and 2015, respectively, including amortization of capitalized software costs of \$397,000, \$88,010, and \$255,000, respectively.

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

Year ending December 31,	
<b>2018</b>	\$ 1,779,682
<b>2019</b>	1,113,422
<b>2020</b>	574,500
<b>2021</b>	291,500
<b>2022</b>	222,000
<b>Thereafter</b>	425,501
<b>Total</b>	\$ 4,406,605

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

**NOTE 8:– LOANS**

The Company maintains credit facilities with JPMorgan Chase Bank, N.A. (“Chase”), whereby Chase provides (i) a \$15,000,000 revolving credit facility (“Revolver”), (ii) a \$10,000,000 Term Loan (“Term Loan A”), (iii) a \$1,730,895 Mortgage Loan (“Term Loan B”) and (iv) a \$1,358,000 Mortgage Loan (“Term Loan C”); collectively referred to as the “Credit Facilities.”

The maturity of the Revolver is March 11, 2021. The Revolver maintains an interest rate on a scale ranging from LIBOR plus 1.75% up to LIBOR plus 3.00%. The effective interest rate for the revolver at December 31, 2017 was 5.0%. The balance at December 31, 2017 and December 31, 2016 was \$5.1 million and \$3.0 million, respectively.

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****In U.S. dollars****NOTE 8:-- LOANS (Cont.)**

The maturity of the Term Loan A is March 11, 2021. Term Loan A maintains an interest rate on a scale ranging from LIBOR plus 2.0% up to LIBOR plus 3.25%. The repayment of Term Loan A consists of 60 consecutive monthly payments of principal plus accrued interest based on annual principal reductions of 10% during the first year, 20% during the second through fourth years, and 30% during the fifth year. The effective interest rate for the Term Loan at December 31, 2017 was 5.25%. The balance at December 31, 2017 and December 31, 2016 was \$7.7 million and \$9.3 million, respectively.

During the quarter ended June 30, 2017, the Company purchased land and a building, previously leased by its Training and Simulation Division, in Ann Arbor, Michigan. As a result, the Company now maintains two Mortgage Loans ("Term Loans B and C"). The maturities of Term Loans B and C are June 1, 2024 and maintain an interest rate on a scale identical to Term Loan A. The monthly payments on Term Loan B and Term Loan C are \$7,212 and \$5,660, respectively, in principal plus accrued interest, with balloon payments due on the maturity date. The effective interest rate for the Mortgage Loans at December 31, 2017 was 5.25%. At December 31, 2017, the balance of Term Loans B and C was \$3.1 million and at December 31, 2016 the balance of Term Loan B was \$967,000.

The Credit Facilities maintain certain reporting requirements, conditions precedent, affirmative covenants and financial covenants. The Company is required to maintain certain financial covenants that include a Maximum Debt to EBITDA ratio of 3.00 to 1.00 and a Minimum Fixed Charge Coverage Ratio of 1.20 to 1.00. The Company was in compliance with its covenants at December 31, 2017. The Credit Facilities are secured by the Company's assets and the assets of the Company's domestic subsidiaries.

Minimum loan payments for the Term and Mortgage Loans are as follows:

	<b>Minimum loan payments</b>	<b>December 31,</b>
<b>2018</b>	\$	2,248,043
<b>2019</b>		2,208,721
<b>2020</b>		2,836,779
<b>2021</b>		1,144,088
<b>2022</b>		154,464
<b>Thereafter</b>		2,226,472
<b>Total</b>	\$	<u>10,818,567</u>

**NOTE 9:-- OTHER ACCOUNTS PAYABLE AND ACCRUED EXPENSES**

The following is a summary of other accounts payable and accrued expenses as of December 31, 2017 and 2016:

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
Employees and payroll accruals	\$ 3,309,950	\$ 3,068,035
Accrued vacation pay	1,082,105	958,160
Accrued expenses	1,205,713	808,284
Government authorities	1,042,386	763,079
<b>Total</b>	<u>\$ 6,640,154</u>	<u>\$ 5,597,558</u>

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**In U.S. dollars****NOTE 10:— COMMITMENTS AND CONTINGENT LIABILITIES**

## a. Royalty commitments:

Under Epsilor-EFL's research and development agreements with the Office of the Chief Scientist ("OCS"), and pursuant to applicable laws, Epsilor-EFL is required to pay royalties at the rate of 3%-3.5% of net sales of products developed with funds provided by the OCS, up to an amount equal to 100% of research and development grants received from the OCS. Amounts due in respect of projects approved after 1999 also bear interest at the LIBOR rate. Epsilor-EFL is obligated to pay royalties only on sales of products in respect of which OCS participated in their development. Should the project fail, Epsilor-EFL will not be obligated to pay any royalties or refund the grants. During 2017, 2016, and 2015, Epsilor-EFL received grants in the total amount of \$461,894, \$612,249, and \$322,820, respectively.

No royalties were expensed for 2017, 2016 and 2015, respectively.

## b. Lease commitments:

The Company rents its facilities under various operating lease agreements, which expire on various dates through 2022. The minimum rental payments under non-cancelable operating leases are as follows:

	<b>December 31</b>	<b>Minimum rental payments</b>
<b>2018</b>		\$ 851,812
<b>2019</b>		739,538
<b>2020</b>		362,890
<b>2021</b>		356,481
<b>2022</b>		278,214
<b>Thereafter</b>		169,471
<b>Total</b>		<u>\$ 2,758,406</u>

Total rent expense for the years ended December 31, 2017, 2016, and 2015, were \$1,332,758, \$1,418,136, and \$1,404,183, respectively.

## c. Guarantees:

The Company obtained bank guarantees in the amount of \$356,775 in connection with (i) obligations of one of the Company's subsidiaries to the Israeli customs authorities, and (ii) the obligation of one of the Company's subsidiaries to secure the return of products loaned to the Company from one of its customers.

## d. Liens:

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

The Company does not have any credit liens collateralized by the assets of the Company and guaranteed by the Company.

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

## e. Litigation and other claims:

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

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****In U.S. dollars****NOTE 11:— COSTS AND ESTIMATED EARNINGS ON UNCOMPLETED CONTRACTS**

Billings in excess of costs generated under the percentage-of-completion method are recorded as deferred revenues until the revenue recognition criteria are met. Deferred revenues also include unearned amounts received under maintenance and support services and customer deposits of \$200,069 and \$346,552 for 2017 and 2016, respectively.

The following is a summary of the costs and estimated earnings on contracts as of December 31, 2017 and 2016. Open contracts are expected to be completed in the following year.

	<b>Year ended December 31,</b>	
	<b>2017</b>	<b>2016</b>
Costs incurred on contracts	\$ 82,639,071	\$ 153,324,167
Estimated earnings	22,047,955	20,754,754
	<u>104,687,026</u>	<u>174,078,921</u>
Less billings to date	(91,605,492)	(166,017,018)
Total	<u>\$ 13,081,534</u>	<u>\$ 8,061,903</u>
Costs and estimated earnings in excess of billings	\$ 16,094,515	\$ 10,981,577
Billings in excess of costs and estimated earnings (included in deferred revenues)	(3,012,981)	(2,919,674)
Total	<u>\$ 13,081,534</u>	<u>\$ 8,061,903</u>

**NOTE 12:— STOCK-BASED COMPENSATION****a. Stockholders' rights:**

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

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

1. 2007 Non-Employee Director Equity Compensation Plan – 750,000 shares reserved for issuance, of which 136,205 were available for future grants to outside directors as of December 31, 2017. In May 2017, the stockholders of the Company approved a new non-employee director equity compensation plan.

2. 2009 Equity Incentive Plan – 5,000,000 shares reserved for issuance, of which 2,709,896 were available for future grants to employees and consultants as of December 31, 2017.

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

4. Stock compensation expense is recorded ratably over the vesting period of the option or the restriction period of the restricted shares and restricted stock units. The stock compensation expense that has been charged in the consolidated statements of comprehensive income in respect of restricted shares and restricted stock units to employees and directors in 2017, 2016, and 2015, was \$421,000, \$878,000, and \$622,000, respectively.

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**In U.S. dollars**

**NOTE 12:— STOCKHOLDERS' EQUITY (Cont.)**

5. A summary of the status of the Company's restricted shares and restricted stock units granted as of December 31, 2017 and 2016, and changes during the years ended on those dates, is presented below:

Restricted Shares and Restricted Stock Units:

	2017		2016		2015	
	Shares	Weighted average fair value at grant date	Shares	Weighted average fair value at grant date	Shares	Weighted average fair value at grant date
Non-vested at the beginning of the year	482,298	\$ 2.41	516,952	\$ 2.94	920,678	\$ 2.99
Changes during year:						
Restricted stock granted	109,320	\$ 3.20	310,735	\$ 2.39	57,028	\$ 2.89
Restricted units granted	198,000	\$ 3.50	150,500	\$ 2.31	—	\$ —
Vested	(166,847)	\$ 2.45	(220,630)	\$ 2.86	(451,122)	\$ 3.15
Forfeited	(249,340)	\$ 2.34	(275,259)	\$ 2.96	(9,632)	\$ 2.38
Non-vested at the end of the year	<u>373,431</u>	<u>\$ 3.25</u>	<u>482,298</u>	<u>\$ 2.41</u>	<u>516,952</u>	<u>\$ 2.94</u>
Restricted shares vested at end of year	<u>3,793,427</u>	<u>\$ 2.27</u>	<u>3,626,580</u>	<u>\$ 2.26</u>	<u>3,405,960</u>	<u>\$ 2.22</u>

6. The remaining total compensation cost related to non-vested restricted share and restricted stock unit awards not yet recognized (before applying a forfeiture rate) in the income statement as of December 31, 2017 was \$137,000. The weighted average period over which this compensation cost is expected to be recognized is approximately one and a half years.

**NOTE 13:— INCOME TAXES**

a. General:

The U.S. Tax Cuts and Jobs Act ("Tax Act") was enacted on December 22, 2017. The Tax Act makes broad complex changes to the U.S. tax code including, but not limited to, reduction of the U.S. federal corporate tax rate from 35% to 21%, requiring companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and creates new taxes on certain foreign sourced earnings and additional limitations on the deductibility of interest.

The SEC issued Staff Accounting Bulletin No. 118 (SAB 118) in December, 2017, to provide guidance on accounting for the effects of the Tax Act. SAB 118 provides for a measurement period of up to one year from the Tax Act enactment date for companies to complete their assessment of and accounting for those effects of the Tax Act. Under SAB 118, a company must first reflect the income tax effects of the Tax Act for which the accounting is complete in the period of the date of enactment. To the extent the accounting for other income tax effects is incomplete, but a reasonable estimate can be determined, companies must record a provisional estimate to be included in their financial statements. For any income tax effect for which a reasonable estimate cannot be determined, an entity must continue to apply ASC 740 based on the provisions of the tax laws in effect immediately prior to the Tax Act being enacted until such time as a reasonable estimate can be determined.

The Company has recorded a provisional deferred income tax benefit of \$3.2 million in the period ended December 31, 2017 related to the change in corporate tax rate from 35% to 21% as a result of the Tax Act. The Company requires additional time to complete its analysis of the impacts of the Tax Act and therefore its accounting for the Tax Act is provisional but is a reasonable estimate based on available information. The Company will complete its analysis and finalize its accounting for this provisional estimate during the one-year measurement period as prescribed by SAB 118.

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**In U.S. dollars**

**NOTE 13:— INCOME TAXES (Cont.)**

For the year ended December 31, 2017, the Company was not required to record any provisional amounts for the Company's foreign subsidiary relating to the one-time tax on accumulated foreign earnings provision of the Tax Act due to the accumulated net loss position of the foreign subsidiary.

Beginning in 2018, the Tax Act provides a 100% deduction for dividends received from 10-percent owned foreign corporations by U.S. corporate shareholders, subject to a one-year holding period. Although dividend income is now exempt from U.S. federal tax in the hands of the U.S. corporate shareholders, companies must still apply the guidance of ASC 740-30-25-18 to account for the tax consequences of outside basis differences and other tax impacts of their investments in non-U.S. subsidiaries.

The Tax Act limits net operating loss ("NOL") deductions to 80 percent of taxable income for tax years beginning after December 31, 2017. The amendments disallow the carryback of NOLs but allow for the indefinite carryforward of NOLs, which would be considered an indefinite lived asset.

As of December 31, 2017, the Company had net operating loss ("NOL") carryforwards for U.S. federal income tax purposes of \$40.7 million, which are available to offset future taxable income, if any, expiring in 2021 through 2037. Utilization of U.S. net operating losses is subject to substantial annual limitations due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

At December 31, 2017, the Company had net deferred tax assets before valuation allowance of \$37.5 million. The deferred tax assets are primarily composed of federal, state and foreign tax NOL carryforwards. Due to uncertainties surrounding the Company's ability to generate future taxable income to realize these assets, a full valuation allowance has been established to offset its net deferred tax assets. Additionally, the future utilization of the Company's NOL carryforwards to offset future taxable income is subject to a substantial annual limitation as a result of IRC Section 382 changes that have occurred. Any carryforwards that will expire prior to utilization as a result of such limitations will be removed from deferred tax assets with a corresponding reduction of the valuation allowance.

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

The Company has also evaluated its income tax positions under FASB ASC 740-10 as of December 31, 2017 and the Company believes that it has no material uncertain tax positions and therefore has no uncertain tax position reserves and does not expect to provide for any such reserves. The Company does not believe that the unrecognized tax benefits will change within 12 months of this reporting date. It is the Company's policy that any assessed penalties and interest on uncertain tax positions would be charged to income tax expense.

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**In U.S. dollars**

**NOTE 13:– INCOME TAXES (Cont.)**

The Company files income tax returns, including returns for its subsidiaries, with federal, state, local and foreign jurisdictions. The Company files consolidated tax returns for its U.S. entities.

b. Israeli subsidiary (Epsilor-EFL):

Epsilor-EFL's tax rate was 24% for 2017, 25% for 2016 and 26.5% for 2015. In addition, dividends paid from the profits of Epsilor-EFL are subject to tax at the rate of 15% in the hands of their recipient. Management has indicated that it has no intention of declaring a dividend.

The Israeli government has established certain development zones so as to incentivize business development and export activities. Companies that reside in this zone and meet certain criteria are subject to a favorable tax rates. Epsilor-EFL is located in an approved development zone, however, currently does not meet the criteria established by the government to obtain the tax incentives.

As of December 31, 2017, the Company has tax loss carryforwards, generated by the predecessor of Epsilor-EFL, of \$91.5 million, which is available indefinitely to offset future taxable income. Due to the 2009 merger of EFL-Epsilor, the utilization of the tax loss carryforward is subject to annual limitations.

c. Consolidated deferred income taxes:

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

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
U.S. operating loss carryforward	\$ 9,271,258	\$ 16,869,205
Foreign operating loss carryforward	21,949,779	19,696,756
Total operating loss carryforward	<u>31,221,037</u>	<u>36,565,961</u>
<b>Temporary differences:</b>		
Compensation and benefits	1,530,669	2,417,056
Warranty reserves	871,219	1,263,499
Foreign temporary differences	684,230	1,112,113
Definite lived intangible assets	1,696,965	304,063
Fixed assets	968,053	1,458,138
AMT credit	387,068	387,068
All other temporary differences	524,781	(57,646)
Total temporary differences	<u>6,662,985</u>	<u>6,884,291</u>
Deferred tax asset before valuation allowance	37,884,022	43,450,252
Valuation allowance	<u>(37,496,954)</u>	<u>(43,063,184)</u>
Total deferred tax asset	<u>\$ 387,068</u>	<u>\$ 387,068</u>
Deferred tax liability – intangible assets	\$ 5,987,789	\$ 8,255,193
Net deferred tax liability – intangible assets	<u>\$ 5,600,721</u>	<u>\$ 7,868,125</u>

The Company provided valuation allowances for the deferred tax assets resulting from tax loss carryforwards and other temporary differences. At present, management currently believes that it is more likely than not that the deferred tax assets related to the operating loss carryforwards and other temporary differences will not be realized.

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

In U.S. dollars

**NOTE 13:– INCOME TAXES (Cont.)**

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

	Year ended December 31		
	2017	2016	2015
Domestic	\$ 476,327	\$ (2,133,486)	\$ (3,071,694)
Foreign	1,333,679	1,437,332	2,181,671
	<u>\$ 1,810,006</u>	<u>\$ (696,154)</u>	<u>\$ (890,023)</u>

e. Taxes on income were comprised of the following:

	Year ended December 31		
	2017	2016	2015
Current federal taxes	\$ –	\$ –	\$ –
Current state and local taxes	47,316	(24,634)	246,403
Deferred taxes	(2,267,404)	836,561	914,543
Foreign taxes	241,267	–	–
Taxes in respect of prior years	(45,309)	(28,507)	–
(Benefit)/expense	<u>\$ (2,024,130)</u>	<u>\$ 783,420</u>	<u>\$ 1,160,946</u>

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

	Year ended December 31,		
	2017	2016	2015
Income (loss) from continuing operations before taxes	<u>\$ 1,810,006</u>	<u>\$ (696,154)</u>	<u>\$ (890,023)</u>
Statutory tax rate	34%	34%	34%
Theoretical income tax on the above amount at the U.S. statutory tax rate	\$ 615,402	\$ (236,692)	\$ (302,608)
Deferred taxes for which valuation allowance was provided	497,850	589,912	1,413,567
Non-deductible expenses	74,153	22,746	31,841
State taxes, net of federal benefit	31,228	(16,258)	181,771
Foreign income in tax rates other than U.S. rate	(36,925)	452,219	(163,625)
Taxes in respect of prior years	(45,309)	(28,507)	–
Re-measurement of deferred taxes	(3,160,529)	–	–
Actual tax expense	<u>\$ (2,024,130)</u>	<u>\$ 783,420</u>	<u>\$ 1,160,946</u>

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**In U.S. dollars****NOTE 14:— FINANCIAL INCOME (EXPENSE)**

Financial income (expense), net:

	<b>Year ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Financial expenses:			
Interest, bank charges and fees	\$ (828,154)	\$ (927,390)	\$ (1,202,224)
Foreign currency transaction differences, net	(248,505)	(47,873)	—
Total financial expenses	<u>(1,076,659)</u>	<u>(975,263)</u>	<u>(1,202,224)</u>
Financial income:			
Foreign currency transaction differences, net	—	—	50,103
Total financial income	<u>—</u>	<u>—</u>	<u>50,103</u>
Financial expense, net	<u>\$ (1,076,659)</u>	<u>\$ (975,263)</u>	<u>\$ (1,152,121)</u>

**NOTE 15:— SEGMENT INFORMATION**

a. General:

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

The Company's reportable segments have been determined in accordance with the Company's internal management structure, which is organized based on operating activities. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based on two primary factors: the segment's operating income and the segment's contribution to the Company's future strategic growth.

b. The following is information about reportable segment gains, losses and assets and are presented after the elimination of intra-segment revenues and expenses:

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

In U.S. dollars

**NOTE 15:— SEGMENT INFORMATION (Cont.)**

	<b>Training and Simulation Division</b>	<b>Power Systems Division</b>	<b>Corporate</b>	<b>Total Company</b>
<b>2017</b>				
Revenues from outside customers	\$ 50,254,324	\$ 48,468,354	\$ -	\$ 98,722,678
Depreciation and amortization expenses (1)	(963,060)	(3,073,365)	(4,638)	(4,041,063)
Direct expenses (2)	(41,644,547)	(46,614,138)	(3,536,265)	(91,794,950)
Segment income (loss)	7,646,717	(1,219,149)	(3,540,903)	2,886,665
Financial expense	(122,875)	(255,835)	(697,949)	(1,076,659)
Income tax (expense) benefit	(41,391)	(195,592)	2,261,113	2,024,130
Net income (loss)	<u>\$ 7,482,451</u>	<u>\$ (1,670,576)</u>	<u>\$ (1,977,739)</u>	<u>\$ 3,834,136</u>
Segment assets (4)	<u>\$ 52,075,040</u>	<u>\$ 61,216,020</u>	<u>\$ 3,107,116</u>	<u>\$ 116,398,176</u>
Additions to long-lived assets	<u>\$ 2,996,452</u>	<u>\$ 2,416,055</u>	<u>\$ -</u>	<u>\$ 5,412,507</u>
<b>2016</b>				
Revenues from outside customers	\$ 46,358,794	\$ 46,616,958	\$ -	\$ 92,975,752
Depreciation and amortization expenses (1)	(1,113,001)	(3,531,851)	(19,732)	(4,664,584)
Direct expenses (2)	(37,637,110)	(43,682,708)	(6,712,241)	(88,032,059)
Segment income (loss)	7,608,683	(597,601)	(6,731,973)	279,109
Financial expense	(41,397)	(87,371)	(846,495)	(975,263)
Income tax (expense) benefit	24,634	28,507	(836,561)	(783,420)
Net income (loss)	<u>\$ 7,591,920</u>	<u>\$ (656,465)</u>	<u>\$ (8,415,029)</u>	<u>\$ (1,479,574)</u>
Segment assets	<u>\$ 43,740,316</u>	<u>\$ 58,955,828</u>	<u>\$ 6,444,053</u>	<u>\$ 109,140,197</u>
Additions to long-lived assets	<u>\$ 586,068</u>	<u>\$ 1,081,815</u>	<u>\$ -</u>	<u>\$ 1,667,883</u>
<b>2015</b>				
Revenues from outside customers	\$ 54,617,611	\$ 41,956,336	\$ -	\$ 96,573,947
Depreciation and amortization expenses (1)	(912,930)	(3,957,368)	(25,220)	(4,895,518)
Direct expenses (2)	(44,711,979)	(41,863,776)	(4,840,578)	(91,416,331)
Segment income (loss)	8,992,702	(3,864,808)	(4,865,798)	262,098
Financial income (expense)	(59,791)	21,432	(1,113,762)	(1,152,121)
Income tax expense	(233,106)	-	(927,840)	(1,160,946)
Net income (loss)	<u>\$ 8,699,805</u>	<u>\$ (3,843,376)</u>	<u>\$ (6,907,400)</u>	<u>\$ (2,050,969)</u>
Segment assets	<u>\$ 57,433,489</u>	<u>\$ 59,498,304</u>	<u>\$ 492,922</u>	<u>\$ 117,424,715</u>
Additions to long-lived assets (3)	<u>\$ 1,139,074</u>	<u>\$ 1,374,354</u>	<u>\$ 4,501</u>	<u>\$ 2,540,005</u>

- (1) Includes depreciation of property and equipment and amortization expenses of intangible assets.
- (2) Including, *inter alia*, sales and marketing, general and administrative, research and development and other income.
- (3) Includes intangible assets associated with the acquisition of UEC.
- (4) Cash balances previously reported in the Training and Simulation Division in 2015 were reported in Corporate in 2016 and 2017.

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**In U.S. dollars**

**NOTE 15:— SEGMENT INFORMATION (Cont.)**

c. Summary information about geographic areas:

The following discloses total revenues according to the locations of the Company's end customers and long-lived assets as of and for the years ended December 31, 2017, 2016, and 2015:

	2017		2016		2015	
	Total revenues	Long-lived Assets	Total revenues	Long-lived Assets	Total revenues	Long-lived assets
U.S.A.	\$ 71,543,220	\$ 50,361,031	\$ 72,645,752	\$ 49,883,172	\$ 77,715,872	\$ 52,938,660
Israel	17,631,139	10,258,698	13,944,078	8,308,931	14,114,688	8,299,367
Canada	1,147,679	—	2,435,134	—	587,516	—
Taiwan	—	—	690,080	—	—	—
Mexico	2,528,220	—	590,919	—	—	—
India	7,818	—	228,449	—	—	—
Japan	770,439	—	182,996	—	—	—
Germany	226,806	—	115,509	—	1,076,872	—
Australia	—	—	75,513	—	109,041	—
Korea	166,271	—	260	—	875,593	—
Saudi Arabia	—	—	—	—	548,837	—
China	2,214,436	—	—	—	154,803	—
U.A.E.	15,209	—	—	—	—	—
Other	2,471,441	—	2,067,062	—	1,390,725	—
	<u>\$ 98,722,678</u>	<u>\$ 60,619,729</u>	<u>\$ 92,975,752</u>	<u>\$ 58,192,103</u>	<u>\$ 96,573,947</u>	<u>\$ 61,238,027</u>

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

Other than for sales to various branches of the United States Military, which accounted for 33%, 41%, and 48% of consolidated continuing revenues for 2017, 2016 and 2015, respectively, no single customer accounted for more than 10% of revenues for any of the three years presented.

e. Revenues from major products:

	Year ended December 31,		
	2017	2016	2015
Simulators	\$ 50,254,324	\$ 46,358,794	\$ 54,617,611
Batteries and charging systems	44,001,695	42,574,102	37,331,372
Water activated batteries	4,466,659	4,042,856	4,624,964
Total	<u>\$ 98,722,678</u>	<u>\$ 92,975,752</u>	<u>\$ 96,573,947</u>

**AROTECH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

In U.S. dollars

**NOTE 16:– WARRANTY**

The following is a summary of the deferred warranty revenue in the Simulation Division included in total deferred revenue as of December 31, 2017 and 2016:

	<b>Year ended December 31,</b>	
	<b>2017</b>	<b>2016</b>
Balance at beginning of period	\$ 2,702,615	\$ 3,358,866
Deferred revenue	3,864,556	3,344,498
Revenue recognized	(3,179,400)	(4,000,749)
Balance at end of period	<u>\$ 3,387,771</u>	<u>\$ 2,702,615</u>

The following is a summary of the warranty liability in the Power Systems Division that is also included in deferred revenue as of December 31, 2017 and 2016:

	<b>Year ended December 31,</b>	
	<b>2017</b>	<b>2016</b>
Balance at beginning of period	\$ 202,429	\$ 380,904
New reserves	88,223	136,668
Costs incurred	(113,699)	(315,143)
Balance at end of period	<u>\$ 176,953</u>	<u>\$ 202,429</u>

**NOTE 17:– QUARTERLY RESULTS OF OPERATIONS (UNAUDITED):**

(in thousands, except per share data)	<b>First Quarter</b>	<b>Second Quarter</b>	<b>Third Quarter</b>	<b>Fourth Quarter</b>
<b>Fiscal year ended December 31, 2017:</b>				
Revenues	\$ 22,347	\$ 21,449	\$ 25,931	\$ 28,996
Gross profit	6,480	5,982	7,257	7,921
Net (loss) income*	(768)	(594)	787	4,409
Basic net income/(loss) per common share	<u>\$ (0.03)</u>	<u>\$ (0.02)</u>	<u>\$ 0.03</u>	<u>\$ 0.17</u>
Diluted net income/(loss) per common share	<u>\$ (0.03)</u>	<u>\$ (0.02)</u>	<u>\$ 0.03</u>	<u>\$ 0.17</u>
<b>Fiscal year ended December 31, 2016:</b>				
Revenues	\$ 25,406	\$ 21,780	\$ 24,301	\$ 21,489
Gross profit	7,694	6,995	7,864	5,597
Net (loss) income	(382)	(569)	1,505	(2,034)
Basic net income/(loss) per common share	<u>\$ (0.02)</u>	<u>\$ (0.02)</u>	<u>\$ 0.06</u>	<u>\$ (0.08)</u>
Diluted net income/(loss) per common share	<u>\$ (0.02)</u>	<u>\$ (0.02)</u>	<u>\$ 0.06</u>	<u>\$ (0.08)</u>

\*Net income for the fourth quarter of 2017 included \$3.2 million in federal income tax benefit to revalue the deferred tax liability under the newly enacted federal income tax rate.

AMENDED AND  
RESTATED CERTIFICATE OF INCORPORATION  
OF  
ELECTRIC FUEL CORPORATION

Electric Fuel Corporation, a corporation duly organized and existing under the laws of the State of Delaware, hereby certifies as follows:

1. The name of this corporation is Electric Fuel Corporation. Electric Fuel Corporation was originally incorporated under the name of Luz Electric Fuel, Inc. The date of the filing of Luz Electrical Fuel, Inc. The date of the filing of its original Certificate of Incorporation with the Secretary of State was December 20, 1990.
2. This Amended and Restated Certificate of Incorporation restates and integrates and further amends the provisions of the corporation's Certificate of Incorporation as amended and supplemented. This Amended and Restated Certificate of Incorporation has been adopted by the Board of Directors and the stockholders of the Company in accordance with Sections 245 (b) and 242 of the Delaware Corporation Law.
3. The text of the Amended and Restated Certificate of Incorporation is amended to read in its entirety as follows:

AMENDED AND  
RESTATED CERTIFICATE OF INCORPORATION  
OF  
ELECTRIC FUEL CORPORATION

ONE: The name of this corporation is Electric Fuel Corporation.

TWO: The address of its registered office in the State of Delaware is 1013 Centre Road, Wilmington, County of New Castle. The name of its registered agent at such address is Corporation Service Company.

THREE: The nature of the business or purposes to be conducted or promoted is to engage in any lawful act or activity for which corporations may be organized under the Delaware General Corporation Law ("DGCL").

FOUR: The total number of shares of all classes of stock which the corporation shall have authority to issue is Fifteen Million (15,000,000) consisting of two classes of shares designated as follows:

A. Fourteen Million (14,000,000) shares of Common Stock, \$.01 par value, (the "Common Stock"); and

B. One Million (1,000,000) shares of Preferred Stock, \$.01 par value, (the "Preferred Stock").

FIVE: The rights, preferences, privileges and restrictions granted to or imposed upon the respective classes of shares or the holders thereof are as follows:

A. Preferred Stock.

1. The Preferred Stock may be issued from time to time in one or more series. All shares of any one series of Preferred Stock shall be identical in all respects, except that shares of any one series issued on different dates may differ as to dates, if any, from which dividends thereon are to cumulate.

2. The Board of Directors of the corporation is expressly granted the authority, at any time and from time to time by the adoption of a resolution or resolutions not inconsistent with the provisions of the Amended and Restated Certificate of Incorporation, to authorize the issuance by this corporation of one or more series of Preferred Stock and to fix and determine with respect to each such series all the designations, preferences, powers and relative, participating, optional or other special rights, and the qualifications, limitations or restrictions thereof, to the full extent now or

hereafter permitted by law, and including, but without limiting the generality of the foregoing, the following:

- (a) the number of shares of such series, which may subsequently be increased (except as otherwise provided by for the issuance of such series) or decrease (to a number not less than the number of shares then outstanding) by resolution or designations thereof;
- (b) the dividend rights of such series, the preferences, if any, over any other class or series of stock, the preferences, if any, over any other class or series of stock, or of any other class or series of stock over such series, as to dividends, the extent, if any, to which shares of such series shall be entitled to participate in dividends with shares of any other class of stock, whether dividends on shares of such series shall be fully, partially or conditionally cumulative, or a combination thereof, and any limitations, restrictions or condition on the payment of such dividends;
- (c) the rights of such series, and the preferences, if any, over any class or series of stock, or of any other class or series of stock over such series, in the event of any voluntary or involuntary liquidation, dissolution or winding up of this corporation and the extent, if any, to which shares of any such series shall be entitled to participate in such event with any other series or class of stock;
- (d) whether or not the shares of such series shall be redeemable, and, if redeemable, the date or dates upon payable thereon in the case of redemption thereof, which amount may vary at different redemption dates;
- (e) the terms of any purchase, retirement or sinking fund which may be provided for the shares of such series;
- (f) the right, if any, of holders of shares of such series to convert the same into, or exchange the same for Common Stock, and the terms and conditions of such conversion or exchange, as well as provision for adjustment of the conversion rate in such events as the Board of Directors shall determine; and,
- (g) the voting powers, if any, of such series in addition to the voting powers by law.

3. In the event of any liquidation, dissolution, or winding up of this corporation, whether voluntary or involuntary, the holders of the Preferred Stock of each series shall be entitled to receive only such or amounts as shall have

been fixed by the Amended and Restated Certificate of Incorporation or resolutions of the Board of Directors providing for the issuance of such series.

B. Common Stock.

1. The holders of Common Stock shall be entitled to one vote for each share of Common Stock registered in the name of such holders.

2. The holders of Common Stock shall be entitled to receive dividends on their shares of stock when and as declared by this corporation's Board of Directors. All dividends declared on the Common Stock shall be declared and paid at the same rate per share on all shares of Common Stock.

3. In the event of the liquidation, dissolution or winding up of the affairs of the corporation, the holders of the Common Stock shall be entitled to share pro rata in the net assets available for distribution to holders of Common Stock after satisfaction of the prior claims of the holders of Preferred Stock of any series or and shares of any other class of capital stock ranking senior to the Common Stock as to assets, in accordance with this Amended and Restated Certificate of Incorporation, as amended from time to time, or of resolutions of the Board of Directors adopted pursuant to the authority herein contained.

SIX: The provisions of Section 203 of the DGCL shall not apply to this Corporation.

SEVEN: The following provisions are inserted for the management of the business and the conduct of the affairs of the corporation, and for further definition, limitation and regulation of the powers of the corporation and of its directors and stockholders.

A. The business and affairs of the corporation shall be managed by or under the direction of the Board of Directors. In addition to the powers and authority expressly conferred upon them by the DGCL or by this Amended and Restated Certificate of Incorporation or the Bylaws of the corporation, the directors are hereby empowered to exercise all such powers and do all such acts and things as may be exercised or done by the corporation.

B. Except as otherwise provided in this Amended and Restated Certificate of Incorporation, or the By-Laws of the Corporation relating to the rights of the holders of any class or series of Preferred Stock, voting separately by class or series, to elect additional directors under specified circumstances, the number of directors of the Corporation shall

be fixed from time to time by or pursuant to the By-Laws of the Corporation. The election of directors need not be by ballot unless the by-laws shall so require. The directors, other than those who may be elected by the holders of any class or series of Preferred Stock voting separately by class or series, shall be classified, with respect to the time for which they severally hold office, into three classes, Class I, Class II and Class III, which shall be as nearly equal in number as possible. Each director holding office as of the date of adoption of this Amended and Restated Certificate of Incorporation (each an "Initial Director"), classified in Class I shall hold office for a term expiring at the 1994 annual meeting of stockholders; each Initial Director in Class II shall hold office for a term expiring at the 1995 annual meeting of stockholders; and each Initial Director in Class III shall hold office for a term expiring at the 1996 annual meeting of stockholders. Notwithstanding the foregoing provision of this paragraph B, each director shall serve until his successor is duly elected and qualified or until his earlier death, resignation or removal. At each annual meeting of stockholders following the 1993 annual meeting, the successors to the class of directors whose term expires at that meeting shall be elected to hold office for a term expiring at the annual meeting of stockholders held in the third year following the year of their election and until their successors have been duly elected and qualified or until their earlier death, resignation or removal.

C. Except as otherwise provided pursuant to the provisions of this Amended and Restated Certificate of Incorporation or the By-laws of the Corporation relating to the rights of the holders of any class or series of Preferred Stock, voting separately by class or series, to elect directors under specified circumstances, any director or directors may be removed from office at any time, but only for cause, by the affirmation vote, at any regular meeting or special meeting of the stockholders, of not less than 85% of the total number of votes of the then outstanding shares of capital stock of the Corporation entitled to vote generally in the election of directors, voting together as a single class, and only if notice of such removal may be filled by vote of a majority of the directors then in office, although less than a quorum, and any director or directors so chosen shall hold office until the next election of the class for which such directors shall have been chosen and until their successors shall be elected and qualified or until their earlier death, resignation or removal.

D. Notwithstanding any other provision of this Amended and Restated Certificate of Incorporation or the By-laws of the Corporation (and notwithstanding the fact that a lesser percentage may be specified by law, this Amended and Restated Certificate of Incorporation or the By-laws of the Corporation),

the affirmative vote, at any regular meeting or special meeting of stockholders, of not less than 85% of the total number of votes of the then outstanding shares of capital stock of the Corporation entitled to vote generally in the election of directors, voting together as a single class, shall be required to amend or repeal, or to adopt any provision, inconsistent with the purpose or intent of, this paragraph SEVEN. Notice of such proposed alteration or amendment must be contained in the notice of such meeting.

E. In the event of any increase or decrease in the authorized number of directors, the newly created or eliminated directorship resulting from such increase or decrease shall be allotted by the Board of Directors among the three classes of directors so as to maintain such classes as nearly equally as possible. No decrease in the number of directors constituting the Board of Directors shall shorten the term of any incumbent director.

F. Notwithstanding the foregoing, whenever the holders of any one or more classes or series of Preferred Stock issued by the Corporation shall have the right, voting separately by class or series, to elect directors at an annual or special meeting of stockholders, the election, term of office, filling of vacancies and other features of such directorships shall be governed by the terms of the Amended and Restated Certificate of Incorporation applicable thereto, and such directors so electe shall not be divided into classes pursuant to paragraph B unless expressly provided for by the terms of the instrument establishing the right to vote separately as a class or series for the purpose of electing directors.

EIGHT: A director of the corporation in exercising his duties as such, including without limitation, evaluating a tender offer or exchange offer for any equity security of the corporation or any merger or consolidation of the corporation, any sale, lease, exchange or transfer of all or any substantial part of the assets of the corporation, the issuance of any securities of the corporation. The acquisition of any securities of a third party or any reclassification, recapitalization or reorganization of the corporation or any of its securities, may consider the following factors as the Board of Directors determines to be relevant, including without limitation: (i) the interests of the corporation's stockholders; (ii) whether the proposed transaction may violate federal or state laws; (iii) not only the consideration being offered in the proposed transaction, in relation to the then current market price for the outstanding capital stock of the corporation, but also the market price for the capital stock of the corporation over a period of years, the estimated price that might be achieved in a negotiated sale of the corporation as a

whole or in part or through orderly liquidation, the premiums over market price for the securities of other corporations in similar transactions, current political, economic and other factors bearing on securities prices and the corporation's financial condition and future prospects; and (iv) the interests of the corporation's employees, suppliers, creditors and customers, the economy of the state, region and nation, community and societal considerations, and the long-term and short-term interests of the corporation and its stockholders, including the possibility that these interests may best be served with any such evaluation, the Board of Directors is authorized to proceedings as the Board of Directors may determine.

NINE: The officers of the corporation shall be chosen in such a manner, shall hold their offices for such terms and shall carry out such duties as are determined solely by the Board of Directors, subject to the right of the Board of Directors to remove any officer or officers at any time with or without cause.

TEN: No director of the corporation shall be personally liable to the corporation or its stockholders for monetary damages for any breach of fiduciary duty by such a director as a director. Notwithstanding the foregoing sentence, a director shall be liable to the extent provided by applicable law (i) for any breach of the director's duty of loyalty to the corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) pursuant to Section 174 of the DGCL or (iv) for any transaction from which such director derived an improper personal benefit. No amendment to or repeal of this Article NINE shall apply to or have any affect on the liability or alleged liability of any director of the corporation for or with respect to any acts or omissions of such director occurring prior to such amendment or repeal. If the DGCL is amended hereafter to further eliminate or limit the personal liability of directors, the liability of a director of this corporation shall be limited or eliminated to the fullest extent permitted by the DGCL, as amended.

ELEVEN: This corporation shall, to the maximum extent permitted from time to time under the DGCL, indemnify and upon request shall advance expenses to any person who is or was a party or is threatened to be made a party to any threatened pending or completed action, suit, proceeding or claim, whether civil, criminal, administrative or investigative, by reason of the fact that such person is or was or has agreed to be a director or officer of this corporation or while a director or officer is or was serving at the request of this corporation as a director, officer, partner, trustee, employee or agent of any corporation, partnership, trustee, employee or agent of any

corporation, partnership, joint venture, trust or other enterprise, including service with respect to employee benefit plans, against expenses (including attorney's fees and expenses), judgements, fines, penalties and amounts paid in settlement incurred in connection with the investigation, preparation to defend or defense of such action, suit, proceeding or claim; provided, however, that the foregoing shall not require this corporation to indemnify or advance expenses to any person in connection with any action, suit, proceeding, claim or counterclaim initiated by or on behalf of such person. Such indemnification shall be exclusive of other indemnification rights arising under any by-law, agreement, vote of directors or stockholders or otherwise and shall inure to the benefit of the heirs and legal representatives of such person. Any person seeking indemnification under this paragraph 11 shall be deemed to have met the standard of conduct required for such indemnification unless the contrary shall be established. Any repeal or modification of the foregoing provisions of this paragraph 11 shall not adversely affect any right or protection of a director or officer of this corporation with respect to any acts or omissions of such director or officer occurring prior to such repeal or modification.

TWELVE: The books of this corporation may (subject to any statutory requirements) be kept outside the State of Delaware as may be designated by the Board of Directors or in the By-Laws of this corporation.

THIRTEEN: The corporation reserves the right to repeal, alter, amend, or rescind any provision contained in this Amended and Restated Certificate of Incorporation, in the manner now or hereafter prescribed by statute, and all rights conferred on stockholders herein are granted subject to this reservation.

IN WITNESS WHEREOF, Electric Fuel Corporation has caused this Amended and Restated Certificate of Amendment to be signed by its President and attested by its Secretary this 2nd day of March, 1994.

ELECTRIC FUEL CORPORATION

By: /s/Yehuda Harats  
President

ATTEST:

/s/ Robert S. Ehrlich  
Secretary

CERTIFICATE OF AMENDMENT  
TO THE RESTATED CERTIFICATE OF INCORPORATION

of

ELECTRIC FUEL CORPORATION

Electric Fuel Corporation, a corporation organized and existing under and by virtue of the General Corporation Law of the State of Delaware, DOES HEREBY CERTIFY:

FIRST: That in an unanimous written consent of the Board of Directors of this corporation a resolution was duly adopted setting forth a proposed amendment to the Amended and Restated Certificate of Incorporation of said corporation, declaring said amendment to be advisable and calling for the presentation of said amendment at the annual meeting of the stockholders of said corporation for consideration thereof. The resolution setting for the proposed amendment is as follows:

RESOLVED: That Article Four of the Corporations Amended and Restated Certificate of Incorporation be amended to read in its entirety as follows:

“FOUR: The total number of shares of all classes of stock which the corporation shall have authority to issue is Twenty-nine Million (29,000,000) consisting of two classes of shares designated as follows:

- A. Twenty-eight Million (28,000,000) shares of Common Stock, \$.01 par value (the “Common Stock”), and
- B. One Million (1,000,000) shares of Preferred Stock, \$.01 par value (the “Preferred Stock”).”

and that such amendment is attached hereto as Exhibit A.

SECOND: That thereafter pursuant to resolution of its Board of Directors the Annual Meeting of the Stockholders of said corporation was duly called and held, upon notice in accordance with Section 222 of the General Corporation Law of State of Delaware, at which meeting a majority of the outstanding stock of the corporation entitled to vote thereon was voted in favor of the amendments.

THIRD: That said amendments were duly adopted in accordance with the provision of Section 242 of the General Corporation Law of State of Delaware.

IN WITNESS WHEREOF, said corporation has caused this certificate to be signed by Yehuda Harats, its President and Chief Executive Officer and attested by Robert S. Ehrlich, its Chairman of the Board, Chief Financial Officer and Secretary, this 24th day of June, 1996.

ELECTRIC FUEL CORPORATION

By /s/Yehuda Harats  
Yehuda Harats, President and  
Chief Executive Officer

ATTEST:

/s/ Robert S. Ehrlich  
Robert S. Ehrlich, Chairman of the Board,  
Chief Financial Officer and Secretary

ELECTRIC FUEL CORPORATION

AMENDMENT TO ARTICLE FOUR OF THE CORPORATION'S AMENDED AND

RESTATED CERTIFICATE OF INCORPORATION (THE "CHARTER")

FOUR: The total number of shares of all classes of stock which the corporation shall have authority to issue is Twenty-nine Million (29,000,000) consisting of two classes of shares designated as follows:

- A. Twenty-eight Million (28,000,000) shares of Common Stock, \$.01 par value (the "Common Stock"), and
- B. One Million (1,000,000) shares of Preferred Stock, \$.01 par value (the "Preferred Stock").

AMENDED AND RESTATED  
BY-LAWS  
OF  
AROTECH CORPORATION

Section 1. LAW, CERTIFICATE OF INCORPORATION AND BY-LAWS

1.1. These by-laws are subject to the certificate of incorporation of the corporation. In these by-laws, references to law, the certificate of incorporation and by-laws mean the law, the provisions of the certificate of incorporation and the by-laws as from time to time in effect.

Section 2. STOCKHOLDERS

2.1. Annual Meeting. The annual meeting of stockholders shall be held at such date, time and place as shall be designated from time to time by the board of directors and stated in the notice of the meeting, at which they shall elect a board of directors and transact such other business as may be required by law or these by-laws or as may properly come before the meeting.

2.2. Special Meetings. A special meeting of the stockholders may be called at any time by the chairman of the board, if any, the president or the board of directors. A special meeting of the stockholders shall be called by the secretary, or in the case of the death, absence, incapacity or refusal of the secretary, by an assistant secretary or some other officer, upon application of a majority of the directors. Any such application shall state the purpose or purposes of the proposed meeting. Any such call shall state the place, date, hour, and purposes of the meeting.

2.3. Place of Meeting. All meetings of the stockholders for the election of directors or for any other purpose shall be held at such place within or without the State of Delaware as may be determined from time to time by the chairman of the board, if any, the president or the board of directors. Any adjourned session of any meeting of the stockholders shall be held at the place designated in the vote of adjournment.

2.4. Notice of Meetings. Except as otherwise provided by law, a written notice of each meeting of stockholders stating the place, day and hour thereof and, in the case of a special meeting, the purposes for which the meeting is called, shall be given not less than ten nor more than sixty days before the meeting, to each stockholder entitled to vote thereat, and to each stockholder who, by law, by the certificate of incorporation or by these by-laws, is entitled to notice, by leaving such notice with him or at his residence or usual place of business, or by depositing it in the United States mail, postage prepaid, and addressed to such stockholder at his address as it appears in the records of the corporation. Such notice shall be given by the secretary, or by an officer or person designated by the board of directors, or in the case of a special meeting by the officer calling the meeting. As to any adjourned session of any meeting of stockholders, notice of the adjourned meeting need not be given if the time and place thereof are announced at the meeting at which the adjournment was taken except that if the adjournment is for more than thirty days or if after the adjournment a new record date is set for the adjourned session, notice of any such adjourned session of the meeting shall be given in the manner heretofore described. No notice of any meeting of stockholders or any adjourned session thereof need be given to a stockholder if a written waiver of notice, executed before or after the meeting or such adjourned session by such stockholder, is filed with the records of the meeting or if the stockholder attends such meeting without objecting at the beginning of the meeting to the transaction of any business because the meeting is not lawfully called or convened. Neither the business to be transacted at, nor the purpose of, any meeting of the stockholders or any adjourned session thereof need be specified in any written waiver of notice.

2.5. Quorum of Stockholders. At any meeting of the stockholders a quorum as to any matter shall consist of a majority of the votes entitled to be cast on the matter, except where a larger quorum is required by law, by the certificate of incorporation or by these by-laws. Any meeting may be adjourned from time to time by a majority of the votes properly cast upon the question, whether or not a quorum is present. If a quorum is present at an original meeting, a quorum need not be present at an adjourned session of that meeting. Shares of its own stock belonging to the corporation or to another corporation, if a majority of the shares entitled to vote in the election of directors of such other corporation is held, directly or indirectly, by the corporation, shall neither be entitled to vote nor be counted for quorum purposes; provided, however, that the foregoing shall not limit the right of any corporation to vote stock, including but not limited to its own stock, held by it in a fiduciary capacity.

2.6. Action by Vote. When a quorum is present at any meeting, a plurality of the votes properly cast for election to any office shall elect to such office and a majority of the votes properly cast upon any question other than an election to an office shall decide the question, except when a larger vote is required by law, by the certificate of incorporation or by these by-laws. No ballot shall be required for any election unless requested by a stockholder present or represented at the meeting and entitled to vote in the election.

2.7. Action without Meetings. Unless otherwise provided in the certificate of incorporation, any action required or permitted to be taken by stockholders for or in connection with any corporate action may be taken without a meeting, without prior notice and without a vote, if a consent or consents in writing, setting forth the action so taken, shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted and shall be delivered to the corporation by delivery to its registered office in Delaware by hand or certified or registered mail, return receipt requested, to its principal place of business or to an officer or agent of the corporation having custody of the book in which proceedings of meetings of stockholders are recorded. Each such written consent shall bear the date of signature of each stockholder who signs the consent. No written consent shall be effective to take the corporate action referred to therein unless written consents signed by a number of stockholders sufficient to take such action are delivered to the corporation in the manner specified in this paragraph within sixty days of the earliest dated consent so delivered.

If action is taken by consent of stockholders and in accordance with the foregoing, there shall be filed with the records of the meetings of stockholders the writing or writings comprising such consent.

If action is taken by less than unanimous consent of stockholders, prompt notice of the taking of such action without a meeting shall be given to those who have not consented in writing and a certificate signed and attested to by the secretary that such notice was given shall be filed with the records of the meetings of stockholders.

In the event that the action which is consented to is such as would have required the filing of a certificate under any provision of the General Corporation Law of the State of Delaware, if such action had been voted upon by the stockholders at a meeting thereof, the certificate filed under such provision shall state, in lieu of any statement required by such provision concerning a vote of stockholders, that written consent has been given under Section 228 of said General Corporation Law and that written notice has been given as provided in such Section 228.

2.8. Proxy Representation. Every stockholder may authorize another person or persons to act for him by proxy in all matters in which a stockholder is entitled to participate, whether by waiving notice of any meeting, objecting to or voting or participating at a meeting, or expressing consent or dissent without a meeting. Every proxy must be signed by the stockholder or by his attorney-in-fact. No proxy shall be voted or acted upon after three years from its date unless such proxy provides for a longer period. A duly executed proxy shall be irrevocable if it states that it is irrevocable and, if, and only as long as, it is coupled with an interest sufficient in law to support an irrevocable power. A proxy may be made irrevocable regardless of whether the interest with which it is coupled is an interest in the stock itself or an interest in the corporation generally. The authorization of a proxy may but need not be limited to specified action, provided, however, that if a proxy limits its authorization to a meeting or meetings of stockholders, unless otherwise specifically provided such proxy shall entitle the holder thereof to vote at any adjourned session but shall not be valid after the final adjournment thereof.

2.9. Inspectors. The directors or the person presiding at the meeting may, but need not, appoint one or more inspectors of election and any substitute inspectors to act at the meeting or any adjournment thereof. Each inspector, before entering upon the discharge of his duties, shall take and sign an oath faithfully to execute the duties of inspector at such meeting with strict impartiality and according to the best of his ability. The inspectors, if any, shall determine the number of shares of stock outstanding and the voting power of each, the shares of stock represented at the meeting, the existence of a quorum, the validity and effect of proxies, and shall receive votes, ballots or consents, hear and determine all challenges and questions arising in connection with the right to vote, count and tabulate all votes, ballots or consents, determine the result, and do such acts as are proper to conduct the election or vote with fairness to all stockholders. On request of the person presiding at the meeting, the inspectors shall make a report in writing of any challenge, question or matter determined by them and execute a certificate of any fact found by them.

2.10. List of Stockholders. The secretary shall prepare and make, at least ten days before every meeting of stockholders, a complete list of the stockholders entitled to vote at such meeting, arranged in alphabetical order and showing the address of each stockholder and the number of shares registered in his name. The stock ledger shall be the only evidence as to who are stockholders entitled to examine such list or to vote in person or by proxy at such meeting.

### Section 3. BOARD OF DIRECTORS

3.1. Number. The number of directors which shall constitute the whole board shall not be less than 3 nor more than the maximum number allowed by law. Thereafter, within the foregoing limits, the stockholders at the annual meeting shall determine the number of directors and shall elect the number of directors as determined. Within the foregoing limits, the number of directors may be increased at any time or from time to time by the stockholders or by the directors by vote of a majority of the directors then in office. The number of directors may be decreased to any number permitted by the foregoing at any time either by the stockholders or by the directors by vote of a majority of the directors then in office, but only to eliminate vacancies existing by reason of the death, resignation or removal of one or more directors. Directors need not be stockholders.

3.2. Tenure. Except as otherwise provided by law, by the certificate of incorporation or by these by-laws, each director shall hold office until the next annual meeting and until his successor is elected and qualified, or until he sooner dies, resigns, is removed or becomes disqualified.

3.3. Powers. The business and affairs of the corporation shall be managed by or under the direction of the board of directors who shall have and may exercise all the powers of the corporation and do all such lawful acts and things as are not by law, the certificate of incorporation or these by-laws directed or required to be exercised or done by the stockholders.

3.4. Vacancies. Vacancies and any newly created directorships resulting from any increase in the number of directors may be filled by vote of the stockholders at a meeting called for the purpose, or by a majority of the directors then in office, although less than a quorum, or by a sole remaining director. When one or more directors shall resign from the board, effective at a future date, a majority of the directors then in office, including those who have resigned, shall have power to fill such vacancy or vacancies, the vote or action by writing thereon to take effect when such resignation or resignations shall become effective. The directors shall have and may exercise all their powers notwithstanding the existence of one or more vacancies in their number, subject to any requirements of law or of the certificate of incorporation or of these by-laws as to the number of directors required for a quorum or for any vote or other actions.

3.5. Committees. The board of directors may, by vote of a majority of the whole board, (a) designate, change the membership of or terminate the existence of any committee or committees, each committee to consist of one or more of the directors; (b) designate one or more directors as alternate members of any such committee who may replace any absent or disqualified member at any meeting of the committee; and (c) determine the extent to which each such committee shall have and may exercise the powers of the board of directors in the management of the business and affairs of the corporation, including the power to authorize the seal of the corporation to be affixed to all papers which require it and the power and authority to declare dividends or to authorize the issuance of stock; excepting, however, such powers which by law, by the certificate of incorporation or by these by-laws they are prohibited from so delegating. In the absence or disqualification of any member of such committee and his alternate, if any, the member or members thereof present at any meeting and not disqualified from voting, whether or not constituting a quorum, may unanimously appoint another member of the board of directors to act at the meeting in the place of any such absent or disqualified member. Except as the board of directors may otherwise determine, any committee may make rules for the conduct of its business, but unless otherwise provided by the board or such rules, its business shall be conducted as nearly as may be in the same manner as is provided by these by-laws for the conduct of business by the board of directors. Each committee shall keep regular minutes of its meetings and report the same to the board of directors upon request.

3.6. Regular Meetings. Regular meetings of the board of directors may be held without call or notice at such places within or without the State of Delaware and at such times as the board may from time to time determine, provided that notice of the first regular meeting following any such determination shall be given to absent directors. A regular meeting of the directors may be held without call or notice immediately after and at the same place as the annual meeting of stockholders.

3.7. Special Meetings. Special meetings of the board of directors may be held at any time and at any place within or without the State of Delaware designated in the notice of the meeting, when called by the chairman of the board, if any, the president, or by one-third or more in number of the directors, reasonable notice thereof being given to each director by the secretary or by the chairman of the board, if any, the president or any one of the directors calling the meeting.

3.8. Notice. It shall be reasonable and sufficient notice to a director to send notice by mail at least forty-eight hours or by telegram at least twenty-four hours before the meeting addressed to him at his usual or last known business or residence address or to give notice to him in person or by telephone at least twenty-four hours before the meeting. Notice of a meeting need not be given to any director if a written waiver of notice, executed by him before or after the meeting, is filed with the records of the meeting, or to any director who attends the meeting without protesting prior thereto or at its commencement the lack of notice to him. Neither notice of a meeting nor a waiver of a notice need specify the purposes of the meeting.

3.9. Quorum. Except as may be otherwise provided by law, by the certificate of incorporation or by these by-laws, at any meeting of the directors a majority of the directors then in office shall constitute a quorum; a quorum shall not in any case be less than one-third of the total number of directors constituting the whole board. Any meeting may be adjourned from time to time by a majority of the votes cast upon the question, whether or not a quorum is present, and the meeting may be held as adjourned without further notice.

3.10. Action by Vote. Except as may be otherwise provided by law, by the certificate of incorporation or by these by-laws, when a quorum is present at any meeting the vote of a majority of the directors present shall be the act of the board of directors.

3.11. Action Without a Meeting. Any action required or permitted to be taken at any meeting of the board of directors or a committee thereof may be taken without a meeting if all the members of the board or of such committee, as the case may be, consent thereto in writing, and such writing or writings are filed with the records of the meetings of the board or of such committee. Such consent shall be treated for all purposes as the act of the board or of such committee, as the case may be.

3.12. Participation in Meetings by Conference Telephone. Members of the board of directors, or any committee designated by such board, may participate in a meeting of such board or committee by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other or by any other means permitted by law. Such participation shall constitute presence in person at such meeting.

3.13. Compensation. In the discretion of the board of directors, each director may be paid such fees for his services as director and be reimbursed for his reasonable expenses incurred in the performance of his duties as director as the board of directors from time to time may determine. Nothing contained in this section shall be construed to preclude any director from serving the corporation in any other capacity and receiving reasonable compensation therefor.

3.14. Interested Directors and Officers.

(a) No contract or transaction between the corporation and one or more of its directors or officers, or between the corporation and any other corporation, partnership, association, or other organization in which one or more of the corporation's directors or officers are directors or officers, or have a financial interest, shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the board or committee thereof which authorizes the contract or transaction, or solely because his or their votes are counted for such purpose, if:

(1) The material facts as to his relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors or the committee, and the board or committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum; or

(2) The material facts as to his relationship or interest and as to the contract or transaction are disclosed or are known to the stockholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the stockholders; or

(3) The contract or transaction is fair as to the corporation as of the time it is authorized, approved or ratified, by the board of directors, a committee thereof, or the stockholders.

(b) Common or interested directors may be counted in determining the presence of a quorum at a meeting of the board of directors or of a committee which authorizes the contract or transaction.

## Section 4. OFFICERS AND AGENTS

4.1. Enumeration; Qualification. The officers of the corporation shall be a president, a treasurer, a secretary and such other officers, if any, as the board of directors from time to time may in its discretion elect or appoint including without limitation a chairman of the board, one or more vice presidents and a controller. The corporation may also have such agents, if any, as the board of directors from time to time may in its discretion choose. Any officer may be but none need be a director or stockholder. Any two or more offices may be held by the same person. Any officer may be required by the board of directors to secure the faithful performance of his duties to the corporation by giving bond in such amount and with sureties or otherwise as the board of directors may determine.

4.2. Powers. Subject to law, to the certificate of incorporation and to the other provisions of these by-laws, each officer shall have, in addition to the duties and powers herein set forth, such duties and powers as are commonly incident to his office and such additional duties and powers as the board of directors may from time to time designate.

4.3. Election. The officers may be elected by the board of directors at their first meeting following the annual meeting of the stockholders or at any other time. At any time or from time to time the directors may delegate to any officer their power to elect or appoint any other officer or any agents.

4.4. Tenure. Each officer shall hold office until the first meeting of the board of directors following the next annual meeting of the stockholders and until his respective successor is chosen and qualified unless a shorter period shall have been specified by the terms of his election or appointment, or in each case until he sooner dies, resigns, is removed or becomes disqualified. Each agent shall retain his authority at the pleasure of the directors, or the officer by whom he was appointed or by the officer who then holds agent appointive power.

4.5. Chairman of the Board of Directors, President and Vice President. The chairman of the board, if any, shall have such duties and powers as shall be designated from time to time by the board of directors. Unless the board of directors otherwise specifies, the chairman of the board, or if there is none the chief executive officer, shall preside, or designate the person who shall preside, at all meetings of the stockholders and of the board of directors.

Unless the board of directors otherwise specifies, the president shall be the chief executive officer and shall have direct charge of all business operations of the corporation and, subject to the control of the directors, shall have general charge and supervision of the business of the corporation.

Any vice presidents shall have such duties and powers as shall be set forth in these by-laws or as shall be designated from time to time by the board of directors or by the president.

4.6. Treasurer and Assistant Treasurers. Unless the board of directors otherwise specifies, the treasurer shall be the chief financial officer of the corporation and shall be in charge of its funds and valuable papers, and shall have such other duties and powers as may be designated from time to time by the board of directors or by the president. If no controller is elected, the treasurer shall, unless the board of directors otherwise specifies, also have the duties and powers of the controller.

Any assistant treasurers shall have such duties and powers as shall be designated from time to time by the board of directors, the president or the treasurer.

4.7. Controller and Assistant Controllers. If a controller is elected, he shall, unless the board of directors otherwise specifies, be the chief accounting officer of the corporation and be in charge of its books of account and accounting records, and of its accounting procedures. He shall have such other duties and powers as may be designated from time to time by the board of directors, the president or the treasurer.

Any assistant controller shall have such duties and powers as shall be designated from time to time by the board of directors, the president, the treasurer or the controller.

4.8. Secretary and Assistant Secretaries. The secretary shall record all proceedings of the stockholders, of the board of directors and of committees of the board of directors in a book or series of books to be kept therefor and shall file therein all actions by written consent of stockholders or directors. In the absence of the secretary from any meeting, an assistant secretary, or if there be none or he is absent, a temporary secretary chosen at the meeting, shall record the proceedings thereof. Unless a transfer agent has been appointed the secretary shall keep or cause to be kept the stock and transfer records of the corporation, which shall contain the names and record addresses of all stockholders and the number of shares registered in the name of each stockholder. He shall have such other duties and powers as may from time to time be designated by the board of directors or the president.

Any assistant secretaries shall have such duties and powers as shall be designated from time to time by the board of directors, the president or the secretary.

## Section 5. RESIGNATIONS AND REMOVALS

5.1. Any director or officer may resign at any time by delivering his resignation in writing to the chairman of the board, if any, the president, or the secretary or to a meeting of the board of directors. Such resignation shall be effective upon receipt unless specified to be effective at some other time, and without in either case the necessity of its being accepted unless the resignation shall so state. Except as otherwise provided by law, or in the certificate of incorporation, a director (including persons elected by directors to fill vacancies in the board) may be removed from office with or without cause by the vote of the holders of a majority of the shares issued and outstanding and entitled to vote in the election of directors. The board of directors may at any time remove any officer either with or without cause. The board of directors may at any time terminate or modify the authority of any agent. No director or officer resigning and (except where a right to receive compensation shall be expressly provided in a duly authorized written agreement with the corporation) no director or officer removed shall have any right to any compensation as such director or officer for any period following his resignation or removal, or any right to damages on account of such removal, whether his compensation be by the month or by the year or otherwise; unless, in the case of a resignation, the directors, or, in the case of removal, the body acting on the removal, shall in their or its discretion provide for compensation.

#### Section 6. VACANCIES

6.1. If the office of the president or the treasurer or the secretary becomes vacant, the directors may elect a successor by vote of a majority of the directors then in office. If the office of any other officer becomes vacant, any person or body empowered to elect or appoint that officer may choose a successor. Each such successor shall hold office for the unexpired term, and in the case of the president, the treasurer and the secretary until his successor is chosen and qualified or in each case until he sooner dies, resigns, is removed or becomes disqualified. Any vacancy of a directorship shall be filled as specified in Section 3.4 of these by-laws.

#### Section 7. CAPITAL STOCK

7.1. Stock Certificates. Each stockholder shall be entitled to a certificate stating the number and the class and the designation of the series, if any, of the shares held by him, in such form as shall, in conformity to law, the certificate of incorporation and the by-laws, be prescribed from time to time by the board of directors. Such certificate shall be signed by the chairman or vice chairman of the board, if any, or the president or a vice president and by the treasurer or an assistant treasurer or by the secretary or an assistant secretary. Any or all of the signatures on the certificate may be a facsimile. In case an officer, transfer agent, or registrar who has signed or whose facsimile signature has been placed on such certificate shall have ceased to be such officer, transfer agent, or registrar before such certificate is issued, it may be issued by the corporation with the same effect as if he were such officer, transfer agent, or registrar at the time of its issue.

7.2. Loss of Certificates. In the case of the alleged theft, loss, destruction or mutilation of a certificate of stock, a duplicate certificate may be issued in place thereof, upon such terms, including receipt of a bond sufficient to indemnify the corporation against any claim on account thereof, as the board of directors may prescribe.

#### Section 8. TRANSFER OF SHARES OF STOCK

8.1. Transfer on Books. Subject to the restrictions, if any, stated or noted on the stock certificate, shares of stock may be transferred on the books of the corporation by the surrender to the corporation or its transfer agent of the certificate therefor properly endorsed or accompanied by a written assignment and power of attorney properly executed, with necessary transfer stamps affixed, and with such proof of the authenticity of signature as the board of directors or the transfer agent of the corporation may reasonably require. Except as may be otherwise required by law, by the certificate of incorporation or by these by-laws, the corporation shall be entitled to treat the record holder of stock as shown on its books as the owner of such stock for all purposes, including the payment of dividends and the right to receive notice and to vote or to give any consent with respect thereto and to be held liable for such calls and assessments, if any, as may lawfully be made thereon, regardless of any transfer, pledge or other disposition of such stock until the shares have been properly transferred on the books of the corporation.

It shall be the duty of each stockholder to notify the corporation of his post office address.

8.2. Record Date and Closing Transfer Books. In order that the corporation may determine the stockholders entitled to notice of or to vote at any meeting of stockholders or any adjournment thereof, the board of directors may fix a record date, which record date shall not precede the date upon which the resolution fixing the record date is adopted by the board of directors, and which record date shall not be more than sixty nor less than ten days before the date of such meeting. If no such record date is fixed by the board of directors, the record date for determining the stockholders entitled to notice of or to vote at a meeting of stockholders shall be at the close of business on the day next preceding the day on which notice is given, or, if notice is waived, at the close of business on the day next preceding the day on which the meeting is held. A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the board of directors may fix a new record date for the adjourned meeting.

In order that the corporation may determine the stockholders entitled to consent to corporate action in writing without a meeting, the board of directors may fix a record date, which record date shall not precede the date upon which the resolution fixing the record date is adopted by the board of directors, and which date shall not be more than ten days after the date upon which the resolution fixing the record date is adopted by the board of directors. If no such record date has been fixed by the board of directors, the record date for determining stockholders entitled to consent to corporate action in writing without a meeting, when no prior action by the board of directors is required by the General Corporation Law of the State of Delaware, shall be the first date on which a signed written consent setting forth the action taken or proposed to be taken is delivered to the corporation by delivery to its registered office in Delaware by hand or certified or registered mail, return receipt requested, to its principal place of business or to an officer or agent of the corporation having custody of the book in which proceedings of meetings of stockholders are recorded. If no record date has been fixed by the board of directors and prior action by the board of directors is required by the General Corporation Law of the State of Delaware, the record date for determining stockholders entitled to consent to corporate action in writing without a meeting shall be at the close of business on the day on which the board of directors adopts the resolution taking such prior action.

In order that the corporation may determine the stockholders entitled to receive payment of any dividend or other distribution or allotment of any rights or to exercise any rights in respect of any change, conversion or exchange of stock, or for the purpose of any other lawful action, the board of directors may fix a record date, which record date shall not precede the date upon which the resolution fixing the record date is adopted, and which record date shall be not more than sixty days prior to such payment, exercise or other action. If no such record date is fixed, the record date for determining stockholders for any such purpose shall be at the close of business on the day on which the board of directors adopts the resolution relating thereto.

#### Section 9. CORPORATE SEAL

9.1. Subject to alteration by the directors, the seal of the corporation shall consist of a flat-faced circular die with the word "Delaware" and the name of the corporation cut or engraved thereon, together with such other words, dates or images as may be approved from time to time by the directors.

#### Section 10. EXECUTION OF PAPERS

10.1. Except as the board of directors may generally or in particular cases authorize the execution thereof in some other manner, all deeds, leases, transfers, contracts, bonds, notes, checks, drafts or other obligations made, accepted or endorsed by the corporation shall be signed by the chairman of the board, if any, the president, a vice president or the treasurer.

Section 11. FISCAL YEAR

11.1. The fiscal year of the corporation shall end on the last day of the month of December.

Section 12. AMENDMENTS

12.1. These by-laws may be adopted, amended or repealed by vote of a majority of the directors then in office or by vote of a majority of the stock outstanding and entitled to vote. Any by-law, whether adopted, amended or repealed by the stockholders or directors, may be amended or reinstated by the stockholders or the directors.

**FIRST AMENDMENT TO CREDIT AGREEMENT**

THIS FIRST AMENDMENT TO CREDIT AGREEMENT, dated as of June 3, 2016 (this "Amendment"), is among AROTECH CORPORATION (collectively, the "Borrower"), the other Loan Parties party to the Credit Agreement described below and JPMORGAN CHASE BANK, N.A. (the "Lender").

**RECITAL**

The Borrower, the other Loan Parties and the Lender are parties to a Credit Agreement dated as of March 11, 2016 (as amended or modified from time to time, the "Credit Agreement"), and desire to amend the Credit Agreement on the terms and conditions of this Amendment.

**TERMS**

In consideration of the premises and of the mutual agreements herein contained, the parties hereby agree as follows:

ARTICLE I. **AMENDMENTS**. Upon fulfillment of the conditions set forth in Article III hereof, the Credit Agreement shall be amended as follows:

1.1 The following definitions are added to Section 1.01 of the Credit Agreement:

"**FAAC**" means FAAC Incorporated, a Michigan corporation.

"**First Amendment**" means the First Amendment to this Agreement among the parties hereto.

"**First Amendment Effective Date**" means the date the First Amendment is effective.

1.2 The definition of "Obligation" in Section 1.01 of the Credit Agreement is restated as follows:

"**Obligations**" means all unpaid principal of and accrued and unpaid interest on the Loans, all LC Exposure, all accrued and unpaid fees and all expenses, reimbursements, indemnities and other obligations and indebtedness (including interest and fees accruing during the pendency of any bankruptcy, insolvency, receivership or other similar proceeding, regardless of whether allowed or allowable in such proceeding), obligations and liabilities of the Loan Parties and their respective Subsidiaries (and including any or all of them individually or collectively) to the Lender or any indemnified party, individually or collectively, existing on the Effective Date or arising thereafter, direct or indirect, joint or several, absolute or contingent, matured or unmatured, liquidated or unliquidated, secured or unsecured, arising by contract, operation of law or otherwise, arising or incurred under this Agreement or any of the other Loan Documents or in respect of any of the Loans made or reimbursement or other obligations incurred or any of the Letters of Credit or other instruments at any time evidencing any thereof.

1.3 The following is added is the end of Section 1.03 of the Credit Agreement: "The parties hereto acknowledge that under the First Amendment FAAC has replaced the Borrower as the borrower of Term B Loan. Accordingly, except as specifically modified in Section 2.01(c), Section 2.08(c) and Article IX under the First Amendment, references in this Agreement to "Borrower" when used in relation to Term B Loan shall be deemed to also include FAAC as determined by the Lender."

1.4 Section 2.01(c) of the Credit Agreement is restated as follows:

(c) Subject to the terms and conditions set forth herein, the Lender agrees to make a Term B Loan in dollars to FAAC, at one time on a date on or after the Effective Date but prior to the Term B Draw Expiration Date in an aggregate principal amount not to exceed the lesser Lender's Term B Commitment or 80% of the appraised value of the Ann Arbor Real Estate as determined pursuant to an appraisal satisfactory to the Lender. Amounts prepaid or repaid in respect of Term B Loans may not be reborrowed.

1.5 Section 2.08(c) of the Credit Agreement is restated as follows:

(c) FAAC hereby unconditionally promises to pay Term B Loan in consecutive monthly principal payments to the Lender on the first Business Day of each month, commencing with the first such Business Day after the Term B Draw Expiration Date, each in the amount of \$5,555 (as adjusted from time to time pursuant to Section 2.09(d) or 2.16(b)), and the remaining principal balance of the Term B Loan will shall be paid in full in cash by FAAC on the Term B Maturity Date.

1.6 The following new Section 9.14 is added to the Credit Agreement:

SECTION 9.14. Other Loan Parties. All Loan Parties acknowledge and agree that (a) all references in this Article IX to "Borrower" means each of the Borrower and FAAC, individually and collectively, and (b) all Loan Parties (i) are Loan Guarantors with respect to all other Loan Parties and (ii) Guarantee, and have granted a security interest and lien under the Collateral Documents to secure, all Secured Obligations of each Loan Party, including without limitation Secured Obligations of Borrower and FAAC as borrowers hereunder and all other Secured Obligations of each Loan Party.

ARTICLE II. REPRESENTATIONS. Each Loan Party represents and warrants to the Lender that:

2.1 The execution, delivery and performance of this Amendment are within its powers, have been duly authorized and are not in contravention with any law, or the terms of its articles of incorporation or organization (as applicable), by-laws or operating agreement (as applicable), or any undertaking to which it is a party or by which it is bound.

2.2 The Amendment is the valid and binding obligation of each Loan Party, enforceable against such Borrower in accordance with its terms.

2.3 After giving effect to the amendments and waivers herein contained, the representations and warranties contained in the Credit Agreement and the other Loan Documents are true on and as of the date hereof with the same force and effect as if made on and as of the date hereof and no Default has occurred and is continuing.

ARTICLE III. CONDITIONS OF EFFECTIVENESS. This Amendment shall be effective as of the date hereof when each of the following is satisfied:

3.1 Each Loan Party and the Lender shall have executed this Amendment.

3.2 Each Loan Party shall have delivered to the Lender resolutions approving this Amendment and such other agreements and documents requested by the Lender.

ARTICLE IV. MISCELLANEOUS.

4.1 References in the Loan Documents to the Credit Agreement shall be deemed to be references to the Credit Agreement as amended hereby and as further amended from time to time. This Amendment is a Loan Document. Terms used but not defined herein shall have the respective meanings ascribed thereto in the Credit Agreement. Without limiting the foregoing, each of the Loan Parties acknowledges and agrees that all references to Secured Obligations in any of the Collateral Documents shall be deemed references to Secured Obligations as such term is amended hereby and as further amended or modified from time to time in accordance with the Loan Documents.

4.2 Except as expressly amended hereby, each Loan Party agrees that the Loan Documents are ratified and confirmed and shall remain in full force and effect and that it has no set off, counterclaim, defense or other claim or dispute with respect to any of the foregoing.

4.3 This Amendment may be signed upon any number of counterparts with the same effect as if the signatures thereto and hereto were upon the same instrument and signatures sent by facsimile or other electronic imaging shall be enforceable as originals.

IN WITNESS WHEREOF, the parties have caused this Amendment to be executed and delivered as of the day and year first above written.

**AROTECH CORPORATION**

By: /s/ Thomas J. Paup

Name: Thomas J. Paup

Title: Sr VP Finance & CFO

**FAAC INCORPORATED**

By: /s/ Thomas J. Paup

Name: Thomas J. Paup

Title: Treasurer

**ELECTRIC FUEL BATTERY CORP.**

By: /s/ Thomas J. Paup

Name: Thomas J. Paup

Title: Treasurer

**UEC ELECTRONICS, LLC**

By: /s/ Thomas J. Paup

Name: Thomas J. Paup

Title: Treasurer

**JPMORGAN CHASE BANK, N.A.**

By: /s/ Kristin Santos

Name: Kirstin Santos

Title: Authorized Officer

**SECOND AMENDMENT TO CREDIT AGREEMENT**

THIS SECOND AMENDMENT TO CREDIT AGREEMENT, dated as of June 25, 2016 (this "Amendment"), is among AROTECH CORPORATION (collectively, the "Borrower"), the other Loan Parties party to the Credit Agreement described below and JPMORGAN CHASE BANK, N.A. (the "Lender").

**RECITAL**

The Borrower, the other Loan Parties and the Lender are parties to a Credit Agreement dated as of March 11, 2016 (as amended or modified from time to time, the "Credit Agreement"), and desire to amend the Credit Agreement on the terms and conditions of this Amendment.

**TERMS**

In consideration of the premises and of the mutual agreements herein contained, the parties hereby agree as follows:

ARTICLE I. **AMENDMENTS**. Upon fulfillment of the conditions set forth in Article III hereof, the Credit Agreement shall be amended as follows:

1.1 Section 5.01(b) of the Credit Agreement is restated as follows:

(b) within 45 days after the end of each of the first three fiscal quarters of the Borrower, its consolidated balance sheet and related statements of operations, stockholders' equity and cash flows as of the end of and for such fiscal quarter and the then elapsed portion of such fiscal year, setting forth in each case in comparative form the figures for the corresponding period or periods of (or, in the case of the balance sheet, as of the end of) the previous fiscal year, all certified by a Financial Officer as presenting fairly in all material respects the financial condition and results of operations of the Borrower and its consolidated Subsidiaries on a consolidated basis in accordance with GAAP consistently applied, subject to normal year-end audit adjustments and the absence of footnotes;

1.2 Sections 5.01(h) and (i) of the Credit Agreement are restated as follows:

(h) promptly upon the request of the Lender, copies of all tax returns filed by any Loan Party with the U.S. Internal Revenue Service;

(i) promptly upon the request of the Lender, a detailed listing of all intercompany loans made by the Borrower to any Affiliate during such calendar month;

ARTICLE II. **REPRESENTATIONS**. Each Loan Party represents and warrants to the Lender that:

2.1 The execution, delivery and performance of this Amendment are within its powers, have been duly authorized and are not in contravention with any law, or the terms of its articles of incorporation or organization (as applicable), by-laws or operating agreement (as applicable), or any undertaking to which it is a party or by which it is bound.

2.2 The Amendment is the valid and binding obligation of each Loan Party, enforceable against such Borrower in accordance with its terms.

2.3 After giving effect to the amendments and waivers herein contained, the representations and warranties contained in the Credit Agreement and the other Loan Documents are true on and as of the date hereof with the same force and effect as if made on and as of the date hereof and no Default has occurred and is continuing.

ARTICLE III. CONDITIONS OF EFFECTIVENESS. This Amendment shall be effective as of the date hereof when each of the following is satisfied:

3.1 Each Loan Party and the Lender shall have executed this Amendment.

ARTICLE IV. MISCELLANEOUS.

4.1 References in the Loan Documents to the Credit Agreement shall be deemed to be references to the Credit Agreement as amended hereby and as further amended from time to time. This Amendment is a Loan Document. Terms used but not defined herein shall have the respective meanings ascribed thereto in the Credit Agreement. Without limiting the foregoing, each of the Loan Parties acknowledges and agrees that all references to Secured Obligations in any of the Collateral Documents shall be deemed references to Secured Obligations as such term is amended hereby and as further amended or modified from time to time in accordance with the Loan Documents.

4.2 Except as expressly amended hereby, each Loan Party agrees that the Loan Documents are ratified and confirmed and shall remain in full force and effect and that it has no set off, counterclaim, defense or other claim or dispute with respect to any of the foregoing.

4.3 This Amendment may be signed upon any number of counterparts with the same effect as if the signatures thereto and hereto were upon the same instrument and signatures sent by facsimile or other electronic imaging shall be enforceable as originals.

IN WITNESS WHEREOF, the parties have caused this Amendment to be executed and delivered as of the day and year first above written.

**AROTECH CORPORATION**

By: /s/ Thomas J. Paup

Name: Thomas J. Paup

Title: Sr VP Finance & CFO

**FAAC INCORPORATED**

By: /s/ Thomas J. Paup

Name: Thomas J. Paup

Title: Treasurer

**ELECTRIC FUEL BATTERY CORP.**

By: /s/ Thomas J. Paup

Name: Thomas J. Paup

Title: Treasurer

**UEC ELECTRONICS, LLC**

By: /s/ Thomas J. Paup

Name: Thomas J. Paup

Title: Treasurer

**JPMORGAN CHASE BANK, N.A.**

By: /s/ Kristin Santos

Name: Kirstin Santos

Title: Authorized Officer

## THIRD AMENDMENT TO CREDIT AGREEMENT

THIS THIRD AMENDMENT TO CREDIT AGREEMENT, dated as of June 1, 2017 (this "Amendment"), is among **AROTECH CORPORATION** (collectively, the "Borrower"), the other Loan Parties party to the Credit Agreement described below and **JPMORGAN CHASE BANK, N.A.** (the "Lender").

## RECITAL

The Borrower, the other Loan Parties and the Lender are parties to a Credit Agreement dated as of March 11, 2016, as amended by a certain First Amendment to Credit Agreement dated as of, and as further amended by a certain Second Amendment to Credit Agreement dated as of June 25, 2016 (as may be further amended or modified from time to time, the "Credit Agreement"), and desire to amend the Credit Agreement on the terms and conditions of this Amendment.

## TERMS

In consideration of the premises and of the mutual agreements herein contained, the parties hereby agree as follows:

**ARTICLE I** AMENDMENTS. Upon fulfillment of the conditions set forth in Article III hereof, the Credit Agreement shall be amended as follows:

1.1 The following definitions are added to Section 1.01 of the Credit Agreement:

"Oak Valley Real Estate" means the Real Property owned by FAAC and commonly known as 1229 Oak Valley Drive, Ann Arbor, MI 48108.

"Term C Commitment" means the commitment of the Lender to make a Term C Loan, expressed as an amount representing the maximum principal amount of the Term C Loan to be made by the Lender. The amount of the Lender's Term C Commitment on the Third Amendment Effective Date is \$1,358,000.

"Term C Draw Expiration Date" means the earlier of (a) the date upon which the Term C Loan is advanced pursuant to Section 2.01(d); and (b) June 30, 2017.

"Term C Loan" means the Loan made pursuant to Section 2.01(d).

"Term C Maturity Date" means June 1, 2024.

"Third Amendment" means the Third Amendment to this Agreement among the parties hereto.

"Third Amendment Effective Date" means the date the Third Amendment is effective.

1.2 The following definitions in Section 1.01 of the Credit Agreement are amended and restated as follows:

“Applicable Rate” means, for any day, with respect to any Loan, or with respect to the commitment fees payable hereunder, as the case may be, the applicable rate per annum set forth below under the caption “Revolving Commitment CBFR Spread”, “Revolving Commitment Eurodollar Spread”, “Term A Loan CBFR Spread”, “Term A Loan Eurodollar Spread”, “Term B Loan CBFR Spread”, “Term B Loan Eurodollar Spread”, “Term C Loan CBFR Spread”, “Term C Loan Eurodollar Spread”, or “Commitment Fee Rate”, as the case may be, based upon the Borrower’s Leverage Ratio as of the most recent determination date, provided that until the delivery to the Lender, pursuant to Section 5.01, of the Borrower’s consolidated financial information for the Borrower’s first fiscal quarter ending after the Effective Date, the “Applicable Rate” shall be the applicable rates per annum set forth (all numbers are in basis points) below in Category IV:

<u>Leverage Ratio</u>	<u>Revolving Commitment CBFR Spread</u>	<u>Revolving Commitment Eurodollar Spread</u>	<u>Term A, B and C Loan CBFR Spread</u>	<u>Term A, B and C Loan Eurodollar Spread</u>	<u>Commitment Fee Rate</u>
<u>Category I</u> < 2.00:1.00	0	175	25	200	25
<u>Category II</u> ≥ 2.00:1.00 but < 2.50:1.00	25	200	50	225	30
<u>Category III</u> ≥ 2.50:1.00 but < 3.00:1.00	50	250	75	275	35
<u>Category IV</u> ≥ 3.00:1.00	75	300	100	325	40

For purposes of the foregoing, (a) the Applicable Rate shall be determined as of the end of each fiscal quarter of the Borrower, based upon the Borrower’s annual or quarterly consolidated financial statements delivered pursuant to Section 5.01 and (b) each change in the Applicable Rate resulting from a change in the Leverage Ratio shall be effective during the period commencing on and including the scheduled date the delivery to the Lender of such consolidated financial statements indicating such change and ending on the date immediately preceding the effective date of the next such change, provided that, at the option of the Lender, if the Borrower fails to deliver the annual or quarterly consolidated financial statements required to be delivered by it pursuant to Section 5.01, the Leverage Ratio shall be deemed to be in Category IV during the period from the expiration of the time for delivery thereof until such consolidated financial statements are delivered.

If at any time the Lender determines that the financial statements upon which the Applicable Rate was determined were incorrect (whether based on a restatement, fraud or otherwise), the Borrower shall be required to retroactively pay any additional amount that the Borrower would have been required to pay if such financial statements had been accurate at the time they were delivered.

“Class”, when used in reference to (a) any Loan or Borrowing, refers to whether such Loan, or the Loans comprising such Borrowing, are Revolving Loans, a Term A Loan, a Term B Loan, or a Term C Loan and (b) any Commitment, refers to whether such Commitment is a Revolving Commitment, a Term A Commitment, a Term B Commitment, or a Term C Commitment.

“Interest Payment Date” means (a) with respect to any CBFR Loan, the first Business Day of each calendar month and the Revolving Credit Maturity Date, the Term A Maturity Date, the Term B Maturity Date, or the Term C Maturity Date as applicable, and (b) with respect to any Eurodollar Loan, the last day of the Interest Period applicable to the Borrowing of which such Loan is a part and, in the case of a Eurodollar Borrowing with an Interest Period of more than three months’ duration, each day prior to the last day of such Interest Period that occurs at intervals of three months’ duration after the first day of such Interest Period and the Revolving Credit Maturity Date, the Term A Maturity Date, the Term B Maturity Date, or the Term C Maturity Date, as applicable.

“Term B Commitment” means the commitment of the Lender to make a Term B Loan, expressed as an amount representing the maximum principal amount of the Term B Loan to be made by the Lender. The amount of the Lender’s Term B Commitment on the Third Amendment Effective Date is \$1,730,895.

“Term B Draw Expiration Date” means the earlier of (a) the date upon which the Term B Loan is advanced pursuant to Section 2.01(c), and (b) May 31, 2017.

“Term B Maturity Date” means June 1, 2024.

“Term Commitments” means the Term A Commitment, the Term B Commitment and the Term C Commitment.

“Term Loans” means the Term A Loan, the Term B Loan and the Term C Loan.

1.3 Section 2.01(c) of the Credit Agreement is restated as follows:

( c ) Subject to the terms and conditions set forth herein, the Lender agrees to make a Term B Loan in dollars to FAAC, at one time on a date on or after the Third Amendment Effective Date but prior to the Term B Draw Expiration Date, in an aggregate principal amount, including the principal amount outstanding as Term Loan B immediately prior to the Third Amendment Effective Date, not to exceed the lesser of the Lender’s Term B Commitment or 70% of the appraised value of the Ann Arbor Real Estate as determined pursuant to an appraisal satisfactory to the Lender. Amounts prepaid or repaid in respect of Term B Loans may not be borrowed. The principal amount of Term Loan B outstanding immediately prior to the Third Amendment Effective Date shall constitute usage of the Term B Commitment (as modified by the Third Amendment) and shall continue to a portion of Term Loan B on and after the Third Amendment Effective Date. The Third Amendment is not a novation of the portion of the Term Loan B outstanding immediately prior to the Third Amendment Effective Date.

1.4 The following new Section 2.01(d) is added to the Credit Agreement:

( d ) Subject to the terms and conditions set forth herein, the Lender agrees to make a Term C Loan in dollars to FAAC, at one time on a date on or after the Third Amendment Effective Date but prior to the Term C Draw Expiration Date in an aggregate principal amount not to exceed the lesser of the Lender's Term C Commitment or 70% of the appraised value of the Oak Valley Real Estate as determined pursuant to an appraisal satisfactory to the Lender. Amounts prepaid or repaid in respect of Term C Loans may not be borrowed.

1.5 Section 2.02(d) of the Credit Agreement is restated as follows:

(d) Notwithstanding any other provision of this Agreement, the Borrower shall not be entitled to request, or to elect to convert or continue, any Borrowing if the Interest Period requested with respect thereto would end after the Revolving Credit Maturity Date, the Term A Maturity Date, the Term B Maturity Date or the Term C Maturity Date, as applicable.

1.6 Section 2.07(a) of the Credit Agreement is restated as follows:

(a) Unless previously terminated, (i) the Term A Commitment shall terminate at 5:00 p.m., Detroit time, on the Effective Date, (ii) the Term B Commitment shall terminate on the Term B Draw Expiration Date, (iii) the Term C Commitment shall terminate on the Term C Draw Expiration Date, and (iv) the Revolving Commitment shall terminate on the Revolving Credit Maturity Date.

1.7 Section 2.08 of the Credit Agreement is restated as follows:

(a) The Borrower hereby unconditionally promises to pay the Lender the then unpaid principal amount of each Revolving Loan on the Revolving Credit Maturity Date.

(b) The Borrower hereby unconditionally promises to pay Term A Loan in consecutive monthly principal payments to the Lender on the first Business Day of each month, commencing with the first Business Day of May, 2016, in the following amounts (as adjusted from time to time pursuant to Section 2.09(d) or 2.16(b)): (i) the first twelve (12) monthly principal payments will each be in the amount of \$83,333.33, (ii) the next thirty six (36) monthly principal payments will each be in the amount of \$166,666.67, (iii) the next eleven (11) monthly principal payments will each be in the amount of \$250,000, and (iv) the remaining principal balance of the Term A Loan will shall be paid in full in cash by the Borrower on the Term A Maturity Date.

(c) FAAC hereby unconditionally promises to pay the Term B Loan in consecutive monthly principal payments to the Lender on the first Business Day of each month, commencing with the first such Business Day after the Term B Draw Expiration Date, in the total amount of \$7,212.00 (as adjusted from time to time pursuant to Section 2.09(d) or 2.16(b)), and the remaining principal balance of the Term B Loan shall be paid in full in cash by FAAC on the Term B Maturity Date.

(d) FAAC hereby unconditionally promises to pay the Term C Loan in consecutive monthly principal payments to the Lender on the first Business Day of each month, commencing with the first such Business Day after the Term C Draw Expiration Date, in the total amount of 5,660.00 (as adjusted from time to time pursuant to Section 2.09(d) or 2.16(b)), and the remaining principal balance of the Term C Loan shall be paid in full in cash by FAAC on the Term C Maturity Date.

(e) Prior to any repayment of any Term Loan Borrowings of any Class under this Section, the Borrower shall select the Borrowing or Borrowings of the applicable Class to be repaid and shall notify the Lender by telephone (confirmed by fax) of such selection not later than 11:00 a.m., Detroit time, three (3) Business Days before the scheduled date of such repayment. Each repayment of a Term Loan Borrowing shall be applied ratably to the Loans included in the repaid Term Loan Borrowing. Repayments of Term Loan Borrowings shall be accompanied by accrued interest on the amounts repaid.

(f) The Lender shall maintain in accordance with its usual practice an account or accounts evidencing the Indebtedness of the Borrower to the Lender resulting from each Loan made by the Lender, including the amounts of principal and interest payable and paid to the Lender from time to time hereunder.

(g) The Lender shall maintain accounts in which it shall record (i) the amount of each Loan made hereunder, the Class and Type thereof and the Interest Period applicable thereto, if any, (ii) the amount of any principal or interest due and payable or to become due and payable from the Borrower to each Lender hereunder and (iii) the amount of any sum received by the Lender hereunder.

(h) The entries made in the accounts maintained pursuant to paragraph (f) and (g) of this Section shall be prima facie evidence of the existence and amounts of the obligations recorded therein; provided that the failure of the Lender to maintain such accounts or any error therein shall not in any manner affect the obligation of the Borrower to repay the Loans in accordance with the terms of this Agreement.

(i) The Lender may request that Loans made by it be evidenced by a promissory note. In such event, the Borrower shall prepare, execute and deliver to the Lender a promissory note payable to the order of the Lender (or, if requested by the Lender, to the Lender and its registered assigns) and in a form approved by the Lender. Thereafter, the Loans evidenced by such promissory note and interest thereon shall at all times (including after assignment pursuant to Section 8.04) be represented by one or more promissory notes in such form payable to the order of the payee named therein (or, if such promissory note is a registered note, to such payee and its registered assigns).

1.8 Section 4.03 of the Credit Agreement is restated as follows:

Section 4.03. Term Loan C Funding. In addition to the satisfaction of all conditions in Section 4.01, the obligation of the Lender to make the Term C Loan shall not become effective until the date on which each of the following conditions are satisfied (or waived in accordance with Section 8.02;

(a) Environmental Reports. The Lender shall have received environmental review reports with respect to the owned real properties of the Borrower and its Subsidiaries specified by the Lender from firm(s) satisfactory to the Lender, which review reports shall be acceptable to the Lender. Any environmental hazards or liabilities identified in any such environmental review reports shall indicate the Loan Parties' plans with respect thereto.

(b) Mortgages, etc. The Lender shall have received, with respect to each owned parcel of real property which is required to be subject to a Lien in favor of the Lender, each of the following, in form and substance reasonably satisfactory to the Lender:

(i) Mortgage on such property;

(ii) evidence that a counterpart of the Mortgage has been recorded in the place necessary, in the Lender's judgment, to create a valid and enforceable first priority Lien in favor of the Lender, for the benefit of the Secured Parties;

(iii) ALTA or other mortgagee's title policy;

(iv) an ALTA survey prepared and certified to the Lender by a surveyor acceptable to the Lender;

(v) an opinion of counsel in the state in which such parcel of real property is located in form and substance and from counsel reasonably satisfactory to the Lender;

(vi) if any such parcel of real property is determined by the Lender to be in a flood zone, a flood notification form signed by the Borrower and evidence that flood insurance is in place for the building and contents, all in form and substance satisfactory to the Lender;

(vii) a current appraisal of the real property prepared by an appraiser reasonably acceptable to the Lender, and in form and substance satisfactory to the Lender;

(viii) an environmental assessment of the real property prepared by an environmental engineer reasonably acceptable to the Lender, and accompanied by such reports, certificates, studies or data as Lender may reasonably require, which shall all be in form and substance satisfactory to the Lender; and

(ix) such other information, documentation, and certifications as may be reasonably required by the Lender.

1.9 The following new Section 4.04 is added to the Credit Agreement:

Section 4.04. Each Credit Event. The obligation of the Lender to make any Loan on the occasion of any Borrowing, and to issue, amend, renew or extend any Letter of Credit, is also subject to the satisfaction of the following conditions:

(a) The representations and warranties of the Loan Parties set forth in the Loan Documents shall be true and correct in all material respects with the same effect as though made on and as of the date of such Borrowing or the date of issuance, amendment, renewal or extension of such Letter of Credit, as applicable (it being understood and agreed that any representation or warranty which by its terms is made as of a specified date shall be required to be true and correct in all material respects only as of such specified date, and that any representation or warranty which is subject to any materiality qualifier shall be required to be true and correct in all respects).

(b) At the time of and immediately after giving effect to such Borrowing or the issuance, amendment, renewal or extension of such Letter of Credit, as applicable, no Default shall have occurred and be continuing.

(c) After giving effect to any Borrowing or the issuance, amendment, renewal or extension of any Letter of Credit, Availability shall not be less than zero.

(d) No event shall have occurred and no condition shall exist which has or could be reasonably expected to have a Material Adverse Effect.

Each Borrowing and each issuance, amendment, renewal or extension of a Letter of Credit shall be deemed to constitute a representation and warranty by the Borrower on the date thereof as to the matters specified in paragraphs (a), (b), (c) and (d) of this Section.

**ARTICLE II**     **REPRESENTATIONS.** Each Loan Party represents and warrants to the Lender that:

2.1 The execution, delivery and performance of this Amendment are within its powers, have been duly authorized and are not in contravention with any law, or the terms of its articles of incorporation or organization (as applicable), by-laws or operating agreement (as applicable), or any undertaking to which it is a party or by which it is bound.

2.2 The Amendment is the valid and binding obligation of each Loan Party, enforceable against such Borrower in accordance with its terms.

2.3 After giving effect to the amendments and waivers herein contained, the representations and warranties contained in the Credit Agreement and the other Loan Documents are true on and as of the date hereof with the same force and effect as if made on and as of the date hereof and no Default has occurred and is continuing.

**ARTICLE III**     **CONDITIONS OF EFFECTIVENESS.** This Amendment shall be effective as of the date hereof when each of the following is satisfied:

3.1 Each Loan Party and the Lender shall have executed this Amendment.

3.2 Closing Certificates; Certified Certificate of Incorporation; Good Standing Certificates. The Lender shall have received (i) a certificate of FAAC, dated the Third Amendment Effective Date and executed by its Secretary or Assistant Secretary, which shall (A) certify the resolutions of its Board of Directors, members or other body authorizing the execution, delivery and performance of the Loan Documents to which it is a party, (B) identify by name and title and bear the signatures of the officers of such Loan Party authorized to sign the Loan Documents to which it is a party and, in the case of the Borrower, its Financial Officers, and (C) contain appropriate attachments, including the charter, articles or certificate of organization or incorporation of each Loan Party certified by the relevant authority of the jurisdiction of organization of such Loan Party and a true and correct copy of its bylaws or operating, management or partnership agreement, or other organizational or governing documents (or a certification that such attachments have not changed since March 11, 2016), and (ii) a good standing certificate for FAAC from its jurisdiction of organization (or a certification that FAAC has been in good standing since March 11, 2016).

3.3 Fees. The Lender shall have received all fees required to be paid, and all expenses required to be reimbursed for which invoices have been presented (including the reasonable fees and expenses of legal counsel), on or before the Third Amendment Effective Date. All such amounts will be paid with proceeds of Loans made on the Third Amendment Effective Date and will be reflected in the funding instructions given by the Borrower to the Lender on or before the Third Amendment Effective Date.

3.4 Lien Searches. The Lender shall have received the results of a recent lien search in the jurisdiction of organization of each Loan Party and each jurisdiction where assets of the Loan Parties are located, and such search shall reveal no Liens on any of the assets of the Loan Parties except for liens permitted by Section 6.02 of the Credit Agreement or discharged on or prior to the Third Amendment Effective Date pursuant to a pay-off letter or other documentation satisfactory to the Lender.

3.5 Insurance. The Lender shall have received evidence of insurance coverage in form, scope, and substance reasonably satisfactory to the Lender and otherwise in compliance with the terms of Section 5.10 of the Credit Agreement and the Collateral Documents.

3.6 Legal Due Diligence. The Lender and its counsel shall have completed all legal due diligence, the results of which shall be satisfactory to Lender in its sole discretion.

3.7 Other Documents. The Lender shall have received such other documents as the Lender or its counsel may have reasonably requested.

#### **ARTICLE IV MISCELLANEOUS**

4.1 References in the Loan Documents to the Credit Agreement shall be deemed to be references to the Credit Agreement as amended hereby and as further amended from time to time. This Amendment is a Loan Document. Terms used but not defined herein shall have the respective meanings ascribed thereto in the Credit Agreement. Without limiting the foregoing, each of the Loan Parties acknowledges and agrees that all references to Secured Obligations in any of the Collateral Documents shall be deemed references to Secured Obligations as such term is amended hereby and as further amended or modified from time to time in accordance with the Loan Documents.

4.2 Except as expressly amended hereby, each Loan Party agrees that the Loan Documents are ratified and confirmed and shall remain in full force and effect and that it has no set off, counterclaim, defense or other claim or dispute with respect to any of the foregoing.

4.3 This Amendment may be signed upon any number of counterparts with the same effect as if the signatures thereto and hereto were upon the same instrument and signatures sent by facsimile or other electronic imaging shall be enforceable as originals.

*[Remainder of Page Intentionally Left Blank – Signature Page Follows ]*

IN WITNESS WHEREOF, the parties have caused this Amendment to be executed and delivered as of the day and year first above written.

**AROTECH CORPORATION**

By: /s/ Thomas J. Paup \_\_\_\_\_

Name: Thomas J. Paup \_\_\_\_\_

Title: Sr VP Finance & CFO \_\_\_\_\_

**FAAC INCORPORATED**

By: /s/ Thomas J. Paup \_\_\_\_\_

Name: Thomas J. Paup \_\_\_\_\_

Title: Treasurer \_\_\_\_\_

**ELECTRIC FUEL BATTERY CORP.**

By: /s/ Thomas J. Paup \_\_\_\_\_

Name: Thomas J. Paup \_\_\_\_\_

Title: Treasurer \_\_\_\_\_

**UEC ELECTRONICS, LLC**

By: /s/ Thomas J. Paup \_\_\_\_\_

Name: Thomas J. Paup \_\_\_\_\_

Title: Treasurer \_\_\_\_\_

**JPMORGAN CHASE BANK, N.A.**

By: /s/ Michelle L. Montague \_\_\_\_\_

Name: Michelle L. Montague \_\_\_\_\_

Title: Vice President \_\_\_\_\_

Signature Page to Third Amendment to Credit Agreement

## FOURTH AMENDMENT TO CREDIT AGREEMENT

THIS FOURTH AMENDMENT TO CREDIT AGREEMENT, dated as of June 20, 2017 (this "Amendment"), is among **AROTECH CORPORATION** (collectively, the "Borrower"), the other Loan Parties party to the Credit Agreement described below and **JPMORGAN CHASE BANK, N.A.** (the "Lender").

## RECITAL

The Borrower, the other Loan Parties and the Lender are parties to a Credit Agreement dated as of March 11, 2016, as amended by a certain First Amendment to Credit Agreement dated as of, as further amended by a certain Second Amendment to Credit Agreement dated as of June 25, 2016, and as further amended by a certain Third Amendment to Credit Agreement dated as of June 1, 2017 (as may be further amended or modified from time to time, the "Credit Agreement"), and desire to amend the Credit Agreement on the terms and conditions of this Amendment.

## TERMS

In consideration of the premises and of the mutual agreements herein contained, the parties hereby agree as follows:

**ARTICLE I** **AMENDMENTS.** Upon fulfillment of the conditions set forth in Article III hereof, the Credit Agreement shall be amended as follows:

1.1 The following definition in Section 1.01 of the Credit Agreement is amended and restated as follows:

"Eligible Unbilled Accounts" means, at any time, those obligations owing to any Loan Party which would constitute an Eligible Account but for the fact that an invoice has not been sent by such Loan Party; provided that each of the following conditions is also satisfied for each such obligation: (a) such obligation is covered under a written work order or other agreement between such Loan Party and the Person owing such obligation, including price verification, which is binding and enforceable on such Person to pay such obligation if it was invoiced at such time, (b) such obligation has not been classified as an Eligible Unbilled Account for more than 60 days, and (c) such obligation is not excluded from Eligible Unbilled Accounts at any time by the Administrative Agent in its Permitted Discretion.

**ARTICLE II** **REPRESENTATIONS.** Each Loan Party represents and warrants to the Lender that:

2.1 The execution, delivery and performance of this Amendment are within its powers, have been duly authorized and are not in contravention with any law, or the terms of its articles of incorporation or organization (as applicable), by-laws or operating agreement (as applicable), or any undertaking to which it is a party or by which it is bound.

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2.2 The Amendment is the valid and binding obligation of each Loan Party, enforceable against such Borrower in accordance with its terms.

2.3 After giving effect to the amendments and waivers herein contained, the representations and warranties contained in the Credit Agreement and the other Loan Documents are true on and as of the date hereof with the same force and effect as if made on and as of the date hereof and no Default has occurred and is continuing.

**ARTICLE III CONDITIONS OF EFFECTIVENESS.** This Amendment shall be effective as of the date hereof when each of the following is satisfied:

3.1 Each Loan Party and the Lender shall have executed this Amendment.

**ARTICLE IV MISCELLANEOUS.**

4.1 References in the Loan Documents to the Credit Agreement shall be deemed to be references to the Credit Agreement as amended hereby and as further amended from time to time. This Amendment is a Loan Document. Terms used but not defined herein shall have the respective meanings ascribed thereto in the Credit Agreement. Without limiting the foregoing, each of the Loan Parties acknowledges and agrees that all references to Secured Obligations in any of the Collateral Documents shall be deemed references to Secured Obligations as such term is amended hereby and as further amended or modified from time to time in accordance with the Loan Documents.

4.2 Except as expressly amended hereby, each Loan Party agrees that the Loan Documents are ratified and confirmed and shall remain in full force and effect and that it has no set off, counterclaim, defense or other claim or dispute with respect to any of the foregoing.

4.3 This Amendment may be signed upon any number of counterparts with the same effect as if the signatures thereto and hereto were upon the same instrument and signatures sent by facsimile or other electronic imaging shall be enforceable as originals.

*[Remainder of Page Intentionally Left Blank – Signature Page Follows ]*

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IN WITNESS WHEREOF, the parties have caused this Amendment to be executed and delivered as of the day and year first above written.

**AROTECH CORPORATION**

By: /s/ Thomas J. Paup \_\_\_\_\_

Name: Thomas J. Paup \_\_\_\_\_

Title: Sr VP Finance & CFO \_\_\_\_\_

**FAAC INCORPORATED**

By: /s/ Thomas J. Paup \_\_\_\_\_

Name: Thomas J. Paup \_\_\_\_\_

Title: Treasurer \_\_\_\_\_

**ELECTRIC FUEL BATTERY CORP.**

By: /s/ Thomas J. Paup \_\_\_\_\_

Name: Thomas J. Paup \_\_\_\_\_

Title: Treasurer \_\_\_\_\_

**UEC ELECTRONICS, LLC**

By: /s/ Thomas J. Paup \_\_\_\_\_

Name: Thomas J. Paup \_\_\_\_\_

Title: Treasurer \_\_\_\_\_

**JPMORGAN CHASE BANK, N.A.**

By: /s/ Michelle L. Montague \_\_\_\_\_

Name: Michelle L. Montague \_\_\_\_\_

Title: Vice President \_\_\_\_\_



**Arotech Corporation**

**Jon B. Kutler**  
**Chairman of the Board**

1229 Oak Valley Drive  
Ann Arbor, Michigan 48108  
Tel: (734) 761-5836 Fax: (734) 761-5368  
<http://www.arotech.com>  
Nasdaq Global Market: ARTX

August 30, 2017

**VIA EMAIL**  
**krutty@arotechusa.com**

Mr. Dean Krutty  
8025 Trillium Lane  
Canton, Michigan 48187

Re: Employment Agreement dated March 16, 2017

Dear Dean:

In connection with your Employment Agreement with Arotech Corporation dated March 16, 2017 (the "Agreement"), we wish to amend the Agreement in certain respects. All capitalized terms used and not otherwise defined herein shall have the meanings ascribed to such terms in the Agreement.

1. Notwithstanding the terms of Section 5 of the Agreement, the time period for giving written notice of Non-Renewal shall be forty-five (45) days prior to the end of the Initial Term and not one hundred twenty (120) days prior thereto.

In all other respects, the terms of the Agreement will govern the relationship between us.

If the foregoing is acceptable to you, kindly sign this letter in the space provided for your signature below, whereupon this letter will become a binding amendment to the Agreement.

Sincerely yours,

**AROTECH CORPORATION**

By: /s/ Jon B. Kutler  
Jon B. Kutler  
Chairman of the Board

**ACCEPTED AND AGREED:**

/s/ Dean M. Krutty  
Dean M. Krutty

## PURCHASE AND SALE AGREEMENT

**THIS PURCHASE AND SALE AGREEMENT** (the “**Agreement**”) is made as of this 1<sup>st</sup> day of May, 2017 (the “**Effective Date**”) by and between **FAAC INCORPORATED**, a Michigan corporation (“**Purchaser**”) and **OAK VALLEY 1229, LLC**, a Michigan limited liability company (“**Seller**”).

## WITNESSETH:

WHEREAS, Seller is the owner of a parcel of land of approximately 2.46 acres improved with a certain one story building containing approximately 17,200 square feet of space commonly known as 1229 Oak Valley Drive, Ann Arbor, Washtenaw County, Michigan; and

WHEREAS, Purchaser desires to purchase the Property (as hereinafter defined) from Seller, upon the terms and conditions as set forth in this Agreement; and

WHEREAS, Seller desires to sell the Property to Purchaser, upon the terms and conditions as set forth in this Agreement.

NOW, THEREFORE, in consideration of TEN DOLLARS (\$10.00) and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, and the foregoing recitals, which are incorporated herein by this reference, Seller and Purchaser agree as follows:

**1 . Sale of Property.** Seller agrees to sell to Purchaser and Purchaser agrees to purchase from Seller, the Real Property, Personal Property, Permits, Warranties and Plans (as each such term is defined herein, collectively, the “**Property**”):

**1.1 Real Property.** The parcel of land and appurtenant easements or other rights more particularly described on Exhibit A attached hereto (collectively, the “**Land**”), including, without limitation, all easements necessary to provide pedestrian and vehicular access to publicly dedicated streets from each driveway on the Land, together with (i) all building structures, improvements and fixtures located on the Land, including, without limitation, all heating, lighting, plumbing, electrical and air-conditioning fixtures (collectively, the “**Improvements**”), and (ii) all easements, air, mineral and riparian rights, all development rights and all rights, privileges, servitudes and appurtenances thereunto belonging or appertaining, including all right, title and interest of Seller, if any, in and to the streets, alleys and rights-of-way adjacent to the Land and the Improvements (collectively, the “**Real Property**”).

**1.2 Personal Property.** Any fixtures, personalty, equipment, personal property, landscaping equipment and all heating, lighting, plumbing, electrical and air-conditioning fixtures and equipment, owned by Seller and situated in or about the Real Property and used in the operation of the Property (the “**Personal Property**”).

**1.3 Permits.** Any licenses, permits, certificates of occupancy and franchises for the Property (the “**Permits**”), to the extent such Permits are assignable.

**1 . 4 Warranties.** Seller's interests in all unexpired warranties and guaranties, if any, given to, assigned to or benefiting Seller or the Real Property or the Personal Property regarding the acquisition, construction, design, use, operation, management or maintenance of the Real Property or the Personal Property (the "**Warranties**").

**1.5 Plans.** All plans and specifications, if any, in Seller's possession or control, relating to the construction of the Improvements (the "**Plans**").

**2. Purchase Price.**

**2.1 Purchase Price.** Purchaser shall pay to Seller, as consideration for the purchase of the Property, the sum of TWO MILLION FIFTY THOUSAND AND NO/100THS DOLLARS (\$2,050,000.00) (the "**Purchase Price**"). The Purchase Price, plus or minus prorations and other adjustments as provided in this Agreement, if any, shall be due at Closing and shall be paid by wire transfer of immediately available funds paid to Seller on the Closing Date (as hereinafter defined).

**3. Earnest Money.** Within five (5) business days after the Effective Date, Purchaser is depositing with Seller, in escrow, the sum of Fifty Thousand and no/100 Dollars (\$50,000.00) (the "**Earnest Money**"), in good funds, either by certified bank or cashier's check or by federal wire transfer. Seller shall hold the Earnest Money in a non-interest-bearing account in accordance with the terms and conditions hereof. In the event that Purchaser does not terminate this Agreement under paragraph 4 hereof by May 15, 2017, except as otherwise provided in paragraph 11 below, TWENTY-FIVE THOUSAND DOLLARS (\$25,000.00) of the Earnest Money shall be non-refundable to Purchaser and shall be retained by Seller. In the event that this transaction fails to close for any reason, TWENTY-FIVE THOUSAND DOLLARS (\$25,000.00) of the Earnest Money shall be refunded to Purchaser.

**4. Investigation Period.**

**4 . 1 Investigation.** No later than five (5) days after the Effective Date, Seller shall deliver to Purchaser the following documents to the extent in the possession of Seller: (i) all plans and specifications for the Property, including, without limitation, the most recent ALTA survey of the Property or any other survey of the Property, if any; (ii) any previous title reports and legible copies of all exceptions thereto, if any; (iii) any environmental reports, soil test reports, soil boring reports of the Property, and, at Purchaser's option, Seller shall cooperate with Purchaser to have any such reports certified to Purchaser; (iv) any physical inspection reports of the Property, and, at Purchaser's option, Seller shall cooperate with Purchaser to have any such reports certified to Purchaser; (v) any letters or orders from the applicable municipality for the Property relating to violations at the Property; (viii) copies of any Warranties including, without limitation, any roof, construction and HVAC warranties; and (ix) copies of any Permits including, without limitation, all certificates of occupancy. In addition, Seller shall promptly deliver to Purchaser all other documents in Seller's possession reasonably requested by Purchaser. Purchaser shall have until May 15, 2017 (herein, the "**Investigation Period**") in which to undertake the following tests and studies which Purchaser, in its sole discretion, deems necessary to determine the feasibility of its acquisition: make soil, ground water, environmental and engineering tests, inspect and audit the Property and records of Seller with respect thereto for

such purposes as Purchaser may require in order for Purchaser to ascertain, in its reasonable discretion, that the environmental condition of the Real Property is satisfactory, that the soil condition of the Real Property is satisfactory, and that the Real Property is not located in a flood hazard or wetlands area as designated by any governmental authority. Seller shall cooperate with Purchaser in the performance of its due diligence. If during the Investigation Period Purchaser elects not to proceed with the transaction contemplated herein because it reasonably determined that the condition of the Real Property does not meet the requirements of this paragraph 4.1 or it is dissatisfied with the state of title to the Real Property or items shown on the Survey (as hereinafter defined), Purchaser may terminate this Agreement by notifying Seller in writing of such election and receive a refund of the Earnest Money. Purchaser shall notify Seller, on or before the expiration of the Investigation Period, whether it desires to proceed with this transaction. A failure to so notify Seller on or before the expiration of the Investigation Period shall be deemed as notice to Seller that Purchaser is satisfied with its investigation of the Real Property and that it waives this condition precedent to Closing.

**5. Title Requirements, Survey and Permitted Exceptions.**

**5.1 Title Evidence.** Within ten (10) days after the Effective Date, Purchaser shall cause Title Source, Inc., as agent for Fidelity National Title Insurance Company (the "**Title Company**"), having its office at 201 West Big Beaver Road, Suite 160, Troy, Michigan, 48084-4169, Attention: Robert Powell, telephone (313) 877-1776, to furnish to Purchaser an ALTA Form B owner's commitment for title insurance (the "**Title Commitment**") covering the Real Property (together with legible copies of the exception documents referenced therein) pursuant to which Title Commitment the Title Company shall agree to issue to Purchaser, upon the Closing of the purchase of the Property, an ALTA owner's title insurance policy for the Property in the amount of the Purchase Price, without exception for any matters except as described in this Article 5 (the "**Buyer's Title Policy**").

**5.2 Survey.** Within twenty (20) days after the Effective Date, Seller shall furnish to Purchaser a new survey or updated survey of the Real Property in accordance with current ALTA standards (the "**Survey**").

**5.3 Objections; Cure of Title and Survey Objections.** On or before ten (10) days after receipt of the Title Commitment and the Survey, Purchaser may make written objections ("**Objections**") to the form and/or contents of the Title Commitment or the Survey. Purchaser's failure to make objections within such time period shall constitute Purchaser's waiver of Objections. Any matter shown on the Title Commitment (except the lien documents securing any monetary liens) or on the Survey which is not objected to by Purchaser shall be a "**Permitted Exception**" hereunder. Seller will have ten (10) days after receipt of the Objections to attempt to cure the Objections. If Seller is unwilling or unable to cure the Objections within such ten (10) day period, Purchaser's may elect to do any of the following by delivering written notice thereof to Seller on or before the expiration of the Investigation Period:

(a) Terminate this Agreement, in which event neither party shall have any further rights or obligations hereunder except for those matters which specifically survive the expiration or termination of this Agreement; or

(b) Waive the Objections and proceed to close on the Property subject thereto. In the event that that an objection may be cured with the payment of money, Purchaser may elect to close and the amount necessary to cure the objection shall be paid from the proceeds payable to the Seller hereunder at Closing. If Purchaser does not timely make the required election in writing, then Purchaser shall be deemed to have made the election provided in clause (a) hereof.

In the event that after issuance of the Title Commitment a new exception is added to the Title Commitment, Purchaser shall again have the foregoing rights as to the new matter. Notwithstanding the foregoing, in no event shall Purchaser be required to object to any monetary liens of any kind or nature all of which Seller shall cause to be released at Closing.

**6. Conditions Precedent to Closing.** Closing on the purchase of the Property hereunder shall be and hereby is conditioned upon satisfaction of each of the following conditions (collectively, the “**Conditions Precedent**”):

6.1 Seller shall have performed all of the obligations required to be performed by Seller under this Agreement, as and when required by this Agreement, in all material respects;

6.2 The representations and warranties of Seller as set forth in this Agreement made by Seller shall be, in all material respects, true, correct and complete;

6.3 Seller shall have performed each and every agreement to be performed by Seller pursuant to this Agreement;

6.4 As of the Closing, the Title Company shall have issued or shall have committed to issue, upon the sole condition of the payment of its regularly scheduled premium, the Purchaser’s title insurance policy in the form required under this Agreement;

6.5 As of the Closing, there shall have occurred no casualty of a material nature to the Property (“material”, for this purpose being defined as costing in excess of \$100,000 to repair) or condemnation or threat of condemnation by any applicable governmental authority affecting all or any part of the Property; and

6.6 If the Property is subject to a declaration of covenants, conditions and restrictions, condominium declaration or similar instrument (“**CCRs**”) governing or affecting the use, operation, maintenance, management or improvement of the Property, at the Closing, or if one or more easements are required to provide access to a public way over the land of others (“**Easements**”), Seller shall deliver to Purchaser (i) estoppel certificates, in form and substance reasonably satisfactory to Purchaser, from the declarant, Association (as hereinafter defined), committee, agent or other person or entity having governing or approval rights under the CCRs and the party burdened by any Easement, and (ii) a recordable assignment, in form and substance satisfactory to Purchaser, assigning any and all developer, declarant or other related rights or interests of Seller (or any affiliate of Seller) in or under the CCRs, if Seller (or such affiliate) holds such rights or interests and an assignment of the Easement or including same in the legal description of the deed all of which shall include any required consents to this transaction.

If any of the Conditions Precedent listed above have not been satisfied on or before the Closing Date, this Agreement may be canceled by Purchaser, at Purchaser's option, by written notice from Purchaser to Seller given on or before the Closing Date and Purchaser shall receive a refund of the Earnest Money or Purchaser may extend the Closing Date for a reasonable period for Seller to attempt to satisfy the foregoing conditions precedent and, if Seller again fails to satisfy the foregoing conditions precedent during such extended period, Purchaser shall again have the rights under this sentence. Upon such cancellation, this Agreement shall terminate except for obligations which expressly survive the termination or cancellation of this Agreement, and Purchaser shall receive a refund of the Earnest Money and neither party shall have any obligations to the other thereafter. Purchaser shall have the right to unilaterally waive any Conditions Precedent by written notice to Seller.

At all times prior to Closing Seller shall:

- (a) Refrain from transferring any of the Property or creating on the Property any easements, liens, mortgages, encumbrances or other interests which would affect the Property or Seller's ability to comply with the terms of this Agreement;
- (b) Refrain from entering into any contracts or other commitments regarding the Property, other than in the ordinary and usual course of business, which may be cancelled at Closing without penalty, and which shall be cancelled by Seller at Closing, without the prior written consent of Purchaser;
- (c) Keep in effect Seller's existing policies of insurance insuring the Property;
- (d) Refrain from storing, treating, or disposing on the Property any Hazardous or Toxic Substance, as defined hereafter. The term "**Hazardous or Toxic Substances**," as used in this Agreement, means any substance the generation, storage, treatment disposal, or transportation of which is prohibited or regulated by any law or governmental regulation having as its object the protection of public health, natural resources, or the environment, including, by way of illustration only, the following: the Resource Conservation and Recovery Act; the Toxic Substances Control Act; the Clean Air Act; the Federal Water Pollution Control Act; the Comprehensive Environmental Response, Compensation, and Liability Act of 1980; the Clean Water Act and all applicable State of Michigan environmental acts (collectively, "**Environmental Laws**");
- (e) Promptly (within three (3) business days after receipt) furnish Purchaser with a copy of all notices of violation of laws or municipal ordinances, regulations, orders or requirements of departments of housing, building, fire, labor, health, or other state, city or municipal departments or other governmental authorities having jurisdiction against or affecting the Property or the use or operation thereof and a copy of all notices of claims or potential claims from any such governmental authority; and
- (f) From the Effective Date through the earlier of the termination of this Agreement or Closing, Seller will not negotiate with any third party, other than Purchaser, the sale or other disposition of the Property, or enter into any contract (whether binding or not) regarding the sale or other disposition of the Property.

7. Closing.

7 . 1 **Closing Date.** The consummation of the purchase of the Property contemplated by this Agreement (the “**Closing**”) shall take place at the offices of the Title Company on a date selected by Purchaser but not later than July 1, 2017 (the “**Closing Date**”) or at such other place and time as Purchaser and Seller may agree to in writing. The Closing may take place through an escrow with the Title Company.

7.2 **Seller’s Obligations at Closing.** On the Closing Date, Seller shall execute and/or deliver to Purchaser, through the Title Company as applicable, the following:

( a ) Deed. A Warranty Deed (the “**Deed**”) for the Property, substantially in the form attached hereto as Exhibit C, conveying the Real Property to Purchaser, subject only to the Permitted Exceptions.

( b ) Bill of Sale. A warranty Bill of Sale, substantially in the form attached hereto as Exhibit D, conveying the Personal Property, if any, to Purchaser in an “AS IS, WHERE IS” physical condition. Such Bill of Sale shall provide for a warranty of title and that the Personal Property is being conveyed lien free.

( c ) Assignment and Assumption of Permits, Plans and Warranties. A Blanket Transfer, Assignment and Assumption, substantially in the form attached hereto as Exhibit E (the “**Blanket Assignment**”), assigning Seller’s interest in the Permits, Plans and Warranties for the Property to Purchaser.

( d ) Original Documents. Original copies of the Permits, the Warranties, and the Plans for the Property to the extent they exist and are in Seller’s possession.

( e ) FIRPTA Affidavit. A non-foreign affidavit properly executed and containing such information as is required by IRC Section 1445(b)(2) and its regulations.

( f ) Owner’s Title Insurance Policy. An owner’s title insurance policy or “marked up” Title Commitment for the Real Property insuring fee simple title to each Real Property to Purchaser in a face amount equal to the Purchase Price and containing no exceptions other than the Permitted Exceptions and other exceptions, if any, to which Purchaser may consent.

( g ) Title Documents. Such affidavits of Seller or other documents as may be reasonably required by Title Company in order to record the closing documents and issue the Buyer’s Title Policy.

( h ) Closing Statement. A closing statement setting forth the Purchase Price, adjustments, prorations and closing costs as set forth herein.

( i ) Keys. Any keys, computer key cards or access codes or devices for entry upon the Property and all rooms contained therein.

( j ) Termination of Lease. A termination of the Lease (as hereinafter defined) (the “**Termination of Lease**”).

( k ) Additional Documents. Such other documents as may be required by the terms and conditions of this Agreement.

**7.3 Purchaser’s Obligations at Closing.** On the Closing Date, Purchaser shall execute and/or deliver to Seller, through the Title Company as applicable, the following with respect to the Property:

(a) Purchase Price. The Purchase Price payable at Closing by wire transfer on the Closing Date.

(b) Blanket Assignment. The Blanket Assignment.

(c) Termination of Lease. The Termination of Lease.

( d ) Title Documents. Such affidavits of Purchaser or other documents as may be reasonably required by Title Company in order to record the closing documents and issue the Buyer’s Title Policy.

(e) Closing Statement. A closing statement setting forth the Purchase Price, the adjustments, prorations and Closing costs as set forth herein.

(f) Additional Documents. Such other documents as may be required by this Agreement.

**7.4 Closing Costs.**

(a) Seller shall pay the following costs and expenses in connection with the Closing for the Property:

(i) One-half (½) of the fees of the Title Company for its escrow services;

(ii) Its costs of document preparation and its attorneys’ fees;

(iii) The title search fee and the premium payable for the owner’s coverage title insurance policy issued by the Title Company;

(iv) Transfer taxes and other taxes assessed by the State of Michigan or any county or municipality thereof due upon the sale of the Property or any portion thereof, including sales taxes, if any, due upon the sale of the Personal Property;

(v) The cost of the Survey; and

(vi) All costs customarily paid by sellers in connection with real estate transactions in Washtenaw County, Michigan.

(b) Purchaser shall pay all other costs, including, without limitation, the following costs, arising in connection with the Closing:

- (i) One-half (½) of the fees of Title Company for its escrow services;
- (ii) All recording fees for recording the deed;
- (iii) All due diligence or inspection costs incurred by Purchaser; and
- (iv) Its cost of document preparation and its attorneys' fees.

**7 . 5 Prorations.** The following items shall be prorated between Seller and Purchaser, as of 12:01 a.m. on the Closing Date (the "**Proration Date**"):

(a) Property Taxes. Since the Purchaser is the current tenant of the Property pursuant to a certain Lease Agreement (as amended, the "Lease") dated April 8, 1997 between AMR Holdings, L.L.C., predecessor in interest to Seller and Purchaser, as amended, there shall be no proration of city, state and county ad valorem taxes for the Property and Purchaser shall be responsible for all such taxes and assessments. If Seller has engaged or will engage prior to the Closing, consultants for the purpose of protesting the amount of taxes or the assessed valuation for certain tax periods for the Property ("**Protest Proceedings**"), any cash refunds or proceeds actually distributed (collectively, "**Cash Refunds**") will be paid to Purchaser (including interest thereon) on account of a favorable determination, after deduction of costs and expenses incurred for such Protest Proceedings. Seller and Purchaser agree to notify the other in writing of any receipt of a Cash Refund within fifteen (15) business days of receipt of such Cash Refund. To the extent either party obtains a Cash Refund, a portion of which is owed to the other party, the receiving party shall deliver the Cash Refund to the other party within fifteen (15) Business Days of its receipt. Seller agrees to execute such document or documents as may be necessary to substitute Purchaser as a party to any Protest Proceedings.

(b) Operating Expense and Utility Charges. Since Purchaser was responsible for all operating expenses of the Property under the Lease there shall be no proration of such items.

(c) Rent. Seller hereby agrees to waive and abate Basic Rent under the Lease from and after March 1, 2017 if this transaction closes. Purchaser shall receive a per diem credit at Closing in the amount of Two Hundred Sixty-two and 50/100 Dollars (\$262.50) (the "**Per Diem**") per day that the Closing occurs prior to July 1, 2017. In the event that the Closing occurs after July 1, 2017 Seller shall receive a credit in the amount of the Per Diem for each day after July 1, 2017, that the Closing occurs. If this Agreement terminates for any reason, all unpaid Basic Rent accrued from March 1, 2017 shall be immediately paid to Seller.

( d ) Association Dues. The annual dues of the Association, as such term is defined below, for the current year, shall be prorated as of the Closing Date.

**8. Damage.** If, prior to the Closing Date, a material portion of the Property is damaged by fire casualty, the elements or any other cause (“material”, for this purpose being defined as damage to the Property in excess of \$100,000.00), Seller shall immediately give notice to Purchaser of such fact and at Purchaser’s option (to be exercised within fifteen (15) days after Seller’s notice) Purchaser may either: elect to proceed with the Closing or terminate this Agreement and receive a refund of its Earnest Money, in which event neither party will have any further obligations under this Agreement, except for those obligations which expressly survive the termination hereof. If Purchaser fails to elect to terminate despite such damage, there shall be no reduction in the Purchase Price, and Seller shall assign to Purchaser at the Closing all of Seller’s right, title and interest to receive the proceeds of all insurance related to such damage, and further, Seller shall pay to Purchaser the amount of any “deductible” which is not funded by the insurance proceeds.

**9. Condemnation.** If, prior to the Closing Date, eminent domain proceedings are commenced against all or any part of the Property, Seller shall immediately give notice to Purchaser of such fact and at Purchaser’s option (to be exercised within fifteen (15) days after Seller’s notice), this Agreement as to the Property shall terminate and receive a refund of its Earnest Money, in which event neither party will have further obligations under this Agreement, except for those obligations which expressly survive the termination of this Agreement. If Purchaser shall fail to give such notice then there shall be no reduction in the Purchase Price, and Seller shall assign to Purchaser at the Closing Date all of Seller’s right, title and interest in and to any award made or to be made in the condemnation proceedings. Prior to the Closing Date, Seller shall not designate counsel, appear in, or otherwise act with respect to the condemnation proceedings without Purchaser’s prior written consent, which shall not be unreasonably withheld, conditioned or delayed.

**10. Representations and Warranties.**

**10.1 Representations and Warranties of Seller.** Seller hereby represents and warrants to Purchaser that the following are true and correct as of the date of this Agreement and shall be true and correct as of the Closing Date:

( a ) Seller is a Michigan limited liability company duly formed and in good standing under the laws of the State of Michigan and authorized to do business in the State of Michigan and is authorized to consummate the transactions contemplated by this Agreement.

( b ) The execution of this Agreement and all documents and instruments executed pursuant to this Agreement by Seller, the delivery thereof to Purchaser, Seller’s performance hereof and the transactions contemplated hereby have been duly authorized by all requisite action on the part of Seller and do not conflict with or result in a violation of Seller’s Articles of Organization or Operating Agreement or any agreement, contract, judgment, order or decree of any court or proceeding to which Seller is a party or by which Seller is bound and all such documents are valid and binding obligations of Seller and are enforceable in accordance with their terms.

(c) Seller holds fee title to the Real Property, to its knowledge, subject only to the Permitted Exceptions and those building and use restrictions, easements and zoning ordinances, if any, of record.

( d ) Seller is not a “foreign person”, “foreign partnership”, “foreign trust” or “foreign estate” as those terms are defined in Section 1445 of the Internal Revenue Code.

( e ) There is no action, litigation, investigation, condemnation or proceeding of any kind, pending or, to Seller’s knowledge, threatened against any portion of the Property or against Seller which would prevent or prohibit this transaction or which would have a material adverse effect upon any portion of the Property or which would result in the imposition of any lien or charge upon the Property. Seller has not received any notice of any existing or threatened condemnation or other legal action of any kind involving the Property or its operation.

( f ) There are no leases effecting the Property or any other agreement giving possession of all or any part of the Property to a third party except for the Lease. No party has an option to purchase the Property or any part thereof or any right of first refusal to purchase or lease all or any part of the Property.

( g ) There are, to Seller’s knowledge, no existing violations of any laws, zoning ordinances, regulations, orders or requirements of departments of housing, building, fire, labor, health, or other municipal departments or other governmental authorities having jurisdiction against or affecting the Property.

( h ) To Seller’s knowledge, no Hazardous or Toxic Substances have been released into or deposited upon or below the surface of the Property or into any water systems on or below the surface of the Property or stored or used on or in the Property or any property adjacent to the Property or in the vicinity of the Property by the Seller which could impact the Property.

( i ) Seller is not subject to any state or federal tax liens of any kind or nature or any commitment, obligation, or agreement in favor of a third party, including, but not limited to, any right of first refusal, redemption rights, option to purchase, management or leasing agreements.

( j ) There is, to Seller’s knowledge, no assessment presently outstanding or unpaid for local improvements or otherwise which has or may become a lien against the Property. Further, Seller knows of no public improvements which have been ordered to be made and/or which have not heretofore been completed, assessed and paid for. Seller has received no written notice of any zoning proceedings concerning the Property, nor has Seller received written notice from any governmental agency or authority or other party concerning any prospective zoning proceeding which may affect the Property.

( k ) Seller has not received any notice from, nor filed any notice or application with, any governmental authority concerning any Hazardous or Toxic Substance.

( l ) Seller has not contracted for any services or employment and has made no commitments or obligations which will affect the Purchaser.

( m ) Seller is a member of a condominium association (“**Association**”) due to its ownership of the Property. All Association fees and expenses due from the Property or the owner thereof have been paid in full and the annual amount due is approximately \$600.00. To Seller’s knowledge, there are no special assessments contemplated by the Association.

( n ) The documents and materials delivered to Purchaser pursuant to this Agreement are true, correct and complete in all material respects and constitute all such documents and materials.

( o ) There are, to Seller’s knowledge, no attachments, executions or assignment for the benefit of creditors or voluntary proceedings in bankruptcy or under any other debtor relief laws contemplated by or pending or threatened by or against Seller and there is no pending or threatened action, suit, arbitration, claim or proceeding against Seller or any of its principals that could adversely affect its ability to perform its obligations under this Agreement and consummate the sale of the Property pursuant hereto.

( p ) Seller and each person or entity owning an interest in Seller is (i) not currently identified on the Specially Designated Nationals and Blocked Persons List maintained by the Office of Foreign Assets Control, Department of the Treasury (“**OFAC**”) and/or on any other similar list maintained by OFAC pursuant to any authorizing statute, executive order or regulation (collectively, the “**List**”), and (ii) not a person or entity with whom a citizen of the United States is prohibited to engage in transactions by any trade embargo, economic sanction, or other prohibition of United States law, regulation, or Executive Order of the President of the United States, and (iii) not an Embargoed Person (as hereinafter defined), (b) none of the funds or other assets of Seller constitute property of, or are beneficially owned, directly or indirectly, by any Embargoed Person, and (c) no Embargoed Person has any interest of any nature whatsoever in Seller (whether directly or indirectly). The term “**Embargoed Person**” means any person, entity or government subject to trade restrictions under U.S. law, including but not limited to, the International Emergency Economic Powers Act, 50 U.S.C. §1701 et seq., the Trading with the Enemy Act, 50 U.S.C. App. 1 et seq., and any Executive Orders or regulations promulgated thereunder.

Seller’s representations and warranties as contained herein shall not merge with the Deed and shall survive Closing.

**10.2 Representations and Warranties of Purchaser.** Purchaser hereby represents and warrants to Seller that the following are true and correct as of the date of this Agreement and shall be true and correct as of the Closing Date:

( a ) Purchaser is a corporation duly formed and in good standing and is authorized to consummate the transactions contemplated by this Agreement and this transaction.

( b ) The execution of this Agreement and all documents and instruments executed pursuant to this Agreement by Purchaser, the delivery thereof to Seller, Purchaser’s performance hereof and the transactions contemplated hereby have been duly authorized by all

requisite corporate action on the part of Purchaser and do not conflict with or result in a violation of Purchaser's organizational documents or any judgment, order or decree of any court or proceeding to which Purchaser is a party and all such documents are valid and binding obligations of Purchaser and are enforceable in accordance with their terms.

(c) Purchaser represents and acknowledges that it and/or its affiliate has been in possession of the Real Property under the Lease. It understands and acknowledges that, except as provided herein, Seller is making no warranties or representations with respect to the physical condition of the Real Property and the Purchaser will be taking the Real Property at Closing in its "AS IS, WHERE IS" condition.

## **11. Default.**

**11.1 Default by Seller.** If within ten (10) business days after notice, Seller fails to perform any of its covenants under this Agreement, or if Seller otherwise defaults hereunder, Purchaser shall have, as its sole and exclusive remedy either: (i) the right of specific performance of all provisions of this Agreement against Seller, or (ii) Purchaser, at its option, may elect to terminate this Agreement and receive a refund of the Earnest Money, as its sole and exclusive remedy.

**11.2 Default by Purchaser.** If within ten (10) business days after notice, Purchaser fails to close the transaction described herein at the time required herein, Seller may retain Twenty-five Thousand Dollars (\$25,000.00) as liquidated damages. Seller hereby acknowledges and agrees that the foregoing shall constitute Seller's sole and exclusive remedy hereunder. Seller agrees to accept such sum as its total damages and relief hereunder in such event.

## **12. Broker.**

**12.1 Broker.** If, and only if, and only in the event that the transaction contemplated by this Agreement closes, a brokerage fee shall be payable by Purchaser to Mohr Partners ("**Broker**") pursuant to a separate agreement. Seller and Purchaser warrant each to the other that, except for the Broker, they have not dealt with any real estate broker or sales-person with regard to this transaction. Purchaser agrees to indemnify and hold harmless Seller from any and all commissions claimed by the Broker or any other broker or third party arising by virtue of this transaction whose commissions might legally arise from acts of Purchaser. Seller agrees to indemnify and hold harmless Purchaser from any and all commissions claimed by any broker (other than the Broker) or third party arising by virtue of this transaction whose commissions might legally arise from acts of Seller. The obligations of indemnity of Purchaser and Seller as contained in this Section 12.1 shall survive the Closing.

## **13. Miscellaneous.**

**13.1 Assignment.** Purchaser may not assign its rights under this Agreement without the prior written consent of Seller not to be unreasonably withheld, conditioned or delayed; provided, however, Purchaser may, without the prior consent of Seller, assign its rights under this Agreement to any trust, corporation, partnership or limited liability company affiliated with, controlling, controlled by or under common control with Purchaser. Any assignment shall

be subject to all the provisions, terms, covenants and conditions of this Agreement, and upon assignment, the assignor shall, be released from all of its obligations under this Agreement.

**13.2 Notices.** All notices which are required or permitted hereunder must be in writing and shall be deemed to have been given, delivered or made, as the case may be, (notwithstanding lack of actual receipt by the addressee) (i) when delivered by personal delivery, (ii) three (3) business days after having been deposited in the United States mail, certified or registered, return receipt requested, sufficient postage affixed and prepaid, (iii) one (1) business day after having been deposited with an expedited, overnight courier service (such as by way of example but not limitation, U.S. Express Mail, Federal Express or UPS), or (iv) when delivered by facsimile, which facsimile is followed by delivery by an expedited, overnight courier service, addressed to the party to whom notice is intended to be given at the address set forth below:

Purchaser:	FAAC Incorporated 1229 Oak Valley Drive Ann Arbor, Michigan 48108 Attention: Mr. Thomas Paup Telephone No. (734) 761-5836
With a copy to:	FAAC Incorporated 1229 Oak Valley Drive Ann Arbor, Michigan 48108 Attention: General Counsel Telephone No. (734) 761- ____
And a copy to:	Honigman Miller Schwartz and Cohn LLP 39400 Woodward Avenue Suite 101 Bloomfield Hills, MI 48304-5151 Attn: Howard Goldman, Esq. Telephone Number: (248) 566-8462
Seller:	Oak Valley 1229, LLC c/o AMR Development, LLC 1182 Oak Valley Drive Ann Arbor, Michigan 48108 Attention: Albert Rodriguez Telephone No. (734) ____ - ____ 3777
With copies to:	Robert A. Peurach 41740 Six Mile Rd., Ste. 101 Northville, MI 48168 Telephone No. (248) 349-0500

Any party may change the address to which its notices are sent by giving the other party written notice of any such change in the manner provided in this Section, but notice of change of address is effective only upon receipt.

**13.3 Entire Agreement.** This Agreement embodies and constitutes the entire understanding among the parties with respect to the transaction contemplated herein, and all prior or contemporaneous agreements, understandings, representations and statements, oral or written, are merged into this Agreement. Neither this Agreement nor any provision hereof may be waived, modified, amended, discharged or terminated except by an instrument in writing signed by the party against which the enforcement of such waiver, modification, amendment, discharge or termination is sought, and then only to the extent set forth in such instrument. The terms hereof shall survive the Closing and shall not merge with the Deed.

**13.4 Applicable Law.** This Agreement shall be governed by and construed in accordance with the laws of the State of Michigan.

**13.5 Headings.** Descriptive headings are for convenience only and shall not control or affect the meaning or construction of any provision of this Agreement.

**13.6 Binding Effect.** Subject to the provisions of Section 13.1, this Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their heirs, personal representatives, successors and assigns.

**13.7 Counterparts.** This Agreement may be executed in any number of counterparts, each of which shall be deemed to be an original instrument, but all such counterparts together shall constitute one and the same instrument.

**13.8 Interpretation.** Whenever the context hereof shall so require, the singular shall include the plural, the male gender shall include the female gender and neuter and vice versa. This Agreement and any related instruments shall not be construed more strictly against one party than against the other by virtue of the fact that initial drafts were made and prepared by counsel for one of the parties, it being recognized that this Agreement and any related instruments are the product of extensive negotiations between the parties hereto and that both parties hereto have contributed substantially and materially to the final preparation of this Agreement and all related instruments.

**13.9 Severability.** In case any one or more of the provisions contained in the Agreement shall for any reason be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provision hereof, and this Agreement shall be construed as if such invalid, illegal or unenforceable provision had never been contained herein.

**13.10 Authority of Parties.** Seller and Purchaser represent to each other that each has full power and authority to enter into and perform this Agreement, all related instruments and the documentation contemplated hereby and thereby in accordance with their respective terms and that the delivery and performance of this Agreement, all related instruments and the documentation contemplated hereby and thereby has been duly authorized by all necessary action.

**13.11 No Waiver.** Neither the failure of either party to exercise any power given such party hereunder or to insist upon strict compliance by the other party with its obligations hereunder, nor any custom or practice of the parties at variance with the terms hereof shall constitute a waiver of either party's right to demand exact compliance with the terms hereof.

**ARTICLE FOURTEEN**

**NO ASSUMPTION OF LIABILITIES**

The parties acknowledge that this transaction contemplates only the sale and purchase of the Property and that Seller is not selling a business nor do the parties intend that Purchaser be deemed a successor of Seller with respect to any liabilities of Seller to any third party. Except as otherwise provided in this Agreement, Purchaser shall neither assume nor be liable for any of the debts, liabilities, taxes or obligations of, or claims against, Seller, or of any other person or entity, of any kind or nature, whether existing now, on the Closing Date or at any time thereafter. All of such debts, liabilities, taxes, obligations and claims shall be solely those of Seller, and Seller hereby represents, warrants, covenants and agrees to defend, indemnify and hold harmless Purchaser from any liability with respect thereto.

**[REMAINDER OF THIS PAGE INTENTIONALLY LEFT BLANK]**

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year set forth below their respective signatures.

**PURCHASER:**

**FAAC INCORPORATED**, a Michigan corporation

By: /s/ Thomas J. Paup  
Name: Thomas J. Paup  
Title: Sr. VP Finance, CFO, & Treasurer  
FAAC, Inc.

**SELLER:**

**OAK VALLEY 1229, LLC**, a Michigan limited liability company

By: /s/ Albert Rodriguez  
Name: Albert Rodriguez  
Title: Manager

**Exhibit 21.1****Subsidiaries of the Registrant**

<b><u>Name of Subsidiary</u></b>	<b><u>Jurisdiction</u></b>	<b><u>Owned By</u></b>	<b><u>Percentage Ownership</u></b>
Epsilon-Electric Fuel Ltd.	Israel	Arotech Corporation	100.0%
Arodelek Ltd.	Israel	Epsilon-Electric Fuel Ltd.	100.0%
Electric Fuel Battery Corporation	Delaware	Arotech Corporation	100.0%
FAAC Incorporated	Michigan	Arotech Corporation	100.0%
UEC Electronics, LLC	South Carolina	Electric Fuel Battery Corporation	100.0%

**Consent of Independent Registered Public Accounting Firm**

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

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (Nos. 333-195141, 333-190808 and 333-153487) and Form S-8 (Nos. 333-222465, 333-160717, 333-146752, 333-124960, 333-86728, and 333-59902) of Arotech Corporation of our reports dated March 15, 2018, relating to the consolidated financial statements and the effectiveness of Arotech Corporation's internal control over financial reporting, which appear in this Form 10-K.

/s/ BDO USA, LLP

Grand Rapids, Michigan  
March 15, 2018

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

I, Dean M. Krutty, certify that:

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

Date: March 15, 2018

/s/ Dean M. Krutty  
Dean M. Krutty, President and Chief Executive Officer  
(Principal Executive Officer)

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

I, Thomas J. Paup, certify that:

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

Date: March 15, 2018

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

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

In connection with the Annual Report of Arotech Corporation (the "Company") on Form 10-K for the year ended December 31, 2017, as filed with the Securities and Exchange Commission (the "Report"), I, Dean M. Krutty, President and Chief Executive Officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that, to the best of my knowledge, the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Dean M. Krutty  
Dean M. Krutty  
President and Chief Executive Officer  
(Chief Executive Officer)

Date: March 15, 2018

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

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

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

In connection with the Annual Report of Arotech Corporation (the “Company”) on Form 10-K for the year ended December 31, 2017, as filed with the Securities and Exchange Commission (the “Report”), I, Thomas J. Paup, Senior Vice President – Finance and Chief Financial Officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that, to the best of my knowledge, the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

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

Date: March 15, 2018

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

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