

AROTECH CORP
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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q/A

**x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED March 31, 2006.**

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)

354 Industry Drive, Auburn, Alabama 36830

(Former address, if changed since last report)

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

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

Large accelerated filer: Accelerated filer: Non-accelerated filer:

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of shares outstanding of the issuer's common stock as of July 24, 2006 was 8,468,957.

SEC 1296 (12-05)

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.

PRELIMINARY NOTE

Arotech Corporation is filing this Amendment No. 1 to its Quarterly Report on Form 10-Q for the period ended March 31, 2006, as filed with the Securities and Exchange Commission on May 15, 2006.

This document does not contain any changes from the versions of such document most recently filed with the Securities and Exchange Commission, except that the financial information contained in “Part I - Financial Information, Item 1. Financial Statements” has been restated to give effect to a one-for-fourteen reverse stock split effected on June 21, 2006. Except in respect of the reverse stock split, the restated financial information does not reflect the restatement of any previously reported financial statements, results of operations or any other related financial disclosures.

Additionally, as required by SEC regulations, we are replacing the Section 302 and Section 906 certifications from the Chairman and Chief Executive Officer and the Vice President - Finance and Chief Financial Officer.

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ITEM 1. INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**CONSOLIDATED BALANCE SHEETS**
(U.S. Dollars)

ASSETS	March 31, 2006 (Unaudited)	December 31, 2005
CURRENT ASSETS:		
Cash and cash equivalents	\$ 5,311,913	\$ 6,150,652
Restricted collateral deposits	6,809,420	3,897,113
Available-for-sale marketable securities	35,899	35,984
Trade receivables (net of allowance for doubtful accounts in the amount of \$158,142 and \$176,180 as of March 31, 2006 and December 31, 2005, respectively)	7,757,463	11,747,876
Unbilled receivables	5,316,019	5,228,504
Other accounts receivable and prepaid expenses	1,949,638	2,114,331
Inventories	7,580,417	7,815,806
Total current assets	34,760,769	36,990,266
SEVERANCE PAY FUND	2,134,487	2,072,034
RESTRICTED DEPOSITS	525,245	779,286
PROPERTY AND EQUIPMENT, NET	3,990,190	4,252,931
INVESTMENT IN AFFILIATED COMPANY	75,972	37,500
OTHER INTANGIBLE ASSETS, NET	10,641,740	11,027,499
GOODWILL	29,481,061	29,559,157
	\$ 81,609,464	\$ 84,718,673

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

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

	March 31, 2006 (Unaudited)	December 31, 2005
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade payables	\$ 2,917,518	\$ 5,830,820
Other accounts payable and accrued expenses	4,905,004	5,586,061
Current portion of promissory notes due to purchase of subsidiaries	453,764	453,764
Short-term bank loans and current portion of long-term loans	1,892,771	2,036,977
Deferred revenues	1,122,440	603,022
Convertible debenture	9,512,011	11,492,238
Liability in connection with warrants issuance	784,266	44,047
Liabilities of discontinued operation	—	120,000
Total current liabilities	21,587,774	26,166,929
LONG TERM LIABILITIES		
Accrued severance pay	3,860,040	3,657,328
Convertible debenture	8,590,454	8,590,233
Total long-term liabilities	12,450,494	12,247,561
MINORITY INTEREST	16,754	38,927
SHAREHOLDERS' EQUITY:		
Share capital -		
Common stock - \$0.01 par value each;		
Authorized: 250,000,000 shares as of March 31, 2006 and December 31, 2005; Issued: 7,307,566 shares as of March 31, 2006 and 6,221,193 shares as of December 31, 2005; Outstanding - 7,267,900 shares as of March 31, 2006 and 6,181,527 shares as of December 31, 2005		
	1,023,062	870,969
Preferred shares - \$0.01 par value each;		
Authorized: 1,000,000 shares as of March 31, 2006 and December 31, 2005; No shares issued and outstanding as of March 31, 2006 and December 31, 2005		
	—	—
Additional paid-in capital	199,618,737	193,560,579
Accumulated deficit	(147,210,412)	(142,996,964)
Treasury stock, at cost (common stock - 39,666 shares as of March 31, 2006 and December 31, 2005)	(3,537,106)	(3,537,106)
Notes receivable from stockholders	(1,845,047)	(1,256,777)
Accumulated other comprehensive loss	(494,792)	(375,445)
Total shareholders' equity	47,554,442	46,265,256
	\$ 81,609,464	\$ 84,718,673

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

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

	Three months ended March 31,	
	2006	2005
Revenues	\$ 8,896,412	\$ 10,387,445
Cost of revenues	6,652,752	6,371,874
Gross profit	2,243,660	4,015,571
Operating expenses:		
Research and development	304,612	414,678
Selling and marketing	899,268	1,158,820
General and administrative	3,102,536	3,356,412
Amortization of intangible assets	510,692	823,088
Impairment of intangible assets	204,059	—
Total operating costs and expenses	5,021,167	5,752,998
Operating loss	(2,777,507)	(1,737,427)
Other income	17,506	—
Financial expenses, net	(1,461,136)	(468,855)
Loss before minority interest in loss (earnings) of subsidiaries, earnings from affiliated company and tax expenses	(4,221,137)	(2,206,282)
Income taxes	(39,972)	(217,264)
Earnings from affiliated company	38,472	—
Minority interest in loss (earnings) of subsidiaries	9,189	(32,954)
Net loss	\$ (4,213,448)	\$ (2,456,500)
Deemed dividend to certain stockholders	\$ (317,207)	\$ —
Net loss attributable to common stockholders	\$ (4,530,655)	\$ (2,456,500)
Basic and diluted net loss per share from continuing operations	\$ (0.70)	\$ (0.43)
Basic and diluted net loss per share	\$ (0.70)	\$ (0.43)
Weighted average number of shares used in computing basic net loss per share	6,480,162	5,721,578

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

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(U.S. Dollars, except share data)

	Common Stock		Additional paid-in capital	Accumulated deficit	Treasury stock	Notes receivable from shareholders	Accumulated other comprehensive income (loss)	Total comprehensive loss
	Shares	Amount						
BALANCE AT JANUARY 1, 2006 - NOTE 1	6,221,193	\$ 870,969	\$ 193,560,579	\$ (142,996,964)	\$ (3,537,106)	\$ (1,256,777)	\$ (375,445)	\$ -
CHANGES DURING THE THREE-MONTH PERIOD ENDED MARCH 31, 2006								
Principal installment of convertible debenture payment in shares	444,005	62,161	2,908,414	-	-	-	-	-
Warrants exercise, net	642,368	89,932	2,907,585	-	-	(577,051)	-	-
Amortization of deferred stock compensation	-	-	230,940	-	-	-	-	-
Interest accrued on notes receivable from shareholders	-	-	11,219	-	-	(11,219)	-	-
Other comprehensive loss – foreign currency translation adjustment	-	-	-	-	-	-	(119,740)	(119,740)
Other comprehensive loss – unrealized gain on available for	-	-	-	-	-	-	393	393

sale marketable
securities

Net loss	-	-	-	(4,213,448)	-	-	-	(4,213,448)
Total comprehensive loss	-	-	-	-	-	-	-	-\$ (4,332,795)
BALANCE AT MARCH 31, 2006-								
UNAUDITED	7,307,566	\$ 1,023,062	\$ 199,618,737	\$ (147,210,412)	\$ (3,537,106)	\$ (1,845,047)	\$ (494,792)	\$ -

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

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

	Three months ended March 31,	
	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss for the period before deemed dividend to certain stockholders of common stock	\$ (4,213,448)	\$ (2,456,500)
Adjustments required to reconcile net loss to net cash used in operating activities:		
Depreciation	380,078	298,110
Amortization of intangible assets, capitalized software costs and impairment of intangible assets	745,528	853,798
Amortization of compensation related to warrants issued to the holders of convertible debentures and beneficial conversion feature	483,609	392,543
Financial expenses in connection with convertible debenture principal repayment	506,960	–
Amortization of deferred expenses related to convertible debenture issuance	242,846	12,128
Remeasurement of liability in connection with warrants granted	(35,270)	–
Stock-based compensation due to shares granted and to be granted to consultants and shares granted as a donation	–	58,560
Stock based compensation due to options and shares granted to employees	230,941	232,739
Adjustment of stock based compensation related to non-recourse note granted to stockholder	–	(11,500)
Earnings (loss) to minority	(9,189)	32,954
Share in earnings of affiliated company	(38,472)	–
Interest expenses accrued on promissory notes issued to purchase of subsidiary	–	2,442
Interest accrued on certificates of deposit due within one year	–	(58,188)
Amortization of premium related to restricted securities	–	38,794
Liability for employee rights upon retirement, net	115,997	57,666
Write-off of inventory	70,577	–
Decrease in deferred tax assets	7,564	72,624
Changes in operating asset and liability items:		
Decrease in trade receivables and notes receivable	3,967,096	1,822,948
Increase in unbilled receivables	(87,515)	(349,083)
Increase in other accounts receivable and prepaid expenses	(91,927)	(194,297)
Decrease (increase) in inventories	146,995	(1,447,620)
Decrease in trade payables	(2,893,400)	(2,130,990)
Increase in deferred revenues	519,418	75,700
Decrease in accounts payable and accruals	(639,714)	(754,834)
<i>Net cash used in operating activities from continuing operations</i>	(591,326)	(3,452,006)
<i>Net cash used in operating activities from discontinuing operations</i>	(120,000)	–
<i>Net cash used in operating activities</i>	(711,326)	(3,452,006)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Repayment of promissory note related to purchase of subsidiary	–	(75,000)
Purchase of property and equipment	(128,132)	(342,248)
Increase in capitalized research and development projects	(202,607)	(37,293)
Increase in restricted securities and deposits, net	(2,864,139)	(50,141)

<i>Net cash used in investing activities</i>	(3,194,878)	(504,682)
FORWARD	\$ (3,906,204)	\$ (3,956,688)

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

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

	Three months ended March 31,	
	2006	2005
FORWARD	\$ (3,906,204)	\$ (3,956,688)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Decrease in short-term credit from banks	(133,747)	(99,156)
Proceeds from exercise of options	–	15,000
Proceeds from exercise of warrants	3,195,772	–
Repayment of long-term loans	(9,906)	(22,226)
<i>Net cash provided by (used in) financing activities</i>	3,052,119	(106,382)
DECREASE IN CASH AND CASH EQUIVALENTS	(854,085)	(4,063,070)
CASH EROSION DUE TO EXCHANGE RATE DIFFERENCES	15,347	698
BALANCE OF CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	6,150,651	6,734,512
BALANCE OF CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	\$ 5,311,913	\$ 2,672,140
SUPPLEMENTARY INFORMATION ON NON-CASH TRANSACTIONS:		
Payment of principal installment of convertible debenture in shares	\$ 2,463,615	\$ –
Warrants exercise against note receivable from shareholder	\$ 577,051	\$ –
Liability in connection with warrants issuance	\$ 775,305	\$ –

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

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1: BASIS OF PRESENTATION

a. Company:

Arotech Corporation (“Arotech” or the “Company”), and its subsidiaries provide defense and security products for the military, law enforcement and homeland security markets, including advanced zinc-air and lithium batteries and chargers, multimedia interactive simulators/trainers and lightweight vehicle armoring. The Company is primarily operating through IES Interactive Training, Inc. (“IES”), a wholly-owned subsidiary based in Littleton, Colorado; FAAC Corporation, a wholly-owned subsidiary based in Ann Arbor, Michigan, and FAAC’s 80%-owned United Kingdom subsidiary FAAC Limited; Electric Fuel Battery Corporation, a wholly-owned subsidiary based in Auburn, Alabama; Electric Fuel Ltd. (“EFL”) a wholly-owned subsidiary based in Beit Shemesh, Israel; Epsilon Electronic Industries, Ltd., a wholly-owned subsidiary located in Dimona, Israel; MDT Protective Industries, Ltd. (“MDT”), a majority-owned subsidiary based in Lod, Israel; MDT Armor Corporation, a majority-owned subsidiary based in Auburn, Alabama; and Armour of America, Incorporated, a wholly-owned subsidiary based in Los Angeles, California.

b. Basis of presentation:

The accompanying interim consolidated financial statements have been prepared by Arotech Corporation in accordance with generally accepted accounting principles for interim financial information, with the instructions to Form 10-Q and with Article 10 of Regulation S-X, and include the accounts of Arotech Corporation and its subsidiaries. Certain information and footnote disclosures, normally included in complete financial statements prepared in accordance with generally accepted accounting principles, have been condensed or omitted. In the opinion of the Company, the unaudited financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of its financial position at March 31, 2006, its operating results for the three-month periods ended March 31, 2006 and 2005 and its cash flow for the three month periods ended March 31, 2006 and 2005.

The results of operations for the three months ended March 31, 2006 are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year ending December 31, 2006.

The balance sheet at December 31, 2005 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. These consolidated financial statements should be read in conjunction with the audited financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2005.

c. Accounting for stock-based compensation:

In December 2004, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 123 (revised 2004), “Share-Based Payments” (“SFAS No. 123(R)”), which is a revision of FASB No. 123, “Accounting for Stock-Based Compensation” (“SFAS No. 123”). Generally, the approach in SFAS No. 123(R) is similar to the approach described in Statement 123. However, SFAS No. 123 permitted, but did not require, share-based payments to employees to be recognized based on their fair values, while SFAS No. 123(R) requires all share-based payments to employees to be recognized based on their fair values. SFAS No. 123(R) also revises, clarifies and expands guidance in several areas, including measuring fair value, classifying an award as equity or as a liability and attributing compensation cost to reporting periods. The Company has elected the modified prospective application method and is expensing all unvested stock options outstanding as of January 1, 2006. The compensation expense is recognized over the requisite service period that still has not been rendered and is based upon the original grant date

fair value of the award as calculated for recognition of the pro forma disclosure under SFAS No. 123. For the three months ended March 31, 2006 the compensation expense recorded related to stock options and restricted shares was \$47,664 and \$183,277 and has been included in reported net income for the first quarter of 2006.

The remaining total compensation cost related to non-vested stock options and restricted share awards not yet recognized in the income statement as of March 31, 2006 was \$270,508, of which \$115,819 was for stock options and \$154,689 was for restricted shares. The weighted average period over which this compensation cost is expected to be recognized is one year.

Per the requirements of SFAS No. 123(R) the balance of deferred stock compensation in stockholders' equity arising from the issuance of restricted stock has been reclassified as paid-in-capital as of March 31, 2006 and as of December 31, 2005.

Pro forma information under SFAS No. 123:

	Three months ended March 31, 2005	
	Unaudited	
	(U.S. Dollars, except per share data)	
Net loss as reported	\$	(2,456,500)
Add – stock-based compensation expense determined under APB 25		232,739
Deduct – stock based compensation expense determined under fair value method for all awards		(449,592)
Pro forma net loss	\$	(2,673,353)
Loss per share:		
Basic and diluted, as reported	\$	(0.43)
Pro forma basic and diluted	\$	(0.43)

A summary of the status of the Company's plans and other share options to employees and restricted shares (except for options granted to consultants) granted as of March 31 2006, and changes during the three months then ended, is presented below:

	2006	
	Amount	Weighted average exercise price
		\$
Options outstanding at be-ginning of quarter	660,353	\$ 9.38
Changes during quarter:		
Granted	—	—
Exercised	—	—
Forfeited	(2,071)	9.38
Options outstanding at March 31, 2006	658,282	\$ 9.38
Options exercisable at end of quarter	581,063	\$ 9.80

The weighted-average remaining contractual term of the outstanding options at March 31, 2006 was 4.79 years.

The Company applies SFAS No. 123 and Emerging Issues Task Force No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services" ("EITF 96-18"), with respect to options and warrants issued to non-employees. SFAS No. 123 and EITF 96-18 require the use of option valuation models to measure the fair value of the options and warrants at the measurement date.

d. Reclassification:

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

NOTE 2: INVENTORIES

Inventories are stated at the lower of cost or market value. Cost is determined using the average cost method. The Company periodically evaluates the quantities on hand relative to current and historical selling prices and historical and projected sales volume. Based on these evaluations, provisions are made in each period to write down inventory to its net realizable value. Inventory write-offs are provided to cover risks arising from slow-moving items, technological obsolescence, excess inventories, and for market prices lower than cost. In the three months ended March 31, 2006, the Company wrote off and wrote down inventory in the amount of \$70,577. Inventories are composed of the following:

	March 31, 2006	December 31, 2005
	(Unaudited)	
Raw and packaging materials	\$ 3,051,044	\$ 3,296,453
Work-in-progress	3,248,502	3,697,361
Finished goods	1,280,871	821,992
	\$ 7,580,417	\$ 7,815,806

NOTE 3: IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments" ("SFAS No. 155"), which amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133") and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("SFAS No. 140"). SFAS No. 155 provides guidance to simplify the accounting for certain hybrid instruments by permitting fair value remeasurement for any hybrid financial instrument that contains an embedded derivative, as well as clarifying that beneficial interests in securitized financial assets are subject to SFAS 133. In addition, SFAS No. 155 eliminates a restriction on the passive derivative instruments that a qualifying special-purpose entity may hold under SFAS No. 140. SFAS No. 155 is effective for all financial instruments acquired, issued or subject to a new basis occurring after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company believes that the adoption of this statement will not have a material effect on its financial condition or results of operations.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets" ("SFAS No. 156"), which amends SFAS No. 140. SFAS No. 156 provides guidance addressing the recognition and measurement of separately recognized servicing assets and liabilities, common with mortgage securitization activities, and provides an approach to simplify efforts to obtain hedge accounting treatment. SFAS No. 156 is effective for all separately recognized servicing assets and liabilities acquired or issued after the beginning of an entity's fiscal year that begins after September 15, 2006, with early adoption being permitted. The Company believes that the adoption of this statement will not have a material effect on its financial condition or results of operations

NOTE 4: SEGMENT INFORMATION

a. General:

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

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

b. The following is information about reported segment revenues, income (losses) and assets for the three months ended March 31, 2006 and 2005:

	Simulation and Training	Battery and Power Systems	Armor	All Others	Total
Three months ended March 31, 2006					
Revenues from outside customers	\$ 4,936,565	\$ 2,041,942	\$ 1,917,905	\$ —	\$ 8,896,412
Depreciation, amortization and impairment expenses ⁽¹⁾	(433,709)	(232,197)	(399,874)	(59,826)	(1,125,606)
Direct expenses ⁽²⁾	(4,195,347)	(2,151,262)	(2,356,205)	(1,820,304)	(10,523,118)
Segment income (loss)	\$ 307,509	\$ (341,517)	\$ (838,174)	\$ (1,880,130)	\$ (2,752,312)
Financial income (after deduction of minority interest)					(1,461,136)
Loss from continuing operations					\$ (4,213,448)
Segment assets ^{(3), (4)}	\$ 32,615,793	\$ 12,012,941	\$ 6,421,605	\$ 643,069	\$ 51,693,408
Three months ended March 31, 2005					
Revenues from outside customers	\$ 4,115,651	\$ 3,006,138	\$ 3,265,656	\$ —	\$ 10,387,445
Depreciation expenses and amortization ⁽¹⁾	(402,660)	(222,699)	(491,548)	(35,000)	(1,151,907)
Direct expenses ⁽²⁾	(3,508,124)	(2,756,990)	(3,316,049)	(1,641,897)	(11,223,060)
Segment income (loss)	\$ 204,867	\$ 26,449	\$ (541,941)	\$ (1,676,897)	\$ (1,987,522)
Financial income (after deduction of minority interest)					(468,978)
Loss from continuing operations					\$ (2,456,500)
Segment assets ⁽³⁾	\$ 31,783,459	\$ 13,265,919	\$ 20,816,358	\$ 759,121	\$ 66,624,857

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

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

⁽³⁾ Consisting of property and equipment, inventory and intangible assets.

⁽⁴⁾Out of those amounts, goodwill in our Simulation and Training, Battery and Power Systems and Armor Divisions stood at \$23,605,069, \$4,902,639 and \$973,352, respectively, as of March 31, 2006 and \$22,845,372, \$5,244,396 and \$11,579,443, respectively, as of March 31, 2005.

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NOTE 5: CONVERTIBLE DEBENTURES AND DETACHABLE WARRANTS

a. 8% Secured Convertible Debentures due September 30, 2006 and issued in September 2003

Pursuant to the terms of a Securities Purchase Agreement dated September 30, 2003, the Company, in September 2003, issued and sold to a group of institutional investors an aggregate principal amount of 8% secured convertible debentures in the amount of \$5.0 million due September 30, 2006. These debentures are convertible at any time prior to September 30, 2006 at a conversion price of \$16.10 per share.

As part of the Securities Purchase Agreement dated September 30, 2003, the Company issued to the purchasers of its 8% secured convertible debentures due September 30, 2006, warrants to purchase an aggregate of 89,286 shares of common stock at any time prior to September 30, 2006 at a price of \$20.125 per share.

As of March 31, 2006, principal amount of \$150,000 remained outstanding under these convertible debentures.

This transaction was accounted according to APB No. 14 "Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants" ("APB No. 14") and Emerging Issue Task Force No. 00-27 "Application of Issue No. 98-5 to Certain Convertible Instruments" ("EITF 00-27"). The fair value of these warrants was determined using the Black-Scholes pricing model, assuming a risk-free interest rate of 1.95%, a volatility factor 98%, dividend yields of 0% and a contractual life of three years.

In connection with these convertible debentures, the Company will recognize financial expenses of \$2,963,043 with respect to the beneficial conversion feature, which is being amortized from the date of issuance to the stated redemption date - September 30, 2006 - as financial expenses.

During the three months ended March 31, 2006, the Company recorded an expense of \$7,299, which was attributable to amortization of debt discount and beneficial conversion feature related to the convertible debenture over its term. These expenses were included in the financial expenses. See also note 6.b.

b. 8% Secured Convertible Debentures due September 30, 2006 and issued in December 2003

Pursuant to the terms of a Securities Purchase Agreement dated September 30, 2003, the Company, in December 2003, issued and sold to a group of institutional investors an aggregate principal amount of 8% secured convertible debentures in the amount of \$6.0 million due September 30, 2006. These debentures are convertible at any time prior to September 30, 2006 at a conversion price of \$20.30 per share.

As of March 31, 2006, principal amount of \$4,387,500 remained outstanding under these convertible debentures.

As a further part of the Securities Purchase Agreement dated September 30, 2003, the Company issued to the purchasers of its 8% secured convertible debentures due September 30, 2006, warrants to purchase an aggregate of 107,143 shares of common stock at any time prior to December 31, 2006 at a price of \$25.375 per share. Additionally, the Company issued to the investors supplemental warrants to purchase an aggregate of 74,143 shares of common stock at any time prior to June 18, 2009 at a price of \$30.80 per share. See Note 6.c.

This transaction was accounted according to APB No. 14 and EITF 00-27. The fair value of the warrants granted in respect of convertible debentures was determined using the Black-Scholes pricing model, assuming a risk-free interest rate of 2.45%, a volatility factor 98%, dividend yields of 0% and a contractual life of three years.

In connection with these convertible debentures, the Company will recognize financial expenses of \$6,000,000 with respect to the beneficial conversion feature, which is being amortized from the date of issuance to the stated redemption date - September 30, 2006 - as financial expenses.

During the three months ended March 31, 2006, the Company recorded an expense of \$385,244, which was attributable to amortization of the beneficial conversion feature of the convertible debenture over its term. These expenses were included in the financial expenses.

See also note 6.c.

c.Senior Secured Convertible Notes due March 31, 2008

Pursuant to the terms of a Securities Purchase Agreement dated September 29, 2005 (the "Purchase Agreement") by and between the Company and certain institutional investors, the Company issued and sold to the investors an aggregate of \$17.5 million principal amount of senior secured notes having a final maturity date of March 31, 2008.

Under the terms of the Purchase Agreement, the Company granted the investors (i) a second position security interest in the stock of MDT Armor Corporation, IES Interactive Training, Inc. and M.D.T. Protective Industries, Ltd. (junior to the security interest of the holders of the Company's 8% secured convertible debentures due September 30, 2006) and in the assets of FAAC Incorporated (junior to a bank that extends to FAAC Incorporated a \$5 million line of credit) and in any stock that the Company acquires in future acquisitions, and (ii) a first position security interest in the assets of all of the Company's other active United States subsidiaries. The Company's active United States subsidiaries are also acting as guarantors of the Company's obligations under the Notes.

As of March 31, 2006, principal amount of \$14.6 million remained outstanding under these convertible notes.

The Notes are convertible at the investors' option at a fixed conversion price of \$14.00. The Notes bear interest at a rate equal to six month LIBOR plus 6% per annum, subject to a floor of 10% and a cap of 12.5%. The Company will repay the principal amount of the Notes over a period of two and one-half years, with the principal amount being amortized in twelve payments payable at the Company's option in cash and/or stock, provided certain conditions are met. In the event the Company elects to make such payments in stock, the price used to determine the number of shares to be issued will be calculated using an 8% discount to the average trading price of our common stock during 17 of the 20 consecutive trading days ending two days before the payment date.

As a further part of the Securities Purchase Agreement dated September 29, 2005, the Company issued warrants, which are not exercisable for the six month period following closing, to purchase up to 375,000 shares of common stock (30% warrant coverage) at an exercise price of \$15.40 per share. These warrants are exercisable until the one-year anniversary of the effective date of the registration statement registering the shares of common stock underlying the warrants.

This transaction was accounted according to APB No. 14 and EITF 00-27. The fair value of the warrants granted in respect of convertible debentures was determined using the Black-Scholes pricing model, assuming a risk-free interest rate of 3.87%, a volatility factor 53%, divi-dend yields of 0% and a contractual life of one year.

In connection with these convertible notes, the Company will recognize financial expenses of \$422,034 with respect to the beneficial compensation related to the warrants issued to the holders of the convertible debenture, which is being amortized from the date of issuance to the stated redemption date - March 31, 2008 - as financial expenses.

As to EITF 00-19, since the terms of the warrants referred to above provided that upon exercise of a warrant the Company could issue only stock that had been registered with the SEC (which occurred in December 2005) and therefore freely tradable, in accordance with Emerging Issues Task Force No 00-19 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," their fair value was recorded as a liability at the closing date. Such fair value was remeasured at each subsequent cut-off date. The fair value of these warrants was remeasured as at March 31, 2006 using the Black-Scholes pricing model assuming a risk free interest rate of 4.79%, a volatility factor of 81%, dividend yields of 0% and a contractual life of approximately six months. The change in the fair value of the warrants in the amount of \$39,407 has been recorded as finance expense during the three months ended March 31, 2006.

The Company has also considered EITF No. 05-2, "The Meaning of 'Conventional Convertible Debt Instrument' in EITF Issue No. 00-19, 'Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock.'" Accordingly, the Company has concluded that these convertible notes would be considered as conventional convertible debt and therefore EITF 00-19 does not apply to them.

During the three months ended March 31, 2006, the Company recorded an expense of \$91,066, which was attributable to amortization of the beneficial conversion feature of the convertible notes over their term. These expenses were included in the financial expenses.

See also Note 9.d.

NOTE 6: WARRANTS

a. Warrants issued in June 2003

In June 2003, warrants to purchase a total of 29,437 shares of common stock, having an aggregate exercise price of \$337,940, were exercised. These warrants had originally been issued in May 2001 at an exercise price of \$45.08 per share, but were repriced immediately prior to exercise to \$11.48 per share. In connection with this repricing, the holder of these 29,437 warrants received an aggregate of 19,625 new five-year warrants to purchase shares at an exercise price of \$20.30 per share and exercisable after January 1, 2004. In March 2006, these new warrants were repriced to an exercise price of \$5.60 per share and exercised. In connection with this repricing, the holder of these warrants received new warrants to purchase 7,850 shares at an exercise price of \$8.316. As a result of this repricing of the existing warrants and the issuance of these new warrants, the Company recorded a deemed dividend in the amount of \$28,369 in the first quarter of 2006.

b. Warrants issued in December 2003

In connection with the transactions described in Note 5.a., the Company, in September 2003, issued warrants to purchase an aggregate of 89,286 shares of common stock at any time prior to September 30, 2006 at a price of \$20.125 per share. In March 2006, 8,929 of these warrants were repriced to an exercise price of \$5.60 per share and exercised. In connection with this repricing, the holder of these warrants received a new warrant to purchase 3,571 shares at an exercise price of \$8.316. As a result of this repricing of the existing warrants and the issuance of these new warrants, the Company recorded a deemed dividend in the amount of \$24,531 in the first quarter of 2006.

c. Warrants issued in September 2003

In connection with the transactions described in Note 5.b., the Company, in December 2003, issued supplemental warrants to purchase an aggregate of 74,143 shares of common stock at any time prior to June 18, 2009 at a price of \$30.80 per share. In February and March 2006, an aggregate of 55,607 of these warrants were repriced to an exercise price of \$5.60 per share and exercised. In connection with this repricing, the holders of these warrants received new warrants to purchase an aggregate of 22,243 shares at an exercise price of \$8.316. As a result of this repricing of the existing warrants and the issuance of these new warrants, the Company recorded a deemed dividend in the amount of \$35,157 in the first quarter of 2006.

See also Note 9.a.

d. Warrants issued in September 2003

Pursuant to the terms of a Securities Purchase Agreement dated January 7, 2004 by and between the Company and several institutional investors, the Company issued and sold (i) an aggregate of 702,888 shares of the Company's common stock at a purchase price of \$26.32 per share, and (ii) three-year warrants to purchase up to an aggregate of 702,888 shares of the Company's common stock at any time beginning six months after closing at an exercise price per share of \$26.32. In March 2006, 56,991 of these warrants were repriced to an exercise price of \$5.60 per share and exercised. In connection with this repricing, the holder of these warrants received a new warrant to purchase an aggregate of 22,796 shares at an exercise price of \$8.316. As a result of this repricing of the existing warrants and the issuance of these new warrants, the Company recorded a deemed dividend in the amount of \$153,234 in the first quarter of 2006.

See also Note 9.b.

e. Warrants issued in July 2004

On July 14, 2004, warrants to purchase 629,588 shares of common stock were exercised. In connection with this transaction, the Company issued to the holders of those exercising warrants an aggregate of 622,662 new five-year warrants to purchase shares of common stock at an exercise price of \$19.32 per share. In February and March 2006, an aggregate of 501,216 of these warrants were repriced to an exercise price of \$5.60 per share and exercised. In connection with this repricing, the holders of these warrants received new warrants to purchase an aggregate of 200,486 shares at an exercise price of \$8.316. As a result of this repricing of the existing warrants and the issuance of these new warrants, the Company recorded a deemed dividend in the amount of \$75,916 in the first quarter of 2006.

See also Note 9.c.

f. As to EITF 00-19, since the terms of the warrants referred to above provided that the warrants were exercisable subject to the Company obtaining stockholder approval, in accordance with Emerging Issues Task Force No 00-19 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," their fair value was recorded as a liability at the closing date. Such fair value was remeasured at each subsequent cut-off date. The fair value of these warrants was remeasured as at March 31, 2006 using the Black-Scholes pricing model assuming a risk free interest rate of 4.73%, a volatility factor of 79%, dividend yields of 0% and a contractual life of approximately two years. The change in the fair value of the warrants between the date of the grant and March 31, 2006 in the amount of \$74,677 has been recorded as finance income.

NOTE 7: IMPAIRMENT OF GOODWILL

SFAS No. 142 requires goodwill to be tested for impairment on adoption of the Statement, at least annually thereafter, and between annual tests in certain circumstances, and written down when impaired, rather than being amortized as previous accounting standards required. Goodwill is tested for impairment by comparing the fair value of the Company's reportable units with their carrying value. Fair value is determined using discounted cash flows. Significant estimates used in the methodologies include estimates of future cash flows, future short-term and long-term growth rates, weighted average cost of capital and estimates of market multiples for the reportable units.

During 2005, the Company performed impairment test of goodwill, based on management's projections and using expected future discounted operating cash flows and as response to several factors. As of December 31, 2005, as a result of this impairment test, the Company identified in AoA an impairment of goodwill in the amount of \$11,757,812.

In connection with the Company's acquisition of AoA, the Company accrued during 2006 an amount of \$204,059 in respect of an earnout obligation, which was charged as an impairment of goodwill (see Note 8).

NOTE 8: CONTINGENT LIABILITIES

In connection with the Company's acquisition of FAAC, the Company has a contingent earnout obligation in an amount equal to the net income realized by the Company from certain specific programs that were identified by the Company and the former shareholders of FAAC as appropriate targets for revenue increases in 2005. Through March 31, 2006, the Company had accrued an amount of \$603,764 in respect of such earnout obligation against FAAC's goodwill. Although the former shareholders of FAAC have indicated to the Company their belief that the specific programs identified include more orders than those with respect to which the Company has made accrual in respect of this earnout obligation, the Company believes there is no basis for this claim.

In connection with the Company's acquisition of AoA, the Company has a contingent earnout obligation in an amount equal to the revenues realized by the Company from certain specific programs that were identified by the Company and the former shareholder of AoA as appropriate targets for revenue increases. The earnout provides that if AoA receives certain types of orders from certain specific customers prior to December 31, 2006 ("Additional Orders"), then upon shipment of goods in connection with such Additional Orders, the former shareholder of AoA will be paid an earnout based on revenues, up to a maximum of an additional \$6 million. Through March 31, 2006 the Company had accrued an amount of \$1.4 million in respect of such earnout obligation (see Note 7).

NOTE 9: SUBSEQUENT EVENTS

a. Warrants issued in September 2003

In connection with the transactions described in Note 5.b., the Company, in December 2003, issued supplemental warrants to purchase an aggregate of 74,143 shares of common stock at any time prior to June 18, 2009 at a price of \$30.80 per share. In April 2006, 11,121 of these warrants were repriced to an exercise price of \$5.60 per share and exercised. In connection with this repricing, the holder of these warrants received a new warrant to purchase 4,449 shares at an exercise price of \$8.316. See also Note 6.c.

b. Warrants issued in September 2003

Pursuant to the terms of a Securities Purchase Agreement dated January 7, 2004 by and between the Company and several institutional investors, the Company issued and sold (i) an aggregate of 702,888 shares of the Company's common stock at a purchase price of \$26.32 per share, and (ii) three-year warrants to purchase up to an aggregate of 702,888 shares of the Company's common stock at any time beginning six months after closing at an exercise price per share of \$26.32. In April 2006, 75,988 of these warrants were repriced to an exercise price of \$5.60 per share and exercised. In connection with this repricing, the holder of these warrants received a new warrant to purchase 30,395 shares at an exercise price of \$8.316. See also Note 6.d.

c. Warrants issued in July 2004

On July 14, 2004, warrants to purchase 629,588 shares of common stock were exercised. In connection with this transaction, the Company issued to the holders of those exercising warrants an aggregate of 622,662 new five-year warrants to purchase shares of common stock at an exercise price of \$19.32 per share. In April 2006, 16,071 of these warrants were repriced to an exercise price of \$5.60 per share and exercised. In connection with this repricing, the holder of these warrants received a new warrant to purchase 6,429 shares at an exercise price of \$8.316. See also Note 6.e.

d. Convertible notes

On April 7, 2006, the Company and each holder (each, an "Investor" and collectively the "Investors") of its Senior Secured Convertible Notes due 2008 (the "Notes") entered into conversion agreements dated April 7, 2006 (collectively, the "Conversion Agreements") pursuant to which an aggregate of \$6,148,903.60 principal amount of the Notes was converted into 1,098,019 shares of the Company's common stock. The amount converted eliminated the Company's obligation to make the installment payments under the Notes on each of March 31, 2008, January 31, 2008, November 30, 2007 and September 30, 2007 (aggregating a total of \$5,833,333.33). In addition, as a result of the conversion an additional \$315,570.27 was applied against part of the installment payment due July 31, 2007. After giving effect to the conversion, \$8,434,429.73 of principal remained outstanding under the Notes. Each Investor also agreed, among other things, to defer the installment payment due on May 31, 2006 to July 31, 2006. See also Note 5.c.

e. Reverse split

The Company's stockholders approved a one-for-fourteen reverse stock split of the Company's common stock on June 19, 2006, which was effected on June 21, 2006. As a result of the reverse stock split, every fourteen shares of Arotech common stock were combined into one share of common stock; any fractional shares created by the reverse stock split were eliminated. The reverse stock split affected all of Arotech's common stock, stock options, warrants and convertible debt outstanding immediately prior to the effective date of the reverse stock split. All shares of common stock, options, warrants, option and warrant exercise prices, convertible debt conversion prices and per share data included in these financial statements for all periods presented have been retroactively adjusted to reflect this one-for-fourteen reverse split.

PART II

ITEM 6. EXHIBITS.

The following documents are filed as exhibits to this amended report:

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

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SIGNATURES

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

Dated: July 24, 2006

AROTECH CORPORATION

By: /s/ Robert S. Ehrlich

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

By: /s/ Thomas J. Paup

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

EXHIBIT INDEX

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