

**CONDENSED INTERIM CONSOLIDATED  
FINANCIAL STATEMENTS**

**As of June 30, 2007  
(Unaudited)**



AND ITS SUBSIDIARIES

**CONDENSED INTERIM CONSOLIDATED  
FINANCIAL STATEMENTS**

**As of June 30, 2007**  
(Unaudited)

**ELRON ELECTRONIC INDUSTRIES LTD.  
AND ITS SUBSIDIARIES**

**CONDENSED INTERIM CONSOLIDATED**

**FINANCIAL STATEMENTS**

**AS OF JUNE 30, 2007**

**UNAUDITED**

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**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

**U.S. dollars in thousands, except share and per share data**

	<b>June 30, 2007</b>	<b>December 31, 2006</b>
	<b>Unaudited</b>	
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 18,502	\$ 52,954
Short-term investments	23,678	19,917
Restricted cash (See Note 3g)	6,789	-
Available for sale marketable securities	47,369	55,862
Trade receivables	1,217	642
Other receivables and prepaid expenses*	7,705	3,043
Inventories	2,019	1,615
Total current assets	107,279	134,033
<b>INVESTMENTS AND LONG-TERM RECEIVABLES</b>		
Investments in affiliated companies	134,090	100,392
Investments in other companies and long-term receivables*	73,845	68,215
Deferred taxes	10,010	9,182
Severance pay deposits	1,798	1,662
Total investments and long-term receivables	219,743	179,451
<b>PROPERTY AND EQUIPMENT, NET</b>	<b>1,434</b>	<b>7,223</b>
<b>INTANGIBLE ASSETS</b>		
Goodwill	2,742	2,742
Other intangible assets	2,791	2,800
Total intangible assets	5,533	5,542
Total assets	<b>\$ 333,989</b>	<b>\$ 326,249</b>

\* Includes short-term receivables from related parties in the aggregate amount of \$242 and \$95 as of June 30, 2007 and December 31, 2006, respectively, and long-term receivables from related parties in the aggregate amount of \$484 and \$467 as of June 30, 2007 and December 31, 2006, respectively.

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

**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

**U.S. dollars in thousands, except share and per share data**

	<b>June 30, 2007</b>	<b>December 31, 2006</b>
	<u><b>Unaudited</b></u>	
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Short-term loans from banks and others	\$ 1,077	\$ 1,891
Current maturities of long-term loans from banks and others	2,237	2,249
Trade payables	3,363	2,988
Other payables and accrued expenses	10,970	13,407
<b>Total current liabilities</b>	<u>17,647</u>	<u>20,535</u>
<b>LONG-TERM LIABILITIES</b>		
Long-term loans from banks and others	2,180	2,113
Convertible debentures (See Note 3g)	5,207	-
Options to convertible debentures (See Note 3g)	1,002	-
Accrued severance pay and retirement obligations	2,481	2,209
Deferred taxes	214	1,408
<b>Total long-term liabilities</b>	<u>11,084</u>	<u>5,730</u>
<b>MINORITY INTEREST</b>	<u>1,786</u>	<u>2,480</u>
<b>SHAREHOLDERS' EQUITY:</b>		
Ordinary shares of NIS 0.003 par value; Authorized - 35,000,000 shares as of June 30, 2007 and December 31, 2006; Issued and outstanding: 29,620,775 and 29,592,748 shares as of June 30, 2007 and December 31, 2006, respectively.	9,573	9,573
Additional paid-in capital	275,710	272,930
Accumulated other comprehensive income	1,110	1,298
Retained earnings	17,079	13,703
<b>Total shareholders' equity</b>	<u>303,472</u>	<u>297,504</u>
<b>Total liabilities and shareholders' equity</b>	<u>\$ 333,989</u>	<u>\$ 326,249</u>

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

**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

**U.S. dollars in thousands, except share and per share data**

	Six months ended June 30,		Three months ended June 30,		Year ended December 31,
	2007	2006	2007	2006	2006
	Unaudited				
<b>INCOME</b>					
Net revenues*	\$ 2,164	\$ 7,138	\$ 1,183	\$ 3,816	\$ 12,863
Equity in losses of affiliated companies	(8,347)	(11,866)	(3,039)	(8,371)	(17,740)
Gain (loss) from disposal of businesses and affiliated companies and changes in holdings in affiliated consolidated companies, net	12,541	(7)	824	(23)	2,547
Other income, net	6,130	3,367	5,657	738	29,310
Financial income, net	1,805	2,280	408	1,196	4,051
	<u>14,293</u>	<u>912</u>	<u>5,033</u>	<u>(2,644)</u>	<u>31,031</u>
<b>COSTS AND EXPENSES</b>					
Cost of revenues	894	3,862	432	2,017	6,625
Research and development costs, net	4,966	5,878	2,591	2,970	11,758
Marketing and selling expenses, net	1,073	2,128	557	1,253	4,717
General and administrative expenses	6,616	5,911	3,168	3,030	12,995
Amortization of intangible assets	9	9	5	4	18
	<u>13,558</u>	<u>17,788</u>	<u>6,753</u>	<u>9,274</u>	<u>36,113</u>
Income (loss) before taxes on income	735	(16,876)	(1,720)	(11,918)	(5,082)
Tax benefit (taxes on income)	(568)	(99)	954	183	(1,110)
Income (loss) after taxes on income	167	(16,975)	(766)	(11,735)	(6,192)
Minority interest in losses of subsidiaries	3,209	7,037	1,574	5,310	9,224
Net income (loss)	<u>\$ 3,376</u>	<u>\$ (9,938)</u>	<u>\$ 808</u>	<u>\$ (6,425)</u>	<u>\$ 3,032</u>
Income (loss) per share:					
Basic :					
Net income (loss)	<u>\$ 0.11</u>	<u>\$ (0.34)</u>	<u>\$ 0.03</u>	<u>\$ (0.22)</u>	<u>\$ 0.10</u>
Diluted:					
Net income (loss)	<u>\$ 0.11</u>	<u>\$ (0.35)</u>	<u>\$ 0.02</u>	<u>\$ (0.22)</u>	<u>\$ 0.07</u>
Weighted average number of ordinary shares used in computing basic net income (loss) per share (thousands)					
	<u>29,603</u>	<u>29,523</u>	<u>29,605</u>	<u>29,532</u>	<u>29,532</u>
Weighted average number of ordinary shares used in computing diluted net income (loss) per share (thousands)					
	<u>29,704</u>	<u>29,523</u>	<u>29,713</u>	<u>29,532</u>	<u>29,624</u>

\* Includes revenues from related parties, in the amount of \$1,762 and \$3,506 for the three and six months ended June 30, 2006, respectively, and an amount of \$6,699 for the year ended December 31, 2006.

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

**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

**U.S. dollars in thousands, except share and per share data**

	Number of shares	Share capital	Additional paid-in capital	Accumulated other comprehensive income	Retained earnings	Total Shareholders' equity	Total comprehensive income (loss)
<b>Audited</b>							
<b>Balance as of January 1, 2006</b>	29,483,455	\$ 9,572	\$ 271,132	\$ 10,741	\$ 10,671	\$ 302,116	
Exercise of options	109,293	1	527			528	-
Stock - based compensation	-	-	344	-	-	344	-
Capital transaction in affiliated company (gain on purchase by affiliate of its subsidiary's preferred stock)	-	-	927	-	-	927	-
Other comprehensive loss, net of tax:							
Unrealized gain on available for sale securities	-	-	-	6,493	-	6,493	6,493
Reclassification adjustment for gain realized included in net income	-	-	-	(16,645)	-	(16,645)	(16,653)
Foreign currency translation adjustments	-	-	-	709	-	709	709
Net income	-	-	-	-	3,032	3,032	3,032
<b>Balance as of December 31, 2006</b>	29,592,748	\$ 9,573	\$ 272,930	\$ 1,298	\$ 13,703	\$ 297,504	
Total comprehensive loss							\$ (6,419)
Exercise of options	28,027	-	140	-	-	140	-
Stock - based compensation	-	-	157	-	-	157	-
Increase in investment due to issuance of shares by a development stage subsidiary company (see note 3.g.)	-	-	2,483	-	-	2,483	-
Other comprehensive loss, net of tax:							
Unrealized gain on available for sale securities	-	-	-	958	-	958	\$ 958
Reclassification adjustment for gain realized included in net loss	-	-	-	(901)	-	(901)	(901)
Foreign currency translation adjustments included in net income due to decrease in holdings in affiliated company	-	-	-	(99)	-	(99)	(99)
Foreign currency translation adjustments	-	-	-	(146)	-	(146)	(146)
Net income	-	-	-	-	3,376	3,376	3,376
<b>Balance as of June 30, 2007 (Unaudited)</b>	29,620,775	\$ 9,573	\$ 275,710	\$ 1,110	\$ 17,079	\$ 303,472	
Total comprehensive income							\$ 3,188
<b>Balance as of January 1, 2006</b>	29,483,455	\$ 9,572	\$ 271,132	\$ 10,741	\$ 10,671	\$ 302,116	-
Exercise of options	48,500	-	242			242	-
Stock - based compensation	-	-	190	-	-	190	-
Other comprehensive loss, net of tax:							
Unrealized loss on available for sale securities	-	-	-	(1,832)	-	(1,832)	\$ (1,832)
Reclassification adjustment for loss realized and other than temporary impairment included in net loss	-	-	-	386	-	386	386
Foreign currency translation adjustments	-	-	-	258	-	258	258
Net loss	-	-	-	-	(9,938)	(9,938)	(9,938)
<b>Balance as of June 30, 2006 (Unaudited)</b>	29,531,955	\$ 9,572	\$ 271,564	\$ 9,553	\$ 733	\$ 291,422	
Total comprehensive loss							\$ (11,126)

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

**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

**U.S. dollars in thousands, except share and per share data**

	Number of shares	Share capital	Additional paid-in capital	Accumulated other comprehensive income	Retained earnings (Accumulated deficit)	Total Shareholders' equity	Total comprehensive income (loss)
<b>Unaudited</b>							
<b>Balance as of April 1, 2007</b>	29,600,775	\$ 9,573	\$ 273,056	\$ 2,247	\$ 16,271	\$ 301,147	-
Exercise of options	20,000	-	100	-	-	100	-
Stock based compensation	-	-	71	-	-	71	-
Increase in investment due to issuance of shares by a development stage subsidiary company (see note 3.g.)	-	-	2,483	-	-	2,483	-
Other comprehensive income (loss), net of tax:							
Unrealized loss on available for sale securities	-	-	-	(246)	-	(246)	\$ (246)
Reclassification adjustment for loss realized included in net loss	-	-	-	(414)	-	(414)	(414)
Foreign currency translation adjustments included in net income due to decrease in holdings in affiliated company	-	-	-	166	-	166	166
Foreign currency translation adjustments	-	-	-	(643)	-	(643)	(643)
Net income	-	-	-	-	808	808	808
<b>Balance as of June 30, 2007 (Unaudited)</b>	<u>29,620,775</u>	<u>\$ 9,573</u>	<u>\$ 275,710</u>	<u>\$ 1,110</u>	<u>\$ 17,079</u>	<u>\$ 303,472</u>	
Total comprehensive loss							<u>\$ (329)</u>
<b>Unaudited</b>							
<b>Balance as of April 1, 2006</b>	29,531,955	\$ 9,572	\$ 271,468	\$ 9,428	\$ 7,158	\$ 297,626	-
Stock based compensation	-	-	96	-	-	96	-
Other comprehensive income (loss), net of tax:							
Unrealized loss on available for sale securities	-	-	-	(352)	-	(352)	\$ (352)
Reclassification adjustment for loss realized included in net loss and other than temporary impairment included in net loss	-	-	-	144	-	144	144
Foreign currency translation adjustments	-	-	-	333	-	333	333
Net loss	-	-	-	-	(6,425)	(6,425)	(6,425)
<b>Balance as of June 30, 2006 (Unaudited)</b>	<u>29,531,955</u>	<u>\$ 9,572</u>	<u>\$ 271,564</u>	<u>\$ 9,553</u>	<u>\$ 733</u>	<u>\$ 291,422</u>	
Total comprehensive loss							<u>\$ (6,300)</u>

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



**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**U.S. dollars in thousands**

	<u>Six months ended June 30,</u>		<u>Year ended December 31,</u>
	<u>2007</u>	<u>2006</u>	<u>2006</u>
	<u>Unaudited</u>		
<u>Cash flows from operating activities</u>			
Net income (loss)	\$ 3,376	\$ (9,938)	\$ 3,032
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Equity in losses of affiliated companies	8,347	11,866	17,740
Minority interest in losses of subsidiaries	(3,209)	(7,037)	(9,224)
Loss (gain) from disposal of businesses and affiliated companies and changes in holdings in affiliated companies, net	(12,541)	7	(2,547)
Loss (gain) from sale of investments in available - for - sale securities	(1,127)	341	(24,899)
Gain from settlement of a subsidiary's loan	-	(2,708)	(2,708)
Depreciation and amortization	465	551	1,192
Equity in losses (gains) of partnerships	372	618	672
Stock - based compensation and changes in liability in respect of call options	892	611	771
Deferred taxes, net	(1,965)	(35)	(4,243)
Convertible debentures and options to convertible debentures issuance costs recognized , included in net income	976	-	-
Gain from sale of real estate	(5,450)	-	-
Changes in operating assets and liabilities			
Decrease (increase) in trade receivables	(575)	41	(457)
Decrease (increase) in other receivables and prepaid expenses	(479)	103	(738)
Decrease in trading securities, net	-	-	(2)
Decrease (increase) in inventories and contracts-in-progress	(404)	48	(1,069)
Increase (decrease) in trade payables	260	189	2,589
Increase (decrease) in other payables and accrued expenses (mainly provision for income taxes)	(3,113)	273	7,195
Other	74	731	843
Net cash used in operating activities	<u>(14,101)</u>	<u>(4,339)</u>	<u>(11,853)</u>
<u>Cash flows from investing activities</u>			
Investment in affiliated companies	(30,459)	(6,226)	(18,395)
Proceeds from sale of affiliated companies shares	413	992	992
Proceeds from repayment of loans and sale of shares of former subsidiary	-	-	2,633
Change in cash and cash equivalents resulting from disposal of businesses and decrease in holdings in formerly consolidated subsidiaries (Schedule A)	-	-	(3,441)
Investment in other companies	(5,580)	(6,439)	(25,153)
Proceeds from sale and maturity of available for sale securities	25,412	22,855	82,332
Investments in deposits	(16,256)	(25,707)	(40,183)
Investment in available for sale securities	(16,129)	(24,668)	(35,377)
Proceeds from deposits	12,576	54,040	72,878
Investment in restricted deposits	(6,789)	-	-
Purchase of property and equipment	(391)	(790)	(1,308)
Proceeds from sale of real estate and property and equipment	7,627	15	19
Net cash provided by investing activities	<u>(29,576)</u>	<u>14,072</u>	<u>34,997</u>
<u>Cash flows from financing activities</u>			
Proceeds from options exercised	90	242	527
Repayment of long-term loans	(4)	(2)	(105)
Decrease in short-term bank loan, net	(188)	(400)	208
Proceeds from issuance of shares to minority of subsidiary, net	3,814	-	-
Proceeds from issuance of Convertible Debentures and Options to Convertible Debentures	5,188	-	-
Receipt of short-term loans, convertible loans and long-term loans from minority shareholders of a subsidiary	325	2,197	2,660
Net cash used in financing activities	<u>9,225</u>	<u>2,037</u>	<u>3,290</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>(34,452)</u>	<u>11,770</u>	<u>26,434</u>
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	<u>52,954</u>	<u>26,520</u>	<u>26,520</u>
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	<u>\$ 18,502</u>	<u>\$ 38,290</u>	<u>\$ 52,954</u>

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

**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**U.S. dollars in thousands**

	<b>Six months ended June 30,</b>		<b>Year ended December 31,</b>
	<b>2007</b>	<b>2006</b>	<b>2006</b>
	<b>Unaudited</b>		
Supplemental cash flow information:			
Cash paid for:			
Income taxes	\$ 7,648	\$ 672	\$ 794
Interest	\$ 47	\$ 42	\$ 69
Non cash transaction			
Proceeds from sale of shares of an affiliate not yet received	\$ 413	\$ -	\$ -

**SCHEDULE A:**

**Change in cash and cash equivalents resulting from disposal of businesses and decrease in holdings in formerly consolidated subsidiaries**

Assets and liabilities at date of sale:

Working capital (working capital deficiency), net (except cash and cash equivalents)	\$ -	\$ -	\$ 2,826
Investment in affiliated Company	-	-	13,207
Property and equipment	-	-	709
Minority interest	-	-	(10,036)
Accrued severance pay, net	-	-	(215)
Long term loans	-	-	(1,401)
Proceeds from repayment of loans and sale of shares of former subsidiary	-	-	2,633
Other investments	-	-	(1,713)
Investment in affiliated Companies	-	-	(6,818)
Net decrease in cash and cash equivalents	\$ -	\$ -	\$ (3,441)

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

## ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

#### NOTE 1:- GENERAL

The accompanying unaudited condensed interim consolidated financial statements have been prepared as of June 30, 2007, and for the three and six months then ended in accordance with accounting principles generally accepted in the United States (U.S. GAAP) relating to the preparation of financial statements for interim periods. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States but which are not required for interim reporting purposes, have been condensed or omitted. See Note 6 for the reconciliation from U.S. GAAP to accounting principles generally accepted in Israel ("Israeli GAAP").

These financial statements should be read in conjunction with the Company's annual financial statements for the year ended December 31, 2006, included in Form 20F for the year ended December 31, 2006 filed with the Securities and Exchange Commission ("the Company's annual financial statements").

The condensed interim consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary to present fairly the financial position, results of operations and cash flows for the period presented.

Results for the three and six months ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

#### NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

- a. The significant accounting policies followed in the preparation of these financial statements are identical to those applied in preparation of the latest annual financial statements.
- b. The financial statements have been prepared in U.S. dollars, since the functional currency of the Company and its principal subsidiaries is the U.S. dollar.
- c. In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. FIN 48 states that a tax benefit from an uncertain position may be recognized only if it is "more likely than not" that the position is sustainable, based on its technical merits. The tax benefit of a qualifying position is the largest amount of tax benefit that is greater than fifty percent likely of being realized upon ultimate settlement with a taxing authority having full knowledge of all relevant information. The adoption of FIN 48 as of January 1, 2007 did not have any effect on the Company's retained earnings and financial position.
- d. In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements". SFAS 157 establishes a single authoritative definition of fair value, sets out a framework for measuring fair value, and requires additional disclosures about fair value measurements. SFAS 157 applies only to fair value measurements that are already required or permitted by other accounting standards. FASB 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently reviewing this new standard to determine its effects, if any, on its financial position and results of operations.

## ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

#### NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

- e. In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"), which permits companies to choose to measure certain financial instruments and other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company will adopt SFAS No. 159 no later than January 1, 2008. The Company is currently reviewing this new standard to determine its effects, if any, on its financial position and results of operations.

#### NOTE 3:- MAJOR TRANSACTIONS

- a. **NetVision**

On January 25, 2007, NetVision Ltd. ("NetVision"), then held 36% by Elron and 36% by Discount Investment Corporation Ltd. ("DIC"), completed the merger with Barak I.T.C (1998) International Telecommunications Services Corp Ltd. ("Barak") and the merger with GlobCall Communications Ltd. ("Globcall"), following which NetVision purchased from Barak shareholders all of Barak's issued share capital in exchange for approximately 46.5% of NetVision's share capital immediately after the transaction ("Barak Merger"), and from DIC, all of GlobCall's issued share capital in exchange for approximately 7% of NetVision's share capital immediately after the Barak Merger and the transaction ("GlobCall Merger"). The above mentioned exchange ratios were based upon companies valuations, that were issued to the parties by independent appraisers, according to which NetVision's value was estimated to be between 533,000 NIS (approximately \$122,000) and 621,000 NIS (approximately \$142,000), Barak's value was estimated to be between 456,000 NIS (approximately \$105,000) and 529,000 NIS (approximately \$121,000), and GlobCall's value was estimated to be between 67,000 NIS (approximately \$15,000) and 90,000 NIS (approximately \$21,000). Barak is a subsidiary of Clal Industries and Investments Ltd. ("Clal"). Elron, Clal and DIC, are part of the IDB group and are considered entities under common control.

Following the transactions, Elron's, DIC's and Clal's holdings in NetVision decreased to approximately 18%, 25% and 29%, respectively. The merger was recorded in NetVision's financial statements based on the fair market value of NetVision ordinary shares issued, according to the purchase method of accounting. As a result of the Barak merger and GlobCall merger, Elron recorded gain of approximately \$10,300 (\$9,100 net of tax).

On June 26, 2007, Netvision consummated a transaction according to which its wholly owned subsidiary, NANA, and Channel 10 established new Israeli company under common control, namely NANA10. Nana is a portal that provides a variety of content and e-commerce services. Channel 10 is an Israeli commercial television channel. Following the transaction, Nana 10 holds exclusive rights for use of television content of Channel 10 on the Internet. As a result of the transaction Netvision recorded a gain net of tax of approximately \$5,300, of which Elron's share was \$1,000.

In June 2007, NetVision raised in a private placement an amount of approximately 52,000 NIS (approximately \$12,000). As a result, Elron's holding in NetVision decreased to approximately 17%, resulting in a gain of approximately \$1,100 (\$800 net of tax).

In addition, Elron recorded gain in the amount of approximately \$1,800 (\$600 net of tax) as a result of exercise of options and debentures in NetVision.

Elron continues to account for NetVision under the equity method of accounting as together with DIC and Clal, Elron has a significant influence over Netvision.

## ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

#### NOTE 3:- MAJOR TRANSACTIONS (Cont.)

b. **AqWise**

On March 15, 2007, Elron completed the acquisition of approximately 34% of the outstanding ordinary shares of AqWise – Wise Water Solutions Ltd., an Israeli-based water technology company ("AqWise"), from Polar Investments Ltd. (TASE: PLR) and other existing shareholders in consideration for approximately \$3,400.

AqWise headquartered in Israel with offices in Mexico, provides advanced biological wastewater treatment technologies. AqWise's patented AGAR® (Attached Growth Airlift Reactor) technology increases capacity and nutrient removal in wastewater treatment plants, utilizing advanced bio film technology to be used in existing plants or in new plants with limited space.

The excess of the purchase price over the company's share in the assets acquired and liability assumed amounted to approximately \$3,400 and was allocated to intangible assets other than goodwill such as customers contracts and technology. The amounts allocated to the above intangible assets will be amortized on a straight-line basis over their weighted average expected useful life of 11 years.

Since the investment was in ordinary shares, the investment in AqWise is accounted for under the equity method of accounting under the provisions of APB 18.

c. **Given Imaging**

During May 2007, Elron has completed the purchase of 2.5% of the ordinary shares of Given Imaging Ltd. ("Given") in a series of open market transactions for an aggregate purchase consideration of approximately \$18,700. As a result of these transactions, Elron's direct and indirect ownership interest in Given (through its direct holdings and its holdings in its subsidiary, RDC-Rafael Development Corporation Ltd. ("RDC")) increased to approximately 23%. In parallel transactions, Discount Investment Corporation Ltd. ("DIC"), a 49% shareholder of Elron, also purchased 2.5% of the ordinary shares of Given for the same aggregate consideration, increasing its holding in Given to approximately 16%. Following these transactions, Elron, DIC and RDC together held approximately 44% of the ordinary shares of Given.

The excess of the purchase price over the Company's share in the equity acquired amounted to approximately \$16,100 and was allocated as follows: approximately \$8,300 to intangible assets other than goodwill, such as customer base and technology, approximately \$1,400 to in-process research and development ("IPR&D") and approximately \$6,400 to goodwill. Products which did not receive marketing clearance by regulatory authorities as of the acquisition date are considered to be incomplete and accordingly the amount allocated to such products is considered to be IPR&D. The amount allocated to IPR&D was charged immediately to the Company's results of operations in accordance with FASB Interpretation No. 4, "Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method" ("FIN 4"). The amounts allocated to intangible assets other than goodwill are amortized on a straight-line basis over their weighted average expected useful life of 10 years. The amortization of the identifiable intangible assets as well as the write-off of the IPR&D are included as part of the line item "Equity in losses of affiliated companies" in the statements of operations.

## ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands, except share and per share data

#### NOTE 3:- MAJOR TRANSACTIONS (Cont.)

d. **BPT**

On April 19, 2007, Elron completed a new investment of \$1,125 in BPT (Bio-Pure Technology) Ltd. ("BPT"), in consideration for 1,292,782 series A preferred shares of BPT. The aggregate financing round of \$2,400 was led by Elron and Aurum Ventures M.K.I. In addition, as part of the transaction, Elron was issued with warrants to purchase an additional 430,927 preferred A shares at a price and upon conditions determined in the agreement. Following the investment, Elron holds approximately 20% of BPT on a fully diluted basis and on an as converted basis.

BPT, an Israeli based water technology company, provides advanced membrane-based separation solutions that address the unique needs of the water, wastewater treatment and chemical process industries, employing its proprietary HMT™ (Hybrid Membrane Treatment) solution, based on NF (Nano-Filtration) membranes. BPT's solutions address aggressive wastewater streams and water-intensive applications in a wide range of industries, such as pharmaceuticals, chemicals, agrochemicals, metals, food & beverage, drinking water, water re-use and desalination.

Since the investment in Preferred A shares is not considered to be an investment that is in-substance common stock, the investment in BPT is accounted for under the cost method BPT is considered to be a variable interest entity, however, the Company is not the primary beneficiary of BPT, and accordingly has not consolidated BPT. As of June 30, 2007, the company's maximum exposure to loss as a result of its investment in BPT does not exceed the carrying value of its investment in BPT in the amount of \$1,125.

e. **Radlive**

On May 30, 2007 Elron completed a new investment of approximately \$3,750 in Radlive Ltd. ("Radlive"), an Israeli company in consideration for 3,750,000 series A Preferred shares of Radlive. The aggregate financing round of \$7,650 was jointly led by Elron and Gemini Israel Funds. As a result of the investment, Elron holds approximately 25% of RADLIVE's equity on a fully diluted basis and on an as converted basis.

Radlive is engaged in the development of high definition telephony technologies and applications.

Since the investment in Preferred A shares is considered to be an investment that is in-substance common stock, the investment in BPT is accounted for under the equity method.

f. **Pocared**

On June 12, 2007, Elron completed a new investment of approximately \$5,350 in Pocared Diagnostics Ltd. ("Pocared"), an Israeli-based medical device company in consideration for 2,294,536 preferred D shares. The aggregate financing round of \$10,700 was led by Elron and SCP Vitalife Partners II, L.P.

The investment was in two installments: the first of \$3,500 was invested immediately, and an additional \$1,900 is subject to the fulfillment of a milestone by Pocared. Following our aggregate investment, we will hold approximately 20% of Pocared's equity on a fully diluted basis and on an as converted basis.

## ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

#### NOTE 3:- MAJOR TRANSACTIONS (Cont.)

f. **Pocared (Cont.)**

Pocared provides an innovative solution for real-time, reagentless In-Vitro Diagnostics (IVD). Pocared's wide technological platform may be used to address a wide range of medical and industrial diagnostic applications.

Since the investment in Preferred D shares is not considered to be an investment that is in-substance common stock, the investment in Pocared is accounted for under the cost method.

g. **Starling**

On June 13, 2007, Starling Advanced Communications Ltd. ("Starling"), then a 72.5% subsidiary of Elron, completed an initial public offering on the Tel Aviv Stock Exchange (TASE) in Israel of shares and convertible securities (convertible interest-bearing and NIS, Israeli CPI linked debentures ("Convertible Debentures") and options to the Convertible Debentures ("Options to Convertible Debentures") in consideration for aggregate gross proceeds of approximately NIS 57,000 (approximately \$14,000). An amount of approximately \$6,800 proceeds from the issuance of the Convertible Debentures is restricted and will be released from the restrictions and used by Starling upon achieving certain milestones, no later than November 30, 2008. Elron invested approximately \$4,000 as part of the offering in consideration for 619,700 ordinary shares, 8,675,800 convertible debentures and 86,758 options to convertible debentures. In addition, immediately prior to the offering, existing shareholders of Starling, including Elron and its subsidiary, RDC, converted shareholder loans in the amount of approximately \$6,500 into 6,488,783 ordinary shares and 393,126 Options to Convertible Debentures. Following the offering, Elron's consolidated holdings (directly and through RDC) in Starling's outstanding shares decreased from 72.5% to approximately 68%. Since Elron still have control over Starling, Elron continues to account for Starling as consolidated subsidiary.

According to SFAS No. 133 "Accounting For Derivative instruments And Hedging Activities" ("FAS 133") as amended by SFAS 155 "Accounting For Certain Hybrid Financial Instruments" ("FAS 155") the Convertible Debentures and the Options to Convertible Debentures is to be presented, in each reporting period, at their fair value in the balance sheet and the changes in fair value will be charged to finance income, net. As of June 30, 2007 the minority portion in the Convertible Debentures and in the Options to Convertible Debentures amounted to \$5,207 and \$1,002, respectively, and was presented as part of long term liabilities in the consolidated balance sheets.

Starling is considered a development stage Company. Accordingly, the changes in Elron's proportional shares of Starling's equity, resulting from the decrease in Elron's shares in Starling, have been accounted for as an equity transaction and as a result a capital reserve of approximately 3,300 (approximately \$2,480 net of minority interest) was recorded.

#### NOTE 4:- SALE OF REAL ESTATE

On April 25, 2007, an agreement for the sale by our wholly owned subsidiary, Elbit Ltd., of its real estate in Carmiel, Israel, was signed for approximately \$11,600. The transaction was completed during June 2007 and as a result, Elron recorded in the second quarter of 2007 a gain,

## ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

#### NOTE 4:- SALE OF REAL ESTATE (Cont.)

in the amount of \$5,500(approximately \$4,100 net of tax).The gain recorded is included in the line item "other income" in the statement of operations.

#### NOTE 5:- CONTINGENT LIABILITIES

There were no material changes in the status of the Company's contingent liabilities as described in the Company's annual financial statements, the details of which are as follows:

1. During September 1999, the Company received a copy of a claim and a request to approve such claim as a class action on behalf of public shareholders of Elscint (formerly an affiliated company) against the Company and others. The allegation raised by the claimants related to the decision regarding the sale of Elscint's substantial assets. The class action claim is for an amount of approximately \$158,000, alternatively \$123,000. The claim alleges that the defendants, by their decisions regarding the sale of Elscint's assets, caused damage to Elscint and its minority shareholders. The plaintiff seeks a court order requiring Elscint, or the other defendants, to purchase from each of the members of the represented class all shares held by them at a price of \$27.46 per share. The claim has been stayed pursuant to an arrangement reached by the parties pending the outcome of the appeal in the claim described in paragraph 2 below. The arrangement provides that if the appeal as described in paragraph 2 below is accepted, then the proceedings to recognize the lawsuit as a class action will proceed. Otherwise, the application to recognize the claim as a class action suit will be dismissed. In light of the decision on the said appeal by the Supreme Court as described in paragraph 2 below, the Company has requested directions from the Court in regard to this action. On June 14, 2007, the plaintiff notified the defendants that it intends to ask the Court to renew proceedings in the case. No such motion has been received yet.
2. On November 2, 1999, the Company received a copy of a claim, and a request to approve such a claim, as a class action on behalf of some institutional investors and others and those who held shares in Elscint on September 6, 1999. The allegations raised against the Company and certain of its officers including former officers, among others, relate to the period prior to the sale of the Company's holdings in Elbit Medical Imaging ("EMI") (the parent company of Elscint and formerly an affiliated company). The claimants sought a court order pursuant to which EMI would be compelled to execute the alleged buy-out of Elscint's share at \$14 per share or other remedies. On August 16, 2000, the Haifa District court dismissed the application to recognize the claim as a class action. Some of the claimants applied for and were granted permission to appeal to the Supreme Court in Israel. On December 14, 2006, the Supreme Court referred the matter back to the Haifa District Court in order to decide whether the claim should be recognized as a class action. On June 10, 2007, in accordance with the directions of the Haifa District Court issued on April 11, 2007, the plaintiffs submitted an updated statement of claim and motion to recognize the claim as a class action. Pursuant to the updated claim, the plaintiffs are no longer seeking an order compelling EMI to execute the alleged buy-out of Elscint's share at \$14 per share but instead are claiming compensation for damages sustained due to the alleged failure of EMI to execute the buy-out, as well as due to other allegations. The amended statement of claim does not specify the monetary amount claimed, however it does include various allegations relating to the manner of determining the damages claimed, which depends, amongst other things, upon verification of the specific circumstances with regard to each shareholder of Elscint separately and the substance of each damage claimed. The Court has ordered the defendants to respond to the revised motion to recognize the claim as a class action and to file statements of defense to the updated statement of claim by September 10 and 11 respectively.



**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 5:- CONTINGENT LIABILITIES (Cont.)**

In addition, in February 2001, the claimants submitted a revised claim similar to the previous one but not as a class action.

3. During September 2006, two claims were filed by a certain individual in the Haifa District Court against the same defendants (including the Company and certain officers and former officers of the Company) of the action described in paragraph 2 above and based substantially on the same facts of such action. The claims are for an undisclosed amount and also include a request to recognize the claims as class actions. The Court has determined that the defendants do not yet have to file statements of defense.

The Company denies all the allegations set forth as described in paragraphs 1, 2 and 3, and based on legal advice received, management is of the opinion that the Company has good defense arguments which, more likely than not, will cause dismissal of the above claims.

4. On September 20, 2006 Rafael Armaments Development Authority Ltd. ("Rafael") filed a claim with the Tel Aviv District Court against the company's 100% subsidiary, DEP Technology Holdings Ltd. ("DEP"), and RDC, 50.1% held by DEP and 49.9% held by Rafael, requesting the court to issue a declaratory order that Rafael is entitled to terminate the rights granted to RDC to commercialize technologies of Rafael for future development of products for use in non-military markets, pursuant to an agreement between DEP, RDC and Rafael. In December 2006, DEP and RDC filed statements of defense. The parties are conducting informal discussions in an effort to reach a mutually acceptable solution, however there is no assurance that these discussions will be successful in achieving such a solution.

Based on legal advice, the management is of the opinion that DEP and RDC have good defense arguments, which, more likely than not, will cause dismissal of the claim.

**NOTE 6:- RECONCILIATION TO ISRAELI GAAP**

The consolidated financial statements of the Company have been prepared in accordance with U.S. GAAP. Had the consolidated financial statements been prepared in accordance with Israeli GAAP, the effects on the financial statements would have been as follows:

- a. Effect on the statement of operations:

	<b>Six months ended June 30, 2007</b>		
	<b>As reported</b>	<b>Adjustments Unaudited</b>	<b>As per Israeli GAAP</b>
Net income (loss)	\$ 3,376	\$ (20,093)	\$ 16,717
Basic net loss per share	0.11	(0.68)	(0.57)
Diluted net loss per share	0.11	(0.68)	(0.57)

**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 6:- RECONCILIATION TO ISRAELI GAAP (Cont.)**

a. Effect on the statement of operations: (Cont.)

	<b>Six months ended June 30, 2006</b>		
	<u>As reported</u>	<u>Adjustments</u> <u>Unaudited</u>	<u>As per Israeli GAAP</u>
Net loss	\$ (9,938)	\$ (8,027)	\$ (17,965)
Basic net loss per share	(0.34)	(0.27)	(0.61)
Diluted net loss per share	(0.35)	(0.27)	(0.62)

	<b>Year ended December 31, 2006</b>		
	<u>As reported</u>	<u>Adjustments</u> <u>Audited</u>	<u>As per Israeli GAAP</u>
Net income (loss)	\$ 3,032	\$ (15,130)	\$ (12,098)
Basic net income (loss) per share	0.10	(0.51)	(0.41)
Diluted net income (loss) per share	0.07	(0.50)	(0.43)

	<b>Three months ended June 30, 2007</b>		
	<u>As reported</u>	<u>Adjustments</u> <u>Unaudited</u>	<u>As per Israeli GAAP</u>
Net income (loss)	\$ 808	\$ (5,006)	\$ (4,198)
Basic net income (loss) per share	0.03	(0.17)	(0.14)
Diluted net income (loss) per share	0.02	(0.17)	(0.14)

	<b>Three months ended June 30, 2006</b>		
	<u>As reported</u>	<u>Adjustments</u> <u>Unaudited</u>	<u>As per Israeli GAAP</u>
Net loss	\$ (6,425)	\$ (3,345)	\$ (9,770)
Basic net loss per share	(0.22)	(0.11)	(0.33)
Diluted net loss per share	(0.22)	(0.11)	(0.33)

**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands, except share and per share data**

**NOTE 6:- RECONCILIATION TO ISRAELI GAAP (Cont.)**

b. Effect on the balance sheet:

	<b>As of June 30, 2007</b>		
	<u>As reported</u>	<u>Adjustments</u> <u>Unaudited</u>	<u>As per Israeli</u> <u>GAAP</u>
Total assets	\$ 333,989	\$ (66,642)	\$ 267,347
Total liabilities including minority interest	30,517	2,909	33,426
Total equity	303,472	(69,551)	233,921
	<b>As of December 31, 2006</b>		
	<u>As reported</u>	<u>Adjustments</u> <u>Audited</u>	<u>As per Israeli</u> <u>GAAP</u>
Total assets	\$ 326,249	\$ (58,970)	\$ 267,279
Total liabilities including minority interest	28,745	(957)	29,702
Total equity	297,504	(59,927)	237,577

c. Material adjustments:

1. The abovementioned adjustments result primarily from the differences between U.S. GAAP and Israeli GAAP detailed in Note 26 to the Company's annual financial statements for 2006 and from the following:

a. NetVision

As described in Note 3a, under U.S GAAP the Barak Merger and GlobCall Merger were accounted in NetVision's financial statement at fair value according to the purchase method. Under Israeli GAAP, the Barak Merger and GlobCall Merger accounted as "as pooling" since these transactions are considered business combination between parties under common control. The difference between Elron's share in NetVision's shareholder's equity before and after the transactions was recorded by Elron as capital reserve, while under U.S GAAP it was recognized as a gain in the statement of operations.

b. Starling IPO

1. As described in note 3g, under U.S GAAP since Starling is considered a development stage company, the changes in Elron's proportional share of Starling's equity, resulting from the decrease in Elron's share in Starling, have been accounted for as an equity transaction and as a result a capital reserve of approximately 3,300 (approximately \$2,480 net of minority interest) was recorded. According to Israeli GAAP, the changes in the Company's

## ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands, except share and per share data

#### NOTE 6:- RECONCILIATION TO ISRAELI GAAP (Cont.)

c. Material adjustments: (Cont.)

b. Starling IPO (Cont.)

proportionate share of Starling's equity will be recorded as gain from disposal of businesses in the higher amount between the accumulated losses to be recorded and a portion of the gain over a period of three years.

c. Sale of real estate

As described in Note 4, during June 2007, Elbit sold its real estate in Carmiel. According to accepted practice in Israel, the merger between Elron and Elbit which occurred in May 2002, was considered a transaction with controlling shareholders and therefore the assets and liabilities of Elbit were recorded by Elron according to their carrying values in Elbit at the date of the merger. Therefore the gain net of tax recorded in respect of the above sale based on Israeli GAAP amounted to approximately \$5,400, as compared to approximately \$4,100 under U.S GAAP.

2. Accounting Standard No. 29 - Adoption of International Financial Reporting Standards (IFRS):

In July 2006, the Israel Accounting Standards Board published Accounting Standard No. 29, "Adoption of International Financial Reporting Standards (IFRS)" ("the Standard"). Pursuant to the Standard, companies that are subject to the provisions of the Securities Law, 1968, and that are required to report according to the regulations published thereunder, will be required to prepare their financial statements in accordance with IFRS starting from the period commencing on January 1, 2008.

Since the financial statements are in accordance to US GAAP, the Company includes in its financial statements a note of reconciliation between US GAAP and Israeli GAAP. Commencing January 1, 2008 the Company will include reconciliation between US GAAP to IFRS in a note to its financial statements.

The Company is evaluating the effect of the new Standard on its financial statements.

**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**ANNEX TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands**

**Details relating to major investments as of June 30, 2007:**

	<b>% of ownership interest <sup>(1)</sup></b>	<b>Carrying value of the investment as of June 30, 2007 <sup>(2)</sup></b>	<b>Market value of the publicly traded investments as of: June 30, 2007</b>	<b>August 14, 2007</b>
<b><u>Consolidated Companies:</u></b>				
Starling <sup>(3)(4)</sup>	50%	3,955	12,475	12,984
SELA <sup>(3)</sup>	39%	681	-	-
Medingo <sup>(3)</sup>	50%	(488)	-	-
<b><u>Affiliated Companies (equity):</u></b>				
Given Imaging Ltd. (Nasdaq: GIVN) <sup>(3)</sup>	23%	82,814	209,690	177,189
NetVision Ltd. (TASE: NTSN)	17%	26,739	56,816	48,830
ChipX	29%	2,075	-	-
AMT	34%	3,029	-	-
Wavion, Inc.	38%	(280)	-	-
Galil Medical Ltd. <sup>(3)</sup>	20%	2,738	-	-
3DV Systems Ltd. <sup>(3)</sup>	44%	1,630	-	-
Notal Vision, Inc.	23%	1,867	-	-
Aqwise	34%	3,340	-	-
Radlive	29%	3,752	-	-
<b><u>Available for sale:</u></b>				
EVS (Nasdaq: EVSNF.OB)	7%	1,243	1,437	1,349
MWise Inc.	6%	982	1,231	947
<b><u>Partnership:</u></b>				
Gemini Israel Fund L.P.	5%	16	-	-
InnoMed Ventures L.P.	14%	2,941	-	-
<b><u>Cost:</u></b>				
Jordan Valley Ltd.	27%	8,137	-	-
Impliant Inc.	22%	8,340	-	-
Teledata Ltd.	21%	16,800	-	-
Nulens Ltd.	29%	4,360	-	-
Brainsgate Ltd.	23%	7,036	-	-
Enure Networks Ltd.	41%	2,215	-	-
Safend Ltd.	26%	3,700	-	-
Neurosonix Ltd.	16%	2,850	-	-
Atlantium Inc.	31%	10,006	-	-
BPT	19%	1,125	-	-
Pocared	17%	3,468	-	-

<sup>(1)</sup> On the basis of the outstanding share capital.

<sup>(2)</sup> Includes loans and convertible notes.

<sup>(3)</sup> Represents the carrying value and the ownership interest of the investment in Elron's books and Elron's share in the carrying value and ownership interest of the investment in RDC's books.

<sup>(4)</sup> Includes Convertible Debentures and Options to Convertible Debentures.