SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2005
Commission File No. 0-11456

ELRON ELECTRONIC INDUSTRIES LTD.

(Exact name of Registrant as specified in its charter and translation of Registrant's name into English)

ISRAEL
(Jurisdiction of incorporation or organization)

3 Azrieli Center, 42nd Floor, Tel-Aviv, Israel 67023
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:
Not Applicable
(Title of Class)

Securities registered or to be registered pursuant to Section 12(g) of the Act:
Ordinary Shares, nominal value 0.003 New Israeli Shekels per share
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:
Not Applicable
(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the Annual Report: **29,483,455**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☐ No ☒

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes ☐ No ☒

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 of 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 [x]** **No [ ]**

Indicate by check mark whether the registrant is a 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 which financial statements the registrant has elected to follow:

Item 17 [ ] **Item 18** [**x**]

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

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For the purpose of this Annual Report on Form 20-F, the terms “group companies” and “companies in our group” collectively refer to subsidiaries, affiliated and other companies in which we have direct or indirect holdings through our wholly-owned subsidiaries, Elbit Ltd., or Elbit, and DEP Technology Holdings Ltd., or DEP, including DEP’s subsidiary, RDC Rafael Development Corporation Ltd., or RDC. Our ownership interests in our group companies reflected in this Annual Report represent our beneficial ownership interests in the outstanding shares of these companies as of May 31, 2006 unless otherwise expressly indicated. Our beneficial ownership interests in the preferred shares of these companies are represented on an as-converted-basis. We have also indicated our direct holding and our share in the holding of RDC in a group company where applicable. The references in this Annual Report to balance sheet items are as of December 31, 2005, unless otherwise indicated.

Throughout this report we discuss certain information regarding Given Imaging Ltd. and Partner Communications Ltd., companies in our group which have securities registered with the Securities and Exchange Commission in the United States (the “SEC”). Our discussions of these Companies are qualified in their entirety by the reports these companies file with the SEC which are posted on the SEC's website at www.sec.gov. Please see these reports for additional information on these companies.

Forward-Looking Statements

This Annual Report on Form 20-F includes certain “forward-looking” statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. The use of the words “projects,” “expects,” “may,” “plans” or “intends,” or words of similar import, identifies a statement as “forward-looking.” There can be no assurance, however, that actual results will not differ materially from our expectations or projections. Factors that could cause actual results to differ from our expectations or projections include the risks and uncertainties described in this Annual Report under Item 3 titled “Risk Factors” as well as those discussed elsewhere in this Annual Report and in our other filings with the SEC. Any forward-looking statements contained in this Annual Report speak only as of the date of this Annual Report, and we caution investors and potential investors not to place undue reliance on these statements. We undertake no obligation to update or revise any forward-looking statements. All subsequent written or oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the Risk Factors.

PART I

Item 1. Identity of Directors, Senior Management and Advisers

Not Applicable.

Item 2. Offer Statistics and Expected Timetable

Not Applicable.

Item 3. Key Information

A. Selected Financial Data

The following selected financial data for the years ended December 31, 2001, 2002, 2003, 2004 and 2005 are derived from our audited consolidated financial statements of which the financial statements as of December 31, 2004 and 2005, and for each of the years ended December 31, 2003, 2004 and 2005 appear later in this Form 20-F. The audited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States, or U.S. GAAP.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands of U.S. Dollars, except per share data)

	Year ended December 31				
	2001	**2002**	**2003**	**2004**	**2005**
Income:					
Net revenues	$ -	$ 5,110	$ 9,157	$ 11,265	$ 12,646
Equity in losses of affiliated companies	(28,787)	(24,189)	(8,698)	(10,492)	(17,522)
Gain from disposal of businesses and affiliated companies and changes in holdings in affiliated companies, net	3,179	6,888	25,754	132,396	23,328
Other income (expenses), net	(4,666)	(747)	14,637	4,749	58,648
Financial income, net	4,538	1,480	751	1,433	5,483
	(25,736)	(11,458)	41,601	139,351	82,583
Costs and Expenses:					
Cost of revenues	-	2,903	5,862	6,791	7,907
Research and development costs, net	55	2,265	3,263	2,889	6,163
Marketing and selling expenses, net	-	5,268	6,498	1,311	2,386
General and administrative expenses	5,100	7,568	12,872	12,292	9,249
Restructuring costs	-	396	-	-	-
Amortization of intangible assets	-	269	299	142	392
Impairment of intangible assets	-	-	-	4,192	-
	5,155	(18,670)	28,794	27,617	26,097
Income (loss) before tax benefit (taxes on income)	(30,891)	(30,128)	12,807	111,734	56,486
Tax benefit (taxes on income)	3,786	2,961	(6,796)	(15,101)	(10,461)
Income (loss) after taxes on income	(27,105)	(27,167)	6,011	96,633	46,025
Minority interest in losses (income) of subsidiaries	438	2,823	(10,907)	(4,135)	5,160
Income (loss) from continuing operations	(26,667)	(24,344)	(4,896)	92,498	51,185
Loss from discontinued operations	(25,692)	(17,235)	(2,309)	(8,365)	(3,850)
Net Income (loss)	$ (52,359)	$ (41,579)	$ (7,205)	$ 84,133	$ 47,335
Income (loss) per share:					
Basic -					
Income (loss) from continuing operations	$ (1.26)	$ (0.93)	$ (0.17)	$ 3.26	$ 1.74
Loss from discontinued operations	(1.21)	(0.65)	(0.08)	(0.39)	(0.13)
Net income (loss)	$ (2.47)	$ (1.58)	$ (0.25)	$ 2.86	$ 1.61
Weighted average number of ordinary shares used in computing basic net income (loss) per share (thousands)	21,191	26,272	29,194	29,266	29,437

	Year ended December 31				
	2001	2002	2003	2004	2005
Diluted -					
Income (loss) from continuing operations...	$ (1.27)	$ (0.93)	$ (0.17)	$ 3.25	$ 1.73
Loss from discontinued operations.............	(1.21)	(0.65)	(0.08)	(0.39)	(0.13)
Net income (loss)	$ (2.48)	$ (1.58)	$ (0.25)	$ 2.86	$ 1.60
Weighted average number of ordinary shares used in computing diluted net income (loss) per share thousands)	21,191	26,272	29,194	29,385	29,550
Dividend paid per share...................................	$	$ —	$ —	$ —	$ 3.0

	As of December 31,				
	2001	2002	2003	2004	2005
Balance Sheet Data	**(U.S. Dollars in thousands)**				
Cash, cash equivalents and short-term and long term investments.......................................	$ 111,896	$ 99,735	$ 119,769	$ 188,106	$ 143,798
Investments in affiliated companies and in other companies and long term receivables..................	164,967	221,338	285,618	273,053	176711
Total assets	321,512	394,253	450,704	501,156	353,773
Shareholders’ equity...	233,915	259,441	296,130	389,080	302,116
Capital stock………………………..	217,478	284,583	328,477	337,294	291,445

B. Capitalization and Indebtedness

Not Applicable.

C. Reasons for the Offer and Use of Proceeds

Not Applicable.

D. Risk Factors

Risks Affecting us and the Companies in our Group

Our financial results and financial condition are principally impacted by the results of, and the value of our holdings in, our group companies. For the year ended December 31, 2005, our share in the results of operations of our group companies and gain upon the sale of shares in our group companies accounted for substantially all of our income. In addition, as of December 31, 2005, our holdings in group companies represented approximately 50% of our total assets. If our group companies experience difficulties in the future, or if there are adverse changes in their market price or fair value, our financial results and/or the value of our assets will be adversely affected, and we may need to write-down or write-off the carrying value of our holding or record the share in our group company's loss. In particular, as of December 31, 2005, the carrying value of our holdings in Given Imaging Ltd., or Given Imaging (Nasdaq:GIVN), represented approximately 19% of our total assets, the carrying value of our holdings in Partner Communications Ltd., or Partner (Nasdaq: PTNR), represented approximately 7% of our total assets and the carrying value of our holdings in Oncura, Inc., or Oncura, through our subsidiary

Galil Medical Ltd., or Galil Medical, represented approximately 6% of our total assets. Any adverse change in the results of operations or financial condition of Given Imaging, Oncura or other of our group companies whose results we consolidate or account for on an equity basis, or any substantial adverse change in the market value of shares in Given Imaging or Partner, may have a substantial negative impact on our results of operations or financial condition.

Our performance significantly depends on the results of operations of our group companies. Our results of operations are directly impacted by the results of operations of our group companies accounted for under the equity or consolidation method. To the extent any of these companies have poor financial results or encounter difficulties in their operations, our financial results will be negatively impacted. Many of these companies have not yet generated significant revenues, have incurred losses and have invested heavily in research, development and marketing of their products. We anticipate that the majority of these companies will continue to record losses in the future.

Our financial results are directly impacted by our ability to conclude profitable "exit" transactions. Our financial results are directly impacted by our ability to conclude profitable "exit" transactions regarding certain of the companies in our group. If worldwide market conditions in the technology industry or other factors do not permit us to conclude these types of transactions, our results will be adversely affected.

We may face difficulties in our ability to dispose of our shares in publicly traded companies in our group. Due to the limitations of U.S. securities laws, material non-public information to which we may become exposed due to our representation on the boards of directors of companies in our group, and contractual and legal limits on the tradability of the shares, we may face difficulties in our ability to dispose of our shares in publicly traded companies in our group at a time and in a manner we deem suitable.

Our market value significantly depends on the market values of publicly-traded companies in our group. Our market value is directly impacted by the market values of Given Imaging and Partner, each of whose shares are traded in the public markets. To the extent that the share prices of either of these companies decline, our market value will be negatively impacted. In particular, we are affected by the price of shares of Given Imaging,. If the share prices of either of these companies decline, our market value could be adversely affected.

The market price of our ordinary shares is subject to fluctuations. The market value of our ordinary shares has fluctuated over time. The following factors, among others, may significantly impact the market price of our ordinary shares:

- the market price of our group companies which are publicly traded, in particular, Given Imaging;
- our group companies, their competitors or other third parties announcing technological innovations, new products or earnings or losses;
- periodic variations in results of operations of our group companies;
- factors that generally affect the market for stocks of medical device, telecommunications, semiconductor and advanced materials companies;
- political, economic or other developments affecting Israel;

- global economic and other external factors; and
- quarter-to-quarter fluctuations in our financial results.

Many of our group companies may face difficulties in obtaining future financing on favorable terms or at all. Many of our group companies have extensive research and development and marketing costs and limited revenues, if any. In order to succeed, these companies may require additional capital to fund these costs. If these companies have difficulties in obtaining financing from their current shareholders, which may also include additional investments by us in these companies, or from new financing sources, their continued operations may be at risk. This would adversely affect our financial performance and results of operations.

Bank of Israel regulations limit our and our group companies' ability to borrow from Israeli banks. Bank of Israel regulations stipulate lending limits of Israeli banks to companies and individuals considered to be in an affiliated group, which limits the amount available to such affiliated group to borrow from such banks. We and our group companies are part of the IDB affiliated group of companies, which is one of the largest groups of affiliated companies in Israel. The IDB group includes many Israeli companies, which require, or which hold ownership interests in companies which require, extensive credit facilities from Israeli banks for the operation of their businesses. These regulations may result in difficulties for us and our group companies to obtain bank financing, if required.

Our results may be affected by volatility in the securities markets. Securities markets in general are volatile, and are particularly volatile with respect to high-technology companies, including companies that have a significant presence in Israel. Although the volatility of these companies' securities is not necessarily related to their operating performance, these companies may experience difficulties in raising additional financing required to effectively operate and grow their businesses. These difficulties and the volatility of the securities markets in general may also affect our and our group companies' ability to realize investments.

The downturn experienced by the technology markets in which our group companies operate may re-occur. Our group companies are affected by the demand for the technologies and technology products they develop and produce. The technology sector has previously experienced a prolonged and severe downturn, reflected in a steep decline in technology spending resulting in revenue declines for our more mature companies and difficulties in raising financing for our early stage companies. There is no assurance that a downturn will not re-occur or that the technology sector will continue to grow. If a downturn re-occurs, our and our group companies' operations will be adversely affected.

We compete with other entities for acquisition and investment opportunities. As part of our overall strategy, we pursue acquisitions of, and investments in, Israeli companies and Israel-related technology companies. The success of a number of Israeli companies, particularly in information and communications technology and medical devices, has prompted potential investors to seek investment opportunities in Israel, which has allowed many Israeli high-technology companies to gain direct access to Israeli and foreign public securities markets. We compete for acquisition and investment opportunities with other established and well-capitalized entities. There can be no assurance that we will be able to locate acquisition or investment opportunities upon favorable terms. Our failure to consummate further acquisitions or investments in the future may hinder our ability to grow and could harm our business, financial condition and results of operations.

There is no assurance that our subsidiary RDC will be able to continue to develop successful technologies and /or group companies. Our wholly-owned subsidiary DEP holds 50.1% of the outstanding shares and voting rights of RDC, established by DEP together with Rafael Armaments Development Authority Ltd., or Rafael pursuant to an agreement entered into between DEP and Rafael in 1993. RDC has first rights to exploit commercially technologies of Rafael for the development of products for use in non-military markets, which rights are dependent primarily upon RDC’s or Rafael’s identification of existing technologies for commercial uses, or the development by Rafael of new technologies, Rafael’s willingness to transfer the necessary human or other resources to develop and exploit commercially its technology in non-military markets, and RDC reaching agreement with Rafael on the terms of any commercial exploitation. RDC is currently involved in a dispute with Rafael regarding Rafael’s request to limit the scope of RDC’s rights under the agreement to certain fields or applications and to limit the period of the agreement even though the agreement is unlimited in time. . Our ability to continue to grow and develop RDC could be harmed, and our business, financial condition and results of operations could be adversely affected, if we are unable to realize the full potential value of RDC’s agreement with Rafael as a result of any of the following:

- Rafael and RDC do not reach consensus on Rafael’s requests regarding limiting the scope and period of RDC’s rights under the agreement,
- Rafael does not cooperate with RDC in the realization of RDC’s rights under the agreement,
- Rafael or RDC do not identify existing technology, or Rafael does not develop new technology, that can be commercially exploited in non-military markets,
- Rafael does not transfer the necessary human or other resources to develop and exploit commercially this technology in non-military markets,
- RDC does not reach agreement with Rafael on the terms of any commercial exploitation, or
- the continued financing of RDC by its shareholders.

Most of our group companies are dependent upon proprietary technology which may be infringed upon or may infringe upon the proprietary technology of others. Most of our group companies greatly depend on their proprietary technology for their success. Like many other technology companies, most of these companies rely on a combination of patent, trade secret, copyright and trademark laws, together with non-disclosure agreements, confidentiality clauses in their agreements, including employment agreements, and technical measures to establish and protect proprietary rights in their products. These companies may not be able to enforce their proprietary rights under the laws of certain jurisdictions. Our group companies may not successfully protect their technology because, among other reasons:

- some foreign countries may not protect their proprietary rights as fully as do the laws of the United States;

- enforcing their rights may be time consuming and costly, diverting management's attention and company resources;
- measures such as entering into non-disclosure agreements afford only limited protection;
- unauthorized parties may attempt to copy aspects of their products and develop similar software or to obtain and use information that they regard as proprietary; and
- competitors may independently develop products that are substantially equivalent or superior to their products or circumvent intellectual property rights.

In addition, others may assert infringement claims against our group companies. The cost of responding to infringement claims could be significant, regardless of whether the claims are valid.

Many of our group companies experience intense competition. Many of our group companies experience competition from companies with significantly greater financial, technical, marketing and public relations resources, who have easier market access, better operational infrastructure, longer operating histories, larger installed client bases, greater name recognition, more established relationships and alliances in their industries and offer a broader range of products and services. As a result, these competitors may be able to respond more quickly to new or emerging technologies or changes in clients' requirements, benefit from greater purchasing economies, offer more aggressive product and services pricing or devote greater resources to the promotion of their products and services. If our group companies are unable to successfully compete, their businesses, financial condition and results of operations could be seriously harmed, which would in turn negatively affect our financial condition and results of operations.

Our group companies may experience delays in product development. Companies in our group involved in technology product development may experience delays in development which may result in loss of, or delay in, market acceptance. Delays and difficulties associated with new product introductions or product enhancements could negatively impact the business, financial condition, prospects and results of operations of these companies and, as a result, our financial results.

Israeli government programs in which certain of our group companies participate may be terminated or reduced in the future. ***In addition, the terms of such programs restrict the ability of our group companies to manufacture products and/or transfer technologies outside of Israel.*** Certain of our group companies participate in programs of the Office of the Israeli Chief Scientist, or the OCS and the Israel Investment Center, for which they receive grants and tax related and other benefits. The benefits available under these programs depend on our group companies meeting specified conditions. If our group companies fail to comply with these conditions, they may be required to pay additional taxes and penalties and be denied future benefits. We cannot assure you that these benefits will be available in the future at their current levels or at all.

Under the Israeli Law for the Encouragement of Industrial Research and Development, 1984, and related regulations, the discretionary approval of an OCS committee is required for any transfer of technology developed with OCS funding. There is no assurance that our group companies will receive the required approvals for any proposed transfer. Such approvals, if granted, may be subject to the following additional restrictions:

- our group companies could be required to pay the OCS a portion of the consideration received upon any sale of such technology or group company to an entity that is not Israeli. The scope of the support received, the royalties that were paid, the amount of time that elapsed between the date on which the technology was transferred and the date on which the grants were received, as well as the sale price, will be taken into account in order to calculate the amount of the payment; and

- the transfer of manufacturing rights could be conditioned upon an increase in the royalty rate and payment of increased aggregate royalties (up to 300% of the amount of the grant plus interest, depending on the percentage of the manufacturing transferred outside of Israel).

These restrictions may limit the ability of our group companies to conclude transactions with international companies, including “exit” transactions.

We and our group companies may have difficulty retaining key employees. Our success and the success of our group companies depend, in large part, on a limited number of key management, scientific and technical personnel. In addition, future success will depend upon, in part, attracting and retaining highly qualified personnel. There can be no assurance that we or our group companies will be able to either retain present personnel or acquire additional qualified personnel as and when needed. The loss of the services of our key personnel or those of our group companies and the failure to attract highly qualified personnel may have a negative impact on our business.

Many of our group companies depend on international operations. Many of our group companies depend on sales to customers outside Israel. We expect that international sales will continue to account for a significant portion of these companies’ revenues for the foreseeable future. As a result, changes in international, political, economic or geographic events could result in significant shortfalls in orders or revenues. These shortfalls could cause the business, financial condition and results of operations of these companies to be harmed. Some of the risks of doing business internationally include:

- unexpected changes in regulatory requirements;
- the fluctuation of the New Israeli Shekel/U.S. Dollar representative rate of exchange;
- the inability of our group companies, their subsidiaries and subcontractors to obtain export licenses;
- imposition of tariffs and other barriers and restrictions;
- burdens of complying with a variety of foreign laws;
- political and economic instability;

- changes in diplomatic and trade relationships; and
- acts of terror.

Some of these factors, such as the ability to obtain export licenses and changes in diplomatic relations, may be affected by Israel's overall political situation. See "Conditions in Israel may affect our operations and the operations of our group companies." In addition, the economic and political stability of the countries of the major customers and suppliers of our group companies may also impact their business.

Conditions in Israel may affect our operations and the operations of our group companies. We and most of our group companies conduct our principal operations in Israel, and therefore are directly affected by the political, economic, and military conditions affecting Israel and the Middle East. In particular, we could be adversely affected by:

- any major hostilities involving Israel;
- a full or partial mobilization of the reserve forces of the Israeli army;
- the interruption or curtailment of trade between Israel and its present trading partners;
- a significant increase in inflation;
- a significant downturn in the economic or financial condition of Israel;
- a significant downgrading of Israel's international credit rating;
- labor disputes and strike actions; and
- political instability

Since September 2000, there has been a significant increase in violence, civil unrest and hostility, including armed clashes, between the State of Israel and the Palestinians, and acts of terror have been committed inside Israel and against Israeli targets in the West Bank and Gaza including armed hostilities between Israel, the Palestinian Authority and other groups in the West Bank and Gaza Strip. Israel has responded with military action and is building a security fence, the route of which has been the subject of a great deal of controversy. Despite Israel's unilateral withdrawal from part of the territories, there is an impasse in the entire peace process. No predictions can be made as to whether or when a final resolution of the area's problems will be achieved or the nature thereof and to what extent the situation will impact Israel's economic development. Any further escalation in these hostilities or any future armed conflict, political instability or violence in the region could have a negative effect on our and our group companies' business and financial condition, harm our and our group companies' results of operations and adversely affect our share price or the share prices of our group companies that are publicly traded.

Our and our group companies' operations could be disrupted as a result of the obligation of key personnel in Israel to perform military service. All non-exempt male adult permanent residents of Israel under a specified age, as a general rule, are obligated to perform military reserve duty and may be called to active duty under emergency circumstances. Our operations and those of our group companies could be disrupted by the absence for a significant period of one or more of our or our group companies' officers or employees. While we and our group companies have operated effectively despite these conditions in the past, we cannot assess what impact these conditions may have in the future, particularly if emergency circumstances arise.

The results of operations of our group companies may be harmed by foreign currency exchange rate fluctuations. To the extent that our group companies are based in Israel and have international operations, or operate only in Israel but conduct their business in different currencies, their revenues, expenses, assets and liabilities, are not necessarily in the same currency and therefore they are exposed to foreign exchange rate fluctuations. These fluctuations may negatively affect their results of operations. Some of our group companies may attempt to hedge their foreign currency exposure from time to time; however, we cannot assure you that if they do so they will be successful.

Our group companies may not be able to enforce covenants not to compete. Some of our group companies currently have non-competition agreements with substantial numbers of their employees who are involved in research and development. In many cases, these employees are located primarily in Israel. These agreements prohibit the company's employees, if they cease working for the company, from directly competing with the company or working for its competitors. Israeli courts have required employers seeking to enforce non-compete undertakings of a former employee to demonstrate that the competitive activities of the former employee will harm one of a limited number of material interests of the employer which have been recognized by the courts, such as the secrecy of a company's confidential commercial information or its intellectual property. If any of our group companies cannot demonstrate that harm would be caused to it, the company may be unable to prevent its competitors from benefiting from the expertise of its former employees.

Product liability claims could adversely affect the business results of our group companies operating in the medical device industry. Product liability is an inherent risk for our group companies operating in the medical device industry. A product liability claim, regardless of its merit or eventual outcome, could result in substantial costs to a group company and a substantial diversion of management attention. A product liability claim or any product recalls could also harm a group company's reputation and result in a decline in revenues. Substantial damages awards have been made in some jurisdictions against medical device companies based upon claims for injuries allegedly caused by the use of their products. There can be no assurance that a future product liability claim or series of claims brought against our group companies would not have an adverse effect on their business or the results of operations, or that product liability insurance would be adequate.

Product regulation may adversely affect the ability of our medical device group companies to bring new products to market or to continue to supply existing products to the market. Our medical device group companies are subject to strict government controls on the development, manufacture, labeling, distribution and marketing of products. They must obtain and maintain regulatory approval for their products from regulatory agencies before products may be sold in a particular jurisdiction. Each regulatory authority may impose its own requirements and delay or refuse to grant approval, even though a product has been approved in another country. Regulatory delays, the inability to successfully complete clinical trials, claims and concerns about safety and efficacy, new discoveries, patents and products of competitors and related patent disputes and claims about adverse side effects are only a few of the factors that could adversely affect the realization of product registration. Noncompliance with applicable regulatory requirements can result in enforcement action which may include recalling products, ceasing product marketing, paying significant fines and penalties, and similar regulatory actions which could limit product sales, delay or halt product shipment, delay new product clearance or approval, and adversely affect such group companies' results of operations.

Because the medical device industry is litigious, our medical device group companies are susceptible to intellectual property suits that could cause our group companies to incur substantial costs or pay substantial damages or prohibit them from selling their products. There is a substantial amount of litigation over patent and other intellectual property rights in the medical device industry. Whether a product infringes a patent involves complex legal and factual issues, the determination of which is often uncertain. Infringement and other intellectual property claims, with or without merit, can be expensive and time-consuming to litigate and can divert management's attention from the company's core business. See below under "Risks Affecting Our Holdings in Given Imaging."

If our medical device group companies are unable to obtain reimbursement coverage from third-party healthcare payors for procedures using their products, or if reimbursement is insufficient to cover the costs of purchasing their products, demand for their products may be adversely affected. If physicians, hospitals and other healthcare providers are unable to obtain sufficient coverage and reimbursement from third-party payors for products produced by our medical device group companies, or if reimbursement is insufficient to cover the costs of purchasing our medical device group companies' products or does not adequately compensate physicians and health care providers as compared to alternative procedures, our medical device group companies may be unable to generate sufficient sales to support their businesses. In addition, our medical device group companies could be adversely affected by changes in reimbursement policies of governmental or private healthcare payors to the extent any such changes affect reimbursement amounts or methods for procedures in which their products are used.

Our telecommunications group companies operate in a highly regulated telecommunications market which limits their flexibility to manage their businesses. The telecommunications market is subject to government regulation regarding licensing, competition, frequency allocation and costs and arrangements pertaining to interconnection and leased lines. The business and operations of our group companies which operate in this market, primarily Partner and NetVision, could be adversely affected by changes in laws, regulations or government policy affecting its business activities. These could include decisions by the regulator increasing the rate of royalties to be paid to the State of Israel, enlarging the types of revenues which the royalties apply to, setting policies and imposing new regulations governing electronic trade and mobile commerce, or further reducing call or Short Message Service, or SMS, termination tariffs, as well as the amendment or revocation of their licenses.

Certain of our telecommunications group companies can only operate their businesses for as long as they have a license from the Ministry of Communications. Partner and NetVision Ltd., or NetVision, conduct their respective operations pursuant to their respective licenses granted to each of them by the Ministry of Communications. These licenses are subject to revocation in accordance with their terms, and the terms of the licenses are subject to change by the Ministry of Communications (including by imposing additional requirements).

The semiconductor industry in which certain of our group companies operate is cyclical in nature and is characterized by ongoing changes. The semiconductor industry has historically been a highly cyclical industry. Companies in the semiconductor industry have expanded aggressively during periods of increased demand. This expansion has frequently resulted in overcapacity and excess inventories during periods of downturn, thereby adversely impacting upon the results of operations of our group companies operating in the semiconductor field.

In addition, the semiconductor industry is characterized by rapid ongoing changes, including: (1) changes in customers' capacity requirements and capital spending, which depend in part on customers' inventory levels relative to demand for their products; (2) the importance of driving down cost of ownership of systems; (3) more complex technology requirements; (4) the increasing significance of consumer electronics as a driver for chip demand and the related focus on lower prices; (5) varying levels of business information technology spending; (6) the growing types and varieties of integrated circuits and applications; (7) a rising percentage of business from customers in Asia and emergence of customers and competitors in new geographical regions; (8) customer demands for shorter lead times for the manufacture and installation of semiconductor manufacturing equipment; and (9) higher capital requirements for new semiconductor fabrication plants. If our semiconductor companies do not successfully manage the risks resulting from the ongoing changes occurring in the semiconductor industry, their businesses, financial condition and results of operation could be materially and adversely affected.

Specific Risks Affecting Elron

We may be deemed to be an investment company under the Investment Company Act of 1940. Generally, a company must register under the Investment Company Act of 1940, or the 1940 Act, and comply with significant restrictions on operations and transactions with affiliates if its investment securities exceed 40% of the company's total assets, or if it holds itself out as being primarily engaged in the business of investing in, owning or holding securities. The 1940 Act provides for various exemptions from the obligation to register thereunder, and in 1980 we received an order from the SEC, declaring that we are not an investment company under the 1940 Act. If certain of our investments were to adversely affect our status under the 1940 Act, we might need to dispose of or acquire other investments to avoid the requirement to register as an investment company on terms that may not be favorable to us. In addition, if we were deemed to be an investment company and therefore required to register as such under the 1940 Act, we would be unable to continue operating as we currently do, as a result of which our market value would be severely harmed.

If we are characterized as a passive foreign investment company for U.S. federal income tax purposes, our U.S. shareholders may suffer adverse tax consequences. Generally, if for any taxable year 75% or more of our gross income is passive income, or at least 50% of our assets are held for the production of, or produce, passive income, we may be characterized as a passive foreign investment company, or PFIC, for U.S. federal income tax purposes.

If we are characterized as a PFIC, our U.S. shareholders may suffer adverse tax consequences, including having gains realized on the sale of our shares taxed at ordinary income rates, rather than the capital gain rate. In addition, both gains upon disposition and amounts received as distributions could be subject to an additional interest charge by the Internal Revenue Service. If we are determined to be a PFIC for any given year, then dividends paid in that year and in the next year cannot qualify as "qualified dividends" which are eligible for the capital gains rate for certain U.S. Shareholders. A determination that we are a PFIC could also have an adverse effect on the price and marketability of our shares.

Following the sale of our shares in Elbit Systems in 2004, we announced that, as a result of the transaction, we may be characterized as a PFIC for 2004. Following a review of our position and consulting with our advisors on this matter in 2004, and based on certain assumptions and facts known at that time (which we believe have not changed), we believe there is substantial authority for the position that we can rely on the “change of business” exception to PFIC status provided under Section 1298(b)(3) of the U.S. Internal Revenue Code of 1986, as amended. Substantial authority is generally sufficient to support a return reporting position. Pursuant to this exception, in order to avoid PFIC status in 2004, among other requirements, we cannot be a PFIC in 2005 or 2006 (which cannot be determined at this time with respect to 2006) or in any year prior to 2004 (which we believe was not the case).

We believe that in 2005 we were not a PFIC. However, since the determination of whether we are a PFIC is based upon such factual matters as the valuation of our assets and, in certain cases, the assets of companies held by us, there can be no assurance with respect to the position of the Internal Revenue Service or a court of law as to our status as a PFIC. Our analysis related to 2005 is based, among others, upon certain assumptions and methodologies with respect to the values that we have used; our percentage ownership (by value), and the appropriate value of our ownership interest, in companies we held; and the manner in which we have allocated the aggregate value of our assets among our active assets and passive assets.

We cannot assure you that the Internal Revenue Service will not challenge our assumptions and methodologies. If the IRS were to challenge successfully such assumptions or methodologies, we would potentially be classified as a PFIC for 2005 or prior years.

With respect to 2006, the ultimate determination of our PFIC status will depend on the composition of our gross income and assets for the entire year, and the values of those assets, which are difficult to predict at this time and the appropriate value of our ownership interest in our group companies.

In view of the above, it is unclear whether the “change of business” exception would ultimately be satisfied for 2004. We cannot assure shareholders that the Internal Revenue Service will not challenge our reliance on the "change of business" exception or our assumptions used in determining our percentage of passive assets and income. If there are such challenges, we could be classified as a PFIC for 2004, even if we are not a PFIC in 2005 and 2006. Furthermore, there can be no assurance that we will not become a PFIC in the future. See “Item 10. Additional Information – Taxation – U.S. Federal Income Tax Considerations - Tax Consequences if We are a Passive Foreign Investment Company”.

U.S. holders of our shares are urged to consult their tax advisors regarding the application of the passive foreign investment company rules.

One of our shareholders beneficially owns a substantial amount of our ordinary shares and may therefore influence our affairs. As of May 31, 2006, Discount Investment Corporation Ltd., or DIC, beneficially owned an aggregate of approximately 47.6% of our ordinary shares and has the ability, in effect, to elect the members of our board of directors and to significantly influence our business. A majority of the members of our board of directors are officers or directors of DIC or its parent company, IDB Development Corporation Ltd., or IDBD, or its parent company, IDB Holding Corporation Ltd., or IDBH.

It may be difficult to serve process or to enforce a U.S. judgment against us, our directors and our officers. Since all of our directors and officers reside outside the United States, it may be difficult to effect service of process on us, our directors or officers within the United States. Furthermore, because most of our assets are located outside the United States, it may not be possible to enforce any judgment obtained in the United States against us or the aforementioned individuals in the United States. There is doubt as to the enforceability of civil liabilities under the U.S. Securities Act of 1933 and U.S. Securities Exchange Act of 1934 in original actions instituted in Israel.

Risks Affecting Our Holdings in Given Imaging

The following risk factor sections have been condensed for the purposes of this Annual Report. The risks associated with Given Imaging are more fully described in documents filed by Given Imaging with the SEC.

The price of Given Imaging's shares could fluctuate significantly as a result of a number of factors, including varying quarterly financial performance or its failure to meet its guidance or the expectations of analysts or investors, which may lead to additional volatility in its share price. Given Imaging's ordinary shares are traded on the Nasdaq National Market and on the Tel Aviv Stock Exchange. In 2005, the closing price of its shares has ranged from $20.39 to $36.04 per share on the Nasdaq National Market and NIS 95.79 to NIS155.3 on the Tel Aviv Stock Exchange. The price of Given Imaging's shares could fluctuate significantly for, among other things, the following reasons: future announcements concerning Given Imaging or its competitors, the existence of litigation concerning Given Imaging's intellectual property assets, changes in third-party reimbursement practices, regulatory developments, and new clinical or economic data regarding Given Imaging's current or future products. In addition, it is Given Imaging's practice to provide guidance to the market as to its expected revenues and earnings per share based on information available to Given Imaging at the time of the guidance. If Given Imaging's quarterly operating results do not meet its guidance or the expectations of securities analysts or investors, the price of Given Imaging's shares would likely decline. Therefore, revenues from system sales may be concentrated at the end of each fiscal quarter making it difficult for Given Imaging to determine the success of each quarter until its end and resulting in lower than expected quarterly revenues if external or other events cause a large number of potential customers to defer their purchasing decisions even for a short period of time. Furthermore, Given Imaging believes that demand for systems and capsules may be materially affected by seasonal factors during the summer months which may result in slower sales during the summer. Share price fluctuations may be exaggerated by low trading volume of Given Imaging's ordinary shares and changes in trading practices in Given Imaging's ordinary shares, such as short buying and selling. Securities class action litigation has often been brought against companies following periods of volatility. Any securities litigation claims brought against Given Imaging could result in substantial expense and divert management's attention from its business.

Given Imaging may be unable to maintain or increase its profitability. Given Imaging was formed in 1998 and recorded initial sales of its principal product, the Given System, in the third quarter of 2001. Given Imaging incurred losses until the second quarter of 2004 and has maintained profitability until the quarter ended December 31, 2005. Given Imaging has significant operating expenses and must continue increasing its revenues from sales of the Given System and of the PillCam capsules at a higher rate than the increase in its expenses in order to maintain and grow its profits.

If Given Imaging is unable to achieve broader penetration of the Given System among gastroenterologists, it may not be able to maintain its current growth rate. Given Imaging's principal product is the Given System, consisting of a line of PillCam capsules and the related data recorder and computer workstation. As of December 31, 2005, Given Imaging had sold over 2,860 systems worldwide. Growth in Given Imaging's installed base has contributed to its revenue growth. If Given Imaging is unable to continue to achieve broad penetration among gastroenterologists, Given Imaging may be unable to maintain its current growth rate.

Given Imaging currently depends on sales of the PillCam SB for a substantial majority of its revenues. A substantial portion of Given Imaging's annual revenue growth to date has resulted from increased sales of the PillCam SB capsule. Given Imaging expects that a substantial majority of its revenues for the foreseeable future will come from sales of the PillCam SB capsule and other PillCam capsules. Sales of the PillCam SB capsule contributed $22.9 million, or 56.4%, in 2003, $41.6 million, or 64%, in 2004 and $62.5 million, or 72% in 2005 of Given Imaging's total revenues. Given Imaging believes that the usage rate of the PillCam capsules is an important factor in growing revenues. Increasing the usage rate of customers is also important to attracting new customers to purchase and use the Given System. If Given Imaging is unable to increase the usage rate of the Given System, Given Imaging may not be able to achieve the revenues necessary to maintain its revenue growth.

Given Imaging's future growth also depends in part on the success of Ethicon Endo-Surgery in marketing its new PillCam ESO video capsule, particularly in the United States. In May 2004, Given Imaging entered into an exclusive sales representation and co-promotion agreement with Ethicon Endo-Surgery, a Johnson & Johnson company. InScope, a division of Ethicon Endo-Surgery established to market products to the gastroenterology market, has exclusive rights to market Given Imaging's PillCam ESO capsule in the United States. Under the agreement, InScope is responsible for marketing the PillCam ESO capsule and, consequently, Given Imaging's future growth depends in part on the success of InScope in doing so. Sales of the PillCam ESO capsule in 2005 were lower than expected and may continue to be lower than expected if InScope is not successful in marketing the PillCam ESO capsule. This may negatively impact Given Imaging's revenue growth.

Given Imaging faces direct competition from manufacturers of capsule endoscopy systems and may lose market share if Given Imaging is unable to compete effectively in the marketplace or utilize its patent portfolio. In October 2005, Olympus Corporation launched a competing capsule endoscopy system and began sales in Europe and Australia. Based on publicly available information, Olympus is also conducting clinical trials in the United States and intends to seek

FDA clearance to market its capsule endoscopy system in the United States. In addition, in April 2006, in response to a request made by Olympus in December 2003 to re-examine Given Imaging's first U.S. Patent #5,604,531, the USPTO issued an office action confirming the validity of 13 of the original 17 claims of this patent. Given Imaging has the right to appeal the rejection of the four other claims. On May 19, 2006, Olympus Corporation and its subsidiaries filed a complaint in the U.S. District Court for the Eastern District of Pennsylvania against Given Imaging for alleged infringement of U.S. Patent 5,010,412, entitled "High Frequency, Low Power Light Source for Video Camera." In addition, other companies in Korea and China began selling capsule endoscopy systems in these territories in 2005. If Given Imaging is unable to compete effectively in the marketplace or utilize its patent portfolio against the Olympus capsule endoscopy system and other competing systems, Given Imaging may lose market share or experience delays in completing sales as a result of longer decision making process among potential customers.

Given Imaging may be unable to introduce other products for use in other parts of the gastrointestinal tract. Given Imaging's objective is to expand the use of the Given System by developing and introducing new capsules for visualizing other parts of the gastrointestinal tract, including the stomach and the colon. There can be no assurance of widespread market acceptance of the Given System as superior to existing technologies for detection of abnormalities in other parts of the gastrointestinal tract or that Given Imaging will succeed in marketing and selling capsules for use in other parts of the gastrointestinal tract. In addition, Given Imaging will be required to obtain FDA clearance in the United States and other regulatory approvals outside of the United States before commercially distributing the Given System for use in other parts of the gastrointestinal tract or introducing new products for use in the gastrointestinal tract. If future clinical trials indicate that the Given System is not as clinically or cost-effective in these parts of the gastrointestinal tract as current methods, or that it causes unexpected complications or other unforeseen negative effects, Given Imaging may not obtain regulatory clearance to market and sell the Given System for use in other parts of the gastrointestinal tract or obtain reimbursement coverage, and its growth would be adversely affected.

Any disruption in the United States market, the primary market for Given Imaging's products, may result in a material reduction in Given Imaging's revenues and negatively affect its results of operations.

Since Given Imaging began selling the Given System in 2001, most of its revenues have been generated from sales in the United States. Sales in the United States accounted for, $26.2 million, or 65%, of its revenues in 2003, $46.7 million, or 72%, of its revenues in 2004 and $63.9 million, or 74%, of its revenues in 2005. Any disruption to Given Imaging's market in the United States resulting from adverse changes in reimbursement policies, regulatory requirements, competitors, macro-economic changes and other events, many of which are outside Given Imaging's control, may result in a material reduction in its revenues and negatively affect its results of operations.

Given Imaging's reliance on sole source suppliers could harm its ability to meet demand for the Given System in a timely manner or within budget. Given Imaging depends on sole source suppliers for some of the components necessary for the production of the Given System. Specifically, Micron Technology, Inc., through its Micron Imaging Group and other wholly-owned subsidiaries, is currently the sole supplier of the imaging sensor and the packaging for the sensor, and Zarlink Semiconductors is currently the sole supplier of the transmitter that is integrated into the PillCam capsules. If the supply of these components is disrupted or terminated, or if these suppliers are unable to supply the quantities of components that Given Imaging requires, it may not be able to find alternative sources for these key components. If Given Imaging is required to change the manufacturer of any of these key components of the Given System, there may be a significant delay in locating and/or verifying a suitable alternative manufacturer. Furthermore, in the event that the manufacturer of a key component of Given Imaging's product ceases operations or otherwise ceases to do business with Given Imaging, Given Imaging may not have access to the information necessary to enable another supplier to manufacture the component. The occurrence of any of the above events could harm the ability of Given Imaging to meet demand for its products in a timely manner or within budget, which could harm its ability to generate revenues, lead to customer dissatisfaction and damage its reputation.

Risks Affecting Our Holdings in Partner

The following risk factor sections have been condensed for the purposes of this Annual Report. The risks associated with Partner are more fully described in documents filed by Partner with the SEC.

We are restricted in our ability to freely dispose of our holdings in Partner. Almost all of our shares in Partner are subject to transfer restrictions stipulated by Partner's license which requires that at least 5% of the economic and voting interest of Partner be owned by Israeli citizens and residents ("Minimum Israeli Percentage"). Pursuant to the relationship agreement between the founding shareholders of Partner, each Israeli party to the relationship agreement, including us, has undertaken to maintain such portion of the shares as is necessary to maintain the Minimum Israeli Percentage. These restrictions limit our ability to freely dispose of our shares in Partner.

Partner expects its subscriber growth rate, and consequently its revenue growth rate, to slow because Israel's mobile telephone services market is highly penetrated, making it more difficult to obtain new subscribers than in the past. Because the Israeli market for mobile telephones is highly penetrated, future demand for Partner's services will not grow at the same rate as it has in the past, and Partner's subscriber growth will not develop at the same rate as in the past and will depend significantly on Partner's ability to retain existing subscribers in its network and to attract subscribers from the other mobile telephone network operators. While Partner's market share, based on internal estimates, has increased from approximately 13% of Israeli mobile subscribers at December 31, 1999 to approximately 32% at December 31, 2005. Partner's market share growth has slowed since 2003 and Partner expects this trend to continue.

Competition from existing competitors may require Partner to increase its subscriber acquisition costs and customer retention costs and increase its churn rate. Partner competes primarily with Cellcom (a company controlled by DIC) and Pelephone, two of the other mobile telephone network operators in Israel. Because of the ease of switching between cellular operators, Partner has already faced and may continue to face an increase in its churn rate and may be forced to increase its customer retention costs, including subsidies towards upgrades of subscribers' handsets, in order to retain subscribers. In 2005, Partner experienced a higher churn rate than in 2004, primarily due to the prepaid sector. Competition, including increased competition resulting from the introduction of number portability, may further increase the churn rate.

Risks Affecting Our Holdings in Oncura

Oncura may incur future losses and be unable to achieve profitability. Oncura was formed in 2003 and has generated net losses from the commencement of its operations in July 2003 through December 31, 2005. Oncura has significant operating expenses and there is no assurance that Oncura will be able to achieve profitability in the future.

Oncura expects to derive a significant portion of its future revenues from its cryotherapy products, which could fail to achieve broad market acceptance or generate significant revenue growth. Oncura expects that revenues from its cryotherapy products will grow significantly over time. Accordingly, Oncura's success is in large part dependent on acceptance by physicians and patients of its cryotherapy products. Although cryotherapy has existed for many years, it has not been widely accepted due to a variety of factors including concerns over the safety and efficacy of the technology and the availability of alternative therapies. If Oncura's cryotherapy products do not achieve broad market acceptance, Oncura may not be able to achieve the revenue growth necessary to achieve and maintain profitability.

Oncura is dependent on its two shareholders, GE Healthcare and Galil Medical and there is no assurance that they will continue to support Oncura. Oncura depends primarily on GE Healthcare and Galil Medical, for manufacturing its products. Although Oncura has long-term supply agreements with each of GE Healthcare and Galil Medical, its business could be seriously harmed if it were unable to maintain these relationships or if GE Healthcare or Galil Medical were unable to continue to manufacture the company's products. In addition, Oncura's operations from inception through December 31, 2005 have not generated positive cash flows and its corresponding working capital deficits have been financed by loans from its shareholders. If Oncura is not able to secure suitable third-party financing to fund its working capital deficits, the company will continue to need to rely on its shareholders to provide necessary funding until such time as the company becomes cash flow positive or can obtain necessary financing from a third-party. Each of Oncura's shareholders provided to Oncura a letter in which they confirmed their intention to continue providing financial support to Oncura through May 31, 2007 or such later date as may be agreed by them. There is no assurance that Oncura's shareholders, including Galil Medical, of which we beneficially own, as of May 31, 2006, 60% of the shares directly and indirectly, will continue to fund Oncura's working capital deficit after May 31, 2007 or maintain their respective holdings in Oncura, which may adversely affect Oncura's business and results of operations.

Risk Affecting Our Holdings in NetVision

The market for the supply of Internet access services and value added services in Israel is very competitive. The supply of Internet access services requires a special license from the Israeli Ministry of Communications whose policy is to encourage competition and therefore does not place any material barriers to entry into the market. Since the beginning of 2004, competition in the market has focused on broadband Internet services. NetVision continues to experience increased competition in gaining broadband communication market share, mainly from companies such as Internet Gold (Nasdaq:IGLD), Bezeq International, Barak I.T.C. (1995) Ltd., or Barak, and 012 Golden Lines Ltd., or Golden Lines. As of December 31, 2005, NetVision estimates that it held approximately 25% of the broadband Internet communication market in Israel. Competition from existing and new competitors may require NetVision to reduce its tariffs and increase its subscriber acquisition and retention costs as a result of which NetVision's results of operations could be adversely impacted. Due to the intense competition, there has been a slow down in the increase of NetVision's subscriber base. NetVision is currently engaged in merger discussions with Barak. There is no assurance that the proposed merger will take place.

The market for the supply of international telephone services in Israel is very competitive The market for international telephony services, which NetVision entered in November 2004, is very competitive. The three major competitors are Bezek International, Golden Lines and Barak. Such competition may result in a decrease in prices to a level which will make penetration for NetVision more difficult, decrease NetVision's profits or even result in losses for NetVision, from these activities. In such event, NetVision's investment in its international telephone activities will be negatively impacted which in turn will negatively affect NetVision's results of operations.

NetVision relies on certain third-parties for leased lines. NetVision relies on certain third-party service providers including local and long distance telecommunications companies, such as Bezeq and Med Nautilus, for leased lines. Internet access by NetVision's customers is dependent on the telecommunications infrastructure owned and maintained by Bezeq and the local cable companies. If NetVision's subscribers' access to Israel's fixed-line telecommunications infrastructure is disrupted, it would significantly impact the services that NetVision provides to its subscribers and could result in a substantial reduction in Internet access volume and revenue. Furthermore an increase in the cost of access to Israel's fixed-line telecommunications infrastructure could also adversely impact NetVision's results of operations.

Item 4. Information on the Company

A. History and Development of the Company

We are a high technology operational holding company that operates through our group companies. Our group companies include both publicly traded and privately held companies.

Founded in 1962, we have been a major force in the development of the Israeli high technology industry by building Israeli and Israel-related companies with technologies in the fields of medical devices, advanced defense electronics, telecommunications, semiconductors, software products and services and advanced materials. Historically, most of our group companies were established together with entrepreneurs or started as activities within Elron and were subsequently spun-off. In addition, some of our group companies grew out of our subsidiary, RDC, established by us (through our subsidiary, DEP) together with Rafael, the largest research and development organization of Israel’s Ministry of Defense, pursuant to an agreement entered into in July 1993 for the purposes of exploiting Rafael’s technology in non-military markets. RDC has first rights to exploit commercially technologies of Rafael in non-military markets, which rights are dependent primarily upon RDC's identification of new and existing military technology developed by Rafael, for commercial exploitation in non-military markets. Potential projects and opportunities are identified through mutual cooperation and ongoing liaison between RDC and their professional advisors and members of Rafael's research and development team. Following the identification of a project, RDC commercially exploits the project, initially using its own finance and management resources and thereafter obtains external financing. Given Imaging and Galil Medical are examples of companies that grew out from this cooperation with Rafael. RDC is currently involved in a dispute with Rafael regarding Rafael's request to limit the scope and period of their agreement. See Item 3 "Risks Affecting Us and the Companies in our Group".

We expect to continue to build and realize value for our shareholders through the sale of a portion or all of our holdings in, or the issuance of shares by any of our group companies to third parties, while simultaneously pursuing the acquisition of, or investment in, new and existing companies at different stages of development including early stage and more mature companies, and building our group companies. We believe that this strategy provides the ability to increase shareholder value as well as capital to support the growth of our group companies.

Our primary activity is our involvement in the management of our group companies, in which we maintain controlling or significant holdings, and, in a limited number of cases, minority holdings. We participate in the management of most of our group companies by means of active membership on their boards of directors and board committees. As a result, we are involved in matters of policy, strategic planning, marketing, selecting and manning senior management positions, approving investments and budgets, financing and the overall ongoing monitoring of our group companies' performance. In addition to our representation on the boards of directors of our group companies, we provide hands-on assistance to our group companies' management in support of their growth. We view our hands-on involvement in the operations of our group companies as a key element of our business. Our group companies therefore benefit from the experience of our management team in various areas in which they need support and leadership, including, but not limited to, market analysis, risk management, identifying joint venture opportunities, introductions to potential customers and investors, business plan preparation, budgetary control and strategic planning and research and development guidance.

Both our legal name and our commercial name is Elron Electronic Industries Ltd. We were incorporated in Israel in 1962 under the name of Elron Electronic Industries Ltd. The principal legislation under which we operate is the Israeli Companies Law, 1999. Our shares are publicly traded on Nasdaq National Market under the symbol "ELRN" and on the Tel Aviv Stock Exchange. Elron's corporate headquarters and registered office is located at 3 Azrieli Center, 42nd Floor, Tel-Aviv 67023, Israel, Tel. 972-3-607-5555, Fax. 972-3-607-5556, e-mail: elron@elron.net. Our web site address is www.elron.com. Information contained on our web site is not part of this Annual Report.

The following are significant transactions and events which we and our group companies have completed or which took place since January 1, 2005:

- **Sale of Partner shares**

  On April 20, 2005 we completed the sale to Partner of 12,765,190 Partner shares for approximately $94 million, as part of the sale together with the other Israeli founding shareholders of Partner of an aggregate of approximately 33.3 million Partner shares to Partner for an aggregate consideration of approximately $245 million. As a result of the sale, we recorded in 2005 a gain of $45.4 million, net of tax.

  In April 2006, we purchased an additional 0.6% of Partner's outstanding shares from Polar Communications Ltd., one of the other founding shareholders of Partner, for approximately $5.3 million, at a 15% discount to the then market price. Following this transaction, our beneficial holding in Partner is approximately 2.6%. Almost all of our holding is subject to certain transfer restrictions under Partner's Israeli communications license.

- **Investment in NuLens Ltd.**

  On April 21, 2005, we invested approximately $1.7 million in NuLens Ltd., or NuLens, an Israeli medical device company operating in the field of intra-ocular lenses, mainly for cataract and presbyopia procedures. The investment was the first of two installments. The second installment of approximately $1.1 million was invested in March 2006 simultaneously with the closing of a new investment round of approximately $6.0 million, led by Warburg Pincus, a leading global private equity fund, in which we also invested an additional $1.5 million. Following these investments, we hold 29% of NuLens.

- **Investment of $16 million in Teledata Networks Ltd.**

  On May 8, 2005, we completed an investment of $16 million in Teledata Networks Ltd., or Teledata. The investment was part of an aggregate round of financing of $19 million, in which FBR Infinity II Ventures, a related venture capital fund, or Infinity, invested $3 million, for approximately 4% of Teledata, and with whom we entered into a voting agreement. (See Item 7b-"Related Party Transactions"). Teledata provides innovative access products and solutions for both traditional and next generation networks to telecom operators and service providers. We hold approximately 21% of Teledata.

- **Sale of Oren Semiconductor**

  On June 10, 2005, Zoran Corporation, or Zoran (NASDAQ: ZRAN), acquired Oren Semiconductor, Inc., or Oren, in which we held a 41% interest. Elron received approximately $12.5 million in cash in the acquisition (of which approximately $2 million was escrowed under the terms of the agreement, of which we already received approximately $1 million) and approximately $7.7 million of Zoran shares (based on Zoran's share price on the completion date of the acquisition). As a result of the transaction we recorded a gain in 2005, net of taxes, of approximately $17.2 million.

In July 2005, we sold Zoran's shares for $8.8 million, resulting in a gain net of tax, of $0.7 million.

- **NetVision Initial Public Offering**

On May 19, 2005, NetVision completed its initial public offering on the Tel Aviv Stock Exchange, or TASE, in Israel for net proceeds of approximately NIS135 million (approximately $31 million). In addition, future proceeds from the exercise of options sold in the offering may amount to approximately NIS28.8 million (approximately $6.6 million). DIC is the other major shareholder of NetVision. We and DIC each converted approximately $3.1 million of loans into equity of NetVision immediately prior to the offering and $2.2 million in loans was repaid to each of us from the proceeds of the offering. As a result of the initial public offering our holding in NetVision decreased from 45.7% to approximately 39% (27.4% on a fully diluted basis taking into account the possible exercise of the convertible securities) resulting in a gain for Elron of approximately $3.0 million.

- **Investment in BrainsGate Ltd.**

On August 8, 2005, we completed an investment of approximately $6.9 million in BrainsGate Ltd., or BrainsGate, for approximately 22% of the equity of BrainsGate, as part of an aggregate investment of approximately $17.0 million. Infinity, with whom we have a voting agreement, holds approximately 5% of the equity of BrainsGate. See Item 7b - "Related Party Transactions". BrainsGate is an Israeli company that is developing innovative technologies for neuro–stimulation treatments of brain diseases.

- **Dividend distribution**.

On September 5, 2005, we declared a cash dividend of $3.00 per share, totaling approximately $88.5 million. The dividend was paid on September 27, 2005, to shareholders of record on September 15, 2005.

- **Investment in Enure Networks Ltd**. **(formerly known as Gaia Broadband Services Management Ltd.).**

On October 2, 2005, we completed an investment of approximately $4.0 million in Enure Networks Ltd., or Enure, for approximately 57% of the equity of Enure. Enure is an Israeli software company engaged in developing solutions in the field of broadband services management and home networks.

- **Establishment of Medingo.**

In November 2005, RDC established Medingo Ltd., or Medingo. Medingo is developing a disposable insulin dispenser for diabetic patients. We beneficially own 100% of the outstanding shares of Medingo through our holding of RDC, which holds directly all the shares of Medingo.

- **Sale of holdings in Elron Telesoft Ltd. and Elron Telesoft Export Ltd**.

  On December 29, 2005, we completed the sale of all of our shares of Elron Telesoft Ltd. and Elron Telesoft Export Ltd. (together, the "ET Group"), to ECtel Ltd. (Nasdaq: ECTX) for $2.5 million, of which $0.4 million shall be paid if certain milestones will be achieved during 2006. The transaction did not materially affect our results of operations

- **Investment in Safend Ltd**.

  On January 2, 2006, we completed an investment of approximately $3.7 million in preferred shares of Safend Ltd., or Safend, for approximately 26% of the equity of Safend. Safend is an Israeli company which develops comprehensive desktop and laptop endpoint security solutions.

- $14 million Investment in AMT. On June 8, 2006, A.M.T. Advanced Metal Technologies, or AMT, completed a $14 million financing led by Shamrock Israel Growth Fund, an Israeli private equity fund. We committed to invest an aggregate of $5 million (of which we invested $2.5 million immediately) in the financing round in which other existing shareholders also participated. Following the transaction, we hold approximately 34% of AMT.

The following are the significant investments and divestitures which we and companies in our group completed in 2003 and 2004, in chronological order:

- **Investment in Notal Vision, Inc.**

  In January 2003, we completed an investment of $2.0 million in Notal Vision, Inc., or Notal, an Israeli related medical device company operating in the field of early detection of Age Related Macular Deterioration (AMD). Our investment formed part of an aggregate investment by other investors in Notal of approximately $4.5 million, including an investment by an existing shareholder, Innomed Ventures (Israel) L.P., or Innomed, in which we also hold an interest. We currently hold 23% of the equity of Notal.

- **Galil Medical and Amersham Health Plc (now GE Healthcare) merge urology therapy units**

  On July 1, 2003, the merger between the urology business of our subsidiary, Galil Medical, and the brachytherapy business of Amersham plc, now a subsidiary of GE Healthcare, was completed and a new company, Oncura, was incorporated. Oncura provides minimally invasive treatment options for prostate cancer using brachytherapy (radio-active seeds) and cryotherapy (hyper-cooling) technologies. Amersham Health Plc (now GE Healthcare) and Galil Medical each contributed the related operations and assets necessary for Oncura to conduct the brachytherapy business and the cryotherapy business, respectively, in the urology field. In exchange for such assets, GE Healthcare received 78% and Galil Medical received 22% of the outstanding shares of Oncura. In addition, at the closing, Galil Medical purchased 3% of Oncura from GE Healthcare for $4.5 million in cash, which was paid in full as of April 26, 2004, resulting in Galil Medical's aggregate ownership interest of 25% of Oncura. Galil Medical has an option to purchase an additional 3% of Oncura from GE Healthcare for $5.4 million, exercisable until 45 days following the closing of an initial public offering of Oncura. As a result of the transaction, a gain in the amount of $21.2 million was recorded by Galil Medical in 2003. Our share in this gain (net of minority interest and income taxes) amounted to $4.4 million.

- **Sale of Shares of Given Imaging by RDC**

  In 2003, RDC sold, in a series of transactions, 753,600 shares of Given Imaging for approximately $7.8 million, resulting in a gain of approximately $4.4 million ($0.1 million net of tax and minority interest).

- **Purchase of Shares of Given Imaging from RDC**

  In May 2003, a Share Purchase Agreement was signed between RDC, Elron and Rafael, according to which RDC sold two million shares of Given Imaging, representing 7.9 % of Given Imaging's then outstanding shares, to Elron and Rafael (one million or 3.95% each) for total consideration of $12.2 million. RDC used $5.0 million of the proceeds to repay shareholders' loans to Rafael and Elron. This transaction did not have any effect on our consolidated results of operations.

- **Sale of approximately 6.3 million Shares of Partner**

  In the second and third quarters of 2003, we sold, in a series of transactions, an aggregate of approximately 6.3 million shares of Partner, representing approximately 3% of Partner's then outstanding shares, to Israeli institutional investors for approximately $29.3 million, as a result of which we recorded in 2003 an aggregate gain, net of tax, of approximately $7.1 million.

- **Sale of Elron SW, Inc.**

  On September 2, 2003, our subsidiary, Elron SW Inc., or ESW, sold substantially all of its assets and business to Zix Corporation, or Zix (Nasdaq: ZIXI), a global provider of e-messaging protection and transaction services, in consideration for 1,709,402 shares of Zix's common stock, then with a market value of approximately $6.0 million and a 5.75% convertible note ("the Note") of $1.0 million. ESW granted a beneficial interest in approximately 85,000 common shares it received to certain of its former employees in recognition of services rendered to ESW. In addition, Zix assumed certain liabilities of ESW in the net amount of approximately $1.0 million. The transaction resulted in a gain of approximately $4.1 million. Simultaneously with the closing of the sale, we purchased the 1,709,402 shares of Zix common stock and the Note from ESW for approximately $6.2 million, based on the principal amount of the Note and the closing sale price of Zix shares on the Nasdaq National Market on the day prior to the closing.

As of December 31, 2004, we had sold all our shares of Zix (including 262,454 shares resulting from the conversion of the Note) for approximately $17 million, and recognized an aggregate gain of approximately $10.2 million ($6.8 million net of tax). In December 2004, ESW was voluntarily dissolved.

- **Purchase of shares of 3DV Systems Ltd.**

  On February 1, 2004, we and our subsidiary, RDC purchased approximately 47% of the outstanding share capital of 3DV Systems Ltd., or 3DV, in which we and RDC previously together held 48%, from the majority of the other shareholders of 3DV in consideration for an option, which has since expired, to receive up to 40% of the share capital of a new company to be established. We and RDC together currently hold 89% of 3DV.

- **Sale of KIT eLearning Ltd.**

  In March 2004, KIT eLearning Ltd., or KIT, a provider of online academic programs, in which we held a 45% ownership interest, was sold to Online Higher Education, a subsidiary of Laureate Education, Inc., or Laureate (Nasdaq: LAUR) (formerly known as Sylvan Learning Systems, Inc.), a global leader in higher education, for an immediate cash payment of $9.4 million and a future payment of up to an additional $10.0 million based on earnings of KIT in 2006 and 2007 (of which our share will be up to $5.7 million). The other selling shareholders of KIT were DIC, our largest shareholder, and Kidum IT Ltd., a privately held Israeli company. From the $9.4 million immediate proceeds of the sale, we received approximately $5.7 million and we recorded a gain of approximately $5.3 million.

- **Given Imaging secondary offering**

  On June 23, 2004, Given Imaging completed a secondary public offering of 2,880,750 ordinary shares at $32.00 per share, of which 1,500,000 shares were sold by Given Imaging and 1,380,750 shares were sold by selling shareholders, including 300,000 shares sold by our subsidiary, RDC. Given Imaging received net proceeds from the offering of approximately $44.3 million. We also hold a direct interest in Given Imaging, but did not participate in the offering.

  As a result of the sale of Given Imaging's shares by RDC and the decrease in our direct and indirect interest (through our holdings in RDC) in Given Imaging to approximately 15%, we recorded a gain in 2004, net of tax and minority interest, of approximately $6.7 million.

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- **Sale of all of our holdings in Elbit Systems Ltd.**

  On July 28, 2004, we sold all of our holdings in Elbit Systems Ltd., or Elbit Systems, (Nasdaq: ESLT), constituting approximately 19.6% of the then outstanding share capital of Elbit Systems, to the Federmann group, following the exercise of its right of first refusal, for approximately $196.6 million. As a result, we recorded in 2004 a gain, net of tax, of approximately $91.5 million.

- **Purchase of additional shares of Given Imaging**

  In August and November 2004, we purchased approximately 1.4 million additional shares of Given Imaging in various transactions for an aggregate amount of approximately $44 million. As a result of these purchases, our direct and indirect ownership interest in Given Imaging (through our holdings in RDC) increased from approximately 15% to approximately 20% and our beneficial ownership increased to approximately 25%.

- **Tender offer by DIC to purchase 7.5% of our shares**

  On August 22, 2004, DIC completed a tender offer to purchase 2,203,425 of our ordinary shares for $15 per share, net to the seller in cash, less any required withholding taxes and without interest. Following consummation of the tender offer, DIC owned approximately 46% of our outstanding shares. DIC has purchased additional shares from time to time and as of May 31, 2006, holds approximately 47.6% of our outstanding shares.

- **Investment of $3 million in Starling Advanced Communications Ltd.**

  On October 21, 2004, we completed an investment of $3 million in preferred shares of Starling Ltd., or Starling, of which $1.5 million was invested immediately and $1.5 million was invested in April 2005. Following the investments our direct interest in Starling is approximately 33% and our beneficial ownership (directly and through RDC) is approximately 66%.

- **Investment of $6.7 million in Jordan Valley Semiconductor Ltd.**

  On October 21, 2004, we invested approximately $6.7 million in Jordan Valley Semiconductor Ltd., or Jordan Valley, for preferred shares constituting 28% of the equity of Jordan Valley, as part of an aggregate amount of approximately $9 million raised by Jordan Valley. Our holding was subject to adjustment based upon Jordan Valley's performance for the period July 1, 2004 until June 30, 2005 with an option to make an additional investment on the same terms as the original investment to enable us to hold 25% of Jordan Valley’s equity, on a fully diluted basis, after the adjustment. In October 2005, we exercised this option and invested an additional amount of approximately $1.4 million, following which we hold approximately 28% of the equity of Jordan Valley. The balance of the aggregate investment in Jordan Valley was invested indirectly by Clal Industries and Investments Ltd., or Clal. Jordan Valley is an Israeli private company engaged in developing solutions for advanced in-line thin film metrology for the semiconductor industry. Jordan Valley is 40% owned (indirectly) by Clal, a subsidiary of IDBD, which then owned approximately 67% of DIC. Clal, IDBD and DIC are publicly traded on the Tel Aviv Stock Exchange. Our investment in Jordan Valley was approved in accordance with Israeli law by the shareholders of Elron and Clal on October 21, 2004.

- **Investment in Impliant**

  On December 28, 2004, we invested approximately $7.3 million for preferred shares of Impliant constituting approximately 23% of the equity of Impliant, as part of a financing round of approximately $18 million from new and existing investors of Impliant. In October 2005, we invested an additional $1 million as part of an extension of the initial financing round. Following this additional investment, we hold 21.5% of the equity of Impliant. Impliant is a privately held medical device company engaged in the development of a novel posterior motion preservation system for spine surgery.

B. Business Overview

Our group companies are engaged in four main fields of advanced technology, namely: (i) medical devices; (ii) information and communications technology; (iii) semiconductors and (iv) advanced materials. The business overview is presented, for the purposes of convenience only, according to the four main fields listed above, none of which is considered a separate reportable segment.

1. Medical Devices

Our activities in the field of medical devices consist mainly of our holdings in the following companies:

- Given Imaging, in which we beneficially own approximately 36% of the outstanding shares representing all shares owned by us, RDC and DIC (which we may be deemed to beneficially own as a result of the voting agreement between DIC and us), or approximately 19% representing our direct holding and our share in the holding of RDC;
- Galil Medical, in which we beneficially own approximately 60% of the outstanding shares representing all shares owned by us and RDC, or approximately 40%, representing our direct holding and our share in the holding of RDC;
- Oncura, in which we beneficially own approximately 25% of the outstanding shares representing shares owned by Galil Medical, or approximately 10%, representing our share in the holding of Galil Medical;
- Notal, in which we hold approximately 23% of the outstanding shares;
- Impliant, in which we hold approximately 21.5% of the outstanding shares;
- NuLens, in which we hold approximately 29% of the outstanding shares;
- BrainsGate, in which we hold approximately 22% of the outstanding shares; and
- Medingo, in which we beneficially own 100% of the outstanding shares representing all shares held by RDC which holds directly all the shares of Medingo.

Given Imaging

Given Imaging is an Israeli company that develops, manufactures and markets innovative diagnostic products for disorders of the gastrointestinal tract. It pioneered capsule endoscopy, a proprietary approach to visual examination of the gastrointestinal tract through the use of a miniaturized video camera contained in a disposable capsule.

Given Imaging was incorporated in Israel by our subsidiary, RDC, in January 1998. Its initial public offering and listing on the Nasdaq National Market occurred in October 2001. In March 2004, Given Imaging also listed its shares on the TASE. In June 2004, Given Imaging completed its secondary public offering raising $44.3 million.

Given Imaging's principal product, which incorporates its core technology, is the Given System, a proprietary wireless imaging system which uses disposable video capsules, referred to as the PillCam capsules. The PillCam video capsules are easily ingested by the patient and move naturally through the gastrointestinal tract without discomfort while wirelessly transmitting high quality color images and data to a portable recorder, enabling gastroenterologists to view high quality video, images and data on their workstations. Given Imaging believes that capsule endoscopy provides a patient-friendly solution that addresses a significant market opportunity and overcomes many of the shortcomings of traditional diagnostic tools for gastrointestinal disorders.

As of December 31, 2005, Given Imaging had an installed base of approximately 2,860 Given Systems and had sold approximately 307,000 PillCam SB capsules in over 50 countries worldwide.

In November 2004, Given Imaging received FDA marketing clearance for its second PillCam capsule, the PillCam ESO capsule, for visualizing the esophagus. Given Imaging markets the PillCam ESO video capsule through a strategic marketing and sales alliance formed in May 2004 with InScope, a division of Ethicon Endo-Surgery, a Johnson & Johnson company. Under the terms of the agreement, InScope committed to pay Given Imaging $50 million subject to achievement of certain milestones. Out of this amount, to date, Given Imaging has received $25 million.

Given Imaging has also developed the AGILE Patency Capsule and system, which is a dissolvable capsule that enables physicians to determine whether there are obstructions or strictures in the gastrointestinal tract. Given Imaging launched the AGILE Patency Capsule and system in Europe in November 2003 and in May 2006 received FDA clearance to market this system in the United States.

Given Imaging’s research and development efforts are focused primarily on developing improvements to its existing products and developing new capsules to be used in the detection of abnormalities in other areas of the gastrointestinal tract. For example, in the second half of 2005, Given Imaging began performing initial clinical trials with the PillCam Colon capsule, which is still under development. If initial results are favorable, Given Imaging intends to commence broader studies during 2006 which will then be used to support a submission of the PillCam Colon capsule for FDA clearance.

In April 2006, Given Imaging appointed Nachum (Homi) Shamir as its new President and Chief Executive Officer, to replace Mr. Gavriel Meron, co-founder of Given Imaging. At the same time Mr. Meron was appointed Executive Vice Chairman of Given Imaging's Board of Directors. Mr. Meron subsequently resigned in June 2006 following a transition period to pursue other interests.

Given Imaging recorded revenues of $86.7 million in 2005, $65.0 million in 2004 and $40.5 million in 2003.

Third-party payors in the United States began issuing coverage policies for capsule endoscopy in early 2002. Initially, all reimbursement policies issued coverage for capsule endoscopy of the small bowel only for the diagnosis of obscure gastrointestinal bleeding. Subsequently, reimbursement coverage has been expanded to include other indications and as of December 31, 2005, most Medicare carriers and private payors, with a total insured population in the United States of approximately 209 million individuals, also cover capsule endoscopy of the small bowel for suspected Crohn's disease, suspected small bowel tumors and other small bowel pathologies. Almost all of the reimbursement policies currently in effect require that a previous procedure, such as endoscopy or radiology, be performed prior to using the Given System and some may require prior authorization. In 2005, several third-party payors have issued new or updated policies that do not require endoscopy or other procedure prior to performing small bowel capsule endoscopy. As of December 31, 2005, approximately 11.5 million individuals in the United States had coverage under these new or updated policies.

As of December 31, 2005, no third party payor had established published coverage policy for capsule endoscopy of the esophagus using the PillCam ESO capsule. Meanwhile, numerous payers are reimbursing this procedure on a case by case basis. Given Imaging does not expect broad coverage for this procedure prior to assignment of a CPT code, which Given Imaging does not expect to occur until late 2006, effective January 2007.

Given Imaging currently markets and sells the Given System through a combination of direct sales through its subsidiaries, and through independent distributors in over 50 jurisdictions. Currently, Given Imaging markets the Given System directly in Australia, France, Germany**,** the United States and Israel through approximately 80 sales and marketing personnel employed by Given Imaging and its subsidiaries in those jurisdictions. In the United States, which accounted for 72% of Given Imaging's revenues in 2004, and 74% of its revenues in 2005, Given Imaging markets its products through its wholly-owned subsidiary, Given Imaging, Inc. As of December 31, 2005**,** Given Imaging had a direct sales force in the United States of approximately 45 personnel. In the first quarter of 2006, Given Imaging substantially increased its direct sales force in the United States.

Sales to Given Imaging's local distributors worldwide accounted for approximately 15% of its revenues in 2005. Under the terms of Given Imaging's distribution agreements, Given Imaging generally grants to one distributor in each particular country or region the right to market the Given System for an initial period of approximately three years. During this period, the distributor is required to meet minimum sales targets set out in each distribution agreement. Given Imaging may, in its sole discretion, upon prior written notice, terminate a distribution agreement with a distributor in the event that a distributor fails to meet its minimum sales targets.

The Given System consists of Pillcam capsules, a portable data recorder and sensor array, and a dedicated computer workstation. Given Imaging manufactures the PillCam capsules at its facilities in Yoqneam, Israel using three semi-automated production lines. Two of these production lines are used to manufacture the PillCam SB capsule and one to manufacture the PillCam ESO capsule. Given Imaging has constructed a fourth semi-automated production line, which it plans to use for manufacturing the PillCam ESO capsule. Each semi-automatic production line in Yoqneam, Israel facility has a capacity to manufacture approximately 270,000 PillCam capsules per year. Given Imaging has also installed at Pemstar's facilities in Ireland, a semi-automated production line of the PillCam SB capsule for backup purposes, which has a capacity to manufacture an additional 270,000 PillCam capsules per year**.** Current production capacity is sufficient to support sales in the foreseeable future.

The portable data recorders are manufactured externally and assembled and tested at Given Imaging's facilities. The sensor arrays are manufactured and assembled externally and are tested at Given Imaging's facilities. The computer workstation is an off-the-shelf computer workstation pre-loaded with Given Imaging's RAPID software. Given Imaging's research and development activities are conducted internally by its research and development staff, primarily at its facilities in Yoqneam, Israel.

Given Imaging's first issued patents in the United States and Israel are on an in vivo video camera system. Given Imaging acquired the rights to these issued U.S. and Israeli patents in January 1998 under a technology purchase and license agreement with Rafael. These issued patents in the United States and Israel expire in January 2014 and January 2015, respectively. As of December 31, 2005, Given Imaging held 36 additional issued patents in Australia, France, South Korea, Israel and the United States covering different elements of its technology and expiring between July 2014 and August 2022. As of December 31, 2005, Given Imaging had 421 patent applications worldwide based on 120 priority applications relating to various elements and functions of its product and enhancements. In April 2006, in response to a request made by Olympus in December 2003 to re-examine Given Imaging's first U.S. Patent #5,604,531, the USPTO issued an office action confirming the validity of 13 of the original 17 claims of this patent. Given Imaging has the right to appeal the rejection of the four other claims. On May 19, 2006, Olympus and its subsidiaries filed a complaint in the U.S. District Court for the Eastern District of Pennsylvania against Given Imaging for alleged infringement of U.S. Patent 5,010,412, entitled "High Frequency, Low Power Light Source for Video Camera." In response to this law suit, Given Imaging announced that it believes the complaint filed by Olympus has no merit and that it intends to take all necessary steps to protect its interests.

For additional information on Given Imaging's business, including additional products, manufacturing and suppliers and regulatory approvals, see Given Imaging's filings with the SEC.

Galil Medical

Galil Medical, an Israeli company established by RDC in 1997, is a provider of minimally invasive temperature based therapies for the treatment of benign and malignant diseases. Since 1999, Galil was focused on developing products to address specific urologic diseases including prostate and kidney cancer. In July 2003, Galil Medical completed the merger of its urology related cryotherapy business with Amersham Health's brachytherapy business, which created Oncura. Galil Medical holds 25% of Oncura. Galil Medical has entered into supply and R&D services agreements with Oncura, pursuant to which Galil Medical provides Oncura with certain exclusive supply, manufacturing and R&D services in the urology field, upon a cost plus basis.

In addition to its urology activities for Oncura, Galil Medical is now focusing on developing minimally invasive cryotherapy solutions for woman's health conditions such as uterine fibroids and breast fibroadenoma. In 2005, Galil Medical received FDA approval for breast fibroadenoma and the CE Mark for uterine fibroids.

Galil Medical's intellectual property consists of intellectual property, which was received from Rafael, and intellectual property developed by Galil Medical's research and development team. Galil Medical has 15 patents and 23 pending applications.

As of December 31, 2005, Galil Medical had 320 SeedNet™ machines installed worldwide. Galil Medical recorded revenues of $8.3 million in 2005, $7.6 million in 2004 and $7.6 million in 2003. Revenues for the first half 2003 represented sales to the end user customer, while the majority of the revenues for the second half of 2003 and for the years 2004 and 2005 represented sales and services to Oncura.

Galil Medical's research and development and manufacturing facilities are based in Yoqneam, Israel.

As of May 31, 2006, Galil Medical had approximately 52 employees.

Oncura

Oncura, a Delaware Corporation, markets and sells therapeutic device systems and related consumables used primarily in the performance of minimally-invasive, urologic cancer treatment. Oncura's products include implantable radioactive seeds and cryotherapy devices and related disposable kits used in the treatment of prostate and other urologic cancers.

Oncura's formation was the result of a merger, completed July 1, 2003, between the urology business of Galil Medical, and the brachytherapy business of Amersham plc, now a subsidiary of General Electric Company ("GE Healthcare"), as a result of which Galil Medical and GE Healthcare acquired 78% and 22% of the issued and outstanding shares of Oncura, respectively. Galil Medical purchased an additional 3% of Oncura from GE Healthcare for $4.5 million, resulting in Galil Medical owning an aggregate interest of 25% in Oncura. In addition, Galil Medical has an option to purchase an additional 3% of Oncura from GE Healthcare for $5.4 million, exercisable until 45 days following the closing of an initial public offering of Oncura.

Oncura is headquartered in Plymouth Meeting, Pennsylvania. In addition, Oncura has an international management office located in Amersham, United Kingdom.

Oncura does not manufacture any of the products it sells. A majority of Oncura's products are manufactured by its two shareholders, GE Healthcare and Galil Medical, and sold to Oncura under long-term supply agreements. Oncura also purchases certain products, principally a type of radioactive seed not manufactured by GE Healthcare, from a third-party supplier.

Oncura markets and distributes its products directly and indirectly to numerous international markets, including, the United States, Canada, Europe, Russia, Israel, Greece, Korea, Philippines, Hong Kong, Australia, New Zealand, and portions of South America. In the United States, Oncura sells principally through its direct sales force. Outside of the United States, Oncura sells through its direct sales force along with a network of affiliated and independent distributors and agents. In certain markets outside the United States Oncura's products are distributed under long-term distribution agreements with affiliates of GE Healthcare.

Oncura has also entered into services and research and development agreements with its shareholders and affiliates for the provision of certain administrative and research and development services.

Oncura terminated most of its existing service and distributor arrangements with its shareholders in 2004 and 2005. Oncura expects to terminate two additional distributor arrangements with GE Healthcare in 2006. Subsequent to 2006 and for the foreseeable future Oncura expects to continue its remaining distribution agreements with GE Healthcare in Scandinavia, Austria, Portugal and New Zealand.

Oncura's intellectual property consists primarily of product brand names and product patented technology that it either owns or is licensed to Oncura by GE Healthcare and Galil Medical under exclusive licensing agreements.

As of May 31, 2006, Oncura had approximately 99 employees.

Oncura's activities in the marketing and distribution of cancer therapy products are subject to extensive laws, regulations, regulatory approvals and guidelines. Within the United States, the Company's products must comply with the U.S. Federal Food Drug and Cosmetic Act, which is enforced by the FDA. Oncura must also comply with the regulations of the Competent Authorities of the European Union for any products sold in the member nations of the European Union. Oncura is also subject to various other regulations, regulatory approvals and guidelines in other markets in which it distributes its products. Oncura's radioactive seeds are manufactured by GE Healthcare and third-party vendors and physical handling and delivery of all radioactive seeds to customers, including those manufactured by third parties, is the exclusive responsibility of these affiliated and other non-affiliated vendors.

Oncura's revenues were approximately $72.1 million in 2005 and $68.8 million in 2004, and approximately $31.4 million for the period from commencement of operations in July 1, 2003 through December 31, 2003.

Notal

Notal is a medical device company founded in 2000, operating mainly in the field of early detection of Age Related Macular Degeneration (AMD). AMD is a common eye disease that gradually destroys central visual function, manifested in two forms: dry AMD, a mild form of the disease, and wet AMD, a progression of dry AMD, which often leads to rapid, severe visual deterioration and blindness. To address the growing need for early detection of wet AMD and for the continuous monitoring of patients with dry AMD, Notal Vision has developed the patented Preferential Hyperacuity Perimetry (PHP), designed to detect and monitor the progression of the disease in a non-invasive manner. Notal launched, together with Carl Zeiss Meditec, or Zeiss, the Preview PHP device, intended for professional use by ophthalmologists and optometrists in their clinics. The current diagnostic device enables early detection of wet AMD among the at-risk population, those already diagnosed with the dry form of the disease. Future versions may also target for screening purposes the full population at risk (e.g., anyone over the age of 55) who may be unaware that they may have dry AMD, as well as patients already treated for wet AMD for post-treatment follow-up. Post treatment follow-up is intended to identify the recurrence of the disease and confirm the stage of the disease. Sales of the Preview PHP device to end-users started in the third quarter of 2004.

Based on the PHP technology, Notal is also developing the “Home Device,” a monitoring device intended for home use. The monitoring device will enable patients with dry AMD to monitor themselves at home on a more frequent basis, ensuring timely intervention by a physician should the disease progress to the wet form. In May 2005, Notal appointed TLC Vision Corporation, or TLC, as it exclusive distributor for the sale and distribution of the "Home Device" in North America. TLC also signed an investment agreement with Notal, pursuant to which TLC committed to invest $4.25 million in Notal (of which $2.8 million has already been invested) subject to achievement of milestones, primarily for the purpose of funding the development of the Home Device.

Notal commenced sales in 2003 and recorded revenues of $0.1 million in 2005, $1.0 million in 2004 and $0.9 million in 2003.

The decrease in Notal's revenues in 2005 resulted primarily from Zeiss' non-compliance with Notal's exclusive distribution agreement with Zeiss. Notal and Zeiss are in the process of negotiating their disputes through arbitration or mediation.

Notal's headquarters are located in Tel Aviv, Israel and as of May 31, 2006, had 25 employees. Notal has one patent and three pending patent applications.

Innomed, 14% held by us, is also a 29% shareholder of Notal (see below, "Other Holdings in Medical Devices").

Impliant

Impliant is a developer of posterior motion preservation spine implants. The company’s TOPS™ System—Total Posterior Spine™ System, is a mobile spine implant that addresses the major degenerative spine diseases of the posterior spinal column. The TOPS™ System reestablishes a full range of motion, including axial rotation, lateral bending, flexion and extension. Impliant began clinical trials on the device in January 2005.

In March 2006, Impliant received a CE Mark to sell its products in Europe.

Impliant's headquarters are located in Milford, Connecticut, with research and development activities taking place in Ramat Poleg, Israel. As of May 31, 2006, Impliant had 26 employees.

Impliant has 10 pending patent applications.

Innomed, 14% held by us, is also a 11% shareholder of Impliant (see below, "Other Holdings in Medical Devices").

Impliant is currently in the development stage and has not commenced sales.

NuLens

NuLens, established in September 2002, operates in the field of intra-ocular lenses or IOLs mainly for treatment of cataracts and presbyopia. NuLens is focused on exploiting the novel technologies in its patents and developing a real accommodative IOL ("RA-IOL") with the capacity of providing over 10 Diopters in real accommodative power to the cataract and presbyopia markets. NuLens is currently in the process of pre-clinical trials. In May 2006, NuLens received approval from the Ministry of Health in Spain to commence clinical trials and is expected to commence a clinical pilot study in the second half of 2006.

NuLens has two patents and nine pending patent applications.

NuLens' offices are located in Herzliya, Israel and Alicante, Spain. As of May 31, 2006, NuLens had 10 employees.

NuLens is currently in the development stage and accordingly has not commenced sales.

BrainsGate

Established in 2000, BrainsGate is a medical device company developing innovative therapies for patients suffering from Central Nervous System (CNS) diseases. BrainsGate's platform technology involves electrical stimulation of the spheno-palatine ganglion (SPG) to increase cerebral blood flow and to increase the permeability of the blood-brain barrier (BBB).

BrainsGate is exploring several applications for its technology, and is currently focusing on two directions, drug delivery into the CNS, and treatment of acute ischemic stroke.

BrainsGate has developed the NeuroPath™ System, based on a miniature electrode implanted at the roof of the mouth using a minimally invasive surgery.

BrainsGate has eight pending patent applications and 24 patents.

BrainsGate initiated clinical feasibility trials in Europe, treating patients with Grade-IV Astrocytoma (GBM). Clinical trials for the ischemic stroke application are planned to commence in the second half of 2006.

BrainsGate is headquartered in Ra'anana, Israel. As of May 31, 2006, BrainsGate had 21 employees.

BrainsGate is currently in the development stage and accordingly has not commenced sales.

Medingo

Medingo, wholly-owned by RDC, was established in November 2005. Medingo develops solutions specifically to the needs of insulin-dependent diabetic patients. Medingo's device is a miniature dispensing patch, which is convenient, easy to use, discreet and more cost-effective than standard insulin pumps.

Medingo has five pending patent applications.

Medingo's offices are located in Yokneam, Israel. As of May 31, 2006, Medingo had 15 employees.

Medingo is currently in the development stage and accordingly has not commenced sales.

Other Holdings in Medical Devices

Our other holding in the medical devices field is in Innomed, which is a seed stage fund that initiates and invests in Israeli and Israeli related companies in the field of medical devices and life sciences. We hold, through our subsidiary DEP, approximately 14% of the partnership interest in Innomed. Innomed is a member of the Jerusalem Global Ventures Group of venture capital funds.

2. Information, Communications & Technology, or ICT.

Our activities in the field of ICT consist of our holdings in the following main companies:

- Partner, in which we hold approximately 2.6% of the outstanding shares;
- NetVision, in which we hold approximately 39% of the outstanding shares;
- Teledata, in which we hold approximately 21% of the outstanding shares and Infinity, a related venture capital fund, holds approximately 4% of the outstanding shares;
- Wavion, in which we hold approximately 38% of the outstanding shares;
- Starling, in which we beneficially own approximately 72% of the outstanding shares representing all shares owned by us and RDC, or approximately 50%, representing our direct holding and our share in the holding of RDC;
- Enure, in which we hold approximately 57% of the outstanding shares;

- Safend, in which we hold approximately 26% of the outstanding shares;
- Pulsicom Israel Technologies Ltd., or Pulsicom, in which we hold approximately 18% of the outstanding shares; and
- CellAct Ltd., or CellAct, in which we hold approximately 45% of the outstanding shares.

Partner

Partner is a publicly traded, Israel-based company. Its shares are traded on the Tel Aviv Stock Exchange under the symbol “PTNR”. American Depositary Shares, or ADSs, each representing one of the Company’s ordinary shares, are quoted on the Nasdaq National Market under the symbol “PTNR” and are traded on the London Stock Exchange under the symbol “PCCD”. Partner was the first Global System for Mobile Communications, or GSM, mobile telephone network operator in Israel and is one of four cellular service providers in Israel.

On April 20, 2005, we completed the sale to Partner of most of our Partner shares for approximately $94 million, as part of the sale together with the other Israeli founding shareholders of Partner of an aggregate of approximately 33.3 million Partner shares to Partner for an aggregate consideration of approximately $245 million, following which we held approximately 2% of Partner's outstanding shares. On March 21, 2006, we purchased an additional 0.6% of Partner’s outstanding shares from one of the other Israeli founding shareholders of Partner for approximately $5.3 million.

Our remaining shares, constituting approximately 2.6% of Partner’s outstanding shares, are no longer pledged to the banks providing financing to Partner. However, almost all Partner shares held by us are subject to certain transfer restrictions under Partner's Israeli communications license. Under Partner's Israeli communications license, the Israeli founding shareholders are required to maintain such amount of shares to ensure that at least 5% of Partner's shares are held by Israeli citizens and residents. In addition, the Israeli founding shareholders are required to appoint, generally, 10% of Partner's board of directors. On April 20, 2005, the Israeli founding shareholders, including us, entered into a Restated Relationship Agreement among themselves and Partner's controlling shareholders, Hutchison BV and Advent Investments Pte Ltd., and a shareholders agreement among themselves to regulate the above issues as between them. For a description of the material terms of these agreements, See Item 10C - "Material Contracts".

Partner’s principal business is the provision of mobile telephone services in Israel. Partner currently operates in the 900 MHz and 1800 MHz bands. Its GSM network covers approximately 97% of the Israeli population. Its services include standard and enhanced GSM services, as well as value added services and products such as voice mail, voice messaging, color picture messaging, icon, ringtone and game downloads, information services, High Speed Circuit Switched Data or HSCSD, General Packet Radio Services, or GPRS, which enables the packet transfer of data in an “always on” mode at a speed of up to 20-30 Kbps, personal numbering and data and fax transmission services. Partner also offers its subscribers the ability to roam using their mobile phones outside Israel.

Partner's 3G network, which as of the end of 2005 covered approximately 92%, of the Israeli population, offers a wide range of new services, such as video calls, a new portal of content services including a broad selection of video-based services under the “obox live” brand, and the transmission of data at speeds of up to 384 Kbps.

Partner distributes its services primarily through direct sales through Partner-owned sales centers and business sales representatives and indirect sales through traditional networks of specialist dealers and non-traditional networks of retail chains and stores, which account for a majority of Partner’s sales. Partner also offers 24-hour, seven days a week customer service, as well as handset repair and replacement services, to subscribers who acquire these services.

Partner is subject to extensive regulation related to the spectrum and its ability to operate mobile telephone service in Israel. The Israeli Ministry of Communications controls the granting of licenses to operate mobile telephone service in Israel. It has granted licenses to several companies to operate such mobile networks, and may grant additional licenses in the future. Additionally, Partner must erect antennae that carry its network transmissions in order to maintain the coverage of the Israeli population required in its license. The erection and operation of these antennae must comply with local, regional and national regulations.

Partner is also dependent on a number of licenses and agreements to operate its mobile telephone network, and Partner maintains contracts with a number of dealers through which its products are sold and has contracts with Nortel, Nokia and Ericsson to provide it with equipment to run its network. Such equipment is available only through a limited number of suppliers. Partner also leases most of its transmission capacity from Bezeq. Partner maintains agreements with mobile telephone network operators in foreign countries through which it provides its customers with international service.

As of December 31, 2005, Partner had approximately 2.529 million subscribers, representing approximately 32% of the total Israeli cellular market. Partner’s revenues were approximately NIS5.12 billion ($1.11 billion) in 2005, NIS 5.14 billion ($1.12 billion) in 2004 and NIS 4.47 billion ($0.97 billion_ in 2003) The dollar amounts are based on the shekel-dollar representative rate of exchange on December 31, 2005 of NIS4.603 equal to $1.00.

In the third quarter of 2005, Partner's Board of Directors and shareholders approved the distribution of its first cash dividend, in the amount of NIS 0.57 per share, totaling approximately NIS 86.4 million to its shareholders of record as of September 26, 2005. In the first quarter of 2006, Partner's Board of Directors and shareholders approved the distribution of an additional cash dividend in the amount of NIS 0.65 per share (totaling approximately NIS 100 million) to its shareholders of record as of April 10, 2006. In the second quarter of 2006, Partner's Board of Directors approved the distribution of an additional cash dividend in the amount of NIS 0.45 per share (totaling approximately NIS70 million) to its shareholders of record as of June 6, 2006.

NetVision

NetVision provides Internet services and solutions in Israel and international telephony services through Voice over IP technology (VoIP). On May 19, 2005, NetVision completed its initial public offering on the TASE of shares and convertible securities in consideration for aggregate immediate net proceeds of approximately NIS135 million (approximately $31 million). In addition, future proceeds from the exercise of options sold in the offering may amount up to approximately NIS28.8 million (approximately $6.6 million). NetVision’s total revenues were $74.3 million in 2005, $66 million in 2004 and $61.3 million in 2003 based on the shekel-dollar representative rate of exchange as of December 31, 2005 of NIS 4.603 equal to $1.00.

NetVision’s activities in the Internet area focus on providing Internet connectivity and related services and products, content and electronic commerce services and the establishment and supply of Internet-based applications. NetVision provides international telephone services through 017 prefix, which are provided using Voice Over Internet Protocol (“VOIP”) technology, a technology that enables voice transmission over the Internet infrastructure.

NetVision estimates that as of December 31, 2005, its share of the Internet connectivity market in Israel was approximately 25%, with 425,000 customers receiving Internet connectivity services from NetVision (of which approximately 272,000 were broadband).

NetVision also provides various content and electronic commerce services. NetVision maintains “Nana”, a portal which provides a variety of content and e-commerce services, such as search engines and mail boxes, chat rooms, forums and blogs, Web site indexing for both local and international sites, shopping and advertising.

NetVision is involved in e-commerce activity and currently operates through "Nanashops” website (previously called "Netaction"), which enable e-commerce through various sale methods - auction, public sale and group purchases.

NetVision is dependent on the communication services provided by Bezeq which has a monopoly for domestic telecommunications in Israel. NetVision is also dependent on maintaining its operating license granted by the Israeli Ministry of Communications

On May 1, 2006, NetVision announced that it will be entering into merger discussions with Barak, a subsidiary of Clal Industries and Investments Ltd., or Clal. Elron, Clal and DIC, the other major shareholder of NetVision, are all part of the IDB group of companies. Barak engages mainly in the provision of international telecommunication services. The transaction, if it takes place, will be subject to the signing of a definitive agreement as well as corporate and regulatory approvals. There is no assurance that the transaction will take place.

NetVision's headquarters are located in Haifa, Israel. As of May 31, 2006, NetVision had 1,195 employees.

Teledata

Teledata provides innovative access products and solutions for both traditional and Next Generation Networks, or NGN, to telecom operators and service providers which allow operators to provide a large variety of wireline services, including Voice, Data and Video (Triple Play) for business and residential customers. Teledata's solutions provide a smooth migration path from existing legacy networks into NGN based on IP and soft switches. Teledata has two families of products: BroadAccess™ which is a carrier-class Integrated Multiservice Access Platform (IMAP) providing integration into both ATM and IP networks and HighPGate™, an access gateway for voice, data and protocol conversion into NGN.

Teledata sells its products directly and through distributors in Europe, Asia, Africa and South America. Teledata's revenues were $55.9 million in 2005, $38.9 million in 2004, and $20.8

million in 2003. Teledata's revenues depend to a large extent on being awarded large projects with new customers mainly in third world countries. There is no assurance that Teledata will be able to maintain its revenues at the same level as in the past.

Teledata was established in 1981 and maintains its headquarters in Herzliya, Israel. Teledata also operates through subsidiaries in the Netherlands, Australia and Brazil. As of May 31, 2006, Teledata had 161 employees worldwide.

Teledata has 14 patents and 26 pending patent applications, primarily in the United States.

Wavion

Wavion develops and delivers access points for outdoor metro applications. Wavion commenced development of its products in the second quarter of 2000. Wavion's proprietary signal processing algorithms for digital beam forming utilize multipath to provide significant performance gains in system capacity, operating range, data rate and interference mitigation. The modular technology can be customized to meet the requirements of most equipment vendors and integrates easily into any wireless communication system.

In May 2006, Wavion launched its product and expects to commence product sales in the second half of 2006.

Wavion is a Delaware corporation with research and development facilities in Yoqneam, Israel.

Wavion has two pending patent applications and as of May 31, 2006, Wavion had 64 employees.

Starling

Founded at the end of 2003, Starling is a provider of innovative connectivity solutions for the broadband access market for mobile platforms, currently focusing on aircraft. Its antenna and SATCOM (satellite communications) systems are based on proven technology developed at Rafael and Elbit Systems Ltd. Starling provides a unique connectivity solution that makes possible the delivery of advanced Internet services and applications for VOIP, security, entertainment and operations on all three major categories of aircraft, namely, business jets, narrow-body and wide-body. The Starling MIJET product line incorporates a two-way Ku-band low profile antenna with a proprietary SATCOM resource allocation system that effectively utilizes satellite transponder capacity. The solution enables the delivery of high-speed Internet services on a broadband connection.

Starling does not expect to receive purchase orders prior to the end of 2006.

Starling has its headquarters in Yoqneam, Israel.

Starling has two pending patent applications. As of May 31, 2006, Starling had 26 employees.

Enure

Enure, established in 2003, develops software that automates the operation of broadband services in the home. Enure's software is intended to ensure that the home network and applications work reliably, problems are automatically fixed and installations, upgrades, and policies management by service providers, are all executed automatically.

Enure's main target market is broadband service providers, a rapidly growing arena with major technology investments. For service providers, such as telecommunication companies and Multi Service Organizations, or MSO's, typically cable companies, Enure's software drives operating expense reduction and establishes the solid basis for future advanced services, such as VoIP, IPTV and Triple and Quadruple Play.

Enure's software uses patent-pending core technology. Enure's home-residing software is sold under the brand ServiceShield™, and its optional service-provider-residing server under the brands ServiceShield Concentrator™ and TIC™.

As of December 31, 2005, Enure had not yet generated revenues.

Enure operates from Herzelia, Israel and as of May 31, 2006, Enure had 25 employees. Enure has two pending patent applications.

Safend

Safend, established in 2003, develops comprehensive endpoint security solutions that enable organizations to adopt new communication technologies without sacrificing security. Safend products focus on securing enterprise desktops and laptops by providing visibility and control over wired and wireless commuinication ports.

Safend's end-point security solutions provide the enterprise with granular visibility and control over the myriad of devices users connect to their desktops and laptops.

In 2005 Safend recorded revenues in the amount of $0.4 million.

Safend is headquartered in Tel Aviv, Israel with a subsidiary in Philadelphia, Pennsylvania. As of May 31, 2006, Safend had 44 employees worldwide.

Safend has filed two Patent Cooperation Treaty or PCT applications and three additional provisional patent applications.

Pulsicom

Pulsicom Israel Technologies Ltd. develops high accuracy, real time locating and tracking systems for confined spaces. Pulsicom's technology employs short-pulse technologies, including very-and ultra-wideband and sophisticated position-determination algorithms.

Pulsicom is an early stage development company, which has not yet completed its commercial product development. In order to generate revenues, Pulsicom provides development services to different customers. Pulsicom has limited resources and its continued operations depend on its ability to raise additional capital. There is no assurance that Pulsicom will be successful in its efforts to raise additional capital. As of May 31, 2006, Pulsicom had 6 employees.

Cellact

Cellact Ltd. is a developer of cellular messaging platforms and applications, based on proprietary technology. Cellact's main product, Large Account gateway, was first commercially released in July 2001. The Large Account gateway is a product aimed at mobile operator, virtual mobile operators and mobile service providers. The Large Account gateway provides the operator with the ability to easily connect and manage content providers and enterprises to its SMS and MMS systems. Cellact's customers come from a variety of industries, including telecom, finance and call centers

3. Semiconductors

Our activities in the field of semiconductors consist of our holdings in the following companies:

- ChipX, in which we hold approximately 29% of the outstanding shares.
- Jordan Valley, in which we hold approximately 28% of the outstanding shares;
- Sela – Semiconductor Engineering Laboratories Ltd., or SELA, in which we beneficially own approximately 66% of the outstanding shares representing all the shares owned by us and RDC, or approximately 39%, representing our direct holding and our share in the holding of RDC; and
- 3DV, in which we beneficially own approximately 89% of the outstanding shares representing all shares owned by us and RDC, or approximately 62%, representing our direct holding and our share in the holding of RDC.

ChipX

ChipX is a manufacturer of late stage programmable structured ASICs (Application Specific Integrated Circuits). ChipX's innovative, patented technology consolidates wafer manufacture tooling, reduces time-to-market and minimizes the cost of initial production. In 2004, ChipX discontinued the low volume OneMask business to focus on specific higher volume vertical markets with its future products, which were introduced during the second half of 2005. Initial customer purchases of these products are expected to commence in late 2006. ChipX also discontinued the back end production processes relating to low volume production, in effect becoming a totally fabless operation.

ChipX's Structured ASIC solution specifically addresses applications with medium to high production volumes. Along with standard cell ASIC vendors, ChipX primarily addresses the hard-wired ASIC market serving a wide variety of end markets, including automotive, computer, consumer, industrial and communications markets.

ChipX depends upon third-party manufacturers to manufacture its products. ChipX uses a wide range of parts and raw materials in the production of its semi-conductors, including silicon wafers, and electronic and mechanical components.

ChipX generally does not have guaranteed supply arrangements with its suppliers and does not maintain an extensive inventory of parts and materials for manufacturing.

ChipX's patented structured ASIC technology is protected by several core patents on its basic architecture, special logic cell and metal configurable memory. In addition, ChipX has internally developed routing software and metal programmable input/output cells to take advantage of its proprietary technology. ChipX has 19 U.S. patents and 2 applications pending.

ChipX's total revenues were $14.7 million in 2005, $16.2 million in 2004 and $13.7 million in 2003.

ChipX's headquarters are located in Santa Clara, California with research and development operations taking place in Haifa, Israel. As of May 31, 2006, ChipX had 73 employees.

Jordan Valley

Jordan Valley offers inline metrology solutions with ultra thin film measurement capability and wide range of application coverage based on X-ray technology. The company's JVX® platform exploits various X-ray-based schemes to provide a broad range of measurement capabilities including thickness, density, roughness, and composition of metals and dielectric films. The platform features small spot size, non-destructive, enabling product wafer metrologies.

Jordan Valley operates two business divisions: analytic division and semiconductor division. Jordan Valley focuses in the semiconductor industry, selling, directly in the United States and via distributors in Japan, Europe, Taiwan, Korea and China.

Jordan Valley's headquarters, manufacturing, and R&D facilities are located in Migdal Haemek, Israel. Marketing offices are located in the United States. As of May 31, 2006, Jordan Valley had 90 employees.

In the field of X-Ray metrology, Jordan Valley holds 19 U.S. patents with 15 applications pending, as well as five patents with 24 applications pending in foreign jurisdictions.

Jordan Valley's revenues were $10.4 million in 2005, $8.2 million in 2004 and $3.2 million in 2003.

SELA

SELA develops and manufactures yield enhancing and automation equipment for the semiconductor and optical component industries. SELA is dedicated to the development and marketing of solutions for failure analysis and process monitoring in the semiconductor industry. SELA's automated sample preparation systems are used primarily by semiconductor manufacturers to prepare samples for scanning electron microscopy and transmission electron microscopy. SELA has six patents and two pending patent applications. SELA's revenues were

$4.2 million in 2005, $5.1 million in 2004 and $4.3 million in 2003. SELA's headquarters are located in Yoqneam, Israel and it maintains a marketing office in Sunnyvale, California. As of May 31, 2006, SELA had 36 employees.

3DV

3DV designs and develops three dimensional image sensors chip sets that generate both color and depth information, for each object captured by a camera, in real time. 3DV’s business is currently focused on applications in the video gaming field and ceased engaging in applications in the medical field.

3DV has not yet generated significant revenues and its ability to continue to operate is dependent upon financial support from its shareholders and its ability to raise financing from external investors. 3DV is headquartered in Yoqneam, Israel and as of May 31, 2006, 3DV had 19 employees.

4. Advanced Materials

Our activities in the field of amorphous metals consist of our holding in AMT, in which we hold approximately 34% of the outstanding shares on an as converted basis as of June 8, 2006.

AMT operates through its group companies in developing, marketing and licensing technologies for amorphous and nano-crystalline advance materials, as a solution for a wide range of commercial applications. AMT's thin ribbons, microwires and nano powder amorphous materials exhibit magnetic, electrical, mechanical and chemical properties that enable the enhancement of existing products and applications, as well as the introduction of new products and solutions for various industrial and high-tech applications and markets. AMT operates in four fields: heating, sensoring (authentication and anti-shop lifting), micro wires and electronic elements. AMT’s current main focus is in the field of heating through A.H.T. Advanced Heating Technology Ltd., or AHT, and in the sensoring field (authentication and anti-shop lifting) through A.C.S. Advanced Coding Systems Ltd, or ACS. The continued operations of AMT’s group companies are largely dependent upon their ability to generate sufficient revenues. There is no assurance that AMT's group companies will be able to successfully market their respective products in the worldwide market.

AHT, in which AMT holds approximately 93% of the outstanding shares, is engaged in the development and production of heating applications based on thin ribbon, amorphous materials**.** AHT holds a global patent on using amorphous ribbons for heating products. AHT has developed a variety of heating products for domestic, outdoor, agricultural and pipe heating markets. AHT’s electrical heating element enables the heating of very large surface areas at lower temperatures and higher efficiency and therefore at a lower cost and presents competitive advantages over other electrical and non-electrical heating alternatives. AHT currently focuses on two principal markets: under floor indoor heating and outdoor heating.

AHT has agreements with distributors in various countries, including most recently, a distribution agreement with Mohawk Carpet Distribution, L.P signed in 2005 for distribution of its products in the United States.

AHT’s revenues were $2.6 million in 2005, $1.2 million in 2004, and $0.8 million in 2003.

AHT has five patents.

AHT is headquatered in Netanya, Israel and as of May 31, 2006, AHT had 21 employees.

ACS

ACS, in which AMT holds directly and indirectly approximately 89% of the outstanding shares, develops, markets and sells products using microwires amorphous material for brand protection against counterfeiting and theft and electronic article surveillance tags for anti-shoplifting. ACS competes in the electronic article surveillance tags, data and authentication tags markets. ACS's revenues were $1.0 million in 2005, $0.8 million in 2004 and $0.6 million in 2003.

ACS has 3 patents and 5 patents pending.

ACS is headquatered in Even Yehuda, Israel and as of May 31, 2006, ACS had 12 employees.

Other Holdings

Elbit Vision Systems Ltd., or EVS, [OTCBB: EVSNF.OB], in which we beneficially hold approximately 9.3% of the outstanding shares (not including 1,512,939 warrants to purchase ordinary shares of EVS), designs, develops, manufactures, markets and supports automatic visual inspection and quality monitoring systems for a broad range of industries. EVS’ automatic in-line inspection and quality monitoring systems are designed to increase the accuracy, consistency and speed of detection of defects in the manufacturing process in order to reduce labor costs, improve product quality and increase manufacturing efficiency. EVS' Microelectronic Division primarily provides optical inspection and correction systems for the manufacture of liquid crystal displays, flat panel displays. EVS's, Industrial Division provides automatic optical inspection (AOI) and non-destructive ultrasound inspection systems for “heavy” manufacturing industries (automotive, aeronautics, steel and others) and industrial materials (textiles, non-wovens, plastic, paper and others).

EVS maintains a global sales force and service coverage with over 850 inspection systems installed in 25 countries and has more than 100 customers.

EVS’s revenues were $20.8 million in 2005, $11.0 million in 2004 and $6.3 million in 2003.

EVS is headquartered in Yoqneam, Israel, with offices in the United States and Korea, and as of May 31, 2006, had 118 employees.

C. Organizational Structure

As of May 31, 2006, DIC, an Israeli company, holds approximately 47.6% of our total outstanding shares. For additional information about DIC, see "Major Shareholders" in Item 7 below. For our holdings in our group companies, see above.

D. Property, plants and equipment

Our corporate headquarters and executive offices are located in Tel-Aviv, Israel. These offices, which measure approximately 980 square meters, are leased at an annual rent of approximately $0.3 million.

We believe that the above facilities are adequate for our operations as currently conducted. In the event that additional facilities are required, we believe that we could obtain such additional facilities at commercially reasonable prices.

In addition, we have contractual rights to long-term leases in property located in Karmiel, in northern Israel, totaling approximately 15,760 square meters, consisting of building facilities. These premises are currently leased to Elbit Systems Ltd., or Elbit Systems.

Item 4A. Unresolved Staff Comments

Not applicable.

Item 5. Operating and Financial Review and Prospects

OVERVIEW

We are a high technology operational holding company that operates through subsidiaries and affiliated companies, referred to as our group companies. Founded in 1962, we have been a major force in the development of the Israeli high technology industry by building Israeli and Israel-related companies with technologies in the fields of medical devices, advanced defense electronics, communications, semiconductors, software products and services and advanced materials. Some of our group companies grew out of our subsidiary, RDC. Our group companies include both publicly traded and privately held companies.

Our primary activity is our involvement in the management of our group companies in which we maintain controlling or significant holdings, and, in a limited number of cases, non-significant holdings. We participate in the management of most of our group companies by means of active membership on their boards of directors and board committees. As a result, we are involved in matters of policy, strategic planning, marketing, selecting and manning senior management positions, approving investments and budgets, financing and the overall ongoing monitoring of our group companies' performance. In addition to our representation on the boards of directors of our group companies, we provide hands-on assistance to the group companies' management in support of their growth. We view our hands-on involvement in the operations of our group companies as a key element of our business. Our group companies therefore benefit from the experience of our management team in various areas in which they need support and leadership, including, but not limited to, strategic planning, research and development guidance, identifying joint venture opportunities, introductions to potential customers and investors, risk management, market analysis, business plan preparation, budgetary control, and legal support.

Technology industries are characterized by the high degree of risk inherent in their products, their continuous technological innovation and their penetration into world markets, which requires investment of considerable resources and continuous development efforts. The future success of our group companies is dependent upon their technological quality, the prices and nature of their products in comparison to their competitors and their ability to introduce new products to the markets at the right time, while offering cost effective solutions suitable to their customers' needs as well as their ability to raise financing and the condition of the capital markets.

We expect to continue to build and realize value for our shareholders through the sale to third parties of a portion or all of our holdings in, or the issuance of shares by, our group companies, while simultaneously pursuing the acquisition of, or investment in, new and existing companies at different stages of development including early stage and more mature companies. We believe that this strategy provides the ability to increase shareholder value as well as to create capital to support the growth of our group companies and to invest in new opportunities. The nature of our business, therefore, will result in some volatility in our results of operations, depending on the transactions that occur within a particular period.

Our net income (or loss) in any given period is due, for the most part, to the results of operations of those of our group companies which are accounted by us under the consolidation or equity method of accounting and dispositions and changes in our holdings of group companies. As most of our group companies are technology companies which have not yet generated significant revenues and which invest considerable resources in research and development and in marketing activities, we have experienced, and expect to continue to experience, losses in respect of these companies. However, as a result of recent accounting pronouncements described below under "CRITICAL ACCOUNTING POLICIES", some of our group companies and new companies in which we may invest may be accounted for at cost, thereby not affecting our results of operation.

Our capital resources in any given period are primarily affected by the extent of our investment in existing and new companies and the realization of certain holdings as well as the impact of any dividends or distributions to our shareholders. The results of operations of our group companies, and consequently, our results of operations and capital resources, are affected by general economic conditions as well as by factors specifically related to the technology markets, which also affect the ability of our group companies to raise financing and our ability to dispose of holdings and realize gains from our holdings.

TREND INFORMATION

Technology industries are affected by economic trends and the condition of the capital markets. Since the second half of 2003, there has been a recovery in the technology sectors and capital markets from the downturn which commenced in 2001. This trend was reflected in the improvement in the results of operations of most of our group companies as well as the raising of funds from new strategic and other investors in private placements completed by some of our group companies. In addition, we recorded significant gains from realizing certain of our holdings, mainly in 2004 as a result of the sale of our holdings in Elbit Systems Ltd. and in the second quarter of 2005 from the sale of most of our shares in Partner and the sale of all of our shares in Oren (see ITEM 4 "Information on the Company"). Should the improvement in the technology sectors and capital markets continue, we anticipate that it will have a positive effect on our group companies and their ability to raise additional capital. In addition, during 2004 and 2005 we invested approximately $48.3 million in new companies (see Item 4 "Information on the Company" for more information regarding new investments in 2005) and an additional $64.8 million in existing group companies (mainly in Given Imaging) including an amount of $12.4 million in consolidated subsidiaries.

CRITICAL ACCOUNTING POLICIES

We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the United States ("US GAAP"). Our significant accounting policies are more fully described in Note 2 to our Consolidated Financial Statements included elsewhere in this report. Certain accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, our financial statements will be affected. The significant accounting policies that we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

- Principles of accounting for holdings in group companies;
- Business combinations and purchase price allocation;
- Impairment of goodwill and other intangible assets;
- Other-than-temporary decline in value of investments in group companies; and
- Accounting for income taxes.

Principles of Accounting for Holdings in Group Companies

The various holdings that we have in our group companies are accounted for under several methods, based among others, on our level of ownership and the type and form of our holdings in our group companies, as described below.

Consolidation. Companies over which we have control are accounted for under the consolidation method of accounting. Control is usually assumed when we own directly or through our subsidiaries, more than 50% of the outstanding voting securities of a company. However, whether or not we control a group company also depends on an evaluation of several factors, including, among others, our representation on the board of directors and any minority participating rights and other factors which require management to make judgment and involve the use of significant estimates and assumptions.

Under the consolidation method, a controlled company's assets and liabilities are included within our consolidated balance sheet and its income and expense items are included within our consolidated statements of operations. The share of other shareholders in the net assets and in the net income or losses of a consolidated company is reflected in minority interest in our consolidated balance sheet and in our consolidated statements of operations, respectively. The minority interest amount adjusts our consolidated net income (loss) to reflect only our share in the earnings or losses of any consolidated company.

Notwithstanding the above, in January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46, “Consolidation of Variable Interest Entities – An Interpretation of Accounting Research Bulletin No. 51” ("FIN 46"), relating to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. In December 2003, the FASB issued FASB Interpretation No. 46 (revised December 2003) (FIN 46R), which replaced FIN 46. FIN 46R defines the provisions under which a Variable Interest Entity ("VIE") should be consolidated. In general, a VIE is a corporation, partnership, limited-liability corporation, trust, or any other legal structure used to conduct activities or hold assets that either (1) has an insufficient amount of equity to carry out its principal activities without additional subordinated financial support, (2) has a group of equity owners that is unable to make significant decisions about its activities, or (3) has a group of equity owners that does not have the obligation to absorb losses or the right to receive returns generated by its operations. FIN 46R provides several exceptions to its scope, such as that an entity that is deemed to be a business need not be evaluated to determine if it is a VIE unless one of the conditions specified in FIN 46R exists. FIN 46R requires a VIE to be consolidated by the party with an ownership, contractual or other pecuniary interest in the VIE (a variable interest holder) that will absorb a majority of the risk of loss from the VIE's activities, is entitled to receive a majority of the VIE's residual returns (if no other variable interests absorb a majority of the VIE's losses), or both. A variable interest holder that consolidates the VIE is called the primary beneficiary.

As an operational holding company, we have made investments in and granted loans to companies that are engaged in various fields of high technology. Some of these companies are in their early stages of development and will require substantial external investments until they can finance their activities, they are currently engaged in, without additional support from other parties and may be considered VIEs. These companies are currently primarily funded with financing from venture capital funds, other holding companies and private investors.

Our assessment of whether a group company is within the scope of FIN 46R, whether a group company is a VIE and the determination of the primary beneficiary is judgmental in nature and involves the use of significant estimates and assumptions regarding the fair value of certain entities and their variable interests. The estimates and assumptions include, among others, forecasted cash flows, their respective probabilities and the economic value of certain preference rights.

As of December 31, 2005, Wavion, in which we hold approximately 37.8% is considered to be a VIE, but Elron is not its primary beneficiary. As of December 31, 2005, our maximum exposure to loss as a result of our involvement in Wavion does not exceed the carrying value of our investment in Wavion in the amount of approximately $0.8 million.

Equity Method. Group companies which we do not control, but over whom we exercise significant influence over the operating and financial policies and in which we hold common stock or in-substance common stock as defined in EITF 02-14 "Whether an Investor Should Apply the Equity Method of Accounting to Investments Other Than Common Stock” ("EITF 02-14") (which is further described below), are accounted for under the equity method of accounting. Significant influence is usually assumed when we hold 20% or more of a group company's voting securities, however, whether or not we exercise significant influence with respect to a group company also depends on an evaluation of several additional factors, including, among others, our representation on the board of directors, agreements with other shareholders, our participation in policy making processes, the existence of material intercompany transactions and technological dependency, the extent of ownership by an investor in relation to the concentration of other shareholdings, and other factors which may require management to make certain judgmental decisions regarding significant influence.

EITF 02-14, which became effective at the beginning of the fourth quarter of 2004, defines in-substance common stock as an investment with similar risk and reward characteristics to common stock. In certain holdings we invested, among others, in preferred shares which include rights, among others, such as cumulative and participating dividends, dividend preferences and liquidation preferences. Based on EITF 02-14, new companies in which we invested in the fourth quarter of 2004 and in 2005, namely Jordan Valley, Impliant, Teledata, NuLens and BrainsGate, are being accounted for at cost notwithstanding our significant influence in such companies, as the investment in these companies is not considered to be in-substance-common stock. Any assessment of whether we hold in substance common stock in a group company is judgmental in nature and involves the use of significant estimates and assumptions such as assessing the fair value of the subordinated equity of the group company.

We also account for our interests in private equity funds under the equity method of accounting, based on our holding percentage.

Under the equity method of accounting, a group company's assets and liabilities are not included within our consolidated balance sheet and their results of operations are not reflected within our consolidated statements of operations. However, our share in the net income or losses of the group company is reflected as an equity income (loss) in our consolidated statements of operations. The share of income or losses is generally based upon our ownership level of the outstanding share capital of the group company. In circumstances where the equity method is being applied, our ownership in an investee is in the form of a preferred security or other senior security which is considered to be in-substance common stock and the investment in common stock is zero, we recognize equity method losses based on our ownership level in the particular investee security or loan held by us to which the equity method losses are being applied.

Other Methods. Our holdings in companies that we do not account for under either the consolidation or the equity method of accounting are accounted for under three different methods:

- Non-marketable securities are presented at cost. Under this method, our share in the income or losses of these entities is not included in our consolidated statements of operations.
- Marketable securities which are classified as available-for-sale are presented at fair market value and the effect of any unrealized change in market value is reflected in other comprehensive income (loss). When realized, gain or loss is included in our results of operations.

See below for a discussion of "Other-Than-Temporary Decline in Value of Investments in Group Companies".

Business Combinations and Purchase Price Allocation

Business combinations are accounted for using the purchase method of accounting, under which the total purchase price is allocated to proportional interest in the acquired company's assets and liabilities based on their estimated fair values, and the remainder, if any, is attributed to goodwill.

The aggregate purchase price of any investment accounted for under either the consolidation or the equity method of accounting is being allocated to identifiable net assets, intangible assets other than goodwill, in-process research and development ("IPR&D") activities, and to goodwill. The amount allocated to IPR&D is being charged immediately to our 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 finite-lived intangible assets other than goodwill are amortized on a straight-line basis over their weighted average expected useful life. In 2005 and 2004, IPR&D charges amounted to $1.1 million and $2.3 million (which are part of our share in the net income or loss of affiliated companies). IPR&D in 2004 resulted mainly from the purchase of Given Imaging shares for approximately $43.9 million.

Estimating the fair value of certain assets acquired and liabilities assumed is judgmental in nature and often involves the use of significant estimates and assumptions, mainly with respect to intangible assets. While there are a number of different methods for estimating the value of intangibles acquired, the primary method we use is the discounted cash flow approach. Some of the more significant estimates and assumptions inherent in the discounted cash flow approach include projected future cash flows, including their timing, a discount rate reflecting the risk inherent in the future cash flows and a terminal growth rate. Another area which requires judgment which can impact our results of operations is estimating the expected useful lives of the intangible assets. To the extent intangible assets are ascribed with longer useful lives, there may be less amortization expenses recorded in any given period. As we and our group companies operate in industries which are rapidly evolving and extremely competitive, the value of the intangible assets, including goodwill, their respective useful lives and the investments in companies is exposed to future adverse changes which can result in a charge to our results of operations (See also "Other-Than-Temporary Decline in Investments in Group Companies" under this section).

Impairment of Goodwill and Other Intangible Assets

We conduct a goodwill impairment review at least annually and on an interim basis whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors that we consider important which could trigger an impairment review include significant underperformance relative to historical or expected future operating results and significant negative industry or economic trends. We test for impairment at a level referred to as a reporting unit. Determining fair value involves the use of significant estimates and assumptions. These estimates and assumptions could have an impact on whether or not an impairment charge is recognized. To determine fair value, we may use a number of valuation methods including quoted market prices, discounted cash flows and revenue multipliers. As mentioned above, these approaches use estimates and assumptions including projected future cash flows, discount rate and terminal growth rate. Using different assumptions could result in different results. In 2005 and 2004, a goodwill impairment charge in the amount of $1.3 million and $2.0 million, respectively, was recorded with respect to the operation of the ET group in light of its results of operation (following the sale of this business, these charges are presented as part of the loss from discontinued operations in the statements of operations). At December 31, 2005, consolidated goodwill amounted to approximately $2.7 million.

Other intangible assets with definite useful lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If an asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. In the evaluation of fair value, we use significant estimates and assumptions such as projected future cash flows which are subject to high degree of judgment. In 2004 we recorded impairment charges of other intangible assets of $2.9 million with respect to the ET group in light of its results of operation (following the sale of this business, this charge is presented as part of the loss from discontinued operations in the statements of operations). In addition in 2004 we recorded impairment charges of other intangible assets of $4.2 million with respect to MediaGate due to our revised estimate about future proceeds from the sale of its technology. Intangible assets with an indefinite useful life are tested for impairment at least annually by comparing the fair value of the intangible asset to its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. In the valuation of fair value we use judgment as to which is the most appropriate method to use for measuring fair value and as to what assumptions to use in implementing the methodology chosen. As we operate in industries which are rapidly evolving and extremely competitive, changes in the assumptions and estimates may affect the carrying value of the intangible assets, and could result in an additional impairment charge to our results of operations. At December 31, 2005, consolidated intangible assets, other than goodwill, amounted to approximately $2.8 million.

Other-Than-Temporary Decline in Value of Investments in Group Companies

At the end of each reported period we evaluate whether an other-than-temporary decline in the value of an investment in a group company has been sustained. This evaluation is judgmental in nature. If it has been determined that an investment has sustained an other-than-temporary decline in its fair value relative to its carrying value, the investment is written down to its fair value by a charge to our results of operations.

An evaluation of fair value is dependent upon specific facts and circumstances. Factors that are considered by us in this determination include financial information (including, among others, budgets, business plans and financial statements) and the value at which independent third parties have invested or have committed to invest and independent appraisals, if available. Factors indicative of an other-than-temporary decline include recurring operating losses, credit defaults, specific conditions affecting the investment, such as in the industry or in geographic area, and subsequent rounds of financing at an amount below the cost basis of the investment. This list is not all inclusive and we weigh all quantitative and qualitative factors in determining if an other-than-temporary decline in value of an investment has occurred. As we operate in industries which are rapidly evolving and extremely competitive, it is possible that our estimates could change in the near term and there can be no assurance that an additional write-down or write-off of the carrying value will not be required in the future. In 2005 and 2004 we recorded write-downs in the amounts of $6.0 million and $1.5 million, respectively, with respect to certain group companies (in 2005 mainly with respect to Oncura and Avantry Ltd., and in 2004 mainly with respect to Textology Inc., 3DV and Ingeneo Ltd.).

Accounting for Income Taxes

At the end of each reported period, we are required to estimate our income taxes. This process requires us to estimate our actual current tax liabilities and make an assessment of temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our net deferred tax assets will be realized through future taxable income and, to the extent we believe that realization is not likely, we must establish a valuation allowance. Management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. Our judgment as to the likelihood to realize our net deferred tax assets is largely based upon interpretations of certain tax laws and estimates and assumptions mainly with respect to our ability to realize investments in our group companies. Our ability to realize investments is mainly dependent upon factors such as the condition of the securities markets and other general economic conditions. As the securities markets for our group companies are highly volatile, changes in our assumptions and estimates may require us to increase the valuation allowance and therefore we may be required to include an expense within the tax provision in our statement of operations.

As of December 31, 2005, deferred tax assets with respect to the corporate carryforward losses that are more likely than not to be realized in future years amounted to approximately $6.5 million ($10.6 million as of December 31, 2004). In 2005, we reduced our previous valuation allowance by $19.6 million, which included $13.3 million as a result of Elbit’s receipt of final tax assessment (of which $3.9 million was recorded as a reduction of goodwill since the deferred tax assets related to carryforward losses of Elbit incurred in periods prior to our acquisition of Elbit) and $5.0 million as a result of the sale of the ET group. In 2004, we reduced our previous valuation allowance by $28.7 million in respect of losses incurred in prior periods mainly due to the sale of our shares in Elbit Systems and due to final tax assessments for previous years.

Deferred tax liabilities as of December 31, 2005 amounted to $9.5 million, mainly with respect to our investment in Partner which is accounted for as available-for-sale securities and with respect to our investment in Given Imaging which is accounted under the equity method.

As of December 31, 2005 Elron had carryforward losses of approximately $69.0 million.

A. Operating Results

Basis of Presentation

Consolidation. Our consolidated financial statements include the accounts of Elron and all of our direct or indirect (through Elbit, DEP and RDC) controlled subsidiaries. The following are our main subsidiaries:

2005	2004	2003
Elron TeleSoft[1]	Elron TeleSoft	Elron Telesoft
RDC	RDC	RDC
Galil Medical	Galil Medical	Galil Medical
SELA	SELA[6]	MediaGate
MediaGate	MediaGate	ESW
3DV	3DV[4]	
Starling	Starling	
Medingo[2]	ESW[5]	
Enure[3]		

[1] Sold on December 29, 2005.
[2] Established by RDC in the fourth quarter of 2005.
[3] Consolidated since the beginning of the fourth quarter of 2005.
[4] Consolidated following the purchase of a controlling interest during the first quarter of 2004
[5] Liquidated as of December 31, 2004 following the sale of all of its assets and business in 2003.
[6] Consolidated since the end of the second quarter of 2004.

Equity Method. Our main group companies held by us or through Elbit, DEP, Galil Medical and/or RDC accounted for under the equity method of accounting include:

2005	2004	2003
Given Imaging	Elbit Systems[2]	Elbit Systems
Oren Semiconductor[1]	Given Imaging	Given Imaging
NetVision	Oren Semiconductor	Oren Semiconductor
ChipX	NetVision	NetVision
Wavion	ChipX	ChipX
Notal Vision	Wavion	Wavion
AMT	Notal Vision	Notal Vision
Oncura	AMT	AMT
Pulsicom	Oncura	Oncura[3]
CellAct	Pulsicom	Pulsicom
	CellAct	CellAct
	SELA[3]	KIT[4]
		3DV
		Avantry (formerly: Witcom) [5]

[1] Sold on June 10, 2005.
[2] Sold on July 28, 2004.
[3] Through the end of the second quarter of 2004.
[4] Sold on March 31, 2004
[5] Through December 31, 2003, following a merger with another Israeli company.

Cost. Our main group companies held by us accounted for under the cost method of accounting include:

2005	2004	2003
Jordan Valley	Jordan Valley	-
Impliant	Impliant	
Teledata	Avantry	
BrainsGate		
NuLens		

Available for Sale. Investments in Partner and EVS were accounted for by us as "securities available for sale" as of December 31, 2005, 2004 and 2003. Our investment in Zix was accounted for by us as "securities available for sale" as of December 31, 2004 and 2003.

Results of Operations

The following tables set forth our results of operations in the reported periods:

	Year ended December 31,		
	2005	**2004**	**2003**
	(millions of $, except per share data)		
Net income (loss)	47.3	84.1	(7.2)
Net income (loss) per share	1.61	2.87	(0.25)

The net income we reported in 2005 was mainly due to the following gains from changes in holding and dispositions of affiliated and other group companies:

(i) a gain, net of tax, of approximately $45.4 million resulting from the sale of Partner's shares. The tax expense relating to the aforementioned gain was decreased by approximately $9.4 million resulting from a decrease in our previous valuation allowance in respect of losses incurred in prior periods, following our receipt of a final tax assessment;

(ii) a gain, net of tax, of approximately $17.2 million resulting from the sale of Oren shares;

(iii) a gain of approximately $3.0 million from the decrease in our interest in NetVision following its initial public offering; and

(iv) a tax benefit of $5 million, resulting from a decrease in our previous valuation allowance in respect of losses incurred on our investment in the ET group.

The above gains were offset by losses, net, which we recorded with respect to our group companies in the amount of $23.0 million in 2005.

The net income we reported in 2004 included the following gains from changes in holding and dispositions of group companies:

(i) a gain, net of tax, of approximately $91.5 million resulting from the sale of our holdings in Elbit Systems. The tax expense relating to the aforementioned gain was decreased by approximately $21.6 million resulting from a decrease in our previous valuation allowance in respect of losses incurred in prior periods following our receipt of a final tax assessment;

(ii) a gain, net of tax and minority interest, of approximately $6.7 million resulting from the sale of Given Imaging shares by RDC and the decrease in our direct and indirect interest in Given Imaging following the completion of Given Imaging's secondary public offering;

(iii) a gain of approximately $5.3 million resulting from the sale of our shares in KIT eLearning; and

(iv) a gain, net after tax, of approximately $3.6 million resulting from the sale of Zix shares (which were received as consideration for the sale of the ESW business in 2003) for aggregate consideration of $8.1 million.

The above gains were offset by losses, net, which we recorded with respect to our group companies in the amount of $23.3 million in 2004.

The net loss we reported in 2003 included the following gains from changes in holding and dispositions of group companies:

(i) a gain, net after tax, of approximately $7.1 million, resulting from the sale of Partner shares in 2003;

(ii) our share in the gain resulting from the merger in 2003 of the urology therapy units of Galil Medical and Amersham (later acquired by GE Healthcare) in the amount of approximately $4.4 million; and

(iii) a gain of approximately $4.1 million resulting from the sale of substantially all of ESW assets and business to Zix and a gain, net of tax, of approximately $3.2 million resulting from the subsequent sale of Zix shares.

The above gains were offset by losses, net, which we recorded with respect to our group companies in the amount of $24.2 million in 2003.

Subsequent to the sale of the ET group in 2005 and ESW in 2003 we operate in one segment. The following table summarizes our operating results in the reported periods:

	Year ended December 31,		
	2005	2004	2003
	(millions of $)		
Net revenues	12.6	11.3	9.1
Net loss from equity investments	(17.5)	(10.5)	(8.7)
Gains from disposal of business and affiliated companies and changes in holdings in affiliated companies	23.3	132.4	25.8
Other income, net	58.6	4.7	14.6
Finance income, net	5.5	1.4	0.8
Total income	82.5	139.3	41.6
Cost of revenues	7.9	6.8	5.9
Operating expenses*	17.8	16.5	22.6
Amortization of intangible assets	0.4	0.1	0.3
Impairment of long-lived assets	-	4.2	-
Total costs and expenses	26.1	27.6	28.8
Gain from continuing operations before income taxes	56.5	111.7	12.8
Taxes on income	(10.5)	(15.1)	(6.8)
Minority interest	5.2	(4.1)	(10.9)
Net income (loss) from continuing operations	51.2	92.5	(4.9)
Discontinued operations of the ET group (**)	(3.9)	(7.9)	(2.1)
Discontinued operations of ESW and others	-	(0.5)	(0.2)
Net income (loss)	47.3	84.1	(7.2)

* Excluding amortization of intangible assets and impairment of long lived assets which are presented as a separate line item.
** As described under ITEM 4 , "Information on the Company", in December 2005, we sold all our holdings in the ET group and accordingly the current period results of operations and the gain on the sale have been classified as discontinued operations, and prior periods results have been reclassified accordingly. The following table sets forth the composition of the discontinued operating results of the ET group for the reported periods:

	Year ended December 31,		
	2005	2004	2003
		(millions of $)	
Loss from operations	(4.1)	(7.9)	(2.1)
Gain on disposal	0.2	-	-
Loss from discontinued operations	(3.9)	(7.9)	(2.1)

The loss from operations in 2004 was primarily due to an impairment charge of long lived assets and goodwill in the aggregate amount of $4.9 million. In 2005, a goodwill impairment in the amount of $1.3 million was recorded.

Year Ended December 31, 2005 compared to Year Ended December 31, 2004.

Income

Net revenues. Net revenues consisted of sales of products and services by our subsidiaries, mainly Galil Medical and SELA. The following table sets forth these revenues:

	Year ended December 31,	
	2005	2004
	(millions of $)	
Galil Medical	8.3	7.6
SELA[1]	4.2	3.3
Other	0.1	0.4
	12.6	11.3

[1] SELA's results have been consolidated since July 1, 2004

In 2005, Galil Medical recorded revenues of $8.3 million, compared to $7.6 million in 2004. Galil Medical's revenues derived mainly from the supply of cryo products and R&D services to Oncura, in which it has a 25% ownership interest.

SELA recorded revenues of $4.2 million in 2005, compared to $5.1 million in 2004 (of which $3.3 million were in the second half of 2004 and was consolidated in our financial statements of 2004).

Share in net losses of affiliated companies. Our share in net losses of affiliated companies resulted from our holdings in certain investments that are accounted for under the equity method (see above under “Basis of Presentation”). Our share in net losses of affiliated companies amounted to $17.5 million in 2005, compared to $10.5 million in 2004. The increase in our share in net losses of our affiliated companies is primarily due to the sale of our holding in Elbit Systems in the third quarter of 2004, which positively contributed $4.7 million in the first half of 2004, and due to impairment charges of $5.1 million, with respect to our investment in Oncura (through Galil Medical) in 2005.

Highlights of the Results of Operations of Our Major Affiliates:

Given Imaging (Nasdaq: GIVN) (a 19.4% holding directly and indirectly through RDC as of December 31, 2005). Given Imaging, a medical device company that develops, manufactures and markets innovative diagnostic systems for visualizing the gastrointestinal tract, using a disposable miniature swallowable video capsules, recorded revenues of $86.8 million in 2005, an increase of approximately 35% over the revenues recorded in 2004 of $65.0 million. The increase in revenues resulted primarily from the increase in sales of Given PillCam video capsule for the small bowel. Given Imaging's net income in 2005 was $6.3 million, compared to $2.9 million in 2004. Given Imaging's net income in 2005 included a special provision recorded in the second quarterof $1.8 million, before tax effect, for uncollectable sales tax related to its U.S. subsidiary.

Oncura (a 25% holding by Galil Medical as of December 31, 2005). Oncura, which markets and sells therapeutic device systems and related consumables used primarily in the performance of minimally-invasive, urologic cancer treatment, recorded revenues in 2005 of approximately $72.1 million compared to $68.8 million in 2004 and its net loss amounted to $6.2 million compared to $2.2 million in 2004. The increase in the net loss resulted primarily due to the increase in operating expenses, mainly selling and marketing expenses. In light of Oncura's results of operations, we recorded an impairment charge of $5.1 million in 2005 ($2.1 million after minority interest). Each of Galil Medical and GE Healthcare have confirmed their intention to continue providing financial support to Oncura through May 31, 2007 or such later date as may be agreed by them.

NetVision (a 39% holding as of December 31, 2005) (TASE: NTSN). NetVision provides internet services and solutions in Israel and commencing in the fourth quarter of 2004, international telephone services through voice over IP (VOIP). NetVision’s revenues increased in 2005 by 12.6% to $74.3 million (of which $3.3 million were derived from international telephony services) from $66.0 million in 2004 and its customer base at December 31, 2005 reached approximately 425,000 (of which approximately 272,000 were broadband) compared to 390,000 at the end of 2004 (of which approximately 225,000 were broadband). NetVision's operating income in 2005 increased by 43.3% to $9.5 million, compared to $6.6 million in 2004 and its net income amounted to $5.4 million compared to $3.9 million in 2004. NetVision's operating currency is the New Israeli Shekel (NIS) and accordingly, all figures above are translations for convenience purposes of NetVision's NIS figures into US dollars at the representative rate of exchange prevailing at December 31, 2005 according to which $1.00 equaled NIS 4.603.

Wavion (a 38% holding as of December 31, 2005). Wavion is a developer of broadband wireless access systems for Wi-Fi networks. Wavion's net loss amounted to $6.3 million in

2005, approximately the same as in 2004, which consists primarily of expenses relating to the development of its product.

ChipX (a 27% holding as of December 31, 2005). ChipX is a manufacturer of late stage programmable application-specific integrated circuits, or structured ASICs. ChipX's revenues in 2005 amounted to $14.7 million, compared to $16.2 million in 2004, and its net loss amounted to $6.3 million, compared to $5.6 million in 2004. Revenues decreased as ChipX shifted from its previous product to the new structured ASIC products.

AMT (a 42% holding as of December 31, 2005). The AMT group develops technologies and products based on amorphous metals. AMT's consolidated revenues in 2005 amounted to $3.6 million, compared to $2.6 million in 2004, and its consolidated net loss amounted to $3.9 million, compared to $3.0 million in 2004. AMT's main subsidiary, AHT, which uses amorphous metals for heating products, recorded revenues of $2.6 million in 2005, compared to $1.2 million in 2004, and recorded a net loss of $1.9 million in 2005, the same as in 2004.

We expect that most of our group companies as well as new companies in which we will invest will continue to recognize losses in future periods, as they invest significant resources in research and development and sales and marketing activities and have not yet generated significant revenues. Our results of operations will therefore be affected by the extent of our share in their net losses (to the extent they are reported under the equity or consolidation method of accounting).

Results of operations of significant group companies which are accounted for other than under the equity method of accounting and whose results do not affect our results of operations.

Partner (Nasdaq: PTNR) (a 2% holding as of December 31, 2005). Partner is a Global System for Mobile Communications, or GSM, mobile telephone network operator in Israel. Our investment in Partner is accounted for as available-for-sale securities. The market value of our investment in Partner as of December 31, 2005 amounted to $26.0 million. Almost all of the remaining Partner shares held by us as of December 31, 2005, amounting to approximately 3.1 million shares, are subject to certain transfer restrictions under Partner's Israeli communications license but are no longer pledged to Partner's lending banks.

In 2005, Partner recorded revenues of $1,113 million compared to $1,117 million in 2004 and its net income amounted to $77 million, compared to $102.4 million in 2004. Partner's subscriber base as of December 31, 2005 was 2,529,000 compared to 2,340,000 at the end of 2004. Partner's operating currency is the NIS and accordingly, all figures above are translations for convenience purposes of Partner's NIS figures into U.S. dollars at the representative rate of exchange prevailing at December 31, 2005 according to which $1.00 equaled NIS 4.603.

Teledata (a 21% holding as of December 31, 2005). Teledata provides innovative access products and solutions for both traditional and next generation networks to telecom operators and service providers. Teledata's revenues in 2005 amounted to $55.9 million compared to $38.9 million in 2004 and its net income amounted to $1.8 million in 2005 compared to a net loss of $2.5 million in 2004. The increase in revenues resulted mainly from an increase in revenues from existing customers.

Jordan Valley (a 28% holding as of December 31, 2005). Jordan Valley is engaged in developing solutions for advanced in-line thin film metrology for the semiconductor industry. Jordan Valley's revenues in 2005 increased to $10.4 million from $8.3 million in 2004, primarily due to the launch of new products. Jordan Valley's net loss in 2005 was $0.1 million, compared to $0.7 million in 2004.

Gains from Disposal of Business and Affiliated Companies and Changes in Holdings in Affiliated Companies. Gains from disposal of businesses and affiliated companies and changes in our holdings in affiliated companies in 2005 amounted to $23.3 million, compared to $132.4 million in 2004. The gain in 2005 resulted primarily from the following: (i) a gain of approximately $19.7 million (which after income taxes amounted to $17.2 million) resulting from the sale of Oren's shares in consideration for $20.3 million; (ii) a gain of approximately $3.0 million from the decrease in our interest in NetVision following its initial public offering; and (iii) a gain of $1.2 million (which after minority interest and income taxes amounted to $0.5 million) resulting from the exercise of a call option granted to a former senior executive of RDC to purchase 70,200 shares of Given Imaging for the aggregate exercise price of approximately $12,000.

The gain recorded in 2004 resulted primarily from the following: (i) a $104.6 million gain (which after income taxes amounted to $91.5 million) resulting from the sale of our holding in Elbit Systems; (ii) a $15.2 million gain (which after minority interest and income taxes amounted to $6.7 million) resulting from the sale of shares of Given Imaging by RDC and the decrease in our direct and indirect interest in Given Imaging following Given Imaging's secondary public offering; and (iii) a gain of $5.8 million (which after minority interest and income taxes amounted to $1.4 million) resulting from the purchase by RDC of treasury shares amounting to approximately 3% of its outstanding shares from one of its shareholders (a former senior executive of RDC) in consideration for distribution of 200,000 shares of Given Imaging; and (iv) a $5.3 million gain from the sale of our share of KIT eLearning, for an immediate cash payment of $9.4 million (from which we received $5.7 million). Based on future earnings of KIT in 2006 and 2007, there may be an additional payment of up to $10 million, of which our share will be up to $5.7 million. If we receive this additional payment, we will record an additional gain.

Other Income, net. Other income, net, amounted to $58.6 million in 2005 compared to $4.7 million in 2004. The gain in 2005 was primarily due to the following (i) a $56.4 million gain (which after income taxes amounted to $45.4 million) from the sale of shares of Partner for approximately $94.0 million; (ii) a gain of $1.1 million ($0.7 million net of tax) from the sale of Zoran's shares received as part of the consideration for Oren's shares; and (iii) a gain from a dividend received from Partner in the amount of $0.4 million. The gain in 2004 resulted mainly from a $5.4 million gain, before tax, from the sale of shares of Zix received in consideration for ESW's assets and business sold to Zix in 2003.

Expenses

Cost of revenues. Cost of revenues consisted primarily of expenses related to salaries and hardware associated with delivering products and services of our subsidiaries, mainly Galil

Medical and SELA (whose results have been consolidated since July 1, 2004). Cost of revenues in 2005 amounted to $7.2 million, compared to $6.3 million in 2004.

Operating expenses. Operating expenses are comprised of research and development expenses, sales and marketing and general and administrative expenses of our and RDC's corporate operations and of our subsidiaries, mainly Galil Medical, SELA, Starling and 3DV. The following table sets forth operating expenses (excluding amortization of intangible assets which is presented as a separate line item and amounted to $0.4 million in 2005 and $0.1 million in 2004, which also constitute part of operating expenses under US GAAP but for presentation purposes are included as a separate line item):

	Year ended December 31,	
	2005	2004
	(millions of $)	
Corporate	6.9	7.3
Galil Medical	2.8	2.3
SELA[1]	3.1	1.6
Starling	2.4	1.6
3DV	1.9	1.2
Other (mainly RDC)	0.7	2.5
	17.8	16.5

[1]SELA's results have been consolidated since July 1, 2004

Operating expenses of Galil Medical in 2005 amounted to $2.8 million, as compared to $2.3 million in 2004, and its operating results amounted to an operating loss of $0.5 million compared to operating income of $0.1 million in 2004. The change in Galil Medical's operating results was due to the commencement of the development of its cryotherapy technology for application in the women's health field at the end of 2004. In November 2005, Galil Medical's cryo products received FDA clearance for the treatment of breast fibroadenoma (non cancerous breast lumps).

SELA's operating expenses amounted to $3.1 million in 2005, compared to $2.9 million in 2004 (of which $1.6 million was incurred in the second half of 2004 and was consolidated in our financial statements of 2004) and its operating loss amounted to $0.7 million compared to an operating income of $0.4 million in 2004 (of which $0.5 million was incurred in the second half of 2004 and was consolidated in our financial statements of 2004), resulting from the decrease in revenues recognized in 2005.

The decrease in operating expenses of the other companies resulted mainly from income recorded by RDC in 2005 with respect to the decrease in the fair value of call options held by RDC's employees to purchase shares of affiliated companies.

Finance income, net*.* Finance income, net, amounted in 2005 to $5.5 million, compared to $1.4 million in 2004. The increase is mainly due to higher cash resources during the period as a result of the sale of our holding in Elbit Systems in 2004 for approximately $197 million and from the sale of Partner shares in the second quarter of 2005 for approximately $94.0 million. Income from interest in future periods is expected to decrease due to a decrease in cash resources mainly as a result of a cash dividend payment to our shareholders on September 27, 2005.

Income Taxes. Income taxes, net, amounted to $10.5 million in 2005 which included mainly $11.0 million of income taxes with respect to the gain from the sale of Partner shares (which includes an offset of $9.4 million due to the reduction in our previous valuation allowance with respect to losses incurred in prior periods following our receipt of a final tax assessment) and $2.4 million from the sale of Oren shares and approximately $3.0 million in respect of financing income. These were partially offset mainly by a tax benefit of $5.0 million, resulting from a decrease in our previous valuation allowance due to the sale of the ET group and an approximately $1.2 million adjustment of a prior year tax provision in Elbit. Income taxes, net, in 2004 were $15.1 million resulting mainly from the sale of our holding in Elbit Systems, the secondary public offering of Given Imaging, the purchase of treasury stock in RDC in consideration for distribution of Given Imaging's shares and the sale of Zix shares. Income taxes were partially offset by a tax benefit in the amount of $2.9 million due to the change in the Israeli tax rate enacted in 2004 and a $1.5 million tax benefit related to the impairment of future royalties to be received by MediaGate.

Year Ended December 31, 2004 compared to Year Ended December 31, 2003.

Income

Net revenues. Net revenues consisted of sales of products and services by our subsidiaries, mainly Galil Medical and SELA (which results have been consolidated since July 1, 2004). The following table sets forth revenues:

	Year ended December 31,	
	2004	2003
	(millions of $)	
Galil Medical	7.6	7.6
SELA	3.3	-
MediaGate	-	1.5
Other	0.4	0.1
	11.3	9.2

Galil Medical's revenues in 2004 and in 2003 (from July 1, 2003) were derived mainly from the supply of cryo products and R&D services to Oncura, in which it has a 25% ownership interest.

SELA recorded revenues of $5.1 million in 2004 (of which $3.3 million were in the second half of 2004) compared to $4.3 million in 2003.

Share in net losses of affiliated companies. The share in net losses of affiliated companies amounted to $10.5 million in 2004, as compared to $8.7 million in 2003. As a result of the completion of the sale of our holding in Elbit Systems during the third quarter of 2004, our share in net income of Elbit Systems was included through the end of the second quarter of 2004 based on Elbit Systems' unaudited financial report as of June 30, 2004 and amounted to $4.7 million.

Our share in the net income of Elbit Systems in 2003 amounted to $9.1 million. Elbit Systems revenues in 2004 through the end of the second quarter amounted to $445.3 million as compared to $420.9 million in the first half of 2003 and its net income amounted to $24.0 million as compared to $21.5 million in the same period of 2003.

Highlights of the Results of Operations of Our Major Affiliates:

Given Imaging (a 20% holding directly and indirectly through RDC as of December 31, 2004). Given Imaging's revenues in 2004 were $65.0 million, an increase of 60.4% over 2003 revenues of $40.5 million. As of December 31, 2004, cumulative unit sales of Given Imaging capsule for the small intestine had reached 171,800 and its installed base reached more than 1,300 workstations in the United States and approximately 2,300 worldwide. Given Imaging's gross profit increased to 72.7% of revenues in 2004 compared to 66.6% in 2003 and it reported net income of $2.9 million in 2004, compared to a net loss of $9.6 million in 2003.

During the second quarter of 2004, Given Imaging completed a secondary offering to the public in which it raised net proceeds of $44.3 million. In addition, Given Imaging entered into an exclusive sales representation and co-promotion agreement with Ethicon Endo-Surgery, Inc., a Johnson & Johnson company, according to which Ethicon has exclusive rights to market Given Imaging's Pillcam™ ESO video capsule for visualization of the esophagus. Following FDA clearance to market the PillCam™ ESO in late November and through December 31, 2004, more than 3,400 PillCam ESO capsules were sold.

Oncura (a 25% holding through Galil as of December 31, 2004). Oncura's revenues in 2004 amounted to $68.8 million and its net loss amounted to $2.2 million. Oncura's revenues in the period since commencing operation on July 1, 2003 and through December 31, 2003 amounted to $31.4 million and its net loss amounted to $0.9 million.

NetVision (a 46% holding as of December 31, 2004). In 2004 NetVision continued to experience increased competition in gaining broadband Internet services market share, resulting from the transition of customers to broadband Internet services. Nonetheless, NetVision revenues increased in 2004 by 7.6% to $70.5 million from $65.5 million in 2003 and its customer base at December 31, 2004 reached approximately 390,000 (of which approximately 225,000 were connected through broadband) compared to 341,000 at December 31, 2003 (of which approximately 146,000 were connected through broadband). NetVision's operating income increased by 47.2% to $7.3 million in 2004 compared to $5.0 million in 2003 and its net income increased to $4.3 million in 2004 compared to $1.0 million in 2003. NetVision's operating currency is the New Israeli Shekel (NIS) and accordingly, all figures above are translations for convenience purposes of NetVision's NIS figures into US dollars at the representative rate of exchange prevailing December 31, 2004 according to which $1.00 equaled NIS 4.308.

During 2004, we and DIC each granted NetVision a $5.3 million loan, in order to enable NetVision to repay its line of credit to one of its lending banks and to set up its international telephony services. As a result of the extension of the original repayment period of the loans and in accordance with EITF 02-18, we recorded a portion of the loan, in the amount of $2.0 million, as a loss, representing the funding of NetVision's previous years' losses.

Wavion (a 38% holding as of December 31, 2004). Following a financing round in which Wavion raised $12.5 million in the second half of 2003, Wavion directed resources away from its subcontracting activities to R&D activities, resulting in a decrease in revenues from subcontracting services in 2004 to $0.1 million compared to $1.8 million in 2003 and an increase in its net loss which amounted to $6.3 million in 2004 compared to $1.7 million in 2003.

ChipX (a 27% holding as of December 31, 2004). ChipX's revenues in 2004 increased by 18% to $16.2 million from $13.7 million in 2003, primarily due to the launch of new products and the recovery in the semiconductor industry, and its net loss in 2004 decreased to $5.6 million from $7.8 million in 2003. In March 2004, ChipX raised $12.0 million in a private placement, the proceeds of which were being used to finance its sales and marketing efforts and development investments in its structured ASIC technology.

AMT (a 40% holding as of December 31, 2004). During 2004 AMT completed a private placement of $6.0 million, in which we invested an additional $3.0 million. AMT's consolidated revenues in 2004 amounted to $2.6 million, compared to $1.3 million in 2003 and its net loss in 2004 amounted to $3.0 million, compared to $3.5 million in 2003.

Results of operations of significant group companies which are accounted for other than under the equity method of accounting.

Partner (an 8.6% holding as of December 31, 2004). At December 31, 2004, the market value of our investment in Partner amounted to approximately $136.2 million. The following are highlights of the results of operations of Partner for 2004 (all figures below are convenience translations of Partner's nominal New Israeli Shekel (NIS) figures into US dollars at the rate of the exchange prevailing at December 31, 2004 according to which $1.00 equaled NIS 4.308). Partner's revenues in 2004 increased to $1,193.3 million, up 15.1% from $1,037.1 million in 2003. Partner's subscriber base at the end of 2004 was 2,340,000 as compared to 2,103,000 at the end of 2003. Partner's net income in 2004 was $109.5 million, as compared to $269.9 million in 2003. The decrease in Partner's net income in 2004 resulted primarily from the utilization of its accumulated tax loss carry forward and the creation of deferred tax asset in 2003 in the amount of $146.9 million.

Jordan Valley (a 28% holding as of December 31, 2004). Jordan Valley's revenues in 2004 increased to $8.3 million from $3.2 million in 2003, primarily due to the launch of new products for the semiconductor industry, and its net loss in 2004 decreased to $0.7 million from $2.5 million in 2003.

Impliant (a 23% holding as of December 31, 2004). Impliant's net loss in 2004 amounted to $3.3 million, compared to $2.3 million in 2003, mainly as a result of increase in research and development expenses.

Gains from Disposals of Businesses and Affiliated companies and Changes in Holdings in Affiliated Companies. Our gains from disposals of businesses and affiliated companies and changes in holdings in affiliated companies amounted to $132.4 million in 2004 compared to $25.8 million in 2003.

The gain in 2004 consisted primarily from the following: (i) a $104.6 million gain (which after income taxes amounted to $91.5 million) resulting from the sale of our holding in Elbit Systems (we used Elbit Systems' unaudited financial report as of June 30, 2004 in order to record the carrying value of our investment in Elbit Systems as of the date of sale and to determine the gain resulting from the sale); (ii) a $15.2 million gain (which after minority interest and income taxes amounted to $6.7 million) resulting from the sale of shares of Given Imaging by RDC and the decrease in our direct and indirect interest in Given Imaging following Given Imaging's secondary public offering; (iii) a $5.3 million gain from the sale of our share of KIT to a subsidiary of Laureate for a cash payment of $9.4 million (from which we received $5.7 million) (based on future earnings of KIT in 2006 and 2007, there may be an additional payment of up to $10 million, of which our share will be up to $5.7 million;. If we receive this additional payment, we will record an additional gain); (iv) a gain of $5.8 million (which after minority interest and income taxes amounted to $1.4 million) resulting from the sale of shares of Given Imaging in connection with the purchase by RDC of treasury shares amounting to approximately 3% of its outstanding shares from one of its shareholders (a former senior executive of RDC) ; and (v) a gain of $0.6 million resulting from the exercise of a call option granted to the chairman of our board of directors to purchase 21,751 shares of Given Imaging from us for the aggregate exercise price of approximately $49,000.

The gain in 2003 was mainly due to the gain from the merger of the urology therapy business of Galil Medical and GE Healthcare in the amount of approximately $21.2 million (which after minority interest and income taxes amounted to $4.4 million) and the $4.5 million gain from the sale of 753,600 shares of Given Imaging held by RDC for approximately $7.8 million and changes in our holding in Given Imaging as a result of exercise of options.

Other Income (expenses), net. Other income, net, amounted to $4.7 million in 2004 compared to $14.6 million in 2003. The gain in 2004 included mainly a $5.4 million gain, before tax, from the sale of shares of Zix received in consideration for ESW's assets and business sold to Zix in 2003, a $0.5 million loss representing the funding of 3DV's previous years' losses and $0.8 million write down of investment, mainly with respect to Textology.

The gain in 2003 resulted primarily from the following: (i) the sale of Partner shares for approximately $29.3 million which resulted in a $11.1 million gain before tax; (ii) the sale of shares of Zix for approximately $9.0 million which resulted in a $4.8 million gain before tax; and (iii) a $2.0 million gain, before tax, from the sale of all of our shares of 24/7 Real Media shares (Nasdaq: TFSM) for approximately $5.2 million. These gains were partially offset by $3.7 million of write-downs mainly with respect to Cellenium and Textology.

Finance income, net. Finance income, net, amounted to $1.4 million in 2004 compared to $0.8 million in 2003. The increase in finance income was primarily due to the increase in cash balances following the completion of the sale of our holding in Elbit Systems for $196.6 million.

Expenses

Cost of revenues. Cost of revenues amounted to $6.3 million, compared to $5.6 million in 2003, which consisted primarily of expenses related to salaries, materials, subcontractors and hardware associated with delivering products and services of our subsidiaries, mainly Galil Medical, MediaGate, 3DV (the results of which have been consolidated since January 1, 2004) and SELA (the results of which have been consolidated since July 1, 2004).

Operating expenses. Operating expenses are comprised of research and development expenses, sales and marketing and general and administrative expenses of our subsidiaries, mainly Galil Medical, MediaGate, 3DV (the results of which have been consolidated since January 1, 2004) and SELA (the results of which have been consolidated since July 1, 2004), and of our and RDC's corporate operations. The following table sets forth operating expenses. The operating expenses presented below for 2004 exclude impairment and amortization of intangible assets in the amount of $0.1 million ($0.3 million in 2003), which also constitute part of operating expenses under US GAAP but for presentation purposes is included as a separate line item:

	Year ended December 31,	
	2004	2003
	(millions of $)	
Corporate……………	7.3	7.1
Galil Medical……….	2.3	10.4
SELA……………….	1.6	-
MediaGate………….	-	3.1
Starling……………..	1.6	-
3DV…………………	1.2	-
Other (mainly RDC)...	2.5	2.0
	16.5	22.6

Operating expenses of Galil Medical in 2004 decreased to $2.3 million from $10.4 million in 2003, resulting in operating loss of $0.1 million, compared to $7.6 million in 2003. The decrease in Galil Medical's operating expenses and operating loss was mainly due to the merger of the urology therapy units of Galil Medical and GE Healthcare which resulted in a significant decrease in Galil Medical's marketing and selling expenses. Galil Medical started at the end of 2004 to develop its cryotherapy technology for application in the women's health field.

The decrease in MediaGate's operating expenses resulted from the sale of its assets and business to Telrad in January 2004, following which MediaGate ceased its operations.

SELA's operating expenses amounted to $2.9 million in 2004 (of which $1.6 million were incurred in the second half of 2004 and the amount was consolidated in our financial statements of 2004), compared to $2.4 million in 2003 and its net income amounted to $0.2 million, compared to $0.1 million.

Impairment. An impairment charge of $4.2 million ($2.7 million net of tax) was recorded with respect to future royalties to be received by MediaGate in connection with the sale of

MediaGate's business in January 2004 to Telrad. The write-off was due to our revised estimate about the realizability of future royalties. However, MediaGate's bank loan in the amount of approximately $2.6 million, which was secured by a first ranking pledge over these future royalties and which was not guaranteed by us, was not written-off even though it could only be repaid from royalties to be received. This is in accordance with SFAS 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - A Replacement of FASB Statement 125", which allows derecognition of a liability only if it has been extinguished, either through payment or when the debtor is legally released from being the primary obligor under the liability. In the first quarter 2006, we recorded a gain of approximately $2.7 million resulting from the extinguishment of the loan as a result of an agreement signed with the bank.

Income Taxes. Income taxes, net, in 2004 were $15.1 million, which included mainly $13.1 million of income taxes with respect to the gain resulted from the sale of our holdings in Elbit Systems (which includes an offset of $21.6 million due to the reduction in our valuation allowance with respect to previous years' losses), $6.7 million resulting from the secondary public offering of Given Imaging and the purchase of treasury stock in RDC in consideration for distribution of Given Imaging's shares and $1.8 million resulting from the sale of Zix shares. These amounts were offset primarily by a tax benefit in the amount of $2.9 million due to the change in the Israeli tax rate enacted in 2004, which gradually reduces the corporate tax rate in Israel from 36% in 2003 to 30% in 2007, a $2.4 million tax benefit with respect to corporate expenses, net and $1.5 million tax benefit related to the impairment of future royalties to be received by MediaGate from Telrad.

Income taxes, net, in 2003 were $6.8 million, which included mainly $7.0 million of income taxes with respect to the sale of shares of Partner, Given Imaging and 24/7 Real Media as well as with respect to the merger of the urology therapy units of Galil Medical and GE Healthcare and a tax benefit of $1.7 million mainly with respect to corporate expenses, net.

B. Liquidity and Capital Resources

Consolidated cash, debentures and deposits at December 31, 2005, were approximately $143.8 million compared with $188.1 million at December 31, 2004. At December 31, 2005, corporate cash, debentures and deposits were $133.8 million compared with $175.7 million at December 31, 2004.

The main sources of corporate cash and other liquid instruments in 2005 were $94.0 million of proceeds from the sale of Partner shares, $10.5 million cash proceeds from the sale of shares in Oren, $8.8 million from the sale of Zoran shares received as part of the consideration for Oren's shares, $2.2 million repayment of loan by NetVision and $2.1 million proceeds from the sale of the ET group.

The main uses of corporate cash and other liquid instruments in 2005 were an $88.5 million dividend, income tax payments of approximately $27.1 million (mainly with respect to the sale of Elbit Systems shares in 2004 and Partner shares in 2005) and $40.5 million of investments (including loans) in new and existing group companies as detailed below (in millions of $):

Consolidated companies (*)	
Starling	1.5
Galil Medical	0.8
3DV	0.7
Enure	4.0
Other	2.1
	9.1

Affiliated companies and other investments	
Wavion	1.4
Teledata	16.0
Brainsgate	6.9
Nulens	1.7
AMT	1.4
Jordan Valley	1.4
Impliant	1.0
Other	1.6
	31.4
Total corporate investments	40.5

* These investments do not affect the cash included in the consolidated financial statements.

In addition, during 2005 RDC invested $6.1 million, which included $0.6 million in a new company established at the end of 2005 (Medingo) which is developing a miniature disposable insulin dispenser for insulin dependent diabetic patients.

Consolidated working capital at December 31, 2005 amounted to $136.2 million compared to $162.2 million at December 31, 2004. The decrease is mainly due to the decrease in corporate cash and other liquid instruments.

Consolidated loans at December 31, 2005, were approximately $7.3 million, compared to $7.5 million at December 31, 2004. In the first quarter of 2006 MediaGate's bank loan in the amount of approximately $2.8 million was settled in consideration for $0.1 million. As a result, we recorded in the first quarter of 2006 a gain of approximately $2.7 million.

Subsequent to December 31, 2005 and through May 31, 2006, we invested an additional aggregate amount of approximately $17.1 million in new and existing group companies as detailed below:

Consolidated companies (*)	
RDC	2.0
Total	2.0

Affiliated companies and other investments	
Wavion	1.4
NuLens	2.6
Partner	5.3
Safend	3.5
ChipX	2.3
Total	15.1
Total corporate investments	17.1

* These investments do not affect the cash included in the consolidated financial statements.
On June 8, 2006 we invested additional $2.5 million in AMT.

Our investment policy for managing our funds is in general to invest in bank deposits and U.S. government securities with high liquidity.

We believe that our existing capital will be sufficient to fund our and our subsidiaries' operations and our investment plan in existing and new companies for at least the next twelve months.

Shareholders' equity at December 31, 2005, was approximately $302.1 million, representing approximately 85% of total assets, compared with $389.1 million, representing approximately 78% of total assets at December 31, 2004. The decrease in shareholders' equity is mainly due to our dividend distribution in 2005.

Market Risk

Market risks relating to our operations result primarily from changes in interest rates, exchange rates and equity prices. In order to limit our exposure, we may enter, from time to time, into various derivative transactions. Our objective is to reduce exposure and fluctuations in earnings and cash flows associated with changes in interest rates, foreign currency rates and equity prices. We do not use financial instruments for trading purposes. It is our policy and practice to use derivative financial instruments only to limit exposure. As part of this policy, in 2005 we hedged the dollar value of the expected proceeds from the sale of our shares in Partner by the purchase of call options and by selling put options, at a dollar/NIS exchange rate ranging from $4.36 to $4.44 for a period of 81 days. This transaction had no material effect on our results of operations.

Interest Rate Risks

We are exposed to market risks resulting from changes in interest rates, relating primarily to our debentures and deposits. We do not use derivative financial instruments to limit exposure to interest rate risk. As of December 31, 2005, we held U.S. government debentures with a market value of approximately $62.6 million. The market value of the debentures depends on changes and expectations of changes in the interest rates in the United States and general market conditions in the United States. At December 31, 2005, all of our debentures and short-term deposits were fixed rate based with an average annual rate of 3.7% and a weighted average maturity of approximately 1.7 years. In 2005, as a result of increase in interest rates, we recorded an other than temporary decline in value, net of tax, of approximately $0.6 million on debentures held by us.

Exchange Rate Risk

Since most of our group companies are Israeli-related, our main exposure, if any, results from changes in the exchange rate between the New Israeli Shekel and the U.S. dollar. Our functional currency, as well as that of our principal subsidiaries and affiliated companies, is the U.S. dollar. Our policy is to reduce exposure to exchange rate fluctuations by having most of our and our subsidiaries' assets and liabilities, as well as most of the revenues and expenditures in U.S. dollars, or U.S. dollar linked. Therefore, we believe that the potential loss that would result from an increase or decrease in the exchange rate is immaterial to our business and net assets. See above regarding the hedging of the dollar value of the proceeds from the sale of our shares in Partner.

Equity Price Risk

We are exposed to fluctuations in the equity price of our holdings in publicly traded companies. At December 31, 2005 we directly and indirectly held shares of publicly traded companies, primarily Given Imaging, Partner, NetVision and EVS. Stock prices in the industries of these companies, and of these companies themselves, have historically experienced significant volatility. Changes in the market value of our publicly traded holdings, including holdings through our affiliates, which are accounted under the equity method of accounting or as available-for-sale securities will not affect our results of operations but may have a significant effect on our market value. We view the risks of reduction in market price of these companies as part of our business risks and we examine, from time to time, the possibility of having a partial hedge against equity price risks. Based on closing market prices at December 31, 2005, the market value of our holdings in public securities was approximately $197.0 million. At December 31, 2005, no instruments were used to hedge the risk of equity price fluctuations.

Changes in the market value of our available-for-sale securities (Partner and EVS) are reported in other comprehensive income, which is included as a component of shareholders' equity, and not as part of our results of operations. The market value of our available-for-sale securities as of December 31, 2005 amounted to $27.85 million.

C. Research and Development

Since we, through our group companies, engage in fields of high-technology, our group companies invest significant resources in research and development ("R&D") activities.

The combined R&D costs of all group companies amounted to approximately$43.5 million in 2005, $58.9 million in 2004 and $85.1 million in 2003 (including R&D expenses of Elbit Systems which was sold in the second half of 2004 in the amount of $0, $27.1 million and $54.9 million, in 2005, 2004 and 2003, respectively). The decrease in R&D costs in 2005 as compared to 2004 was primarily due to the sale of Elbit Systems. This decrease was offset by the R&D expenses of our new affiliates and subsidiaries in which we invested at the end of 2004 and during 2005, including Jordan Valley, Impliant, Teledata, BrainsGate, NuLens, Enure and Medingo as well by the increase in the R&D expenses of our group companies, mainly RDC, Given Imaging, Galil Medical, Oncura, 3DV, Starling and SELA. The decrease in R&D costs in 2004 as compared to 2003 was primarily due to the sale or discontinued operations of some of our group companies during 2003 and 2004 (mainly Elbit Systems in July 2004, ESW and MediaGate), which was partially offset by an increase in R&D expenses in some of our group companies (mainly Wavion, Starling and ChipX).

Our consolidated research and development costs amounted to $6.2 million, $2.9 million and $3.3 million in 2005, 2004 and 2003, respectively. The increase in the consolidated R&D costs resulted mainly from the increase in R&D expenses of our subsidiaries RDC, Galil Medical, Starling and 3DV as well as from our new consolidated companies, Medingo and Enure (both consolidated since the fourth quarter of 2005) and SELA (consolidated since the second half of 2004).

D. Trend Information

"Trend Information" pertaining to our group companies and us is incorporated by reference to Item 4, "Information on the Company" of this Report and this Item 5 under "Results of Operations".

E. Off Balance Sheet Arrangements

There is no principal amount of off balance sheet transactions.

F. Tabular Disclosure of Financial Obligations

At December 31, 2005, we and our subsidiaries had no material contractual obligations which are expected to affect our consolidated cash flow in future periods, except for lease obligations and payments of bank credits, bank loans and loans from others, including short term loans taken by our subsidiaries, in each case due in future periods as set forth in the table below (in million of $):

Type of Obligation*	2006	2007	2008	2009	2010	Total
Loans from banks	3.8	-	-	-	-	3.8
Loans from other	2.1	1.4	-	-	-	3.5
Operating leases	0.8	0.7	0.4	0.2	-	2.1

* Does not include accrued severance pay and retirement obligation of $2.6 million at December 31, 2005.

Item 6. Directors, Senior Management and Employees

A. Directors and Senior Management

As of May 31, 2006, our executive officers and directors are as follows:

Name	Age	Position
Ami Erel [(5)]	59	Chairman of the Board of Directors
Avraham Asheri [(1)(4)]	68	Director
Prof. Gabi Barbash	56	Director
Prof. Yair Be'ery	49	Director
Nochi Dankner[(5) (6)]	51	Director
Avraham Fischer[(5)]	49	Director
Yaacov Goldman [(1)(2)(3) (4)]	50	External Director
Ari Bronshtein[(5)]	36	Director
Shay Livnat[(5) (6)]	47	Director
Dori Manor[(5) (6)]	39	Director
Professor Daniel Sipper[(1)(2)]	73	External Director
Doron Birger	55	President and CEO
Moshe Fourier	58	Vice President, Chief Technology Officer
Rinat Remler	34	Vice President, Chief Financial Officer
Yair Cohen	51	Vice President
Assaf Topaz [(7)]	35	Vice President

1. Member of our audit committee.
2. External director under the Israeli Companies Law.
3. Designated Financial Expert under Sarbanes-Oxley Act of 2002.
4. Designated Financial Expert under Israeli Companies Law.
5. Director or Officer of IDBH, IDBD and/or DIC.
6. See Item 7A – "Major Shareholders".
7. Assaf Topaz is the husband of Michal Topaz, daughter of Ruth and Isaac Manor. See Item 7A – "Major Shareholders."

Ami Erel has served as the Chairman of our Board of Directors of Elron since November 1999 and served as our Chief Executive Officer from November 1999 to December 2001. Mr. Erel has served as President and Chief Executive Officer of DIC since June 1, 2001. Mr. Erel is also Chairman of the board of directors of Cellcom Israel Ltd., NetVision and Scailex Corporation (formerly Scitex Corporation) and serves as a director of Property and Building Corporation Ltd. and Super-Sol Ltd. Mr. Erel also serves as the Chairman or a member of the boards of various other subsidiaries and affiliates of DIC and Elron. From 1997 to 1999, Mr. Erel served as President and Chief Executive Officer of Bezeq-The Israel Telecommunications Corp. Ltd. (“Bezeq”). From 1997 to 1998, he was Chairman of the board of directors of PelePhone Communications Ltd. As of January 2005, Mr. Erel serves as Chairman of the Executive Committee of the Manufacturers Association of Israel. From January 2000 to January 2004, Mr. Erel served as Chairman of the Board of Israel Association of Electronics & Information Industries. Mr. Erel holds a B.Sc. in electrical engineering from the Technion, Israel Institute of Technology.

Avraham Asheri joined Elron as a director in December 1999. He serves as the Chairman of our Audit Committee. He is an economic and financial advisor. Mr. Asheri is a member of the boards of directors of Discount Mortgage Bank Ltd., Africa Israel Investments Ltd., Elbit Systems Ltd. and Scailex Corporation Ltd. (formerly Scitex Corporation Ltd.) Mr. Asheri was the President and Chief Executive Officer of Israel Discount Bank from November 1991 until July 1998. Prior to joining Israel Discount Bank in 1983 as Senior Executive Vice President and a member of its management committee, Mr. Asheri held the position of Director General of the Ministry of Industry and Trade. During his 23 years at the Ministry of Industry and Trade and at the Ministry of Finance, Mr. Asheri held several key offices in Israel and abroad, including Managing Director of the Investment Center in Israel, and Trade Commissioner of Israel to the United States. Mr. Asheri holds a bachelors degree in economics and political science from the Hebrew University in Jerusalem.

Prof. Gabi Barbash joined Elron as a director in May 2003. Since 1999, Prof. Barbash has been Director General of the Tel-Aviv Sourasky Medical Center and between 2000 and 2003 he served as Chairman of the Board of Directors of Teuza Venture Capital Fund. Between 1998 and 2000, Prof. Barbash was the Chairman of the Israeli National Transplant Center. Between 1996 and 1999, Prof. Barbash was the Director General of the Israeli Ministry of Health. Between 1995 and 1998, Prof. Barbash was a member of the Scientific Committee of the Interdisciplinary Center for Technological Analysis and Forecasting at Tel-Aviv University. Between 1993 and 1996, Prof. Barbash was the Director General of the Sourasky Medical Center. Between 1986 and 1993, Prof. Barbash was the Deputy Director of the Sheba Medical Center and from 1990 to 1993, he was Director of the Rehabilitation Hospital of the Sheba Medical Center. Prof. Barbash holds an M.D. degree from the Hebrew University, Jerusalem, Hadassah Medical School and a masters degree in public health from Harvard University.

Prof. Yair Be'ery joined Elron as a director in January 2004. Since 1985, Prof. Be'ery has been with the Department of Electrical Engineering at Tel Aviv University and served as its Chairman from 1999 until 2003. From 1998 until 2005, Prof. Be'ery worked with Benny Steinmetz's Group and co-founded STI Ventures, a high technology venture investment company. From 1989 until 1996, Prof. Be'ery served as Vice President of Advanced Technology of the DSP Group Inc. Prof. Be'ery serves as a member of the board of directors of Teledata, one of our group companies. Prof. Be'ery is also a member of the advisory boards of ChipX, also one of our group companies, and Mplicity Ltd. Prof. Be'ery served previously on the boards of directors and advisory boards of numerous Israel-related technology companies. Prof. Be'ery holds B.Sc., M.Sc. and Ph.D. degrees (Electrical Engineering) from Tel Aviv University, Israel.

Ari Bronshtein joined Elron as a director in March 2006. In January 2006, Mr. Bronshtein joined DIC as Vice-President. From 2004 to 2005, Mr. Bronshtein served as Vice President and head of the Economics and Business Development division of Bezeq. From 2000 to 2003, Mr. Bronshtein served as Director of Finance and Investments at Bezeq. From 1999 to 2000, Mr. Bronshtein served as Manager of business analysis at Comverse Technologies, Inc. From 1996 to 1999, Mr. Bronshtein served in various positions at Tadiran Ltd., his last position being Director of the Finance and Investments division. Mr. Bronshtein serves as a director of American Israeli Paper Mills Ltd., and as an external director and chairman of the investment committee of Koor - Tadiran Gemel. Mr. Bronshtein has previously served as a director of Bezeq International Ltd., Xpert Systems Ltd. and Simcha Urieli & Sons Engineering & Construction Company Ltd. In addition, Mr. Bronshtein has served as an external director and member of the investment committee of Dash Mutual Fund Management Ltd. Mr. Bronshtein has also served as chairman of the investment committee of Stage One and as a member of the investment committee of Eurofund, both venture capital funds. Mr. Bronshtein holds a Bachelors Degree in Finance and Management and Masters Degree in Finance and Accounting, both from Tel Aviv University.

Nochi Dankner joined Elron as a director in June 2005. Mr. Dankner is the Chief Executive Officer and Chairman of the board of directors of IDBH and serves as Chairman of the board of directors of IDBD, DIC and Clal Industries and Investments Ltd. Mr. Dankner is the founder of the Ganden Group and serves as a director of companies in the Ganden Group which holds investments in companies operating primarily in the fields of real estate and tourism, including as Chairman of Ganden Holdings Ltd. and Ganden Investments (2000) Ltd. and as Co-Chairman of Ganden Tourism and Aviation Ltd. and Israir Ltd. In addition, Mr. Dankner serves as a director of Cellcom Israel Ltd., Clal Insurance Company Ltd., Nesher-Israeli Cement Enterprises Ltd., Property and Building Corporation Ltd., Azorim Investments, Development and Construction Company Ltd., Super-Sol Ltd. and other public and private companies in the IDB group. Mr. Dankner is Chairman of the IDB Fund "For the Community" and is a member of "Matan - Your Way to Give", a non-profit organization. Mr. Dankner also serves as a member of the Management Committee of the Association of Friends of the Tel Aviv Sourasky Medical Center, and as a member of the Board of Trustees of the Tel Aviv University. Mr. Dankner holds an LL.B. degree from the Tel Aviv University and a Bachelor of Arts degree in Political Science from Tel Aviv University.

Avraham Fischer joined Elron as a director in August 2003. He is the Executive Vice President of IDBH, the deputy Chairman of IDBD, Co-Chief Executive Officer of Clal Industries and Investments Ltd. and Chairman of Clal Biotechnology Industries Ltd. In addition, he is a partner of Fischer, Behar, Chen & Co., a leading Israeli law firm. Mr. Fischer is the co-founder and co-Chairman of Ganden Tourism and Aviation Ltd., a company holding investments in Israeli companies, operating primarily in the field of tourism, and is the co-founder and Vice-Chairman of Ganden Holdings Ltd., which is the principal shareholder of IDB Holding Ltd. He serves as a director of Clal Industries & Investments Ltd., IDBH, DIC, Scailex Corporation (formerly Scitex Corporation Ltd.), ECI Telecom Ltd., American Israeli Paper Mills Ltd., Vyyo Inc. and several other companies. Mr. Fischer is a co-chairman of "Matan – Your Way to Give", a non-profit organization. Mr. Fischer holds an LL.B. degree from the Tel Aviv University and is a member of the Israeli bar association.

Yaacov Goldman joined Elron as an external director in March 2003 and was reappointed as an external director for a second three year term in March 2006. He serves as a member of our Audit Committee and is our designated financial expert on the audit committee. Mr. Goldman also serves as a director of Bank Leumi Le'Israel B.M., Mer Telemanagement Solutions Ltd., Golden House Ltd. and Renewable Resources Ltd. Mr. Goldman serves as the Professional Secretary of the Peer Review Institute of the Certified Public Accountants Institute in Israel. Commencing in 1981 Mr. Goldman worked for Kesselman & Kesselman (member firm of PriceWaterhouseCoopers) for 19 years, and from 1991 until 2000, as a partner and then senior partner of such firm. From September 2000 until November 2001, Mr. Goldman served as managing director of Argoquest Holdings, LLC. From March 2002 until October 2002, Mr. Goldman acted as a consultant to a private equity initiative with Poalim Capital Markets & Investments Ltd. Mr. Goldman is a certified public accountant in Israel, having received his Bachelor of Economics and Accounting from the Tel Aviv University.

Shay Livnat joined Elron as a director in June 2005 and is the founder, President & Chief Executive Officer of Zoe Holdings Ltd. He is also the founder and co-chairman of UPS Israel and UTI (Isuzu) Israel. Since 2004, Mr. Livnat has been a director of IDBD, Clal Industries and Investments Ltd., Clal, Scaelix Corporation and Scitex Vision Ltd. Since 1992, Mr Livnat has been a director of Taavura Holdings Ltd. Between 1988 and 1998, Mr. Livnat was the Managing Director of Tashtit Ltd (DAF, Liebherr) and Vice-President of the Taavura Group. Mr. Livnat holds a Bachelor of Science in Electrical Engineering, Fairleigh Dickinson University, New Jersey, USA.

Dori Manor joined Elron as a director in August 2003. He has served as Chief Executive Officer of David Lubinski Ltd., a group of automotive companies, since 2000, and was the Vice President from 1997 until 2000 and Assistant Director from 1994 until 1996. During 1994 and 1995, he served as a director of Morasco Ltd. During 1992 and 1993, he was engaged as an Industrial Engineering consultant for Factory Design Ltd. Mr. Manor serves as a director of IDBH, IDBD, DIC and Clal Industries and Investments Ltd. Mr. Manor received an MBA degree from the European Institute of Business Administration (INSEAD) in Fontainebleau, France, in 1996 and a Bachelor of Science degree in Industrial Engineering from Tel Aviv University in 1993.

Professor Daniel Sipper joined Elron as an external director in February 2001. Professor Sipper serves on our Audit Committee. Professor Sipper serves in the faculty of the Department of Industrial Engineering at Tel-Aviv University. He received his bachelor of science from the Technion, Israel Institute of Technology, a masters of science degree from Columbia University and a Ph.D. in Industrial Engineering from the Georgia Institute of Technology.

Doron Birger joined Elron in 1994 as Vice President of Finance. Mr. Birger has served as President and Chief Executive Officer of Elron since August 2002, President since September 2001, Chief Financial Officer from 1994 to May 2002 and Corporate Secretary from 1994 to September 2001. Mr. Birger is Chairman of Given Imaging and ChipX Corporation as well as a director of RDC, NetVision, Teledata and various others of our group companies. From 1991 to 1994, Mr. Birger was Vice President-Finance at North Hills Electronics Ltd., an advanced electronics company. From 1990 to 1991, Mr. Birger served as Chief Financial Officer of Middle-East Pipes Ltd., a manufacturer in the metal industry. From 1988 to 1990, Mr. Birger served as Chief Financial Officer of Maquette Ltd., a manufacturer and exporter of fashion items. From 1981 to 1988, Mr. Birger was Chief Financial Officer and director at Bateman Engineering Ltd. and I.D.C. Industrial Development Company Ltd. From 1979 to 1981, Mr.

Birger was the Chief Financial Officer of Fibronics Ltd. Mr. Birger is a member of "Young Entrepeneurs", a non-profit organization, and a director of the National Science & Technology Museum in Haifa. Mr. Birger holds a B.A. and an M.A. in economics from the Hebrew University, Jerusalem.

Moshe Fourier joined Elron as Vice-President and Chief Technical Officer on June 1, 2000. Mr. Fourier serves as a director of Wavion, Starling and other Elron group companies. From 1999 to 2000, he served as the Chief Operations Officer for Terayon Communications' broadband voice division, one of the leading companies that provides cable modems and telecommunications solutions over the cable television infrastructure. From December 1993 until 1999, he joined the founder of Telegate and jointly initiated this start-up providing telecommunications equipment for delivering voice, data and video over cable television infrastructure, and served as Deputy Chief Executive Officer and Vice President of Research and Development and Technology. In June 1992, he joined RADA Electronic Industries as Vice President of Engineering. In August 1975, Mr. Fourier joined Astronautics Corporation of America - the Israeli division, as the first engineer and was promoted in 1978 to Vice President of Engineering. Mr. Fourier holds a bachelor of science degree in electrical engineering (BSEE) and an associated electrical engineering degree from the Technion, Israel Institute of Technology.

Rinat Remler joined Elron in April 2000 as Director of Finance and in November 2005 was appointed as Vice President & Chief Financial Officer. From 1997 to 2000, Ms. Remler worked for Luboshitz Kasierer, a leading Israeli auditing firm, now part of Ernst & Young International. Ms. Remler serves on the boards of directors of NetVision, RDC and other Elron group companies. Ms. Remler was a lecturer in accounting and economics at the University of Haifa from to 1997 to 1998 and at the Technion, Israel Institute of Technology, from 1995 to 1997. Ms. Remler holds a BA degree in Economics from the Haifa University (summa cum laude) and a M.A. degree in Business Administration from the Technion, Israel Institute of Technology. Ms. Remler has been a licensed CPA in Israel since 1997.

Yair Cohen joined Elron in July 2005 as Vice President. Prior to joining Elron, Mr. Cohen served since 2000 as Brigadier General of the special Unit 8200, the central military intelligence unit of the Israeli Defense Force, engaged in the development of state of the art technology. Mr. Cohen serves on the Boards of Directors of RDC, Galil Medical and other Elron group companies. Mr. Cohen holds a BA degree in History and Arabic (summa cum laude) from Bar-Ilan University, Israel, and a M.A. degree in Management of National Resources (summa cum laude) from Industrial College (NDU), Washington D.C.

Assaf Topaz joined Elron in April 2004 as Director of Business Development and in April 2005, was appointed as Vice President. Mr. Topaz serves as director of Enure Networks and Jordan Valley Semiconductor. Prior to joining Elron, from 1998 to 2002, Mr. Topaz was co-founder and Chief Operations Officer of Gilian Technologies, Inc, a technology company engaged in the web security market. From 1996 to 1998, Mr. Topaz was a business development executive for Euro Tel Aviv, an advertising agency. From 1995 to 1996, Mr. Topaz was an account executive at McCann Erickson-Kesher Advertising Ltd. Mr. Topaz holds a B.A., Economics and Geography from the Hebrew University of Jerusalem, Israel and a Masters Degree in Business from Stanford University.

B. Compensation

During the year ended December 31, 2005, we paid aggregate remuneration to our directors and officers as a group who served in the capacity of director or executive officer during such year of approximately $2,192,000. This amount does not include amounts expended by us for automobiles made available to our officers in the aggregate amount of $38,000.

The following table sets forth the approximate aggregate compensation paid by us during the fiscal year ended on December 31, 2005 to all of our directors and officers.

	Cash and Cash-Equivalent Forms of Compensation (in thousands of U.S. $)	
	Salaries, Fees, Directors' Fees, Commissions and Bonuses	**Securities(2) or Property, Insurance Benefits or Reimbursements and Personal Benefits**
2005(1)		
All Directors	245	-
All Officers................................	1,734	213

(1) Does not include an increase in provision for vacation in the amount of approximately $30,000.

(2) See "Share Ownership" under this Item 6 and "Compensation of the Chairman under Item 7- Related Party Transactions.

C. Board Practices

None of our directors have service contracts with us or any of our group companies providing for benefits upon termination of employment. Two of our directors have consulting agreements with us pursuant to which they provide services to us. See Item "7" – Related Party Transactions". Compensation of our officers is recommended by our senior management and approved by the board of directors or a committee of the board of directors. Compensation of all other employees is determined by our senior management.

Board of Directors

Our Articles of Association provide for a board of directors of not less than five members and no more than fifteen members, including external directors. Each director, other than external directors, is elected to serve until the end of the first annual meeting following their appointment. However, if no directors are elected at such annual meeting, the then present directors shall continue in office. The board of directors may appoint additional directors, provided that the total number of directors does not exceed the maximum number of fifteen as mentioned above. A director appointed as such shall serve until the end of the next annual meeting held following his or her appointment and he or she shall be eligible for re-appointment. Notwithstanding any of the above, any director, other than external directors, may be removed from office by an ordinary resolution of a general shareholders meeting or by two thirds of the directors. A director need not hold any of our shares to qualify as one of our directors. Our

Articles provide that our board of directors may delegate its powers to its committees, subject to limitations determined by the Israeli Companies Law.

Substitute Directors

Our Articles of Association provide that any director may, by written notice to us, appoint another person to serve as a substitute director and may cancel such appointment. The identity of a substitute director requires the approval of the board of directors. Under the Israeli Companies Law, there shall not be appointed as a substitute director, any person who is not himself qualified to be appointed as a director or a person who is already serving as a director or a person who is already serving as a substitute director for another director. Nevertheless, a director may be appointed as a substitute director for a committee of the board of directors if he or she is not already serving as a member of the committee. Under the Israeli Companies Law, there shall not be appointed a substitute director for an external director.

The term of appointment of a substitute director may be for one meeting of the board of directors or for a specified period or until notice is given of the cancellation of the appointment. To our knowledge, no director currently intends to appoint any other person as a substitute director, except if the director is unable to attend a meeting of the board of directors.

External Directors

The Israeli Companies Law requires Israeli companies with shares that have been offered to the public in or outside of Israel (public companies) to appoint two external directors. No person may be appointed as an external director if the person or the person's spouse, siblings, parents, grandparents, descendants, spouses descendants and the spouses of any of the foregoing (referred to as a relative), partner, employer or any entity under the person's control, has or had, within the two years preceding the date of the person's appointment to serve as external director, any affiliation with the company or any entity controlling, controlled by or under common control with the company. The term "affiliation" includes:

- an employment relationship;
- a business or professional relationship maintained on a regular basis;
- control; and
- service as an office holder, as defined below in Item 10, excluding service as a director who was appointed to serve as an external director in a company which is going to initially offer its shares to the public.
- No person may serve as an external director if the person's position or other business activities create, or may create, a conflict of interest with the person's responsibilities as an external director or may otherwise interfere with the person's ability to serve as an external director. If, at the time external directors are to be appointed, all current members of the board of directors are of the same gender, then at least one external director must be of the other gender.

Pursuant to a 2005 amendment to the Companies Law, a public company is required to appoint as an external director a person, who has "professional capability" or a person, who has "financial and accounting expertise", provided that at least one of the external directors shall have "financial and accounting expertise". In addition, pursuant to the same amendment to the

Companies Law, the board of directors of a public company is required to determine the minimum number of directors with “financial and accounting expertise” serving on the board of directors. The qualifications for “professional capability” and “financial and accounting expertise” are determined by regulations. In March 2006, we determined the minimum number of directors with “financial and accounting expertise” serving on our board of directors to be two. Mr. Goldman and Mr. Asheri are designated as our two directors with financial and accounting expertise.

External directors are to be elected by a majority vote at a shareholders’ meeting, provided that either:

- the majority of shares voted at the meeting, including at least one-third of the shares held by non-controlling shareholders, or their representatives, which voted at the meeting, vote in favor of election of the director without taking abstentions into account. According to the Israeli Companies Law, a controlling shareholder is defined as a person who has the ability to direct the activities of a company, other than if this power derives solely from its position on the board of directors or any other position with the company. A person is presumed to be a controlling shareholder if he holds half or more of the following: (1) voting rights in the general meeting, or (2) rights to appoint directors or the Chief Executive Officer; or
- the total number of shares held by non-controlling shareholders voted against the election of the director does not exceed one percent of the aggregate voting rights in the company.

The initial term of an external director is three years and may be extended for an additional three years. Both of our external directors are currently serving their respective additional terms, which end in 2007 and 2009, respectively. External directors may be removed only in a general meeting, by the same percentage of shareholders as is required for their election, or by a court, and in both cases only if the external directors cease to meet the statutory qualifications for their appointment or if they violate their duty of loyalty to the company. Each committee of a company’s board of directors must include at least one external director and all of the external directors must be members of the audit committee.

An external director is entitled to compensation in accordance with the regulations adopted under the Israeli Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with service provided as an external director.

Audit Committee

The Israeli Companies Law requires public companies to appoint an audit committee. The responsibilities of the audit committee include identifying irregularities in the management of the company’s business and approving related party transactions as required by law. An audit committee must consist of at least three directors, including, as mentioned, all of the external directors of the company. The Chairman of the board of directors, any director employed by or otherwise providing services to the company, and a controlling shareholder or any relative of a controlling shareholder, may not be a member of the audit committee.

Our two external directors serve on the audit committee of the board of directors. All members of our audit committee meet the definition of independent directors under the Sarbanes

Oxley Act of 2002 and the Nasdaq Marketplace Rules. None of them is an affiliated person of us or has received any consulting, advisory or other compensatory fee from us, other than in their capacity as directors. Yaacov Goldman is our designated financial expert under the Sarbanes-Oxley Act of 2002.

Internal Auditor

Under the Israeli Companies Law, the board of directors of public companies must appoint an internal auditor, nominated by the proposal of the audit committee. The role of the internal auditor is to examine, among other matters, whether the company's actions comply with the law and orderly business procedure. Under the Israeli Companies Law, the internal auditor may be an employee of the company but not an office holder (as defined below in Item 10), an interested party, a relative of an office holder or an interested party, and he may not be the company's independent accountant or its representative. According the Israeli Companies Law, an interested party is defined as a shareholder who holds 5% or more of the outstanding share capital or the voting power, a director, a general manager or a shareholder who has the right to appoint at least one director or the general manager. Doron Cohen of Fahn Kane, a member of Grant Thornton International, is our internal auditor.

Nasdaq Listing Standards

Our ordinary shares are currently listed on the Nasdaq National Market and are subject to the rules and regulations established by Nasdaq as being applicable to listed companies. Rule 4350 imposes various corporate governance requirements on listed securities. Section (a)(1) of Rule 4350 provides that foreign private issuers are required to comply with certain specific requirements of Rule 4350, but, as to the balance of Rule 4350, foreign private issuers may comply with the laws of their home jurisdiction in lieu of the requirements of such sections of Rule 4350.

We have chosen to follow the rules of our home jurisdiction, the Israeli Companies Law, in lieu of the requirements of Section 4350(c) relating to:

- independence of the board of directors;
- executive sessions of independent directors;
- the requirement that compensation of executive officers is to be determined by an independent committee of the board or by the independent members of the board of directors;
- the requirement that director nominees must be selected by an independent committee of the board or by the independent members of the board of directors.

The above requirements of Rule 4350 are not required under the Israeli Companies Law.

D. Employees

All of our employees are located in Israel. The following table sets forth, for the last three financial years, the number of our employees.

Period ended December 31,	**2005**	**2004**	**2003**
Management and Administration	22	22	22

Certain provisions of Israeli employment laws and of Extension Orders based upon provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) and the Coordination Bureau of Economic Organizations (including the Industrialists' Associations) are applicable to employees in Israel by order of the Israeli Ministry of Labor. These provisions concern principally the length of the work day, minimum daily wages for professional workers, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay, and other conditions of employment. We generally provide employees with benefits and working conditions beyond the minimum requirements.

Israeli law generally requires severance pay, which may be funded by Managers' Insurance described below, upon the retirement or death of an employee or termination of employment without cause (as defined in the law). The payments thereto amount to approximately 8.33% of wages. Furthermore, Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute, which is similar to the United States Social Security Administration. Such amounts also include payments for national health insurance. The payments to the National Insurance Institute are equal to approximately 16.3% of the wages, of which the employee contributes approximately 66% and the employer contributes approximately 34%.

A general practice followed by us and some of our group companies although not legally required, is the contribution of additional funds on behalf of most of the employees to a fund known as Managers' Insurance. This fund provides a combination of savings plan, insurance and severance pay benefits to the employee, giving the employee a lump sum payment upon retirement and securing the severance pay, if legally entitled, upon termination of employment. The employer decides which employees are entitled to participate in the plan, and each employee who agrees to participate contributes an amount equal to 5% of his or her salary and the employer contributes between 13.3% and 15.8% of the employee's salary.

Share Ownership

The number of our ordinary shares beneficially owned by each of our directors, and by our directors and officers as a group, as of May 31, 2006, is as follows:

Director	**Ordinary Shares**
Ami Erel, Chairman(1)	10,376(2)
Avraham Asheri	0
Prof. Gabi Barbash	0
Ari Bronshtein(1)	0
Prof. Yair Be'ery	0
Nochi Dankner(1)	0
Avraham Fischer(1)	0
Yaacov Goldman	0
Shay Livnat(1)	0
Dori Manor(1)	0
Prof. Daniel Sipper	0
All officers and directors as a group	171,866(3)

(1) Director or officer of DIC, IDBD or IDBH. Ownership excludes shares beneficially owned by these companies.

(2) Consists solely of options to purchase our ordinary shares, based on our share price as of May 31, 2006. See below Series 9 and Series 11 under "Stock Option Plans".

(3) Includes options to purchase 170,626 of our ordinary shares currently exercisable or exercisable within 60 days of May 31, 2006.

Stock Option Plans

As of May 31, 2006, 451,551 options to purchase our ordinary shares granted to our officers and employees were outstanding. Details concerning these options are as follows:

Series 9 Options

The Chairman of our board of directors was granted options to purchase 58,154 of our ordinary shares (the “Series 9 Options”). The Series 9 Options were granted ratably over a period of three years commencing on February 2000 and are exercisable for a period of three years, commencing two years after the date of grant. Series 9 Options to purchase 38,768 of our ordinary shares, granted in February 2000 and 2001, have since expired.

The per share exercise price of the Series 9 Options granted in February 2002 is $10.01. Upon exercise of the Series 9 Options, the option holder is granted a number of shares reflecting the benefit component of the options exercised, as calculated at the exercise date.

Series 10 Options

There are outstanding options to purchase an aggregate of 25,000 of our ordinary shares which are held by two of our officers (the “Series 10 Options"). The Series 10 Options are exercisable at a price of $29.38 per share. The optionholders are entitled to exercise 25% of the amount granted, each year, starting in October 2001. The Series 10 Options will expire in October 2007.

Series 11 Options

The Chairman of our board of directors was granted options to purchase 58,000 of our ordinary shares (the “Series 11 Options”). The Series 11 Options were granted ratably over a period of three years commencing in June 2001 and are exercisable for a period of three years, commencing two years after the date of grant. The first amount of 19,333 Series 11 Options was granted in June 2001 and expired in June 2006. The second amount of 19,333 Series 11 Options was granted in June 2002 and were exercised in December 2004 into 8,623 shares based upon a per share exercise price of $8.337. The third amount of 19,334 Series 11 Options was granted in June 2003. The per share exercise price of the Series 11 Options granted in June 2003 is $5.437.

Upon exercise of the Series 11 Options, the option holder is granted a number of shares reflecting the benefit component of the options exercised, as calculated at the exercise date.

Series 12 Options

There are outstanding options to purchase an aggregate of 24,000 of our ordinary shares held by one of our officers (the "Series 12 Options"). The Series 12 Options are exercisable at a price per share of $18.87 per share. The officer is entitled to exercise 25% of the amount granted each year, starting in February 2002. The Series 12 Options will expire in June 2008.

2003 Option Plan

During May 2003, our Board of Directors adopted the 2003 Option Plan which was subsequently ratified by our shareholders on November 30, 2003. Under this plan, options to purchase an aggregate of up to 500,000 ordinary shares may be granted. The 2003 Option Plan provides that the exercise price per share shall be reduced by an amount equal to the amount of any dividend per share distributed. The optionees are entitled to exercise 25% of the amount granted, each year, commencing on the date of grant and expiring five years later. In granting the options, the Board of Directors selected the capital gains tax track pursuant to the new tax reform legislation which came into effect on January 1, 2003. For more details see Item 10 – "Taxation" – "Employee Stock Options."

The following options were granted by during the period May 2003 to March 2006 and remain outstanding:

Date of Grant	Aggregate No. of Options	Aggregate No. of Options Granted to Officers (or former Officers)	Exercise Price
May 2003	199,500	175,000	$5.00(i)
December 2004	20,000	20,000	$9.41(i)
July 2005	40,000	40,000	$7.84(i)
November 2005	80,000	55,000(ii)	$9.12
March 2006	5,000	-	$9.05

(i) Exercise price reduced as a result of $3.00 dividend per share distributed in September 2005.

(ii) 30,000 options were issued under Section 3(i) of the Israeli Income Tax Ordinance due to the classification of the optionee as a "controlling person" under the Income Tax Ordinance. These options are still subject to shareholder approval. (For more details – see Item 10 – "Taxation" – Employee Stock Options.")

Options of certain officers to acquire shares in our private group companies

During 2001, the Board of Directors approved the grant of options to certain of our officers to acquire between 1% and 2% of our investments in certain private companies. The options are exercisable at the weighted average price of our investments. The options vest ratably over a three year period and are exercisable for an additional three years. These options are in addition to those granted to our Chairman, Mr. Ami Erel. See Item 7 – "Major Shareholders and Related Party Transactions - Compensation of Chairman."

Item 7. Major Shareholders and Related Party Transactions

A. Major Shareholders

The following table sets forth, as of May 31, 2006, unless otherwise specified, the number of ordinary shares beneficially owned by all shareholders known to us to beneficially own more than 5% of our ordinary shares. The voting rights of our major shareholders do not differ from the voting rights of other holders of our ordinary shares. As of May 12, 2006, there were a total of 526 holders of record of our ordinary shares, of which 416 were registered with addresses in the United States. We believe that the number of beneficial owners is substantially greater than the number of record holders, because a large portion of our common stock is held of record in broker "street names." United States holders of record held approximately 11% of our then outstanding ordinary shares.

Name and Address	Number of Ordinary Shares	Percent of Ordinary Shares
Discount Investment Corporation Ltd. (1) Tel Aviv, Israel…………………………………	14,048,613	47.6%
Clal Insurance Group (2) Tel Aviv, Israel………………………………..	109,972	0.4%
All Officers and Directors as a group (3) ………..	171,866	0.6%

(1) IDBH is the parent of IDBD, which, in turn, is the parent of DIC and Clal Insurance Enterprise Holdings Ltd. ("Clal"). IDBH, IDBD, DIC and Clal are public companies traded on the Tel Aviv Stock Exchange.

As of May 31, 2006, approximately 51.7% of the outstanding share capital of IDBH was owned by a group comprised of: (i) Ganden Investments I.D.B. Ltd. ("Ganden Investments"), a private Israeli company controlled by Nochi Dankner and his sister, Shelly Bergman, which held 31.02% of the equity of and voting power in IDBH; (ii) Manor Investments-IDB Ltd. ("Manor Investments"), a private Israeli company controlled by Ruth Manor, which held 10.37% of the equity of and voting power in IDBH; and (iii) Avraham Livnat Investments (2002) Ltd. ("Livnat Investments"), a private Israeli company controlled by Avraham Livnat, which held 10.34% of the equity of and voting power in IDBH. Ganden Investments, Manor Investments and Livnat Investments, owning in the aggregate approximately 51.7% of the equity of and voting power in IDBH, entered into a Shareholders Agreement relating, among other things, to their joint control of IDBH, the term of which is until May 19, 2023 ("IDB Shareholders Agreement"). Ganden Investments, Manor Investments and Livnat Investments pledged their shares of IDBH to a financial institution as collateral for the repayment of loans borrowed to purchase such shares.

In addition, as of May 31, 2006, (i) Ganden Holdings Ltd. ("Ganden Holdings"), another private Israeli company controlled by Nochi Dankner and his sister, Shelly Bergman, which is the parent company of Ganden Investments, held directly approximately 11.38% of the equity and voting power of IDBH, (ii) Ganden Investments additionally held directly approximately 6.71% of the equity in IDBH, (iii) Shelly Bergman held, though a wholly owned company, approximately 7.23% of the equity of and voting power in IDBH, (iv) another private Israeli company controlled by Ruth Manor, which is the parent company of Manor Investments, held approximately 0.03% of the equity and voting power in IDBH and (v) another private Israeli company controlled by Avraham Livnat, which is the parent company of Livnat Investments, held approximately 0.04% of the equity and voting power in IDBH. Substantially all of the additional shares of IDBH set forth in (i) and (ii) above held directly by Ganden Holdings and Shelly Bergman's wholly owned company, were acquired with borrowed funds and are pledged to each respective shareholder's lending institution. None of the shares set forth in (i) – (v) above are subject to the IDB Shareholders Agreement.

Ganden Investments, Manor Investments and Livnat Investments have pledged their shares of IDBH in favor of certain financial institutions as collateral for the repayment of certain loans borrowed by them in order to finance part of the consideration paid for the shares of IDBH purchased by them. The lenders may realize these pledges in certain events described in the agreements with such financial institutions.

Nochi Dankner is Chairman of IDBH, IDBD and DIC and a director of Clal and Elron. Zehava Dankner (the mother of Nochi Dankner) is a director of IDBH, IDBD and DIC and Clal. Zvi Livnat (a son of Avraham Livnat) is a director of IDBH, IDBD and DIC. Shay Livnat (a son of Avraham Livnat) is a director of IDBD and Elron. Isaac Manor (the husband of Ruth Manor) is a director of IDBH, IDBD, DIC and Clal and Dori Manor (the son of Isaac and Ruth Manor) is a director of IDBH, IDBD, DIC and Elron.

DIC’s address is 3 Azrieli Center, 44th floor, Tel Aviv 67023, Israel.

(2) The Clal Insurance Group is comprised of Clal and its subsidiary companies, which are deemed to be major shareholders of the Company. Clal is majority owned by IDBD, the parent company of DIC, which in turn is a controlling shareholder of the Company. As of May 31 2006, the other major shareholder of Clal was Bank Hapoalim, which held approximately 17.53% of Clal’s shares (including holdings of mutual and provident funds that are controlled by Bank Hapoalim B.M.). None of the remaining shareholders of Clal held more than 5% of its shares.

The Clal Insurance Group’s address is 48 Menachem Begin Rd., Clal Development Bldg., Tel Aviv, Israel.

(3) This amount includes 170,626 shares underlying options that are currently exercisable or that will become exercisable within 60 days of May 31, 2006. This amount does not include any shares that may be deemed to be beneficially owned by directors by virtue of their affiliation with DIC.

B. Related Party Transactions

Directors' Compensation

In 2006, we agreed to grant compensation to each of our external directors and to one of our other directors not employed by DIC or IDBH equal to the maximum compensation permitted under the Companies Law and Regulations for a dual listed company, namely NIS112,008 (approximately $25,000) per director and up to NIS3,360 (approximately $750) per director for participation in each meeting of the board of directors or any committee thereof, in each case, adjusted to the Israeli Consumer Price Index from time to time. With respect to the remaining directors, in 2006, and with respect to all the directors, in each of the fiscal years 2004 and 2005 respectively, we agreed to grant compensation, according to the amount then permitted according to the Israeli Companies Regulations (Rules Regarding Compensation and Expenses for an External Director), 2000 (the "External Director Regulations"), for companies of the same classification in relation to its shareholder's equity, which were as of May 31, 2006, in addition to reimbursement of expenses, approximately NIS 47,320 (approximately $10,500) per director for one year and in addition approximately NIS 1,820 (approximately $400) per director for participation in each meeting of the board of directors or any committee thereof.

Consulting Agreements with Directors

On March 12, 2006, following the approval of the Audit Committee and the Board of Directors, our shareholders approved a consulting agreement with Prof. Yair Beery with effect from January 1, 2005 until December 31, 2006 pursuant to which Prof. Beery provides services to us and our group companies in consideration for $5,000 per month.

In May 2006, the Audit Committee and the Board of Directors approved a consulting agreement with Prof. Gabi Barbash with effect from January 1, 2006 until December 31, 2006 pursuant to which Prof. Barbash provides services to us and our group companies in consideration for $5,000 per month. The agreement with Prof. Barbash is subject to shareholders approval. The matter will be presented to shareholders at our annual meeting to be held later this year.

Compensation of the Chairman

Mr. Ami Erel has options to acquire up to 1.5% of any shares or other securities acquired by us in Wavion, Inc. and up to 0.75% of any shares or other securities acquired by us and through DEP in Galil Medical Ltd. (each an "Invested Company") (together, the "Option"). The Option shall be exercisable at the weighted average price of investments made by us with respect to any such Invested Company until the date of exercise of the Option. The Option shall be exercisable for a period of three years commencing on the later of January 1, 2000 or the date of the latest investment by us in the relevant Invested Company, provided that at the time of the Option exercise Mr. Erel is a director or an employee of ours and that we have not sold or otherwise transferred to a third party our securities in the relevant Invested Company.

Mr. Erel shall be entitled to participate in a sale by us of shares which were, or are, subject to Mr. Erel's Option hereunder, by selling the same proportion of his shares along with us. We may require Mr. Erel to sell such shares together with a sale of shares by us. Sales by Mr. Erel of shares acquired upon exercise of the foregoing Options, which are not publicly traded, will require our approval. To date, none of the foregoing options have been exercised.

Investments in and loans to Galil Medical Ltd.

From January 1, 2005 through May 31, 2006, we, our subsidiary RDC, and DIC invested in and provided loans to Galil Medical.

These transactions were approved by our Audit Committee and our Board of Directors due to DIC's participation in the transactions.

Grant of Letters of Exemption and Indemnification

In 2001, following the approval of our audit committee, board of directors and shareholders, and in accordance with the provisions of the Companies Law, we granted letters of indemnification to our directors and officers. The aggregate indemnification shall not exceed 25% of our shareholders equity according to our consolidated financial statements for the year ended December 31, 2000, for all persons and cases to be indemnified. In addition, we undertook to exempt our directors and officers, to the extent permitted by law, from any liability towards us for any damage caused or that may be caused to us by them, if caused or that may be caused following a breach of their duty of care towards us. We continue to grant letters of indemnification and exemption to our directors and officers in accordance with the above terms.

Directors and Officers Insurance Policy

In April 2005, following the resolution and recommendation of our Audit Committee and Board of Directors, our shareholders approved and ratified the purchase of a directors' and officers' liability insurance policy (the "Policy") for our directors and officers from Clal Insurance Company Ltd., a related party and separately approved the application of the Policy to Dori Manor, one of our directors, and any future director or officer of the Company who may currently be considered a "Controlling Shareholder" under the Companies Law, 1999. The principal terms of the Policy are as follows:

(1) The Policy was for a period beginning on January 1, 2005 and ending on June 30, 2006.

(2) The coverage under the Policy was limited to $30 million per claim and in the aggregate during the Policy period.

(3) The annual premium to be paid with respect to the Policy was approximately $475,000.

In addition, our shareholders approved: (i) any renewal and/or extension of the Policy for all our directors and officers; and (ii) the purchase of any other directors' and officers' liability insurance policy for our directors and officers upon the expiration of the Policy; provided that any such renewal, extension or purchase referred to in clauses (i) and (ii) above is for the benefit of our previous and/or current and/or future directors and officers and on terms substantially similar to those of the Policy; and that the premium will not increase by more than 25% in any year, as compared to the previous year.

We expect to renew the Policy by June 30, 2006.

Voting Agreement with DIC regarding Given Imaging

On September 29, 2003, we and DIC entered into a voting agreement pursuant to which, among other things, DIC agreed to vote all of its ordinary shares in favor of nominees to the board of directors of Given Imaging proposed by us. The voting agreement is for a term of one year and renews automatically each year thereafter unless terminated by notice of either party to the other party no later than August 30 in each year. By virtue of this agreement, we may be deemed to beneficially own the shares held by DIC in Given Imaging, which together with the shares of Given Imaging which we hold directly as well as those held by RDC, represents approximately 36% of the outstanding shares of Given Imaging. This agreement was approved by our Audit Committee and our Board of Directors.

Voting Agreement with Infinity regarding Teledata

On May 8, 2005, as part of our investment in Teledata, we and Infinity, a related venture capital fund, entered into a voting agreement pursuant to which we agreed to vote in concert with each other at meetings of shareholders of Teledata. Clal, a subsidiary of IDBD, is the largest limited partner of Infinity. DIC, our largest shareholder, is also a subsidiary of IDBD. This agreement was approved by our Audit Committee and our Board of Directors as part of our investment in Teledata.

Voting Agreement with Infinity regarding Brainsgate

On July, 2005, as part of our investment in BrainsGate, we and Infinity entered into a voting agreement pursuant to which we agreed to vote in concert with each other at meetings of shareholders of BrainsGate. This agreement was approved by our Audit Committee and our Board of Directors as part of our investment in BrainsGate.

Shareholders Agreement with DIC regarding NetVision

On May 10, 2005, immediately prior to the NetVision initial public offering, we and DIC entered into a shareholders agreement pursuant to which we and DIC agreed to vote all of our shares in favor of our respective nominees to the board of directors of NetVision. In addition, under the agreement, we and DIC have rights of first refusal and co-sale rights on the sale of our respective shares subject to and in accordance with the mechanisms set forth in the agreement. The agreement shall terminate upon the earlier of our mutual consent or either us or DIC holding less than 10% of NetVision. This agreement was approved by our Audit Committee and our Board of Directors.

C. Interests of Experts and Counsel

Not Applicable.

Item 8. Financial Information

A. Consolidated Statements and Other Financial Information

Our consolidated financial statements and other financial information are incorporated herein by reference to Item 18 below.

Legal Proceedings

Gesser Claim

On September 8, 1999, we received a copy of a statement of claim, along with a court order requiring a motion to approve this claim as a class action, submitted by David Gesser, a shareholder of Elscint Ltd., or Elscint, The motion requests that this claim be approved as class action instead of the previous claim submitted by Yonatan Aderet. This claim names as defendants Elscint, Elbit, our company, and Emmanuel Gill, Uzia Galil, Dov Tadmor, Micha Angel and Yigal Baruchi, former directors of Elscint, and Yonatan Aderet, the former President and director of Elscint. The motion was submitted by the applicant on behalf of all existing shareholders of Elscint who held Elscint's shares on February 18, 1999. The plaintiff seeks damages of approximately $158.0 million.

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 lawsuit has been suspended pursuant to an arrangement reached by the parties pending the outcome of the appeal in the Investors claim described below. The arrangement provides that if the appeal as described in the "Investors Claim" immediately 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.

Investors Claim

On November 2, 1999, we received a statement of claim and an application to claim as a class action against Europe Israel (M.M.S.) Ltd. (EIL), Elbit Medical Imaging, Elscint, Control Centers Ltd. (the controlling shareholder of EIL), Marina Herzliya Limited Partnership 1988 (which is controlled by Control Centers) and against us and 25 past and present officers of the above companies, including our officers.

The claim was submitted by a number of investors and others, who hold shares in Elscint, while the application to approve the claim as a class action was submitted on behalf of shareholders who held shares in Elscint on September 6, 1999 and continued to hold such shares on the date of application, excluding the respondents.

The allegations, which the claimants raised against us and our officers, relate to the period prior to the sale of our holdings in Elbit Medical Imaging to EIL. These allegations include, among others, that (i) we and our officers gave preference to the interests of our company and the personal interests of our officers over the interests of Elscint and its minority shareholders; (ii) we and our officers did not act in order to enable the minority shareholders of Elscint to participate in the proceeds of the sale of Elscint's assets; and (iii) general allegations against the transactions whereby we sold our holdings in Elbit Medical Imaging to EIL. Further allegations were raised against the other respondents.

The plaintiffs seek a court order pursuant to which Elbit Medical Imaging would be compelled to execute the alleged buy-out of shares at $14 per share. Alternatively, the claimants have requested additional remedies set forth in the statement of claim, including a remedy requested also from us and our officers regarding compensation for the damages that they allege were suffered by them and/or by Elscint. Certain of the remedies have been requested also as derivative claims on behalf of Elscint. The maximum liability in this claim is not specified by the plaintiffs.

On August 16, 2000, the Haifa District Court dismissed the application to recognize the claim as a class action. Some of the claimants requested and were granted permission to appeal to the Supreme Court of Israel. The appeal to the Supreme Court is still pending. In addition, the claimants submitted an amended claim in February 2001, which was not recognized as a class action suit. The allegations are similar to those in the previous claim. It has not yet been determined when the defendants are required to file their statements of defense to the claim. The claimants and the defendants are currently involved in various proceedings, primarily involving a disagreement concerning the court fees.

We deny all the allegations set forth in the above claims and are defending and intend to continue defending against such claims.

Other than the above matters, we are not a party to any material litigation.

Dividend Policy

Currently we do not have any fixed dividend policy. The declaration of dividends is determined by the board of directors taking into consideration our financial status, profitability, realization of assets and our investment requirements. In September 2005, we distributed a dividend of $3.00 per share, or approximately $88.5 million in the aggregate.

B. Significant Changes

Except as otherwise disclosed in this Annual Report, no significant change has occurred since December 31, 2005.

Item 9. The Offer and Listing

A. Offer and Listing Details

Markets and Share Price History

Our ordinary shares are traded on the Nasdaq National Market, where our shares are listed and traded under the symbol "ELRN". Our shares are also traded on the Tel Aviv Stock Exchange (TASE) in Israel. The following table sets forth, for the periods indicated, the high and low reported sales prices of our Ordinary Shares on the Nasdaq National Market and, in New Israeli Shekels (NIS), on the Tel Aviv Stock Exchange, which reflect the distribution of a dividend of $3.00 per share in 2005:

Period	NASDAQ High (US dollars)	NASDAQ Low (US dollars)	TASE High (NIS)	TASE Low (NIS)
2001……………………………………….	20.44	8.37	86.26	41.12
2002 …………………………………….	11.77	4.37	54.24	23.40
2003	9.06	3.91	42.53	20.09
First Quarter 2004..................................	11.23	9.2	53.59	43.55
Second Quarter 2004	11.64	9.86	55.70	48.86
Third Quarter 2004	11.85	10.57	56.82	51.46
Fourth Quarter 2004................................	12.09	9.875	56.30	46.94
First Quarter 2005	13.09	11.51	60.05	54.11
Second Quarter 2005	12.82	9.92	58.68	47.93
Third Quarter 2005	11.55	9.61	55.04	46.52
Fourth Quarter 2005	11.74	9.8	54.01	46.41
December 2005.......................................	11.74	10.63	54.01	48.72
January 2006...	11.64	10.79	54.19	48.77
February 2006..	11.47	10.55	52.37	49.42
March 2006	11.09	10.4	52.01	49.33
April 2006..	11.25	10.76	50.81	49.30
May 2006...	12.2	10.39	54.04	46.38

B. Plan of Distribution

Not Applicable.

C. Markets

As noted above, our Ordinary Shares are traded on the Nasdaq National Market under the symbol "ELRN". Our shares are also traded on the Tel Aviv Stock Exchange in Israel.

D. Selling Shareholders

Not Applicable.

E. Dilution

Not Applicable.

F. Expenses of the Issue

Not Applicable.

Item 10. Additional Information

A Share Capital

Not Applicable

B. Memorandum and Articles of Association

Articles of Association; Israel Companies Law

Our shareholders approved the adoption of our Articles of Association in March 2001. The objective of Elron as stated in our Articles and in our Memorandum of Association is to engage in any lawful activity.

We have currently outstanding only one class of securities, our ordinary shares, par value NIS 0.003 per share. No preferred shares are currently authorized.

Holders of ordinary shares have one vote per share, and are entitled to participate equally in the payment of dividends and share distributions and, in the event of our liquidation, in the distribution of assets after satisfaction of liabilities to creditors. According to our Articles, any modification of the Articles requires the approval of a special majority at a general meeting. A special majority is defined in our Articles as at least a majority of 67% of the shareholders who voted at the general meeting, without taking abstaining votes into account.

The Israeli Companies Law and our Articles require that we hold our annual general meeting of shareholders each year no later than 15 months from the last annual meeting, at a time and place determined by the board of directors, upon at least 21 days prior notice to our shareholders. Under the Israeli law and regulations and our Articles of Association, notice of the meeting is required to be published in two widely distributed daily newspapers published in Hebrew and to be sent to shareholders whose names appear in the shareholders register if their registered shares are not in Israel. Commencing April 2, 2006, The Companies Law requires us to issue a voting instrument in order to enable shareholders to vote through a voting instrument, if certain matters are on the agenda of the meeting. No business may be commenced until a quorum of two or more shareholders holding at least one third of the voting rights are present in person or by proxy. The Israeli Companies Law provides that the record date for the participation of shareholders of a company whose shares are traded or registered outside of Israel such as us may be no more than 40 but no less than 4 days prior to the meeting, provided that notice for said meeting is given prior to the record date. Resolutions regarding the following matters must be passed at a general meeting of shareholders:

- amendments to our Articles and Memorandum of Association;
- appointment or termination of our auditors;
- appointment and dismissal of directors;
- approval of interested party actions and transactions requiring general meeting approval as provided in sections 255 and 268 to 275 of the Israeli Companies Law;
- increase or reduction of our authorized share capital and alterations of our share capital;

- a merger as provided in section 320 of the Israeli Companies Law;
- the exercise of the board of directors' powers by a general meeting, if the board of directors is unable to exercise its powers and the exercise of any of its powers is vital for our proper management, as provided in section 52(a) of the Israeli Companies Law; and
- any matter that is required to be adopted by resolution of a general meeting pursuant to the Israeli Companies Law or in accordance with our Articles.

An extraordinary meeting of our shareholders shall be convened by the decision of the board, or at the request of any two directors or one quarter of the officiating directors, or by request of one or more shareholders holding at least 5% of the voting rights in our company. Shareholders requesting an extraordinary meeting must submit their proposed resolution with their request. Within 21 days of receipt of the request, the board must convene an extraordinary meeting and send out notices setting forth the date, time and place of the meeting. Such notice must be given at least 21 days, but not more than 35 days, prior to the extraordinary meeting.

The Israeli Companies Law codifies the fiduciary duties and duty of care that office holders owe to a company. An office holder, is defined in the Israeli Companies Law, as a (i) director, (ii) general manager, (iii) chief business manager, (iv) deputy general manager, (v) vice general manager, (vi) executive vice president, (vii) vice president, (viii) another manager directly subordinate to the general manager or (ix) any other person assuming the responsibilities of any of the forgoing positions without regard to such person's title. Each person listed in the table under "Directors and Senior Management" in Item 6 above is an office holder.

The Israeli Companies Law requires that an office holder of a company promptly disclose, and no later than the first board meeting in which such transaction is discussed, any personal interest that he or she may have and all related material information known to him or her, in connection with any existing or proposed transaction by the company. In addition, if the transaction is an extraordinary transaction, the office holder must also disclose any personal interest held by the office holder's relative. An extraordinary transaction is defined as a transaction not in the ordinary course of business, not on market terms, or that is likely to have a material impact on the company's profitability, assets or liabilities.

In the case of a transaction in which an officer has a personal interest that is not an extraordinary transaction, after the office holder complies with the above disclosure requirement, board approval is required unless the Articles of Association of the company provide otherwise. Our Articles of Association provide that a transaction with one of our office holders or a transaction, in which an office holder has a personal interest which, in each case, is not regarded as an extraordinary transaction, requires the approval of the board or the audit committee or by such other organ empowered by the board for such purpose. If the transaction in which an officer has a personal interest is an extraordinary transaction, then, it must also be approved by the audit committee and by the board of directors.

Agreements regarding directors' terms of employment require the approval of audit committee, the board of directors and the shareholders. In all matters in which a director has a personal interest, including matters of his/her terms of employment, he/she shall not be permitted to vote on the matter or be present in the meeting in which the matter is considered. However, should a majority of the audit committee or of the board of directors have a personal interest in the matter then:

a) all of the directors shall be permitted to vote on the matter and attend the meeting in which the matter is considered; and

b) the matter requires approval of the shareholders at a general meeting.

According to the Israeli Companies Law, the disclosure requirements discussed above also apply to a controlling shareholder of a public company. The term "controlling shareholder" for these purposes also includes shareholders that hold 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights in the company. In general, extraordinary transactions with a controlling shareholder or in which a controlling shareholder or his relative has a personal interest, and agreements relating to employment and compensation terms of a controlling shareholder require the approval of the audit committee, the board of directors and the shareholders of the company.

Such shareholder approval must either include at least one-third of the shares held by disinterested shareholders who participate in the vote (without taking abstaining votes into account), or, alternatively, the total shareholdings of the disinterested shareholders who vote against the transaction must not represent more than one percent of the voting rights in the company. Under specified circumstances, such shareholder approval is not required.

Under the Israeli Companies Law, if a private placement: (1) will entail 20% or more of the voting rights of a company prior to the placement, and all or part of the private placement consideration is not in cash or in public traded securities or is not upon market terms and if as a result of the private placement the holdings of substantial shareholder shall increase or result in a person becoming a substantial shareholder, or (2) result in a person becoming a controlling shareholder, then the allotment must be approved by the board of directors and by the shareholders of the company. A "substantial shareholder" is defined as a shareholder that holds 5% or more of the company's outstanding share capital, assuming the exercise of all of the securities convertible into shares held by that person. In order for the private placement to be on "market terms" the board of directors has to determine, on the basis of a detailed examination, that the private placement is on market terms, unless proved otherwise. Any placement of securities that does not fall within the above description may be issued at the discretion of the board of directors.

Under the Israeli Companies Law, a shareholder has a duty to act in good faith towards the company and other shareholders when exercising his rights and refrain from abusing his power in the company, including, among other things, voting in the general meeting of shareholders on the following matters:

- any amendment to the Articles of Association;
- an increase of the company's authorized share capital;
- a merger; or
- approval of interested party acts and transactions that require general meeting approval as provided in sections 255 and 268 to 275 of the Israeli Companies Law.

In addition, any controlling shareholder, any shareholder who knows that it possesses power to determine the outcome of a shareholder vote and any shareholder who has the power to appoint or prevent the appointment office holder in the company is under a duty to act with fairness towards the company. The Israeli Companies Law does not describe the substance of this duty. The Israeli Companies Law requires that specified types of transactions, actions and arrangements be approved as provided for in a company's articles of association and in some circumstances by the audit committee, by the board of directors and by the general meeting of the shareholders. The vote required by the audit committee and the board of directors for approval of these matters, in each case, is a majority of the directors participating in a duly convened meeting.

C. Material Contracts

1. *Deed of Transfer for Sale of Shares of Elbit Systems*

On July 28, 2004, we signed a deed of transfer to sell all of our holdings in Elbit Systems, constituting approximately 19.6% of the outstanding share capital of Elbit Systems, to the Federmann group, for approximately $196.6 million.

2. *Sale of shares of Partner*

Buyback

On April 20, 2005 we completed the sale to Partner of 12,765,190 Partner shares for approximately $94 million, as part of the sale together with the other Israeli founding shareholders of Partner of an aggregate of approximately 33.3 million Partner shares to Partner for an aggregate consideration of approximately $245 million, pursuant to the terms of an irrevocable offer letter February 7, 2005. Under the terms of the offer letter, we, Polar Communications Ltd. ("Polar") and Eurocom Communications Ltd. ("Eurocom"), offered to sell to Partner, severally and not jointly, all of our respective Ordinary Shares, for aggregate consideration of between NIS 984.6 million ($225.2 million) and NIS 1.02 billion ($233.6 million) (the "Buyback"). Matav Investments Ltd. ("Matav"), the remaining Israeli founding shareholder, had the option to participate in the Buyback which it exercised. The sale price formula of the Buyback reflected a 10% discount from the 20-trading day volume weighted average market price of the Partner ordinary shares on the Tel Aviv Stock Exchange prior to the meeting of Partner shareholders in which the Buyback is approved, up to a maximum price of NIS 32.22 per share ($7.37 based on the applicable exchange rate of NIS 4.372 per $1.00) but not below NIS 31.04 per share ($7.10 based on such exchange rate). The sale was completed at the maximum price per share.

Restatement of Relationship Agreement

On April 20, 2005, in connection with the completion of the Buyback, we, the other Israeli founding shareholders, Eurocom, Polar and Matav (the "Israeli Shareholders") together with Advent Investments Pte Ltd. and Hutchison Telecommunications International (Netherlands) B.V., entered into the Restated Relationship Agreement, which replaced the Relationship Agreement dated October 10, 1999 among the parties.

The Restated Relationship Agreement requires the Israeli Shareholders, severally but not jointly, based on their respective holdings in Partner as of April 20, 2005, to hold a sufficient number of Partner ordinary shares to comply with the minimum aggregate holdings by Israeli entities required under Partner's license and articles of association (the "Required Israeli Percentage"). The Required Israeli Percentage is currently 5% of the outstanding share capital of Partner. The number of Partner ordinary shares required to be held by the Israeli Shareholders to maintain the Required Israeli Percentage is calculated based on the number of Partner ordinary shares outstanding from time to time up to a maximum of 160,922,344 ordinary shares outstanding, as adjusted to reflect stock splits, stock dividends and similar changes that apply to all the ordinary shares.

The Restated Relationship Agreement also requires the Israeli Shareholders to transfer such ordinary shares that are subject to the holding requirement of Required Israeli Percentage (the "Restricted Shares") only in accordance with the transfer limitations provided by Partner's license and articles of association.

In addition, pursuant to the Restated Relationship Agreement, the Israeli Shareholders undertook to appoint and retain the number of Israeli directors of Partner that are required pursuant to applicable law (including its license and articles of association) to be appointed and retained by Israeli Shareholders (the "Israeli Director(s)"). Partner's license currently requires that at least 10% of its directors be Israeli Directors, but one Israeli director is sufficient so long as there are fewer than 15 directors. Based on the current size of Partner's board of directors, which is comprised of 13 directors, one Israeli Director is currently required.

On March 21, 2006, pursuant to our purchase of Polar's shares in Partner, we joined the Restated Relationship Agreement in place of Polar.

Shareholders Agreement

On April 20, 2005, we together with the other Israeli Shareholders also entered into a shareholders agreement. The shareholders agreement sets forth the mechanism for appointing the Israeli Director(s). Specifically, the Israeli Director(s) will be appointed on a rotation basis. Subsequently, this agreement was amended to provide that we will not participate in the rotation. On March 21, 2006, pursuant to our purchase of Polar's shares in Partner, we joined the shareholders agreement in place of Polar.

D. Exchange Controls

The Israeli Currency Control Law, 1978 imposes certain limitations concerning foreign currency transactions and transactions between Israeli and non-Israeli residents, which limitations may be regulated or waived by the Controller of Foreign Exchange at the Bank of Israel, through "general" and "special" permits. In May 1998, a new "general permit" was issued pursuant to which substantially all transactions in foreign currency are permitted. Any dividends or other distributions paid in respect of ordinary shares and any amounts payable upon our dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of our securities to an Israeli resident are freely repatriable into non-Israeli currencies at the rate of exchange prevailing at the time of conversion, provided that Israeli income tax has been paid on (or withheld from) such payments.

E. Taxation

General

The following is a summary of the material provisions of the current tax law applicable to companies in Israel, with special reference to its effect on us and our group companies. The following also contains a discussion of material Israeli tax consequences to our shareholders and government programs from which we and some of our group companies benefit. To the extent that the discussion is based on tax legislation that has not been subject to judicial or administrative interpretation, we cannot assure you that the views expressed in the discussion will be accepted by the tax authorities in question.
The discussion is not intended, and should not be construed, as legal or professional tax advice and is not exhaustive of all possible tax considerations.

Israeli Tax Reform

In July 2002, the Israeli Parliament approved a law enacting extensive changes to Israel's tax law (the "Tax Reform Legislation") generally effective January 1, 2003. Among the key provisions of the Tax Reform Legislation are (i) changes which may result in the imposition of taxes on dividends received by an Israeli company from its foreign subsidiaries; and (ii) the introduction of the "controlled foreign corporation" concept according to which an Israeli company may become subject to Israeli taxes on certain income of a non-Israeli subsidiary if the subsidiary's primary source of income is passive income (such as interest, dividends, royalties, rental income or capital gains). An Israeli company that is subject to Israeli taxes on the income of its non-Israeli subsidiaries will receive a credit for income taxes paid/withheld or will be paid/withheld by the subsidiary in its country of residence, according to the terms and conditions determined in the Israeli Tax Ordinance.

On July 25, 2005, the Israeli Knesset (Parliament) approved a significant amendment which came into effect on January 1, 2006. This amendment includes, among others, changes in the capital markets tax rate.

General Corporate Tax Structure

Israeli companies are generally subject to company tax at the rate of 34% (31% in 2006, 29% in 2007 and 27% in 2008, 26% in 2009 and 25% in 2010 and thereafter) of taxable income. However, the effective tax rate payable by a company that derives income from an Approved Enterprise (as further discussed below) may be considerably less, or the same in 2010.

Law for the Encouragement of Capital Investments, 1959

From time to time, certain operations of our group companies have been granted Approved Enterprise status under the Law for the Encouragement of Capital Investments, 1959, as amended, or the Investment Law.

The Investment Law provides that a capital investment in eligible facilities may, upon application to the Investment Center of the Ministry of Industry and Trade of the State of Israel, or the Investment Center, be designated as an Approved Enterprise. Each certificate of approval for an Approved Enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, e.g., the equipment to be purchased and utilized pursuant to the program. The tax benefits derived from any such certificate of approval relate only to taxable income attributable to the specific Approved Enterprise.

Taxable income of a company derived from an Approved Enterprise is subject to company tax at the rate of up to 25% (rather than 34%, in 2005, as stated above) for a period of time termed the benefit period. The benefit period is a period of seven years commencing with the year in which the Approved Enterprise first generated taxable income. The benefits may be shorter as it is limited to 12 years from the commencement of production of the Approved Enterprise or 14 years from the date of approval, whichever is earlier. Under certain circumstances (as further detailed below), the benefit period may extend to a maximum of ten years from the commencement of the benefit period. A company which operates under more than one approval or that has capital investments which are only partly approved (such a company being designated as a Mixed Enterprise), may have an effective company tax rate that is the result of a weighted combination of the various applicable rates.

A company owning an Approved Enterprise may elect to forego certain government grants extended to Approved Enterprises in return for what is termed an alternative package of tax benefits (referred to as the Alternative Package). Under the Alternative Package, a company's undistributed income derived from an Approved Enterprise will be exempt from company tax for a period of between two and ten years, depending on the geographic location of the Approved Enterprise within Israel. Such company will be eligible for the tax benefits under the Investment Law for the remainder of the benefit period.

Should the percentage of share capital of the companies having Approved Enterprises held by foreign shareholders exceed 25%, future Approved Enterprises of such companies would qualify for reduced tax rates for an additional three years, after the seven years mentioned above.

The company tax rate applicable to income earned from Approved Enterprise programs (currently, for programs on which an application for an approved enterprise status was submitted before December 31, 2004) in the benefit period by a company meeting these qualifications is as follows:

% of Foreign Ownership	**Tax Rate**
Over 25% but less than 49%	25%
49% or more but less than 74%	20%
74% or more but less than 90%	15%
90% or more	10%

Entitlement to these benefits is subject to the final ratification of the Investment Center, and is conditioned upon fulfillment of all terms of the approved program. However, there can be no assurance that our group companies which enjoy Approved Enterprise benefits will obtain approval for additional Approved Enterprises, or that the provisions of the Investment Law will not change with respect to future approvals, or that the above-mentioned shareholding portion will be reached for each subsequent year.

A company that pays a dividend out of income derived from the Approved Enterprise(s) during the tax exemption period will be subject to deferred company tax in respect of the amount distributed (including the recipient's tax thereon) at the rate which would have been applicable had such company not elected the Alternative Package. This rate is generally 10% to 25%, depending on the extent to which non-Israeli shareholders hold such company's shares.

The dividend recipient is taxed at the reduced rate applicable to dividends from Approved Enterprises (generally 15% as compared to 25% (or compared to 20% from January 1, 2006 if the dividend recipient is not a substantial shareholder - shareholders owning, directly or indirectly, 10% or more of our outstanding voting capital) for individuals or an exemption for companies), if the dividend is distributed during the tax benefit period or within 12 years after this period. However, the limitation does not apply if the company qualifies as a foreign investors' company. This tax must be withheld by such company at source, regardless of whether the dividend is converted into foreign currency.

Subject to certain provisions concerning income subject to Mixed Enterprises, all dividends are considered to be attributable to the entire enterprise and the effective tax rate on the dividend is the result of a weighted combination of the various applicable tax rates. However, such company is not obliged to distribute exempt retained profits under the Alternative Package, and such company may generally decide from which year's profits to declare dividends.

Each application to the Investment Center is reviewed separately, and a decision as to whether or not to approve such application is based, among other things, on the then prevailing criteria set forth in the Investment Law, on the specific objectives of the applicant company set forth in such application and on certain financial criteria of the applicant company. Accordingly, there can be no assurance that any such application by any of our group companies will be approved. In addition, the benefits available to an Approved Enterprise are conditional upon the fulfillment of certain conditions stipulated in the Investment Law and its regulations and the criteria set forth in the certificate of approval, as described above. In the event that these conditions are violated, in whole or in part, a company with an Approved Enterprise would be required to refund the amount of tax benefits, with the addition of the Israeli consumer price index linkage differences and interest

Reform (Amendment) of the Encouragement of Capital Investment Law

On March 29, 2005, the Israeli Knesset (Parliament) passed an amendment to the Investment Law, that revamps the Israeli tax incentives for future industrial and hotel investments ("2005 amendment"). A tax "holiday" package can now be elected for up to 15 years for a "Privileged Enterprise" as defined in the 2005 amendment, if certain conditions are met, without needing to obtain approval. The extent of the tax benefits available depends mainly upon the level of foreign investment and the geographical location of the "Privileged Enterprise".

The 2005 amendment became effective on April 1, 2005. Taxpayers may, under certain conditions, claim Privileged Enterprise status for new and expanded enterprises with respect to 2004 or subsequent years, unless the Investment Center granted such taxpayer Approved Enterprise status prior to December 31, 2004.

Subject to certain conditions, various alternative tax-only benefit packages can now be elected with respect to investments in a "Privileged Enterprise". Companies in industry or tourism in Israel may elect between:

• Tax "holiday" package - for a “Privileged Enterprise”: a tax exemption applies to undistributed profits for 2 to 15 years depending on geographical location of the "Privileged Enterprise" and the level of foreign ownership. Company tax rates of between 10% and 25% apply to distributed exempt profits or profits derived subsequent to the exempt period. The total period of tax benefits is 7 to 15 years, or

• Grant / Reduced tax package - for an “Approved Enterprise”: Fixed asset grants up to 24% for enterprises in a development area and reduced company tax rates between 0% and 25% for 7 to 15 years.

Dividend withholding tax also applies at a rate of 4% or 15% depending on the package selected.

Taxation under Inflationary Conditions

The Income Tax Law (Inflationary Adjustments), 1985 (referred to as the Inflationary Adjustments Law) is intended to neutralize the erosion of capital investments in business and to prevent tax benefits resulting from deduction of inflationary expenses. This law applies a supplementary set of inflationary adjustments to the normal taxable profits computed under regular historical cost principles. We and our group companies operating in Israel are taxed under this law.

Under the Inflationary Adjustments Law, results for tax purposes are measured in real terms, in accordance with the changes in the consumer price index. In addition, subject to certain limitations, depreciation of fixed assets and losses carried forward are adjusted for inflation on the basis of changes in the consumer price index.

The salient features of the Inflationary Adjustments Law can be described generally as follows:

A special tax adjustment for the preservation of equity whereby certain corporate assets are classified broadly into Fixed (inflation resistant) Assets and Non-Fixed (soft) Assets. Where a company’s equity, as defined in such law, exceeds the depreciated cost of Fixed Assets, a deduction from taxable income that takes into account the effect of the applicable annual rate of inflation on such excess is allowed (up to a ceiling of 70% of taxable income in any single tax year, with the unused portion permitted to be carried forward on a linked basis to the following year and will be considered a business loss). If the depreciated cost of Fixed Assets exceeds a company’s equity, then such excess multiplied by the applicable annual rate of inflation is added to taxable income.

Subject to certain limitations, depreciation deductions on Fixed Assets and losses carried forward are adjusted for inflation based on the increase in the consumer price index (from the beginning of the 1982 fiscal year, and as of the 1985 fiscal year, with respect to equipment).

Law for the Encouragement of Industry (Taxes), 1969

Certain of our group companies currently qualify as Industrial Companies within the definition of the Law for the Encouragement of Industry (Taxes), 1969 (referred to as the Industry Encouragement Law). According to the Industry Encouragement Law, an Industrial Company is a company resident in Israel, at least 90% of the income of which in any tax year (exclusive of income from defense loans, capital gains, interest and dividends) is derived from an

Industrial Enterprise owned by it. An Industrial Enterprise is defined as an enterprise whose major activity in a given tax year is industrial production activity.

The following preferred corporate tax benefits are available to Industrial Companies: (a) deduction of purchases of know-how and patents over an eight-year period for tax purposes; (b) under certain interpretations, deduction of expenses incurred in connection with a public issuance of securities over a three-year period; and (c) an election under certain conditions to file a consolidated tax return with additional related Israeli Industrial Companies and/or with a company that controls an Industrial Company and a specified percentage of its assets are invested in industrial companies; and (d) accelerated depreciation rates on equipment and buildings.

Eligibility for the benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority. No assurance can be given that any of our group companies will qualify and/or continue to qualify as an Industrial Company or that the benefits described above will be available in the future.

Capital Gains Tax

Israeli law imposes a capital gains tax on the sale of capital assets. The law distinguishes between the Real Gain and the Inflationary Surplus. The Real Gain is the excess of the total capital gain over the Inflationary Surplus, computed on the basis of the increase of the consumer price index between the date of purchase and date of sale. The Inflationary Surplus accumulated until December 31, 1993 is taxed at a rate of 10% for residents of Israel (reduced to no tax for non-residents if calculated according to the exchange rate of the foreign currency lawfully invested in shares of an Israeli resident company, instead of the consumer price index). Inflationary Surplus accumulated from and after December 31, 1993 is exempt from any capital gains tax, while the Real Gain is added to ordinary income, which effective until December 31 2002 is taxed at the marginal rate of up to 49% for individuals and 34% for corporations (in 2005). Effective January 1, 2003, the capital gains tax rate imposed upon sale of capital assets acquired after that date has been reduced to 25%; capital gains accrued from assets acquired before that date are subject to a blended tax rate based on the relative periods of time before and after that date that the asset was held.

Under current law, effective January 1, 2003 so long as our ordinary shares are listed on a stock exchange the sale of these shares is subject to 15% tax (20% tax from January 1,2006) in case the shares were purchased after December 31, 2002, and in case the shares were purchased before that date the sale will be subject to a blended tax in which the portion of the gain accrued until December 31, 2002 will be exempt from Israeli capital gains tax and the portion of the real gain accrued from January 1, 2003 until the date of sale will be subject to 15% tax (20% tax from January 1, 2006). Companies upon which the provisions of the Income Tax Law (Inflationary Adjustments), 1985 were not imposed before January 1, 2006 are subject to a 25% tax rate on real capital gains derived on or after January 1, 2003 from the sale of the shares. Notwithstanding the above, companies upon which the provisions of the Income Tax law (Inflationary Adjustments), 1985 were imposed before January 1, 2006 are subject to regular corporate tax rate on real capital gains derived on the sale of the shares prior to January 1,2006.

The taxable real gain will be based on the difference between the adjusted average value of the shares during the last three trading days before January 1, 2003 (or the adjusted original cost if it is higher than the adjusted average value) and the value of the shares at the date of sale. In the event the above mentioned calculation creates a loss, such loss can only be offset against a capital gain from other traded securities according to the provisions of the Israeli law. The amount of the loss is limited to the difference between the adjusted average value and the value of the shares at the date of sale.

Employee Stock Options

Effective from January 1, 2003, the Tax Reform Legislation enables a company to grant options through one of three tax tracks:

(a) the income tax track through a trustee pursuant to which the optionee pays income tax rate (according to the marginal tax rate of the optionee- up to 49% tax) plus payments to the National Insurance Institute and health tax on the profit gained upon the earlier to occur of the transfer of the options or the underlying shares from the trustee to the optionee or the sale of the options or the underlying shares by the trustee, and the company may recognize expenses pertaining to the options for tax purposes. The options (or upon their exercise, the underlying shares), must be held by a trustee for a period of 12 months commencing from the end of the year in which the options were granted (as of January 1, 2006, a period of 12 months commencing from the date of which the options were granted ; or

(b) the capital gains tax track through a trustee pursuant to which the optionee pays capital gains tax at a rate of 25% on the capital profit portion and marginal tax rate (including payments to the National Insurance Institute and health tax) on the income portion (in general, the income portion is the profit derived from the difference between the average market value of the share 30 days before the allotment date and the exercise price of the option) upon, the earlier to occur of the transfer of the options or the underlying shares from the trustee to the optionee or the sale of the options or the underlying shares by the trustee. (On the capital profit the optionee is not required to make payments to the National Insurance Institute and health tax). In this track, on the capital profit, the Company may not recognize expenses pertaining to the options for tax purposes but may do so on the income portion. The options (or upon their exercise, the underlying shares), must be held by a trustee for a period of 24 months commencing from the end of the year in which the options were granted (as of January 1, 2006, a period of 24 months commencing from the date of which the options were granted); or

(c) the income tax track without a trustee pursuant to which the optionee pays income tax rate (according to the marginal tax rate of the optionee- up to 49% tax) plus payments to the National Insurance Institute and health tax on the profit at the allotment date, and pays capital gains tax at a rate of 25% on the capital profit upon the sale of the underlying shares, and the company may not recognize expenses pertaining to the capital gain for tax purposes but may recognize expenses pertaining to the profit at the allotment date.

In accordance with the provisions of the Tax Reform Legislation, if a company has selected the capital gains track, the company must continue granting options under the selected capital gains track until the end of the year following the year in which the first grant of options under that trustee track will be made. Notwithstanding the above, the company may at any time also grant options under the provisions of the income tax track without a trustee.

The above rules apply only to employees, including officer holders but excluding controlling shareholders.

Controlling shareholders will be taxable under section 3i to the tax ordinance, according to which, the optionee pays income tax rate (according to the marginal tax rate of the optionee- up to 49%) on the profit upon the sale of the underlying shares.

U.S.-Israel Tax Treaty

Pursuant to the Convention Between the Government of the United States of America and the Government of Israel with Respect to Taxes on Income (referred to as the U.S.-Israel Tax Treaty), the sale, exchange or disposition of ordinary shares by a person who qualifies as a resident of the United States within the meaning of the U.S.-Israel Tax Treaty and who is entitled to claim the benefits afforded to such resident by the U.S.-Israel Tax Treaty (called a Treaty U.S. Resident) will not be subject to Israeli capital gains tax unless (a) such Treaty U.S. Resident is an individual and was present in Israel for more than 183 days during the relevant taxable year or (b) such Treaty U.S. Resident holds, directly or indirectly, shares representing 10% or more of the voting power of a company during any part of the 12-month period preceding such sale, exchange or disposition. A sale, exchange or disposition of shares by a Treaty U.S. Resident who is an individual and was present in Israel for more than 183 days during the relevant taxable year or who holds, directly or indirectly, shares representing 10% or more of the voting power of a company at any time during such preceding 12-month period would be subject to such Israeli tax, to the extent applicable, unless the aforementioned exemption from capital gain tax for shares listed on the Tel-Aviv Stock Exchange applies; however, in case under the U.S.-Israel Tax Treaty and the Israeli tax law a Treaty U.S. Resident will be subject to capital gain tax in Israel, such Treaty U.S. Resident would be permitted to claim a credit for such taxes against the U.S. income tax imposed with respect to such sale, exchange or disposition, subject to the limitations in U.S. laws applicable to foreign tax credits.

Taxation of Non-Residents

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel. Such sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel and capital gain as mentioned above. On distributions of dividends other than bonus shares (stock dividends), income tax at the rate of 20% is withheld at source, unless a different rate is provided in a treaty between Israel and the shareholder’s country of residence. For example, the tax rate would be 12.5% if the non-resident is a company which holds 10% or more of our voting power (during the part of our tax year which precedes the date of payment of the dividend and during the entire prior tax year) which pursuant to the U.S.-Israel Tax Treaty. Under the U.S.-Israel Tax Treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a resident of the United States will be 25%. However, under the Investment Law, dividends generated by an Approved Enterprise in any case are taxed at the rate of 15%. In addition, if our ordinary shares are traded on the Tel Aviv Stock Exchange (or listed on a stock exchange recognized by the Israeli Ministry of Finance), gains on the sale of ordinary shares held by non-Israeli tax resident investors will generally be exempt from Israeli capital gains tax.

U.S. Federal Income Tax Considerations

Subject to the limitations described herein, this discussion summarizes the material U.S. federal income tax consequences of the purchase, ownership and disposition of our ordinary shares to a U.S. holder. A U.S. holder is a holder of our ordinary shares who is:

- an individual citizen or resident of the U.S. for U.S. federal income tax purposes;
- a corporation or partnership (or another entity taxable as a corporation or partnership for U.S. federal income tax purposes) created or organized under the laws of the United States or any political subdivision thereof;
- an estate, the income of which may be included in gross income for U.S. federal income tax purposes regardless of its source; or
- a trust (i) if, in general, a U.S. court is able to exercise primary supervision over its administration and one or more U.S. persons have the authority to control all of its substantial decisions or (ii) that has in effect a valid election under applicable U.S. Treasury regulations to be treated as a U.S. person.

Unless otherwise specifically indicated, this discussion does not consider the U.S. tax consequences to a person that is not a U.S. holder and considers only U.S. holders that will own the ordinary shares as capital assets.

This discussion is based on current provisions of the Internal Revenue Code of 1986, as amended (the “Code”), current and proposed Treasury regulations promulgated under the Code and administrative and judicial interpretations of the Code, all as currently in effect and all of which are subject to change, possibly with a retroactive effect. This discussion does not address all aspects of U.S. federal income taxation that may be relevant to any particular U.S. holder based on the U.S. holder’s particular circumstances. In particular, this discussion does not address the U.S. federal income tax consequences to U.S. holders who are broker-dealers or who own, directly, indirectly or constructively, 10% or more of our outstanding voting shares, U.S. holders holding the ordinary shares as part of a hedging, straddle or conversion transaction, U.S. holders whose functional currency is not the U.S. dollar, insurance companies, tax-exempt organizations, financial institutions and persons subject to the alternative minimum tax, who may be subject to special rules not discussed below. Additionally, the tax treatment of persons who are, or hold the ordinary shares through, a partnership or other pass-through entity is not considered, nor is the possible application of U.S. federal estate or gift taxes or any aspect of state, local or non-U.S. tax laws.

You are advised to consult your tax advisor with respect to the specific U.S. federal, state, local and foreign income tax consequences to you of purchasing, holding or disposing of our ordinary shares.

Taxation of Distributions on Ordinary Shares

Subject to the discussion below under "Tax Consequences If we are a Passive Foreign Investment Company," a distribution paid by us with respect to the ordinary shares to a U.S. holder will be treated as dividend income to the extent that the distribution does not exceed our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. The amount of a distribution with respect to the ordinary shares will equal the amount of cash and the fair market value of any property distributed and will also include the amount of any Israeli taxes withheld as described above under "Taxation of Non-Residents." Dividends that are received by U.S. holders that are individuals, estates or trusts will be taxed at the rate applicable to long-term capital gains (a maximum rate of 15%), provided that such dividends meet the requirements of “qualified dividend income.” Dividends that fail to meet such requirements, and dividends received by corporate U.S. holders are taxed at ordinary income rates. No dividend received by a U.S. holder will be a qualified dividend (1) if the U.S. holder held the ordinary share with respect to which the dividend was paid for less than 61 days during the 121-day period beginning on the date that is 60 days before the ex-dividend date with respect to such dividend, excluding for this purpose, under the rules of Code section 246(c), any period during which the U.S. holder has an option to sell, is under a contractual obligation to sell, has made and not closed a short sale of, is the grantor of a deep-in-the-money or otherwise nonqualified option to buy, or has otherwise diminished its risk of loss by holding other positions with respect to, such ordinary share (or substantially identical securities); or (2) to the extent that the U.S. holder is under an obligation (pursuant to a short sale or otherwise) to make related payments with respect to positions in property substantially similar or related to the ordinary share with respect to which the dividend is paid. If we were to be a “passive foreign investment company” (as such term is defined in the Code) for any year, dividends paid on our ordinary shares in such year or in the following year would not be qualified dividends. In addition, a non-corporate U.S. holder will be able to take a qualified dividend into account in determining its deductible investment interest (which is generally limited to its net investment income) only if it elects to do so; in such case the dividend will be taxed at ordinary income rates.

The amount of any distribution which exceeds the amount treated as a dividend will be treated first as a non-taxable return of capital, reducing the U.S. holder’s tax basis in its ordinary shares to the extent thereof, and then as capital gain from the deemed disposition of the ordinary shares. Corporate holders will not be allowed a deduction for dividends received in respect of the ordinary shares.

Dividends paid by us in NIS will be included in the income of U.S. holders at the dollar amount of the dividend (including any Israeli taxes withheld therefrom), based upon the spot rate of exchange in effect on the date the distribution is included in income. U.S. holders will have a tax basis in the NIS for U.S. federal income tax purposes equal to that dollar value. Any subsequent gain or loss in respect of the NIS arising from exchange rate fluctuations will generally be taxable as U.S. source ordinary income or loss.

Subject to the limitations set forth in the Code and the Treasury regulations thereunder, U.S. holders may elect to claim as a foreign tax credit against their U.S. federal income tax liability the Israeli income tax withheld from dividends received in respect of the ordinary shares. The limitations on claiming a foreign tax credit include, among others, computation rules under which foreign tax credits allowable with respect to specific classes of income cannot exceed the U.S. federal income taxes otherwise payable with respect to each such class of income. In this regard, dividends paid by us will be foreign source “passive income” for U.S. foreign tax credit purposes or, in the case of a financial services entity, “financial services income”(and, for tax years beginning after December 31, 2006, as "general category income"). U.S. holders that do not elect to claim a foreign tax credit may instead claim a deduction for the Israeli income tax withheld if they itemize deductions. The rules relating to foreign tax credits are complex, and you should consult your tax advisor to determine whether and to what extent you would be entitled to this credit. A U.S. holder will be denied a foreign tax credit for Israeli income tax withheld from a dividend received on the ordinary shares (i) if the U.S. holder has not held the ordinary shares for at least 16 days of the 31-day period beginning on the date which is 15 days before the ex-dividend date with respect to such dividend or (ii) to the extent the U.S. holder is under an obligation to make related payments with respect to positions in substantially similar or related property. Any days during which a U.S. holder has substantially diminished its risk of loss on the ordinary shares are not counted toward meeting the required 16 day holding period. Distributions of current or accumulated earnings and profits will be foreign source passive income for U.S. foreign tax credit purposes.

Taxation of the Disposition of Ordinary Shares

Subject to the discussion below under "Tax Consequences if We are a Passive Foreign Investment Company," upon the sale, exchange or other disposition of our ordinary shares, a U.S. holder will recognize capital gain or loss in an amount equal to the difference between the amount realized on the disposition and the U.S. holder's tax basis in the ordinary shares. The gain or loss recognized on the disposition of the ordinary shares will be long-term capital gain or loss if the U.S. holder held the ordinary shares for more than one year at the time of the disposition and is eligible for a maximum 15% rate of taxation for individuals. Capital gain from the sale, exchange or other disposition of ordinary shares held for one year or less is short-term capital gain and taxed as ordinary income at a maximum rate of 35%. Gain or loss recognized by a U.S. holder on a sale, exchange or other disposition of ordinary shares will be treated as U.S. source income or loss for U.S. foreign tax credit purposes.

A U.S. holder that uses the cash method of accounting calculates the dollar value of the proceeds received on the sale as of the date that the sale settles. However, a U.S. holder that uses the accrual method of accounting is required to calculate the value of the proceeds of the sale as of the trade date and may therefore realize foreign currency gain or loss. A U.S. holder may avoid realizing foreign currency gain or loss by electing to use the settlement date to determine the proceeds of sale for purposes of calculating the foreign currency gain or loss. In addition, a U.S. holder that receives foreign currency upon disposition of ordinary shares and converts the foreign currency into dollars after the settlement date or trade date (whichever date the U.S. holder is required to use to calculate the value of the proceeds of sale) will have foreign exchange gain or loss based on any appreciation or depreciation in the value of the foreign currency against the dollar, which will generally be U.S. source ordinary income or loss.

Tax Consequences if We are a Passive Foreign Investment Company

We will be a passive foreign investment company, or PFIC, if either (1) 75% or more of our gross income in a taxable year is passive income; or (2) the average percentage (by value) in a taxable year of our assets that produce, or are held for the protection of, passive income, is at least 50%. If we own (directly or indirectly) at least 25% by value of the stock of another corporation, we will be treated for purposes of the foregoing tests as owning our proportionate share of the other corporation's assets and as directly earning our proportionate share of the other corporation's income. If we are a PFIC, a U.S. holder must determine under which of three alternative taxing regimes it wishes to be taxed:

The "QEF" regime applies (to the exclusion of the "excess distribution" regime, described below) if the U.S. holder elects to treat us as a "qualified electing fund" ("QEF") for the first taxable year in which the U.S. holder owns our ordinary shares during which we are a PFIC, and if we comply with certain reporting requirements. If the QEF regime applies, then each year that we are a PFIC such U.S. holder will include in its gross income a proportionate share of our ordinary earnings (which is taxed as ordinary income) and net capital gain (which is taxed as long-term capital gain), subject to a separate election to defer payment of taxes, which deferral is subject to an interest charge. These amounts would be included in income by an electing U.S. holder for its taxable year in which our taxable year ends, whether or not such amounts are actually distributed to the U.S. holder. A U.S. holder's basis in our ordinary shares for which a QEF election has been made would be increased to reflect the amount of any taxed but undistributed income. Generally, a QEF election allows an electing U.S. holder to treat any gain realized on the disposition of his ordinary shares as capital gain.

Once made, the QEF election applies to all subsequent taxable years of the U.S. holder in which it holds our ordinary shares and for which we are a PFIC and can be revoked only with the consent of the Internal Revenue Service. A shareholder makes a QEF election by attaching a completed Internal Revenue Service Form 8621, including the PFIC annual information statement, to a timely filed United States federal income tax return. Even if a QEF election is not made, a U.S. person who is a shareholder in a PFIC must file a completed Internal Revenue Service Form 8621 every year.

If a QEF election is made by the U.S. holder after the first taxable year in which the U.S. holder holds our ordinary shares during which we are a PFIC, then both the QEF regime and the excess distribution regime, defined below, will apply simultaneously unless the U.S. holder makes a special election.

A second regime, the "mark-to-market" regime, may be elected so long as our ordinary shares are publicly traded. Pursuant to this regime, an electing U.S. holder's ordinary shares are marked-to-market each year in which we are a PFIC, and the U.S. holder recognizes as ordinary income or loss an amount equal to the difference as of the close of the taxable year between the fair market value of our ordinary shares and the U.S. holder's adjusted tax basis in our ordinary shares. Losses are allowed only to the extent of net mark-to-market gain previously included by the U.S. holder under the election for prior taxable years. An electing U.S. holder's adjusted basis in our ordinary shares is increased by income recognized under the mark-to-market election and decreased by the deductions allowed under the election.

Under the mark-to-market election, as long as we are a PFIC, gain on the sale of our ordinary shares is treated as ordinary income, and loss on the sale of our ordinary shares, to the extent the amount of loss does not exceed the net mark-to-market gain previously included, is treated as ordinary loss. The mark-to-market election applies to the tax year for which the election is made and all later tax years in which we are a PFIC, unless the ordinary shares cease to be marketable or the Internal Revenue Service consents to the revocation of the election.

If the mark-to-market election is made after the first taxable year in which a U.S. holder holds our ordinary shares and we are a PFIC, then special rules would apply.

A U.S. holder making neither the QEF election nor the mark-to-market election is subject to the "excess distribution" regime. Under this regime, "excess distributions" are subject to special tax rules. An excess distribution is either (1) a distribution with respect to shares that is greater than 125% of the average distributions received by the U.S. holder from us over the shorter of either the preceding three years or such U.S. holder's holding period for our shares, or

(2) 100% of the gain from the disposition of our shares (including gain deemed recognized if the ordinary shares are used as security for a loan).

Excess distributions must be allocated ratably to each day that a U.S. holder has held our ordinary shares. A U.S. holder must include amounts allocated to the current taxable year, as well as amounts allocated to taxable years prior to the first year in which we were a PFIC, in its gross income as ordinary income for that year. All amounts allocated to prior years of the U.S. holder during which we were a PFIC would be taxed at the highest tax rate applicable to ordinary income for each such prior year. The U.S. holder also would be liable for interest on the deferred tax liability for each such prior year calculated as if such liability had been due with respect to each such prior year. A U.S. holder that is an individual is not allowed a deduction for interest on the deferred tax liability. The portions of gains and distributions that are not characterized as "excess distributions" are subject to tax in the current year under the normal tax rules of the Code.

A U.S. person who inherits shares in a foreign corporation that was a PFIC in the hands of the decedent (who was not a nonresident alien and did not make either of the elections described above), is denied the otherwise available step-up in the tax basis of such shares to fair market value at the date of death. The U.S. person steps into the shoes of the decedent and will be subject to the rules described above.

If we are determined to be a PFIC for any given year, then dividends in that year and in the next year cannot qualify as "qualified dividends" which are eligible for the capital gains rate.

Following the sale of our shares in Elbit Systems in 2004, we announced that, as a result of the transaction, we may be characterized as a PFIC for U.S. federal income tax purposes for 2004. Following a review of our position and consulting with our advisors on this matter in 2004, and based on certain assumptions and facts known at that time (which we believe have not changed), we believe there is substantial authority for the position that we can rely on the "change of business" exception to PFIC status provided under Section 1298(b)(3) of the U.S. Internal Revenue Code of 1986, as amended. Substantial authority is generally sufficient to support a return reporting position. Pursuant to this exception, in order to avoid PFIC status in 2004, among other requirements, we cannot be a PFIC in 2005 or 2006 (which cannot be determined at this time with respect to 2006) or in any year prior to 2004 (which we believe was not the case).

We believe that in 2005 we were not a PFIC. However, since the determination of whether we are a PFIC is based upon such factual matters as the valuation of our assets and, in certain cases, the assets of companies held by us, there can be no assurance with respect to the position of the Internal Revenue Service or a court of law as to our status as a PFIC. Our analysis related to 2005 is based, among others, upon certain assumptions and methodologies with respect to the values that we have used; our percentage ownership (by value), and the appropriate value of our ownership interest, in companies we held; and the manner in which we have allocated the aggregate value of our assets among our active assets and passive assets.

We cannot assure you that the Internal Revenue Service will not challenge our assumptions and methodologies. If the IRS were to challenge successfully such assumptions or methodologies, we would potentially be classified as a PFIC for 2005 or prior years.

With respect to 2006, the ultimate determination of our PFIC status will depend on the composition of our gross income and assets for the entire year, and the values of those assets, which are difficult to predict at this time and the appropriate value of our ownership interest in our group companies.

In view of the above, it is unclear whether the “change of business” exception would ultimately be satisfied for 2004. We cannot assure shareholders that the Internal Revenue Service will not challenge our reliance on the "change of business" exception or our assumptions used in determining our percentage of passive assets and income. If there are such challenges, we could be classified as a PFIC for 2004, even if we are not a PFIC in 2005 and 2006. Furthermore, there can be no assurance that we will not become a PFIC in the future.

With respect to subsequent years, the tests for determining passive foreign investment company status are applied annually and it is difficult to make accurate predictions of future income and assets, which are relevant to this determination. As described above, the tests are impacted, by, among other factors, changes in value of our group companies which are difficult to predict at this time and the appropriate value of our ownership interest in our group companies. Accordingly, there can be no assurance that we will not become a PFIC for the current fiscal year ending December 31, 2006 or in a future year. We will notify U.S. holders in the event we conclude that we will be treated as a PFIC for any taxable year to enable U.S. holders to consider whether or not to elect to treat us as a QEF for U.S. federal income tax purposes or to “mark to market” the ordinary shares or to become subject to the “excess distribution” regime.

U.S. holders are urged to consult their tax advisors regarding the application of the PFIC rules, including eligibility for and the manner and advisability of making, the QEF election or the mark-to-market election.

Information Reporting and Backup Withholding

A U.S. holder generally is subject to information reporting and may be subject to backup withholding at a rate of up to 28% with respect to dividend payments and receipt of the proceeds from the disposition of the ordinary shares. Backup withholding will not apply with respect to payments made to exempt recipients, including corporations and tax-exempt organizations, or if a U.S. holder provides a correct taxpayer identification number (or certifies that he has applied for a taxpayer identification number), certifies that such holder is not subject to backup withholding or otherwise establishes an exemption. Backup withholding is not an additional tax and may be claimed as a credit against the U.S. federal income tax liability of a U.S. holder, or alternatively, the U.S. holder may be eligible for a refund of any excess amounts withheld under the backup withholding rules, in either case, provided that the required information is furnished to the Internal Revenue Service.

Non-U.S. holders of Ordinary Shares

Except as provided below, a non-U.S. holder of ordinary shares (except certain former U.S. citizens and long-term residents of the United States) will not be subject to U.S. federal income or withholding tax on the receipt of dividends on, and the proceeds from the disposition of, an ordinary share, unless that item is effectively connected with the conduct by the non-U.S. holder of a trade or business in the United States and, in the case of a resident of a country which has an income tax treaty with the United States, that item is attributable to a permanent establishment in the United States or, in the case of an individual, a fixed place of business in the United States. In addition, gain recognized by an individual non-U.S. holder will be subject to tax in the United States if the non-U.S. holder is present in the United States for 183 days or more in the taxable year of the sale and other conditions are met.

Non-U.S. holders will not be subject to information reporting or backup withholding with respect to the payment of dividends on ordinary shares unless the payment is made through a paying agent, or an office of a paying agent, in the United States. Non-U.S. holders will be subject to information reporting and backup withholding at a rate of up to 28% with respect to the payment within the United States of dividends on the ordinary shares unless the holder provides its taxpayer identification number, certifies to its foreign status, or otherwise establishes an exemption.

Non-U.S. holders will be subject to information reporting and backup withholding at a rate of up to 28% on the receipt of the proceeds from the disposition of the ordinary shares to, or through, the United States office of a broker, whether domestic or foreign, unless the holder provides a taxpayer identification number, certifies to its foreign status or otherwise establishes an exemption. Non-U.S. holders will not be subject to information reporting or backup withholding with respect to the receipt of proceeds from the disposition of the ordinary shares by a foreign office of a broker; provided, however, that if the broker is a U.S. person or a "U.S. related person," information reporting (but not backup withholding) will apply unless the broker has documentary evidence in its records of the non-U.S. holder's foreign status or the non-U.S. holder certifies to its foreign status under penalties of perjury or otherwise establishes an exemption. For this purpose, a "U.S. related person" is a broker or other intermediary that maintains one or more enumerated U.S. relationships. Backup withholding is not an additional tax and may be claimed as a credit against the U.S. federal income tax liability of a non-U.S. holder, or alternatively, the non-U.S. holder may be eligible for a refund of any excess amounts withheld under the backup withholding rules, in either case, provided that the required information is furnished to the Internal Revenue Service.

F. Dividends and Paying Agents

Not Applicable.

G. Statement by Experts

Not Applicable.

H. Documents on Display

We are required to file reports and other information with the Securities and Exchange Commission, or SEC, under the Securities Exchange Act of 1934 and the regulations thereunder applicable to foreign private issuers. Reports and other information filed by us with the SEC may be inspected and copied at the SEC's public reference facilities described below. Although as a foreign private issuer we are not required to file periodic information as frequently or as promptly as United States companies, we generally do publicly announce our quarterly and year-end results promptly and file periodic information with the SEC under cover of Form 6-K. As a foreign private issuer, we are also exempt from the rules under the Exchange Act prescribing the furnishing and content of proxy statements and our officers, directors and principal shareholders are exempt from the reporting and other provisions in Section 16 of the Exchange Act.

You may review a copy of our filings with the SEC, including any exhibits and schedules, at the SEC's public reference facilities in Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549 and at the regional offices of the SEC. You may also obtain copies of such materials from the Public Reference Section of the SEC, Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. You may call the SEC at 1-800-SEC-0330 for further information on the public reference rooms. You may read and copy any reports, statements or other information that we file with the Securities and Exchange Commission at the facilities listed above. In addition, certain of our filings are available to the public at the SEC's website at http://www.sec.gov. We also generally make available on our own web site (www.elron.com) all our quarterly and year-end financial statements as well as other information. Our website is not part of this Annual Report.

Any statement in this Annual Report about any of our contracts or other documents is not necessarily complete. If the contract or document is filed as an exhibit to this Annual Report, the contract or document is deemed to modify the description contained in this Annual Report. We urge you to review the exhibits themselves for a complete description of the contract or document.

I. Subsidiary Information

Not Applicable.

Item 11. <u>Quantitative and Qualitative Disclosures About Market Risk</u>

For disclosures regarding our market risk exposures, see Item 5, Operating and Financial Review and Prospects above.

Item 12. <u>Descriptions of Securities Other than Equity Securities</u>

Not Applicable.

PART II

Item 13. <u>Defaults, Dividend Arrearages and Delinquencies</u>

Not Applicable.

Item 14. <u>Material Modifications to the Rights of Security Holders and Use of Proceeds</u>

Not Applicable**.**

Item 15. <u>Controls and Procedures</u>

Our Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e)of the Securities Exchange Act of 1934, as amended), have concluded that, as of December 31, 2005, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure and is recorded, processed, and reported within the periods specified by the SEC's rules and forms. There were no changes in our internal controls over financial reporting identified with the evaluation thereof that occurred during the period covered by this annual report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 16. [Reserved]

Item 16A. Audit Committee Financial Expert

The board of directors has determined that Mr. Yaacov Goldman is the audit committee financial expert serving on its audit committee. Mr. Goldman is "independent" as defined in Rule 4200 of the NASDAQ Marketplace Rules.

Item 16B. Code of Ethics

We have adopted a code of ethics applicable to our employees, officers and directors A copy of the code of ethics was filed as an Exhibit 11.1 to our Annual Report on Form 20F filed with the Securities Exchange Commission on June 29, 2004, and is also available on our website, *www.elron.com*.

Item 16C. Principal Accountant Fees and Services

The following table sets forth the total remuneration that was paid by us and our subsidiaries to our principal accountants Kost Forer Gabbay & Kasierer (a member of Ernst & Young Global) in each of our previous two fiscal years:

	2004	2005
	(in thousands)	
Audit fees (1)	250	269
Tax fees (2)	109	144
All other fees (3)	100	20
Total	459	433

No audit – related fees were paid in 2004 or 2005.

(1) Audit Fees consist of fees billed for the annual audit services engagement and other audit services, which are those services that only the external auditor can reasonably provide, and include statutory audits; consents; and assistance with and review of documents filed with the SEC.

(2) Tax Fees include fees billed for tax compliance services, including the preparation of original and amended tax returns and claims for tax refund; tax consultations, such as assistance and representation in connection with tax audits and appeals, and requests for rulings or technical advice from taxing authority; and tax planning services.

(3) Services relating to Elron's status under the PFIC rules.

Our audit committee's policy is to pre-approve each audit and non-audit service to be performed by our independent auditors for us and our subsidiaries.

Item 16D. Exemptions from the Listing Standards for Audit Committees

Not Applicable

Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers

During 2005 and 2006 to date, DIC purchased an additional aggregate of 604,955 of our ordinary shares on the TASE as set forth in the table below, thereby increasing its shareholding to approximately 47.6%. Except for these purchases, neither we nor any affiliated purchaser purchased any of our equity securities during the period covered by this Annual Report.

Period	(a) Total number of shares (or units purchased)	(b) Average price paid per share (or units)	(c) Total number of shares (or units) purchased as part of publicly announced plans or programs	(d) Maximum number (or approximate dollar value) of shares (or units) that may yet be purchased under the plans or programs
June 19 to June 30, 2005	565,111	NIS58.40	-	-
March 29, 2006	39,844	NIS49.76	-	-

PART III

Item 17. <u>Financial Statements</u>

Not Applicable.

Item 18. <u>Financial Statements</u>

Our financial statements follow the certifications following the signature page of this Annual Report.

Item 19. Exhibits

1.1 Articles of Association (English translation) approved by the registrant's shareholders on March 19, 2000, incorporated by reference to Exhibit 1.1 to the registrant's Form 20-F for the year ended December 31, 2000, filed with the Commission on June 8, 2001.

1.2 Memorandum of Association of Elron Electronic Industries Ltd., incorporated by reference to Exhibit 1.2 to the registrant's Form 20-F for the year ended December 31, 2000, filed with the Commission on June 8, 2001.

4.1 Agreement dated as of April 1993 among Discount Investment Corporation Ltd., PEC Israel Economic Corporation, Rafael Armament Development Authority Ltd., Galram Technology Industries Limited, incorporated by reference to Exhibit 10.4 to Amendment No. 5 to the registrant's Registration Statement on Form F-4, filed with the Commission on March 14, 2002.

4.2 License from the Israeli Ministry of Communications issued to Partner Communications Company Ltd. on April 8, 1998, incorporated by reference to Exhibit 4.5 to the Annual Report on Form 20-F/A of Elbit Ltd., filed with the Commission on March 15, 2002 as may be amended from time to time and incorporated in subsequent filings by Partner with the Commission.

4.3 Addendum to Agreement dated June 16, 2003 among DEP Technology Holdings Ltd., Rafael Armament Development Authority Ltd., Galram Technologies Industries Ltd. and RDC Rafael Development Corporation Ltd. incorporated by reference to Exhibit 4.17 of the registrant's Form 20-F, filed with the Commission on June 30, 2003.

4.4 Restatement of Relationship Agreement dated April 20, 2005 by and among Hutchison Telecommunications International (Netherlands) B.V., Advent Investments Pte Ltd., Elbit Ltd., Eurocom Communications Ltd. Polar Comunications Ltd., Matav Investments Ltd., Matav Cable Systems Media Ltd. and Tapuz Cellular Systems Ltd. incorporated by reference to Exhibit 1 to amendment no. 3 to registrant's filing on Form 13 D filed with the Commission on May 16, 2005.

4.5 Shareholders Agreement dated April 20, 2005 by and among Elbit Ltd., Eurocom Communications Ltd. Polar Comunications Ltd., Matav Investments Ltd. and Matav Cable Systems Media Ltd. incorporated by reference to Exhibit 2 to amendment no.3 to registrant's filing on Form 13 D filed with the Commission on May 16, 2005.

8.1 List of subsidiaries

11.1 Code of Ethics incorporated by reference to Exhibit 11.1 to the registrant's Annual Report on Form 20-F filed with the Commission on June 30, 2004.

12.1 Certification of Chief Executive Officer of the Registrant pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

12.2 Certification of Chief Financial Officer of the Registrant pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

13.1 Certification of Chief Executive Officer of the Registrant pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

13.2 Certification of Chief Financial Officer of the Registrant pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

15.1 Consent of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, for Elron Electronic Industries Ltd.

15.2 Consent of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, for

Elbit Systems Ltd.

15.3 Consents of Brightman Almagor & Co., a member of Deloitte Touche Tohmatsu, for A.M.T. Advanced Metal Technologies Ltd.

15.4 Consent of Somekh Chaikin, a member firm of KPMG International, for Given Imaging Ltd.

15.5 Consent of PricewaterhouseCoopers LLP for ChipX Incorporated.

15.6 Consent of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, for ChipX (Israel) Ltd.

15.7 Consent of Kesselman & Kesselman CPA(Isr.) a member of PricewaterhouseCoopers International Limited for Notal Vision, Inc.

15.8 Consentsof PriceWaterhouseCoopers LLP for Oncura, Inc.

15.9 Consent of Kesselman & Kesselman CPA(Isr.) a member of PricewaterhouseCoopers International Limited for Pulsicom Israel Technologies Ltd.

15.10 Consent of Kesselman & Kesselman CPA(Isr.) a member of PricewaterhouseCoopers International Limited for Ingenio Technologies Ltd.

* This document is being furnished in accordance with SEC Release No. 33-8212 and 34-47551.

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this Annual Report on its behalf.

Dated: June 27, 2006

ELRON ELECTRONIC INDUSTRIES LTD.

By: /s/ Doron Birger
Name: Doron Birger
Title: President & Chief Executive Officer

By: /s/ Rinat Remler
Name: Rinat Remler
Title: Vice President & Chief Financial Officer