ELRON ELECTRONIC INDUSTRIES LTD.

AND ITS SUBSIDIARIES

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

As of March 31, 2004
(Unaudited)

ELRON ELECTRONIC INDUSTRIES LTD.
AND ITS SUBSIDIARIES

CONDENSED INTERIM CONSOLIDATED

FINANCIAL STATEMENTS

AS OF MARCH 31, 2004

UNAUDITED

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CONSOLIDATED BALANCE SHEETS

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

	March 31, 2004	December 31, 2003
	Unaudited	Audited
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 66,929	$ 83,906
Short-term investments	14,960	37,158
Trade receivables, net*	4,827	5,016
Other receivables and prepaid expenses*	4,448	2,516
Inventories and contracts-in-progress	1,230	1,471
Total current assets	92,394	130,067
LONG-TERM ASSETS		
Investments in affiliated companies	159,839	156,819
Investments in other companies and long-term receivables*	131,544	128,799
Debentures and bank deposits	709	700
Deferred taxes	-	1,871
Severance pay deposits	2,481	2,144
Total long-term assets	294,573	290,333
PROPERTY AND EQUIPMENT, NET	8,488	8,317
INTANGIBLE ASSETS		
Goodwill	12,019	12,019
Other intangible assets	9,774	9,968
	21,793	21,987
Total assets	$ 417,248	$ 450,704

* Includes receivables from related parties in the aggregate amount of $5,996 and $3,684 as of March 31, 2004 and December 31, 2003, respectively.

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

CONSOLIDATED BALANCE SHEETS

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

	March 31, 2004	December 31, 2003
	Unaudited	Audited
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Short-term loans from banks and others	$ 18,299	$ 11,986
Current maturities of long-term loans from banks and others	2,291	44,021
Trade payables	2,830	3,408
Other payables and accrued expenses	16,133	13,620
Total current liabilities	39,553	73,035
LONG-TERM LIABILITIES		
Long-term loans from banks and others	12,191	17,221
Accrued severance pay and retirement obligations	3,408	2,850
Deferred taxes	40,541	40,684
Other	237	103
Total long-term liabilities	56,377	60,858
MINORITY INTEREST	18,948	20,681
SHAREHOLDERS' EQUITY:		
Ordinary shares of NIS 0.003 par value; Authorized - 35,000,000 shares as of March 31, 2004 and December 31, 2003; Issued and outstanding -29,211,345 and 29,206,845 shares as of March 31, 2004 and December 31, 2003, respectively;	9,572	9,572
Additional paid-in capital	267,327	267,113
Accumulated other comprehensive income	54,096	51,792
Accumulated deficit	(28,625)	(32,347)
Total shareholders' equity	302,370	296,130
Total liabilities and shareholders' equity	$ 417,248	$ 450,704

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

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Three months ended March 31, 2004	Three months ended March 31, 2003	Year ended December 31, 2003
	Unaudited	Unaudited	Audited
INCOME			
Net revenues*	$ 3,425	$ 3,787	$ 16,547
Equity in losses of affiliated companies	(389)	(2,954)	(8,698)
Gain from disposal of businesses and affiliated companies and changes in holdings in affiliated companies, net	6,080	371	25,754
Other income (expenses), net	2,437	(1,223)	14,665
	11,553	(19)	48,268
COSTS AND EXPENSES			
Cost of revenues	2,055	2,308	10,198
Research and development costs, net	1,014	1,271	3,787
Marketing and selling expenses, net	566	3,294	7,763
General and administrative expenses	4,655	2,843	13,923
Amortization of intangible assets	194	295	1,073
Financial expenses, net	45	225	753
	8,529	10,236	37,497
Income (loss) before tax benefit (taxes on income)	3,024	(10,255)	10,771
Tax benefit (taxes on income)	(642)	367	(6,834)
Income (loss) from continuing operations after tax benefit (taxes on income)	2,382	(9,888)	3,937
Minority interest in losses (income) of subsidiaries	1,640	1,972	(10,907)
Income (loss) from continuing operations	4,022	(7,916)	(6,970)
Loss from discontinued operations	(300)	(1354)	(235)
Net income (loss)	$ 3,722	$ (9,270)	$ (7,205)
Income (loss) per share:			
Basic:			
Income (loss) from continuing operations	$ 0.14	$ (0.27)	$ (0.24)
Loss from discontinued operations	(0.01)	(0.05)	(0.01)
Net income (loss)	$ 0.13	$ (0.32)	$ (0.25)
Diluted:			
Income (loss) from continuing operations	$ 0.13	$ (0.27)	$ (0.24)
Loss from discontinued operations	(0.01)	(0.05)	(0.01)
Net income (loss)	$ 0.12	$ (0.32)	$ (0.25)
Weighted average number of ordinary shares used in computing basic net income (loss) per share (thousands)	29,209	29,181	29,194
Weighted average number of ordinary shares used in computing diluted net income (loss) per share (thousands)	29,307	29,181	29,194

* Includes revenues from related parties, in the amount of $2,238 and $165 for the three months ended March 31, 2004 and 2003, respectively, and $4,156 for the year ended December 31, 2003.

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

STATEMENTS OF SHAREHOLDERS' EQUITY

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

	Number of shares	Share capital	Additional paid-in capital	Accumulated other comprehensive income	Accumulated deficit	Total comprehensive income (loss)	Total Shareholders' equity
Audited							
Balance as of January 1, 2003	29,180,970	$ 9,572	$ 267,482	$ 7,529	$ (25,142)		$ 259,441
Exercise of options	25,875	-	177				177
Changes in additional paid-in capital in affiliated companies	-	-	(932)	-	-		(932)
Amortization of deferred stock compensation	-	-	386	-	-		386
Other comprehensive income, net of tax:							
Unrealized gains on available for sale securities	-	-	-	55,960	-	$ 55,960	55,960
Reclassification adjustment for gain realized included in net loss	-	-	-	(11,113)	-	(11,113)	(11,113)
Foreign currency translation adjustments	-	-	-	(304)	-	(304)	(304)
Unrealized loss on derivative instrument in affiliated company	-	-	-	(108)	-	(108)	(108)
Minimum pension liability in affiliated company	-	-	-	(172)	-	(172)	(172)
Net loss	-	-	-	-	(7,205)	(7,205)	(7,205)
Balance as of December 31, 2003	29,206,845	$ 9,572	$ 267,113	$ 51,792	$ (32,347)		296,130
Total comprehensive income						$ 37,058	
Unaudited							
Exercise of options	4,500	-	31	-	-		31
Amortization of deferred stock compensation	-	-	183	-	-		183
Other comprehensive income, net of tax:							
Unrealized gains on available for sale securities	-	-	-	3,958	-	$ 3,958	3,958
Reclassification adjustment for gain realized included in net income	-	-	-	(2,045)	-	(2,045)	(2,045)
Foreign currency translation adjustments	-	-	-	409	-	409	409
Unrealized loss on derivative instrument in affiliated company	-	-	-	(18)	-	(18)	(18)
Net income	-	-	-	-	3,722	3,722	3,722
Balance as of March 31, 2004	29,211,345	$ 9,572	$ 267,327	$ 54,096	$ (28,625)		$ 302,370
Total comprehensive income						$ 6,026	
Unaudited							
Balance as of January 1, 2003	29,180,970	$ 9,572	$ 267,482	$ 7,529	$ (25,142)		$ 259,441
Changes in additional paid-in capital in affiliated companies	-	-	277	-	-		277
Amortization of deferred stock compensation	-	-	58	-	-		58
Other comprehensive loss, net of tax:							
Unrealized losses on available for sale securities	-	-	-	(2,805)	-	$ (2,805)	(2,805)
Reclassification adjustment for gain realized included in net loss	-	-	-	(18)	-	(18)	(18)
Foreign currency translation adjustments	-	-	-	(53)	-	(53)	(53)
Net loss	-	-	-	-	(9,270)	(9,270)	(9,270)
Balance as of March 31, 2003	29,180,970	$ 9,572	$ 267,817	$ 4,653	$ 34,412		$ 247,630
Total comprehensive loss						$ (12,146)	

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

ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Three months ended March 31, 2004	Three months ended March 31, 2003	Year ended December 31, 2003
	Unaudited	Unaudited	Audited
Cash flows from operating activities			
Net income (loss)	$ 3,722	$ (9,270)	$ (7,205)
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Equity in losses of affiliated companies	389	2,954	8,698
Dividend from affiliated companies	-	-	2,971
Minority interest in income (losses) of subsidiaries	(1,640)	(1,972)	10,907
Gain from disposal of businesses and affiliated companies and changes in holdings in affiliated companies, net	(6,080)	(371)	(25,754)
Loss (gain) from sale of investments in available for sale securities	(3,096)	28	(17,924)
Gain from disposal of businesses including in discontinued operations	-	-	(4,137)
Depreciation and amortization	487	1,084	3,573
Decline in value of other investments	150	1,238	3,716
Equity in (gains) losses of partnerships	(32)	-	547
Amortization of deferred stock compensation and call options	2,353	187	2,564
Deferred taxes, net	553	(412)	6,229
Changes in operating assets and liabilities			
Decrease in trade receivables	549	2,749	3,491
Decrease (increase) in other accounts receivable and prepaid expenses	(1,840)	(652)	1,888
Increase in trading securities, net	(4)	(6)	(4)
Decrease (increase) in inventories and contracts–in-progress	241	(717)	589
Decrease in trade payables	(909)	(1,574)	(2,009)
Decrease in other accounts payable and accrued expenses	(699)	(1,133)	(5,275)
Other	578	367	652
Net cash used in operating activities	(5,278)	(7,500)	(16,483)
Cash flows from investing activities			
Investment in affiliated companies	(3,224)	(3,174)	(13,384)
Proceeds from sale of KIT shares	5,706	-	-
Proceeds from sale of Given Imaging shares	-	813	13,878
Cash and cash equivalents resulting from newly consolidated subsidiaries (a)	133	-	-
Cash and cash equivalents divested upon sale of businesses and subsidiaries (b)	-	-	(6,148)
Investment in other companies	(500)	(600)	(299)
Collection of long term receivables	-	-	772
Proceeds from sale of available for sale securities	4,241	2,614	46,143
Investments in held to maturity debentures and deposits	(4,472)	(2,346)	(10,877)
Proceeds from maturities of held to maturity debentures and from deposits	26,664	1,209	8,975
Purchase of property and equipment	(239)	(241)	(547)
Proceeds from sale of property and equipment	26	106	329
Net cash provided by (used in) investing activities	28,335	(1,619)	38,842
Cash flows from financing activities			
Proceeds from options exercised	31	-	177
Receipt of long-term loans from banks	355	1,201	4,032
Repayment of long-term loans	(40,565)	(82)	(6,200)
Decrease in short-term bank loan, net	(65)	(1,554)	(4,076)
Repayment of loans from minority shareholders of a subsidiary	-	-	(4,246)
Receipt of short-term loans from minority shareholders of a subsidiary	316	-	904
Proceeds from convertible loans from minority shareholders of a subsidiary	140	1,125	3,055
Issuance expenses in a subsidiary	(179)	-	-
Dividend to minority shareholders of a subsidiary	(67)	-	-
Net cash provided by (used in) financing activities	(40,034)	690	(6,354)
Increase (decrease) in cash and cash equivalents	(16,977)	(8,429)	16,005
Cash and cash equivalents at the beginning of the period	83,906	67,901	67,901
Cash and cash equivalents at the end of the period	$ 66,929	$ 59,472	$ 83,906

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Three months ended March 31, 2004	Three months ended March 31, 2003	Year ended December 31, 2003
	Unaudited	Unaudited	Audited
Supplemental cash flow information:			
Cash paid for:			
Income taxes	$ 48	$ 18	$ 96
Interest	$ 537	$ 419	$ 1,466

	Three months ended March 31, 2004 (Unaudited)
(a) Cash and cash equivalents resulting from newly consolidated subsidiaries	
Assets acquired and liabilities assumed at the purchase date:	
Working capital, net (except cash and cash equivalents)	(1,254)
Deposits	31
Property and equipment	423
Other assets	878
Accrued severance pay, net	(186)
Long-term liabilities	(5)
Investment at equity prior to acquisition	(49)
Minority interests	29
Cash and cash equivalents acquired	133

	Year ended December 31, 2003 (Audited)
(b) Cash and cash equivalents divested upon sale of business and subsidiaries	
Assets and liabilities at date of sale:	
Working capital, net (except cash and cash equivalents)	$ (708)
Property and equipment	1,274
Other assets	6,532
Deferred tax liability	(907)
Gain resulting from sale of business	22,833
Securities received:	
Marketable securities	(5,400)
Other investments	(1,000)
Investment in affiliated Company	(30,272)
Liability incurred	1,500
Cash and cash equivalents paid	$ (6,148)

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

NOTE 1:- GENERAL

The accompanying unaudited condensed interim consolidated financial statements have been prepared as of March 31, 2004, and for the three months then ended in accordance with accounting principles generally accepted in the United States (U.S. GAAP) relating to the preparation of financial statements for interim periods. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States but which are not required for interim reporting purposes, have been condensed or omitted. See Note 8 for the reconciliation from U.S. GAAP to accounting principles generally accepted in Israel ("Israeli GAAP").

These financial statements should be read in conjunction with the Company's annual financial statements and accompanying notes as of December 31, 2003.

Comparative data in the condensed interim consolidated financial statements for the three months ended March 31, 2003 have been restated - see Note 3(d).

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

Results for the three months ended March 31, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004.

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

a. The significant accounting policies followed in the preparation of these financial statements are identical to those applied in preparation of the latest annual financial statements , except as follows:

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation 46, Consolidation of Variable Interest Entities, an interpretation of ARB No. 51 (FIN 46). In December 2003, the FASB modified FIN 46 to make certain technical corrections and address certain implementation issues that had arisen. FIN 46 provides a new framework for identifying variable interest entities (VIEs) and determining when a company should include the assets, liabilities, noncontrolling interests and results of activities of a VIE in its consolidated financial statements.

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 are unable to make significant decisions about its activities, or (3) has a group of equity owners that do not have the obligation to absorb losses or the right to receive returns generated by its operations.

FIN 46 requires a VIE to be consolidated by the party with an ownership, contractual or other financial 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. Upon consolidation, the primary beneficiary generally must initially record all of the

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

VIE's assets, liabilities and noncontrolling interests at fair value and subsequently account for the VIE as if it were consolidated based on majority voting interest. FIN 46 also requires disclosures about VIEs that the variable interest holder is not required to consolidate but in which it has a significant variable interest.

FIN 46 was effective immediately for VIEs created after January 31, 2003. For VIEs created before January 31, 2003, the provisions of FIN 46, as revised, were adopted as of March 31, 2004. The adoption of FIN 46 did not have significant effect on the Company's financial statements. For additional information on the Company's VIEs, see Note 4.

b. The financial statements have been prepared in U.S. dollars, since the functional currency of the Company and its principal subsidiaries is the U.S. dollar.

NOTE 3:- MAJOR TRANSACTIONS

a. **K.I.T. eLEARNING B.V ("KIT")**

On March 31, 2004, Elron together with the other shareholders of KIT, Discount Investment Corporation Ltd. ("DIC"), a controlling shareholder of Elron (through approximately a 38.5% interest), and Kidum IT Ltd. (together "the sellers") completed the sale of KIT, then held 45% by Elron, to Online Higher Education B.V, a subsidiary of Sylvan Learning Systems, Inc. (Nasdaq: SLVN), a global leader in higher education, in consideration for $9,400. In addition, the sellers are entitled to a future payment of up to $10,000 based on future earnings of KIT in the years 2006 and 2007. Elron received approximately $5,700 and recorded a gain of approximately $5,300.

b. **ChipX ("ChipX") (Formerly: CHIP EXPRESS CORPORATION)**

On March 4, 2004, ChipX completed a private placement in which it issued 7,594,936,710 redeemable preferred shares in consideration for $12,000. Elron purchased 1,632,564,563 redeemable preferred shares in consideration for approximately $2,600. As a result, Elron's interest in ChipX decreased from approximately 33% to approximately 27%. This decrease had no effect on Elron's results of operations.

c. **ZIX CORPORATION ("ZIX")**

During the first quarter of 2004, Elron sold 362,416 shares of Zix (Nasdaq: ZIXI) in consideration for approximately $4,200, and recognized a gain of approximately $3,100 ($2,000 net of tax).
Subsequent to balance sheet date, Elron sold an additional 90,604 shares of ZIX in consideration for approximately $1,400, resulting in a gain of approximately $1,100 ($700 net of tax), which will be recorded in the second quarter of 2004.

d. **Restatement**

As a result of the increase in holdings in Oren Semiconductor inc. ("Oren") in July 2003 from 17% to 41% (see Note 7d(7) to the Company's annual financial statements for 2003), Elron is able to exercise significant influence in Oren. In accordance with APB 18, "The Equity Method of Accounting for Investments in Common Stock", Elron's interest

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 3:- MAJOR TRANSACTIONS (Cont.)

d. **Restatement (Cont.)**

in Oren, which was previously accounted for by Elron at cost, is accounted for retroactively under the equity method of accounting ("step-by-step acquisition"). Implementing step-by-step acquisition resulted in a restatement of Elron’s financial statements for all prior periods in which Elron’s investments in Oren were recorded at cost.

Following are the effects of the restatement for the three months ended March 31, 2003:

1. Consolidated statements of operations

	Three months ended March 31, 2003		
	As reported	Effect of restatement	As restated
Equity in losses of affiliated companies	(2,295)	(659)	(2,954)
Net loss	(8,611)	(659)	(9,270)
Basic and diluted net loss per share	(0.30)	(0.02)	(0.32)

2. Total comprehensive loss

	As reported	Effect of restatement	As restated
Total comprehensive loss	(11,487)	(659)	(12,146)

NOTE 4:- VARIABLE INTEREST ENTITIES

Towards the end of 2003, RDC, (a subsidiary) and Elbit Systems Ltd. ("ESL"), an affiliated company, formed a new company, Starling Advanced Communications Ltd. ("Starling") in order to develop connectivity solutions for broadband access for commercial aircraft. RDC and ESL both contributed technologies in exchange for a 50% ownership interest each in Starling. In addition, RDC and ESL granted Starling convertible loans in the amount of $300 each. Upon the adoption of FIN 46 (see Note 2a) the Company has consolidated Starling as Starling was determined to be a variable interest entity and the Company is its primary beneficiary.

In August 2002, Elron completed an investment of approximately $5,000 in A.M.T Advanced Metal Technologies Ltd. ("AMT") as part of an aggregate investment of $8,700. AMT, an Israeli private company, develops, markets and licenses technologies, through its group companies, for amorphous and nano-crystalline advanced materials, for a wide range of commercial applications. Currently, AMT is focusing on two of its group companies, namely A.H.T. Advanced Heating Technologies Ltd., which uses amorphous metals for heating products, and Confirm Technology Ltd. ("Confirm") (formerly: ACS Advanced Coding Systems Ltd.), which develops, markets and sells products using amorphous metals for brand protection against counterfeiting and diversion and anti-shoplifting electronic article surveillance. The investment was in the form of notes which are convertible into preferred shares of AMT or into shares held by AMT in certain of its subsidiaries. Elron is entitled to the rights attached to the convertible notes on an "as converted" basis as a shareholder of AMT and in addition, has special voting rights in certain specified circumstances. As a result, Elron holds approximately 28% of AMT on a diluted basis and on an "as converted" basis (excluding loans).

From December 2002 to March 31, 2004, Elron and the other shareholders of AMT's group companies granted convertible loans to AMT group companies. Elron's share in the convertible loans granted was approximately $2,200.

AMT is considered to be a variable interest entity, however the Company is not the primary beneficiary of AMT, and accordingly has not consolidated AMT.

As of March 31, 2004, the Company’s maximum exposure to loss as a result of its involvement in AMT does not exceed its investment in AMT in the amount of approximately $3,800.

NOTE 5:- STOCK BASED EMPLOYEE COMPENSATION

The Company elected to follow Accounting Principles Board Opinion No. 25, ("APB 25") "Accounting for Stock Issued to Employees" and FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation" in accounting for its employee stock option plans granted prior to 2003. According to APB 25, compensation expense is measured under the intrinsic value method, whereby compensation expense is equal to the excess, if any, of the quoted market price of the stock at the grant date of the award or other measurement date over the exercise price.

Effective January 1, 2003, the Company adopted the fair value recognition provisions of FASB Statement No.123 "Accounting for Stock-Based Compensation ("SFAS No.123"). Under the prospective method of adoption selected by the Company in accordance with the provisions of FASB Statement No.148, "Accounting for Stock-Based Compensation - Transition and Disclosure" ("SFAS No.148"), the recognition provisions will be applied to all employee awards granted, modified, or settled after January 1, 2003.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 5:- STOCK BASED EMPLOYEE COMPENSATION (Cont.)

The following pro forma information presents the effect on the Company's and subsidiaries' stock-based employee compensation expense, consolidated net income (loss) and income (loss) per share as if the fair value based method provided under SFAS No. 123 had been applied to all outstanding awards in each reported period.

	Three months ended March 31,		Year ended December 31,
	2004	2003	2003
	Unaudited		Audited
Net income (loss), as reported	$ 3,722	$ (9,270)	$ (7,205)
Add: Stock-based employee compensation expense included in reported net income (loss)	194	227	973
Deduct: Total stock-based compensation expense determined under fair value based method for all awards	(230)	(353)	(1,377)
Pro forma net income (loss)	$ 3,686	$ (9,396)	$ (7,609)
Income (loss) per share:			
Basic - as reported	$ 0.13	$ (0.32)	$ (0.25)
Basic - pro forma	$ 0.13	$ (0.32)	$ (0.26)
Diluted - as reported	$ 0.12	$ (0.32)	$ (0.25)
Diluted - Pro forma	$ 0.12	$ (0.32)	$ (0.25)

The fair value for each award granted was estimated at the date of grant using the Black-Scholes option-pricing model assuming no dividends and the following assumptions:

	Three months ended March 31,		Year ended December 31,
	2004(*)	2003	2003
	Unaudited		Audited
Average risk-free interest rate	-	1.5	1%
Average expected life (in years)	-	2	2.7
Volatility	-	48%	55%

(*) No options were granted during the period.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands, except share and per share data

NOTE 6:- CONTINGENT LIABILITIES

There were no material changes in the status of the Company's contingent liabilities as described in the annual report for 2003, the details of which are as follows:

a. During September 1999, the Company received copies of two claims and a request to approve such claims as a class action on behalf of public shareholders of Elscint (formerly an affiliated company) against the Company and others. The allegation raised by the claimants related to the decision regarding the sale of Elscint's substantial assets. The request has been stayed pursuant to an arrangement reached by the parties pending the outcome of the appeal in the claim described in paragraph b below. The arrangement provides that if the appeal described in paragraph b below is accepted, then the proceedings to recognize the claims as a class action will proceed. Otherwise, the application to recognize the claims as a class action will be dismissed.

b. On November 2, 1999, the Company received a copy of a claim, and a request to approve such a claim, as a class action on behalf of some institutional investors and others and those who held shares in Elscint on September 6, 1999. The allegations raised against the Company and certain of its officers including former officers, among others, relate to the period prior to the sale of the Company's holdings in Elbit Medical Imaging ("EMI") (the parent company of Elscint and formerly an affiliated company). The claimants seek a court order pursuant to which EMI would be compelled to execute the alleged buy-out of Elscint's share at $14 per share or other remedies. On August 17, 2000, the Haifa District court dismissed the application to recognize the claim as a class action. Some of the claimants applied for and have been granted permission to appeal to the Supreme Court in Israel, which appeal is currently pending. In addition, in February 2001, the claimants submitted a new claim similar to the previous one but not as a class action.

   The Company denies all the allegations set forth in the above claims, and based on legal advice received, management is of the opinion that the Company has good defense arguments which, if accepted, will cause dismissal of the above allegations.

c. In July 2003, ESW terminated the lease of its premises in the U.S. due to defects in the premises and the lessor's failure to repair the defects. The lessor rejected the termination of the lease and is seeking to enforce the lease and to claim all amounts due under the lease from ESW and Elron, as guarantor of the lease. The balance of the rental under the lease amounts to approximately $2,000. ESW is counterclaiming damages caused by the lessor. The Company's management is of the opinion that ESW has good defense arguments which, if accepted, will cause dismissal of the above claim and accordingly, the above claim will not have a significant effect on the Company's results of operations.

NOTE 7:- BUSINESS SEGMENTS

As of March 31, 2004, the Company operates in two business segments: (1) the System and Projects segment through its subsidiary ETI and (2) the Other Holdings and Corporate Operations which reflects the investments in companies engaged in various fields of advanced technology and includes corporate headquarters.

The operations of the System and Projects segment include development and supply of software solutions for revenue assurance and management of large and complex communication and internet networks.

The Other Holdings and Corporate Operations segment includes holdings in various companies that operate in the medical devices, communications, defense industry, semiconductors, software and advanced materials and the corporate operations.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7:- BUSINESS SEGMENTS (Cont.)

On September 2, 2003, Elron's majority owned subsidiary, ESW, sold substantially all of its assets and business to Zix (See Note 3d to the Company's annual financial statements for 2003). The business sold by ESW represented a component of an entity as defined in SFAS No. 144 and since the criteria for reporting discontinued operations under SFAS No. 144 were met, operations relating to ESW have been classified as discontinued operations in the statement of operations. Comparative data have been reclassified.

Prior to the above sale, the Company operated indirectly through ESW in a third business segment - Internet Products.

Segment information is as follows:

	Systems and Projects	Other holdings and corporate operations	Internet Products (Discontinued operations)	Adjustments	Total
For the three months ended March 31, 2004 (Unaudited):					
Net revenues	1,656	1,769	-	-	3,425
Net loss	(557)	4,577	(298)		3,722
As of March 31, 2004 (Unaudited):					
Total assets	14,439	407,196	42	(4,429)(*)	417,248
For the three months ended March 31, 2003 (Unaudited):					
Net revenues	$ 2,074	$ 1,713	$ -	$ -	$ 3,787
Net loss	(562)	(6,900)	(1,808)	-	(9,270)
For the year ended December 31, 2003 (Audited):					
Net revenues	$ 7,390	$ 9,157	$ -	$ -	$ 16,547
Net loss	(2,074)	(4,442)	(689)	-	(7,205)
As of December 31, 2003 (Audited):					
Total assets	15,177	450,222	75	(14,770)(*)	450,704

(*) Inter-company balances.

The revenues relating to ESW's discontinued operations for the three months ended March 31, 2003, were $1,804 and pre-tax losses were $1,804.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 8:- RECONCILIATION TO ISRAELI GAAP

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

a. Effect on the statement of operations:

	Three months ended March 31, 2004		
	As reported	Adjustments	As per Israeli GAAP
		Unaudited	
Net income	$ 3,722	$ 1,687	$ 5,409
Basic net income per share	0.13	0.06	0.19
Diluted net income per share	0.12	0.06	0.18

	Three months ended March 31, 2003		
	As reported(*)	Adjustments	As per Israeli GAAP
		Unaudited	
Net loss	$ (9,270)	$ 1,180	$ (8,090)
Basic and diluted net loss per share	(0.32)	0.04	(0.28)

	Year ended December 31, 2003		
	As reported	Adjustments	As per Israeli GAAP
		Audited	
Net income (loss)	$ (7,205)	$ 18,436	$ 11,231
Basic and diluted net income (loss) per share	(0.25)	0.63	0.38

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
U.S. dollars in thousands, except share and per share data

NOTE 8:- RECONCILIATION TO ISRAELI GAAP (Cont.)

b. Effect on the balance sheet:

	March 31, 2004		
	As reported	Adjustments	As per Israeli GAAP
		Unaudited	
Total assets	$ 417,248	$ (179,269)	$ 237,979
Total liabilities including minority interest	114,878	(63,349)	51,529
Total equity	302,370	(115,918)	186,452
	December 31, 2003		
	As reported	**Adjustments**	**As per Israeli GAAP**
		Unaudited	
Total assets	$ 450,704	$ (176,981)	$ 273,723
Total liabilities including minority interest	154,574	(61,289)	93,285
Total equity	296,130	(115,692)	180,438

c. Material adjustments:

The abovementioned adjustments result primarily from the differences between U.S. GAAP and Israeli GAAP as detailed in Note 29 to the Company's annual financial statements for 2003.

ANNEX TO THE FINANCIAL STATEMENTS

U.S. dollars in thousands

Details relating to major investments as of March 31, 2004:

	% of ownership interest (1)	Carrying value of the investment as of March 31, 2004 (2)	Market value of the publicly traded investments as of: March 31, 2004	May 10, 2004
Consolidated Companies:				
Elron Telesoft Inc.	99%	$ 9,100	-	-
Galil Medical Ltd. (3)	39%	-	-	-
3DV Systems Ltd. (3)	70%	(634)	-	-
Starling (3)	24%	-	-	-
Affiliated Companies (equity):				
Elbit Systems Ltd. (Nasdaq: ESLT)	19%	90,554	140,287	143,492
Given Imaging Ltd. (Nasdaq: GIVN) (3)	17%	20,690	146,683	141,330
NetVision Ltd.	46%	417	-	-
Wavion, Inc.	38%	2,441	-	-
ChipX	27%	4,834	-	-
Pulsicom Israel Technologies Ltd.	18%	420	-	-
Advanced Metal Technologies Ltd. (AMT)	28%	3,817	-	-
CellAct Ltd.	45%	327	-	-
SELA (3)	24%	593	-	-
Notal Vision, Inc.	24%	1,068	-	-
Oren Semiconductor Inc.	41%	2,155	-	-
Oncura (4)	10%	11,698	-	-
Available for sale:				
Partner Communication Company (Nasdaq: PTNR)	9%	126,060	126,060	116,403
Zix Corporation (Nasdaq: ZIXI)	1%	7,132	7,132	3,835
EVS (Nasdaq: EVSNF.OB)	17%	1,190	3,389	3,204
Partnership:				
Gemini Israel Fund L.P.	5%	198	-	-
InnoMed Ventures L.P.	14%	2,466	-	-
Cost:				
Avantry (formerly: Witcom Ltd) (3)	7%	388	-	-

(1) On the basis of the outstanding share capital.

(2) Includes loans and convertible notes.

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

(4) Represents Elron's share in the carrying value and the ownership interest of the investment in Galil's book

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