MANAGEMENT REPORT FOR 2004

The following discussion should be read in conjunction with our consolidated financial statements for the year ended December 31, 2004 and the notes thereto, which are included in this Annual Report. This discussion contains forward-looking statements that involve risks and uncertainties. Such forward-looking statements may be identified by the words “anticipate”, “believe”, “estimate”, “expect”, “plan” and similar expressions. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those discussed in our filings with the U.S. Securities and Exchange Commission from time to time.

OVERVIEW

We are a multi-national 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, telecom, 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 Rafael Development Corporation Ltd. (“RDC”), a joint venture with Rafael Armament Development Ltd. ("Rafael"), the largest research and development organization of Israel's Ministry of Defense. RDC was established pursuant to a joint venture agreement entered into in July 1993 for the purposes of exploiting Rafael's technology in non-military markets. RDC has first rights to commercially exploit 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.

Our group companies include both publicly traded and privately held companies.

Our activities range from complete operational control over the business to 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, 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. 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.

Our net income (or loss) in any given period is due, for the most part, to the results of operations 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 new 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. We anticipate this change may have a significant effect on our results of operations.

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. 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. The downturn in the world economy and, in particular, in the technology sector, during 2001 and through the middle of 2003, affected our group companies' ability to raise additional financing from other sources, the results of operations of our group companies and our ability to successfully "exit" some of our group companies and record gains at the same level that we experienced in the years prior to the downturn. Since the second half of 2003, there has been a recovery in the technology sector and capital markets. 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 gains from realizing certain of our holdings, mainly in 2004, as a result of the sale of our holdings in Elbit Systems Ltd., and we anticipate that we may record a significant gain in 2005 from the sale of our shares in Partner Communications Company Ltd. ("Partner") (NASDAQ and TASE: PTNR; LSE: PCCD), if and when the sale of Partner shares is consummated (see below under "MAJOR TRANSACTIONS AND NEW INVESTMENTS"). Should the recovery in the world economy and, in particular, the technology sector, continue, we anticipate that it will have a positive effect on our group companies and their ability to raise additional capital.

We also anticipate increasing our investments in new companies in our main areas of operation, and we are currently considering investments in new companies in different stages of their life, mainly in the fields of medical devices and communications. In this regard, new companies in which we invested in 2004 include a $6.7 million investment in Jordan Valley Semiconductors Ltd. ("Jordan Valley"), operating in the field of semiconductors, a $3.0 million investment in Starling Advanced Communications ("Starling"), operating in the field of broadband communication, and a $7.3 million investment in Impliant Inc. ("Impliant"), a medical device company (see below under "MAJOR TRANSACTIONS AND NEW INVESTMENTS").

MAJOR TRANSACTIONS AND NEW INVESTMENTS

Sale of all of our holdings in Elbit Systems Ltd. (Nasdaq: ESLT). On July 28, 2004, we sold all of our holdings in Elbit Systems, constituting approximately 19.6% of the 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, of which approximately $21.6 million resulted from the decrease in our previous valuation allowance with respect to losses incurred in prior periods which were realized in 2004.

Acquisition of Shares of Given Imaging (Nasdaq: GIVN). During 2004 we purchased approximately 1.4 million additional shares of Given Imaging, one of our group companies that operates in the medical device field and which develops, produces and markets a disposable miniature video camera for detecting gastrointestinal disorders. The shares were purchased in the open market for aggregate consideration of approximately $43.9 million. As a result, our direct and indirect (through RDC) interest in Given Imaging increased to approximately 20%.

Tender offer to purchase 7.5% of our shares. On August 22, 2004 we announced that Discount Investment Corporation Ltd. ("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 owns approximately 46% of our outstanding shares.

Investment in Jordan Valley. On October 21, 2004, we invested approximately $6.7 million in Jordan Valley, an Israeli private company engaged in developing solutions for advanced in-line thin film metrology for the semi-conductor industry. Following the investment we hold 25% of Jordan Valley on a fully diluted basis. Our holding percentage is subject to adjustment based on Jordan Valley's future performance. Jordan Valley is also 40% indirectly owned (following the investment) by Clal Industries and Investments Ltd. ("Clal"), an approximately then 64% held subsidiary of IDB Development Corporation Ltd. ("IDBD"), which then held approximately 67% of our parent company, DIC. Clal, IDBD, and DIC are publicly traded on the Tel Aviv Stock Exchange. The investment was approved by our shareholders and the shareholders of Clal.

Investment in Starling. On October 21, 2004 we completed an investment of $3.0 million in Starling of which $1.5 million was invested immediately and an additional $1.5 million will be invested no later than April 21, 2005. Starling was formed in November 2003 and was equally held by Elbit Systems and our subsidiary RDC, prior to our investment.

Following the investment, our direct and indirect interest in Starling is approximately 50%. Starling develops connectivity solutions for broadband access for commercial aircraft.

Investment in Impliant. On December 28, 2004, we invested approximately $7.3 million in Impliant as part of a financing round of approximately $18 million from new and existing investors. Impliant is a privately held medical device company, engaged in the development of an innovative posterior motion preservation system for spine surgery and a line of cushion-bearing joint arthroplasty products. Following the investment, we hold approximately 20% of Impliant, on a fully diluted basis. Innomed, in which we hold approximately 14%, is also a shareholder of Impliant.

Offer to sell Partner shares. On February 8, 2005 we announced that we, Eurocom Communications Limited and Polar Communications Limited (together the "Sellers") have irrevocably offered to sell to Partner an aggregate of 31.7 million Partner shares (of which approximately 15.8 million shares have been offered by us), representing the Sellers' entire holdings in Partner (equal to 17.2% of Partner's outstanding ordinary shares, of which we hold approximately 8.6%). The aggregate consideration for the shares shall be determined based on a price per share reflecting a 10% discount to Partner's 20 day volume weighted average market price prior to the date Partner obtains the approval of its shareholders, up to a maximum price per share of NIS32.22 (approximately $7.37 per share) and not less than NIS31.04 (approximately $7.10 per share). On February 23, 2004 Partner announced that its Board of Directors has approved the acceptance of the offer. The closing of the transaction is conditional upon various conditions precedent, including the release of share pledges in favor of Partner's lending banks currently covering the shares. The closing is also subject to Partner obtaining all corporate and regulatory consents and approvals required by law or Partner's general license. Subject to all conditions to closing being satisfied, closing of the sale to Partner is scheduled to occur no later than 80 days from date of the offer. There is no assurance that the sale to Partner will be consummated.

In certain circumstances in which Partner does not purchase shares from the Sellers, an alternative arrangement entered into between the Sellers and Partner's largest shareholder, Hutchison Telecommunications International Limited (NYSE: HTX, SEHK: 2332) ("Hutchison") shall become effective. Under this arrangement, the Sellers shall be entitled to sell their 31.7 million Partner shares in the market in coordinated stages. As part of the alternative transaction, Hutchison shall have an option to acquire up to 13.8 million of these shares at a 12% discount to the average market price, prior to such shares being offered for sale into the market. The Sellers may elect not to proceed with the alternative arrangement. The alternative arrangement is subject to certain conditions being satisfied and there is no assurance that the alternative arrangement will be consummated.

Matav Investment Limited ("Matav"), Partner's other Israeli founding shareholder shall have the option to participate, as seller, in the sale to Partner or the alternative arrangement with respect to a majority of its Partner shares. If Matav elects not to exercise such option, Matav has a three month option to sell to the Sellers the same amount of its Partner shares at the same price that Matav could have sold, had it originally participated in the sale to Partner or the alternative arrangement, as the case may be. If Matav participates in the sale to Partner, Elron's beneficial holding in Partner after the sale to Partner will be reduced to approximately 2.1%.

In the event of the completion of the sale to Partner, we will receive proceeds ranging between approximately $90 million and $116 million and will record an estimated gain, after tax, ranging between approximately $33 million and $44 million, depending among other things, on the price per share in the sale to Partner and the amount of shares sold to Partner based on whether or not Matav participates in the sale.

CERTAIN U.S. FEDERAL INCOME TAX CONSIDERATIONS

Concurrently with the announcement of the sale of our shares in Elbit Systems, we announced that, as a result of the transaction, Elron may be characterized as a “passive foreign investment company” (PFIC) for U.S. federal income tax purposes for 2004. This would result in adverse tax consequences for our U.S. shareholders but not for Elron. At the time we issued our last Form 6-K regarding this matter, however, we believed, and our tax advisors concurred, that we could potentially 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, for 2004. Pursuant to this exception, in order to avoid PFIC status in 2004, we cannot be a PFIC in 2005 and 2006 (which cannot be determined at this time) or in any year prior to 2004 (which we believe was not the case). The tests for determining PFIC status are impacted, among others, by changes in our holdings and in the value of our group companies which are difficult to predict. In addition, the sale of our shares in Partner in 2005, as described above, if completed, would generate significant passive income. As a result, we believe that it is likely that we will be treated as a PFIC in 2005 and, as a result, in 2004 as well. Therefore, it is unclear whether the “change of business” exception would ultimately be satisfied for 2004.

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. 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
- Revenue recognition
- Accounting for income taxes
- Non-monetary transactions

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 and/or our subsidiary owns 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, the level of financing provided by us to the group company and any minority 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. 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.

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 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.

FIN 46 was effective immediately for VIEs created after January 31, 2003. For VIEs created before January 31, 2003, FIN 46R was adopted as of March 31, 2004. Upon the adoption of the Interpretation, and upon certain events which require a reassessment, we assessed and will reassess our investments in our group companies. 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.

Equity Method. Group companies which we do not control, but over whom we exercise significant influence and in which we hold common stock or in-substance common stock as defined 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.

In July 2004, the EITF reached a consensus on Issue No. 02-14, "Whether an Investor Should Apply the Equity Method of Accounting to Investments Other Than Common Stock" ("EITF 02-14"), according to which the equity method of accounting should be applied to investments in common stock and in in-substance common stock if the investor has the ability to exercise significant influence over the operating and financial policies of the investee. EITF 02-14 defines in-substance common stock as an investment with similar risk and reward characteristics to common stock. The provisions of EITF 02-14 were effective beginning in the fourth quarter of 2004. For investments that are not common stock or in-substance common stock, but were accounted for under the equity method of accounting prior to the effective date of EITF 02-14, the equity method of accounting should be discontinued at the effective date. Previously recognized equity method earnings and losses should not be reversed. 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. Upon adoption of EITF 02-14, we evaluated the impact of its provisions and found that there are no investments that were previously accounted for by the equity method which are not considered to be in-substance-common stock, nor are there investments that are in-substance common stock that were not accounted for under the equity method of accounting prior to the effective date of EITF 02-14 and which should be accounted as such in accordance with EITF 02-14. However, new companies in which we invested in the fourth quarter of 2004, namely Jordan Valley and Impliant, 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. Notwithstanding the above, in circumstances where the equity method is being applied and our ownership in an investee is in the form of a preferred security or other senior security, 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 trading securities, are presented at fair market value and the changes in the market value are reflected in our results of operations during each reporting period.
- 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, realized gain or loss is included in our results of operations.

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 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 the shares of Given Imaging purchased during 2004 of approximately $43.9 million has been allocated as follows: $4.4 million to Given Imaging identifiable net assets, $30.4 million to intangible assets other than goodwill, such as customer base and technology, $1.7 million to in-process research and development activities, and $7.4 million to goodwill. Products which had not received marketing clearance by regulatory authorities as of the acquisitions dates, were considered to be incomplete and accordingly the amount allocated to such products is considered to be in-process research and development activities ("IPR&D"). The amount allocated to IPR&D was 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

intangible assets other than goodwill are amortized on a straight-line basis over their weighted average expected useful life of 12 years. The amortization of the identifiable intangible assets as well as the write-off of the IPR&D, which were recorded in 2004 in the amount of approximately $3.2 million, are included as part of our share in the income or losses of our equity investments.

In 2002 we allocated the aggregate purchase price of approximately $103.5 million, resulting from the merger with Elbit and the share purchase of DEP's shares, to Elbit and DEP assets based on their estimated fair values. The majority of the purchase price was allocated to Elbit's holding in Partner and to DEP's holdings accounted for under the equity method (including holdings through its subsidiary, RDC). An amount of $19.0 million has been allocated to goodwill which reflected the anticipated synergies resulted from the combined entity, including anticipated reductions in operational and management costs, the creation of an enhanced platform, a more simplified and efficient organizational structure and greater resources and scope of operations, which will benefit the group companies. Subsequently to the acquisition date and through December 31, 2004, goodwill was reduced by $14.3 million as a result of the reversal of a valuation allowance recorded at the acquisition date in respect of Elbit's carry forward losses that had accumulated through that date, due to final tax assessments for previous years.

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 used was 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 required judgment which can impact our results of operations was 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. In 2004 and 2003, we recorded impairment losses in respect of certain investments of Elbit and DEP, to which we allocated a portion of the purchase price at the time of the aforementioned acquisitions, in the amounts of $1.1 million and $2.5 million, respectively (See also "Critical Accounting Policies" and "Other-Than-Temporary Decline in Investments in Group Companies").

Impairment of Goodwill and Other Intangible Assets

We conduct a goodwill impairment review at least annually on goodwill 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 2004, a goodwill impairment charge in the amount of $2.0 million was recorded with respect to the operation of Elron TeleSoft in light of its results of operation in 2004. 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 future goodwill impairment review will not result in an additional charge to our results of operations. At December 31, 2004, consolidated goodwill amounted to approximately $10.3 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 $7.1 million mainly with respect to Elron TeleSoft, Inc. ("Elron Telesoft") in light of its results of operation in 2004 and MediaGate N.V ("MediaGate") due to our revised estimate about future proceeds from the sale of its technology. 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, 2004, consolidated intangible assets, other than goodwill, amounted to approximately $3.0 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 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, 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 2004 and 2003 we recorded write-downs in the amounts of $1.5 million and $4.2 million, respectively, with respect to certain group companies, in 2004 mainly with respect to Textology Inc,. 3DV Systems Ltd. ("3DV") and Ingeneo Ltd. and in 2003 mainly with respect to Cellenium M.C.S Ltd. ("Cellenium") and Textology.

Revenue Recognition

Our revenues are derived from our consolidated subsidiaries. Revenues in 2004 and 2003 amounted to $16.3 million and $16.5 million, respectively. Revenues from sales of products and services are recognized after all of the following occurs: the product is delivered, collection is probable, fees are fixed or determinable, vendor-specific objective evidence exists to allocate the total fee to elements of an arrangement and persuasive evidence of an arrangement exists. The determination whether collection is probable is judgmental in nature and based on a variety of factors, including the payment and other terms of the individual customer contract, credit history of the customer, prior dealings with specific customers, and certain other factors. Maintenance revenue is recognized on a straight-line over the term of the contract period. Reserves for estimated returns and allowances are provided at the time revenue is recognized when a right of return exists. Such reserves are recorded based upon historical rates of returns and other factors.

Income and profit derived from projects related to software development are recognized upon the percentage of completion method, based on the ratio of hours performed to date to estimated total hours at completion. Estimated gross profit or loss may change due to changes in estimates resulting from differences between actual performance and original forecasts. Estimates are reviewed periodically, and the effect of any change in the estimated gross profit for a project is recorded in results of operations in the period in which the change becomes known on a cumulative catch-up basis. Anticipated losses on projects are charged to earnings when identified. A number of internal and external factors affect our subsidiaries cost estimates, including labor rates, revised estimates of uncompleted work, efficiency variances, customers' specifications and testing requirements changes. If any of these factors were to change, or if different assumptions are used, our results of operations may be affected. In addition estimates are made as to the total hours at completion. The number of hours may change due to the actual progress on the project. Change in estimates regarding the percentage of completion may affect the results of operations.

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 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 probability 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, 2004, 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 $10.6 million ($8.9 million in 2003). In 2004 we reduced our previous valuation allowance by $23.3 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. In 2003 we reduced our previous

valuation allowance by $8.5 million, the majority of which was recorded as a reduction of goodwill since the deferred tax assets related to carryforward losses in Elbit and RDC incurred in periods prior to the acquisition of these companies (see also “Business Combinations and Purchase Price Allocation”).

Deferred tax liabilities amounted as of December 31, 2004, to $46.5 million, mainly with respect to our investment in Partner which is accounted for as available-for-sale securities.

During 2004, we recorded tax expenses in the amount of $15.1 million which was mainly due to the sale of our shares in Elbit Systems, which was largely offset by decreasing our valuation allowance as discussed above. During 2003, we recorded tax expenses of $6.8 million mainly by realizing our deferred taxes due to the sale of shares of Partner, Given Imaging, Zix Corporation ("Zix") and 24/7 Real Media Inc.

Non-Monetary Transactions

The basic principle in APB 29 “Accounting for Non-monetary Transactions” is that the accounting for non-monetary transactions should be based on the fair values of the assets exchanged. The cost of a non-monetary asset acquired in exchange for another non-monetary asset is the fair value of the asset received or the fair value of the asset surrendered to obtain it (if more clearly evident than the asset received). However, in an exchange of similar productive assets, since the culmination of an earning process has not occurred, the exchange should not be recorded at fair value and the asset received should be recorded at the recorded amount of the assets given up. According to EITF 01-2, “Interpretations of APB Opinion No. 29”, transactions by SEC registrants that involve the exchange of a business for any non-monetary asset, including an equity method investment that is not an interest in a joint venture, are not exchanges of productive assets and must be accounted for at fair value unless fair value is not determinable within reasonable limits. In determining whether the asset given up constitutes a business, the guidance in EITF 98-3, “Determining whether a non-monetary transaction involved receipt of productive assets or of a business” should be followed.

Determining whether the assets transferred constitute a business requires significant judgment and is dependent on the particular facts and circumstances, mainly regarding the determination of the degree of difficulty or level of investment necessary to obtain access or to acquire missing elements in the set of assets transferred. In addition, determining the fair value of the transaction is judgmental in nature and often involves the use of significant estimates and assumptions.

In determining the fair value of the business transferred by Galil Medical Ltd. ("Galil Medical") to Oncura Inc. ("Oncura"), a method of discounted cash flow was used, which includes significant estimates and assumptions. As Oncura operates in an industry which is rapidly evolving and extremely competitive, its value, as well as the value of its intangible assets, including goodwill, can be exposed to future adverse changes which can result in a charge to its, and in turn, to our results of operations.

BASIS OF PRESENTATION

Consolidation. Our consolidated financial statements include the accounts of the Company and all of its direct or indirect controlled subsidiaries. The following are our main subsidiaries:

Year ended December 31,			
2004		2003	
Elbit	3DV [1]	Elbit	Mediagate
DEP	Sela [2]	DEP	ESW[3]
RDC	Starling	RDC	
Elron TeleSoft	ESW[3]	Elron Telesoft	
Galil Medical	MediaGate	Galil Medical	

1 3DV Systems Ltd. ("3DV") was consolidated following the purchase of a controlling interest during the first quarter of 2004 from other shareholders of 3DV.

2 Following the conversion of shareholder loans granted by RDC to Sela Semiconductor ("Sela") at the end of the second quarter of 2004.

3 Elron SW Inc. ("ESW") (formerly: Elron Software Inc.)

Equity Method. Our main group companies accounted for under the equity method of accounting include:

Year ended December 31,			
2004		2003	
Elbit Systems[1]	AMT	Elbit Systems	Notal Vision
Given Imaging	Notal Vision	Given Imaging	Oren Semiconductor
Oncura	Sela[2]	Oncura[3]	CellAct
NetVision	Pulsicom	NetVision	3DV
ChipX	CellAct	ChipX	Pulsicom
Wavion		Wavion	Avantry (formerly: Witcom)
Oren Semiconductor		KIT	
		AMT	

[1] Through June 30, 2004
[2] Through June 30, 2004
[3] Since July 1, 2003

RESULTS OF OPERATIONS

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

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

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

The net income we reported in 2004 included the following main factors:

(i) a gain, net of tax, of approximately $91.5 million resulting from the sale of our holdings in Elbit Systems for approximately $196.6 million. This gain includes approximately $21.6 million resulting from a decrease in our previous valuation allowance in respect of losses incurred in prior periods. The decrease in our previous valuation allowance was made in light of the transaction, following which we revised our estimate about the realizability of deferred tax;

(ii) a gain, net of tax and minority interest, of approximately $6.7 million from the sale of Given Imaging's 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, a provider of online academic programs, to a subsidiary of Laureate Education, Inc. (formerly known as Sylvan Learning Systems) (Nasdaq: LAUR), a global leader in higher education;

(iv) a gain, net after tax, of approximately $3.6 million resulting from the sale of 854,701 Zix shares for aggregate consideration for $8.1 million; and

(v) a tax benefit in the amount of approximately $2.9 million due to the change in the tax rate in Israel enacted in 2004.

Additional factors that positively affected 2004 results were the following:

(i) The sale of the businesses of ESW and MediaGate in 2003 and the sale of our holding in KIT which our share in the losses of these companies accounted for an aggregate loss of $10.4 million in 2003;

(ii) the decrease of $3.2 million in our share in Galil Medical's operating losses following the formation of Oncura as a result of the merger of its urology unit and that of Amersham plc (Amersham was subsequently acquired by General Electric Company (NYSE: GE) ("GE")); and

(iii) our share in the net income reported for the first time by Given Imaging in the amount of $0.5 million in 2004, compared to $1.8 million loss in 2003.

These were offset by the following factors:

(i) a write-off of IPR&D related to the acquisition of additional shares of Given Imaging in the amount of $1.7 million;

(ii) the increase in Elron Telesoft losses from $2.1 million in 2003 to $7.9 million in 2004 which include impairment charges in the amount of $4.9 million;

(iii) a $2.7 million loss, net of tax, resulting from the write-off of future royalties to be received by MediaGate from Telrad in connection with the sale of MediaGate business in 2003 to Telrad;

(iv) a $2.0 million loss representing the funding of NetVision's previous years' losses; and

(v) the effect of the sale of our holding in Elbit Systems in the third quarter of 2004, following which we ceased including our share in its net income (Elbit Systems accounted in 2003 for $9.1 million of income and for $4.7 million of income in 2004 through the date of its sale).

Reportable Segments

Subsequent to the sale of the business of ESW on September 2, 2003 to Zix, our reportable segments are i) The Systems and Projects Segment - Elron TeleSoft; and ii) Other holdings and the corporate operations, which includes our holdings in subsidiaries, affiliates and other companies, engaged in various fields of advanced technology, and corporate operations, which provide the strategic and operational support to the group companies. Prior to September 2, 2003, we operated through ESW in a third business segment – Internet Products – which has been reclassified as discontinued operations. ESW has been liquidated as of December 31, 2004.

At December 31, 2004, our main group companies were classified into the following segments:

	Systems and projects	Other holdings and corporate operations
Consolidated	Elron TeleSoft	Elbit; DEP; RDC; Galil Medical; 3DV, Starling; Sela; MediaGate.
Equity basis		Given Imaging; Oncura; NetVision; ChipX; Oren Semiconductor; Notal Vision; Wavion; AMT; Pulsicom; CellAct.
Cost		Jordan Valley; Impliant; Avantry.
Available-for-sale Securities		Partner, Elbit Vision Systems

The following tables reflect our consolidated data by reported segments:

	Systems and projects - Elron TeleSoft	Other holdings and corporate operations	Discontinued operations of Internet products - Elron SW	Consolidated
	(millions of $)			
	Year ended December 31, 2004			
Income*	5.1	137.9	-	143.0
Costs and Expenses	13.0	26.2	-	39.2
Income (loss) from continuing operations	(7.9)	92.5	-	84.6
Net income (loss)	(7.9)	92.5	**(0.5)	84.1
	Year ended December 31, 2003			
Income*	7.4	40.9	-	48.3
Costs and Expenses	9.5	28.0	-	37.5
Loss from continuing operations	(2.1)	(4.8)	-	(6.9)
Net loss	(2.1)	(4.4)	**(0.7)	(7.2)

* Income in the other holdings and corporate operations includes net losses from equity investments.
** The composition of the discontinued operation of ESW is as follow:

	Year ended December 31,	
	2004	2003
	(millions of $)	
Loss from operations	(0.5)	(4.8)
Gain on disposal	-	4.1
Loss from Discontinued operations	(0.5)	(0.7)

Systems and Projects - Elron TeleSoft

Elron TeleSoft is focused on telecom network management and revenue assurance products. The following table sets forth the operating results of Elron TeleSoft:

	Year ended December 31,	
	2004	2003
	(millions of $)	
Net revenues	5.1	7.4
Cost of revenues	3.4	4.6
Gross profit	1.7	2.8
Operating expenses*	3.1	2.6
Amortization of other assets	0.6	0.8
Restructuring charges, net	0.2	-
Impairment of long-lived assets	2.9	-
Impairment of goodwill	2.0	-
Operating loss	(7.1)	(0.6)
Finance expenses, net	0.8	1.5
Net loss	(7.9)	(2.1)

*Excluding amortization of other assets, impairment charges and restructuring charges which are presented separately.

Net Revenues. Elron TeleSoft's net revenues in 2004 decreased by $2.3 million, or 31%, to $5.1 million, compared to $7.4 million in 2003. The decrease resulted mainly from the decrease in revenues derived from sale of third parties' products as well as in license and project revenues, mainly due to longer sale cycles in its efforts to penetrate the international market with its new revenue assurance line of products.

Cost of revenues. Cost of revenues of Elron TeleSoft in 2004 were $3.4 million, representing a gross margin of 33%, compared to $2.8 million in 2003, representing a gross margin of 38%. The decrease in the gross margin resulted mainly from the decrease in license and project revenues.

Operating expenses. Elron TeleSoft's operating expenses (excluding amortization of other assets, impairment charges and restructuring charges which are presented separately) in 2004 were $3.1 million, an increase of 19% over the $2.6 million in 2003. The increase in operating expenses resulted from an increase in development expenses of the company's new revenue assurance line of products and an increase in sales and marketing expenses associated with launching these products to the international market.

Restructuring expenses. In response to its operating results and in an effort to adjust its operations to the decrease in revenues, Elron TeleSoft underwent a restructuring program in the third quarter of 2004 which included workforce reduction of 15% across all functions of the organization. Restructuring expenses amounted to $0.2 million.

Impairment charges. In light of Elron TeleSoft's results of operations and its difficulties in penetrating international markets, Elron Telesoft tested for impairment its technology and fixed assets and subsequently the goodwill associated with its operations, resulting in an impairment loss of $2.9 million and $2.0 million relating to the technology and property and equipment and goodwill, respectively.

Operating loss. As a result of all the above, Elron TeleSoft's operating loss increased to $7.1 million in 2004 compared to $0.6 million in 2003.

Finance expense, net. Finance expenses decreased to $0.8 million in 2004 compared to approximately $1.5 million in the same periods in 2003. The decrease in finance expenses resulted mainly from the significant decrease in loan balances following the repayment of $51.1 million of bank loans by Elron TeleSoft (financed by an investment by us) during 2004.

The ability of Elron TeleSoft to increase its revenues and improve its operating results in the near future is dependent upon general economic conditions and, in particular, on an increase in telecom capital expenditure, its ability to penetrate the international market and whether its efforts to bring enhanced and new products to market are successful.

Other Holdings and Corporate Operations Segment

The other holdings and corporate operations segment includes our holdings in subsidiaries, affiliates and other companies engaged in various fields of advanced technology, and corporate operations which provide strategic and operational support to the group companies. The following table sets forth this segment's operating results:

	Year ended December 31,	
	2004	2003
	(millions of $)	
Net revenues	11.3	9.2
Net loss from equity investments	(10.5)	(8.7)
Gain from disposals of businesses and affiliated companies and changes in holdings in affiliated companies, net	132.4	25.8
Other income (expenses), net	4.7	14.6
Total income	137.9	40.9
Cost of revenues	6.3	5.6
Operating expenses*	17.0	22.9
Amortization of other assets	0.1	0.3
Impairment of long-lived assets	4.2	-
Finance expenses (income), net	(1.4)	(0.8)
Total costs and expenses	26.2	28.0
Income (loss) from continuing operations before tax benefit (taxes on income)	111.7	12.9
Tax benefit (taxes on income)	(15.1)	(6.8)
Minority interest	(4.1)	(10.9)
Income (loss) from continuing operations	92.5	(4.8)
Gain (loss) from discontinued operations	-	0.4
Net gain (loss)	92.5	(4.4)

*Excluding amortization of other assets and impairment charges which are presented separately.

Income

Net revenues. Net revenues of the other holdings and corporate operations segment consisted of sales of products and services by our subsidiaries, mainly Galil Medical and Sela (which results are consolidated since July 1, 2004). The following table sets forth the segment 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 derived mainly from the supply of cryo products and R&D services to Oncura, in which it has a 25% ownership interest, as a result of the merger of the urology therapy units of Galil Medical and GE on July 1, 2003.

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. 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"). 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 and amounted to $4.7 million. Our share in the net income of Elbit Systems in 2003 amounted to $9.1 million.

Highlights of the Results of Operations of Our Major Affiliates:

Given Imaging (Nasdaq: GIVN) (a 20% holding directly and indirectly through RDC). Given Imaging revenues in 2004 were $65.0 million, an increase of 60.4% over the revenues recorded in 2003 of $40.5 million. As of December 31, 2004, cumulative unit sales of Given Imaging capsule for the small intestine have reached 171,800 and its installed base reached more than 1,300 workstation in the US 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 for the first time in its history 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, more than 3,400 PillCam ESO capsules were sold.

Oncura (a 25% holding by Galil). Oncura commenced its operations on July 1, 2003 following the completion of the merger of the urology therapy units of Galil and GE which created Oncura. Oncura markets and sells therapeutic device systems and related consumables used primarily in the performance of minimally-invasive, urologic cancer treatment. 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 and trough December 31, 2003 amounted to $31.4 million and its net loss amounted to $0.9 million.

Notal Vision (a 26% holding). Notal Vision, a medical device company operating in the field of early detection of Age Related Macular Deterioration (AMD), formally launched its product in October 2004 through Carl Zeiss Meditec Inc., one of the leading manufacturers of professional optics equipment. In 2004 Notal's revenues amounted to approximately $1.0 million, as compared to $0.9 million in 2003, and its net loss amounted to $1.6 million, the same as in 2003.

NetVision (a 46% holding). NetVision provides Internet services and solutions in Israel. The other major shareholder of NetVision is our controlling shareholder, DIC, which also holds 46% of NetVision, following DIC's purchase of NetVision shares from Tevel International Communications Ltd ("Tevel"), in March 2004. In 2004 NetVision continues 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 411,000 (of which approximately 225,000 were connected through broadband) compared to 357,000 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.

NetVision’s future period results will continue to be affected mainly by the highly competitive broadband market environment in Israel, and whether Internet prices will continue to decrease or will stabilize.

On August 3, 2004, NetVision received a license from the Israeli Ministry of Communications to provide international telephony services, which NetVision commenced to provide through Voice over IP technology (VoIP) in the fourth quarter of 2004.

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 bank and to set up its international telephony services. As a result of the extension of the original repayment period of the loans and the uncertainty of a public offering (announced by NetVision on March 30, 2004) 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). Wavion is a developer of broadband wireless access systems for wireless LANs. Following a financing round led by Sequoia Seed Capital 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). ChipX is a manufacturer of late stage programmable application-specific integrated circuits, or structured ASICs. 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, led by a new investor, Vantage Point Venture Partners, the proceeds of which are being used to finance its sales, marketing and development investments in its structured ASIC technology.

Oren Semiconductor (a 41% holding). Oren is a developer of integrated circuits for digital broadcasting. In 2004, Oren's revenues amounted to $3.1 million, compared to $4.4 million in 2003, mainly as a result of a decrease in product revenues due to delay in product development, and its net loss in 2004 amounted to $4.8 million compared to $4.6 million in 2003. In 2003, Oren completed an $8.0 million financing round from existing shareholders and from Zoran Corporation (Nasdaq: ZRAN), the second strategic investor in Oren after Sony Corporation invested in April 2001. Zoran and Oren have agreed to cooperate to sell Oren's front-end solution with Zoran's back-end chips to major players in the digital television market.

AMT (a 40% holding). The AMT group develops technologies and products based on amorphous metals. AMT's two main operating subsidiaries are AHT, which uses amorphous metals for heating products, and ACS, which uses amorphous metals for identification, authentication and anti-shoplifting solutions. During 2004 AMT completed a private placement of $6.0 million, in which an international strategic partner invested $3.0 million and 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.

We expect that most of our group companies 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. Therefore, we anticipate that our share in the results of our group companies will continue to negatively affect our results of operations to the extent they are reported under the equity or consolidation method of accounting. In addition, following the sale of our holding in Elbit Systems in 2004 which positively contributed to our net income in previous periods, and in light of expected investments in new companies, to the extent they will be accounted for under the equity method of accounting, our share in the net losses of our group companies, is expected to increase.

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

Partner (an 8.6% holding). Our investment in Partner is accounted for as available-for-sale security, whose results do not affect our results of operations. At December 31, 2004, the market value of our investment in Partner amounted to $136.2 million. Partner is a Global System for Mobile Communications, or GSM, mobile telephone network operator in Israel. As described above under "MAJOR TRANSACTIONS AND NEW INVESTMENTS IN 2004 AND SUBSEQUENTLY", on February 8, 2005 we announced that we have irrevocably offered to sell to Partner all our shares in Partner. The offer is conditional, among others, upon the release of the share pledges in favor of Partner's lending banks and regulatory approvals. There is no assurance that the sale to Partner will be consummated.

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. The increase was mainly due to increased revenues from services (including data and content) and equipment. Partner's subscriber base at the end of 2004 was 2,340,000 as compared to 2,103,000 at the end of 2003. At the end of 2004 Partner launched its 3G network in the central part of Israel.
- Partner's operating income in 2004 increased to $236.6 million from $198.4 million in 2003, an increase of 19.2%. Operating income in 2004, as a percentage of revenues, increased to 19.8% versus 19.1% in 2003.
- Partner's income before tax in 2004 increased to $176.1 million from $122.9 million in 2003, an increase of 43.3%.
- 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.

Partner has a line of credit agreement with a consortium of banks that provides for borrowings of up to $423 million of which $268 million had been drawn as of December 31, 2004. As of December 31, 2004 the line of credit is guaranteed by shares held by the original shareholders of Partner, including us, pro rata to their respective

original holdings. All of the shares held by us as of December 31, 2004, amounting to approximately 15.9 million shares, are pledged by us in favor of the consortium of banks. Partner has announced that it renegotiating its bank facility and considering other financing alternatives.

Jordan Valley (a 28% holding). Jordan Valley is engaged in developing solutions for advanced in-line thin film metrology for the semiconductor industry. 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 28% holding). Impliant is engaged in the development of an innovative posterior motion preservation system for spine surgery and a line of cushion-bearing joint arthroplasty products. 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; (ii) a $15.2 million gain (which after minority interest and income taxes amounted to $6.7 million) resulting from the sale of 300,000 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 eLearning to a subsidiary of Laureate Education, Inc. for a cash payment of $9.4 million (from which we received $5.7 million) and a future payment of up to an additional $10.0 million based on future earnings of KIT in 2006 and 2007 (from which our share will be up to $5.7 million); (iv) 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 to him of 200,000 shares of Given Imaging; 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 for the aggregate exercise price of approximately $49 thousand.

The gain in 2003 was mainly due to the gain from the merger of the urology therapy business of Galil Medical and GE 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 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 854,701 shares of Zix (Nasdaq: ZIXI) which were 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 6,278,226 Partner shares for approximately $29.3 million which resulted in a $11.1 million gain before tax; (ii) the sale of 1,117,155 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 the 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 is 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 (which results have been consolidated since January 1, 2004) and Sela (which results 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 (which results have been consolidated since January 1, 2004) and Sela (which results have been consolidated since July 1, 2004), and of our and RDC's corporate operations. The following table sets forth the segment operating expenses. The operating expenses

presented below for 2004 exclude impairment and amortization of other 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 item:

	Year ended December 31,	
	2004	2003
	(millions of $)	
Corporate	7.3	7.1
Galil Medical	2.8	10.7
Sela	1.6	-
MediaGate	-	3.1
Starling	1.6	-
3DV	1.2	-
Other (mainly RDC)	2.5	2.0
	17.0	22.9

Operating expenses of Galil Medical in 2004 decreased to $2.8 million from $10.7 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 which resulted in a significant decrease in Galil Medical's marketing and selling expenses. Galil started at the end of 2004 to develop its cryotherapy technology for application in the women's health field and its results of operations in 2005 will be affected by the increase in research and developments costs relating to the development of the new cryotherapy applications.

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), 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 from Telrad in connection with the sale of MediaGate's business in 2003 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 is secured by a first ranking pledge over these future royalties and which is not guaranteed by us, was not written-off even though it can only be repaid from royalties to be received from Telrad. 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. We are currently holding discussions with the bank as to reaching an agreement that will legally release Mediagate from being the primary obligor under the loan. If and when the loan is extinguished, we will record a gain in the amount of the loan of approximately $2.6 million.

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 losses 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 and a tax benefit of $1.7 million mainly with respect to corporate losses.

LIQUIDITY AND CAPITAL RESOURCES

Consolidated cash, debentures and deposits at December 31, 2004 were approximately $188.6 million compared with $114.6 million at December 31, 2003. At December 31, 2004, the corporate cash, debentures and deposits were $175.7 million compared with $107.3 million at December 31, 2003. The increase in consolidated and corporate cash and other liquid instruments resulted primarily from the sale of our holding in Elbit Systems for approximately $196.6 million. This increase was offset mainly by the repayment of approximately $67.8 million loans of Elron Telesoft and ESW and

investments in and loan to new and existing companies in the amount of $74.8 million. As of December 31, 2004, total bank loan which were guaranteed by us amounted to $1.7 million, consistiting of bank loans granted to Elron TeleSoft, as compared to $67.5 million at December 31, 2003 (which consisted of bank loans granted to Elron TeleSoft and ESW).

The main sources of corporate cash and other liquid instruments in 2004 were approximately $196.6 million of proceeds from the sale of all of our shares in Elbit Systems, $5.7 million of proceeds from the sale of all of our shares in KIT eLearning, $8.1 million proceeds from the sale of Zix shares and a $1.7 million dividend received from Elbit Systems prior to the sale of our holding.

The main uses of the corporate cash and other liquid instruments in 2004, were the $67.8 million repayment of bank loans and $74.8 million of investments in and loans to existing and new group companies. The following table sets forth investments and loans made during 2004 by Elron (in millions of $):

Given Imaging	43.9
Impliant	7.3
Jordan Valley	6.7
NetVision	5.3
AMT	3.4
ChipX	2.6
Starling	1.5
Galil Medical	1.0
Innomed	1.0
Oren Semiconductor	0.8
3DV	0.7
Other	0.6
	74.8

Consolidated working capital at December 31, 2004 amounted to $158.8 million compared to $57.0 million at December 31, 2003. The increase is due primarily to the proceeds received from the sale of our share in Elbit Systems.

At December 31, 2004, 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	2005	2006	2007	2008	With no specified maturity date	Total
Loans from banks	2.9	0.1	-	-	2.6	5.6
Loans from other	2.2	1.3	-	-		3.5
leases	0.6	0.5	0.3	0.2	-	1.6

Consolidated loans at December 31, 2004, were approximately $9.1 million, of which $1.7 million was attributed to Elron TeleSoft compared to $73.2 million at December 31, 2003 (of which $67.5 million were attributed to Elron Telesoft and ESW). During 2004 we repaid Elron TeleSoft's and ESW's loans to the lending banks in the amount of approximately $67.8 million. As a result of the repayment of the loans, the line of credit of ESW was closed and the line of credit of Elron TeleSoft was reduced from $53.6 million at December 31, 2003, to $2.7 million (of which $1.7 million was drawn as of December 31, 2004). Elron TeleSoft's lines of credit are guaranteed to the banks by us. In addition, we have provided to a certain lending bank a comfort letter pursuant to which we undertook not to reduce our holding in Elron Telesoft below a certain percentage.

In connection with the credit lines granted to NetVision, we and DIC provided letters of comfort to the lending banks pursuant to which we jointly undertook not to reduce our joint holdings below a certain percentage. The amount outstanding under NetVision's credit lines at December 31, 2004, was approximately $10.8 million. During 2004 we granted NetVision a $5.3 million loan, in order to enable NetVision to repay its line of credit to one of the lending banks and to enable NetVision to set up its international telephony services.

MediaGate's bank loan in the amount of approximately $2.6 million has been secured by a first ranking pledge over the future proceeds to be received as royalties as a consideration for the sale of its technology to Telrad. The loan is not guaranteed by us. We are currently discussing with the bank ways to legally release Mediagate from the loan.

All of Partner's shares held by us as of December 31, 2004, amounting to approximately 15.9 million shares, are pledged by us in favor of Partner's consortium of banks. The release of the share pledges is one of the conditions to the sale of Partner shares as described above under "MAJOR TRANSACTIONS AND NEW INVESTMENTS". In order to hedge the dollar value to be received from the sale of our share in Partner, if completed, we purchased call options and sold put options, at a dollar/NIS exchange rate ranging from $4.36 to $4.44 for a period of 81 days.

Subsequent to December 31, 2004 and through March 1, 2005 we have invested an additional aggregate amount of approximately $0.9 million.

Our investment policy for manging our funds is in general to invest in time 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, 2004, was approximately $389.1 million representing approximately 78% of our total assets compared with $296.1 million representing approximately 66% of total assets at December 31, 2003.

QUALITIVE AND QUANTITIVE DISCLOSURE ABOUT 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, we hedged the dollar value to be received 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.

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. At December 31, 2004, all of our deposits and debentures were fixed rate based with a weighted average maturity of approximately 1 year.

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 to be received from the sale of our share in Partner, if completed.

Equity Price Risk. We are exposed to fluctuations in the equity price of our holdings in publicly traded companies. At December 31, 2004 we directly and indirectly held shares of the following publicly traded companies: Given Imaging, Partner and Elbit Vision Systems Ltd. ("EVS") (Nasdaq: EVSNF). Stock prices in the industries of these companies, and of these companies themselves, have experienced significant historical 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, 2004, the fair market value of our holdings in public securities was approximately $383.0 million. At December 31, 2004 no financial instruments are used to hedge against 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, 2004 amounted to $137.2 million.

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