ELRON ELECTRONIC INDUSTRIES LTD.

AND ITS SUBSIDIARIES

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

As of June 30, 2003

(Unaudited)

ELRON ELECTRONIC INDUSTRIES LTD.

AND ITS SUBSIDIARIES

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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(Unaudited)

C O N T E N T S

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9272-06-2003e

ELRON ELECTRONIC INDUSTRIES LTD.

AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

In thousands of U.S. Dollars ,except share data

	June 30, 2003 (Unaudited)	December 31, 2002 (Audited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 75,793	$ 67,901
Marketable securities	21	3,180
Trade receivables, net	5,945	9,238
Other receivables and prepaid expenses	4,876	4,528
Inventories and contracts-in-progress	2,989	2,197
Total current assets	89,624	87,044
Long-term assets:		
Investments in affiliated companies	128,542	131,256
Investments in other companies and long-term receivables	107,742	97,158
Long-term debentures and deposits	31,428	28,928
Deferred taxes	3,985	2,990
Severance pay deposits	2,768	2,262
Total long-term assets	274,465	262,594
Property and equipment, net	11,187	11,576
Intangible assets:		
Goodwill	20,788	21,538
Other intangible assets	17,553	18,577
	38,341	40,115
Total assets	$ 413,617	$ 401,329

The accompanying notes to the consolidated financial statements form an integral part thereof.

ELRON ELECTRONIC INDUSTRIES LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

In thousands of U.S. Dollars ,except share data

	June 30, 2003 (Unaudited)	December 31, 2002 (Audited)
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Short-term loans from banks	$ 11,075	$ 15,362
Current maturities of long-term loans from banks and others	19,329	17,637
Trade payables	4,231	5,738
Other payables and accrued expenses	14,729	16,516
Total current liabilities	49,364	55,253
Long-term liabilities:		
Long-term loans from banks and others	47,746	49,389
Accrued severance pay and retirement obligations	3,437	2,921
Deferred taxes	33,499	23,650
Other	396	414
Total long-term liabilities	85,078	76,374
Minority interest	7,821	3,185
Shareholders' equity:		
Ordinary shares of NIS 0.003 par value; Authorized - 35,000,000 shares; Issued and outstanding - 29,203,470 and 29,180,970 shares as of June 30, 2003 and December 31, 2002, respectively	9,572	9,572
Additional paid-in capital	269,040	267,482
Accumulated other comprehensive income	22,818	7,529
Accumulated deficit	(30,076)	(18,066)
Total shareholders' equity	271,354	266,517
Total liabilities and shareholders' equity	$ 413,617	$ 401,329

The accompanying notes to the consolidated financial statements form an integral part thereof.

ELRON ELECTRONIC INDUSTRIES LTD.

AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	For the six months ended June 30, 2003 (Unaudited)	For the six months ended June 30, 2002 (Unaudited)	For the three months ended June 30, 2003 (Unaudited)	For the three months ended June 30, 2002 (Unaudited)	For the year ended December 31, 2002 (Audited)
Income					
Net revenues	$ 11,596	$ 11,649	$ 6,005	$ 5,743	$ 23,468
Equity in losses of affiliated companies	(5,544)	(15,273)	(3,249)	(9,593)	(21,911)
Gain from disposal and changes in holdings in subsidiaries and affiliated companies, net	1,259	2,032	888	1,892	6,888
Other income (expenses), net	6,060	284	7,283	(204)	(743)
	13,371	(1,308)	10,927	(2,162)	7,702
Costs and Expenses					
Cost of revenues	4,658	5,537	2,178	2,517	11,557
Research and development expenses, net	4,088	3,606	1,999	1,683	7,818
Marketing and selling expenses, net	9,828	4,778	4,694	2,340	14,428
General and administrative expenses	6,763	4,703	3,491	2,342	11,272
Restructuring costs	-	1,405	-	1,383	2,318
Amortization of intangible assets	1,095	895	546	460	2,058
Financial expenses, net	1,212	214	893	446	474
	27,644	21,138	13,801	11,171	49,925
Loss before tax benefit (taxes on income)	(14,273)	(22,446)	(2,874)	(13,333)	(42,223)
Tax benefit (taxes on income)	(1,843)	1,164	(2,206)	431	2,855
Loss from continuing operations after tax benefit (taxes on income)	(16,116)	(21,282)	(5,080)	(12,902)	(39,368)
Minority interest in losses of subsidiaries	3,653	234	1,681	115	2,823
Loss from continuing operations	(12,463)	(21,048)	(3,399)	(12,787)	(36,545)
Gain (loss) from discontinued operations	453	(2,368)	-	(2,368)	(2,756)
Net loss	$ (12,010)	$ (23,416)	$ (3,399)	$ (15,155)	$ (39,301)
Basic and diluted loss per share -					
Loss from continuing operations	$ (0.43)	$ (0.90)	$ (0.12)	$ (0.50)	$ (1.39)
Gain (loss) from discontinued operations	0.02	(0.10)	-	(0.09)	(0.11)
Net loss	$ (0.41)	$ (1.00)	$ (0.12)	$ (0.59)	$ (1.50)
Weighted average number of shares used in computing per share amounts (thousands)	29,183	23,382	29,185	25,552	26,272

The accompanying notes to the consolidated financial statements form an integral part thereof.

ELRON ELECTRONIC INDUSTRIES LTD.

AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

In thousands of U.S. Dollars , except share data

	Number of shares	Share capital	Additional paid-in capital	Accumulated other comprehensive income	Retained earnings (Accumulated deficit)	Total shareholders' equity	Total comprehensive income (loss)
Audited							
Balance as of January 1, 2002	21,213,664	$ 9,567	$ 165,680	$ 42,231	$ 21,235	$ 238,713	
Exercise of options	87,863	-	605			605	
Issuance of shares pursuant to the merger with Elbit	5,617,601	4	71,191	-	-	71,195	
Issuance of shares pursuant to the purchase of DEP	2,261,842	1	29,448	-	-	29,449	
Changes in additional paid-in capital in affiliated companies	-	-	336	-	-	336	
Amortization of deferred stock compensation	-	-	222	-	-	222	
Other comprehensive loss, net of tax:							
Unrealized losses on available for sale marketable securities	-	-	-	(33,035)	-	(33,035)	(33,035)
Reclassification adjustment for gain realized net of other than temporary decline included in net loss	-	-	-	(1,070)	-	(1,070)	(1,070)
Minimum pension liability in an affiliated Company	-	-	-	(597)	-	(597)	(597)
Net loss	-	-	-	-	(39,301)	(39,301)	(39,301)
Balance as of December 31, 2002	29,180,970	$ 9,572	$ 267,482	$ 7,529	$ (18,066)	$ 266,517	
Total comprehensive loss							$ (74,003)
Unaudited							
Exercise of options	22,500	-	154	-	-	154	
Changes in additional paid-in capital in affiliated companies	-	-	1,278	-	-	1,278	
Amortization of deferred stock compensation	-	-	126	-	-	126	
Other comprehensive income (loss), net of tax:							
Unrealized gains on available for sale marketable securities	-	-	-	19,370	-	19,370	19,370
Reclassification adjustment for gain realized included in net loss	-	-	-	(4,155)	-	(4,155)	(4,155)
Foreign currency translation adjustment	-	-	-	(353)	-	(353)	(353)
Unrealized gains on derivative instruments in affiliated companies	-	-	-	427	-	427	427
Net loss	-	-	-	-	(12,010)	(12,010)	(12,010)
Balance as of June 30, 2003	29,203,470	$ 9,572	$ 269,040	$ 22,818	$ (30,076)	$ 271,354	
Total comprehensive income							$ 3,279
Unaudited							
Balance as of January 1, 2002	21,213,664	$ 9,567	$ 165,680	$ 42,231	$ 21,235	$ 238,713	
Exercise of options	65,250	-	449	-	-	449	
Issuance of shares pursuant the merger with Elbit	5,617,601	4	71,191	-	-	71,195	
Issuance of shares pursuant the purchase of DEP	2,261,843	1	29,448	-	-	29,449	-
Changes in additional paid-in capital in affiliated companies	-	-	398	-	-	398	-
Amortization of deferred stock compensation	-	-	129	-	-	129	-
Other comprehensive income (loss), net of tax:							
Unrealized losses on available for sale marketable securities	-	-	-	(23,444)	-	(23,444)	(23,444)
Reclassification adjustment for gain realized included in net loss	-	-	-	(1,396)	-	(1,396)	(1,396)
Foreign currency translation adjustment	-	-	-	12	-	12	12
Net loss	-	-	-	-	(23,416)	(23,416)	(23,416)
Balance as of June 30, 2002	29,158,358	$ 9,572	$ 267,295	$ 17,403	$ (2,181)	$ 292,089	
Total comprehensive loss							$ (48,244)

The accompanying notes to the consolidated financial statements form an integral part thereof.

ELRON ELECTRONIC INDUSTRIES LTD.

AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (Cont.)

In thousands of U.S. Dollars , except share data

	Number of shares	Share capital	Additional paid-in capital	Accumulated other comprehensive income	Retained earnings (Accumulated deficit)	Total shareholders' equity	Total comprehensive income (loss)
Unaudited							
Balance as of April 1, 2003	29,180,970	$ 9,572	$ 267,817	$ 4,653	$ (26,677)	$ 255,365	$ -
Exercise of options	22,500	-	154	-	-	154	-
Changes in additional paid-in capital in affiliated companies	-	-	1,001	-	-	1,001	
Amortization of deferred stock compensation	-	-	68	-	-	68	-
Other comprehensive income (loss), net of tax:							
Unrealized gains on available for sale marketable securities	-	-	-	22,238	-	22,238	22,238
Reclassification adjustment for gain realized included in net loss	-	-	-	(4,200)	-	(4,200)	(4,200)
Foreign currency translation adjustment	-	-	-	(300)	-	(300)	(300)
Unrealized gains on derivative instruments in affiliated companies	-	-	-	427	-	427	427
Net loss	-	-	-	-	(3,399)	(3,399)	(3,205)
Balance as of June 30, 2002	29,203,470	9,572	269,040	22,818	(30,076)	271,354	
Total comprehensive income							14,960
Balance as of April 1, 2002	21,213,664	9,567	165,747	28,783	12,974	217,071	
Exercise of options	65,250	-	449	-	-	449	-
Issuance of shares pursuant to the merger with Elbit	5,617,601	4	71,191	-	-	71,195	-
Issuance of shares pursuant to the purchase of DEP	2,261,843	1	29,448	-	-	29,449	-
Changes in additional paid-in capital in affiliated companies	-	-	387		-	387	-
Amortization of deferred stock compensation	-	-	73	-	-	73	-
Other comprehensive income (loss), net of tax:							
Unrealized losses on available for sale marketable securities	-	-	-	(11,317)	-	(11,317)	(11,317)
Reclassification adjustment for gain realized included in net loss	-	-	-	(65)	-	(65)	(65)
Foreign currency translation adjustment	-	-	-	2	-	2	2
Net loss	-	-	-	-	(15,155)	(15,155)	(15,155)
Balance as of June 30, 2002	29,158,358	9,572	267,295	17,403	(2,181)	292,089	
Total comprehensive loss							(26,535)

The accompanying notes to the consolidated financial statements form an integral part thereof.

ELRON ELECTRONIC INDUSTRIES LTD.

AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

In thousands of U.S. Dollars

	For the six months ended June 30, 2003 (Unaudited)	For the six months ended June 30, 2002 (Unaudited)	For the year ended December 31, 2002 (Audited)
CASH FLOWS FROM OPERATING ACTIVITIES			
Net loss	$ (12,010)	$ (23,416)	$ (39,301)
Adjustments to reconcile net loss to net cash used in operating activities:			
Equity in losses of affiliated companies	5,544	15,273	21,911
Dividend from affiliated companies	1,407	1,312	2,670
Minority interest in losses of subsidiaries	(3,653)	(234)	(2,823)
Gain from disposal and changes in holdings in affiliated companies, net	(1,259)	(2,032)	(6,888)
Gain from sale of investments in available for sale securities	(7,100)	(629)	(706)
Gain resulting from sale of business	-	-	(1,991)
Depreciation and amortization	2,142	1,408	4,372
Decline in value of other investments	1,365	400	2,169
Amortization (appreciation) of deferred stock compensation and call options	320	(160)	(104)
Deferred taxes, net	1,778	(1,148)	(3,398)
Changes in operating assets and liabilities			
Decrease (increase) in trade receivables	3,293	(1,232)	2,515
Decrease (increase) in other receivables and prepaid expenses	(347)	2,326	3,439
Decrease (increase) in trading marketable securities, net	(3)	225	231
Decrease (increase) in inventories and contracts-in-progress	(1,330)	675	698
Decrease in trade payables	(1,507)	(1,298)	(1,385)
Decrease in other payables and accrued expenses	(1,669)	(4,432)	(11,314)
Other	661	425	695
Net cash used in operating activities	(12,368)	(12,537)	(29,210)
CASH FLOWS FROM INVESTING ACTIVITIES			
Investment in affiliated companies	(6,405)	(11,459)	(19,951)
Cash and cash equivalents resulting from the merger with Elbit (Schedule A)	-	14,907	14,883
Cash and cash equivalents resulting from the share purchase of DEP (Schedule B)	-	284	284
Cash and cash equivalents resulting from newly consolidated subsidiaries (Schedule C)	-	2,270	2,978
Cash and cash equivalents resulting from sale of businesses and subsidiaries (Schedule D)	-	-	(1,984)
Investment in other companies	(1,100)	(2,200)	(3,700)
Proceeds from sale of Elbit Systems shares	-	-	5,862
Proceeds from sale of Given Imaging shares	8,899	2,587	6,918
Proceeds from sale of investments in other companies	-	24	405
Proceeds from sale of available for sale securities	22,911	789	890
Investments in held to maturity debentures and deposits	(5,821)	(6,406)	(11,381)
Proceeds from maturities of held to maturity debentures and from deposits	3,257	2,147	4,482
Purchase of property and equipment	(336)	(284)	(969)
Proceeds from sale of property and other investment	170	63	515
Proceeds from sale of certain activities	-	6,110	6,589
Net cash provided by investing activities	21,575	8,832	5,821
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from options exercised	154	449	605
Proceeds from exercise of options in a subsidiary	-	2	2
Receipt of long-term loans from banks	2,501	-	9,152
Repayment of loans from shareholder	-	(1,378)	(1,378)
Repayment of long-term loans	(135)	(193)	(706)
Decrease in short-term bank credit, net	(4,293)	(612)	(8,954)
Repayment of loans from minority shareholders of a subsidiary	(2,499)	-	-
Proceeds from issuance of shares to the minority shareholders of a subsidiary	2,957	-	2,165
Net cash provided by (used in) financing activities	(1,315)	(1,732)	886
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	7,892	(5,437)	(22,503)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	67,901	90,404	90,404
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	$ 75,793	84,967	$ 67,901

The accompanying notes to the consolidated financial statements form an integral part thereof.

ELRON ELECTRONIC INDUSTRIES LTD.

AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Cont.)

In thousands of U.S. Dollars

	For the six months ended June 30, 2003	For the six months ended June 30, 2002	For the year ended December 31, 2002
	(Unaudited)	(Unaudited)	(Audited)
Supplemental cash flow information:			
Cash paid during the year for:			
Income taxes	$ 44	$ 78	$ 521
Interest	$ 698	$ 791	$ 1,916
SCHEDULE A:			
Cash and cash equivalents resulting from the merger with Elbit			
Assets acquired and liabilities assumed on the merger date:			
Working capital (except cash and cash equivalents)		$ 6,970	$ 6,970
Property and equipment		(9,225)	(9,225)
Investments in affiliated companies		(5,423)	(5,423)
Other investments		(111,482)	(111,482)
Other long -term assets		(1,820)	(1,820)
Goodwill		(18,251)	(18,275)
Long-term liabilities		40,123	40,123
Investment at equity prior to merger		42,739	42,739
Minority interests		82	82
Issuance of shares		71,194	71,194
Cash and cash equivalents acquired		$ 14,907	$ 14,883
SCHEDULE B:			
Cash and cash equivalents resulting from the share purchase of DEP			
Assets acquired and liabilities assumed at the share purchase date:			
Working capital (except cash and cash equivalents)		$ 19,115	$ 19,115
Property and equipment		(28)	(28)
Investments in affiliated companies		(40,493)	(40,493)
Other investments		(3,315)	(3,315)
Other assets		(5,486)	(5,486)
Long-term liabilities		1,451	1,451
Investment at equity prior to acquisition		385	385
Minority interests		(794)	(794)
Issuance of shares		29,449	29,449
Cash and cash equivalents acquired		$ 284	$ 284

The accompanying notes to the consolidated financial statements form an integral part thereof.

ELRON ELECTRONIC INDUSTRIES LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Cont.)

In thousands of U.S. Dollars

	For the six months ended June 30, 2002 (Unaudited)	Year ended December 31, 2002 (Audited)
SCHEDULE C:		
Cash and cash equivalents resulting from newly consolidated subsidiaries		
Assets acquired and liabilities assumed at the purchase date:		
Working capital (except cash and cash equivalents)	$ (1,064)	$ 3,230
Property and equipment	(1,449)	(2,007)
Other assets	(5,007)	(12,024)
Deferred taxes	1,667	3,260
Accrued severance pay, net	20	179
Investment at equity prior to acquisition	5,994	8,231
Minority interests	2,109	2,109
Cash and cash equivalents acquired	$ 2,270	$ 2,978

	Year ended December 31, 2002 (Audited)
SCHEDULE D:	
Cash and cash equivalents resulting from sale of businesses and subsidiaries	
Assets and liabilities at date of sale:	
Working capital (except cash and cash equivalents)	$ (677)
Property and equipment	266
Other assets	200
Accrued severance pay, net	(33)
Gain resulting from sale of business	1,991
Marketable securities received	(1,600)
Other investments received	(2,131)
Cash and cash equivalents received	$ (1,984)

The accompanying notes to the consolidated financial statements form an integral part thereof.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

In thousands of U.S. Dollars
(Unaudited)

Note 1 - GENERAL

The accompanying unaudited condensed interim consolidated financial statements have been prepared as of June 30, 2003, and for the six months and 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, 2002 included in the Company's Annual Report on Form 20F.

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 periods presented. All such adjustments were of a normal recurring nature.

Results for the three months and six months periods ended June 30, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003.

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.

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.

B. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In January 2003, the Financial Accounting Standards Board issued Interpretation No. 46, *Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51* ("the interpretation"). In general, a variable interest entity (VIE) is an entity that has (1) insufficient amount of equity for the entity to carry on its principal operations, without additional subordinated financial support from other parties, (2) a group of equity investors that do not have the ability through voting or similar rights to make decisions about the entity's activities, or (3) a group of equity investors that do not have the obligation to absorb the entity's losses or have the right to receive the benefits of the entity. The interpretation requires the consolidation of a VIE by the primary beneficiary. The primary beneficiary is the entity that absorbs a majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

B. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS (Cont.)

Presently, entities are generally consolidated by an enterprise that has a controlling financial interest through ownership of a majority voting interest in the entity.

The provisions of this interpretation are to be applied commencing from July 1, 2003, to variable interests in VIEs created before February 1, 2003 and immediately to variable interests in VIEs created after January 31, 2003. Since the Company has no such interests in VIEs created after January 31, 2003, the application of this interpretation had no impact on the Company's consolidated results of operations or consolidated balance sheet to date.

The Company has investments in and loans to various companies that are engaged primarily in the fields of high technology. Most of these companies are in their early stages of development and will require substantial third party investments until they can finance their activities without additional support from other parties. These companies are currently primarily funded with financing from venture capital funds, other holding companies and private investors. The investments in these companies are consolidated or accounted for by the equity or cost method by the Company.

The Company is currently evaluating the effects of this interpretation in respect of its investments. It is possible that some of its investees may be considered a VIE in accordance with the interpretation. Accordingly, if it is determined that the Company is the primary beneficiary of a VIE, the Company will be required to consolidate the financial statements of such a VIE with its own financial statements commencing from July 1, 2003.

As of June 30, 2003, the Company's maximum exposure to loss does not exceed its investment in any of these companies.

Note 3 - MAJOR TRANSACTIONS

A. GALIL MEDICAL LTD. ("Galil")

1. In the first and second quarters of 2003, Elron and RDC invested a total amount of approximately $3,800 in Galil in the form of notes convertible into Galil's shares ("Notes") pursuant to addenda to the note purchase agreement which Galil originally signed with certain existing shareholders, including Elron and RDC, in May 2002 (the "Note Agreement"), upon the same terms and conditions as the Note Agreement.

Note 3 - MAJOR TRANSACTIONS (Cont.)

A. GALIL MEDICAL LTD. (“Galil”) (Cont.)

2. On July 1, 2003 Galil announced the completion of the merger of Galil's urology business and the Brachytherapy business of Amersham plc (LSE, NYSE, OSE: AHM) ("Amersham"). According to an agreement signed on April 22, 2003, a new company, Oncura Inc. (“Oncura”), was incorporated. Oncura is to provide minimally invasive treatment options for prostate cancer using brachytherapy and cryotherapy technologies. At the closing, Amersham and Galil each contributed the assets necessary for Oncura to conduct the Cryotherapy business and the Brachytherapy business, respectively, in the urology field and in exchange therefor, Amersham received 78% and Galil received 22%, of the outstanding shares of Oncura. In addition, at the closing, Galil purchased 3% of Oncura from Amersham in consideration for $4,500 in cash of which $1,500 was paid at the closing and the balance will be paid in two equal installments in December 2003 and June 2004, resulting in Galil's aggregate ownership interest of 25% in Oncura. Until the payment of the balance, 4% of Oncura shares held by Galil, are pledged in favor of Amersham.

   Galil and Amersham each entered, separately, into supply and R&D service agreements pursuant to which Galil and Amerham shall provide Oncura with certain exclusive supply, manufacturing and R&D services, upon a cost plus basis, according to terms and conditions stipulated in the relevant agreements.

B. WAVION INC. (“Wavion”)

On June 1, 2003, Elron invested $2,000 in Wavion in consideration for Series B preferred shares, out of an aggregate amount of $6,000 raised by Wavion in a private placement from Elron and new investor. In addition to this investment, , Elron converted loans in the amount of approximately $1,600 previously granted to Wavion in 2001 and 2002 to Series A1 preferred shares. Following the transaction and the loan conversion, Elron's holdings in Wavion increased from approximately 45% to 52% of the outstanding shares of Wavion.

The investment in Wavion is continuing to be accounted for under the equity method, as Elron does not have control over Wavion.

Note 3 - MAJOR TRANSACTIONS (Cont.)

C. KIDUM ELRON IT LTD. (“KIT”)

On July 14, 2003 Elron invested $2,000 in K.I.T. eLearning B.V ("K.I.T. eLearning", formerly Kidum Holding B.V.), in consideration for Series B-2 preferred shares, as part of an aggregate investment of $4,000, the balance of which was invested by Discount Investment Corporation ("DIC"). Elron and DIC each advanced $500 on account of the investment in 2002 and in 2003, respectively. K.I.T. eLearning was previously the operating subsidiary of KIT in which Elron held approximately 29%. In addition to this investment, Elron's holdings in KIT and a loan in the amount of $1,500 were converted into shares of K.I.T. eLearning. The loan was converted to Series B-1 preferred shares. The investment in K.I.T. eLearning, which was received in consideration for the shares of KIT, was recorded at the carrying value of Elron’s previous investment in KIT. Following the transaction and the loan conversion, Elron holds approximately 45% of K.I.T. eLearning’s outstanding shares.

D. NOTAL VISION INC. (“Notal”)

In January 2003, Elron completed an investment in the amount of $2,000 in Notal, out of an aggregate amount of $4,500 raised by Notal. Notal, an Israeli related medical device company, operates in the field of early detection of Age Related Macular Deterioration (AMD). As a result of the investment, Elron holds 23.6% of Notal’s outstanding shares. The excess of the purchase price over the equity acquired, in the amount of approximately $900, was assigned to technology and to a distribution agreement, which will be amortized over a period of up to 7 years.

E. GIVEN IMAGING LTD. (“Given”)

1. On May 12, 2003, a Share Purchase Agreement ("the SPA") was signed between RDC, Elron and Rafael Armament Development Authority Ltd. ("Rafael"). According to the SPA, RDC sold two million unregistered shares of Given to Elron and Rafael (one million each) for a total consideration of $12,184. RDC used $5,000 of the proceeds to repay shareholders’ loans to each of Rafael and Elron. As a result of the above sale, there was no change in Elron’s direct and indirect holdings in Given and accordingly, the sale did not have any effect on the Company’s consolidated results of operations.

2. In the first and second quarters of 2003, RDC sold 320,000 shares of Given for a total consideration of $2,807, resulting in a gain of approximately $1,300 ($900 net of tax). As a result Elron's beneficial ownership in Given decreased to approximately 25.1%.

Note 3 - MAJOR TRANSACTIONS (Cont.)

F. OREN SEMICONDUCTORS INC. ("Oren")

On July 31, 2003, Elron completed an investment of $3,000 in Oren, as part of an aggregate investment of $8,000 from existing shareholders and from Zoran Corporation. Elron advanced $500 on account of the investment in May 2003. In addition to this investment, Elron and other existing shareholders converted all the loans previously granted to Oren, in the amount of approximately $8,400, of which Elron's part was approximately $4,400. Following the investment and the loan conversion Elron's interest in Oren increased from 17% to approximately 41% .

As a result of this transaction 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 in Oren, which is currently accounted for by Elron at cost, will be accounted for retroactively under the equity method of accounting ("step-by-step acquisition"). Implementing step-by-step acquisition will result in a restatement of Elron's financial statements for all prior periods in which Elron's investments in Oren were recorded at cost. The restatement will be reflected for the first time in the financial statements for the third quarter of 2003.

Elron anticipates that the effect of the aforementioned restatement on the results of the operations for the year ended December 31, 2002, for the six months ended June 30, 2002 and 2003 and for the three months ended June 30, 2002 and 2003 will be an increase in net loss of approximately $2,278, $1,282, $1,329, $566 and $670, respectively.

G. PARTNER COMMUNICATIONS COMPANY LTD. ("Partner")

In the second quarter of 2003 Elbit sold 3,500,000 shares of Partner, in which it previously held 12.2%, in consideration for approximately $15,200. As a result, Elron recorded a realized gain of approximately $5,000 ($3,200 net of tax). As of June 30, 2003 Elbit holds approximately 10.2% of the outstanding shares of Partner.
Subsequent to the balance sheet date, on August 11, 2003, Elbit sold an additional 2,778,226 shares of Partner in consideration for approximately $14,100 million. As a result Elron will record in the third quarter of 2003, a gain of approximately $3,900. Following the additional sale, Elbit holds approximately 8.7% of the outstanding shares of Partner.

H. 24/7 REAL MEDIA INC. ("24/7")

In the first and second quarters of 2003, Elbit and Elbit Vflash ("Vflash") sold all their shares in 24/7 (an aggregate amount of 8,215,150 shares), for a total consideration of approximately $5,200. As a result, Elron recorded a realized gain of approximately $2,000 ($800 net of tax).

In thousands of U.S. Dollars

Note 4 - SUPPLEMENTAL PRO FORMA INFORMATION (UNAUDITED)

A. The pro forma information for 2002 presents the results of operations of Elron after giving effect to the merger with Elbit, the share purchase of DEP and the acquisition of a controlling interest in Galil and MediaGate (all of the above transactions are detailed in Notes 3A(3), 3B(1), 3D(2), 3F(2), respectively, to the Company's annual financial statements as of December 31, 2002) as if they had been in effect at January 1, 2002, and includes the effect of amortization of identifiable intangible assets from that date.

B. The following pro forma information is based upon the historical financial statements of Elron and upon the historical financial statements of Elbit (after reclassification of discontinuing operations), DEP, Galil and MediaGate. The pro forma data does not incorporate, nor does it assume, any benefits from cost savings or synergies of the combined companies.

C. The pro forma data is presented for comparative purposes only and is not necessarily indicative of the operating results that would have occurred had the merger with Elbit, the share purchase of DEP or the acquisition of a controlling interest in Galil and MediaGate been consummated at the date indicated, nor are they necessarily indicative of future operating results or financial condition.

PRO FORMA COMBINED RESULTS OF OPERATIONS

	For the six months ended June 30,		For the three months ended June 30,		For the year ended December 31,
	2003	2002	2003	2002	2002
	As reported	Pro forma	As reported	Pro forma	Pro forma
Net revenues	11,596	14,078	6,005	7,142	$ 25,897
Equity in losses of affiliated companies	(5,544)	(7,393)	(3,249)	(4,326)	(14,030)
Gain from disposal and changes in holdings in subsidiaries and affiliated companies, net	1,259	1,818	888	1,892	6,674
Other income, net	6,060	2,828	7,283	3,261	1,801
Total income	13,371	11,331	10,927	7,969	20,342
Costs and expenses	27,644	41,036	13,801	23,359	69,822
Loss before tax benefit (taxes on income) and minority interests	(14,273)	(29,705)	(2,874)	(15,390)	$ (49,480)
Loss from continuing operations	(12,463)	(24,799)	(3,399)	(13,005)	$ (40,294)
Net loss	(12,010)	(36,487)	(3,399)	(18,714)	$ (52,371)
Basic and diluted net loss from continuing operations per share	(0.43)	(0.85)	(0.12)	(0.45)	(1.38)
Basic and diluted net loss per share	(0.41)	(1.25)	(0.12)	(0.64)	(1.80)
Weighted average number of ordinary shares used in computation (thousands)	29,183	29,104	29,185	29,114	29,131

In thousands of U.S. Dollars

Note 5 - SHARE - BASED EMPLOYEE COMPENSATION

The Company has 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 share option plans. 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 share at the grant date of the award or other measurement date over the exercise price.

The following pro forma information presents the effect on the consolidated share-based employee compensation expense, net loss and loss per share as if the fair value based method provided under FASB Statement No. 123, "Accounting for Stock-Based Compensation"("SFAS 123"), had been applied to all outstanding awards in each period.

Under SFAS 123 the fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions in all periods presented: (1) expected life of the option of 1-4 years; (2) dividend yield of 0%; (3) expected volatility of 34%-55% (4) risk-free interest rate of 1%-1.5%.

	For the six months ended June 30,		For the three months ended June 30,		For the year ended December 31,
	2003	2002	2003	2002	2002
	(Unaudited)		(Unaudited)		(Audited)
Net loss, as reported	$ (12,010)	$ (23,416)	$ (3,399)	$ (15,155)	$ (39,301)
Add: share-based employee compensation expense included in reported net loss	467	443	240	220	933
Deduct: Total share-based employee compensation expense determined under fair value based method for all awards	(698)	(975)	(344)	(441)	(2,876)
Pro forma net loss	$ (12,241)	$ (23,948)	$ (3,503)	$ (15,376)	$ (41,244)
Loss per share:					
Basic and diluted – as reported	$ (0.41)	$ (1.00)	$ (0.12)	$ (0.59)	$ (1.50)
Basic and diluted – pro forma	$ (0.42)	$ (1.02)	$ (0.12)	$ (0.60)	$ (1.57)

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 2002 on Form 20F, the details of which are as follows:

(1) 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 claim has been stayed pursuant to an arrangement reached by the parties pending the outcome of the appeal in the claim described in paragraph 2 below. The arrangement provides that if the appeal as described in paragraph 2 below is accepted, then the proceedings to recognize the lawsuit as a class action will proceed. Otherwise, the application to recognize the claim as a class action suit will be dismissed.

(2) On November 2, 1999, the Company received a copy of a claim, and a request to approve such a claim, as a class action on behalf of some institutional investors and others and those who held shares in Elscint on September 6, 1999. The allegations raised against the Company and its officers, among others, relate to the period prior to the sale of the company's holding in Elbit Medical Imaging ("EMI"). 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.

Note 7 - BUSINESS SEGMENTS

The Company operates indirectly through its subsidiaries, Elron Software Inc. and Elron Telesoft Inc., in two business segments: the Internet Products segment and the System and Projects segment. The Company is also directly engaged in a third business segment, other holdings and corporate operations, which includes corporate headquarters and reflects the investments in companies engaged in various fields of advanced technology.

The operations of the Internet Product segment include development and marketing of network management software products, which enable organizations to manage the access to the internet network and to control the incoming and outgoing internet content.

In thousands of U.S. Dollars

Note 7 - BUSINESS SEGMENTS (Cont.)

The operations of the System and Projects segment include development and supply of software solutions for the 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 communications, software, defense industry, medical devices, semiconductors, amorphous metals and other fields and the corporate operations.

Segment information is as follows**:**

	Internet products	Systems and Projects	Other Holdings and Corporate Operations	Adjustments	Total
For the six months ended June 30, 2003					
Total income	3,765	4,207	5,399	-	13,371
Net loss	(3,454)	(1,223)	(7,333)	-	(12,010)
For the six months ended June 30, 2002					
Total income	4,251	7,398	(12,957)	-	(1,308)
Net loss	(4,915)	(2,234)	(16,267)	-	(23,416)
For the three months ended June 30, 2003					
Total income	1,961	2,127	6,839	-	10,927
Net loss	(1,648)	(661)	(1,090)	-	(3,399)
For the three months ended June 30, 2002					
Total income	2,380	3,363	(7,905)	-	(2,162)
Net loss	(2,229)	(1,593)	(11,333)	-	(15,155)
For the year ended December 31, 2002					
Total income	8,290	10,073	(10,661)	-	7,702
Net loss	(8,567)	(5,912)	(24,822)	-	(39,301)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

In thousands of U.S. Dollars
(Unaudited)

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:

For the six months ended June 30, 2003:

	As reported	Adjustments	As per Israeli GAAP
Net loss	$ (12,010)	$ 11,198	$ (812)
Basic and diluted net loss per share	(0.41)	0.38	(0.03)

For the six months ended June 30, 2002:

	As Reported (*)	Adjustments	As per Israeli GAAP
Net loss	$ (23,416)	$ (1,657)	$ (25,073)
Basic and diluted net loss per share	(1.00)	(0.07)	(1.07)

For the three months ended June 30, 2003:

	As reported	Adjustments	As per Israeli GAAP
Net loss	$ (3,399)	$ 10,678	$ 7,279
Basic and diluted net loss per share	(0.12)	0.37	0.25

For the three months ended June 30, 2002:

	As reported	Adjustments	As per Israeli GAAP
Net loss	$ (15,155)	$ (1,848)	$ (17,003)
Basic and diluted net loss per share	(0.59)	(0.07)	(0.66)

For the year ended December 31, 2002 (audited):

	As reported	Adjustments	As per Israeli GAAP
Net loss	$ (39,301)	$ 933	$ (38,368)
Basic and diluted net loss per share	(1.50)	0.04	(1.46)

B. Effect on the balance sheet:

As of June 30, 2003:

	As reported	Adjustments	As per Israeli GAAP
Total assets	$ 413,617	$ (138,359)	$ 275,258
Total liabilities including minority interest	142,263	(32,736)	109,527
Total equity	271,354	(105,623)	165,731

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

In thousands of U.S. Dollars
(Unaudited)

Note 8 - RECONCILIATION TO ISRAELI GAAP (Cont.)

B. Effect on the balance sheet (cont.):

As of December 31, 2002 (audited):

	As reported	Adjustments	As per Israeli GAAP
Total assets	$ 401,329	$ (129,064)	$ 272,265
Total liabilities including minority interest	134,812	(27,462)	107,350
Total equity	266,517	(101,602)	164,915

C. MATERIAL ADJUSTMENTS:

The abovementioned adjustments result primarily from the differences between U.S. GAAP and Israeli GAAP as detailed in Note 26 to the Company's annual financial statements for the year ended 2002 as well as transactions which occurred during the period ended June 30,2003, as follows:

As described in Note 3G, Elbit sold 3,500,000 shares of Partner. According to accepted practice in Israel, the merger between Elron and Elbit which occurred in May 2002, is considered a transaction with controlling shareholders and accordingly the assets and liabilities of Elbit were recorded according to their carrying values in Elbit at the date of the merger. Under Israeli GAAP, the carrying value of the Partner shares was approximately $50 and therefore the gain after tax recorded in respect of the above sale of Partner shares based on Israeli GAAP amounts to approximately $9,700 as compared to approximately $3,200 under US GAAP.

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ELRON ELECTRONIC INDUSTRIES LTD.
AND ITS SUBSIDIARIES

ANNEX TO THE CONSOLIDATED FINANCIAL STATEMENTS
In thousands of U.S. Dollars

Details relating to major investments as of June 30, 2003:

	% Holding	Carrying value of the investment as of June 30, 2003 [1]	Market value of the publicly traded investments as of: June 30, 2003	August 11, 2003
Consolidated Companies:				
Elron Software Inc.	96%	(1,409)	$ -	$
Elron Telesoft Inc.	99%	9,521	-	
Galil Medical Ltd. [2]	33%	6,046	-	
MediaGate N.V.	69%	22	-	
Affiliated Companies (equity):				
Elbit Systems Ltd. (Nasdaq: ESLT)	20%	87,256	151,620	138,568
Given Imaging Ltd. (Nasdaq: GIVN) [2]	18%	23,517	37,948	52,857
NetVision Ltd.	46%	744	-	
Wavion Inc.	52%	2,552	-	
Kidum Elron IT (KIT) Ltd.	29%	(544)	-	
Chip Express Corporation	33%	3,641	-	
Pulsicom Israel Technologies Ltd.	17%	608	-	
3DV Systems Ltd. [2]	24%	225	-	
Advanced Metal Technologies Ltd. (AMT)	28%	3,822	-	
Witcom Ltd. [2]	20%	447	-	
CellAct Ltd.	45%	315	-	
Semiconductors Engineering Laboratories Ltd. (SELA) [2]	24%	565	-	
Ingeneo Ltd. [2]	17%	447	-	
Notal Vision Ltd.	24%	1,392	-	
Available for sale:				
Partner Communications Company Ltd. (Nasdaq: PTNR)	10%	91,310	91,310	94,851[3]
Partnership:				
Gemini Israel Fund	5%	263	-	
InnoMed	14%	1,982	-	
Cost:				
Oren Semiconductor Inc.	17%	9,124	-	

(1) Includes loans and convertible notes.

(2) Represents the carrying value and the percentage holding of the investment in Elron's books and Elron's share in the carrying value and percentage holding of the investment in RDC's books.

(3) Including $14,100 proceeds from sale of 2,778,226 shares on August 11, 2003 – see Note 3G.