ELRON ELECTRONIC INDUSTRIES LTD.

AND ITS SUBSIDIARIES

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

As of September 30, 2003

(Unaudited)

ELRON ELECTRONIC INDUSTRIES LTD.

AND ITS SUBSIDIARIES

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

As of September 30, 2003

(Unaudited)

C O N T E N T S

	Page
Consolidated Balance Sheets	1 - 2
Consolidated Statements of Operations	3
Consolidated Statements of Shareholders' Equity	4 - 5
Consolidated Statements of Cash Flows	6 - 8
Notes to the Consolidated Financial Statements	9 - 24
Annex to the Consolidated Financial Statements	25

\# \# \# \# \# \#

ELRON ELECTRONIC INDUSTRIES LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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

	September 30, 2003 (Unaudited)	December 31, 2002 (Audited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 80,948	$ 67,901
Marketable securities, debentures and bank deposits	41,074	3,180
Trade receivables, net	5,488	9,238
Other receivables and prepaid expenses	3,451	4,528
Inventories and contracts-in-progress	2,169	2,197
Total current assets	133,130	87,044
Long-term assets:		
Investments in affiliated companies	158,762	132,204(*)
Investments in other companies and long-term receivables	98,256	89,134(*)
Debentures and bank deposits	725	28,928
Deferred taxes	1,878	2,990
Severance pay deposits	2,372	2,262
Total long-term assets	261,993	255,518
Property and equipment, net	8,813	11,576
Intangible assets:		
Goodwill	18,921	21,538
Other intangible assets	10,210	18,577
	29,131	40,115
Total assets	$ 433,067	$ 394,253

(*)Restated –see note 3(G)

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

	September 30, 2003 (Unaudited)	December 31, 2002 (Audited)
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Short-term loans from banks	$ 11,667	$ 15,362
Current maturities of long-term loans from banks and others	58,832	17,637
Trade payables	5,197	5,738
Other payables and accrued expenses	16,093	16,516
Total current liabilities	91,789	55,253
Long-term liabilities:		
Long-term loans from banks and others	1,544	49,389
Accrued severance pay and retirement obligations	3,069	2,921
Deferred taxes	35,155	23,650
Other	103	414
Total long-term liabilities	39,871	76,374
Minority interest	24,416	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 September 30, 2003 and December 31, 2002, respectively	9,572	9,572
Additional paid-in capital	268,426	267,482
Accumulated other comprehensive income	34,454	7,529
Accumulated deficit	(35,461)	(25,142)(*)
Total shareholders' equity	276,991	259,441
Total liabilities and shareholders' equity	$ 433,067	$ 394,253

(*)Restated –see note 3(G)

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 nine months ended September 30, 2003	For the nine months ended September 30, 2002	For the three months ended September 30, 2003	For the three months ended September 30, 2002	For the year ended December 31, 2002
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
Income					
Net revenues	$ 12,555	$ 10,877	$ 4,724	$ 3,479	$ 15,179
Equity in losses of affiliated companies	(8,051)	(*)(20,833)	(1,178)	(*)(4,277)	(*)(24,189)
Gain from disposal and changes in holdings in subsidiaries and affiliated companies, net	4,391	5,259	3,132	3,227	6,888
Other income (expenses), net	30,967	319	24,907	35	(743)
	39,862	(4,378)	31,585	2,464	(2,865)
Costs and Expenses					
Cost of revenues	7,746	8,002	3,454	2,893	10,716
Research and development expenses, net	3,199	2,380	762	1,232	3,418
Marketing and selling expenses, net	7,195	3,095	1,004	2,642	6,412
General and administrative expenses	10,091	6,356	4,181	2,576	9,658
Restructuring costs	-	1,169	-	91	1,747
Amortization of intangible assets	839	800	251	413	1,044
Financial expenses (income), net	779	45	(234)	18	81
	29,849	21,847	9,418	9,865	33,076
Income (loss) before tax benefit (taxes on income)	10,013	(26,225)	22,167	(7,401)	(35,941)
Tax benefit (taxes on income)	(5,735)	1,579	(3,897)	403	2,862
Income (loss) from continuing operations after tax benefit (taxes on income)	4,278	(24,646)	18,270	(6,998)	(33,079)
Minority interest in losses (income) of subsidiaries	(11,915)	305	(15,569)	71	2,823
Income (loss) from continuing operations	(7,637)	(24,341)	2,701	(6,927)	(30,256)
Income (loss) from discontinued operations	(2,682)	(9,061)	319	(1,777)	(11,323)
Net income (loss)	$ (10,319)	$ (33,402)	$ 3,020	$ (8,704)	$ (41,579)
Basic income (loss) per share -					
Income (loss) from continuing operations	$ (0.26)	$ (*)(0.96)	$ 0.09	$ (*)(0.24)	$ (*)(1.15)
Income (loss) from discontinued operations	(0.09)	(0.36)	0.01	(0.06)	(0.43)
Net income (loss)	$ (0.35)	$ (*)(1.32)	$ 0.10	$ (*)(0.30)	$ (*)(1.58)
Diluted income (loss) per share -					
Income (loss) from continuing operations	$ (0.26)	$ (*)(0.97)	$ 0.09	$ (*)(0.24)	$ (*)(1.15)
Income (loss) from discontinued operations	(0.09)	(0.36)	0.01	(0.06)	(0.43)
Net income (loss)	$ (0.35)	$ (*)(1.33)	$ 0.10	$ (*)(0.30)	$ (*)(1.58)
Weighted average number of shares used in computing basic and diluted net income (loss) per share (thousands)	29,190	25,308	29,203	29,158	26,272

(*)Restated–see note 3(G)

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	$ 16,437(*)	$ 233,915	
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	-	-	-	-	(41,579)(*)	(41,579)(*)	(41,579)(*)
Balance as of December 31, 2002	29,180,970	$ 9,572	$ 267,482	$ 7,529	$ (25,142)	$ 259,441	
Total comprehensive loss							$ (76,281)
Unaudited							
Exercise of options	22,500	-	154	-	-	154	
Changes in additional paid-in capital in affiliated companies	-	-	609	-	-	609	
Amortization of deferred stock compensation	-	-	181	-	-	181	
Other comprehensive income (loss), net of tax:							
Unrealized gains on available for sale marketable securities	-	-	-	35,080	-	35,080	35,080
Reclassification adjustment for gain realized included in net loss	-	-	-	(7,963)	-	(7,963)	(7,963)
Foreign currency translation adjustment	-	-	-	(365)	-	(365)	(365)
Unrealized gains on derivative instruments in affiliated companies	-	-	-	173	-	173	173
Net loss	-	-	-	-	(10,319)	(10,319)	(10,319)
Balance as of September 30, 2003	29,203,470	$ 9,572	$ 268,426	$ 34,454	$ (35,461)	$ 276,991	
Total comprehensive income							$ 16,606
Unaudited							
Balance as of January 1, 2002	21,213,664	$ 9,567	$ 165,680	$ 42,231	$ 16,437(*)	$ 233,915	
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	-	-	278	-	-	278	
Amortization of deferred stock compensation	-	-	129	-	-	129	
Other comprehensive income (loss), net of tax:							
Unrealized losses on available for sale marketable securities	-	-	-	(27,478)	-	(27,478)	(27,478)
Reclassification adjustment for gain realized included in net loss	-	-	-	(1,399)	-	(1,399)	(1,399)
Foreign currency translation adjustment	-	-	-	27	-	27	27
Net loss	-	-	-	-	(33,402)(*)	(33,402)(*)	(33,402)(*)
Balance as of September 30, 2002	29,158,358	$ 9,572	$ 267,175	$ 13,381	$ (16,965)	$ 273,163	
Total comprehensive loss							$ (62,252)

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 July 1, 2003	29,203,470	$ 9,572	$ 269,040	$ 22,818	$ (38,481)	$ 262,949	
Changes in additional paid-in capital in affiliated companies	-	-	(669)	-	-	(669)	
Amortization of deferred stock compensation	-	-	55	-	-	55	
Other comprehensive income (loss), net of tax:							
Unrealized gains on available for sale marketable securities	-	-	-	15,710	-	15,710	15,710
Reclassification adjustment for gain realized included in net income	-	-	-	(3,808)	-	(3,808)	(3,808)
Foreign currency translation adjustment	-	-	-	(12)	-	(12)	(12)
Unrealized losses on derivative instruments in affiliated companies	-	-	-	(254)	-	(254)	(254)
Net Income	-	-	-	-	3,020	3,020	3,020
Balance as of September 30, 2003	29,203,470	$ 9,572	$ 268,426	$ 34,454	$ (35,461)	$ 276,991	
Total comprehensive income							$ 14,656
Balance as of July 1, 2002	29,158,358	$ 9,572	$ 267,295	$ 17,403	$ (8,261)	$ 286,009	
Exercise of options	-	-	-	-	-	-	
Changes in additional paid-in capital in affiliated companies	-	-	(120)	-	-	(120)	
Other comprehensive income (loss), net of tax:							
Unrealized losses on available for sale marketable securities	-	-	-	(4,034)	-	(4,034)	(4,034)
Reclassification adjustment for gain realized included in net loss	-	-	-	(3)	-	(3)	(3)
Foreign currency translation adjustment	-	-	-	15	-	15	15
Net loss	-	-	-	-	(8,704)(*)	(8,704)(*)	(8,704)(*)
Balance as of September 30, 2002	29,158,358	$ 9,572	$ 267,175	$ 13,381	$ (16,965)	$ 273,163	
Total comprehensive loss							$ (12,726)

(*)Restated –see note 3(G)

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 nine months ended September 30, 2003	For the nine months ended September 30, 2002	For the year ended December 31, 2002
	(Unaudited)	(Unaudited)	(Audited)
CASH FLOWS FROM OPERATING ACTIVITIES			
Net loss	$ (10,319)	$ (33,402)	$ (41,579)
Adjustments to reconcile net loss to net cash used in operating activities:			
Equity in losses of affiliated companies	8,051	20,833	24,189
Dividend from affiliated companies	2,189	1,967	2,670
Minority interest in income (losses) of subsidiaries	11,915	(305)	(2,823)
Gain from disposal and changes in holdings in affiliated companies, net	(4,391)	(5,259)	(6,888)
Gain from sale of investments in available for sale securities	(13,122)	(634)	(706)
Gain resulting from sale of businesses	(22,825)	(2,095)	(1,991)
Depreciation and amortization	3,017	2,825	4,372
Decline in value of other investments	4,104	839	2,169
Amortization (appreciation) of deferred stock compensation and call options	1,551	(1,558)	(104)
Deferred taxes, net	5,647	(1,519)	(3,398)
Changes in operating assets and liabilities			
Decrease (increase) in trade receivables	3,366	1,771	2,515
Decrease (increase) in other receivables and prepaid expenses	891	3,758	3,439
Decrease (increase) in trading securities, net	(6)	235	231
Decrease (increase) in inventories and contracts-in-progress	(109)	1,130	698
Decrease in trade payables	(220)	(1,427)	(1,385)
Decrease in other payables and accrued expenses	(5,680)	(10,672)	(11,314)
Other	(182)	1,361	695
Net cash used in operating activities	(16,123)	(22,152)	(29,210)
CASH FLOWS FROM INVESTING ACTIVITIES			
Investment in affiliated companies	(12,218)	(18,118)	(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)	-	2,978	2,978
Cash and cash equivalents resulting from sale of businesses and subsidiaries (Schedule D)	(2,959)	(1,984)	(1,984)
Investment in other companies	(299)	(1,521)	(3,700)
Proceeds from sale of Elbit Systems shares	-	-	5,862
Proceeds from sale of Given Imaging shares	13,878	6,918	6,918
Proceeds from sale of investments in other companies	-	-	405
Repayment of long term receivables	772	-	-
Proceeds from sale of available for sale securities	37,191	789	890
Investments in held to maturity debentures and deposits	(8,807)	(7,480)	(11,381)
Proceeds from maturities of deposits and held to maturity debentures	9,057	2,147	4,482
Purchase of property and equipment	(433)	(463)	(969)
Proceeds from sale of property and equipment	235	63	515
Proceeds from sale of certain activities	-	6,110	6,589
Net cash provided by investing activities	36,417	4,630	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	3,516	402	9,152
Repayment of loans from shareholder	-	(1,378)	(1,378)
Repayment of long-term loans	(6,031)	(193)	(706)
Decrease in short-term bank credit, net	(4,124)	(2,706)	(8,954)
Repayment of loans from minority shareholders of a subsidiary	(4,246)	-	-
Receipt of short-term loans from minority shareholders of a subsidiary	429	-	-
Proceeds from issuance of convertible notes to minority shareholders of a subsidiary	3,055	727	2,165
Net cash provided by (used in) financing activities	(7,247)	(2,697)	886
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	13,047	(20,219)	(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	$ 80,948	$ 70,185	$ 67,901

(*)Restated –see note 3(G)

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 nine months ended September 30, 2003	For the nine months ended September 30, 2002	For the year ended December 31, 2002
	(Unaudited)	(Unaudited)	(Audited)
Supplemental cash flow information:			
Cash paid during the year for:			
Income taxes	$ 83	$ 133	$ 521
Interest	$ 1,186	$ 1,390	$ 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 net (except cash and cash equivalents)	$ -	$ 6,969	$ 6,969
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	-	71,195	71,195
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 net (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 nine months ended September 30, 2003	For the nine months ended September 30, 2002	For the year ended December 31, 2002
	(Unaudited)	(Unaudited)	(Audited)
SCHEDULE C:			
Cash and cash equivalents resulting from newly consolidated subsidiaries			
Assets acquired and liabilities assumed at the purchase date:			
Working capital net (except cash and cash equivalents)	$ -	$ 3,230	$ 3,230
Property and equipment	-	(2,007)	(2,007)
Other assets	-	(12,024)	(12,024)
Deferred taxes	-	3,260	3,260
Accrued severance pay, net	-	179	179
Investment at equity prior to acquisition	-	8,231	8,231
Minority interests	-	2,109	2,109
Cash and cash equivalents acquired	$ -	$ 2,978	$ 2,978
SCHEDULE D:			
Cash and cash equivalents resulting from sale of businesses and subsidiaries			
Assets and liabilities at date of sale:			
Working capital net (except cash and cash equivalents)	$ 458	$ (758)	$ (677)
Property and equipment	1,274	266	266
Other assets	6,532	200	200
Deferred tax liability	(907)	-	-
Accrued severance pay, net	531	(33)	(33)
Gain resulting from sale of businesses	22,825	2,072	1,991
Securities received:			
Marketable securities	(5,400)	(1,600)	(1,600)
Other investments	(1,000)	(2,131)	(2,131)
Investment in affiliated Company	(30,272)	-	-
Liability incurred	3,000	-	-
Cash and cash equivalents received	$ (2,959)	$ (1,984)	$ (1,984)

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 September 30, 2003, and for the nine 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 9 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.

Results for the nine months and three months periods ended September 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) equity investors that as a group do not have the ability through voting or similar rights to make decisions about the entity's activities, or (3) investors that as a group 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. Presently, entities are generally consolidated by an enterprise that has a controlling financial interest through ownership of a majority voting interest in the entity.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

B. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS (Cont.)

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 method by the Company.

Pursuant to FASB Staff Position Fin 46-6, the Company has decided to apply the provisions of this interpretation as of December 31, 2003, in respect of variable interests in VIEs created before February 1, 2003. The provisions of this interpretation apply 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 is currently evaluating the effects of this interpretation in respect of its investments. It is possible that some of its unconsolidated 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 as of December 31, 2003.

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

Note 3 - MAJOR TRANSACTIONS

A. ELRON SW, INC (("ESW"), Formerly ELRON SOFTWARE INC ("ESI""))

On September 2, 2003, Elron's majority owned subsidiary, ESI, sold substantially all of its assets and business to Zix Corporation (Nasdaq: ZIXI) ("Zix"), a publicly traded company on Nasdaq and a global provider of e-messaging protection and transaction services. In consideration for the assets and business sold, Zix issued to ESI 1,709,402 unregistered shares of its common stock, with a market value of approximately $6,000 and a convertible note bearing an interest rate of 5.75% (the "Note") in the amount of $1,000 which is due in twelve monthly installments commencing in September 2004. The Note may be converted at Elron's instance into Zix common stock at a conversion price of $3.86 per share. As part of the transaction, Zix assumed certain liabilities of ESI in the net amount of approximately $1,000.

Note 3 - MAJOR TRANSACTIONS (Cont.)

A. ELRON SW, INC (("ESW"), Formerly ELRON SOFTWARE INC. ("ESI"")) (Cont.)

Following the transaction, ESI changed its name to ELRON SW, INC. (“ESW”).

Of the 1,709,402 shares of Zix common stock, ESW undertook to grant a beneficial interest in approximately 85,000 common shares to certain of its former employees in recognition of services rendered to ESW. The fair value of these shares on September 2, 2003 was approximately $300.

As of September 30, 2003 the Zix common stock held by Elron constitute approximately 6% of the outstanding share capital of Zix.

In determining the gain on the sale of ESI’s business, Elron valued the Zix common stock at $ 5,400 (a discount from market value of approximately 10% due to certain restrictions on their sale). Accordingly, Elron recorded a gain on the sale of approximately $1,600 in the third quarter of 2003. In addition, following the transaction, substantially all of ESW’s employees were transferred to Zix and ESW options held by these former employees are expected to expire 90 days after the transaction date as a result of which Elron expects to record an additional gain of approximately $2,500 in the fourth quarter of 2003. This gain represents the elimination of the liability to minority shareholders previously recorded by Elron in respect of these options.

The Zix common stock will be registered for sale on Nasdaq and therefore are accounted for as available for sale securities in accordance with SFAS 115 "Accounting for Certain Investments in Debt and Equity Securities".

The business sold by ESI represents a component of an entity as defined in SFAS 144, “Accounting for the Impairment or Disposal of Long-Lived Assets.” Since the operations and cash flows of the business sold have been eliminated from the operations of ESI and ESI will no longer have any significant continuing involvement in the operations of the business after its sale, the results of operations of the business and the gain on the sale have been classified as discontinued operations in the statement of operations.

Note 3 - MAJOR TRANSACTIONS (Cont.)

B. GALIL MEDICAL LTD. ("Galil")

1. In 2003, Elron and RDC invested a total amount of approximately $4,700 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.

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 therefore, 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.

   Galil accounted for the transfer of its business in exchange for an interest in Oncura as a nonmonetary exchange which is to be recorded at fair value. The fair value of the transaction was determined based on an independent valuation of Oncura, according to which the fair value of Oncura is approximately $150,000. As Galil retains an indirect interest in the tangible and intangible assets transferred to Oncura, the portion of the gain relating to the interest retained is to be deferred until realization by sale or amortization by Oncura. Accordingly, the investment in Oncura, which is to be accounted for under the equity method, was recorded in the amount of approximately $30,000.

Note 3 - MAJOR TRANSACTIONS (Cont.)

B. GALIL MEDICAL LTD. ("Galil")

2. (Cont.)

As a result, a gain from the transaction of approximately $21,300 was recorded in the statements of operations as "other income". The gain is net of realization of goodwill in the amount of approximately $500. Elron's share in the gain (net of minority interest and income taxes) amounted to approximately $4,400.

The investment in Oncura includes amounts allocated to goodwill of approximately $14,200, to other intangibles of $24,500 and to deferred tax liabilities of $ 9,300.

3. On September 4, 2003 Galil entered into a convertible loan agreement with certain of its shareholders, according to which Galil received a loan in the amount of $1,200. The loan shall be converted into Ordinary Shares of Galil subject to certain events, otherwise, the loan shall be repaid to the lenders together with interest at a rate of LIBOR +2%. Elron's and RDC's investment pursuant to the loan agreement amounted to approximately $700.

C. 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 ("Series B Share Purchase Agreement"). 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 above transaction and the loan conversion, Elron's ownership interest in Wavion increased from approximately 45% to 52% of the outstanding shares of Wavion.

Subsequent to the balance sheet date, on October 28, 2003, Wavion signed an addendum to the Series B Share Purchase Agreement with Elron and additional new investors, pursuant to which Elron invested an additional $1,000 in Wavion in consideration for Series B preferred shares as part of an additional aggregate investment of $6,500 in the company. As a result, Elron's ownership interest in Wavion decreased to approximately 38%.

Note 3 - MAJOR TRANSACTIONS (Cont.)

D. 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.

E. 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.

F. 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 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 half of 2003, RDC sold 320,000 shares of Given for a total consideration of approximately $2,800, resulting in a gain of approximately $1,300 ($900 net of tax).

In thousands of U.S. Dollars

Note 3 - MAJOR TRANSACTIONS (Cont.)

F. GIVEN IMAGING LTD. ("Given")

2. (Cont.)

In the third quarter of 2003, RDC sold 433,600 shares of Given for a consideration of approximately $5,000 resulting in a gain of approximately $3,100 ($2,400 net of tax). As a result of these transactions, Elron's combined interest in Given decreased to approximately 23.3%.

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

Following are the effects of the restatement:

(1) Consolidated balance sheet

	December 31, 2002		
	As reported	**Effect of restatement**	**As restated**
Investments in affiliated companies	$ 131,256	$ 948	$ 132,204
Investments in other companies and long-term receivables	97,158	(8,024)	89,134
Accumulated deficit	(18,066)	(7,076)	(25,142)
Total shareholders' equity	266,517	(7,076)	259,441

In thousands of U.S. Dollars

Note 3 - MAJOR TRANSACTIONS (Cont.)

G. OREN SEMICONDUCTOR INC. ("Oren") (Cont.)

(2) Consolidated statements of operations

	Year ended December 31, 2002		
	As reported	**Effect of restatement**	**As restated**
Equity in losses of affiliated companies	$ (21,911)	$ (2,278)	$ (24,189)
Net loss	(39,301)	(2,278)	(41,579)
Total comprehensive loss	(74,003)	(2,278)	(41,579)
Basic net loss per share	(1.50)	(0.08)	(1.58)
Diluted net loss per share	(1.50)	(0.08)	(1.58)

	For the nine months ended September 30, 2002		
	As reported	**Effect of restatement**	**As restated**
Equity in losses of affiliated companies	$ (18,791)	$ (2,042)	$ (20,833)
Net loss	(31,360)	(2,042)	(33,402)
Total comprehensive loss	(60,210)	(2,042)	(62,252)
Basic net loss per share	(1.24)	(0.08)	(1.32)
Diluted net loss per share	(1.25)	(0.08)	(1.33)

	For the three months ended September 30, 2002		
	As reported	**Effect of restatement**	**As restated**
Equity in losses of affiliated companies	$ (3,517)	$ (760)	$ (4,277)
Net loss	(7,944)	(760)	(8,704)
Total comprehensive loss	(11,966)	(760)	(12,726)
Basic net loss per share	(0.27)	(0.03)	(0.30)
Diluted net loss per share	(0.27)	(0.03)	(0.30)

H. 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).

In the third quarter of 2003, Elbit sold an additional 2,778,226 shares of Partner in consideration for approximately $14,100 million. As a result, Elron recorded a realized gain of approximately $6,000 ($3,900 net of tax). As of September 30, 2003, Elbit holds approximately 8.7% of the outstanding shares of Partner.

Note 3 - MAJOR TRANSACTIONS (Cont.)

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

In the first half of 2003, Elbit and Elbit Vflash, a wholly owned subsidiary of Elbit ("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).

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), 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 (after restatement and reclassification of discontinued operations, including the restatement in respect of the application of "step by step acquisition" method for the investment in Oren and the reclassification of discontinued operations relating to the business sold by ESW) of Elron and upon the historical financial statements of Elbit, 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.

In thousands of U.S. Dollars

Note 4 - SUPPLEMENTAL PRO FORMA INFORMATION (UNAUDITED) (Cont.)

PRO FORMA COMBINED RESULTS OF OPERATIONS

	For the nine months ended September 30,		For the year ended December 31,
	2003	2002	2002
	As reported	Pro forma	Pro forma
Net revenues	$ 12,555	$ 13,306	$ 17,608
Equity in losses of affiliated companies	(8,051)	(12,952)	(16,308)
Gain from disposal and changes in holdings in subsidiaries and affiliated companies, net	4,391	5,045	6,674
Other income, net	30,967	2,863	1,801
Total income	39,862	8,262	9,775
Costs and expenses	29,849	41,748	52,973
Income (Loss) before tax benefit (taxes on income) and minority interests	$ 10,013	$ (33,486)	$ (43,198)
Loss from continuing operations	$ (7,637)	$ (28,904)	$ (34,005)
Net loss	$(10,319)	$ (46,473)	$ (54,649)
Basic net loss from continuing operations per share	$ (0.26)	$ (0.99)	$ (1.17)
Basic net loss per share	$ (0.35)	$ (1.59)	$ (1.88)
Diluted net loss from continuing operations per share	$ (0.26)	$ (1.00)	$ (1.17)
Diluted net loss per share	$ (0.35)	$ (1.60)	$ (1.88)
Weighted average number of ordinary shares used in computation (thousands)	29,190	29,158	29,131

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.

In thousands of U.S. Dollars

Note 5 - SHARE - BASED EMPLOYEE COMPENSATION (Cont.)

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 nine months ended September 30,		For the three months ended September 30,		For the year ended December 31,
	2003	2002	2003	2002	2002
	(Unaudited)		(Unaudited)		(Audited)
Net income (loss), as reported	$ (10,319)	$ (*)(33,402)	$ 3,020	$ (*)(8,704)	$ (*)(41,579)
Add: share-based employee compensation expense included in reported net loss	785	655	387	212	933
Deduct: Total share-based employee compensation expense determined under fair value based method for all awards	(1,079)	(1,889)	(462)	(968)	(2,876)
Pro forma net loss	$ (10,613)	$ (34,636)	$ 2,945	$ (9,460)	$ (43,522)
Income (Loss) per share:					
Basic – as reported	$ (0.35)	$ (*)(1.32)	$ 0.10	$ (*)(0.30)	$ (*)(1.58)
Basic – pro forma	$ (0.36)	$ (1.37)	$ 0.10	$ (0.32)	$ (1.66)
Diluted – as reported	$ (0.35)	$ (*)(1.33)	$ 0.10	$ (*)(0.30)	$ (*)(1.58)
Diluted – pro forma	$ (0.36)	$ (1.38)	$ 0.10	$ (0.32)	$ (1.66)

(*)Restated –see note 3(G)

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 certain of its officers including former 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

Subsequent to the sale of ESW on September 2, 2003 (see Note 3A), the Company operates indirectly through its subsidiary, Elron Telesoft Inc., in one business segment - System and Projects - and is also directly engaged in a second business segment, Other Holdings and Corporate Operations, which includes corporate headquarters and reflects the investments in companies engaged in various fields of advanced technology.

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.

Prior to September 2, 2003, the Company operated indirectly through ESW in a third business segment – Internet Products – which has been reclassified as discontinued operations.

Segment information is as follows**:**

	Internet products	Systems and Projects	Other Holdings and Corporate Operations	Total
For the nine months ended September 30, 2003				
Total income	$ -	$ 5,949	$ 33,798	$ 39,747
Net loss	(3,135)	(1,632)	(5,552)	(10,319)
For the nine months ended September 30, 2002				
Total income (loss)	-	8,189	(*)(12,567)	(4,378)
Net loss	(6,799)	(4,492)	(*)(22,111)	(33,402)
For the three months ended September 30, 2003				
Total income	-	1,742	29,728	31,470
Net Income (loss)	319	(409)	3,110	3,020
For the three months ended September 30, 2002				
Total income	-	802	(*)1,662	2,464
Net loss	(1,884)	(2,257)	(*)(4,563)	(8,704)
For the year ended December 31, 2002				
Total income (loss)	-	10,073	(*)(12,938)	(2,865)
Net loss	(8,567)	(5,912)	(*)(27,100)	(41,579)

(*)Restated –see note 3(G)

In thousands of U.S. Dollars

Note 8 - DISCONTINUED OPERATIONS

As described in Note 3(A), the results of operations of ESW's business sold (which comprised the "Internet Products" segment) and the gain on the sale have been classified as discontinued operations in the statement of operations according to SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Comparative data for this business have been reclassified accordingly.

The following is the composition of discontinued operations:

	For the nine months ended September 30, 2003	2002	For the three months ended September 30, 2003	2002	For the year ended 2002
	(Unaudited)		(Unaudited)		(Audited)
Income (loss) from operations of discontinued components					
Vflash	$ 453	$ (2,352)	$ -	$ (821)	$ (1,852)
ESW	(4,705)	(6,799)	(1,251)	(1,884)	(8,567)
Other	-	(1,982)	-	(1,144)	(2,389)
	$ (4,252)	$ (11,133)	$ (1,251)	$ (3,849)	$ (12,808)
Gain (loss) on disposal					
Vflash	$ -	$ 2,072	$ -	$ 2,072	$ 1,991
ESW	1,570	-	1,570	-	-
Other	-	-	-	-	(506)
	1,570	2,072	1,570	2,072	1,485
	$ (2,682)	$ (9,061)	$ 319	$ (1,777)	$ (11,323)

Note 9 - 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 nine months ended September 30, 2003:

	As reported	Adjustments	As per Israeli GAAP
Net loss	$ (10,319)	$ 18,405	$ 8,086
Basic and diluted net loss per share	(0.35)	0.62	0.27

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

In thousands of U.S. Dollars
(Unaudited)

Note 9 - RECONCILIATION TO ISRAELI GAAP (Cont.)

A. Effect on the statements of operations (Cont.):

For the nine months ended September 30, 2002:

	As reported	Adjustments	As per Israeli GAAP
Net loss	$ (*)(33,402)	$ 62	$ (33,340)
Basic net loss per share	(1.32)	-	(1.32)
Diluted net loss per share	(1.33)	0.01	(1.32)

For the three months ended September 30, 2003:

	As reported	Adjustments	As per Israeli GAAP
Net (income) loss	$ 3,020	$ 5,879	$ 8,899
Basic and diluted net income per share	0.10	0.20	0.30

For the three months ended September 30, 2002:

	As reported	Adjustments	As per Israeli GAAP
Net loss	$ (*)(8,704)	$ 437	$ (8,267)
Basic and diluted net loss per share	(0.30)	0.02	(0.28)

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

	As reported	Adjustments	As per Israeli GAAP
Net loss	$ (*)(41,579)	$ 3,211	$ (38,368)
Basic and diluted net loss per share	(1.58)	0.12	(1.46)

B. Effect on the balance sheet:

As of September 30, 2003:

	As reported	Adjustments	As per Israeli GAAP
Total assets	$ 433,067	$ (152,481)	$ 280,586
Total liabilities including minority interest	156,076	(49,239)	106,837
Total equity	276,991	(103,242)	173,749

As of December 31, 2002 (audited):

	As reported	Adjustments	As per Israeli GAAP
Total assets	$ (*)394,253	$ (121,988)	$ 272,265
Total liabilities including minority interest	134,812	(27,462)	107,350
Total equity	(*)259,441	(94,526)	164,915

(*)Restated –see note 3(G)

Note 9 - RECONCILIATION TO ISRAELI GAAP (Cont.)

C. MATERIAL ADJUSTMENTS:

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

1. As described in Note 3G, Elbit sold in the second and third quarter of 2003, 3,500,000 and 2,778,226 shares of Partner, respectively. 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. 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 and $9,000 in the second and third quarter of 2003, respectively, as compared to approximately $3,200 and $3,900 under US GAAP.

2. According to U.S. GAAP the transfer of Galil's business in exchange for an interest in Oncura was recorded at fair value and as a result Elron recognized a gain on the transaction (net of minority interest and income taxes) in the amount of $4,400 and recorded the investment in Oncura at fair value. According to Israeli GAAP, the aforementioned exchange is accounted for as an exchange of similar productive assets. Accordingly the investment in Oncura was recorded at the carrying value of the assets transferred and no gain was recognized.

3. As a result of the purchase of an additional interest in Oren, Elron is able to exercise significant influence in Oren. In accordance with U.S GAAP, Elron's interest in Oren, which was accounted for by Elron at cost, is accounted for retroactively under the equity method of accounting ("step-by-step acquisition") which resulted in a restatement of Elron's financial statements for all prior periods. According to Israeli GAAP , the equity method should be applied only from the first time Elron could exercise significant influence in Oren. Accordingly, under Israeli GAAP the excess of the investment over the equity acquired ("excess cost") in the amount of approximately $8,800 was assigned to intangible assets and will be amortized over a period of five years. Under U.S GAAP no such excess cost exists.

# # # # # # # #

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 September 30, 2003:

	% of ownership interest	Carrying value of the investment as of September 30, 2003 [1]	Market value of the publicly traded investments as of: September 30, 2003	November 10, 2003
Consolidated Companies:				
Elron SW Inc.	96%	(4,134)	$ -	$ -
Elron Telesoft Inc.	99%	9,354	-	-
Galil Medical Ltd. [2]	33%	518	-	-
MediaGate N.V.	69%	(252)	-	-
Affiliated Companies (equity):				
Elbit Systems Ltd. (Nasdaq: ESLT)	20%	87,916	133,488	143,023
Given Imaging Ltd. (Nasdaq: GIVN) [2]	17%	20,843	46,468	75,376
NetVision Ltd.	46%	635	-	-
Wavion, Inc.	52%	2,040	-	-
K.I.T elearning B.V.	45%	413	-	-
Chip Express Corporation	33%	3,128	-	-
Pulsicom Israel Technologies Ltd.	17%	513	-	-
3DV Systems Ltd. [2]	24%	213	-	-
Advanced Metal Technologies Ltd. (AMT)	28%	3,758	-	-
Witcom Ltd. [2]	20%	420	-	-
CellAct Ltd.	45%	308	-	-
Semiconductors Engineering Laboratories Ltd. (SELA) [2]	24%	596	-	-
Ingeneo Ltd. [2]	17%	400	-	-
Notal Vision, Inc.	24%	1,360	-	-
Oren Semiconductor Inc.	41%	3,020	-	-
Oncura [3]	8%	10,128		
Available for sale:				
Partner Communications Company Ltd. (Nasdaq: PTNR)	9%	93,237	93,237	110,362
Zix Corporation (Nasdaq: ZIXI)	6%	13,846	13,846	14,991
Partnership:				
Gemini Israel Fund L.P.	5%	198	-	-
InnoMed Ventures L.P.	14%	1,996	-	-

(1) Includes loans and convertible notes.

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

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