



**CONDENSED INTERIM CONSOLIDATED  
FINANCIAL STATEMENTS**

**As of March 31, 2002**  
(Unaudited)



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## CONSOLIDATED BALANCE SHEETS

In thousands of U.S. Dollars

	<b>March 31 2002 (Unaudited)</b>	<b>December 31 2001 (Audited)</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	86,509	90,404
Debentures and deposits	16,548	15,465
Marketable securities	55	237
Trade receivables (net of allowance for doubtful accounts of \$238 and \$252 at March 31, 2002 and December 31, 2001, respectively)	9,327	9,627
Other receivables and prepaid expenses	6,789	4,395
Inventories and work-in-progress	1,616	1,671
Total current assets	120,844	121,799
Long-term assets:		
Investments in affiliated companies	140,979	155,967
Other investments	24,659	27,484
Long-term deposits and debentures	7,450	6,689
Severance pay fund	1,232	2,313
Total long-term assets	174,320	192,453
Property and equipment, net	2,952	4,971
Other assets (net of accumulated amortization of \$8,316 and \$9,834 at March 31, 2002 and December 31, 2001, respectively)	15,284	19,801
Total assets	313,400	339,024

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



## CONSOLIDATED BALANCE SHEETS

In thousands of U.S. Dollars

	<b>March 31 2002 (Unaudited)</b>	<b>December 31 2001 (Audited)</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Short-term loans and current maturities of long-term loans from banks	14,634	16,617
Trade payables	3,366	4,515
Other payables and accrued expenses	9,904	9,321
<b>Total current liabilities</b>	<b>27,904</b>	<b>30,453</b>
Long-term liabilities:		
Long-term loans from banks	53,544	51,808
Retirement obligations	2,066	3,914
Deferred taxes	3,134	3,254
Other	378	383
<b>Total long-term liabilities</b>	<b>59,122</b>	<b>59,359</b>
Minority interest	1,084	1,040
Shareholders' equity:		
Ordinary shares of NIS 0.003 par value;		
Authorized – 31,500,000 shares		
Issued and outstanding - 21,213,664 shares	9,567	9,567
Capital surplus	162,159	162,109
Accumulated other comprehensive income	34,356	49,745
Retained earnings	19,208	26,751
<b>Total shareholders' equity</b>	<b>225,290</b>	<b>248,172</b>
<b>Total liabilities and shareholders' equity</b>	<b>313,400</b>	<b>339,024</b>

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

**CONSOLIDATED STATEMENTS OF OPERATIONS**

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

	<b>For the three months ended March 31</b>		<b>For the year ended December 31</b>
	<b>2002</b>	<b>2001</b>	<b>2001</b>
	<b>(Unaudited)</b>	<b>(Unaudited)</b>	<b>(Audited)</b>
<b>Income</b>			
Revenues	5,906	9,603	32,859
Net loss from equity investments	(4,960)	(2,192)	(24,558)
Gain (loss) from disposal and changes in holdings in related companies, net	140	(144)	3,179
Other income (expenses), net	488	(3,210)	(5,105)
Finance income	906	1,793	5,215
	2,480	5,850	11,590
<b>Costs and Expenses</b>			
Cost of revenues	3,020	6,836	22,048
Research and development expenses	1,921	2,345	8,979
Marketing and selling expenses	2,439	3,181	10,587
General and administrative expenses	2,361	3,165	11,810
Amortization of other assets	435	983	3,734
Finance expenses	676	1,233	3,964
Restructuring charges, net	22	-	2,203
	10,874	17,743	63,325
Loss before tax benefit	(8,394)	(11,893)	(51,735)
Tax benefit	733	2,420	2,947
Loss after tax benefit	(7,661)	(9,473)	(48,788)
Minority interest	118	118	438
Net loss	(7,543)	(9,355)	(48,350)
<b>Earnings (loss) per share:</b>			
<b>Basic per share data -</b>			
Basic net loss per share	(0.36)	(0.44)	(2.28)
Weighted average number of shares outstanding used in computing per share amounts (thousands)	21,214	21,189	21,191
<b>Diluted per share data -</b>			
Diluted net loss per share	(0.36)	(0.44)	(2.29)
Weighted average number of shares outstanding used in computing per share amounts (thousands)	21,214	21,189	21,191

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

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

In thousands of U.S. Dollars

	<u>Number of shares</u>	<u>Share capital</u>	<u>Capital surplus</u>	<u>Accumulated other comprehensive income</u>	<u>Retained earnings</u>	<u>Total shareholders' equity</u>	<u>Total comprehensive income (loss)</u>
<b>Audited</b>							
Balance as of January 1, 2001	21,188,664	9,567	158,916	36,459	75,101	280,043	
Options exercised	25,000	-	306	-	-	306	
Other comprehensive income, net of tax:							
Unrealized gains on securities	-	-	-	14,364	-	14,364	14,364
Reclassification adjustment for net amounts included in net income	-	-	-	(1,056)	-	(1,056)	(1,056)
Foreign currency translation adjustment	-	-	-	(22)	-	(22)	(22)
Changes in capital surplus in affiliated companies	-	-	2,893	-	-	2,893	-
Amortization of deferred stock compensation	-	-	(6)	-	-	(6)	-
Net loss	-	-	-	-	(48,350)	(48,350)	(48,350)
Balance as of December 31, 2001	<u>21,213,664</u>	<u>9,567</u>	<u>162,109</u>	<u>49,745</u>	<u>26,751</u>	<u>248,172</u>	<u>(35,064)</u>
<b>Unaudited</b>							
Balance as of January 1, 2002	21,213,664	9,567	162,109	49,745	26,751	248,172	
Other comprehensive income, net of tax:							
Unrealized losses on securities	-	-	-	(14,068)	-	(14,068)	(14,068)
Reclassification adjustment for net amounts included in net income	-	-	-	(1,331)	-	(1,331)	(1,331)
Foreign currency translation adjustment	-	-	-	10	-	10	10
Changes in capital surplus in affiliated companies	-	-	(6)	-	-	(6)	-
Amortization of deferred stock compensation	-	-	56	-	-	56	-
Net loss	-	-	-	-	(7,543)	(7,543)	(7,543)
Balance as of March 31, 2002	<u>21,213,664</u>	<u>9,567</u>	<u>162,159</u>	<u>34,356</u>	<u>19,208</u>	<u>225,290</u>	<u>(22,932)</u>
<b>Unaudited</b>							
Balance as of January 1, 2001	21,188,664	9,567	158,916	36,459	75,101	280,043	
Other comprehensive income, net of tax:							
Unrealized losses on securities	-	-	-	(10,420)	-	(10,420)	(10,420)
Reclassification adjustment for net amounts included in net income	-	-	-	(95)	-	(95)	(95)
Foreign currency translation adjustment	-	-	-	(39)	-	(39)	(39)
Changes in capital surplus in affiliated companies	-	-	1,322	-	-	1,322	-
Amortization of deferred stock compensation	-	-	(123)	-	-	(123)	-
Net loss	-	-	-	-	(9,355)	(9,355)	(9,355)
Balance as of March 31, 2001	<u>21,188,664</u>	<u>9,567</u>	<u>160,115</u>	<u>25,055</u>	<u>65,746</u>	<u>260,483</u>	<u>(20,759)</u>

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

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

In thousands of U.S. Dollars

	<b>For the three months ended March 31</b>		<b>For the year ended December 31</b>
	<b>2002</b>	<b>2001</b>	<b>2001</b>
	<b>(Unaudited)</b>		<b>(Audited)</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net loss	(7,543)	(9,355)	(48,350)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Income and expenses not affecting operating cash flows:			
Net loss from equity investments	4,960	2,192	24,558
Dividend from affiliated companies	-	-	13,805
Minority interest	(118)	(118)	(438)
Gain (loss) from disposal and changes in holdings in related companies, net	(140)	144	(3,179)
Gain on sale of other investments	(605)	(1,030)	(999)
Depreciation and amortization	834	1,619	6,362
Decrease (increase) in other investments and accrued interest	(3)	(540)	1,468
Amortization of deferred stock compensation	223	(123)	29
Deferred taxes	(718)	(4,216)	(2,796)
Restructuring charges	(381)	-	774
Other	128	76	(206)
Changes in operating assets and liabilities-			
Decrease (increase) in trade receivables	300	(1,173)	2,328
Decrease (increase) in other receivables and prepaid expenses	852	(26)	(1,305)
Decrease in trading account securities	182	14,668	16,652
Decrease (increase) in inventories	55	222	(1,310)
Increase (decrease) in trade payables	(1,149)	(716)	1,435
Decrease in other payables and accrued expenses	(100)	(2,582)	(7,711)
Net cash provided by (used in) operating activities	<u>(3,223)</u>	<u>(958)</u>	<u>1,117</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Investment in affiliated companies	(1,544)	(7,649)	(16,276)
Merger costs	(475)	-	(250)
Other investments	(1,087)	(2,118)	(3,305)
Proceeds from repayment of convertible debentures	-	1,270	-
Proceeds from sale of available for sale securities	789	-	1,332
Proceeds from sale of Elbit Systems shares	-	-	6,655
Investments in deposits	(1,583)	-	(12,213)
Investments in held to maturity debentures	(1,270)	-	-
Proceeds from deposit and maturities of held to maturity debentures	1,100	21,947	39,357
Purchase of property and equipment	(204)	(722)	(1,132)
Proceeds from sale of property and equipment and other investments	33	101	1,426
Proceeds from sale of activities	3,816	-	3,430
Net cash provided by (used in) investing activities	<u>(425)</u>	<u>12,829</u>	<u>19,024</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Proceeds from options exercised	-	-	306
Proceeds from options exercised in a subsidiary	-	2	71
Long-term loans from banks	1,860	-	9,540
Repayment of long-term loans	(291)	(140)	(630)
Increase (decrease) in short-term bank credit, net	(1,816)	3,802	401
Net cash provided by (used in) financing activities	<u>(247)</u>	<u>3,664</u>	<u>9,688</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(3,895)	15,535	29,829
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	<u>90,404</u>	<u>60,575</u>	<u>60,575</u>
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	<u>86,509</u>	<u>76,110</u>	<u>90,404</u>

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

**CONSOLIDATED STATEMENTS OF CASH FLOWS (Cont.)**

In thousands of U.S. Dollars

	<b>For the three months ended March 31</b>		<b>For the year ended December 31</b>
	<b>2002</b>	<b>2001</b>	<b>2001</b>
	<b>(Unaudited)</b>		<b>(Audited)</b>
Supplemental cash flow information:			
Cash paid for:			
Income taxes	349	4,329	6,025
Interest	338	1,167	4,202
Non-cash transaction:			
Receivable on account of activity sale	2,795	-	-

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 March 31, 2002, and for the three months then ended in accordance with accounting principles generally accepted in the United States (US GAAP) relating to the preparation of financial statements for interim periods. See Note 6 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, 2001.

The interim financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair presentation. All such adjustments were of a normal recurring nature.

Results for the three month period ended March 31, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002.

**Note 2 - SIGNIFICANT ACCOUNTING POLICIES**

The significant accounting policies followed in the preparation of these financial statements are identical to those applied in preparation of the latest annual financial statements, except as described in Note 4.

The financial statements have been prepared in US dollars, since the functional currency of the Company and its principal subsidiaries and affiliated companies is the US dollar.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)**

In thousands of U.S. Dollars  
(Unaudited)

**Note 3 - MAJOR TRANSACTIONS**

- A. On May 9, 2002, Elron announced that the district court of Tel Aviv approved the merger with Elbit Ltd. ("Elbit") and that the completion of the merger will occur on May 15, 2002. Pursuant to the merger agreement, Elbit will merge with Elron and Elron will issue to Elbit shareholders, other than Elron, approximately 5,600,000 ordinary shares of Elron based on an exchange ratio of 0.45 ordinary share of Elron for each ordinary share of Elbit and will assume Elbit options such that they are deemed to constitute options to purchase approximately 400,000 of its ordinary shares.
- B. On May 6, 2002, Elron announced the closing of the share purchase of DEP Technology Holdings Ltd. ("DEP"). Pursuant to the share purchase agreement signed on November 19, 2001 with Discount Investment Corporation Ltd. ("DIC"), which then held approximately 42% of Elron's shares, Elron issued 2,261,843 ordinary shares to DIC in exchange for DIC's shares (67%) in DEP, including rights to loans provided by DIC to a subsidiary of DEP, RDC Rafael Development Corporation Ltd. ("RDC"), held 48% by DEP.

Elron has direct holdings in certain companies in which RDC also holds shares. As a result of the purchase of DEP, Elron's interest in these companies will increase and enable Elron to exercise significant influence in these companies. In accordance with APB 18, Elron's direct holdings in these companies, which are currently accounted for by Elron at cost, will be accounted for retroactively under the equity method of accounting ("step-by-step acquisition"). The effect of implementing step-by-step acquisition will result in restatement of Elron's financial statements for all prior periods in which Elron's investments in these companies were recorded at cost. As the acquisition was finalized subsequent to balance sheet date, in May 2002, the restatement of prior period data will be reflected in the financial statements commencing for the period ended June 30, 2002. The Company anticipates that the effect of the aforementioned restatement on the results of operations for the year ended December 31, 2001 and for the three months ended March 31, 2001 and 2002, will be an increase in net loss of approximately \$ 2,700, \$600 and \$ 750, respectively.



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)**

In thousands of U.S. Dollars  
(Unaudited)

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)**

In thousands of U.S. Dollars  
(Unaudited)

**Note 3 - MAJOR TRANSACTIONS (Cont.)**

The merger with Elbit and the purchase of DEP will be accounted under the purchase method of accounting. The Company is currently evaluating both of these acquisitions for the purpose of determining the amount, if any, that should be allocated to identifiable intangibles and goodwill.

Following the closing of the two transactions, Elbit and DEP, as wholly owned subsidiaries of Elron, will be consolidated with Elron commencing on May 2002.

Summarized unaudited financial information of Elbit and DEP is as follows:

	<b>Elbit</b>	<b>DEP</b>
<b>Balance sheet information -</b>		
<b>March 31, 2002:</b>		
Current assets	24,040	957
Total assets	156,643	24,670
Current liabilities	14,503	18,592
Long-term liabilities	39,631	4,266
Minority interest	82	-
Shareholders' equity	102,427	1,888
<b>Statement of operations</b>		
<b>information-</b>		
<b>For the three months ended</b>		
<b>March 31, 2002:</b>		
Income	154	3,952
Gross loss	(839)	-
Loss from continuing operations	(12,131)	(1,754)

- C. In November 2001, Elron TeleSoft Inc. ("ETI") signed an agreement with Elbit Systems Ltd. ("ESL"), held approximately 21% by Elron, for the sale of the net assets and activities of ETI in the government field, in consideration for approximately \$5,700. The transaction was completed during the first quarter of 2002 and resulted in an immaterial gain to Elron.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)**

In thousands of U.S. Dollars  
(Unaudited)

**Note 4 - GOODWILL AND OTHER INTANGIBLE ASSETS**

On January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS 142) and accordingly goodwill is no longer being amortized as of January 1, 2002. In accordance with SFAS 142, the Company has also evaluated the useful lives of its other intangible assets and has concluded that no change in the period of amortization is necessary.

The annual amortization expense relating to intangibles other than goodwill existing at January 1, 2002 for each of the five years in the period ending December 31, 2006 is approximately as follows:

2002	-	\$ 3,000
2003	-	\$ 3,000
2004	-	\$ 2,200
2005	-	\$ 1,800
2006	-	\$ 700

As of January 1, 2002, the Company has unamortized goodwill in the amount of approximately \$6,600. In connection with SFAS 142's transitional goodwill impairment evaluation, the Company has estimated the fair value of each reporting unit (subsidiary) and has compared it to the reporting unit's carrying amount. Based on this comparison the company concluded that as of January 1, 2002, no goodwill impairment loss should be recorded.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)**

In thousands of U.S. Dollars  
(Unaudited)

**Note 4 - GOODWILL AND OTHER INTANGIBLE ASSETS (Cont.)**

The following transitional information is presented to reflect net income and earnings per share for all prior periods adjusted to exclude amortization of goodwill:

	<b>For the three months ended March 31 2002</b>	<b>For the three months ended March 31 2001</b>	<b>For the year ended December 31 2001</b>
Reported net loss	(7,543)	(9,355)	(48,350)
Goodwill amortization	-	418	1,565
Adjusted net loss	<u>(7,543)</u>	<u>(8,937)</u>	<u>(46,785)</u>
Earnings (loss) per share:			
Reported basic loss per share	(0.36)	(0.44)	(2.28)
Goodwill amortization	-	0.02	0.07
Adjusted basic loss per share	<u>(0.36)</u>	<u>(0.42)</u>	<u>(2.21)</u>
Reported diluted loss per share	(0.36)	(0.44)	(2.29)
Goodwill amortization	-	0.02	0.07
Adjusted diluted loss per share	<u>(0.36)</u>	<u>(0.42)</u>	<u>(2.22)</u>

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)**

In thousands of U.S. Dollars  
(Unaudited)

**Note 5 - BUSINESS SEGMENTS**

The Company operates in three business segments: the Internet products segment, the systems and projects segment and a segment which includes the holdings in affiliated and other companies, engaged in various fields of advanced technology, and the corporate operations. Segment information is as follows:

	<u>Internet Products</u>	<u>Systems and Projects</u>	<u>Holdings (including corporate headquarters)</u>	<u>Adjustments</u>	<u>Total</u>
<b>For the three months ended</b>					
<b>March 31, 2002</b>					
Revenues	1,871	4,035	-	-	5,906
Net loss	(2,686)	(642)	(4,215)	-	(7,543)
Total assets	7,020	26,920	291,083	(11,623)	313,400
<b>For the three months ended</b>					
<b>March 31, 2001</b>					
Revenues	2,231	7,384	-	(12)	9,603
Net loss	(3,003)	(3,350)	(3,002)	-	(9,355)
<b>For the year ended</b>					
<b>December 31, 2001</b>					
Revenues	9,077	23,782	-	-	32,859
Net loss	(11,188)	(15,302)	(21,860)	-	(48,350)
Total assets	7,801	32,060	310,652	(11,489)	339,024

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)**

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

**Note 6 - 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 STATEMENTS OF OPERATIONS:**

For the three months ended March 31, 2002 -

	<u>As reported</u>	<u>Adjustments</u>	<u>As per Israeli GAAP</u>
Net loss	(7,543)	(527)	(8,070)
Basic and diluted net loss per share	(0.36)	(0.03)	(0.39)

For the three months ended March 31, 2001 -

	<u>As reported</u>	<u>Adjustments</u>	<u>As per Israeli GAAP</u>
Net loss	(9,355)	(663)	(10,018)
Basic and diluted net loss per share	(0.44)	(0.03)	(0.47)

For the year ended December 2001 -

	<u>As reported</u>	<u>Adjustments</u>	<u>As per Israeli GAAP</u>
Net loss	(48,350)	1,835	(46,515)
Basic net loss per share	(2.28)	0.08	(2.20)
Diluted net loss per share	(2.29)	0.08	(2.21)



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)**

In thousands of U.S. Dollars  
(Unaudited)

**Note 6 - RECONCILIATION TO ISRAELI GAAP (Cont.)**

**B - EFFECT ON BALANCE SHEET ITEMS:**

As of March 31, 2002 -

	<b>As reported</b>	<b>Adjustments</b>	<b>As per Israeli GAAP</b>
Total assets	313,400	(51,332)	262,068
Total liabilities including minority interest	88,110	(3,134)	84,976
Total shareholders' equity	225,290	(48,198)	177,092

As of December 31, 2001 -

	<b>As reported</b>	<b>Adjustments</b>	<b>As per Israeli GAAP</b>
Total assets	339,024	(66,509)	272,515
Total liabilities including minority interest	90,852	(3,496)	87,356
Total shareholders' equity	248,172	(63,013)	185,159

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