ELRON ELECTRONIC INDUSTRIES LTD.

AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

As of December 31, 2002

ELRON ELECTRONIC INDUSTRIES LTD.

AND ITS SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

C O N T E N T S

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REPORT OF INDEPENDENT AUDITORS

To the shareholders of
ELRON ELECTRONIC INDUSTRIES LTD.

We have audited the accompanying consolidated balance sheets of Elron Electronic Industries Ltd. (the “Company”) and its subsidiaries, as of December 31, 2002 and 2001, and the related consolidated statements of operations, changes in shareholders’ equity and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We did not audit the financial statements of certain subsidiaries, whose assets constitute 4.5% of consolidated total assets as of December 31, 2002, and whose net losses constitute approximately 4.8% of consolidated net loss for the year ended December 31, 2002. Also, we did not audit the financial statements of certain affiliates, the investment in which, at equity, amounted to $13.0 million and $11.5 million as of December 31, 2002 and 2001, respectively, and the Company’s equity in their losses amounted to $4.6 million and $8.1 million for the years ended December 31, 2002 and 2001, respectively. Those financial statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for those companies, is based solely on the reports of other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subisidiaries as of December 31, 2002 and 2001 and the consolidated results of their operations, and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in United States.

Luboshitz Kasierer
An affiliate member of Ernst & Young International

Tel Aviv, Israel
March 12, 2003

ELRON ELECTRONIC INDUSTRIES LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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

	Note	December 31 2002	December 31 2001(*)
ASSETS			
Current assets:			
Cash and cash equivalents	(4)	$ 67,901	$ 90,404
Marketable securities		3,180	264
Trade receivables, net	(5)	9,238	9,627
Other receivables and prepaid expenses		4,528	4,395
Inventories and contracts-in-progress		2,197	1,671
Total current assets		87,044	106,361
Long-term assets:			
Investments in affiliated companies	(6)	131,256	162,260
Investments in other companies and long-term receivables	(7)	97,158	7,504
Long-term debentures and deposits	(9)	28,928	22,127
Deferred taxes	(15)	2,990	973
Severance pay deposits		2,262	2,313
Total long-term assets		262,594	195,177
Property and equipment, net	(10)	11,576	4,971
Other assets:	(11)		
Goodwill		21,538	8,833
Other intangible assets		18,577	10,968
		40,115	19,801
Total assets		$ 401,329	$ 326,310

(*) Restated - see Note 3(G).

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

ELRON ELECTRONIC INDUSTRIES LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (Cont.)

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

	Note	December 31 2002	2001 (*)
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Short-term loans from banks	(12)	$ 15,362	$ 16,009
Current maturities of long-term loans from banks and others	(14)	17,637	608
Trade payables		5,738	4,514
Other payables and accrued expenses	(13)	16,516	9,321
Total current liabilities		55,253	30,452
Long-term liabilities:			
Long-term loans from banks and others	(14)	49,389	51,808
Accrued severance pay and retirement obligations		2,921	3,914
Deferred taxes	(15)	23,650	-
Other		414	383
Total long-term liabilities		76,374	56,105
Contingent liabilities, pledges and commitments	(16)		
Minority interest		3,185	1,040
Shareholders' equity:	(17)		
Ordinary shares of NIS 0.003 par value; Authorized – 35,000,000 and 31,500,000 shares as of December 31, 2002 and 2001 respectively; Issued and outstanding - 29,180,970 and 21,213,664 shares as of December 31, 2002 and 2001, respectively;		9,572	9,567
Additional paid-in capital		267,482	165,680
Accumulated other comprehensive income		7,529	42,231
Retained earnings (deficit)		(18,066)	21,235
Total shareholders' equity		266,517	238,713
Total liabilities and shareholders' equity		$ 401,329	$ 326,310

AMI EREL	AVRAHAM ASHERI	DORON BIRGER
Chairman of the Board of Directors	Director	President & Chief Executive Officer

Date of approval of financial statements: March 12, 2003

(*) Restated – See Note 3(G).

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

ELRON ELECTRONIC INDUSTRIES LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Note	Year ended December 31 2002	2001 (*)	2000 (*)
Income				
Revenues		$ 23,468	$ 32,859	$ 39,162
Equity in losses of affiliated companies' investments	(19)	(21,911)	(*)(27,242)	(*)(9,483)
Gain from disposal and changes in holdings in subsidiaries and affiliated companies, net	(20)	6,888	3,179	(*)26,819
Other income (expenses), net	(21)	(743)	(*)(4,885)	43,458
		7,702	3,911	99,956
Costs and Expenses				
Cost of revenues		11,557	22,048	26,523
Research and development costs, net		7,818	8,979	7,785
Marketing and selling expenses, net		14,428	10,587	14,710
General and administrative expenses		11,272	11,810	13,740
Restructuring costs	(3C(3))	2,318	2,203	-
Amortization of intangible assets		2,058	3,734	3,180
Financial expenses (income), net	(22)	474	(1,251)	(2,406)
		$ 49,925	$ 58,110	$ 63,532
Income (loss) before taxes on income		(42,223)	(*)(54,199)	(*)36,424
Taxes on income (tax benefit)	(15)	(2,855)	(2,947)	8,079
Income (loss) from continuing operations after taxes on income		(39,368)	(*)(51,252)	(*) 28,345
Minority interest in losses of subsidiaries		2,823	438	171
Income (loss) from continuing operations		(36,545)	(*)(50,814)	(*)28,516
Loss from discontinued operations	(23)	(2,756)	-	-
Net income (loss)		$ (39,301)	$ (*)(50,814)	$ (*)28,516
Income (loss) per share:	(18)			
Basic income (loss) per share data -				
Income (loss) from continuing operations		$ (1.39)	$ (*) (2.40)	$ (*)1.35
Income (loss) from discontinued operations		(0.11)	-	-
Net income (loss)		$ (1.50)	$ (2.40)	$ 1.35
Weighted average number of ordinary shares used in computing basic net income (loss) per share (thousands)		26,272	21,191	21,172
Diluted income (loss) per share data -				
Income (loss) from continuing operations		$ (1.39)	$ (*) (2.41)	$ (*)1.33
Income (loss) from discontinued operations		(0.11)	-	-
Net income (loss)		$ (1.50)	$ (2.41)	$ 1.33
Weighted average number of ordinary shares used in computing diluted net income (loss) per share (thousands)		26,272	21,191	21,446

(*) Restated – See Note 3(G).

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

ELRON ELECTRONIC INDUSTRIES LTD.
AND ITS SUBSIDIARIES

STATEMENT OF SHAREHOLDERS' EQUITY

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

	Number of shares	Share capital	Additional paid-in capital	Accumulated other comprehensive income	Retained earnings (deficit)	Total shareholders' equity	Total comprehensive loss
Balance as of January 1, 2000 (*)	21,140,664	$ 9,567	$ 156,196	$ 187,302	$ 99,022	$ 452,087	
Dividend paid	-	-	-	-	(55,489)	(55,489)	
Exercise of options	48,000	-	485	-	-	485	
Changes in additional paid-in capital in affiliated companies	-	-	1,972	-	-	1,972	
Amortization of deferred stock compensation	-	-	245	-	-	245	
Other comprehensive loss, net of tax:							
Unrealized losses on available for sale marketable securities	-	-	-	(122,072)	-	(122,072)	$ (122,072)
Reclassification adjustment for gain realized in net income	-	-	-	(28,786)	-	(28,786)	(28,786)
Foreign currency translation adjustment	-	-	-	15	-	15	15
Net income	-	-	-	-	28,516	28,516	28,516
Balance as of December 31, 2000(*)	21,188,664	9,567	158,898	36,459	72,049	276,973	
Total comprehensive loss							$ (122,327)
Exercise of options	25,000	-	306	-	-	306	
Changes additional paid-in capital in affiliated companies	-	-	2,899	-	-	2,899	
Deferred gain from change in holding in affiliated company			3,583			3,583	
Amortization of deferred stock compensation	-	-	(6)	-	-	(6)	
Other comprehensive loss, net of tax:							
Unrealized gains on available for sale marketable securities	-	-	-	6,850	-	6,850	$ 6,850
Reclassification adjustment for gain realized in net loss	-	-	-	(1,056)	-	(1,056)	(1,056)
Foreign currency translation adjustment	-	-	-	(22)	-	(22)	(22)
Net loss	-	-	-	-	(50,814)	(50,814)	(50,814)
Balance as of December 31, 2001 (*)	21,213,664	9,567	165,680	42,231	21,235	238,713	
Total comprehensive loss							$ (45,042)
Exercise of options	87,863	-	605			605	
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	-	-	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 and other than temporary decline included in net loss	-	-	-	(1,070)	-	(1,070)	(1,070)
Foreign currency translation adjustment	-	-	-	-	-		-
Minimum pension liability in an affiliated Company	-	-	-	(597)	-	(597)	(597)
Net loss	-	-		-	(39,301)	(39,301)	(39,301)
Balance as of December 31, 2002	29,180,971	$ 9,572	$ 267,482	$ 7,529	$ (18,066)	$ 266,517	
Total comprehensive loss							$ (74,003)
Accumulated unrealized gains from available for sale marketable securities, net of taxes				$ 8,459			
Accumulated foreign currency translation adjustments				(333)			
Minimum pension liability in an affiliated Company				(597)			
Accumulated other comprehensive loss				$ 7,529			

(*) Restated – See Note 3(G).

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

ELRON ELECTRONIC INDUSTRIES LTD.
AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

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

	Year ended December 31		
	2002	2001 (*)	2000(*)
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss)	$ (39,301)	$ (50,814)	$ 28,516
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Equity in losses of affiliated companies	21,911	27,242	9,483
Dividend from affiliated companies	2,670	13,805	13,242
Minority's interest in losses of subsidiaries	(2,823)	(438)	(171)
Gain from disposal and changes in holdings in affiliated companies, net	(6,888)	(3,179)	(26,819)
Gain from sale of investments in other companies	(605)	(999)	(27,288)
Gain resulting from sale of business	(1,991)	-	-
Depreciation and amortization	4,372	6,362	5,122
Decrease in other investments and accrued interest	2,380	1,247	615
Amortization of deferred stock compensation and call options	(104)	29	1,745
Deferred taxes, net	(3,398)	(2,796)	2,229
Decrease (increase) in trade receivables	2,515	2,328	(1,059)
Decrease (increase) in other accounts receivable and prepaid expenses	3,439	(1,305)	(827)
Decrease in trading marketable securities, net	231	16,652	48
Decrease (increase) in inventories and contracts–in-progress	698	(1,310)	(47)
Increase (decrease) in trade payables	(1,385)	1,435	1,212
Increase (decrease) in other accounts payable and accrued expenses	(11,314)	(7,710)	5,290
Other	383	568	(175)
Net cash provided by (used in) operating activities	(29,210)	1,117	11,116
CASH FLOWS FROM INVESTING ACTIVITIES			
Investment in affiliated companies	(19,951)	(17,931)	(29,994)
Proceeds from sale of Elbit Systems shares	5,862	6,655	-
Proceeds from sale of Given Imaging shares	6,918	-	-
Cash and cash equivalents resulting from the merger with Elbit (Schedule A)	14,883	-	-
Cash and cash equivalents resulting from the share purchase of DEP (Schedule B)	284	-	-
Cash and cash equivalents resulting from newly consolidated subsidiaries (Mediagate and Galil Medical) (Schedule C)	2,978	-	-
Cash and cash equivalents resulting from sale of businesses and subsidiaries (Schedule D)	(1,984)	-	-
Investment in other companies	(3,700)	(1,900)	(1,774)
Proceeds from sale of investments in other companies	405	1,115	152
Proceeds from sale of available for sale securities	890	1,332	22,282
Investments in held to maturity debentures and deposits	(11,381)	(12,213)	(59,309)
Proceeds from maturities of held to maturity debentures and from deposits	4,482	39,357	104,025
Purchase of property and equipment	(969)	(1,132)	(4,549)
Proceeds from sale of property and equipment and other investments	515	311	81
Proceeds from sale of certain activities	6,589	3,430	-
Net cash provided by investing activities	5,821	19,024	30,914
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from exercise of options	605	306	485
Proceeds from exercise of options in a subsidiary	2	71	171
Long-term loans from banks	9,152	9,540	10,632
Repayment of loans from shareholder	(1,378)	-	-
Repayment of long-term loans	(706)	(630)	(10,417)
Increase (decrease) in short-term bank credit, net	(8,954)	401	11,130
Proceeds from issuance of shares to the minority in a subsidiary	2,165	-	4,626
Dividend paid	-	-	(55,489)
Net cash provided by (used in) financing activities	886	9,688	(38,862)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(22,503)	29,829	3,168
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR	90,404	60,575	57,407
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	$ 67,901	$ 90,404	$ 60,575

* Restated – see Note 3(G).

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

CONSOLIDATED STATEMENTS OF CASH FLOWS (Cont.)

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

	Year ended December 31		
	2002	2001	2000
Supplementary cash flows activities:			
Cash paid during the year for:			
Income tax	$ 521	$ 6,025	$ 2,459
Interest	$ 1,916	$ 4,202	$ 3,929
Non-cash transactions:			
Investment in Netvision against liabilities	$ -	$ -	$ 3,500
Exchange of marketable securities	$ -	$ 2,140	$ 7,823
Reclassification of inventory from inventory and contracts-in-progress to property and equipment, net	$ 477	$ -	$ -
Reclassification of other assets to tax liability	$ 6,600	$ -	$ -

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
Property and equipment	(9,225)
Investments in affiliated companies	(5,423)
Other investments	(111,482)
Other long term assets	(1,820)
Goodwill	(18,275)
Long-term liabilities	40,123
Investment at equity prior to merger	42,739
Minority interests	82
Issuance of shares	71,194
Cash and cash equivalents acquired	$ 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
Property and equipment	(28)
Investments in affiliated companies	(40,493)
Other investments	(3,315)
Other assets	(5,486)
Long-term liabilities	1,451
Investment at equity prior to acquisition	385
Minority interests	(794)
Issuance of shares	29,449
Cash and cash equivalents acquired	$ 284

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

CONSOLIDATED STATEMENTS OF CASH FLOWS (Cont.)

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

SCHEDULE C:

	Year ended December 31, 2002
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)	$ 3,230
Property and equipment	(2,007)
Other assets	(12,024)
Deferred taxes	3,260
Accrued severance pay, net	179
Investment at equity prior to acquisition	8,231
Minority interests	2,109
Cash and cash equivalents acquired	$ 2,978

SCHEDULE D:

	Year ended December 31, 2002
Cash and cash equivalents resulting from sale of business 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 are an integral part of the consolidated financial statements.

Note 1 - GENERAL

Elron Electronic Industries Ltd. ("Elron" or "the Company"), an Israeli corporation, is a multi-national high technology operational holding company. Elron's global business is conducted through subsidiaries and affiliates ("related companies"), primarily in the fields of defense electronics, software, communication, medical devices, semiconductors and amorphous metals.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("US GAAP").

The significant accounting policies followed in the preparation of the financial statements, applied on a consistent basis, are:

A. USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the reported period. Actual results could differ from those estimates.

B. FINANCIAL STATEMENTS IN U.S. DOLLARS

The financial statements have been prepared in U.S. dollars, since the currency of the primary economic environment in which the operations of the Company, its principal subsidiaries's and affiliates are conducted is the U.S. dollar. Most of the Company's assets and liabilities are in U.S. dollars. Substantially most of the subsidiaries' sales are in U.S. dollars and most of the cost and expenses are nominated in U.S. dollars. Therefore, the functional and reporting currency of the Company and of its subsidiaries is the U.S. dollar.

Transactions and balances originally denominated in U.S. dollars are presented at their original amounts. Transactions and balances in other currencies have been remeasured into U.S. dollars in accordance with principles set forth in Statement of Financial Accounting Standards ("SFAS") No. 52 "Foreign Currency Translation: ("SFAS 52").

Accordingly, items have been translated as follows:
Monetary items – at the exchange rate in effect on the balance sheet date.
Nonmonetary items – at historical exchange rates.
Revenue and expense items – at the exchange rates in effect as of the date of recognition of those items (excluding depreciation and other items deriving from non-monetary items).

All exchange gains and losses from the remeasurement mentioned above are reflected in the statement of operations in financial expenses (income), net.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

B. FINANCIAL STATEMENTS IN U.S. DOLLARS (Cont.)

The financial statements of an affiliate accounted for under the equity method, whose functional currency is not the U.S. dollar, have been translated into dollars, in accordance with SFAS 52. All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. Statement of income amounts have been translated using the average exchange rate for the year. The resulting aggregate translation adjustments are reported as a component of accumulated other comprehensive income in shareholders' equity.

C. PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its subsidiaries. Inter-company balances and transactions have been eliminated upon consolidation.

As of the balance sheet date the significant subsidiaries whose balances and results are consolidated are: DEP Technology Holdings Ltd. ("DEP"), Elbit Ltd. ("Elbit"), RDC Rafael Development Corporation ("RDC"), Elron Telesoft ("ETI"), Elron Software ("ESI"), Galil Medical Ltd. ("Galil") and Mediagate N.V. ("Mediagate").

D. BUSINESS COMBINATIONS

Business combinations have been accounted for using the purchase method of accounting. Under the purchase method of accounting the results of operations of the acquired business are included from the effective date of acquisition. The costs to acquire companies, including transactions costs, have been allocated to the underlying net assets of the acquired company in proportion to their respective fair values. Any excess of the purchase price over estimated fair values of the net assets acquired has been recorded as goodwill.

E. CASH AND CASH EQUIVALENTS

Cash and cash equivalents are short-term highly liquid investments that are readily convertible to cash with original maturity of three months or less.

F. LONG-TERM DEBENTURES AND DEPOSITS

Bank deposits with maturities of more than one year and short-term bank deposits held as a security for long-term loans are included in long-term investments, and presented at their cost. Long-term debentures are classified as held-to-maturity since the Company has the intent and ability to hold these securities to maturity. The debentures are stated at cost plus accrued interest. Accrued interest is included as finance income.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

G. MARKETABLE SECURITIES

Management determines the classification of marketable investments in debt securities with fixed maturities and marketable equity securities at the time of purchase and reevaluates such designations at each balance sheet date.

Some marketable securities are classified as trading securities and are stated at the quoted market prices at each balance sheet date. Gains and losses (realized and unrealized) related to trading securities as well as interest on such securities are included as other income (expenses).

Certain marketable securities covered by SFAS No 115 "Accounting for Certain Investments in Debt and Equity Securities", ("SFAS No 115") were classified as available-for-sale. Accordingly, these securities are stated at fair value, with unrealized gains and losses reported in accumulated other comprehensive income, a separate component of shareholders' equity, net of taxes. Realized gains and losses on sales of investments, and decline in value judged to be other than temporary, are included in the consolidated statement of operations. Cost is determined in computing realized gain or loss on an average basis.

H. INVENTORIES AND CONTRACTS IN PROGRESS

Inventories are stated at the lower of cost or market value. Inventory write-offs are provided for slow-moving items or technological obsolescence.

Cost is determined as follows:

Raw materials – using the average cost method, or the "first in, first out" method.

Contracts-in-progress – represent amounts related to long-term contracts as determined by the percentage of completion method of accounting.

Finished Products – raw materials as mentioned above and direct manufacturing costs with the additional allocable indirect manufacturing costs on an average basis.

I. INVESTMENT IN AFFILIATED COMPANIES

Investments in which the Company has significant influence but less than a controlling voting interest are accounted for using the equity method. Significant influence is presumed to exist when the Company owns between 20%-50% of the investee. However, whether or not the Company has significant influence depends on evaluation of certain factors including among others, the Company's representation on the investee's board of directors, agreements with other shareholders, additional voting rights, participation in policy making processes, existence of material intercompany transactions and technological dependency and the extent of ownership by the Company in relation to the concentration of other shareholders.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

I. INVESTMENT IN AFFILIATED COMPANIES (Cont.)

The Company discontinues to applying the equity method when its investment (including advances and loans) is reduced to zero and it has no guaranteed obligations of the affiliate or is otherwise committed to provide further financial support to the affiliate.

In circumstances where the Company's ownership in an investee is in the form of a preferred security or other senior security, the Company recognizes equity method losses based on the ownership level of the particular investee security or loan held by the Company to which the equity method losses are being applied.

The excess of the purchase price over the fair value of net intangible assets acquired is attributed to goodwill, technology and other identifiable intangible assets. Goodwill is no longer amortized. Technology and other identifiable intangible assets are amortized over a period of approximately 5-12 years, commencing from the acquisition date.

Gains arising from issuance of shares by affiliated companies to third parties are recorded as "Gains from disposal and changes in holdings in subsidiaries and related companies, net" in the consolidated statements of operations, unless the issuing company is a development stage company for which the gain (loss) from issuance is accounted for as an equity transaction pursuant to SAB 51 "Accounting for Sales of Stock by a Subsidiary".

J. INVESTMENTS IN OTHER COMPANIES

Investments in other companies in which the Company does not have the ability to exercise significant influence over operating and financial policies, is presented at cost.

Management evaluates investment in affiliates and other companies for evidence of other than temporary declines in value. When relevant factors indicate a loss in value that is other than temporary, the Company records a provision for the decline in value.

K. PROPERTY AND EQUIPMENT

Property and equipment are stated at cost, net of accumulated depreciation and investment grants. Depreciation is calculated by the straight-line method over the estimated useful lives of the assets at the following annual rates:

	%
Land and Buildings	0-4
Computers, Machinery and Furniture	6 - 33
Motor vehicles	15-20
Leasehold improvements	over the term of the lease

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

L. IMPAIRMENT AND DISPOSAL OF LONG-LIVED ASSETS

The Company's and its subsidiaries' long-lived assets (including identifiable intangible assets subject to amortization) are reviewed for impairment in accordance with SFAS No. 144, "Accounting for the impairment or disposal of long-lived assets", whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If an asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. Assets to be disposed of are reported at the lower of their carrying amount or fair value less costs to sell.

M. INTANGIBLE ASSETS

Other assets include mainly technology, goodwill and other identifiable intangible assets acquired in connection with the purchase of subsidiaries and activities. Technology and other identifiable intangible assets are amortized over their estimated useful life.

The Company and its subsidiaries evaluate the amortization periods of all identifiable intangible assets to determine whether events or circumstances warrant revised estimates of useful lives.

Under SFAS No. 142 "Goodwill and Other Intangible Assets" ("SFAS 142"), goodwill and intangible assets with indefinite lives are no longer amortized but are reviewed annually for impairment (or more frequently if impairment indicators arise). The amortization provisions of SFAS 142 apply to goodwill and intangible assets acquired after June 30, 2001. With respect to goodwill acquired prior to July 1, 2001, the Company and its subsidiaries adopted SFAS 142 effective January 1, 2002.

SFAS No. 142 requires goodwill to be tested for impairment on adoption and at least annually thereafter or between annual tests in certain circumstances, and written down when impaired, rather than being amortized as previous accounting standards required. Goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. Fair value is determined using discounted cash flows. Significant estimates used in the methodologies include estimates of future cash flows, future short-term and long-term growth rates discount rates for each of the reportable units. The Company expects to perform the impairment tests during the fourth fiscal quarter of each year.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

N. REVENUE RECOGNITION

The Company's subsidiaries sell, license and support computer software, systems and disposable products.

Software sales are accounted for in accordance with Statement of Position (SOP) 97-2, "Software Revenue Recognition," as amended.

Revenues from license fees or product sales are recognized when delivery of the product has occurred, the fee is fixed or determinable, collectibility is probable, vendor specific objective evidence exists to allocate total fee to elements of an arrangement (in the case of license fees) and persuasive evidence of an arrangement exists.

Maintenance and support revenue included in multiple element arrangements is deferred and recognized on a straight-line basis over the term of the maintenance and support agreement.

When the products are warrantied, a provision is recorded for probable costs, in connection with the warranties, based on the Company's subsidiaries' experience and estimates.

Revenues from software licenses that require significant customization, integration and installation and from projects, related to software development are recognized based on SOP 81-1 "Accounting for Performance of Construction - Type and Certain Production - Type Contracts", according to which revenues are recognized on a percentage of completion basis. Percentage of completion is measured by the efforts expended method based on the ratio of hours performed to date to estimated total hours at completion to be incurred over the duration of the contract. Anticipated losses on contracts are charged to earnings when identified.

Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original forecasts. Such changes in estimated gross profit are recorded in results of operations when they are reasonably determinable by management, on a cumulative catch-up basis.

When a right of return exists, an estimate of the allowance for returns is provided in accordance with Statement of Financial Accounting Standards ("SFAS") No. 48, "Revenue Recognition When Right of Return Exists". Reserves for estimated returns and allowances are provided at the time revenue is recognized. Such reserves are recorded based upon historical rates of returns and allowances and other factors.

Deferred revenues include unearned amounts received under maintenance and support contracts and amounts received from customers but not recognized as revenues.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

O. RESEARCH AND DEVELOPMENT COSTS

Research and development costs, net of grants received, are charged to the statement of income as incurred. SFAS No. 86 "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed", requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based on the subsidiaries' product development process, technological feasibility is established upon completion of a working model. Costs incurred by the Company's subsidiaries between completion of the working models and the point at which the products are ready for general release have been insignificant. Therefore, research and development costs are charged to the statement of operations, as incurred.

P. ADVERTISING COSTS

Advertising costs are charged to the consolidated statement of operations as incurred.

Q. ROYALTY-BEARING GRANTS

Royalty-bearing grants from the government of Israel for funding approved research and development projects, and royalty-bearing grants from the Government of Israel for the encouragement of marketing activity are recognized at the time the Company is entitled to such grants, on the basis of the costs incurred and included as a deduction of research and development costs and sales and marketing expenses, respectively.

Research and development and marketing grants received by certain of the company's subsidiaries in 2002 amounted to $850 and $105, respectively.

R. INCOME TAXES

The Company and its subsidiaries account for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes". This Statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

S. INCOME (LOSS) PER SHARE

Basic net income (loss) per share is computed based on the weighted average number of shares of ordinary shares outstanding during each year. Diluted net income (loss) per share is computed based on the weighted average number of shares outstanding during each year, plus dilutive potential shares of ordinary shares considered outstanding during the year.

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

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

S. INCOME (LOSS) PER SHARE (Cont.)

In 2001 and 2002 all outstanding stock options have been excluded from the calculation of the diluted net loss per ordinary share because all such stock options were anti-dilutive. The total weighted average number of shares related to the outstanding options excluded from the calculations of diluted net loss per share was 86,626 and 125,815 for the years ended December 31, 2002 and 2001, respectively.

T. STOCK BASED COMPENSATION

The Company has elected to follow Accounting Principles Board Opinion No. 25, ("APB 25") "Accounting for Stock Issued to Employees" and the FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation" in accounting for its employee stock 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 stock at the grant date of the award or other measurement date over the exercise price. Compensation expense is recorded over the vesting period on a straight line basis. The Company provides the disclosures required by SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") and SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure".

If compensation cost (including in respect of subsidiaries' stock options) had been determined under the alternative fair value accounting method provided under FASB Statement No. 123, the Company's and subsidiaries stock-based employee compensation cost, consolidated net income (loss) and basic and diluted net income (loss) per share would have changed to the following consolidated pro forma amounts:

	Year ended December 31		
	2002	**2001**	**2000**
Stock-based employee compensation cost:			
As reported	$ 933	$ 29	$ 1,745
Pro forma	2,876	974	2,043
Net income (loss):			
As reported	(39,301)	(50,814)	28,516
Pro forma	(41,244)	(51,759)	28,218
Basic net income (loss) per share:			
As reported	(1.50)	(2.40)	1.35
Pro forma	(1.57)	(2.44)	1.33
Diluted net income (loss) per share:			
As reported	(1.50)	(2.41)	1.33
Pro forma	(1.57)	(2.45)	1.32

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

T. STOCK BASED COMPENSATION (Cont.)

Under SFAS 123 the fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions for grants in 2002, 2001 and 2000: (1) expected life of the option of 1-4 years (2001 and 2000 – same); (2) dividend yield of 0% (2001 – 0%, 2000 – 6.95%); (3) expected volatility of 43% (2001 – 54%, 2000 – 64%), (4) risk-free interest rate of 1.5% (2001 – 3%, 2000 – 6%).

Call options granted to employees to purchase shares in subsidiaries, affiliates and other companies are recorded at fair value using the Black-Scholes option-pricing model. The fair value of the option is recorded as a liability and changes in the liability are recorded as compensation expenses.

U. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) consists of net income (loss) and other gains and losses affecting shareholders equity that under generally accepted accounting prinicples are excluded from the net income (loss). For the Company, such items consist of unrealized gains and losses on available for sale securities and foreign currency translation adjustments.

V. SEVERANCE PAY

The Company's liability for severance pay is calculated pursuant to Israeli severance pay law and employee agreements based on the most recent salary of the employees. The Company's liability for all of its employees, is fully provided by monthly deposits with insurance policies and by an accrual. The value of these policies is recorded as an asset in the Company's balance sheet.

The deposited funds include profits accumulated up to the balance sheet date. The deposited funds may be withdrawn only upon the fulfillment of the obligation pursuant to Israeli severance pay law or labor agreements. The value of the deposited funds are based on the cash surrendered value of these policies, and include immaterial profits.

Severance pay expenses for the years ended December 31, 2002, 2001 and 2000 amounted to $611, $277 and $405, respectively.

Certain of the Company's U.S. subsidiaries adopted retirement Plans, in respect of their U.S. employees, which are qualified under section 401(K) of the Internal Revenue Code. Pursuant to the 401(K) plan, eligible participants may elect to contribute a percentage of their annual gross compensation to the 401(K) plan. Contributions to the 401(K) plan by the Company's U.S. subsidiaries are discretionary. Total expenses under 401(K) plan amounted to $0, $719 and $126 for the years ended December 31, 2002, 2001 and 2000, respectively.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

W. FAIR VALUE OF FINANCIAL INSTRUMENTS

SFAS No. 107 "Disclosure About Fair Value of Financial Instruments", requires disclosure of an estimate of the fair value of certain financial instruments. The Company's financial instruments consist of cash and cash equivalents, marketable securities, long term deposits and debentures, trade receivables, other receivables, trade payables, other payables and short-term and long-term bank loans. The estimated fair value of these financial instruments approximate their carrying value as of December 31, 2002 and 2001, unless otherwise stated. The estimated fair values have been determined through information obtained from market sources and management estimates.

It was not practical to estimate the fair value of the Company's investments in ordinary shares of non-public affiliates and other companies because of the lack of a quoted market price and the inability to estimate the fair value of each investment without incurring excessive costs. The carrying amounts of these companies were \$33,812 and \$21,981 at December 31, 2002 and 2001, respectively, and represent the original cost, net of impairment, and in the case of affiliates also the Company's equity in the earnings or losses of the affiliates, since the dates of acquisition.

X. CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject the Company and its subsidiaries to concentrations of credit risk consist principally of cash and cash equivalents, long-term bank deposits, marketable bonds and trade receivables.

Cash and cash equivalents and bank deposits are invested mainly in U.S. dollars with major banks in Israel and the United States. Marketable bonds are bonds of U.S. Corporations. Management believes that the financial institutions that hold the Company and its subsidiaries' investments and the above corporations are financially sound and, accordingly, minimal credit risk exists with respect to these investments.

Trade receivables are derived from sales to major customers located in North America, and Israel. The Company and its subsidiaries perform ongoing credit evaluations of their customers and obtain letter of credit and bank guarantees for certain receivables. An allowance for doubtful accounts is determined with respect to those amounts that were determined to be doubtful of collection and a general allowance is provided to cover additional potential exposures.

As of the balance sheet date there are no significant off-balance-sheet concentration of credit risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Y. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

(1) In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which addresses recognition, measurement, and reporting of costs associated with exit and disposal activities, including restructuring activities. SFAS No. 146 requires that costs associated with exit or disposal activities be recognized when they are incurred rather than at the date of a commitment to an exit or disposal plan. The liability in respect of such costs should be measured at fair value. SFAS No. 146 is effective for all exit or disposal activities initiated after December 31, 2002. The Company does not expect the adoption of SFAS No.146 to have a material impact on its results of operations or financial position.

(2) In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, and interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FASB Interpretation No. 34" ("FIN No. 45"). FIN No. 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. FIN No. 45 does not prescribe a specific approach for subsequently measuring the guarantor's recognized liability over the term of the related guarantee. It also incorporates, without change, the guidance in FASB Interpretation No. 34, "Disclosure of Indirect Guarantees of Indebtedness of Others", which is being superseded. The disclosure provisions of FIN No. 45 are effective for financial statements of interim or annual periods that end after December 15, 2002 and the provisions for initial recognition and measurement are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002, irrespective of a guarantor's year-end. The Company does not expect the adoption of FIN No. 45 to have a material impact on its results of operations or financial position.

(3) In January 2003, the EITF issued EITF 02-18, "Accounting for Subsequent Investments in an Investee after Suspension of Equity Method Loss Recognition" ("EITF 02-18"). According to EITF 02-18, if an additional investment in an investee, in whole or in part, represents, in substance, the funding of prior losses, the investor should recognize previously suspended losses up to the amount of the additional investment determined to represent the funding of prior losses. Whether the investment represents the funding of prior losses depends on the facts and circumstances and judgment is required. EITF 02-18 should be applied to additional investments in equity-method investees made subsequent to February 5, 2003. The Company is currently evaluating the effect of EITF 02-18 on its financial statements.

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

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Z. RECLASSIFICATIONS

Certain prior year amounts were reclassified to conform with current year financial statement presentation.

Note 3 - BUSINESS COMBINATIONS AND SUBSIDIARIES

A . ELBIT

(1) During 2000, Elbit Ltd. (“Elbit”), held at that time 41% by Elron, completed the sale of its entire interest in Peach Networks Ltd. (“Peach”) to Microsoft Corporation, for approximately $43,000. In addition, Elbit completed the sale of the assets, properties, rights and certain liabilities of Hynex Ltd. (“Hynex”), in which Elbit held approximately 77% on a fully diluted basis, to Cisco Systems Inc. (“Cisco”) in consideration for $107,000, of which approximately $11,000 was paid in cash and the balance was in Cisco’s shares. As a result, Elbit recorded a capital gain, before taxes and minority interest, of approximately $129,000.

(2) In the first quarter of 2001, Elron purchased 600,000 additional shares of Elbit in consideration for approximately $3,600. As a result, Elron’s share in Elbit increased to approximately 44%.

(3) On May 15, 2002, Elron completed its merger with Elbit. As a result, each outstanding ordinary share of Elbit, other than shares held by Elron, was exchanged for 0.45 ordinary shares of Elron and, accordingly, Elron issued 5,617,601 ordinary shares. Elron also assumed options of Elbit held by Elbit employees to purchase 240,525 ordinary shares of Elron with a fair value of $997.

Elbit invests in high technology companies, which are primarily engaged in the fields of e-business (electronic business) and m-commerce (mobile commerce).

The purchase price of the Elbit acquisition was approximately $73,914, which was calculated as follows:

Fair value of Elron ordinary shares issued	$ 70,220
Transaction and other costs	2,719
Fair value of options assumed(*)	975
Total	$ 73,914

(*) Net of intrinsic value of $22.

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

Note 3 - BUSINESS COMBINATIONS AND SUBSIDIARIES (Cont.)

A. ELBIT (Cont.)

(3) (Cont.)

Ordinary shares were valued based on the average price of Elron's ordinary shares during the period beginning on the day of the announcement of the exchange ratio (September 4, 2001) and ending five days thereafter. The fair value of options assumed was determined using the Black-Scholes pricing method.

The purchase price has been allocated to the fair value of Elbit's tangible and intangible assets acquired and liabilities assumed, based on an analysis made by an independent valuation appraiser. The excess of the purchase price over the estimated fair values of the identifiable net assets acquired was recorded as goodwill, which is not deductible for tax purposes.

The allocation of the purchase price to assets purchased and liabilities assumed was as follows:

Current assets	$ 12,216
Long-term investments	65,586
Other long-term assets	1,061
Property and equipment, net	6,285
Goodwill	12,135
Liabilities assumed	(23,369)
Net assets acquired	$ 73,914

At the acquisition date net deferred tax assets relating to operating loss carryforwards have been fully offset by a valuation allowance. Subsequent to that date, Elbit recorded a tax benefit in the amount of $6,600 and reduced its valuation allowance in respect of the abovementioned deferred tax asset. Since the tax benefits recognized were in respect of the operating loss carryforwards of Elbit at the acquisition date, Elron recorded the entire tax benefit as a reduction to goodwill.

The goodwill recorded relates to the "Other Holdings and Corporate Operations" segment and reflects the synergies that resulted from the combined entity, including a reduction in operational and management costs, the creation of an enhanced platform, a more simplified and efficient organizational structure and greater resources and scope of operations, which benefited Elron's subsidiaries and affiliated companies.

The operating results of Elbit, as a wholly owned subsidiary, have been included in the Company's consolidated financial statements from the date of the merger (May 15, 2002). See Note 8 for supplemental pro forma information.

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

Note 3 - BUSINESS COMBINATIONS AND SUBSIDIARIES (Cont.)

B. DEP

(1) On May 6, 2002, Elron completed the purchase of shares of DEP Technology Holdings Ltd. ("DEP") in which it previously held 33%. 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 investment (67%) in DEP, including rights to loans in the amount of approximately $3,529 provided by DIC to subsidiary of DEP, RDC Rafael Development Corporation Ltd. (“RDC”), RDC is a joint venture between DEP and Rafael Armament Development Authority (“Rafael”) through its subsidiary Galram Technology Industry Ltd. (“Galram”) which holds 47.84% of the outstanding shares of RDC. RDC is controlled by DEP which holds 48.04% of its outstanding shares (50.1% of the voting rights). RDC was established for the purpose of exploiting Rafael’s technology in non-military markets.

DEP invests in high technology companies, which are primarily engaged in the fields of communications, medical devices, semiconductors and software.

The share purchase enhanced Elron’s position in the high technology markets enabling Elron to manage existing DEP investments independently.

The purchase price of the DEP acquisition was $29,502, of which $29,449 represents the fair market value of newly issued Elron ordinary shares, which has been calculated using the average price of Elron's shares during a period of a few days before and after the announcement date multiplied by the number of shares to be issued to DIC, and $53 represents transaction costs.

The purchase price has been allocated to the fair value of DEP’s tangible and intangible assets acquired and liabilities assumed, based on an analysis made by an independent valuation appraiser.

The allocation of the purchase price was as follows:

Current assets	$ 467
Long-term investments	38,233
Property and equipment, net	19
Intangible assets	2,339
Liabilities assumed	(11,556)
Total	$ 29,502

Net deferred tax assets relating to operating loss carryforwards have been fully offset by a valuation allowance.

Note 3 - BUSINESS COMBINATIONS AND SUBSIDIARIES (Cont.)

B. DEP (Cont.)

(1) (Cont.)

The amount of $38,233, allocated to investments in companies accounted for under the equity method, included amounts allocated to intangible assets of these equity investments and is net of any related deferred taxes. Out of the $38,233 the aggregate amount allocated to identifiable intangible assets of the equity investments with a weighted average amortization period of approximately 11 years was $16,500 and aggregate amount of $6,500 has been recorded as goodwill. The goodwill is not deductible for tax purposes.

The operating results of DEP have been included in the Company's consolidated financial statements from the date of closing of the share purchase (May 6, 2002). See Note 8 for pro forma information.

(2) DEP undertook to invest up to $27,000 in RDC, of which approximately $22,300 was invested as of December 31, 2002. The balance of the obligation is to be paid based on percentages of annual sales of RDC's affiliates in which RDC holds more than 25% or yearly increase in the value of RDC's holdings. The liability will expire on July, 2003.

C. ELRON SOFTWARE AND ELRON TELESOFT

Elron's activities in the field of IT software products are conducted by its majority owned subsidiaries Elron Software Inc. ("ESI") and Elron Telesoft Inc. ("ETI").

(1) On April 1, 2000, ESI transferred substantially all the assets and liabilities of the systems and projects division to ETI. Following this transaction ESI focuses on the Internet software products activities and ETI focuses on the system integration and projects activities of Elron.

(2) In the third quarter of 2000, ESI issued 615,764 shares (2.5% of its share capital) to a third party in consideration for $5,000. As a result, Elron holdings in ESI decreased to 96%. Elron recorded in 2000 a gain of approximately $4,500.

(3) In response to the economic conditions, and in particular, the slowdown in IT spending, Elron Software Inc. ("ESI") and Elron Telesoft Inc. ("ETI") underwent restructuring programs in 2001 and 2002 in order to focus their operations on core areas of their business, to reduce expenses and improve efficiency. These restructuring programs mainly include workforce reductions and consolidation of excess facilities. Restructuring charges were recorded in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", EITF Issue 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs in a Restructuring)" and SAB No. 100, "Restructuring and Impairment Charges".

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

Note 3 - BUSINESS COMBINATIONS AND SUBSIDIARIES (Cont.)

C. ELRON SOFTWARE AND ELRON TELESOFT (Cont.)

(3) (Cont.)

Employee termination costs in 2002 and 2001 amounted to $934 and $739, respectively. During 2001, approximately 40 employees of ESI, mainly in the sales and marketing division, and 77 employees of ETI, mainly in the telecom activity and in its headquarters, were terminated. During 2002, approximately 28 employees of ESI, across all functions of the organization, and 65 employees of ETI in the telecom activity were terminated. The majority of these termination expenses were paid as of December 31, 2002. Facilities related expenses in 2002 and 2001 amounted to $1,071 and $1,292, respectively, which included termination costs of a facility lease contract, future rental losses, and write-offs of leasehold improvements with respect to facilities of ESI and ETI, and in 2002 also of Elbit, which facilities were vacated as a result of the merger.

As part of its restructuring program, ETI sold in the third quarter of 2001 and at the beginning of 2002 certain activities in its E-business field to Forsoft Multimedia Solutions Ltd. and in the defense system fields to Elbit Systems Ltd. ("ESL") in consideration for $3,400 and $5,700, respectively, resulting with an immaterial loss.

Components of the restructuring charge for the years ended December 31, 2002 and 2001, amounts paid during the periods and remaining accrued liability as of December 31, 2001 and 2002, are as follows:

	Employee termination and severance costs	Write-off of long-lived assets	Facilities termination charges, future rental losses and other exit costs	Total
Restructuring charges in 2001	$ 739	$ 289	$ 1,175	$ 2,203
Payments and write-offs	(739)	(289)	(401)	(1,429)
Accrued restructuring liability at December 31, 2001	-	-	774	774
Restructuring charges in 2002	934	772	612	2,318
Payments and write-offs	(916)	(772)	(862)	(2,550)
Accrued restructuring liability at December 31, 2002	$ 18	$ -	$ 524	$ 542

Note 3 - BUSINESS COMBINATIONS AND SUBSIDIARIES (Cont.)

D. GALIL MEDICAL

Galil Medical Ltd. develops, manufactures and markets systems and disposable kits for the performance of minimal invasive cryo-therapy by means of freezing tissues.

(1) On April 30, 2002, Elron and RDC converted notes of Galil Medical Ltd. ("Galil"), in which Elron held 3.7% and in which RDC held 32.1%, amounting to approximately $3,160 to 2,671,385 preferred C shares. As a result, Elron's and RDC's interests in Galil increased to approximately 4.3% and 37.4%, respectively.

In May 2002, certain existing shareholders of Galil entered into a note purchase agreement with Galil (the "Note Agreement") to invest in convertible notes of Galil (the "Notes") in an aggregate amount of up to $5,000 with an option to invest an additional amount of $1,000 (the "option"). The Notes are automatically convertible into preferred shares in May 2003, or may be converted at an earlier date upon the occurrence of certain events as determined in the Note Agreement.

In the event the Notes shall be converted into preferred shares, Galil shall grant to the shareholders holding such convertible notes, warrants in the amount equal to 200% of their investment under the Note Agreement, exercisable into Galil's preferred C shares, or into Galil's ordinary shares if converted after an IPO, until the earlier of 3 years after their issuance, or 1 year after Galil's IPO, at the same conversion price set forth for the notes, at the date of conversion.

In October and December 2002, Elron signed the first addendum and second addendum to the Note Agreement, respectively, according to which Elron invested an aggregate amount of approximately $356 and $900, respectively in the form of notes convertible into Galil's shares upon the same conditions as the Note Agreement. RDC did not participate in these investments.

As of balance sheet date, Elron's and RDC's investment, pursuant to the Note Agreement amounted to approximately $3,712. Subsequent to the balance sheet date, in January 2003, Elron signed the third addendum to the Note Agreement according to which Elron committed to invest $327 in the form of notes convertible into Galil's shares upon the same terms and conditions as the Note Agreement.

Note 3 - BUSINESS COMBINATIONS AND SUBSIDIARIES (Cont.)

D. GALIL MEDICAL (Cont.)

(2) On June 27, 2002, Elron purchased 10.75% of the outstanding shares of Galil from Lumenis Ltd. in consideration for $850 which has been allocated to identifiable intangible assets. As part of the agreement, Lumenis Ltd. ("Lumenis") has the right to receive a future earn-out payment, conditional upon the occurrence of certain events on or before May 27, 2004 in accordance with the terms of the share purchase agreement. As a result of this transaction, Elron's direct interest in Galil increased to 15.09% and together with its indirect share through RDC, Elron has acquired a controlling voting interest in Galil and, accordingly, Galil's financial statements have been consolidated in the Company's consolidated financial statements subsequent to the date of the purchase from Lumenis. See Note 8 for pro forma information.

The purchase price has been allocated to the fair value of Galil's tangible and intangible assets acquired and liabilities assumed, based on an analysis made by an independent appraiser. The portion of the purchase price assigned to technology and the remaining technology which arose from previous acquisitions, including the DEP transaction, amounted to approximately $4,600. The technology will be amortized over a period of 7 years. An amount of approximately $300 was recorded as goodwill, which is not deductible for tax purposes.

E. VFLASH

On September 23, 2002, Elbit VFlash ("VFlash"), a wholly-owned subsidiary of Elbit, sold a significant portion of its assets to 24/7 Real Media Inc. ("24/7"), a publicly traded company on Nasdaq, in exchange for 4,100,000 common shares of 24/7. 24/7 provides marketing and technology solutions to online marketers and publishers.

Concurrently with the above sale, Elron invested through Elbit, $1,000 in consideration for 100,000 convertible preferred shares of 24/7.

The Company viewed the sale of Vflash's principal assets and the purchase of the preferred shares as one transaction and accordingly recorded a gain of approximately $2,000 in respect of the sale. The sale of VFlash's operations meets the definition of discontinued operations under SFAS 144 "Accounting for the Impairment or Disposal of Long-Lived Assets'. Therefore, all results relating to VFlash, including the above gain, were classified as discontinued operations in the statement of operations (see Note 23).

The common shares are accounted for as available for sale securities in accordance with SFAS 115 "Accounting for Certain Investments in Debt and Equity Securities". The market value of these shares on September 23, 2002 was based on the then closing price of the common stock of 24/7.

Note 3 - BUSINESS COMBINATIONS AND SUBSIDIARIES (Cont.)

E. VFLASH (Cont.)

The preferred shares are being accounted for under the cost method. Each preferred share is convertible at any time into 48.40271 common shares, subject to adjustment upon certain events described in the investment agreement. The fair value of the preferred shares received, was based on the market price of the common shares on the transaction date.

As of December 31, 2002, the common and preferred shares held by Elron constitute approximately 8.3% of the outstanding share capital of 24/7 (on a fully diluted basis).

Of the 4,100,000 common shares of 24/7 it received, Vflash undertook to grant a beneficial interest in approximately 725,000 common shares to former employees in recognition of services they rendered to VFlash prior to the sale. The fair value of these shares on September 23, 2002 was approximately $283.

During February 2003, the preferred shares were converted into 4,840,271 common shares of 24/7.

F. MEDIAGATE

(1) During 2000 Mediagate issued, in two private placements and through exercise of options, approximately 10,200,000 shares in consideration for approximately $12,000. Elron purchased approximately 1,000,000 shares from existing shareholders and received approximately 500,000 shares in these private placements, in consideration for approximately $1,600. As a result, Elron’s interest in Mediagate decreased to 29.1%, resulting in a gain of $3,104.

(2) During 2001 and 2002, Elron invested $2,794 and $794 respectively in Mediagate by way of convertible loans. On August 7, 2002, Elron converted the above mentioned loans to 32,828,510 preferred F shares. Elron also invested approximately $2,500 in MediaGate through a rights offering and received 58,562,543 preferred F shares. As a result of these transactions, Elron's interest in MediaGate increased to approximately 68% of the outstanding shares and accordingly the accounts of MediaGate have been consolidated with those of Elron subsequent to the date of the additional investment. See Note 8 for pro forma information.

The purchase price has been allocated to the fair value of Mediagate’s tangible and intangible assets acquired and liabilities assumed, based on an analysis made by an independent appraiser. The portion of the purchase price assigned to technology and the remaining technology which arose on previous acquisitions amounted to approximately $4,400. The technology will be amortized over a period of 7 years. The excess of the purchase price over the estimated fair values of the identifiable net assets acquired in the amount of approximately $2,500 was recorded as goodwill, which is not deductible for tax purposes.

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

Note 3 - BUSINESS COMBINATIONS AND SUBSIDIARIES (Cont.)

F. MEDIAGATE (Cont.)

(3) In December 2002, Elron participated in a rights offering of Mediagate pursuant to which Elron entered into a convertible loan agreement to grant a convertible loan of $1,500 of which $600 was transferred as of December 31, 2002 and the balance of $900 on January 6, 2003. The loan shall be converted into preferred shares of Mediagate upon the earliest to occur of (i) the closing of a third party financing in excess of $1,000 (ii) the closing of a second round of the rights offering and (iii) the closing of an merger or acquisition transaction (as defined in the convertible loan agreement), none of which occurred as of December 31, 2002. Should none of the above events occur prior to July 31, 2003, the loans will be automatically converted into preferred shares.

G. RESTATEMENT

Elron has direct holdings in certain companies in which RDC also holds shares. As a result of the purchase of DEP, Elron's aggregate interest in these companies has increased and enables Elron to exercise significant influence in these companies. In accordance with U.S. Accounting Principles Board Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock", Elron's direct holdings in these companies, which were accounted for by Elron at cost or as available for sale securities, are 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 these companies were recorded at cost or as available for sale securities.

Following are the effects of the restatement:

(1) Consolidated balance sheet

	December 31, 2001		
	As reported	**Effect of restatement**	**As restated**
Investments in affiliated companies	$ 155,967	$ 6,293	$ 162,260
Other investments and long-term receivables	27,484	(19,980)	7,504
Deferred tax assets (liabilities)	(3,254)	4,227	973
Additional paid in Capital	162,109	3,571	165,680
Accumulated other comprehensive income(*)	49,745	(7,514)	42,231
Retained earnings	26,751	(5,516)	21,235
Total shareholders' equity	248,173	(9,460)	238,713

(*) Restatement of unrealized gains on securities

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

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

Note 3 - BUSINESS COMBINATIONS AND SUBSIDIARIES (Cont.)

G. RESTATEMENT (Cont.)

(2) Consolidated statements of operations

	Year ended December 31, 2001		
	As reported	Effect of restatement	As restated
Equity in losses of affiliated companies' investments	$ (24,558)	$ (2,684)	$ (27,242)
Other income (expenses), net	(5,105)	220	(4,885)
Net loss	(48,350)	(2,464)	(50,814)
Basic net loss per share	(2.28)	(0.12)	(2.40)
Diluted net loss per share	(2.29)	(0.12)	(2.41)

	Year ended December 31, 2000		
	As reported	Effect of restatement	As restated
Equity in losses of affiliated companies' investments	$ (7,218)	$ (2,265)	$ (9,483)
Gain from disposal and changes in holdings in affiliated companies, net	26,400	419	26,819
Net income	30,362	(1,846)	28,516
Basic net income per share	1.43	(0.08)	1.35
Diluted net income per share	1.41	(0.08)	1.33

(3) Total Comprehensive loss

	Year ended December 31, 2001		
	As reported	Effect of restatement	As restated
Total Comprehensive loss	$ (35,064)	$ (9,978)	$ (45,042)

	Year ended December 31, 2000		
	As reported	Effect of restatement	As restated
Total Comprehensive loss	$ (120,481)	$ (1,846)	$ (122,327)

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

Note 4 - CASH AND CASH EQUIVALENTS

Includes mainly bank deposits in U.S. dollars bearing annual interest rate of 1.06% - 1.6% (December 31, 2001 1.75% - 1.98%).

Note 5 - TRADE RECEIVABLES, NET

	December 31	
	2002	2001
Open balances (*)	$ 7,824	$ 4,263
Unbilled receivables	1,414	5,364
	$ 9,238	$ 9,627
(*) Net of allowance for doubtful accounts	$ 845	$ 252

Note 6 - INVESTMENTS IN AFFILIATED COMPANIES

A. MAJOR AFFILIATED COMPANIES ARE AS FOLLOWS:

		December 31	
	Note	2002 % of holdings	2001 % of holdings
Elbit Systems ("ESL")	6D (1)	19.9	21.2
Elbit	3A	(*)	44.0
DEP	3B	(*)	33.3
Galil Medical	3D	(*)	(**) 3.7
Given Imaging	6D(7)	30.4	(**) 7.3
Chip Express	6D(3)	33.0	34.2
NetVision		45.7	45.9
MediaGate	3F	(*)	28.8
Wavion	6D(4)	44.7	44.8
KIT	6D(5)	28.6	28.6
Pulsicom	6D(6)	17.0	17.0
AMT	6D(2)	29	-
3DV	6D(9)	47.7	(**) 1.8
Notal Vision	6D(8)	-	-
CellAct		45.0	-

(*) Consolidated in 2002.
(**) Restated – See Note 3(G).

Note 6 - INVESTMENTS IN AFFILIATED COMPANIES (Cont.)

B. COMPOSITION OF INVESTMENTS:

	Cost of shares and loans(1)(2)	Equity in post acquisition profits (losses) and additional paid in capital	Total investment
As of December 31, 2002			
ESL	$ 27,773	$ 54,942	$ 82,715
Given Imaging	41,013	(8,234)	32,779
Others	53,241	(37,479)	15,762
	$ 122,027	$ 9,229	$ 131,256

(1) Includes convertible loans	$ 4,000
(2) Includes balance of technology, goodwill and other intangible assets	$ 21,092

	Cost of shares and loans(1)(2)	Equity in post acquisition profits (losses) and additional paid in capital	Total investment
As of December 31, 2001			
ESL	$ 29,124	$ 51,761	$ 80,885
Elbit	47,095	13,861	60,956
Others(*)	(*)71,519	(*)(51,100)	(*)20,419
	$ 147,738	$ 14,522	$ 162,260

(1) Includes convertible loans	$ 7,336
(2) Includes balance of technology, goodwill and other intangible assets	$ 3,079

* Restated – See Note 3(G).

C. FAIR MARKET VALUE OF MARKETABLE SECURITIES:

	December 31	
	2002	2001
	(U.S. dollars in millions)	
ESL	$ 126	$ 152
Given Imaging	71	33

Shares of ESL are quoted on the Tel Aviv Stock Exchange and over the counter on Nasdaq in the U.S. Shares of Given Imaging are quoted on Nasdaq in the U.S.

Note 6 - INVESTMENTS IN AFFILIATED COMPANIES (Cont.)

D. ADDITIONAL INFORMATION

(1) ESL

a. On July 5, 2000, the merger between ESL and EL-OP Electro-Optical Industries Ltd. ("EL-OP") was completed. As part of the merger, ESL issued 12,100,000 ordinary shares representing 32% of ESL’s share capital to the shareholders of EL-OP (“the Federmann Group”) with a value of $180,000, in consideration for their shares in EL-OP. As a result of the merger, Elron's share in ESL decreased from 33.0% to 22.5%.

The merger was recorded in ESL’s financial statements based on the fair market value of the ESL shares issued according to the purchase method. As a result of the merger, Elron recorded in the third quarter of 2002 a gain of approximately $19,000 from the decrease in holdings in ESL.

ESL’s results in 2000, included a charge for purchased in-process research and development, as a result of the merger with EL-OP, in the amount of $40,000 and restructuring costs in the amount of approximately $22,100.

As part of this transaction, Elron entered into a shareholders agreement with the Federmann Group, which sets forth the relationship of the primary shareholders of ESL. The shareholders agreement includes limitation on the transfer of shares in ESL, including first refusal rights and tag along rights. The shareholders agreement also includes joint voting arrangements with respect to the election of an equal number of directors to ESL’s board of directors.

b. In the fourth quarter of 2001 Elron sold 380,000 shares of ESL for approximately $6,600. As a result, Elron recorded a gain of approximately $3,000 and its share in ESL decreased to 21.2%.

c. In the fourth quarter of 2002, Elron sold 380,000 shares of ESL for approximately $5,900. As a result, Elron recorded a gain of approximately $1,800 and its share in ESL decreased to approximately 20%. Elron continues to account for ESL according to the equity method as a result of the abovementioned agreement with the Federmann Group.

Note 6 - INVESTMENTS IN AFFILIATED COMPANIES (Cont.)

D. ADDITIONAL INFORMATION (Cont.)

(2) AMT

On August 6, 2002, Elron completed an investment of approximately $5,000 in convertible notes of A.M.T Advanced Metal Technologies Ltd. ("AMT"). AMT, an Israeli private company, develops, markets and licenses technologies, through its group companies, for amorphous and nano-crystalline advanced materials, for a wide range of commercial applications. Currently, AMT is focusing on two of its group companies, namely A.H.T. Advanced Heating Technologies Ltd., which uses amorphous metals for heating products, and A.C.S. Advanced Coding Systems Ltd., which develops, markets and sells products using amorphous metals for brand protection against counterfeiting and diversion and anti-shoplifting electronic article surveillance.

The investment was part of an aggregate investment in AMT of approximately $8,700 of which the existing shareholders of AMT invested approximately $3,700. The notes are convertible into preferred shares of AMT or into shares held by AMT in certain of its subsidiaries. Elron is entitled to the rights attached to the convertible notes on an “as converted” basis as a shareholder of AMT (which constitutes 29% of the voting rights of AMT) and in addition, has special voting rights in certain specified circumstances.

In addition, Elron and the other investors in AMT were issued warrants to purchase preferred shares of AMT for a total amount of up to approximately $19,140, which may be exercised over various periods up to a maximum of 48 months from the closing, as well as an option to invest up to $5,000 in AMT on the same terms and conditions of the original investment, which may be exercised for a period of eight months from the closing.

In December 2002, Elron granted a convertible loan to AMT in the amount of $200. The loan bears interest at 8% and shall automatically be converted into convertible notes of AMT upon the same terms and conditions as Elron’s original investment no later than June 30, 2003. In February 2003, Elron granted a further loan in the amount of $150 under the same terms and conditions as the above-mentioned loan.

As of December 31, 2002, following the abovementioned investments, Elron holds 29% of AMT on a diluted (excluding warrants) and “as converted” basis, and 41% on a fully diluted and “as converted” basis.

Note 6 - INVESTMENTS IN AFFILIATED COMPANIES (Cont.)

D. ADDITIONAL INFORMATION (Cont.)

(3) Chip Express

On June 25, 2002, Chip Express Corporation ("Chip Express"), in which Elron held approximately 35% interest, issued, approximately 21,650,700 redeemable preferred shares in consideration for $16,000 in a private placement. Elron purchased approximately 6,984,000 redeemable preferred shares in consideration for approximately $5,000, of which approximately $500 was paid by a conversion of a convertible note. As a result, Elron's interest in Chip Express decreased to approximately 34%.

During October 2002, Chip Express issued an additional 666,700 redeemable prefered shares for a considiration of $520, upon the same terms and conditions of the private placement of June 2002. Elron did not participate in that issuance and as a result Elron’s interest in Chip Express decreased to approximately 33%.

A gain amounting to approximately $100 as a result of the decrease in interest was deferred since the preferred shares issued are redeemable.

(4) Wavion

During 2000, Elron invested $5,000 in Wavion, which develops fixed wireless broadband access systems and is engaged in supplying development services for military and commercial applications, in consideration for 45% of Wavion's outstanding share capital and 100% of Wavion’s preferred shares.

During 2001 and 2002, Elron invested $1,000 and $500, respectively, in Wavion by way of convertible loans. The loans bear interest at LIBOR +2% and are repayable at the end of two years following the installment dates.

(5) KIT

In 2000, Elron invested $6,000 in KIT in consideration for preferred shares constituting 28.6% of KIT’s outstanding share capital. KIT was formed, in 2000, by the Kidum group, and offers academic education through the internet.

During 2001, Elron signed a loan agreement with KIT in the amount of $1,500 advanced in two installments of $1,000 in December 2001 and $500 in September 2002, by way of convertible loans. The loans are convertible into preferred shares of KIT.

Note 6 - INVESTMENTS IN AFFILIATED COMPANIES (Cont.)

D. ADDITIONAL INFORMATION (Cont.)

(5) KIT (Cont.)

In December 2002, Elron executed a term sheet with KIT pursuant to which Elron will invest $2,000 in KIT out of an aggregate sum of $ 4,000 and granted to KIT an advance in the amount of $500 on account of Elron's investment. The investment is conditional upon the fulfillment of certain conditions. As of December 31, 2002, these conditions have not been met yet.

(6) Pulsicom

In 2001, Elron invested $1,618 in Pulsicom in consideration for 17% of Pulsicom’s outstanding share capital which represent 70.95% of its preferred shares. Pulsicom was formed in 2000 and is engaged in research and development of communication technology.

On January 1 2003, Elron entered into a bridge loan agreement with Pulsicom pursuant to which Elron undertook to grant a loan of $480 in two installments of $240 each. The first installment of $240 was paid in January 2003 and the second installment was paid in March 2003. The bridge loan is secured by a floating charge over Pulsicom’s assets and is convertible into preferred shares of Pulsicom.

(7) Given Imaging

During 2002, Elron and RDC sold 98,666 shares and 500,000 shares, respectively, of Given Imaging Ltd. (“Given”) in consideration for approximately $1,100 and $5,900, respectively. In addition, a former senior executive of RDC exercised a call option granted to him in 1999, and purchased from RDC 172,800 shares of Given at an exercise price of $0.17 per share (see also Note 13(D)).

As a result of the above transactions, a gain of approximately $5,300 was recorded.

See Note 16(G) regarding RDC’s pledge over its Given Imaging shares.

(8) Notal Vision

In October 2002, Elron executed an agreement to invest $2,000 in Notal Vision Ltd. (“Notal”), out of an aggregate amount of $4,000 raised by Notal. Notal, an Israeli medical device company, operates in the field of early detection of Age Related Macular Deterioration (AMD). As of 31 December 31, 2002, Elron advanced a loan to Notal in the amount of $300 on account of the investment. The investment was completed in January 2003. As a result of the investment, Elron holds 25% of Notal’s outstanding shares.

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

Note 6 - INVESTMENTS IN AFFILIATED COMPANIES (Cont.)

D. ADDITIONAL INFORMATION (Cont.)

(9) 3DV

On March 2002, 3DV systems Ltd. ("3DV"), in which Elron holds 1.8% and in which RDC holds 45.9%, entered into the second Joinder Agreement according to which 3DV issued Series A convertible notes in consideration for an amount of $4,000, bearing the rights and obligations set forth in the Note Purchase Agreement, dated August 15, 2001, between 3DV and certain shareholders and their affiliates.

As of the balance sheet date, Elron and RDC invested their total commitment under this agreement of $1,900.

E. SUMMARIZED INFORMATION

Summarized combined financial information is as follows:

	ESL	Given Imaging	Others
December 31, 2002:			
Balance sheet information -			
Current assets	$ 562,874	$ 56,059	$ 46,314
Total assets	935,841	68,728	69,269
Current liabilities	365,322	12,087	54,579
Long-term liabilities	154,443	882	15,940
Minority interest	4,675	2,182	86
Redeemable preferred stock	-	-	44,384
Shareholders' equity (deficiency)	411,361	53,577	(45,720)
Statement of operations information -			
Total income	$ 827,456	$ 28,904	$ 86,860
Gross profit	222,143	16,977	16,670
Net income (loss) from continuing operations	45,113	(18,310)	(28,338)

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

Note 6 - INVESTMENTS IN AFFILIATED COMPANIES (Cont.)

E. SUMMARIZED INFORMATION (Cont.)

	ESL	Elbit	Netvision	Others
December 31, 2001:				
Balance sheet information -				
Current assets	$ 509,448	$ 30,157	$ 14,853	$ 15,685
Total assets	899,552	209,431	27,990	48,619
Current liabilities	385,521	9,858	38,273	30,991
Long-term liabilities	130,052	57,431	1,967	10,109
Minority interest	5,994	91	-	792
Shareholders' equity (deficiency)	377,985	142,051	(12,250)	6,727
Statement of operations information -				
Total income	$ 764,501	$ 1,000	$ 58,909	$ 20,778
Gross profit (loss)	210,544	499	5,450	10,458
Net income (loss) from continuing operations	40,796	(31,539)	(3,601)	(35,164)
Year ended December 31, 2000:				
Statement of operations information -				
Total income	$ 591,084	$ 3,011	$ 48,488	$ 39,072
Gross profit	154,659	424	(9,009)	12,558
Net income (loss) from continuing operations	(20,531)	45,233	(24,772)	(24,874)

F. GOODWILL AND INTANGIBLE ASSETS ALLOCATED TO INVESTMENTS

The annual estimated amortization expense relating to intangible assets allocated to investments accounted for under the equity method, which will be included in the line item "Equity in earnings losses of affiliated companies investments in the statement of operations, for each of the five years in the period ending December 31, 2007 is approximately as follows:

		Total amortization
2003	-	$ 2,100
2004	-	$ 1,200
2005	-	$ 1,100
2006	-	$ 1,400
2007	-	$ 1,400

At the balance sheet date, the Company has unamortized goodwill in the amount of $5,731 allocated to investments accounted for under the equity method.

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

Note 6 - INVESTMENTS IN AFFILIATED COMPANIES (Cont.)

G. IMPAIRMENT

As a result of an other than temporary decline in value of certain investments, the company recorded impairment losses of $2,400 and $3,300 in 2002 and 2001, respectively.

Note 7 - INVESTMENTS IN OTHER COMPANIES AND LONG-TERM RECEIVABLES

	December 31	
	2002	**2001**
Marketable securities presented as available- for- sale securities: (1)		
Partner(3)	$ 78,578	$ -
Other	-	787
	78,578	787
Partnerships: (2)		
Gemini Fund, L.P.	266	421
Innomed	2,181	-
	2,447	421
Other investments and long-term receivables:		
Oren(4)	8,024	5,524
Cellenium(5)	2,500	-
ASSA-OR(6)	1,872	-
Others	3,737	772
	16,133	6,296
	$ 97,158	$ 7,504
(1) Includes unrealized gains	$ 14,176	$ 591

(2) Investments in partnerships are accounted for under the equity method.

(3) See Note 16(E) regarding the pledging of Partner shares.

(4) OREN

During 2001, Elron invested an amount of $1,000 in Oren Semiconductors Inc. ("Oren"), in which it held 18.4% at that time, out of a total of $8,000 raised by Oren. As a result, Elron's interest in Oren decreased to 17.33%. In addition, Elron granted $400 by way of long-term convertible loans.

During 2002, certain of Oren's existing shareholders, including Elron, invested a total of approximately $6,900 in Oren by way of long-term convertible loans, of which Elron invested $2,500. The loans bear a monthly accumulated interest rate of 3%, and shall be repaid after two years from the date of grant. The loans shall be converted into preferred shares conditional upon the occurrence of certain events stipulated in the convertible loan agreements. In addition, the lenders, including Elron, received warrants in the amount of twice the principal amount of the loans. The warrants are exercisable upon the same terms of the loan.

Note 7 - INVESTMENTS IN OTHER COMPANIES AND LONG-TERM RECEIVABLES (Cont.)

(4) OREN (Cont.)

Subsequent to the balance sheet date, an additional $600 were invested by Elron by way of long-term convertible loans upon the same terms and conditions of the convertible agreement.

(5) CELLENIUM

In July 2002, Elbit granted to Cellenium M.C.S. Ltd. and Cellenium Inc. (together - "Cellenium") a loan of $750. The loan, bearing an interest of LIBOR + 2% and secured by a charge over a residential property owned by Cellenium, shall be repaid by July 2003, or earlier if certain conditions are met.

In November 2002, Elbit executed an agreement with the other shareholder of Cellenium pursuant to which Elbit sold all of its shares in Cellenium in which it previously held 50%, to the other shareholder of Cellenium, for a future consideration of up to $14,000, conditional upon the occurrence of certain events stipulated in the agreement.

Simultaneously with the sale, Elbit granted an additional loan of $600 to Cellenium, bearing interest at the rate of LIBOR + 2%. The loan, secured by a floating charge over the intellectual property of Cellenium, and existing debt of $225 shall be repaid by Cellenuim to Elbit upon the occurrence of certain events as stipulated in the agreement.

(6) ASSA OR

On September 10, 2002, Elbit sold all of its shares in Textology Inc. ("Textology"), in which it previously held 63.75%, to Assa-Or Ltd. ("Assa-Or"), the other shareholder of Textology, in consideration for $3,300, for which Elbit granted a loan to Assa-Or. In addition, Elbit advanced a loan to Assa-Or in the amount of $1,100 of which approximately $1,000 was advanced as of the balance sheet date. Pursuant to the transaction, a loan in the amount of approximately $1,600 previously extended by Elbit to Textology was assigned by Textology to Assa-Or. All the above loan amounts, including an existing loan in the amount of approximately $1,600 previously granted to Assa-Or (collectively referred to as "the loans") will be repaid in accordance with the provisions of the agreement. In addition, Elbit has an option to convert a portion of the loans into ordinary shares of Assa-Or, pursuant to the terms of the agreement.

As a result of the above transaction, a gain in the amount of approximately $5,600 was deferred and will be recognized as income upon repayment of the loan. As of December 31, 2002, the balance of the loans to Assa-Or, net of the deferred gain, amounted to approximately $1,700.

The results of the operations of Textology until the date of the closing were classified as discontinued operations in the statement of operations.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

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

Note 8 - SUPPLEMENTAL PRO FORMA INFORMATION (UNAUDITED)

The pro forma information 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 as if they had been in effect at the beginning of each of the reported periods, and includes the effect of amortization of intangible assets from these dates.

The following pro forma information is based upon the historical financial statements of Elron (after restatement, as discussed in Note 3(G)), and upon the historical financial statements of Elbit, DEP, Galil and MediaGate (after reclassification of discontinuing operations)). The pro forma data does not incorporate, nor does it assume, any benefits from cost savings or synergies of the combined companies.

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, the share purchase or the acquisition of a controlling interest in Galil and MediaGate been consummated at the dates indicated, nor are they necessarily indicative of future operating results or financial condition.

PRO FORMA COMBINED RESULTS OF OPERATIONS

	Year ended December 31		
	2002	2001	2000
Net revenues	$ 25,897	$ 36,243	$ 44,283
Net loss from equity investments	(14,030)	(25,426)	(26,165)
Gain (loss) from disposal and changes in holdings in related companies, net	6,674	3,612	155,725
Other expenses, net	1,801	(18,633)	12,267
Total income	20,342	(4,204)	186,110
Costs and expenses	69,822	90,486	110,296
Income (loss) before taxes on income (tax benefit) and minority interests	$ (49,480)	$ (94,690)	$ 75,814
Income (loss) from continuing operations	$ (40,294)	$ (78,550)	$ 42,682
Net loss	$ (52,371)	$ (90,168)	$ 35,400
Basic net income (loss) from continuing operations per share	$ (1.38)	$ (2.70)	$ 1.47
Diluted net income (loss) from continuing operations per share	$ (1.39)	$ (2.71)	$ 1.45
Basic net income (loss) per share	$ (1.80)	$ (3.10)	$ 1.22
Diluted net income (loss) per share	$ (1.80)	$ (3.11)	$ 1.21
Weighted average number of ordinary shares used in computation (thousands) of basic income (loss) per share	29,131	29,070	29,051
Weighted average number of ordinary shares used in computation (thousands) of diluted income (loss) per share	29,131	29,070	29,325

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

Note 8 - SUPPLEMENTAL PRO FORMA INFORMATION (UNAUDITED) (Cont.)

Pro forma results of operations for the year ended December 31, 2001 and 2000, include amortization of goodwill in the amount of $2,317 and $2,085. Goodwill is no longer being amortized in accordance with SFAS 142, effective as of January 1, 2002.

Note 9 - LONG-TERM DEBENTURES AND DEPOSITS

The long-term debentures and deposits are used to secure long-term loans taken by ETI and ESI (See Note 16(D)). The amounts, which are denominated in U.S. dollars, bear weighted average interest of 1.60% per annum (December 31, 2001 – 2.25%) and mature in the following years:

2003	$ 26,292
2004	1,237
2005	699
2006	700
	$ 28,928

The scheduled maturities of held-to-maturity securities as of December 31, 2002 are as follows:

	Cost and accrued interest	Estimated fair value
Held to maturity:		
Due within one year	$ 2,640	$ 2,562
Due after one through four years	$ 2,636	$ 2,623

Note 10 - PROPERTY AND EQUIPMENT, NET

	December 31	
	2002	2001
Land and Building	$ 10,292	$ -
Leasehold improvements	2,527	3,967
Computers , furniture and machinery	9,032	4,978
Motor vehicles	989	1,506
	22,840	10,451
Less - accumulated depreciation	11,264	5,480
Property and equipment, net	$ 11,576	$ 4,971

Depreciation expense amounted to approximately $1,940, $2,628 and $2,360 for the years ended December 31, 2000, 2001 and 2002, respectively.

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

Note 11 - GOODWILL AND OTHER INTANGIBLE ASSETS

	Period of Amortization (years)	December 31 2002	December 31 2001
Cost:			
Technology and know-how (1)	5-12	$ 25,051	$ 16,495
Goodwill (2)		24,809	13,140
		49,860	29,635
Accumulated amortization:			
Technology and know-how (1)		$ 6,474	$ 5,528
Goodwill (4)		3,271	4,306
		9,745	9,834
Amortized cost		$ 40,115	$ 19,801

(1) During 2002 technology and know-how increased by $7,223 as a result of the acquisition of a controlling interest in Galil Medical and Mediagate (see Note 3). The above technology has a weighted average life of 7 years.

(2) The annual estimated amortization expense relating to Elron's intangible assets, other than goodwill existing as of December 31, 2002, for each of the five years in the period ending December 31, 2007 is approximately as follows:

		Total amortization
2003	-	$ 2,200
2004	-	$ 2,800
2005	-	$ 3,200
2006	-	$ 2,600
2007	-	$ 2,200

(3) As of January 1, 2002, the Company had unamortized goodwill in the amount of approximately $8,800. In connection with SFAS 142 transitional goodwill impairment evaluation, the Company estimated the fair value of each reporting unit and has determined that the carrying amount of each reporting unit does not exceed its fair value. Accordingly, the Company concluded that as of January 1, 2002, there was no indication of impairment of goodwill.

The changes in the carrying amount of goodwill for the year ended December 31, 2002 are as follows:

	Internet products	System and projects	Corporate operations and other holdings	Total
Balance as of January 1, 2002	$ 1,085	$ 7,748	$ -	$ 8,833
Goodwill acquired during the year (net of subsequent adjustments)	-	-	15,062	15,062
Goodwill realized related to sale of businesses	-	(2,157)	(200)	(2,357)
Balance as of December 31, 2002	$ 1,085	$ 5,591	$ 14,862	$ 21,538

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

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

Note 11 - GOODWILL AND OTHER INTANGIBLE ASSETS (Cont.)

(4) Until December 31, 2001, goodwill was amortized over a period of 7-10 years.

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

	For the year ended December 31	
	2001	**2000**
Reported net income (loss)	$ (*)(50,814)	$ (*)28,516
Goodwill amortization	1,565	1,513
Adjusted net loss	$ (49,249)	$ 30,029
Loss per share:		
Reported basic loss per share	$ (*)(2.40)	$ (*)1.35
Goodwill amortization	0.07	0.07
Adjusted basic loss per share	$ (2.33)	$ 1.42
Reported diluted loss per share	$ (*)(2.41)	$ (*)1.32
Goodwill amortization	0.07	0.07
Adjusted diluted loss per share	$ (2.34)	$ 1.39

(*) Restated – See Note 3(G).

Note 12 - SHORT-TERM LOANS FROM BANKS

Includes loans primarily from banks in U.S. dollars, bearing interest of Libor plus 0.6%-3.8% (The Libor rate as of December 31, 2002 was 1.4%).

For liens – see Note 16(D).

Note 13 - OTHER PAYABLES AND ACCRUED EXPENSES

	December 31	
	2002	**2001**
Payroll and related expenses (1)	$ 3,462	$ 3,347
Provision for income taxes	1,247	-
Advances from customers, net of inventories	-	435
Accrued expenses	2,815	657
Accrued projects expenses	1,451	1,826
Deferred revenues	2,914	1,824
Employee call options (2)	1,189	352
Others	3,438	880
	$ 16,516	$ 9,321
(1) Includes provision for vacation pay	$ 1,458	$ 1,331

Note 13 - OTHER PAYABLES AND ACCRUED EXPENSES (Cont.)

(2) EMPLOYEE CALL OPTIONS

A. As part of the retirement benefit approved by the Company's shareholders in December 1999, the former Chairman of the Board of Directors and president, received an option to purchase from the Company 2% of its holdings in ESI for $0.50 per share. The option was immediately exercisable and will expire on the earlier of five years or upon ESI's initial public offering. The option is accounted for under the provisions of APB 25. No compensation expense was recorded since at the grant date the exercise price equaled the fair value of ESI's ordinary shares. In connection with the transfer of assets and liabilities of the systems and projects activities to ETI (see Note 3C(3)), this option provides, upon exercise, an equal number of shares of common stock of ESI and ETI, for no additional consideration.

B. In March 2001, the Shareholders of the Company approved the grant of option to its Chairman of the Board to acquire up to 1.5% of any investments made by the Company after January 1, 2001 and an option to acquire up to 0.75% of any investments in private companies held by Elron prior to January 1, 2001 on the same terms and prices paid by Elron. These investments of Elron may be directly or indirectly held through DEP or RDC . The options granted are recorded at their fair value. Fair value of each option is estimated using the Black and Scholes option pricing model with the following weighted average assumptions used for grants: (1) expected life of the option of 3 years from the date of Elron's investment; (2) dividend yield of 0% and 0% as of December 31, 2001 and 2002, respectively; (3) expected volatility of 0% to 55% and 0% to 92% for the options for the years ended December 31, 2001 and 2002, respectively; (4) risk-free interest rate of 2.45% and 1.5% for the years ended December 31, 2001 and 2002. The option shall be exercisable for a period of three years from the later of 1 January, 2000 or the date of Elron's last investment in each of the private companies.

C. During 2001, the Board of directors approved the grant of options to certain officers of the Company to acquire between 1% to 2% of Elron's investments in certain private companies. The options are exercisable at the weighted average price of investments of Elron. The options vest ratably over a three year period and are exercisable for an additional three years. The options granted were recorded at fair value.

D. According to a call option agreement signed in November 1999, RDC awarded two former senior employees with call options as an incentive and a stock-based employee compensation. As of December 31, 2002, the two former senior employees are entitled to up to 3% of the equity interest in each held company, out of RDC's equity interest in such held companies at an exercise price as determined in the call option agreement. During 2002, a former senior employee of RDC exercised the call option granted to him into 172,800 shares of Given at an exercise price of $0.17 per share.

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

Note 13 - OTHER PAYABLES AND ACCRUED EXPENSES (Cont.)

(2) EMPLOYEE CALL OPTIONS (Cont.)

E. The fair value of each option is estimated using the Black and Scholes option pricing model with the following weighted average assumptions used for grants: (1) expected life of the option of 6 years; (2) dividend yield of 0% to 55% and 0% to 92% as of December 31, 2001 and 2002; (3) expected volatility of the options of 0% for the years ended December 31, 2001 and 2002; (4) risk-free interest rate of 2.45% and 1.5% for the years ended December 31, 2001 and 2002.

According to the aforesaid call options, compensation income amounted to $780 and compensation expenses amounted to $352 for the year ended December 31, 2002 and 2001.

Note 14 - LONG-TERM LOANS FROM BANKS AND OTHERS

	December 31	
	2002	**2001**
Long-term loans from banks and others	$ 67,026	$ 52,416
Less-current maturities	17,637	608
	$ 49,389	$ 51,808

The majority of the loans are from banks in U.S. dollars, bearing annual interest of LIBOR plus 0.5% – 3.5% (the LIBOR rate as of December 2002 was 1.4%).

The maturities of long-term loans for years subsequent to the balance sheet date are as follows:

First year (current maturities)	$ 17,637
Second year	48,054
Third year	1,322
Fourth year	13
	$ 67,026

An amount of $6,006 represents a loan from Galram to RDC. Out of the $6,006, $2,739 is included in current maturities and is New Israeli Shekel (“NIS”) denominated and linked to the Israeli Consumer Price Index. (“CPI”). An amount of $3,267 is due not before January 1, 2004 and bears no interest or linkage.

Liens – see note 16(D).

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

Note 15 - INCOME TAXES

A. Measurement of taxable income under the Income Tax (Inflationary Adjustments) Law, 1985:

Results for tax purposes are measured and reflected in real terms in accordance with the change in the Israeli CPI. As explained in note 2B the consolidated financial statements are presented in U.S. dollars. The differences between the change in the Israeli CPI and in the NIS/U.S. dollar exchange rate causes a difference between taxable income or loss and the income or loss before taxes reflected in the consolidated financial statements. In accordance with paragraph 9(f) of SFAS No. 109, the Company has not provided deferred income taxes on this difference between the reporting currency and the tax bases of assets and liabilities.

B. Tax benefits under Israel's Law for the Encouragement of Industry (Taxation), 1969:

Certain subsidiaries in Israel are classified as an "industrial companies", as defined by the law for the Encouragement of Industry (Taxes), 1969, and as such, are entitled to certain tax benefits, mainly amortization of costs relating to know-how and patents over eight years and accelerated depreciation.

C. Taxes on income (tax benefit) are comprised as follows:

	Year ended December 31		
	(*)2002	2001	2000
Current taxes	$ 106	$ 435	$ 6,308
Taxes in respect of prior years	119	(812)	-
Deferred income taxes (benefit)	(3,080)	(2,570)	1,771
	$ (2,855)	$ (2,947)	$ 8,079
Domestic	$ (2,855)	$ (2,947)	$ 7,420
Foreign	$ -	$ -	$ 659

(*) All taxes recorded in 2002 relate to continuing operations.

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

Note 15 - INCOME TAXES (Cont.)

D. Deferred taxes on income:

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax liabilities and assets are as follows:

		Deferred Tax Asset		Deferred Tax Liability	
	Total	Non Current	Current	Current	Non Current
As of December 31, 2002					
Deferred tax assets:					
Provision for doubtful accounts, vacation and others	$ 469	$ -	$ 469	$ -	$ -
Accrued severance pay, net	229	229	-	-	-
Trading marketable securities	23	-	23	-	-
Investments in affiliated companies, net	61,410	61,410	-	-	-
Property and equipment and other assets	2,618	5,863	-	-	(3,245)
Tax losses carryforward	73,766	65,911	-	-	7,855
Other	512	-	512	-	-
	139,027	133,413	1,004	-	4,610
Deferred tax liabilities:					
Available-for-sale marketable securities	(28,066)	-	194	-	(28,260)
	(28,066)	-	194	-	(28,260)
	110,961	133,413	1,198	-	(23,650)
Valuation allowance (1)	(131,621)	(130,423)	(1,198)	-	-
	$ (20,660)	$ 2,990	$ -	$ -	$ (23,650)
As of December 31, 2001					
Deferred tax assets:					
Provision for doubtful accounts, vacation and others	$ 368	$ -	$ 368	$ -	$ -
Accrued severance pay, net	167	167	-	-	-
Trading securities	3	-	3	-	-
Investments in affiliated companies, net	16,294	16,294	-	-	-
Property and equipment	8,386	8,386	-	-	-
Tax losses carryforward	16,508	15,772	736	-	-
Other	1,558	1,558	-	-	-
	43,284	42,177	1,107	-	-
Deferred tax liabilities:					
Available for sale marketable securities	(*)973	(*)973	-	-	(*)-
	44,257	(*)43,150	1,107	-	-
Valuation allowance	42,545	(42,177)	(368)	-	(*)-
	$ (*)1,712	$ (*)973	$ 739	$ -	$ (*)-

(*) Restated- See Note 3(G).

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

Note 15 - INCOME TAXES (Cont.)

D. Deferred taxes on income (Cont.)

Valuation allowance for deferred tax assets, for which subsequently recognized tax benefits will be allocated to reduce goodwill or other non-current intangible assets, amounts to approximately $4,500 as of December 31, 2002.

Regarding the deferred taxes in respect of the losses in Elbit prior to the merger date – see Note 3(A).

E. A reconciliation between the theoretical tax expense, assuming all income is taxed at the statutory tax rate applicable to income of the Company and the actual tax expense as reported in the statement of income, is as follows:

	Year ended December 31		
	2002	**(*)2001**	**(*)2000**
Income (loss) before taxes as reported in the consolidated statements of operations	$ (42,223)	$ (54,199)	$ 36,424
Statutory tax rate	36%	36%	36%
Theoretical tax expense (income)	(15,200)	(*)(19,512)	(*)13,113
Equity in (earnings) losses from affiliated companies	7,888	(*)9,807	(*)3,593
Tax exempt and reduced tax rate on capital gains	(637)	-	(2,024)
Tax exempt income, net of non-deductible expenses	(2,943)	(1,916)	(2,842)
Differences arising from the basis of measurement for tax purposes	(3,504)	(*)(3,264)	(*)(3,761)
Deferred taxes on losses for which valuation allowance was provided	11,422	12,750	-
Taxes in respect of previous years	119	(812)	-
Actual tax expenses	$ (2,855)	$ (2,947)	$ 8,079
Effective tax rate	(6.8)%	(5.4)%	22.2%

* Restated – See Note 3(G).

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

Note 15 - INCOME TAXES (Cont.)

F. The Company's subsidiaries in the U.S. have estimated aggregate available carryforward tax losses of approximately $98,800 to offset against future taxable profits, which expire between 2002 and 2022. A valuation allowance for the entire balance was recorded due to the uncertainty of the tax asset's future realization.

As of December 31, 2002 the Company and its Israeli subsidiaries had a tax loss carry forward of approximately $44,500. Carryforward tax losses in Israel may be carryforward indefinitely and may be set against future taxable income.

G. Income (loss) before income taxes is comprised as follows:

	Year ended December 31		
	2002	(*)2001	(*)2000
Domestic	$ (19,771)	$(*)(28,543)	$ (*)64,086
Foreign	(22,452)	(25,656)	(27,662)
	$ (42,223)	$ (54,199)	$ 36,424

* Restated – See Note 3(G).

Note 16 - CONTINGENT LIABILITIES, PLEDGES AND COMMITMENTS

A. The Company and its subsidiaries have operating lease agreements in respect of their premises for periods ending through 2007. Rent expenses amounted to approximately $1,329, $2,416 and $1,675 for the years ended December 31 2000, 2001 and 2002, respectively. The future minimum rental payments under these agreements in the years following the balance sheet date are as follows:

First year	$ 1,492
Second year	1,294
Third year	721
Fourth year	22
Fifth year	10
	$ 3,539

Elron is the guarantor for the lease agreements of ESI in respect of their facilities in the U.S. in the amount of approximately $2,100.

B. ESI has a number of royalty bearing agreements for technology included in its products, generally the royalty fees are paid as a percentage of net revenue earned and are included in cost of sales. Royalty expenses amounted to approximately $456, $320 and $300 for the years ended December 31, 2000, 2001 and 2002, respectively.

Note 16 - CONTINGENT LIABILITIES, PLEDGES AND COMMITMENTS (Cont.)

C. Certain of the Company's subsidiaries are required to pay royalties to the Office of the Chief Scientist of the Israeli Ministry of Industry and Trade and other institutions at the rate of 3%-5% of revenues derived from research and development projects in which the Government of Israel or the other institutions participates in financing until an amount equal to 100% of the amount received by each company. As of December 31, 2002, the aggregate contingent obligation to pay royalties amounted to approximately $2,400.

D. Elron provided guarantees to banks of approximately $74,000 to secure bank loans made available to ETI and ESI and of which approximately $69,300 have been utilized as of December 31, 2002. Out of the $74,000 an amount of approximately $31,000 is to be collateralized by Elron's investment in debentures, marketable securities and deposits, and of which approximately $28,900 has been utilized as of December 31, 2002.

Elron also provided a letter of comfort in connection with the credit line granted to ETI by certain banks, pursuant to which Elron undertook not to dilute its holdings in ETI below a certain percentage. The Company also agreed to subordinate any amounts owed to it by ETI, other than interest on outstanding loans and payments in the ordinary course of business.

E. Elbit has pledged approximately 70% of its shares in Partner Communications Company Ltd. to the banks which are providing financing to Partner, pro rata to the other original shareholders of Partner.

F. The Company has provided letters of comfort in connection with a credit line granted to Netvision by banks. The credit line at December 31, 2002 amounted to approximately $19,700. The comfort letters were jointly provided with the other major shareholder of Netvision, pursuant to which the Company and the other shareholder undertook not to dilute their holdings in Netvision below a certain percentage.

G. RDC's bank loan in the amount of $4,000 is secured by a floating pledge and by a first degree fixed pledge over the securities, and all rights derived therefrom, deposited in RDC's bank account. As of December 31, 2002, RDC has deposited in the bank 2,840,000 shares of Given.

H. As collateral for Mediagate's liability to its bank, in the amount of approximately $2,500, a first ranking fixed and floating charge were placed on all of Mediagate Ltd's intellectual property and assets, including its insurance rights.

Note 16 - CONTINGENT LIABILITIES, PLEDGES AND COMMITMENTS (Cont.)

I. Legal proceedings:

(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 8, 1999, the Company received a copy of a claim and 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 Elron and it's officers, among others, relate to the period prior to the sale of Elron'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 17 - SHAREHOLDERS' EQUITY

A. SHARE CAPITAL

(1) Ordinary share confer upon their holder's voting rights, the right to receive dividends and the right to share in excess assets upon liquidation of the Company.

(2) On May 15, 2002 under the merger with Elbit, the Company issued 5,617,601 ordinary shares. See note 3A.

(3) On May 6, 2002, under the acquisition of DEP shares, the Company issued 2,261,843 ordinary shares. See note 3B.

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

Note 17 - SHAREHOLDERS' EQUITY (Cont.)

B. OPTIONS TO EMPLOYEES

(1) Options to Elron's Employees

The options vest over a four-year period from date of grant and have a term of 5-9 years. Stock options activity is summarized as follows:

	2002		2001		2000	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding-beginning of the year	463,025	$ 15.14	158,404	$ 20.26	163,404	$ 20.54
Granted (*)	270,525	10.48	345,871	13.38	43,000	29.38
Exercised	(87,863)	6.88	(25,000)	12.21	(48,000)	10.18
Forfeited	(68,475)	12.91	(16,250)	22.89	-	-
Outstanding - end of the year	577,212	$ 14.09	463,025	$ 15.14	158,404	$ 20.26
Options exercisable at the end of the year	207,681	$ 14.59	45,135	$ 19.28	18,000	$ 12.44

Weighted average fair value of options granted at their grant date were $12.07, $6.37 and $3.97 during 2000, 2001 and 2002, respectively. All options were granted at a price approximately 10%-15% below market price on date of grant.

* Includes 240,525 options granted to Elbit's employees as a result of the merger. See Note 3A.

(2) The following table summarizes information regarding outstanding and exercisable options as of December 31, 2002:

Options outstanding				Options exercisable	
Exercise price	Number outstanding at December 31, 2002	Weighted-average remaining contractual life (years)	Weighted-average exercise price	Number outstanding at December 31, 2002	Weighted-average exercise price
$ 6.911-8.34	88,708	4.00	$ 7.49	31,500	6.86
$ 10.38-11.69	196,750	4.80	$ 10.70	57,250	10.75
$ 12.51-13.39	97,130	4.33	$ 13.11	40,905	12.91
$ 18.09-19.05	122,854	4.39	$ 18.66	42,141	18.28
$ 21.38	38,770	2.59	$ 21.38	19,385	21.38
$ 29.38	33,000	4.83	$ 29.38	16,500	29.38
	577,212			207,681	

Note 17 - SHAREHOLDERS' EQUITY (Cont.)

B. OPTIONS TO EMPLOYEES (Cont.)

(3) In December 1999, the Company's Shareholders approved a plan whereby the Chairman of the Board and then Chief Executive Officer of the Company were granted options to purchase up to 58,154 Ordinary shares of the Company (the "1999 grant"). The options are to be granted ratably over a period of 3 years commencing February 2000 and are exercisable for a period of three years, commencing two years after the date of the grant.

The exercise price of the options granted in December 1999, 2000 and 2001 was $21.38, $21.38 and $13.01, respectively.

In March 2001, the Company's Shareholders approved a plan whereby the Chairman of the Board and then Chief Executive Officer of the Company were be granted options to purchase up to 58,000 Ordinary shares of the Company (the "2001 grant"). The options are to be granted ratably over a period of 3 years commencing June 2001 and are exercisable for a period of three years, commencing two years after the date of the grant.

The exercise price of the options granted in March 2001 and 2002 was $19.05 and 8.34, respectively. The exercise price of the options to be granted in June 2003 will be determined based on the market value of the Company's shares but shall not exceed $19.05 per share.

As of grant date, the weighted average fair value of the 1999 grant and the 2001 grant was $7.67 and $4.29 per share, respectively. The fair value was calculated using the Black and Scholes option-pricing model. (See Note 2T for the assumptions used in the calculation).

Upon exercise of the options, the option holder will be granted a number of shares reflecting the benefit component of the options exercised, as calculated at the exercise date, in consideration for their par value only. The plan is considered to be a variable plan as defined in APB 25. Compensation expense is calculated based on the quoted market price of the Company's stock at the end of each reporting period and is amortized over the remaining vesting period of the options.

(4) Compensation expenses (income) recorded during 2002 amounted to $(222) (2001 - $(6), 2000 - $245).

(5) The balance of deferred compensation as of December 31, 2002 amounted to $553.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

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

Note 18 - INCOME (LOSS) PER SHARE

Earning (loss) per share is computed as follows:

	Year ended December 31								
	2002			2001			2000		
	Loss	Number of shares (in thousands)	Per share amount	Loss	Number of shares (in thousands)	Per share amount	Income	Number of shares (in thousands)	Per share amount
Basic	(39,301)	26,272	$(1.50)	(*) (50,814)	21,191	$(*)(2.40)	(*)28,516	21,172	$(*)1.35
Effect of options of investees	(209)	-		(246)	-		(63)	-	
Effect of options of Elron	-	-		-	-		-	274	
Diluted	(39,510)	26,272	$(1.50)	(*) (51,060)	21,191	$(*)(2.41)	(*)28,453	21,446	$(*)1.33

* Restated – See Note 3(G).

Note 19 - EQUITY IN EARNINGS (LOSSES) OF AFFILIATED COMPANIES' INVESTMENTS

	Year ended December 31		
	2002	2001	2000
Affiliated companies:			
Elbit[(1)]	$ (8,658)	$ (13,138)	$ 17,350
ESL	9,469	9,064	(2,981)
Netvision	(436)	(2,504)	(12,774)
Given	(4,376)	(*) (1,575)	(*) (781)
Others	(17,910)	(*) (19,089)	(*) (10,297)
	$ (21,911)	$(*) (27,242)	$ (*) (9,483)

(1) In 2002 – Until the merger date, see Note 3(A).
* Restated – See Note 3(G).

Note 20 - GAIN FROM DISPOSAL AND CHANGES IN HOLDINGS IN SUBSIDIARIES AND AFFILIATED COMPANIES, NET

	Year ended December 31		
	2002	2001	2000
ESL	$ 1,603	$ 2,985	$ 19,133
Given	5,251	-	-
Mediagate	-	-	3,104
Others	34	194	4,582
	$ 6,888	$ 3,179	$ 26,819

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

Note 21 - OTHER INCOME (EXPENSES), NET

	Year ended December 31		
	2002	2001	2000
Gain (loss) from sale and increase (decrease) in market value of:			
ArelNet shares (4)	$ (27)	$ -	$ -
Netmanage shares (4)	632	-	-
ServiceSoft shares (1)(7)	-	-	6,831
Broadbase shares (2)	-	(3,952)	(570)
Kana shares (3)(7)	(34)	(691)	-
Zoran shares and options (5)(6)	-	954	34,281
Other companies, net (6)(7)	(1,778)	(1,196)	3,054
Other income (expenses)	464	(*)-	(138)
	$ (743)	$ (*)(4,885)	$ 43,458

* Restated – See Note 3(G).

(1) In December 2000 Servicesoft Inc., in which Elron held approximately 3.3% on a fully diluted basis, was acquired by Broadbase Software Inc. ("Broadbase"), which was then a public company traded on Nasdaq, in a share exchange transaction. As a result, Elron received 1,159,022 ordinary shares of BroadBase with a fair market value on that date of approximately $7,833 resulting in a gain of $6,831.

(2) In June 2001, BroadBase was acquired by Kana Software Inc. ("Kana"), a public company traded on Nasdaq, in a share exchange transaction. As a result, Elron received approximately 1 million ordinary shares of Kana with a fair market value on that date of approximately $2,140 resulted in a gain of $172.

(3) In the last quarter of 2001 and in 2002, the Company sold most of the Kana shares held by it in consideration for $1,211 and $197 respectively.

(4) In 2002, the Company sold all its shares in Netmanage and ArelNet in consideration for $790.

(5) During 2000, 611,566 shares of Zoran were sold for a total consideration of approximately $27,000. The gain of approximately $34,281 consists of gain on the sale of the shares, changes in the market value of Zoran's shares, gains arising from transfer to trading securities account in the amount of $24,121, and changes in the Zoran's options. During 2000, as part of the Company's policy to limit its exposure to market risks, Elron hedged the price of most of its Zoran shares by the purchase of put options and by selling call options, in a strike price range of $35.00-$53.00 for periods ended September and December 2000 and February 2001. The hedged shares were transferred to the trading securities account.

During the first quarter of 2001, the Company sold all of the 252,399 remaining shares of Zoran, out of which 188,400 were hedged, in consideration for approximately $10,600 resulting in a gain of approximately $954.

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

Note 21 - OTHER INCOME (EXPENSES), NET (Cont.)

(6) Including realized gains from sale of available-for-sale securities in the amount of approximately $17,000, $1,000 and $100 in the years ended December 31, 2000, 2001 and 2002, respectively. The proceeds from such sales amounted to approximately $28,500, $10,700 and $100 for the years ended December 31, 2000, 2001 and 2002, respectively.

(7) Including unrealized losses from trading securities held as of the end of the year in the amount of $1,975, $11 and $54 for the years ended December 31, 2000, 2001 and 2002 respectively.

(8) Including other than temporary decline in value of available-for-sale securities in the amount of approximately $1,000 and $600 for the years ended December 31, 2001 and 2002, respectively.

Note 22 - FINANCING INCOME, NET

	Year ended December 31		
	2002	**2001**	**2000**
Income:			
Interest on cash equivalents, bank deposits and trading marketable bonds	$ 2,314	$ 4,419	$ 6,888
Foreign currency gains	1,257	796	121
	3,571	5,215	7,009
Expenses:			
Interest on short-term credit and long-term loans	$ 3,601	$ 3,878	$ 4,492
Foreign currency losses	444	86	111
	4,045	3,964	4,603
	$ (474)	$ 1,251	$ 2,406

Note 23 - DISCONTINUED OPERATIONS

During 2002, the Company realized certain subsidiaries and activities, which met the definition of a component under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets". Accordingly, the Company classified the results relating to the above subsidiaries and activities to discontinued operations.

The following is the composition of discontinued operations:

	For the year ended December 31, 2002
Loss from operations of discontinued components	
Vflash (see Note 3E)(*)	$ (1,852)
Other	(2,389)
	(4,241)
Gain (loss) on disposal	
Vflash (see Note 3E)	1,991
Other	(506)
	1,485
	$ (2,756)

* Net of tax

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

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Note 23 - DISCONTINUED OPERATIONS (Cont.)

The revenue relating to discontinued operations for the year ended December 31, 2002 amounted to $560.

Note 24 - RELATED PARTY TRANSACTIONS

A. RELATED PARTY RECEIVABLE BALANCES:

	December 31	
	2002	**2001**
Trade receivables:		
Affiliated companies	$ -	$ 2,350
Other companies	1,308	-
	1,308	2,350
Other receivables:		
Affiliated companies	204	220
Other companies	497	135
	701	355
Long-term receivables:		
Other companies	453	-
	453	-
	$ 2,462	$ 2,705

B. INCOME AND EXPENSES FROM AFFILIATED COMPANIES:

	Year ended December 31		
	2002	**2001**	**2000**
Revenues:	$ 2,487	$ 3,347	$ 2,345
Interest and commission for guarantees	75	126	31
Participation in Directors' remuneration	13	28	18
Participation in expenses	308	724	194
Costs and Expenses:			
Participation in expenses	356	33	287
Cost of revenue	1,752	728	-

C. Option to the Chairman of the Board - see Note 17.

D. Sale of activities to ESL – see Note 3C.

E. Loans from Galram – see Note 14.

Note 25 - BUSINESS SEGMENTS

A. The Company is operating through its subsidiaries, ESI and ETI, in two business segments: the internet product segment and the system and projects segment. A third business segment is the Corporate Operation and Other Holdings in affiliated and other companies engaged in various fields of advanced technology and the corporate operation.

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.

The operation of the system and project segment includes development and supply of software solutions for the management of large and complex communication and internet networks.

The third segment includes holdings in various companies that operate in the communications, software, defense industry, medical devices, semiconductors amorphous metals and others and the corporate operations.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

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

Note 25 - BUSINESS SEGMENTS (Cont.)

B. Segment information is as follows:

	Internet products	System and projects	Corporate Operations and Other Holdings	Adjustments	Total
2002					
Net revenues	$ 8,290	$ 10,069	$ 5,109	$ -	$ 23,468
Other expenses, net	-	4	(747)	-	(743)
Equity in losses of affiliated companies	-	-	(21,911)	-	(21,911)
Gain from changes in holdings in affiliated companies, net	-	-	6,888	-	6,888
Finance income (expense), net	(393)	(1,562)	1,481	-	(474)
Tax benefit (income taxes)	(7)	(99)	2,961	-	2,855
Net loss	(8,567)	(5,912)	(24,822)	-	(39,301)
Depreciation and amortization	1,517	1,473	1,421	-	4,411
Capital expenditures	247	158	33,698	-	34,103
Total assets as of December 31, 2002	6,057	17,601	390,344	(12,673)	401,329
Goodwill as of December 31, 2002	1,085	5,591	14,862	-	21,538
2001					
Net revenues	$ 9,077	$ 23,782	$ -	$ -	$ 32,859
Other expenses, net(*)	-	(218)	(4,667)	-	(*)(4,885)
Equity in losses of affiliated companies(*)	-	-	(27,242)	-	(27,242)
Gain from changes in holdings in affiliated companies, net	-	-	3,179	-	3,179
Finance income (expense), net	(458)	(2,832)	4,541	-	1,251
Income taxes	(38)	(798)	3,783	-	2,947
Net loss(*)	(11,188)	(15,302)	(24,324)	-	(50,814)
Depreciation and amortization	(2,151)	(3,985)	(226)	-	(6,362)
Capital expenditures	18	402	20,496	-	20,916
Total assets(*)	7,801	32,060	297,938	(11,489)	326,310
Goodwill as of December 31, 2001	1,085	7,748	-	-	8,833

* Restated – See Note 3(G).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

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

Note 25- BUSINESS SEGMENTS (Cont.)

B. Segment information is as follows (Cont.):

	Internet products	System and projects	Corporate Operations and Other Holdings	Adjustments	Total
2000					
Net revenues	$ 12,144	$ 27,223	$ -	$ (205)	$ 39,162
Other income	-	-	43,458	-	43,458
Equity in net losses of affiliated companies(*)	-	-	(9,483)	-	(9,483)
Gain from changes in holdings in affiliated companies, net(*)	-	-	26,819	-	26,819
Finance income (expense), net	(628)	(4,411)	7,445	-	2,406
Income taxes	(18)	(20)	(8,041)	-	(8,079)
Net income (loss) (*)	(11,702)	(15,998)	56,216	-	28,516
Depreciation and amortization	(1,310)	(3,675)	(137)	-	(5,122)
Capital expenditures	1,391	16,347	32,311	(13,702)	36,347

* Restated – See Note 3(G).

C. Revenue data according to geographical destination is as follows:

	2002	2001	2000
Israel	$ 9,101	$ 21,736	$ 20,581
Overseas (mainly USA)	14,367	11,123	18,581
	$ 23,468	$ 32,859	$ 39,162

D. In 2002 and 2001 revenues from one customer in the systems and project segment were approximately 13% and 14% of total consolidated revenues, respectively, and from other customer 11% and 0%, of total consolidated revenues, respectively.

E. The majority of the long-lived assets are located in Israel.

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

Note 26 - RECONCILIATION TO ISRAELI GAAP

The consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the U.S. Had the consolidated financial statements been prepared in accordance with accounting principles generally accepted in Israel ("Israeli GAAP"), the effects on the financial statements would have been as follows:

A. Effect on the statement of operations for the year ended December 31, 2002:

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

Effect on the statement of operations for the year ended December 31, 2001:

	As reported	Adjustments	As per Israeli GAAP
Net loss*	$ (50,814)	$ 4,299	$ (46,515)
Basic net loss per share*	(2.40)	0.2	(2.20)
Diluted net loss per share*	(2.41)	0.2	(2.21)

Effect on the statement of operations for the year ended December 31, 2000:

	As reported	Adjustments	As per Israeli GAAP
Net income*	$ 28,516	$ (7,600)	$ 20,916
Basic net income per share*	1.35	(0.37)	0.98
Diluted net income per share*	1.32	(0.35)	0.97

* Restated – See Note 3(G).

B. Effect on the balance sheet:

As of December 31, 2002:

	As reported	Adjustments	As per Israeli GAAP
Other investments	$ 97,158	$ (78,185) (5)	$ 18,973
Investment in affiliated companies	131,256	(19,036) (1)	99,788
		(12,122) (6) (8)	
		(364) (2)	
		55	
Total assets	$ 401,329	$ (129,064)	$ 272,265
Deferred taxes	23,650	(1,085) (1)	(5,117)
		(28,260) (5)	
		578 (2)	
Retained earnings	(18,066)	(11,206) (6) (8)	(22,015)
		4,415 (2)	
		4,175 (9)	
		(1,389) (3)	
		2,904 (1)	
		(2,848) (1)	
Total equity	266,517	(101,602)	164,915

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

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

Note 26 - RECONCILIATION TO ISRAELI GAAP (Cont.)

B. Effect on the balance sheet (Cont.)

As of December 31, 2001:

	As reported	Adjustments	As per Israeli GAAP
Other investments*	$ 7,504	$ 8,237 (2) (591) (5)	$ 15,150
Investment in affiliated companies*	162,260	(41,240) (5) (1,924) (6) (6,293) (2) (8,942) (8) (2,070) (9)	101,791
Deferred taxes*	973	(731) (5)	242
Total assets*	326,310	(53,795)	272,515
Retained earnings*	21,235	(1,455) (6) (8,942) (8) 5,516 (2)	16,354
Total equity*	238,713	(53,554)	185,159

* Restated – see Note 3(G).

C. MATERIAL ADJUSTMENTS:

The abovementioned adjustments include material differences between U.S. GAAP and Israeli GAAP are as follows:

(1) According to U.S. GAAP, the merger of Elron and Elbit and the DEP share purchase as described in Note 3 are accounted for by the purchase method in Elron's financial statements. According to accepted practice in Israel, the merger between Elron and Elbit and the DEP share purchase, are considered transactions with controlling shareholders and accordingly, the assets and liabilities should be recorded according to their carrying values in the transferring company at the dates of the relevant transactions. In addition, according to U.S. GAAP, when at the acquisition date, a full valuation allowance is recorded to offset deferred tax assets in respect of loss carryforwards and subsequent to that date, the valuation allowance is reduced by recording a tax benefit in respect of those loss carryforwards, the entire tax benefit should be recorded as an adjustment to the purchase price recorded in additional paid-in capital. According to accepted practice in Israel, only the portion of the tax benefit relating to the interest acquired should be recorded as an adjustment to additional paid-in capital while the portion relating to the interest previously held by the acquiror should be recorded as a tax benefit in net income.

Note 26 - RECONCILIATION TO ISRAELI GAAP (Cont.)

C. MATERIAL ADJUSTMENTS (Cont.)

(2) As a result of the purchase of DEP, Elron's aggregate interest in certain companies has increased and enabled Elron to exercise significant influence in these companies. In accordance with U.S. GAAP, Elron's direct holdings in these companies, which were accounted for by Elron at cost or as available-for-sale securities, are 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 these companies.

(3) Effective January 1, 2002 the Company adopted SFAS 142, "Goodwill and Other Intangible Assets" according to which goodwill and intangible assets with indefinite lives are no longer amortized periodically but are reviewed annually for impairment (or more frequently if impairment indicators arise). According to Israeli GAAP, all intangibles, including goodwill should be amortized.

(4) According to U.S. GAAP the fair value of options to acquire shares of affiliated companies held by Elron and RDC is recorded as a liability. According to Israeli GAAP, no liability should be recorded if the exercise of the options would not result in a loss to Elron.

(5) Pursuant to SFAS 115, marketable securities which are available-for-sale are presented on the basis of their market value and changes in such value should be charged (or credited) to other comprehensive income. According to Israeli GAAP non-current investments in marketable securities are presented at cost.

(6) In 1999, Elbit sold all its rights in real estate in Haifa to Elbit systems in consideration for $16,000. In accordance with Israeli GAAP, the gain on sale of real estate, as presented by Elbit, in the amount of $10,000, should be credited to capital surplus in shareholders' equity due to the significant influence of Elron in Elbit and Elbit Systems. Under U.S. GAAP, the gain is recognized in the statement of operations.

(7) According to US GAAP, dividends are recorded in the period to which they are declared. Until December 31, 2001, according to Israeli GAAP, dividends declared after balance sheet date, were recorded in the financial statements at balance sheet date if distributed from earnings incurred up to balance sheet date.

Note 26 - RECONCILIATION TO ISRAELI GAAP (Cont.)

C. MATERIAL ADJUSTMENTS (Cont.)

(8) According to U.S. GAAP, the merger of ESL and EL-OP as described in Note 6(D)(1)(a) is accounted by the purchase method in ESL's financial statements and accordingly a gain from the decrease in holding in ESL was recorded in Elron's financial statements. According to accepted practice in Israel , the merger between ESL and EL-OP, from the perspective of Elron, is considered a non-monetary exchange of similar assets and accordingly should be recorded at book value, with no gain recognized.

(9) According to U.S. GAAP, the gain arising from the initial public offering of Given is accounted for as an equity transaction, as Given was a development stage company at the time. According to Israeli GAAP, this gain is recognized in the statement of operations over three years from date of issuance.

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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 December 31, 2002

	% Outstanding shares	Carrying value of the investment December 31, 2002 (1)	Market value of the publicly traded investments as of: December 31, 2002	March 10, 2002
Consolidated Companies:				
Elron Software Inc.	96%	$ -	$ -	$ -
Elron Telesoft Inc.	99%	10,309	-	-
Galil Medical Ltd. (2)	34%	4,297	-	-
MediaGate N.V.	68%	2,490	-	-
Affiliated Companies (equity):				
Elbit Systems Ltd. (Nasdaq: ESLT)	20%	82,715	131,701	128,587
Given Imaging Ltd. (Nasdaq: GIVN) (2)	19%	25,563	42,637	41,072
NetVision Ltd.	46%	962	-	-
Wavion Inc.	45%	670	-	-
Kidum Elron IT (KIT) Ltd.	29%	1,329	-	-
Chip Express Corporation	33%	5,188	-	-
Pulsicom Israel Technologies Ltd.	17%	336	-	-
3DV Systems Ltd. (2)	25%	959	-	-
Advanced Metal Technologies Ltd. (AMT)	29%	4,177	-	-
Witcom Ltd. (2)	20%	519	-	-
CellAct Ltd.	45%	290	-	-
Semiconductors Engineering Laboratories Ltd. (SELA) (2)	25%	471	-	-
Ingeneo Ltd.	21%	400	-	-
Available for sale:				
Partner Communications Company Ltd. (Nasdaq: PTNR)	12%	78,587	78,587	64,862
24/7 Real Media (Nasdaq: TFSM)	3%	776	776	709
Partnership:				
Gemini Israel Fund	5%	266	-	-
InnoMed	12%	2,181	-	-
Cost:				
Oren Semiconductor Inc.	17%	8,024	-	-
24/7 Real Media (4)	5%	1,113	-	-

(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) 182,000 shares.
(4) Investment in preferred shares of 24/7 Real Media which represent 4,840,271 common shares on an as converted basis. The preferred shares were converted in February 2003.