SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2002
Commission File No. 0-11456

ELRON ELECTRONIC INDUSTRIES LTD.

(Exact name of Registrant as specified in its charter and translation of Registrant's name into English)

ISRAEL
(Jurisdiction of incorporation or organization)

3 Azrieli Center, 42nd Floor, Tel-Aviv, Israel 67023
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:
Not Applicable
(Title of Class)

Securities registered or to be registered pursuant to Section 12(g) of the Act:
Ordinary Shares, nominal value 0.003 New Israeli Shekels per share
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:
Ordinary Shares, nominal value 0.003 New Israeli Shekels per share
(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the Annual Report: **29,180,970**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 of 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: **Yes [x]** **No [ ]**

Indicate by check mark which financial statements the registrant has elected to follow:

Item 17 [ ] **Item 18** [x]

TABLE OF CONTENTS

This Annual Report on Form 20-F includes certain “forward-looking” statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. The use of the words “projects,” “expects,” “may,” “plans” or “intends,” or words of similar import, identifies a statement as “forward-looking.” There can be no assurance, however, that actual results will not differ materially from our expectations or projections. Factors that could cause actual results to differ from our expectations or projections include the risks and uncertainties relating to our business described in this Annual Report under Item 3 titled “Risk Factors” as well as those discussed elsewhere in this Annual Report and in our other filings with the Securities and Exchange Commission. Any forward-looking statements contained in this Annual Report speak only as of the date of this Annual Report, and we caution investors and potential investors not to place undue reliance on these statements. We undertake no obligation to update or revise any forward-looking statements. All subsequent written or oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the Risk Factors.

For the purpose of this Annual Report on Form 20-F, the terms “group companies” and “companies in our group” collectively refer to subsidiaries, affiliated and other companies in which we have direct or indirect holdings through our wholly-owned subsidiaries, Elbit Ltd., or Elbit, and DEP Technology Holdings Ltd., or DEP, including DEP’s subsidiary, RDC Rafael Development Corporation Ltd., or RDC. Our ownership interests in our group companies reflected in this Annual Report represent our beneficial ownership interests in these companies as of May 31, 2003 unless otherwise expressly indicated. We have also indicated our direct holding and our share in the holding of RDC in a group company where applicable. The references in this Annual Report to balance sheet items are as of December 31, 2002.

PART I

Item 1. <u>Identity of Directors, Senior Management and Advisers</u>

Not applicable.

Item 2. <u>Offer Statistics and Expected Timetable</u>

Not applicable.

Item 3. <u>Key Information</u>

The following selected financial data for the years ended December 31, 1998, 1999, 2000, 2001 and 2002 are derived from our audited consolidated financial statements of which the financial statements as of December 31, 2001 and 2002, and for each of the years ended December 31, 2000, 2001 and 2002 appear later in this Form 20-F. The audited consolidated financial statements have been prepared in accordance with US GAAP.

CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands of U.S. Dollars, except per share data)

	Year ended December 31				
	1998*	**1999***	**2000***	**2001***	**2002**
Income:					
Revenues	$16,041	$39,863	$39,162	$32,859	$23,468
Equity in earnings (losses) of affiliated companies' investments	36,597	1,850	(9,483)	(27,242)	(21,911)
Gain from disposal and changes in holdings in subsidiaries and affiliated companies, net	2,876	32,522	26,819	3,179	6,888
Other income (expenses), net	9,685	28,211	43,458	(4,885)	(743)
	65,199	102,446	99,956	3,911	7,702
Costs and Expenses:					
Cost of revenues	3,383	19,553	26,523	22,048	11,557
Research and development costs, net	1,836	3,821	7,785	8,979	7,818
Marketing and selling expenses, net	10,078	10,025	14,710	10,587	14,428
General and administrative expenses	5,513	10,401	13,740	11,810	11,272
Restructuring costs	—	—	—	2,203	2,318
Amortization of intangible assets	764	3,128	3,180	3,734	2,058
Financial expenses (income), net	469	(4,133)	(2,406)	(1,251)	474
Retirement compensation	—	5,000	—	—	—
In-process research and development Acquired	19,012	—	—	—	—
	41,055	47,795	63,532	58,110	49,925
Income (loss) before taxes on income	24,144	54,651	36,424	(54,199)	(42,223)
Taxes on income (tax benefit)	—	12,173	8,079	(2,947)	(2,855)
Income (loss) from continuing operations after taxes on income	24,144	42,478	28,345	(51,252)	(39,368)
Minority interest in losses of subsidiaries	—	—	171	438	2,823
Income (loss) from continuing operations	24,144	42,478	28,516	(50,814)	(36,545)
Loss from discontinued operations	—	—	—	—	(2,756)
Net Income (loss)	$24,144	$42,478	$28,516	$(50,814)	$(39,301)
Income (loss) per share:					
Basic income (loss) per share data-					
Income (loss) from continuing operations	$1.17	$2.01	$1.35	$(2.40)	$(1.39)
Loss) from discontinued operations	—	—	—	—	(0.11)
Net income (loss)	$1.17	$2.01	$1.35	$(2.40)	$(1.50)
Weighted average number of ordinary shares used in computing basic net income (loss) per share (thousands)	20,595	21,112	21,172	21,191	26,272
Diluted income (loss) per share data -					
Income (loss) from continuing operations	$1.10	$1.99	$1.33	$(2.41)	$(1.39)
Loss) from discontinued operations	—	—	—	—	(0.11)
Net income (loss)	$1.10	$1.99	$1.33	$(2.41)	$(1.50)
Weighted average number of ordinary shares used in computing diluted net income (loss) per share thousands)	20,777	21,174	21,446	21,191	26,272
Dividend per share	$0.38	$1.46	$2.62	$—	$—

Balance Sheet Data	1998*	1999*	2000*	2001*	2002
	(U.S. Dollars in thousands)				
Cash and short-term cash investments................	$23,869	$144,342	$118,280	90,668	71,081
Long-term investments.......................................	262,318	337,407	200,436	195,177	262,594
Working capital	21,772	138,968	91,666	75,909	31,791
Short-term debt...	2,478	5,328	16,458	16,617	32,999
Long-term debt	39,702	42,582	42,797	51,808	49,389
Shareholders' equity...	278,976	452,087	276,973	238,713	266,517
Total assets	333,288	529,198	367,275	326,310	401,329

* Restated (see Item 18, Consolidated Financial Statements, Note 3G)

Risk Factors

General Risks Affecting us and the Companies in our Group

Our assets significantly consist of investment in our group companies. As of December 31, 2002, our holdings in group companies represented approximately 57% of our total assets. If our group companies experience difficulties in the future, or if there are adverse changes in their market price or fair value, we may need to write-down or write-off the carrying value of our holding. In particular, as of December 31, 2002, Elbit Systems represented approximately 21% of our total assets, our holdings in Given Imaging represented approximately 8% of our total assets and Elbit's holding in Partner represented approximately 20% of our total assets. Any adverse change in the market price of the shares or financial condition and results of operations of Elbit Systems, Given Imaging or Partner may have a substantial negative impact on our assets and results of operations.

Our performance significantly depends on the results of operations of companies in our group. Our results of operations are directly impacted by the results of operations of those companies whose financial results we report on an equity basis or which we consolidate. To the extent any of these companies have poor financial results, our financial results will be negatively impacted. Many of these companies are early stage development companies that have not yet generated significant revenues, have incurred losses and have invested heavily in research, development and marketing of their products. We anticipate that the majority of these companies will continue to record losses in the future.

Our results may be affected by volatility in the securities markets. Due to the continuing downturn in the world economy and the impact of worldwide terrorist activities and the responses to these activities, the securities markets in general have recently experienced increased volatility which has particularly affected the securities and operations of many high-technology companies, including companies that have a significant presence in Israel. Although the volatility of these companies' securities has often been unrelated to the operating performance of these companies, these companies, particularly those in the fields of communications, software and Internet, may experience difficulties in raising additional financing required to effectively operate and grow their businesses. These difficulties and the volatility of the securities markets in general may affect our and our group companies' ability to realize investments, such as by selling holdings in these companies. Our financial results are directly impacted by our ability to conclude profitable "exit" transactions regarding certain of the companies in our group. If worldwide market conditions in the technology industry do not permit us to conclude these types of transactions, our results will be adversely affected. In addition, due to the depressed prices of stocks in the securities markets and the continuing downturn of the economy, we and our group companies may have to reduce the book value of certain of our holdings.

Our market value significantly depends on the market values of publicly-traded companies in our group. Our market value is directly impacted by the market values of those companies in our group with shares traded in the public markets. To the extent that the share prices of any of these companies decline, our market value will be negatively impacted. In particular, we are dependent on the price of shares of Elbit Systems Ltd. (Nasdaq: ESLT), of which we hold approximately 19.9% of the outstanding shares, Partner Communications Company Ltd. (Nasdaq: PTNR), of which we hold approximately 10.2% of the outstanding shares as of June 2, 2003, and Given Imaging Ltd. (Nasdaq: GIVN), of which we beneficially own approximately 25.4% of the outstanding shares, or approximately 18.1%, representing our direct holding and our share in the holding of RDC. If any of these companies experience difficulties in the future and their share prices decline, our market value could be adversely affected.

We may face difficulties in our ability to dispose of our shares in publicly traded companies in our group. Due the limitations of Rule 144 of the Securities Act of 1933, material non-public information to which we may become exposed due to our representation on the boards of directors of companies in our group, and contractual and legal limits on the tradability of the shares, we may face difficulties in our ability to dispose of our shares in publicly traded companies in our group at a time and in a manner we deem suitable.

The market price of our ordinary shares has been and may continue to be volatile. The market price of our ordinary shares is subject to fluctuations. The following factors may significantly impact the market price of our ordinary shares:

- the market price of our group companies which are publicly traded, in particular Elbit Systems, Partner and Given Imaging, which represent a substantial portion of our total assets;
- our group companies, competitors or other third parties announcing technological innovations, new products or earnings or losses;
- periodic variations in results of operations and stock prices of our group companies;
- factors that generally affect the market for stocks of defense, communications, semiconductor, information technology and medical device companies;
- political, economic or other developments affecting Israel;
- global economic and other external factors; and
- quarter-to-quarter fluctuations in our financial results.

Many of our group companies may be unable to obtain future financing on favorable terms or at all. Many of our group companies have extensive research and development and marketing costs and limited revenues, if any. In order to succeed, these companies may require additional capital to fund these costs, which in light of the ongoing economic downturn may prove to be more difficult than in the past. If these companies are unable to obtain financing from their current shareholders, which may also include additional investments by us in these companies, or from new financing sources, their continued operations may be at risk. This would adversely affect our financial performance and results of operations.

The main technology markets which our group companies serve are currently experiencing a prolonged and severe downturn, and it is difficult to predict the length of the downturn or the timing or strength of a recovery. Historically, many of our group companies derived their revenues, and expect to continue to derive their revenues, from the technology sector. Most of our group companies' businesses depend largely upon demand for the technologies developed, marketed and sold by our group companies. The technology sector is experiencing a prolonged and severe downturn, which is reflected in a steep decline in technology spending. As a result of the general economic decline, the more mature companies in our group have experienced revenue declines, longer sales cycles and longer accounts receivable payment cycles. If any of the material customers of our group companies becomes insolvent or has difficulties meeting its financial obligations to our group companies, our operating results and financial condition may be adversely affected.

In addition, our group companies have only a limited ability to reduce expenses during any period of a downturn in demand because of the need for significant ongoing expenditures related to engineering, research and development and worldwide customer service and support operations. Accordingly, we and our group companies may incur further losses as a result of our and our group companies' inability to further reduce expenses.

We compete with other entities for acquisition and investment opportunities. As part of our overall strategy, we pursue acquisitions of, and investments in, Israeli companies and Israel-related technology companies. The success of a number of Israeli companies, particularly information technology and communication companies, has prompted potential investors to seek investment opportunities in Israel allowing many Israeli high-technology companies to gain direct access to Israeli and foreign public securities markets. We compete for acquisition and investment opportunities with other established and well-capitalized entities. There can be no assurance that we will be able to locate acquisition or investment opportunities upon favorable terms. Our failure to consummate further acquisitions or investments in the future may hinder our ability to grow and could seriously harm our business, financial condition and results of operations.

There is no assurance that our subsidiary, RDC, or Rafael Armaments Development Authority will identify existing technology, or that Rafael Armaments Development Authority will develop new technology, for commercial exploitation in non-military markets. Our wholly-owned subsidiary, DEP, holds approximately 48% of the outstanding shares and effectively controls a majority of the voting power of RDC, a joint venture between DEP, Galram Technology Industries Ltd. and Rafael Armaments Development Authority Ltd., or Rafael. Galram was established by Rafael, the largest research and development organization of Israel's Ministry of Defense, for the purposes of exploiting Rafael's technology in non-military markets. RDC has rights to exploit commercially technologies of Rafael in non-military markets, which rights are dependent primarily upon RDC's or Rafael's identification of existing technology, or the development by Rafael of new technology, for commercial exploitation in non-military markets, Rafael's willingness to transfer the necessary human resources to develop and exploit commercially its technology in non-military markets, and RDC reaching agreement on the terms of any commercial exploitation. If Rafael or RDC do not identify existing technology, or Rafael does not develop new technology, for commercial exploitation in non-military markets, or if Rafael does not transfer the necessary human resources to develop and exploit commercially this technology in non-military markets, or if RDC does not reach agreement on the terms of any commercial exploitation, then DEP will not realize the full potential value of the joint venture agreement with Rafael, which could harm our ability to continue to grow and develop RDC.

We may be required to repay the indebtedness of our majority owned subsidiaries, Elron Telesoft and/or Elron Software to their lending banks. As of December 31, 2002, Elron Software and Elron Telesoft had received bank loans of $19.0 million and $50.7 million respectively. In connection with these loans, we have provided guarantees to their lending banks up to the amount of approximately $74.0 million of which an amount of $28.9 million is secured by a pledge of our debentures, marketable securities and deposits in favor of the banks. Neither Elron Software nor Elron Telesoft is currently generating or is expected, in the near future, to generate sufficient cash from its operations to repay such indebtedness and therefore we may be required to repay such indebtedness when due, which will negatively affect our cash resources. (For more details, see Item 5 "Liquidity and Capital Resources".)

We may be deemed to be an investment company under the Investment Company Act of 1940. Generally, a company must register under the Investment Company Act of 1940 and comply with significant restrictions on operations and transactions with affiliates if its investment securities exceed 40% of the company's total assets, or if it holds itself out as being primarily engaged in the business of investing, owning or holding securities. The 1940 Act provides for various exemptions from the obligation to register thereunder, and we have received an order from the SEC declaring that we are not an investment company under the 1940 Act. If certain of our investments were to adversely affect our status under the 1940 Act, we might need to dispose of or acquire investments to avoid the requirement to register as an investment company on terms that may not be favourable to us. In addition, if we were deemed to be an investment company and therefore required to register as such under the 1940 Act, we would be unable to continue operating as we currently do, as a result of which our market value would be severely harmed.

If we are characterized as a passive foreign investment company for U.S. federal income tax purposes, our U.S. shareholders may suffer adverse tax consequences. Generally, if for any taxable year 75% or more of our gross income is passive income, or at least 50% of our assets are held for the production of, or produce, passive income, we may be characterized as a passive foreign investment company for U.S. federal income tax purposes.

If we are characterized as a passive foreign investment company, our U.S. shareholders may suffer adverse tax consequences, including having gains realized on the sale of our shares taxed at ordinary income rates, rather than the capital gain rate. In addition, both gains upon disposition and amounts received as distributions could be subject to an additional interest charge by the Internal Revenue Service. In addition, a determination that we are a passive foreign investment company could have an adverse effect on the price and marketability of our shares.

We do not believe that we were a passive foreign investment company for 2002. However, since the determination of whether we are a passive foreign investment company is based upon such factual matters as the valuation of our assets and, in certain cases, the assets of companies held by us, there can be no assurance with respect to the position of the Internal Revenue Service on our status as a passive foreign investment company. Our analysis related to 2002 is based, among others, upon certain assumptions and methodologies with respect to the values that we have used, the appropriate value of our ownership interest in companies we held, and the manner in which we have allocated the value among our active assets and passive assets.

We cannot assure you that the Internal Revenue Service will not challenge our assumptions and methodologies. If there were such a challenge, we could be classified as a passive foreign investment company for 2002.

With respect to 2003 and subsequent years, the tests for determining passive foreign investment company status are applied annually and it is difficult to make accurate predictions of future income and assets, which are relevant to this determination. Accordingly, there can be no assurance that we will not become a passive foreign investment company in 2003 or subsequent years. (See “Item 10. Additional Information – Taxation – Federal Income Tax Considerations - Tax Consequences if We are a Passive Foreign Investment Company”.)

U.S. holders of our shares are urged to consult their tax advisors regarding the application of the passive foreign investment company rules.

One of our shareholders beneficially owns a substantial amount of our ordinary shares and may therefore, influence our affairs. As of May 31, 2003, Discount Investment Corporation Ltd. or DIC, beneficially owned an aggregate of approximately 38.5% of our ordinary shares and has the ability, in effect, to elect the members of our board of directors and to influence our business. In addition, Mr. Ami Erel, our Chairman, serves as President and Chief Executive Officer of DIC.

There has been a recent change in the control of IDB Holding Corporation Ltd, the controlling shareholder of DIC. On May 19, 2003, there was a change of control of IDB Holding Corporation Ltd., or IDBH, which is deemed to effectively control DIC and consequently has the ability to dispose of DIC’s shares in our company, and indirectly control our Board of Directors. (For more details, see “Item 6 – Major Shareholders”). There is no assurance that there will not be a change in our Board, management or management policy as a result of the change of control of IDBH.

Our group companies may experience delays in product development and their products may contain defects. Companies in our group involved in technology product development in the past have experienced delays in development. There can be no assurance that these companies will not experience delays in connection with their current or future product development activities or that their products will not contain undetected errors or version compatibility issues, particularly when first introduced or when new versions are released, which may result in loss of, or delay in, market acceptance. Delays and difficulties associated with new product introductions or product enhancements could negatively impact the business, financial condition, prospects and results of operations of these companies and, as a result, our financial results.

Many of our group companies experience intense competition. Many of our group companies experience competition from companies with significantly greater financial, technical, marketing and public relations resources, who have easier market access, better operational infrastructure, longer operating histories, larger installed client bases, greater name recognition, more established relationships and alliances in their industries and offer a broader range of products and services. As a result, these competitors may be able to respond more quickly to new or emerging technologies or changes in clients' requirements, benefit from greater purchasing economies, offer more aggressive product and services pricing or devote greater resources to the promotion of their products and services. If our group companies are unable to successfully compete, their businesses, financial condition and results of operations could be seriously harmed, which would in turn negatively affect our financial condition and results of operations.

Most of our group companies are dependent upon proprietary technology which may be infringed upon or may infringe upon the proprietary technology of others. Most of our group companies greatly depend on their proprietary technology for their success. Like other technology companies, most of these companies rely on a combination of patent, trade secret, copyright and trademark laws, together with non-disclosure agreements, confidentiality clauses in their agreements, including employment agreements, and technical measures to establish and protect proprietary rights in their products. Some of our group companies rely on shrink-wrap or "click-through" licenses, which are not signed by end-users, to protect their products. These companies may not be able to enforce their proprietary rights under the laws of certain jurisdictions. Our group companies may not successfully protect their technology because:

- some foreign countries may not protect their proprietary rights as fully as do the laws of the United States;
- enforcing their rights may be time consuming and costly, diverting management's attention and company resources;
- measures such as entering into non-disclosure agreements afford only limited protection;
- unauthorized parties may attempt to copy aspects of their products and develop similar software or to obtain and use information that they regard as proprietary; and
- competitors may independently develop products that are substantially equivalent or superior to their products or circumvent intellectual property rights.

In addition, others may assert infringement claims against our group companies. The cost of responding to infringement claims could be significant, regardless of whether the claims are valid.

Israeli government programs and tax benefits may be terminated or reduced in the future*. *In addition, the terms of such programs restrict the ability of our group companies to manufacture products and/or transfer technologies outside of Israel. Many of our group companies participate in programs of the Israeli Chief Scientist's Office and the Israel Investment Center, for which they receive grants and tax related and other benefits. The benefits available under these programs depend on our group companies meeting specified conditions. If our group companies fail to comply with these conditions, they may be required to pay additional taxes and penalties and be denied future benefits. The government of Israel is considering reducing or eliminating the benefits that will be available under similar programs. We cannot assure you that these benefits will be available in the future at their current levels or at all.

In addition, the terms of the government research and development grants which many of our group companies have received from the Israeli Chief Scientist's Office and the laws applicable to such grants restrict their ability to manufacture products and/or transfer technologies outside of Israel. These restrictions may limit the ability of our group companies to conclude transactions with international companies including “exit” transactions which may affect our results of operations.

We and our group companies may have difficulty retaining key employees. Our success and the success of our group companies depends in large part on a limited number of key management, scientific and technical personnel. In addition, future success will depend upon, in part, attracting and retaining highly qualified personnel. There can be no assurance that we or our group companies will be able to either retain present personnel or acquire additional qualified personnel as and when needed. The loss of the services of our key personnel or those of our group companies and the failure to attract highly qualified personnel may have a negative impact on our business.

Many of our group companies depend on international operations. Many of our group companies depend on sales to customers outside Israel. We expect that international sales will continue to account for a significant portion of these companies’ revenues for the foreseeable future. As a result, changes in international, political, economic or geographic events could result in significant shortfalls in orders or revenues. These shortfalls could cause the business, financial condition and results of operations of these companies to be harmed. Some of the risks of doing business internationally include:

- unexpected changes in regulatory requirements;
- the inability of our group companies, their subsidiaries and subcontractors to obtain export licenses;
- imposition of tariffs and other barriers and restrictions;
- burdens of complying with a variety of foreign laws;
- political and economic instability; and
- changes in diplomatic and trade relationships.

Some of these factors, such as the ability to obtain export licenses and changes in diplomatic relations, may be affected by Israel’s overall political situation. See “Conditions in Israel may affect our operations and the operations of our group companies.” In addition, the economic and political stability of the countries of the major customers and suppliers of our group companies may also impact their business.

Conditions in Israel may affect our operations and the operations of our group companies. We and most of our group companies conduct our principal operations in Israel, and therefore are directly affected by the political, economic, and military conditions affecting Israel and the Middle East. In particular, we could be adversely affected by:

- any major hostilities involving Israel;
- a full or partial mobilization of the reserve forces of the Israeli army;
- the interruption or curtailment of trade between Israel and its present trading partners;
- a significant increase in inflation;

- a significant downturn in the economic or financial condition of Israel; and
- a significant downgrading of Israel's international credit rating.

Israel's economy has been subject to numerous destabilizing factors, including a period of rampant inflation in the early to mid-1980's, low foreign exchange reserves, fluctuations in world commodity prices, military conflicts and civil unrest. Since the establishment of the State of Israel in 1948, a state of hostility has existed, varying in degree and intensity, between Israel and the Arab countries. In addition, Israel and companies doing business with Israel have been the subject of an economic boycott by the Arab countries since Israel's establishment. Israel has entered into peace agreements with Egypt and Jordan, various agreements with certain Arab countries and the Palestine Liberation Organization and the Palestinian Authority, and various declarations have been signed in connection with efforts to resolve some of the economic and political problems in the Middle East. Nevertheless, it cannot be predicted whether or in what manner these problems will be resolved.

Since September 2000, there has been a marked increase in violence, civil unrest and hostility, including armed clashes, between the State of Israel and the Palestinians, and acts of terror have been committed inside Israel and against Israeli targets in the West Bank and Gaza. In March 2002, following a significant increase in violence in Israel, the West Bank and the Gaza Strip, armed hostilities broke out between Israel, the Palestinian Authority and other groups in the West Bank and Gaza Strip as a result of which Israel instituted a partial mobilization of its reserve forces. There is no indication how long the current hostilities will last or whether there will be any further escalation. The future effect of this deterioration in Israeli-Palestinian relations and violence on the Israeli economy and our operations is unclear. Any further escalation in these hostilities or any future armed conflict, political instability or violence in the region may have a negative effect on our business condition, harm our results of operations and adversely affect our share price.

In addition, there are a number of countries that restrict business with Israel or Israeli companies.

Restrictive laws or policies directed towards Israel or Israeli businesses and civil unrest, military conflict and uncertainty may have an adverse impact on our operating results, financial condition or the expansion of our business.

Our and our group companies' operations could be disrupted as a result of the obligation of key personnel in Israel to perform military service. All non-exempt male adult permanent residents of Israel, as a general rule, under the age of 54 are obligated to perform military reserve duty and may be called to active duty under emergency circumstances. Some of our directors, officers and employees as well as those of our group companies are currently obligated to perform annual reserve duty and as a result of an increase in hostilities in March 2002, a number of them were called temporarily to active duty. While we and our group companies have operated effectively despite these conditions in the past, we cannot assess what impact these conditions may have in the future, particularly if emergency circumstances arise.

The results of operations of our group companies may be harmed by foreign currency exchange rate fluctuations. To the extent that our group companies are based in Israel and have international operations, or operate only in Israel but conduct their business in different currencies, their revenues, expenses, assets and liabilities, are not necessarily in the same currency and therefore they are exposed to foreign exchange rate fluctuations. These fluctuations may negatively affect their results of operations. Some of our group companies may attempt to hedge their foreign currency exposure from time to time; however, we cannot assure you that they will be successful.

Our group companies may not be able to enforce covenants not to compete. Some of our group companies currently have non-competition agreements with substantial numbers of their employees who are involved in research and development. In many cases, these employees are located primarily in Israel. These agreements prohibit the company's employees, if they cease working for the company, from directly competing with the company or working for its competitors. Israeli courts have required employers seeking to enforce non-compete undertakings of a former employee to demonstrate that the competitive activities of the former employee will harm one of a limited number of material interests of the employer which have been recognized by the courts, such as the secrecy of a company's confidential commercial information or its intellectual property. If any of our group companies cannot demonstrate that harm would be caused to it, the company may be unable to prevent its competitors from benefiting from the expertise of its former employees.

It may be difficult to serve process or to enforce a U.S. judgment against us, our directors and our officers. Since substantially all of our directors and officers reside outside the United States, it may be difficult to effect service of process on us, our directors or officers within the United States. Furthermore, because most of our assets are located outside the United States, it may not be possible to enforce any judgment obtained in the United States against us or the aforementioned individuals in the United States. There is doubt as to the enforceability of civil liabilities under the Securities Act of 1933 and Securities Exchange Act of 1934 in original actions instituted in Israel.

Risks Related to Our Holdings in Group Companies Representing the Largest Portion of Our Assets.

Our holdings in our publicly traded group companies, Elbit Systems, Partner and Given Imaging, comprised in the aggregate approximately 49.0% of our assets as of December 31, 2002. The sections below summarize the main risks, the occurrence of which could materially adversely affect the results of operations, financial condition and business of these companies, Elbit Systems, Partner and Given Imaging. The sections below have been condensed for the purposes of this Annual Report and the risks associated with these companies are more fully described in documents filed by Elbit Systems, Partner and Given Imaging, respectively, with the SEC.

Risks Affecting Our Holdings in Elbit Systems

As of December 31, 2002, our holdings in Elbit Systems represented approximately 21% of our assets and a significant source of income for the year then ended. The following are risk factors associated with our holdings in Elbit Systems:

Elbit Systems' revenues depend on a continued level of government business. A significant portion of Elbit Systems' revenues come from contracts or subcontracts with domestic and foreign government agencies. A reduction in the level of the purchase of Elbit Systems' systems, products, services and upgrade projects by these agencies, mainly the Israeli

Ministry of Defense, or IMOD, and the U.S. Department of Defense, would have a material adverse effect on Elbit Systems' business.

The level of Elbit Systems' contracts may be reduced due to changes in governmental priorities. The risk that governmental purchases of Elbit Systems' systems, products, services and upgrade projects may decline is affected by the possibility that government purchasing agencies may:

- terminate, reduce or modify contracts or subcontracts if their requirements or budgetary constraints change;
- cancel multi-year contracts and related orders if funds become unavailable;
- shift spending priorities into other areas or for other products; and
- adjust contract costs and fees on the basis of audits.

Elbit Systems depends on governmental approval of its exports. Many of Elbit Systems' exports and the receipt of technology and components from suppliers depend on receipt of export license approvals from the Israeli government, the United States government and other governments. There is no assurance that such approvals will be given in the future, current approvals will not be revoked or governmental export policies will remain unchanged.

Elbit Systems' revenues depend on obtaining follow-on business. Follow-on orders are important because Elbit Systems' contracts are for fixed terms. These terms may be up to five years or more, particularly for contracts where the customer has options to purchase additional items. In addition, when we have supplied a system for a defense platform, we often have the potential to supply other items for that platform. If a customer is dissatisfied with Elbit Systems' performance on a particular program or if the customer's priorities change, it could negatively effect Elbit Systems' ability to receive follow-on business. Inability to obtain follow-on business could result in a loss of revenues if revenues from the award of new contracts do not offset the loss of follow-on business.

Elbit Systems' contracts may be terminated for convenience of the customer. Elbit Systems' contracts with the government of Israel and other governments often contain provisions permitting termination for convenience of the customer. Elbit Systems' subcontracts with non-governmental prime contractors sometimes contain similar provisions. In general, in order to reduce risks of financial exposure resulting from the early termination of a contract, Elbit Systems attempts to flow down these requirements to its subcontractors and expend funds for projects according to the contract performance schedule. If the customer were to make an early termination for convenience, in most cases Elbit Systems would be entitled to reimbursement for its incurred contract costs and a proportionate share of its fee or profit for work actually performed. If, however, Elbit Systems is not entitled to such compensation, it could cause Elbit Systems' to suffer corresponding losses.

Elbit Systems faces risks of changes in costs under fixed price contracts. Most of Elbit Systems' contracts are fixed-price contracts, as opposed to cost-plus or cost-share type contracts. Generally, a fixed-price contract price is not adjusted as long as the work performed falls within the original contract scope. Under these contracts, we often assume the risk that increased or unexpected costs may reduce profits or generate a loss. However, long-term contracts sometimes allow for price escalations based on specific labor and material indices. The risk can be particularly significant under a fixed-price contract involving research and development for new technology. The frequent need to bid on fixed price programs before completing the necessary design may result in unexpected technological difficulties and cost overruns. In addition, there is difficulty in forecasting long-term costs and schedules and the potential obsolescence of products or components related to long-term fixed price contracts.

Elbit Systems faces fluctuations in revenues and profit margins. The level of Elbit Systems' revenues may fluctuate over different periods. These fluctuations may not relate directly to changes in pricing or sales volume. Instead they may be dependent on Elbit Systems' mix of projects during any given period. In addition, since project revenues generally are recognized in connection with achievement of specific milestones, Elbit Systems may experience significant fluctuations in year-to-year and quarter-to-quarter financial results. Similarly, Elbit Systems' profit margins may vary significantly from project to project. As a result, the overall profit margin in a particular period is influenced by a number of conditions. These include the types, size and stage of projects, the percentage of work performed by subcontractors and the timing of the recognition of revenue.

Elbit Systems sometimes has risks relating to financing for its programs. A number of Elbit Systems' major projects require it to arrange, and sometimes to provide guarantees in connection with, the customer's financing of the project. These include guarantees of Elbit Systems as well as guarantees provided by financial institutions relating to advance payments received from customers.

Elbit Systems may experience production delays or liability if suppliers fail to make timely deliveries. The manufacturing process for some of Elbit Systems' products consists in large part of the assembly, integration and testing of purchased components. Although Elbit Systems generally can obtain materials and purchase components from a number of suppliers, some components are available from a small number of suppliers. In a few cases, Elbit Systems works with effectively sole source suppliers. If a supplier should stop delivery of such components, Elbit Systems would probably be able to find other sources, however, this could result in added cost and manufacturing delays. Moreover, if Elbit Systems' subcontractors fail to meet their design, delivery schedule or other obligations Elbit Systems could be held liable by its customers. There is no assurance Elbit Systems would be able to obtain full recovery from its subcontractors for those liabilities. In addition, when Elbit Systems acts as a subcontractor, the failure or inability of the prime contractor to perform its contract with the customer may affect Elbit Systems' ability to obtain payments under its subcontract.

Elbit Systems' industry has experienced significant consolidation. As the number of companies in the overall defense industry has decreased in recent years, the industry has experienced substantial consolidation, increasing the market share of some prime contractors. Failure to maintain its relationships with these major contractors could negatively impact Elbit Systems' future business. In addition, some of these companies are vertically integrated with in-house capabilities similar to those of Elbit Systems in certain areas.

Elbit Systems faces acquisition and integration risks. Over the past several years Elbit Systems has made a number of acquisitions and investments in companies that complement its business. Elbit Systems intends to continue to acquire businesses that complement its operations. Elbit Systems' growth may place significant demands on its management and its operational, financial and marketing resources. In connection with acquisitions and the opening of new facilities Elbit Systems has increased and may continue to increase the number of its employees. In addition, Elbit Systems has expanded and may continue to expand the scope and geographic area of its operations. Elbit Systems believes this growth will increase the complexity of its operations and the level of responsibility exercised by both existing and new management personnel. Failure to successfully integrate and manage its growth may have a material adverse effect on Elbit Systems' business, financial condition, results of operations or prospects.

Reduction in Israeli Government spending or changes in priorities for defense products may adversely affect Elbit Systems' earnings. The Israeli Government may reduce its expenditures for defense items or change its defense priorities in the coming years. Over the last year the Israeli Government budget approval process has been extended. Also, the overall budget as well as the IMOD NIS budget, have been subject to overall reductions as part of an economic reform initiative. To date, Elbit Systems' current programs have not been impacted by such reductions, however, there is no assurance that its programs will not be affected in the future. If there is a reduction in Israeli Government defense spending for Elbit Systems' programs or a change in priorities to products other than those of Elbit Systems, its revenues and earnings could be reduced.

Risks Affecting Our Holdings in Partner

As of December 31, 2002, our holdings in Partner represented approximately 20% of our assets. The following are risk factors associated with our holdings in Partner:

We may be forced to reduce our indirect ownership percentage in Partner under terms that may not be optimal to us. The Israeli Ministry of Communications has imposed limitations on the disclosure of information concerning Partner to entities in Elbit's chain of ownership which also have an interest in Cellcom Israel Ltd., one of the existing Israeli cellular operators. The Ministry of Communications has also required that certain individuals who hold offices associated with Cellcom resign from directorships held by them in Elbit and Elron. In addition, the Ministry of Communications has required all of our officers and employees to sign non-disclosure undertakings regarding the transfer of information relating to Partner. In the event that these requirements are not complied with at any future time, the Ministry of Communications is entitled to require that our beneficial ownership in Partner be reduced to below 5%. The price of Partner's ordinary shares is subject to fluctuation, and, therefore, there can be no assurance that the possible sale of certain of Elbit's holdings in Partner at the request of the Ministry of Communications will be on terms beneficial to us.

We are restricted in our ability to freely dispose of our holdings in Partner. We have pledged approximately 15.9 million of our shares of Partner representing, as of June 2, 2003, approximately 85% of our total holdings of Partner, in favor of a consortium of banks as security by us and Partner's other original shareholders for Partner's obligations under its line of credit with the banks, each pro rata to its respective holding at that time. As of December 31, 2002, the amount of Partner's facility with the banks was $710.0 million of which $519.0 million was outstanding. Should Partner default in its obligations to the banks, the banks would be entitled to exercise their rights against us under the pledge and seize our shares of Partner in satisfaction of our pro rata portion of Partner's obligations under its line of credit, which would severely harm the value of our assets.

Partner's license requires that, at a minimum, 20% of the economic and voting interest, and certain other defined means of control, of Partner be owned by Israeli citizens and residents. In addition, no transfer or acquisition of 10% or more of any of such means of control, or the acquisition of control of Partner, may be made without the consent of the Israeli Ministry of Communications. Partner's license also restricts cross-ownership and cross-control among competing mobile telephone operators, including the ownership of 5% or more of the means of control of both Partner and of a competing operator, without the consent of the Ministry of Communications, which may limit certain persons from acquiring Partner shares.

Pursuant to the relationship agreement between the original shareholders of Partner, each Israeli party to the relationship agreement, including us, has undertaken to maintain such portion of the shares as is necessary to ensure that at least 20% of the shares are held by citizens and residents of Israel. The original shareholders are also required to continue to hold an aggregate of at least 51% of Partner's ordinary shares.

These restrictions limit our ability to freely dispose of our shares in Partner, as a result of which our results of operations may be negatively affected.

Partner expects its growth to slow, because Israel's mobile telephone market is highly penetrated, making it difficult to obtain new subscribers. At December 31, 1998, prior to Partner's full commercial launch, approximately 35% of the Israeli population had mobile telephones. At December 31, 2002, that percentage was estimated to be 95%, although this includes dormant subscribers as well as other subscribers who are not included in the Israeli population figures, such as Palestinians, new immigrants, and foreign workers. Because the Israeli market for mobile telephones is highly penetrated, future demand for Partner's services may not develop at the same rate as it has in the past, and depends largely on the company's ability to retain existing subscribers in its network and to attract subscribers from the other mobile telephone network operators. While Partner's market share, based on internal estimates, has increased from approximately 13% of Israeli mobile subscribers at December 31, 1999 to approximately 29% at December 31, 2002, the company expects its market share growth to slow down in 2003.

A continuing deterioration in the economic conditions in Israel may adversely affect Partner's financial condition and results of operations. Partner is incorporated and based in, and currently derives almost all its revenues from markets within, the State of Israel. A continuing deterioration in the economic conditions in Israel may adversely affect usage patterns of Partner's services and the ability of its customers to pay for its services, which would adversely affect its financial condition and results of operations. Such continuing deterioration may also cause Partner to delay its future investments and its launch of Universal Mobile Telecommunications System, or UMTS, third generation, technology, also known as Wideband Code Division Multiple Access, or W-CDMA technology. In addition, if the economic deterioration in Israel continues, it may also affect the ability of Israeli banks to provide Partner with financing under its current credit facility and additional financing on reasonable terms and conditions, should the company need it in the future.

Increased competition from existing competitors may affect Partner's market share and require it to reduce its tariffs in the future, may increase its subscriber acquisition costs and customer retention costs and may continue to increase its churn rate. Although Partner was once the only GSM network operator in Israel, Cellcom, another mobile network operator in

Israel, began providing GSM 1800 services during the second half of 2002, and Partner expects competition to intensify as it will be much easier than before for Cellcom to attract new subscribers, including those who are currently Partner's subscribers. As a result, Partner may face an increase in its churn rate and may be forced to increase its customer retention costs, including subsidies towards upgrades of subscribers' handsets, in order to retain its subscribers. Moreover, Partner has lost and does not expect to regain a material part of its revenues from roaming services offered to GSM subscribers visiting from abroad. These developments, among others, may adversely affect Partner's market share and financial condition and results of operations.

Risks and uncertainties in connection with UMTS third generation technology mean that Partner may not make an economic return on its investment in acquiring UMTS third generation spectrum, establishing a UMTS third generation network, or developing UMTS third generation services. The technology for new UMTS third generation services has not yet been fully developed by the limited number of suppliers of the handsets, network equipment and software to be used by Partner and its competitors in providing UMTS third generation services. If these suppliers do not provide reasonably priced devices, technologically proven network equipment and software with sufficient functionality or speed or if they experience delays in the delivery or functional deployment of such devices and related network equipment or software, Partner's ability to develop its UMTS third generation network and its customers' ability to access it, will be impaired.

The telecommunications industry is subject to rapid and significant changes in technology which could reduce the appeal of Partner's services. The effect of emerging and future technological changes on the viability or competitiveness of Partner's network cannot be accurately predicted. Partner cannot assure you that the technologies the company employs or intends to employ, including UMTS third generation technology, will not become obsolete or subject to competition from new technologies in the future.

Partner operates in a highly regulated telecommunications market which limits its flexibility to manage its business. In particular, the regulator's decisions, including those relating to tariffs, may materially adversely affect its results of operations. Partner's business is subject to government regulation regarding licensing, competition, frequency allocation and costs and arrangements pertaining to interconnection and leased lines. Partner's business and operations could be adversely affected by changes in laws, regulations or government policy affecting its business activities, such as decisions by the regulator increasing the rate of royalties to be paid to the State of Israel, enlarging the types of revenues which the royalties apply to, setting policies and imposing new regulations governing electronic trade and M-Commerce, or further reducing call or SMS termination tariffs, as well as the amendment or revocation of its license.

Partner may be unable to obtain necessary financing to support its network expansion and enhancement plans. Operating a mobile telephone network like Partner's requires high levels of capital investment and marketing expenditures. From January 1, 1998 to December 31, 2002 Partner made cumulative net capital expenditures of approximately NIS 3,073 million ($649 million), and paid license fees and associated costs totaling approximately NIS 1,793 million ($378 million). In an auction process completed on December 18, 2001, the Ministry of Communications awarded Partner the two bands of spectrum for which the company had submitted bids: one band of 1800 MHz spectrum, which is GSM compatible, or GSM 1800 spectrum, and one band of UMTS third generation spectrum. The cost of the license fees is NIS 180 million (approximately $38 million) for the GSM 1800 spectrum, payable in two installments, and NIS 220 million (approximately $46 million) for the UMTS third generation spectrum, payable in six installments. To date, Partner has paid NIS 108 million and NIS 100 million for the GSM 1800 spectrum and the UMTS third generation spectrum, respectively. Partner will incur additional substantial capital expenditures in building out its UMTS third generation network and increasing the capacity of its existing network. Partner estimates that capital expenditures in connection with building out its UMTS third generation network will be approximately $300 million over the three to five years from the beginning of the network build-out, with approximately $150 million in capital expenditures required in the first twelve months of the build-out. The network build-out is expected to begin towards the end of 2003 or the beginning of 2004. Although at present Partner believes it has a fully funded business plan, including the support necessary for its UMTS third generation operations, the company may require additional funding for capital expenditures in connection with building out its UMTS third generation network.

Partner may also be forced to incur additional debt or raise additional equity to meet such costs and any unanticipated requirements. In addition, there is a risk that Partner has underestimated its future capital requirements or overestimated its future revenues and operating profits in the build-out and operation of a third generation network.

Partner's credit facility and its indenture each contain a number of restrictions and obligations that limit its operating and financial flexibility. Partner's credit facility and the indenture governing its notes each contain a number of financial, operating and other obligations that limit the company's operating and financial flexibility. There can be no assurance that such obligations will not materially adversely affect Partner's ability to finance its future operations, or the manner in which the company operates its business. In particular, any non-compliance with performance-related covenants and other undertakings of Partner's credit facility or indenture could result in an acceleration of the company's outstanding debt under the credit facility and the indenture and restrict its ability to draw additional funds.

Partner's substantial leverage could adversely affect its financial health. Partner is highly leveraged. At December 31, 2002, the company's total long-term indebtedness was approximately NIS 3,297 million ($696 million). This debt represents approximately 103% of Partner's total capitalization (bank loans plus notes payable net of capital deficiency) at December 31, 2002. Partner's substantial debt could adversely affect its financial health by, among other things:

- increasing the company's vulnerability to adverse economic conditions or increases in prevailing interest rates;
- limiting the company's ability to obtain the additional finance it needs to operate, develop and expand its business;
- requiring the company to dedicate a substantial portion of its cash flow from operations to service its debt; and
- exposing the company to the effects of foreign exchange fluctuations on its obligations under its notes.

Partner may not be able to make its debt payments in the future. If Partner is unable to generate sufficient cash flow from operations to meet principal and interest payments on its debt, it may have to refinance all or part of its indebtedness. Partner cannot ensure that any such refinancing would be possible on terms that the company could accept or that it could obtain additional financing.

Historically, Partner has experienced substantial operating and net losses. Although, for the first time, in 2002 Partner experienced net income, Partner cannot assure that it will continue to do so, or that future net income will offset its cumulative losses. To date, the launch and development of Partner's business have required substantial capital, operating and marketing expenditures. These expenditures have historically resulted in net cash outflows, negative EBITDA and substantial operating and net losses. For the years ended December 31, 1999 and 2000, Partner had negative EBITDA of approximately NIS 582 million and NIS 59 million, respectively. Although Partner generated positive EBITDA of approximately NIS 656 million and NIS 1,052 million ($222 million) for the years ended December 31, 2001 and 2002, respectively, and net income of approximately NIS 84 million ($18 million) in 2002, the company may experience net losses and continue to have net cash outflows in the next few years while it continues to expand its network and build and maintain its subscriber base.

Partner has had difficulties obtaining some of the permits for which it has applied, and has not yet applied for other permits that are required for the erection of its antenna sites. These difficulties could continue and therefore affect Partner's ability to erect or maintain antenna sites. This could have an adverse effect on the extent, quality and capacity of its network coverage which could prevent the company from achieving or maintaining the network coverage and quality requirements contained in its license and adversely affect its business.

Partner is dependent upon its ability to interconnect with other telecommunications carriers. It also depends on Bezeq for transmission services. The failure of these carriers to provide these services on a consistent basis could have a material adverse effect on the company.

Partner may be required in the future to offer access to its network infrastructure to other operators. This may lower the entry barriers for potential new competitors and adversely affect the company's financial condition and its ability to provide services to its subscribers. Under the Communications Law (Telecommunications and Broadcasting), 1982, the Ministry of Communications has the power to require Partner, like the other telephone operators in Israel, to offer access to its network infrastructure to other operators, although the Ministry of Communications has not required Partner to do so yet.

Partner can only operate its business for as long as it has a license from the Ministry of Communications. Partner conducts its operations pursuant to a general license granted to the company by the Ministry of Communications on April 7, 1998. The company's license as been extended until February 2022. Partner has provided a bank guarantee to the Ministry of Communications in the amount of $20 million to guarantee its performance under its license. If Partner are found to be in material breach of its license, the guarantee may be forfeited and its license may be revoked.

Partner's telecommunications license imposes certain restrictions on who can own its shares. If these restrictions are breached, the company could lose its license. As with other companies engaged in the telecommunications business in Israel, Partner's license requires that, at a minimum, 20% of the economic and voting interest, and certain other defined means of control, of the company be owned by Israeli citizens and residents.

Risks Affecting Our Holdings in Given Imaging

As of December 31, 2002, our direct and indirect holdings in Given Imaging Ltd. represented approximately 8% of our assets. The following are risk factors associated with our holdings in Given Imaging:

Given Imaging's quarterly financial performance is likely to vary in the future, Based on Given Imaging's experience to date, the company believes that many of its customers delay purchasing systems until the end of the fiscal quarter because they believe this will enable them to negotiate a more favorable price. Therefore, revenues from system sales may be concentrated at the end of each fiscal quarter making it difficult for Given Imaging to determine the success of each quarter until its end and resulting in lower than expected quarterly revenues if external or other events cause a large number of potential customers to defer their purchasing decisions even for a short period of time. Furthermore, Given Imaging believes that demand for systems and capsules may be affected by seasonal factors during the summer months when physicians and administrators are more likely to postpone purchasing decisions relating to systems due to summer vacations and patients are more likely to postpone non-essential diagnostic procedures until later in the year. Both of these factors may result in fluctuations in the company's quarterly operating results.

Future sales of Given Imaging's ordinary shares in the public market and low trading volume could adversely affect its share price. As of the date of this annual report, Given Imaging have approximately 25.4 million ordinary shares outstanding. Approximately 60% of these shares are available for resale subject, however, to volume limitations under Rule 144. Future sales of these shares, or the perception that these sales could occur, could adversely affect the market price of Given Imaging's ordinary shares.

Given Imaging has a history of losses and may never achieve or maintain profitability. Given Imaging was formed in 1998 and recorded initial sales of the Given System in the third quarter of 2001. The company has generated losses each year since its inception and as of December 31, 2002, had accumulated losses of $49.0 million. Given Imaging's losses could continue unless it increases sales of the Given System. In addition, the company anticipates that its operating expenses will increase as it expands its sales, marketing and manufacturing capabilities, increases its research and development activities, conducts further clinical trials and seeks regulatory clearances to market and sell the Given System for use in other parts of the gastrointestinal tract and for new products.

Given Imaging is currently dependent on the Given System for all of its revenue. The Given System is currently Given Imaging's only commercial product. As a result, if Given Imaging is unable to manufacture, market or sell the Given System, its financial condition and results of operations would be materially adversely affected.

If Given Imaging is unable to achieve broad penetration of the Given System among gastroenterologists, it will not be able to generate the revenues necessary to become profitable. Given Imaging commenced marketing the Given System in the United States and Europe in the second half of 2001. The company believes that its initial sales of the Given System were to physicians focused on technological developments in the gastroenterology field who are open to the adoption of products incorporating new technologies. In order for its revenues from the Given System to continue to grow, the company must sell the Given System to other physicians who may be slower to adopt products incorporating new technologies.

If Given Imaging is unable to obtain reimbursement coverage from third-party healthcare payors for procedures using the Given System, or if reimbursement is insufficient to cover the costs of purchasing the Given System, demand for the Given System may be adversely affected. If physicians, hospitals and other healthcare providers are unable to obtain sufficient coverage and reimbursement from third-party payors for procedures using the Given System, or if reimbursement is insufficient to cover the costs of purchasing the company's product or does not adequately compensate physicians and health care providers compared to alternative procedures, Given Imaging may be unable to generate sufficient sales to support its business.

Even if Given Imaging obtains reimbursement coverage for the Given System, changes in healthcare system policies may make it difficult for physicians, hospitals and other healthcare providers to obtain full reimbursement for the purchase of, and procedures using, the Given System, which could adversely affect demand for the Given System. Many U.S. and non-U.S. healthcare providers are moving toward a managed care system in which they contract to provide comprehensive healthcare for a fixed cost per person, irrespective of the amount of care actually provided. These providers, in an effort to control healthcare costs, are increasingly challenging the prices charged for medical products and services and, in some instances, have pressured medical suppliers to lower their prices. Therefore, even if reimbursement approvals are obtained elsewhere, the amount of reimbursement provided may not be sufficient to encourage physicians to recommend the Given System.

Given Imaging's future growth depends in part on its ability to market the Given System for a variety of disorders of the small intestine. The Given System has been cleared by the U.S. Food and Drug Administration, or FDA, for use as an additional tool in the detection of abnormalities of the small intestine. Nearly all of the reimbursement approvals that Given Imaging has received in the United States only cover use of the Given System for patients with symptoms of undetected bleeding and do not automatically cover its use for other symptoms. The company's ability to expand the use of the Given System to other disorders of the small intestine depends substantially on its ability to demonstrate to governmental and private third-party payors the diagnostic and cost-effectiveness of the Given System for other disorders of the small intestine.

Given Imaging's future growth also depends in part on its ability to expand the use of the Given System to, or introduce other products for use in, other parts of the gastrointestinal tract. Given Imaging's long-term objective is to develop technology to permit the Given System to be used in the detection of abnormalities in other parts of the gastrointestinal tract, including the esophagus, the stomach and the colon. The company also plans to develop new products for use in other parts of the gastrointestinal tract. Given Imaging cannot provide any assurance that it will be able to achieve these objectives.

Given Imaging is subject to extensive regulation by the FDA which could restrict the sale and marketing of the Given System and could cause it to incur significant costs. Noncompliance with applicable regulatory requirements can result in enforcement action which may include recalling products, ceasing product marketing, paying significant fines and penalties, and similar FDA actions which could limit product sales, delay or halt product shipment, delay new product clearance or approval, and adversely affect Given Imaging's profitability.

If Given Imaging or its distributors do not obtain and maintain the necessary regulatory approvals in a specific country or region, it will not be able to market and sell the Given System in that country or region. While the regulations of some countries do not impose barriers to marketing and selling the Given System or only require notification, others require that Given Imaging or its distributors obtain the approval of a specified regulatory body. Obtaining regulatory approvals is expensive and time-consuming, and the company cannot be certain that it or its distributors will receive regulatory approvals in each country or region in which it plans to market its product.

Given Imaging has limited experience in manufacturing significant quantities of the Given System and may encounter manufacturing problems or delays that could result in lost revenue. Given Imaging does not have experience in manufacturing the M2A capsule in the commercial quantities that it expects to require to meet demand for the Given System. In order to meet such demand, the company installed in the first quarter of 2003 an additional semi-automated production line at its facilities in Yoqneam, Israel. Given Imaging has also installed a back-up semi-automatic production line at the facilities of Pemstar, Inc. in Ireland and may order from Pemstar one or more fully-automated production lines for installation either at its facilities or Pemstar's facilities. Given Imaging may be unable to establish or maintain reliable, high-volume manufacturing capacity and may encounter difficulties in scaling up production of the Given System, whether by installing one or more fully-automated production lines, or otherwise. If demand for the Given System exceeds the company's manufacturing capacity, it could develop a substantial backlog of customer orders and its ability to generate revenues will be limited and its reputation in the marketplace may be harmed.

Given Imaging has experienced rapid growth and its failure to manage this growth could harm our business. The Given System requires a complex sales and marketing effort targeted at physicians and hospitals. Given Imaging faces significant challenges and risks in building and managing its sales and marketing team, including managing geographically dispersed sales efforts and adequately training its sales people in the use and benefits of the Given System.

Given Imaging relies on local distributors to market and distribute its products. With the exception of the United States, Germany, France and certain other countries, Given Imaging relies on distributors for the marketing and distribution of the Given System. Given Imaging's success in making sales in countries or regions where it has engaged local distributors depends in part on the efforts of others whom the company does not control. If a distributor is terminated by the company or goes out of business, Given Imaging's ability to sell the Given System in that distributor's country or region could be adversely affected.

Given Imaging's reliance on single source suppliers could harm its ability to meet demand for the Given System in a timely manner or within budget. Given Imaging depends on single source suppliers for some of the components necessary for the production of the Given System. Specifically, Micron Technology, Inc., through its Micron Imaging Group and other wholly-owned subsidiaries, is currently the sole supplier of the imaging sensor and the packaging for the sensor, and Asicom Technologies Ltd. is currently the sole supplier of the transmitter that is integrated into the M2A capsule. If the supply of these components is disrupted or terminated, or if these suppliers are unable to supply the quantities of components that the company requires, it may not be able to find alternative sources for these key components. Furthermore, in the event that the manufacturer of a key component of our product ceases operations or otherwise ceases to do business with Given Imaging, the company may not have access to the information necessary to enable another supplier to manufacture the component.

Because the medical device industry is litigious, Given Imaging is susceptible to intellectual property suits that could cause the company to incur substantial costs or pay substantial damages or prohibit it from selling its product. There is a substantial amount of litigation over patent and other intellectual property rights in the medical device industry. Whether a product infringes a patent involves complex legal and factual issues, the determination of which is often uncertain. Infringement and other intellectual property claims, with or without merit, can be expensive and time-consuming to litigate and can divert management's attention from the company's core business.

The use of the Given System, including ingestion of the M2A capsule, could result in product liability claims that could be expensive, damage Given Imaging's reputation and harm its business. Given Imaging's business exposes it to an inherent risk of potential product liability claims related to the manufacturing, marketing and sale of medical devices. A product liability claim, regardless of its merit or eventual outcome, could result in substantial costs to the company and a substantial diversion of management attention. A product liability claim or any product recalls could also harm the company's reputation and result in a decline in revenues.

Item 4. Information on the Company

History and Development of the Company

We are a multi-national high technology operational holding company that operates through our group companies in three reportable segments namely: (i) The Internet products segment – Elron Software; (ii)The systems and projects segment - Elron Telesoft; and (iii) Other holdings and our corporate operations, which includes our holdings in our group companies, engaged in various fields of advanced technology, and our corporate operations, which provide strategic and operational support to our group companies. Founded in 1962, we have been a major force in the development of the Israeli high technology industry by building Israeli and Israel-related companies with technologies in the fields of advanced defense electronics, communications, semiconductors and medical imaging. In recent years, we have pursued a strategy of focusing our holdings, and increasing our direct involvement in defense electronics, information technology, software products and services, communications, medical devices, semiconductors and amorphous metals. Our group companies include both publicly traded and privately held companies.

During May 2002, we completed our merger with Elbit Ltd. or Elbit and the purchase of the remaining shares of DEP Technology Holdings Ltd., or DEP, a technology holding company, from Discount Investment Corporation Ltd., or DIC. Following the merger with Elbit and the share purchase of DEP, Elbit and DEP became our wholly-owned subsidiaries and our holdings include direct and indirect holdings through Elbit, DEP and DEP's subsidiary, RDC Rafael Development Corporation Ltd., or RDC. RDC is a joint venture between DEP and Rafael Armament Development Authority Ltd., or Rafael, the largest research and development organization of Israel's Ministry of Defense. RDC was established for the purpose of exploiting

Rafael's technology in non-military markets. DEP holds approximately 48% of the outstanding shares of RDC. DEP is entitled to appoint the majority of the members of RDC's board of directors and effectively controls the majority of the voting power of RDC.

Our activities range from complete operational control over the business of our group companies to involvement in the management of our group companies in which we maintain controlling or significant holdings, and, in a limited number of cases, minority holdings. We participate in the management of most of our group companies by means of active membership on their boards of directors and board committees. As a result, we are involved in matters of policy, strategic planning, marketing, selecting and manning senior management positions, approving investments and budgets, financing and the overall ongoing monitoring of our group companies' performance. In addition to our representation on the boards of directors of our group companies, we provide hands-on assistance to the group companies' management in support of their growth. We view our hands-on involvement in the operations of our group companies as a key element of our business. Our group companies therefore benefit from the experience of our management team in various areas in which they need support and leadership, including, but not limited to, market analysis, risk management, identifying joint venture opportunities, introductions to potential customers and investors, business plan preparation, budgetary control and strategic planning and research and development guidance.

Our shares are publicly traded on Nasdaq National Market under the symbol "ELRN" and on the Tel Aviv Stock Exchange. Elron's corporate headquarters are located at 3 Azrieli Center, 42nd Floor, Tel-Aviv 67023, Israel, Tel. 972-3-607-5555, Fax. 972-3-607-5556, e-mail: elron@elron.net. Our web site address is www.elron.com. Information contained on our web site is not part of this Annual Report.

The following are significant transactions and events which we and our group companies have completed or which took place since January 1, 2002:

- **Sale of the Government Activity of Elron TeleSoft to Elbit Systems**

  In January 2002, Elron TeleSoft completed the sale of its net assets and activities in the government field to Elbit Systems for approximately $5.7 million, with no material effect on our consolidated results of operations.

- **Merger with Elbit**

  On May 15, 2002, we completed our merger with Elbit Ltd., in which we previously held 44% of the outstanding shares. Pursuant to the Agreement and Plan of Merger signed on October 31, 2002, Elbit merged with us and we issued to Elbit's shareholders (other than us) approximately 5,617,600 of our shares, based on an exchange ratio of 0.45 of one of our ordinary shares for each ordinary share of Elbit. The value of our ordinary shares issued amounted to approximately $70.2 million. The merger was approved by our and Elbit's shareholders, creditors and optionholders on April 28, 2002 and April 29, 2002, respectively, and by the District Court of Tel-Aviv-Jaffa. At the end of trading on May 15, 2002, Elbit shares ceased trading on Nasdaq and the TASE.

- **DEP Share Purchase**

  On May 5, 2002, we completed the share purchase of DIC's shares in DEP, a technology holding company in which we previously held 33% of the outstanding share capital. Pursuant to the share purchase agreement signed on November 19, 2001 with DIC, we issued 2,261,843 ordinary shares to DIC in exchange for all of the shares held by DIC in DEP, representing 67% of the outstanding share capital of DEP, and DIC's rights to loans provided by DIC to RDC. The aggregate value of our Ordinary Shares issued amounted to approximately $29.5 million. The transaction was approved by our shareholders at a special meeting held on April 28, 2002.

- **Acquisition of controlling interest in Galil Medical Ltd.**

During 2002, we and RDC converted notes of Galil Medical Ltd. or Galil, in the amount of approximately $3.2 million which were granted during November and December of 2001 into preferred shares and invested approximately $3.7 million in new convertible notes which will be converted into preferred shares by the end of June 2003. Through May 31, 2003, we and RDC invested an additional $4.6 million in convertible notes which will be converted into preferred shares during the fourth quarter of 2003.

On June 27, 2002, we purchased an additional 10.75% of Galil's outstanding shares from Lumenis Ltd., in consideration for $0.8 million. Lumenis also received the right to receive a future earn-out payment, conditioned upon the occurrence of certain events on or before May 27, 2004. In the same transaction, DIC also purchased an additional 10.75% of Galil's outstanding shares from Lumenis under the same terms and conditions.

As a result of these transactions, our ownership interest increased to approximately 15% directly and approximately 37% indirectly through RDC, thereby giving us directly and indirectly, through RDC, a controlling voting interest in Galil. Accordingly, Galil's financial results were consolidated with our results of operations subsequent to June 30, 2002.

- **New Investment in A.M.T. Advanced Metal Technologies Ltd.**

In August 2002, we completed a new investment of approximately $5.0 million in convertible notes of AMT, an Israeli private company which develops, markets and licenses technologies, through its group companies, for amorphous and nano-crystalline advanced materials, as methods and solutions for a wide range of commercial applications. Currently, AMT is focusing on two of its group companies, 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 materials for brand protection against counterfeiting and anti-shoplifting electronic article surveillance. The investment formed part of an aggregate investment in AMT of approximately $8.7 million, of which the existing shareholders of AMT invested $3.7 million. The convertible notes are convertible into preferred shares of AMT or its group companies. Following the investment, Elron holds approximately 28% of AMT on a fully diluted and as converted basis.

- **Sale of Elbit Vflash**

On September 23, 2002, Elbit VFlash, a wholly-owned subsidiary of Elbit, sold a significant portion of its assets to 24/7 Real Media Inc., or 24/7 (Nasdaq: TFSM), in exchange for 4,100,000 shares of common stock of 24/7. 24/7 provides marketing and technology solutions to online marketers and publishers. Of the 4,100,000 shares of common stock of 24/7 it received, Elbit Vflash undertook to grant a beneficial interest in approximately 725,000 shares of common stock to former employees in recognition of services they rendered to Elbit VFlash prior to the sale. Concurrently with the above sale, Elron invested through Elbit $1.0 million in consideration for 100,000 convertible preferred shares of 24/7 which were subsequently converted into 4,840,271 shares of common stock of 24/7.

Through June 3, 2003, Elbit sold the majority of its shares of 24/7 resulting in no material gain. As of June 3, 2003, we held 3.15% of the outstanding shares of 24/7.

- **Sale of 380,000 Shares of Elbit Systems**

  In the fourth quarter of 2002, we sold 380,000 shares of Elbit Systems for approximately $5.9 million. As a result, we recorded a gain, before tax, of approximately $1.8 million and our share in Elbit Systems decreased to approximately 20.0%.

- **New Investment in Notal Vision**

  In January 2003, we completed a new investment of $2.0 million in Notal Vision, an Israeli medical device company operating in the field of early detection of Age Related Macular Deterioration (AMD) for an approximately 23.6% ownership interest. Our investment formed part of an aggregate investment by other investors in Notal of approximately $4.5 million, including an investment by an existing shareholder, Innomed Ventures (Israel) L.P., in which we also hold an interest.

- **Galil Medical and Amersham Health Plc merge urology therapy units**

  On April 22, 2003, Galil Medical announced the signing of a definitive agreement with Amersham Health Plc (LSE, NYSE, OSE: AHM) to merge Amersham's brachytherapy business with Galil's urology business. The new company will have a global presence in the treatment of prostate cancer. The new company will provide minimally invasive treatment options for prostate cancer using brachytherapy (radio-active seeds) and cryotherapy (hyper-cooling) technologies. According to the agreement, following the closing Amersham will hold 78% and Galil Medical will hold 22% of the new company. In exchange for the parties' shares in the new company, each will contribute the assets necessary for the new company to conduct the cryotherapy business and the brachytherapy business, respectively, in the urology field. In addition, at the closing Galil Medical will purchase 3% of the new company from Amersham for $4.5 million in cash, resulting in an aggregate ownership interest of 25% upon completion of the transaction. The transaction is subject to regulatory approvals and is expected to close during July 2003.

- **Sale of 3.5 million Shares of Partner**

  In the second quarter of 2003, we sold, in a series of transactions, an aggregate amount of 3.5 million shares of Partner to Israeli institutional investors for approximately $15.3 million, as a result of which we will record, in the second quarter, an estimated gain, after tax, of approximately $3.3 million. As a result of the above sales, Elron's beneficial holding in Partner has been reduced from approximately 12.2% to approximately 10.2 %.

- **Transfer of Our Interests in Textology, Cellenium and I.C.C. Israel Commerce Community**
  During 2002 and at the beginning of 2003, we transferred all our shares in Textology, Inc, in which we held a 67.8% interest, to the other shareholder of Textology, all of our shares in Cellenium MCS Ltd, in which we held a 50% interest, to the other shareholder of Cellenium, and substantially all of the assets of I.C.C. Israel Commerce Community Ltd. to Yael Software & Systems Ltd., in each case for future consideration conditional upon the occurrence of certain events. None of these transactions had a material affect on our results of operations.

The following are the significant investments and divestitures which we and companies in our group completed in 1999, 2000 and 2001:

- **Sale of the E-business Activity of Elron TeleSoft to Forsoft Multimedia**

  During the third quarter of 2001, Elron TeleSoft sold certain activities in its E-business field to Forsoft Multimedia Solutions Ltd. in consideration for $3.4 million, resulting in no material effect on our consolidated results of operations.

- **Given Imaging Initial Public Offering**

  In October, 2001 Given Imaging completed its initial public offering of 5,000,000 shares at a price to the public of $12.00 per share. Given Imaging's Ordinary Shares were listed on the Nasdaq National Market under the symbol "GIVN".

- **Sale of 380,000 Shares of Elbit Systems**

  In the fourth quarter of 2001, we sold 380,000 shares of Elbit Systems for approximately $6.6 million resulting in a gain of approximately $3.0 million.

- **Sale of Elbit's interest in Peach Networks Ltd.**

  In March, 2000, Elbit Ltd. sold its 57% interest in Peach Networks Ltd. to Microsoft Corporation for approximately $43.0 million in cash, resulting in a gain for Elbit of $39.6 million before taxes and minority interests. Our share of the gain amounted to approximately $16.5 million.

- **Increase in Holdings in NetVision**

  During March and April of 2000, we increased our holdings in NetVision Ltd. to 50% of NetVision's outstanding preferred shares (representing approximately 46.2% of its outstanding shares) by acquiring approximately 17% of NetVision's outstanding shares from Aurec Local Information Services Ltd. and from Monitin Itonut Ltd. for an aggregate purchase price of approximately $12.0 million.

- **Wavion**

  In April 2000, we formed, together with two entrepreneurs, Wavion Inc. in which we invested an aggregate amount of $5.0 million for a 38% ownership interest (on a fully diluted basis).

- **Kidum Elron IT (KIT) Ltd.**

  In June 2000, we formed, together with an entrepreneur, KIT, in which we invested $6.0 million in KIT for a 29% ownership interest.

- **Merger of Elbit Systems Ltd. and El-OP Electro-Optics Industries Ltd.**

  In July 2000, Elbit Systems completed its merger with Elop Electro-Optics Industries Ltd. (El-Op) pursuant to which Elbit Systems acquired all of the outstanding shares of El-Op in consideration for approximately 32.3% of Elbit Systems' outstanding shares. As a result our ownership interest decreased from approximately 33% to approximately 22.5%, resulting in a gain of approximately $19.0 million.

- **Sale of HyNEX Ltd.**

  In September 2000, HyNEX Ltd., in which Elbit then held approximately 77% of the outstanding shares on a fully-diluted basis, completed the sale of all its assets, properties, rights and certain liabilities to Cisco Systems, Inc. for an aggregate consideration of approximately $129.0 million. Elbit recorded a capital gain, before taxes and minority interests, of approximately $89.0 million and recognized an unrealized loss of approximately $23.0 million. Our share of the gain amounted to approximately $28.2 million.

- **Sale of Shares of Zoran Corporation**

  During 2000, we sold 611,566 shares of Zoran Corporation for $27.1 million resulting in a gain of approximately $24.5 million. In January 2001, we sold our remaining 252,399 shares of Zoran for approximately $10.6 million resulting in an additional gain of approximately $1.0 million.

- **Sale of Shares of Elbit Medical Imaging**

  On May 4, 1999, we completed the sale of all our holdings in Elbit Medical Imaging, or EMI, to Europe Israel (M.M.S.) Ltd. for $127.8 million in addition to a $17.2 million dividend received from EMI on April 13, 1999. As a result we recorded a gain before tax of approximately $31.7 million. The consideration is subject to adjustments in connection with certain EMI commitments related to provisions included in EMI's balance sheet as of December 31, 1998, in accordance with an indemnification provision in the sale agreement, which expires on December 31, 2003.

Business Overview

The business overview discussed below is presented in accordance with our three reportable segments, the Internet products segment, the systems and projects segment and other holdings and corporate operations.

Internet Products Segment – Elron Software, Inc.

Elron Software is focused on web access control and email content filtering for organizations of all sizes. Elron Software's Internet Manager® product family, including IM Message Inspector,™ IM Web Inspector,™ and IM AntiVirus,™ is a comprehensive set of solutions for web access control, email content filtering and virus protection. These solutions maximize the productive use of the Internet while minimizing the associated risks such as confidential data loss, reduced productivity, legal liability, network congestion and virus attacks.

Elron Software has licensed its products to over 4,500 organizations and government entities, including Sony Pictures Entertainment, Anheuser Busch, Eli Lilly, Occidental Petroleum Corporation, Liberty Mutual and The American Red Cross. The Internet Manager family of products is sold primarily through indirect channels, however, large enterprise accounts often prefer to purchase on a direct basis. In addition to these traditional sales channels, Elron Software has strategically licensed its technology on a limited basis to original equipment manufacturers (known as OEMs), particularly manufacturers of Internet access appliances or email switches.

Elron Software's annual revenues were $8.3 million in 2002, $9.1 million in 2001 and, $12.1 million in 2000, most of which were derived from sales in the United States. Elron Software continues to incur operating losses, which draw upon its financial resources. As a result, we may be required to increase our guarantee securing Elron Software's line of credit. (For more details – see Item 5 under "Liquidity and Capital Resources"). Elron Software's ability to decrease its operating losses depends largely on its ability to substantially increase annual revenues. We are currently exploring ways in which to improve Elron Software's position, including implementing cost reduction programs and exploring possible merger or sale opportunities.

Products

The Internet Manager® family of products enables organizations to clearly see their Internet activity so that they can make informed business decisions that protect the company's personnel, assets and reputation.

IM Web Inspector, a web filtering solution, allows organizations to proactively monitor, manage and, if necessary, block access to inappropriate web sites. Using proprietary, SmartList™ technology and an extensive set of pre-classified sites, Web Inspector identifies and verifies suspect sites on-the-fly, based on statistical language analysis of actual web page content. Web Inspector can manage web access by individuals or groups and handle an organization with 50 to 50,000 plus users. In addition, Web Inspector provides extensive reporting capabilities including more than 500 customizable reports.

IM Message Inspector provides intelligent, context-sensitive filtering of Simplified Mail Transport Protocol (SMTP) email, as well as internal communications by way of Microsoft Exchange and Lotus Domino. Message Inspector utilizes patented and patent-pending full text analysis technologies that surpass simple "string matching" by determining the actual context of the message, thereby accurately identifying and managing offensive, inappropriate or proprietary email content. In addition, Message Inspector incorporates a built-in spam manager that utilizes lexical-based analysis and statistical filters to automatically and accurately identify spam.

IM Message Inspector Partner Edition (MIPE) utilizes the same technology as IM Message Inspector. MIPE offers an open and extremely scalable message filtering platform that can be used by a variety of strategic partners, including appliance vendors, service providers and mail platform providers. MIPE enables these partners to offer complete email content filtering and spam management services to their customers.

IM Anti-Virus incorporates anti-virus detection and repair technology from industry-leading vendors such as McAfee and Sophos and detects inbound and outbound viruses going through SMTP gateways, as well as viruses passing through internal Microsoft Exchange environments. Unlike desktop or server-based solutions, IM Anti-Virus sits at the Internet gateway to prevent viruses from invading the entire network. In addition, IM Anti-Virus offers fully automatic updates through the Internet to ensure accurate and comprehensive virus protection.

Competition

Elron Software competes with companies that offer Web filtering products, such as Secure Computing, SurfControl Incorporated, and Websense. Elron Software also competes with companies such as Clearswift, Trend Micro and Tumbleweed Communications that offer email content filtering products. In addition, Elron Software competes with Brightmail and Postini for anti-spam solutions. Elron Software may face increased competition as these competitors partner with others to expand the functionality that they can offer to their customers.

Elron Software also faces competition from vendors of Internet server appliances, such as Cipher Trust, as well as operating systems and networking hardware, many of which now, or may in the future, develop or bundle employee Internet policy management products with their products. These competitors have the advantage of a single vendor solution for software and hardware requirements. In addition, Elron Software competes against, and expects increased competition from, traditional network management and security software developers.

Sales and Marketing

Beginning in the second quarter of 2002, Elron Software transitioned from a direct sales model to an indirect sales model. As a result, Elron Software currently sells its products indirectly to end-users through resellers that focus on corporate, enterprise and government accounts, located primarily in the United States, although larger sized enterprise accounts may still purchase directly from Elron Software. Elron Software's corporate sales team consists of phone-based sales representatives who work in conjunction with the resellers to focus on small to mid-size opportunities. The enterprise sales team employs a group of outbound sales representatives located in key strategic locations throughout the United States. The channel sales representatives are located in strategic regions throughout the United States and focus on managing the reseller partner relationships and driving partner-initiated opportunities.

Research and Development

Elron Software's engineering team is based in Elron Software's corporate headquarters in Burlington, Massachusetts. In addition, Elron Software has a development laboratory in Haifa, Israel, specializing in linguistic research and technology. Elron Software's research and development efforts are focused on enhancing the integration, scalability and functionality of the Internet Manager product family. The current priority of Elron Software's research and development team is to bolster the capabilities of its anti-spam offering as the accuracy of its anti-spam product directly impacts sales. The new versions of the anti-spam product are due to be released within the next 12 months.

Maintenance and Support

Elron Software provides field support and on-site assistance as well as phone and web-based support. Technical support through the Internet is provided free of charge to all customers through an extensive technical support web site, 24 hours a day, seven days a week. In addition, Elron Software offers annual maintenance and support contracts. Maintenance contracts entitle customers to various telephone support options, including 24 hours a day, seven days a week, standard business hours, five days a week, pay-as-you-go and until recently free product upgrades.

The Systems and Projects Segment – Elron TeleSoft, Inc.

Elron TeleSoft, Inc. develops and markets revenue assurance software products for telecom customers as well as providing network management and IP solution products, services and solutions. Elron Telesoft also distributes Agilent Technology's Signaling Systems number 7 or SS#7, based products in the Israeli market.

During 2001 and through the beginning of 2002, Elron TeleSoft sold its activities in the e-business and government fields and since then has been focused exclusively on the telecommunications service provider market. This mainly accounts for the decrease in Elron Telesoft's annual revenues in 2002 as compared to 2001 presented below. During the first half of 2002, Elron TeleSoft also underwent a change in its senior management**.**

Elron TeleSoft's annual revenues amounted to $10.1 million in 2002 ($8.0 million in Israel and $2.1 million in the rest of the world); $23.8 million (including $11.0 million from the telecommunications service provider market) in 2001 ($21.7 million in Israel and $2.1 million in the rest of the world) and $27.2 million (including $11.8 million from the telecommunications service provider market) in 2000 ($20.1 million in Israel and $7.1 million in the rest of the world). Elron TeleSoft's customers in the telecommunications service provider market include Israeli operators (Bezeq, Cellcom, Partner and Pelephone) and international operators acquired either directly (such as MobiTel Bulgaria) or indirectly through its partners Agilent Technologies (such as NTT and Verizon) and ECtel (such as Cable & Wireless Panama and Cable & Wireless Barbados).

<u>Products</u>

Elron TeleSoft's product portfolio consists of three product lines: revenue assurance solutions (switch to bill and data base conformity), Internet Protocol, or IP Service Management and Network Management Systems, or NMS. Elron TeleSoft's main products are:

ESSB. ESSB is a or Call Detail Records or CDR reconciliation and billing verification application that also offers network operators the ability to analyze inter-carrier traffic. Using either SS#7 or switch-generated Call Detail Records (CDRs), ESSB can compare, analyze and detect revenue leakages.

Call Performance Management. Call Performance Management, or CPM, works in conjunction with Agilent Technology's SS#7 surveillance systems to resolve telecommunications carrier needs. CPM analyzes, in real time, network traffic and quality of service on the Public Switched Telephone Network.

InterTools. InterToolsis an integrated IP service management platform for Internet access management. It supports progressive Internet and other service providers, offering value-added services such as managed remote access, secure tunneling (virtual private networking). It also wholesales low and high speed Internet access infrastructure to service providers.

Network Management System. Network Management System is a platform for developing element management products for telecommunications vendors' equipment.

Competition

Elron TeleSoft has transitioned its business from a pure systems integration company operating mainly in Israel to a global telecommunications software product and system integration company in the fields of revenue assurance (switch to bill and data base conformity), IP service management and NMS (Network Management Systems). As a result, in addition to existing competitors such as TTI Telecom, Elron TeleSoft now faces competition worldwide from companies such as Vibrant, Sotas, Intec, and local in-country competitors which operate in these fields.

Sales and Marketing

Elron TeleSoft's sales and marketing activities include the issuance of press releases and the publication of case studies. Its sales process involves the following steps:

- early contacts and discussions with potential customers and partners directly or through resellers or agents;
- understanding the customer's needs and constructing the implementation plan – product and services. The plan is usually based on a fixed time and fixed-effort custom-tailored solution;
- solutions may incorporate the licensing of Elron TeleSoft's products, third party products and software development; and
- preparation of proposals and contract negotiations.

Research and Development

While Elron TeleSoft's research and development team consists of product-dedicated teams for each product, its efforts are currently primarily directed toward revenue assurance products (ESSB), functionality enhancements and the development of new modules intended to broaden Elron Telesoft's product portfolio in the telecommunications field.

Maintenance and Support

Elron TeleSoft provides maintenance services packages to its customers adjusted to the specific needs and requirements of each customer in accordance with Elron TeleSoft's standard terms and with the applicable terms of its suppliers/subcontractors. Such maintenance packages vary among customers and may include working hours coverage, 24 hours a day, seven days a week coverage, bug fixing, updates, upgrades, third party coverage including updates/upgrades and consultation.

Other Holdings and Corporate Operations

This segment includes our holdings in other companies in our group, engaged in six main fields of advanced technology, namely: (i) medical devices; (ii) defense electronics; (iii) communications; (iv) software products and services; (v) semiconductors and (vi) amorphous metals as well as our corporate operations, which provide strategic and operational support to the group companies. The business overview of this reportable segment is presented, for the purposes of convenience only, according to the six main fields listed above, none of which is considered a separate reportable segment.

1. Medical Devices

Our activities in the field of medical devices consists mainly of our holdings in the following companies:

- Given Imaging Ltd., in which we beneficially own approximately 25.4% of the outstanding shares, or approximately 18.1%, representing our direct holding and our share in the holding of RDC;
- Galil Medical Ltd., in which we beneficially own approximately 51.8% of the outstanding shares, or approximately 33.3%, representing our direct holding and our share in the holding of RDC; and
- Notal Vision, Inc., in which we hold approximately 23.6% of the outstanding shares.

Given Imaging Ltd.

Given Imaging, an Israeli company, is engaged in the development and commercialization of the Given Diagnostic Imaging System, or "Given System." The Given System uses a miniaturized video camera contained in a disposable capsule, referred to as an "M2A capsule" that is ingested by the patient and delivers high quality color images in a painless and noninvasive manner.

Given Imaging was incorporated in Israel by RDC in January 1998. Its initial public offering and listing on the Nasdaq National Market occurred in October 2001. In May 2001, Given Imaging received authorization to affix the "CE" mark to the Given System, which is necessary for marketing the Given System in member countries of the European Union. In August 2001, Given Imaging received clearance from the FDA to market the Given System in the United States for adjunctive use in the detection of abnormalities of the small intestine. Given Imaging has also obtained clearance to market the Given System in over 27 countries, including Canada, Russia and several countries in Latin America and Asia. As of December 2002, Given Imaging had sold more than 1,000 systems and approximately 30,000 M2A capsules in approximately 40 countries worldwide.

In October 2002, Given Imaging launched in Europe, a suspected bleeding feature as part of its RAPID software, which automatically marks images that correlate with the existence of suspected bleeding. This feature was cleared by the FDA in February 2003 and was made commercially available in the United States in April 2003.

During 2002, numerous healthcare payors in the United States began reimbursing capsule endoscopy procedures through reimbursement codes for endoscopy or miscellaneous procedures, mostly for detection of gastrointestinal bleeding which was undetected by conventional methods.

In 2002, which was the first full year of sales for Given Imaging following FDA clearance of its product in August 2001, Given Imaging recorded revenues of $28.9 million compared to $4.7 million in 2001.

Given Imaging currently markets and sells the Given System through a combination of direct sales through its marketing subsidiaries, and through independent distributors in approximately 54 countries.

The Given System consists of the M2A capsule, a portable data recorder and sensor array, and a dedicated computer workstation. Given Imaging currently assembles and tests each M2A capsule at its facilities in Yoqneam, Israel. The manufacturing process for the M2A capsule consists primarily of assembling externally purchased components and sub-assemblies in an environmentally controlled area. In March 2002, Given Imaging completed installation of a semi-automated production line for the manufacture of the M2A capsule. During the first quarter of 2003, Given Imaging installed an additional semi-automated production line in Yoqneam, Israel and has also installed a third semi-automated production line outside of Israel for backup purposes. In June 2002, Given Imaging also entered into a one year non-exclusive technical services agreement with Pemstar, the supplier of the production line, pursuant to which Pemstar provided Given Imaging with technical services relating to the manufacture of the M2A capsule. The portable data recorder and sensor array forming part of the Given System are manufactured externally and assembled tested at its facilities. The computer workstation is an off-the-shelf computer workstation pre-loaded with Given Imaging's RAPID software.

Given Imaging's research and development activities are conducted internally by its research and development staff, primarily at its facilities in Yoqneam, Israel. Given Imaging's research and development efforts are focused primarily on developing new capsules to be used in the detection of abnormalities in other areas of the gastrointestinal tract, including the esophagus, the stomach and the colon. Given Imaging holds one issued patent in the United States and Israel on an in vivo video camera system and one issued patent in France and Israel on an optical system for in vivo imaging. Given Imaging acquired the rights to its issued U.S. and Israeli patents in January 1998 under a technology purchase and license agreement with Rafael. Given Imaging's issued patents in the United States, Israel and France expire in January 2014, July 2014 and July 2015, respectively. As of January 31, 2003, Given Imaging had 73 inventions relating to various elements and functions of its product and enhancements to it, which are the subject of various patent applications filed worldwide.

Galil Medical Ltd.

Galil Medical Ltd., an Israeli company established in 1997, is a provider of minimally invasive temperature-based therapies for treatment of both benign and malignant diseases of the prostate and other urological diseases such as kidney tumors. Galil Medical's technology involves freezing and thereby ablating diseased tissue in a technique commonly referred to as cryotherapy. While Galil currently focuses on developing products to address specific urologic diseases including prostate, kidney and benign prostate hyperplasia (BPH), Galil has indicated that it expects to also apply its technology in other areas including women's health and cardiology.

Galil Medical's research and development and manufacturing facilities are based in Yokneam, Israel. As of December 31, 2002, Galil Medical had over 130 SeedNet™ machines installed worldwide.

Galil Medical's intellectual property consists of a combination of the intellectual property which it received from Rafael and the intellectual property developed by Galil Medical's research and development team. Galil Medical has 11 patents and 8 new pending application of which five patents were submitted in 2002.

Following the completion of the merger of Galil Medical's urology related cryotherapy business with Amersham Health's brachytherapy business into a new company which was announced in April 2003 and which is expected to occur during July 2003, the new company will provide minimally invasive treatment options for prostate cancer using Amersham's brachytherapy (radio-active seeds) and Galil Medical's cryotherapy (hyper-cooling) technologies. As part of the transaction, Galil Medical will license its intellectual property and transfer certain patents in the urology field to the new company. At the closing of the transaction, Galil Medical will purchase 3% of the new company from Amersham for consideration of $4.5 million in cash, resulting in Galil Medical holding an aggregate ownership interest of 25% upon the completion of the transaction. Galil Medical will continue to be the exclusive manufacturer and supplier of research and development services for the new company with respect to long-term services in the urology field and intends to continue to focus on developing new applications in the cardiological and women's health.

Galil Medical recorded annual revenues of $5.0 million in 2002, $2.8 million in 2001 and $1.3 million in 2000.

Notal Vision

Notal Vision Inc. is a medical device company operating in the field of early detection of Age Related Macular Deterioration (AMD). AMD is a common eye disease that gradually destroys central visual function, manifested in two forms: dry AMD, a mild form of the disease, and wet AMD, a progression of dry AMD, which often leads to rapid, severe visual deterioration and blindness. To address the growing need for early detection of wet AMD and for the continuous monitoring of patients with dry AMD, Notal Vision has developed the patent-pending Preferential Hyperacuity Perimetry (PHP), designed to detect and monitor the progression of the disease in a non-invasive manner. Based on the PHP technology, the company is launching, together with Carl Zeiss Meditech, the Macuteck Preview PHP device, intended for professional use by ophthalmologists and optometrists in their clinics. The diagnostic device will enable early detection of the full spectrum of dry AMD within the population at risk (e.g., anyone over the age of 55) who may be unaware that they may have dry AMD, as well as within the population of patients already known to have dry AMD and Chroidal Neo-Vascularization (CNV) population. The device will enable early detection of AMD, detection of CNV and post-Photo Dynamic Therapy (PDT) follow-up. PDT follow-up is intended for identifying the recurrence of the disease and confirming the stage of the disease. Sales of the Preview PHP device are expected to begin in late 2003.

Based on the PHP technology, the company is also developing the "Home Device," a monitoring device intended for home use. The monitoring device will enable patients with dry AMD to monitor themselves at home on a frequent basis, ensuring a timely intervention by a physician should the disease progress to the wet form.

Notal is an early development stage company which was formed in 2000. Notal has not yet commenced sales and its ability to generate revenues will depend largely on it obtaining and maintaining applicable regulatory approvals for its products, reimbursement of its products by healthcare payors and the success of its strategic alliance with Carl Zeiss Meditech.

Other Holdings in Medical Devices

Our other holding in the medical devices field is in Innomed Ventures (Israel)L.P., which is a seed stage fund that initiates and invests in Israeli and Israeli related companies in the field of medical devices and life sciences. DEP holds approximately 14% of the partnership interest of Innomed. Innomed is a member of the Jerusalem Global Ventures Group of venture capital funds.

2. Defense Electronics

Our activities in the field of defense electronics consists of our holdings in Elbit Systems Ltd., in which we hold approximately 20% of the outstanding shares. Elbit Systems operates through a number of wholly-owned and partially-owned subsidiaries in Israel and the United States.

Elbit Systems Ltd.

Elbit Systems Ltd., an Israel-based company, was formed in 1996 as a result of the demerger of Elbit Ltd. into three independent publicly traded companies, Elbit Systems, Elbit Ltd. and Elbit Medical Imaging Ltd. Elbit Systems' shares are publicly traded on the Nasdaq National Market under the symbol "ESLT" and on the Tel Aviv Stock Exchange.

Elbit Systems develops, manufactures and integrates advanced, high-performance defense electronic and electro-optic systems for customers throughout the world. Elbit Systems focuses on designing, developing, manufacturing and integrating command, control, communication, computer and intelligence (C4I) systems and intelligence, surveillance and reconnaissance (ISR) systems for defense and homeland security applications. It also performs upgrade programs for airborne, ground and naval defense platforms, often as a prime contractor.

Elbit Systems' total annual revenues were approximately $828 million in 2002, $765 million in 2001 and $591 million in 2000.

In July 2000, Elbit Systems and Electro-Optics Industries Ltd., or, El-Op merged, resulting in El-Op becoming a wholly-owned subsidiary of Elbit Systems. As part of this merger, the Federmann Group, the shareholders of El-Op, received 12,100,000 newly-issued shares of Elbit Systems, then representing approximately 32.3% of Elbit Systems' outstanding shares following the merger.

As part of this transaction, we entered into a shareholders agreement with the Federmann Group, which sets forth the relationship of the primary shareholders of Elbit Systems. The shareholders agreement includes limitation on the transfer of shares in Elbit Systems, 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 Elbit Systems' board of directors. In addition, we, Elbit Systems and the Federmann Group entered into a registration rights agreement, pursuant to which Elbit Systems agreed to register our and the Federmann Group's shares in Elbit Systems for trade on a stock exchange in the United States under certain conditions.

Elbit Systems tailors and adapts its technologies, integration skills, market knowledge and battle-proven systems to each customer's individual requirements in both existing and new platforms. By upgrading existing platforms with advanced electronic and electro-optic technologies, Elbit Systems provides customers with cost-effective solutions enabling customers to improve their technological and operational capabilities within limited defense budgets.

The recent military actions in Iraq and Afghanistan and ongoing terrorist activities have caused a shift in the defense priorities for many of Elbit Systems' major customers. While Elbit Systems continues to perform platform upgrades, more emphasis is being placed on ISR, including information systems, intelligence gathering, border and perimeter security, UAVs, space and satellite based defense capabilities and homeland security issues. Elbit Systems has indicated that it believes its existing systems, products and capabilities place it in a position to meet emerging customer requirements in many of these areas. Elbit Systems has also indicated that it believes that some types of upgrade programs and electronic and electro-optic systems, particularly those that emphasize information gathering, analysis and distribution, will continue to be a significant portion of defense budgets in many countries.

Elbit Systems' major activities are:

Fixed Wing Aircraft and Helicopter Programs and Systems. Elbit Systems is a prime contractor for aircraft and helicopter upgrade programs. It supplies advanced airborne electronic and electro-optic systems and products to leading aircraft manufacturers and end users. Such airborne systems and products include weapons guidance and fire control systems, mission computers, cockpit management systems, display systems, head-up displays, digital maps, night vision systems, forward-looking infra-red (FLIR) systems, laser range finders and designators, airborne C4I systems, cockpit instruments, stabilized line-of-sight payloads, aerial reconnaissance systems, store management systems, digital video recording systems and virtual training aids. Elbit Systems acts as the upgrade integrator, and supplies systems and products, for airborne platforms including:

- fixed wing aircraft such as the F-4, F-5, F-15, F-16, F-18, T-38, T-45, MiG-21, SU-25, SU-30, C-130, A-4, A-10, Mirage, Kfir, AL-X, AM-X, IAR-99, AT-63 Pampa, Beachcraft and Gulfstream-V; and
- helicopters such as the CH-47, CH-53, Cobra, Puma, Super Puma, OH-58 Kiowa Warrior, AH-64 Apache, RAH-66 Comanche, H-60 Black Hawk, S-70 Black Hawk, Linx, EC225 and EC725 and the V-22 Osprey tilt rotorcraft.

Helmet Mounted Systems. Elbit Systems designs and supplies advanced helmet mounted systems for fighter aircraft and helicopter pilots and ground vehicles. These include tracking and display systems for target designation, weapon and sensor slaving and processing and display of tactical information for pilots, both for day and night flying. Its helmet mounted systems are supplied as part of its upgrade programs as well as on a stand-alone basis.

UAV Integrated Systems. Elbit Systems designs and supplies integrated UAV systems. Through its Silver Arrow subsidiary, Elbit Systems designs and manufactures a variety of UAV platforms, including the Hermes family of UAVs. Elbit Systems also designs and supplies C4I ground stations systems for UAVs.

Tactical and Security Systems. Elbit Systems designs, manufactures and integrates a range of tactical and security systems and products for airborne naval and homeland security applications. These include laser and infrared seeker kits for guided munitions, naval electro-optic observation systems, naval tactical trainers, submarine electronic warfare systems, shipboard decoy countermeasure launching systems, naval combat management systems, maritime and coastal control systems, facility perimeter security products, electronic fences and electro-optic warning systems for defense, police, border control and homeland security uses.

Ground C4I and Battlefield Systems. Elbit Systems designs, manufactures and integrates C4I and battlefield systems for ground forces and battlefield management applications. These include artillery command and control systems, day-night observation systems, C4I battlefield management systems for headquarters command and for low-echelon armored formations, tactical communications systems, and tactical ground reconnaissance systems. Elbit Systems also designs and manufactures governmental information technology systems and integrated intelligence gathering systems for border control, crime prevention and other governmental applications.

Combat Vehicle Programs and Systems. Elbit Systems upgrades and modernizes tanks and other combat vehicles both as a prime contractor and as a systems supplier to leading platform manufacturers. Its combat vehicle systems include fire control systems, electric gun and turret drive systems, command and control systems, FLIRs, sights, lasers, laser warning systems, displays, life support systems and hydraulic systems for tanks, personnel carriers and other combat vehicles. Elbit Systems also supplies training systems for tanks and fighting vehicles. Tank and combat fighting vehicle programs containing its systems and products include the Merkava, M1 Abrams, Centurion, Patton, Paladin, M-60, T-55, T-72, Bradley A-3, MLRS, AMX-30, SK-105, ULAN and LAV.

Electro-Optic and Countermeasures Systems. Through El-Op, Elbit Systems wholly-owned subsidiary, Elbit Systems designs and manufactures a full range of electro-optics sensors and systems for space, air, land and sea applications. The range of electro-optics products includes space cameras and specialized sensors, airborne reconnaissance and observation systems, FLIRs for ground, naval and airborne applications, laser designators based on diode pumped technology used in manned and unmanned airborne vehicles and ground and naval platforms, including products for detection, identification and intelligence gathering as well as for ground vehicle upgrades. El-Op's ISR related business activities – space cameras, airborne reconnaissance and observation and surveillance – share a broad infrastructure of technologies that provide image intelligence, long range observation solutions for space, air, sea and ground based sources. In the space area, El-Op also maintains in-house Israel's national space electro-optics infrastructure and is currently a principal subcontractor for the Israeli Ofek satellites. In addition, El-Op supplies dedicated satellite payloads for space research and advanced multi-spectral and high resolution pan-chromatic cameras for commercial satellites.

Technology Spin-Offs. Elbit Systems is engaged in spin-offs of its defense technologies to commercial applications. Its spin-off activities to date are in the areas of medical equipment, optical communications, commercial satellites and satellite communication for commercial aircraft.

Governmental Regulation

Government Contracting Regulations. Elbit Systems operates under laws, regulations and administrative rules governing defense contracts, mainly in Israel and the United States. Some of these carry major penalty provisions for non-compliance, including disqualification from participating in future contracts. In addition, its participation in governmental procurement processes in Israel, the United States and other countries is subject to specific regulations governing the conduct of the procurement process.

Israeli Export Regulations. Israel's defense export policy regulates the sale of a number of Elbit Systems' systems and products. Current Israeli policy encourages exports to approved customers of defense systems and products such as those of Elbit Systems, as long as the export is consistent with Israeli Government policy. A permit is required for an export and must be obtained to initiate a sales proposal. Elbit Systems also must receive a specific export license for any hardware eventually exported. In 2002, approximately 50% of Elbit Systems' revenue was derived from exports subject to Israeli export regulations.

U.S. and Other Export Regulations. The export of defense products, military technical data and technical services by Elbit Systems' U.S. subsidiary, EFW Inc. (EFW) (and EFW's subsidiaries) to Israel and other countries is subject to applicable approvals of the U.S. Government. Such approvals are typically in the form of an export license or a technical assistance agreement (TAA). Other U.S. companies wishing to export defense products or military related services and technology to Elbit Systems' Israeli entities are also required to obtain such licenses and TAAs. An application for an export license, or a TAA, requires disclosure of the intended sales of the product and the use of the technology. The U.S. Government may deny the export license or TAA if it determines that a transaction is contrary to U.S. policy or national security. Other governments' export regulations also affect Elbit Systems' business from time to time, particularly with respect to end user restrictions of Elbit Systems' suppliers' governments. Recently, some European governments have indicated the possibility of limiting defense exports to Israel.

"Buy American" Laws. The U.S. "Buy American" laws impose price differentials or prohibitions on procurement of products purchased under U.S. Government programs. The price differentials or prohibitions apply to products that are not made in the United States or that do not contain U.S. components making up at least 50% of the total cost of all components in the product. However, a Memorandum of Agreement between the United States and Israeli Governments waives the Buy American laws for specified products, including almost all the products currently sold in the United States by Elbit Systems, El-Op and Elbit Systems other Israeli subsidiaries.

Foreign Military Funding (FMF). EFW and its subsidiaries participate in United States FMF programs. These programs require countries, including Israel, receiving military aid from the United States to use the funds to purchase products containing mainly U.S. origin components. In most cases, subcontracting under FMF contracts to non-U.S. entities is not permitted. As a consequence, EFW and its subsidiaries generally either perform FMF contracts themselves or subcontract with U.S. suppliers.

Antitrust Laws. Antitrust laws and regulations in Israel, the United States and other countries often require governmental approvals for transactions that are considered to limit competition. Such transactions may include cooperative agreements for specific programs or areas, as well as mergers and acquisitions.

Buy-Back

As part of their standard contractual requirements for defense programs, several of Elbit Systems' customers include "buy-back" provisions. These provisions are typically best efforts obligations to make, or to facilitate third parties to make, specified transactions in the customer's country. Such transactions may include the purchase of local goods and services; cooperative ventures with, or investment in, local entities; and transfers of equipment, infrastructure or know-how for the benefit of local parties. In most cases, the buy-back transactions are to be fulfilled over a multi-year period that extends after completion of deliveries under the contract.

Elbit Systems is required to make or facilitate local purchases or goods and services only if the local suppliers can meet the commercial and technical competitive terms of the specific procurement. Thus, the local industry must be able to meet the price of other international suppliers for the procurement in question as well as to meet the required delivery schedule and technical specifications. Typically, if the local supplier is unable to meet such conditions following the award of a purchase order, the buy-back credit is nonetheless granted. To date, Elbit Systems has not encountered significant difficulties in identifying qualified local suppliers and placing purchase orders.

Elbit Systems typically has the right to apply multiplier factors in calculating the amount of buy-back credit recognized, and certain types of investments and transactions receive buy-back credit of up to five or more times the value of the specific transaction. Therefore, even if the buy-back provisions apply in an aggregate amount of up to 100% of the price of the contract with its customer, the actual effective buy-back obligation amount is significantly less due to the application of the multiplier factors.

Although failure to meet a best efforts buy-back obligation may limit Elbit Systems' ability to be awarded future business from the applicable customer, buy-back generally is not linked to delivery payments or subject to specific contractual monetary penalties. The buy-back activities are a normal part of doing business in the defense industry with these customers. Over the number of years that Elbit Systems has been performing buy-back activities, Elbit Systems has not experienced significant difficulties in meeting its buy-back obligations, and therefore these buy-back activities are not believed to represent a material financial risk to Elbit Systems' operations. Elbit Systems' maximum aggregate buy-back undertakings as of December 31, 2002 were approximately $715 million, to be fulfilled over an eleven-year period.

Financing Terms

Types of Financing. There are several types of financing terms applicable to Elbit Systems' defense contracts. In some cases, Elbit Systems receives progress payments according to a percentage of the cost incurred in performing the contract. Sometimes Elbit Systems receives advances from the customer at the beginning of the project and also receives milestone payments for achievement of specific milestones. In some programs, Elbit Systems extends credit to the customer, sometimes based on receipt of guarantees or other security. In other situations work is performed before receipt of the payment, which means that Elbit Systems finances all or part of the project's costs. Occasionally, Elbit Systems assists in arranging third party financing for its customers. Financing arrangements may extend beyond the term of the contract's performance. When Elbit Systems believes it is necessary, it seeks to protect all or part of its financial exposure by letters of credit, insurance or other measures, although in some cases such measures may not be available.

Advance Payment Guarantees. In some cases where Elbit Systems receives advances prior to incurring contract costs or making deliveries, the customer may require guarantees against advances paid. These guarantees are issued either by financial institutions or by Elbit Systems. Elbit Systems has received substantial advances from customers under some of its contracts. If a contract is canceled for default and there has been an advance or progress payment, Elbit Systems may be required to return payments to the customer as provided in the specific guarantee. As part of the guarantees, Elbit Systems provides to receive progress payments or advance payments, some of its customers require it to transfer to them title in inventory acquired with such payments. In addition, Elbit Systems receives payments for some of its projects in currencies other than U.S. dollars. In such cases, Elbit Systems sometimes elects to adopt measures to reduce the risk of exchange rate fluctuations. As of December 31, 2002, the balance of customer advances that were covered by guarantees amounted to approximately $192 million. While Elbit Systems attempts to obtain appropriate insurance regarding such guarantees, Elbit Systems sometimes is unable to fully insure all risks.

Performance Guarantees. A number of projects require Elbit Systems to provide performance guarantees in an amount equal to a percentage of the contract price. Some of its contracts contain clauses that impose penalties or reduce the amount payable to it if there is a delay or failure in completion of a phase of work, including in some cases during the warranty period.

Financial Risks Relating to Projects. The nature of Elbit Systems' projects and contracts creates some potential financial risks, including risks relating to dependence on governmental budgets, fixed price contracts for development effort, schedule extensions beyond Elbit Systems' control, termination for the customer's convenience, potential for monetary penalties for late deliveries and liability for subcontractors.

Audit Regulations. The IMOD audits Elbit Systems' books and records relating to its contracts with Elbit Systems. Elbit Systems books and records and other aspects of projects related to U.S. defense contracts are subject to audit by the U.S. Defense Contract Audit Agency. Such audits review compliance with applicable government contracting cost accounting and other applicable standards. Some other customers obtain similar rights under specific contract provisions.

Intellectual Property

Patents, Trademarks and Trade Secrets. Elbit Systems holds more than 250 patents in Israel, the United States and other countries relating to approximately 100 different inventions. El-Op alone holds approximately 150 patents on some 70 different products or applications. Elbit Systems' technology spin-off companies often rely in part on Elbit Systems' patented technology. In a few cases, Elbit Systems holds trademarks relating to specific products. A significant part of Elbit Systems' intellectual property assets relates to unique applications of advanced software-based technologies, development process and production technologies. These applications are often not easily patentable, but are considered as Elbit Systems' trade secrets and proprietary information. Elbit Systems takes a number of measures to guard its intellectual property against infringement as well as to avoid infringement of other parties' intellectual property.

Government Rights in Data. The Israeli Government usually retains specific rights to technologies and inventions resulting from Elbit Systems' performance under Israeli Government contracts. This generally includes the right to disclose the information to third parties, including other defense contractors that may be Elbit Systems' competitors. Consistent with common practice in the defense industry, approximately 30% of Elbit Systems' revenues in 2002 were dependent on products incorporating technology that a government customer may disclose to third parties. When the Israeli Government funds research and development, it usually acquires rights to data and title to inventions. Elbit Systems often may retain a non-exclusive license for such inventions. The Israeli Government usually is entitled to receive royalties on export sales to the extent that such sales result from government financed development. However, if only the end product is purchased, Elbit Systems normally retains the principal rights to the technology. Sales of Elbit Systems' products to the U.S. Government and some other customers are subject to similar conditions. Subject to applicable law, regulations and contract requirements, Elbit Systems attempts to maintain its intellectual property rights and provide customers with the right to use the technology only for the specific project under contract.

Licensing. In the relatively few cases where Elbit Systems manufactures under license, the licensor typically is entitled to royalties or other types of compensation. However, EFW's acquisition in 2000 of the display and orientation product business of Honeywell included an exclusive, royalty free license to use the applicable technology for defense applications. Occasionally, Elbit Systems licenses parts of its intellectual property to customers as part of the requirements of a particular contract. Elbit Systems also sometimes licenses technology to other companies for specific purposes or markets. Elbit Systems' technology spin-offs typically receive licenses to use relevant parts of Elbit Systems' intellectual property for their designated business purposes.

Research and Development

Elbit Systems invests in research and development (R&D) according to a long-term plan based on estimated market needs. Elbit Systems' R&D efforts focus on anticipating operational needs of its customers, achieving reduced time to market and increasing affordability. Elbit Systems emphasizes improving existing systems and products and developing new ones using emerging or existing technologies. Elbit Systems performs R&D projects to produce new systems for the IMOD and other customers. These products give Elbit Systems the opportunity to develop and test emerging technologies. Elbit Systems developed new tools for fast prototyping for both the design and development process. This permits the operational team members to effectively specify requirements and to automatically transfer them into software code. Examples of Elbit Systems' ongoing defense-related R&D projects include those for night operation capabilities, laser systems, display systems, helmet mounted systems, C4I systems, electric tank turret drive systems and homeland security systems. Elbit Systems also performs R&D in the area of commercial aviation and through its technology spin-offs. Elbit Systems employs more than 1,600 software and hardware development and systems engineers engaged in advance programs for airborne, ground and naval defense, homeland security and space applications. Approximately 60% of Elbit Systems' total workforce is engaged in research, development and engineering.

3. Communications

Our activities in the field of communications consist of our holdings in the following companies:

- Partner Communications Company Ltd., in which we hold, through Elbit Ltd., approximately 10.2% of the outstanding shares as of June 2, 2003;
- NetVision Ltd., mainly an Internet service provider, in which we hold 50% of the outstanding voting shares which represents approximately 45.7% of all of NetVision's outstanding shares;
- Kidum Elron IT Ltd., in which we hold approximately 28.6% of the outstanding shares;
- Wavion, Inc., in which we hold approximately 51.8% of the outstanding shares;
- Witcom Ltd., in which we beneficially own approximately 32.9% of the outstanding shares or approximately 20.2% representing our direct holding and our share in the holding of RDC;
- Pulsicom Israel Technologies Ltd., in which we hold 17% of the outstanding shares; and
- CellAct Ltd., in which we hold 45% of the outstanding shares.

Partner Communications Company Ltd.

Partner is a publicly traded, Israel-based company. Its shares are traded on the Nasdaq National Market under the symbol "PTNR", on the London Stock Exchange under the symbol "PCCD" and on the Tel Aviv Stock Exchange. Partner is a Global System for Mobile Communications, or GSM, mobile telephone network operator in Israel and one of four cellular service providers in Israel. We indirectly hold approximately 10.2% of Partner's share capital through Elbit, as of June 2, 2003.

Elbit founded Partner in 1997 by forming a consortium of Israeli and foreign companies and successfully leading the consortium in the license auction held by the Minister of Communications to operate a GSM cellular network.

The structure and percentage of Elbit's ownership interest in Partner were specifically dictated by the Ministry of Communications in order to prevent our controlling shareholder, DIC and its affiliates (which have a significant influence over Cellcom, another cellular operator in Israel) from having a significant influence over Partner. Consequently, Elbit had to waive veto rights that had previously been granted to it. Elbit further undertook not to enter into any agreement, or make any arrangement or other understanding with regard to budget approval and business plan approval, by which other veto rights would be exercised for Elbit's benefit. In addition, Elbit was prevented from appointing more than two of Partner's board members, which as of December 31, 2002 comprised 17 members. As part of the grant of the license to Partner to operate a cellular network in Israel, the Israeli Ministry of Communications imposed limitations on the disclosure of information concerning Partner to DIC and some of its affiliates. Pursuant to our merger with Elbit, the Ministry of Communications required all our officers and employees to sign non-disclosure undertakings regarding the transfer of information relating to Partner. These requirements have been complied with. In the event that those future requirements are not met at any time in the future, the Israeli Ministry of Communications is entitled to require Elbit to reduce its beneficial ownership in Partner to below 5%.

In March 1998, Partner signed a mandate letter with a consortium of leading international and Israeli banks for non-recourse financing in the amount of up to $650.0 million. The line of credit under the facility is secured by a pledge of shares held by us and the other original shareholders of Partner, each pro rata to its respective holdings at that time. We have pledged approximately 15.9 million of our shares of Partner representing, as of June 2, 2003, approximately 85% of our total holdings of Partner in favor of the consortium of banks. As of December 31, 2002, the amount of the facility was $710.0 million of which $519.0 million was outstanding.

Partner uses radio spectrum over which its network operates. The Israeli government owns the spectrum and grants licenses to use the spectrum to certain mobile network operators. In an auction process completed on December 18, 2001, the Israeli Ministry of Communications awarded Partner the two bands of spectrum for which Partner had submitted bids: one band of GSM 1800 spectrum and one band of UMTS third generation spectrum. Cellcom was also awarded a band of GSM 1800 spectrum in the auction. Cellcom commenced providing GSM 1800 services in the second half of 2002. As a result of the allocation to existing operators of additional spectrum that is suitable for provisioning of GSM mobile telephone service, Partner is no longer the sole GSM operator in Israel. According to publicly available information, Cellcom and Pelephone were also each awarded one band of UMTS third generation spectrum in the auction.

Partner’s principal business is the provision of mobile telephone services in Israel. In addition to its standard and enhanced GSM services, including international dialing and roaming, Partner offers its customers value added services, including voice mail, short message services, intelligent network services, content based on our mobile portal, data and fax transmission and other services. Partner’s products and services are marketed under the Orange Brand pursuant to a license agreement with Orange International Developments Limited, a subsidiary of Orange plc.

Partner distributes its services primarily through direct sales through Partner-owned sales centers and business sales representatives; and indirect sales through traditional networks of specialist dealers and non-traditional networks of retail chains and stores, which account for a majority of Partner’s sales.

Partner also offers 24-hour, seven days a week customer service, as well as handset repair and replacement services, to subscribers who acquire these services.

Partner is subject to extensive regulation related to the spectrum and its ability to operate mobile telephone service in Israel. The Israeli Ministry of Communications controls the granting of licenses to operate mobile telephone service in Israel. It has granted licenses to several companies to operate such mobile networks, and may grant additional licenses in the future. Additionally, Partner must erect antennae that carry its network transmissions in order to maintain the coverage of the Israeli population required in its license agreement with the Ministry. These antennae must comply with local, regional and national regulations.

Partner is also dependent on a number of licenses and agreements with private companies to operate its mobile telephone network and Partner maintains contracts with a number of dealers through which its products are sold and has contracts with Nokia and Ericsson to provide it with equipment to run its network. Such equipment is available only through a limited number of suppliers. Partner also leases a substantial number of lines for its transmission network from

Bezeq. Finally, Partner maintains agreements with several mobile telephone network operators in foreign countries through which it provides its customers with international service.

As of December 31, 2002, Partner had accumulated about 1,837,000 subscribers, an increase of approximately 379,000 subscribers during 2002. Resulting from the increased number of subscribers, according its internal statistics, Partner believes that its market share rose to approximately 29% of the Israeli cellular market, from 27% in 2001.

Partner's revenues were $855.9 million 2002, $685.9 million in 2001 and $444.2 million in 2000 based on the shekel-dollar rate of exchange as of December 31, 2002 of NIS 4.737.

NetVision Ltd.

NetVision Ltd. is a privately-held, Israel-based company. NetVision is one of the largest Internet service and solutions providers in Israel, as well as a developer of Internet solutions. NetVision's total revenues were $56.4 million in 2002, $58.9 million in 2001 and $48.5 million in 2000. NetVision's services utilize advanced technologies, including:

- high-speed modem dial-up (including integrated services digital network, or ISDN, asymmetric digital subscriber line, or ADSL, and cable),
- dedicated lines (using fiber, frame relay and asynchronous transfer mode, or ATM),
- communication servers (mail, web, proxy),
- data security installations and maintenance,
- private networks for multi-national corporations, commercial Web servers and application hosting, and
- custom on-line services.

NetVision's wholly-owned subsidiary, NetVision Internet Applications Ltd., provides software for e-commerce and Internet systems and Broadnet, which NetVision jointly owns with John Bryce Products, is the Israeli representative of Broadvision, which specializes in one-to-one e-business marketing solutions.

NetVision's market is extremely competitive especially in the broadband Internet market in which NetVision has invested substantial resources in order to incease the number of its broadband Internet subscribers. Netvision has approximately 340,000 subscribers as of December 31, 2002, representing, according to NetVision's internal statistics, a general market share of approximately 30%. NetVision holds approximately 25% of the broadband Internet market according to Netvision's internal statistics. The intense competition in the broadband Internet market and the consequent reduction in prices negatively affected NetVision's results of operations in 2002.

In July 1999, NetVision launched the Nana portal, which provides a variety of content and e-commerce services such as auctions, shopping and advertising. Nana's index and search applications can be operated in Hebrew, English, Russian and Arabic. NetVision has been involved in e-commerce activity since 1998, through Netaction, NetVision's auction site.

NetVision's marketing and distribution channels include major systems integration houses as well as software and hardware resellers. NetVision provides field support and on-site assistance as well as phone and web-based support. Technical support is provided free of charge to all customers by NetVision's technical call center, 24 hours a day, seven days a week.

NetVision is dependent on the communication services provided by Bezeq Telecommunications Company Ltd., the government owned telecommunications operator which is regarded as a monopoly for domestic telecommunications in Israel. NetVision is also dependent on maintaining its operating license granted by the Israeli Ministry of Communications. If NetVision loses its license, it will not be permitted to operate. As to international telecommunication services provided by Bezeq, there are alternative providers.

The other substantial shareholder of NetVision is Tevel International Communications Ltd or, Tevel, which is under joint control of DIC. Mr. Ami Erel, our Chairman, also serves Chairman of Tevel. Tevel has obtained a stay of proceedings in Israel under the Israel Companies Law, and is currently managed by a trustee appointed by an Israeli court as a result of an act of insolvency. The trustee operates under the supervision of the court. As part of the recovery and settlement plan filed by Tevel's trustee with the court, there is a proposal to sell all of Tevel's shares in NetVision. If and when the recovery plan is approved and confirmed, the trustee is expected to offer Tevel's shares in NetVision for sale. Such sale is subject to our priority right to purchase Tevel's shares in NetVision, alternatively, our right to sell our shares in NetVision in the sale of Tevel's shares in NetVision to a third party.

Kidum Elron IT Ltd.

Kidum Elron IT Ltd., or KIT, is a privately held Israeli corporation with a wholly-owned Dutch subsidiary that offers online academic programs for professionals in business administration and information technology, in cooperation with the University of Liverpool in England. Currently, KIT is serving professionals from more than 70 countries but mostly from the U.K., Netherlands, Germany, North America, Singapore and China.

KIT's total revenues were $2.6 million in 2002 and $1.0 million in 2001, having commenced generating revenues in 2001. KIT has a five-year agreement to provide online academic programs with the University of Liverpool that expires in 2005. As a result, KIT is required to comply with the quality assurance standards imposed by the Higher Education Agencies in Britain.

Wavion, Inc.

Wavion is a Delaware corporation with research and development facilities in Israel. Wavion commenced development of its products in the second quarter of 2000. Wavion develops broadband wireless systems for the residential, small office/home office and enterprises markets. The company is developing a high performance base-station that support data applications over Internet Protocol (IP), with a migration path for voice and video. The company is currently focusing on the development of "smart antenna" technology to enhance the performance of wireless systems and expects to commence product sales in 2004.

In May 2003, Wavion completed a financing round led by Sequoia Seed Capital, raising $6 million out of which we invested $2 million. Following the financing, we hold approximately 51.8% of the outstanding shares of Wavion.

Witcom Ltd.

Witcom Ltd. is an Israeli company that designs, develops and manufactures radio-based point-to-point digital networking solutions for different bandwidth and frequencies for the worldwide telecommunications, data communications, and Internet access markets. Witcom currently offers the Witlink-2000, a product that supports the capacity range from low to medium (50 Megabytes per second) in various frequencies. Witcom is currently developing an ultra high capacity product.

Witcom generated revenues in the amount of $5.0 million in 2002, $4.4 million in 2001 and $0.5 million in 2000. Witcom's products require regulatory approvals from the United States Federal Communications Commission and similar regulatory agencies in other countries.

Pulsicom Israel Technologies Ltd.

Pulsicom Israel Technologies Ltd. commenced operations in March 2001. It develops high accuracy real time locating and tracking systems for confined spaces. Such systems can be operated alone or can complement closed-circuit television systems and bar code systems. Pulsicom's technology employs short-pulse technologies, including very-and ultra-wideband and sophisticated position-determination algorithms, and combines high performance with simple installation and affordable prices. Potential applications include logistics, hospitals and retail stores, enhancing efficiency, safety and security.

Pulsicom is an early stage development company, which has not yet completed its commercial product development and does not expect to commence generating revenues from sales before 2004. In order to generate revenues, Pulsicom has commenced selling development services to different customers. Pulsicom has limited resources and its continued operations depend on its ability to raise additional capital. There is no assurance that Pulsicom will be successful in its efforts to raise additional capital.

Cellact Ltd.

Cellact Ltd. is an Israeli provider of two-way cellular data messaging platforms. Cellact's flagship product, Nimbus, provides the enterprise with a comprehensive solution for generating, managing and operating cellular data messaging applications. Nimbus was first commercially released in July 2001.Cellact's customers are mobile operators and financial institutions. Cellact is now focusing on marketing its product in Western Europe and Israel. To date, Cellact has not generated significant revenues.

Cellact has limited resources and its continued operations are largely dependent upon its ability to generate sufficient revenues or raise additional capital to finance its continued operations and there is no assurance that Cellact will be able to do so.

4. Software Products and Services

We conduct our activities in the field of software products and services in the following businesses:

- MediaGate N.V., in which we hold approximately 69.1% of the outstanding shares;
- Ingenio, in which we beneficially own, through DEP and RDC, approximately 33.1% of the outstanding shares, or 21.1%, representing our direct holding and our share in the holding of RDC.

MediaGate

Mediagate develops and markets iPost® next generation voicemail and advanced messaging platform, a carrier-class, IP-based, email - centricVoicemail and Advanced Messaging solution. iPost® provides service providers with revenue generating basic and advanced messaging capabilities on one standards based platform. MediaGate markets its products mainly to mobile network operators and to Internet Service Providers (ISPs).

MediaGate's total revenues were $2.6 million in 2002, $0.7 million in 2001 and $0.9 million in 2000.

MediaGate's revenues and operating results have been and will continue to be affected by the slowdown in the telecommunications market as well as by the competition from more established companies in the market with larger resources. Due to increased competition, during the first half of 2003, MediaGate's results of operations severely deteriorated. MediaGate's continued operations are largely dependent upon financial support of its shareholders. Currently, there is no commitment by MediaGate's shareholders to finance MediaGate's continued operations and there is no assurance that MediaGate will be able to generate sufficient revenues to enable it to continue its operations.

Ingeneo Ltd.

Ingeneo is an early stage company which did not generate significant revenues through 2002. Ingeneo develops customer relationship management solutions that enable organizations to turn inbound customer service contacts into business opportunities by delivering customer-centric marketing to the inbound customer.

Ingeneo's continued operations are largely dependent upon financial support of its shareholders. There is no assurance that Ingenio will be able to raise capital from its shareholders or any other party or generate sufficient revenues to enable it to finance its operations.

5. Semi-Conductors

Our activities in the field of semi-conductors consist of our holdings in the following companies:

- Chip Express Corporation, in which we hold approximately 33.5% of the outstanding shares;

- Oren Semiconductor, Inc., in which we hold approximately 17.3% of the outstanding shares;
- 3DV Systems Ltd., in which we beneficially own approximately 47.7% of the outstanding shares, or approximately 24.8%, representing our direct holding and our share in the holding of RDC; and
- Semiconductor Engineering Laboratories Ltd. (SELA), in which we beneficially own approximately 49.5% of the outstanding shares, or approximately 24.8%, representing our direct holding and our share in the holding of RDC.

Chip Express Corporation

Chip Express Corporation is a manufacturer of late stage programmable gate array Application Specific Integrated Circuits, or ASICs. The company's innovative, patented technology consolidates wafer manufacture tooling, reduces time-to-market and minimizes the cost of initial production. Headquartered in Santa Clara, California, Chip Express was founded in 1989. Chip Express' total revenues were $16.5 million in 2002, $29.8 million in 2001 and $39.0 million in 2000. In 2002 and during the first half of 2003, Chip Express was and continues to be affected by the slowdown in the semiconductor industry as a result of which its revenues decreased and losses increased during such periods.

Chip Express' modular array solution specifically addresses applications with low-to-medium production volumes. Along with standard cell ASIC vendors, Chip Express primarily addresses the hard-wired ASIC market serving a wide variety of end markets, including automotive, computer, consumer, industrial and communications markets. Chip Express depends upon third-party manufacturers to manufacture its products. Chip Express uses a wide range of parts and raw materials in the production of its semi-conductors, including silicon wafers, processing chemicals and electronic and mechanical components. Chip Express generally does not have guaranteed supply arrangements with its suppliers and does not maintain an extensive inventory of parts and materials for manufacturing.

Chip Express' patented modular array technology is protected by four core patents on its basic architecture, special logic cell and metal configurable memory. In addition, Chip Express has internally developed routing software and metal programmable input/output cells to take advantage of its proprietary technology.

Oren Semiconductor, Inc.

Oren Semiconductor, a privately held Delaware corporation, designs and markets integrated circuits for digital television reception. In particular, Oren designs and markets products that enable reception of rich digital media by consumer appliances, such as digital set-top boxes, digital televisions and personal computers. Oren has developed patented digital signal processing architecture that allows its products to handle the complexities of receiving radio frequency transmissions together with flexibility and programmability. This core technology enables the offering of digital television receiver integrated circuits that combine all the necessary front-end receiver functions to reproduce the digital data transmitted through the air, or by satellite or cable with the support of multiple transmission standards. Oren also has a product that eliminates ghosts generated by reflections from buildings, mountains and trees when receiving analog broadcasting using television equipment. Oren's total revenues were $2.0 million in 2002, $2.5 million in 2001, and $5.6 million in 2000.

3DV Systems Ltd.

3DV Systems Ltd. designs and develops three dimensional image sensors chip sets that generates both color and depth information, for each object captured by the camera, in real time. The technology may be used in variety of applications such as the gaming and automotive markets.

3DV is a development-stage company without any revenues and with limited resources at its disposal. Currently 3DV is experiencing difficulties in raising capital to continue its operations. 3DV's continued operations are largely dependent upon financial support of its shareholders. There is no assurance that 3DV will be able to raise capital from its shareholders or any other party to enable it to continue its operations.

Semiconductor Engineering Laboratories Ltd. (SELA)

SELA develops and manufactures yield enhancing and automation equipment for the semiconductor and optical component industries. SELA is dedicated to the development and marketing of solutions for failure analysis and process monitoring in the semiconductor industry. SELA's automated sample preparation systems are used primarily by semiconductor manufacturers to prepare samples for scanning electron microscopy and transmission electron microscopy. SELA's revenues amounted to $3.5 million in 2002, $3.5 million in 2001 and $7.0 million in 2000.

6. Amorphous Metals

Our activities in the field of amorphous metals consist of our holding in A.M.T Advanced Metal Technologies Ltd., or AMT, in which we hold approximately 28% of the outstanding shares on an as converted basis.

A.M.T. Advanced Metal Technologies Ltd.

AMT, while operating through its group companies, develops, markets and licenses technologies for amorphous and nano-crystalline advance materials, as methods and a solution for a wide range of commercial applications. Amorphous materials exhibit magnetic, electrical, mechanical and chemical properties that enable the enhancement of existing products and applications, as well as the introduction of new products and solutions for various industrial and high-tech applications and markets. AMT operates in four fields: heating, sensoring (authentication and anti-shop lifting), micro wires and electronic elements. AMT's current main focus is in the field of heating through A.H.T. Advanced Heating Technology Ltd., or AHT, and in the sensoring field (authentication and anti-shop lifting) through A.C.S Advanced Coding Systems Ltd., or ACS.

A.H.T. Advanced Heating Technology Ltd.

AHT, in which AMT holds 72% of its outstanding shares, is engaged in the development and production of heating applications based on amorphous materials**.** AHT holds a global patent on using amorphous metals for heating products. AHT has developed a variety of innovative heating products for domestic, under-floor, agricultural and pipe heating markets. AHT's heating element enables the heating of very large surface areas at lower temperatures using less electricity and therefore at a lower cost and presents competitive advantages over other heating alternatives. AHT competes in two principal markets: under floor heating and outdoor heating.

During 2001 and 2002, AHT's revenues were not significant.

A.C.S Advanced Coding Systems Ltd.

ACS, in which AMT holds directly and indirectly 58% of the outstanding shares, develops, markets and sells products using amorphous material for brand protection against counterfeiting and theft and electronic article surveillance tags for anti-shoplifting. Pitkit Printing Enterprises Ltd., an Israeli public company is invested in ACS through an affiliate and has a strategic relationship with ACS. ACS competes in the electronic article surveillance tags and authentication tags markets.

During 2001 and 2002, ACS's revenues were not significant.

The continued operations of AMT's group companies are largely dependent upon their ability to generate sufficient revenues or raise additional capital to finance their continued operations.

Property, plant and equipment

Our corporate headquarters and executive offices are located in Tel-Aviv, Israel. These offices, which measure approximately 3186 square feet, are leased at an annual rent, including management fees, of approximately $0.3 million.

We believe that the above facilities are adequate for our operations as currently conducted. In the event that additional facilities are required, we believe that we could obtain such additional facilities at commercially reasonable prices.

In addition, we have contractual rights to long-term leases in property located in Karmiel, in northern Israel, totaling approximately 15,760 square meters, consisting of building facilities. These premises are currently leased to Elbit Systems. (See "Item 7 – Related Party Transactions".)

Organizational Structure

Discount Investment Corporation, or DIC, an Israeli company holds approximately 38.5% of our total outstanding shares. For additional information about DIC, please see "Major Shareholders" in Item 7 below. For our holdings in our group companies, please see the discussion in this Item 4 above.

Item 5. Operating and Financial Review and Prospects

We are a multi-national high technology operational holding company that operates through our group companies.Our activities range from complete operational control over the business of our group companies to involvement in the management of our group companies in which we maintain controlling or significant holdings, and, in a limited number of cases, minority holdings. We participate in the management of most of our group companies by means of active membership on their boards of directors and board committees. As a result, we are involved in matters of policy, strategic planning, marketing, selecting and manning senior management positions, approving investments and budgets, financing and the overall ongoing monitoring of the companies' performance. In addition to our representation on the boards of directors of our group companies, we provide hands-on assistance to the group companies' management in support of their growth. We view our hands-on involvement in the operations of our group companies as a key element of our business. Our group companies therefore benefit from the experience of our management team in various areas in which they need support and leadership, including, but not limited to, budgetary control, market analysis, risk management, identifying joint venture opportunities, introductions to potential customers and investors, business plan preparation, strategic planning and research and development guidance.

We expect to continue to build and realize value to our shareholders from our group companies and simultaneously pursue the acquisition of, or investment in, new and existing companies. However, as we hold interests in early-stage technology companies, which invest considerable resources in research and development and marketing and which have not reached the income-producing stage, we have experienced, and expect to continue to experience, losses in respect of these companies. Therefore, our net income (or loss) in any given period is due, for the most part, to the results of operations of our group companies and dispositions and changes in our holdings of group companies.

CRITICAL ACCOUNTING POLICIES

For a description of our significant accounting policies see below Item 18. Consolidated Financial Statements - Note 2 ("Significant Accounting Policies").

We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the United States ("US GAAP"). These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, our financial statements will be affected. The significant accounting policies that we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

- Principles of accounting for holdings in group companies
- Merger accounting
- Impairment of goodwill and other intangible assets
- Other-than-temporary decline in investments in group companies
- Revenue recognition
- Accounting for income taxes

Principles of Accounting for Holdings in Group Companies

The various holdings that we have in our group companies are accounted for under several broad methods as described below. The applicable accounting method is generally determined based on our voting interest in the entity.

Consolidation. Companies over which we have control are accounted for under the consolidation method of accounting. Control is usually assumed when we own or our subsidiary owns more than 50% of the outstanding voting securities, however, whether or not we control a group company also depends on an evaluation of several factors, including, among others, our representation on the board of directors, the level of financing provided by us to the group company and any minority rights. Under the consolidation method, a company's assets and liabilities are included within our consolidated balance sheet and its income and expense items are included within our consolidated statements of operations. The share of other shareholders in the net assets and in the net income or losses of a consolidated company is reflected in minority interest in our consolidated balance sheet and in our consolidated statements of operations, respectively. The minority interest amount adjusts our consolidated net income (loss) to reflect only our share in the earnings or losses of the consolidated company.

Equity Method. Group companies which we do not control, but over whom we exercise significant influence, are accounted for under the equity method of accounting. Significant influence is usually assumed when we hold 20% or more of a group company's voting securities, however, whether or not we exercise significant influence with respect to a group company also depends on an evaluation of several factors, including, among others, our representation on the board of directors, agreements with other shareholders, our participation in policy making processes, the existence of material intercompany transactions and technological dependency, the extent of ownership by an investor in relation to the concentration of other shareholdings, and other factors which may require management to make certain judgmental decisions regarding significant influence. We also account for our interests in some private equity funds under the equity method of accounting, based on our holding interest. Under the equity method of accounting, a group company's assets and liabilities are not included within our consolidated balance sheet and their results of operations are not reflected within our consolidated statements of operations; however, our share in the net income or losses of the group company is reflected as an equity income (loss) in our consolidated statements of operations. The share of income or losses is generally based upon our voting ownership of the group company's securities, which may be different from the percentage of the economic ownership of the group company held by us. Notwithstanding the above, 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 effect of a group company's net results of operations on our results of operations is the same under either the consolidation method of accounting or the equity method of accounting, as under each of these methods only our share in the net income or losses of a group company is reflected in our net results of operations in the consolidated statements of operations.

Other Methods. Group companies that we do not account for under either the consolidation or the equity method of accounting are accounted for under three different methods:

- Non-marketable group companies are presented at cost. Under this method, our share in the income or losses of these entities is not included in our consolidated statements of operations.
- Marketable group companies, which are classified as trading securities, are presented at fair market value and the changes in the market value are reflected in our results of operations during each reporting period.
- Marketable group companies which are classified as available-for-sale are presented at fair market value and the effect of any change in market value is reflected in our comprehensive income (loss).

In accordance with APB 18, an investee that was previously accounted for other than under the equity method of accounting may become qualified for use of the equity method of accounting by an increase in the level of ownership. In such cases, the results of operations and retained earnings should be adjusted retroactively under the equity method of accounting ("step-by-step acquisition"). As a result of the DEP share purchase, our interest in Given Imaging, Galil Medical, Witcom and 3DV Systems, in which we had direct and indirect interests through RDC, increased. This enables us to exercise significant influence over these companies and in accordance with APB 18, we have restated our financial statements for all prior periods in which our investments in these companies were not recorded under the equity method of accounting. The aforementioned restatements resulted in increased net losses of approximately $2.5 million, or $0.12 per share, and by a decrease in net income of approximately $1.8 million, or $0.08 per share, for the years ended December 31, 2001 and 2000, respectively.

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

As an operational holding company, we have investments in and loans to various companies that are engaged primarily in the fields of high technology. Most of these companies are in their early stages of development and will require substantial external investments until they can finance their activities without additional support from other parties. These companies are currently primarily funded with financing from venture capital funds, other holding companies and private investors. As described above, we are currently accounting for the investments in these companies either by the consolidation, equity or cost method.

The provisions of this interpretation are to be applied commencing from July 1, 2003, to variable interests in VIEs created before February 1, 2003 and immediately to variable interests in VIEs created after January 31, 2003.

We are currently evaluating the effects of this interpretation in respect of our holding in our group companies. It is likely that some of our investees may be considered VIEs in accordance with the interpretation. Accordingly, when it is determined that we are the primary beneficiary of a VIE, we will be required to consolidate the financial statements of such a VIE with our own financial statements commencing from July 1, 2003. Our maximum exposure to loss to date does not exceed the carrying value of our investment in any of these companies.

Merger accounting

The merger with Elbit has been accounted for as an acquisition under the purchase method of accounting for business combinations. The aggregate purchase price of approximately $74.0 million consisted of 5,617,601 Elron ordinary shares valued at $12.50 per ordinary share, based on the average closing price of Elron’s ordinary shares during the period commencing from the date of the announcement of the exchange ratio and ending five days thereafter, $1.0 million of assumed options and $2.7 million of transaction and integration costs. The purchase price has been allocated to Elbit’s assets based on their estimated fair value according to an analysis made by an independent appraiser. Of the total purchase price, $55.0 million has been allocated to Elbit’s identifiable net assets and the remaining $19.0 million has been allocated to goodwill. The goodwill recorded reflects the anticipated synergies that will result from the combined entity, including anticipated reductions in operational and management costs, the creation of an enhanced platform, a more simplified and efficient organizational structure and greater resources and scope of operations, which will benefit the group companies. At the acquisition date, net deferred tax assets relating to operating loss carryforwards have been fully offset by a valuation allowance. Subsequent to the acquisition date, Elbit recorded a tax benefit in the amount of $6.6 million and reduced its valuation allowance for the deferred tax asset in respect of its operating loss carryforwards (see also, critical accounting policies; Accounting for income taxes). Since the tax benfits recognized were in respect of an operating loss carryforward of Elbit that had accumulated through the acquisition date, we recorded the entire tax benefit as a reduction of goodwill. In accordance with U.S. GAAP, the remaining goodwill, in the amount of $12 million, will not be amortized and is reviewed annually for impairment (or more frequently if impairment indicators arise).

The share purchase of DEP’s shares has been accounted for as an acquisition under the purchase method of accounting for business combinations. The aggregate purchase price of approximately $29.5 million consisted of 2,261,843 ordinary shares of Elron valued at $13.02 per ordinary share, based on the average closing price of Elron’s ordinary shares during a period of few days before and after the announcement date. The purchase price has been allocated to DEP’s assets acquired in the amount of $41.0 million, of which includes $36.0 million are in investments accounted for under the equity method, and liabilities assumed in the amount of $11.6 million. The allocation to DEP’s assets was based on an analysis made by an independent appraiser. Of $36.0 million allocated to investments accounted for under the equity method, an aggregate amount of $16.5 million was allocated to identifiable net intangible assets of the equity investments, with a weighted average amortization period of approximately 11 years, and an aggregate amount of $6.5 million was allocated to goodwill. The amortization of the identifiable intangible assets is included as part of our share in the net losses of equity investments, except for Galil Medical, which is consolidated in our financial statements, and therefore the amortization will be included under “Amortization of intangible assets”.

Determining the fair value of certain assets acquired and liabilities assumed is judgmental in nature and often involves the use of significant estimates and assumptions, mainly with respect to intangible assets. As mentioned above, we obtained appraisals from an independent appraiser in order to assist us in this process. While there were a number of different methods used in estimating the value of intangibles acquired, the primary method used was the discounted cash flow approach. Some of the more significant estimates and assumptions inherent in the discounted cash flow approach include projected future cash flows, a discount rate reflecting the risk inherent in the future cash flows and terminal growth rate. Another area which required judgement was determining the expected useful lives of the intangible assets. As we operate in an industry which is rapidly evolving and extremely competitive, the value of the intangible assets, including goodwill, is exposed to future adverse changes which can result in a charge to our results of operation.

Impairment of Goodwill and Other Intangible Assets

In 2002, Statement of Financial Accounting Standards No. 142, “Goodwill and Other Intangible Assets” (“SFAS 142”) became effective, and as a result, commencing on January 1, 2002, goodwill is no longer being amortized. In lieu of amortization, we performed an initial impairment review of goodwill as of January 1, 2002 and will perform an annual impairment review thereafter at the level of each reporting unit. SFAS 142 prescribes a two-phase process for impairment testing of goodwill. The first phase screens for impairment while the second phase (if necessary) measures the impairment. During 2002, we completed our first phase impairment analysis by estimating the fair value of each reporting unit and comparing it to its reported carrying amount. To determine fair value, we have used a number of valuation methods including quoted market prices, discounted cash flows and revenue multiples. In certain cases we obtained an opinion from an independent appraiser. Based on this comparison for each reporting unit, we found no instances of impairment of our recorded goodwill. As we operate in an industry which is rapidly evolving and extremely competitive, it is possible that our estimates could change in the near term and there can be no assurance that future goodwill impairment tests will not result in a charge to our results of operation. Net goodwill amounted to approximately $21.5 million as of December 31, 2002.

Other intangible assets with definite useful lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If an asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. In the evaluation of impairment, we use significant estimates and assumptions such as projected future cash flows which are subject to high degree of judgment. As we operate in an industry which is rapidly evolving and extremely competitive, changes in the assumptions and estimates may affect the carrying value of the intangible assets, and could result in impairment charge to our results of operation.

Other-Than-Temporary Decline in Investments in Group Companies

At the end of each reported period, we must evaluate whether an other-than-temporary decline in value of an investment in a group company has been sustained. This evaluation is judgmental in nature. If it has been determined that an investment has sustained an other-than-temporary decline in its value, the investment is written down to its fair value by a charge to our results of operations. Such a valuation is dependent upon the specific facts and circumstances. Factors that are considered by us in this determination include the financial condition and prospects of the group company, the value at which independent third parties have invested or have committed to invest and independent appraisals, if available. As we operate in an industry which is rapidly evolving and extremely competitive, it is reasonably possible that our estimates could change in the near term and there can be no assurance that a write-down or write-off of the carrying value will not be required in the future.

Revenue Recognition

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

Income and profit derived from projects related to software development are recognized upon the percentage of completion method, based on estimates of costs to be incurred for the total project. Under this approach, we compare the estimated cost to complete an entire project to the total revenues for the term of the contract to arrive at an estimated gross margin percentage for each project. The estimated gross margin percentage is applied to the cumulative revenue recognized on the project to arrive at cost of revenues for the period. Estimates are reviewed periodically, and the effect of any change in the estimated gross margin percentage for a project is reflected in costs of revenues in the period in which the change becomes known. Provisions for project losses are made when the loss becomes known and quantifiable. A number of internal and external factors affect our cost estimates, including labor rates, revised estimates of uncompleted work, efficiency variances, customer specifications and testing requirements changes. If any of these factors were to change, or if different assumptions are used, our results of operations may be affected.

Accounting for Income Taxes

At the end of each reported period, we are required to estimate our income taxes. This process requires us to estimate our actual current tax liabilities and make an assessment of temporary differences resulting from differing treatment of items, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not likely, we must establish a valuation allowance. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. Our judgment is largely based upon estimates and assumptions with respect to our ability to realize investments by selling holdings in our group companies, which is mainly dependent upon factors such as the condition of the securities market and other general economic conditions. As the securities markets for our group companies are highly volatile, changes in our assumptions and estimates may require us to increase the valuation allowance and therefore we may be required to include an expense within the tax provision in our statement of operations.

In 2002, we reduced our previous valuation allowance by $6.6 million to increase our deferred tax asset in respect of past losses. As mentioned above (See “Merger accounting”), the entire reduction of the valuation allowance was recorded as a reduction of goodwill. In addition, in each of 2002 and 2001, we recorded a tax benefit due to current losses in the amount of $2.9 million. As of December 31, 2002, deferred tax assets amounted to $11.3 million ($7.8 million of which is offset against deferred tax liabilities). This amount represents carry forward losses that are more likely than not to be realized in future years. Deferred tax liabilities amounted, as of December 31, 2002, to $30.2 million (which are offset by $7.8 million deferred tax assets), primarily with respect to our investment in Partner. Changes in the tax liability resulting from the changes in the value of Partner, which is accounted for as available for sale securities, are charged to comprehensive income.

RESULTS OF OPERATIONS

Basis of Presentation

Consolidation. Our consolidated financial statements include the following main subsidiaries:

Year ended December 31,		
2002	**2001**	**2000**
Elron Software	Elron Software	Elron Software
Elron Telesoft	Elron Telesoft	Elron Telesoft
Elbit[1]		
DEP[1]		
RDC[1]		
Galil Medical[2]		
MediaGate[2]		

[1] Since May 2002, following the completion of the Elbit merger and DEP share purchase

[2] Since July 2002

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

Year ended December 31,					
2002		2001		2000	
Elbit Systems	Pulsicom	Elbit Systems	Given Imaging[3]	Elbit Systems	Given Imaging[3]
Elbit[1]	AMT[4]	Elbit	Galil Medical[3]	Elbit	Galil Medical[3]
NetVision	Given Imaging[3]	NetVision	Witcom[3]	NetVision	Witcom[3]
MediaGate[2]	Galil Medical[2,3]	Chip Express	Pulsicom	Chip Express	3DV[3]
Chip Express	Witcom[3]	DEP	3DV[3]	DEP	
DEP[1]	3DV[3]	Wavion		Wavion	
Wavion	Cellenium[5]	KIT		KIT	
KIT	CellAct	MediaGate		MediaGate	

1 Through May 2002, prior to the completion of the Elbit merger and DEP share purchase

2 Through July 2002

3 Restated (see "Critical Accounting Policies- Principles of Accounting for Holdings in Group Companies")

4 Since August 2002

5 Through November 2002

Year Ended December 31, 2002 compared to Year Ended December 31, 2001

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

	Year ended December 31,	
	2002	2001*
	(millions of $, except per share data)	
Net loss	39.3	50.8
Net loss per share	1.5	2.4

* Restated (see "Critical Accounting Policies - Principles of Accounting for Holding in Group Companies")

Our net loss in 2001 adjusted to exclude amortization expenses related to goodwill that is no longer being amortized commencing January 1, 2002 in accordance with SFAS 142 was as follows:

	Year ended December 31,	
	2002	2001*
	(millions of $, except per share data)	
Net loss	39.3	49.2
Net loss per share	1.50	2.33

* Restated (see "Critical Accounting Policies - Principles of Accounting for Holding in Group Companies")

Pro forma net loss, which gives effect to the merger with Elbit, the share purchase of DEP and the acquisition of a controlling interest in Galil and in MediaGate as if these transactions had occurred at the beginning of each reporting period presented, was as follows:

	Year ended December 31,	
	2002	2001
	(millions of $, except per share data)	
Pro forma Net loss	52.4	90.2
Pro forma Net loss per share	1.8	3.1

The general slowdown in spending for technology products continues to affect the results of operations of our group companies, which continue to report net losses. The current economic conditions continue to limit our ability to successfully "exit" some of our group companies and to record capital gains. However, as reflected in the pro forma information, we reported a significant decrease in our pro forma net loss, primarily as a result of the following: (i) the decrease, net, of approximately $10.1 million in losses with respect to certain companies from which we divested; (ii) the decrease, net, in the operating losses of certain of our subsidiaries and the decrease in our share in the losses of our affiliated companies in the aggregate amount of approximately $20.7 million, mainly due to the restructuring plans and cost reduction programs taken by most of our group companies during 2002, which enabled these companies to reduce their losses notwithstanding the adverse economic and market conditions; and (iii) significant reduction in corporate costs of $4.0 million.

Reportable Segments

Our reportable segments are (i), the Internet products segment - Elron Software; (ii) the systems and projects segment - Elron Telesoft; and (iii) Other holdings and the corporate operations, which includes our holdings in subsidiaries, affiliates and other companies, engaged in various fields of advanced technology, and the corporate operations, which provide strategic and operational support to our group companies.

For the reported periods, our main group companies were classified into the following segments:

	Internet product	**Systems and projects**	**Other holdings and the corporate operations**
Consolidated	Elron Software	Elron Telesoft	Elbit; DEP; RDC; Galil Medical and MediaGate; Elbit Systems;
Equity basis			NetVision; Chip Express; Wavion; KIT; Pulsicom; Given Imaging; Witcom Ltd.; 3DV; Cellenium; CellAct; and AMT
Non-marketable securities presented at cost			Oren Semiconductor
Marketable securities presented as available-for-sale			Partner Communications Company; 24/7 Real Media

Consolidated Results

The following table reflects our consolidated data by reported segments:

	Internet Products – Elron Software	Systems and Projects – Elron Telesoft	Other holdings and the corporate operations	Consolidated
	(millions of $)			
	Year ended December 31, 2002			
Income**	8.3	10.1	(10.7)	7.7
Costs and Expenses	16.9	15.9	17.1	49.9
Net loss	(8.6)	(5.9)	(24.8)	(39.3)
	Year ended December 31, 2001			
Income**	9.1	23.6	(28.7)*	4.0*
Costs and Expenses	19.5	38.1	0.5	58.1*
Net loss	(10.4)	(15.3)	(25.1)*	(50.8)*

* Restated (see "Critical Accounting Policies - Principles of Accounting for Holding in Group Companies")

** With respect to the Other Holdings and Corporate Operations Segment, this includes net losses from equity investments.

Internet Products - Elron Software

The following table sets forth the operating results of Elron Software:

	Year ended December 31, 2002	Year ended December 31, 2001
	(millions of $)	
Revenues	8.3	9.1
Cost of revenues	0.9	1.0
Gross profit	7.4	8.1
Operating expenses*	14.0	15.7
Amortization of intangible assets	1.0	1.3
Restructuring charges, net	0.6	1.0
Operating loss	(8.2)	(9.9)
Finance expenses, net	0.4	0.5
Net loss	(8.6)	(10.4)

* Excluding amortization of intangible assets and restructuring charges, net, in the amount of $1.6 million and $2.3 million in 2002 and 2001, respectively, which are presented separately.

Revenues. Elron Software's net revenues decreased by $0.8 million, or 9%, from $9.1 million in 2001 to $8.3 million in 2002. The decrease was primarily due to increased competition in the web access monitoring market and the continued economic slowdown, which continues to cause customers to delay or postpone purchases of IT products. The ability of Elron Software to increase its revenues in the near future is dependent upon general economic conditions and, in particular, on an increase in IT spending and whether its efforts to bring enhanced and new products to market are successful.

Cost of revenues. Elron Software's cost of revenues was $1.0 million in 2001 and $0.9 million in 2002, representing a gross margin of 89% for both years.

The decrease in the amortization of intangible assets reflects the adoption of SFAS 142, according to which goodwill is no longer being amortized.

In response to the prolonged economic downturn, and, in particular, the slowdown in IT spending, Elron Software undertook restructuring programs in 2001 and 2002 in order to reduce expenses and improve efficiency. Restructuring charges in 2001 amounted to $1.0 million, of which $0.4 million was with respect to workforce reductions of approximately 40 employees, mainly in the sales and marketing division, and $0.6 million were facilities related expenses, including fixed asset write-offs associated with vacated facilities. Due to the continuation of the slowdown in IT spending in 2002, Elron Software implemented additional restructuring programs in 2002. Restructuring charges in 2002 amounted to $0.6 million which included primarily $0.4 million in respect of workforce reductions of approximately 28 employees, across all functions of the organization, in order to further adjust Elron Software's operations to the current economic conditions.

Operating loss. Elron Software's operating loss decreased by $1.7 million, or 17%, from $9.9 million in 2001 to $8.2 million in 2002. The decrease in losses was a result of a decrease in operating expenses (excluding amortization of intangible assets and restructuring charges, net) in the amount of $1.7 million, or 11%, from $15.7 million in 2001 to $14.0 million in 2002, which resulted from the restructuring and cost reduction programs implemented by Elron Software during 2001 and 2002.

Elron Software continues to incur operating losses which draws upon its financial resources. Elron Software's ability to further decrease operating losses and reach breakeven is dependent upon its ability to increase its revenues in 2003.

Systems and Projects - Elron TeleSoft

The following table sets forth the operating results of Elron Telesoft:

	Year ended December 31,	
	2002	**2001**
	(millions of $)	
Net revenues	10.1	23.8
Cost of revenues	8.0	21.1
Gross profit	2.1	2.7
Operating expenses*	4.3	10.6
Amortization of intangible assets	0.8	2.4
Restructuring charges, net	1.3	1.2
Operating loss	(4.3)	(11.5)
Finance expenses, net	1.5	2.8
Other expenses, net	—	0.2
Tax provision	0.1	0.8
Net loss	(5.9)	(15.3)

* Excluding amortization of intangible and restructuring charges, net, in the amount of $2.1 million and $3.6 million in 2002 and 2001, respectively, which are presented separately.

Revenues. Elron Telesoft's net revenues decreased by $13.7 million, or 58%, from $23.8 million in 2001 to $10.1 million in 2002. The decrease resulted in part from a $12.8 million decrease in revenues due to the sale of non-core activities of Elron TeleSoft during the second half of 2001 as part of its restructuring program to focus its operations on core areas of its business - the development and marketing of products to the telecommunications market. The balance of the decrease of $0.9 million resulted from reduced sales of products and services to the telecommunications market due to a slowdown in telecom capital expenditures as well as longer sales cycles as telecom service providers postponed purchase decisions. The ability of Elron TeleSoft to increase its revenues in the near future is dependent upon general economic conditions and, in particular, on an increase in telecom capital expenditure and whether its efforts to bring enhanced and new products to market are successful.

Cost of revenues. Cost of revenues of Elron TeleSoft in 2002 were $8.0 million, representing a gross margin of 21%, compared to $21.1 million in 2001, representing a gross margin of 11%. The increase in gross margin resulted mainly from higher efficiencies due to the restructuring program, including a reduction in the workforce which, the company undertook during 2001 and 2002.

The decrease in the amortization of other assets reflects the adoption of SFAS 142, according to which goodwill is no longer being amortized, as well as the decrease in intangible assets associated with activities sold during 2001 and 2002.

Elron Telesoft recorded restructuring charges of $1.3 million in 2002 and $1.2 million in 2001. As part of the restructuring programs, Elron TeleSoft sold in the third quarter of 2001 certain non-core activities in the e-business field to Forsoft Multimedia Solutions Ltd. in consideration for $3.4 million and in January 2002, it completed the sale of its remaining non-core activities in the government field to Elbit Systems for $5.7 million. These transactions resulted in a loss of $0.2 million in 2001 and $0.3 million in 2002. Elron TeleSoft's restructuring charges also included $0.5 million in 2002 and $0.4 million in 2001 with respect to workforce reductions of 65 employees in 2002 and 77 employees in 2001. Facilities related expenses in 2001 amounted to $0.7 million which included $0.4 million termination cost of a facility lease. In 2002, facilities related expenses amounted to $0.5 million resulting mainly from the consolidation of excess facilities that involved the write-off of leasehold improvements in the vacated facilities.

Operating Loss. Elron Telesoft's operating loss decreased by $7.2 million, or 63%, from $11.5 million in 2001 to $4.3 million in 2002. The decrease in losses was a result of a decrease in operating expenses (excluding amortization of intangible assets and restructuring charges) in the amount of $6.3 million, or 59%, from $10.6 million in 2001 to $4.3 million in 2002, which resulted from the restructuring and cost reduction programs implemented by Elron Telesoft which included the sale of non-core activities.

Finance expenses. Finance expenses decreased by $1.3 million, or 46%, to $1.5 million in 2002 from approximately $2.8 million in 2001. The decrease in finance expenses is primarily attributed to the decrease in interest rates. The majority of finance expenses are due to loans associated with the purchase of the main operations and net assets of Network, Communications and Computer Systems (NCC) Ltd. by Elron Telesoft in 1998.

Other Holdings and the Corporate Operations segment

Other holdings and the corporate operations segment includes our holdings in subsidiaries, affiliates and other companies, engaged in various fields of advanced technology, and the corporate operations, which provide strategic and operational support to the group companies.

The following table sets forth this segment operating results:

	Year ended December 31,	
	2002	2001*
	(millions of $)	
Revenues	5.1	—
Net loss from equity investments	(21.9)	(27.2)
Gain from disposal and changes in holdings in related companies, net	6.9	3.2
Other income, net	(0.8)	(4.7)
Total Income	(10.7)	(28.7)
Cost of revenues	2.7	—
Operating expenses**	15.3	5.1
Amortization of intangible assets	0.2	—
Restructuring charges, net	0.4	—
Finance income, net	(1.5)	(4.6)
Total cost and expenses	17.1	(0.5)
Loss from continuing operations before tax benefit	(27.8)	(29.2)
Tax benefit	3.0	3.7
Minority Interest	2.8	0.4
Loss from continuing operations	(22.0)	(25.1)
Loss from discontinued operations	2.8	—
Net loss	(24.8)	(25.1)

* Restated (see "Critical Accounting Policies - Principles of Accounting for Holding in Group Companies")

** Excluding amortization of intangible assets and restructuring charges, net, in the amount of $0.6 million in 2002, which are presented separately.

Income

Revenues

Net revenues of the Other Holdings and the Corporate Operations segment consisted of sales of products and services by our subsidiaries, Galil Medical and MediaGate, which were consolidated for the first time in 2002.

The following table sets the segment revenues:

	Year ended December 31,	
	2002	2001
	(millions of $)	
Galil Medical	3.0	—
MediaGate	2.1	—
	5.1	—

Galil Medical recorded revenues of $5.0 million in 2002 (of which $3.0 million were in the second half of 2002 and were consolidated within our consolidated revenues) compared to $2.8 million in 2001. The increase in revenues is mainly due to increased penetration in the US market. The majority of the revenues derived from sales of disposable products.

MediaGate's revenues amounted to $2.6 million in 2002 (of which $2.1 million were in the second half of 2002 and were consolidated within our consolidated revenues) compared to $0.7 million in 2001. MediaGate develops and markets advanced messaging systems. The increase in revenues is mainly due to large projects received from mobile operators mainly in the Far East. MediaGate's revenues and operating results have been and will continue to be affected by the slowdown in the telecommunications market as well as by competition from more established companies.

Share in net losses of affiliated companies

Our share in net losses of affiliated companies resulted from our holdings in certain investments that are accounted for under the equity method (see above under "Basis of Presentation"). The share in net losses of affiliated companies amounted to $21.9 million in 2002 compared to $27.2 million in 2001. The decrease in our share in net losses of our affiliated companies in 2002 resulted mainly from Elbit and DEP ceasing to be equity method investments from the date of completion of the Elbit merger and the DEP share purchase, respectively. Elbit and DEP accounted for $19.1 million of equity losses in the full year of 2001 compared to $9.6 million in the period through the completion of both transactions in 2002. In addition, our share in Wavion's losses decreased in 2002 as a result of the decrease in Wavion's net loss.

The above decrease was partially offset mainly as a result of the increase in our share of the net losses of Galil Medical (which was accounted under the equity method through July 2002), Given Imaging, 3DV and Cellenium as a result of the merger with Elbit and the share purchase of DEP, and the increase in the losses of Chip Express.

Highlights of the Results of Operations of Our Major Affiliates:

Elbit Systems Ltd. Our share in net earnings of Elbit Systems amounted to $9.5 million in 2002 compared to $9.1 million in 2001.

The following are highlights of the results of operations of Elbit Systems:

- Elbit Systems' revenues increased from $764.5 million in 2001 to $827.5 million in 2002. As of December 31, 2002, Elbit Systems' backlog of orders was $1,689 million, of which approximately 79% was scheduled to be performed in 2003 and 2004 compared to a backlog of orders of $1,566 million on December 31, 2001. The increase in Elbit Systems' revenues in 2002 resulted mainly from the increase in sales of airborne and command, control, communication, computers, intelligence, surveillance and reconnaissance systems.

- Elbit Systems' operating income in 2002 was $57.8 million (7% of revenues) compared to $53.7 million in 2001 (7% of revenue).

- Elbit Systems' net income in 2002 was $45.1 million (5.5% of revenues) compared to a net income of $40.8 million (5.3% of revenues) in 2001. Elbit Systems' net income in 2002 included $9.8 million non-recurring charge, before tax, in connection with

Elbit Systems' agreement to repay the Office of the Chief Scientist of the Israeli Ministry of Industry and Trade ("OCS") an agreed amount of $10.6 million in exchange for a release by the OCS from all obligations to pay royalties in the future. The abovementioned non-recurring charge was offset by $2.8 tax adjustment as a result of the completion of tax assessments for prior years in various tax jurisdictions as well as adjustment of estimated taxes. Elbit Systems' net income in 2001 included the effect of $9.1 million, before tax, of share price linked compensation expenses. In 2002 the expenses related to share price linked compensation were not material.

Given Imaging. Given Imaging recorded revenues of $28.9 million in 2002, compared to $4.7 million in 2001, and a gross profit of 59% of revenues, compared to 48% in 2001. 2002 represented the first full year of sales for Given Imaging following FDA clearance of its product in August 2001. Given Imaging's net loss in 2002 was $18.3 million compared to $18.7 million in 2001.

NetVision. NetVision's net income in 2002 amounted to $2.8 million compared to a net loss of $3.6 million in 2001. The shift from a net loss in 2001 to a net income in 2002 was primarily due to a restructuring program implemented by NetVision, which included cost reduction programs which resulted in decrease in NetVision's operating expenses in 2002 by $8.5 million, or 14%, from $61.6 million in 2001 to $53.1 million in 2002. NetVision's revenues decreased in 2002 by $2.5 million, or 4%, from $58.9 million in 2001 to $56.4 million in 2002 mainly due to the intensive competition in gaining broadband communication market share and due to the economic slowdown affecting business and corporate spending. At the end of 2002, NetVision has a customer base of approximately 340,000 (compared to 330,000 at the end of 2001).

NetVision expects that its revenues in 2003 will be affected by the transition of customers to broadband communication from narrow-band dial-up connections and by the increased competition which will result in lower prices.

Wavion. Wavion recorded a net profit in the second half of 2002 of $0.2 million and a net loss in the full year 2002 of $0.6 million compared to a net loss of $3.4 million for the full year 2001. In light of the downturn in the broadband wireless communications market which delayed the release of Wavion's products, Wavion significantly reduced its research and development expenses and began to sell subcontracting services for the development of wireless sub-systems, recording revenues of $1.7 million in 2002. The increase in revenue enabled Wavion to record a net profit in the second half of 2002.

KIT. KIT's net losses in 2002 amounted to $5.2 million compared to $3.0 million in 2001, mainly as a result of an increase of $1.3 million in marketing and sales expenses as KIT expanded its sales efforts mainly in Holland and in the United Kingdom. As a result of these efforts, KIT generated revenues of $2.6 million in 2002 compared to $1.0 million in 2001. At the end of 2002, KIT had approximately 1,000 students, mainly from Holland and United Kingdom.

Witcom. Witcom recorded revenues of $5.0 million in 2002 compared to $4.4 million in 2001. Witcom's revenues were affected by the slowdown in the telecommunications industry. Witcom's net loss in 2002 was $5.5 million compared to $6.9 million in 2001. The decrease in net losses resulted from a cost reduction program implemented by Witcom beginning in 2001. Witcom's revenues and operating results have been and will continue to be affected by the slowdown in the telecommunications industry.

Pulsicom. Pulsicom commenced its operations in 2001. In 2002, its net losses amounted to $0.8 million, consisting mainly of research and development costs, compared to $1.0 million in 2001. Pulsicom is expecting to complete its first prototype and commence field tests during 2003 and therefore sales are not anticipated to commence before 2004.

Chip Express. Chip Express continued to be affected in 2002 by the slowdown in the semiconductor industry and its revenues decreased by $13.3 million, or 45%, from $29.8 million in 2001 to $16.5 million in 2002. Operating expenses in 2002 decreased by $8.4 million, or 27%, to $22.7 million from $31.1 million in 2001, mainly due to the implementation of a cost reduction program. However, due to larger decrease in revenues, Chip Express' net losses in 2002 increased to $6.4 million compared to $1.6 million in 2001. Chip Express expects that the introduction of new products will contribute it to increase its revenues in the second half of 2003.

During 2002, Chip Express raised $16.5 million from investors of which we invested $5.0 million. Consequently, our ownership percentage in Chip Express decreased from approximately 35% to approximately 33%. The amount raised is expected to be used for research and development, to expand global marketing activities and to increase Chip Express' sales efforts. At the end of 2002, Chip Express had $12.7 million in cash and cash equivalents.

3DV. 3DV recorded net losses of $5.1 million in 2002 compared to $7.6 million in 2001. The decrease in 3DV's net losses was the result of restructuring and cost reduction programs. 3DV is a development stage company and its future revenues are largely dependent on the demand for three dimensional applications, such as the three-dimensional video games.

A.M.T. Advanced Metal Technology ("AMT"). Since Elron's investment in the company in August 2002, two of AMT's operating companies, namely A.H.T. Advanced Heating Technologies ("AHT") and A.C.S. Advanced Coding Systems ("ACS") started to introduce their products to the market and had recorded initial sales of few hundred thousand dollars. Both companies have built up their operating and manufacturing infrastructure and completed staffing the management positions. 2003 will be the first full year of revenues for AHT and ACS offering their products based on amorphous metals technology to the worldwide market.

Despite the decrease in our share in the net losses of our group companies, we expect that most of our group companies will continue to recognize losses in 2003, as most of them have not yet generated significant revenues. Therefore, they will continue to negatively affect our results of operations.

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

In addition to companies accounted for under the equity method, we have several significant investments in companies which we account for on a cost basis or as available-for-sale and whose results do not affect our results of operations. These significant investments mainly include our holding in Partner (Nasdaq: PTNR) through Elbit, which is accounted for as available-for-sale securities, and Oren Semiconductor, which is presented at cost.

Partner. At December 31, 2002, the market value of our investment in Partner amounted to $78.6 million. In 2002, Partner reached a significant milestone, as it became a profitable company and generated free cash flow from operations for three consecutive quarters. The following are highlights of the results of operations of Partner for 2002 based on the shekel-dollar rate of exchange as of December 31, 2002 of NIS 4.737:

- Partner's revenues for 2002, driven primarily by subscriber growth of 26%, increased by 25% to $855.9 million from $685.9 million in 2001. Partner's subscriber base at the end of 2002 was 1,837,000 compared to 1,458,000 at the end of 2001.
- Partner's operating income for 2002 increased to $112.6 million from $21.7 million in 2001, an increase of 418%. Operating income in 2002, as a percentage of revenues, reached 13% as compared to 3% in 2001.
- Partner's net income for 2002 was $17.8 million compared to a net loss of $64.0 million for 2001.
- Partner has a line of credit agreement with a consortium of banks that provides for borrowings of up to $710 million. As of December 31, 2002, $519 million was outstanding under this facility. The line of credit is guaranteed by shares held by the original shareholders of Partner, pro rata to their respective holdings. In connection with this guarantee, we have pledged approximately 15.9 million of our shares of Partner representing, as of June 2, 2003, approximately 85% of our total holdings of Partner, in favor of a consortium of banks.
- Partner expects revenue growth in 2003 to be slowed by lower subscriber growth as a result of a more penetrated market, the reduction in incoming rates mandated by the regulator, increasing competition and the economic slowdown in its industry.

Oren Semiconductor. During 2002, we invested $2.5 million in Oren by way of bridge loans, bringing the book value of our holding in Oren at December 31, 2002 to $8.0 million compared to $5.5 million at December 31, 2001.

In 2002, Oren's revenues were $2.0 million compared to $2.5 million in 2001. Operating expenses in 2002 decreased to $7.1 million from $9.1 million in 2001, mainly due to the decrease in research and development costs as a result of cost reduction programs. Oren's net loss in 2002 was $8.7 million compared to $8.6 million in 2001.

Gains from Sale of Shares and Changes in Holdings in Related Companies.

Our gains from the sale of shares and changes in our holdings in related companies amounted to $6.9 million in 2002 compared to $3.2 million in 2001. The gain in 2002 resulted primarily from a $5.3 million gain from the sale of approximately 98,700 and 672,800 shares of Given Imaging held by Elron and RDC, respectively. As a result, our direct and indirect holdings in Given Imaging decreased to 18.3%. In addition, a gain of $1.8 million resulted from the sale of 380,000 shares of Elbit Systems in the fourth quarter of 2002. Gains in 2001 included an approximately $3.0 million gain from the sale of 380,000 shares of Elbit Systems.

Our ability to record future gains from the disposition of and changes in holdings in our group companies will be affected by the financial market conditions in future periods.

Other Income, net. Other income, net, of the Other Holding Corporate Operation segment amounted to a loss of $0.8 million in 2002 compared to a loss of $4.7 million in 2001. The loss in 2002 included mainly a $1.1 million decrease in the price of marketable securities of Cisco (Nasdaq: CSCO) and Elbit Vision Systems (Nasdaq: EVSN) which were mainly offset by $0.7

million gains from the sale of marketable securities, primarily of NetManage (Nasdaq: NETM). The loss in 2001 resulted primarily from a $5.8 million decrease in the market value of BroadBase Software's and Kana Communication's (Nasdaq: KANA) shares, which we subsequently received in exchange for BroadBase Software's shares following the acquisition of BroadBase Software by Kana, and a $1.0 million write-down in the market value of the shares of ArelNet (TASE: ARNT). The loss in 2001 was partially offset by a $1.0 million gain from the sale of the remaining shares of Zoran Corporation (Nasdaq: ZRAN) during the first quarter of 2001 and a $1.2 million gain from the sale of shares of Kana during the fourth quarter of 2001.

See "Market Risk" for information regarding our exposure to changes in prices of marketable securities held by us at the end of 2002.

Expenses

Cost of revenues. Cost of revenues consisted primarily of expenses related to salaries and hardware associated with delivering products and services of our subsidiaries, Galil Medical and MediaGate, which were consolidated for the first time in the second half of 2002. Cost of revenues of Galil Medical and MediaGate in the second half of 2002 was $2.7 million.

Operating Expenses. Operating expenses are comprised of research and development expenses, sales and marketing and general and administrative expenses of Elron's and RDC's corporate operations and of our subsidiaries, mainly Galil Medical and MediaGate, which were consolidated for the first time during 2002. The following table sets forth the segment operating expenses. The operating expenses presented in the table below exclude restructuring expenses and amortization of other assets, in the amount of $0.6 million in 2002 which also constitute part of operating expenses under U.S. GAAP but for presentation purposes are included as a separate item:

	Year ended December 31,	
	2002	**2001**
	(millions of $)	
Corporate	6.1	5.1
Galil Medical	7.4	—
MediaGate	1.8	—
	15.3	5.1

Our corporate operating costs increased by $1.0 million, or 20%, to $6.1 million in 2002 from approximately $5.1 million in 2001. Since the merger with Elbit, corporate operating costs reflect the costs of the combined management.

Operating expenses of Galil Medical in 2002 were $13.0 million, of which $7.4 million was reported in the second half of 2002, compared to $9.4 million in 2001. Galil Medical's operating loss in 2002 amounted to $9.8 million compared to $7.8 million in 2001. The increase in Galil Medical's operating loss in 2002 is mainly due to increased selling and marketing expenses resulting from its effort to penetrate the market in the United States. The increase in operating expenses was partially offset by the increase in Galil Medical's revenues.

Operating expenses of MediaGate in 2002 were $4.2 million, of which $1.8 million was reported in the second half of 2002, compared to $9.1 million in 2001. MediaGate's operating loss in 2002 amounted to $3.6 million compared to $8.8 million in 2001. The decrease in the operating loss of MediaGate resulted primarily from increased revenues and the decrease in operating expenses due to cost reduction programs implemented by MediaGate.

Amortization of Other Assets. Amortization of other assets in 2002 in the amount of $0.2 million related to the excess costs in the acquisition of a controlling interest in Galil Medical and MediaGate which were attributed to these companies' other identifiable assets.

Restructuring Charges. In connection with the merger with Elbit, restructuring charges in the amount of $0.4 million were recorded which included mainly fixed asset write-offs associated with Elbit facilities which were vacated as a result of the consolidation of Elron and Elbit facilities.

Finance Expenses, net. Finance expenses, net, in the corporate operations and other holdings segment amounted in 2002 to income of $1.5 million compared to $4.6 million in 2001. The decrease is attributed mainly to the corporate operations and is a result of the decrease in interest rates and the decrease in our cash resources which were used mainly for investment purposes.

Gain or loss from Discontinued Operations. As part of VFlash's restructuring program in response to a slowdown in the market for Internet value added services, in September 2002 VFlash sold most of its operating assets to 24/7 Real Media, or 24/7, in exchange for 4,100,000 shares of 24/7 common stock. The market value of these shares on September 23, 2002 was $1.6 million, based on the then closing price per share of 24/7. In conjunction with the above sale, we invested $1.0 million in 100,000 shares of 24/7 convertible preferred stock convertible into 48.40271 shares of common stock for each share of preferred stock. The convertible preferred stock was converted into 4,840,271 shares of common stock in February 2003. As a result of the above mentioned sale, we recorded a gain of $2.0 million. This gain was offset by the net loss of VFlash in the amount of $1.9 million.

Also included in this item is our share in the net losses of Textology which was sold, with no gain recognized, during 2002 and the net loss of ICC, in the aggregate amount of $2.9 million.

Year Ended December 31, 2001 compared to Year Ended December 31, 2000

The figures of 2001 and 2000 were restated as a result of the DEP share purchase which was completed on May 2002 - See Critical Accounting Policies – Principles of Accounting For Holdings in Group Companies.

The following tables set forth our results of operations in the reported periods (as restated):

	Year ended December 31,	
	2001*	**2000***
	(millions of $, except per share data)	
Net income (loss)..	(50.8)	28.5
Net income (loss) per share	(2.40)	1.35

* Restated (see "Critical Accounting Policies - Principles of Accounting for Holding in Group Companies").

The general slowdown in spending for technology products due to adverse economic conditions in 2001 affected the results of operations of our group companies. This has limited our ability to successfully exit some of our group companies and to record capital gains. While in 2000 we were positively affected by our sale of Zoran's shares, the merger of Elbit Systems with El-Op and by our share in Elbit's gains from the sale of its holding in Peach Networks and the sale of the assets of its subsidiary HyNEX Ltd., in 2001, we were negatively affected by the net losses of our subsidiaries, Elron Software and Elron TeleSoft, and our share in the net losses of Elbit and our other affiliated companies.

In view of the adverse economic conditions, Elron Software and Elron TeleSoft, as well as other companies in our group implemented restructuring programs in order to focus their operations, reduce their operating expenses and assist them meeting these challenging market conditions.

The following table reflects our consolidated data by reported segments:

	Internet Products – Elron Software	**Systems and Projects – Elron Telesoft**	**Other holdings and the corporate operations**	**Adjustments**	**Consolidated**
			(millions of $)		
			Year ended December 31, 2001		
Income**	9.1	23.6	(28.7)*	—	4.0*
Costs and Expenses	19.5	38.1	0.5	—	58.1
Net loss	(10.4)	(15.3)	(25.1)*	—	(50.8)*
			Year ended December 31, 2000		
Income**	12.1	27.2	60.8*	(0.1)	100.0*
Costs and Expenses	23.8	43.2	(3.4)	(0.1)	63.5
Net loss	(11.7)	(16.0)	56.2*	—	28.5*

* Restated (see "Critical Accounting Policies - Principles of Accounting for Holding in Group Companies")

** With respect to the Other Holdings and Corporate Operations Segment, this includes net losses from equity investments.

Internet Products - Elron Software

The following table sets forth the operating results of Elron Software:

	Year ended December 31,	
	2001	**2000**
	(millions of $)	
Revenues	9.1	12.1
Cost of revenues	1.0	1.2
Gross profit	8.1	10.9
Operating expenses*	15.7	21.5
Amortization of intangible assets	1.3	0.5
Restructuring charges, net	1.0	—
Operating loss	(9.9)	(11.1)
Finance expenses, net	0.5	0.6
Net loss	(10.4)	(11.7)

* Excluding amortization of intangible assets and restructuring charges, net, in the amount of $2.3 million and $0.5 million in 2001 and 2000, respectively, which are presented separately.

Revenues. Elron Software's net revenues decreased by $3 million, or 25%, from $12.1 million in 2000 to $9.1 million in 2001. The decrease was primarily due to the economic slowdown, which caused customers to delay or postpone purchases of IT products. In addition, in 2001, almost all of Elron Software's revenues were derived from its Internet Policy Management products as a result of its reduced marketing efforts for its legacy products. In 2000, revenues from legacy products amounted to $1.2 million.

Cost of revenues. Cost of revenues decreased by $0.2 million, or 17%, to $1.0 million in 2001, representing a gross margin of 89%, from $1.2 million in 2000, representing a gross margin of 90%, as a result of the decrease in revenues.

Amortization of intangible Assets. Amortization of other assets amounted to approximately $1.3 million and $0.5 million in 2001 and 2000, respectively. As provided by SFAS 142 "Goodwill and Other Intangible Assets", commencing January 2002, Elron Software no longer amortizes goodwill. Had SFAS 142 been adopted on January 1, 2001 and on January 1, 2000, Elron Software would not have recorded amortization of goodwill and other intangible asset of approximately $0.2 million and $0.1 million, respectively.

Restructuring Charges. Elron Software undertook a restructuring program in response to adverse economic conditions, and, in particular, the slowdown in IT spending, in order to reduce expenses and improve efficiency. These restructuring programs mainly included workforce reductions as detailed above and facilities related expenses. In connection with these programs, Elron Software recorded restructuring charges of $1.0 million in 2001. These charges include employee termination costs of $0.4 million which were paid in 2001. Facilities related expenses amounted to $0.6, million of which $0.3 million expected to be incurred to sublet the facilities, and $0.3 million write-off of leasehold improvements, which were vacated as a result of the consolidation of excess facilities was written off.

Operating loss. Elron Software's operating loss decreased by $1.2 million, or 11%, from $11.1 million in 2000 to $9.9 million in 2001. The decrease in losses was a result of a decrease in operating expenses (excluding amortization of other assets and restructuring charges, net) in the amount of $5.8 million, or 27%, from $21.5 million in 2000 to $15.7 million in 2001. The decrease resulted primarily from the restructuring of Elron Software's sales and marketing operations and decreases in general and administrative expenses. The restructuring programs included a reduction of 40 employees, of which 24 were mainly from enterprise sales, sales support and from the marketing group due to the decision at the beginning of the second quarter of 2001 to transition Elron Software from a direct to an indirect sales model, utilizing value added resellers and distributors, and nine employees from its headquarters. This resulted in a $3.0 million savings in salaries and related expenses in 2001. In addition, as part of the cost reduction initiatives, certain sales and marketing campaigns were reduced, resulting in savings of $0.4 million in marketing programs.

Finance expenses, net. Finance expenses, net decreased by $0.1 million, or 17%, to $0.5 million in 2001 from approximately $0.6 million in 2000. The decrease in finance expenses was attributable to a decrease in interest rates.

Systems and Projects - Elron TeleSoft

The following table sets forth the operating results of Elron Telesoft:

	Year ended December 31,	
	2001	**2000**
	(millions of $)	
Net revenues	23.8	27.2
Cost of revenues	21.1	25.3
Gross profit	2.7	1.9
Operating expenses*	10.6	10.8
Amortization of intangible assets	2.4	2.7
Restructuring charges, net	1.2	—
Operating loss	(11.5)	(11.6)
Finance expenses, net	2.8	4.4
Other expenses, net	0.2	—
Tax provision	0.8	—
Net loss	(15.3)	(16.0)

* Excluding amortization of intangible assets and restructuring charges, net, in the amount of $3.6 million and $2.7 million in 2001 and 2000, respectively, which are presented separately.

Revenues. Elron Telesoft's net revenues decreased by $3.4 million, or 13%, from $27.2 million in 2000 to $23.8 million in 2001. The decrease resulted primarily from the sale of non-core activities of Elron TeleSoft as part of its restructuring program to focus its operations on core areas of its business, which is the development and marketing of products to the telecommunication market.

Cost of revenues. Cost of revenues decreased by $4.2 million, or 17%, to $21.1 million in 2001, representing a gross margin of 11%, from $25.3 million in 2000, representing a gross margin of 7%, as a result of the decrease in revenues. The improvement in Elron TeleSoft's gross margin rate was a result of the restructuring program it was undergoing, which included workforce reductions of approximately 50 employees, primarily at the end of the second quarter of 2001, resulting in savings of $2.2 million in salaries and related expenses.

Amortization of intangible Assets. Amortization of other assets amounted to approximately $2.4 million and $2.7 million in 2001 and 2000, respectively. Elron TeleSoft's other assets relate to the intangibles associated with the acquisition of the main operations and net assets of Network, Communications and Computer Systems (NCC) Ltd. According to a new accounting standard, SFAS 142 "Goodwill and Other Intangible Assets", commencing January 2002, Elron TeleSoft is no longer amortizing goodwill. Had SFAS 142 been adopted on January 1, 2001 and January 1, 2000, Elron TeleSoft would not have recorded amortization of goodwill and other intangible asset of approximately $1.3 million and $1.4 million, respectively.

Restructuring Charges. In response to the adverse economic conditions, and, in particular, the slowdown in IT spending, Elron TeleSoft underwent restructuring programs in order to focus its operations on core areas of its business, to reduce expenses and to improve efficiency. These restructuring programs mainly included workforce reductions and facilities- related expenses. In connection with these programs, Elron Telesoft recorded in 2001 restructuring charges of $1.2 million. These charges include employee termination costs of $0.4 million, which were paid in 2001. As of December 31, 2001, approximately 77 employees of Elron TeleSoft, mainly in the telecommunications activity and in its headquarters, were terminated. Facilities related expenses amounted to $0.7 million, which included a $0.4 million termination cost of a facility lease, of which $0.2 million was paid as of December 31, 2001, and the balance was paid in February 2002, and $0.3 million, expected termination expenses of lease agreements before the end of their terms.

As part of the restructuring programs, in the third quarter of 2001, Elron Telesoft sold certain non-core activities in the e-business field to Forsoft Multimedia Solutions Ltd. in consideration for $3.4 million and with no material effect on our consolidated results of operations. In addition, in the fourth quarter of 2001, Elron TeleSoft signed an agreement with Elbit Systems for the sale of other non-core activities in the government field for $5.7 million. The transaction was finalized in January 2002 with no material effect on our consolidated results of operations.

Operating Loss. Elron Telesoft's operating loss decreased by $0.1 million from $11.6 million in 2000 to $11.5 million in 2001. The decrease is primarily due to the implementation of restructuring programs by Elron TeleSoft. The restructuring programs included a workforce reduction of approximately 27 employees of Elron TeleSoft in the research and development, sales and marketing and in headquarter departments (in addition to 50 employees whose salaries were accounted for under cost of revenues), which resulted in savings of $0.7 million in salaries and related expenses in 2001. The decrease was partially offset due to an increase in Elron TeleSoft's research and development expenses in order to complete the development of new products as a result of the decision taken in 2000 to transition Elron TeleSoft from a project oriented company to a product oriented company.

Finance expenses, net. Finance expenses, net, decreased by $1.6 million, or 36%, to $2.8 million in 2001 from approximately $4.4 million in 2000. The decrease in finance expenses, despite an increase in loans outstanding, was due to the decrease in interest rates and a foreign currency translation gain due to the devaluation of the Israeli Shekel against the U.S. dollar, as Elron Telesoft's liabilities in Israeli Shekels exceeded its assets in Israeli Shekels during 2001. The finance expenses were principally due to loans associated with the purchase of the main operations and net assets of Network, Communications and Computer Systems (NCC) Ltd by Elron Telesoft in 1998.

Other Holdings and the Corporate Operations segment

Other holdings and the corporate operations segment included in 2001 and 2000 our holdings in affiliates and other companies, engaged in various fields of advanced technology, and corporate operations, which provide strategic and operational support to the group companies. The following table sets forth this segments operating results:

	Year ended December 31,	
	2001*	**2000***
	(millions of $)	
Net loss from equity investments	(27.2)	(9.5)
Gain (loss) from disposal and changes in holdings in related companies, net	3.2	26.8
Other income (expenses), net	(4.7)	43.5
Total Income	(28.7)	60.8
Operating expenses	5.1	4.0
Finance expenses (income), net	(4.6)	(7.4)
Total cost and expenses	(0.5)	(3.4)
Income (loss) from continuing operations before tax benefit	(29.2)	64.2
Tax benefit (taxes on income)	3.7	(8.1)
Minority interest	0.4	0.1
Net income (loss)	(25.1)	56.2

* Restated (see "Critical accounting Policies, Principles of Accounting for Holding in Group Companies")

Income

Our share in net losses of affiliated companies

Our share in net losses of affiliated companies resulted from our holdings in certain investments that were accounted for under the equity method. Our share in net losses of affiliated companies (as restated) amounted to $27.2 million in 2001 compared to $9.5 million in 2000.

Highlights of the Results of Operations of Our Major Affiliates:

Elbit Systems Ltd. Our share in net earnings of Elbit Systems amounted to $9.1 million in 2001 compared to a net loss of $3.0 million in 2000. In the third quarter of 2000, Elbit Systems completed its merger with El-Op and began consolidating its results of operations with the results of El-Op. Elbit Systems' net loss in 2000 was due to a $40.0 million charge relating to purchased in-process research and development as a result of the merger with El-Op and a pre-tax restructuring costs of $22.1 million.

Elbit Systems' results of operations in 2001 were affected by $9.2 million pre-tax compensation expenses resulting from variable accounting for an employees option plan in connection with "phantom" options granted by Elbit Systems. As Elbit Systems' share price increased significantly during 2001, under U.S. GAAP, the increase in the benefit resulting from the increase in the share price was recorded periodically as compensation expense. Accordingly, future changes in Elbit Systems' share price will continue to affect compensation expenses and therefore, Elbit Systems' results of operations.

The following are highlights of the results of operations of Elbit Systems:

- Elbit Systems' revenues increased from $591.1 million in 2000 to $764.5 million in 2001 primarily because it began consolidating El-Op's revenues with its own in the third quarter of 2000. As of December 31, 2001, Elbit Systems' backlog of orders was $1,566 million, of which approximately 78% was scheduled to be performed in 2002 and 2003 compared to backlog of orders of $1,437.0 million on December 31, 2000.
- Elbit Systems' operating income in 2001 was $52.0 million or 6.8% of revenues compared to an operating loss of $12.8 million in 2000. The operating results of Elbit Systems in 2001 included the effect of $9.2 million variable option plan compensation cost. In 2000, Elbit Systems' net loss included a $40.0 million charge relating to purchased in process research and development related to the merger with El-Op and a $22.1 million charge for restructuring costs.
- Elbit Systems' net income in 2001 was $40.8 million, or 5.3% of revenues, compared to a net loss of $20.5 million in 2000. Elbit Systems' net income in 2001 included a $7.1 million cost, reflecting the effect of variable option plan compensation cost, net of the related tax. The net results in 2000 included purchased in-process research and development related to the merger with El-Op and restructuring expenses in the aggregate amount of $56.8 million, net of the related tax.

Elbit Ltd. Our share in the net loss of Elbit amounted to $13.1 million in 2001 compared to our share in net earnings of $17.4 million in 2000. Elbit's net earnings in 2000 were primarily due to capital gains from the sale of its holding in Peach Networks to Microsoft Corporation in the first quarter of 2000 and from the sale of the assets of HyNEX Ltd. to Cisco Systems Inc. in the third quarter of 2000. Elbit's results of operations in 2001 were affected by the fact that Elbit shifted its focus from holdings in developed companies that were realized during 2000 to holdings in early-stage technology companies that have not reached the income-producing stage and which recorded net losses in 2001.

The following are highlights of the operating results of Elbit:

- In 2001, Elbit sold a considerable part of its holdings in Elbit Vision Systems, or EVS, and ceased consolidating EVS' results of operations. Elbit's consolidated revenues in 2001 were $1.0 million, resulting mainly from $0.9 million revenues of Elbit Vflash, which was established in June 2001. Revenues in 2000 were $3.0 million resulting from revenues of HyNEX, whose business and assets had been sold in the third quarter of 2000.
- Elbit's operating loss increased from $12.4 million in 2000 to $21.1 million in 2001. The increase in operating loss was primarily due to an increase of $3.2 million in marketing and sales expenses as a result of expansion of sales and marketing channels and an increase of $2.1 million in investments in the development of new products of Elbit's consolidated companies: Dealigence and Textology, which were acquired in the third quarter of 2000, ICC whose results had been consolidated from the third quarter of 2001 and Elbit Vflash. In addition, general and administrative expenses increased in 2001 by $3.4 million, which includes a $1.3 million severance retirement grant to the former President and CEO of Elbit.
- Elbit's subsidiaries, Elbit Vflash, Textology, Dealigence and ICC, had an aggregate operating loss of approximately $12.8 million in 2001 compared to an aggregate operating loss of HyNEX, Textology and Dealigence of approximately $5.9 million in 2000. Elbit's investment in Elbit Vflash was made in 2001.
- Elbit's equity in net losses of affiliated companies increased from $5.1 million in 2000 to $6.8 million in 2001, resulting primarily from an increase in Elbit's equity in net losses of Cellenium and StarkeyNET Ltd. and from new investments in AdreAct PLC and CellAct. The contribution of Cellenium to Elbit's equity losses in 2001 amounted to approximately $4.5 million. The revenues of Cellenium amounted to approximately $0.3 million in 2001 compared to $68,000 in 2000. Cellenium's operating loss in 2001 amounted to approximately $5.9 million compared to approximately $3.7 million in 2000. The increase in Cellenium's operating loss was the result of an increase in expenses due mainly to research and development and expenses relating to sales and marketing efforts in order to enhance Cellenium's sales and marketing channels. Cellenium's net loss in 2001 amounted to approximately $5.6 million compared to approximately $3.1 million in 2000.
- Elbit's consolidated net loss in 2001 was $30.6 million compared to net income of $40.4 million in 2000. Net loss in 2001 included write-offs of approximately $6.3 million in respect of Cell Data, which ceased its operations at the beginning of 2002 and the impairment in the value of certain of Elbit's subsidiaries and affiliated companies, AdreAct, StarkeyNet and Dealigence and from a $3.7 million charge (before tax) to results of operations due to the permanent impairment in the market value of Cisco's shares. Net income in 2000 included a gain of $39.5 million (before tax) from the sale of Peach Networks to Microsoft in the first quarter of 2000, and a $89.0 million gain (before tax and minority interest) from the sale of the business and assets of HyNEX to Cisco Systems in the third quarter of 2000.
- In addition to companies accounted for by Elbit under the equity method, Elbit held a 12.4% interest in Partner, which was accounted for as available for sale securities and

whose results did not affect Elbit's results of operations. At December 31, 2001, Elbit's investment in Partner represented approximately 72% of Elbit's assets. The following are highlights of the results of operations of Partner for the year ended December 31, 2001, based on the then Shekel-U.S. Dollar exchange rate of $4.416:

- Partner's total revenues for 2001 reached $735.8 million, an increase of 54% from 2000. Partner's subscriber base at year's end was 1,458,000, compared to 834,000 at the end of 2000, an increase of 624,000 subscribers.

- Partner's operating profit for 2001 was $23.3 million, compared to an operating loss of $122.3 million in 2000. Partner's net loss for 2001 amounted to $68.7 million, compared to net loss of $174.0 million in 2000.

Our share in net losses of our other affiliated companies (as restated) amounted to approximately $23.2 million in 2001 compared to $23.9 million in 2000. The decrease in our share in net losses of our other affiliated companies resulted mainly from the significant decrease in NetVision's losses and the restructuring programs implemented by our group companies in order to reduce costs.

NetVision. NetVision's net losses in 2001 amounted to $3.6 million compared to $24.8 million in 2000. The significant decrease in net losses was a result of a restructuring program implemented by NetVision, which included cost reduction programs. The number of NetVision's subscribers increased by 10% in 2001 from approximately 302,000 at the end of 2000 to approximately 333,000 subscribers at the end of 2001 and its revenues increased by $10.4 million, or 21%, from $48.5 million in 2000 to $58.9 million in 2001. NetVision's operating expenses in 2001 decreased by $10.9 million, or 15%, from $72.5 million in 2000 to $61.6 million in 2001.

The decrease in our share in NetVision's net losses were partially offset by an increase in our share in net losses of early stage technology companies in which we invested in 2000 and 2001, such as KIT, Wavion and Pulsicom. These companies continued to have high research and development and marketing expenses.

Wavion. Wavion's net losses in 2001 amounted to $3.4 million compared to $1.9 million for the period from commencement of its operations in April 2000 to the end of 2000, mainly as a result of a $1.4 million increase in research and development expenses to complete the development of its products. However, the downturn in the broadband wireless commercial market has delayed the release of Wavion's products. Consequently, at the beginning of 2002, Wavion began selling development services for communication systems to customers.

KIT. KIT's net losses in 2001 amounted to $3.1 million compared to $2.5 million in 2000, mainly as a result of an increase of $0.7 million in marketing and sales expenses as KIT expanded its direct sales efforts in Holland and through a local representative in the United Kingdom. As a result of these efforts, KIT generated revenues of $1.0 million in 2001 compared to $0.1 million in 2000.

Pulsicom. Pulsicom commenced its operations in 2001. In 2001, its net losses amounted to $1.0 million, consisting mainly of research and development costs.

DEP. The aggregate revenues of the DEP group companies were approximately $16.0 million in 2001 compared to approximately $12.0 million in 2000. The increase in revenues resulted from increased sales and marketing expenses of approximately $8.0 million, or 50%, in 2001 compared to 2000, and from increased research and development expenses of approximately $2.0 million, or 9%, in 2001 compared to 2000, in order to complete new product developments.

Given Imaging. Given Imaging initiated commercial sales in the third quarter of 2001 after receiving FDA clearance for its product and generated revenues of $4.7 million in 2001. Given Imaging's net loss in 2001 was $18.7 million compared to $7.5 million in 2000. The increase in Given Imaging's net loss was primarily due to a $10.0 million increase in marketing expenses resulting from the anticipated launch of Given Imaging's product upon receipt of necessary regulatory approvals.

Chip Express. Chip Express was affected in 2001 by the slowdown in the semiconductor industry and its revenues decreased by $9.2 million, or 24%, from $39.0 million in 2000 to $29.8 million in 2001. Chip Express' net losses in 2001 amounted to $1.6 million compared to $1.8 million in 2000, mainly due to the implementation of a cost reduction program. Operating expenses in 2001 amounted to $31.1 million compared to $40.6 million in 2000.

MediaGate. MediaGate was affected by the slowdown in the communications market and particularly in the unified messaging market and its revenues in 2001 decreased to $0.7 million from $0.9 million in 2000. However, due to cost reductions programs implemented by MediaGate, operating expenses in 2001 decreased by $0.7 million and MediaGate's net losses in 2001 decreased to $9.2 million from $10.3 million in 2000.

In addition to companies accounted for under the equity method, we had several investments in companies which we accounted for on a cost basis and whose results did not affect our results of operations. These companies are not material to Elron, except for our interest in Oren Semiconductor. During 2001, we invested $1.4 million in Oren, bringing the book value of our holding in Oren as of December 31, 2001 to $5.5 million, compared to $4.1 million on December 31, 2000. In 2001, Oren's revenues were $2.5 million, compared to $5.6 million in 2000. The decrease in revenues resulted from the downturn in the communications industry as well as to the decrease in revenues derived from Oren's old analog product line. Gross profit in 2001 amounted to $0.8 million, or 33% of revenues, compared to $1.6 million, or 28% of revenues, in 2000. The increase in gross margins resulted from the increase in revenues derived from sales of products with high gross margin while revenues derived from development projects with low gross margin decreased. Operating expenses in 2001 increased to $9.1 million from $8.4 million in 2000, mainly due to an increase in research and development costs for the development of its next generation digital products. Oren's net losses in 2001 amounted to $8.6 million compared to $6.8 million in 2000.

Gains from Sale of Shares and Changes in Holdings in Related Companies. Our gains from the sale of shares and changes in our holdings in related companies (as restated) amounted to $3.2 million in 2001 compared to $26.8 million in 2000. Gains in 2001 included a $3.0 million pre-tax gain from the sale of 380,000 shares of Elbit Systems. Gains in 2000 were primarily due to an approximately $19.1 million gain from changes in holdings in Elbit Systems following its merger with El-Op. In addition, a gain of approximately $4.6 million resulted from the completion of a private placement upon which Elron Software issued 615,764 shares (2.5% of its share capital) to Critical Path in consideration for $5.0 million.

Other Income, net. Other income, net (as restated), amounted to a loss of $4.7 million in 2001 compared to income of $43.5 million in 2000. Other income in 2000 resulted primarily from a $34.3 million pre-tax gain on the sale of 611,566 shares of Zoran, changes in the market value of Zoran's shares in our trading securities account and in the value of Zoran's call and put options held by us. In addition, a pre-tax gain of $6.3 million resulted from the sale of our holdings in Servicesoft, which was acquired by Broadbase Software Inc. in consideration for the issuance of Broadbase Software's shares. The loss in 2001 resulted primarily from a $5.8 million decrease in the market value of BroadBase Software's and Kana's shares which we subsequently received in exchange for Broadbase Software's shares following the acquisition of Broadbase Software by Kana Communications on June 29, 2001 and a $1.0 million write-down in the market value of the shares of ArelNet, which we believed constituted a permanent impairment. The loss in 2001 was partially offset by a $1.0 million gain from the sale of the remaining shares of Zoran during the first quarter of 2001 and a $1.2 million gain from the sale of shares of Kana Communications during the fourth quarter of 2001.

Expenses

Operating Expenses. Corporate costs increased by $1.1 million, or 28%, to $5.1 million in 2001 from approximately $4.0 million in 2000 mainly as a result of a $0.4 million increase in salaries and compensation costs, a $0.4 million increase in facilities related expenses and a $0.3 million increase in professional services fees and insurance expenses.

Finance Expenses, net. Finance expenses, net amounted to an income of $4.6 million in 2001 compared to $7.4 million in 2000. The decrease was primarily due to the decrease in interest rates and to our lower cash, deposits and debentures balances in 2001 as compared to 2000.

LIQUIDITY AND CAPITAL RESOURCES

Consolidated cash, debentures, deposits and marketable securities (including short and long-term) at December 31, 2002 were approximately $100.0 million, compared with $112.8 million at December 31, 2001. At December 31, 2002, the corporate cash, debentures, deposits and marketable securities (including short and long term) were $94.1 million (of which 99% were held in U.S. dollar accounts) compared with $111.5 million at December 31, 2001. An amount of $28.9 million is collateralized to secure bank loans of Elron Software and Elron Telesoft. The balance of $65.2 million has average maturities of less than three months.

Consolidated working capital at December 31, 2002 was $31.8 million compared to $75.9 million at December 31, 2001. The decrease resulted mainly from (i) investment in our group companies and new companies in the amount of $29.5 million; (ii) classification as short-term loans of $14.5 million which were previously classified as long-term loans; and (iii) increase of $6.8 million in long-term loans which are secured by our debentures and securities and which were reclassified from current assets to long-term assets.

Our main cash and other liquid instruments resources in 2002 included mainly $5.9 million proceeds from the sale of 380,000 shares of Elbit Systems, $1.1 million proceeds from the sale of Given Imaging shares, proceeds from the sale of other marketable securities of NetManage, ArelNet and Kana of $0.8 million and a $2.7 million dividend received from Elbit Systems. In addition, our cash and other liquid instruments increased by approximately $13.6 million, mainly as a result of the merger with Elbit.

Our main cash and other liquid instruments applications in 2002 included mainly $29.5 million of investments in companies, of which $24.5 million were investments in our then existing group companies to secure their cash needs for future growth and $5.0 million were investments in new companies (see table below for more details about our investment activity in 2002), and cash, net, of approximately $8.8 million used for our corporate activities, which includes merger expenses of approximately $5.0 million with respect to the merger with Elbit.

The following table sets forth the investments made in the Other holdings and Corporate Operations segment, including investments in subsidiaries, during 2002:

	Amount (millions of $)
Investments in then existing group companies:	
Chip Express	4.5
MediaGate	3.9
Galil Medical	2.8
Oren	2.5
VFlash	2.3
ICC	1.3
24/7 Real Media	1.0
KIT	1.0
Wavion	0.5
Cellenium	1.4
Textology and Assa-Or	1.4
Other	1.9
	24.5
Investments in new companies:	
AMT	4.7
Notal	0.3
	5.0
	29.5

At December 31, 2002, we and our subsidiaries had no material contractual obligations which are expected to affect our consolidated cash flow in future periods, except for capital lease obligations and payments of bank credits, bank loans and loans from others, including short term loans taken by our subsidiaries, in each case due in future periods as set forth in the table below.

Type of Obligation	**2003**	**2004**	**2005**	**Total**
Loans, bank credits	$33.0 million	$48.1 million	$1.3 million	$82.4 million
Capital leases	$1.5 million	$1.3 million	$0.7 million	$3.5 million

Consolidated loans at December 31, 2002 were approximately $82.4 million, the majority of which is attributed to Elron Telesoft and Elron Software. Elron provided guarantees to banks of up to approximately $74.0 million of which an amount of $28.9 million has been secured by our pledged debentures, marketable securities and deposits to secure bank loans made available to Elron TeleSoft and Elron Software and of which $69.3 million have been utilized as of December 31, 2002. In addition, in connection with some of Elron TeleSoft's bank loans, we have provided to the lending bank a comfort letter. Neither Elron Telesoft nor Elron Software is currently generating or is expected, in the near future, to generate sufficient revenues to repay their loans to the banks and accordingly we may be required to repay such indebtedness when due under the current lending arrangements, which will negatively affect our cash resources. We believe but cannot assure you, that it will be possible to refinance this indebtedness, although not necessarily on terms favorable to us.

RDC's bank loan as of December 31, 2002 in the amount of $4.0 million was secured by a floating pledge and by a first degree fixed pledge over 2,840,000 shares of Given deposit in RDC's bank account. As of May 31, 2003, RDC repaid its bank loan in full and the pledges were removed.

In 2001, we provided letters of comfort in connection with 50% of the credit line granted to NetVision by banks. The amount outstanding under the credit line at December 31, 2002 was approximately $19.7 million. The comfort letters were jointly provided with Tevel, the other major shareholder of NetVision which secured the remaining 50% of the credit line.

We believe that our existing capital will be sufficient to fund our and our subsidiaries' operations and our investment plan in existing and new companies for at least the next twelve months.

Shareholders' equity at December 31, 2002, was approximately $266.5 million, representing approximately 66% of the total assets compared with $238.7 million representing approximately 73% of total assets at December 31, 2001. The increase in shareholders' equity in 2002 was a result of the share issuance pursuant to the Elbit merger agreement and the DEP share purchase agreement.

Market Risk

Market risks relating to our operations result primarily from changes in interest rates, exchange rates and equity prices. In order to limit our exposure, we may enter, from time to time, into various derivative transactions. Our objective is to reduce exposure and fluctuations in earnings and cash flows associated with changes in interest rates, foreign currency rates and equity prices. We do not use financial instruments for trading purposes. It is our policy and practice from time to time to use derivative financial instruments only to limit exposure.

At December 31, 2002, we held $5.3 million in commercial marketable debentures, all with high credit quality issuers and with a limited amount of credit exposure to any one issuer. In addition, no more than 30% of our bank deposits were deposited in any single bank.

Interest Rate Risks. We are exposed to market risks resulting from changes in interest rates, relating primarily to our cash, deposits and debentures, and our subsidiaries' loan obligations to banks. We do not currently use derivative financial instruments to limit exposure to interest rate risk. At December 31, 2002, we had fixed rate financial assets of $5.3 million held on average for 2 years, and variable rate financial assets of $88.4 million. At the same time, our subsidiaries had variable interest loans of $76.4 million. Therefore, we believe that the potential loss that would result from an increase or decrease in the interest rate is immaterial to our business and consolidated net assets.

Exchange Rate Risk. Since most of our group companies are Israeli-related, our main exposure, if any, results from changes in the exchange rate between the Israeli Shekel and the U.S. dollar. Our functional currency, as well as that of our principal subsidiaries and affiliated companies, is the U.S. dollar.

Our policy is to reduce exposure to exchange rate fluctuations by having most of our and our subsidiaries' assets and liabilities, as well as most of the revenues and expenditures in U.S. dollars, or U.S. dollar linked. Therefore, we believe that the potential loss that would result from an increase or decrease in the exchange rate is immaterial to our business and net assets.

Equity Price Risk. We are exposed to fluctuations in the equity price of our holdings in publicly traded companies. At December 31, 2002 we directly and indirectly held shares of the following publicly traded companies: Elbit Systems, Given Imaging, Partner Communication Company, Elbit Vision Systems, 24/7 Real Media and Cisco Systems. All of Cisco Systems shares held by us at the end of 2002 were sold at the beginning of 2003 with no material effect on our results of operations. As of June 3, 2003, we sold the majority of our shares of 24/7 Real Media resulting in an immaterial gain leaving us holding a balance 3.15% of shares of 24/7 Real Media. In the second quarter of 2003, we sold an aggregate of 3.5 million shares of Partner, recording an aggregate gain of $3.3 million, following which we hold approximately 10.2% of the shares of Partner.

Stock prices in the industries of these companies have experienced significant historical volatility. Changes in the market value of our publicly traded holdings, included holdings through our affiliates, which are accounted under the equity method of accounting or as available-for-sale securities will not affect our results of operations but may have a significant effect on our market value. We view the risks of reduction in market price of these companies as part of our business risks and we examine, from time to time, the possibility of having a partial hedge against equity price risks. Based on closing market prices at December 31, 2002, the fair market value of our holdings in public securities was approximately $280.4 million. A 10% decrease in equity prices would result in an approximately $28.0 million decrease in the fair market value of our publicly traded holdings.

Changes in the market value of our available-for-sale securities (which mainly include our indirect holding in Partner) are reported in other comprehensive income, which is included as a component of shareholders' equity, and not as part of our results of operations.

Research and Development, Patents and Licenses

Since we, through our group companies, engage in fields of high-technology, our group companies invest significant resources in research and development activities. The combined research and development costs of all group companies amonted to $99.1 million in 2002, $118.3 million in 2001 and $91.0 million in 2000, the majority of which in each year was spent by Elbit Systems. Our consolidated research and development costs amounted to $7.8 million, 9.0 million and $7.8 million in 2002, 2001 and 2000, respectively. The decrease in research and development costs in 2002 as compared to 2001 was primarily due to restructuring programs undertaken by Elron Software and Elron Telesoft as a result of the economic downturn, especially the slowdown in IT spending and capital equipment for telecommunications service providers.

Elron Software's research and development efforts are focused on enhancing the integration, scalability and functionality of the Internet Manager product family. The current priority of Elron Software's research and development team is to bolster the capabilities of its anti-spam offering as the accuracy of its anti-spam product directly impacts sales. The new versions of the anti-spam product are due to be released within the next 12 months.

Elron TeleSoft's research and development team's efforts are currently primarily directed toward revenue assurance products (ESSB), functionality enhancements and the development of new modules intended to broaden Elron Telesoft's product portfolio in the telecommunications field.

Following the completion of the merger of Galil Medical's urology business with Amersham Health's brachytherapy business, Galil Medical's research and development team will continue to support the urology business and will also focus on the application of its cryotherapy technology to women's health and cardiology.

Trend Information

In recent years, we have focused on defense electronics, software products and services, communication, medical devices and semi-conductors. In 2002, we invested in the new field of amorphous metals. We have increased our direct involvement in these areas by investing in existing and new companies. More recently, we have divested from certain companies in our group not operating in our main areas of involvement described above and have focussed our efforts and financial resources on supporting our existing companies and investing in new companies which we believe have the potential to develop into mature companies, thereby enhancing shareholder value.

We also seek to realize gains through the selective sale of holdings or having our group companies sell minority interests to outside investors, or through the introduction of strategic partners.

Through 2000, we recorded substantial net income from the sale of some of our shares of publicly traded companies like Zoran and Orbotech which we have liquidated, and from the sale of Peach Networks and HyNEX by Elbit. In 2001 and 2002, we did not realize similar levels of gains, nor do we expect to do so in the foreseeable future.

The continued downturn in the world economy and in particular in the high technology sector may affect our results or those of our group companies and affiliates and, consequently, our results. The downturn may also affect these companies' abilities to raise additional financing. In addition, this may affect our ability to sell holdings in these companies and realize gains from our investments. Our inability to conclude profitable "exit" transactions will have an adverse affect on our ability to realize profits. The effects of the recent downturn may also require us to make additional cash investments in our group companies, as they face increasing difficulties in raising funds from other sources. In addition, we may have to write down or write off the carrying value of certain of our holdings.

"Trend Information" pertaining to our group companies is incorporated by reference to Item 4 of this Report and this Item 5 under "Results of Operations".

Item 6. Directors, Senior Management and Employees

Directors and Senior Management

Our executive officers and directors are as follows:

Name	Age	Position
Ami Erel [(4)]	56	Chairman of the Board of Directors
Avraham Asheri [(1)]	65	Director
Gabi Barbash	53	Director
Dr. Chen Barir	44	Director
Yaacov Goldman [(1)(2)(3)]	47	External Director
Michael F. Kaufmann	59	Director
Oren Lieder[(4)]	55	Director
Dr. Dalia Meggido	52	Director
Itzhak Ravid	48	Director
Professor Daniel Sipper[(1)(2)]	70	External Director
Doron Birger	52	President and CEO
Moshe Fourier	55	Vice President, Chief Technology Officer
Tal Raz	41	Vice President, Chief Financial Officer
Shmuel Kidron	53	Vice President

1 Independent director under the Marketplace Rules of the Nasdaq National Market and member of our audit committee.

2 External director under the Israeli Companies Law.

3 Designated Financial Expert under Sarbanes-Oxley Act of 2002.

4 Officer of DIC.

Ami Erel has served as our Chairman of the board of directors since November 1999 and served as our Chief Executive Officer from November 1999 to December 2001. Mr. Erel has served as President of DIC since June 1, 2001. Mr. Erel is also a director of Property and Building Corporation Ltd. and Super-Sol Ltd. as well as the Chairman or member of the boards of other companies in the DIC group and the Elron group. From 1997 to 1999, Mr. Erel served as President and Chief Executive Officer of Bezeq - The Israel Telecommunications Corp. Ltd. From 1997 to 1998, he was Chairman of the board of directors of PelePhone Communications Ltd. From 1993 to 1997, he served as Chief Executive Officer and director of ForSoft Ltd. and as a director of its subsidiaries. From 1990 to 1997, he served as Chief Executive Officer and director of F.C.T. Formula Computer Technologies Ltd. and as director of its subsidiaries. In January 2000, Mr. Erel was elected as Chairman of the board of Israel Association of Electronics & Information Industries. Mr. Erel holds a B.Sc. in electrical engineering from the Technion, Israel Institute of Technology.

Avraham Asheri has been a director of Elron since December 1999. He serves as the Chairman of our Audit Committee. He is an economic and financial advisor. Mr. Asheri is a member of the boards of directors of Discount Mortgage Bank Ltd., Kardan Nadlan Ltd., ISAL Amlat Investments (1993) Ltd., Meditor Pharmaceuticals Ltd., Elbit Systems Ltd. and Scitex Corporation Ltd. Mr. Asheri was the President and Chief Executive Officer of Israel Discount Bank from November 1991 until July 1998. Prior to joining Israel Discount Bank in 1983 as Senior Executive Vice President and a member of its management committee, Mr. Asheri held the position of Director General of the Ministry of Industry and Trade. During his 23 years at the Ministry of Industry and Trade and at the Ministry of Finance, Mr. Asheri held several key offices in Israel and abroad, including: Managing Director of the Investment Center in Israel, and Trade Commissioner of Israel to the United States. Mr. Asheri holds a bachelors degree in economics and political science from the Hebrew University in Jerusalem.

Prof. Gabi Barbash joined Elron as a director in May 2003. Since 1999, Prof. Barbash has been Director General of the Tel-Aviv Sourasky Medical Center and since 2000, he has been the Chairman of the Board of Directors of Teuza Venture Capital Fund. Between 1998 and 2000, Prof. Barabash was the Chairman of the Israeli National Transplant Center. Between 1996to 1999, Prof. Barbash was the Director General of the Israeli Ministry of Health. Between 1995 and 1998, Prof. Barbash was a member of the Scientific Committee of the Interdisciplinary Center for Technological Analysis and Forecasting at Tel-Aviv University. Between 1993 and 1996, Prof. Barbash was the Director General of the Sourasky Medical Center. Between 1986 and 1993, Prof. Barbash was the Deputy Director of the Sheba Medical Center and from 1990 to 1993, he was Director of the Rehabilitation Hospital of the Sheba Medical Center. Prof. Barbash holds an M.D. in medicine from the Hebrew University, Jerusalem, Hadassah Medical School and a Masters degree in public health from Harvard University.

Dr. Chen Barir has been a director of Elron since December 1999. He is the Chairman of Berman & Co. Trading and Investments Ltd. and its subsidiaries and affiliates, a private group specializing in seed stage venture capital investments, management and real estate. Dr. Barir is also Chairman of Galil Medical Ltd., Chairman of Sunlight Medical, a director of Optonol Ltd. and a director of Given Imaging Ltd. Dr. Barir holds a masters in business administration from the European Institute of Business Administration (INSEAD) in Fontainebleau, France and a doctorate in law and economics from Harvard Law School.

Yaacov Goldman joined Elron as an external director in March 2003. He serves as a member of our Audit Committee and is our designated financial expert on the audit committee. Commencing in 1981, Mr. Goldman worked for Kesselman & Kesselman (member firm of PricewaterhouseCoopers) for 19 years, and from 1991 until 2000, as a partner and then senior partner of such firm. From September 2000 until November 2001, Mr. Goldman served as managing director of Argoquest Holdings, LLC. From March 2002 until October 2002, Mr. Goldman acted as a consultant to a private equity initiative with Poalim Capital Markets & Investments Ltd. Mr. Goldman is a certified public accountant in Israel, having received his Bachelor of Economics and Accounting from the Tel Aviv University.

Michael F. Kaufmann has been a director of Elron since December 1999. He owns and manages D.S. Ltd. & Kibernetics Ltd. He was the Chairman of Alcatel Telecom Israel Ltd. and Corporate Senior Officer In-Country until September 2002. Since 1970, he has managed Orterac, a family owned company whose charter has been to initiate business and to market and implement the product portfolio of its principal companies. In the past, Mr. Kaufmann served as a board member of Gvanim (a cable television company) and as a General Manager of Hapoalim Technological Infrastructures Ltd. Mr. Kaufmann holds a bachelor of science degree in applied physics from the Technion, Israel Institute of Technology, and attended the Harvard International Senior Management Program.

Oren Lieder joined Elron as a director in January 2003. Since January 2003, he has been the Chief Financial Officer of DIC. Prior to joining DIC, from 1997 until 2002, Mr. Lieder was the Chief Financial Officer of Bezeq Israel Telecommunications Company Ltd. and from 1989 until 1996, he was the Chief Financial Officer of Zim Israel Navigation Co. Ltd. He is a director of Supersol Ltd. and Property and Building Ltd. Between 2000 and 2002, Mr. Lieder was a director of DBS Satellite Services (1998) Ltd. and between 1998 and 2002, he was a director of Pelephone Communication Ltd. Between 1994 and 1996, he was the Chairman of Ramon – Granit Insurance Brokers, Ramon International Insurance Brokers and Layam Ltd. Since 1995, he has been a member of the Board of Trustees and Investment Committee of the University of Haifa. Mr. Lieder holds a degree in economics and statistics from the University of Haifa.

Dr. Dalia Megiddo has served as a director of Elron since January 2003. Dr. Megiddo is Managing Partner of InnoMed Ventures L.P., an Israeli venture capital fund in the field of medical devices and the life sciences, and serves as a director of Given Imaging Ltd. Since 1994, Dr. Megiddo has also served as Chief Editor of Academia Medica, a multimedia medical teaching program in Israel and between 1996 and 2003 as Editor of the Israeli medical audio magazine, The Journal Club. From 1981 to 1986, Dr. Megiddo practiced family medicine at the Hebrew University Hadassah Medical Health Center. Dr. Megiddo holds an M.D. in medicine from Hebrew University, Jerusalem and an M.B.A. from the Kellogg Recanati International Executive M.B.A. program of Tel Aviv University and Northwestern University.

Itzhak Ravid has been a director of Elron since May 2000. He has been a partner in the Tel Aviv accounting firm of Raveh-Ravid & Co. since 1988. He was a director of Y.L.R Capital Markets from 1992 until 1998. Mr. Ravid was the Chairman of the board of directors of Nessuah Zannex from 1998 to 1999. From 1981 to 1988, he was an accountant with Kost Levary & Forer. Mr. Ravid has been a licensed accountant since 1983. He holds degrees in economics and accounting from Tel Aviv University.

Professor Daniel Sipper joined Elron as an external director in February 2001. Professor Sipper serves on our Audit Committee. Professor Sipper serves in the faculty of the Department of Industrial Engineering at Tel-Aviv University. He received his bachelor of science from the Technion, Israel Institute of Technology, a masters of science degree from Columbia University and a Ph.D. in Industrial Engineering from the Georgia Institute of Technology. Professor Sipper has been involved in industry both in Israel and the United States.

Doron Birger joined Elron in 1994 as Vice President of Finance. Mr. Birger has served as President and Chief Executive Officer of Elron since August 2002, President since September 2001, Chief Financial Officer from 1994 to May 2002 and Corporate Secretary from 1994 to September 2001. Mr. Birger is Chairman of Given Imaging Ltd. and a director of Elbit Systems Ltd. and various other of our group companies. From 1991 to 1994, Mr. Birger was Vice President-Finance at North Hills Electronics Ltd., an advanced electronics company. From 1990 to 1991, Mr. Birger served as Chief Financial Officer of Middle-East Pipes Ltd., a manufacturer in the metal industry. From 1988 to 1990, Mr. Birger served as Chief Financial Officer of Maquette Ltd., a manufacturer and exporter of fashion items. From 1981 to 1988, Mr. Birger was Chief Financial Officer and director at Bateman Engineering Ltd. and I.D.C. Industrial Development Company Ltd. From 1979 – 1981, Mr. Birger was the Chief Financial Officer of

Fibronics Ltd. Mr. Birger holds a B.A. and an M.A. in economics from the Hebrew University, Jerusalem.

Moshe Fourier was appointed as our Chief Technical Officer (CTO) on June 1, 2000. From 1999 to 2000, he served as the Chief Operations Officer (COO) for Terayon Communications' broad band voice division, one of the leading companies that provides cable modems and telecommunications solutions over the cable television infrastructure. From December 1993 until 1999, he joined the founder of Telegate and jointly initiated this start-up providing telecommunications equipment for delivering voice, data and video over cable television infrastructure, and served as Deputy Chief Executive Officer and Vice President of Research and Development and Technology. In 1999, Terayon acquired Telegate. In June 1992, he joined RADA Electronic Industries as Vice President of Engineering. RADA is involved in military avionics and sophisticated automatic test equipment (ATE) for military and commercial aviation. In August 1976, Mr. Fourier joined Astronautics Corporation of America - the Israeli division, as the first engineer and was promoted in 1978 to Vice President of Engineering. During this period, he was in charge of the development of advanced technology avionics, military ground vehicles electronics and naval systems. Mr. Fourier holds a bachelor of science degree in electrical engineering (BSEE) and an associated electrical engineering degree from the Technion, Israel Institute of Technology.

Tal Raz was appointed as our Vice President and Chief Financial Officer as of May 15, 2002. Prior to joining us, Mr. Raz was the acting President and Chief Executive Officer of Elbit Ltd. from October 2001. Mr. Raz was appointed Vice President of Elbit in June 1998, and served as Chief Financial Officer of Elbit since he joined Elbit in April 1997, having previously served in the same capacity at Agentsoft Ltd., Jerusalem, and Paul Winston Corporation, New York. Prior thereto he was a senior auditor at Deloitte & Touche LLP's New York office. He also serves as a director and a member of the executive committee of Partner Communications Company Ltd., and as a director of RDC. Mr. Raz is a certified public accountant, and holds BA and MA degrees in accounting and business administration from Baruch College, City University, New York.

Shmuel Kidron was appointed as our Vice President in June 2000. Since March 2001, Mr. Kidron has been the acting Chief Executive Officer of Mediagate. Since October 2002 Mr. Kidron has been Vice-Chairman of Elron Telesoft. From 1993 to 2000, Mr. Kidron was the President and Chief Executive Officer of Tadiran Electronic Systems Ltd. From 1990 to 1993, Mr. Kidron was a Business Unit Manager in Tadiran Electronic Systems. From 1980 to 1990, Mr. Kidron fulfilled various managerial and engineering positions in Tadiran Electronic Systems. Mr. Kidron holds a Bachelor of Science degree in Electrical Engineering from the Technion, Israel Institute of Technology.

Compensation

During the year ended December 31, 2002, we paid aggregate remuneration to our directors and officers as a group who served in the capacity of director or executive officer during such year of approximately $1,373,000. This amount does not include amounts expended by us for automobiles made available to our officers in the aggregate amount of approximately $19,000.

The following table sets forth the approximate aggregate compensation paid by us during the fiscal year ended on December 31, 2002 to all our directors and officers.

	Cash and Cash-Equivalent Forms of Compensation (in thousands of U.S. $)	
	Salaries, Fees, Directors' Fees, Commissions and Bonuses	**Securities[2] or Property, Insurance Benefits or Reimbursements and Personal Benefits**
2002 [1]		
All Directors	133	
All Officers	1,067	174

(1) Does not include an increase in provision for vacation in the amount of approximately $70,000.

(2) See "Share Ownership" under this Item 6 and "Compensation of the Chairman " under Item 7- Related Party Transactions.

Board Practices

None of our directors have service contracts with us or any of our group companies providing for benefits upon termination of employment. Compensation of our officers is recommended by our senior management and approved by the board of directors. Compensation of all other employees is determined by our senior management.

Board of Directors

Our Articles of Association provide for a board of directors of not less than five members and no more than fifteen members, including external directors. Each director, other than external directors, is elected to serve until the end of the first annual meeting following their appointment. However, if no directors are elected at such annual meeting, the then present directors shall continue in office. The board of directors may appoint additional directors, provided that the total number of directors does not exceed the maximum number of fifteen as mentioned above. A director appointed as such shall serve until the end of the next annual meeting held following his or her appointment and he or she shall be eligible for re-appointment. Notwithstanding any of the above, any director, other than external directors, may be removed from office by an ordinary resolution of a general shareholders meeting or by two thirds of the directors. A director need not hold any of our shares to qualify as one of our directors. Officers serve at the discretion of the board of directors.

Our Articles provide that our board of directors may delegate its powers to its committees, subject to limitations determined by the Israeli Companies Law.

Substitute Directors

Our Articles of Association provide that any director may, by written notice to us, appoint another person to serve as a substitute director and may cancel such appointment. The identity of a substitute director requires the approval of the board of directors. Under the Israeli Companies

Law, there shall not be appointed as a substitute director, any person who is not himself qualified to be appointed as a director or a person who is already serving as a director or a person who is already serving as a substitute director for another director.

The term of appointment of a substitute director may be for one meeting of the board of directors or for a specified period or until notice is given of the cancellation of the appointment. To our knowledge, no director currently intends to appoint any other person as a substitute director, except if the director is unable to attend a meeting of the board of directors.

External Directors

The Israeli Companies Law requires Israeli companies with shares that have been offered to the public in or outside of Israel (public companies) to appoint two external directors. No person may be appointed as an external director if the person or the person's spouse, siblings, parents, grand parents, descendants, spouses descendants and the spouses of any of the foregoing (referred to as a relative), partner, employer or any entity under the person's control, has or had, on or within the two years preceding the date of the person's appointment to serve as external director, any affiliation with the company or any entity controlling, controlled by or under common control with the company. The term "affiliation" includes:

- an employment relationship;
- a business or professional relationship maintained on a regular basis;
- control; and
- service as an office holder, as defined below in Item 10, excluding service as a director for a period of not more than three months, during which the company initially offered shares to the public.

No person may serve as an external director if the person's position or other business activities create, or may create, a conflict of interest with the person's responsibilities as an external director or may otherwise interfere with the person's ability to serve as an external director. If, at the time external directors are to be appointed, all current members of the board of directors are of the same gender, then at least one external director must be of the other gender.

External directors are to be elected by a majority vote at a shareholders' meeting, provided that either:

- the majority of shares voted at the meeting, including at least one-third of the shares held by non-controlling shareholders, or their representative, voted at the meeting, vote in favor of election of the director without taking abstentions into account. According to the Israeli Companies Law, a controlling shareholder is defined as a person who has the ability to direct the activities of a company, other than if this power derives solely from its position on the board of directors or any other position with the company. A person is presumed to be a controlling shareholder if he holds half or more of the following: (1) voting rights in the general meeting, or (2) rights to appoint directors or the Chief Executive Officer; or
- the total number of shares held by non-controlling shareholders voted against the election of the director does not exceed one percent of the aggregate voting rights in the company.

The initial term of an external director is three years and may be extended for an additional three years. External directors may be removed only in a general meeting, by the same percentage of shareholders as is required for their election, or by a court, and in both cases only if the external directors cease to meet the statutory qualifications for their appointment or if they violate their duty of loyalty to the company. Each committee of a company's board of directors must include at least one external director and all of the external directors must be members of the audit committee.

An external director is entitled to compensation in accordance with the regulations adopted under the Israeli Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with service provided as an external director.

In addition, the Nasdaq National Market requires us to have at least two independent directors on our board of directors. Our two external directors also qualify as independent directors under the Nasdaq National Market requirements.

Audit Committee

The Israeli Companies Law requires public companies to appoint an audit committee. The responsibilities of the audit committee include identifying irregularities in the management of the company's business and approving related party transactions as required by law. An audit committee must consist of at least three directors, including, as mentioned, all of the external directors of the company. The Chairman of the board of directors, any director employed by or otherwise providing services to the company, and a controlling shareholder or any relative of a controlling shareholder, may not be a member of the audit committee.

Our two external directors serve on the audit committee of the board of directors. All members of our audit committee meet Nasdaq's definition of independent directors. None of them is an affiliated person of us or has received any consulting, advisory or other compensatory fee from us, other than in their capacity as directors.

Internal Auditor

Under the Israeli Companies Law, the board of directors of public companies must appoint an internal auditor, nominated by the proposal of the audit committee. The role of the internal auditor is to examine, among other matters, whether the company's actions comply with the law and orderly business procedure. Under the Israeli Companies Law, the internal auditor may be an employee of the company but not an office holder (as defined below in Item 10), an interested party, a relative of an office holder or an interested party, and he may not be the company's independent accountant or its representative. According the Israeli Companies Law, an interested party is defined as a shareholder who holds 5% or more of the outstanding share capital or the voting power, a director, a general manager or a shareholder who has the right to appoint at least one director or the general manager. Eyal Weizman of Fahn Kane, a member of Grant Thornton International, is our internal auditor.

Employees

All of our employees are located in Israel. The following table sets forth, for the last three financial years, the number of our full time employees broken down into categories.

Period ending December 31,	2002	2001	2000
Administration and Management	20	18	20
Total	20	18	20

The following table sets forth for the last three financial years the number of employees of Elron Software broken down into categories.

Period ending December 31,	2002	2001	2000
Research and Development	24	30	35
Marketing, Sales and Customer Support	35.5	41	68
Administration and Management	10.5	16	24
Total	70	87	127

The following table sets forth for the last three financial years the number of employees of Elron TeleSoft broken down into categories.

Period ending December 31,	2002	2001	2000
Research and Development	8	23	23
Marketing and Sales	5	7	12
Software Projects and Engineering	31	148	292
Administration and Management	18	35	51
Total	62	213	378

Certain provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) and the Coordination Bureau of Economic Organizations (including the Industrialists' Associations) are applicable to our employees in Israel, and to Elron Software and Elron TeleSoft employees in Israel by order of the Israeli Ministry of Labor. These provisions concern principally the length of the work day, minimum daily wages for professional workers, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay, and other conditions of employment. We generally provide employees with benefits and working conditions beyond the minimum requirements.

Israeli law generally requires severance pay, which may be funded by Managers' Insurance described below, upon the retirement or death of an employee or termination of employment without cause (as defined in the law). The payments thereto amount to approximately 8.33% of wages. Furthermore, Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute, which is similar to the United States Social Security Administration. Such amounts also include payments for national health insurance. The payments to the National Insurance Institute are equal to approximately 14.5% of the wages, of which the employee contributes approximately 66% and the employer contributes approximately 34%.

A general practice followed by us and some of our group companies although not legally required, is the contribution of additional funds on behalf of most of the employees to a fund known as Managers' Insurance. This fund provides a combination of savings plan, insurance and severance pay benefits to the employee, giving the employee a lump sum payment upon retirement and securing the severance pay, if legally entitled, upon termination of employment. The employer decides which employees are entitled to participate in the plan, and each employee who agrees to participate contributes an amount equal to 5% of his or her salary and the employer contributes between 13.3% and 15.8% of the employee's salary.

Share Ownership

The number of our ordinary shares and options owned by each of our directors, and by our directors and officers as a group, as of May 31, 2003, is as follows:

Director	Ordinary Shares and Options
Ami Erel, Chairman[1]	116,154[2]
Avraham Asheri	0
Prof. Gabi Barbash	0
Dr. Chen Barir	0
Yaacov Goldman	0
Michael Kaufmann	0
Oren Lieder[1]	0
Dr. Dalia Meggido	0
Itzhak Ravid	0
Prof. Daniel Sipper	0
All officers and directors as a group	623,140[3]

(1) Officer of DIC. Ownership excludes shares owned by DIC.

(2) Consists solely of options to purchase our ordinary shares and includes options to purchase 19,334 ordinary shares granted subsequent to May 31, 2003.

(3) Includes options to purchase 618, 525 of our ordinary shares.

Stock Option Plan

We have granted options to purchase up to a total of 734, 275 of our ordinary shares to our officers and employees as of May 31, 2003. Details concerning these options are as follows:

Series 6 Options

There are outstanding options to purchase an aggregate of 4,500 of our ordinary shares, of which options to purchase an aggregate of 2,500 shares are held by one of our officers (the "Series 6 Options"). The Series 6 Options are exercisable at a price of approximately $11.29 per share. The optionholder is entitled to exercise 25% of the amount granted, each year, starting in March 1998. The Series 6 Options will expire in March 2006.

Series 7 Options

There are outstanding options to purchase an aggregate of 21,500 of our ordinary shares, of which options to purchase an aggregate of 12,500 shares are held by one of our officers (the “Series 7 Options”). The Series 7 Options are exercisable at a price of approximately $12.51 per share. The option holders are entitled to exercise 25% of the amount granted, each year, starting in March 1999. The Series 7 Options will expire in March 2005.

Series 9 Options

The Chairman of our board of directors was granted options to purchase 58,154 of our ordinary shares (the “Series 9 Options”). The Series 9 Options are to be granted ratably over a period of three years commencing on February 2000 and are exercisable for a period of three years, commencing two years after the date of grant.

The per share exercise price of the Series 9 Options granted in February 2000 and 2001 is approximately $21.38. The per share exercise price of the Series 9 Options granted in February 2002 is $13.01. Upon exercise of the Series 9 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.

Series 10 Options

There are outstanding options to purchase an aggregate of 33,000 of our ordinary shares of which options to purchase an aggregate of 20,000 shares are held by one of our officers (the “Series 10 Options). The Series 10 Options are exercisable at a price of approximately $29.38 per share. The optionholders are entitled to exercise 25% of the amount granted, each year, starting in October 2001. The Series 10 Options will expire in October 2007.

Series 11 Options

The Chairman of our board of directors was granted options to purchase 58,000 of our ordinary shares (the “Series 11 Options”). The Series 11 Options are to be granted ratably over a period of three years commencing in June 2001 and are exercisable for a period of three years, commencing two years after the date of grant. The first amount of 19,333 Series 11 Options was granted in June 2001. The per share exercise price of the Series 11 Options granted in June 2001 is $19.05. The second amount of 19,333 Series 11 Options was granted in June 2002. The per share exercise price of the Series 11 Options granted in June 2002 is $8.337. The third amount of 19,334 Series 11 Options was granted in June 2003. The per share exercise price of the Series 11 Options granted in June 2003 is $8.437.

Upon exercise of the Series 11 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.

Series 12 Options

There are outstanding options to purchase an aggregate of 42,000 of our ordinary shares held by two of our officers (the “Series 12 Options”). The Series 12 Options are exercisable at a price per share of approximately $18.87 per share. The officers are entitled to exercise 25% of the amount granted, each year, starting in June 2002. The Series 12 Options will expire in June 2008.

Series 13 Options

There are outstanding options to purchase an aggregate of 34,871 of our ordinary shares held by one of our officers (the “Series 13 Options”). The Series 13 Options are exercisable at a price of approximately $13.39 per share. The officer is entitled to exercise 25% of the amount granted, each year, starting in August 2002. The Series 13 Options will expire in August 2008.

Series 14 Options

There are outstanding options to purchase an aggregate of 33,750 of our ordinary shares of which options to purchase an aggregate of 20,000 shares are held by one of our officers (the “Series 14 Options”). The Series 14 Options are exercisable at a price of approximately $11.69 per share. The optionholders are entitled to exercise 25% of the amount granted, each year, starting in September 2002. The Series 14 Options will expire in September 2008.

Series 15 Options

There are outstanding options to purchase an aggregate of 140,500 of our ordinary shares of which options to purchase an aggregate of 120,000 shares are held by three of our officers (the “Series 15 Options”). The Series 15 Options are exercisable at a price of approximately $10.38 per share. The optionholders are entitled to exercise 25% of the amount granted, each year, starting in October 2002. The Series 15 Options will expire in October 2007.

Series 16 Options

There are outstanding options to purchase an aggregate of 18,000 of our ordinary shares held by one of our employees (the “Series 16 Options”). The Series 16 Options are exercisable at a price of approximately $11.15 per share. The officer is entitled to exercise 25% of the amount granted each year, starting in October 2002. The Series 16 Options will expire in November 2007.

Series 17 Options

There are outstanding options to purchase an aggregate of 30,000 of our ordinary shares, of which options to purchase an aggregate of 20,000 shares are held by one of our officers (the “Series 17 Options”). The Series 17 Options are exercisable at a price of approximately $7.67 per share. The optionholders are entitled to exercise 25% of the amount granted each year, starting in July 2003. The Series 17 Options will expire in July 2008.

2003 Option Plan

On May 8, 2003, our Board of Directors adopted the 2003 Option Plan. Pursuant to the 2003 Option Plan, the Board of Directors authorized the issuance of options to purchase 260,000 ordinary shares at an exercise price of $7.00 per share to our officers and employees. The optionees are entitled to exercise 25% of the amount granted, each year, starting in June 2003. The options will expire in June 2008. In granting the options, the Board of Directors selected the capital gains tax track pursuant to the new tax reform legislation which came into effect on

January 1, 2003. (For more details – see Item 10 – “Taxation” – “Employee Stock Option Plan.”) The grant of these options is subject to the approval of our shareholders at our next annual general meeting which has not yet been convened.

Elbit Ltd. Options

As part of our merger with Elbit, we assumed each outstanding option to purchase ordinary shares of Elbit. Each such option was deemed to be an option to purchase our ordinary shares. Each assumed option entitles the optionholder to acquire, on substantially the same terms and conditions applicable under the original Elbit option plan and agreements, the number of our ordinary shares equal to the number of Elbit ordinary shares subject to the option, multiplied by the exchange ratio of 0.45. Any fractional interests resulting from the assumption of options for each optionholder will be aggregated and rounded up to the nearest whole number. With these exceptions, the existing Elbit option plan and agreements remain in full force and effect. The Elbit option plan provides that each option becomes exercisable as to 50% of the shares on the second anniversary of the date of grant, 25% of the shares on the third anniversary of the date of grant, and the remaining 25% on the fourth anniversary of the date of grant.

As of May 31, 2003, options to acquire 94,249 of our shares by virtue of the Elbit options were outstanding. The exercise price of these options range from $6.84 to $18.09 and their expiration date range from December 2004 to December 2006.

Elron Software Stock Option Plans

One of our officers was granted options exercisable for up to 125,000 shares of common stock of Elron Software in accordance with the option plans approved and amended by Elron Software’s board of directors in November 1997, December 1998, November 1999, May 2000 and November 2001. Pursuant to the terms of the plans, the exercise price of the options was the fair market value of the shares on the date of grant of $0.50 per share. The options will vest over a four year period.

As a result of the demerger of Elron Software effective as of April 1, 2000 to two companies, Elron Software and Elron TeleSoft each option granted prior to the demerger is exercisable for one share of common stock of Elron Software and one share of common stock of Elron TeleSoft for no additional consideration. The exercise price of $0.50 will be divided equally between Elron Software and Elron TeleSoft.

Options of Certain Officers to acquire shares in our private group companies

During 2001, the Board of Directors approved the grant of options to certain of our officers to acquire between 1% to 2% of our investments in certain private companies. The options are exercisable at the weighted average price of our investments. The options vest ratably over a three year period and are exercisable for an additional three years. To date, none of the foregoing options has been exercised.

Item 7. Major Shareholders and Related Party Transactions

Major Shareholders

The following table sets forth, as of May 31, 2003, unless otherwise specified, the number of ordinary shares beneficially owned by all shareholders known to us to beneficially own more than 5% of our ordinary shares. The voting rights of our major shareholders do not differ from the voting rights of other holders of our ordinary shares. As of May 31, 2003, there were a total of 557 holders of record of our ordinary shares, of which 439 were registered with addresses in the United States. Such United States holders represented as of such date, holders of record of approximately 6.45% of our then outstanding ordinary shares.

Name and Address	Number of Ordinary Shares	Percent of Ordinary Shares
Discount Investment Corporation Ltd.(1) Tel Aviv, Israel	11,240,232	38.51%
Bank Leumi Group(2) Tel Aviv, Israel	2,398,463	8.22%
Clal Insurance Group(3)*	627,072	2.15%

* less than 5%

(1) IDB Holding Corporation Ltd. ("IDBH") is the parent of IDB Development Corporation Ltd. ("IDBD"), which, in turn, is the parent of Discount Investment Corporation Ltd. ("DIC") and the Clal Insurance Group. IDBH, IDBD and DIC are public companies traded on the Tel Aviv Stock Exchange.

On May 19, 2003, private companies controlled by Oudi Recanati, Leon Y. Recanati, Judith Yovel Recanati and Elaine Recanati completed a sale of all of the shares of IDBH held by them, constituting approximately 51.7% of the outstanding share capital of IDBH, to a group comprised of: (i) Ganden Investments I.D.B. Ltd. ("Ganden"), a private Israeli company controlled by Nochi Dankner and his sister, Shelly Dankner-Bergman, which, following this transaction, holds 31.02% of the equity of and voting power in IDBH; (ii) Manor Investments-IDB Ltd. ("Manor"), a private Israeli company controlled by Ruth Manor, which, following this transaction, holds 10.34% of the equity of and voting power in IDBH; and (iii) Avraham Livnat Investments (2002) Ltd. ("Livnat"), a private Israeli company controlled by Avraham Livnat, which, following this transaction, holds 10.34% of the equity of and voting power in IDBH. Ganden, Manor and Livnat, owning in the aggregate approximately 51.7% of the equity of and voting power in IDBH, entered into a Shareholders Agreement relating, among other things, to their joint control of IDBH, the term of which is until May 19, 2023.

Nochi Dankner is Chairman of IDBH, IDBD and DIC. Shelly Dankner-Bergman, Isaac Manor (the husband of Ruth Manor), Dori Manor (the son of Isaac and Ruth Manor) and Zvi Livnat (the son of Avraham Livnat) are directors of each of IDBH, IDBD and DIC.

DIC's address is 3 Azrieli Center, 43rd floor, Tel Aviv 67023, Israel.

(2) The Bank Leumi Group is comprised of the holdings of mutual and provident funds that are controlled by Bank Leumi. As of May 31, 2003, the State of Israel held approximately 41% of the outstanding shares of Bank Leumi. The balance of the shares of Bank Leumi were held as follows: (i) Migdal Insurance and Financial Holdings Ltd. held approximately 9.2% of the shares of Bank Leumi; (ii) Shlomo Eliahu Holdings Ltd. and affiliated companies held approximately 10% of Bank Leumi's shares; (iii) mutual funds of the Bank Hapoalim group held approximately 5% of Bank Leumi's shares; (iii) Otzar Hityashvuth Hayehudim B.M. held approximately 5.5% of Bank Leumi's shares; and (iv) the public held the remainder of Bank Leumi's shares. Migdal Insurance and Financial Holdings Ltd.'s shares are held by the Generali group, which holds approximately 64%, Bank Leumi, which holds approximately 22%, and by the public, which hold approximately 14%.

The Bank Leumi Group's address is 13 Ahad Haam Street, Tel Aviv, Israel.

(3) The Clal Insurance Group, is comprised of Clal Insurance Enterprises Holdings Ltd. ("Clal Insurance") and its subsidiary companies, which are deemed to be major shareholders. Clal Insurance is majority owned by IDBD, the parent company of DIC, which is our parent company. The other major shareholder of Clal Insurance is Bank Hapoalim, which holds approximately 23% of Clal Insurance's shares. The remaining shareholders of Clal Insurance hold less than 5% of the shares.

The Clal Insurance Group's address is 48 Menachem Begin Rd., Clal Development Bldg., Tel Aviv, Israel.

Related Party Transactions

Directors' Compensation

In July 2002, we agreed to grant compensation to all of our directors for the fiscal year 2002, according to the maximum amount then permitted according to the Israeli Companies Regulations (Rules Regarding Compensation and Expenses for an External Director), 2000 (the "External Director Regulations"), for companies of the same classification in relation to its shareholder's equity, which were, in addition to reimbursement of expenses, approximately NIS 43,000 (approximately $9,100) per director for one year and in addition approximately NIS 1,650 (approximately $348) per director for participation in each meeting of the board of directors or the audit committee.

Compensation of the Chairman

As long as Mr. Erel is the Chairman of the board of directors he is to receive an option to acquire up to 1.5% of any shares or other securities acquired in all of the investments in new companies, made or to be made by us after January 1, 2000, and an option to acquire up to 0.75% of any shares or other securities acquired in all the investments in private companies, held by us prior to January 1, 2000 (together, the "Option"). Our investment in those companies (the "Invested Company") might be directly or indirectly (through DEP). The Option shall be exercisable at the weighted average price of investments made by us with respect to any such Invested Company until the date of exercise of the Option. The Option shall be exercisable for a period of three years commencing on the later of January 1, 2000 or the date of the latest investment by us in the relevant Invested Company, provided that at the time of the Option exercise Mr. Erel is a director or an employee of ours and that we have not sold or otherwise transferred to a third party our securities in the relevant Invested Company.

Mr. Erel shall be entitled to participate in a sale by us of shares which were, or are, subject to Mr. Erel's Option hereunder, by selling the same proportion of his shares along with us. We may require Mr. Erel to sell such shares together with a sale of shares by us. Sales by Mr. Erel of shares acquired upon exercise of the foregoing Options, which are not publicly traded, will require our approval. To date, none of the foregoing options have been exercised.

Acquisition of 67% of the shares of DEP

On May 6, 2002, we completed the purchase of DIC's holding of 67% of the shares of DEP. Pursuant to the share purchase agreement with DIC dated November 19, 2001 we issued 2,261,843 ordinary shares to DIC in exchange for all of the shares held by DIC in DEP, including DIC's rights to loans provided by DIC to RDC. We and DIC received written opinions from our respective financial advisors that the number of shares issued to DIC in the transaction was fair from a financial point of view The transaction was approved by our shareholders at a special meeting held on April 28, 2002.

Merger with Elbit Ltd.

On May 15, 2002, we completed our merger with Elbit Ltd. Pursuant to the Agreement and Plan of Merger dated October 31, 2002, Elbit merged with us and we issued to Elbit's shareholders (other than us) approximately 5,617,600 Elron shares, based on an exchange ratio of 0.45 of our ordinary shares for each Ordinary Share of Elbit. We and Elbit received written opinions from our respective financial advisors that the exchange ratio was fair from a financial point of view. The merger was approved by our and Elbit's shareholders, creditors and optionholders on April 28, 2002 and April 29, 2002, respectively, and by the District Court of Tel-Aviv-Jaffa.

Acquisition of Shares of Galil Medical Ltd.

During 2002 and through May 31, 2003, we and, our subsidiary RDC, invested approximately $8.3 million and our parent company, DIC, invested approximately $3.5 million in convertible notes of Galil Medical in accordance with the terms of the Note Purchase Agreement dated May 2002 and the various addenda thereto. In addition, on June 27, 2002, we purchased an additional 10.75% of Galil's outstanding shares from Lumenis Ltd., in consideration for $0.8 million. Lumenis also received the right to receive a future earn-out payment, conditioned upon the occurrence of certain events on or before May 27, 2004. In the same transaction, DIC also purchased an additional 10.75% of Galil's outstanding shares from Lumenis under the same terms and conditions. These transactions were approved by our Audit Committee and our Board of Directors due to DIC's participation in the transactions.

Lease Agreement with Elbit Systems.

Elbit Systems currently leases from Elbit Ltd. approximately 170,000 square feet of office and manufacturing space in Karmiel, Israel. The lease expires in October 2006 and may be terminated earlier by Elbit Systems upon twelve months' prior written notice. The monthly rent is an amount in NIS equal to approximately $0.548 per square foot linked to the U.S. dollar and the U.S. CPI, payable quarterly at the beginning of each quarter. In the event that the area leased is substantially reduced, the monthly rent will be determined by the parties.

Directors and Officers Insurance Policy

In February 2003, following the resolution and recommendation of our Audit Committee and Board of Directors, our shareholders approved and ratified the purchase of a directors' and officers' liability insurance policy (the "Policy") for the directors and officers of the Company and separately approved the application of the Policy to Lenny Recanati, then one of our directors, and any future director or officer of the Company who may be considered a "Controlling Shareholder" under the Companies Law, 1999. The principal terms of the Policy are as follows:

(1) The Policy is for a period beginning on January 1, 2003 and ending on December 31, 2003.

(2) The coverage under the Policy is limited to $20 million per claim and in the aggregate during the Policy period.

(3) The annual premium to be paid with respect to the Policy will be approximately $1,075,000.

In addition, the shareholders approved: (i) any renewal and/or extension of the Policy for all our directors and officers; and (ii) the purchase of any other directors' and officers' liability insurance policy for our directors and officers upon the expiration of the Policy; provided that any such renewal, extension or purchase referred to in clauses (i) and (ii) above is for the benefit of our previous and/or current and/or future directors and officers and on terms substantially similar to those of the Policy; and that the premium will not increase by more than 25% in any year, as compared to the previous year.

Purchase of Shares of Given Imaging from RDC

On May 13, 2003, we and Rafael, the minority shareholder of RDC, purchased 2,000,000 shares of Given Imaging (1,000,000 each) from RDC for total consideration of approximately $12.2 million. Of the proceeds, a total of $4.0 million was used by RDC to repay shareholders' loans to each of Rafael and us and $2.5 million was used to repay its bank loan.

Item 8. Financial Information

Consolidated Statements and Other Financial Information

Our consolidated financial statements and other financial information are incorporated herein by reference to Item 18 below.

Legal Proceedings

Gesser Claim

On September 8, 1999, we received a copy of a statement of claim, along with a court order requiring a motion to approve this claim as a class action, submitted by Mr. David Gesser, a shareholder of Elscint. The motion requests that this claim be approved as class action instead of the previous claim submitted by Mr. Yonatan Aderet. This claim names as defendants Elscint

Ltd., Elbit, our company, and Messrs. Emmanuel Gill, Uzia Galil, Dov Tadmor, Micha Angel and Yigal Baruchi, former directors of Elscint, and Mr. Yonatan Aderet, the former President and director of Elscint. The motion was submitted by the applicant on behalf of all existing shareholders of Elscint who held Elscint's shares on February 18, 1999. The plaintiff seeks damages of approximately $158.0 million.

The claim alleges that the defendants, by their decisions regarding the sale of Elscint's assets, caused damage to Elscint and its minority shareholders. The plaintiff seeks a court order requiring Elscint, or the other defendants, to purchase from each of the members of the represented class all shares held by them at a price of $27.46 per share. The lawsuit has been suspended pursuant to an arrangement reached by the parties pending the outcome of the appeal in the Investors claim described below. The arrangement provides that if the appeal as described in the "Investors Claim" immediately 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.

Investors Claim

On November 2, 1999, we received a statement of claim and an application to claim as a class action against Europe Israel (M.M.S.) Ltd. (EIL), Elbit Medical Imaging, Elscint, Control Centers Ltd. (the controlling shareholder of EIL), Marina Herzliya Limited Partnership 1988 (which is controlled by Control Centers) and against us and 25 past and present officers of the above companies, including officers of Elron.

The claim was submitted by a number of investors and others, who hold shares in Elscint, while the application to approve the claim as a class action was submitted on behalf of shareholders who held shares in Elscint on September 6, 1999 and continued to hold such shares on the date of application, excluding the respondents.

The allegations, which the claimants raised against us and our officers, relate to the period prior to the sale of our holdings in Elbit Medical Imaging to EIL. These allegations include, among others, that (i) we and our officers gave preference to the interests of our company and the personal interests of our officers over the interests of Elscint and its minority shareholders; (ii) we and our officers did not act in order to enable the minority shareholders of Elscint to participate in the proceeds of the sale of Elscint's assets; and (iii) general allegations against the transactions whereby we sold our holdings in Elbit Medical Imaging to EIL. Further allegations were raised against the other respondents.

The plaintiffs seek a court order pursuant to which Elbit Medical Imaging would be compelled to execute the alleged buy-out of shares at $14 per share. Alternatively, the claimants have requested additional remedies set forth in the statement of claim, including a remedy requested also from us and our officers regarding compensation for the damages that they allege were suffered by them and/or by Elscint. Certain of the remedies have been requested also as derivative claims on behalf of Elscint. The maximum liability in this claim is not specified by the plaintiffs.

On August 16, 2000, the Haifa District court dismissed the application to recognize the claim as a class action. Some of the claimants requested and were granted permission to appeal to the Supreme Court of Israel. In addition, the claimants submitted an amended claim in

February 2001, which was not recognized as a class action suit. The allegations are similar to those in the previous claim. The appeal to the Supreme Court is still pending.

We deny all the allegations set forth in the above claims and are defending and intend to continue defending against such claims. Other than the above matters, we are not a party to any material litigation and we are not aware of any pending or threatened litigation that would have a material adverse effect on us or our business.

Dividend Policy

The declaration of dividends is determined each quarter by the board of directors taking into consideration our financial status, profitability, realization of assets and our investment requirements.

Significant Changes

Except as otherwise disclosed in this Annual Report, no significant change has occurred since December 31, 2002.

Item 9. The Offer and Listing

Markets and Share Price History

Our ordinary shares are traded on the Nasdaq National Market, where our shares are listed and traded on the under the symbol "ELRN". Prior to March 27, 2001, our shares were traded under the symbol "ELRNF". Our shares are also traded on the Tel Aviv Stock Exchange (TASE) in Israel. The following table sets forth, for the periods indicated, the high and low reported sales prices of our Ordinary Shares on the Nasdaq National Market and, in New Israeli Shekels (NIS), on the Tel Aviv Stock Exchange:

Period	NASDAQ High (US dollars)	NASDAQ Low (US dollars)	TASE High (NIS)	TASE Low (NIS)
May 2003	8.78	6.79	38.93	31.18
April 2003	8.05	6.32	36.55	29.46
March 2003	6.81	5.76	31.79	27.94
February 2003	5.78	4.92	27.34	23.97
January 2003	5.70	5.02	27.26	24.83
December 2002	7.56	5.75	35.55	27.76
Fourth Quarter 2002	7.56	5.50	35.55	27.71
Third Quarter 2002	9.15	6.26	43.24	30.63
Second Quarter 2002	9.94	7.71	47.58	37.68
First Quarter 2002	14.83	10.57	65.80	45.58
Fourth Quarter 2001	14.65	11.00	64.90	48.17
Third Quarter 2001	15.65	10.55	65.00	47.51
Second Quarter 2001	16.29	11.63	67.60	49.55
First Quarter 2001	27.00	11.50	105.00	51.40
2000	55.12	25.00	216.68	104.40
1999	30.25	14.44	122.70	60.80
1998	19.25	10.00	69.33	44.03
1997	18.50	10.75	63.24	34.33

Item 10. Additional Information

Memorandum and Articles of Association

Articles of Association; Israel Companies Law

Our shareholders approved the adoption of our new Articles of Association in March 2001. The objective of Elron as stated in our Articles and in our Memorandum of Association is to engage in any lawful activity.

We have currently outstanding only one class of securities, our Ordinary Shares, par value NIS 0.003 per share. No preferred shares are currently authorized.

Holders of Ordinary Shares have one vote per share, and are entitled to participate equally in the payment of dividends and share distributions and, in the event of our liquidation, in the distribution of assets after satisfaction of liabilities to creditors. According to our Articles, any modification of the Articles requires the approval of a Special Majority at a General Meeting. A Special Majority is defined in our Articles as at least a majority of 67% of the shareholders who voted at the General Meeting, without taking abstaining votes into account.

The Israeli Companies Law and our Articles require that we hold our annual general meeting of shareholders each year no later than 15 months from the last annual meeting, at a time and place determined by the board of directors, upon at least 21 days prior notice to our shareholders. Under the Israeli law and regulations and our Articles of Association, notice of the meeting is required to be published in two widely distributed daily newspapers published in Hebrew and to be sent to shareholders whose names appear in the Shareholders Register if their registered shares are not in Israel. No business may be commenced until a quorum of two or more shareholders holding at least one third of the voting rights are present in person or by proxy. The Israeli Companies Law provides that the record date for the participation of shareholders of a company whose shares are traded or registered outside of Israel such as us may be no more than 40 but no less than 4 days prior to the meeting, provided that notice for said meeting is given prior to the record date. Resolutions regarding the following matters must be passed at a general meeting of shareholders:

- amendments to our Articles and Memorandum of Association;
- appointment or termination of our auditors;
- appointment and dismissal of directors;
- approval of interested party actions and transactions requiring general meeting approval as provided in sections 255 and 268 to 275 of the Israeli Companies Law;
- increase or reduction of our authorized share capital and alterations of our share capital;
- a merger as provided in section 320(a) of the Israeli Companies Law;
- the exercise of the board of directors' powers by a general meeting, if the board of directors is unable to exercise its powers and the exercise of any of its powers is vital for our proper management, as provided in section 52(a) of the Israeli Companies Law; and
- any matter that is required to be adopted by resolution of a general meeting pursuant to the Israeli Companies Law or in accordance with our Articles.

An extraordinary meeting of our shareholders shall be convened by the decision of the board, or at the request of any two directors or one quarter of the officiating directors, or by request of one or more shareholders holding at least 5% of the voting rights in our company. Shareholders requesting an extraordinary meeting must submit their proposed resolution with their request. Within 21 days of receipt of the request, the board must convene an extraordinary meeting and send out notices setting forth the date, time and place of the meeting. Such notice must be given at least 21 days, but not more than 35 days, prior to the extraordinary meeting.

The Israeli Companies Law codifies the fiduciary duties and duty of care that office holders owe to a company. An office holder, is defined in the Israeli Companies Law, as a (i) director, (ii) general manager, (iii) chief business manager, (iv) deputy general manager, (v) vice general manager, (vi) executive vice president, (vii) vice president, (viii) another manager directly subordinate to the general manager or (ix) any other person assuming the responsibilities of any of the forgoing positions without regard to such person’s title. Each person listed in the table under “Directors and Senior Management” in Item 6 above is an office holder.

The Israeli Companies Law requires that an office holder of a company promptly disclose, and no later than the first board meeting in which such transaction is discussed, any personal interest that he or she may have and all related material information known to him or her, in connection with any existing or proposed transaction by the company. In addition, if the transaction is an extraordinary transaction, the office holder must also disclose any personal interest held by the office holder’s relative (as defined above). An extraordinary transaction is defined as a transaction not in the ordinary course of business, not on market terms, or that is likely to have a material impact on the company’s profitability, assets or liabilities.

In the case of a transaction in which an officer has a personal interest that is not an extraordinary transaction, after the office holder complies with the above disclosure requirement, board approval is required unless the Articles of Association of the company provide otherwise. If the transaction in which an officer has a personal interest is an extraordinary transaction, then, it must also be approved by the audit committee and by the board of directors.

Agreements regarding directors’ terms of employment require the approval of audit committee, the board of directors and the shareholders. In all matters in which a director has a personal interest, including matters of his/her terms of employment, he/she shall not be permitted to vote on the matter or be present in the meeting in which the matter is considered. However, should a majority of the audit committee or of the board of directors have a personal interest in the matter then:

a) all of the directors shall be permitted to vote on the matter and attend the meeting in which the matter is considered; and

b) the matter requires approval of the shareholders at a general meeting.

According to the Israeli Companies Law, the disclosure requirements discussed above also apply to a controlling shareholder of a public company. The term “controlling shareholder” for these purposes also includes shareholders that hold 25% or more of the voting rights if no other shareholder owns more than 50% of the voting rights in the company. In general, extraordinary transactions with a controlling shareholder or in which a controlling shareholder has a personal interest, and agreements relating to employment and compensation terms of a controlling shareholder require the approval of the audit committee, the board of directors and the shareholders of the company.

Such shareholder approval must either include at least one-third of the shares held by disinterested shareholders who are present in person or by proxy at the meeting (without taking abstaining votes into account), or, alternatively, the total shareholdings of the disinterested shareholders who vote against the transaction must not represent more than one percent of the voting rights in the company. Under specified circumstances, such shareholder approval is not required.

Under the Israeli Companies Law and the regulations thereunder, if a private placement will result in a party acquiring 20% or more of the voting rights of a company, then the allotment must be approved by the board of directors and by the shareholders of the company. If a substantial placement is made to a director or a Chief Executive Officer, or if any placement is made to any person that will become a controlling shareholder after the issuance, the allotment must be approved by the board of directors and the by the shareholders. A substantial private placement of securities is defined as a private placement that will increase the relative holdings of a shareholder that holds five percent or more of the company's outstanding share capital, assuming the exercise of all of the securities convertible into shares held by that person, or that will cause any person to become, as a result of the issuance, a holder of more than five percent of the company's outstanding share capital. Any placement of securities that does not fall within the above description may be issued at the discretion of the board of directors.

Under the Israeli Companies Law, a shareholder has a duty to act in good faith towards the company and other shareholders when exercising his rights and refrain from abusing his power in the company, including, among other things, voting in the general meeting of shareholders on the following matters:

- any amendment to the Articles of Association;
- an increase of the company's authorized share capital;
- a merger; or
- approval of interested party acts and transactions that require general meeting approval as provided in sections 255 and 268 to 275 of the Israeli Companies Law.

In addition, any controlling shareholder, any shareholder who knows that it possesses power to determine the outcome of a shareholder vote and any shareholder who has the power to appoint or prevent the appointment office holder in the company is under a duty to act with fairness towards the company. The Israeli Companies Law does not describe the substance of this duty. The Israeli Companies Law requires that specified types of transactions, actions and arrangements be approved as provided for in a company's articles of association and in some circumstances by the audit committee, by the board of directors and by the general meeting of the shareholders. The vote required by the audit committee and the board of directors for approval of these matters, in each case, is a majority of the directors participating in a duly convened meeting.

Material Contracts

For a discussion of the merger agreement relating to our merger with Elbit Ltd. and the share purchase agreement relating to our purchase of DIC's 67% shareholding in DEP, see Item 4- "Information on the Company" above.

On December 2, 2002, Elbit.Com Ltd., a wholly owned subsidiary of Elbit and through which we hold our shares in Partner, executed a Deed of Pledge with Bank Leumi Le-Israel B.M. pursuant to which we pledged approximately 15.9 million of our shares of Partner representing, as of June 2, 2003, approximately 85% of our total holdings of Partner, to a consortium of banks as security by us and Partner's other original shareholders for Partner's obligations under its line of credit with the consortium of banks, each pro rata to its respective holding. The Deed of Pledge replaced a previous pledge of the same shares. The Deed of Pledge has been filed as Exhibit 4.16 to this Annual Report.

On June 16, 2003, we signed an Addendum to the RDC Joint Venture Agreement dated June 16, 2003 among DEP Technology Holdings Ltd., Rafael Armament Development Authority Ltd., Galram Technologies Industries Ltd. and RDC Rafael Development Corporation Ltd. The RDC Joint Venture Agreement grants RDC certain rights to exploit commercially technologies of Rafael in non-military markets. This Addendum has been filed as Exhibit 4.17 to this Annual Report.

Exchange Controls

The Israeli Currency Control Law, 1978 imposes certain limitations concerning foreign currency transactions and transactions between Israeli and non-Israeli residents, which limitations may be regulated or waived by the Controller of Foreign Exchange at the Bank of Israel, through "general" and "special" permits. In May 1998, a new "general permit" was issued pursuant to which substantially all transactions in foreign currency are permitted. Any dividends or other distributions paid in respect of Ordinary Shares and any amounts payable upon our dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of our securities to an Israeli resident are freely repatriable into non-Israeli currencies at the rate of exchange prevailing at the time of conversion, provided that Israeli income tax has been paid on (or withheld from) such payments.

Taxation

The following is a summary of the material provisions of the current tax law applicable to companies in Israel, with special reference to its effect on us and our group companies. The following also contains a discussion of material Israeli tax consequences to our shareholders and government programs from which we and some of our group companies benefit. To the extent that the discussion is based on tax legislation that has not been subject to judicial or administrative interpretation, we cannot assure you that the views expressed in the discussion will be accepted by the tax authorities in question.

In July 2002, the Israeli Parliament approved a law enacting extensive changes to Israel's tax law (the "Tax Reform Legislation") generally effective January 1, 2003. Among the key provisions of the Tax Reform Legislation are (i) changes which may result in the imposition of taxes on dividends received by an Israeli company from its foreign subsidiaries; and (ii) the introduction of the "controlled foreign corporation" concept according to which an Israeli company may become subject to Israeli taxes on certain income of a non-Israeli subsidiary if the subsidiary's primary source of income is passive income (such as interest, dividends, royalties, rental income or capital gains). An Israeli company that is subject to Israeli taxes on the income of its non-Israeli subsidiaries will receive a credit for income taxes paid/withheld or will be paid/withheld by the subsidiary in its country of residence, according to the terms and conditions determined in the Israeli Tax Ordinance.

The discussion is not intended, and should not be construed, as legal or professional tax advice and is not exhaustive of all possible tax considerations.

General Corporate Tax Structure

Israeli companies are generally subject to company tax at the rate of 36% of taxable income. However, the effective tax rate payable by a company that derives income from an Approved Enterprise (as further discussed below) may be considerably less.

Law for the Encouragement of Capital Investments, 1959

From time to time, certain operations of our group companies have been granted Approved Enterprise status under the Law for the Encouragement of Capital Investments, 1959, as amended, or the Investment Law.

The Investment Law provides that a capital investment in eligible facilities may, upon application to the Investment Center of the Ministry of Industry and Trade of the State of Israel, or the Investment Center, be designated as an Approved Enterprise. Each certificate of approval for an Approved Enterprise relates to a specific investment program delineated both by its financial scope, including its capital sources, and by its physical characteristics, e.g., the equipment to be purchased and utilized pursuant to the program. The tax benefits derived from any such certificate of approval relate only to taxable income attributable to the specific Approved Enterprise.

Taxable income of a company derived from an Approved Enterprise is subject to company tax at the rate of up to 25% (rather than 36% as stated above) for a period of time termed the benefit period. The benefit period is a period of seven years commencing with the year in which the Approved Enterprise first generated taxable income. The benefits may be shorter as it is limited to 12 years from the commencement of production or 14 years from the date of approval, whichever is earlier. Under certain circumstances (as further detailed below), the benefit period may extend to a maximum of ten years from the commencement of the benefit period. A company which operates under more than one approval or that has capital investments which are only partly approved (such a company being designated as a Mixed Enterprise), may have an effective company tax rate that is the result of a weighted combination of the various applicable rates.

A company owning an Approved Enterprise may elect to forego certain government grants extended to Approved Enterprises in return for what is termed an alternative package of tax benefits (referred to as the Alternative Package). Under the Alternative Package, a company's undistributed income derived from an Approved Enterprise will be exempt from company tax for a period of between two and ten years, depending on the geographic location the Approved Enterprise within Israel. Such company will be eligible for the tax benefits under the Investment Law for the remainder of the benefit period.

Should the percentage of share capital of the companies having Approved Enterprises held by foreign shareholders exceed 25%, future Approved Enterprises of such companies would qualify for reduced tax rates for an additional three years, after the seven years mentioned above.

The company tax rate applicable to income earned from Approved Enterprise programs (currently, for programs on which an application for an approved enterprise status was submitted before 31, December, 2002) in the benefit period by a company meeting these qualifications is as follows:

% of Foreign Ownership	**Tax Rate**
Over 25% but less than 49%	25%
49% or more but less than 74%	20%
74% or more but less than 90%	15%
90% or more	10%

Entitlement to these benefits is subject to the final ratification of the Investment Center, and is conditioned upon fulfillment of all terms of the approved program. However, there can be no assurance that our group companies which enjoy Approved Enterprise benefits will obtain approval for additional Approved Enterprises, or that the provisions of the Investment Law will not change with respect to future approvals, or that the above-mentioned shareholding portion will be reached for each subsequent year.

A company that has elected the Alternative Package and that subsequently pays a dividend out of income derived from the Approved Enterprise(s) during the tax exemption period will be subject to deferred company tax in respect of the amount distributed (including the recipient's tax thereon) at the rate which would have been applicable had such company not elected the Alternative Package. This rate is generally 10% to 25%, depending on the extent to which non-Israeli shareholders hold such company's shares.

The dividend recipient is taxed at the reduced rate applicable to dividends from Approved Enterprises (generally 15% as compared to 25%), if the dividend is distributed during the tax benefit period or within 12 years after this period. However, the limitation does not apply if the company qualifies as a foreign investors' company. This tax must be withheld by such company at source, regardless of whether the dividend is converted into foreign currency.

Subject to certain provisions concerning income subject to Mixed Enterprises, all dividends are considered to be attributable to the entire enterprise and the effective tax rate on the dividend is the result of a weighted combination of the various applicable tax rates. However, such company is not obliged to distribute exempt retained profits under the Alternative Package, and such company may generally decide from which year's profits to declare dividends.

Each application to the Investment Center is reviewed separately, and a decision as to whether or not to approve such application is based, among other things, on the then prevailing criteria set forth in the Investment Law, on the specific objectives of the applicant company set forth in such application and on certain financial criteria of the applicant company. Accordingly, there can be no assurance that any such application will be approved. In addition, the benefits available to an Approved Enterprise are conditional upon the fulfillment of certain conditions stipulated in the Investment Law and its regulations and the criteria set forth in the certificate of approval, as described above. In the event that these conditions are violated, in whole or in part, a company with an Approved Enterprise would be required to refund the amount of tax benefits, with the addition of the Israeli consumer price index linkage differences and interest.

Taxation under Inflationary Conditions

The Income Tax Law (Inflationary Adjustments), 1985 (referred to as the Inflationary Adjustments Law) is intended to neutralize the erosion of capital investments in business and to prevent tax benefits resulting from deduction of inflationary expenses. This law applies a supplementary set of inflationary adjustments to the normal taxable profits computed under regular historical cost principles. We are taxed under this law.

Under the Inflationary Adjustments Law, results for tax purposes are measured in real terms, in accordance with the changes in the consumer price index. In addition, subject to certain limitations, depreciation of fixed assets and losses carried forward are adjusted for inflation on the basis of changes in the consumer price index.

The salient features of the Inflationary Adjustments Law can be described generally as follows:

A special tax adjustment for the preservation of equity whereby certain corporate assets are classified broadly into Fixed (inflation resistant) Assets and Non-Fixed (soft) Assets. Where a company's equity, as defined in such law, exceeds the depreciated cost of Fixed Assets, a deduction from taxable income that takes into account the effect of the applicable annual rate of inflation on such excess is allowed (up to a ceiling of 70% of taxable income in any single tax year, with the unused portion permitted to be carried forward on a linked basis to the following year, to be deducted from any taxable income, the excess amount will be considered a business loss). If the depreciated cost of Fixed Assets exceeds a company's equity, then such excess multiplied by the applicable annual rate of inflation is added to taxable income.

Subject to certain limitations, depreciation deductions on Fixed Assets and losses carried forward are adjusted for inflation based on the increase in the consumer price index (from the beginning of the 1982 fiscal year, and as of the 1985 fiscal year, with respect to equipment); and gains on the sale of certain traded securities are taxable.

However, dealers in securities are subject to the regular tax rules applicable to business income in Israel.

Law for the Encouragement of Industry (Taxes), 1969

Certain of our group companies currently qualify as Industrial Companies within the definition of the Law for the Encouragement of Industry (Taxes), 1969 (referred to as the Industry Encouragement Law). According to the Industry Encouragement Law, an Industrial Company is a company resident in Israel, at least 90% of the income of which in any tax year (exclusive of income from defense loans, capital gains, interest and dividends) is derived from an Industrial Enterprise owned by it. An Industrial Enterprise is defined as an enterprise whose major activity in a given tax year is industrial production activity.

The following preferred corporate tax benefits are available to Industrial Companies: (a) deduction of purchases of know-how and patents over an eight-year period for tax purposes; (b) under certain interpretations, deduction of expenses incurred in connection with a public issuance of securities over a three-year period; and (c) an election under certain conditions to file a consolidated tax return with additional related Israeli Industrial Companies and/or with a company that controls an Industrial Company and a specified percentage of its assets are invested in industrial companies.

Eligibility for the benefits under the Industry Encouragement Law is not subject to receipt of prior approval from any governmental authority. No assurance can be given that our group companies will continue to qualify as an Industrial Company or that the benefits described above will be available in the future.

Capital Gains Tax

Israeli law imposes a capital gains tax on the sale of capital assets. The law distinguishes between the Real Gain and the Inflationary Surplus. The Real Gain is the excess of the total capital gain over the Inflationary Surplus, computed on the basis of the increase of the consumer price index between the date of purchase and date of sale. The Inflationary Surplus accumulated until December 31, 1993 is taxed at a rate of 10% for residents of Israel (reduced to no tax for non-residents if calculated according to the exchange rate of the foreign currency lawfully invested in shares of an Israeli resident company, instead of the consumer price index). Inflationary Surplus accumulated from and after December 31, 1993 is exempt from any capital gains tax, while the Real Gain is added to ordinary income, which effective until December 31 2002 is taxed at the marginal rate of up to 50% for individuals and 36% for corporations. Effective January 1, 2003, the capital gains tax rate imposed upon sale of capital assets acquired after that date has been reduced to 25%; capital gains accrued from assets acquired before that date are subject to a blended tax rate based on the relative periods of time before and after that date that the asset was held.

Under current law, effective January 1, 2003 so long as our Ordinary Shares are listed on a stock exchange the sale of these shares is subject to 15% tax in case the shares were purchased after December 31, 2002, and in case the shares were purchased before that date the sale will be subject to a blended tax in which the portion of the gain accrued until December 31, 2002 will be exempt from Israeli capital gains tax and the portion of the real gain accrued from January 1, 2003 until the date of sale will be subject to 15% tax. The taxable real gain will be based on the difference between the adjusted average value of the shares during the last three trading days before January 1, 2003 (or the adjusted original cost if it is higher than the adjusted average value) and the value of the shares at the date of sale. In the event the above mentioned calculation creates a loss, such loss can only be offset against a capital gain from other traded securities according to the provisions of the Israeli law. The amount of the loss is limited to the difference between the adjusted average value and the value of the shares at the date of sale.

In addition, if our ordinary shares are traded on the Tel Aviv Stock Exchange (or listed on a stock exchange recognized by the Israeli Ministry of Finance), gains on the sale of ordinary shares held by non-Israeli tax resident investors will generally be exempt from Israeli capital gains tax. Notwithstanding the foregoing, dealers in securities in Israel and companies taxed under the Inflationary Adjustment Law are taxed at regular tax rates applicable to business income.

Employee Stock Options

Effective from January 1, 2003, the Tax Reform Legislation enables a company to grant options through one of three tax tracks:

(a) the income tax track through a trustee pursuant to which the optionee pays income tax rate (according to the marginal tax rate of the optionee- up to 50% tax) plus payments to the National Insurance Institute and health tax on the profit gained upon the earlier to occur of the transfer of the options or the underlying shares from the trustee to the optionee or the sale of the options or the underlying shares by the trustee, and the company may recognize expenses pertaining to the options for tax purposes. The options (or upon their exercise, the underlying shares), must be held by a trustee for a period of 12 months commencing from the end of the year in which the options were granted; or

(b) the capital gains tax track through a trustee pursuant to which the optionee pays capital gains tax at a rate of 25% on the profit upon, the earlier to occur of the transfer of the options or the underlying shares from the trustee to the optionee or the sale of the options or the underlying shares by the trustee (in this track the optionee is not required to make payments to the National Insurance Institute and health tax) and the Company may not recognize expenses pertaining to the options for tax purposes. The options (or upon their exercise, the underlying shares), must be held by a trustee for a period of 24 months commencing from the end of the year in which the options were granted; or

(c) the income tax track without a trustee pursuant to which the optionee pays income tax rate (according to the marginal tax rate of the optionee- up to 50% tax) plus payments to the National Insurance Institute and health tax on the profit upon the sale of the underlying shares, and the company may not recognize expenses pertaining to the options for tax purposes.

In accordance with the provisions of the Tax Reform Legislation, if a company has selected the capital gains track, the company must continue granting options under the selected capital gains track until the end of the year following the year in which the first grant of options under that trustee track will be made. Notwithstanding the above, the company may at any time also grant options under the provisions of the income tax track without a trustee.

The above rules apply only to employees, including officer holders but excluding controlling shareholders.

U.S.-Israel Tax Treaty

Pursuant to the Convention Between the Government of the United States of America and the Government of Israel with Respect to Taxes on Income (referred to as the U.S.-Israel Tax Treaty), the sale, exchange or disposition of ordinary shares by a person who qualifies as a resident of the United States within the meaning of the U.S.-Israel Tax Treaty and who is entitled to claim the benefits afforded to such resident by the U.S.-Israel Tax Treaty (called a Treaty U.S. Resident) will not be subject to Israeli capital gains tax unless (a) such Treaty U.S. Resident is an individual and was present in Israel for more than 183 days during the relevant taxable year or (b) such Treaty U.S. Resident holds, directly or indirectly, shares representing 10% or more of the voting power of a company during any part of the 12-month period preceding such sale, exchange or disposition. A sale, exchange or disposition of shares by a Treaty U.S. Resident who is an individual and was present in Israel for more than 183 days during the relevant taxable year or who holds, directly or indirectly, shares representing 10% or more of the voting power of a company at any time during such preceding 12-month period would be subject to such Israeli tax, to the extent applicable, unless the aforementioned exemption from capital gain tax for shares listed on the Tel-Aviv Stock Exchange applies; however, in case under the U.S.-Israel Tax

Treaty and the Israeli tax law a Treaty U.S. Resident will be subject to capital gain tax in Israel, such Treaty U.S. Resident would be permitted to claim a credit for such taxes against the U.S. income tax imposed with respect to such sale, exchange or disposition, subject to the limitations in U.S. laws applicable to foreign tax credits.

Taxation of Non-Residents

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel. Such sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel and capital gain as mentioned above. On distributions of dividends other than bonus shares (stock dividends), income tax at the rate of 25% is withheld at source, unless a different rate is provided in a treaty between Israel and the shareholder's country of residence. For example, the tax rate would be 12.5% if the non-resident is a company which holds 10% or more of our voting power pursuant to the U.S.-Israel Tax Treaty. Under the U.S.-Israel Tax Treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a resident of the United States will be 25%. However, under the Investment Law, dividends generated by an Approved Enterprise in any case are taxed at the rate of 15%.

U.S. Federal Income Tax Considerations

Subject to the limitations described herein, this discussion summarizes the material U.S. federal income tax consequences of the purchase, ownership and disposition of our ordinary shares to a U.S. holder. A U.S. holder is a holder of our ordinary shares who is:

- an individual citizen or resident of the U.S.;
- a corporation (or another entity taxable as a corporation for U.S. federal income tax purposes) created or organized under the laws of the United States or any political subdivision thereof;
- an estate, the income of which may be included in gross income for U.S. federal income tax purposes regardless of its source; or
- a trust (i) if, in general, a U.S. court is able to exercise primary supervision over its administration and one or more U.S. persons have the authority to control all of its substantial decisions or (ii) that has in effect a valid election under applicable U.S. Treasury regulations to be treated as a U.S. person.

Unless otherwise specifically indicated, this discussion does not consider the U.S. tax consequences to a person that is not a U.S. holder and considers only U.S. holders that will own the ordinary shares as capital assets.

This discussion is based on current provisions of the Internal Revenue Code of 1986, as amended (the "Code"), current and proposed Treasury regulations promulgated under the Code and administrative and judicial interpretations of the Code, all as currently in effect and all of which are subject to change, possibly with a retroactive effect. This discussion does not address all aspects of U.S. federal income taxation that may be relevant to any particular U.S. holder based on the U.S. holder's particular circumstances. In particular, this discussion does not address the U.S. federal income tax consequences to U.S. holders who are broker-dealers or who own, directly, indirectly or constructively, 10% or more of our outstanding voting shares, U.S.

holders holding the ordinary shares as part of a hedging, straddle or conversion transaction, U.S. holders whose functional currency is not the U.S. dollar, insurance companies, tax-exempt organizations, financial institutions and persons subject to the alternative minimum tax, who may be subject to special rules not discussed below. Additionally, the tax treatment of persons who hold the ordinary shares through a partnership or other pass-through entity is not considered, nor is the possible application of U.S. federal estate or gift taxes or any aspect of state, local or non-U.S. tax laws.

You are advised to consult your tax advisor with respect to the specific U.S. federal, state, local and foreign income tax consequences to you of purchasing, holding or disposing of our ordinary shares.

Taxation of Distributions on Ordinary Shares

The amount of a distribution with respect to the ordinary shares will equal the amount of cash and the fair market value of any property distributed and will also include the amount of any Israeli taxes withheld as described above under "Taxation of Non-Residents." A distribution paid by us with respect to the ordinary shares to a U.S. holder will be treated as dividend income to the extent that the distribution does not exceed our current and accumulated earnings and profits, as determined for U.S. federal income tax purposes. Dividends that are received by U.S. holders that are individuals, estates or trusts will be taxed at the rate applicable to long-term capital gains (a maximum rate of 15%), provided that such dividends meet the requirements of "qualified dividend income." Dividends that fail to meet such requirements, and dividends received by corporate U.S. holders are taxed at ordinary income rates. No dividend received by a U.S. holder will be a qualified dividend (1) if the U.S. holder held the ordinary share with respect to which the dividend was paid for less than 61 days during the 120-day period beginning on the date that is 60 days before the ex-dividend date with respect to such dividend, excluding for this purpose, under the rules of Code section 246(c), any period during which the U.S. holder has an option to sell, is under a contractual obligation to sell, has made and not closed a short sale of, is the grantor of a deep-in-the-money or otherwise nonqualified option to buy, or has otherwise diminished its risk of loss by holding other positions with respect to, such ordinary share (or substantially identical securities); or (2) to the extent that the U.S. holder is under an obligation (pursuant to a short sale or otherwise) to make related payments with respect to positions in property substantially similar or related to the ordinary share with respect to which the dividend is paid. If we were to be a "passive foreign investment company," a "foreign personal holding company" or a "foreign investment company" (as such terms are defined in the Code) for any year, dividends paid on our ordinary shares in such year or in the following year would not be qualified dividends. In addition, a non-corporate U.S. holder will be able to take a qualified dividend into account in determining its deductible investment interest (which is generally limited to its net investment income) only if it elects to do so; in such case the dividend will be taxed at ordinary income rates. Distributions received by a foreign corporation that is not a "qualified foreign corporation" are taxed at a minimum rate of 35%.

The amount of any distribution which exceeds the amount treated as a dividend will be treated first as a non-taxable return of capital, reducing the U.S. holder's tax basis in its ordinary shares to the extent thereof, and then as capital gain from the deemed disposition of the ordinary shares. Corporate holders will not be allowed a deduction for dividends received in respect of the ordinary shares.

Dividends paid by us in NIS will be included in the income of U.S. holders at the dollar amount of the dividend (including any Israeli taxes withheld therefrom), based upon the spot rate of exchange in effect on the date of the distribution. U.S. holders will have a tax basis in the NIS for U.S. federal income tax purposes equal to that dollar value. Any subsequent gain or loss in respect of the NIS arising from exchange rate fluctuations will generally be taxable as U.S. source ordinary income or loss.

Subject to the limitations set forth in the Code and the Treasury regulations thereunder, U.S. holders may elect to claim as a foreign tax credit against their U.S. federal income tax liability the Israeli income tax withheld from dividends received in respect of the ordinary shares. The limitations on claiming a foreign tax credit include, among others, computation rules under which foreign tax credits allowable with respect to specific classes of income cannot exceed the U.S. federal income taxes otherwise payable with respect to each such class of income. In this regard, dividends paid by us will be foreign source "passive income" for U.S. foreign tax credit purposes or, in the case of a financial services entity, "financial services income." U.S. holders that do not elect to claim a foreign tax credit may instead claim a deduction for the Israeli income tax withheld. The rules relating to foreign tax credits are complex, and you should consult your tax advisor to determine whether and to what extent you would be entitled to this credit. A U.S. holder will be denied a foreign tax credit for Israeli income tax withheld from a dividend received on the ordinary shares (i) if the U.S. holder has not held the ordinary shares for at least 16 days of the 30 day period beginning on the date which is 15 days before the ex-dividend date with respect to such dividend or (ii) to the extent the U.S. holder is under an obligation to make related payments with respect to positions in substantially similar or related property. Any days during which a U.S. holder has substantially diminished its risk of loss on the ordinary shares are not counted toward meeting the required 16 day holding period. Distributions of current or accumulated earnings and profits will be foreign source passive income for U.S. foreign tax credit purposes.

Taxation of the Disposition of Ordinary Shares

Subject to the discussion below under "Tax Consequences if We are a Passive Foreign Investment Company," upon the sale, exchange or other disposition of our ordinary shares, a U.S. holder will recognize capital gain or loss in an amount equal to the difference between the amount realized on the disposition and the U.S. holder's tax basis in the ordinary shares. The gain or loss recognized on the disposition of the ordinary shares will be long-term capital gain or loss if the U.S. holder held the ordinary shares for more than one year at the time of the disposition and is eligible for a maximum 15% rate of taxation for individuals. The maximum rate of 15% applies to sales or exchanges on or after May 6, 2003. Capital gain from the sale, exchange or other disposition of ordinary shares held for one year or less is short-term capital gain and taxed as ordinary income at a maximum rate of 35%. Gain or loss recognized by a U.S. holder on a sale, exchange or other disposition of ordinary shares will be treated as U.S. source income or loss for U.S. foreign tax credit purposes.

A U.S. holder that uses the cash method of accounting calculates the dollar value of the proceeds received on the sale as of the date that the sale settles. However, a U.S. holder that uses the accrual method of accounting is required to calculate the value of the proceeds of the sale as of the trade date and may therefore realize foreign currency gain or loss. A U.S. holder may avoid realizing foreign currency gain or loss by electing to use the settlement date to determine the proceeds of sale for purposes of calculating the foreign currency gain or loss. In addition, a

U.S. holder that receives foreign currency upon disposition of ordinary shares and converts the foreign currency into dollars after the settlement date or trade date (whichever date the U.S. holder is required to use to calculate the value of the proceeds of sale) will have foreign exchange gain or loss based on any appreciation or depreciation in the value of the foreign currency against the dollar, which will generally be U.S. source ordinary income or loss.

Tax Consequences if We are a Passive Foreign Investment Company

We will be a passive foreign investment company, or PFIC, if either (1) 75% or more of our gross income in a taxable year is passive income; or (2) 50% or more of the value, determined on the basis of a quarterly average, of our assets in a taxable year are held for the production of passive income. If we own (directly or indirectly) at least 25% by value of the stock of another corporation, we will be treated for purposes of the foregoing tests as owning our proportionate share of the other corporation's assets and as directly earning our proportionate share of the other corporation's income. If we are a PFIC, a U.S. holder must determine under which of three alternative taxing regimes it wishes to be taxed:

The "QEF" regime applies if the U.S. holder elects to treat us as a "qualified electing fund" ("QEF") for the first taxable year in which the U.S. holder owns our ordinary shares or in which we are a PFIC, whichever is later, and if we comply with certain reporting requirements. If the QEF regime applies, then each year that we are a PFIC such U.S. holder will include in its gross income a proportionate share of the our ordinary earnings (which is taxed as ordinary income) and net capital gain (which is taxed as long-term capital gain), subject to a separate election to defer payment of taxes, which deferral is subject to an interest charge. These amounts would be included in income by an electing U.S. holder for its taxable year in which our taxable year ends, whether or not such amounts are actually distributed to the U.S. holder. A U.S. holder's basis in our ordinary shares for which a QEF election has been made would be increased to reflect the amount of any taxed but undistributed income. Generally, a QEF election allows an electing U.S. holder to treat any gain realized on the disposition of his ordinary shares as capital gain.

Once made, the QEF election applies to all subsequent taxable years of the U.S. holder in which it holds our ordinary shares and for which we are a PFIC and can be revoked only with the consent of the Internal Revenue Service. A shareholder makes a QEF election by attaching a completed Internal Revenue Service Form 8621, including the PFIC annual information statement, to a timely filed United States federal income tax return. Even if a QEF election is not made, a U.S. person who is a shareholder in a PFIC must file a completed Internal Revenue Service Form 8621 every year.

If a QEF election is made after the first taxable year in which a U.S. holder holds our ordinary shares and we are a PFIC, then both the QEF regime and the excess distribution regime, defined below, will apply simultaneously unless the U.S. holder makes a special election.

A second regime, the "mark-to-market" regime, may be elected so long as our ordinary shares are publicly traded. Pursuant to this regime, an electing U.S. holder's ordinary shares are marked-to-market each year and the U.S. holder recognizes as ordinary income or loss an amount equal to the difference as of the close of the taxable year between the fair market value of our ordinary shares and the U.S. holder's adjusted tax basis in our ordinary shares. Losses are allowed only to the extent of net mark-to-market gain previously included by the U.S. holder under the election for prior taxable years. An electing U.S. holder's adjusted basis in our ordinary shares is increased by income recognized under the mark-to-market election and decreased by the deductions allowed under the election.

Under the mark-to-market election, gain on the sale of our ordinary shares is treated as ordinary income, and loss on the sale of our ordinary shares, to the extent the amount of loss does not exceed the net mark-to-market gain previously included, is treated as ordinary loss. The mark-to-market election applies to the tax year for which the election is made and all later tax years, unless the ordinary shares cease to be marketable or the Internal Revenue Service consents to the revocation of the election.

If the mark-to-market election is made after the first taxable year in which a U.S. holder holds our ordinary shares and we are a PFIC, then special rules would apply.

A U.S. holder making neither the QEF election nor the mark-to-market election is subject to the “excess distribution” regime. Under this regime, “excess distributions” are subject to special tax rules. An excess distribution is either (1) a distribution with respect to shares that is greater than 125% of the average distributions received by the U.S. holder from us over the shorter of either the preceding three years or such U.S. holder’s holding period for our shares, or (2) 100% of the gain from the disposition of our shares.

Excess distributions must be allocated ratably to each day that a U.S. holder has held our ordinary shares. A U.S. holder must include amounts allocated to the current taxable year, as well as amounts allocated to taxable years prior to the first year in which we were a PFIC, in its gross income as ordinary income for that year. All amounts allocated to prior years of the U.S. holder during which we were a PFIC would be taxed at the highest tax rate for each such prior year applicable to ordinary income. The U.S. holder also would be liable for interest on the deferred tax liability for each such prior year calculated as if such liability had been due with respect to each such prior year. A U.S. holder that is an individual is not allowed a deduction for interest on the deferred tax liability. The portions of gains and distributions that are not characterized as “excess distributions” are subject to tax in the current year under the normal tax rules of the Code.

A U.S. person who inherits shares in a foreign corporation that was a PFIC in the hands of the decedent (who did not make either of the elections described above), is denied the otherwise available step-up in the tax basis of such shares to fair market value at the date of death. The U.S. person steps into the shoes of the decedent and will be subject to the rules described above.

We believe that in 2002 we were not a PFIC. However, since the determination of whether we are a PFIC is based upon such factual matters as the valuation of our assets and, in certain cases, the assets of companies held by us, there can be no assurance with respect to the position of the Internal Revenue Service on our status as a PFIC. In addition, there can be no assurance that we will not become a PFIC for the current fiscal year ending December 31, 2003 or in a future year. We will notify U.S. holders in the event we conclude that we will be treated as a PFIC for any taxable year to enable U.S. holders to consider whether or not to elect to treat us as a QEF for U.S. federal income tax purposes or to “mark to market” the ordinary shares or to become subject to the “excess distribution” regime.

U.S. holders are urged to consult their tax advisors regarding the application of the PFIC rules, including eligibility for and the manner and advisability of making, the QEF election or the mark-to-market election.

Information Reporting and Backup Withholding

A U.S. holder generally is subject to information reporting and may be subject to backup withholding at rate of up to 28% with respect to dividend payments and receipt of the proceeds from the disposition of the ordinary shares. Backup withholding will not apply with respect to payments made to exempt recipients, including corporations and tax-exempt organizations, or if a U.S. holder provides a correct taxpayer identification number (or certifies that he has applied for a taxpayer identification number), certifies that such holder is not subject to backup withholding or otherwise establishes an exemption. Backup withholding is not an additional tax and may be claimed as a credit against the U.S. federal income tax liability of a U.S. holder, or alternatively, the U.S. holder may be eligible for a refund of any excess amounts withheld under the backup withholding rules, in either case, provided that the required information is furnished to the Internal Revenue Service.

Non-U.S. holders of Ordinary Shares

Except as provided below, a non-U.S. holder of ordinary shares (except certain former U.S. citizens and long-term residents of the United States) will not be subject to U.S. federal income or withholding tax on the receipt of dividends on, and the proceeds from the disposition of, an ordinary share, unless that item is effectively connected with the conduct by the non-U.S. holder of a trade or business in the United States and, in the case of a resident of a country which has an income tax treaty with the United States, that item is attributable to a permanent establishment in the United States or, in the case of an individual, a fixed place of business in the United States. In addition, gain recognized by an individual non-U.S. holder will be subject to tax in the United States if the non-U.S. holder is present in the United States for 183 days or more in the taxable year of the sale and other conditions are met.

Non-U.S. holders will not be subject to information reporting or backup withholding with respect to the payment of dividends on ordinary shares unless the payment is made through a paying agent, or an office of a paying agent, in the United States. Non-U.S. holders will be subject to information reporting and backup withholding at a rate of up to 28% with respect to the payment within the United States of dividends on the ordinary shares unless the holder provides its taxpayer identification number, certifies to its foreign status, or otherwise establishes an exemption.

Non-U.S. holders will be subject to information reporting and backup withholding at a rate of up to 28% on the receipt of the proceeds from the disposition of the ordinary shares to, or through, the United States office of a broker, whether domestic or foreign, unless the holder provides a taxpayer identification number, certifies to its foreign status or otherwise establishes an exemption. Non-U.S. holders will not be subject to information reporting or backup withholding with respect to the receipt of proceeds from the disposition of the ordinary shares by a foreign office of a broker; provided, however, that if the broker is a U.S. person or a "U.S. related person," information reporting (but not backup withholding) will apply unless the broker has documentary evidence in its records of the non-U.S. holder's foreign status or the non-U.S. holder certifies to its foreign status under penalties of perjury or otherwise establishes an exemption. For this purpose, a "U.S. related person" is a broker or other intermediary that maintains one or more enumerated U.S. relationships. Backup withholding is not an additional tax and may be claimed as a credit against the U.S. federal income tax liability of a non-U.S. holder, or alternatively, the non-U.S. holder may be eligible for a refund of any excess amounts withheld under the backup withholding rules, in either case, provided that the required information is furnished to the Internal Revenue Service.

Documents on Display

We are required to file reports and other information with the Securities and Exchange Commission, or SEC, under the Securities Exchange Act of 1934 and the regulations thereunder applicable to foreign private issuers. Reports and other information filed by us with the SEC may be inspected and copied at the SEC's public reference facilities described below. Although as a foreign private issuer we are not required to file periodic information as frequently or as promptly as United States companies, we generally do publicly announce our quarterly and year-end results promptly and file periodic information with the SEC under cover of Form 6-K. As a foreign private issuer, we are also exempt from the rules under the Exchange Act prescribing the furnishing and content of proxy statements and our officers, directors and principal shareholders are exempt from the reporting and other provisions in Section 16 of the Exchange Act.

You may review a copy of our filings with the SEC, including any exhibits and schedules, at the SEC's public reference facilities in Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549 and at the regional offices of the SEC. You may also obtain copies of such materials from the Public Reference Section of the SEC, Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. You may call the SEC at 1-800-SEC-0330 for further information on the public reference rooms. You may read and copy any reports, statements or other information that we file with the Securities and Exchange Commission at the facilities listed above. In addition, certain of our filings are available to the public at the SEC's website at http://www.sec.gov. We also generally make available on our own web site (www.elron.com) all our quarterly and year-end financial statements as well as other information.

Any statement in this Annual Report about any of our contracts or other documents is not necessarily complete. If the contract or document is filed as an exhibit to the registration statement, the contract or document is deemed to modify the description contained in this Annual Report. We urge you to review the exhibits themselves for a complete description of the contract or document.

Item 11. Quantitative and Qualitative Disclosures About Market Risk

For disclosures regarding our market risk exposures, see Item 5 Operating and Financial Review and Prospects above.

Item 12. Descriptions of Securities Other than Equity Securities

Not Applicable.

PART II

Item 13. Defaults, Dividend Arrearages and Delinquencies

Not Applicable.

Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

Not Applicable**.**

Item 15. Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our periodic filings with the SEC is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Furthermore, management necessarily was required to use its judgment in evaluating the cost to benefit relationship of possible disclosure controls and procedures.

Within 90 days prior to the date of this report, we performed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures. The evaluation was performed with the participation of senior management of key corporate functions, and under the supervision of the CEO and CFO. Based on the evaluation, our management, including the CEO and CFO, concluded that our disclosure controls and procedures were effective. There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls after the date we completed the evaluation.

Item 16. [Reserved]

PART III

Item 17. Financial Statements

Not Applicable.

Item 18. Financial Statements

The financial statements follow the certifications following the signature page of this Annual Report.

Item 19. Exhibits

1.1 Articles of Association (English translation) approved by the registrant's shareholders on March 19, 2000, incorporated by reference to Exhibit 1.1 to the registrant's Form 20-F for the year ended December 31, 2000, filed with the Commission on June 8, 2001.

1.2 Memorandum of Association of Elron Electronic Industries Ltd., incorporated by reference to Exhibit 1.2 to the registrant's Form 20-F for the year ended December 31, 2000, filed with the Commission on June 8, 2001.

4.1 Shareholders Agreement entered into between Elron Electronic Industries Ltd., Federmann Enterprises Ltd. and Heris Finanz A.G., dated December 19, 1999, incorporated by reference to Exhibit 4.1 to the registrant's Form 20-F for the year ended December 31, 1999, filed with the Commission on June 30, 2000.

4.2 Joint Venture Agreement dated as of April 1993 among Discount Investment Corporation Ltd., PEC Israel Economic Corporation, Rafael Armament Development Authority Ltd., Galram Technology Industries Limited, incorporated by reference to Exhibit 10.4 to Amendment No. 5 to the registrant's Registration Statement on Form F-4, filed with the Commission on March 14, 2002 ("RDC Joint Venture Agreement").

4.4 Merger Agreement dated December 19, 1999 by and between Elbit Systems Ltd., Elop Electro-Optics Industries Ltd., Federmann Enterprises Ltd., Heris Finanz Aktiengeselshaft, and Rehovot Instruments Ltd., incorporated by reference to Exhibit 2 to the Form 6-K of Elbit Systems Ltd., filed with the Commission on March 6, 2000.

4.5 Registration Rights Agreement dated as of July 5, 2000 among the registrant, Elbit Systems Ltd., Federmann Enterprises Ltd., and Heris Finanz A.G., incorporated by reference to Exhibit 2 to the Form 6-K of Elbit Systems Ltd., filed with the Commission on March 6, 2000.

4.6 Share purchase agreement dated as of March 2, 2000 among Microsoft Corporation, Peach Networks Ltd. ("Peach"), Elbit Ltd., Ofir Paz, Avishai Keren, Meir Feder and the shareholders of Peach, incorporated by reference to Exhibit 4.1 to the Annual Report on Form 20-F/A of Elbit Ltd., filed with the Commission on March 15, 2002.

4.7	Asset purchase agreement dated as of June 5, 2000, by and among Cisco Systems, Inc., Elbit, Ltd. and HyNEX Ltd., incorporated by reference to Exhibit 4.2 to the Annual Report on Form 20-F/A of Elbit Ltd., filed with the Commission on March 15, 2002.
4.8	Bank Facility of Partner Communications Company Ltd. dated August 13, 1998, incorporated by reference to Exhibit 4.3 to the Annual Report on Form 20-F/A of Elbit Ltd., filed with the Commission on March 15, 2002.
4.9	Amending and Rescheduling Agreement dated July 9, 2000 (amending the Bank Facility of Partner Communications Company Ltd.), incorporated by reference to Exhibit 4.4 to the Annual Report on Form 20-F/A of Elbit Ltd., filed with the Commission on March 15, 2002.
4.11	License from the Israeli Ministry of Communications issued to Partner Communications Company Ltd. on April 8, 1998, incorporated by reference to Exhibit 4.5 to the Annual Report on Form 20-F/A of Elbit Ltd., filed with the Commission on March 15, 2002.
4.12	Form of Indenture between Partner Communications Company Ltd. and The Bank of New York, as Trustee, including form of note, incorporated by reference to Exhibit 4.6 to the Annual Report on Form 20-F/A of Elbit Ltd., filed with the Commission on March 15, 2002.
4.13	Relationship Agreement dated October 10, 1999 by and among Matav-Cable Systems Media, Hutchison Whampoa Limited and Matbit Telecommunication Systems Ltd. (original shareholders of Partner Communications Company), incorporated by reference to Exhibit 4.7 to the Annual Report on Form 20-F/A of Elbit Ltd., filed with the Commission on March 15, 2002.
4.14	Agreement and Plan of Merger between Elron Electronic Industries Ltd. and Elbit Ltd. dated October 31, 2001, incorporated by reference to Exhibit 2.1 to the registrant’s Registration Statement on Form F-4, filed with the Commission on November 15, 2001.
4.15	Share Purchase Agreement dated as of November 19, 2001, between Elron Electronic Industries Ltd. and Discount Investment Corporation Ltd., incorporated by reference to Exhibit 10.1 to the registrant’s Registration Statement on Form F-4, filed with the Commission on November 15, 2001.
4.16	Deed of Pledge dated December 2, 2002 between Elbit.Com Ltd. and Bank Leumi Le- Israel B.M.
4.17	Addendum to RDC Joint Venture Agreement dated June 16, 2003 among DEP Technology Holdings Ltd., Rafael Armament Development Authority Ltd., Galram Technologies Industries Ltd. and RDC Rafael Development Corporation Ltd.
8.1	List of subsidiaries.
10.1	Consent of Luboshitz Kasierer, an affiliate member of Ernst & Young International, for Elron Electronic Industries Ltd.
10.2	Consent of Luboshitz Kasierer, an affiliate member of Ernst & Young International, for NetVision Ltd.

10.3 Consent of Luboshitz Kasierer, an affiliate member of Ernst & Young International, for Elbit Systems Ltd.

10.4 Consent of Brightman Almagor & Co., a member of Deloitte Touche Tohmatsu, for A.M.T. Advanced Metal Technologies Ltd.

10.5 Consent of Somekh Chaikin, a member of KPMG International, for Given Imaging Ltd.

10.6 Consent of Somekh Chaikin, a member of KPMG International, for DEP Technology Holdings Ltd.

10.7 Consent of PricewaterhouseCoopers LLP for Chip Express Corporation.

99.1 Certification of Chief Executive Officer of the Registrant pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

99.2 Certification of Chief Financial Officer of the Registrant pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

* This document is being furnished in accordance with SEC Release No. 33-8212 and 34-47551

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this Annual Report on its behalf.

Dated: June 26, 2003

ELRON ELECTRONIC INDUSTRIES LTD.

By: /s/ Doron Birger
Name: Doron Birger
Title: President & Chief Executive Officer

By: /s/ Tal Raz
Name: Tal Raz
Title: Vice President & Chief Financial Officer

CERTIFICATIONS

I, Doron Birger, certify that:

1. I have reviewed this annual report on Form 20-F of Elron Electronic Industries Ltd.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
   a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
   b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
   c. presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
   a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
   b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: June 26, 2003

/s/ Doron Birger
Doron Birger
President and Chief Executive Officer

CERTIFICATIONS

I, Tal Raz, certify that:

1. I have reviewed this annual report on Form 20-F of Elron Electronic Industries Ltd.

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

    a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

    b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

    c. presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

    a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

    b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: June 26, 2003

/s/ Tal Raz
Tal Raz
Vice President and Chief Financial Officer