MANAGEMENT REPORT FOR 2002

The following management report should be read in conjunction with our Consolidated Financial Statements and Notes thereto. This report contains forward-looking statements that involve risks and uncertainties. Such forward-looking statements may be identified by the words “anticipate”, “believe”, “estimate”, “expect”, “plan” and similar expressions. The Company’s actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but are not limited to, those discussed in our filings with the Securities and Exchange Commission from time to time.

GENERAL

We are a multi-national high technology operational holding company that operates through subsidiaries and affiliated companies, referred to as 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 Israeli-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 and semiconductors. In addition, we have recently invested in the field of amorphous metals (see below under “Recent Developments”). Our group companies include both publicly traded and privately held 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 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, 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, in the most part, to the results of operations of our group companies and dispositions and changes in our holdings of group companies.
Elron’s shares are publicly traded on Nasdaq National Market under the symbol "ELRN" and on the TASE. 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 the management report.

RECENT DEVELOPMENTS

Merger with Elbit. On May 15, 2002, we completed our merger with Elbit Ltd. (“Elbit”). Pursuant to the merger agreement signed on October 31, 2001, we issued 5,617,601 ordinary shares to Elbit’s shareholders (other than Elron), based on an exchange ratio of 0.45 ordinary shares of Elron for each ordinary share of Elbit, and assumed options to purchase Elbit ordinary shares, which, after the merger, entitled the holders to purchase 240,525 ordinary shares of Elron. As a result of the merger, Elbit became a wholly owned subsidiary of Elron. The transaction was accounted for as a purchase, and accordingly, our results of operations include the revenues and expenses of Elbit subsequent to the acquisition date. For more details regarding the accounting treatment see: “Critical Accounting Policies, Merger accounting”.

Share Purchase of DEP. On May 6, 2002, we issued 2,261,843 ordinary shares to Discount Investment Corporation Ltd. (“DIC”) (which at that time held 42% of the shares of Elron), pursuant to the share purchase agreement signed on November 19, 2001 with DIC, in exchange for all of the shares held by DIC in DEP Technology Holdings Ltd. (“DEP”), including DIC’s rights to loans provided by DIC to RDC Rafael Development Corporation Ltd. (“RDC”), a subsidiary of DEP. RDC is a joint venture, controlled by and consolidated with DEP, in which DEP holds 48% of the outstanding shares. DEP is a technology

holding company in which Elron previously held 33% of the outstanding share capital and in which DIC held the remaining 67%. Following the closing of the transaction, DEP became a wholly owned subsidiary of Elron. The transaction was accounted for as a purchase, and accordingly, our results of operations include the revenues and expenses of DEP subsequent to the acquisition date. For more details regarding the accounting treatment see: “Critical Accounting Policies, Merger accounting”.

These transactions enabled us to further enhance our position in the high technology markets, allowed us to pursue additional investment opportunities, optimized our holding structure, combined resources, benefited our group companies with potential synergies and demonstrated our ability to achieve cost savings in respect of our corporate operations.

Following the two transactions, our holdings include direct and indirect holdings through Elbit, DEP and DEP’s subsidiary, RDC. As most Elbit, DEP and RDC group companies are technology-related companies which have not yet generated significant revenues and earnings, we expect that they will continue to recognize losses and, therefore, our share in their losses will continue to constitute a significant portion of our results of operations.

Acquisition of controlling interest in Galil Medical. During 2002, we and RDC converted notes of Galil Medical Ltd. (“Galil”) in the amount of approximately $3.2 million into preferred shares and invested approximately $3.7 million in new convertible notes. At the beginning of 2003, we invested additional $0.8 million in convertible notes.

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, we hold 15.09% directly and RDC holds 37.4% of Galil’s outstanding shares, thereby giving us directly and indirectly, through RDC, a controlling voting interest in Galil, and accordingly, Galil's financial results are consolidated into our results of operations subsequent to June 30, 2002.

Acquisition of controlling interest in MediaGate. In July 2002, we converted notes of MediaGate N.V. (“MediaGate”) in the amount of approximately $3.6 million into preferred shares and invested, through a rights offering, an additional $2.5 million in preferred shares. As a result of these transactions, our interest in MediaGate increased to 68.3% of its outstanding shares and therefore MediaGate's financial results are consolidated into our results of operations subsequent to that date. During December 2002 and January 2003 we invested an aggregate amount of $1.5 million in MediaGate on account of an additional rights offering.

For comparison purposes, we have provided pro forma information in accordance with SFAS 141, 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 (see Note 8 to the Consolidated Financial Statements as of December 31, 2002).

Investment in A.M.T. Advanced Metal Technologies Ltd. ("AMT"). In August 2002, we invested 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 29% of AMT on a fully diluted and as converted basis (excluding warrants). The investment in AMT is being accounted for under the equity method.

In addition, we and the other investors in AMT were issued warrants to purchase up to an additional $19.1 million in convertible notes, over different periods of up to a maximum of 48 months from the closing. We also have an option to invest up to $5.0 million in AMT on the same terms and conditions as the original investment for a period of eight months from the closing. In December 2002, Elron made a

convertible loan to AMT in the amount of $0.2 million. The loan is convertible into convertible notes of AMT upon the same terms and conditions as Elron's original investment.

We are entitled to voting and other rights attached to the convertible notes on an as converted basis as a shareholder of AMT, and to special rights in certain specific circumstances.

Investment in Notal Vision ("Notal"). In January 2003, we invested $2.0 million in Notal, an Israeli medical device company operating in the field of early detection of Age Related Macular Deterioration (AMD). Our investment formed part of an aggregate investment in Notal of approximately $4.0 million, including an investment by an existing shareholder, Innomed Ventures L.P., a venture capital fund focused on the medical field. Elron is also invested directly in Innomed. Following the transaction, we hold directly approximately 25% of Notal. In January 2003, Notal signed a distribution agreement with a strategic partner, Carl Zeiss Meditec, Inc., one of the leading manufacturers of professional optics equipment.

CRITICAL ACCOUNTING POLICIES

We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the United States ("US GAAP"). Our significant accounting policies are more fully described in Note 2 of the Notes to our Consolidated Financial Statements. Certain of our accounting policies are particularly important to the description of our financial position and results of operations. In applying some of these critical accounting policies, our management uses its judgment to determine the appropriate assumptions to be used in making certain estimates. These estimates are subject to an inherent degree of uncertainty. Estimates are used for, but are not limited to, the accounting for impairments of investment, goodwill and other intangible assets. Actual results could differ from these estimates.

Our critical accounting policies include:

- Principles of accounting for holding in group companies
- Merger accounting
- Impairment of goodwill and other intangible assets
- Impairment of investments in group companies
- Revenue recognition
- 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 directly or indirectly own 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. In certain cases, and in accordance with EITF 99-10 "Percentage Used to Determine the Amount of Equity Method Losses" we recognize equity method losses based on the ownership level of the particular investee security held by us.

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 recorded at cost. The aforementioned restatements resulted in increased net losses of approximately $2.5 million, or $0.12 per share and by $1.8 million, or $0.08 per share for the years ended December 31, 2001 and 2000, respectively.

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 an average market price of $12.50 per ordinary share, which was 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; Income taxes). In accordance with generally accepted accounting principles in the United States, the tax benefit from eliminating the valuation allowance after the acquisition date had been recorded as a reduction of goodwill related to the acquisition. In accordance with generally accepted accounting principles in the United States, the remaining goodwill, in the amount of $12 million, will not be amortized and is reviewed annually (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 an average market price of $13.02 per ordinary share, which was based on the average closing price of Elron's ordinary shares a few days before and after the date that the number of shares to be issued to DIC was announced. The purchase price has been allocated to DEP's assets

acquired, primarily long-term investments, in the amount of $41.0 million, loans from DIC to RDC in the amount of $3.5 million and liabilities assumed in the amount of $15.1 million. The allocation to DEP's assets was based on an analysis made by an independent appraiser. Of the total purchase price allocated to DEP's assets acquired, an aggregate amount of $16.5 million was allocated to identifiable net intangible assets related to equity investments, with a weighted average amortization period of approximately 11 years, according to the economic benefit of the underlying assets, and an aggregate amount of $6.5 million was allocated to each equity investment's goodwill. The amortization of the identifiable intangible assets is included in our share of the net losses of each equity investment, except for Galil Medical, which is consolidated in our financial statements, and therefore the amortization will be included under "Amortization of other 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 the valuation of certain intangible assets. 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 expected useful lives assigned to 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

We periodically assess the impairment of goodwill and other intangible assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. 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 have performed an initial impairment review of goodwill as of January 1, 2002 and an annual impairment review thereafter at the level of each reporting unit. We have estimated the fair value of each reporting unit and compared 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, taking into consideration factors such as control premiums and synergies. In certain cases we have obtained an opinion from an independent appraiser. Based on this comparison for each reporting unit, no goodwill impairment losses were recorded. 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 and other intangible assets amounted to approximately $40.1 million as of December 31, 2002.

Impairment of Investments in Group Companies

At the end of each reported period we evaluate the carrying value of each investment in our group companies for possible impairment based on the financial condition and prospects of the group company and other relevant factors and by comparing the fair value of each investment relative to its carrying value, and whether the decline, if any, in the fair value has been other than temporary. The fair value of our holdings in privately held companies is generally determined based on the value at which independent third parties have invested or have committed to invest in these companies. 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. While 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 total fee to elements of an arrangement and persuasive evidence of an arrangement exists. Maintenance revenue is recognized over the term of the contract period. Training revenue is recognized when a right of return exists as the services are provided. 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 derived from projects related to software development is recognized upon the percentage of completion method, provided that a material portion of costs have been incurred or that a material portion of

milestones have been achieved and where contract results can reasonably be estimated. Provision for losses, if any, on uncompleted contracts are made in the period when such losses are apparent.

Income Taxes

At the end of each reported period, we must assess the likelihood that the deferred tax assets will be recovered from future taxable income and to the extent that we believe recovery is not likely, we must establish a valuation allowance. In 2002 we have reduced our previously valuation allowance by $6.6 million to increase our deferred tax asset to an amount that is more likely than not to be realized in future years.

Basis of Presentation

Consolidation. The consolidated financial statements include the accounts of the Company and all its subsidiaries in which we directly or indirectly own more than 50% of the outstanding voting securities. Our consolidated financial statements include the following main subsidiaries:

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

[1] Since May 2002, following the completion of the 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	
Elbit Systems	AMT[4]	Elbit Systems	Galil Medical[,3]
Elbit[1]	Given Imaging[3]	Elbit	Witcom[3]
NetVision	Galil Medical[2,3]	NetVision	3DV[3]
MediaGate[2]	Witcom[3]	Chip Express	
Chip Express	3DV[3]	DEP	
DEP[1]	Cellenium[5]	Wavion	
Wavion	CellAct	KIT	
KIT		Pulsicom	
Pulsicom		Given Imaging[3]	

[1] Through May 2002, following the completion of the merger and DEP share purchase.
[2] Through July 2002
[3] Restated (see "Critical accounting polices, Principles of Accounting for Holdings in Group Companies")
[4] Since August 2002
[5]Through November 2002

RESULTS OF OPERATIONS

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	1.50	2.40*

* Restated (see "Critical accounting polices, 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 polices, 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	1.80	3.10

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 on a more comparable basis in the pro forma information, we reported a decrease in our share in the losses of our affiliated companies as a result of the restructuring plans and cost reduction programs taken by some of our group companies during 2001 and 2002, which enabled these companies to reduce their losses notwithstanding the adverse economic and market conditions.

Reportable Segments

Our reportable segments are i) Elron Software, the Internet products segment; ii) Elron Telesoft, the systems and projects segment; 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 the strategic and operational support to the group companies.

For the reported periods, the 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;
Equity basis			Elbit Systems; NetVision; Chip Express; Wavion; KIT; Pulsicom; Given Imaging; Witcom Ltd.; 3DV; Cellenium; CellAct; and AMT
Cost			Oren Semiconductor
Marketable securities presented as available- for- sale			Partner Communications Company , 24/7 Real Media

The following table reflects our consolidated data by reported segments:

	Elron Software	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)	3.0
Costs and Expenses	19.5	38.1	0.5	58.1
Net loss	(10.4)	(15.3)	(25.1)	(50.8)

Elron Software

Elron Software is focused on web access control and e-mail content filtering for organizations. The following table sets forth the operating results of Elron Software:

	Year ended December 31,	
	2002	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 other 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 other assets and restructuring charges, net, in the amount of $1.7 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.

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.

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 other 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's ability to further decrease operating losses and reach breakeven is dependent upon its ability to grow its revenues in 2003.

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

In response to the economic conditions, and, in particular, the slowdown in IT spending, Elron Software underwent 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.

Elron TeleSoft

Elron TeleSoft is focused on telecom network and service management products and solutions. 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 other 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 other assets 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 - 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.

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 the company underwent during 2001 and 2002.

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 other 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 include the sale of non- core activities. Elron Telesoft expects to report breakeven on an operating basis in 2003.

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 in 2002 and 2001 restructuring charges of $1.3 million and $1.2 million, respectively. 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 in 2002 and 2001 also included $0.5 million and $0.4 million with respect to workforce reductions of 77 and 65 employees, respectively. 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 write-off of leasehold improvements in the vacated facilities.

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 the finance expenses is primarily attributed to the decrease in interest rates. The majority of the finance expenses are 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 which include our holdings in subsidiaries, affiliates and other companies, engaged in various fields of advanced technology, and the corporate operations, which provide the 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 (loss) from disposal and changes in holdings in related companies, net	6.9	3.2
Other income (expenses), net	(0.8)	(4.7)
Total Income	(10.7)	(28.7)
Cost of revenues	2.7	
Operating expenses*	15.3	5.1
Amortization of other assets	0.2	-
Restructuring charges, net	0.4	-
Finance expenses (income), net	(1.5)	(4.5)
Total Cost and expenses	17.1	(0.6)
Loss from continuing operations before tax benefit	(27.8)	(29.3)
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)

*Excluding amortization of other assets and restructuring charges, net, in the amount of $0.6 million and $0 million in 2002 and 2001, respectively, 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. As these companies were not consolidated in 2001 and were only consolidated during 2002, the following table does not represent the companies' revenues on a full year basis (full year information is presented below):

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

Galil Medical, a medical device company performing minimally invasive cryotherapy, 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.

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 ceasing accounting for Elbit's and DEP's results of operations under the equity method of accounting from the date of completion of the merger and the 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 were 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. (Nasdaq: ESLT) (a 20% holding). Elbit Systems develops, manufactures and integrates advanced high-performance defense electronic systems. 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 (C4ISR) 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-recurrent 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-recurrent 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 nor material.

Given Imaging (Nasdaq: GIVN) (an 18% holding directly and indirectly through RDC). Given Imaging, a medical device company using a disposable miniature video camera in a capsule to examine the gastrointestinal tract, 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 represents the first full year of sales for Given Imaging following FDA clearance of its product in August 2001, and the fifth consecutive quarter of increased revenues. Given Imaging's net loss in 2002 was $18.3 million compared to $18.7 million in 2001. Given Imaging expects its revenues for 2003 to increase approximately 100% over 2002 revenues of $28.9 million and to reach breakeven and achieve sustainable profitability in the second half of 2003.

NetVision (a 46% holding). NetVision provides Internet services and solution in Israel. 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 (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 on account of narrow-band dial-up connections and by the increased competition which will result in lower prices.

Wavion (a 48% holding). Wavion, a developer of broadband wireless access systems for wireless LANs, 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 net losses 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. Wavion intends to commence beta site tests of its products in the second half of 2003 and to begin selling its products in 2004.

KIT (a 28% holding). KIT provides online academic programs. 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 (a 20% holding directly and indirectly through RDC). Witcom, a company operating in the field of radio-based point-to-point digital networking solutions, 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.

Pulsicom (a 17% holding). Pulsicom commenced its operations in 2001 and is engaged in the development of high accuracy real time location and tracking systems. 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 (a 34% holding). Chip Express, a manufacturer of late stage programmable gate array ASICs (Application Specific Integrated Circuits) 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. In 2003, Chip Express expects that the introduction of new products will contribute it to increase its revenues.

During the second quarter of 2002, Chip Express raised $16.0 million, of which we invested $5.0 million. Consequently, our ownership percentage in Chip Express decreased from approximately 35% to approximately 34%. 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 (a 24% holding directly and indirectly through RDC). 3DV, a developer of products in the field of 3-D cameras, 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") (a 33% holding). Since Elron's investment in the company in August 2002, AMT's two operating companies, namely A.H.T. Advanced Heating Technologies ("A.H.T.") 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. In addition, 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 net losses from our group companies, we expect that most of our group companies will continue to recognize losses in 2003, as they 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 (Nasdaq: PTNR) (a 12% holding through Elbit). At December 31, 2002, the market value of our investment in Partner amounted to $78.6 million. Partner is a Global System for Mobile Communications, or GSM, mobile telephone network operator in Israel. In 2002 Partner reached a significant milestone, as it became a profitable company and generated free cash flow for three consecutive quarters. The following are highlights of the results of operations of Partner for 2002:

- 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, Elbit has pledged approximately 70% of the Partner shares held by it in favor of the 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 (a 17% holding). Oren is a developer of integrated circuits for digital broadcasting. 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. Oren expects to achieve revenue growth in 2003 and a decrease in its net losses.

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 $4.9 million in 2001. The loss in 2002 includes mainly a $1.1 million decrease in the price of marketable securities of Cisco (Nasdaq: CSCO) and EVS (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's shares which we subsequently received in exchange for BroadBase Software's shares following the acquisition of BroadBase Software by Kana (Nasdaq: 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 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 "Qualitive and Quantitive Disclosure about 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. As the subsidiary companies were not consolidated in 2001 and were only consolidated during 2002, the following table does not represent the companies' operating expenses on a full year basis (full year information is presented below). The operating expenses presented below exclude restructuring expenses and amortization of other assets, in the amount of $0.6 million and $0 million in 2002 and 2001, respectively, which also constitute part of operating expenses under US 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. In 2001 the aggregate corporate expenses of both Elron and Elbit, which than operated as separate companies, were approximately $12.0 million. In the second half of 2002, which gives effects to the merger of Elbit, the corporate costs amounted to $3.2 million, reflecting potential annual savings of more than $5.0 million in corporate operation costs.

Operating expenses of Galil Medical in 2002 were $13.0 million (of which $7.4 million were 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 were 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 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 an income of $1.5 million compared to $4.5 million in 2001. The decrease is attributed mainly to the corporate operation 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, VFlash sold on September 23, 2002, a significant portion of its business to 24/7 Real Media Inc. (Nasdaq: TFSM) ("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 of the share of 24/7. 24/7 provides marketing and technology solutions to online marketers and publishers. In conjunction with the above sale, we invested through Elbit, $1.0 million in 100,000 shares of 24/7 convertible preferred stock convertible into 48.40271 shares of common stock for each preferred stock. The convertible preferred stock was converted into 4,840,271 common stock in February 2003. As a result of the above mentioned sale, we recorded a gain of $2.0 million. This gain was partially offset by the results of operations 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 results of operations of ICC, in the aggregate amount of $2.9 million.

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 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 $64.8 million has average maturities of less than three months.

Company's 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 shares , $1.1 million proceeds from the sale of Given Imaging shares, 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.

Company's main cash and other liquid instruments applications in 2002 included mainly $29.5 million investments in companies, of which $24.5 million were investments in our 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), approximately $5.8 million of merger expenses and cash net of approximately $6.0 million used to finance the corporate activities.

The following table sets forth the investments made during 2002:

	Amount (million of $)
Investments in 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
Other	4.7
	24.5
Investments in new companies:	
AMT	4.7
Notal	0.3
	5.0
	29.5

Consolidated working capital on 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 are classified from current assets to long-term assets.

At December 31, 2002, we and our subsidiaries had no material contractual obligations except for capital lease obligations in the aggregate amount of $3.5 million, which are expected to affect our consolidated cash flow in future periods as follows: 2003 - $1.5 million, 2004 - $1.3 million and in 2005 - $0.7 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 approximately $74.0 million 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. Out of the $74.0 million an amount of $31.0 million is collateralized by Elron’s investment in debentures, marketable securities and deposits, and of which $28.9 million has 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.

RDC’s bank loan in the amount of $4.0 million is 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.

Payments of bank credits and bank loans of our subsidiaries are due in future periods as follows: 2003 - $17.6 million, 2004 - $48.0 million, 2005 - $1.3 million.

In 2001, we have provided a letter 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 the other major shareholder of NetVision.

At December 31, 2002 we had commitments in the aggregate amount of approximately $8.2 million to invest in certain of our group companies, of which $4.6 million were invested through March 10, 2002.

We believe that our existing capital will be sufficient to fund our and our subsidiaries operations and our investment activities in existing and new companies.

Shareholders’ equity at December 31, 2002, was approximately $266.5 million representing approximately 65% of the total assets compared with $248.2 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.

QUALITIVE AND QUANTITIVE DISCLOSURE ABOUT 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 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 funds and loans obligations to banks. We do not 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 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 (Nasdaq: ESLT), Given Imaging (Nasdaq: GIVN), Partner Communication Company Ltd. (Nasdaq: PTNR), Elbit Vision Systems (Nasdaq: EVSN), 24/7 Real Media (Nasdaq: TFSM) and Cisco (Nasdaq: CSCO). All of Cisco's shares held by us at the end of 2002 were sold at the beginning of 2003 with no material effect to our results of operations.

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 $285.3 million. A 10% decrease in equity prices would result in an approximately $28.5 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.

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