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ELBIT SYSTEMS LTD
Form 20-F
June 28, 2005

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, 2004

Commission File No. 0-28998

ELBIT SYSTEMS LTD.

(Exact Name of Registrant as Specified in its charter and Translation of
Registrant's Name into English)

ISRAEL
(Jurisdiction of incorporation or organization)

ADVANCED TECHNOLOGY CENTER, HAIFA 31053, ISRAEL
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section
12(b) of the Act:

NOT APPLICABLE

Securities registered or to be registered pursuant to Section
12(g) of the Act:

ORDINARY SHARES, NOMINAL VALUE 1.0 NEW ISRAELI SHEKELS PER SHARE
(Title of Class)

Securities for which there is a reporting obligation pursuant to
Section 15(d) of the Act:

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:

40,561,126 SHARES

Indicate by check mark whether the registrant (1) has filed all reports
required to be filed by Section 13 or 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 NO

Indicate by check mark which financial statement item the registrant
has elected to follow.

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PART I

INTERNATIONAL DISCLOSURES STANDARDS

Elbit Systems Ltd.'s (Elbit Systems) consolidated financial statements are prepared based upon United States Generally Accepted Accounting Principles (U.S. GAAP). Unless otherwise indicated, all financial information contained in this Form 20-F is in U.S. dollars. References in this Form 20-F to the "Group" are to Elbit Systems and our subsidiaries.

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Information not required in Annual Report on Form 20-F.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

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Information not required in Annual Report on Form 20-F.

ITEM 3. KEY INFORMATION

SELECTED FINANCIAL DATA

The following selected consolidated financial data of Elbit Systems for the years ended December 31, 2000, 2001, 2002, 2003 and 2004 are derived from our audited consolidated financial statements of which the financial statements as of December 31, 2003 and 2004 and for each of the years ended December 31, 2002, 2003 and 2004, appear later in this Form 20-F. The audited financial statements have been prepared in accordance with U.S. GAAP.

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| | YEAR ENDED DEC | | |
|--|----------------|--------|--------|
| | 2000 | 2001 | 2002 |
| | (U.S. dolla | | |
| INCOME STATEMENT DATA: | | | |
| Revenues | \$591 | \$765 | \$827 |
| Cost of revenues | 433 | 554 | 605 |
| Gross profit | 148 | 211 | 222 |
| Research and development costs, net | 44 | 59 | 57 |
| Marketing, selling, general and administrative expenses, net | 65 | 98 | 107 |
| Operating income (loss) | (13) | 54 | 58 |
| Finance income (expense) | -- | (3) | (3) |
| Income (loss) before taxes on income | (13) | 52 | 54 |
| Taxes on income | 6 | 11 | 9 |
| Equity in net earnings of affiliated companies and partnership | (1) | - | 1 |
| Net income (loss) | \$(21) | \$41 | \$45 |
| Earnings (loss) per share: | | | |
| Basic net income (loss) per share | \$(0.65) | \$1.07 | \$1.17 |
| Weighted average number of shares used in computation (in thousands) | 31,572 | 37,975 | 38,489 |
| Diluted net income (loss) per share | \$(0.65) | \$1.04 | \$1.13 |
| Weighted average number of shares used in computation (in thousands) | 31,572 | 39,359 | 39,863 |

| | DECEMBER 31 | | | |
|--|----------------------------|------|------|------|
| | 2000 | 2001 | 2002 | 2003 |
| | (U.S. dollars in millions) | | | |
| BALANCE SHEET DATA: | | | | |
| Cash, cash equivalents and short-term cash | | | | |

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| | | | | |
|---|--------|--------|---------|---------|
| investments | \$55 | \$42 | \$78 | \$77 |
| Long-term deposits and loans | 4 | 3 | 4 | 2 |
| Working capital | 74 | 121 | 206 | 199 |
| Short-term debt | 51 | 47 | 31 | 15 |
| Long-term debt | 58 | 69 | 73 | 62 |
| Shareholders' equity | 341 | 378 | 411 | 452 |
| Total assets | \$827 | \$901 | \$1,000 | \$1,024 |
| | | | | |
| Dividends paid per ordinary share with respect to the applicable year | \$0.32 | \$0.32 | \$0.34 | \$0.40 |

* including an extraordinary dividend of \$1.80 declared in the second quarter of 2004.

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FORWARD LOOKING STATEMENTS

This Annual Report on Form 20-F contains "forward-looking" statements within the meaning of Section 27A of the U.S. Securities Act of 1933 and Section 21E of the U.S. Securities and Exchange Act of 1934. These are statements that are not historical facts and include statements about our beliefs and expectations. These statements contain potential risks and uncertainties, and actual results may differ significantly.

Forward-looking statements are typically identified by the words "believe," "expect," "intend," "estimate" and similar expressions. Those statements appear in this Annual Report and include statements regarding the intent, belief or current expectation of Elbit Systems or our directors or officers. Actual results may differ materially from those projected, expressed or implied in the forward-looking statements as a result of several factors including, without limitation, the factors set forth below under the caption "Risk Factors" (we refer to these factors as Cautionary Statements). Any forward-looking statements contained in this Annual Report speak only as of the date of this Report, and we caution 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 Cautionary Statements.

RISK FACTORS

GENERAL RISKS RELATED TO OUR BUSINESS

OUR REVENUES DEPEND ON A CONTINUED LEVEL OF GOVERNMENT BUSINESS. A significant portion of our revenues come from contracts or subcontracts with domestic and foreign government agencies. A reduction in the level of the purchase of our systems, products, services and upgrade projects by these agencies, mainly the Israeli Ministry of Defense (IMOD), the U.S. Department of Defense (DOD) and governmental customers of our other major programs, would have a material adverse effect on our business. The development of our business in the future will depend on the continued willingness of the IMOD, the DOD and other governmental purchasing agencies to commit substantial resources to defense programs and, in particular, to continue to purchase our systems, products, services and upgrade projects. For risks related to the IMOD budget see below "Risks Related to Our Israeli Operations".

THE LEVEL OF OUR CONTRACTS MAY BE REDUCED DUE TO CHANGES IN GOVERNMENTAL PRIORITIES AND AUDITS. The risk that governmental purchases of our systems, products, services and upgrade projects may decline is affected by the

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possibility that government purchasing agencies may:

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

WE DEPEND ON GOVERNMENTAL APPROVAL OF OUR EXPORTS. Many of our exports and the receipt of technology and components from suppliers depend on receipt of export license approvals from the Israeli Government, the U.S. Government and other governments. Such licenses and approvals also are required for technological exchanges with our customers and for employment of our technical personnel abroad. 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. See below - Item 4. Information on the Company - Governmental Regulations.

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WE DEPEND ON INTERNATIONAL OPERATIONS. We depend on sales to customers outside Israel. We expect that international sales will continue to account for a significant portion of 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 our business, financial condition and results of operations to be harmed. Some of the risks of doing business internationally include:

- unexpected changes in regulatory requirements;
- our or our subcontractors inability 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 "Risks Related to Our Israeli Operations" below. In addition, the economic and political stability of the countries of our major customers and suppliers may also impact our business.

OUR REVENUES DEPEND ON OBTAINING FOLLOW-ON BUSINESS. Follow-on orders are important because our contracts mainly are for fixed periods. These periods 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 our performance on a particular program or if the customer's priorities change, it could negatively affect our 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

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contracts do not offset the loss of follow-on business.

OUR CONTRACTS MAY BE TERMINATED FOR CONVENIENCE OF THE CUSTOMER. Our contracts with the Government of Israel and other governments often contain provisions permitting termination for convenience of the customer. Our 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, we attempt to flow down these requirements to our 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 we would be entitled to reimbursement for our incurred contract costs and a proportionate share of our fee or profit for work actually performed. If, however, we are not entitled to such compensation, it could cause us to suffer corresponding losses.

WE FACE RISKS OF CHANGES IN COSTS UNDER FIXED- PRICE CONTRACTS. Most of our 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, where estimated gross profit or loss from long-term projects may change and such changes in estimated gross profit/loss are recorded on a cumulative catch-up basis. See below - Item 5. Operating Financial Review and Prospects - Management's Analysis and Review - Critical Accounting Policies. The frequent need to bid on fixed-price programs before completing the necessary design may result in unexpected technological difficulties, cost overruns and potential contractual penalties. Typically, costs must be accounted for in the period they are

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recognized. In addition, although we have extensive experience in these types of programs, there is difficulty inforecasting long-term costs and schedules and the potential obsolescence of products or components related to long-term fixed-price contracts.

WE FACE FLUCTUATIONS IN REVENUES AND PROFIT MARGINS. The level of our 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 our mix of projects during any given period. In addition, since project revenues generally are recognized in connection with achievement of specific milestones, we may experience significant fluctuations in year-to-year and quarter-to-quarter financial results. Similarly, our 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.

WE SOMETIMES HAVE RISKS RELATING TO FINANCING FOR OUR PROGRAMS. A number of our major projects require us to arrange, and sometimes to provide, specific guarantees in connection with, the customer's financing of the project. However, in such cases we are not required to provide collateral covering the full amounts financed. These include guarantees of Elbit Systems as well as guarantees provided by financial institutions relating to advance payments received from customers. Customers typically have the right to draw down against advance payment guarantees if we were to default under the applicable contract. In addition, some customers require that the payment period under the contract

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be extended for a number of years, sometimes beyond the period of contract performance. See below - Item 4. Information on the Company - Financing Terms. Also, we face exchange rate risks when our contracts call for payments in currencies other than the U.S. dollar. See below "Risk Related to Our Israeli Operations - Changes in the U.S. Dollar - New Israeli Shekel (NIS) Exchange Rate" and Item 4. Operating Financial Review and Prospects - Management Review and Analysis - Impact of Inflation and Exchange Rates.

WE MAY EXPERIENCE PRODUCTION DELAYS OR LIABILITY IF SUPPLIERS FAIL TO MAKE TIMELY DELIVERIES. The manufacturing process for some of our products consists in large part of the assembly, integration and testing of purchased components. Although generally we can obtain materials and purchase components from a number of different suppliers, some components are available from a small number of suppliers. In a few cases we work with suppliers that are effectively sole source. If a supplier should stop delivery of such components, we would probably be able to find other sources; however, this could result in added cost and manufacturing delays. Moreover, if our subcontractors fail to meet their design, delivery schedule or other obligations we could be held liable by our customers. Therefore, we attempt to impose liability on our subcontractors on a "back-to-back" basis to our liability to our customers. However, there can be no assurance that we would be able to obtain full or partial recovery from our subcontractors for those liabilities. In addition, when we act as a subcontractor, the failure or inability of the prime contractor to perform its contract with the customer may affect our ability to obtain payments under our subcontract.

WE OPERATE IN A COMPETITIVE INDUSTRY. The defense electronics and electro-optics, platform upgrade, homeland security and commercial aircraft product markets in which we participate are highly competitive and characterized by rapid technological change. If we are unable to improve existing systems and products and develop new systems and technologies in order to meet evolving customer demands, our business could be adversely affected. In addition, our competitors could introduce new products with innovative capabilities, which could adversely affect our business. There are many competitors in our markets. We compete with many large and mid-tier defense contractors on the basis of system performance, cost, overall value, delivery and reputation. Many of these competitors are much larger than us and generally have greater resources. Consequently, these competitors may be better positioned to take advantage of economies of scale and develop new technologies. Some of these competitors are also our suppliers in some programs.

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OUR BUSINESS DEPENDS ON PROPRIETARY TECHNOLOGY THAT MAY BE INFRINGED. Many of our systems and products depend on our proprietary technology for their success. Like other technology oriented companies, we rely on a combination of patent, trade secret, copyright and trademark laws, together with non-disclosure agreements, contractual confidentiality clauses, including those in employment agreements, and technical measures to establish and protect proprietary rights in our products. Our ability to successfully protect our technology may be limited because:

- o some foreign countries may not protect proprietary rights as fully as do the laws of the United States and Israel;
- o detecting infringements and enforcing proprietary rights may be time consuming and costly, diverting management's attention and company resources;

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- o measures such as entering into non-disclosure agreements afford only limited protection;
- o unauthorized parties may attempt to copy aspects of our products and develop similar products or obtain and use information that we regard as proprietary; and
- o competitors may independently develop products that are substantially equivalent or superior to our products or circumvent intellectual property rights.

In addition, others may allege infringement claims against us and affiliated companies. The cost of responding to infringement claims could be significant, regardless of whether the claims are valid.

WE WOULD BE ADVERSELY AFFECTED IF WE ARE UNABLE TO RETAIN KEY EMPLOYEES. Our success depends in part on a limited number of key management, scientific and technical personnel and our continuing ability to attract and retain highly qualified personnel. There is competition for the services of such personnel. The loss of the services of key personnel, and the failure to attract highly qualified personnel in the future, may have a negative impact on our business.

OUR 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 our relationships with these major contractors could negatively impact our future business. In addition, some of these companies are vertically integrated with in-house capabilities similar to ours in certain areas.

WE FACE ACQUISITION AND INTEGRATION RISKS. Over the past several years we have made a number of acquisitions and investments in companies that complement our business. See below - Item 4. Information on the Company - Recent Acquisitions and - Current Business Operations. We intend to continue to acquire businesses that complement our operations. Our growth may place significant demands on our management and our operational, financial and marketing resources. In connection with acquisitions and the opening of new facilities we have increased and may continue to increase the number of our employees. In addition, we have expanded and may continue to expand the scope and geographic area of our operations. We believe this growth will increase the complexity of our operations and the level of responsibility exercised by both existing and new management personnel. Failure to successfully integrate and manage our growth may have a material adverse effect on our business, financial condition, results of operations or prospects. We may also encounter anti-trust issues in certain areas as our operations expand.

OUR DUE DILIGENCE IN ACQUISITIONS MAY NOT ADEQUATELY COVER ALL RISKS. There may be liabilities or risks that we fail or are unable to discover in the course of performing due diligence investigations relating to businesses we have acquired or merged with or may acquire in the future. Examples of these liabilities include employee benefits contribution obligations and non-compliance with applicable environmental requirements by prior owners for which we, as a successor owner, may be responsible. Such risks may include changes in estimated costs to complete programs and estimated future revenues. In addition, there may be additional costs relating to acquisitions including, but not limited to, possible purchase price adjustments. Moreover, if the value of the acquired company were to decrease after the acquisition, or after follow-on investments

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in that company, we could face impairment issues. We try to minimize these risks by conducting due diligence as we deem appropriate under the circumstances. However, there is no assurance that we have identified, or in the case of future acquisitions, will identify, all existing or potential risks. Also, although generally we require the sellers of acquired businesses or assets to indemnify us against undisclosed liabilities, we cannot assure you that the indemnification will be enforceable, collectible or sufficient to fully offset the possible liabilities. Such liabilities could have a material adverse effect on our business, financial condition, results of operations or prospects. In addition, there may be situations in which our management determines, based on market conditions or other applicable considerations, to pursue an acquisition without performing due diligence.

RISKS RELATED TO OUR ISRAELI OPERATIONS

CONDITIONS IN ISRAEL MAY AFFECT OUR OPERATIONS. Political, economic and military conditions in Israel directly affect our operations. Since the establishment of the State of Israel, a number of armed conflicts have taken place between Israel and its Arab neighbors. A state of hostility, varying in degree and intensity has led to security and economic problems for Israel, despite Israel having signed peace agreements with Egypt and Jordan. Since 2000, there has been ongoing hostilities between Israel and the Palestinians, which has adversely affected the peace process and at times has negatively influenced Israel's economy as well as its relationship with several other countries. Despite recent Palestinian elections and discussion between the Israeli Government and the Palestinian Authority, there is no assurance that the current situation with the Palestinians will improve or, if it did, that the political and economic situation in Israel would improve as a result.

POLITICAL RELATIONS COULD LIMIT OUR ABILITY TO SELL OR BUY INTERNATIONALLY. We could be adversely affected by the interruption or reduction of trade between Israel and its trading partners. Some countries, companies and organizations continue to participate in a boycott of Israeli firms and others doing business with Israel or with Israeli companies. Foreign government defense export policies towards Israel could also make it more difficult for us to obtain the export authorizations necessary for our activities. Also, over the past several years there have been calls in Europe and elsewhere to reduce trade with Israel. To date, these measures have not had a material adverse effect on our business. However, there can be no assurance that restrictive laws, policies or practices directed towards Israel or Israeli businesses will not have an adverse impact on our business.

MANY OF OUR OFFICERS AND EMPLOYEES ARE OBLIGATED TO PERFORM MILITARY RESERVE DUTY IN ISRAEL. Generally, Israeli adult male citizens and permanent residents are obligated to perform annual military reserve duty up to a specified age. They also may be called to active duty at any time under emergency circumstances. Since we began operations, we have operated effectively under these requirements, including during hostilities in recent years with the Palestinians. However, no assessment can be made as to the full impact of such requirements on our workforce or business if conditions should change.

ISRAEL'S ECONOMY MAY BECOME UNSTABLE. Over the years, Israel's economy has been subject to a number of factors that have affected its stability. These include periods of inflation, low foreign exchange reserves, fluctuations in world commodity prices, military conflicts and civil unrest. For these and other reasons, the Government of Israel has intervened in different sectors of the

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economy. Such intervention has included employing fiscal and monetary policies, import duties, foreign currency restrictions, controls of wages, prices and foreign currency exchange rates and regulations regarding the lending limits of Israeli banks to companies considered to be in an affiliated group. The Israeli Government has periodically changed its policies in all of these areas. Although in recent years the stability of the Israeli economy has increased, and the Israeli Government has liberalized many economic regulations, reoccurrence of previous destabilizing factors could make it more difficult for us to operate our business as we have in the past.

CHANGES IN THE U.S. DOLLAR - NEW ISRAELI SHEKEL (NIS) EXCHANGE RATE. The exchange rate between the NIS and the U.S. dollar has fluctuated in recent years, although it was relatively stable in 2004. While most of our sales and expenses are denominated in dollars, a portion of our expenses is paid in NIS, and most of our sales to customers in Israel are in NIS. Our primary expenses paid in NIS that are not linked to the dollar are employee expenses in Israel and lease payments on some of our Israeli facilities. As a result, a change in the value of the NIS compared to the dollar could affect our research and development expenses, manufacturing labor costs and general and administrative expenses. See below - Item 5. Operating Financial Review and Prospects - Management's Review and Analysis - Impact of Inflation and Exchange Rates - Inflation and Devaluation.

REDUCTION IN ISRAELI GOVERNMENT SPENDING OR CHANGES IN PRIORITIES FOR DEFENSE PRODUCTS MAY ADVERSELY AFFECT OUR EARNINGS. The Israeli Government may reduce its expenditures for defense items or change its defense priorities in the coming years. In recent years, the overall Israeli Government budget as well as the IMOD NIS budget have been subject to reductions as part of an economic reform initiative. To date, our current programs have not been significantly impacted by such reductions, but there is no assurance that our programs will not be affected in the future. If there is a reduction in Israeli Government defense spending for our programs or a change in priorities to products other than ours, our revenues and earnings could be reduced.

ISRAELI GOVERNMENT PROGRAMS AND TAX BENEFITS MAY BE TERMINATED OR REDUCED IN THE FUTURE. Elbit Systems and some of our Israeli subsidiaries participate in programs of the Israeli Chief Scientist's Office (OCS) and the Israel Investment Center, for which we receive tax and other benefits. The benefits available under these programs depend on our meetings specified conditions. If we fail to comply with these conditions, we may be required to pay additional taxes and penalties, make refunds and be denied future benefits. From time to time, the Government of Israel has discussed reducing or eliminating the benefits available under these programs. See below - Item 4. Information on the Company - Conditions in Israel - Chief Scientist and Investment Center Funding. We cannot assure you that these benefits will be available in the future at their current levels or at all.

IT MAY BE DIFFICULT TO ENFORCE A NON-ISRAELI JUDGMENT AGAINST US, OUR OFFICERS AND DIRECTORS. We are incorporated in Israel. Most of our executive officers and directors are nonresidents of the United States, and a substantial portion of our assets and the assets of these persons are located outside the United States. Therefore, it may be difficult for an investor, or any other person or entity, to enforce against us or any of those persons in an Israeli court a U.S. court judgment based on the civil liability provisions of the U.S. federal securities laws. It may also be difficult to effect service of process on these persons in the United States. Additionally, it may be difficult for an investor, or any other person or entity, to enforce civil liabilities under U.S. federal securities laws in original actions filed in Israel. See below - Item 4. Information on the Company - Conditions in Israel - Enforcement of Judgments.

ITEM 4. INFORMATION ON THE COMPANY

BUSINESS OVERVIEW

MAIN ACTIVITIES

We develop, manufacture and integrate advanced, high-performance defense electronic and electro-optic systems for customers throughout the world. We focus on designing, developing, manufacturing and integrating command, control, communication, computer, intelligence, surveillance and reconnaissance (C4ISR) network centric systems for defense and homeland security applications. We also perform upgrade programs for airborne, land and naval defense platforms, often as a prime contractor.

Our major areas of operations include:

- o aircraft and helicopter systems and upgrades;
- o helmet mounted systems;
- o unmanned air vehicle (UAV) systems;
- o C4I and government information systems;
- o land vehicle systems and upgrades;
- o electro-optic and countermeasures systems and products;
- o naval systems;
- o homeland security systems;
- o services; and
- o technology spin-offs for commercial applications.

These major activities have a number of common and related elements. Therefore, marketing, research and development, manufacturing, performance of programs, sales and after sales support often are conducted jointly among these areas of activities.

We tailor and adapt our 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, we provide customers with cost-effective solutions, and our customers are able to improve their technological and operational capabilities within limited defense budgets.

MARKET ENVIRONMENT

The military actions in recent years and ongoing terrorist activities have caused a shift in the defense priorities for many of our major customers. We continue to perform platform upgrades. However, more emphasis is being placed on command, control, computers, communications and intelligence (C4I) systems,

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as well as intelligence, surveillance and reconnaissance (ISR) systems. These include network centric information systems, intelligence gathering, border and perimeter security, UAVs, space and satellite based defense capabilities and homeland security applications. There is also a growing demand for cost effective logistic support and training services. We believe our existing systems, products and capabilities place us in a position to meet emerging customer requirements in many of these areas. We also believe that some types of upgrade programs and electronic and electro-optic systems, particularly those that emphasize C4ISR, will continue to be a significant portion of defense budgets in many countries.

The worldwide defense market has been characterized over the last decade by significant consolidation and merger and acquisition activities. Part of our growth strategy includes our continued activity in mergers and acquisitions both in Israel and internationally. We view positively the declared policy of the Government of Israel to privatize portions of government-owned industries and view us as a natural candidate to acquire some of these activities.

We operate as a multi-domestic organization in order to meet the needs of our customers around the world. The Group's structure enables us to benefit from the synergy of our overall capabilities while at the same time focus on local requirements.

COMPANY HISTORY

We have many decades of operational experience. Elbit Systems was formed in 1996 as part of the Elbit Ltd. corporate demerger, which spun-off Elbit Ltd.'s defense related assets and business to Elbit Systems. From its founding in 1966 until the demerger, Elbit Ltd. was involved, among other operations, in a wide range of defense related airborne, land, naval and C4I programs throughout the world, and Elbit Systems continues these activities.

In 2000, Elbit Systems merged with Elop Electro-Optics Industries, Ltd. (El-Op). Following the merger, El-Op became a wholly-owned subsidiary of Elbit Systems. El-Op has more than 60 years of experience in the electro-optics area. The merger enhanced our position as the largest non-government owned defense company in Israel. This position was further enhanced by the agreement we signed in December 2004 to purchase the major shareholder interest in Tadiran Communications Ltd. and the completion of the first phase of that purchase in April 2005. See below - Item 7. Major Shareholders and Related Party Transactions - Related Party Transactions - Agreements Relating to the Tadiran Acquisition.

TRADING SYMBOLS AND ADDRESS

Elbit Systems' shares are traded on the Nasdaq National Market (Nasdaq) under the symbol "ESLT" and on the Tel-Aviv Stock Exchange (TASE).

Our main offices are in the Advanced Technology Center, Haifa 31053, Israel, and our main telephone number at that address is (972-4) 8315315.

MAJOR ACTIVITIES

AIRCRAFT AND HELICOPTER PROGRAMS AND SYSTEMS. We supply advanced airborne electronic and electro-optic systems and products to leading aircraft manufacturers and end users. Such airborne systems and products include weapons

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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, laser and infrared seekers for guided munitions, mission planning and mission debriefing systems, full mission simulators, tactical simulators and virtual training systems. Elbit Systems also is a prime contractor for aircraft and helicopter upgrade programs. We act as the upgrade integrator, and supply systems and products, for airborne platforms including:

- o fixed-wing aircraft such as the F-4, F-5, F-15, F-16, F-18, F-35, T-38, T-45, MiG-21, SU-25, SU-30, C-130, A-4, A-10, Mirage, AL-X, AM-X, IAR-99, AT-63 Pampa, Beechcraft, Gulfstream-550, MD-10, MD-11, Airbus A300 and A310; and
- o helicopters such as the CH-47, CH-53, Cobra, Puma, Super Puma, OH-58 Kiowa Warrior, AH-64 Apache, H-60 Black Hawk, S-70 Blackhawk, MI-8, MI-17, MI-24, Linx EC225 and EC725 and the V-22 Osprey tilt rotorcraft.

HELMET MOUNTED SYSTEMS. We design and supply advanced helmet mounted systems for fighter aircraft and helicopter pilots and land applications. 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. Our helmet mounted systems are supplied as part of Elbit Systems' upgrade programs as well as on a stand-alone basis.

UAV SYSTEMS. We design and supply integrated UAV systems and mini-UAV systems. We design and manufacture a variety of UAV platforms, including the Hermes family of UAVs and the Skylark man-packed UAV. We also design and supply command and control ground stations elements that can be adapted for various types of UAVs, as well as training systems with capabilities to simulate payload performance, malfunctions and ground control station operation.

C4I AND GOVERNMENT INFORMATION SYSTEMS. We design, manufacture and integrate C4I systems for ground forces and battlefield management and control applications. These include artillery command and control systems, day-night observation systems, C4I battlefield management systems for headquarters and maneuvering forces as well as battle management systems for battalion combat teams, tactical communications systems and radios that provide infrastructure and connectivity for network centric architecture solutions, tactical ground reconnaissance systems and tactical battle group trainers. This includes our prime contractor role for the Israeli Digital Army Program. We also design and manufacture governmental information technology systems and integrated information gathering systems for border control and management systems, crime prevention and other governmental applications.

LAND VEHICLE PROGRAMS AND SYSTEMS. We upgrade and modernize tanks and other combat vehicles both as a prime contractor and as a systems supplier to leading platform manufacturers. Our land vehicle systems include fire control systems, electric gun, turret drive and stabilization systems, overhead remote control weapon stations, battle management systems, FLIRs, gunner's and commander's sights, lasers range finders, laser warning systems, displays, life support systems and hydraulic systems for tanks, personnel carriers and other combat vehicles. We develop and supply unmanned ground vehicles for a variety of land based missions. We also supply training systems for tanks and fighting vehicles. Land vehicle programs containing our systems and products include the Merkava, M1 Abrams, Centurion, M-60, T-55, T-72, Bradley A-3, MLRS, HIMARS, AMX-30, SK-105, MK-109, ULAN, Pandur and LAV.

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ELECTRO-OPTIC AND COUNTERMEASURES SYSTEMS. Through El-Op, our wholly-owned subsidiary, we design and manufacture 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 land, naval and airborne applications, laser range finders and laser designators based on flash lamp pumped and diode pumped technologies used in manned and unmanned airborne vehicles and land and naval platforms. Our electro-optic solutions are used for detection, identification and information gathering as well as for land vehicle upgrades. El-Op's ISR related business activities - space cameras, airborne reconnaissance and observation & surveillance - share a broad infrastructure of technologies that provide imagery intelligence, long range observation solutions for space, air, sea and land 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.

NAVAL SYSTEMS. Our naval systems include naval combat management systems, shipboard combat system integration, naval electro-optic observation systems, naval tactical trainers, submarine electronic support management systems and shipboard decoy countermeasure launching systems.

HOMELAND SECURITY SYSTEMS. We design, manufacture and integrate a range of security systems and products for air, ground and sea homeland security and homeland defense applications. These include maritime and coastal control and surveillance systems, harbor protection systems, border control systems automatic access gates for border control, C4I homeland security applications, facility perimeter security products, remote suspect identification systems for aviation security, electronic fences and electro-optic warning systems for defense, police, border and coast guards and homeland security uses.

SERVICES. We provide a wide range of logistic support, training, simulation, maintenance and repair services for our customers around the world. This includes cutting edge simulators for air, land and naval platforms; "power by the hour" flight training under private finance initiatives; and establishing and operating maintenance and repair centers.

TECHNOLOGY SPIN-OFFS. We are engaged in spin-offs of our defense technologies to commercial applications. Our spin-off activities to date are in the areas of medical equipment, optical communications, commercial satellites and satellite communication for commercial aircraft.

REVENUES

The table below shows our consolidated revenues for groups of major areas of operations for the years ended December 31, 2002, 2003 and 2004:

| | 2002 | 2003 | 2004 |
|--|-------|-------|-------|
| | ---- | ---- | ---- |
| Airborne Systems: | \$373 | \$374 | \$368 |
| Land Vehicle Systems: | 136 | 200 | 199 |
| C4ISR Systems: | 123 | 134 | 109 |
| Electro-Optic Systems: | 148 | 140 | 200 |
| Other (mainly non-defense engineering and production): | 48 | 50 | ___64 |

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| | | | |
|--------|-------------------------|-------------------------|-------------------------|
| Total: | ----- \$828 ===== | ----- \$898 ===== | ----- \$940 ===== |
|--------|-------------------------|-------------------------|-------------------------|

SYSTEMS AND PRODUCTS

The following is a brief description of our main systems and products:

AIRCRAFT AND HELICOPTER SYSTEMS

COCKPIT MANAGEMENT SYSTEMS - for reduced pilot workload while operating complex weapons platforms.

AIRBORNE COMPUTERS - for mission management performance.

WEAPON DELIVERY AND NAVIGATION SYSTEMS - for controlling weapon delivery and navigation.

DISPLAY SYSTEMS - for processing and displaying tactical information, including head-up and multi-functional displays.

AIRBORNE C4I SYSTEMS - for network centric airborne, command, control, communication and intelligence and situational awareness.

DIGITAL MAP SYSTEMS AND MASS MEMORY DEVICES - for storing digitized mapping information and providing pilots with mapping and other tactical information correlated with aircraft position.

STORES MANAGEMENT SYSTEMS - for operating and releasing airborne weapons.

DIGITAL VIDEO RECORDING DEVICES - for mission and maintenance debriefing.

WEAPON GUIDANCE SYSTEMS - laser and infrared kits for guiding precision weapons launched from aircraft.

ENHANCED VISION SYSTEMS - for all weather landing of commercial and military aircraft.

COCKPIT INSTRUMENTATION - altimeters, pressure meters, cockpit indicators and avionics test equipment for civil and military aircraft.

SIMULATORS - for airborne and ground flight training.

VIRTUAL TRAINING SYSTEMS - for embedded training.

MISSION PLANNING AND DEBRIEFING SYSTEMS - for planning and debriefing of fixed and rotary-wing aircraft missions.

HELMET MOUNTED SYSTEMS

PILOT HELMET MOUNTED SYSTEMS - for air superiority, target designation, weapon and sensor slaving and information display.

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NIGHT VISION SYSTEMS - for improving range and clarity of what pilots see while flying at low altitude and with poor flight visibility.

LAND HELMET MOUNTED SYSTEMS - for use on land platforms and individual soldier applications.

COCKPIT MAPPING SYSTEMS - advanced adaptive technologies for line of sight alignment in a cockpit.

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UAV SYSTEMS

UAV SYSTEMS -comprehensive systems, including the air vehicle, payloads, data link, ground control system and ground support equipment.

HERMES 1500 - medium altitude long endurance UAV system designed for Corps and Command level support missions and for maritime patrol.

HERMES 450 - tactical long endurance UAV system designed for Division level support missions.

HERMES 180 - tactical short range UAV system designed for Brigade level support missions.

SKYLARK - man-packed close range UAV system for Company and Battalion level support missions.

GROUND CONTROL STATIONS -designed with an open architecture concept that is adaptable to various types of UAVs.

TRAINING SYSTEMS - for simulation of full UAV operation, payload data and malfunctions.

C4I AND GOVERNMENT INFORMATION SYSTEMS

DIGITAL ARMY "SYSTEM OF SYSTEMS" - advanced combat concepts geared to increase operational effectiveness and connectivity throughout all land force echelons, in all combat situations, under a unified operational concept, providing computerized systems down to the single soldier level to facilitate transmission of integrated, real-time situation pictures to and from all battlefield and command echelons.

ARTILLERY C4I SYSTEMS - for C4I applications among field artillery units deployed from the platform to brigade levels, managing all aspects of artillery operations..

BATTLEFIELD MANAGEMENT SYSTEMS - comprehensive solutions comprising advanced electro-optical sensors, multi functional displays, command and control software, information and dissemination systems and advanced mission computers, for enabling coordination between fighting vehicles, that provide situational awareness to peace-keeping operations and maneuvering forces, including combat vehicles, engineering corps and logistic support personnel.

HEADQUARTERS AND FORCE MANEUVERING MANAGEMENT SYSTEMS - integrated

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command and control systems for maneuvering forces, providing updated situational awareness, command dissemination and decision support tools.

TACTICAL GROUND RECONNAISSANCE SYSTEMS - for border control and ground reconnaissance operations.

TACTICAL DATA COMMUNICATION SYSTEMS - for network centric information exchange for ground applications, using data radios, modems, protocols, message handling systems, voice over IP and tactical internet.

ENHANCED TACTICAL COMPUTERS - tactical PCs for military field use.

MILITARY WIRELESS LAN - immune wireless systems for wideband data transmission, with high survivability in dynamic and noisy military environments.

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TACTICAL BATTLE GROUP TRAINERS - for training commanders and staff from company level to battalion battle group and brigade-sized operations.

BORDER, PERIMETER AND FACILITY SECURITY SYSTEMS - for use by armed forces, police, border patrols, coast guards and security personnel to monitor by innovative means border crossing points, airports, seaports, military bases, high risk installations and other sensitive areas.

INFORMATION TECHNOLOGY SYSTEMS - for crime prevention, and other governmental applications.

INTEGRATIVE COMPONENT-BASED EXPLOITATION (ICE) SYSTEM - fully integrative multi-sensor exploitation system providing an end-to-end solution for the entire operational cycle of satellite and airborne digital imagery.

ANTI-MONEY LAUNDERING SYSTEMS - information technology systems for law enforcement anti-money laundering and combating of terrorist financing activities.

BORDER CONTROL AND MANAGEMENT SYSTEMS - automatic systems that supervise and control all movements across borders.

LAND VEHICLE SYSTEMS

FIRE CONTROL SYSTEMS - for target identification, acquisition and engagement, incorporating thermal imaging, laser range finders, day TV, digital ballistic computers and sensors using day and night vision systems and displays.

ELECTRIC GUN AND TURRET DRIVE SYSTEMS - for controlling electrically driven turrets and guns, using advanced brushless technology and digital/software based servo systems.

BATTLE MANAGEMENT SYSTEMS - for data processing and situational awareness of vehicle crews and commanders.

OVERHEAD REMOTE WEAPON STATIONS - for transforming armored vehicles into armored fighting vehicles by providing the crew with the combat

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capabilities of a turreted vehicle.

COLOR FLAT PANEL DISPLAYS - for presentation of maps and command and control data, as well as video generated by thermal imaging systems.

MASS STORAGE DEVICES - for storage of maps and battle command information using solid state memory devices based on commercial off the shelf and PCMCIA technology.

COMMANDER PANORAMIC SIGHTS - for 360(0) independent panoramic target location and identification and gun-turret direction, using day and night vision systems.

LASER WARNING SYSTEMS - for identifying and pinpointing the angular direction of laser sources generated by laser range finders and laser guided and laser beamrider missiles.

UNMANNED GROUND VEHICLES (UGVS) - dedicated autonomous vehicles, equipped with sensory perception and artificial intelligence capabilities for various land based applications.

SIMULATOR AND TRAINING SYSTEMS - for tank and fighting vehicle training, based on optical and computerized image generation technology.

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HYDRAULIC SYSTEMS - for vehicle fueling, braking, suspension and power pack operation.

LIFE SUPPORT SYSTEMS - for environmental, climate and nuclear, bacterial and chemical (NBC) protection and control.

ELECTRO-OPTIC AND COUNTERMEASURES SYSTEMS

FLIR SYSTEMS - for thermal imaging observation without need for natural or artificial light for air, land and sea platforms, including hand-carried portable solutions.

LASER RANGE-FINDERS AND DESIGNATORS - for range finding and designation of targets for air, land and naval platforms based on flash lamp and solid state diode pumped technologies, including eye-safe systems.

PAYLOADS - for observation, target acquisition, target engagement training and fire control using stabilized line-of-sight systems, incorporating laser range finders or designators and thermal and TV cameras.

COUNTERMEASURES SYSTEMS - for airborne and naval applications.

AERIAL RECONNAISSANCE SYSTEMS - for long-range and day/night information collection from high, medium and low altitude in penetrating and stand-off missions using digital photography, transmission, processing and display systems.

LONG-RANGE DAY & NIGHT SURVEILLANCE SYSTEMS - for improving day and night vision, including computerized information processing.

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SPACE CAMERAS AND TELESCOPES- advanced panchromatic and multi-spectral cameras for high resolution, remote sensing satellites.

NAVAL SYSTEMS

NAVAL COMBAT MANAGEMENT SYSTEMS (CMS) - command and control, data links, sensors and effector control systems for naval ships including integrated tactical information and operation of weapon systems.

NAVAL COMBAT SYSTEMS INTEGRATION - integration of weapons and sensors for naval platforms.

STABILIZED ELECTRO-OPTICAL PAYLOADS - for naval observation and electro-optical stabilized line of sight fire control systems.

COMPUTERIZED NAVAL SIMULATORS - for tactical training of naval officers at shore-based locations.

SUBMARINE ELECTRONIC WARFARE SYSTEMS - electronic support measurements (ESM) for threat identification and electro-magnetic analysis.

SHIPBOARD DECOY COUNTERMEASURE LAUNCHING SYSTEMS - sophisticated countermeasures deployment of chaff and flair against missile threats.

UNMANNED NAVAL VEHICLES - unmanned naval systems for various maritime applications that adapt the capabilities and applications of UAVs.

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SATELLITE COMMUNICATION SYSTEMS - VSAT communication systems with high band rate data and voice transfer for land and naval forces.

HOMELAND SECURITY SYSTEMS

BORDER AND COASTAL SURVEILLANCE AND CONTROL SYSTEMS - turn-key solutions including a wide variety of day and night electro-optical sensors with perimeter security, image processing, acoustic sensing technology, command and control and systems integration capabilities for monitoring and information gathering at border entry points and coastal areas.

HARBOR PROTECTION SYSTEMS - for securing and monitoring access to harbors.

FACILITY SECURITY SYSTEMS - for protecting unauthorized access and exit to and from sensitive facilities.

AVIATION SECURITY APPLICATIONS - for protection of commercial aircraft, airports and air travelers, including remote suspect identification systems.

AUTOMATIC BORDER ACCESS GATES - for controlling access of passengers, vehicles and carriages at border entry points.

CRITICAL INFRASTRUCTURE SECURITY SYSTEMS - a wide range of electro-optical intruder detection sensors with advance day and night capabilities for monitoring and securing critical infrastructure

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facilities and assets, including integrated pipeline security system solutions based on acoustic detection fusion technology.

ELECTRONIC AND ELECTRO-OPTICAL PERIMETER AND ACCESS CONTROL SYSTEMS - for night and day "smart" monitoring of perimeter fences and entry/exit points.

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PRINCIPAL SUBSIDIARIES

EL-OP

Based in Rehovot, Israel, our wholly-owned subsidiary El-Op operates in the area of electro-optic systems and products mainly for defense, space and homeland security applications. It has significant design, engineering and manufacturing capabilities. El-Op has a broad customer base, both in Israel and internationally.

El-Op designs, engineers, manufactures and supports a wide range of advanced electro-optic airborne, land, naval and space systems and products described elsewhere in this Form 20-F. These include IMINT solutions, airborne reconnaissance systems, spaceborne reconnaissance systems, observation and surveillance stabilized payloads, laser systems, head-up displays, thermal imaging systems, integrated sights for ground forces and electro-optical homeland security and defense security systems. See below "Current Business Operations - Aircraft and Helicopter Systems - Aircraft Head-Up Displays, Aircraft Electro-Optic Systems, Aerial Reconnaissance Systems and Electro-Optics Products for Helicopters; Land Vehicle Systems - Merkava and Thermal Imaging Systems - Electro-Optical and Countermeasures Systems - Naval Systems and - Homeland Security Systems."

EFW

We conduct most of our business in the United States through our wholly-owned subsidiary, EFW Inc. (EFW) and EFW's subsidiaries, collectively the Elbit Systems of America group of companies. Elbit Systems holds its shares in EFW through a Delaware holding company Elbit Systems U.S. Corp. (ESC). EFW is incorporated in Delaware and based in Fort Worth, Texas. In 1993, EFW acquired most of the assets of General Dynamics Corporation's (General Dynamics) Electronics Manufacturing Center in Fort Worth, which mainly manufactured and supplied electronic components for F-16 aircraft. Over the last decade EFW has expanded its activities to a number of additional areas involving tactical aircraft, helicopters, land vehicles, UAVs and smart munitions. These include programs for the V-22 Osprey tilt rotorcraft, the Bradley A-3 fighting vehicle, the Multiple Launch Rocket System, JDAM munitions, the AH-64 Apache helicopter, the UH-60 Blackhawk helicopter, the OH-58D Kiowa Warrior helicopter, the A-10 aircraft, the F/A-18 aircraft, the C-130 transport aircraft as well as additional systems for the F-16. EFW is involved in a number of joint projects with Elbit Systems Group companies and with other U.S. defense companies.

As described below, EFW and Rockwell Collins Inc. each own 50% of Vision Systems International LLC, which is engaged in the area of helmet mounted systems for fighter aircraft.

EFW has expanded significantly through mergers and acquisitions.

KOLLSMAN. EFW acquired Kollsman, Inc. (Kollsman), a wholly-owned

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Delaware subsidiary located in Merrimack, New Hampshire. Kollsman is engaged mainly in developing and manufacturing cockpit instruments and enhanced vision systems for civil and military aircraft and observation and targeting systems for land vehicles and aircraft. Kollsman has also recently begun activities in the U.S. homeland security market. Kollsman through its wholly-owned subsidiary, KMC Systems, Inc., is also involved in manufacturing medical instrumentation.

IEI. EFW also acquired International Enterprises, Inc. (IEI), a wholly-owned Alabama subsidiary located in Talladega, Alabama, that provides repair, maintenance and logistics support for a number of military electronic systems and components installed on aircraft, helicopters and ground support equipment for the U.S. military and other customers worldwide. IEI serves as EFW's focal point for after-market support capability.

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HONEYWELL DISPLAY BUSINESS. Another acquisition of EFW was the purchase of the Display and Orientation Products business of Honeywell Inc. (Honeywell). This business includes the military helmet display and tracker activities that were performed by Honeywell, a major part of which is the production and support of helmet mounted systems for the U.S. Army's Apache helicopters. Part of this business is based in Warner Robins, Georgia, and the other activities are carried out at EFW's Fort Worth facilities and at IEI's facilities in Alabama.

EFW'S MAJOR CUSTOMERS. Major customers of EFW and its subsidiaries include Lockheed Martin Corporation (Lockheed Martin), the Boeing Company (Boeing), the U.S. Army, U.S. Navy, U.S. Air Force, U.S. Marine Corps, the IMOD, United Defense, Gulfstream Aircraft Corporation, Federal Express, Honeywell International Inc., Oto Melara S.p.A. and CMI - Cockerill Mechanical Industries S.A.

EFW'S RECENT CONTRACTS. Recent contract awards include development of displays for F/A-18 E/F aircraft, design of an electronic unit for the helmet mounted system and design of a new mission computer for the AH-64 Apache helicopter, development and supply of smart displays for the UH-60 Q/L Blackhawk helicopter, development and supply of Enhanced Vision Systems and head-up displays for Federal Express wide body aircraft, multi-year supply of commercial data entry electronic units, commercial central interface units, color multi-function displays and digital video recorders for the F-16, development and supply of multi-function displays for the C-130, supply of displays for the A-10 and semi-active laser seekers for JDAM munitions. See below "Current Business Operations - Aircraft and Helicopter Systems - Helmet Mounted Systems and - Land Vehicle Systems".

FMF. EFW and its subsidiaries also act as prime contractors for U.S. Foreign Military Funding programs. See below "Governmental Regulations - Foreign Military Funding".

ENGINEERING AND MANUFACTURING. EFW has extensive engineering and manufacturing capabilities at its Fort Worth facilities as does Kollsman at its facilities in New Hampshire. IEI's facilities in Alabama and EFW's facilities in Georgia have significant maintenance and repair capabilities. See below "Manufacturing" and "Customer Satisfaction and Quality Assurance".

SSA. EFW, Elbit Systems, ESC and the DOD are parties to a Special Security Agreement (SSA). The SSA provides controls and procedures to protect classified information and export controlled data received by EFW and its subsidiaries in performing U.S. Government contracts. The SSA allows EFW and its subsidiaries to participate in classified U.S. Government programs even though,

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due to its ownership by Elbit Systems, EFW is considered under the control of a non-U.S. interest. Under the SSA, a Government Security Committee of EFW's board of directors was permanently established to supervise and monitor compliance with EFW's security procedures. The SSA also requires EFW's board of directors to include outside directors who have no other affiliation with the Elbit Systems Group. EFW's board of directors also contains officers of EFW and up to two inside directors, who have other affiliations with the Elbit Systems Group. The SSA requires outside directors and officers of EFW who are directors, and some other senior officers, to be U.S. resident citizens and eligible for DOD personal security clearances.

VSI

Vision Systems International LLC (VSI) is a California limited liability investee company based in San Jose, California. EFW and Rockwell Collins Inc. (Rockwell Collins), through Kaiser Electronics, each own 50% of VSI. Founded in 1996, VSI acts on a world-wide basis on behalf of Rockwell Collins/Kaiser and Elbit Systems/EFW in the area of helmet mounted display systems for fixed-wing military and paramilitary aircraft. VSI performs marketing, project management, contract administration and systems engineering. Elbit Systems, EFW and Kaiser each have provided VSI with licenses to use their helmet mounted display technologies. In general, VSI subcontracts product development and production to its owners on an approximately equal basis. Each owner has equal representation on VSI's management.

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VSI is the prime contractor to Boeing and Lockheed Martin for the design and manufacture of the Joint Helmet Mounted Cueing System (JHMCS) for the U.S. Air Force and U.S. Navy F-15, F-16 and F/A-18 aircraft. VSI also has contracts to supply helmet mounted systems for fighter aircraft to the Israel Air Force (IAF), the Danish Air Force and other customers. In 2003, VSI was selected to develop a dual-seater version of the JHMCS and in January 2004 was authorized to begin full scale JHMCS production. In addition, in 2003, Lockheed Martin selected VSI as its team member to develop the helmet mounted system for the U.S. F-35 Joint Strike Fighter (JSF). See below "Current Business Operations - Helmet Mounted Systems".

CYCLONE. Cyclone Aviation Products Ltd. (Cyclone) is a wholly-owned Israeli subsidiary of Elbit Systems. Located near Karmiel, Israel, Cyclone designs and produces composite and metal structural parts for civil and military aircraft. Cyclone also performs maintenance, integration of systems and upgrades for aircraft and helicopters. Cyclone recently acquired the assets of IMI's Aircraft Systems Division, which is involved in manufacturing weapons pylons and external fuel tanks for fighter aircraft. See below - "Recent Acquisitions". Both directly and through its affiliated company Snunit, Cyclone works with Elbit Systems in supplying flight training services for fixed-wing aircraft and helicopters of the IAF. Cyclone's customers include the IMOD, the U.S. Air Force, Boeing, Lockheed Martin, Vought Aircraft Industries Inc., Bell Helicopters Textron Inc., Sikorsky Aircraft Company (Sikorsky), Israel Aircraft Industries Ltd. (IAI) and other aircraft manufacturers and end users around the world. See below "Current Business Operations - Aircraft and Helicopter Systems - Civil Aviation and - Logistics Support Services"..

SILVER ARROW. Silver Arrow LP (Silver Arrow), is an Israeli limited partnership owned by Elbit Systems together with a wholly-owned holding company subsidiary of Elbit Systems. It operates as an integral part of Elbit Systems' UAV Systems business, which is located both in Nes Ziona and Haifa, Israel. Silver Arrow develops and manufactures UAVs. UEL - UAV Engines Ltd., a

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wholly-owned British subsidiary of Silver Arrow, manufactures engines for UAVs and other applications. See below "Current Business Operations - UAV Systems".

ORTEK . Ortek Ltd. (Ortek) is a wholly-owned Israeli subsidiary of Elbit Systems. Located in Sderot, Israel, Ortek operates mainly in the field of defense security and surveillance systems and tactical products including day and night vision instruments based on starlight amplification. It develops and manufactures electro-optical systems for day and night use, counter-terrorism systems, command and control, image processing and intruder detection, night vision goggles, sniper vision systems and other defense and homeland security systems including for border, perimeter and access control. See below "Current Business Operations - Battlefield Management and Government Information Systems and - Homeland Security Systems"

EUROPEAN SUBSIDIARY. The European Subsidiary is a wholly-owned Belgium subsidiary. It develops, manufactures and supports electro-optical products, mainly for the defense and space markets.

KINETICS. Kinetics Ltd. (Kinetics), based in Airport City, Israel, is owned 51% by Elbit Systems. The balance is owned by founding employees and private investors in Israel and the United States. Some of these other shareholders have a "put" option that, if exercised, would require Elbit Systems to acquire their shares in Kinetics at a specified price. Kinetics develops technologies, systems and products in the field of advanced life support and environmental controls, such as climate control systems and nuclear, biological and chemical protection systems for combat vehicles. Also, Kinetics develops and manufactures other products for land vehicles, such as hydraulic, fuel, braking and suspension systems, an auxiliary power unit for land vehicle power pack systems and hydraulic systems for aircraft. Kinetics sells its products to the IDF, the U.S. Army and other customers. Kinetics wholly-owns Real-Time Laboratories, LLC. a company based in Boca Raton, Florida, engaged in the U.S. market in similar activities to those of Kinetics. See below "Current Business Operations - Land Vehicle Systems - Environmental Control and Hydraulic Systems". Elbit Systems has a "call" option to purchase the shares of the other shareholders in Kinetics at a specific price. With regard to a "put" option of other shareholders in Kinetics, see below - Item 5. Operating Financial Review and Prospects - Management's Discussion and Analysis - General - Off-Balance Sheet and Other Long-Term Arrangements and Commitments.

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SCD. Semi-Conductor Devices (SCD) is an Israeli investee partnership equally owned by Elbit Systems and Rafael Armaments Development Authority Ltd. (Rafael). Located in Leshem, Israel, SCD develops and manufactures infrared detectors for thermal imaging equipment and laser diodes used in defense and commercial applications. SCD also owns approximately 8%, on a fully-diluted basis, of CyOptics Inc., a spin-off company engaged in the development of optical communications components based on Indium Phosphide technology. See below "Current Business Operations - Electro-Optical and Countermeasures Systems and - Technology Spin-Offs".

OPGAL. Opgal - Optronics Industries Ltd. (Opgal) is an Israeli investee company owned 50.1% by Elbit Systems and 49.9% by a subsidiary of Rafael. Located in Karmiel, Israel, Opgal focuses mainly on commercial applications of thermal imaging and electro-optic technologies. Its developments include an enhanced vision sensor designed to assist in landing aircraft under limited visibility and harsh weather conditions. Opgal also designs thermal imaging cameras and FLIR systems for applications, such as surveillance, industrial, medical and fire fighting. It also produces OEM FLIR cameras for defense

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applications. See below "Current Business Operations - Aircraft and Helicopter Systems - Civil Aviation and - Electro-Optical and Countermeasures Systems."

TADIRAN COMMUNICATIONS

Tadiran Communications Ltd. (Tadiran Communications) is a publicly traded Israeli investee company owned as of May 31, 2005, approximately 20% by Elbit Systems and approximately 18% by Koor Industries Ltd. (Koor), with the balance of the shares traded on the TASE. Located in Holon and Petach Tikva, Israel, Tadiran Communications has over 40 years of experience in military communications technologies, with internationally recognized expertise in the fields of RF design and development in frequencies ranging from 1.5 MHz - 5 GHz and 50 GHz to 60 GHz, spread spectrum techniques (e.g. frequency hopping and direct sequence), crypto algorithms, wireless data transfer application modems, error detection and correction adapted to radio channels, advanced synchronization techniques, communications protocols, including radio over IP (RoIP) and voice over IP (VoIP), and radio channel control.

In addition to being the main supplier of communication equipment to the IDF's Signal Corps, Tadiran Communications is active in the global military and civilian communication markets. Tadiran Communications has a large worldwide customer base for which it provides advanced communications technology, equipment, systems and solutions. Over 90% of its 2004 revenues was derived from its international exports. Tadiran Communications' wholly-owned subsidiary, Talla-Com, Tallahassee Communications Industries Inc. (Talla-Com), and Talla-Com's wholly-owned subsidiary, Tallahassee Technologies Inc., both based in Tallahassee, Florida, serve as Tadiran Communications' U.S. development, production and marketing arm and as a base for participation in FMS projects. Tadiran Communications' 75%-owned Ulm, Germany-based subsidiary, Telefunken RACOMS, is active in both military and civilian communications and serves as Tadiran Communications' base for the German and European communications markets.

For further information on Elbit Systems agreements regarding the purchase of shares in Tadiran Communications see below - Item 7. Major Shareholders and Related Party Transactions - Related Party Transactions - Agreements Relating to the Tadiran Acquisition.

OTHERS. We have several other smaller subsidiaries and investee companies in Israel and other countries.

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RECENT ACQUISITIONS

During the past year we have expanded our capabilities through several acquisitions as well as divested our shareholdings in one of our non-core businesses.

TADIRAN COMMUNICATIONS. In April 2005, Elbit Systems completed the first stage of the acquisition of Koor's shares in Tadiran Communications, acquiring from Koor approximately 13.7% of Tadiran Communications shares, for an aggregate purchase price of approximately \$62.5 million. Including shares purchased by Elbit Systems on the stock market, as of May 31, 2005, we hold in the aggregate approximately 20% of Tadiran Communications' shares. Subject to the terms of agreements between Elbit Systems and Koor, Elbit Systems is to purchase the balance of the Tadiran Communications' shares held by Koor (approximately 18%). See above "Principal Subsidiaries - Tadiran Communications" and below - Item 7. Major Shareholders and Related Party Transactions - Related Party Transactions - Agreements Relating to the Tadiran Acquisition.

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IMI AIRCRAFT SYSTEMS DIVISION. In March 2005, Cyclone acquired the assets of Israel Military Industries Ltd.'s (IMI) Aircraft Systems Division (the Aircraft Division) located in Tirat Hacarmel, Israel, for a price of approximately \$7 million, subject to adjustments, a portion of which was paid in cash and the balance through assumption of obligations of the Aircraft Division. The transaction was made through a wholly-owned subsidiary of Cyclone. The Aircraft Division manufactures weapon pylons and external fuel tanks for fighter aircraft. The Aircraft Division's customers include the IMOD, the DOD, U.S. aircraft manufacturers and other customers worldwide.

CIC. In September 2004, Kollsman acquired the product line and assets of Computer Instruments Company (CIC), located in Westbury New York, for approximately \$2.3 million. The CIC business line relates to the manufacture of air data computers and modules and air data pressure probes for military and commercial aircraft. Following the acquisition, the CIC business was relocated to Kollsman's facilities in New Hampshire. The acquisition positions Kollsman as a key supplier of air data probes for tactical missile and UAV programs and enhances Kollsman's product line for commercial and military aircraft.

REDC. In November 2004, El-Op acquired the preferred shares of RedC Optical Networks Inc. (RedC) held by MRV Communications Inc. for a purchase price of \$2 million, which together with the 36.5% of RedC's shares previously held by El-Op, brought El-Op's shareholdings in RedC's voting shares to approximately 72.5%. RedC is a Delaware corporation, which together with its Israeli subsidiary, designs and manufactures optical amplifiers for dense wave-length multiplexing optical networks for telecommunications. In December 2004, El-Op entered into an agreement for the sale of its entire interest in RedC in consideration for approximately \$3.1 million. The closing conditions for that sale were completed in January 2005. Approximately 90% of El-Op's equity interest in RedC was sold to the Cedar Fund with the balance redeemed by RedC itself.

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CURRENT BUSINESS OPERATIONS

The contract amount for programs described below is provided only where the amount is considered to be material to Elbit Systems. The areas of operation described below often operate in an interrelated manner.

AIRCRAFT AND HELICOPTER SYSTEMS

NATURE OF OUR AIRBORNE SYSTEMS AND UPGRADES

Fighter and transport aircraft and helicopters require advanced electronic and electro-optic systems to perform their complex missions accurately, reliably and efficiently. Our airborne systems are used in upgrading and modernizing fighter aircraft and helicopters, extending the useful life of a fleet and provide a cost-effective alternative to replacing existing equipment. Our systems are also installed as original equipment in new aircraft.

Our airborne systems and products include, head-up displays, mission computers, digital maps, displays, display processors, weapon control systems, airborne C4I systems, FLIRs, laser products, cockpit instruments, payloads and aerial reconnaissance systems. We also supply helmet mounted display and tracking systems as described below. By reducing the pilot's workload, these systems are designed to provide greater accuracy, reliability and efficiency in performing missions. We also supply a comprehensive line of aircraft simulator

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and training systems.

Aircraft and helicopter upgrade programs are a part of our business strategy. We have implemented this strategy over the past several years in major upgrade programs for existing aircraft and helicopters.

AIRCRAFT AVIONICS SYSTEMS AND UPGRADE PROGRAMS

IAR 99. In November 2004, Elbit Systems, in cooperation with the Romanian aircraft manufacturer Avioane Craiova, was awarded a \$43 million contract from the Romanian Defense Ministry to supply eight IAR-99 lead-in trainer aircraft. The project will be executed in cooperation with Romanian industries over a period of approximately four years. This contract followed our upgrade project of four IAR-99 aircraft which was announced in 2001. The first program has been completed and the aircraft are currently used by the Romanian Air Force.

F-18 DISPLAYS. In April 2004, EFW was awarded a contract from Boeing for the design and development of Upfront Control Display (UFCD) and Multi-Purpose Color Display (MPCD) units for F/A-18E/F aircraft. Under the terms of the contract, EFW will provide Form, Fit, Function and Interface (FFFI) replacements of the existing aircraft configuration in support of the F/A-18E/F Multi-Year II program, to take place from 2005 to 2009. The contract award provides options for production units of up to 360 aircraft. The first of these production options was awarded to EFW in October 2004. The development, production and support contract for the full program is estimated to be at a value of more than \$45 million.

AL-X BRAZIL. In 2002, Elbit Systems was awarded contracts by the Brazilian Government and by a subsidiary of the Brazilian aircraft company Embraer - Empresa Brasileira de Aeronautica S.A. (Embraer) for the production and logistic support phases of the AL-X Super Tucano aircraft program for the Brazilian Air Force. The contracts are valued at more than \$80 million and are being performed over a period of approximately four years. Under the contracts we supply avionics systems, equipment and logistic support for 76 AL-X light attack and trainer aircraft being manufactured by Embraer for the Brazilian Air Force. This followed our completion of a development contract for the AL-X. We began delivering production aircraft in January 2004. The avionics system for the AL-X includes an advanced mission computer, liquid crystal displays, head-up display and a navigation system. In addition, we are supplying simulators, planning mission stations and debriefing stations.

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Maintenance and logistic support to the Brazilian Air Force are provided mainly through Elbit Systems' Brazilian subsidiary Aeroeletronica - Industria de Componentes Avionicos S.A. (AEL), located in Porto Alegre, Brazil. Program funding is provided in part through a financing arrangement between the Brazilian Government and commercial banks. The contracts call for "buy-back" to be performed over a multi-year period. See below "Buy Back".

F-5 BRAZIL. In 2001, Elbit Systems began work under contracts for the Brazilian F-5 Aircraft Modernization Program. The program calls for the upgrade of 46 F-5 aircraft for the Brazilian Air Force. Ours contracts for the program are with Embraer and the Brazilian Government, with a total value of approximately \$230 million to be performed over a six-year period. The contract with Embraer provides for an avionics upgrade, which includes an electronic warfare (EW) suite, mission computers, radar, displays and other avionics products. Prototype flight testing began in January 2004 and delivery of production aircraft is scheduled during 2005. The contract with the Brazilian

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Government covers a logistic support program including establishment of an in-country maintenance center based at AEL. Program funding is provided through a financing arrangement between the Brazilian Government and commercial banks. We obtained an insurance policy from the Israeli Foreign Trade Risk Insurance Company (IFTRIC) covering up to 90% of our financial exposure under the program, subject to the policy's terms. The program also includes buy-back provisions.

MIG-21 ROMANIA. During 2003, we completed work and received the remaining payments under the contract for the upgrade of MiG-21 aircraft for the Romanian Air Force. Following completion of aircraft deliveries, we are supplying ACTS, an Advanced Combat Training System, which aids pilot training and the transition to upgraded MiG-21 aircraft and other future fighters.

SU-25 SCORPION. In 2003 and 2004, Elbit Systems was awarded contracts to deliver to Georgia avionics for upgraded SU-25 Scorpion aircraft, with deliveries scheduled for 2005 and 2006, respectively. This followed Elbit Systems and TAM, the Georgian aircraft manufacturer, conduct of the maiden flight of an upgraded SU-25 Scorpion aircraft in 2001.

PAMPA. In 2001, Elbit Systems signed a contract with Lockheed Martin Aircraft Argentina S.A. for the avionics upgrade of 24 AT-63 Pampa aircraft for the Argentinean Air Force. In 2002, completion of the contract was delayed due to the economic situation in Argentina. Based on an understanding reached between Lockheed Martin and the Argentinean Government the program was resumed and roll-out of the first upgraded aircraft occurred in the third quarter of 2004. We anticipate completing deliveries by 2007.

F-16 PROGRAMS

For more than two decades, we have supplied numerous customers with systems and electronic components for F-16 aircraft. We have supplied systems for the IAF's entire F-16 fleet. In addition, we have received a number of contracts from the U.S. Government, Lockheed Martin, the prime contractor of the F-16, and others, to supply electronic and electro-optic systems for F-16 aircraft used by the U.S. Air Force and other air forces.

In recent years, Elbit Systems, EFW, El-Op and Cyclone have received a number of orders to supply additional systems and equipment, as well as to repair equipment, for F-16 aircraft of the IAF and other Lockheed Martin customers. We are supplying a wide range of items to Lockheed Martin for the new IAF F-16 aircraft (F-16I). These items include mission computers, helmet mounted systems, head-up displays, display systems, stores management systems, structural assemblies and other equipment.

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In recent years, EFW was awarded F-16 related contracts to develop and supply the commercial central interface unit, color multi-function display systems (CMFDS) and a digital video recorder. EFW also is supplying advanced air to ground, air to air and emergency jettison remote interface units to Lockheed Martin for an F-16 customer and supplies commercial data entry electronic units (CDEEU) for the F-16. In February 2004, EFW was awarded a contract by the U.S. Air Force to provide more than 1,200 CDEEUs in support of the CCIP program for pre-Block 40 F-16 aircraft. The contract will be performed over a three-year period.

El-Op was awarded a contract in 2001 to supply the head-up display for the F-16I. El-Op also supplies aerial reconnaissance systems for the F-16.

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Since its March 2005 acquisition of IMI's Aviation Systems Division, Cyclone manufactures weapons for pylons and F-16 aircraft. See above "Recent Acquisitions". Cyclone also manufactures the leading edge flap for U.S. Air Force F-16 aircraft. During 2002, Cyclone was awarded orders for the supply of other structural parts for the F-16, including the horizontal stabilizer, the rudder, the ventral fin and the engine access doors.

As of December 31, 2004, our overall F-16 related systems and components backlog, which extends through 2008, totaled approximately \$175 million.

AIRCRAFT HEAD-UP DISPLAYS. El-Op supplies its head-up displays for fixed-wing fighter and trainer aircraft such as the F-4, F-5, F-16, T-38C, MiG-21, Mig-27, Mig-29, SU-25, SU-30, A-4, AL-X. AM-X, AT-63 Pampa, IAR-99, Jaguar, KO-1, IDF, L-39, Mirage, MD-10/11 and Airbus 300/310.

AIRCRAFT ELECTRO-OPTIC SYSTEMS. El-Op supplies laser range finders for a range of airborne platforms. El-Op also has supplied laser designators for other airborne applications such as the laser designator for the U.S. Kiowa Warrior helicopter, the U.S. Navy's Nite Hawk pod and for pods of other customers.

AERIAL RECONNAISSANCE SYSTEMS. El-Op supplies airborne reconnaissance systems for a range of fighter aircraft including the F-16. In 2000, El-Op was awarded a contract to supply advanced airborne reconnaissance systems for the Turkish Air Force's RF-4E aircraft. The program is expected to be completed during 2005.

HELICOPTER UPGRADE PROGRAMS

IAF MISSION MANAGEMENT SYSTEM. In February 2005, Elbit Systems was awarded a contract to provide the Israeli Air Force with a command and control mission management system for helicopter platforms. This advanced system provides the combat forces with a real-time updated situational picture, which enables them to share mission critical data based on data communication. The system will allow all mission participants to benefit from an accurate tactical picture for enhanced situational awareness, as well as effective synchronized operation on the battlefield. The system enables support coordination, identification of friendly forces and prevention of inadvertent gunfire.

APACHE MISSION COMPUTER. In April 2004, EFW was selected by Boeing to design a new mission computer for the Apache AH-64 helicopter. The contract is to be performed over a two-year period.

TURKISH S-70 BLACKHAWK. In 2003, Elbit Systems' contract with Turkish Aerospace Industries became effective for the modernization of the Turkish Armed Forces Command Sikorsky S-70 Blackhawk helicopters. we act as the avionics systems integrator and is developing and supplying "glass cockpit" avionics and advanced mission equipment. The program is to be performed in two stages, development and production, over a four-year period.

BLACK HAWK WEAPON MANAGEMENT SYSTEMS. In 2002 and 2003, Elbit Systems was awarded follow-on orders by Sikorsky to provide the weapons management system for the upgrade of Black Hawk helicopters. This followed award of the original contract from Sikorsky in 2001. We completed deliveries of these systems during 2002 and anticipate completing logistic support orders during 2005.

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V-22 DIGITAL MAP AND DISPLAY SYSTEMS. We supply both digital maps and multi-function display systems for the U.S. Armed Forces' V-22 Osprey tilt rotor aircraft (V-22). Our digital map provides pilots with real-time high resolution digital topographical images and other information pilots need to perform their missions. We developed and supplied the digital map system for the V-22 under a contract of EFW with Boeing. In 1998, Boeing awarded EFW a contract for the V-22 Active Matrix Liquid Crystal Multi-function Display Upgrade Program. The program calls for delivery of display subsystems for 246 V-22 aircraft over seven years. EFW is also under contract from Boeing to produce a series of interface units for the V-22. In 2002, EFW was awarded orders by Boeing to redesign the V-22's display electronic unit and digital map. During November 2004, EFW received initial production orders for these second generation digital map and display electronics for the V-22. Additional production orders were received in January 2005.

DIGITAL MAPS AND DISPLAYS FOR EUROCOPTER. In 2003, we received an order from Eurocopter S.A. (Eurocopter) to supply 120 smart displays for French search and rescue helicopters. This followed earlier contracts from Eurocopter for display development and supply of digital map systems and displays.

ELECTRO-OPTIC PRODUCTS FOR HELICOPTERS. El-Op supplies several products for heliborne applications. These include laser range-finders and target designators including those based on solid state diode pumped laser technology. In 2002, El-Op was awarded a contract to develop and supply its Laser Obstacle Ranging & Display Systems (LORD) for IAF helicopters, which has successfully completed its first flight test series. Performance of the contract is through 2006. In June 2005, El-Op's LORD system received Flight International's Aerospace Industry Award in the Avionics and Electronics category. El-Op is developing a laser designator for an upgrade of the OH-58D Kiowa Warrior surveillance helicopter. El-Op also supplies the laser-spot tracker integrated with the fire-control system, as well as display monitors, for the AH-64 Apache helicopter. Kollsman supplies the upgraded FLIR enhanced night targeting system for the U.S. Marines' AH-1W Super Cobra helicopters. El-Op also supplies electro-optic payloads for a variety of helicopters.

PRECISION GUIDANCE SYSTEMS

OPHER AND LIZARD. In the area of guided munitions, we developed and are supplying our "Whizzard" family of precision guided systems. The Whizzard family includes the "OPHER" and "Lizard" systems. OPHER is a thermal-imaging, autonomous precision guidance system. The Lizard system provides munitions guidance towards laser designated targets. We have supplied OPHER systems to customers such as the IDF, the Italian Air Force and the Romanian Air Force and are currently supplying Lizard systems to the Italian Air Force.

JDAM. In July 2004, EFW was awarded an order from Boeing to modify a Lizard Semi Active Laser (SAL) seeker to serve as the SAL seeker for Boeing's JDAM munitions, adding the capability of laser terminal guidance against targets of opportunity and moving targets. To date, two successful guidance tests have been completed, one against a stationary target and the second against a moving target. After completion of the design phase of this program, low rate initial production and serial production orders are anticipated.

VIPER STRIKE. In 2003, under an order received by EFW from Northrop Grumman Corporation (NG), our semi-active laser seeker was successfully tested with NG's brilliant anti-tank (BAT) munitions - Viper Strike. Orders for additional units were received in 2003, 2004 and 2005. These munitions are used in connection with the Hunter UAV. New derivatives of this product are being modified for use on other platforms.

CIVIL AVIATION

KOLLSMAN COMMERCIAL AVIONICS. Kollsman designs and manufactures a range of altimeters, pressure monitors, other cockpit indicators and avionics test equipment for commercial as well as military aircraft. Kollsman is also supplying air data computers and air data pressure probes for commercial aircraft following its acquisition in September 2004 of the assets of CIC. Following the CIC acquisition, Kollsman obtained an FAA Technical Service Order (TSO) for an RVSM-compliant air data computer that is designed to interface with a wide variety of avionics systems and is currently being supplied for RVSM upgrades for older corporate and commercial aircraft. See above "Recent Acquisitions".

EVS

Kollsman designs and produces the Enhanced Vision System (EVS) for commercial aircraft. The EVS utilizes an advanced FLIR system developed together with Opgal. EVS projects an image on the pilot's head-up display, providing FLIR picture overlaying the outside view in a conformal manner. It is designed to improve flight safety and situational awareness and allows the pilot to detect lights and ground features such as runways, aircraft and buildings at night and in low visibility conditions. In 2001, the U.S. Federal Aviation Administration (FAA) certified the installation of the EVS on General Dynamics' Gulfstream-550 business jet. EVS is installed as a baseline system on Gulfstream-550 aircraft and is an option on Gulfstream-500 aircraft. In 2003, EVS also was installed and became operational on the Gulfstream-400.

In October 2004 and January 2005, Kollsman was awarded additional follow-on orders for EVS by Gulfstream for all their large cabin aircraft models. These additional orders bring the total EVS orders from Gulfstream to approximately \$70 million. The EVS will be installed on the top of the line Gulfstream G450 and ultra long-range G550 as production standard items. The system will also be available as optional equipment on the Gulfstream G200, G350, G400 AND G500.

During 2004, Kollsman was awarded the National Aeronautic Association's 2003 Collier Trophy for aviation safety technological advances as a team member for the Gulfstream G550. Kollsman's EVS was a significant part of the basis for the award and was sited as the G550's greatest safety feature.

In October 2003, EVS was selected for installation on FedEx Express' Boeing MD-10, MD-11 and Airbus A300 and A310 aircraft fleet. The contract calls for certification by 2006 and installations on aircraft beginning in 2007.

COMMERCIAL HUDS. In 2003, Kollsman entered into a contract with Honeywell International Inc. to develop and supply, together with El-Op, head-up display overhead projection units for the Federal Express (FedEx) fleet. The contract calls for deliveries through 2012. In addition, Kollsman and El-Op are currently working on a cost sharing research and development contract with the Maryland Advanced Design Laboratory awarded in 2002 to develop a low cost solution for head-up displays for the General Aviation market. The project is being performed for the U.S. National Air and Space Agency (NASA) and is scheduled to be completed during 2005.

CABIN PRESSURIZATION CONTROL SYSTEM. In December 2004, Kollsman was

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awarded a contract by Raytheon Aircraft Company to provide the cabin pressurization control system for the Hawker and Beechcraft King Air Series of aircraft. Kollsman's next-generation autoschedule pressurization system, KAPS II, will be incorporated into new production aircraft models, including the Hawker 400XP and 800XP and Beechcraft King Air Models 350, B200 and C90

STRUCTURAL PARTS, Cyclone manufactures structural parts for several types of commercial aircraft.

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FLIGHT TRAINING SERVICES

We provide aircraft flight training solutions. In June 2004, Cyclone was awarded a ten-year contract from the IMOD for the operation and maintenance of the helicopters of the IAF Flight School. Under the contract, which will be executed by providing flight hours on a "power by the hour" basis, Cyclone will provide full maintenance services to the IAF Bell 206 and Cobra AH-1A helicopters. The contract is valued at approximately \$40 million.

In 2002, Snunit Aviation Services Ltd., an Israeli company established by Elbit Systems and Cyclone, was awarded a contract for the supply and operation of the Grob 120A light trainer aircraft for the IAF. The contract for operation of the aircraft is for ten years and is based on an operational concept known as Private Finance Initiative (PFI), adopted for the first time by the IAF. Under the PFI concept, we purchase, own, maintain and operate the aircraft and make them available to the IAF, who is charged according to flight hours. Full scale operation of the training began in 2003.

TRAINING AND SIMULATORS

We provide training and simulation programs offering across-the-board systems engineering and integration expertise applied to a comprehensive line of training and simulation solutions for airborne platforms. These solutions range from mission preparation, through execution, to post-mission debriefing and analysis. Our total solution concept encompasses ground support systems, including mission planning and debriefing for pre-and-post multi-mission rehearsal and review.

Our training systems include virtual training systems such as the Advanced Combat Training System (ACTS) for fixed-wing aircraft and HeliACTS for helicopter crew training. We also supply live, virtual and constructive (LVC) training systems. In addition, we offer comprehensive simulator support services such as contractor logistics support (CLS), training, manuals and spare parts.

In 2003, Elbit Systems was awarded a contract by the U.S. State Department to supply full mission/full motion simulators for Mi-24 and Mi-8 helicopters for the Uzbekistan Air Force over a two-year period. The contract is part of the U.S. Government's "Operation Enduring Freedom".

We are supplying simulators for the AL-X and F-5 programs for the Brazilian Air Force. Simultec S.A., our wholly-owned Romanian subsidiary, manufactures training systems and flight simulators for the Romanian Ministry of Defense. See above "Aircraft Avionics Systems and Upgrade Programs".

LOGISTIC SUPPORT SERVICES

We provide logistic support services for fixed wing aircraft and helicopters such as repair, maintenance and supply of spare parts to the IAF and

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other customers, often as a part of our upgrade and other programs. Acquisitions in recent years have added to our logistic support capabilities for a wide range of aircraft in Israel, the United States, Brazil and for other customers.

Cyclone performs various levels of maintenance services for a number of types of military and commercial aircraft and helicopters. Its facilities near Karmiel, Israel include hangars and a runway. In 2003, Cyclone also obtained a license to use another runway and facilities in Israel for aircraft maintenance for the IAF. At IEI in Alabama and at EFW's facilities in Georgia, we repair and maintain electronic systems and components for aircraft, helicopters and ground support equipment for U.S. and other customers. IEI also assists customers in establishing the appropriate level of maintenance and repair close to the user to improve operational readiness. Kollsman maintains a U.S. Federal Aviation Authority (FAA) certified repair facility in Wichita, Kansas for

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commercial avionics repairs. At AEL in Porto Alegre, Brazil, we are implementing a logistic support center for our aircraft modernization programs for the Brazilian Air Force.

HELMET MOUNTED SYSTEMS

FIGHTER AIRCRAFT HELMET MOUNTED SYSTEMS

Our pilot helmet mounted systems are in operation with a number of customers throughout the world. For over 15 years we have been designing and manufacturing Display and Sight Helmet (DASH) systems. DASH allows the pilot to target the weapons systems by looking at the target and also displays flight information on the helmet's visor. The DASH system has been purchased by the IAF and other customers. In 2000, we were awarded a contract by Lockheed Martin to supply the DASH IV helmet mounted cueing system for the IAF's

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F-16I aircraft. Boeing previously awarded EFW a contract to supply the DASH as the helmet mounted display system for the IAF's F-15I aircraft.

JHMCS

Since 2000, VSI has received several contracts from Boeing and Lockheed Martin to supply production quantities of the Joint Helmet Mounted Cueing System (JHMCS) and associated development and integration efforts. The JHMCS was developed under contracts awarded by Boeing and Lockheed Martin to VSI. It is used in United States Air Force and Navy F-15, F-16 and F/A-18 fighter aircraft. The JHMCS provides visual information to the pilot and other crew members, based on the position and orientation of the operator's head. The JHMCS has been successfully flown in all three aircraft types. In April 2004, VSI was awarded a contract from Boeing for the delivery of more than 400 additional Joint Helmet Mounted Cueing Systems (JHMCS). Under the contract, valued at \$62.2 million, VSI will provide JHMCS systems, including spare parts, technical support and support equipment for the LRIP 4 (Low Rate Initial Production) acquisition. This procurement fills U.S. government domestic requirements for the U.S. Air Force F-15, and F-16 and U.S. Navy F/A-18 aircraft as well as Foreign Military Sales (FMS) production commitments including: Australia (F/A-18), Chile (F-16), Finland 9F/A-18), and Poland (F-16). Additionally, this award fulfills commercial commitments from Boeing for the F-15K program for South Korea. Deliveries under LRIP 4 are currently in process and will continue through 2005.

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In August 2004, VSI was awarded a \$75.6 million contract for over 3000 JHMCS systems from Boeing. This award is the first Full Rate Production (FRP) of JHMCS following four LRIP lot deliveries. Under the contract, VSI will provide JHMCS display systems, spare parts and support equipment for the FRP lot 1 acquisition. This procurement fills additional U.S. government domestic requirements for the U.S. Air Force and Air National Guard F-15, F-16 and USN F/A platforms as well as FMS production commitments for Australia (F/A-18), Finland (F/A-18), Poland (F-16), Greece (F-16) and Switzerland (F/A-18). Deliveries under FRP 1 are currently in process and continue through December 2006. This order brings VSI's total JHMCS production quantity to more than 1,000 systems with more than 500 systems delivered to date.

IEI serves as the depot repair center for the JHMCS electronics unit.

JSF. In 2003, VSI was awarded an approximately \$85 million contract by Lockheed Martin to develop the helmet mounted system for the U.S. F-35 Joint Strike Fighter (JSF) Program. The majority of the development effort is scheduled to be completed in 2006 with continuing support activities through 2012. The JSF helmet mounted system is expected to contain the most advanced helmet mounted display ever designed and will be used as the aircraft's primary flight and weapon delivery system.

PNVG. In February 2005, VSI was awarded a contract to supply panoramic night vision goggles (PNVG) for use by U.S. Navy tactical aircraft. The PNVG is based on the "Quad Eye" (TM) product developed by Kollsman.

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MLU. VSI also performs helmet mounted display programs for other customers, including supply of the helmet mounted systems for Lockheed Martin's F-16 Mid-Life Upgrade (MLU) Program for the Danish and Norwegian Air Forces.

HELICOPTER HELMET MOUNTED SYSTEMS

NVG/HUD. Our Night Vision Goggles Head-Up Display (NVG/HUD) system allows helicopter pilots continuous head-up operation, which greatly improves night-flying safety. The NVG/HUD is operational in the IAF, having been integrated into various assault and attack helicopters. Over the past ten years Elbit Systems and EFW have supplied more than 4,000 NVG/HUD systems for a variety of U.S. Army programs. In recent years, we also received contracts to supply NVG/HUD systems for customers and end users in Korea, Australia, Canada, the U.K. and other countries. In 2002, EFW was selected to supply NVG/HUDs for the Agusta 129 helicopter over a five-year period. Also, in 2002, EFW was selected by the U.S. Army as the prime contractor to supply the NVG/HUD to the U.S. Army over a five-year period.

IHADSS. In 2000, EFW acquired Honeywell's display and orientation products business, which mainly includes supply of the Integrated Helmet Display and Sighting System (IHADSS) for the U.S. Army and other users of Apache helicopters and for the Italian-made Agusta 129 helicopter. In 2002, Boeing awarded EFW a contract to upgrade the AH-64 Apache IHADSS system with new electronics to achieve increased image resolution to accommodate longer range thermal imaging systems being developed for the AH-64. In March 2004, EFW received a follow-on order to complete qualification and transition the new system to full rate production.

UAV SYSTEMS

OVERVIEW OF UAV BUSINESS. Recent advances in technology have resulted in an increased use of UAVs for many military applications, particularly in the area of ISR. The ongoing military actions in Afghanistan and Iraq use UAVs extensively. As part of our business strategy to enter into this expanding market, in the early 1990's we acquired an interest in Silver Arrow, which develops and manufactures UAVs. In 2003, we acquired a majority interest in AD&D, Advanced Design and Development Ltd., an Israeli company engaged in the development of a variety of unmanned systems.

UAV SYSTEMS

Silver Arrow develops and manufactures several types of UAV platforms for the IDF and other customers. These include the Hermes family of UAVs, including the Hermes 1500, the Hermes 450 and the Hermes 180.

The Hermes 1500 is a medium altitude long endurance UAV for maritime patrol and other types of support missions. The Hermes 450 supplies real-time intelligence data to ground forces. The Hermes 180 is a tactical short range UAV designed for brigade-level intelligence, surveillance, target acquisition and reconnaissance missions.

We also are involved in smaller UAVs, such as the Skylark and the Seagull. The Skylark is a man-packed UAV for close range, over the hill surveillance and reconnaissance. The Seagull is a foldable and canister deployable tactical close range UAV.

We also develop and supply ground control stations for the operation of UAVs. In addition, we supply to the IDF the latest generation of surveillance UAVs, based on the Hermes 450. Silver Arrow's U.K. subsidiary, UEL Engines Ltd., produces engines for UAVs.

We also provide training systems for UAV operations.

UAV PROGRAMS

WATCHKEEPER. In June 2004, a team consisting of Elbit Systems/Silver Arrow and Thales Defence Ltd. (as prime contractor) was selected by the United Kingdom Ministry of Defense (UK MOD) for the Watchkeeper Tactical UAV program. The Watchkeeper Program commences with the Demonstration, Manufacture and Initial Support Phase (DMIS) phase for the development, manufacture, and in-service support program to meet the UK MOD requirement to provide accurate, timely and high quality imagery and IMINT (Image Intelligence) to satisfy commanders' critical information requirements. The solution proposed and selected by the UK MOD is based on the Hermes 450 UAV in dual payload configuration, e.g. SAR and E/O payloads. The Program calls for the Hermes 450 to be capable of flying in icing conditions and of performing automatic takeoff and landing.

IUP. In May 2005, IUP, a partnership equally owned by Elbit Systems and IAI, was selected as the supplier of UAV systems for the Turkish TIHA Program. IUP has signed a contract for performance of the program, which is anticipated to enter into effect in the near future. Under the contract IUP will be responsible for delivering UAV systems including advanced payloads. IUP will subcontract 50% of the work to Elbit Systems to supply ground control stations, data links and payloads. The expected contract to Elbit Systems is to be performed over a three-year period and is anticipated to be in an amount material to Elbit Systems.

SKYLARK IMOD. In 2004, the IMOD selected Elbit Systems to supply several Skylark mini-UAVs for operational evaluation by the IDF ground forces. The system deliveries were completed and the systems are now in operational evaluation phase. Recently, we issued several international proposals for Skylark, and orders for additional systems have been received from several customers worldwide.

ARIZONA BORDER CONTROL. In June 2004, EFW was awarded a contract to provide through a lease arrangement to the U.S. Department of Homeland Security, Customs and Border Protection (CBP) Elbit Systems' Hermes 450 Unmanned Air Vehicles (UAV) along Arizona's southern border as part of the Arizona Border Control Initiative (ABCI). The ABCI initiative is intended to provide improved surveillance along the Mexican border for various homeland security applications, including illegal immigration and drug smuggling. Under the CBP lease contract, EFW and Elbit Systems provide UAV's, ground control stations, operational crews and support personnel for UAV flight support of border patrol operations. Following completion of this initial successful pilot program, which was focused on the Arizona border with Mexico, it is anticipated that such contractor operated lease activities for UAVs may be expanded.

FALLON NAVAL AIR STATION. In 2003, EFW was awarded a contract to operate Elbit Systems' Hermes-450 UAV system at Fallon Naval Air Station in Nevada. The contract was in support of the DOD's Joint UAV test and evaluation exercise and was completed in 2004.

IMOD INTEGRATED PROGRAM. Elbit Systems received contracts from the Israeli Government to act as the prime contractor under a program to develop and supply integrated defense electronic systems. We completed the first phase of this program in 2002. During 2002 through 2004, we received additional orders. As of December 31, 2004, we had a backlog for the program of approximately \$67 million, to be performed mainly through 2006.

AIRBORNE C4ISR. In November 2004, Elbit Systems was awarded a contract in an amount of approximately US\$300 million by the Israeli Ministry of Defense to supply advanced systems. The contract will be performed over a multi-year period, under which Elbit Systems will supply airborne systems and command and control systems. The contract includes integration of various systems, part of whose purpose includes providing advanced solutions in the area of homeland security.

C4I AND GOVERNMENT INFORMATION SYSTEMS

NATURE OF OUR C4I AND GOVERNMENT INFORMATION SYSTEMS. We design our C4I and battlefield systems to manage the growing amount of data supplied by information systems and sensors in defense, border control, crime prevention and other government intelligence gathering applications. This is an area of growing importance in light of increased priority for communications among defense forces and the growing need of many governments for anti-terrorism measures, such as ISR, access control and integrated intelligence gathering. Our C4I battlefield and information systems process and interpret data received from the different sources and present it in a user-friendly format. We integrate

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advanced software tools with general and special purpose hardware into full C4I battlefield and information technology systems.

LAND C4I AND BATTLEFIELD MANAGEMENT SYSTEMS

Our land C4I and battlefield management systems are supplied through turn-key projects for tactical command and control. We provide solutions from the level of individual fighting vehicles, mortars and artillery to the divisional and headquarters command level. Our systems are based on hardware and software building blocks, including tactical computers, modems, communication controllers, data radios, military WLAN radios and digital map systems among others. We also provide products for facilitating operations in the battlefield based on commercial off-the-shelf technology (COTS).

ISRAEL DIGITAL ARMY PROGRAM. In December 2004, Elbit Systems was awarded a contract by the IMOD for the Digital Army Program (DAP), in an amount of approximately \$200 million. The DAP, which will also include an additional material amount of FMF funding, will be performed over a ten-year period. Elbit Systems was selected approximately two years ago by the IMOD to be the prime contractor for the DAP. Rafael and Tadiran Systems Ltd. will serve as our major subcontractors. Within the framework of the program, all land forces operations will be computerized (command, control, communications), integrated and interfaced with new and advanced applications. Under the DAP, we will supply the IDF with computerized systems down to the single soldier level. The systems will facilitate transmission of integrated, real time situation pictures to and from all battlefield and command echelons. The program calls for supply and support of all hardware and software, including command and control stations, data processing and distribution systems. It will enable force coordination at all levels, access to updated situational pictures, improved overall operational capabilities, including survivability and accuracy, and more efficient utilization of personnel and other resources.

TORC2H. The IDF has selected Elbit Systems' TORC2H border protection command and control system. During 2004, Elbit Systems successfully deployed the TORC2H to support border security activities in Israel. Further phases of TORC2H are anticipated to be implemented under the scope of the DAP.

WIRELESS LAN. In September 2004, Elbit Systems was awarded a contract by the IMOD to develop a Wireless LAN solution for the IDF. This solution is based on commercial standards which are adapted and tailored to the military tactical needs and environments.

NETHERLANDS BATTLE MANAGEMENT SYSTEM. In 2003, Elbit Systems was awarded a contract by the Royal Netherlands Army (RLNA) to supply battle management system equipment for the RLNA ground forces. The equipment includes enhanced tactical computers integrated with tactical communication devices. The initial contract was completed, and we received additional orders under the project to be performed during 2005.

IDF BATTLE MANAGEMENT SYSTEM. In 2002, Elbit Systems was awarded a contract by the IMOD to serve as prime contractor for the IDF's Battle Management Systems for Battalion Combat Teams program. The program includes the development, supply and support of advanced electro-optical sensors, multi-functional displays, command and control software, information and dissemination systems and advanced mission computers. The program will enable coordination among the IDF's main battlefield tanks, armored fighting vehicles and infantry fighting vehicles. It will provide situational awareness to

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maneuvering forces and improve the overall operational capabilities of fighting units. The first phase of the program, including initial deployment, was completed. Elbit Systems received additional orders under the scope of the Battle Management Systems for Battalion Combat Teams, to be performed through 2006. In addition, Elbit Systems received a related order to develop and provide a battle management solution for infantry to be performed through 2009.

ETC. The IDF selected Elbit Systems to develop and deliver Enhanced Tactical Computers (ETCs), which serve as the hardware building blocks for the IDF's ground command and control systems. These building blocks are based on high performance military computers, "ruggedization" of COTS circuit boards for application in harsh military environments, as well as specialized displays and communication controllers for higher echelon levels. The ETCs are equipped with several types of communication interfaces and powerful display features. We also develop, manufacture and supply ETCs to a number of customers worldwide.

SOLTAM, Soltam Systems Ltd. (Soltam) of Yokneam, Israel, in which Elbit Systems owns a 10% equity interest, develops and manufactures artillery systems and products for the IDF and other customers. We have developed systems integrating Soltam's products with our fire control and command and control systems, including a program currently being performed for the IMOD.

GOVERNMENTAL INFORMATION TECHNOLOGY AND INFORMATION GATHERING SYSTEMS

ELRON TELESOFT. We acquired the assets of the Government Systems Division of Elron Telesoft (formerly part of the NCC Group) in 2002. These activities include computerized communication systems, information technology and image intelligence processing for defense and other governmental applications in Israel and abroad.

ANTI-MONEY LAUNDERING SYSTEM. In 2003, Elbit Systems was awarded a contract for the development and support of an information processing system for the Israeli Money-Laundering Prohibition Authority (IMPA). The project is to be performed over a two-year period. The project will provide IMPA with an information technology system that includes a database and a collection center for relevant data from financial institutions such as banks, insurance companies and customs authorities. The project includes the management of an official data base containing the currency transactions and suspicious activities reports submitted to IMPA by the Israeli financial community, as well as reports of enrichment from governmental law enforcement and information resources and from corresponding governmental financial intelligence units in other countries.

ISRAELI BORDER CONTROL SYSTEM. In 2001, Elbit Systems was awarded a contract by the Israeli Government for the development and supply of the National Border Control Registration System (BCRS). BCRS is a computerized system for registration and control of all of Israel's border crossing points. The system, which will be deployed at all Israeli airports, sea ports and land entry points, supports border inspection processes and helps control the passage of vehicles and goods. The contract was completed during 2004.

LAND VEHICLE SYSTEMS

NATURE OF OUR LAND VEHICLE SYSTEMS

Our land vehicle systems capabilities combine Elbit Systems' electronic tank systems experience with El-Op's electro-optics expertise. The combined land

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vehicles business offers capabilities ranging from complete tank modernization programs with full logistics support, to situational awareness and battle management systems, advanced day and night fire control systems incorporating eye-safe lasers and advanced FLIRs, electrical turret drive and stabilization systems to life support and hydraulic systems.

The survivability of tanks and other combat vehicles on the modern battlefield depends largely on their ability to achieve a first-round hit. This requires the gunner to quickly and accurately coordinate many complex tasks with a large number of variables. We were one of the first companies to introduce modern electronic technology in tank applications using our expertise in developing advanced avionics systems to adapt and to develop control systems and electronics for combat vehicles. We replaced manually operated fire control systems with an advanced digital tank fire control system, improving on-the-move hit probability and reducing the time required for targeting.

For over twenty years, we have been developing and supplying a family of fire control systems for new and upgraded main battle tanks, medium and light tanks and light armored vehicles. Our systems integration expertise and extensive experience in developing and manufacturing these systems led to an expansion into a new generation of tank turret drive systems. We developed an electric gun and turret drive and stabilization system that can be integrated with the fire control system to improve turret stabilization and accuracy. This, in turn, improves fire-on-the-move performance.

We develop overhead remote controlled weapon stations that transform armored vehicles into armored fighting vehicles by providing the crew with combat capabilities of a turreted vehicle - including guns, anti-tank missiles and capabilities to perform in harsh battlefield conditions.

El-Op is a long time developer and producer of electro-optic systems for combat vehicles in Israel and abroad. These systems include eye safe laser range finders, second generation thermal imaging systems, gunners' sights with or without line-of-sight stabilization, commander panoramic sights, computers and sensors. We supply our integrated battle management systems as part of our modern fire control systems sold to the IDF and to other customers around the world. We also furnish combat vehicle logistic support services to the IDF.

MERKAVA

All of the models of the most advanced IDF battle tank, the Merkava, use our fire control and electric gun and turret drive and stabilization systems as original equipment. We are both a prime and a subcontractor for the supply of systems to various Merkava tank models. Elbit Systems, El-Op and Kinetics are supplying a significant number of systems for the IDF's newest Merkava tank, the MK-4. These systems include the day/night gunner and commander sighting systems, the electronic gun and turret drive system, flat panel displays, advanced warning systems against laser guided threats (TDS), life support systems and a battle management system.

During the last two years, we were awarded several orders for the development and supply of electronic and optical systems and electrical drive systems for the Merkava. In January 2004, Elbit Systems was awarded orders by the IMOD to supply electronic and electro-optical systems for the Merkava MK-4. The orders will be performed over a two to three-year period. We are the prime contractor to the IMOD for all Merkava tank fire control systems. We also are supplying the upgrade of the firing computer of the IDF's Merkava and M-60 tanks. Kinetics also supplies several systems, including the life support system, for Merkava programs. As of December 31, 2004, we had a total of approximately \$120 million in our backlog relating to Merkava orders, to be supplied through 2007.

LAND VEHICLE MODERNIZATION PROGRAMS

TURKISH M-60 MODERNIZATION PROGRAM. In March 2004, the definitive agreement for Elbit Systems' portion of the Turkish Army M60A1 Tank Modernization Program became effective. The contract, in the amount of approximately \$183 million, was signed with the IMOD, with deliveries to be completed over an approximately five-year period. The contract is for the supply of electronic and electro-optical fire control systems, electrical gun and turret drive systems and support equipment for the Program. our contract is being performed within the framework of the agreement for the Program between Israel Military Industries Ltd. and the Turkish Ministry of Defense. The contract contains buy-back obligations. See below "Buy-Back".

MULTIPLE LAUNCH ROCKET SYSTEM (MLRS) AND HIGH MOBILITY ARTILLERY ROCKET SYSTEM (HIMARS). EFW is a subcontractor to Lockheed Martin for the U.S. Army MLRS M270A1 upgrade program. EFW supplies the fire control system that includes an on-board computer processor, a 14-inch color flat panel display, a mass storage device and a keyboard. Following EFW's completion of development, in 2002 and 2003 Lockheed Martin awarded EFW production and retrofit contracts. EFW completed production deliveries in 2004 and is performing ongoing retrofit activities. The equipment developed for MLRS is also directly compatible with the HIMARS to be used by the U.S. Army and U.S. Marine Corps.

BRADLEY A-3 PROGRAM. EFW is a subcontractor for the U.S. Army Bradley A-3 fighting vehicle modernization program. EFW was awarded contracts by United Defense, the prime contractor for the program, to develop and supply the turret and hull processors, the gunners' and commanders' hand stations, the position interface box and the map operational software. EFW completed the development contracts and was awarded multi-year production contracts by United Defense for those systems. These contracts are to be performed through 2004. In April 2005, EFW was awarded additional orders for Bradley systems for the U.S. Army's ongoing operations in Afghanistan and Iraq.

LAV COMMAND AND CONTROL UPGRADE PROGRAM. In June 2005, EFW was awarded a demonstration contract by Lockheed Martin as part of the Lockheed Martin team for the development of an upgrade of the command and control variant of the U.S. Marine Corps Light Armored Vehicle (LAV). The demonstration contract is to be completed in 2006. EFW is to provide the mission equipment package for a new vehicle intercommunication system. If, following completion of the demonstration program, Lockheed Martin is selected by the U.S. Government to perform the development phase of the program, EFW is anticipated to participate in that phase as part of the Lockheed Martin team.

ARMORED FIGHTING VEHICLE PROGRAM. In 1999, a Western European prime contractor awarded contracts to Elbit Systems to supply advanced fire control systems for armored fighting vehicles. The amount of the contracts was approximately \$43 million and performance was completed in 2004.

THERMAL IMAGING SYSTEMS. El-Op has sold more than 700 thermal imaging systems for the Leopard 2/A5 commander sight to customers including the armed forces of Germany, the Netherlands, Sweden and Denmark and more than 3,000 thermal imaging systems to other customers for different types of tanks. In

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addition, El-Op has sold numerous hand-held thermal imagers and thermal imager kits.

TRAINING SYSTEMS AND SIMULATORS. Elbit Systems and EFW have supplied tank gunnery training systems to the IDF and the U.S. Army. We are currently supplying the Deployable Range Training and Safety System (DRTSS) to the U.S. Army. This system provides real time crew gunnery evaluation, recorded after action video, battle status assessment, positive target recognition, ammunition conservation and reduces friendly fire casualties. DRTSS has been fielded at the Forts Hood, Carson, and Stewart tank gunnery ranges. In addition, we supply ground forces trainers to other customers worldwide including the Appended Tactical Combat Trainer Systems, Tactical Battle Group Trainers, Artillery Training Centers, and the Conduct of Fire Trainer. We also supply simulators for, tank gunnery, snipers, sensors, command and control and missiles.

ENVIRONMENTAL CONTROL AND HYDRAULIC SYSTEMS. Kinetics develops advanced life support systems, including environmental and climate control and NBC protection systems, for combat vehicles. Kinetics also develops and manufactures hydraulic, fuel, braking and suspension systems as well as an auxiliary power unit for combat vehicles of the IDF, the U.S. Army and other customers.

ROBOTIC GROUND VEHICLES. Elbit Systems and El-Op are involved in the development of robotic unmanned ground vehicles (UGVs) for defense and homeland security applications. In March 2004, Elbit Systems teamed with SciAutonics LLC to compete in the U.S. Defense Advanced Research Projects Agency (DARPA) Grand Challenge in which the team finished second out of numerous competitors.

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ELECTRO-OPTICAL AND COUNTERMEASURES SYSTEMS

ELECTRO-OPTICS

El-Op has more than 60 years of experience in the field of electro-optics and designs and manufactures electro-optic systems and products for defense, space, homeland security and commercial applications worldwide. This includes expertise in thermal imaging, laser systems, optronic stabilized payloads, head-up displays, space and airborne reconnaissance systems, IMINT solutions and electro-optic countermeasures. These systems are supplied for spaceborne, airborne, land and naval applications as described above. In addition, El-Op develops and supplies payload based observation and fire control systems for naval and airborne platforms, including day and night vision, laser range finders and designators and integrated sights for ground forces. These products and systems are further described above in "Aircraft and Helicopter Systems" and "Land Vehicle Systems" and below in "Naval Systems" and "Homeland Security Systems".

IMINT. El-Op was selected in January 2005 to supply advanced Imagery Intelligence Systems (IMINT) to various customers at a total value of over \$100 million. During 2004, El-Op received orders, exceeding \$100 million in the aggregate, from customers worldwide for hand held, surveillance and homeland security and armored vehicles applications of thermal imaging products and systems.

INFRARED DETECTORS. SCD also develops and manufactures infrared detectors and laser diodes for electro-optical applications. Opgal develops electro-optics "engines" that combine detectors with proprietary electronics for a wide range of applications including for commercial aviation and homeland security.

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SPACE SYSTEMS

SPACE CAMERAS. El-Op is actively expanding space applications for its technology and products. El-Op has developed a variety of cameras for the Ofek Satellite, including the Ofek-3 and Ofek-5, and for other initiatives of the Israel Space Agency. In 2000, EROS A1, a commercial reconnaissance satellite, began transmitting images taken by an advanced digital camera developed and manufactured by El-Op. EROS A1 was launched by ImageSat International N.V. in which El-Op owns a minority interest. See below "Technology Spin-Offs". In 2004, El-Op completed delivery of an advanced electro-optic multi-spectral space camera to the Korean Space Agency.

TAUVEX II. In June 2004, El-Op was awarded a contract from the Ministry of Science and Technology and the Israel Space Agency for the supply of "Tauvex II" (Tel-Aviv University Ultra-Violet Explorer) scientific space camera. The Tauvex II camera will be launched into space mounted on the Indian Satellite GSAT-4, for the purpose of scientific research in exploration of the galaxies. The camera will be supplied for integration into the GSAT-4 by the end of 2005. The contract follows an agreement signed in 2003 between the Israel Space Agency and ISRO, the Indian Space Research Organization, for scientific cooperation between the two countries in the field of the astronomy in the "Ultra-Violet" spectrum.

HYPERSPECTRAL SYSTEMS. El-Op has been selected by the IMOD to be Israel's hyperspectral systems development house. Currently, El-Op is involved in an on-going hyperspectral system development program for the IMOD.

SUBSIDIARIES. In 2003, Elbit Systems acquired a minority interest in AeroAstro, Inc., a U.S. company engaged in development of advanced micro and nano space systems and components, focusing on remote sensors and optical systems. In May 2004, El-Op signed a cooperation agreement with OHB-System A.G. (OHB) of Germany relating to space-related activities, and in March 2005, El-Op and OHB established a jointly-owned (50% each) German subsidiary, OHB Electro-Optics GmbH.

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NAVAL SYSTEMS

Over the past two decades, we have worked with the Israeli Navy to develop high capability naval command and control systems for surface ship applications. These systems are currently being used by the Israeli Navy and several other navies throughout the world.

C4I SYSTEMS. For more than ten years, we have been the prime contractor for the C4I system for the Israeli Navy SAAR 5 corvette class missile boat. We also developed and supply the anti-missile decoy countermeasure launching system for the SAAR 5 program.

TRAINERS AND SIMULATORS. We develop advanced naval training simulators. Our simulators address the need to improve training due to the high cost of activating naval forces. Our naval training systems provide realistic simulations of combat conditions at sea. They are used in on-shore facilities for training in naval tactical command decision procedures, anti-submarine warfare and electronic warfare. Our training systems are currently used by the Israeli Navy and several other navies. Our naval training and simulator systems include naval tactics and commander trainers, naval operational trainers, electronic warfare trainers and anti-submarine trainers.

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ELECTRO-OPTIC SYSTEMS. El-Op supplies electro-optic products for naval applications to several customers. In 2004, El-Op completed the supply to the IMOD of upgraded electro-optics observation and surveillance systems for the Israeli Navy. El-Op also supplies electro-optic shipboard payloads to several navy and maritime forces for both observation and fire control applications.

EW SYSTEMS. Elbit Systems has developed and supplied several naval electronic intelligence systems. The systems are designed to detect and recognize threats under a wide range of conditions and to initiate automatic countermeasures to protect ships against enemy missiles. Our systems equip the Israeli Navy Dolphin class submarines and are installed on board submarines of several navies worldwide. In 2001, Elbit Systems was awarded a contract by the German shipyard Howaldtswerke Deutsche Werft to supply our Timmex II EW system for submarines, and the first system was delivered in 2003 with two additional systems delivered in 2004. An additional system was ordered in 2004, and deliveries are anticipated to be completed during 2006.

NIRIT NAVIGATION SYSTEM. Kollsman supplies navigation systems for the Israel Navy's Nirit patrol boats.

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HOMELAND SECURITY SYSTEMS

We are involved in the homeland security market that includes airports, coastal authorities and other critical infrastructure facilities. These efforts are a natural extension of our expertise gained in the development of our C4I and battlefield management systems, UAVs and electro-optic systems. National and local governments are allocating greater resources in this area in light of increasing terrorist threats around the world. This has led to increased opportunities for systems and products that meet the growing demand for perimeter and homeland security solutions.

Elbit Systems, El-Op and Ortek develop and supply detection sensors and other products for facility security, border and coastal control, perimeter protection and combating terrorist activity. Kollsman has also established a homeland security business unit to market, manufacture and distribute the Group's homeland security products and technology in the U.S. market. Products in this area include thermal imaging detection systems, remote controlled surveillance systems, smart perimeter protection systems, automatic access gates for border control and remote suspect identification systems for aviation security. Customers in this field include the Israeli Police, the IMOD and several international defense forces and security organizations.

PERIMETER SECURITY. In 2002, Elbit Systems was awarded a contract by the IMOD to supply an electronic warning systems "smart" fence. Elbit Systems is executing the program through Ortek. The two phases of the project have been awarded and include construction of an electronic perimeter system and warning system spanning 34 kilometers, with potential for expansion. During 2003 and 2004, Ortek was awarded additional contracts for a total of approximately 50 kilometers of electronic perimeter systems for military bases and municipalities.

GOVERNMENTAL MONETARY SYSTEMS. We also are supplying a border control registration system and an anti-money laundering system to the Israeli Government. See below - "C4I and Government Information Systems".

MUSIC. El-Op currently is applying its defense based technologies to

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develop a Multi-Spectral Infrared Countermeasure System (MUSIC) for commercial aircraft applications in preventing terrorism. MUSIC enables identification of shoulder-launched missiles resulting in a break of the missile lock on the target. The Israeli Government is currently reviewing the system for use in Israel's civil aviation protection plan.

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TECHNOLOGY SPIN-OFFS

Both Elbit Systems and El-Op explore on an ongoing basis potential spin-offs of their defense related technologies for commercial applications. Our technology spin-offs are involved in intra-body navigation medical equipment, optical communications, commercial satellites and internet communications for commercial aviation. The following is a description of our current technology spin-offs.

MEDIGUIDE

Elbit Systems established MediGuide Inc. (MediGuide) in 2000. MediGuide, through its wholly-owned Israeli subsidiary, leverages specific technologies developed by Elbit Systems in the defense area for use in various medical procedures and intra-body navigation. Elbit Systems provided MediGuide with an exclusive license to use specific technologies for medical applications, and MediGuide provided Elbit Systems with a cross license to use MediGuide's developments for defense applications. Outside equity investments were made in MediGuide by venture capital groups in 2000 through 2002.

In 2003, MediGuide signed an agreement with Boston Scientific Corporation (BSC) to develop and commercialize technology platforms in the fields of 3-D intravascular imaging and intrabody navigation. The agreement included an equity investment by BSC in MediGuide, co-development responsibilities for integrating BSC's device platforms with MediGuide's proprietary guidance system, exclusive global distribution by BSC for a specified period and an option for BSC to acquire MediGuide at a future time. During 2004, BSC made two follow-on investments in MediGuide in accordance with the agreement, as well as a third follow-on investment in May 2005.

In December 2004, MediGuide and Philips Medical Systems Nederland B.V. entered into a set of three agreements. These agreements relate to development and distribution of a MediGuide product integrated into a Philips product as well as an equity investment of Philips in MediGuide, with a follow-on investment option.

As of May 31, 2005, MediGuide's shareholders other than Elbit Systems, have invested approximately \$43 million in MediGuide's equity. Following these investments, as of May 31, 2005, Elbit Systems equity interest in MediGuide, on a fully-diluted basis, was approximately 41%.

STARLING - In 2001, Rafael and Elbit Systems established a joint venture known as "Starling" Advanced Communications. In 2003, the joint venture was incorporated in Israel under the name Starling Advanced Communications Ltd. (Starling). Starling combines the expertise of both parties to develop products in the area of internet communications through satellite transmissions and broad band information transfer for commercial aircraft. Rafael contributes expertise in the area of aerial antennas, and Elbit Systems contributes expertise in the area of satellite communications and broad band information transfer for aircraft. Rafael assigned its interest in Starling to RDC Rafael Development Corporation Ltd. (RDC), an Israeli company jointly owned by Rafael and Elron

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Electronic Industries Ltd. (Elron). In October 2004, Starling signed an agreement with Elron, according to which Elron agreed to purchase from Starling preferred shares for an aggregate consideration of approximately \$3 million, based on a pre-money valuation of Starling of \$7.2 million, calculated on a fully-diluted basis. Following this investment, Elbit Systems equity interest in Starling, on a fully-diluted basis, is approximately 30%.

IMAGESAT - El-Op has an approximately 14% equity interest (11% on a fully-diluted basis) and approximately 12.5% voting power (11.5% on a fully-diluted basis) in ImageSat International N.V. (ImageSat). Other shareholders include IAI and private equity groups. ImageSat is involved in the operation of satellites for commercial and other applications and providing satellite imagery. ImageSat's EROS A1 satellite contains an advanced electro-optical payload produced by El-Op.

CYOPTICS - Our 50%-owned partnership SCD owns an approximately 8% equity interest in CyOptics Inc. (CyOptics) on a fully-diluted basis. Through its wholly-owned Israeli subsidiary, CyOptics is involved in the development of wave-length domain multiplexing components for optical communications.

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PROPERTY, PLANT AND EQUIPMENT

Our executive offices and main research and development facilities are located on approximately 595,000 square feet of property in the Advanced Technology Center in Haifa, Israel, including the recently constructed building described below. We own approximately 311,000 square feet of our main facilities in Haifa. The remainder of our facilities in Haifa is leased. We also have ownership and long-term leasehold rights in a facility of approximately 65,000 square feet near our headquarters building in Haifa. Our main manufacturing operations are located in a facility of approximately 169,000 square feet in Karmiel, Israel that is leased from Elron Electronic Industries Ltd. (which assumed the lease from Elbit Ltd.). We also lease approximately 50,400 square feet in Petach Tikva, Israel and approximately 21,500 square feet in Rehovot, Israel.

In May 2004, we completed construction and began using a new building that houses our offices and operations and that is connected to our current headquarters building in Haifa. The building covers approximately 356,200 square feet of building space, including underground parking facilities. We own half of the building and lease the other half from Matam - Advanced Technology Center Ltd. (Matam). The facility consolidates a large portion of our operations in the Advanced Technology Center in Haifa. Total costs to Elbit Systems for the land and construction of the new building were approximately \$20 million.

El-Op owns or has long-term leasehold rights to approximately 609,000 square feet of property and leases approximately 5,000 square feet of its facilities in Rehovot, Israel. These facilities contain El-Op's headquarters, offices, development facilities and manufacturing operations.

EFW owns approximately 25 acres of property in Fort Worth, Texas. That property includes an approximately 200,000 square foot facility containing EFW's offices and manufacturing operations, which includes an approximately 20,000 square foot engineering and integration center that was added in 2004. Kollsman owns property in Merrimack, New Hampshire covering a total of approximately 66 acres. This includes buildings containing offices and manufacturing operations of approximately 352,000 square feet. Kollsman is currently in discussions to lease approximately 44 unbuilt acres on the Merrimack property. IEI owns

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property covering approximately 38 acres in Talladega, Alabama, on which are located offices and manufacturing facilities of approximately 64,000 square feet. The operation in Warner Robins, Georgia occupies approximately 13,000 square feet of leased facilities.

Cyclone owns approximately 1,406,100 square feet of property near Karmiel, Israel. This includes approximately 210,000 square feet on which its offices, manufacturing, maintenance and hangar facilities are located. Kinetics owns office, laboratory and manufacturing facilities in Airport City, Israel, covering approximately 32,000 square feet. Silver Arrow leases facilities in Nes Ziona, covering approximately 26,000 square feet. Ortek owns approximately 109,000 square feet of property in Sderot, Israel, which includes approximately 16,000 square feet of offices and manufacturing facilities.

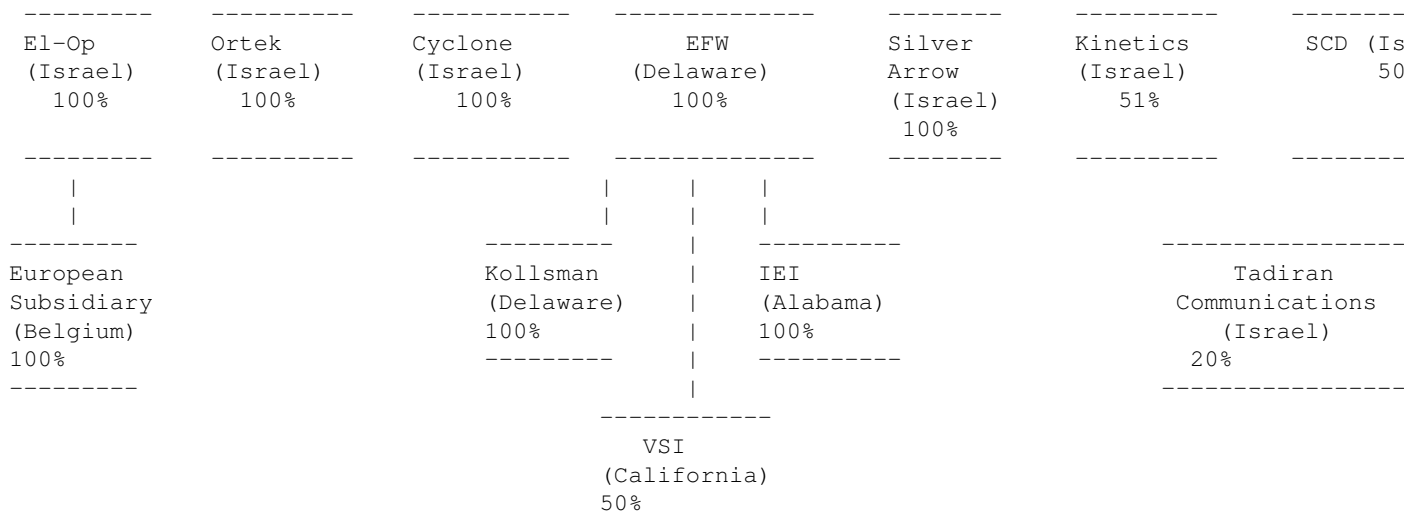
AEL owns approximately 282,000 square feet of property in Porto Alegre, Brazil, including offices and buildings covering approximately 23,000 square feet. The European Subsidiary leases approximately 81,000 square feet in Belgium.

Over the last two years the average annual investment in our facilities, including the building projects in Haifa and Rehovot, as well as equipment, machinery and vehicles, amounted to approximately \$57 million. We believe that our current facilities are adequate for our operations as now conducted.

ORGANIZATIONAL STRUCTURE

Our beneficial ownership interest in, and place of incorporation of, our major subsidiaries and investees is set forth below. Our equity and voting interests in these entities are identical.

Elbit Systems Ltd.



GOVERNMENTAL REGULATION

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GOVERNMENT CONTRACTING REGULATIONS. We operate 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, our 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 our systems and products. Current Israeli policy encourages exports to approved customers of defense systems and products such as ours, 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. We also must receive a specific export license for any hardware eventually exported from Israel. In 2004, approximately 50% of our revenue was derived from exports subject to Israeli export regulations.

U.S. AND OTHER EXPORT REGULATIONS. EFW's export of defense products, military technical data and technical services 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 our Israeli entities are also required to obtain such export licenses and TAAs. This applies to data required by our Israeli entities to perform work for U.S. programs. Licenses are also required for Israeli nationals assigned to work at our U.S. affiliated companies. An application for an export license or a TAA requires disclosure of the intended sales of the product and the use of the technology. Recently, the U.S. has implemented enhanced scrutiny of its export control regulations, and the U.S. Government may deny an export authorization if it determines that a transaction is counter to U.S. policy or national security. Other governments' export regulations also affect our business from time to time, particularly with respect to end user restrictions of our suppliers' governments.

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APPROVAL OF DEFENSE ACQUISITIONS. Many countries require governmental approval of acquisitions of local defense companies or assets by foreign entities. Mergers and acquisitions of defense related businesses in the U.S. are subject to "Exon Florio" regulations that require review, and in some cases approval, by the Committee on Foreign Investments in the United States (CFIUS). Israel is in the process of adopting similar regulations.

"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 our 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

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subcontract with U.S. suppliers. The U.S. Government may authorize the IMOD to utilize a portion of the FMF budget under the United States Subcontracting Procurement (USSP) channel. In such cases, companies such as Elbit Systems or El-Op, who are acting as the Israeli prime contractor to the IMOD under the NIS funded portion of an a IMOD program, are authorized to negotiate and enter into a subcontract directly with a U.S. supplier. However, payment of the funds under a USSP channel subcontract is administered by the IMOD Purchasing Mission to the U.S.

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.

CIVIL AVIATION REGULATIONS. Several of the products sold by Group companies for commercial aviation applications are subject to flight safety and airworthiness standards of the U.S. Federal Aviation Administration and similar civil aviation authorities in Israel, Europe and other countries.

BUY-BACK

As part of their standard contractual requirements for defense programs, several of our 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.

We are 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 and quality 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, we have not encountered significant difficulties in identifying qualified local suppliers and placing purchase orders.

We typically have 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 several 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 our customer, the actual effective buy-back obligation amount typically is significantly less due to the application of the multiplier factors.

Although failure to meet a best efforts buy-back obligation may limit our ability to be awarded future business from the applicable customer, in the majority of the cases buy-back is not linked to delivery payments or subject to specific or material contractual monetary penalties. The buy-back activities are a normal part of doing business in the defense industry with these customers.

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Over the number of years that we have been performing buy-back activities, we have not experienced significant difficulties in meeting our buy-back obligations, and therefore these buy-back activities are not believed to represent a material financial risk to our operations. Our maximum aggregate buy-back undertakings as of December 31, 2004 were approximately \$673 million, to be fulfilled over a period of up to 11 years.

FINANCING TERMS

TYPES OF FINANCING. There are several types of financing terms applicable to our defense contracts. In some cases, we receive progress payments according to a percentage of the cost incurred in performing the contract. Sometimes we receive advances from the customer at the beginning of or during the course of the project, and sometimes we also receive milestone payments for achievement of specific milestones. In some programs we extend 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 we finance all or part of the project's costs for various periods of time. In some cases we arrange or assist in arranging third party financing for our customers. Financing arrangements may extend beyond the term of the contract's performance. When we believe it is necessary, we seek to protect all or part of our 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 we receive 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 us. We have received substantial advances from customers under some of our contracts. If a contract is canceled for default and there has been an advance or progress payment, we may be required to return payments to the customer as provided in the specific guarantee. As part of the guarantees we provide to receive progress payments or advance payments, some of our customers require us to transfer to them title in inventory acquired with such payments. As of December 31, 2004, the balance of customer advances that were covered by guarantees amounted to approximately \$286 million.

PERFORMANCE GUARANTEES. A number of projects require us to provide performance guarantees in an amount equal to a percentage of the contract price. Some of our contracts contain clauses that impose penalties or reduce the amount payable to us if there is a delay or failure in performing in accordance with the contract or the completion of a phase of work, including in some cases during the warranty period. We provide these types of guarantees in the normal course of our business. As of December 31, 2003, the balance of performance guarantees for Group companies amounted to approximately \$65 million.

FINANCIAL RISKS RELATING TO OUR PROJECTS. The nature of our 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 our control, termination for the customer's convenience, potential for monetary penalties for late deliveries or failure to perform in accordance with the contract requirements and liability for subcontractors. In addition, we receive payments for some of our projects in currencies other than U.S. dollars. In such cases, we sometimes elect to adopt measures to reduce the risk of exchange rate fluctuations.

AUDIT REGULATIONS. The IMOD audits our books and records relating to its contracts with us. Our books and records and other aspects of projects

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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. If discrepancies were found this could result in a downward adjustment of the applicable contract's price. Some other customers obtain similar rights under specific contract provisions.

INTELLECTUAL PROPERTY

PATENTS, TRADEMARKS AND TRADE SECRETS. We hold more than 230 patents and applications in Israel, the United States and other countries relating to approximately 110 different inventions. El-Op alone holds approximately 110 patents and applications on some 45 different products or applications. Our technology spin-off companies often rely in part on our patented technology. We also hold 25 trademarks relating to specific products. A significant part of our 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 our trade secrets and proprietary information. We take a number of measures to guard our intellectual property against infringement as well as to avoid infringement of other parties' intellectual property.

GOVERNMENT RIGHTS IN DATA. The IMOD usually retains specific rights to technologies and inventions resulting from our performance under Israeli Government contracts. This generally includes the right to disclose the information to third parties, including other defense contractors that may be our competitors. Consistent with common practice in the defense industry, approximately 35% of our revenues in 2004 was 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. We 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, we normally retain the principal rights to the technology. Sales of our products to the U.S. Government and some other customers are subject to similar conditions. Subject to applicable law, regulations and contract requirements, we attempt to maintain our intellectual property rights and provide customers with the right to use the technology only for the specific project under contract.

LICENSING. There are relatively few cases where we manufacture under license. In such cases, the licensor typically is entitled to royalties or other types of compensation. 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. See above "Principal Subsidiaries - EFW". Occasionally, we license parts of our intellectual property to customers as part of the requirements of a particular contract. We also sometimes license technology to other companies for specific purposes or markets. Our technology spin-offs typically receive licenses to use relevant parts of our intellectual property for their designated business purposes. See above "Technology Spin-Offs - MediGuide and - Starling".

RESEARCH AND DEVELOPMENT

We invest in research and development (R&D) according to a long-term plan based on estimated market needs. Our R&D efforts focus on anticipating operational needs of our customers, achieving reduced time to market and increasing affordability. We emphasize improving existing systems and products and developing new ones using emerging or existing technologies.

We perform R&D projects to produce new systems for the IMOD and other customers. These projects give us the opportunity to develop and test emerging technologies. We 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 our 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. We also perform R&D in the area of commercial aviation. In addition, our technology spin-offs perform R&D in their areas of operation.

We employ more than 1,650 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 our total workforce is engaged in research, development and engineering.

Our customers fund part of our R&D, and we also invest in our research and development activities. This investment is in accordance with our strategy and plan of operations. The table below shows amounts we invested in R&D activities for the years ended December 31, 2002, 2003 and 2004:

| | 2002 ---- | 2003 ---- | 2004 ---- |
|---------------------------------|----------------------------|--------------|--------------|
| | (U.S. dollars in millions) | | |
| Total Investment | \$62.6 | \$65.5 | \$86.4 |
| Less Third Party Participation* | 5.6 | 10.6 | 19.6 |
| | ----- | ----- | ----- |
| Net Investment | \$57.0 | \$54.9 | \$66.8 |
| | ===== | ===== | ===== |

*See above - "Government Rights in Data" and see below - "Conditions in Israel - Chief Scientist and Investment Center Funding"

MANUFACTURING

We manufacture and assemble most of our systems at Elbit Systems' production facility in Karmiel, Israel, at El-Op's facilities in Rehovot, Israel, and at EFW's facilities in Fort Worth, Texas and at Kollman's facilities in Merrimack, New Hampshire. These facilities contain warehouses, electronic assembly areas, test evaluators and final test stations. They also have mechanical workshops, infrastructure for "through hole" automated and semi-automated assembly, fully automated surface mount technology lines and clean rooms. We have fully independent capabilities in electronic card assembly, electro-optic components, solid state components integration, environmental testing and final testing, including space simulation and thermal chambers. We also have computerized logistics systems for managing manufacturing and material supply. At Kollman, we also manufacture commercial avionics and medical equipment in FAA and U.S. Food and Drug Administration approved facilities.

Cyclone, Silver Arrow, Kinetics, Ortek, SCD, Opgal, AEL and the European Subsidiary also perform manufacturing and assembly at their facilities. IEI has facilities for manufacturing test equipment and other items. Some components of our products are manufactured in Romania at S.C. A-E Electronics S.A., a majority-owned Romanian subsidiary of Elbit Systems that manufactures military components and at Elmet International SRL, a wholly-owned subsidiary of Elbit Systems involved in machining and metal works.

PURCHASING

Elbit Systems purchasing activities in Israel are based in our facilities in Haifa and in Karmiel. El-Op, Cyclone and most of our other operating subsidiaries also conduct purchasing activities. In the U.S., purchasing activities are based at the facilities of EFW, Kollsman and IEI . EFW also assists Elbit Systems in procurement activities in the United States, as does Elmec Inc., a wholly-owned subsidiary of Elbit Systems located in Chelmsford, Massachusetts.

We generally are not dependent on single sources of supply. We manage our inventory according to project requirements. In some projects, specific major subcontractors are designated by the customer.

CUSTOMER SATISFACTION AND QUALITY ASSURANCE

We invest in continuous improvement of processes to ensure customer satisfaction throughout all stages of our operations. This includes development, engineering, design and integration of hardware and software, manufacturing, installation and service. Our quality teams are involved in assuring compliance with processes and administrating quality plans. These activities begin at the precontract stage and continue through the customer's acceptance of the product or services.

Elbit Systems uses a project management method based on Theory of Constraints (TOC) in most of our development projects. Using advanced software, work plans are continuously updated and are available to all integrated product team members. This method makes management more efficient and improves our ability to meet schedule demands of complex projects. Another TOC methodology is used successfully to manage the manufacturing floor in Karmiel. We also use methods such as Keizen and Lean.

Our processes are based on a cutting edge tool case and CAD-CAM tools. This infrastructure, together with well defined development methodology and management tools, assists us in providing high quality and on time implementation of projects.

Representatives of our customers generally test our products before acceptance. Branches of the IDF and other customers have authorized us to conduct acceptance testing of our products on their behalf. In addition, Elbit Systems is certified for Software Compatibility Maturity Model (CMM) Level 3 of the U.S. Software Engineering Institute (SEI), indicating a high level of software maturity and software development capability. Elbit Systems is certified for ISO-9001:2000 including ISO-90003 for software and ISO-14001 and AS9100. El-Op is certified for ISO-9001:2000, ISO-14001 and OSHAS 18001. Cyclone and Silver Arrow are certified for ISO-9001:2000. All the above are certified by the National Standard Institution of Israel and by the National Quality Assurance (NQA) authority for AS9100.

EFW, IEI and Kollsman are certified for ISO-9001:2000 and AS9100. Kollsman also holds a European Aviation Safety Authority (EASA) certificate, and. the quality systems of Kollsman and IEI comply with NATO AQAP requirements.

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SERVICE AND WARRANTY

We instruct our customers on the proper maintenance of our systems and products. In addition, we often offer training and provide equipment to assist our customers in performing their own maintenance. When required, support may be provided by a local support team or by experts sent from our main facilities.

We generally offer a one-year warranty for our systems and products following delivery to, or installation by, the customer. We maintain reserves for warranty obligations specifically determined for each project based on our experience and engineering estimates. These reserves are intended to cover post-delivery functionality and operating issues for which we are responsible under the applicable contract.

MARKETING AND SALES

We actively take the initiative in identifying the individual defense needs of our customers throughout the world. We then focus our research and development activities on systems designed to provide tailored solutions to those needs. We often provide demonstrations of prototypes and existing systems to potential customers.

We market our systems and products either as a prime contractor or as a subcontractor to various governments and defense contractors worldwide. In Israel, we sell our military systems and products mainly to the IMOD, which procures all equipment for the IDF. Our marketing and technical support personnel for sales in Israel operate out of our headquarters in Haifa, El-Op's facilities in Rehovot, our offices in Tel-Aviv and the facilities of our other Israeli subsidiaries. We are assisted in marketing our systems, products and services in other parts of the world through subsidiaries, joint ventures, consultants and representatives.

In the U.S., EFW leads our marketing activities, both from Fort Worth and from offices in the Washington, D.C. area. Kollman and IEI also market their products and services. EFW operates under an SSA that allows it and its subsidiaries to work on certain classified U.S. Government programs. See above "Principal Subsidiaries - EFW".

Over the past several years, Elbit Systems, El-Op and EFW have entered into cooperation agreements with major defense contractors in the United States. These agreements provide for joint participation in marketing and performance of a range of projects. In other countries, we actively pursue business opportunities as either a prime contractor or a subcontractor, usually together with local companies. Often we enter into cooperation agreements with other companies for such opportunities.

The following table provides our net revenues by geographic regions, expressed as a percentage of total revenues for the periods indicated:

| | Year Ended December 31 | | |
|---------------|------------------------|------|------|
| | 2002 | 2003 | 2004 |
| Israel | 27% | 29% | 26% |
| United States | 32% | 37% | 37% |
| Europe | 18% | 12% | 13% |
| Others | 23% | 22% | 24% |

COMPETITION

We operate in a competitive environment for most of our projects, systems and products. Competition is based on product and program performance, price, reputation, reliability, maintenance costs and responsiveness to customer requirements. This includes the ability to respond to rapid changes in technology. In addition, our competitive position sometimes is affected by specific requirements in particular markets.

In recent years consolidation in the defense industry has affected competition. This has decreased the number but increased the relative size and resources of our competitors. We adapt to market conditions by adjusting our business strategy to changing defense market conditions. We also anticipate continued competition in defense markets due to declining defense budgets in many countries.

Competitors in the sale of some of our products to the Government of Israel include IAI and Rafael among others. From time to time we also cooperate with some of our competitors on specific projects.

Outside of Israel, we compete in a number of areas with major international defense contractors. These include divisions and subsidiaries of Boeing, Northrop Grumman Corporation, Honeywell, BAE Systems Ltd., Rockwell Collins, L-3 Communications Holdings, Inc., Thales S.A. and Harris Corporation. Our competitors also include a number of other major defense contractors in the United States and Europe. Most of these competitors have greater financial, marketing and other resources than ours. We also compete with numerous smaller companies and other Israeli companies around the world.

Overall, we believe we are able to compete on the basis of our systems development and technological expertise, our systems' combat-proven performance and our policy of offering customers overall solutions to technological, operational and financial needs.

MAJOR CUSTOMERS

Sometimes, our revenues from an individual customer account for more than 10% of our revenues in a specific year. Our only such customers during the last three years were the IMOD, that accounted for 20% of our revenues in 2002, 21% in 2003 and 17% in 2004 and the U.S. Government, that accounted for 10% of our revenues in 2004.

CONDITIONS IN ISRAEL

POLITICAL, MILITARY AND ECONOMIC RISKS. Our operations in Israel are subject to several potential political, military and economic risks. See above - Item 3. Key Information - Risk Factors - Risks Related to our Israeli Operations.

TRADE AGREEMENTS

Israel is a member of the United Nations, the International Monetary Fund, the International Bank for Reconstruction and Development and the International Finance Corporation. Israel also is a party to the General

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Agreement on Tariffs and Trade, which provides for reciprocal lowering of trade barriers among its members. In addition, Israel has been granted preferences under the Generalized System of Preferences from the United States, Australia, Canada and Japan. These preferences allow Israel to export products covered by such programs either duty-free or at reduced tariffs.

Israel and the European Community are parties to a Free Trade Agreement that provides some advantages for Israeli exports to most European countries and requires Israel to lower its tariffs on imports from these countries over a number of years. Israel and the United States entered into an agreement to establish a Free Trade Area that eliminates tariff and some non-tariff barriers on most trade between the two countries. An agreement between Israel and the European Free Trade Association, which includes Austria, Norway, Finland, Sweden, Switzerland, Iceland and Liechtenstein, established a free-trade zone between Israel and those nations.

CHIEF SCIENTIST AND INVESTMENT CENTER FUNDING

The Government of Israel, through the OCS and the Israel Investment Center (the Investment Center), encourages research and development projects oriented towards export products and participates in the funding of such projects.

Under the terms currently applying to OCS funding, companies receiving funding must pay the Israeli Government a royalty of usually 2% to 5% of the sales of products developed from a project funded by the OCS. These payments start with the beginning of sales of such products and typically end when 100% of the dollar value of the grant is repaid. For grants provided starting in 1999, the recipient must also pay interest payments to the OCS on the amount of the grant. The annual interest payment rate is LIBOR. The terms of Israeli Government participation also require that the manufacture of products developed with government grants be performed in Israel, unless a special approval has been granted. Separate Israeli Government consent is required to transfer to third parties technologies developed through projects in which the Government participates.

In 2002, El-Op reached agreement with the OCS to join an OCS initiative applicable to large, research and development intensive Israeli companies. This initiative allows participating companies to receive OCS funding for generic research and development without the need for payment of future royalties. However, as a condition to joining the initiative, companies are required to reach agreement with the OCS on an unconditional prepayment for existing OCS funded programs in exchange for a release by the OCS from all obligations. Under El-Op's agreement with the OCS, El-Op is paying \$10.6 million over a five-year period beginning in 2002 in exchange for a release of El-Op's obligations to pay further royalties.

The Investment Center promotes Israeli export products and increased industrialization of peripheral areas through investment in industrial infrastructure. The Investment Center either provides grants for qualified projects or provides tax benefits for qualified industrial investments by Israeli companies. In 2005, the regulations relating to the tax benefit programs of the Investment Center were revised to provide for review and approval of the tax benefit by the Israel Tax Authority only after a company has made the applicable investment.

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labor laws. Some employees are also affected by some provisions of collective bargaining agreements between the Histadrut - General Federation of Labor in Israel and the Coordination Bureau of Economic Organizations, which includes the Industrialists' Association. These labor laws and collective bargaining provisions mainly concern the length of the work day, minimum daily wages for professional workers, insurance for work-related accidents, procedures for dismissing certain employees, determination of severance pay and other conditions of employment.

SEVERANCE PAY. Under Israeli law, our Israeli companies are required to make severance payments to terminated Israeli employees, other than in some cases of termination for cause. The severance reserve is calculated based on the employee's last salary and period of employment. The severance pay and pension obligation is discharged by payment of premiums to insurance companies under approved plans and to pension funds. The balance of the severance liability not covered by these deposits is recorded as a liability on the balance sheet. The deposits presented in the balance sheet include profits accumulated to the balance sheet date. The amounts deposited may be withdrawn only after fulfillment of the obligations under the Israeli laws relating to severance pay.

NATIONAL INSURANCE INSTITUTE. Israeli employees and employers are required to pay predetermined sums to the National Insurance Institute, which is similar to the U.S. Social Security Administration. These amounts also include payments for national health insurance. The payments to the National Insurance Institute are equal to approximately 16.3% of wages. The employee contributes approximately 66% and the employer contributes approximately 34%.

ENFORCEMENT OF JUDGMENTS

Israeli courts may enforce U.S. and other foreign jurisdiction final executory judgments for liquidated amounts in civil matters, obtained after due process before a court of competent jurisdiction. This enforcement is made according to the private international law rules currently applicable in Israel, which recognize and enforce similar Israeli judgments, provided that:

- o adequate service of process has been made and the defendant has had a reasonable opportunity to be heard;
- o the judgment and its enforcement are not contrary to the law, public policy, security or sovereignty of the State of Israel;
- o the judgment was not obtained by fraud and does not conflict with any other valid judgment in the same matter between the same parties;
- o an action between the same parties in the same matter is not pending in any Israeli court at the time the lawsuit is instituted in the foreign court; and
- o the judgment is no longer subject to a right of appeal.

Foreign judgments enforced by Israeli courts generally will be payable in Israeli currency. The usual practice in Israel in an action to recover an amount in a non-Israeli currency is for the Israeli court to provide for payment of the equivalent amount in Israeli currency at the exchange rate in effect on the judgment date. Under existing Israeli law, a foreign judgment payable in foreign currency may be paid in Israeli currency at the foreign currency's exchange rate on the payment date or in foreign currency. Until collection, an Israeli court judgment stated in Israeli currency will ordinarily be linked to the Israeli Consumer Price Index (CPI) plus interest at the annual rate (set by Israeli regulations) in effect at that time. Judgment creditors must bear the risk of unfavorable exchange rates.

ITEM 5. OPERATING FINANCIAL REVIEW AND PROSPECTS - MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis should be read together with our audited consolidated financial statements and notes appearing in Item 18 below.

GENERAL

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

Our results of operations and financial condition are based on the preparation of consolidated financial statements in conformity with U.S. GAAP. The preparation of the consolidated financial statements requires management to select accounting policies for critical accounting areas as well as make estimates and assumptions that affect the amounts reported in the financial statements. Significant changes in assumptions or conditions and changes in critical accounting policies could materially impact our operating results and financial condition.

We believe our most critical accounting policy relates to revenue recognition as described below.

Revenues from long-term contracts are recognized based on Statement of Position 81-1 "Accounting for Performance of Construction-Type and Certain Production-Type Contracts" (SOP 81-1) according to which revenues are recognized on the percentage of completion basis.

Sales under long-term fixed-price contracts which provide for a substantial level of development efforts in relation to total contract efforts are recorded using the cost-to-cost method of accounting as the basis to measure progress toward completing the contract and recognizing revenues. According to this method, sales and profits are recorded based on the ratio of costs incurred to estimated total costs at completion. In certain circumstances, when measuring progress toward completion, we consider other factors, such as achievement of performance milestones.

Sales and anticipated profit under long-term fixed-price production type contracts are recorded on a percentage of completion basis, using the units-of-delivery as the basis to measure progress toward completing the contract and recognizing revenues.

Sales and anticipated profit under long-term fixed-price contracts that involve both development and production are recorded on a percentage of completion basis, using the cost-to-cost method and units-of-delivery method, as applicable. In addition, when measuring progress toward completion under the development portion of a contract, we usually consider other factors, such as achievement of performance milestones.

Estimated contract profit is included in earnings in proportion to recorded sales.

The percentage-of-completion method of accounting requires management to estimate the cost and gross profit margin for each individual contract.

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

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Sales under cost-reimbursement-type contracts are recorded as costs are incurred. Applicable estimated profits are included in earnings in the proportion that incurred costs bear to total estimated costs.

Amounts representing contract change orders, claims or other items are included in sales only when they can be reliably estimated and realization is probable. Penalties and awards applicable to performance of contracts are considered in estimating sales and profit rates and are recorded when there is sufficient information to assess anticipated contract performance.

We believe that the use of the percentage of completion method is appropriate since the Group has the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, contracts executed include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged and the manner and terms of settlement. In all cases the Group expects to perform its contractual obligations, and its customers are expected to satisfy their obligations under the contract.

In cases where the contract involves the delivery of products and performance of services, we follow the guidelines specified in EITF 00-21, "Revenue Arrangements with Multiple Deliveries" in order to allocate the contract fees between the products accounted for under SOP 81-1 and the services accounted for under SAB 104. The services are recognized throughout the service period.

Management reviews periodically the estimates of progress towards completion and project costs. These estimates are determined based on engineering estimates and past experience, by personnel having the appropriate authority and expertise to make reasonable estimates of the related costs. Such engineering estimates are reviewed periodically for each specific contract by professional personnel from various disciplines within the organization. These estimates take into consideration the probability of achievement of certain milestones as well as other factors that might impact the contract's completion.

A number of internal and external factors affect our cost estimates, including labor rates, estimated future material prices, revised estimates of uncompleted work, efficiency variances, linkage to indices and exchange rates, customer specifications and testing requirement changes. If any of the above factors were to change, or if different assumptions were used in the application of this and other accounting policies, it is likely that materially different amounts would be reported in our consolidated financial statements.

IMPAIRMENT OF GOODWILL AND OTHER LONG-LIVED ASSETS

Consistent with Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," goodwill is not amortized and is tested at least annually for impairment. According to SFAS 142, an impairment loss will be recognized when the carrying value of the goodwill is not recoverable and exceeds its fair value.

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The methods commonly used to value the fair value of reporting units are the Income, Market and Cost approaches. Our reported units' fair market value was estimated using two valuation methodologies: the Income Approach and the Market Approach.

These methodologies use estimates and assumptions which include, among others, projected future cash flows, discount rate and terminal growth rate. Using different assumptions could result in different results.

As of December 31, 2004, our goodwill amounted to \$32.8 million. We tested our goodwill as of December 31, 2004 and concluded that no impairment of value exists.

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Consistent with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," we evaluate long-lived assets for impairment and assess their recoverability based upon anticipated future cash flows. As of December 31, 2004, our long-lived assets amounted to \$307.4 million, including \$63.1 million in intangible assets, and we concluded that no impairment loss was necessary. Our estimates of future cash flows to be derived from such evaluation may differ from actual future cash flows.

Should future impairment tests we make determine that impairment has occurred in the value of our goodwill or long-lived assets, such impairment may have a material effect on our financial results in the period in which the impairment is determined.

Intangible assets are amortized over their estimated useful lives. Determining the useful life of intangible assets involves the use of estimates and judgments. In determining the useful live we take into account various factors such as the expected use of the asset, effects of obsolescence, competition, demand and other economic factors. If our estimates change and the useful lives of intangible assets increase or decrease, it will affect our results of operations.

INVESTMENT IN AFFILIATES, PARTNERSHIP AND OTHER ENTITIES

When relevant factors indicate an other than temporary decline in the fair value of these investments in affiliates, partnerships and other entities below their book values, we adjust the investment to the estimated fair value. The value of these entities is subject to ongoing changes resulting from their business conditions. No write offs were required in 2004.

SARBANES-OXLEY ACT

According to Section 404 of the U.S. Sarbanes-Oxley Act of 2002, Elbit Systems is required to include in our annual report for the fiscal year ending December 31, 2006 an assessment, as of the end of the fiscal year, of the effectiveness of our internal controls over financial reporting. In March 2005, the SEC extended the period for implementation of Section 404 by Foreign Private Issuers such as Elbit Systems from 2005 until 2006.

During 2004, we took steps to assure compliance of our documentation and internal controls over financial reporting with the guidelines stipulated in the Sarbanes-Oxley Act. We plan to continue with these steps during 2005 and 2006.

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NEW ACCOUNTING STANDARDS

The significant accounting policies applied in the preparation of our financial statements for 2004 were identical to those applied in preparation of the previous annual financial statements except as follows:

In accordance with FASB Statement No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure", Elbit Systems adopted the fair-value -based method of accounting for share-based payments as described in FASB

Statement No. 123 "Accounting for Stock-Based Compensation", effective January 1, 2004 using the "modified prospective method" described in FASB Statement No. 148. This adoption did not have a material impact on our results of operations or our financial position.

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Until December 31, 2003, Elbit Systems followed Accounting Principles Board Opinion No. 25 (APB 25) "Accounting for Stock Issued to Employees" and FASB Interpretation No. 44 (FIN 44) "Accounting for Certain Transactions Involving Stock Compensation" in accounting for our employee stock option plans. The change in Elbit Systems' share price affected our financial results due to the impact of the employee stock option plan adopted in 2000. See below - Item 6. Directors, Senior Management and Employees - Share Ownership - Post Merger Plan. The plan is comprised of options for 5 million shares, divided into options to purchase up to 2.5 million shares and an additional 2.5 million "phantom" options. The phantom options grant the option holders a number of shares corresponding to the benefit component of the options exercised, as calculated on the exercise date, in consideration for their par value only, and are considered as a variable option plan. As such, compensation expense was measured based on the intrinsic value of options at the end of each reporting period. Consequently, changes in Elbit Systems share price affected our earnings.

As noted above, effective January 1, 2004, we adopted the fair value recognition provision of SFAS No. 123. Elbit Systems uses the Black-Scholes-Merton formula to estimate the fair value of stock options granted to employees. Compensation cost is recorded over the vesting period on a straight-line basis.

Following the adoption of SFAS No. 123, the financial results will no longer be materially affected by the impact of changes in Elbit Systems' share price on employee stock-based compensation.

The following pro forma information shows the impact of SFAS No. 123, had it been in effect in 2002 and

2003:

| | 2004 | YEAR ENDED DECEMBER 2003 |
|------------------------|-----------|-----------------------------|
| | ----- | ----- |
| Net income as reported | \$ 52,993 | \$ 45,945 |
| | ===== | ===== |
| Pro forma net income | \$ 52,993 | \$ 46,782 |
| | ===== | ===== |

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| | | |
|--|---------|---------|
| Diluted net earnings per share as reported | \$ 1.29 | \$ 1.14 |
| | ===== | ===== |
| Pro forma diluted net earnings per share | \$ 1.29 | \$ 1.16 |
| | ===== | ===== |

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As result of the adoption of SFAS No. 123 from January 1, 2004, the net income and diluted net earnings per share of the first three quarters of 2004 were restated as follows:

| | Q1/04 | Q2/04 | Q3/04 | TOTAL |
|--|----------|----------|----------|----------|
| | ----- | ----- | ----- | ----- |
| Net income as reported on Form 6-K | \$12,727 | \$11,311 | \$13,708 | \$37,746 |
| | ===== | ===== | ===== | ===== |
| Net income as restated | \$12,251 | \$13,301 | \$13,316 | \$38,868 |
| | ===== | ===== | ===== | ===== |
| Diluted net earnings per share as reported on Form 6-K | \$0.31 | \$0.28 | \$0.33 | \$0.92 |
| | ===== | ===== | ===== | ===== |
| Diluted net earnings per share as restated | \$0.30 | \$0.33 | \$0.32 | \$0.95 |
| | ===== | ===== | ===== | ===== |

The compensation expense for the fourth quarter of 2004 was reported in accordance with the new method under SFAS No. 123. For a description of the compensation expense recorded for each income statement period presented related to the "phantom" options and the income statement caption where the expense was recorded see below - Item 18. Financial Statements - Note 17E (Shareholder's Equity).

In December 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123 (revised 2004) (123(R)), "Share-Based Payment", which is a revision of FASB Statement No. 123, "Accounting for Stock-Based Compensation", Statement 123(R) supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees", and amends FASB Statement No. 95, "Statement of Cash Flows". Generally, the approach in Statement 123(R) is similar to the approach described in Statement 123. However, Statement 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. We do not anticipate that the adoption of Statement 123(R) will have a material impact on our results of operations or our financial position.

OFF-BALANCE SHEET AND OTHER LONG-TERM ARRANGEMENTS AND COMMITMENTS

BUY-BACK. In connection with long-term projects in specific countries, Elbit Systems and some of our subsidiaries undertook to use their respective best efforts to make or facilitate purchases or investments in those countries at certain percentages (typically up to 100%) of the amount of the specific contract. Our obligations to make or facilitate third parties making such investments and purchases are subject to commercial conditions in the local market, in the majority of cases without a specific financial penalty. The

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maximum aggregate undertaking as of December 31, 2004 amounted to \$673 million to be performed over a period of up to 11 years. In the opinion of management, the actual amount of the investments and purchases is anticipated to be less than that mentioned above, since certain investments and purchases can result in reducing the overall undertaking on more than a one-to-one basis. See above - Item 4. Information on the Company - Buy-Back.

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OCS. Elbit Systems and some of other Israeli subsidiaries partially finance their research and development expenditures under programs sponsored by the Office of the Chief Scientist in Israel (OCS) for the support of research and development activities conducted in Israel. At the time the OCS participations were received, successful development of the related projects was not assured. In exchange for OCS participation in the programs, Elbit Systems and the subsidiaries agreed to pay 2% - 5% of total sales of products developed within the framework of these programs. The obligation to pay these royalties is contingent on actual sales of the products. See above - Item 4. Information on the Company - Conditions in Israel - Chief Scientist and Investment Center Funding. In addition, we also receive funding from other third parties that bear royalty obligations.

GOVERNMENT DATA RIGHTS. Elbit Systems and some of our subsidiaries are also obligated to pay agreed upon amounts to the IMOD and others on specific sales including sales resulting from the development of specified technology. See above - Item 4. Information on the Company - Intellectual Property - Government Rights in Data.

LEASE COMMITMENTS. Future minimum lease commitments of the Group under various non-cancelable operating lease agreements for premises, motor vehicles and office equipment as of December 31, 2004 are as follows: \$6.7 million for 2005, \$5.9 million for 2006, \$4.5 million for 2007, \$3 million for 2008 and \$13.1 million for 2009 and thereafter. See above - Item 4. Information on the Company - Property, Plant and Equipment.

KINETICS PUT OPTION. Three founding employees (the Founders), who collectively hold approximately 32.3% of the outstanding shares of Kinetics, a 51%-owned Israeli subsidiary, have a put option to jointly sell all of their shares in Kinetics to Elbit Systems. See above - Item 4. Information on the Company - Principal Subsidiaries - Kinetics. Two private investors holding in the aggregate approximately 16.7% of Kinetics' outstanding shares have "tag along" rights in the event the Founders exercise the put option. The put option is exercisable from January 1, 2005 until December 31, 2005 at a price equal to the higher of:

- (a) the Founder's pro-rata share (corresponding to the Founder's shareholding percentage) of the value of Kinetics as of the option exercise date as determined by a third party appraiser mutually acceptable to the Founders and to Elbit Systems, (the appraiser will value Kinetics as if Kinetics had distributed as dividends net profits accumulated up to the option exercise date), or
- (b) \$12,077,077, reduced by 3% per annum, or pro-rata part thereof, for the period beginning on July 1, 2003 and ending on the option exercise date.

BANK GUARANTEES. We had, as of December 31, 2004, approximately \$380 million in guarantees issued on our behalf by banks, mainly in respect of advance payment and performance guarantees provided in the regular course of

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business. See above - Item 4. Information on the Company - Financing Terms.

BANK COVENANTS. In connection with bank credits and loans, including performance guarantees issued by banks and bank guarantees securing certain advances from customers, Elbit Systems and some of our subsidiaries are obligated to meet certain covenants. Such covenants include requirements for shareholders' equity, current ratio, operating profit margin, tangible net worth, EBITDA, interest coverage ratio and total leverage. As of December 31, 2004, we were in compliance with all covenants.

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PURCHASE COMMITMENTS. As of December 31, 2004 and 2003, we had purchase commitments that amounted to approximately \$345 and \$348 million, respectively. These purchase orders and subcontracts are typically in a standard format proposed by us, with the subcontracts and purchase orders also reflecting provisions from our applicable prime contract that are appropriate to flow down to subcontractors and vendors. The terms typically included in these purchase orders and subcontracts are consistent with Uniform Commercial Code provisions in the United States for sales of goods, as well as with specific terms called for by our customers in international contracts. These terms include our right to terminate the purchase order or subcontract in the event of the vendors' or subcontractors' default, as well as our right to terminate the order or subcontract for our convenience (or if our prime contractor has so terminated the prime contract). Such purchase orders and subcontracts typically are not subject to variable price provisions.

ACQUISITIONS DURING 2004.

See above - Item 4. Information on the Company - Recent Acquisitions.

BACKLOG

Our backlog includes firm orders received from customers for systems, products and projects that have yet to be completed. Our policy is to include orders in our backlog only when specific conditions are met. Examples of these conditions may include, among others, program funding, receipt of advances, letters of credit and guarantees from customers. As a result, from time to time we could have unbooked orders in excess of the level of backlog.

We reduce system and product backlog when revenues for a specific contract are recognized. We reduce project backlog as delivery or acceptance occurs or when contract milestones or engineering progress under the long-term contracts are recognized as achieved. In some cases we reduce project backlog when costs are incurred. In the unusual event of a contract cancellation, we would also be required to reduce our backlog accordingly. The method of backlog recognition used often changes depending on the particular contract. As of December 31, 2004, we had a backlog of approximately \$2,154 million, of which 66% was for orders outside Israel, as opposed to \$1,752 million, of which 63% was for orders outside of Israel, as of December 31, 2003. Approximately 74% of our backlog as of December 31, 2004 is scheduled to be performed during 2005 and 2006. The majority of the 26% balance is scheduled to be performed in 2007 and 2008. Backlog information and any comparisons of backlog as of different dates may not necessarily represent an indication of future sales.

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TRENDS

Trends in the defense electronics and homeland security markets in which we operate have been impacted by the nature of recent conflicts and terrorism activities throughout the world. Lessons learned in Operation Iraqi Freedom, Afghanistan, and the attacks of September 11, 2001, among other events, have increased the focus of defense forces on low intensity conflicts and homeland security.

In the defense electronics market, there is an increasing demand for products and systems in the areas of C4ISR. Accordingly, while we continue to perform platform upgrades, more emphasis is being placed on C4ISR, including network centric information systems, information gathering, situational awareness, precision guidance, all weather and day/night operations, border and perimeter security, UAVs, space and satellite based defense capabilities and homeland security systems. There is also a growing demand for cost effective logistic services and training. We believe that our core technologies and abilities will enable us to take advantage of many of these emerging trends, as well as to continue to participate in the "Current Force" legacy operations of our customers.

In recent years consolidations in the defense industry have affected competition. This has decreased the number but increased the relative size and resources of our competitors. We adapt to evolving market conditions by adjusting our business strategy to changing defense market conditions. We also anticipate continued competition in defense markets due to declining defense budgets in many countries. We believe in our ability to compete on the basis of our systems development and technological expertise, combat-proven performance and policy of offering customers overall solutions to technological, operational and financial needs.

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SUMMARY OF FINANCIAL RESULTS

The following table sets forth the consolidated statements of operations of Elbit Systems and our subsidiaries for the years ended December 31, 2004 and December 31, 2003.

| | For the year ended on December 31 | | |
|--|--|-------|---------|
| | 2004 | | 2003 |
| | \$ | % | \$ |
| | ----- | ----- | ----- |
| | (In thousands of U.S dollar except for share data) | | |
| Total revenues | 939,925 | 100.0 | 897,980 |
| Cost of revenues | 689,626 | 73.4 | 672,711 |
| Gross profit | 250,299 | 26.6 | 225,269 |
| Research and development expenses, net | 66,846 | 7.1 | 54,919 |

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| | | | |
|--|---------|-------|---------|
| Marketing and selling expenses | 69,912 | 7.4 | 69,943 |
| General and administrative expenses | 47,832 | 5.1 | 46,077 |
| | ----- | ----- | ----- |
| | 184,590 | 19.6 | 170,939 |
| | ----- | ----- | ----- |
| Operating profit | 65,709 | 7.0 | 54,330 |
| Financing expenses, net | (5,852) | (0.6) | (4,870) |
| Other income (expenses), net | 770 | 0.1 | 53 |
| | ----- | ----- | ----- |
| Income before income taxes | 60,627 | 6.5 | 49,513 |
| Provision for income taxes | 15,219 | 1.6 | 11,334 |
| | ----- | ----- | ----- |
| | 45,408 | 4.8 | 38,179 |
| Minority interest | (180) | 0.0 | 557 |
| Company's share of income of affiliated entities | 7,765 | 0.8 | 7,209 |
| | ----- | ----- | ----- |
| Net income | 52,993 | 5.6 | 45,945 |
| | ===== | ===== | ===== |
| Diluted earnings per share | 1.29 | | 1.14 |
| | ===== | | ===== |
| Weighted average number of shares used in computation | 41,041 | | 40,230 |
| | ===== | | ===== |

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2004 COMPARED TO 2003

REVENUES

Our consolidated revenues increased by 4.7%, from \$898.0 million in 2003 to \$939.9 million in 2004.

Our revenues generated by groups of areas of operations in 2003 and 2004 were as follows:

| | Year ended | | | |
|---------------------------------------|-------------------|------|-------------------|------|
| | December 31, 2004 | | December 31, 2003 | |
| | \$ millions | % | \$ millions | % |
| Airborne systems | 367.9 | 39.1 | 373.6 | 41.6 |
| Land vehicle systems | 199.2 | 21.2 | 199.8 | 22.2 |
| C4ISR systems | 108.9 | 11.6 | 133.9 | 14.9 |
| Electro-optics systems | 200.3 | 21.3 | 140.5 | 15.7 |
| Other (mainly non-defense engineering | | | | |

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| | | | | |
|--------------------------|-------|-------|-------|-------|
| and production services) | 63.6 | 6.8 | 50.2 | 5.6 |
| | ----- | ----- | ----- | ----- |
| Total | 939.9 | 100.0 | 898.0 | 100.0 |
| | ===== | ===== | ===== | ===== |

C4ISR systems sales decreased by 19% from \$133.9 million to \$108.9 million. The decrease in revenues resulted mainly from the delay in the receipt of certain orders for new projects, which were received but for which revenues were not yet recognized. Electro-optics sales increased by 43% from \$140.5 million to \$200.3 million. The increase in revenues resulted from increased sales of homeland security systems for international customers, night sights for various customers, the Night Targeting System to the U.S. Marine Corps and other customers, as well as sales of electro-optic products by a European subsidiary. "Other" sales increased by 27% from \$50.2 million to \$63.6 million. The increase in revenues was mainly from the manufacture of medical instrumentation by Kollsman.

The geographic breakdown of revenues in 2003 and 2004 was as follows:

| | Year ended | | |
|-----------------|-------------------|-------|-------------|
| | December 31, 2004 | | Dec |
| | \$ millions | % | \$ millions |
| Israel | 241.6 | 25.7 | 255.8 |
| United States | 348.5 | 37.1 | 332.3 |
| Europe | 124.1 | 13.2 | 109.4 |
| Other countries | 225.7 | 24.0 | 200.5 |
| | ----- | ----- | ----- |
| Total | 939.9 | 100.0 | 898.0 |
| | ===== | ===== | ===== |

Our sales are primarily to governmental entities and prime contractors under government defense programs. Accordingly, the level of our revenues is subject to governmental budgetary constraints.

Revenues from customers in Europe increased by 13% from \$109.4 million to \$124.1 million. The increase in revenues in Europe resulted mainly from the inclusion of a European subsidiary's revenues, starting only in the third quarter of 2003 and for the entire year in 2004. Revenues also increased in the United States and in other countries, mainly in Latin America and Asia, while revenues in Israel declined as deliveries under certain major programs entered final phases.

GROSS PROFIT. Our gross profit represents the aggregate results of our activities and projects and is based on the mix of programs in which we engaged during the reported period. Reported gross profit in 2004 was \$250.3 million (with gross profit margin of 26.6%), as compared to \$225.3 million (gross profit margin of 25.1%) in 2003. The increase in the gross profit percentage was caused mainly by the sale of a mix of products and projects with improved profitability.

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RESEARCH AND DEVELOPMENT (R&D)

We continually invest in R&D in order to maintain and further advance our technologies, in accordance with a long-term plan, based on our estimate of future market needs. Our R&D activities in the reported period are coordinated with, and partially funded by, third parties, including the IMOD and the OCS. These programs were mainly in the areas of advanced airborne systems, cutting edge electro-optics technology and products for surveillance, aerial reconnaissance, lasers and space based sensors.

Gross R&D expenses in 2004 totaled \$86.4 million (9.2% of revenues), as compared with \$65.5 million (7.3% of revenues) in 2003. Net R&D expenses (after deduction of third party participation, including the IMOD and the OCS) in 2004 totaled \$66.8 million (7.1% of revenues), as compared to \$54.9 million (6.1% of revenues) in 2003.

During the second half of 2004, and especially during the fourth quarter, we invested significant R&D efforts to support strategic business opportunities by developing products and technologies for U.S. airborne programs and additional efforts relating to the electro-optics systems. In support of these activities and additional R&D projects, we were successful in obtaining additional funding from external sources, to provide for the development of advanced technologies and related products.

MARKETING AND SELLING EXPENSES. We maintain our activities in developing new markets and pursue various business opportunities according to our plans. Marketing and selling expenses in 2004 were \$69.9 million (7.4% of revenues), as compared to a similar amount of \$69.9 million (7.8% of revenues) in 2003.

GENERAL AND ADMINISTRATIVE (G&A) EXPENSES. G&A expenses in 2004 were \$47.8 million (5.1% of revenues), as compared to \$46.1 million (5.1% of revenues) in 2003. The increase in G&A expenses in 2004 compared to 2003 were related to the cost of various exploratory merger and acquisition, legal, audit and control activities, including expenses related to compliance with the Sarbanes-Oxley Act.

OPERATING PROFIT. As a result of all of the above, reported operating income in 2004 was \$65.7 million (7.0% of revenues), as compared to \$54.3 million (6.1% of revenues) in 2003.

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FINANCING EXPENSES (NET). Net financing expenses in 2004 were \$5.9 million, as compared to \$4.9 million in 2003. The increase in the net finance expense resulted mainly from a decrease in finance income as a result of a lower level of cash and cash equivalents as well as costs incurred in hedging with regards to Great Britain Pounds (GBP).

TAXES ON INCOME. Our tax rate represents a weighted average of the tax rates to which the various companies in the Group are subject. Provision for taxes in 2004 was \$15.2 million (effective tax rate of 25.1%), as compared to a provision for taxes of \$11.3 million (effective tax rate of 22.9%) in 2003. The change in the effective tax rate is attributable to the mix of the tax rates in the various tax jurisdictions in which the Group's companies generating the taxable income operate.

SHARE IN EARNINGS OF AFFILIATED ENTITIES. In 2004, we had net income of \$7.8 million from our share in earnings of affiliated entities, as compared to

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\$7.2 million in 2003. The companies and partnerships, in which Elbit Systems holds 50% or less in shares or voting rights and are therefore not consolidated in our financial statements, operate in complementary areas to our core business activities, including electro-optics and airborne systems. We believe that our affiliates will continue to contribute significantly to our earnings.

NET EARNINGS AND EARNINGS PER SHARE (EPS)

Net earnings in 2004 were \$53 million (5.6% of revenues), as compared to net earnings of \$45.9 million (5.1% of revenues) in 2003. Fully diluted EPS was \$1.29 in 2004, as compared to \$1.14 in 2003.

The number of shares used for computation of diluted EPS in the year ended December 31, 2004 was 41,041 thousand shares, as compared to 40,230 thousand shares in the year ended December 31, 2003. The increase in the number of shares used for computation of diluted EPS was due mainly to exercise of options by employees during 2003 and 2004, and the change in Elbit Systems' share price.

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2003 COMPARED TO 2002

REVENUES

Our consolidated revenues increased by 8.5%, from \$827.5 million in 2002 to \$898.0 million in 2003.

Our revenues generated by groups of areas of operations in 2002 and 2003 were as follows:

| | Year ended | | |
|---|-------------------|-------|---------|
| | December 31, 2003 | | De |
| | \$ millions | % | \$ mill |
| Airborne systems | 373.6 | 41.6 | 3 |
| Land vehicle systems | 199.8 | 22.2 | 1 |
| C4ISR systems | 133.9 | 14.9 | 1 |
| Electro-optics systems | 140.5 | 15.7 | 1 |
| Other (mainly non-defense engineering and production services) | 50.2 | 5.6 | — |
| | ----- | ----- | — |
| Total | 898.0 | 100.0 | 8 |
| | ===== | ===== | = |

We maintained our revenue from airborne systems projects, resulting mainly from upgrade programs in their final stages and newer projects in Brazil and other countries. Revenues also included new programs in the U.S. (F-16 and others). The increase in the land vehicle systems revenues of approximately 47% was mainly due to revenues from the major projects Elbit Systems and our subsidiaries performed in Israel (Merkava), and in the U.S. (Bradley and MLRS).

The geographic breakdown of revenues in 2002 and 2003 was as follows::

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| | Year ended | | |
|-----------------|-------------------|-------|-------------|
| | December 31, 2003 | | Decem |
| | \$ millions | % | \$ millions |
| Israel | 255.7 | 28.5 | 225.7 |
| United States | 332.3 | 37.0 | 267.7 |
| Europe | 109.4 | 12.2 | 144.9 |
| Other countries | 200.5 | 22.3 | 189.2 |
| | ----- | ----- | ----- |
| Total | 898.0 | 100.0 | 827.5 |
| | ===== | ===== | ===== |

Revenues are generated mainly from sales to the United States, Israel and countries in Europe, Latin America and Asia. Revenues from customers in the United States increased by 24%, from \$267.7 million to \$332.3 million. Revenues also increased in other countries, mainly in Latin America and Asia, while revenues in Europe declined as deliveries under some major programs entered final phases. The IMOD accounted for 20% of our revenues in 2002 and 21% in 2003 and was the only customer to exceed 10% of our revenues in those years.

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GROSS PROFIT

Reported gross profit in 2003 was \$225.3 million (with a gross profit margin of 25.1%) as compared to \$222.1 million (gross profit margin of 26.8%) in 2002.

Our cost of goods sold in the year ended December 31, 2003 included \$2.6 million in non-cash expenses resulting from our phantom option plan, as compared to income of \$0.5 million in the year ended December 31, 2002.

The reduction in gross profit margin resulted mainly from our ongoing involvement in significant engineering projects that required investment of increased time and costs in order to achieve project milestones. These projects represent cutting edge technology and were mainly in the areas of aerial reconnaissance, space-based electro-optic payloads and advanced airborne systems. In addition, our gross profit in 2003 was negatively impacted by the increase in the value of the NIS against the U.S. dollar.

R&D. Gross R&D expenses in 2003 totaled \$65.5 million (7.3% of revenues), as compared with \$62.6 million (7.6% of revenues) in 2002. Net R&D expenses (after deduction of third party participation, including the IMOD and the OCS) in 2003 totaled \$54.9 million (6.1% of revenues), as compared to \$57.0 million (6.9% of revenues) in 2002.

MARKETING AND SELLING EXPENSES. Marketing and selling expenses in 2003 were \$69.9 million (7.8% of revenues), as compared to \$65.7 million (7.9% of revenues) in 2002. The increase in these expenses was due mainly to increased marketing efforts in the U.S. and European markets, in view of identified business opportunities.

G&A EXPENSES. Reported G&A expenses in 2003 were \$46.1 million (5.1% of revenues), as compared to \$41.7 million (5.0% of revenues) in 2002. In the

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second half of 2003, our G&A expenses consolidated for the first time the expenses related to newly acquired companies (European Subsidiary and AD&D). Additional increases in G&A expenses in 2003 compared to 2002 were related to an increase in insurance expenses and the cost of various audit and control activities, including expenses related to compliance with the U.S. Sarbanes-Oxley Act of 2002.

OPERATING INCOME. As a result of all of the above, reported operating income in 2003 was \$54.3 million (6.1% of revenues), as compared to \$57.8 million (7.0% of revenues) in 2002. For the year ended December 31, 2003, our operating profit included \$4.7 million in non-cash expenses associated with our phantom option plan, as compared to an income of \$0.9 million in the year ended December 31, 2002.

FINANCING EXPENSES (NET). Net financing expenses in 2003 were \$4.9 million, as compared to \$3.0 million of net financing expenses in 2002. The increase in the net financing expenses during the year ended December 31, 2003, as compared to the year ended December 31, 2002, resulted mainly from a higher level of short-term loans from banks, and from the effect of the devaluation in 2003 of the U.S. dollar against the NIS on NIS denominated loans.

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TAXES ON INCOME. Provision for taxes in 2003 was \$11.3 million (effective tax rate of 22.9%), as compared to a provision for taxes of \$9.3 million (effective tax rate of 17.2%) in 2002. The provision for taxes in 2002 included reduction of tax expenses in the amount of \$2.8 million that was made in the third quarter of 2002, due to adjustment of estimated taxes and completion of tax assessments for prior years in respect of various Group entities. Excluding the tax reduction mentioned above, our tax rate for the year 2002 would have been 22.4%.

SHARE IN EARNINGS OF AFFILIATED ENTITIES. In 2003, we had net income of \$7.2 million from our share in earnings of affiliated entities, as compared to \$0.7 million in 2002. The affiliated entities in which we hold 50% or less in shares or voting rights and are therefore not consolidated in our financial statements, operate mainly in our core business areas, including electro-optics and airborne systems. The earnings from affiliated entities in 2003 resulted mainly from SCD and VSI. See above - Item 4. Information on the Company - Principal Subsidiaries.

NET EARNINGS AND EPS

Net earnings in 2003 were \$45.9 million (5.1% of revenues), as compared to net earnings of \$45.1 million (5.5% of revenues) in 2002. Fully diluted EPS was \$1.14 in 2003, as compared to \$1.13 in 2002.

The number of shares used for computation of diluted EPS in 2003 was 40,230 thousand shares, as compared to 39,863 thousand shares in 2002. The increase in the number of shares used for computation of diluted EPS was due mainly to the exercise of options by employees during 2003.

CONDITIONS IN ISRAEL

For information on how our operating results may be affected by conditions in Israel see above - Item 3. Key Information - Risks Factors - Risks Related to Our Israeli Operations; and Item 4. Information on the Company - Conditions in Israel.

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LIQUIDITY AND CAPITAL RESOURCES

CASH FLOW

Our cash flow is affected by the cumulative cash flow of our various projects in the reported periods. Project cash flows are affected by the timing of the receipt of advances and the collection of accounts receivable from customers, as well as the timing of payments made by us in connection with the performance of the project. The receipt of payments usually relates to specific events during the project, while expenses are ongoing. As a result, our cash flow may vary from a period to another. Our policy is to invest our cash surplus mainly in interest bearing deposits, in accordance with our projected needs.

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FINANCIAL RESOURCES

The financial resources available to us include profits, collection of accounts receivable, advances from customers and Government of Israel and other third parties' programs such as the OCS and development grants. In addition, Elbit Systems has access to bank credit lines and financing in Israel and abroad based on our capital, assets and activities. We also have the possibility of raising funds through offering of securities to the public from time to time subject to market conditions. Elbit Systems and some subsidiaries are obligated to meet various financial covenants set forth in our respective loan and credit agreements. Such covenants include requirements such as for shareholders' equity, current ratio, operating profit margin, tangible net worth, EBITDA, interest coverage ratio and total leverage. As of May 31, 2005, each of the companies subject to financial covenants was in compliance with the applicable covenants.

On December 31, 2004, we had total borrowings in the amount of \$96.5 million, including \$86.2 million in long-term loans, and \$380 million in guarantees issued on our behalf by banks, mainly in respect of advance payment and performance guarantees provided in the regular course of business. On December 31, 2004, we had a cash balance amounting to \$34.1 million.

As of December 31, 2004, we had working capital of \$172.6 million, and our current ratio was 1.46. Our ratio of equity to total assets was 41.8%.

In 2003, the Controller of the Banks in Israel instituted regulations governing lending by Israeli banks to groups of affiliated borrowers. Under these regulations the banks are limited in their maximum exposure to groups of affiliated companies under a combined lending ceiling based on objective and subjective guidelines. As a result, our borrowing capacity may be limited under certain circumstances, even if we have unused lines of credit, due to borrowing by companies affiliated with shareholders that are defined by the Controller of the Banks as our controlling shareholders. As a result we developed credit facilities that will not be affected by these regulations.

For further information on the level and maturity of our borrowings, see below - Item 18. Financial Statements - Note 10 (Short-Term Bank Credit and Loans) and Note 13 (Long-Term Loans). We believe our working capital is sufficient to support our current requirements.

2004 CASH FLOW

Our net cash flow generated from operating activities in 2004 was \$81.5 million, resulting mainly from net income for the period and increase of

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accounts payable, which was partly offset by a decrease in advances from customers.

Net cash flows used for investment activities in the year ended December 31, 2004 were \$70.9 million, which were used mainly for procurement of property, plant and equipment and investment in Tadiran Communications' shares. The investments in fixed assets were made primarily in equipment for the Group's various manufacturing plants and in a building constructed at Elbit Systems' facility in Haifa, Israel.

Net cash flow used for financing activities in 2004 was \$52.6 million, which were used mainly for paying dividends.

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2003 CASH FLOW

Our net cash flow generated from operating activities in 2003 was \$91.4 million. Net cash flow used for investment activities in 2003 was \$53.8 million, which was used mainly for procurement of property, plant and equipment. The investments were primarily in equipment for the Group's various manufacturing plants and in buildings constructed at Elbit Systems' facility in Haifa, Israel and El-Op's site in Rehovot, Israel.

Net cash flow used for financing activities in 2003 was \$37.7 million, which was used mainly for reduction of long-term loans and dividends payable, which were partially offset by proceeds from the exercise of share options. On December 31, 2003, we had total borrowings in the amount of \$77.4 million, including \$15 million in short-term loans. On December 31, 2003, we had a cash balance amounting to \$76.8 million. As of December 31, 2003, we had working capital of \$198.9 million, our current ratio was 1.52 and our ratio of equity to total assets was 44%.

MATERIAL COMMITMENTS FOR CAPITAL EXPENDITURES

We believe that we have adequate sources of funds to meet our material commitments for capital expenditures for the fiscal year ended December 31, 2004 and the subsequent fiscal year. See above "Financial Resources". Our specific material commitments for capital expenditures as of December 31, 2004 and May 31, 2005 were approximately \$3 million and \$2 million respectively. See also below - Item 18. Financial Statements - Consolidated Statements of Cash Flows and Note 8 (Property, Plant and Equipment, Net) to the Financial Statements.

IMPACT OF INFLATION AND EXCHANGE RATES

FUNCTIONAL CURRENCY

Our functional currency is the U.S. dollar, which is the currency we use for most of our consolidated operations. A majority of our sales are made outside of Israel in non-Israeli currency, mainly U.S. dollars, as are a majority of our purchases of materials and components. Transactions and balances originally denominated in U.S. dollars are presented in their original amounts. Transactions and balances in currencies other than the U.S. dollar are remeasured in U.S. dollars according to the principles set forth in Statement No. 52 of the Financial Accounting Standards Board. Exchange gains and losses arising from remeasurement are reflected in the income statement.

MARKET RISKS AND VARIABLE INTEREST RATES

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Market risks relating to our operations result mainly from changes in interest rates and exchange rates. We typically use financial instruments to limit exposure to changes in exchange rates. We also typically enter into forward contracts in connection with transactions where the contract has been signed and that are denominated in currencies other than U.S. dollars and NIS. We also enter from time to time into forward contracts and other hedging instruments related to NIS based on marked conditions.

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On December 31, 2004, our liquid assets were comprised of bank deposits. Our deposits and loans are based on variable interest rates. Should interest rates either increase or decrease, such change may affect our results of operations due to changes in the cost of our liabilities and the return on our assets that are based on variable rates.

NIS/U.S. DOLLAR EXCHANGE RATES

We attempt to manage our financial activities in order to reduce material financial losses in U.S. dollar terms resulting from the impact of inflation and exchange rate fluctuations on our non-U.S. dollar assets and liabilities. Our income and expenses in Israeli currency are translated into U.S. dollars at the prevailing exchange rates. Consequently, we are affected by changes in the NIS/U.S. dollar exchange rates. On December 31, 2003 and 2004, we had exposure due to NIS denominated liabilities of \$44 million and \$57 million, respectively, in excess of NIS denominated assets. These liabilities represent mostly provisions for wages and trade payables. The amount of our exposure to the changes in the NIS/U.S. dollar exchange rate may vary from time to time. In order to hedge against certain expected NIS payments, we entered into forward contracts. On December 31, 2004, we had no hedging contracts covering NIS exposure.

INFLATION AND DEVALUATION

The U.S. dollar cost of our operations in Israel is influenced by any increase in the rate of inflation in Israel that is not fully offset by the devaluation of the NIS in relation to the U.S. dollar. Unless inflation in Israel is offset by a devaluation of the NIS, it may have a negative effect on the profitability of contracts where Elbit Systems or any of our Israeli subsidiaries receives payment in U.S. dollars, NIS linked to U.S. dollars or other foreign currencies, but incurs expenses in NIS linked to the CPI. Inflation in Israel and currency fluctuations may also have a negative effect on the profitability of fixed price contracts where we receive payments in NIS.

In the past, our profitability was somewhat negatively affected when inflation in Israel exceeded the devaluation of the NIS against the U.S. dollar and at the same time we experienced corresponding increases in the U.S. dollar cost of our operations in Israel. For example, in 2001, the inflation rate was approximately 1.4% and the devaluation rate was 9.3%. In 2002, the inflation rate was approximately 6.5% and the devaluation rate was 7.3%. In 2003, the inflation rate was approximately negative 1.9% and the devaluation rate was negative 7.6%. In 2004, the inflation rate was approximately 1.2%, the devaluation rate was negative 1.6%. There can be no assurance that we will not be materially adversely affected in the future if inflation in Israel exceeds the devaluation of the NIS against the U.S. dollar or if the timing of such devaluation lags behind increases in inflation in Israel.

A devaluation of the NIS in relation to the U.S. dollar also has the

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effect of decreasing the dollar value of any of our assets that consist of NIS or accounts receivable denominated in NIS, unless such accounts receivable are linked to the U.S. dollar. Such a devaluation also has the effect of reducing the U.S. dollar amount of any of our liabilities that are payable in NIS, unless such payables are linked to the U.S. dollar. On the other hand, any increase in the value of the NIS in relation to the U.S. dollar will have the effect of increasing the U.S. dollar value of any unlinked NIS assets as well as the U.S. dollar amount of any unlinked NIS liabilities and expenses.

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FOREIGN CURRENCY EXPENSES, DERIVATIVES AND HEDGING

While our functional currency is the U.S. dollar, we also have some non-U.S. dollar or non-U.S. dollar linked currency exposure for currencies other than NIS. These are mainly non-U.S. dollar customer debts, payments to suppliers and subcontractors, obligations in other currencies, assets or undertakings. Some subcontractors are paid in local currency under prime contracts where we are paid in U.S. dollars. The exposure on these transactions has not been in amounts that are material to Elbit Systems. However, when we view it necessary, we seek to minimize our foreign currency exposure, by entering into hedging arrangements, obtaining periodic payments upon the completion of milestones, obtaining guarantees and security from customers and sharing currency risks with subcontractors.

Most of our assets and liabilities that are denominated in currencies other than the NIS and the U.S. dollar were covered as of December 31, 2004 by forward contracts and options. On December 31, 2004, we had forward contracts and options for the sale and purchase of Euro, GBP and various other currencies). All of the forward contracts and options, as of December 31, 2004, are expected to mature during 2005.

The table below presents (in millions) the balance of the hedging acquired in derivative instruments in order to limit the exposure to exchange rate fluctuations as of December 31, 2004 and is presented in U.S. dollar equivalent terms.

| FORWARD ----- | NOTIONAL AMOUNT ----- | FAIR VALUE OF DERIVATIVE ----- |
|-----------------------------|--------------------------|--------------------------------------|
| Buy US\$ and Sell: ----- | | |
| Euro | 9.1 | (0.1) |
| GBP | 5.1 | (0.4) |
| Other various currencies | 3.9 | (0.3) |
| | --- | --- |

| FORWARD ----- | NOTIONAL AMOUNT ----- | FAIR VALUE OF DERIVATIVE ----- |
|-----------------------------|--------------------------|--------------------------------------|
| Buy US\$ and Sell: ----- | | |
| Euro | 11.8 | 0.3 |
| GBP | 0.3 | 0 |
| Other various currencies | 0.7 | 0 |
| | --- | --- |

| OPTIONS | NOTIONAL AMOUNT | FAIR VALUE OF DERIVATIVE |
|---------|-----------------|-----------------------------|
| | | |

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| Buy US\$ and Sell: | | |
|--------------------|-----|---|
| GBP | 154 | 0 |
| | === | = |

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CONTRACTUAL OBLIGATIONS

PAYMENTS DUE BY PERIOD

 (U.S. dollars in millions)

| | LESS THAN 1 YEAR | 1-3 YEARS | 3-5 YEARS |
|---|---------------------|-----------|-----------|
| 1. Long-Term Debt | \$1.7 | \$83.1 | \$0.3 |
| 2. Capital Lease Obligations | -- | -- | -- |
| 3. Operating Leases | 6.7 | 10.5 | 6.1 |
| 4. Purchase Obligations* | 270.1 | 67.2 | 5.2 |
| 5. Other Long-Term Liabilities Reflected on the Issuer's Balance Balance Sheet Under GAAP** | -- | -- | -- |
| Total | \$278.5 | \$160.8 | \$11.3 |
| | ===== | ===== | ===== |

* For further description of the Purchase Obligations see above "Off-Balance Sheet and Other Long-Term Arrangements and Commitments - Purchase Commitments" and see below - Item 18. Financial Statements - Note 16H (Commitments and Contingent Liabilities - Contractual Obligations).

** See above - Item 4. Information on the Company - Buy-Back.

OFF-BALANCE SHEET TRANSACTIONS

See above "General - Off-Balance Sheet and Other Long-Term Arrangements and Commitments."

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ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES.

DIRECTORS AND EXECUTIVE OFFICERS

The directors and executive officers of Elbit Systems as of May 31, 2005 are as follows:

BOARD OF DIRECTORS

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| NAME ---- | AGE --- | DIRECTOR SINCE ----- |
|-------------------------------------|------------|-------------------------|
| Michael Federmann (Chairman) | 62 | 2000 |
| Moshe Arad | 70 | 2005 |
| Avraham Asheri | 67 | 2000 |
| Rina Baum | 60 | 2001 |
| Aharon Beth-Halachmi | 69 | 2000 |
| Jonathan Kolber | 43 | 2005 |
| Yigal Ne'eman | 63 | 2004 |
| Yaacov Lifshitz (External Director) | 61 | 2003 |
| Dov Ninveh | 58 | 2000 |
| Nathan Sharony (External Director) | 70 | 2002 |

The term of office of each director, other than the External Directors, expires at the annual general shareholders meeting to be held during 2005. The term of office for Nathan Sharony as an External Director expires in March 2008 and for Yaacov Lifshitz as an External Director in July 2006.

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EXECUTIVE OFFICERS

| NAME ---- | AGE --- | POSITION ----- |
|-------------------|------------|--|
| Joseph Ackerman | 56 | President, Chief Executive Officer and Director |
| David Block Temin | 50 | Corporate Vice President and General Counsel |
| Guy Brill | 53 | Corporate Vice President and Co-General Manager - Technologies and Operations |
| Itzhak Dvir | 57 | Corporate Vice President and Chief Operating Officer |
| Jacob Gadot | 58 | Corporate Vice President - Mergers and Acquisitions |
| Ran Galli | 56 | Corporate Vice President - Major Campaigns |
| Joseph Gaspar | 57 | Corporate Vice President and Chief Financial Officer |
| Zeev Gofer | 53 | Corporate Vice President - Business Development and Marketing |
| Dalia Gonen | 53 | Vice President - Human Resources |
| Ran Hellerstein | 54 | Corporate Vice President and Co-General Manager - Airborne and Helmet Systems |
| Haim Kellerman | 51 | Corporate Vice President and General Manager - UAV Systems |
| Bezhalel Machlis | 42 | Corporate Vice President and General Manager - Land Systems and C4I |
| Ilan Pacholder | 50 | Corporate Secretary and Vice President - Finance and Capital Markets |
| Marco Rosenthal | 58 | Corporate Vice President and Co-General Manager - Technologies and Operations |
| Haim Rousso | 59 | Corporate Vice President and General Manager - El-Op |
| Gideon Sheffer | 56 | Corporate Vice President - Strategic Planning |
| Yoram Shmuely | 45 | Corporate Vice President and Co-General Manager - Airborne and Helmet Systems |

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Timothy Taylor

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President and Chief Executive Officer - EFW

MICHAEL FEDERMANN. Michael Federmann has served as Chairman of the Board of Directors since the merger with El-Op in 2000. He served as Chairman of the Board of Directors of El-Op from 1988 until the merger. He has held managerial positions in the Federmann Group since 1969, and since 2002 he has served as Chairman and CEO of Federmann Enterprises Ltd. (FEL). Currently, he also serves as Chairman of the Board of Directors of Dan Hotels Corp. Ltd. (Dan Hotels). Mr. Federmann is Deputy Chairman of the Board of Governors of the Hebrew University in Jerusalem (the Hebrew University) and a member of the Board of Governors and the Executive Committee of the Weizmann Institute of Science. Mr. Federmann holds a bachelor's degree in economics and political science from the Hebrew University.

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MOSHE ARAD. Moshe Arad served as Vice President for External Relations of the Hebrew University from 1994 to 2004. He currently serves on the board of directors of Discount Investment Corporation Ltd. From 1994 to 1999, he was member of the board of directors of Elbit Ltd. During 1992 and 1993, Mr. Arad served as Director General of the Israel Ministry of Communications. From 1990 to 1992, he was a member of the Tel-Aviv law firm of Herzog, Fox, Ne'eman. Mr. Arad served as Israel's Ambassador to the United States from 1987 to 1990 and as Israel's Ambassador to Mexico from 1983 to 1987. Ambassador Arad holds a bachelor's degree in political science and international relations and a L.L.B. degree from the Hebrew University.

AVRAHAM ASHERI. Avraham Asheri has served as an economic advisor and a director of several companies since 1998. He currently serves on the boards of directors of Elron Electronic Industries Ltd., Discount Mortgage Bank Ltd., Kardan Nadlan Ltd., Scitex Corporation Ltd. (Scitex) and Africa Israel Investment Ltd. Mr. Asheri was President and Chief Executive Officer of Israel Discount Bank from 1991 until 1998, and Executive Vice President and member of its management committee from 1983. Prior to that, he served for 23 years at the Israel Ministry of Industry and Trade and at the Israel Ministry of Finance, including as Director General of the Israel Ministry of Industry and Trade, Managing Director of the Israel Investment Center and Trade Commissioner of Israel to the United States. Mr. Asheri holds a bachelor's degree in economics and political science from the Hebrew University.

RINA BAUM. Rina Baum is Vice President for Investments of Federmann Enterprises and since 1986 has served as Director and General Manager of Unico Investment Company Ltd. and other managerial positions within the Federmann Group. She serves as a director of Dan Hotels, Etanit Building Products Ltd. and Harel Mutual Funds Ltd. Mrs. Baum holds an L.L.B. degree from the Hebrew University.

AHARON BETH-HALACHMI. Aharon Beth-Halachmi has served as President of Federmann Enterprises - Division of Industries and Technologies since 1985 and as President of Eurofund L.P. - Venture Capital Fund since 1994. He served as a director of El-Op from 1985 until 2000. From 1983 to 1985, he served as President of Tahal Engineering Co. Ltd. From 1982 to 1983, he was Director General of the IMOD. Prior to that he served in the IDF, including as head of Defense Research and Development from 1977 to 1982. He retired with the rank of Brigadier General. Mr. Beth-Halachmi holds a bachelor of science degree in electronic engineering from the Israel Institute of Technology (the Technion)

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and a master of science degree in computer science from the Naval Postgraduate School in Monterey, California.

JONATHAN B. KOLBER. Jonathan Kolber has served as Chief Executive Officer of Koor Industries Ltd. (Koor) since 1998. Mr. Kolber served as the Vice Chairman of the Board of Directors of Koor from 1997 to 2003. He served as President of Claridge Israel Ltd. from 1989 to 2001 and as Vice President of Claridge Inc. from 1986 to 1990. Mr. Kolber was associated with Cemp Investments from 1985 to 1987. He serves as a director of several Israeli companies, including ECI Telecom Ltd., Makhteshim-Agan Industries Ltd., Telrad Networks Ltd., Sheraton-Moriah Israel Ltd. and Knafaim - Arkia Holdings Ltd. Mr. Kolber holds a bachelor's degree in near eastern languages and civilizations from Harvard University and a certificate on advanced Arabic from the American University of Cairo.

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YAACOV LIFSHITZ (EXTERNAL DIRECTOR). Yaacov Lifshitz serves as a director of several companies and as a lecturer in the fields of economics, public policy and management. He currently is a lecturer at the Department of Economics and the Department of Public Policy and Management of Ben-Gurion University and at the Department of Political Sciences of the Tel-Aviv University. He also currently serves on the boards of directors of Israel Discount Bank, Kali - Insurance Agencies Ltd., Springs - Pension Fund Management Ltd., Carmel Investments Ltd. and Tesnet Software Testing Ltd. During the period from 1994 to 2002, Mr. Lifshitz served at various times as the chairman of the boards of directors of Hamashbir Lazarchan Israel Ltd., Israel Military Industries Ltd., Spectronix Ltd., Dor Chemicals Ltd., Dor Energy Ltd., DorGas Ltd. and the Israeli Foreign Trade Risk Insurance Corp. Ltd. He also served from 1995 to 2002 as the Chairman of the Executive Board of the Israel Management Center. Prior to that he held various senior positions in government, banking and industry, including Director General of the Israel Ministry of Finance, Chief Economic Advisor to the IMOD, Senior Vice President and Chief Credit Officer of Israel Discount Bank and President and CEO of Electra (Israel) Ltd. Mr. Lifshitz holds a bachelor's degree in economics and political science and a master's degree in economics from the Hebrew University.

YIGAL NE'EMAN. Yigal Ne'eman has served since 1994 as the Chairman and President of the Israel College. From 1989 to 1993, he served as Chairman and as a shareholder of several industrial, commercial and service companies. Mr. Ne'eman served as the President and CEO of Tadiran Electronic Industry Ltd. (Tadiran) from 1981 to 1989. Prior to that he held a number of management positions in the control and finance departments of Tadiran. Mr. Ne'eman is a certified public accountant and holds an accounting degree from the Hebrew University.

DOV NINVEH. Dov Ninveh has served since 1994 as Chief Financial Officer and a manager in Federmann Enterprises. He serves as a director of Dan Hotels and Etanit Ltd. Mr. Ninveh served as a director of El-Op from 1996 until 2000. From 1989 to 1994, he served as Deputy General Manager of Etanit Building Products Ltd. Mr. Ninveh holds a bachelor's degree in economics and management from the Technion.

NATHAN SHARONY (EXTERNAL DIRECTOR). Nathan Sharony has served since 1997 as a director for several companies. He currently serves as a director for Technorov Holdings (1993) Ltd. (Technorov), a high technology investment company, Bituach Yashir Ltd., Union Bank, Ormat Industries Ltd., Genoa Technologies Ltd. and Israel Bonds International Inc. From 1997 to 1999, he served as Chairman of Technorov. From 1994 to 1997, he was Chief Executive

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Officer of Israel Bonds, a U.S. brokerage. Mr. Sharony served as the Director General of the Israel Ministry of Industry and Trade from 1992 to 1994. Prior to that, Mr. Sharony held a number of positions in industry and government including head of the Israeli Government Economic Mission to the U.S., President and Chief Executive Officer of El-Op and Vice President for Logistics of Tadiran Ltd. In 1982, Mr. Sharony completed 30 years of service in the IDF, retiring with the rank of Major General. Mr. Sharony participated in the Field Artillery Battery Officers Course in Fort Sill, Oklahoma.

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JOSEPH ACKERMAN. Joseph Ackerman was appointed as President and Chief Executive Officer in 1996. From 1996 to November 2004, he served as a member of the board of directors of the Company. From 1994 to 1996, he served as Senior Vice President and General Manager of Elbit Ltd.'s Defense Systems Division (EDS). Mr. Ackerman joined Elbit Ltd. in 1982 and held various management positions, including General Manager - EFW, Senior Vice President - Operations Group, Vice President - Operations and Vice President - Advanced Battlefield Systems. He serves as a director for Tadiran Communications. Mr. Ackerman holds a bachelor of science degree in aeronautical engineering from the Technion.

DAVID BLOCK TEMIN. David Block Temin was appointed Corporate Vice President in 2000 and has served as General Counsel since 1996. From 1987 to 1996, he was a Legal Advisor to Elbit Ltd. Prior to that, Mr. Block Temin was an attorney with law firms in New York City. Mr. Block Temin received a juris doctor degree as well as a master of arts degree in international relations from Stanford University and holds a bachelor of arts degree in political science from the University of Maryland. He is admitted to the Israeli and New York bars.

GUY BRILL. Guy Brill was appointed as Corporate Vice President and Co-General Manager - Technologies and Operations Division in March 2005. From 2001 until his current appointment, he served as Corporate Vice President - Business Synergy of Elbit Systems U.S. Corp., a U.S. subsidiary of the Company. Prior to that he held various management positions including Elbit Systems' Chief Operating Officer, Co-Manager of the C(3) and Battlefield Information Systems Strategic Business Unit, Vice President for Processes Improvement and Quality and Vice President and Division Manager of the Command and Control Systems Division of EDS. Mr. Brill joined Elbit Ltd. in 1985. Prior to that, Mr. Brill served in the IDF in the R&D branch of the Ground Forces, and as an artillery officer, where he holds the rank of Colonel (reserve). Mr. Brill holds a bachelor of science degree in electronic engineering from the Technion and a master of science of management degree from the Polytechnic University of New York. He is also a graduate of the Harvard University Business School's Advanced Management Program.

ITZHAK DVIR. Itzhak Dvir was appointed as Chief Operating Officer in July 2004. He was appointed as a Corporate Vice President in 2000. Mr. Dvir served as General Manager - UAV, Tactical and Security Systems from 2003 until his current appointment. From 2000 through 2002, he was General Manager - C4I and Battlefield Systems. From 1996 until 2000, he was Vice President and Division Manager - UAV and C(3) Division. Mr. Dvir joined Elbit Ltd. in 1989 and held various management positions, including Vice President - UAV Division, Vice President - Advance Battlefield Systems Division and Marketing Director - Battlefield Systems Division. Prior to that he served as a career officer in the IAF, retiring with the rank of Colonel. Mr. Dvir holds a bachelor of science degree in aeronautical engineering from the Technion and a master of science degree in aeronautical engineering from the U.S. Air Force Institute of Technology at Wright Patterson Air Force Base.

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JACOB GADOT. Jacob Gadot was appointed Corporate Vice President - Mergers and Acquisitions in 2000. He served as Chief Technology Officer from 2001 until March 2004. Mr. Gadot held the position of Vice President - Mergers and Acquisitions from 1998 to 2000 and Vice President - Business Development from 1996 to 1998. Mr. Gadot joined Elbit Ltd. in 1983 and held various positions in EDS, including Vice President - International Marketing and head of the Airborne Division. Prior to that, he worked for Motorola Israel, after serving for ten years as an officer in the IAF. He serves as a director for Tadiran Communications. Mr. Gadot holds a bachelor of science degree in electrical engineering from the Technion.

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RAN GALLI. Ran Galli was appointed Corporate Vice President - Major Campaigns in 2003. From 1999 until 2003 he served as Corporate Vice President - Business Development and Marketing. Mr. Galli joined Elbit Systems in 1997 as Vice President - Business Development. Prior to that, he served as Corporate Vice President - Business Development and Marketing at Rafael, which he joined in 1990, after retiring from the IAF with the rank of Colonel. In the IAF he served as head of Research and Development, following numerous aircraft program management positions. Mr. Galli holds bachelor and master of science degrees in aeronautical engineering from the Technion.

JOSEPH GASPAR. Joseph Gaspar was appointed Corporate Vice President and Chief Financial Officer in 2001. He served as Corporate Vice President - Strategy, Technology and Subsidiaries from the El-Op merger in 2000 until 2001. From 1996 until the merger, he held the position of Corporate Vice President, Marketing and Business Development of the El-Op Group. Mr. Gaspar joined El-Op in 1975 and held several management positions, including Vice President and General Manager of El-Op's Optronics Product Division and co-manager of an El-Op subsidiary in the United States. He serves as a director for Tadiran Communications. Mr. Gaspar holds a bachelor of science degree from the Technion in electronic engineering with advanced studies in digital signal processing and communication.

ZEEV GOFER. Zeev Gofer was appointed Corporate Vice President - Business Development and Marketing in 2003. He previously served as Corporate Vice President and as Co-General Manager - Aircraft and Helicopter Upgrades and Systems from 2000. From 1999 until 2000, he was Vice President - Aircraft Upgrades and Airborne Systems Division, having served as Division Manager since 1996. He joined Elbit Ltd. in 1982 and held various management positions, including Director of EDS' Aircraft Upgrade Division, director of a major aircraft upgrade program, director of avionics system engineering and technical manager of the LAVI avionics program. Mr. Gofer holds bachelor and master of science degrees in electronic engineering from the Technion and a master of science of management degree from the Polytechnic University of New York.

DALIA GONEN. Dalia Gonen was appointed as Vice President - Human Resources in 2000. She became Director of Human Resources in 1996. Ms. Gonen joined Elbit Ltd. in 1971 and held various positions in the Human Resources Department. Ms. Gonen holds a bachelor of arts degree in sociology from Haifa University and a master of science of management degree from the Polytechnic University of New York.

RAN HELLERSTEIN. Ran Hellerstein was appointed Corporate Vice President and Co-General Manager - Aircraft and Helicopter Upgrades and Systems in 2000 and became Co-General Manager - Airborne and Helmet Systems in 2003. From 1996 until 2000, he served as Vice President - Development and Engineering Division,

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having served as Division Manager since 1993. Mr. Hellerstein joined Elbit Ltd. in 1978 and served in various management positions, including Manager of EDS' Engineering Division, department manager, technical manager and systems engineer. Mr. Hellerstein holds bachelor and master of science degrees in electrical engineering from the Technion.

HAIM KELLERMAN. Haim Kellerman was appointed Corporate Vice President and General Manager - UAV Systems in July 2004. From 2002 until his current appointment, Mr. Kellerman was Vice President - UAV Programs. Prior to that he held various senior program management positions relating to UAV, C4I and airborne programs. He joined Elbit Ltd. in 1978. Mr. Kellerman holds a bachelor of science degree in computer science from the Technion.

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BEZHALEL MACHLIS. Bezhalet Machlis was appointed Corporate Vice President and General Manager - Land Systems and C4I in January 2004. In 2003, he served as Corporate Vice President and General Manager - Ground C4I and Battlefield Systems. From 2000 until 2002, he served as Vice President - Battlefield and Information Systems. Mr. Machlis joined Elbit Ltd. in 1991 and held various management positions in the battlefield and information systems area. Prior to that, he served as an artillery officer in the IDF, where he holds the rank of Colonel (reserves). Mr. Machlis holds a bachelor of science degree in mechanical engineering and a bachelor of arts degree in computer science from the Technion and a MBA from Tel-Aviv University.

ILAN PACHOLDER. Ilan Pacholder was appointed as Corporate Secretary and Vice President - Finance and Capital Markets in 2003. From 2001 until his current appointment, Mr. Pacholder served as Vice President - Finance. Mr. Pacholder joined Elbit Ltd. in 1994 and held various senior positions in the Finance Department. Prior to joining Elbit Ltd. he served as the Chief Financial Officer for Sanyo Industries in New York. Before that Mr. Pacholder worked for Bank Leumi in New York for 10 years and held the position of Vice President in the international and domestic lending departments. Mr. Pacholder holds a bachelor of arts degree in accounting and economics from Queens College in New York and a MBA in finance and investments from Adelphi University.

MARCO ROSENTHAL. Marco Rosenthal was appointed Corporate Vice President - Co-General Manager Technologies and Operations in March 2005. He served as Corporate Vice President - Manufacturing and Purchasing from 2001 until his current appointment, having served from 1999 - 2001 as Vice President - Operations and General Manager of the Karmiel facility. From 1996 to 1999, he served as Vice President - Material. Mr. Rosenthal joined Elbit Ltd. in 1975 and held various management positions, including Vice President - Material of EDS and Director of the Sales Department. Mr. Rosenthal holds a degree in technical engineering from the Technion and a degree in business management from Haifa University.

HAIM ROUSSO. Haim Rouso was appointed Corporate Vice President and General Manager of El-Op following the merger in 2000. Prior to that, Mr. Rouso held the position of Corporate Vice President of the El-Op Group and General Manager of El-Op. He has held various managerial positions in El-Op since 1972. Mr. Rouso holds bachelor and master of science degrees in electrical engineering from the Technion.

GIDEON SHEFFER. Gideon Sheffer joined Elbit Systems in 2001 as Corporate Vice President - Strategic Planning. Prior to that he served as Acting Head of Israel's National Security Council and as National Security Advisor to former Prime Minister Ehud Barak. In 1998, he completed 32 years of service in

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the IDF, retiring with the rank of Major General. From 1995 to 1998, he served on the General Staff as Head of the IDF's Human Resources Branch. Before that, he served as Deputy Commander of the IAF. Mr. Sheffer held a number of command positions in the IAF after serving as a fighter aircraft and helicopter pilot. Mr. Sheffer holds a bachelor's degree in Israel studies from Bar Ilan University and is a graduate of the Harvard University Business School's Advanced Management Program.

YORAM SHMUELY. Yoram Shmuely was appointed Corporate Vice President and General Manager - Helmet Mounted Systems in 2000 and became Co-General Manager - Airborne and Helmet Systems in 2003. From 1998 until 2000, he was Vice President - Helmet Mounted Systems Division. From its founding in 1996 until 1998, he served as President of VSI. Mr. Shmuely joined Elbit Ltd. in 1990 and served as director of Elbit Ltd.'s Helmet Mounted Display group. He served as a fighter aircraft pilot in the IAF. Mr. Shmuely holds a bachelor of science degree in electronic engineering from the Technion.

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TIMOTHY TAYLOR. Timothy Taylor was appointed President and Chief Executive Officer of EFW in 2000 after serving as EFW's President and General Manager since 1997. He joined EFW in 1994 and held the positions of Executive Vice President and General Manager, Vice President - Strategic Planning and Business Development and Vice President - Aircraft Systems. A more than 30-year veteran of the aerospace industry, he previously held various management and strategic business development positions with Allied Signal Inc. (now Honeywell) and GEC Marconi Avionics (now BAE Systems). A native of the United Kingdom, he became a U.S. citizen shortly after joining EFW. Mr. Taylor received an engineering degree in England.

COMPENSATION OF DIRECTORS AND OFFICERS

The following table sets forth the aggregate compensation paid to all directors and officers of Elbit Systems as a group, other than the President, and the President individually, for the fiscal year ended December 31, 2004:

| | Salaries, Directors' Fees Commissions and Bonuses(1) | Pension, Retirement and Similar Benefits |
|--|---|---|
| | ----- | ----- |
| All directors and officers other than the President (consisting of [28] persons) | \$5,110,301 | \$562,040 |
| President | \$1,290,840 | \$95,503 |

(1) Elbit Systems' shareholders at the annual general shareholders meeting held in November 2004 approved payment to directors in accordance with maximum regulatory rates payable to External Directors under Israeli law for companies similarly classified based on their shareholding equity. This amount currently includes an annual fee \$10,015 and a per meeting fee of \$388. Such payments are made either directly to the director or to his or her employing company.

Joseph Ackerman, Elbit Systems' President and Chief Executive Officer, served as

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a director until November 2004, however, he did not receive any compensation for service as a director other than his salary as President. Mr. Ackerman's employment contract was originally approved by Elbit Systems' shareholders in 2000, and an amendment was approved in April 2004, when the agreement was extended through July 2006 in accordance with its terms. In April 2005, Elbit Systems' board of directors approved an amendment to Mr. Ackerman's employment agreement increasing his severance benefits to an amount equal to 71 times rather than 48 times his last monthly salary.

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BOARD PRACTICES

APPOINTMENT AND TERMINATION OF DIRECTORS.

The current External Directors on Elbit Systems' board of directors were each appointed to three-year terms at a general meeting of shareholders, held in August 2003 with respect to Mr. Lifshitz and in March 2005 with respect to Mr. Sharony. Six of the other eight current directors were appointed at the annual general meeting of shareholders held in November 2004. The other two current directors, Jonathan Kolber and Moshe Arad, were appointed by the board of directors in April 2005 and May 2005, respectively.

There are no service contracts or similar arrangements with any director that provide for benefits upon termination of directorship. See below - Item 10. Additional Information - General Provisions of Israeli Law and Related Provisions - Appointment of Directors. With respect to the employment agreement of Joseph Ackerman, Elbit Systems' President and Chief Executive Officer, who served as a member of the board of directors until November 2004, see above "Compensation of Directors and Officers".

Nasdaq's director independence and related rules applicable to the board of directors will take effect with respect to Elbit Systems as of July 31, 2005. Under these regulations, unless more than 50% of Elbit Systems shares are held by a single shareholder or affiliated group of shareholders (which is not currently the case) Elbit Systems would not meet the definition of a "controlled company". If it is not a "controlled company", then as of July 31, 2005 the majority of Elbit Systems Ltd.'s board of directors would need to meet the Nasdaq rules director independence criteria. Certain other rules will also become applicable regarding independent directors serving on a director nomination committee and approving the compensation to Elbit Systems' Chief Executive Officer.

For information on contractual arrangements for appointment of directors resulting from the agreements for the Tadiran Communications acquisition, see below - Item 7. Major Shareholders and Related Party Transactions - Agreements Relating to the Tadiran Acquisition.

AUDIT COMMITTEE. Dov Ninveh (chairman), Avraham Asheri, Yaacov Lifshitz, Yigal Ne'eman and Nathan Sharony are currently members of the audit committee of the Board (the Audit Committee). The Audit Committee operates in accordance with an Audit Committee charter that provides the framework for their oversight functions consistent with Israeli and U.S. legal and regulatory requirements. Nasdaq's director independence requirements for audit committee members will take effect with respect to Elbit Systems as of July 31, 2005. See below - Item 10. Additional Information - General Provisions of Israeli Law and Related Provisions - Internal Auditor and Audit Committee; Item 16A. Audit Committee - Financial Expert and Item 16D. Exemptions from Listing Standards for Audit Committees.

EMPLOYEES

Most of our employees are based in Israel, and we have a significant amount of employees in the United States. The total number of employees worldwide and the number of employees in the U.S. at the end of 2004, 2003 and 2002 were as follows:

| | Total Employees ----- | U.S. Employees ----- |
|------|--------------------------|-------------------------|
| 2004 | 5,782 | 1,150 |
| 2003 | 5,449 | 1,110 |
| 2002 | 5,187 | 1,077 |

Most of our Israeli employees have individual employment contracts. However, by law some employees receive rights under a number of general collective bargaining agreements and under Israeli employment laws. See above - Item 4. Information on the Company - Conditions in Israel - Israeli Labor Laws. Approximately 520 of El-Op's employees are covered by a collective bargaining agreement extending through the end of 2004, and El-Op has notified the union of its desire to conduct negotiations regarding the terms of the agreement. Union collective bargaining agreements in effect through December 2004 apply to approximately 175 of Cyclone's employees. Each of El-Op's and Cyclone's collective bargaining agreements continues in effect until a new agreement is reached. Approximately 165 of EFW's employees in Fort Worth are subject to union collective bargaining agreements expiring in November 2005. We believe our overall relationship with our employees is satisfactory.

SHARE OWNERSHIP

ELBIT SYSTEMS' STOCK OPTION PLANS

Elbit Systems adopted employee stock option plans in 1996 (the 1996 Plan) and following the merger with El-Op in 2000 (the Post Merger Plan). Under these Plans, stock options for our ordinary shares were granted to officers and employees of Elbit Systems and wholly-owned subsidiaries. The Plans were designed to enable us to attract and retain employees and to link their incentives to the performance of our ordinary shares. The Plans were approved by our Board and shareholders and described in prospectuses filed with the Israel Securities Authority (the ISA), and summaries were filed with the U.S. Securities and Exchange Commission (the SEC). Although the options themselves are not transferable or registered for trading, the shares underlying the options granted under the Plans were registered for trading with the SEC and the ISA. All options granted under the 1996 Plan have fully vested and expired.

POST MERGER PLAN

OPTIONS GRANTED. Under the Post Merger Plan, 5,000,000 options were authorized to be granted to approximately 800 key employees of Elbit Systems and

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wholly-owned subsidiaries. Approximately 4,500,000 of these options were granted to employees through a trustee in 2000. 400,000 of the options were granted to Joseph Ackerman, Elbit Systems' President and CEO. No other directors were granted options, but executive officers other than Mr. Ackerman were granted an aggregate of 635,000 options under the Post Merger Plan. Approximately 500,000 of the options under the Post Merger Plan were issued to the Plan's trustee in reserve for subsequent grants to key employees, as determined from time to time by Elbit Systems' President. As of May 31, 2005, 269,340 of these reserve options were issued to employees. In addition, options that lapsed or were canceled before exercise could be added to the reserve and re-granted under the Post Merger Plan. The general terms of these options are the same as those for other options granted under the Post Merger Plan. Half of the options granted to any employee under the Post Merger Plan are exercisable into one Elbit Systems ordinary share per option in consideration for the employee's payment to Elbit Systems of the exercise price.

PHANTOM OPTIONS. The second half of the options granted to any employee under the Post Merger Plan consisted of "phantom" options, similar to share appreciation rights. These options entitle the employee, on exercise of the phantom options, to receive shares in an amount corresponding to the value of the difference between the "deemed" option exercise price and the closing TASE trading price on the date before the option exercise date. For phantom options the employee pays only the par value of the shares actually received.

OPTION EXERCISE PRICE. The exercise price for the options granted in December 2000 was \$12.32 per option. The exercise price was determined based upon a discount of 15% from the average trading price of Elbit Systems' shares on the TASE in July and August 2000. The exercise price for options granted under the future reserve is 85% of the average price of Elbit Systems' shares on the TASE for the 60 trading days prior to the specific option grant. The "deemed" option exercise price for the phantom options is the same as the option exercise price for the regular options granted at the same time under the Post Merger Plan.

VESTING. The options vest at the rate of 25% per year following their grant and must be exercised no later than six years after the date of grant. Termination of employment for any reason, except in special circumstances approved by Elbit Systems' President, will result in cancellation of the options that have not vested before termination of employment. Following termination of employment, unexercised options that have vested before the termination must be exercised within 90 days of termination. As of May 31, 2005, options exercisable into approximately 111,430 ordinary shares, based on the shares' May 31, 2005 closing price on Nasdaq of \$24.38, remain unvested under the Post Merger Plan.

SHARE RIGHTS AND TAX CONSEQUENCES. Shares issued to employees as a result of exercise of the options, including phantom options, will bear rights identical to our other ordinary shares. Employees bear all tax consequences to them resulting from the Post Merger Plan. The Israeli tax authorities approved the Post Merger Plan's qualification under Section 102 of the Israeli Income Tax Ordinance (New Version). This enables employees who hold the options at least for two years to be exempt from Israeli tax on the gains derived from exercising the option. This also enables Elbit Systems to benefit from a deductible tax expense that amounts to the employee's above-mentioned gain.

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MAJOR SHAREHOLDERS

PERCENTAGES

Elbit Systems had, as of May 31, 2005, 40,736,047 ordinary shares (1). The following table sets forth specific information as of May 31, 2005, to the best of our knowledge, concerning:

- o beneficial ownership of more than 5% of our outstanding ordinary shares; and
- o the number of ordinary shares beneficially owned by all of our officers and directors as a group.

Federmann Enterprises Ltd.

| | | |
|---------------------|------------|--------|
| 99 Hayarkon Street | | |
| Tel-Aviv, Israel(2) | 17,755,448 | 43.58% |

Heris Aktiengesellschaft

| | | |
|------------------------|---------------|-------|
| c/o 99 Hayarkon Street | | |
| Tel-Aviv, Israel | 3,836,458 (3) | 9.41% |

Bank Leumi Group

| | | |
|---------------------|-----------|-------|
| Tel-Aviv, Israel(4) | 2,364,920 | 5.80% |
|---------------------|-----------|-------|

Bank Hapoalim Group

| | | |
|---------------------|-----------|-------|
| Tel-Aviv, Israel(4) | 2,255,467 | 5.53% |
|---------------------|-----------|-------|

Koor Industries Ltd.

| | | |
|-----------------------------|-----------|-------|
| 14 Hamelacha Street | | |
| Rosh Ha'ayin, Israel(5) (6) | 2,160,000 | 5.30% |

All officers and directors

| | | |
|-------------------------|-------------|-------|
| as a group (28 persons) | 406,648 (7) | 0.99% |
|-------------------------|-------------|-------|

- (1) The total number of ordinary shares includes 23,091 ordinary shares held by a subsidiary of Elbit Systems but excludes 385,000 ordinary shares held by Elbit Systems as treasury shares.
- (2) Federmann Enterprises Ltd. (FEL) owns the shares of Elbit Systems directly and indirectly through Heris Aktiengesellschaft (Heris) which is controlled by FEL. FEL is controlled by Beit Federmann Ltd. (BFL). BFL is controlled by Beit Bella Ltd. (BBL) and Beit Yekutiel Ltd. (BYL). Michael Federmann is the controlling shareholder of BBL and BYL. He is also the Chairman of Elbit Systems' Board and the Chairman of the Board and the Chief Executive Officer of FEL. Therefore, Mr. Federmann controls, directly and indirectly, the vote of the shares owned by Heris and FEL. As of May 31, 2005, 5,655,448 Elbit Systems ordinary shares held by

FEL were pledged to Bank Leumi Le-Israel BM to guarantee loans provided to FEL in connection with FEL's purchase in July 2004 of the Elbit Systems shares held by Elron.

- (3) The amount of shares owned by Heris is included in the amount of shares

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held by FEL as set forth in footnote (1) above.

- (4) The holdings in Elbit Systems' shares by the Bank Leumi and the Bank Hapoalim Group are divided among several entities, mainly mutual and/or provident funds.
- (5) Koor Industries Ltd. (Koor) is an Israeli multi-industry holding company engaged through its direct and indirect wholly and partially owned subsidiaries and affiliates in the following core businesses: telecommunications, defense electronics, agrochemicals and investments in start-ups in the fields of telecommunications and life science. Koor is also involved in tourism, real estate and international trade businesses. The Elbit Systems shares held by Koor have been pledged in favor of Bank Hapoalim as a guarantee for a loan provided by Bank Hapoalim to Koor. The principal shareholders of Koor are Claridge Israel LLC (Claridge Israel), Esarbee Investments Limited (Esarbee) and IDB Development Corporation Ltd. (IDBD). As of May 31, 2005, Claridge Israel held approximately 14.7%, Esarbee held approximately 14.1% and IDBD held approximately 9.7% of Koor's outstanding ordinary shares.

Claridge Israel is a Delaware limited liability company, mainly owned (99%) by The Charles Bronfman Trust. The Charles Bronfman Trust is a trust established under U.S. law primarily for the benefit of Ellen J. Bronfman Hauptman and her issue. Mr. Andrew Hauptman, one of Koor's directors is the husband of Mrs. Ellen J. Bronfman Hauptman, the daughter of Charles R. Bronfman, Koor's Chairman of the Board. The holdings of the Claridge Israel in Koor's shares were pledged in favor of Bank Hapoalim as a guarantee for a loan that was given to Claridge Israel by Bank Hapoalim.

Esarbee, a company registered in Canada, is owned by The Charles Rosner Bronfman Family Trust. The Charles Rosner Bronfman Family Trust is a trust established under the laws of Canada primarily for the benefit of Stephen R. Bronfman and his issue. Mr. Stephen R. Bronfman is the son of Charles R. Bronfman. The holdings of the Esarbee in Koor's shares were pledged in favor of Bank Hapoalim as a guarantee for a loan that was given to Esarbee.

IDBD is controlled (64%) by IDB Holding Corporation Ltd. (IDBH). IDBD and IDBH are public companies traded on the TASE. Approximately 51.7% of the outstanding share capital of IDBH are owned by a group comprised of: (i) Ganden Investments I.D.B. Ltd. (Ganden Investments), a private Israeli company controlled by Nochi Dankner and his sister, Shelly Bergman, which holds 31.02% of the equity of and voting power in IDBH; (ii) Manor Investments-IDB Ltd. (Manor Investments), a private Israeli company controlled by Ruth Manor, which holds 10.34% of the equity of and voting power in IDBH; and (iii) Avraham Livnat Investments (2002) Ltd. (Livnat Investments), a private Israeli company controlled by Avraham Livnat which holds 10.34% of the equity of and voting power in IDBH. Ganden Investments, Manor Investments and Livnat Investments, 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. In addition, Shelly Bergman holds approximately 4.9% of the equity of and voting power in IDBH.

- (6) FEL and Heris (collectively the Federmann Group) and Koor may be deemed

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for purposes of U.S. securities laws to be joint owners of the aggregate ordinary shares of Elbit Systems beneficially owned by them by virtue of a shareholders agreement dated December 27, 2004 between FEL and Koor, which provides, among other things, for Koor to vote at general shareholders meetings of Elbit Systems in accordance with FEL's instructions with certain exceptions. See below "Related Party Transactions - Agreements Related to the Tadiran Acquisition - FEL - Koor Shareholder Agreement". FEL and Koor have each disclaimed beneficial ownership of the other's shares in Elbit Systems.

- (7) This amount does not include any shares that may be deemed to be beneficially owned by Michael Federmann as described in footnote (1) above. The amount includes 239,844 shares underlying options that are currently exercisable or that will become exercisable within 60 days of May 31, 2005. A portion of the underlying options are "phantom options" that have been calculated based on Elbit Systems' May 31, 2005 share closing price on TASE of \$24.38.

RIGHTS IN SHARES, SIGNIFICANT CHANGES IN SHAREHOLDERS AND CONTROLLING SHAREHOLDERS

Except to the extent provided in the Shareholders Agreement entered into on December 27, 2004 between FEL and Koor (the Koor - FEL Shareholders Agreement) described below in "Related Party Transactions - Agreements Relating to the Tadiran Acquisition", Elbit Systems' major shareholders have the same rights as other holders of Elbit Systems' ordinary shares. The only significant changes in shareholdings by major shareholders in the last three years were:

- o In July 2004, FEL purchased approximately 19.6% of Elbit Systems ordinary shares from Elron, resulting in FEL's shareholdings increasing from approximately 30.2% to approximately 49.8%.
- o In April 2005, Koor purchased 2,160,000 ordinary shares from FEL, resulting in FEL's shareholding percentage decreasing from approximately 48.9% to approximately 43.6%. (The 0.9% dilution in FEL's percentage of shareholdings from July 2004 to April 2005 was a result of exercise of options by Elbit Systems' employees under the stock option plan.)

FEL and Koor may be considered under Israeli law as controlling shareholders of Elbit Systems due to the FEL - Koor Shareholders Agreement. See below "Related Party Transactions - Agreement Relating to the Tadiran Acquisition". We are not aware of any other arrangement, including by way of a shareholder agreement or registration rights agreement, that in the future may lead to a change in control of Elbit Systems. Except as provided in the FEL - Koor Shareholders Agreement regarding appointment of directors and the Chairman of the Board, no appointment of a director is made as a result of a related party transaction. Also, there are no outstanding loans by Elbit Systems or its subsidiaries to such persons.

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RELATED PARTY TRANSACTIONS

AGREEMENTS RELATING TO THE EL-OP MERGER

SHAREHOLDERS AGREEMENT. A shareholders agreement was entered into in 1999 between Elron and the Federmann Group in connection with the merger between

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Elbit Systems and El-Op. That shareholders agreement terminated in July 2004 upon the sale of all of Elron's shares in Elbit Systems to FEL.

REGISTRATION RIGHTS AGREEMENT.

Also in connection with the merger with El-Op, in 2000 Elbit Systems, the Federmann Group and Elron entered into a Registration Rights Agreement (the Registration Rights Agreement). Elron's rights under the Registration Rights Agreements ceased upon its sale in July 2004 of Elbit Systems' shares to FEL. Under the FEL - Koor Shareholders Agreement (see below - "Agreements Relating to the Tadiran Acquisition"), so long as Koor holds 5% or more of Elbit Systems' issued share capital, the Federmann Group agreed to support granting to Koor one demand right on similar conditions as available to the Federmann Group under the Registration Rights Agreement.

The principal terms of the Registration Rights Agreement which remain applicable to the Federmann Group, are as follows:

DEMAND REGISTRATION. The Federmann Group may twice require Elbit Systems to register the Federmann Group's ordinary shares for sale in the United States. It may not demand registration of ordinary shares less than 180 days following the effective date of any registration statement previously filed by Elbit Systems under a demand registration. Elbit Systems has the right to delay filing of a registration statement in specific circumstances.

PIGGYBACK REGISTRATION. The Federmann Group has an unlimited number of "piggyback" registration rights. This means that, subject to certain limitations, any time Elbit Systems proposes to file a registration statement in connection with any public offering of our ordinary shares in the United States, whether for the account of Elbit Systems or our shareholders, the Federmann Group may require us to include its ordinary shares in that offering.

TERMINATION OF REGISTRATION RIGHTS. The registration rights of the Federmann Group terminate if it and its affiliates collectively cease to own at least 5% of the then issued and outstanding Elbit Systems ordinary shares or such shares of any successor corporation.

EXPENSES AND INDEMNITY. Other than fees and disbursements of counsel to the shareholders, Elbit Systems agreed to pay all expenses that result from the registration of ordinary share under the Registration Rights Agreement, all underwriting fees, commissions and discounts connected with the sale of any ordinary shares and any transfer taxes incurred in such sale. Elbit Systems also agreed to indemnify the Federmann Group against liabilities that any result from misrepresentations or omissions in any registration statement filed under the Registration Rights Agreement or any violation of U.S. federal or state securities laws in connection with any such registration, other than those liabilities caused by any act or omission of the Federmann Group.

AGREEMENTS RELATED TO THE TADIRAN ACQUISITION

OVERVIEW OF THE TRANSACTIONS

In December 2004, Elbit Systems and Koor entered into agreements for Elbit Systems to purchase all of Koor's approximately 32% holdings in Tadiran

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Communications for a total consideration of approximately \$146 million, representing a price of approximately \$37 per share (the Tadiran Acquisition). These agreements were entered into concurrently with agreements between FEL and Koor for Koor to purchase approximately 9.8% of Elbit Systems' shares from FEL for a total consideration of approximately \$99 million, representing a price of approximately \$24.70 per share (the FEL - Koor Transaction). (The Tadiran Acquisition and the FEL - Koor Transaction are collectively referred to as the "Transactions"). The Transactions are executed in two stages - A and B, as described below. The agreements between Elbit Systems and Koor relating to the Tadiran Acquisition were approved by Elbit Systems' Audit Committee and Board in January 2005 and by Elbit Systems shareholders at a general shareholders meeting in February 2005.

Stage A of the Transactions was completed in April 2005, following receipt of all applicable approvals for that Stage. In Stage A, Elbit Systems purchased from Koor approximately 13.7% of Tadiran Communications' shares, and Koor purchased from FEL approximately 5.3% of Elbit Systems' shares. Prior to that purchase Elbit Systems already held approximately 6% of Tadiran Communications' shares acquired through prior purchases on the market, and therefore, following completion of the first stage Elbit Systems owned approximately 20% of Tadiran Communications' shares.

Following completion of the Stage A, three Elbit Systems' nominees were appointed to Tadiran Communications' board of directors, and Jonathan Kolber, a Koor nominee, was appointed to Elbit Systems' Board.

The IMOD conditioned its approval of the Tadiran Acquisition on Elbit Systems agreeing to maintain various Israeli security safeguards at Tadiran Communications and on the requirement for IMOD approval in the future in the event Elbit Systems desires to sell a significant part of the shares we hold in Tadiran Communications.

In June 2005, we reported that we were considering together with Koor, the possibility of Elbit Systems purchasing directly Koor's interest in Elisra Electronic Systems Ltd. (Elisra), however no agreement has yet been reached by the parties on this subject. We also reported that the process is progressing for completing the Stage B of the purchase of Koor's shares in Tadiran Communications.

SUMMARY OF APPLICABLE AGREEMENTS

The four agreements entered into relating to the Transactions, each entered into on December 27, 2004, are as follows:

- (1) The Share Transfer Deed between Elbit Systems and Koor (the Tadiran Deed);
- (2) The Shareholders Agreement between Elbit Systems and Koor (the Tadiran Shareholders Agreement);
- (3) The Share Transfer Deed between FEL and Koor (the FEL - Koor Deed); and

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- (4) The Shareholders Agreement between FEL and Koor (the FEL - Koor Shareholders Agreement).

The following is a summary of the principal provisions of these agreements as they relate to the yet completed Stage B of the Transactions as

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well as the applicable terms of the respective shareholders agreements.

PRINCIPAL APPLICABLE TERMS OF THE TADIRAN DEED

REPRESENTATIONS. Elbit Systems is purchasing the Tadiran Communications shares under the Tadiran Deed (the Transaction Shares) on the basis that the condition of Tadiran Communications and its assets are "as is". However, Koor undertook that upon the completion of each stage of the Tadiran Acquisition the Transaction Shares that will be purchased at the relevant stage will be transferred to Elbit Systems free and clear of any third party rights. Koor also warranted that from the time the Transaction Shares were acquired by Koor until the time of signing the Tadiran Deed, Tadiran Communications had not brought to Koor's attention nor given any report to the public that any material agreement to which Tadiran Communications is a party had been terminated or modified or that there was any intent to terminate or modify any material agreement to which Tadiran Communications is a party.

STAGE B OF THE TADIRAN ACQUISITION

TIMING. The completion deadline for Stage B of the Tadiran Acquisition is October 31, 2005. However, if all the Stage B conditions precedent (see below) have not been fulfilled by October 31, 2005, the Stage B completion deadline will automatically be deferred until January 31, 2005. Moreover, if by January 31, 2005, all the Stage B conditions precedent have been fulfilled, except for the completion of the Elisra Acquisition, Koor will be entitled to provide written notice to Elbit Systems of deferral of the Stage B completion deadline until August 31, 2006 or such later date as may be determined by the parties.

SHARE PURCHASE AND CONSIDERATION. In Stage B, Elbit Systems will purchase from Koor 2,244,276 ordinary shares of Tadiran Communications, which currently constitute approximately 18% of Tadiran Communications' outstanding share capital without deduction of treasury shares, for a consideration of \$37 per share, totalling \$83,038,212. Such amount accrues interest from April 1, 2005 until the time of actual payment, at the interest rate of three-month LIBOR at Bank Leumi Le-Israel BM, plus annual interest at the rate of 1.5% compounded quarterly.

BOARD NOMINEES. Subject to the completion of Stage B, Koor will act to support the appointment or election to Tadiran Communications' board of directors of such number of directors as are nominated by Elbit Systems, and who meet the board member qualification conditions, such that after their appointment or election, the number of directors nominated by Elbit Systems will constitute more than 50% of the total directors of Tadiran Communications at that time.

CONDITIONS PRECEDENT

Stage B of the Tadiran Deed and Stage B of the FEL - Koor Deed (see below) are to be completed concurrently. Therefore obtaining all the consents and approvals necessary for the fulfilment of the FEL - Koor

Deed Stage B conditions precedent and the completion of Stage B of the FEL - Koor Deed is a condition precedent for the completion of Stage B of the Tadiran Deed. Nevertheless, this condition may not apply if the completion deadline for Stage B of the FEL - Koor Deed will not be extended concurrently with the

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extension of Stage B of the Tadiran Deed, under the circumstances described below regarding the timing of Stage B under the FEL - Koor Deed.

The other remaining conditions precedent for the performance of Stage B are:

- (1) the completion of the Elisra Acquisition. See below "Voting for the Elisra Acquisition";
- (2) insofar as necessary, obtaining applicable regulatory approvals in Israel and outside Israel; and
- (3) insofar as necessary, obtaining applicable approvals from certain banks or other financial institutions.

The parties agreed to use their best efforts to cause such conditions precedent to be fulfilled.

LOCK-UP PERIOD

Elbit Systems and Koor agreed to a lock-up period from the signing of the Tadiran Deed until August 31, 2006 during which each of them will not conduct any transaction in Tadiran Communications' shares. This obligation will continue in force even if the Tadiran Deed is cancelled for any reason, except for termination due to its breach by Koor and except if Elbit Systems exercises its walk-away rights under the terms of the Tadiran Deed as described below. Nevertheless, during the lock-up period either party may purchase up to 350,000 shares of Tadiran Communications. To the extent one of the parties does not exercise its right to purchase such a quantity of shares, the other party may exercise the right in the first party's place, subject to certain notice provisions. During the lock-up period through May 31, 2005, Elbit Systems purchased 315,405 shares of Tadiran Communications.

VOTING FOR THE ELISRA ACQUISITION

During the period that the Tadiran Deed is in effect and binding on Elbit Systems, Elbit Systems has agreed to vote all of the shares in Tadiran Communications then held by Elbit Systems at a general shareholders meeting of Tadiran Communications' shareholders in favor of approving Tadiran Communications' purchase from Koor of Koor's at least 70% equity interest in Elisra (the Elisra Acquisition). This obligation will apply whether or not any or all of the transactions contemplated by the Tadiran Deed are actually implemented, provided that:

- (1) the Elisra Acquisition consideration to be paid by Tadiran Communications is established in reliance on an evaluation by an outside independent appraiser obtained by Tadiran Communications for the purpose of the Elisra Acquisition, and the consideration and terms and conditions of the Elisra Acquisition have been duly approved by Tadiran Communications' audit committee and board of directors and by any independent committee of Tadiran Communications that is or may be established for the purpose of considering the Elisra Acquisition, and Tadiran Communications' audit committee and board of directors have determined that the Elisra Acquisition is not contrary to the interests of Tadiran Communications;
- (2) the consideration for the Elisra Acquisition, as payable by Tadiran Communications, reflects a company value for Elisra of not more than \$225 million; and

- (3) the Elisra Acquisition is approved by a general shareholders meeting of Tadiran Communications' shareholders by August 31, 2006.

FURTHER UNDERTAKINGS BY KOOR

Koor has undertaken that, from the date of the signature of the Tadiran Deed and until the earlier of:

- (1) the Stage B completion deadline, if the Stage B conditions precedent have not been fulfilled by that time; or
- (2) the "Second Closing Date", as defined in the Tadiran Deed;

Koor and/or its subsidiaries and/or the controlling shareholders and/or officers of Koor and/or companies under the control of any of them will not enter into an extraordinary transaction with Tadiran Communications in which any of them has a "personal interest", other than the Elisra Acquisition. In addition, Koor has undertaken that it will oppose and vote against certain shareholder resolutions of Tadiran Communications, in relation to certain events as specified in the Tadiran Deed.

"WALK-AWAY" PROVISIONS. Elbit Systems may rescind the Tadiran Deed with respect to Stage B before Stage B has been completed and performed in the event of the occurrence of one or more of events such as: liquidation, insolvency or similar proceedings of Tadiran Communications; merger proceedings of Tadiran Communications; alterations to Tadiran Communications' incorporation documents; private placements that vest a right to more than 1,500,000 shares of Tadiran Communications (with certain exclusions); certain new transactions of Tadiran Communications that are not in the ordinary course of business or that involve the sale or purchase of assets or equity, if their aggregate amount exceeds \$35 million, except for the Elisra Acquisition; distributions of dividends in an aggregate amount exceeding NIS 2.5 per share of Tadiran Communications in any calendar quarter; or completion of the Elisra Acquisition for consideration paid by Tadiran Communications reflecting a company value for Elisra in excess of \$225 million.

RELATION TO KOOR - FEL DEED. Contemporaneously with the signing of the Tadiran Deed, the FEL - Koor Deed was also signed. Elbit Systems is not a party to the Koor - FEL Deed, and the provisions of the Koor - FEL Deed do not impose any obligation, that is not expressly provided in the Tadiran Deed, on Koor to Elbit Systems or on Elbit Systems to Koor.

PRINCIPAL APPLICABLE TERMS OF THE TADIRAN SHAREHOLDERS AGREEMENT.

EFFECTIVE DATE AND DURATION. The Tadiran Shareholders Agreement signed between Elbit Systems and Koor became effective upon the completion of Stage A of the Tadiran Acquisition, and it will remain in force so long as the parties cumulatively hold shares entitling them to at least 15% of the voting rights in Tadiran Communications and provided that each party holds shares of Tadiran Communications.

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NOMINATION OF DIRECTORS FOLLOWING THE COMPLETION OF STAGE A

Following completion of Stage A of the Tadiran Acquisition, Koor and Elbit Systems agreed to support the appointment or election of directors nominated by Elbit Systems to Tadiran Communications' board, constituting at least 20% of the directors on the Tadiran board. Subject to applicable law, Koor and

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Elbit Systems will act so that there will serve at least one director nominated by Elbit Systems on every board of directors' committee of Tadiran Communications, other than the audit committee. The parties also will act so that a director of Tadiran Communications, who has been nominated by Elbit Systems, will serve as chairperson nominees of the finance committee of Tadiran Communications' board.

If Koor exercises its right under the Tadiran Deed to defer the Stage B completion deadline from January 31, 2006 until August 31, 2006 (the "Additional Period"), on commencement of the Additional Period Koor will support the appointment or election of an additional director nominated by Elbit Systems to Tadiran Communications' board, so that there will be a total of twelve directors on Tadiran Communications' board of directors, four of whom will have been nominated by Elbit Systems. Also, during the Additional Period, Koor will act to support that on every board of directors' committee, at least one-third of the committee members will be directors who were nominated by Elbit Systems.

ARRANGEMENTS FOLLOWING COMPLETION OF STAGE B

VOTING AT SHAREHOLDERS MEETINGS. After and subject to completion of Stage B of the Tadiran Acquisition, if and to the extent that at that time Koor continues to be a shareholder of Tadiran Communications, Koor has undertaken to participate in every general shareholders meeting of Tadiran Communications and vote in respect of all the Tadiran Communications shares held by it on every matter and/or decision that is referred for a resolution of Tadiran Communications' shareholders in accordance with instructions that are given to it by Elbit Systems. However, Koor will not be so obligated with respect to shareholders' resolutions concerning the approval of transactions of Tadiran Communications in which Elbit Systems, or Elbit Systems' controlling shareholders or officers, has a "personal interest", if such voting by Koor as instructed by Elbit Systems would cause Koor to breach any obligations imposed on Koor by law.

ELBIT SYSTEMS OPTION TO PURCHASE KOOR'S ADDITIONAL SHARES IN TADIRAN COMMUNICATIONS

Subject to the completion of Stage B of the Tadiran Acquisition, Koor grants Elbit Systems the option to purchase from Koor any or all of the shares of Tadiran Communications that may be issued to or vested in Koor by Tadiran Communications after the signature of the Tadiran Deed (the Additional Shares). Said option will apply as follows:

- (1) to all of the Additional Shares for a period of 90 days after the completion of Stage B;
- (2) to one-half of the Additional Shares for a period commencing at the end of 90 days from the completion of Stage B and ending 180

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days after said completion, provided these shares were not purchased by Elbit Systems in accordance with the sub-section (1) above; and

- (3) to one-quarter of the Additional Shares for a period commencing at the end of 180 days from the completion of Stage B and ending 365 days after said completion, provided these shares were not purchased by Elbit Systems in accordance with sub-sections (1) or (2) above.

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The Additional Shares will be purchased for consideration per Additional Share equal to the average of: (a) the price per share at which the Additional Shares were issued to Koor by Tadiran Communications or vested in Koor by Tadiran Communications, less any dividends distributed for each share by Tadiran Communications, commencing from the date on which Koor was issued or vested in the share, and (b) the price per share of Tadiran Communications on the TASE. For this purpose, the stock exchange price per share of Tadiran Communications will be the average price of the share at the end of each of the ten stock exchange trading days preceding the date on which notice is provided by Elbit Systems in respect of the option's exercise.

ARRANGEMENTS IF STAGE B IS NOT COMPLETED

If after the Stage B completion deadline, including any extension of that date in accordance with the Tadiran Deed, Stage B is not completed the following arrangements will apply between Koor and Elbit Systems in respect of their cumulative holdings in Tadiran Communications:

BOARD OF DIRECTORS

- (1) So long as the holdings of each of the parties are not less than 12% of Tadiran Communications' issued share capital, the parties will act and vote by virtue of all their cumulative holdings so that:
- (a) There will be 12 directors of Tadiran Communications, including five who are nominated by Elbit Systems, five who are nominated by Koor and two External Directors.
 - (b) On all board of directors' committees there will be equal representation of the directors who are nominated by each party.
 - (c) When the term of office of the first of the two External Directors serving on Tadiran Communications' board comes to an end, Elbit Systems will be entitled to nominate a candidate for the office of External Director. When the term of office of the other of the two External Directors comes to an end, Koor will be entitled to nominate a candidate for the office of External Director.
 - (d) Until December 31, 2006, the chairperson of Tadiran Communications' board will be a director recommended to that office by Koor. For the next 24 months, the

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office will be held by a director recommended to the office by Elbit Systems, and thereafter the right to recommend the chairperson will so alternate every 24 months.

- (2) Should the holdings of either of the parties fall below 12% of Tadiran Communications' issued share capital, but so long as such party's holdings are not less than 9% of Tadiran Communications' issued share capital, that party will be entitled (under the above mentioned arrangements) to a number of directors equal to its percentage holdings in Tadiran Communications divided by the total cumulative holdings of the parties multiplied by the number of directors then serving on the Tadiran Communications' board (rounded to the nearest whole number), provided that the number of directors who are appointed or elected on the recommendation of that party will not be less than 20% of the total number of directors (rounded up to a whole number).

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- (3) Should the holdings of either of the parties fall below 9% of the issued share capital of Tadiran Communications, but so long as they have not fallen below 5% of Tadiran Communications' issued share capital, that party will be entitled (under the above mentioned arrangements) to a number of directors equal to its percentage holdings in Tadiran Communications divided by the total cumulative holdings of the parties multiplied by the number of directors then serving on the Tadiran Communications' board (rounded to the nearest whole number).
- (4) Should the holdings of either of the parties fall below 5% of the issued share capital of Tadiran Communications, that party will not be entitled (under the above mentioned arrangements) to representation on Tadiran Communications' board.

VOTING AT SHAREHOLDERS' MEETINGS

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- (1) The parties will coordinate between them in advance the manner in which they will vote on every resolution at a general shareholders meeting of Tadiran Communications. The parties will act and vote by virtue of their cumulative holdings against any proposed resolution in a general shareholders meeting unless it is first agreed in writing between them to vote in its favor.
 - (2) Should the holdings of a party fall below 12% of Tadiran Communications' issued share capital, but so long as they have not fallen below 9% of the issued share capital, the provisions regarding coordination in advance of voting at general shareholders meetings will not apply between the parties.
 - (3) If the holdings of a party fall below 9% of Tadiran Communications' issued share capital, that party undertakes to vote with all its shares in Tadiran Communications at every general shareholders meeting in accordance with the other

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party's instructions, except in connection with a shareholders' resolution concerning the approval of a transaction in which the other party or its controlling shareholders or officers has a "personal interest," if so voting would cause the first party to breach duties imposed on it by law.

RESTRICTIONS ON TRANSFER OF SHARES

- (1) A transfer by either Elbit Systems or Koor of any of the 4,462,764 shares of Tadiran Communications, constituting all the shares held by Koor or by Elbit Systems as of December 27, 2004, and any shares which may be issued or vested with respect to these shares, (the Core Shares), will be subject to a right of first refusal of the other party, excluding a sale by a party of Core Shares on the stock exchange, provided that such sale meets both of the following conditions: (a) a party will not sell more than 3% of Tadiran Communications' issued share capital during a 12-month period; and (b) a party will not sell more than 1.5% of Tadiran Communications issued share capital in the course of one transaction or one act.
- (2) If a party's total holdings in Tadiran Communications' shares fall below 5% of the issued share capital of Tadiran Communications, that party may sell the shares in the course of trading on the stock exchange without the application the above mentioned right of first refusal provisions or the conditions for sale on the stock exchange.
- (3) Koor granted Elbit Systems options to purchase from Koor shares that are not part of the Core Shares, which may be issued to Koor by Tadiran Communications or vested in Koor by Tadiran Communications after signature of the Tadiran Deed, at the times and on the terms described above under "Arrangements following Completion of Stage B".

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PRINCIPAL APPLICABLE TERMS OF THE FEL - KOOR DEED

REPRESENTATIONS. Under the FEL - Koor Deed, Koor is purchasing from FEL in two stages 4,000,000 of Elbit Systems' ordinary shares (the Transaction Shares) on an "as is" basis and on the basis that the condition of Elbit Systems and its assets are "as is". However, FEL undertook that upon the completion of each Stage of the FEL - Koor Transaction the Transaction Shares to be purchased at the relevant stage, would be free and clear of any third party rights.

STAGE B

TIMING. The completion deadline for Stage B of the FEL - Koor Transaction is October 31, 2005. However, subject to FEL's rights as provided below not to approve a deferment, if all the Stage B conditions precedent have not been fulfilled by October 31, 2005, the Stage B completion deadline will be automatically deferred until January 31, 2006. The Stage B completion deadline will be further deferred until August 31, 2006 if and to the extent the Stage B completion deadline for the Tadiran Acquisition is deferred, unless FEL informs

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Koor that FEL is unwilling to defer the Stage B completion deadline. If FEL so informs Koor, Koor may elect to complete Stage B of the FEL - Koor Transaction even if Stage B of the Tadiran Acquisition has not been completed, if all other conditions precedent for Stage B of the FEL - Koor Transaction have been met other than the completion of the Elisra Acquisition and the conditions precedent specified in the Tadiran Deed for Stage B of the Tadiran Acquisition.

SHARE PURCHASE AND CONSIDERATION. Pursuant to Stage B of the FEL - Koor Transaction, Koor will purchase from FEL 1,840,000 ordinary shares of Elbit Systems, which currently constitute approximately 4.5% of Elbit Systems' issued share capital, for a consideration of \$24.70 per share, totalling \$45,448,000. Such amount accrues interest from April 1, 2005 until the time of actual payment at the same rate interest as applicable to Elbit Systems under the Tadiran Deed. Also, the amount of the consideration and the quantity of Transaction Shares are subject to modification if certain changes in the capital or equity of Elbit Systems occur, such as distribution of dividends, distribution of bonus shares, rights offerings, consolidations, sub-divisions or similar events.

BOARD NOMINEES. Subject to the completion of Stage B of the FEL - Koor Transaction, FEL will support the appointment or election to Elbit Systems' Board of such number of directors as are nominated by Koor, who meet the applicable qualification conditions, including any applicable independence criteria, so that after their appointment or election, the number of directors nominated by Koor will be the greater of:

- (1) two directors; or
- (2) a number of directors equal to 20% of the number of Elbit Systems' directors (including External Directors and the director or directors appointed or elected pursuant to Koor's nomination as provided above), rounded up to the nearest whole number. (If required to

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meet applicable "director independence" requirements, Koor's nominees will comply with the applicable independence criteria.)

CONDITIONS PRECEDENT

Stage B of the FEL - Koor Deed and Stage B of the Tadiran Deed will be completed together. Therefore obtaining all the consents and approvals necessary for the fulfillment of the Tadiran Deed Stage B conditions precedent and the completion of Stage B of the FEL - Koor Deed is a condition precedent for the completion of Stage B of the FEL - Koor Deed. Nevertheless, this condition may not apply if the completion deadline for Stage B of the FEL - Koor Deed is not extended contemporaneously with Stage B of the Tadiran Deed, as described above.

Other conditions precedent for the performance of Stage B of the FEL - Koor Transaction are:

- (1) the completion of the Elisra Acquisition; and
- (2) insofar as necessary, obtaining applicable regulatory approvals in Israel.

Koor will be entitled to waive fulfillment of part of the conditions precedent for the completion of Stage B of the FEL - Koor Transaction as described in the FEL - Koor Deed, and in this case, Stage B will be completed

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notwithstanding non-fulfillment of such conditions precedent.

The parties agreed to use their best efforts to cause the conditions precedent to be fulfilled.

TRANSACTIONS WITH INTERESTED PARTIES

From the date of signing the FEL - Koor Deed until the earlier of:

- (1) the Stage B completion deadline, if the Stage B conditions precedent have not been fulfilled by that time; or
- (2) the Second Closing Date;

FEL and/or its subsidiaries and/or the controlling shareholders and/or officers of FEL and/or companies under the control of any of them, will not enter into an extraordinary transaction with Elbit Systems in which any of them has a "personal interest", other than the transactions contemplated by the FEL - Koor Deed and the Tadiran Deed. In addition, FEL has undertaken that it will oppose and vote against certain resolutions of Elbit Systems' shareholders in relation to certain events as described in the FEL - Koor Deed.

"WALK-AWAY" PROVISIONS. Koor may rescind the FEL - Koor Deed before Stage B has been completed upon the occurrence of one or more of certain events such as: liquidation, insolvency or similar proceedings of Elbit Systems or merger proceedings of Elbit Systems.

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PRINCIPAL APPLICABLE TERMS OF THE FEL - KOOR SHAREHOLDERS AGREEMENT

EFFECTIVE DATE AND DURATION

The FEL - Koor Shareholders Agreement entered into effect upon completion of Stage A of the FEL - Koor Transaction. The FEL - Koor Shareholders Agreement will remain in effect for a period of 15 years from its effective date or until such time as FEL's (or a "Transferor Party" as defined in the FEL - Koor Shareholders Agreement) holdings in the FEL Shares together with Koor's (or a Transferor Party) holdings in the "Koor Shares" (as defined in the FEL - Koor Shareholders Agreement) fall below 25% of Elbit Systems' issued and outstanding share capital, whichever is earlier.

In addition, after April 1, 2009, Koor may elect to bring to an end its rights and obligations under the FEL - Koor Shareholders Agreement, with the exception of certain sales of a limited amount of Elbit Systems' shares by Koor on a stock exchange, and except for Koor's obligation to vote its shares in accordance with FEL's instructions.

BOARD MEMBERS

After the completion of Stage A of the FEL - Koor Transaction and until the completion of Stage B of the FEL - Koor Transaction, and if Stage B of the FEL - Koor Transaction does not occur, then until such time as Koor's holdings of the Koor Shares fall below 4.32% of Elbit Systems' share capital, or below 2,050,000 shares, whichever is sooner, FEL will vote all its holdings of Elbit

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Systems' shares in favor of the election of one director nominated by Koor.

Commencing from the time of completion of Stage B of the FEL - Koor Transaction, FEL will support the appointment or vote for the election of directors to Elbit Systems' Board who are nominated by Koor, in a number equal to the higher of either: (a) two or (b) 20% of the number of Elbit Systems' directors (including External Directors and the director(s) appointed or elected pursuant to Koor's nomination), rounded up to the nearest whole number.

After the completion of Stage B of the FEL - Koor Transaction, from such time as Koor's holdings of the Koor Shares fall below 6.45% of Elbit Systems' share capital, or below 3,050,000 shares, whichever is sooner, and until Koor's holdings in the Koor Shares fall below 4.32% of Elbit Systems' share capital or 2,050,000 shares, whichever is earlier, FEL will vote all its holdings in Elbit Systems' shares in favor of the election of one director nominated by Koor.

Koor has undertaken to vote for the election of all the candidates nominated by FEL for the offices of the other directors of Elbit Systems (including External Directors). Koor also has undertaken to support the appointment of the candidate nominated by FEL as chairperson of Elbit Systems' Board.

If required to meet applicable "director independence" requirements, Koor's nominees will comply with the applicable independence criteria.

VOTING AT SHAREHOLDERS MEETINGS.

Koor has undertaken to vote, in every matter and proposed resolution that will be submitted for approval to a general shareholders meeting of Elbit Systems' shareholders, in accordance with instructions that will be given to it by FEL, subject to certain exceptions.

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RESTRICTIONS ON TRANSFER OF ELBIT SYSTEMS' SHARES

Both Koor and FEL are subject under the FEL - Koor Shareholders Agreement, to certain limitations and rights regarding the transfer of their respective shares in Elbit Systems. Accordingly, under the conditions described in the FEL - Koor Shareholders Agreement:

- (1) Koor has been granted a right to tag along to FEL's sale of shares in Elbit Systems in the event FEL wishes to transfer to a third party more than half of FEL's shares in Elbit Systems;
- (2) FEL has been granted a right of first refusal if Koor wishes to transfer to a third party any of the Koor Shares;
- (3) If Koor elects to withdraw from the "Controlling Interest" in Elbit Systems (according to the provisions of the FEL - Koor Shareholders Agreement) FEL will have a right of first offer to acquire Koor's shares in Elbit Systems;
- (4) The parties have been granted a mutual right to jointly participate in the acquisition of shares from a single third

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party if the proposed acquisition will exceed a total consideration of \$25 million;

- (5) Koor will not transfer any of the Koor Shares during the period commencing on the date of signing the FEL - Koor Shareholders Agreement and ending on the later of the following:
 - (a) 12 months after completion of Stage A of the FEL - Koor Transaction (April 17, 2006); or
 - (b) if Stage B of the FEL - Koor Transaction has been completed - then nine months after the Second Closing Date.
- (6) A transfer to a third party of: (1) Koor Shares that are subject to FEL's right of first refusal, or (2) "Federmann Shares" (as defined in the FEL - Koor Deed) that are subject to Koor's tag along rights, will be subject to the third party transferee's undertaking to assume the transferor's undertakings according to the FEL - Koor Shareholders Agreement.

The above mentioned limitations and rights on transfer of C Elbit Systems shares apply only to the Federmann Shares and the Koor Shares and not to any other Elbit Systems shares that may be held by FEL or Koor, as the case may be.

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ADDITIONAL NON-TRANSFERABLE RIGHTS GRANTED TO KOOR

After the completion of Stage B of the FEL - Koor Transaction, Koor will be granted, subject to applicable law, certain non-transferable rights, as specified below, which will expire if Koor's holdings fall below 6.45% of Elbit Systems' share capital, or below 3,050,000 ordinary shares, whichever is earlier. In addition, FEL will have the right to terminate such non-transferable rights if members of the Charles Bronfman family, or trusts for their benefit, cease to own a controlling interest in Koor.

- (1) The appointment of one of the directors nominated by Koor to the position of Vice Chairperson of the Elbit Systems' Board, and the appointment of one director nominated by Koor to each of the Elbit Systems Board's committees. Such right may be terminated by FEL in the event of a change of control of Koor as specified in the FEL - Koor Shareholders Agreement.
- (2) Establishment of a Elbit Systems' Board Committee for Strategic Planning, in which at least one member will be a director nominated by Koor, having the authority to assist and recommend on strategic issues;
- (3) In the event of a change of the current Elbit Systems' President and Chief Executive Officer (Joseph Ackerman), a search committee having the authority to recommend will be appointed to attempt to identify a suitable candidate for such office. If the search committee does not succeed in unanimously so recommending a candidate, Elbit Systems' Board will appoint a Chief Executive Officer by a majority vote of

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its members.

- (4) FEL will support, if so requested by Koor, granting registration rights to Koor. (See above "Agreements Relating to the El-Op Merger - Registration Rights Agreement".)
- (5) In the event that an officer or any of the holders of control in FEL serves as a director in a subsidiary of Elbit Systems, Koor will be entitled, subject to applicable law, to appoint as a director in that subsidiary one of the directors of Elbit Systems nominated by Koor. (Currently officers or holders of control in FEL do not serve as directors in any of Elbit Systems' subsidiaries.)

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TRANSACTIONS WITH AFFILIATED COMPANIES

In the ordinary course of business, some subsidiaries and affiliates of Elbit Systems engage in business activities with each other. The purchases among our related parties are made at prices and on terms equivalent to those used in transacting business with unrelated parties under similar conditions. The sales among our related parties in respect to government defense contracts are made on the basis of costs incurred.

TRANSACTIONS WITH OFFICERS AND DIRECTORS

Some members of Elbit Systems' Board are also directors of FEL Group or Koor or companies controlled by either FEL or Koor, including Tadiran Communications and Elisra. Therefore, in the event of an issue or transaction between Elbit Systems and any of those companies, those individuals who are affiliated with both of the applicable companies will be excluded from any decisions concerning such issue or transaction. Transactions with officers, directors, key employees and affiliates may require authorization in accordance with the requirements of the Companies Law. See below - Item 10. Additional Information - Approval of Certain Transactions.

For information on the grant of options in Elbit Systems' shares to officers and directors, see above - Item 6. Directors, Senior Management and Employees - Share Ownership - Elbit Systems' Stock Option Plans.

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ITEM 8. FINANCIAL INFORMATION.

CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

See Consolidated Financial Statements attached to this Form 20-F.

LEGAL PROCEEDINGS

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Elbit Systems and our subsidiaries are involved in legal proceedings from time to time. Based on the advice of our legal counsel, management believes such current proceedings will not have a material adverse effect on the financial position or results of operations of Elbit Systems.

DIVIDEND DISTRIBUTIONS

Elbit Systems does not have a declared dividend policy. Our Articles of Association provide that the Board may approve dividend payments to shareholders out of surplus earnings as permitted by applicable law. To date we have consistently paid a quarterly dividend to our shareholders.

Our dividend payments for the last three full fiscal years were as follows:

| | |
|------|---|
| 2002 | \$0.34 per share |
| 2003 | \$0.40 per share |
| 2004 | \$2.17 per share (including an extraordinary dividend of \$1.80 per share declared in the second quarter of 2004) |

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ITEM 9. OFFER AND LISTING.

SHARE LISTINGS AND TRADING PRICES

Elbit Systems' ordinary shares are quoted on Nasdaq under the symbol "ESLT" and are also listed on the TASE.

The high and low sale prices for our ordinary shares for the five most recent full financial years are:

| | NASDAQ | | TASE (1) | |
|------|--------------|------------|--------------|------------|
| | HIGH ---- | LOW --- | HIGH ---- | LOW --- |
| 2000 | \$19.37 | \$11.00 | \$19.18 | \$11.75 |
| 2001 | \$19.60 | \$12.81 | \$19.24 | \$12.81 |
| 2002 | \$19.31 | \$14.68 | \$18.92 | \$14.32 |
| 2003 | \$20.00 | \$14.51 | \$20.08 | \$14.99 |
| 2004 | \$26.40 | \$17.85 | \$26.29 | \$17.73 |

The high and low quarterly sale prices for our ordinary shares for the two most recent full financial years and the first two subsequent quarters are:

| | NASDAQ | | TASE (1) | |
|----------------|--------------|------------|--------------|------------|
| | HIGH ---- | LOW --- | HIGH ---- | LOW --- |
| 2003 | | | | |
| First Quarter | \$16.84 | \$14.51 | \$17.00 | \$14.77 |
| Second Quarter | \$20.00 | \$16.60 | \$20.08 | \$16.39 |
| Third Quarter | \$19.53 | \$16.64 | \$19.48 | \$16.43 |
| Fourth Quarter | \$18.88 | \$15.36 | \$18.72 | \$14.99 |

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| | | | | |
|---------------------------------------|---------|---------|---------|---------|
| 2004 | | | | |
| First Quarter | \$19.99 | \$17.85 | \$20.55 | \$18.01 |
| Second Quarter | \$20.51 | \$17.88 | \$20.50 | \$17.73 |
| Third Quarter | \$22.50 | \$19.78 | \$21.23 | \$18.80 |
| Fourth Quarter | \$26.40 | \$19.78 | \$26.29 | \$19.55 |
| 2005 | | | | |
| First Quarter | \$26.85 | \$22.97 | \$27.07 | \$22.45 |
| Second Quarter (through May 31, 2005) | \$25.35 | \$23.07 | \$25.11 | \$23.10 |

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The monthly high and low sale prices of our ordinary shares for the most recent six months are:

| | NASDAQ | | TASE (1) | |
|---------------|--------------|------------|--------------|------------|
| | HIGH ---- | LOW --- | HIGH ---- | LOW --- |
| December 2004 | \$26.40 | \$22.20 | \$26.29 | \$22.17 |
| January 2005 | \$26.85 | \$23.26 | \$27.07 | \$23.29 |
| February 2005 | \$25.63 | \$23.37 | \$25.39 | \$23.85 |
| March 2005 | \$25.26 | \$22.97 | \$25.09 | \$22.45 |
| April 2005 | \$25.35 | \$23.07 | \$24.59 | \$23.10 |
| May 2005 | \$25.21 | \$24.17 | \$25.11 | \$24.42 |

 (1) The closing prices of our ordinary shares on the TASE have been translated into U.S. dollars using the daily representative rate of exchange of the NIS to the U.S. dollar as published by the Bank of Israel.

As of May 31, 2005, approximately 4.1% of our outstanding ordinary shares was held in the United States by approximately 232 holders registered on the books of our transfer agent.

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ITEM 10. ADDITIONAL INFORMATION.

GENERAL PROVISIONS OF ISRAELI LAW AND RELATED PROVISIONS OF ARTICLES OF ASSOCIATION

ISRAELI COMPANIES LAW AND REVISED ARTICLES OF ASSOCIATION. The Israel Companies Law - 1999 (the Companies Law) is the basic corporation law governing Israeli publicly and privately held companies. The Companies Law mandates specific provisions be included in an Israeli company's articles of association, which are included in Elbit Systems Restated Articles of Association (the

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Articles of Association).

APPOINTMENT OF DIRECTORS. Elbit Systems' directors are appointed by the shareholders at the annual general shareholders meeting. They hold office until the next annual general shareholders meeting, which is held at least once every calendar year but not more than 15 months after the previous general shareholders meeting. Between annual general shareholders meetings the Board may appoint new directors to fill vacancies, however new External Directors must be elected at a general shareholders meeting as described in "External Directors" below. Appointment of directors is also subject to the terms of the FEL - Koor Shareholders' Agreement. See above - Item 7. Major Shareholders and Related Party Transactions - Related Party Transactions - Agreements Relating to the Tadiran Acquisition. Under that agreement FEL and Koor agreed to support each other's appointments/nominees to the Board, with Koor being entitled to nominate up to two directors and FEL the balance of the directors, other than the External Directors. The Chairman of the Board is appointed from the FEL nominees. The Articles of Association authorizes a maximum of 17 and a minimum of five directors. However, unless otherwise approved by the Board or a general shareholders meeting or during an interim period following a director's resignation, there are 10 directors, including two External Directors as described in "External Directors" below.

SUBSTITUTE DIRECTORS. The Articles of Association provide that any director may appoint another person to serve as a substitute director. A substitute director must be qualified under the Companies Law to serve as a substitute director. If his or her appointment is for more than one meeting it will be subject to the approval of the Board. Such person may not act as a substitute director for more than one director at the same time. In addition, a board committee member may not substitute for another board committee member in committee meetings. The same rules, including compensation, will apply to a substitute director as to the director who appointed him or her, and the substitute director may participate in Board and Board committee meetings in the same manner as the appointing director. Subject to the Companies Law, a director who has appointed a substitute director may revoke the appointment at any time. In addition, the office of a substitute director will be vacated at any time that the office of the director who appointed the substitute is vacated for any reason. Any appointment or revocation of the appointment of a substitute director will be made by notice in writing to the substitute director and Elbit Systems. The appointment or revocation, as the case may be, will become effective on the later of the date of receipt of the above notice or the date fixed in the notice.

EXTERNAL DIRECTORS. Under the Companies Law publicly held Israeli companies are required to appoint two "External Directors". Among other requirements, External Directors must be unaffiliated with Elbit Systems and our controlling shareholders. External Directors serve for a three-year term that may be extended for an additional three-year term. Any committee of the Board must include at least one

External Director. Nathan Sharony and Yaacov Lifshitz currently serve as an External Directors of Elbit Systems, and their terms of office end in March 2008 and July 2006, respectively. Under a recent amendment to the Companies Law, at least one of the External Directors is required to have "financial and accounting expertise" and the other External Director(s) are required to have "professional expertise". These requirements are subject to regulations to be promulgated in which the terms "financial and accounting expertise" and "professional expertise" will be defined. This amendment does not apply to

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External Directors who were appointed prior to March 17, 2005 (such as our External Directors). A substitute for an External Director who has "financial and accounting expertise" or "professional expertise" must have similar expertise.

INTERNAL AUDITOR AND AUDIT COMMITTEE. Publicly held Israeli companies are required to appoint an internal auditor. The main role of the internal auditor is to examine whether the company's activities comply with the law, integrity and orderly business procedure. Publicly held companies are also required to establish an audit committee of the Board of Directors. The audit committee must consist of at least three directors qualified under the Companies Law, including all External Directors. The audit committee and the internal auditor operate in accordance with an audit committee charter that provides the framework for their functions, consistent with applicable Israeli and U.S. laws and regulations. See above - Item 6. Directors, Senior Management and Employees - Board Practices - Audit Committee.

OFFICE HOLDERS

The Companies Law specifies the duty of care and fiduciary duties that an "Office Holder" owes to a company. An Office Holder is defined as a director, general manager, chief business manager, executive vice president, vice president or any other person who fulfills these functions without regard to that person's title or other manager directly under the general manager. Each person listed above in Item 6. Directors and Executive Officers is an Office Holder of Elbit Systems.

Under the Companies Law, an Office Holder's fiduciary duty includes avoiding any conflict of interest between the Officer Holder's position in the company and his or her personal affairs. The fiduciary duty also includes avoiding any competition with the company and avoiding exploiting any business opportunity of the company in order to receive personal advantage for the Office Holder or others. Also, the Office Holder is required to disclose to the company any information or documents relating to the company's affairs that the Officer Holder has received due to his or her position as an Office Holder. Under the Companies Law voting agreements among directors are considered a breach of fiduciary duty. In addition, all compensation arrangements between the company and Office Holders who are not directors require approval of the Board.

APPROVAL OF CERTAIN TRANSACTIONS

APPROVAL PROCEDURES. The Companies Law requires that certain transactions, actions and arrangements, mainly with related parties, be approved as provided for in the Companies Law and in a company's articles of association and in some cases by the audit committee and by the board of directors. Sometimes shareholder approval is also required.

PERSONAL INTEREST AND EXTRAORDINARY TRANSACTIONS. The Companies Law requires that an Office Holder or a controlling shareholder of a company immediately disclose (and no later than the first board meeting the 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. An Office Holder with a personal interest in any such matter that is brought for approval of the audit committee or board of directors may not be present at the meeting where the matter is being approved and may not vote on

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the matter. "Personal Interest" also includes any interest held by the Office Holder's spouse, siblings, parents, grandparents, descendants, spouse's descendants and the spouses of any of them. It also includes an interest by any corporation in which the Office Holder or his or her relative is a 5% or greater shareholder, director or general manager or in which he or she has the right to appoint at least one director or the general manager. An "extraordinary transaction" is other than in the ordinary course of business, other than on market terms, or is likely to have a material impact on the company's profitability, assets or liabilities.

APPROVAL OF TRANSACTIONS

The Companies Law requires approval by the board of directors for transactions that are not extraordinary with an Office Holder or in which an Office Holder has a Personal Interest.

The Companies Law requires approval by both the audit committee and the board of directors for the following transactions:

- (1) extraordinary transactions with an Office Holder or in which an Office Holder has a Personal Interest;
- (2) the grant of indemnification, exemption or insurance to Office Holders;
- (3) material actions or arrangements that may otherwise be considered a breach of fiduciary duty of an Office Holder; or
- (4) terms of service of directors, including the grant of indemnification, exemption or insurance and terms of employment of directors in other roles; or

Matters referred to in (4) may also require shareholder approval, including, where applicable, a specified percentage of non-interested shareholders.

Extraordinary transactions with controlling shareholders or extraordinary transactions with another person in which the controlling shareholder has a personal interest, including terms of service of controlling shareholders or their immediate relatives who serve as employees or directors of the applicable company require approval by the audit committee, the board of directors and a general meeting of shareholders by a special majority as provided in the Companies Law.

EXEMPTION, INSURANCE AND INDEMNIFICATION OF DIRECTORS AND OFFICERS

EXEMPTION, INSURANCE AND INDEMNIFICATION UNDER THE COMPANIES LAW

Under the Companies Law, an Israeli company may not exempt an Office Holder from liability with respect to a breach of his or her duty of loyalty, but may exempt in advance an Office Holder from his or her liability to the company, in whole or in part, with respect to a breach of his or her duty of care. However, a company may not exempt in advance a director from his or her liability to the company with respect to a breach of duty of care in connection with a distribution made by the company.

The Companies Law permits a company to obtain an insurance policy

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covering liabilities of Office Holders resulting from a breach of the Office Holder's duty of care to the company or to another person. This includes liabilities from the breach of his or her fiduciary duty to the company, to the extent that the Office Holder acted in good faith and had reasonable cause to believe that the act would not prejudice the interests of the company. It also covers monetary liabilities charged against an Office Holder while serving the company.

Under the Companies Law, a company may indemnify an Office Holder against any monetary liability incurred in his or her capacity as an Office Holder whether imposed on him or her in favor of another person pursuant to a judgment, a settlement or an arbitrator's award approved by court. A company also can indemnify an Office Holder against reasonable litigation expenses including attorneys' fees, incurred by him or her in his or her capacity as an Office Holder, in a proceeding instituted against him or her by the company, on its behalf or by a third party, in connection with criminal proceedings in which the Office Holder was acquitted, or as a result of a conviction for a crime that does not require proof of criminal intent, or in which an indictment was not brought against the Office Holder.

Under the Companies Law, a company may indemnify an Office Holder in respect of certain liabilities, either in advance of an event or following an event. If a company undertakes to indemnify an Office Holder in advance of an event, the indemnification, other than litigation expenses, must be limited to foreseeable types of events in light of the company's actual activities at the time the company undertook such indemnification and also limited to reasonable amounts or standards, as determined by the board of directors.

A company may not indemnify an Office Holder or enter into an insurance contract that would provide coverage for any monetary liability incurred as a result of the following:

- (1) a breach of fiduciary duty, except for a breach of a fiduciary duty to the company while acting in good faith and having reasonable cause to assume that such act would not prejudice the interests of the company;
- (2) a willful breach of the duty of care or reckless disregard for the circumstances or to the consequences of a breach of the duty of care other than mere negligence;
- (3) an act done with the intent to unlawfully realize a personal gain; or
- (4) a fine or monetary penalty imposed for an offense.

INSURANCE AND INDEMNIFICATION UNDER THE ARTICLES OF ASSOCIATION

Elbit Systems' Articles of Association allows for directors and officers liability insurance, subject to the provisions of the Companies Law. This insurance may cover:

- (1) a breach of his or her duty of care to Elbit Systems or to another person;
- (2) a breach of his or her fiduciary duty to Elbit Systems, provided that the director or officer acted in good faith and had reasonable cause to assume that his or her act would not harm the interests of Elbit Systems; or
- (3) any other event for which insurance of a director or officer is permitted.

In addition, Elbit Systems' Articles of Association permit indemnification, retroactively or in advance, of a director or officer against:

- (1) a monetary liability imposed on the director or officer in favor of a third party under a judgment, including a judgment by way of compromise or a judgment of an arbitrator approved by a court;
- (2) reasonable expenses of the proceedings, including lawyers fees, expended by the director or officer or imposed on him or her by the court for:
 - (a) proceedings issued against him or her by or on Elbit Systems' behalf or by a third party;
 - (b) criminal proceedings from which the director or officer was acquitted; or
 - (c) criminal proceedings in which he or she was convicted but that do not require proof of criminal intent; or
- (3) any other liability or expense for which it is or may be permissible to indemnify a director or an officer.

However, any indemnification so granted by Elbit Systems may not exceed 25% of Elbit Systems' consolidated equity as reflected in our last consolidated annual financial statements published prior to the payment of such indemnification.

The Articles of Association permit the grant of similar indemnification to any person acting as a director or officer of another company in which Elbit Systems is directly or indirectly a shareholder or has any interest.

Elbit Systems' shareholders approved the grant to members of our Board of indemnification letters reflecting the above conditions and limitations. Similar letters were also approved by the Board for grant to officers of Elbit Systems.

In April 2004, a general meeting of Elbit Systems' shareholders approved a framework resolution that allows Elbit Systems to purchase directors and officers (D&O) liability insurance that meets the framework resolution's terms. The framework resolution covers a five-year period beginning in August 2004, and allows for an aggregate increase of insurance coverage of up to \$45,000,000 (from the then current level of \$30,000,000) for any year covered by the policy. As of May 31, 2005, the level of D&O insurance coverage was \$35,000,000. The framework resolution also allows for an increase of up to 25% per year in the D&O insurance premium up to a maximum aggregate of 125% of the current annual premium (\$660,000). The Audit Committee and the Board must approve that any purchase of D&O insurance falls within the terms of the framework resolution.

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MATERIAL CONTRACTS

Elbit Systems has not entered into material contracts since June 1, 2003, other than in the ordinary course of business and other than the agreements related to the Tadiran Communications' acquisition. See above - Item 7. Major Shareholders and Related Party Transactions - Related Party Transactions - Agreements Relating to the Tadiran Acquisition.

EXCHANGE CONTROLS AND OTHER LIMITATIONS AFFECTING SECURITY HOLDERS

Non-residents of Israel may freely hold and trade our ordinary shares under general and specific permits issued under the Israeli Currency Control Law, 1978. Our Memorandum of Association and Articles of Association do not restrict the ownership of ordinary shares by non-residents of Israel. Neither the Memorandum of Association and Articles of Association nor Israeli law restrict the voting rights of non-residents.

Under the general permit given through the Israeli Currency Control Law, 1978, non-residents of Israel who buy our ordinary shares inside or outside of Israel with any foreign currency are able to receive a number of types of distributions in freely repatriable U.S. dollars or specified other currencies. These distributions include dividends, proceeds from the sale of shares and any amounts payable on the dissolution, liquidation or winding-up of Elbit Systems.

In the last several years, the Government of Israel liberalized its policies regarding exchange controls and investments in Israel and abroad.

TAXATION

GENERAL

The following is a summary of some aspects of the current tax law applicable to companies in Israel, with special reference to its effect on Elbit Systems and our Israeli subsidiaries. The following also contains a discussion of specified Israeli tax consequences to our shareholders and government programs from which we and some of our Israeli subsidiaries benefit. To the extent that the discussion is based on tax legislation that has not been subject to judicial or administrative interpretation, there can be no assurance that the views expressed in the discussion will be accepted by the tax authorities in question.

The Israeli Parliament approved a law enacting extensive changes to Israel's tax law (the Tax Reform Legislation) generally effective as of January 2003. Among the key provisions of the Tax Reform Legislation are:

- (i) changes which may result in the imposition of taxes on dividends and interest 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).

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its non-Israeli subsidiaries will receive a credit for income taxes paid or withheld or that will be paid or withheld by the subsidiary in its country of residence according to the 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.

EFFECTIVE CORPORATE TAX RATE

Generally, Israeli corporations were subject to a 35% "Company Tax" in 2004. Elbit Systems' income tax liability in Israel is based on our unconsolidated earnings and such earnings of our Israeli-based subsidiaries. It is determined in NIS and not in U.S. dollars. Tax liability of non-Israeli subsidiaries is determined according to the law of their countries of residence. As a result, the tax provision in Elbit Systems' consolidated financial statements does not directly relate to income reported on these statements. A portion of our Israeli operations have been granted "Approved Enterprise" status, as described under "Investment Law" below. These operations are subject to taxation at reduced rates applicable to those types of enterprises. In addition, they are permitted special adjustments in computing taxable income under the Income Tax Law (Inflationary Adjustments), 1985.

In September 2004, the Israeli Parliament approved the Amendment to the Income Tax Ordinance (No. 140 and Temporary Provision) (the Amendment) that reduces the corporate tax rate from 36% to 35% in 2004, 34% in 2005, 32% in 2006 and 30% in 2007. The Amendment was signed and published in July 2004 and is therefore considered enacted in July 2004. The adoption of the Amendment did not have a significant effect on our financial statements.

INDUSTRY ENCOURAGEMENT. Under the Law for the Encouragement of Industry (Taxes), 1969, a company qualifies as an "Industrial Company" if it is resident in Israel and at least 90% of its income in a given tax year, with some exceptions, comes from "Industrial Enterprises" owned by that company. An Industrial Enterprise is defined as an enterprise whose primary activity in a particular tax year is industrial manufacturing activity. We believe Elbit Systems qualifies as an Industrial Company. The principal benefits of this status are amortization of the cost of know-how and patents, under certain interpretations, deduction of expenses incurred in connection with a public issuance of securities over a three-year period and an election under certain conditions to file a consolidated tax return with additional related Israeli Industrial Companies.

INVESTMENT LAW

The Israeli Law for the Encouragement of Capital Investments, 1959 provides that a capital investment in eligible facilities approved by the Israel Investment Center may be designated as an "Approved Enterprise". Each approval for an Approved Enterprise relates to a specific investment program. The approvals specify both the program's financial scope, including its capital resources, and its physical characteristics, such as the equipment to be purchased and used under the program.

An Approved Enterprise is entitled to several benefits, including Israeli Government cash grants and tax benefits. The applicable tax benefits relate only to taxable profits attributable to the specific Approved Enterprise. As of December 31, 2004, Elbit Systems had four and El-Op had four active approved programs eligible for tax benefits. These programs will expire during the years 2005 to 2012.

In March 2005, the Israeli Parliament passed an amendment to Investment Law, which revamps the Israeli tax incentives for future industrial and other

investments (the 2005 Amendment). A tax

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holiday package can now be elected for up to 15 years for a "Privileged Enterprise" if certain conditions are met, without needing to obtain approval. The 2005 Amendment became effective on April 1, 2005. Taxpayers may claim Privileged Enterprise status for new and expanded enterprises with a year of election of 2004 or thereafter, unless the Investment Center granted Approved Enterprise status by December 31, 2004. Various alternative tax-only benefit packages can now be elected for investments in a "Privileged Enterprise", if certain conditions are met without needing to obtain approval. Israeli industrial companies can choose between the following two tax packages:

- o Tax holiday package - for a "Privileged Enterprise": Tax exemption applies to undistributed profits for 2-15 years depending on location and foreign ownership. Low company tax rates (10% - 25%) apply to distributed and subsequent profits. The total period of tax benefits is 7 - 15 years;
- o Grant / low tax package - for an "Approved Enterprise": Fixed asset grants (20% to 32%) for enterprises in a "Development Area" and low company tax rates (0% to 25%) for 7 to 15 years.

Dividend withholding tax applies at a rate of 4% or 15% depending on the package selected.

CAPITAL GAINS TO A COMPANY

Israeli law imposes a capital gains tax on the sale of capital assets. The law distinguishes between the real capital gain and the inflationary surplus. The inflationary surplus accumulated through 1993 was taxed at a rate of 10%. Inflationary surplus accumulated from and after 1993 is exempt from any capital gains tax. The real capital gain was taxed through 2002 at a rate of 36% for corporations.

Effective as of 2003, the real capital gains tax rate imposed on the sale of capital assets acquired after that date were 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 the date that the asset was held as well as accumulated depreciation.

CAPITAL GAINS TO A SHAREHOLDER

Effective as of 2003, so long as our ordinary shares are listed on a stock exchange the sale of these shares is subject to a blended tax in which the portion of the gain accrued through 2002 is exempt from Israeli capital gains tax, and the portion of the real gain accrued from January 1, 2003 until the date of sale is subject to a 15% tax. The real gain is 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 later case, the capital loss that might be set off is the difference between the adjusted average value and the value of the shares at the date of sale. In addition, since Elbit Systems ordinary shares are traded on the TASE and Nasdaq, gains on the sale of ordinary shares held by non-Israeli resident investors for tax purposes will generally be exempt from Israeli capital gains tax subject to the provisions of the Israeli tax legislation.

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However, dealers in securities in Israel and companies taxed under the Inflationary Adjustment Law are taxed at regular tax rates applicable to business income.

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INFLATIONARY ADJUSTMENTS. The Income Tax (Inflationary Adjustments) Law, 1985 attempts to overcome some of the problems of a tax system effected by an economy experiencing rapid inflation. This was the case in Israel at the time the law was enacted. Generally, this law provides significant tax deductions and adjustments to depreciation methods, finance income and expenses and tax loss carry forwards to compensate for loss of value resulting from an inflationary economy. Elbit Systems' taxable income is determined under this law. In 2002 inflation during the year exceeded 6%. In 2003 the inflation rate was a negative 1.9%. In 2004 the inflation rate was 1.2%.

INCOME TAX FOR NON-RESIDENTS OF ISRAEL. Non-residents of Israel are subject to a graduated income tax on income from sources in Israel. On distributions of dividends other than bonus shares (stock dividends), the paying company withholds at source income tax at the rate of 25%, unless a lower rate is applicable under a double taxation treaty. Generally, dividends distributed from taxable income accrued during the period of benefit of an Approved Enterprise are taxable at the rate of 15% if the dividend is distributed during the tax benefit period under the Investment Law or within 12 years after the period. (This limitation does not apply if the company qualifies as a foreign investors' company according to the Investment Law.) These rates are the final tax on dividends for individual and corporate non-residents and for individual Israeli residents. Foreign residents who have Israeli derived income for which tax was withheld at the source are generally exempt from the duty to file tax returns in Israel for such income. This includes income from Israeli derived interest, dividends and royalties.

ISRAELI TAX ON UNITED STATES SHAREHOLDERS

Dividends paid by Elbit Systems to a shareholder resident in the United States are generally subject to withholding tax deducted at source in Israel. Israel and the United States are parties to a tax treaty. Under the treaty, the withholding tax rate on a dividend is normally 25% of the dividend amount, or 15% in connection with an Approved Enterprise.

A U.S. corporation would have a reduced withholding rate on dividends if it were to own 10% or more of Elbit Systems' voting shares under specified conditions. The reduced withholding tax rate on the dividend would be 12.5%. The U.S. corporation must own at least 10% of the voting shares during the portion of Elbit Systems' tax year before the payment of the dividend and during the entire prior tax year. The reduced rate is also subject to two other conditions. First, not more than 25% of Elbit Systems' gross income for the prior tax year could consist of interest, other than interest received from banking, financing or similar businesses or from certain subsidiaries. Second, the dividend cannot be derived from income during any period for which Elbit Systems is entitled to the reduced tax rate applicable to an Approved Enterprise. In this case the withholding tax rate would be 15%.

Under the terms of the tax treaty, Israel may tax, subject to any exemptions under Israeli law, any capital gain realized by a shareholder resident in the United States on a sale of Elbit Systems' shares if the shareholder owned, directly or indirectly, 10% or more of Elbit Systems' voting shares at any time during the 12-month period before the sale or the above

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shareholder is an individual and was present in Israel for more than 183 days during the relevant taxable year. However, according to an amendment in the Israeli Tax Ordinance, which became effective in 2003, since Elbit Systems ordinary shares are traded on the TASE and on Nasdaq, gains on the sale of ordinary shares held by non-Israeli resident investors for tax purposes will generally be exempt from Israeli capital gains tax, subject to the provisions of the Israeli tax legislation.

With some limitations, any Israeli tax withheld or paid for dividends on ordinary shares generally will be eligible for credit against a U.S. shareholder's U.S. federal income tax liability. Such limitations

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include separate computation rules limiting foreign tax credits allowable for specific classes of foreign source income. The tax credits are limited to the corresponding U.S. federal income taxes otherwise payable for each such class of income. Alternatively, a U.S. shareholder may elect to claim a U.S. tax deduction for such Israeli tax, but only for a year in which the U.S. shareholder elects to do so for all foreign income taxes.

This summary of taxation is based on existing treaties, laws, regulations and judicial and administrative interpretations. There can be no assurance that any of these may not be amended or repealed, possibly with retroactive effect, or that a tax authority may take a contrary position. Also, this summary does not address the tax consequences that may be applicable to specific persons based on their individual circumstances. It also does not address any state, local or other foreign tax consequences. A shareholder should consult his or her own tax advisor as to the specific tax consequences of purchasing, holding or transferring shares of Elbit Systems.

DOCUMENTS ON DISPLAY

We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended. In accordance with these requirements, we file reports and other information with the SEC. These materials, including this Annual Report and its exhibits, may be inspected and copied at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549 and at the SEC's regional office at 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. Copies of the materials may be obtained from the Public Reference Room of the SEC at 450 Fifth Street, N.W., Washington, D.C. 20549 at prescribed rates. The public may obtain information on the operation of the Commission's Public Reference Room by calling the SEC in the United States at 1-800-SEC-0330.

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ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURE OF MARKET RISK.

While our functional currency is the U.S. dollar, we also have some non-U.S. dollar or non-U.S. dollar linked currency exposure from time to time. See above - Item 5. Operating Financial Review and Prospects - Management's Discussion and Analysis - Impact of Inflation and Exchange Rates - Foreign Currency Expenses.

Except when we view it necessary, we do not invest in derivative

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financial instruments or other market risk sensitive instruments. Therefore, we do not believe that we are exposed to any material market risk with regard to market risk sensitive instruments.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES.

Not applicable.

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.

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ITEM 15. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures 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. These controls and procedures also provide 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. Also, 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 major business areas and 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.

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ITEM 16.

ITEM 16.A - AUDIT COMMITTEE FINANCIAL EXPERT

Yaacov Lifshitz, a member of our Audit Committee, meets the criteria of an "Audit Committee Financial Expert" under the applicable rules and regulations of the SEC, and his designation as the Audit Committee's Financial Expert has

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been ratified by the Board. Mr. Lifshitz is "independent", as that term is defined in the Nasdaq listing standards.

ITEM 16.B - CODE OF ETHICS

We have adopted a code of business conduct and ethics that is applicable to all our directors, officers and employees including our principal executive, financial and accounting officers and persons performing similar functions. The code of ethics was approved by our Board and covers areas of professional and business conduct. It is intended to promote honest and ethical behavior, including fair dealing and the ethical handling of conflicts of interest. The code of ethics includes a "whistleblower" process to encourage reports of violations. Our code of ethics is posted on our website: www.elbitsystems.com.

ITEM 16.C - PRINCIPAL ACCOUNTANT FEES AND SERVICES

In the annual general shareholders meeting held in November 2004, our shareholders reappointed Kost Forer Gabbay & Kasierer (Kost), a member of Ernst & Young Global (E&Y), to serve as our independent auditors. We paid to Kost and other E&Y affiliates the following fees for professional services in each of the last two fiscal years:

| | Year Ended December 31 | |
|--------------------|-----------------------------|---------|
| | 2004 | 2003 |
| | ---- | ---- |
| | (U.S. dollars in thousands) | |
| Audit Fees | \$730 | \$656 |
| Audit-Related Fees | -- | -- |
| Tax Fees | \$499 | \$398 |
| All Other Fees | \$121 | \$54 |
| | ----- | ----- |
| Total | \$1,350 | \$1,108 |
| | ===== | ===== |

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"Audit Fees" are the aggregate fees for the audit of our annual financial statements. This category also includes services generally provided by the independent auditor, such as statutory audits required by the Office of the Chief Scientist and other Israeli government entities, consents and assistance with and review of documents filed with the SEC. "Audit Related Fees" are the aggregate fees billed for assurance and related services that are reasonably related to the performance of the audit and are not reported under Audit Fees. These fees include mainly accounting consultations regarding the accounting treatment of matters that occur in the regular course of business, implications of new accounting pronouncements and other accounting issues that occur from time to time. "Tax Fees" are the aggregate fees billed for professional services rendered for tax compliance and tax advice, other than in connection with the audit. Tax compliance involves preparation of original and amended tax returns, tax planning and tax advice. "Other Fees" relate to permissible services provided by the independent auditors that do not fall into the three above-mentioned categories.

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Our Audit Committee has adopted a pre-approval policy for the engagement of our independent accountant to perform permitted audit and non-audit services. Under this policy, which is designed to assure that such engagements do not impair the independence of our auditors, the Audit Committee pre-approves annually a range of specific audit and non-audit services in the categories of Audit Service, Audit-Related Services, Tax Services and other services that may be performed by our independent accountants, and the maximum pre-approved fees that may be paid as compensation for each pre-approved service in those categories. Any proposed services exceeding the maximum pre-approved fees require specific approval by the Audit Committee.

ITEM 16.D - EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not yet applicable to Registrant.

ITEM 16.E - PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

Neither Elbit Systems nor any affiliated purchaser purchased any of Elbit Systems' equity securities during 2004, other than Elbit Systems purchase of shares of Tadiran Communications that were purchased prior to signing the agreements with Koor. See above - Item 7. Major Shareholders and Related Party Transactions - Related Party Transactions - Agreements Relating to the Tadiran Acquisition.

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ITEM 17. FINANCIAL STATEMENTS.

Not applicable.

ITEM 18. FINANCIAL STATEMENTS.

See Financial Statements attached.

ITEM 19. EXHIBITS.

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| Consolidated Statements of Cash Flows | F-9 |
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| Schedule II - Valuation and Qualifying Accounts | S-1 |

(b) Exhibits

| | |
|-----|---|
| 1.1 | Elbit Systems' Memorandum of Association * |
| 1.2 | Elbit Systems' Restated Articles of Association**** |

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- 4.1 Spin-off Agreement among Elbit Ltd., Elbit Medical Imaging Ltd. and Elbit Systems **
- 4.2 Technology Assignment and Cross License Agreement among Elbit Ltd., Elbit Medical Imaging Ltd. and Elbit Systems **
- 4.3 Tadiran Share Transfer Deed between Elbit Systems and Koor *****
- 4.4 Tadiran Shareholders Agreement between Elbit Systems and Koor *****
- 4.5 FEL - Koor Share Transfer Deed *****
- 4.6 FEL - Koor Shareholders Agreement *****
- 8 Elbit Systems' Post Merger Stock Option Plan (Summary in English) *
- 8.1 Principal Operating Subsidiaries of Elbit Systems

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- 10.1 Consent of Kost Forer Gabbay & Kasierer
- 10.2 Consent of Luboshitz Kasierer
- 31.1 Certification of Chief Executive Officer of the Registrant pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer of the Registrant pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer of the Registrant pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
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* Filed as an exhibit to Elbit Systems' Annual Report on Form 20-F (File No. 0-28998) for the year ended December 31, 2000, which was filed with the Securities and Exchange Commission on April 5, 2001, and incorporated herein by reference.

** Filed as an exhibit to Elbit Systems' Registration Statement on Form 20-F (File No. 0-28998), which was filed with the Securities and Exchange Commission on November 22, 1996, and incorporated herein by reference.

*** Filed as an exhibit to Elbit Systems' Report on Form 6-K for February 2000, which was filed by Elbit Systems with the Securities and Exchange Commission on March 6, 2000, and incorporated herein by reference.

**** Filed as an exhibit to Elbit Systems Report on Form 6-K for October 2004, which was filed by Elbit Systems with the Securities and Exchange Commission on October 20, 2005 and incorporated herein by reference

***** Filed as an exhibit to Elbit Systems Report on Form 6-K for February 2005, which was filed by Elbit Systems with the Securities and Exchange Commission on February 7, 2005 and incorporated herein by reference.

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SIGNATURES

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Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the Registrant certifies that it meets all of the requirements for filing on Form 20-F and has duly caused this Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: June 28, 2005

ELBIT SYSTEMS LTD.

By: /s/ Joseph Ackerman

Name: Joseph Ackerman
Title: President and Chief
Executive Officer

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ELBIT SYSTEMS LTD. AND SUBSIDIARIES

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS (In thousands of U.S. dollars)

| DESCRIPTION ----- | COLUMN A Balance at Beginning of Period ----- | COLUMN B Additions (Charged to Costs and Expenses) ----- | COLUMN C Deductions (Write-Offs and Actual Losses Incurred) ----- | COLUMN D Balance End of P ----- |
|---|---|---|---|--|
| YEAR ENDED DECEMBER 31, 2004: | | | | |
| Provisions for Losses on Long- Term Contracts (*) | 13,016 | 5,516 | 8,181 | 10,35 |
| Provisions for Claims and Potential Contractual Penalties and Others | 4,882 | 1,058 | 3,403 | 2,53 |
| Allowance for Doubtful Accounts | 3,861 | 33 | 830 | 3,06 |
| Valuation Allowance on Deferred Taxes | 3,879 | - | 434 | 3,44 |
| YEAR ENDED DECEMBER 31, 2003: | | | | |
| Provisions for Losses on Long- Term Contracts (*) | 13,607 | 5,032 | 5,623 | 13,01 |
| Provisions for Claims and Potential Contractual Penalties and Others | 5,988 | 1,492 | 2,598 | 4,88 |
| Allowance for Doubtful Accounts | 3,411 | 908 | 458 | 3,86 |
| Valuation Allowance on Deferred Taxes | 2,362 | 1,553 | - | 3,87 |

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YEAR ENDED DECEMBER 31, 2002:

| | | | | |
|--|--------|-------|-------|-------|
| Provisions for Losses on Long- Term Contracts (*) | 14,418 | 6,077 | 6,888 | 13,60 |
| Provisions for Claims and Potential Contractual Penalties and Others | 3,507 | 5,612 | 3,131 | 5,98 |
| Allowance for Doubtful Accounts | 3,200 | 459 | 248 | 3,41 |
| Valuation Allowance on Deferred Taxes | 2,202 | 124 | - | 2,32 |

* An amount of \$11,016, \$12,263 and \$7,636 as of December 31, 2002, 2003 and 2004, respectively, is presented as a deduction from inventories, and an amount of \$2,591, \$753 and \$2,715 as of December 31, 2002, 2003 and 2004, respectively, is presented as part of other accrued expenses.

S-1

EXHIBIT INDEX

| | |
|------|---|
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FINANCIAL STATEMENTS

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2004

(IN U.S. DOLLARS)

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2004

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IN U.S. DOLLARS

C O N T E N T S

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| CONSOLIDATED FINANCIAL STATEMENTS: | |
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#

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[OBJECT OMITTED]ERNST & YOUNG

TO THE SHAREHOLDERS OF
ELBIT SYSTEMS LTD.

Haifa, Israel

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We have audited the accompanying consolidated balance sheets of Elbit Systems

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Ltd. (the "Company") and its subsidiaries as of December 31, 2004 and 2003 and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the two years in the period ended December 31, 2004. Our audits also include the financial statement schedule listed in the Index at Item 19a. These consolidated financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2004 and 2003 and the consolidated results of their operations and their cash flows for each of the two years in the period ended December 31, 2004 in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 2(X) to the consolidated financial statements, on January 1, 2004 the Company adopted SFAS No. 123 "Accounting for Stock-Based Compensation."

/s/ Kost Forer Gabbay & Kasierer
KOST FORER GABBAY & KASIERER
A MEMBER OF ERNST & YOUNG GLOBAL

Haifa, Israel
March 14, 2005

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To the Shareholders of Elbit Systems Ltd.

We have audited the accompanying consolidated statements of operations, changes in shareholders' equity and cash flows of Elbit Systems Ltd. And its subsidiaries for the year ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated results of the Company and its subsidiaries' operations and their cash flows for the year ended December 31, 2002 in conformity with United States generally accepted accounting principles.

/s/ Luboshitz Kasierer
LUBOSHITZ KASIERER
AN AFFILIATE MEMBER OF ERNST & YOUNG INTERNATIONAL

Haifa, Israel
March 24, 2003

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U. S. dollars (In thousands)

NOTE

2004

CURRENT ASSETS:

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| | | | |
|---|------|----|---------|
| Cash and cash equivalents | | \$ | 34,1 |
| Short-term bank deposits | | | 7 |
| Trade receivables, (net of allowance for doubtful accounts in the amount of \$3,064 and \$3,861 as of December 31, 2004 and 2003, respectively) | (3) | | 214,8 |
| Other receivables and prepaid expenses | (4) | | 52,3 |
| Inventories, net of advances | (5) | | 249,0 |
| | | | ----- |
| Total current assets | | | 551,0 |
| | | | ----- |
| INVESTMENTS AND LONG-TERM RECEIVABLES: | | | |
| Investments in affiliated companies and a partnership | (6A) | | 33,1 |
| Available for sale securities | (1G) | | 18,0 |
| Investments in other companies | (6B) | | 11,7 |
| Long-term bank deposits and trade receivables | (7) | | 2,1 |
| Severance pay fund | (2P) | | 82,9 |
| | | | ----- |
| | | | 147,9 |
| | | | ----- |
| PROPERTY, PLANT AND EQUIPMENT, NET | (8) | | 244,2 |
| | | | ----- |
| INTANGIBLE ASSETS: | | | |
| Goodwill | (9) | | 32,8 |
| Other intangible assets, net | | | 63,1 |
| | | | ----- |
| | | | 95,9 |
| | | | ----- |
| | | \$ | 1,039,3 |
| | | | ===== |

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

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U. S. dollars (In thousands)

| | NOTE | DE ----- 2004 ----- |
|--|---------|------------------------------|
| CURRENT LIABILITIES: | | |
| Short-term bank credit and loans | (10) | \$ 8,5 |
| Current maturities of long-term loans | (13) | 1,6 |
| Trade payables | | 118,3 |
| Other payables and accrued expenses | (11) | 169,7 |
| Customers advances and amounts in excess of costs incurred on contracts in progress | (12) | 80,1 |
| Total current liabilities | | ----- 378,4 ----- |
| LONG-TERM LIABILITIES: | | |
| Long-term loans | (13) | 86,2 |
| Advances from customers | (12) | 10,3 |
| Deferred income taxes | (15) | 24,5 |
| Accrued termination liability | (14,2P) | 100,7 |
| | | ----- 221,8 ----- |
| COMMITMENTS AND CONTINGENT LIABILITIES | (16) | |
| MINORITY INTERESTS | | 4,3 ----- |
| SHAREHOLDERS' EQUITY: | (17) | |
| Share capital | | |
| Ordinary shares of New Israeli Shekels (NIS) 1 par value; | | |
| Authorized - 80,000,000 shares as of | | |
| December 31, 2004 and 2003; | | |
| Issued - 40,969,947 and 39,746,125 shares as | | |
| of December 31, 2004 and 2003, respectively; | | |
| Outstanding - 40,561,126 and 39,337,304 shares | | |
| as of December 31, 2004 and 2003, respectively | | 11,5 |
| Additional paid-in capital | | 274,4 |
| Accumulated other comprehensive loss | | (3,3) |
| Retained earnings | | 156,3 |
| Treasury shares - 408,821 shares as of | | |
| December 31, 2004 and 2003 | | (4,3) |
| | | ----- 434,7 ----- |
| | | ----- \$ 1,039,3 ===== |

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

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

U. S. dollars (In thousands, except share and per share data)

| | | YEAR ENDED DEC | |
|---|-------|----------------|------------|
| | NOTE | 2004 | 2003 |
| Revenues | (18) | \$ 939,925 | \$ 897,000 |
| Cost of revenues | | 689,626 | 672,000 |
| Gross profit | | 250,299 | 225,000 |
| Research and development costs, net | (19) | 66,846 | 54,000 |
| Marketing and selling expenses | | 69,912 | 69,000 |
| General and administrative expenses | | 47,832 | 46,000 |
| | | 184,590 | 170,000 |
| Operating income | | 65,709 | 54,000 |
| Financial expenses, net | (20) | (5,852) | (4,000) |
| Other income (expenses), net | | 770 | |
| Income before taxes on income | | 60,627 | 49,000 |
| Taxes on income | (15) | 15,219 | 11,000 |
| | | 45,408 | 38,000 |
| Equity in net earnings of affiliated companies and partnership | | 7,765 | 7,000 |
| Minority interests in losses (earnings) of subsidiaries | | (180) | |
| Net income | | \$ 52,993 | \$ 45,000 |
| Earnings per share | (17G) | | |
| Basic net earnings per share | | \$ 1.33 | \$ 1.33 |
| Diluted net earnings per share | | \$ 1.29 | \$ 1.29 |
| Number of share used in computation of basic net earnings per share | | 39,952 | 39,952 |
| Number of share used in computation of diluted net earnings per share | | 41,041 | 40,200 |

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

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U. S. dollars (In thousands, except share and per share data)

| | NUMBER OF OUTSTANDING SHARES | SHARE CAPITAL | ADDITIONAL PAID-IN CAPITAL | A CO IN |
|---|------------------------------------|----------------------------------|---------------------------------------|---------------|
| | ----- | ----- | ----- | ----- |
| BALANCE AS OF JANUARY 1, 2002 | 38,330,272 | \$ 11,054 | \$ 244,625 | \$ |
| Exercise of options | 473,235 | 100 | 4,040 | |
| Tax benefit in respect of options exercised | - | - | 648 | |
| Stock based compensation | - | - | (926) | |
| Dividends paid | - | - | - | |
| Other comprehensive income (loss): | | | | |
| Minimum pension liability | - | - | - | |
| Net income | - | - | - | |
| | ----- | ----- | ----- | ----- |
| Total comprehensive income | | | | |
| BALANCE AS OF DECEMBER 31, 2002 | 38,803,507 | \$ 11,154 | \$ 248,387 | \$ |
| Exercise of options | 533,797 | 119 | 5,147 | |
| Tax benefit in respect of options exercised | - | 758 | - | |
| Stock based compensation | - | - | 4,741 | |
| Dividends paid | - | - | - | |
| Other comprehensive income (loss): | | | | |
| Unrealized loss on derivative instruments | - | - | - | |
| Foreign currency translation differences | - | - | - | |
| Minimum pension liability | - | - | - | |
| Net income | - | - | - | |
| | ----- | ----- | ----- | ----- |
| Total comprehensive income | | | | |
| BALANCE AS OF DECEMBER 31, 2003 | 39,337,304 | \$ 11,273 | \$ 259,033 | \$ |
| | ===== | ===== | ===== | ===== |
| | TREASURY SHARES | TOTAL SHAREHOLDERS' EQUITY | TOTAL OTHER COMPREHENSIV INCOME | |
| | ----- | ----- | ----- | |
| BALANCE AS OF JANUARY 1, 2002 | \$ (4,321) | \$ 377,985 | | |
| Exercise of options | - | 4,140 | | |
| Tax benefit in respect of options | | | | |

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| | | | |
|---|------------|------------|------------|
| exercised | - | 648 | |
| Stock based compensation | - | (926) | |
| Dividends paid | - | (12,717) | |
| Other comprehensive income (loss): | | | |
| Minimum pension liability | - | (2,882) | \$ (2,882) |
| Net income | - | 45,113 | 45,113 |
| | | ----- | ----- |
| Total comprehensive income | | | \$ 42,231 |
| | | ----- | ----- |
| BALANCE AS OF DECEMBER 31, 2002 | \$ (4,321) | \$ 411,361 | |
| | | | |
| Exercise of options | - | 5,266 | |
| Tax benefit in respect of options exercised | 758 | | |
| | | | |
| Stock based compensation | - | 4,741 | |
| Dividends paid | - | (14,882) | |
| Other comprehensive income (loss): | | | |
| Unrealized loss on derivative instruments | - | (578) | \$ (578) |
| Foreign currency translation differences | - | 340 | 340 |
| Minimum pension liability | - | (872) | (872) |
| Net income | - | 45,945 | 45,945 |
| | | ----- | ----- |
| Total comprehensive income | | | \$ 44,835 |
| | | ----- | ----- |
| BALANCE AS OF DECEMBER 31, 2003 | \$ (4,321) | \$ 452,079 | |
| | ===== | ===== | |

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

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (CONT.)

U. S. dollars (In thousands, except share and per share data)

| | NUMBER OF OUTSTANDING SHARES | SHARE CAPITAL | ADDITIONAL PAID-IN CAPITAL | A CO |
|--|------------------------------------|------------------|----------------------------------|---------|
| | ----- | ----- | ----- | ----- |
| BALANCE AS OF JANUARY 1, 2004 | 39,337,304 | \$ 11,273 | \$ 259,033 | \$ |
| Cumulative effect of first time adoption of the fair value based method for stock based compensation expense | - | - | (152) | |
| Exercise of options | 1,223,822 | 275 | 10,985 | |
| Tax benefit in respect of options exercised | - | - | 1,179 | |
| Stock based compensation | - | - | 3,387 | |
| Dividends paid | - | - | - | |
| Other comprehensive income (loss): | | | | |
| Unrealized loss on derivative instruments | - | - | - | |
| Foreign currency translation differences | - | - | - | |

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| | | | | |
|--|----------------|---------------|----------------|--------|
| Unrealized gains on available for sale securities, net | | | | |
| Minimum pension liability | - | - | - | - |
| Net income | - | - | - | - |
| | ----- | ----- | ----- | ----- |
| Total comprehensive income | | | | |
| BALANCE AS OF DECEMBER 31, 2004 | 40,561,126 | \$ 11,548 | \$ 274,432 | \$ |
| | ===== | ===== | ===== | ===== |

| | TREASURY SHARES | TOTAL SHAREHOLDERS' EQUITY | TOTAL OTHER COMPREHENSIVE INCOME |
|--|--------------------|----------------------------------|--|
| | ----- | ----- | ----- |
| BALANCE AS OF JANUARY 1, 2004 | \$ (4,321) | \$ 452,079 | |
| Cumulative effect of first time adoption of the fair value based method for stock based compensation expense | - | (152) | |
| Exercise of options | - | 11,260 | |
| Tax benefit in respect of options exercised | - | 1,179 | |
| Stock based compensation | - | 3,387 | |
| Dividends paid | - | (86,692) | |
| Other comprehensive income (loss): | | | |
| Unrealized loss on derivative instruments | - | (299) | (299) |
| Foreign currency translation differences | - | 450 | 450 |
| Unrealized gains on available for sale securities, net | - | 1,396 | 1,396 |
| Minimum pension liability | - | (901) | (901) |
| Net income | - | 52,993 | 52,993 |
| | ----- | ----- | ----- |
| Total comprehensive income | | | \$ 53,639 |
| | | | ===== |
| BALANCE AS OF DECEMBER 31, 2004 | \$ (4,321) | \$ 434,700 | |
| | ===== | ===== | |

ACCUMULATED OTHER COMPREHENSIVE LOSS (NET OF TAXES)

| | |
|--|----|
| ----- | |
| Accumulated gains on derivative instruments | \$ |
| Accumulated foreign currency translation differences | |
| Accumulated gains on available for sale securities | |
| Accumulated minimum pension liability | |
| ----- | |
| Accumulated other comprehensive loss | \$ |
| ===== | |

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

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CONSOLIDATED STATEMENTS OF CASH FLOWS

U. S. dollars (In thousands)

CASH FLOWS FROM OPERATING ACTIVITIES

Net income

Adjustments required to reconcile net income to net cash provided by operating activities:

Depreciation and amortization

Stock based compensation

Deferred income taxes, net

Accrued severance pay, net

Gain (loss) on sale of property, plant and equipment

Tax benefit in respect of options exercised

Minority interests in earnings (losses) of subsidiaries

Equity in net losses (earnings) of affiliated companies and partnership, net of dividend received (*)

Changes in operating assets and liabilities:

Decrease (increase) in short and long-term trade receivables, other receivables and prepaid expenses

Decrease (increase) in inventories

Increase (decrease) in trade payables, other payables and accrued expenses

Increase (decrease) in advances received from customers

Settlement of royalties with the Office of the Chief Scientist

Other adjustments

Net cash provided by operating activities

CASH FLOWS FROM INVESTING ACTIVITIES

Purchase of property, plant and equipment

Investment grants received for property, plant and equipment

Acquisition of subsidiaries and businesses (Schedule A)

Investments in affiliated companies and subsidiaries

Proceeds from sale of property, plant and equipment

Grant of long-term loan

Collection of long-term loan

Collection of short-term loan

Investment in long-term bank deposits

Proceeds from sale of long-term bank deposits

Short-term bank deposits, net

Investment in available for sale securities

Net cash used in investing activities

CASH FLOWS FROM FINANCING ACTIVITIES

Proceeds from exercise of options

Repayment of long-term bank loans

Receipt of long-term bank loans

Dividends paid

Change in short-term bank credit and loans, net

Net cash used in financing activities

NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS

CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR

CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR

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(*) Dividend received

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

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONT.)

U. S. dollars (In thousands)

| | YEAR EN | |
|--|------------|----|
| | 2004 | |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Cash paid during the year for: | | |
| Income taxes | \$ 13,305 | \$ |
| Interest | \$ 3,122 | \$ |
| SCHEDULE A: | | |
| Subsidiaries and businesses acquired (*) | | |
| Estimated net fair value of assets acquired and liabilities assumed at the date of acquisition was as follows: | | |
| Working capital (surplus) deficiency (excluding cash and cash equivalents) | \$ (707) | \$ |
| Property, plant and equipment | (10) | |
| Goodwill and other intangible assets | (1,598) | |
| Deferred income taxes | - | |
| Long-term liabilities | - | |
| Minority interest | - | |
| Less short-term debt incurred on acquisition | (2,315) | |
| | \$ (2,315) | \$ |

(*) Defense Systems Division of Elron Telesoft in 2002 (see Note 1(C)). In 2003 a European subsidiary (see Note 1(D)) and AD&D (see Note 1(E)). In 2004 the assets of Computer Instruments Corporation Inc. (see Note 1(F))

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

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U. S. dollars (In thousands)

NOTE 1 - GENERAL

- A. Elbit Systems Ltd. (the "Company") is an Israeli corporation, 49% owned by the Federmann Group. On July 28, 2004, Elron Electronic Industries Ltd. completed the sale of all of its holdings in the Company, constituting approximately 19% of the Company's outstanding share capital, to Federmann Enterprises Ltd. The Company's shares are traded on the Tel Aviv Stock Exchange and on the Nasdaq National Market in the United States. The Company and its subsidiaries (the "Group") are engaged mainly in the field of defense electronics. The Company's principal wholly-owned subsidiaries are EFW Inc. ("EFW") and Elop Electro-Optics Industries, Ltd. ("El-Op").
- B. A majority of the Group's revenues are derived from direct or indirect sales to governments or to government agencies. As a result, a substantial portion of the Group's sales is subject to the special risks associated with sales to governments or to government agencies. These risks include, among others, the dependency on the resources allocated by governments to defense programs, changes in governmental priorities and changes in governmental approvals regarding export licenses required for the Group products and for its suppliers. As for major customers refer to Note 18(C).
- C. In January 2002, the Company acquired from Elron Telesoft Inc. and its subsidiaries ("Elron Telesoft") the assets and the business of the Defense Systems Division of Elron Telesoft ("the Government Division") in consideration for \$5,700 in cash. The excess of the purchase price over the fair value of net tangible assets acquired in the amount of approximately \$5,100 was allocated to technology and other intangible assets to be amortized over a weighted average period of 3 years.

The Government Division is engaged mainly in the development of communication systems, information technology and image intelligence processing for defense and military applications.

The results of the Government Division have been included in the consolidated financial statements from the first quarter of 2002.

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Pro forma information in accordance with SFAS No. 141 has not been provided, since the revenues and net income of the Government Division were not material in relation to total consolidated revenues and net income for the year 2002.

- D. In June 2003, the Company (through El-Op) acquired all of the outstanding ordinary shares of a European subsidiary, a company registered in Belgium, in consideration for \$1,846 in cash. The acquisition was accounted for by the purchase method of accounting.

This subsidiary develops, manufactures and supports electro-optical products, mainly for the defense and space markets.

The results of this subsidiary's operations have been included in the consolidated financial statements from the date of acquisition.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 1 - GENERAL (CONT.)

Pro forma information in accordance with SFAS No. 141 has not been provided, since the revenues and net income of this subsidiary were not material in relation to total consolidated revenues and net income for the years 2002 and 2003.

- E. In July 2003, the Company acquired approximately 54% of the outstanding shares of Aero Design Development Ltd. ("AD&D") an Israeli company in consideration for \$1,406 in cash. The acquisition was accounted for by the purchase method of accounting.

AD&D develops, manufactures and builds airborne models and other engineered products.

The excess of the purchase price over the fair value of net tangible assets acquired in the amount of approximately \$1,334 was allocated to technology (\$1,000) to be amortized by the straight-line method over a period of 10 years and to technology goodwill (\$334).

The results of AD&D's operations have been included in the consolidated financial statements from the date of acquisition.

Pro forma information in accordance with SFAS No. 141 has not been provided, since the revenues and net income of AD&D were not material in relation to total consolidated revenues and net income for the years 2002 and 2003.

- F. In August 2004, the Company (through a subsidiary of EFW) acquired a business from Computer Instruments Corporation Inc. ("CIC") of Westbury, New York in consideration for approximately

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\$2,315 in cash. The acquired assets relate to the design and manufacture of aviation pressure transducers, air data probes and air data computers.

The following table summarizes the fair value of the assets acquired and liabilities assumed at the date of acquisition as estimated by the Company, with the support of an external appraisal: Current Assets \$ 994 Property and equipment 10 Technology 1,327 Goodwill 271 Total assets acquired 2,602 Current liabilities assumed (287) Net assets acquired \$ 2,315

| | | |
|-----------------------------|----|-------|
| Current Assets | \$ | 994 |
| Property and equipment | | 10 |
| Technology | | 1,327 |
| Goodwill | | 271 |
| | | ----- |
| Total assets acquired | | 2,602 |
| Current liabilities assumed | | (287) |
| | | ----- |
| Net assets acquired | \$ | 2,315 |
| | | ===== |

The technology acquired will be amortized by the straight-line method over a period of 5-7 years. The results of CIC's operations have been included in the consolidated financial statements from the date of acquisition.

Pro forma information in accordance with SFAS No. 141 has not been provided, since the revenues and net income of CIC were not material in relation to total consolidated revenues and net income for the years 2003 and 2004.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 1 - GENERAL (CONT.)

- G. On December 27, 2004, the Company reached an agreement with Koor Industries ("Koor") to purchase all of Koor's holdings in Tadiran Communications Ltd. ("Tadiran"), which represents approximately a 32% interest in Tadiran. This purchase will be made in parallel to Koor's purchase of approximately 9.8% of the Company's shares from Federmann Enterprises Ltd. ("Federmann") based on agreements reached between Federmann and Koor. The transaction will be executed in two stages as described below.

In the first stage, the Company will purchase from Koor approximately 13.8% of Tadiran's shares, and Koor will purchase from Federmann approximately 5.3% of the Company's shares. As of March 1, 2005, the Company held approximately 6% of Tadiran's shares acquired through purchases on the market, and therefore,

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following completion of the first stage the Company will own approximately 20% of Tadiran's shares. On completion of the first stage, Koor will support the Company's appointment of the greater of 3 members or 20% of Tadiran's board of directors, and Federmann will support Koor's appointment of a member to the Company's board of directors.

In the second stage, the Company will purchase the balance of Koor's holdings in Tadiran. Koor will purchase an additional approximately 4.5% of the Company's shares from Federmann, and Federmann will support Koor's appointment of an additional member to the Company's board of directors, including the board's Vice Chairman. The second stage is subject to Koor completing the sale to Tadiran of Koor's 70% holdings in Elisra Electronic Systems Ltd. ("Elisra") on agreed upon terms. Subject to those terms the Company agreed to support the purchase of the Elisra shares by Tadiran at Tadiran's general shareholders meeting. In the event that the sale of the Elisra shares to Tadiran is not made by April 2006, then Koor and the Company will have equal representation on Tadiran's board of directors, and an agreement regarding joint control of Tadiran will enter into effect between the Company and Koor.

The Company will purchase from Koor the 32% of the Tadiran shares at a price of \$37 per share, resulting in a total purchase price of approximately \$146,000. Koor will purchase from Federmann the 9.8% of the shares in the Company at a price of \$24.70 per share, resulting in a total purchase price of approximately \$99,000.

Under the Koor-Federmann shareholders agreement, which will become effective upon the completion of the first stage of the Koor-Federmann transaction, Koor will obtain certain tag along rights in the event of Federmann's sale of shares in the Company, and Koor will be subject to certain restrictions on the transfer of its shares in the Company. Also, Koor has agreed to vote at general shareholders meetings of the Company in accordance with Federmann's instructions, with certain exceptions, and Koor will receive certain additional non-transferable rights.

On January 5, 2005, the Company's Audit Committee and board of directors approved the agreements with Koor relating to the Company's purchase of Koor's shares in Tadiran.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 1 - GENERAL (CONT.)

On February 28, 2005, the Company's shareholders at an extraordinary general shareholders meeting approved the agreements with Koor relating to the Company's purchase of Koor's shares in Tadiran. As of March 1, 2005, the parties were in the

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process of obtaining the remaining approvals required for the transaction.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP"). As applicable to the consolidated financial statements of the Group, such principles are substantially identical to accounting principles generally accepted in Israel, except as described in Note 22.

A. USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported and disclosure of contingent assets and liabilities in the financial statements and accompanying notes. Actual results could differ from those estimates.

B. FINANCIAL STATEMENTS IN U.S. DOLLARS

The Company's revenues are generated mainly in U.S. dollars. In addition, most of the Company's costs are incurred in U.S. dollars. The Company's management believes that the U.S. dollar is the primary currency of the economic environment in which the Company operates. Thus, the functional and reporting currency of the Company is the U.S. dollar.

Transactions and balances originally denominated in U.S. dollars are presented at their original amounts. Transaction and balances in other currencies have been remeasured into U.S. dollars in accordance with principles set forth in SFAS No. 52 "Foreign Currency Translation". All exchange gains and losses from the remeasurement mentioned above are reflected in the statement of income in financial income or expenses.

For those foreign subsidiaries whose functional currency has been determined to be other than the U.S. dollar, assets and liabilities are translated at year-end exchange rates and statement of income items are translated at average exchange rates prevailing during the year. Such translation adjustments are recorded as a separate component of accumulated other comprehensive income in shareholders' equity.

C. PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly and majority-owned subsidiaries.

The consolidated subsidiaries include El-Op, EFW and other Israeli and non-Israeli subsidiaries.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

C. PRINCIPLES OF CONSOLIDATION (CONT.)

Intercompany transactions and balances including profit from intercompany sales not yet realized outside the Group have been eliminated upon consolidation.

D. CASH EQUIVALENTS

Cash equivalents, are short-term highly liquid investments that are readily convertible to cash with maturities of three months or less at the date of acquisition.

E. SHORT-TERM BANK DEPOSITS

Short-term bank deposits are deposits with maturities of more than three months but less than one year. The short-term bank deposits are presented at their cost.

F. MARKETABLE SECURITIES

Investments in a marketable securities are designed as available for sale according to Statement of Financial Accounting Standard No. 115 "Accounting for Certain Investments in Debt and Equity Securities", ("SFAS No. 115"). Accordingly, these securities are stated at fair value, with unrealized gains and losses, net of taxes, reported in accumulated other comprehensive income (loss), a separate component of the shareholders equity.

G. INVENTORIES

Inventories are stated at the lower of cost or net realizable value. Inventory write-offs are provided for slow-moving items or technological obsolescence for which recoverability is not probable.

Cost is determined as follows:

- o Raw materials using the average cost method.

- o Costs incurred on long-term contracts in progress include direct labor costs, material costs, subcontractors, other direct costs and overheads. These costs represent recoverable costs incurred for production, allocable operating overhead cost and, where appropriate, research and development costs (refer to Note 2(T)).

- o Labor overhead is generally included in our hourly rate and is allocated to each project according to the amount of hours invested. Material overhead is allocated to each project based on the value of direct material that is charged to the project.

Advances from customers are allocated to the applicable contract inventories and are reflected as an offset against the related inventory balances.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

H. INVESTMENT IN AFFILIATED COMPANIES, PARTNERSHIP AND OTHER COMPANIES

Investments in non-marketable shares of companies in which the Group holds less than 20% and the Group does not have the ability to exercise significant influence over operating and financial policies of the companies are recorded at cost.

Investments in companies and partnership over which the Group can exercise significant influence (generally, entities in which the Group holds between 20% and 50% of voting rights) are presented using the equity method of accounting. Profits on intercompany sales, not realized outside the Group, were eliminated. The Group discontinues applying the equity method when its investment (including advances and loans) is reduced to zero and it has not guaranteed obligations of the affiliate or otherwise committed to provide further financial support to the affiliate.

The Group applies Emerging Issues Task Force ("EITF 99-10") "Percentage Used to Determine the Amount of Equity Method Losses", according to which the Group recognizes equity method losses based on the ownership level of the particular investee security or loan held by the Group to which the equity method losses are being applied.

A change in the Company's proportionate share of a subsidiary's or investee's equity, resulting from issuance of shares by the subsidiary or investee to third parties, is recorded as a gain or loss in the consolidated income statements. If the realization is not assured, such as when the issuing company is a development stage company, the gain from issuance is accounted for as an equity transaction pursuant to SAB 51 "Accounting Sales of Stock by a Subsidiary".

Management evaluates investments in affiliates and other companies for evidence of other than temporary declines in value. When relevant factors indicate a decline in value that is other than temporary, the Company records a provision for the decline in value. A judgmental aspect of accounting for investments involves determining whether an other-than-temporary decline in value of the investment has been sustained. Such evaluation is dependent on the specific facts and circumstances. Accordingly, management evaluates financial information (e.g. budgets, business plans, financial statements, etc.) in determining whether an other-than-temporary decline in value exists. Factors indicative of an other-than-temporary decline include recurring operating losses, credit defaults and subsequent rounds of financings at an amount below the cost basis of the investment.

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This list is not all inclusive and management weighs all quantitative and qualitative factors in determining if an other-than-temporary decline in value of an investment has occurred.

I. LONG-TERM TRADE RECEIVABLES

Long-term trade receivables from extended payment agreements are recorded at their estimated present values (determined based on the original rates of interest).

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

J. LONG-TERM BANK DEPOSITS

Long-term bank deposits are deposits with maturities of more than one year. These deposits are presented at cost including accumulated interest.

K. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost, net of accumulated depreciation and investment grants. For equipment produced for the Group's own use, cost includes materials, labor and overhead, but not in excess of the fair value of the equipment.

Depreciation is calculated by the straight-line method over the estimated useful life of the assets at the following annual rates:

| | % |
|--------------------------------------|--------------------|
| | ----- |
| Buildings | 2-4 (mainly 4%) |
| Instruments, machinery and equipment | 10-33 |
| Office furniture and other | 6-33 |
| Motor vehicles | 15-20 (mainly 15%) |

Land rights and leasehold improvements - over the term of the lease.

L. INVESTMENT GRANTS

As a governmental incentive for industrial companies in Israel, the "Investment Center", which is a branch of the Israel Ministry of Industry and Trade, permits industrial companies to submit a request to qualify as an "Approved Enterprise". An Approved Enterprise is entitled to certain benefits in respect of capital investments. The benefits may be in the form of reduced tax rates

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and of capital grants received as a percentage of the investments of the Approved Enterprise. The amount of a capital grant is determined as a percentage of the Approved Enterprise investment in property, plant and equipment. As a condition to the granting of these benefits, the Approved Enterprise is obligated to perform the applicable industrial plan as detailed in the request to the Investment Center (see Note 15(A)(3) and 16(J)). These capital grants are non-royalty bearing and are not conditioned on the results of operations. As the capital grants are a direct participation in the cost of the acquisition, of property, plant and equipment they are offset against property, plant and equipment and amortized over the period of the related investments.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

M. IMPAIRMENT OF LONG-LIVED ASSETS

The Group's long-lived assets and identifiable intangible assets are reviewed for impairment in accordance with SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If an asset is determined 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. As of December 31, 2004, no impairment losses have been identified.

N. INTANGIBLE ASSETS

Intangible assets are stated at cost net of accumulated amortization. Intangible assets are being amortized over their useful life using the straight-line method.

O. GOODWILL

Goodwill represents the excess of the cost of acquired businesses over the net fair values of the assets acquired and liabilities assumed. Goodwill that arose from acquisitions prior to July 1, 2001, was amortized until December 31, 2001 on a straight-line

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basis over 10 - 20 years. Under SFAS No. 142, effective as of January 1, 2002, goodwill is no longer amortized, but is instead tested for impairment at least annually (or more frequently if impairments indicators arise).

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 impairment.

In the first phase of impairment testing, goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. If the carrying value of the reporting unit exceeds its fair value, the second phase is then performed. The second phase of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess.

Fair value of a reporting unit is determined using discounted cash flows. Significant estimates used in the methodology include estimates of future cash flows, future short-term and long-term growth rates and weighted average cost of capital for each of the reporting units.

As of December 31, 2004, no impairment losses have been identified.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

P. SEVERANCE PAY

Under Israeli law and employment agreements, the Group's companies in Israel are required to make severance payments and, in certain situations, pay pensions to terminated employees. The calculation is based on the employee's latest salary and the period of his/her employment. The companies' obligation for severance pay and pension is provided by monthly deposits with insurance companies, pension funds and by an accrual.

The value of severance pay funds is presented in the balance sheet and includes profits accumulated to balance sheet date. The amounts deposited may be withdrawn only after fulfillment of the obligations pursuant to Israeli severance pay law or labor agreements. The values of the deposited funds are based on the cash surrendered value of these funds and include immaterial profits.

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Severance pay expenses for the years ended December 31, 2004, 2003 and 2002, amounted to approximately \$15,574, \$11,491 and \$10,138, respectively.

Q. REVENUE RECOGNITION

The Group generates revenues from long-term contracts involving the design, development, manufacture and integration of defense systems and products and providing support and services for such systems and products.

Revenues from long-term contracts are recognized based on Statement of Position 81-1 "Accounting for Performance of Construction-Type and Certain Production-Type Contracts" ("SOP 81-1") according to which revenues are recognized on the percentage of completion basis.

Sales under long-term fixed-price contracts which provide for a substantial level of development efforts in relation to total contract efforts are recorded using the cost-to-cost method of accounting as the basis to measure progress toward completing the contract and recognizing revenues. According to this method, sales and profits are recorded based on the ratio of costs incurred to estimated total costs at completion. In certain circumstances, when measuring progress toward completion, the Company considers other factors, such as achievement of performance milestones.

Sales and anticipated profit under long-term fixed-price production type contracts are recorded on a percentage of completion basis, using the units-of-delivery as the basis to measure progress toward completing the contract and recognizing revenues.

Sales and anticipated profit under long-term fixed-price contracts that involve both development and production are recorded on a percentage of completion basis, using the cost-to-cost method and units-of-delivery method as applicable. In certain circumstances, when measuring progress toward completion under the development portion of the contract, the Company considers other factors, such as achievement of performance milestones.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

Q. REVENUE RECOGNITION (CONT.)

Estimated contract profit is included in earnings in proportion to recorded sales.

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The percentage-of-completion method of accounting requires management to estimate the cost and gross profit margin for each individual contract. Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original estimated forecasts. Such changes in estimated gross profit are recorded in results of operations when they are reasonably determinable by management, on a cumulative catch-up basis. Anticipated losses on contracts are charged to earnings when determined to be probable.

Sales under cost-reimbursement-type contracts are recorded as costs are incurred. Applicable estimated profits are included in earnings in the proportion that incurred costs bear to total estimated costs.

Amounts representing contract change orders, claims or other items are included in sales only when they can be reliably estimated and realization is probable. Penalties and awards applicable to performance on contracts are considered in estimating sales and profit rates and are recorded when there is sufficient information to assess anticipated contract performance.

The Group believes that the use of the percentage of completion method is appropriate as the Group has the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, contracts executed include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged and the manner and terms of settlement. In all cases the Group expects to perform its contractual obligations and its customers are expected to satisfy their obligations under the contract.

In cases where the contract involves the delivery of products and performance of services, the Group follows the guidelines specified in EITF 00-21, "Revenue Arrangements with Multiple Deliverables" in order to allocate the contract fees between the products accounted for under SOP 81-1 and the services accounted for under SAB 104. The services are recognized throughout the service period.

In certain circumstances, sales under short-term fixed-price production type contracts are accounted for in accordance with SAB No. 104, "Revenue Recognition in Financial Statements" ("SAB 104"), and recognized when the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the seller's price to the buyer is fixed or determinable, no further obligation exists and collectability is reasonably assured.

As for research and development costs accounted for as contract costs refer to Note 2(T) .

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

R. PRE-CONTRACT COSTS

Pre-contract costs are deferred and included in inventory, only when such costs can be directly associated with a specific anticipated contract and if their recoverability from the specific contract is probable according to the guidelines of SOP 81-1.

S. WARRANTY

The Group estimates the costs that may be incurred under its basic warranty and records a liability in the amount of such costs at the time revenue is recognized as part of contract costs. The specific terms and conditions of those warranties vary depending upon the product sold, the country in which the Group does business, etc. In addition, the Company estimates the costs to be incurred in connection with basic design and system operating difficulties arising subsequent to delivery and acceptance by the customers and records a liability for such costs as part of contract costs. Factors that affect the Group's warranty liability include the number of delivered products, the warranty period, engineering estimates and anticipated rates of warranty claims. The Group periodically assesses the adequacy of its recorded warranty liability and adjusts the amount as necessary.

Changes in the Group's provision for warranty during the year are as follows:

| | 2004 | 2003 |
|---|-----------|-----------|
| | ---- | ---- |
| Balance, at January 1 | \$ 36,653 | \$ 37,800 |
| Warranties issued during the year | 17,907 | 13,301 |
| Warranties forfeited or exercised during the year | (20,527) | (14,448) |
| | ----- | ----- |
| Balance, at December 31 | \$ 34,033 | \$ 36,653 |
| | ===== | ===== |

T. RESEARCH AND DEVELOPMENT COSTS

Research and development costs, net of participations, are charged to operations as incurred. Group sponsored research and development costs primarily include independent research and development and bid and proposal efforts.

Under certain arrangements in which a customer participates in product development costs, the Group's portion of such unreimbursed costs is expensed as incurred. Customer-sponsored research and development costs incurred pursuant to contracts are accounted for as part of the contract costs.

Certain Group companies in Israel receive grants (mainly royalty-bearing) from the Government of Israel and from other

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sources for the purpose of funding approved research and development projects. These grants are recognized as a deduction from research and development costs at the time the applicable company is entitled to such grants on the basis of the research and development costs incurred.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

U. INCOME TAXES

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

V. CONCENTRATION OF CREDIT RISKS

Financial instruments that potentially subject the Group to concentrations of credit risk consist principally of cash and cash equivalents, short and long-term deposits and trade receivables.

The majority of the Group's cash and cash equivalents and deposits are invested in dollar instruments with major banks in Israel and in the U.S. Management believes that the financial institutions that hold the Group investments are financially sound, and accordingly, minimal credit risk exists with respect to these investments.

The Group's trade receivables are derived primarily from sales to large and stable customers and governments located mainly in Israel, the United States and Europe. The Group performs ongoing credit evaluations of its customers and to date, has not experienced any unexpected material losses except for a one time loss in 2002 of approximately \$4,600 due to the insolvency of one of the Group's customers. An allowance for doubtful accounts is determined with respect to those amounts that the Group has determined to be doubtful of collection.

W. DERIVATIVE FINANCIAL INSTRUMENTS

Financial Accounting Standards Board Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities"

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("SFAS No. 133"), requires companies to recognize all of its derivative instruments as either assets or liabilities in the statement of financial position at fair value. The accounting for changes in the fair value (i.e. gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operation.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

W. DERIVATIVE FINANCIAL INSTRUMENTS (CONT.)

For derivative instruments that are designated and qualify as a fair value hedge (i.e., hedging the exposure to changes in the fair value of an asset or a liability or an identified portion thereof that is attributable to a particular risk), the gain and loss on the derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in the same line item associated with the hedged item in current earnings during the period of the change in fair values. For derivative instruments that are designated and qualify as a cash flow hedge (i.e. hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same line item associated with the forecasted transaction in the same period or periods during which the hedged transaction affects earnings.

The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized as a financial expense in current earnings during the period of change.

For derivative instruments not designated as hedging instruments, the gain or loss is recognized as a financial expense in current earnings during the period of change.

As part of its hedging strategy, the Group enters into forward exchange contracts in order to protect the Group from the risk that the eventual dollar cash flows from the sale of products to international customers will be adversely affected by changes in the exchange rates.

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As part of its cash flow hedging strategy the Group enters into forward exchange contracts to hedge forecasted salary expenses denominated in a currency other than the U.S. dollar.

As of December 31, 2004, the Group had forward contracts with a notional amount of approximately \$30,900 to purchase and sell foreign currencies (\$20,800 in Euro, \$5,400 in Great Britain Pounds ("GBP") and \$4,800 in other currencies). The Group also had options to hedge future cash flow denominated in GBP in the amount of \$154,000. The forward contracts and the options mature in 2005.

The fair value of the foreign exchange contracts and the options as of December 31, 2004 is minimal.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

X. STOCK-BASED COMPENSATION

Up until January 1, 2004, the Company elected to follow Accounting Principles Board Opinion No. 25 ("APB 25") "Accounting for Stock Issued to Employees" and FASB Interpretation No. 44 ("FIN 44") "Accounting for Certain Transactions Involving Stock Compensation" in accounting for its employee stock option plans. Under APB 25, the Company accounted for stock option grants using the intrinsic value method whereby compensation expense is equal to the excess, if any, of the quoted market price of the stock over the exercise price at the grant date of the award or if applicable at a subsequent measurement date. The Company recognized the expense over the vesting period of the award on a straight-line basis. Phantom options were accounted for as variable awards and accordingly, compensation expenses were measured at the end of each reporting period and amortized on an accelerated basis over the remaining vesting period. (See Note 17).

Effective January 1, 2004, the Company adopted the fair value recognition provisions of SFAS No. 123. Under the modified prospective method of adoption selected by the Company under the provisions of SFAS No. 148, the recognition provisions are applied to all employee awards granted, modified, or settled after January 1, 2004, and to previously granted awards that were not fully vested on the date of adoption. Compensation cost is recorded over the vesting period on a straight-line basis.

The cumulative effect on the deferred taxes relating to stock based compensation resulting from the adoption of SFAS No. 123 amounted to a reduction of \$152 and was recorded as a one time adjustment to additional paid-in capital.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands, except share and per share data)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

X. STOCK-BASED COMPENSATION (CONT.)

If the Company had elected to adopt the fair value recognition provisions of SFAS No. 123 as of its original effective date, pro forma net income and pro forma basic diluted net income per share for the years ended December 31, 2002 and 2003 would be as follows:

| | YEAR ENDED DECEMBER 31, | |
|---|-------------------------|-----------|
| | 2004 | 2003 |
| | ----- | ----- |
| Net income as reported | \$ 52,993 | \$ 45,945 |
| Add - Stock based compensation expense (income), net of related tax effects as reported (intrinsic method in 2003 and 2002) | 2,710 | 3,793 |
| Deduct - Stock based compensation expense under fair value based method of SFAS 123 net of related of tax effects | (2,710) | (2,956) |
| Pro forma net income | \$ 52,993 | \$ 46,782 |
| | ===== | ===== |
| Net earnings per share: | | |
| Basic net earnings per share as reported | \$ 1.33 | \$ 1.18 |
| | ===== | ===== |
| Diluted net earnings per share as reported | \$ 1.29 | \$ 1.14 |
| | ===== | ===== |
| Pro forma basic net earnings per share | \$ 1.33 | \$ 1.20 |
| | ===== | ===== |
| Pro forma diluted net earnings per share | \$ 1.29 | \$ 1.16 |
| | ===== | ===== |

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The fair value for these options was estimated using a Black-Scholes option pricing model with the following weighted average assumptions:

| | 2004 | 2003 | 2002 |
|-------------------------|---------|---------|---------|
| Divided yield | 2.20% | 2.19% | 1.99% |
| Expected volatility | 26.7% | 19.03% | 21.9% |
| Risk-free interest rate | 4% | 1.20% | 1.34% |
| Expected life | 4 years | 6 years | 6 years |

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

Y. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount reported in the balance sheet for cash and cash equivalents, short-term bank deposits, trade receivables, short-term bank credit and loans and trade payables approximate their fair values due to the short-term maturities of such instruments.

The carrying amount of the available for sale marketable securities is recorded according to its fair market value, as determined by quoted market prices on stock exchange.

Long-term loans are estimated by discounting the future cash flows using current interest rates for loans of similar terms and maturities. The carrying amount of the long-term loans approximates their fair value.

The fair value of foreign currency contracts (used for hedging purposes) is estimated by obtaining current quotes from investment bankers.

It was not practicable to estimate the fair value of the Group's investments in shares of non-public companies that are accounted for under the cost and equity method because of the lack of a quoted market price and the inability to obtain valuation of each company without incurring excessive costs. The carrying amounts of these companies as of December 31, 2003 and 2004 were \$38,223 and \$44,869, respectively, and represent the original cost of acquisition, and in the case of affiliates also the Company's

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equity in the earnings/losses of the affiliates and its share in the changes of the affiliates' equity since the dates of acquisition.

Z. BASIC AND DILUTED NET EARNINGS PER SHARE

Basic net earnings per share are computed based on the weighted average number of ordinary shares outstanding during each year. Diluted net earnings per share is computed based on the weighted average number of ordinary shares outstanding during each year, plus dilutive potential ordinary shares considered outstanding during the year. Outstanding stock options are excluded from the calculation of the diluted net earnings per ordinary share when such securities are anti-dilutive. In all the years presented no stock options were excluded.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

AA. IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

- (1). In February 2004, the FASB issued EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("EITF 03-1"). This EITF was issued to determine the meaning of other-than-temporary impairment and its application to investments in debt and equity securities within the scope of SFAS 115. EITF 03-1 also applies to investments in equity securities that are both outside SFAS 115's scope and are not accounted for by the equity method, which are defined as "cost method investments". The impairment measurement and recognition guidance prescribed in EITF 03-1 is delayed until the final issuance of FSP EITF 03-01-a. The disclosure requirements for investments accounted for under SFAS 115 are effective for annual reporting periods ending after June 15, 2003 and for costs method investments for annual reporting periods ending after June 15, 2004. The Company does not expect that the adoption of the provisions of EITF 03-1 will have a material effect on its financial position or results of operations.
- (2). In November 2004, the FASB issued Statement of Financial Accounting Standard No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4." ("SFAS 151"). SFAS 151 amends Accounting Research Bulletin ("ARB") No. 43, Chapter 4, to clarify that abnormal amounts of idle facility expense, freight handling costs and wasted materials (spoilage) should be recognized as current-period charges. In addition, SFAS 151 requires that allocation of fixed production overheads to the costs of conversion be based on normal

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capacity of the production facilities. SFAS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not expect that the adoption of SFAS 151 will have a material effect on its financial position or results of operations.

- (3). On December 16, 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123 (revised 2004) ("123(R)", "Share-Based Payment", which is a revision of FASB Statement No. 123, "Accounting for Stock-Based Compensation". Statement 123(R) supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees", and amends FASB Statement No. 95, "Statement of Cash Flows". Generally, the approach in Statement 123(R) is similar to the approach described in Statement 123. However, Statement 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. Statement 123(R) must be adopted no later than July 1, 2005. Early adoption will be permitted in periods in which financial statements have not yet been issued. The Company expects to adopt Statement 123(R) on July 1, 2005. Since, as noted in Note 2(AA) below, the Company adopted, effective January 1, 2004, the fair-value-based method of accounting for share-based payments, the adoption of Statement 123(R) is not expected to have a material impact on the Company's results of operation or its financial position.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

AA. IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS (CONT.)

Statement 123(R) permits public companies to adopt its requirements using one of two methods:

- o A "modified prospective" method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of Statement 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of Statement 123(R) for all awards granted to employees prior to the effective date of Statement 123(R) that remains unvested on the effective date.
- o A "modified retrospective" method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under Statement 123 for purposes of pro forma disclosures either (a) all prior

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periods presented or (b) prior interim periods of the year of adoption.

The Company plans to adopt Statement No. 123(R) using the modified prospective method.

The Company adopted the fair-value-based method of accounting for share-based payments effective January 1, 2004 using the "modified prospective method" described in FASB Statement No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure". Currently, the Company uses the Black-Scholes-Merton formula to estimate the value of stock options granted to employees and expects to continue to use this acceptable option valuation model upon the required adoption of Statement 123(R) on July 1, 2005. The Company does not anticipate that adoption of Statement 123(R) will have a material impact on its results of operations or its financial position. However, Statement 123(R) also requires that the benefits of tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after the effective date. While the Company cannot estimate what those amounts will be in the future (because they depend on, among other things, when employees exercise stock options), the amount of operating cash flows recognized in prior periods for such excess tax deductions was \$1,179, \$758, and \$648 in 2004, 2003 and 2002, respectively.

AB. RECLASSIFICATIONS

Certain financial statement data for prior years has been reclassified to conform to current year financial statement presentation.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 3 - TRADE RECEIVABLES, NET

Trade receivables

| | DECEMBER 31, | |
|--|--------------|------------|
| | 2004 | 2003 |
| Open accounts (*) | \$ 181,995 | \$ 170,287 |
| Unbilled receivables | 35,885 | 36,855 |
| Less - allowance for doubtful accounts | (3,064) | (3,861) |
| | \$ 214,816 | \$ 203,281 |
| (*) Includes affiliated companies | \$ 10,823 | \$ 6,668 |

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NOTE 4 - OTHER RECEIVABLES AND PREPAID EXPENSES

| | DECEMBER 31, | |
|-------------------------|------------------|------------------|
| | 2004 | 2003 |
| Deferred income taxes | \$ 20,603 | \$ 21,908 |
| Prepaid expenses | 17,914 | 14,310 |
| Government institutions | 5,719 | 5,826 |
| Employees | 1,204 | 513 |
| Others | 6,895 | 5,806 |
| | <u>\$ 52,335</u> | <u>\$ 48,363</u> |

NOTE 5 - INVENTORIES, NET OF ADVANCES

| | DECEMBER 31, | |
|--|-------------------|-------------------|
| | 2004 | 2003 |
| Cost incurred on long-term contracts in progress | \$ 254,009 | \$ 254,910 |
| Raw materials | 71,813 | 78,504 |
| Advances to suppliers and subcontractors | 21,164 | 20,137 |
| | <u>346,986</u> | <u>353,551</u> |
| Less - | | |
| Cost incurred on contracts in progress deducted from customer advances | 14,533 | 14,581 |
| | <u>332,453</u> | <u>338,970</u> |
| Less - | | |
| Advances received from customers (*) | 75,776 | 77,482 |
| Provision for losses | 7,636 | 12,263 |
| | <u>\$ 249,041</u> | <u>\$ 249,225</u> |

The Company has transferred legal title of inventories to certain customers as collateral for advances received.

(*) Advances are allocated to the relevant inventories on a per-project basis. In cases (projects) where the advances are in excess of the inventories, the net amount is presented as a liability. In cases where the inventories are in excess of advances received, the net amount is presented as an asset.

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U. S. dollars (In thousands)

NOTE 6 - INVESTMENTS IN AFFILIATED COMPANIES, PARTNERSHIP AND OTHER COMPANIES

A. INVESTMENTS IN COMPANIES ACCOUNTED FOR UNDER THE EQUITY METHOD:

| | DECEMBER 31, | |
|------------|--------------|-----------|
| | 2004 | 2003 |
| SCD (1) | \$ 19,186 | \$ 17,347 |
| VSI (2) | 6,966 | 6,149 |
| RedC (5) | 3,100 | - |
| Opgal (3) | 2,873 | 2,390 |
| Others (4) | 999 | 592 |
| | \$ 33,124 | \$ 26,478 |

- (1) Semi Conductor Devices ("SCD") is an Israeli partnership, held 50% by the Company and 50% by Rafael Armaments Development Authority Ltd. ("Rafael"). SCD is engaged in the development and production of various thermal detectors and laser diodes. SCD is jointly controlled and therefore is not consolidated in the Company's financial statements.
- (2) Vision Systems International LLC ("VSI") based in San Jose, is a California limited liability company that is held 50% by EFW and 50% by a subsidiary of Rockwell Collins Inc. VSI operates in the area of helmet mounted display systems for fixed wing military and paramilitary aircraft. VSI is jointly controlled and therefore is not consolidated in the Company's financial statements.
- (3) Opgal Optronics Industries Ltd. ("Opgal") is an Israeli company owned 50.1% by the Company and 49.9% by a subsidiary of Rafael. Opgal focuses mainly on commercial applications of thermal imaging and electro-optic technologies. The Company jointly controls Opgal with Rafael, and therefore Opgal is not consolidated in the Company's financial statements.
- (4) Mediguide Inc. ("Mediguide") and its Israeli subsidiary, Mediguide Ltd., were established in 2000 as a spin-off from the Company. The share capital of Mediguide consists of Common shares and Preferred A, B, C and D shares. The Common shares and the Preferred shares, both have voting rights. The Company holds all of the Common shares of Mediguide which constitute approximately 55% (43% on a fully diluted basis) of the voting rights of Mediguide. During 2001 - 2004, Mediguide issued Preferred shares to other investors in consideration for approximately \$34,355. The Preferred shares issued entitle the other investors to preference rights senior to all other classes of shares previously issued by Mediguide in a liquidation or a deemed liquidation event. Therefore, the Company did not record any gain as a result of the above transaction. In addition, the Preferred shares entitle their holders to certain participating rights. Accordingly, based on the guidance in EITF 96-16, the Company does not consolidate Mediguide. The carrying value of the investment in Mediguide is zero.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 6 - INVESTMENTS IN AFFILIATED COMPANIES, PARTNERSHIP AND OTHER COMPANIES
(CONT.)

A. INVESTMENTS IN COMPANIES ACCOUNTED FOR UNDER THE EQUITY METHOD
(CONT.)

- (5) RedC Optical Networks Inc. ("RedC"), a company registered in Delaware, is engaged in the multi-focal optic communications sector and as of December 31, 2003 was held 36.5% by El-Op. RedC designs develops and manufactures optical amplifiers for dense wave-length multiplexing optical networks for telecommunications. In the year ended December 31, 2002, the Company recorded a provision for loss on its investment in RedC of \$2,500. This provision has been presented in the Consolidated Statements of Income under "Equity in net earnings of affiliated companies and partnership".

In November 2004, El-Op acquired all of the outstanding voting Preferred A shares of RedC from MRV Communications Inc. for a consideration of \$2,000, in accordance with El-Op's right of first refusal based on the Preferred A shares investment agreement. Prior to the acquisition, El-Op held 57% of the Ordinary shares of RedC which reflected 36.5% of its voting rights. Following the acquisition, El-Op held 57% of the Ordinary shares and 100% of the Preferred A shares, which reflected 72.5% of RedC's voting rights.

In December 2004, El-Op signed a Transfer Agreement for selling all of it's holdings in RedC, including the Ordinary shares and Preferred A shares, in consideration for \$3,100, which was paid in cash on the closing date in January 2005. The closing was subject to certain conditions, which were all met by January 21, 2005.

El-Op allocated the purchase price to the fair value of the assets acquired and liabilities assumed.

Such allocation resulted in negative goodwill amounting to approximately to \$1,100. Since RedC had no assets which could be reduced by the negative goodwill, according to the provisions of FAS 141, this goodwill was recorded as other income in the financial statements.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 6 - INVESTMENTS IN AFFILIATED COMPANIES, PARTNERSHIP AND OTHER COMPANIES
(CONT.)

A. INVESTMENTS IN COMPANIES ACCOUNTED FOR UNDER THE EQUITY METHOD
(CONT.)

(6) The summarized aggregate financial information of companies accounted for under the equity method is as follows:

Balance Sheet Information:

| | DECEMBER 31, | |
|---|-------------------|-------------------|
| | 2004 | 2003 |
| Current assets | \$ 124,352 | \$ 105,457 |
| Non-current assets | 21,646 | 15,799 |
| Total assets | 145,998 | 121,256 |
| <hr style="border-top: 1px dashed black;"/> | | |
| Current liabilities | 68,655 | 59,076 |
| Non-current liabilities | 3,868 | 4,584 |
| Shareholders' equity | 73,475 | 57,596 |
| | \$ 145,998 | \$ 121,256 |

Income Statement Information:

| | YEAR ENDED DECEMBER 31, | |
|--------------|-------------------------|------------|
| | 2004 | 2003 |
| Revenues | \$ 213,680 | \$ 183,426 |
| Gross profit | 55,285 | 45,616 |
| Net income | 15,195 | 13,976 |

(7) See Note 16(F) for guarantees.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 6 - INVESTMENTS IN AFFILIATED COMPANIES, PARTNERSHIP AND OTHER COMPANIES (CONT.)

B. INVESTMENTS IN COMPANIES ACCOUNTED FOR UNDER THE COST METHOD

| | DECEMBER 31, | |
|------------|--------------|-----------|
| | 2004 | 2003 |
| Sultam (1) | \$ 3,500 | \$ 3,500 |
| ISI (2) | 7,230 | 7,230 |
| AAI (3) | 1,000 | 1,000 |
| Others | 15 | 15 |
| | \$ 11,745 | \$ 11,745 |
| | \$ 11,745 | \$ 11,745 |

(1) Sultam Systems Ltd. ("Sultam"), held 10%, is an Israeli company engaged in the development and manufacturing of military systems in the artillery sector.

(2) ImageSat International N.V. ("ISI"), held 14% (10% on a fully diluted basis), is engaged in the operation of satellite photography formations and commercial delivery of satellite photography for civil purposes.

(3) AeroAstro Inc. ("AAI") - In January 2003, the Company purchased 8.33% (on a fully diluted basis) of the common stock of AAI, a Delaware corporation in consideration for \$1,000. AAI is engaged in innovative micro and nanospacecraft applications. AAI manufactures low-cost satellite systems and components, used in its own spacecraft and for spacecraft development in and outside the U.S.

NOTE 7 - LONG-TERM BANK DEPOSITS AND TRADE RECEIVABLES

| | DECEMBER 31, | |
|--|--------------|----|
| | 2004 | |
| Deposits with banks for loans granted to employees (*) | \$ 1,603 | \$ |
| Long-term trade receivables | 452 | |
| Other deposits with banks | 47 | |
| | \$ 2,102 | \$ |
| | \$ 2,102 | \$ |

(*) The deposits are linked to the Israeli CPI, bear annual interest of 4% and are presented net of current maturities of \$534 (2003 - \$633).

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 8 - PROPERTY, PLANT AND EQUIPMENT, NET

| | DECEMBER 31, | |
|--|--------------|------------|
| | 2004 | 2003 |
| Cost (1): | | |
| Land, buildings and leasehold improvements (2) | \$ 151,285 | \$ 151,285 |
| Instruments, machinery and equipment (3) | 222,153 | 222,153 |
| Office furniture and other | 26,828 | 26,828 |
| Motor vehicles | 37,308 | 37,308 |
| | ----- | ----- |
| Accumulated depreciation | 437,574 | (193,286) |
| | (193,286) | ----- |
| Depreciated cost | \$ 244,288 | \$ 244,288 |
| | ===== | ===== |

Depreciation expenses for the years ended December 31, 2004, 2003 and 2002 amounted to \$35,001, \$30,775 and \$26,525, respectively.

(1) Net of investment grants received (mainly for instruments, machinery and equipment) in the amounts of approximately \$29,800 as of both December 31, 2004 and 2003.

(2) Includes, rights in approximately 9,225 square meters of land in Tirat Hacarmel, Israel. The land is leased from the Israel Land Administration until the years 2014 to 2024 with a renewal option for additional periods of up to 49 years. The Company's rights in the land have not yet been registered in its name.

Includes, rights in approximately 10,633 square meters of land in Rehovot, Israel. The land is leased from the Israel Land Administration until the year of 2043 with a renewal option for additional periods of up to 49 years. The Company's rights in the land have not yet been registered in its name.

(3) Includes equipment produced by the Group for its own use in the aggregate amount of \$69,146 and \$59,318 as of December 31, 2004 and 2003, respectively.

(4) As for pledges of assets - see Note 16(I).

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 9 - INTANGIBLE ASSETS, NET

A.

| | WEIGHTED AVERAGE NUMBER OF YEARS OF AMORTIZATION | DECEMBER 31, | |
|---------------------------|--|--------------|------------|
| | | 2004 | 2003 |
| Original cost: | | | |
| Technology (1) | 15 | \$ 85,413 | \$ 82,413 |
| Trade marks (2) | 17 | 8,000 | 8,000 |
| Goodwill (3) | | 37,884 | 37,600 |
| | | 131,297 | 128,013 |
| Accumulated amortization: | | | |
| Technology | | 28,365 | 21,500 |
| Trade marks | | 1,908 | 1,400 |
| Goodwill | | 5,037 | 5,000 |
| | | 35,310 | 28,000 |
| Amortized cost | | \$ 95,987 | \$ 100,013 |

(1) The technology acquired consists of four major items as follows:

In 2000, the Company completed a merger with El-Op. A portion of the purchase price was allocated to technology (\$45,000), based on an independent appraisal. The technology acquired in the merger with El-Op comprises various technologies relating to:

- a. Diode pumped and other advanced solid-state lasers incorporating add-on eye-safety options.
- b. Detectors for thermal imaging devices, including 2-D arrays for second and third generation forward looking infrared sensors.
- c. Line of sight command, control and stabilization systems employing computerized digital controllers.
- d. Sophisticated image and signal processing, utilizing the modern equipment and software.

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- e. High precision mechanical and optical component design and manufacturing for the visible, ultraviolet and infrared spectra, including special and exotic materials, diffractive and planar optics, space borne lightweight optics and multi-layer coatings.
- f. Aviation instruments such as precision altimeters and air speedometer.

In 2000, EFW acquired from Honeywell Inc., Honeywell's business relating to head-up displays and tracking systems for pilot helmets. An amount of \$9,300 was allocated to the acquired technology based on its estimated fair value as prepared by the Company.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 9 - INTANGIBLE ASSETS, NET (CONT.)

In 2001 and 2002, the Company acquired a Brazilian company which serves as a center for the production and logistic support of defense electronics programs in Brazil. An amount of \$5,500 was allocated to technology related to the maintenance and support of avionic equipment.

In 2002, the Company acquired the business of the Defense Systems Division of Elron Telesoft as detailed in Note 1(C) above in consideration for \$5,700. An amount of \$5,100 was allocated to the technology related to the government information technology control systems software developed by Elron Telesoft.

- (2) Includes trade marks acquired in the merger with El-Op in 2000.
 - (3) Includes mainly goodwill resulting from the merger with El-Op (\$34,200) in 2000 and goodwill acquired from Honeywell Inc. (\$1,800) in 2000. Until January 1, 2002, goodwill was amortized at an annual rate of 5% - 10%. The change in goodwill results from an acquisition of the business of CIC (See Note 1(F) above).
- B. Amortization expenses amounted to \$7,260, \$7,222 and \$6,412 for the years ended December 31, 2004, 2003 and 2002, respectively.
- C. The annual amortization expense relating to intangible assets existing as of December 31, 2004 is estimated to be approximately as follows:

| | | |
|------|----|-------|
| 2005 | \$ | 6,900 |
| 2006 | | 5,600 |
| 2007 | | 5,400 |

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| | |
|------------|-----------|
| 2008 | 5,200 |
| 2009 | 4,900 |
| Thereafter | 35,140 |
| | ----- |
| Total | \$ 63,140 |
| | ===== |

NOTE 10 - SHORT-TERM BANK CREDIT AND LOANS

| | DECEMBER 31, | | |
|--------------------------------|---------------|-----------|----------|
| | 2004 | 2003 | 2004 |
| | ----- | | |
| Short-term bank loans: | | | |
| | Interest Rate | | |
| | ----- | | |
| In U.S. dollars | 4.2-4.6% | 3.3-4.75% | \$ 3,967 |
| In Euro | - | 3.5% | - |
| | | | ----- |
| | | | 3,967 |
| | | | ----- |
| Short-term bank credit: | | | |
| In NIS unlinked | 5.7-8.1% | 7.2% | 2,120 |
| In U.S. dollars | 4.4% | 2.6% | 2,505 |
| | | | ----- |
| | | | 4,625 |
| | | | ----- |
| | | | \$ 8,592 |
| | | | ===== |
| Weighted Average Interest Rate | 4.7% | 5.4% | |

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 11 - OTHER PAYABLES AND ACCRUED EXPENSES

| | DECEMBER 31, |
|--|--------------|
| | 2004 |
| | ----- |
| Payroll and related expenses | \$ 42,491 |
| Provision for vacation pay | 26,936 |
| Provision for income taxes, net of advances paid, and VAT | 13,774 |
| Provisions for royalties | 17,845 |
| Provision for warranty | 34,033 |
| Cost provision for unbilled services rendered to the Company | |

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| | |
|---------------|------------|
| and others(*) | 34,623 |
| | ----- |
| | \$ 169,702 |
| | ===== |

(*) The other cost provision, primarily includes provisions for estimated future costs in respect of contractual penalties and the probable loss resulting from claims (legal or unasserted) in the ordinary course of business.

NOTE 12 - CUSTOMERS ADVANCES AND AMOUNTS IN EXCESS OF COSTS INCURRED ON CONTRACTS IN PROGRESS

| | DECEMBER |
|--|------------|
| | 2004 |
| | ----- |
| Advances received | \$ 180,738 |
| Less - | |
| Advances presented under long-term liabilities | 10,320 |
| Advances deducted from inventories | 75,776 |
| | ----- |
| | 94,642 |
| Less - | |
| Costs incurred on contracts in progress | 14,533 |
| | ----- |
| | \$ 80,109 |
| | ===== |

As for guarantees and liens see Note 16(F).

NOTE 13 - LONG-TERM LOANS

| | CURRENCY | INTEREST % | YEARS OF MATURITY | 20 |
|------------------------------|----------------------------------|------------------------|----------------------|---------|
| | ----- | ----- | ----- | ----- |
| Banks | U.S. dollars | Libor + 0.75%-1.25% | mainly 2-3 | \$ 83,4 |
| Banks | NIS-unlinked | Israeli Prime | - | |
| Office of Chief Scientist | NIS-linked to the Israeli-CPI | 4.4% | 3 | 4,1 |
| Other | | | | 2 |
| | | | | ----- |
| | | | | 87,8 |
| Less-current maturities | | | | 1,6 |
| | | | | ----- |
| | | | | \$ 86,2 |
| | | | | ===== |

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 13 - LONG-TERM LOANS (CONT.)

The Libor rate as of December 31, 2004 was 2.56%. The maturities of these loans after December 31, 2004 are as follows:

| | | |
|---------------------------|----|--------|
| 2005 - current maturities | \$ | 1,656 |
| 2006 | | 40,527 |
| 2007 | | 42,550 |
| 2008 | | 165 |
| 2009 | | 170 |
| 2010 and thereafter | | 2,822 |
| | | ----- |
| | \$ | 87,890 |
| | | ===== |

See Note 16(G) for covenants.

NOTE 14 - BENEFIT PLANS

EFW, the Company's subsidiary in the U.S., has adopted for its employees in the U.S. benefits plans as follows:

DEFINED BENEFIT RETIREMENT PLAN

EFW has two defined benefit pension plans (the "Plans") substantially covering its employees in the U.S. Monthly benefits are based on years of benefit service and annual compensation. Annual contributions to the Plans are determined using the unit credit actuarial cost method and are equal to or exceed the minimum required by law. Pension fund assets of the Plans are invested primarily in stock, bonds and cash by a financial institution, as the investment manager of the Plans' assets.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 14 - BENEFIT PLANS (CONT.)

The following table reconciles the benefit obligations, Plans assets, funded status and net asset (liability) information of the Plans:

DECEMBER

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| | ----- | 2004 | ----- |
|--|-------|----------|-------|
| Benefit obligation at beginning of year | \$ | 34,965 | |
| Service cost | | 3,000 | |
| Interest cost | | 2,191 | |
| Actuarial losses | | 2,307 | |
| Unrecognized transition obligation | | 1,056 | |
| Benefits repaid | | (822) | |
| | | ----- | |
| Benefit obligation at end of year | | 42,697 | |
| | | ----- | |
| Plans assets at beginning of year | | 21,196 | |
| Actual return on Plan assets | | 1,756 | |
| Contributions by employer | | 2,971 | |
| Benefits repaid | | (822) | |
| | | ----- | |
| Plans assets at end of year | | 25,101 | |
| | | ----- | |
| Funded status of Plans (underfunded) | | (17,595) | |
| Unrecognized prior service cost | | (180) | |
| Unrecognized transition obligation | | 1,056 | |
| Unrecognized net actuarial loss | | 11,447 | |
| | | ----- | |
| Net amount recognized | \$ | (5,272) | |
| | | ===== | |
| Net asset (liability) consists of: | | | |
| Accrued benefit liability | \$ | (13,899) | |
| Intangible asset | | 895 | |
| Accumulated other comprehensive income | | 7,732 | |
| | | ----- | |
| Net amount recognized | \$ | (5,272) | |
| | | ===== | |
| Weighted average assumptions: | | | |
| Discount rate as of December 31, | | | 6.00% |
| Expected long-term rate of return on Plan's assets | | | 8.50% |
| Rate of compensation increase | | | 3.00% |

| | YEAR ENDED DECEMBER | |
|--|---------------------|----------|
| | 2004 | 2003 |
| | ----- | ----- |
| Components of net periodic pension cost: | | |
| Service cost | \$ 3,000 | \$ 2,480 |
| Interest cost | 2,191 | 1,921 |
| Expected return on Plans' assets | (1,951) | (1,573) |
| Amortization of prior service cost | (15) | (15) |
| Recognized net actuarial loss | 451 | 339 |
| | ----- | ----- |
| Net periodic pension cost | \$ 3,676 | \$ 3,152 |
| | ===== | ===== |

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 14 - BENEFIT PLANS (CONT.)

DEFINED CONTRIBUTION PLAN

The 401(k) savings plan ("401(k) plan") is a defined contribution retirement plan that covers all eligible employees, as defined in section 401(k) of the U.S. Internal Revenue Code. EFW's employees may elect to contribute a percentage of their annual gross compensation to the 401(k) plan. EFW may make discretionary matching contributions as determined by the subsidiary. Total expense under the 401(k) plan amounted to \$1,744 for the year ended December 31, 2004 (2003 - \$1,629, 2002 - \$1,369).

NOTE 15 - TAXES ON INCOME

A. APPLICABLE TAX LAWS

(1) MEASUREMENT OF TAXABLE INCOME UNDER ISRAEL'S INCOME TAX (INFLATIONARY ADJUSTMENTS) LAW, 1985:

Results for tax purposes for the Company and certain of its Israeli subsidiaries are measured and reflected in accordance with the change in the Israeli Consumer Price Index ("CPI"). As explained above in Note 2(B), the consolidated financial statements are presented in U.S. dollars. The differences between the change in the Israeli CPI and in the NIS/U.S. dollar exchange rate cause a difference between taxable income and the income before taxes reflected in the consolidated financial statements.

In accordance with paragraph 9(f) of SFAS No. 109, the Company has not provided deferred income taxes on the above differences resulting from changes in exchange rates and indexing for tax purposes.

(2) TAX BENEFITS UNDER ISRAEL'S LAW FOR THE ENCOURAGEMENT OF INDUSTRY (TAXES), 1969:

The Company and certain subsidiaries in Israel (mainly El-Op and Cyclone Aviation Products Ltd.) are "Industrial Companies", as defined by the Law for the Encouragement of Industry (Taxes), 1969, and as such, these companies are entitled to certain tax benefits, mainly amortization of costs relating to know-how and patents over eight years, accelerated depreciation and the right to deduct public issuance expenses for tax purposes.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 15 - TAXES ON INCOME (CONT.)

(3) TAX BENEFITS UNDER ISRAEL'S LAW FOR THE ENCOURAGEMENT OF CAPITAL INVESTMENTS, 1969:

Several expansion programs of the Company and certain of its Israeli subsidiaries ("the companies") have been granted "Approved Enterprise" status under Israel's Law for the Encouragement of Capital Investments, 1959. For some expansion programs, the companies have elected the grants track and for others they have elected the alternative tax benefits track, waiving grants in return for tax exemptions.

Accordingly, certain income of the companies, derived from the "Approved Enterprise" expansion programs is tax exempt for two-year to ten-year period and subject to reduced tax rates of 25% for a five-year to eight-year period commencing in the year in which the companies had taxable income (limited to twelve years from commencement of production or fourteen years from the date of approval, whichever is earlier). As of December 31, 2004, the tax benefits for these exiting expansion programs will expire within the period of 2005 to 2012.

The entitlement to the above benefits is subject to the companies fulfilling the conditions specified in the above referred law, regulations published hereunder and the letters of approval for the specific investments in "Approved Enterprises". In the event of failure to comply with these conditions, the benefits may be canceled and the companies may be required to refund the amount of the benefits, in whole or in part, including interest. (For liens - see Note 16(J)). As of December 31, 2004, Management believes that the companies are meeting all conditions of the approvals.

As of December 31, 2004, retained earnings included approximately \$116,500 in tax-exempt profits earned by the companies' "Approved Enterprises". If the retained tax-exempt income is distributed, it would be taxed at the corporate tax rate applicable to such profits as if the Company had not elected the alternative tax benefits track (currently - 25%) and an income tax liability would be incurred of approximately \$29,100 as of December 31, 2004.

The companies' boards of directors have decided that their policy is not to declare dividends out of such tax-exempt income. Accordingly, no deferred income taxes have been provided on income attributable to the companies' "Approved Enterprises".

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

 U. S. dollars (In thousands)

NOTE 15 - TAXES ON INCOME

(3) TAX BENEFITS UNDER ISRAEL'S LAW FOR THE ENCOURAGEMENT OF CAPITAL INVESTMENTS, 1969 (CONT.):

In Israel, income from sources other than the "Approved Enterprise" during the benefit period will be subject to tax at the regular corporate tax rate of 35%.

Since the companies are operating under more than one approval, and since part of their taxable income is not entitled to tax benefits under the above mentioned law and is taxed at the regular tax rate of 35%, the effective tax rate is the result of a weighted combination of the various applicable rates and tax exemptions, and the computation is made for income derived from each approval on the basis of formulas specified in the law and in the approvals.

B. NON - ISRAELI SUBSIDIARIES

Non-Israeli subsidiaries are taxed based on tax laws in their countries of residence (mainly in the U.S.).

C. INCOME BEFORE TAXES ON INCOME

| | YEAR ENDED DECEMBER 31 | |
|--------------------------------|------------------------|-----------|
| | 2004 | 2003 |
| | ----- | ----- |
| Income before taxes on income: | | |
| Domestic | \$ 43,642 | \$ 38,423 |
| Foreign | 16,985 | 11,090 |
| | ----- | ----- |
| | \$ 60,627 | \$ 49,513 |
| | ===== | ===== |

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 15 - INCOME TAXES (CONT.)

D. TAXES ON INCOME

| | YEAR ENDED DECEMBER | |
|---------------------------------|---------------------|-----------|
| | 2004 | 2003 |
| Taxes on income: | | |
| Current taxes: | | |
| Domestic | \$ 7,415 | \$ 12,346 |
| Foreign | 7,651 | 718 |
| | 15,066 | \$ 13,064 |
| Deferred income taxes: | | |
| Domestic | 709 | (4,672) |
| Foreign | (556) | 2,942 |
| | 153 | (1,730) |
| Taxes in respect of prior years | - | - |
| | \$ 15,219 | \$ 11,334 |

(*) A reduction of tax expenses due to adjustments of estimated tax provision pursuant to the completion of prior years' tax assessments in respect of various Group companies with the tax authorities.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 15 - INCOME TAXES (CONT.)

E. DEFERRED INCOME TAXES

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of net deferred tax assets

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and liabilities are as follows:

| | TOTAL | DEFERRED TAX ASSET (LIABIL) | |
|---------------------------------------|------------|--------------------------------|----|
| | | CURRENT | NO |
| As of December 31, 2004 | | | |
| Deferred tax assets: | | | |
| Reserves and allowances | \$ 12,797 | \$ 13,191 | \$ |
| Inventory | 5,376 | 5,376 | |
| Net operating loss carryforwards | 5,395 | 149 | |
| | 23,568 | 18,716 | |
| Valuation allowance | (3,445) | - | |
| Net deferred tax assets | 20,123 | 18,716 | |
| Deferred tax liabilities: | | | |
| Property, plant and equipment | (12,999) | - | |
| Intangible assets | (10,285) | 2,639 | |
| Available for sale securities | (752) | (752) | |
| | (24,036) | 1,887 | |
| Net deferred tax assets (liabilities) | \$ (3,913) | \$ 20,603 | \$ |
| As of December 31, 2003 | | | |
| Deferred tax assets: | | | |
| Reserves and allowances | \$ 11,149 | \$ 11,187 | \$ |
| Inventory | 7,952 | 7,952 | |
| Net operating loss carryforwards | 6,606 | 439 | |
| | 25,707 | 19,578 | |
| Valuation allowance | (3,879) | - | |
| Net deferred tax assets | 21,828 | 19,578 | |
| Deferred tax liabilities: | | | |
| Property, plant and equipment | (12,769) | - | |
| Intangible assets | (12,067) | 2,330 | |
| | (24,836) | 2,330 | |
| Net deferred tax assets (liabilities) | \$ (3,008) | \$ 21,908 | \$ |

(1) The current tax asset is included in other receivables.
Noncurrent tax liability is included as a long-term liability.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 15 - INCOME TAXES (CONT.)

- F. As of December 31, 2004, The Group's Israeli subsidiaries have estimated total available carryforward tax losses of approximately \$16,700, and the Group's non-Israeli subsidiaries have estimated available carryforward tax losses of approximately \$7,300. These losses can be offset against future taxable profits for an indefinite period. Deferred tax assets in respect of the above carryforward losses amount to approximately \$5,400 in respect of which a valuation allowance has been recorded in the amount of approximately \$3,400.
- G. Reconciliation of the theoretical tax expense, assuming all income is taxed at the statutory rate applicable to income of the Group, and the actual tax expense as reported in the statements of operations, is as follows:

| | YEAR ENDED | |
|--|------------|-----------|
| | 2004 | 2003 |
| Income before taxes as reported in the consolidated statements of operations | \$ 60,627 | \$ 49,513 |
| Statutory tax rate | 35% | 36% |
| Theoretical tax expense | \$ 21,219 | \$ 17,825 |
| Tax benefit arising from reduced rate as an "Approved Enterprise" and other tax benefits | (7,196) | (8,391) |
| Tax adjustment in respect of different tax rates for foreign subsidiaries | 496 | 279 |
| Operating carryforward losses for which valuation allowance was provided | (434) | 126 |
| Increase (decrease) in taxes resulting from nondeductible expenses | 1,095 | 993 |
| Difference in basis of measurement for financial reporting and tax return purposes | (210) | 846 |
| Taxes in respect of prior years | - | - |
| Other differences, net | 248 | (344) |
| Actual tax expenses | \$ 15,219 | \$ 11,334 |
| Effective tax rate | 25.1% | 22.9% |

- H. AMENDMENT TO THE INCOME TAX ORDINANCE

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On September 29, 2004, the Israeli Parliament approved the Amendment to the Income Tax Ordinance (No. 140 and Temporary Provision) (the "Amendment") which reduces the corporate tax rate from 36% to 35% in 2004 and to a rate of 30% in 2007 progressively. The Amendment was signed and published in July 2004 and is therefore considered enacted in July 2004. The adoption of the Amendment did not have a significant effect on the Company's financial statements.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 16 - COMMITMENTS AND CONTINGENT LIABILITIES

A. ROYALTY COMMITMENTS

1. The Company and certain Israeli subsidiaries partially finance their research and development expenditures under programs sponsored by the OCS for the support of research and development activities conducted in Israel. At the time the participations were received, successful development of the related projects was not assured.

In exchange for participation in the programs by the OCS, the Company and the subsidiaries agreed to pay 2% - 5% of total sales of products developed within the framework of these programs. The royalties will be paid up to a maximum amount equaling 100% to 150% of the grants provided by the OCS, linked to the dollar and for grants received after January 1, 1999, also bearing annual interest at a rate based on LIBOR. The obligation to pay these royalties is contingent on actual sales of the products, and in the absence of such sales payment of royalties is not required.

In some cases, the Government of Israel participation (through the OCS) is subject to export sales or other conditions. The maximum amount of royalties is increased in the event of production outside of Israel.

The Company and certain of its subsidiaries may also be obligated to pay certain amounts to the Israeli Ministry of Defense and others on certain sales including sales resulting from the development of certain technologies.

Royalties expensed amounted to \$5,802, \$7,812 and \$14,471 in 2004, 2003 and 2002, respectively.

2. In September 2001, the OCS issued "Regulations for the Encouragement of Research and Development in Industry" (rules for determining the level and payment of royalties) (the "regulations"). The regulations allow large R&D intensive companies to reach certain agreements with the OCS

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regarding determination of the amount and payment schedule of royalties, subject to certain conditions.

If the Company elects to adopt the regulations, it will have to record a significant one-time expense resulting from accruing a liability for an absolute amount of royalties.

In May 2002, El-Op's Board of Directors approved an arrangement, proposed by the OCS, according to which El-Op pays commencing in 2002, an agreed amount of \$10,632 in exchange for a release from all obligations to pay royalties in the future. As a result, El-Op recorded an expense for the agreed amount net of the accrual for royalties previously recorded by El-Op in the amount of \$9,801. This expense is included cost of revenues.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 16 - COMMITMENTS AND CONTINGENT LIABILITIES (CONT.)

B. COMMITMENTS IN RESPECT OF LONG-TERM PROJECTS

In connection with long-term projects in certain countries, the Company and certain subsidiaries undertook to use their respective best efforts to make or facilitate purchases or investments in those countries at certain percentages of the amount of the projects. The companies' obligation to make or facilitate third parties making such investments and purchases is subject to commercial conditions in the local market, typically without a specific financial penalty. The maximum aggregate undertaking as of December 31, 2004 amounted to \$673,000 to be performed over a period of up to 11 years. This amount is typically tied to a percentage (up to 100%) of the amount of a specific contract.

In the opinion of the Company's Management, the actual amount of the investments and purchases is anticipated to be less than that mentioned above, since certain investments and purchases can result in reducing the overall undertaking on more than a one-to-one basis.

C. LEGAL CLAIMS

The Company and its subsidiaries are involved in legal claims arising in the ordinary course of business, including claims by employees, consultants and others. Company's Management, based on the opinion of its legal counsel, believes that the financial impact for the settlement of such claims in excess of the accruals recorded in the financial statements will not have a material adverse effect on the financial position or results of operations of the Group.

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D. LEASE COMMITMENTS

The future minimum lease commitments of the Group under various non-cancelable operating lease agreements in respect of premises, motor vehicles and office equipment are as of December 31, 2004 as follows:

| | | |
|---------------------|----|--------|
| 2005 | \$ | 6,655 |
| 2006 | | 5,939 |
| 2007 | | 4,547 |
| 2008 | | 3,022 |
| 2009 and thereafter | | 13,060 |
| | | ----- |
| | \$ | 33,223 |
| | | ===== |

Rent expenses for the years ended December 31, 2004, 2003 and 2002 amounted to \$6,842, \$9,177, and \$9,215, respectively.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 16 - COMMITMENTS AND CONTINGENT LIABILITIES (CONT.)

E. PUT OPTION

Three founding employees (the "Founders"), who collectively hold approximately 32.3% of the outstanding shares of Kinetics Ltd. ("Kinetics"), a 51%-owned Israeli subsidiary, have a put option to jointly sell all of their shares in Kinetics to the Company. Two private investors holding in the aggregate approximately 16.7% of Kinetics' outstanding shares have "tag along" rights in the event the Founders exercise the put option.

The put option is exercisable from January 1, 2005 until December 31, 2005 at a price equal to the higher of the Founder's pro-rata share (corresponding to the Founder's shareholding percentage) of:

(1) The value of Kinetics as of the option exercise date as determined by a third party appraiser mutually acceptable to the Founders and to the Company. The appraiser will value Kinetics as if Kinetics had distributed as dividends net profits accumulated up to the option exercise date; or

(2) \$12,077, reduced by 3% per annum, or pro-rata part thereof, for the period beginning on July 1, 2003 and ending on the option exercise date.

As of December 31, 2004, the fair value of the aforementioned option was immaterial.

F. GUARANTEES

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1. Guarantees in the amount of approximately \$380,000 were issued by banks on behalf of Group companies in order to secure certain advances from customers and performance bonds.
2. The Company has provided, on a proportional basis to its ownership interest, guarantees for two of its investees in respect of credit lines granted to them from banks amounting to \$12,000 (2003- \$13,900), of which \$11,500 (2003 - \$13,400) relates to a 50%-owned foreign investee. The guarantees will exist as long as the credit lines are in effect. The Company would be liable under the guarantee for any debt for which the investee would be in default under the terms of the credit line.

G. COVENANTS

In connection with bank credits and loans, including performance guarantees issued by banks and bank guarantees in order to secure certain advances from customers, the Company and certain subsidiaries are obligated to meet certain financial covenants. Such covenants include requirements for shareholders' equity, current ratio, operating profit margin, tangible net worth, EBITDA, interest coverage ratio and total leverage. As of December 31, 2004 the Company and its subsidiaries were in full compliance with all covenants.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 16 - COMMITMENTS AND CONTINGENT LIABILITIES (CONT.)

H. CONTRACTUAL OBLIGATIONS

Substantially all of the purchase commitments relate to obligations under purchase orders and subcontracts entered into by the Company. These purchase orders and subcontracts are typically in a standard format proposed by the Company, with the subcontracts and purchase orders also reflecting provisions from the Company's applicable prime contract that are appropriate to flow down to subcontractors and vendors. The terms typically included in these purchase orders and subcontracts are consistent with Uniform Commercial Code provisions in the United States for sales of goods, as well as with specific terms called for by its customers in international contracts. These terms include the Company's right to terminate the purchase order or subcontract in the event of the vendors' or subcontractors' default, as well as the Company's right to terminate the order or subcontract for the Company's convenience (or if the Company's prime contractor has so terminated the prime contract). Such purchase orders and subcontracts typically are not subject to variable price

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provisions. As of December 31, 2004 and 2003 the purchase commitments were \$345,000 and \$348,400 respectively.

- I. In order to secure bank loans and bank guarantees in the amount of \$10,019 as of December 31, 2004, certain Group companies recorded fixed charges on most of their machinery and equipment, mortgages on most of their real estate and floating charges on most of their assets.
- J. A lien on the Group's Approved Enterprises has been registered in favor of the State of Israel. Grants received in respect of projects which have not yet been approved amount to approximately \$220 (see Note 15 (A) (3) above).

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands, except share and per share data)

NOTE 17 - SHAREHOLDER'S EQUITY

A. SHARE CAPITAL

Ordinary shares confer upon their holders voting rights, the right to receive dividends and the right to share in equity upon liquidation of the Company.

B. 2000 EMPLOYEE STOCK OPTION PLAN

In 2000, the Company adopted an employee stock option plan for employees comprising options to purchase up to 2,500,000 ordinary shares. The exercise price approximates the market price of the shares at the grant date. The plan includes an additional 2,500,000 options to be issued as "phantom" share options that grant the option holders 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. Options vest over a period of one to four years from the date of grant and expire no later than six years from the date of grant.

Any options which are canceled or forfeited before expiration become available for future grants. As of December 31, 2004, 453,794 options of the Company were still available for future grants.

C. "PHANTOM" SHARE OPTIONS

Until January 1, 2004, the Company applied the provision of APB No. 25, under which the phantom share options were considered to be part a variable awards as defined in APB No. 25, and accordingly the compensation cost of the options was measured at the end of each reporting period and amortized by the accelerated

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method over the remaining vesting period. Starting January 1, 2004, the Company accounts for its stock based compensation awards under the fair value based method.

- D. A summary of the Company's share option activity under the plans is as follows:

| | 2004 | | 2003 | |
|--|----------------------|--|----------------------|--|
| | NUMBER OF OPTIONS | WEIGHTED AVERAGE EXERCISE PRICE | NUMBER OF OPTIONS | WEIGHTED AVERAGE EXERCISE PRICE |
| Outstanding - beginning of the year | 3,735,602 | \$ 12.30 | 4,511,724 | \$ 12.26 |
| Granted | 130,500 | 15.67 | 13,000 | 14.91 |
| Exercised | (1,666,774) | 12.12 | (757,947) | 12.13 |
| Forfeited | (69,071) | 12.10 | (31,175) | 12.29 |
| | 2,130,257 | \$ 12.60 | 3,735,602 | \$ 12.30 |
| Options exercisable at the end of the year | 1,950,903 | \$ 12.36 | 2,547,196 | \$ 12.23 |

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands, except share and per share data)

NOTE 17 - SHAREHOLDER'S EQUITY (CONT.)

- E. The options outstanding as of December 31, 2004, have been separated into ranges of exercise prices, as follows:

| EXERCISE PRICE | OPTIONS OUTSTANDING | | | OPTIONS EXERCISED | |
|-----------------|---|---|--|---|--|
| | NUMBER OUTSTANDING AS OF DECEMBER 31, 2004 | WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (YEARS) | WEIGHTED AVERAGE EXERCISE PRICE PER SHARE | NUMBER OUTSTANDING AS OF DECEMBER 31, 2004 | WEIGHTED AVERAGE EXERCISE PRICE |
| \$10.61-\$12.16 | 1,500 | 0.82 | \$ 12.16 | 1,500 | \$ 12.16 |
| \$12.18-\$18.99 | 1,050,427 | 2.17 | 12.60 | 960,750 | 12.60 |

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| | | | | | |
|--------------------|-----------|-------|----------|-----------|-------|
| \$12.18-\$18.99(*) | 1,078,330 | 2.23 | 12.59 | 988,563 | |
| | ----- | ----- | ----- | ----- | ----- |
| | 2,130,257 | 2.20 | \$ 12.60 | 1,950,903 | \$ |
| | ===== | ===== | ===== | ===== | ===== |

(*) Phantom share options.

Compensation expense (income) amounted to \$3,387, \$4,741 and \$(926) were recognized during the years ended December 31, 2004, 2003 and 2002, respectively. All the compensation expenses (income) in the years 2002 and 2003 were related to the Phantom share options under the stock option plan. The expenses in 2004 were recorded based on SFAS No. 123 and SFAS No. 148 according to the modified prospective method. The expenses (income) were recorded as follows:

| | YEAR ENDED DECEMBER 31, | | |
|-------------------------------------|-------------------------|----------|-------|
| | 2004 | 2003 | |
| Cost of revenues | \$ 1,863 | \$ 2,608 | \$ |
| R&D and marketing expenses | 677 | 948 | |
| General and administration expenses | 847 | 1,185 | |
| | ----- | ----- | ----- |
| | \$ 3,387 | \$ 4,741 | \$ |
| | ===== | ===== | ===== |

F. The weighted average exercise price and fair value of options granted during the years ended December 31, 2004, 2003 and 2002 were:

| | LESS THAN MARKET PRICE | | |
|--|-------------------------|----------|----|
| | YEAR ENDED DECEMBER 31, | | |
| | 2004 | 2003 | |
| Weighted average exercise price | \$ 15.67 | \$ 14.91 | \$ |
| Weighted average fair values on grant date | \$ 6.62 | \$ 4.63 | \$ |

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NOTE 17 - SHAREHOLDER'S EQUITY (CONT.)

G. Computation of basic and diluted net earnings per share:

| | YEAR ENDED DECEMBER 31, 2004 ----- | | | YEAR ENDED DECEMBER 31, 2003 ----- | | |
|--------------------------------|--|---|---------------------|---|---|---------------------|
| | NET INCOME TO SHAREHOLDERS OF ORDINARY SHARES | NET INCOME WEIGHTED AVERAGED NUMBER OF SHARES (*) | PER SHARE AMOUNT | TO SHAREHOLDERS OF ORDINARY SHARES | WEIGHTED AVERAGED NUMBER OF SHARES (*) | PER SHARE AMOUNT |
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Basic net earnings | \$ 52,993 | 39,952 | \$1.33 | \$ 45,945 | 39,061 | \$1.18 |
| Effect of dilutive securities: | | | | | | |
| Employee stock options | - | 1,089 | | - | 1,169 | |
| Diluted net earnings | ----- | ----- | ----- | ----- | ----- | ----- |
| | \$ 52,993 | 41,041 | \$1.29 | \$ 45,945 | 40,230 | \$1.14 |
| | ===== | ===== | ===== | ===== | ===== | ===== |

* In thousands

H. TREASURY SHARES

The Company's shares held by the Company and its subsidiaries are presented at cost and deducted from shareholder's equity.

I. DIVIDEND POLICY

Dividends declared by the Company are paid subject to statutory limitations. The Company's board of directors has determined not to declare dividends out of tax exempt earnings.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 18 - MAJOR CUSTOMER AND GEOGRAPHIC INFORMATION

The Group applies Statement of Financial Accounting Standards No. 131, "Disclosures About Segments of an Enterprise and Related Information", ("SFAS No. 131"). The Group operates in one reportable segment (see Note 1 for a brief description of the Group's business).

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- A. Revenues are attributed to geographic areas based on location of the end customers as follows:

| | Year ended December 31, | |
|--------|-------------------------|------------|
| | 2004 | 2003 |
| Europe | \$ 124,130 | \$ 109,409 |
| U.S. | 348,509 | 332,323 |
| Israel | 241,601 | 255,742 |
| Others | 225,685 | 200,506 |
| | \$ 939,925 | \$ 897,980 |
| | \$ 939,925 | \$ 897,980 |

- B. Revenues are generated by the following product lines:

| | YEAR ENDED DECEMBER 31, | |
|--|-------------------------|------------|
| | 2004 | 2003 |
| Airborne systems | \$ 367,927 | \$ 373,580 |
| Land vehicles systems | 199,224 | 199,800 |
| Command, control, communications, computers, intelligence, surveillance and reconnaissance systems (C(4)ISR) | 108,925 | 133,900 |
| Electro-optical systems | 200,322 | 140,500 |
| Others | 63,527 | 50,200 |
| | \$ 939,925 | \$ 897,980 |
| | \$ 939,925 | \$ 897,980 |

- C. Revenues from single customers, which exceed 10% of total revenues in the reported years:

| | YEAR ENDED DECEMBER 31, | |
|-----------------|-------------------------|------|
| | 2004 | 2003 |
| IMOD | 17% | 21% |
| U.S. Government | 10% | * |

*Less than 10%

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 18 - MAJOR CUSTOMER AND GEOGRAPHIC INFORMATION (CONT.)

D. Long-lived assets by geographic areas:

| | YEAR ENDED DECEMBER | |
|--------|---------------------|------------|
| | 2004 | 2003 |
| Israel | \$ 237,887 | \$ 229,396 |
| U.S. | 84,701 | 81,261 |
| Others | 17,687 | 18,576 |
| | \$ 340,275 | \$ 329,233 |
| | \$ 340,275 | \$ 329,233 |

NOTE 19 - RESEARCH AND DEVELOPMENT COSTS, NET

| | YEAR ENDED DECEMBER | |
|-----------------------|---------------------|-----------|
| | 2004 | 2003 |
| Total expenses | \$ 86,368 | \$ 65,487 |
| Less - participations | (19,522) | (10,568) |
| | \$ 66,846 | \$ 54,919 |
| | \$ 66,846 | \$ 54,919 |

NOTE 20 - FINANCIAL EXPENSES, NET

| | YEAR ENDED DECEMBER | |
|---|---------------------|------------|
| | 2004 | 2003 |
| Expenses: | | |
| On long-term bank debt | \$ (1,544) | \$ (2,215) |
| On short-term bank credit and loans | (2,309) | (2,182) |
| Others | (3,181) | (3,905) |
| | \$ (7,034) | (8,302) |
| Income: | | |
| Interest on cash, cash equivalents and bank deposits | 628 | 309 |

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| | | |
|--|------------|------------|
| Others | 1,115 | 4,397 |
| | ----- | ----- |
| | 1,743 | 4,706 |
| | ----- | ----- |
| Gain (loss) from exchange rate differences | (561) | (1,274) |
| | ----- | ----- |
| | \$ (5,852) | \$ (4,870) |
| | ===== | ===== |

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 21 - RELATED PARTIES TRANSACTIONS AND BALANCES

| | YEAR ENDED DECEMBER 31, | |
|--|-------------------------|-----------|
| | 2004 | 2003 |
| | ----- | ----- |
| Income - | | |
| Sales to affiliated companies (*) | \$ 56,346 | \$ 34,674 |
| Participation in expenses | \$ 2,594 | \$ 1,773 |
| Cost and expenses - | | |
| Supplies and services from affiliated companies (**) | \$ 16,338 | \$ 21,606 |
| Participation in expenses | \$ 627 | \$ 1,751 |
| Financial expenses | \$ 3 | \$ 23 |
| | | |
| | DECEMBER 31, | |
| | ----- | ----- |
| | 2004 | 2003 |
| | ----- | ----- |
| Trade receivables and other receivables (*) | \$ 13,214 | \$ 6,668 |
| Trade payables (**) | \$ 5,445 | \$ 4,975 |

The purchases from our related parties are made at prices and on terms equivalent to those used in transacting business with unrelated parties under similar conditions. The sales to our related parties in respect with government defense contracts are made on the basis of costs incurred.

(*) The significant sales include sales of helmet mounted cueing systems purchased from the Company by VSI. (**) Includes electro-optics components and sensors purchased by the Company from SCD and electro-optics products purchased by the Company from Opgal.

NOTE 22 - RECONCILIATION TO ISRAELI GAAP

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As described in Note 1, the Company prepares its financial statements in accordance with U.S. GAAP. The effects of the differences between U.S. GAAP and generally accepted accounting principles in Israel ("Israeli GAAP") on the Company's financial statements are detailed below.

A building purchased from Elbit Ltd.

According to Israeli GAAP, the Company charged to additional paid-in capital reserves the excess of the amount paid over net book value of a building acquired from Elbit Ltd in 1999. According to U.S. GAAP, the entire amount paid is considered as the cost of the building acquired.

Proportional consolidation method

According to Israeli GAAP, a jointly controlled company should be included according to the proportional consolidation method. According to U.S. GAAP, the investment in such a company is recorded according to the equity method.

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U. S. dollars (In thousands)

NOTE 22 - RECONCILIATION TO ISRAELI GAAP (CONT.)

Tax benefit in respect of options exercised

According to Israeli GAAP, tax benefits from employee options exercised are recorded as a reduction of tax expense. According to U.S. GAAP, the difference between the above mentioned tax benefits and the benefits recorded in respect of compensation expense in the financial statements are credited to additional paid-in capital.

Goodwill

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

Investment in marketable securities - Tadiran

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

1. EFFECT ON NET INCOME AND EARNINGS PER SHARE

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| | YEAR ENDED DECEMBER | |
|---|---------------------|-----------|
| | 2004 | 2003 |
| Net income as reported according to U.S. GAAP | \$ 52,993 | \$ 45,945 |
| Adjustments to Israeli GAAP | (458) | 595 |
| Net income according to Israeli GAAP | \$ 52,535 | \$ 46,540 |

2. EFFECT ON SHAREHOLDERS' EQUITY

| | AS REPORTED | ADJUSTED |
|---|-------------|-------------|
| AS OF DECEMBER 31, 2004 Shareholders' equity | \$ 434,700 | \$ (13,100) |
| AS OF DECEMBER 31, 2003 Shareholders' equity | \$ 432,079 | \$ (10,300) |

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