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א.ג.נ.,

הנדון: אלביט מערכות בע"מ ("החברה") – דוחות כספיים לרבעון השני של 2004

מצ"ב הדוחות הכספיים ודוח ההנהלה על תוצאות פעילות החברה ברבעון השני של שנת 2004.
בכוונתנו להגיש דוחות אלה לרשות ניירות ערך בארה"ב.

בכבוד רב,

א. פכולדר
מזכיר החברה

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES
CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS

AS OF JUNE 30, 2004
(Unaudited)
(In thousands of U.S. dollars)

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AS OF JUNE 30, 2004
(Unaudited)
(In thousands of U.S. dollars)

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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

	June 30, 2004	December 31, 2003
	(Unaudited)	(Audited)
CURRENT ASSETS		
Cash and cash equivalents	\$ 90,336	\$76,156
Short-term bank deposits	565	690
Trade receivables, net	180,330	203,281
Other receivables and prepaid expenses	46,749	48,363
Inventories, net of advances	241,868	249,225
Total current assets	<u>559,848</u>	<u>577,715</u>
INVESTMENTS AND LONG-TERM RECEIVABLES		
Investments in affiliated companies and partnership	27,634	26,478
Investments in other companies	11,745	11,745
Long-term bank deposits and loan	1,984	2,347
Severance pay fund	77,003	76,218
	<u>118,366</u>	<u>116,788</u>
PROPERTY, PLANT AND EQUIPMENT, NET	<u>237,204</u>	<u>229,221</u>
INTANGIBLE ASSETS, NET		
Goodwill	32,576	32,576
Other intangible assets, net	64,044	67,436
	<u>96,620</u>	<u>100,012</u>
	<u>\$ 1,012,038</u>	<u>\$1,023,736</u>

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands of U.S. dollars except share and per share data)

	June 30, 2004	December 31, 2003
	(Unaudited)	(Audited)
CURRENT LIABILITIES		
Short-term bank credit and loans	\$ 7,374	\$8,509
Current maturities of long-term loans	6,585	6,532
Trade payables	100,495	106,252
Other payables and accrued expenses	159,496	157,820
Customers advances and amounts in excess of costs incurred on contracts in progress	84,721	99,618
Total current liabilities	358,671	378,731
LONG-TERM LIABILITIES		
Long-term loans	48,711	62,324
Advances from customers	2,762	7,592
Deferred income taxes	26,015	24,916
Accrued severance pay	93,931	93,979
	171,419	188,811
MINORITY INTERESTS	3,972	4,115
SHAREHOLDERS' EQUITY		
Share capital		
Ordinary shares of New Israeli Shekels (NIS) 1 par value;		
Authorized – 80,000,000 shares as of June 30, 2004 and		
December 31, 2003;		
Issued – 40,337,372 and 39,746,125 shares as of June 30, 2004		
and December 31, 2003, respectively;		
Outstanding – 39,928,551 and 39,337,304 shares as of		
June 30, 2004 and December 31, 2003, respectively	11,405	11,273
Additional paid-in capital	269,047	259,033
Accumulated other comprehensive loss	(3,584)	(3,992)
Retained earnings	205,429	190,086
Treasury shares – 408,821 shares as of June 30, 2004 and		
December 31, 2003	(4,321)	(4,321)
	477,976	452,079
	<u>\$ 1,012,038</u>	<u>\$1,023,736</u>

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

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

	Six months ended June 30,		Three months ended June 30,		Year ended December 31,
	2004	2003	2004	2003	2003
	(Unaudited)		(Unaudited)		(Audited)
Revenues	\$ 445,317	\$420,948	\$ 231,645	\$218,758	\$897,980
Cost of revenues	329,879	306,804	173,127	161,513	673,561
Gross profit	115,438	114,144	58,518	57,245	224,419
Research and development costs, net	27,121	28,488	13,857	13,636	54,919
Marketing and selling expenses	35,444	35,123	19,035	18,970	69,943
General and administrative expenses	23,204	22,889	11,791	11,905	46,077
	85,769	86,500	44,683	44,511	170,939
Operating income	29,669	27,644	13,835	12,734	53,480
Financial expenses, net	1,301	3,306	822	2,030	4,870
Other income (expenses), net	(84)	91	(299)	(18)	903
Income before taxes on income	28,284	24,429	12,714	10,686	49,513
Taxes on income	7,401	6,602	3,207	2,956	11,334
	20,883	17,827	9,507	7,730	38,179
Equity in net earnings of affiliated companies and partnership	2,969	2,949	1,612	1,048	7,209
Minority interests in losses of subsidiaries	187	690	193	433	557
Net income	\$ 24,039	\$ 21,466	\$ 11,312	\$ 9,211	\$ 45,945
Earnings per share					
Basic net earnings per share	\$ 0.61	\$ 0.55	\$ 0.28	\$ 0.24	\$ 1.18
Diluted net earnings per share	\$ 0.59	\$ 0.54	\$ 0.28	\$ 0.23	\$ 1.14

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

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

	Number of outstanding shares	Share capital	Additional paid-in capital	Accumulated other comprehensive loss	Retained earnings	Treasury shares	Total shareholders' equity	Total other comprehensive income
Balance as of January 1, 2003								
(Audited)	38,803,507	\$ 11,154	\$ 248,387	\$(2,882)	\$159,023	\$ (4,321)	\$411,361	
Exercise of options	533,797	119	5,147	-	-	-	5,266	
Tax benefit in respect of options exercised	-	-	758	-	-	-	758	
Amortization of stock based compensation	-	-	4,741	-	-	-	4,741	
Dividends paid	-	-	-	-	(14,882)	-	(14,882)	
Comprehensive income (loss):								
Unrealized losses on derivative instruments	-	-	-	(578)	-	-	(578)	\$(578)
Foreign currency translation differences	-	-	-	340	-	-	340	340
Minimum pension liability	-	-	-	(872)	-	-	(872)	(872)
Net income	-	-	-	-	45,945	-	45,945	45,945
Total comprehensive income								<u>\$44,835</u>
Balance as of December 31, 2003								
(Audited)	39,337,304	\$11,273	\$259,033	\$(3,992)	\$190,086	\$(4,321)	\$452,079	
Exercise of options	591,247	132	5,584	-	-	-	5,716	
Tax benefit in respect of options exercised	-	-	691	-	-	-	691	
Amortization of stock based compensation	-	-	3,739	-	-	-	3,739	
Dividends paid	-	-	-	-	(8,696)	-	(8,696)	
Comprehensive income (loss):								
Unrealized gains on derivative instruments	-	-	-	428	-	-	428	\$ 428
Foreign currency translation differences	-	-	-	(20)	-	-	(20)	(20)
Net income	-	-	-	-	24,039	-	24,039	24,039
Total comprehensive income								<u>\$24,447</u>
Balance as of June 30, 2004								
(Unaudited)	<u>39,928,551</u>	<u>\$ 11,405</u>	<u>\$ 269,047</u>	<u>\$(3,584)</u>	<u>\$ 205,429</u>	<u>\$ (4,321)</u>	<u>\$ 477,976</u>	

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

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

	Number of outstanding shares	Share capital	Additional paid-in capital	Accumulated other comprehensive loss	Retained earnings	Treasury shares	Total shareholders' equity	Total other comprehensive income
Balance as of January 1, 2003								
(Audited)	38,803,507	\$11,154	\$248,387	\$(2,882)	\$159,023	\$(4,321)	\$411,361	-
Exercise of options	348,641	77	3,338	-	-	-	3,415	-
Tax benefit in respect of options exercised	-	-	434	-	-	-	434	-
Amortization of deferred stock compensation	-	-	6,421	-	-	-	6,421	-
Dividend paid	-	-	-	-	(7,051)	-	(7,051)	-
Comprehensive income (loss):								
Unrealized gains on derivative instruments	-	-	-	2,144	-	-	2,144	\$2,144
Net income	-	-	-	-	21,466	-	21,466	21,466
Total comprehensive income								<u>\$23,610</u>
Balance as of June 30, 2003								
(Unaudited)	<u>39,152,148</u>	<u>\$11,231</u>	<u>\$258,580</u>	<u>\$(738)</u>	<u>\$173,438</u>	<u>\$(4,321)</u>	<u>\$438,190</u>	
Balance as of April 1, 2004								
(Unaudited)	39,718,413	\$11,358	\$263,324	\$(3,942)	\$198,486	\$(4,321)	\$464,905	
Exercise of options	210,138	47	2,032	-	-	-	2,079	
Tax benefit in respect of options exercised	-	-	280	-	-	-	280	
Amortization of deferred stock compensation	-	-	3,411	-	-	-	3,411	
Dividend paid	-	-	-	-	(4,369)	-	(4,369)	
Comprehensive income (loss):								
Unrealized gains on derivative instruments	-	-	-	522	-	-	522	\$ 522
Foreign currency translation differences	-	-	-	(164)	-	-	(164)	(164)
Net income	-	-	-	-	11,312	-	11,312	11,312
Total comprehensive income								<u>\$ 11,670</u>
Balance as of June 30, 2004								
(Unaudited)	<u>39,928,551</u>	<u>\$11,405</u>	<u>\$ 269,047</u>	<u>\$ (3,584)</u>	<u>\$ 205,429</u>	<u>\$ (4,321)</u>	<u>\$ 477,976</u>	

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

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

	Number of outstanding shares	Share capital	Additional paid-in capital	Accumulated other comprehensive loss	Retained earnings	Treasury shares	Total shareholders' equity	Total other comprehensive income
Balance as of April 1, 2003 (Unaudited)	38,843,262	\$ 11,162	\$ 250,250	\$(2,882)	\$ 167,786	\$ (4,321)	\$ 421,995	
Exercise of options	308,886	69	2,918				2,987	-
Tax benefit in respect of options exercised	-	-	382	-	-	-	382	-
Amortization of deferred stock compensation	-	-	5,030	-	-	-	5,030	-
Dividend paid	-	-	-	-	(3,559)	-	(3,559)	-
Comprehensive income (loss):								
Unrealized gains on derivative instruments	-	-	-	2,144	-	-	2,144	\$ 2,144
Net income	-	-	-	-	9,211	-	9,211	9,211
Total comprehensive income								<u>\$ 11,355</u>
Balance as of June 30, 2003 (Unaudited)	<u>39,152,148</u>	<u>\$11,231</u>	<u>\$ 258,580</u>	<u>\$ (738)</u>	<u>\$ 173,438</u>	<u>\$ (4,321)</u>	<u>\$ 438,190</u>	

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of U.S. dollars)

	Six months ended June 30,		Year ended December 31,
	2004	2003	2003
	(Unaudited)		(Audited)
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	\$24,039	\$21,466	\$45,945
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	20,304	18,452	37,890
Amortization of deferred stock compensation	3,739	6,421	4,741
Deferred income taxes, net	1,274	(1,536)	35
Accrued severance pay, net	(833)	703	(1,240)
Gain (loss) on sale of property, plant and equipment	16	141	(915)
Tax benefit in respect of options exercised	691	434	758
Minority interests in earnings (losses) of subsidiaries	(187)	(690)	(557)
Equity in net losses (earnings) of affiliated companies and partnership, net of dividend received (*)	681	(2,789)	(4,995)
Changes in operating assets and liabilities:			
Decrease in short and long-term receivables and prepaid expenses	23,889	12,589	45,297
Increase in inventories	(5,062)	(41,998)	(38,651)
Increase (decrease) in trade payable, other payables and accrued expenses	(5,216)	47,075	32,147
Decrease in advances received from customers	(7,308)	(49,288)	(27,855)
Settlement of royalties with the Office of the Chief Scientist	(1,247)	(204)	(1,581)
Other adjustments	(91)	417	337
Net cash provided by operating activities	54,689	11,193	91,356
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property, plant and equipment	(26,262)	(29,147)	(61,287)
Acquisition of activity (Schedule A)	-	(1,052)	(2,458)
Investments in affiliated companies and subsidiaries	(250)	-	(1,049)
Proceeds from sale of property, plant and equipment	1,351	2,112	5,815
Repayment (grant) of short-term loan	714	2,050	2,400
Investment in long-term bank deposits	(167)	(794)	(1,750)
Proceeds from sale of long-term deposits	317	1,413	3,568
Short-term bank deposits, net	125	255	960
Net cash used in investing activities	(24,172)	(25,163)	(53,801)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from exercise of options	5,716	3,415	5,266
Repayment of long-term credit for purchase of a building	-	-	-
Repayment of long-term bank loans	(12,222)	(7,278)	(27,066)
Proceeds from long-term bank loans	-	-	10,000
Dividends paid	(8,696)	(7,051)	(14,882)
Change in short-term bank credit and loans, net	(1,135)	(4,396)	(10,997)
Net cash used in financing activities	(16,337)	(15,310)	(37,679)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	14,180	(29,280)	(124)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	76,156	76,280	76,280
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	\$90,336	\$47,000	\$76,156
(*) Dividend received	\$ 3,650	\$ -	\$ 2,214

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of U.S. dollars)

	Six months ended June 30,		Year ended December 31,
	2004	2003	2003
	(Unaudited)		(Audited)
SUPPLEMENTARY CASH FLOWS			
ACTIVITIES:			
Cash paid during the period for:			
Income taxes	\$ 6,614	\$ 8,167	\$14,666
Interest	\$ 844	\$ 1,214	\$ 4,034
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 deficiency (except cash and cash equivalents)	-	\$ 816	\$ 657
Property, plant and equipment	-	(168)	(249)
Goodwill, know-how and other intangible assets	-	-	(1,334)
Deferred income taxes	-	(1,700)	(1,765)
Long-term liabilities	-	-	198
Minority interest	-	-	35
	\$ -	\$ (1,052)	\$ (2,458)

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

(In thousands of U.S. dollars)

Note 1 - GENERAL

The accompanying financial statements have been prepared in a condensed format as of June 30, 2004, and for the six months and three months then ended in accordance with generally accepted accounting principles in the United States (U.S. GAAP) relating to the preparation of financial statements for interim periods. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States but which are not required for interim reporting purposes, have been condensed or omitted. See Note 5 for the reconciliation from U.S. GAAP to accounting principles generally accepted in Israel (Israeli GAAP).

These financial statements should be read in conjunction with the Company's annual financial statements and accompanying notes as of December 31, 2003.

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

Operating results for the six months ended June 30, 2004, are not necessarily indicative of the results that may be expected for the year ending December 31, 2004.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES

- A. The significant accounting policies followed in the preparation of these statements are identical to those applied in preparation of the latest annual financial statements except as follows:

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation 46, Consolidation of Variable Interest Entities, an interpretation of ARB No. 51 (FIN 46). In December 2003, the FASB modified FIN 46 to make certain technical corrections and address certain implementation issues that had arisen. FIN 46 provides a new framework for identifying variable interest entities (VIEs) and determining when a company should include the assets, liabilities, non-controlling interests and results of a VIE in its consolidated financial statements.

In general, a VIE is a corporation, partnership, limited liability corporation, trust or any other legal structure used to conduct activities or hold assets that either (1) has an insufficient amount of equity to carry out its principal activities without additional subordinated financial support, (2) has a group of equity owners that are unable to make significant decisions about its activities or (3) has a group of equity owners that do not have the obligation to absorb losses or the right to receive returns generated by its operations.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

(In thousands of U.S. dollars, except share and per share data)

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.)

FIN 46 requires a VIE to be consolidated if a party with an ownership, contractual or other financial interest in the VIE (a variable interest holder) is obligated to absorb a majority of the risk of loss from the VIE's activities, is entitled to receive a majority of the VIE's residual returns (if no party absorbs a majority of the VIE's losses), or both. A variable interest holder that consolidates the VIE is called the primary beneficiary. Upon consolidation, the primary beneficiary generally must initially record all of the VIE's assets, liabilities and non-controlling interest at fair value and subsequently account for the VIE as if it were consolidated based on majority voting interest. FIN 46 also requires disclosures about VIEs that the variable interest holder is not required to consolidate but in which it has a significant variable interest.

FIN 46 was effective immediately for VIEs created after January 31, 2003. The provisions of FIN 46, as revised, were adopted as of June 30, 2004 for the Company's interests in all VIEs. The adoption of FIN 46 did not have a significant effect on the Company's financial statements.

- B. The accompanying financial statements have been prepared in U.S. dollars since the functional currency of the primary economic environment in which the operations of the Group (which includes Elbit Systems Ltd. and its subsidiaries) are conducted is the U.S. dollar.

Note 3 - INVENTORIES, NET OF ADVANCES

	June 30, 2004 (Unaudited)	December 31, 2003 (Audited)
Cost of long-term contracts in progress	\$ 255,606	\$ 253,663
Raw materials	76,295	78,504
Advances to suppliers and subcontractors	20,573	20,137
	<u>352,474</u>	<u>352,304</u>
Less - Cost incurred on contracts in progress deducted from customer advances	<u>15,135</u>	<u>14,581</u>
	337,339	337,723
Less -Advances received from customers	89,347	77,482
Provision for losses	<u>6,124</u>	<u>11,016</u>
	<u>\$ 241,868</u>	<u>\$ 249,225</u>

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

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

Note 4 - STOCK-BASED COMPENSATION

The Company has elected to follow Accounting Principles Board Opinion No. 25. ("APB 25") "Accounting for Stock Issued to Employees" and the FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation" in accounting for its employee stock option plans. According to APB 25, compensation expense is measured under the intrinsic value method, whereby compensation expense is equal to the excess, if any, of the quoted market price of the stock at the grant date of the award or other measurement date over the exercise price.

The Company adopted the disclosure provisions of Financial Accounting Standards Board Statement No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure" ("SFAS No. 148"), which amended certain provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation, effective as of the beginning of the fiscal year. The Company continues to apply the provisions of APB No. 25, in accounting for stock-based compensation.

Pro forma information regarding the Company's net income and net earnings per share is required by SFAS No. 123 and has been determined as if the Company had accounted for its employee stock options under the fair value method prescribed by SFAS No. 123.

If compensation cost had been determined under the alternative fair value accounting method provided under SFAS No. 123, the Company's stock-based employee compensation cost, net income and basic and diluted net earnings per share would have changed to the following pro forma amounts:

	Six months ended June 30,		Three months ended June 30,		Year ended December 31,
	2004	2003	2004	2003	2003
	(Unaudited)		(Unaudited)		(Audited)
Net income as reported	\$ 24,039	\$ 21,466	\$ 11,312	\$ 9,211	\$ 45,945
Add - Stock based compensation expense net of related tax effects as reported (intrinsic method)	2,991	5,137	2,729	4,115	3,793
Deduct – Stock based compensation expense under fair value based method of SFAS 123 net of related tax effects	(1,478)	(1,478)	(739)	(799)	(2,956)
Pro forma net income	<u>\$25,552</u>	<u>\$ 25,125</u>	<u>\$ 13,302</u>	<u>\$ 12,527</u>	<u>\$ 46,782</u>
Net earnings per share:					
Basic net earnings per share as reported	\$ 0.61	\$ 0.55	\$ 0.28	\$ 0.24	\$ 1.18
Diluted net earnings per share as reported	\$ 0.59	\$ 0.54	\$ 0.28	\$ 0.23	\$ 1.14
Pro forma basic net earnings per share	\$ 0.64	\$ 0.65	\$ 0.33	\$ 0.32	\$ 1.20
Pro forma diluted net earnings per share	\$ 0.63	\$ 0.63	\$ 0.33	\$ 0.31	\$ 1.16

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

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

Note 5 - On June 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. Accordingly, the Company will record the effect of the change in the tax rate in the third quarter of 2004. The adoption of the Amendment will not have a significant effect on the Company's financial statements.

Note 6 - RECONCILIATION TO ISRAELI GAAP

As described in Note 1, the Company prepares its financial statements in accordance with U.S. GAAP. See Note 26 to the 2003 annual financial statements for a description of the differences between U.S. GAAP and Israeli GAAP in respect to the Company. The effects of the differences between U.S. GAAP and Israeli GAAP on the Company's financial statements are detailed below.

1. Effect on net income and earnings per share

	Six months ended June 30,		Year ended December 31,
	2004	2003	2003
	(Unaudited)		(Audited)
Net income as reported according to U.S. GAAP	\$ 24,039	\$ 21,466	\$ 45,945
Adjustments to Israeli GAAP	\$ (1,907)	3,595	595
Net income according to Israeli GAAP	<u>\$ 22,132</u>	<u>\$ 25,061</u>	<u>\$ 46,540</u>

2. Effect on shareholders' equity

	As reported	Adjustments	As per Israeli GAAP
As of June 30, 2004 (Unaudited)			
Shareholders' equity	<u>\$ 477,976</u>	<u>\$ (12,957)</u>	<u>\$ 465,019</u>
As of December 31, 2003 (Audited)			
Shareholders' equity	<u>\$ 452,079</u>	<u>\$ (10,367)</u>	<u>\$ 441,712</u>

Elbit Systems Ltd.
Management's Report
For The Three and Six-Month Period Ended June 30, 2004

This report should be read together with the unaudited financial statements of Elbit Systems Ltd. ("Elbit Systems" or the "Company") and together with its subsidiaries (the "Group") for the quarter ended June 30, 2004, the Company's audited consolidated financial statements and related notes for the year ended December 31, 2003, the Company's management report for the year ended December 31, 2003 and the Company's Form 20-F for the year ended December 31, 2003, filed by the Company with the U.S. Securities and Exchange Commission and with the Israeli Securities Authority.

Forward looking statements with respect to the Company's business, financial condition and results of operations in this document are subject to risks and uncertainties that could cause actual results to differ materially from those contemplated in such forward looking statements, including, but not limited to, product demand, pricing, market acceptance, changing economic conditions, risks in product and technology development, the effect of the Company's accounting policies as well as certain other risk factors which are detailed from time to time in the Company's filings with the U.S. Securities and Exchange Commission.

A. Executive Overview

Business Description

Elbit Systems is engaged in projects involving the design, development, manufacture and integration of advanced integrated defense systems, electronic systems, electro-optic systems and products and software intensive programs and products for the defense and homeland security sectors. In addition, the Company operates in the area of upgrading existing airborne, land and naval defense platforms and provides support services for such platforms, systems and products.

The Company is involved in leading projects in Israel and worldwide, in areas such as air, land and naval Command, Control, Communication, Computers, Intelligence, Surveillance and Reconnaissance ("C⁴ISR") systems, digital maps, night vision systems, pilot helmet mounted systems, display and data processing systems, unmanned air vehicles ("UAVs"), computerized simulators, communication systems, thermal imaging products, laser products, optical systems for space applications, airborne reconnaissance systems, optic communication systems, surveillance products and systems, electric drive systems and products, and systems for Homeland Defense.

The Company provides a wide range of logistic support services, including operation of pilot training services and aircraft maintenance services for the Israeli Air Force on a private financing initiative ("PFI") basis. Several of the Group's companies also provide advanced engineering and manufacturing services to various customers, utilizing their significant manufacturing capabilities. The Company often cooperates with industries in Israel and in various other countries.

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

The Company operates in a competitive environment for most of its 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.

Recent Events

- On July 1, 2004, Itzhak Dvir was appointed as Chief Operating Officer (COO) of the Group.
- On July 20, 2004, the U.K. Ministry of Defence announced the selection of Thales U.K. as preferred bidder for the next phase of the acquisition cycle of the Watchkeeper program. Elbit Systems is a significant part of the Thales U.K. team for the program. Watchkeeper will provide the U.K. armed forces with an essential Intelligence, Surveillance, Target Acquisition and reconnaissance capability based on a tactical unmanned air vehicle (UAV) system and will be a key component of the U.K.'s drive for Network Enabled Capability. The Thales/Elbit System Joint Venture will play a significant part as the provider of core UAV subsystems to the U.K.'s Watchkeeper Prime Contract Management Organization of Thales U.K. In the event that contract negotiations for the Watchkeeper program are concluded and a contract is awarded to Thales, the contract to be awarded to the Thales/Elbit Systems Joint Venture is anticipated to be in an amount material to Elbit Systems.
- On July 28, 2004, Elron Electronic Industries Ltd. completed the sale of all of its holdings in the Company, constituting approximately 19.6% of the Company's outstanding share capital, to Federmann Enterprises Ltd., in consideration for approximately \$197 million. The transaction was consummated following the exercise by Federmann Enterprises Ltd. of its right of first refusal that was triggered by the agreement signed on July 8, 2004 between Elron Electronic Industries Ltd. and Tadiran Communications Ltd. As a result of the sale, the Federmann Enterprises Ltd. and certain of its affiliates are the beneficial owner of approximately 49.8% of the Company's outstanding shares.
- On July 28, 2004, Mr. Doron Birger and Mr. Avi Fisher submitted their resignations, and on August 8, 2004, Mr. Ami Erel submitted his resignation, from the Company's Board of Directors, following the completion of the sale of Elron Electronic Industries Ltd.'s holdings in the Company to Federmann Enterprises Ltd.
- On August 8, 2004, the Board of Directors approved the appointment of Mr. Yigal Ne'eman as a member of the Board of Directors.

Financial Highlights

The Company's revenues increased by 5.9% and reached \$231.6 million in the second quarter of 2004, as compared to \$218.8 million in the second quarter of 2003. The main increase in revenues was in the land vehicles systems area.

Net earnings in the second quarter of 2004 were \$11.3 million and the diluted earnings per share were \$0.28, as compared to \$9.2 million and \$0.23 in the second quarter of 2003. Excluding the phantom option plan non-cash expenses, net earnings in the quarter ended June 30, 2004 were \$14 million, and the EPS was \$0.34, as compared to \$13.3 million and \$0.33 in the second quarter of 2003.

The Company's backlog as of June 30, 2004 reached \$1.9 billion, as compared to \$1.75 billion as of December 31, 2003.

The Company's cash flow generated from operations in the six months period ended June 30, 2004 was \$54.7 million, as compared to \$11.2 million in the six months period ended June 30, 2003.

The Board of Directors declared an extraordinary dividend of \$1.80 per share.

B. Backlog of Orders

The Company's backlog of orders as of June 30, 2004 reached \$1,906 million, of which 68% were for orders outside Israel. The Company's backlog as of December 31, 2003 was \$1,752 million, of which 63% were for orders outside Israel.

Approximately 63% of the Company's backlog as of June 30, 2004 is scheduled to be performed in the following two quarters of 2004 and during 2005. The majority of the 37% balance is scheduled to be performed in 2006 and 2007.

C. Critical Accounting Policies and Estimates

The Company's significant accounting policies are described in Note 2 to the audited consolidated financial statements for the year ended December 31, 2003 and in Note 2 to the un-audited consolidated financial statements for the quarter ended June 30, 2004. See also the Company's management report for the year ended December 31, 2003.

D. Sarbanes-Oxley Act

According to Section 404 of the U.S. Sarbanes-Oxley Act of 2002, the Company is required to include in its annual report for 2005 an assessment, as of the end of the fiscal year, of the effectiveness of its internal controls over financial reporting.

During 2003 and the first two quarters of 2004, the Company took steps to assure compliance of its documentation and internal controls over financial reporting with the guidelines stipulated in the Sarbanes-Oxley Act. The Company plans to continue with these steps during the remainder of 2004 and 2005.

E. New Accounting Standards

The significant accounting policies in the preparation of these statements are identical to those applied in preparation of the latest annual financial statements except as follows:

In January 2003, the FASB issued Financial Accounting Standard Board (FASB) Interpretation No. 46, Consolidation of Variable Interest Entities, an interpretation of ARB No. 51 ("FIN 46"). In December 2003, the FASB modified FIN 46 to make certain technical corrections and address certain implementation issues that arose. FIN 46 provides a new framework for identifying Variable Interest Entities ("VIEs") and determining when a company should include the assets, liabilities, non-controlling interests and results of activities of a VIE in the activities of the company's financial

statements. The provisions of FIN 46 were adopted as of March 31, 2004. The adoption of FIN 46 did not have a significant effect on the Company's financial statements.

F. Employee Stock Option Plan

The change in the Company's share price affected the Company's financial results due to the impact of the employee stock option plan adopted in 2000. The plan was 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. The actual number of options granted as of June 30, 2004 was approximately 4.8 million.

Under U.S. GAAP, the total compensation is computed periodically according to the change in the share price and amortized as compensation expense, or income, based on the vesting period of the options. The amount of the net expense related to the "phantom" stock option compensation in the first two quarters of 2004 was approximately \$3.0 million.

I. Summary of Financial Results

The following table sets forth the reported consolidated statements of operations of the Company for the three and six-month periods ended June 30, 2004 and June 30, 2003.

	For the six months ended June 30				For the three months ended June 30			
	2004		2003		2004		2003	
	\$	%	\$	%	\$	%	\$	%
	(In thousands of U.S. dollars except per share data)							
Total revenues	445,317	100.0	420,948	100.0	231,645	100.0	218,758	100.0
Cost of revenues	329,879	74.1	306,804	72.9	173,127	74.7	161,513	73.8
Gross profit	115,438	25.9	114,144	27.1	58,518	25.3	57,245	26.2
Research and development expenses, net	27,121	6.1	28,488	6.8	13,857	6.0	13,636	6.2
Marketing and selling expenses	35,444	8.0	35,123	8.3	19,035	8.2	18,970	8.7
General and administrative expenses	23,204	5.2	22,889	5.4	11,791	5.1	11,905	5.5
	85,769	19.3	86,500	20.5	44,683	19.3	44,511	20.4
Operating income	29,669	6.7	27,644	6.6	13,835	6.0	12,734	5.8
Finance expenses, net	(1,301)	(0.3)	(3,306)	(0.8)	(822)	(0.4)	(2,030)	(0.9)
Other income (expenses), net	(84)	-	91	-	(299)	(0.1)	(18)	-
Income before income taxes	28,284	6.4	24,429	5.8	12,714	5.5	10,686	4.9
Taxes on income	7,401	1.7	6,602	1.6	3,207	1.4	2,956	1.4
	20,883	4.7	17,827	4.2	9,507	4.1	7,730	3.5
Minority interest in losses of subsidiaries	187	-	690	0.2	193	0.1	433	0.2
Equity in net earnings of affiliated companies and partnership	2,969	0.7	2,949	0.7	1,612	0.7	1,048	0.5
Net earnings	24,039	5.4	21,466	5.1	11,312	4.9	9,211	4.2
Diluted net earnings per share	0.59		0.54		0.28		0.23	

Non –US GAAP Disclosure

The following table sets forth the Company's results of operations excluding the effect of the Company's phantom stock option plan ("phantom plan") in 2004 and 2003:

	For the six months ended June 30				For the three months ended June 30			
	2004		2003		2004		2003	
	\$	%	\$	%	\$	%	\$	%
	(In thousands of U.S. dollars except per share data)							
Gross profit as reported	115,438	25.9	114,144	27.1	58,518	25.3	57,245	26.3
Non-cash expense related to phantom plan	<u>2,056</u>	0.5	<u>3,520</u>	0.9	<u>1,876</u>	0.8	<u>2,767</u>	1.3
Gross profit excluding phantom plan effect in 2004 and 2003	<u>117,494</u>	26.4	<u>117,664</u>	28.0	<u>60,394</u>	26.1	<u>60,012</u>	27.6
Operating profit as reported	29,669	6.7	27,644	6.6	13,835	6.0	12,734	5.8
Non-cash expense related to phantom plan	<u>3,739</u>	0.8	<u>6,421</u>	1.5	<u>3,411</u>	1.5	<u>5,030</u>	2.3
Operating profit excluding phantom plan	<u>33,408</u>	7.5	<u>34,065</u>	8.1	<u>17,246</u>	7.4	<u>17,764</u>	8.1
Net earnings as reported	24,039	5.4	21,466	5.1	11,312	4.9	9,211	4.2
Non-cash expense related to phantom plan	<u>2,991</u>	0.7	<u>5,137</u>	1.2	<u>2,729</u>	1.2	<u>4,115</u>	1.9
Net earnings excluding phantom plan effect	<u>27,030</u>	6.1	<u>26,603</u>	6.3	<u>14,041</u>	6.1	<u>13,326</u>	6.1
Diluted net earnings per share as Reported	0.59		0.54		0.28		0.23	
Diluted net earnings per share excluding phantom plan effect	<u>0.66</u>		<u>0.66</u>		<u>0.34</u>		<u>0.33</u>	

Revenues

Six Months Ended on June 30, 2004, Compared to Six Months Ended on June 30, 2003

The Company's consolidated revenues increased by 5.8%, from \$420.9 million in the first six months of 2003 to \$445.3 million in the first six months of 2004.

The following table sets forth the Company's revenue distribution by areas of operation:

	Six-Month Period ended			
	June 30, 2004		June 30, 2003	
	\$ millions	%	\$ millions	%
Airborne systems	187.3	42.1	201.2	47.8
Land vehicle systems	107.7	24.2	75.8	18.0
C ⁴ I systems	57.3	12.9	64.6	15.3
Electro-optics	69.2	15.5	54.7	13.0
Other (mainly non-defense engineering and production services)	<u>23.8</u>	<u>5.3</u>	<u>24.6</u>	<u>5.9</u>
Total	<u>445.3</u>	<u>100.0</u>	<u>420.9</u>	<u>100.0</u>

The decrease in the airborne systems sales was mainly a result of completion of certain upgrade programs, while new programs are expected to generate revenues in the future.

The increase in the land vehicle systems revenues of approximately 42% was mainly due to revenues from fire control systems sold for new land vehicle projects in various countries.

The following table sets forth the Company's distribution of revenues by geographic regions:

	Six-Month Period ended			
	June 30, 2004		June 30, 2003	
	\$ millions	%	\$ millions	%
Israel	110.5	24.8	111.9	26.6
United States	166.7	37.4	159.6	37.9
Europe	65.7	14.8	49.0	11.6
Other countries	<u>102.4</u>	<u>23.0</u>	<u>100.4</u>	<u>23.9</u>
Total	<u>445.3</u>	<u>100.0</u>	<u>420.9</u>	<u>100.0</u>

Revenues from sales to Europe increased by 34.1%, from \$49.0 million to \$65.7 million. The increase was mainly from other new projects sold to European customers and due to consolidating sales of a subsidiary in Europe ("OIP") that was acquired during the second half of 2003.

Three Months Ended on June 30, 2004, Compared to Three Months Ended on June 30, 2003

The consolidated revenues increased by 5.9% from \$218.8 million in the second quarter of 2003 to \$231.6 million in the second quarter of 2004.

The following table sets forth the Company's revenue distribution by areas of operation:

	Three-Month Period ended			
	June 30, 2004		June 30, 2003	
	\$ millions	%	\$ millions	%
Airborne systems	98.7	42.6	102.3	46.8
Land vehicle systems	50.5	21.8	43.5	19.9
C ⁴ I systems	27.8	12.0	32.6	14.9
Electro-optics	38.5	16.6	27.5	12.5
Other (mainly non-defense engineering and production services)	<u>16.1</u>	<u>7.0</u>	<u>12.9</u>	<u>5.9</u>
Total	<u>231.6</u>	<u>100.0</u>	<u>218.8</u>	<u>100.0</u>

The following table sets forth the Company's distribution of revenues by geographic regions:

	Three-Month Period ended			
	June 30, 2004		June 30, 2003	
	\$ millions	%	\$ millions	%
Israel	56.6	24.4	61.5	28.1
United States	87.3	37.7	82.5	37.7
Europe	33.7	14.5	27.6	12.6
Other countries	<u>54.1</u>	<u>23.4</u>	<u>47.2</u>	<u>21.6</u>
Total	<u>231.6</u>	<u>100.0</u>	<u>218.8</u>	<u>100.0</u>

The Company's sales are primarily to governmental entities and prime contractors under government defense programs. Accordingly, the level of the Company's revenues is subject to governmental budgetary constraints. The recent economic situation in Israel has created some uncertainty with respect to the Israeli Government's general and defense budgets.

Gross Profit

The Company's gross profit represents the aggregate results of the Company's activities and projects, and is based on the mix of programs in which the Company is engaged during the reported period.

Six Months Ended on June 30, 2004, Compared to Six Months Ended on June 30, 2003

Reported gross profit in the six months ended June 30, 2004 was \$115.4 million as compared to \$114.1 million in the six months ended June 30, 2003. The reported gross profit margin in the six months ended June 30, 2004 was 25.9% as compared to 27.1% in the corresponding period of the previous year. The difference in the gross profit was the result of the mix of programs generating revenues in the applicable periods.

The Company's cost of goods sold in the six months ended June 30, 2004 included \$2.1 million in non-cash expenses resulting from its phantom option plan, as compared \$3.5 million in the six months ended June 30, 2003. Excluding non-cash expenses related to the Company's phantom option, gross profit in the six months ended June 30, 2004 was \$117.5 million, or 26.4% of revenues, as compared to \$117.7 million, or 28.0% of revenues in the six months ended June 30, 2003.

Three Months Ended on June 30, 2004, Compared to Three Months Ended on June 30, 2003

Reported gross profit in the quarter ended June 30, 2004 was \$58.5 million as compared to \$57.2 million in the quarter ended June 30, 2003. The reported gross profit margin in the second quarter of 2004 was 25.3% as compared to 26.2% in the same period last year. The difference in the gross profit was as a result of the mix of programs generating revenues in the applicable periods.

The Company's cost of goods sold in the second quarter of 2004 included \$1.9 million in non-cash expenses resulting from its phantom option plan, as compared to \$2.8 million in the second quarter of 2003. Excluding non-cash expenses related to the Company's phantom option compensation costs, gross profit in the quarter ended June 30, 2004 was \$60.4 million, or 26.1% of revenues, as compared to \$60.0 million, or 27.6% in the quarter ended June 30, 2003.

Research and Development ("R&D")

The Company continually invests in R&D in order to maintain and further advance its technologies, in accordance with a long-term plan, based on its estimate of future market needs.

The Company's R&D activities in the reported period were in accordance with its plans. Some of these activities are coordinated with, and partially funded by, third parties, including the Israeli Ministry of Defense ("IMOD") and the Office of the Chief Scientist ("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.

Six Months Ended on June 30, 2004, Compared to Six Months Ended on June 30, 2003

Gross R&D expenses in the six months ended June 30, 2004 totaled \$32.8 million (7.4% of revenues), as compared to \$30.9 million (7.3% of revenues) in the six months ended June 30, 2003.

Net R&D expenses (after deduction of third party participation, including the IMOD and the OCS) in the six months period ended June 30, 2004 totaled \$27.1 million (6.1% of revenues), as compared to \$28.5 million (6.8% of revenues) in the six months period ended June 30, 2003.

Three Months Ended on June 30, 2004, Compared to Three Months Ended on June 30, 2003

Gross R&D expenses in the quarter ended June 30, 2004 totaled \$16.3 million (7.1% of revenues), as compared to \$15.2 million (6.9% of revenues) in the quarter ended June 30, 2003.

Net R&D expenses (after deduction of third party participation, including the IMOD and the OCS) in the quarter ended June 30, 2004 totaled \$13.8 million (6.0% of revenues), as compared to \$13.6 million (6.2% of revenues) in the quarter ended June 30, 2003.

Marketing and Selling Expenses

The Company maintains its activities in developing new markets and pursues various business opportunities according to the Company's plan.

Six Months Ended on June 30, 2004, Compared to Six Months Ended on June 30, 2003

Marketing and selling expenses in the six months ended June 30, 2004 were \$35.4 million (8.0% of revenues), as compared to \$35.1 million (8.3% of revenues) in the six months ended June 30, 2003.

Three Months Ended on June 30, 2004, Compared to Three Months Ended on June 30, 2003

Marketing and selling expenses in the quarter ended June 30, 2004 were \$19.0 million (8.2% of revenues), as compared to \$19.0 million (8.7% of revenues) in the quarter ended June 30, 2003.

General and Administrative (“G&A”) Expenses**Six Months Ended on June 30, 2004, Compared to Six Months Ended on June 30, 2003**

G&A expenses were \$23.2 million (5.2% of revenues) in the six months ended June 30, 2004, as compared to \$22.9 million (5.4% of revenues) in the six months ended June 30, 2003.

Excluding the phantom option plan non-cash expenses, G&A expenses in the six months ended June 30, 2004 were \$22.3 million (5.0% of revenues), as compared to \$22.3 million (5.1% of revenues) in the six months ended June 30, 2003.

Three Months Ended on June 30, 2004, Compared to Three Months Ended on June 30, 2003

G&A expenses were \$11.8 million (5.5% of revenues) in the quarter ended June 30, 2004, as compared to \$11.9 million (5.5% of revenues) in the quarter ended June 30, 2003.

Excluding the phantom option plan non-cash expenses, G&A expenses in the quarter ended June 30, 2004 were \$10.9 million (4.7% of revenues), as compared to \$10.6 million (4.9% of revenues) in the quarter ended June 30, 2003.

Operating Profit**Six Months Ended on June 30, 2004, Compared to Six Months Ended on June 30, 2003**

As a result of all of the above, reported operating income in the six months ended June 30, 2004 was \$29.7 million (6.7% of revenues), as compared to \$27.6 million (6.6% of revenues) in the six months ended June 30, 2003.

For the six months ended June 30, 2004, the Company’s operating profit included \$3.7 million in non-cash expenses associated with the Company’s phantom option plan, as compared to \$6.4 million in the six months ended June 30, 2003.

Excluding phantom share compensation costs, operating income totaled \$33.4 million (7.5% of revenues) in the six months ended June 30, 2004, as compared to \$34.1 million (8.1% of revenues) in the six months ended June 30, 2003.

Three Months Ended on June 30, 2004, Compared to Three Months Ended on June 30, 2003

As a result of all of the above, reported operating income in the quarter ended June 30, 2004 was \$13.8 million (6.0% of revenues), as compared to \$12.7 million (5.8% of revenues) in the quarter ended June 30, 2003.

During the second quarter of 2004, the Company's operating profit included \$3.4 million in non-cash expenses associated with the Company's phantom option plan, as compared \$5.0 million in the second quarter of 2003.

Excluding phantom share compensation costs, operating income totaled \$17.2 million (7.4% of revenues) in the quarter ended June 30, 2004, as compared to \$17.7 million (8.1% of revenues) in the quarter ended June 30, 2003.

Finance Expense (Net)**Six Months Ended on June 30, 2004, Compared to Six Months Ended on June 30, 2003**

Net finance expense in the six months ended June 30, 2004 was \$1.3 million, as compared to \$3.3 million of finance expense in the six months ended June 30, 2003.

Three Months Ended on June 30, 2004, Compared to Three Months Ended on June 30, 2003

Net finance expense in the quarter ended June 30, 2004 was \$0.8 million, as compared to \$2.0 million of finance expense in the quarter ended June 30, 2003.

The decrease in the net finance expense resulted mainly from a lower level of short and long-term loans in the second quarter of 2004 as compared to the second quarter of 2003.

Taxes on Income

The Company's tax rate represents a weighted average of the tax rates to which the various companies in the Group are subject. The changes in the effective tax rate are attributable mainly to the mix of the tax rates in the various tax jurisdictions in which the Group's companies generating the taxable income operate.

Six Months Ended on June 30, 2004, Compared to Six Months Ended on June 30, 2003

Provision for taxes in the six months ended June 30, 2004 was \$7.4 million (effective tax rate of 26.2%), as compared to a provision for taxes of \$6.6 million (effective tax rate of 27.0%) in the six months ended June 30, 2003.

Three Months Ended on June 30, 2004, Compared to Three Months Ended on June 30, 2003

Provision for taxes in the quarter ended June 30, 2004 was \$3.2 million (effective tax rate of 25.2%), as compared to a provision for taxes of \$3.0 million (effective tax rate of 27.7%) in the quarter ended June 30, 2003.

Company's Share in Earnings of Affiliated Companies and Partnership

The companies, in which the Company holds 50% or less in shares or voting rights and are therefore not consolidated in its financial statements, operate mainly in complementary areas related to the Company's core business areas, including electro-optics and airborne systems.

The Company believes that its affiliates will continue to contribute significantly to the Company's earnings.

Six Months Ended on June 30, 2004, Compared to Six Months Ended on June 30, 2003

In the six months ended June 30, 2004 the Company had net income of \$3.0 million from its share in earnings of affiliated companies and partnership, as compared to \$2.9 million in the six months ended June 30, 2003.

Three Months Ended on June 30, 2004, Compared to Three Months Ended on June 30, 2003

In the second quarter of 2004 the Company had net income of \$1.6 million from its share in earnings of affiliated companies and partnership, as compared to \$1.0 million in the second quarter of 2003.

Net Earnings and Earnings Per Share ("EPS")

Six Months Ended on June 30, 2004, Compared to Six Months Ended on June 30, 2003

Reported net earnings in the six months ended June 30, 2004 were \$24.0 million (5.4% of revenues), as compared to reported net earnings of \$21.5 million (5.1% of revenues) in the six months ended June 30, 2003. Diluted EPS in the six months ended June 30, 2004 was \$0.59, as compared to \$0.54 per share in the six months ended June 30, 2003.

Excluding the phantom option plan non-cash expenses, net earnings in the six months ended June 30, 2004 were \$27.0 million (6.1% of revenues), and the EPS was \$0.66, as compared to \$26.6 million (6.3% of revenues) and an EPS of \$0.66 in the six months ended June 30, 2003.

The number of shares used for computation of diluted EPS in the six months ended June 30, 2004 was 40,805 thousand shares, as compared to 40,095 thousand shares in the six months ended June 30, 2003. The increase in the number of shares used for computation of diluted EPS was due mainly to the change in the average share price during the six months ended June 30, 2004 which, due to the impact of the Company's stock option plan, affects the number of shares calculated on a diluted basis, and due to exercise of options by employees during the period.

Three Months Ended on June 30, 2004, Compared to Three Months Ended on June 30, 2003

Reported net earnings in the quarter ended June 30, 2004 were \$11.3 million (4.9% of revenues), as compared to reported net earnings of \$9.2 million (4.2% of revenues) in the quarter ended June 30, 2003. Diluted EPS in the quarter ended June 30, 2004 was \$0.28, as compared to \$0.23 in the quarter ended June 30, 2003.

Excluding the phantom option plan non-cash expenses, net earnings in the quarter ended June 30, 2004 were \$14.0 million (6.1% of revenues), and the EPS was \$0.34, as compared to \$13.3 million (6.1% of revenues) and an EPS of \$0.66 in the quarter ended June 30, 2003.

The number of shares used for computation of diluted EPS in the quarter ended June 30, 2004 was 40,892 thousand shares, as compared to 40,396 thousand shares in the quarter ended June 30, 2003. The increase in the number of shares used for computation of diluted EPS was due mainly to the change in the average share price during the second quarter of 2004 which, due to the impact of the Company's stock option plan, affects the number of shares calculated on a diluted basis, and due to exercise of options by employees during the period.

J. Liquidity and Capital Resources

The Company's cash flows are effected by the cumulative cash flows of its 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, which relate to specific events during the project, while expenses are on-going. As a result, the Company's cash flows may vary from one period to another.

The Company's policy is to invest its cash surplus primarily in interest bearing deposits in accordance with its projected needs.

The resources available to the Company include mainly profits, collection of accounts receivable, advances from customers, as well as Government of Israel grants and participation and bank financing in Israel and elsewhere based on its capital, assets and activities. In addition, the Company has the ability to raise funds through the offering of shares and debentures to the public from time to time.

The Company's net cash flows generated from operating activities in the six-month period ended June 30, 2004 were \$54.7 million, resulting mainly from net income for the period and collection of accounts receivable.

Net cash flows used for investment activities in the quarter ended June 30, 2004 were \$24.2 million, which were used mainly for procurement of property, plans and equipment. The investments were made primarily in equipment for the Group's various manufacturing plants and in a building constructed at Elbit Systems' facility in Haifa, Israel. The building is planned to house employees currently located in various leased locations in the industrial park in Haifa, and the Company plans to complete its population during the third quarter of 2004.

Net cash flows used for financing activities in the six-month period ended June 30, 2004 were \$16.3 million, reflecting \$5.7 million in proceeds from the exercise of options and repayment of short and long-term borrowings.

On June 30, 2004, the Company had total borrowings in the amount of \$62.7 million, including \$48.7 million in long-term loans, and \$433 million in guarantees issued on its behalf by banks, mainly in respect of advance payment and performance guarantees provided in the regular course of business. On June 30, 2004, the Company had a cash balance amounting to \$90.3 million.

As of June 30, 2004, the Company had working capital of \$201.2 million and its current ratio was 1.56. The Company's ratio of equity to total assets was 47%.

K. Derivatives and Hedges

Market risks relating to the Company's operations result primarily from changes in interest rates and exchange rates. The Company typically uses financial instruments to limit its exposure to those changes. The Company also typically enters into forward contracts in connection with transactions that are denominated in currencies other than U.S. dollars and New Israeli Shekels ("NIS"). The Company may enter from time to time into forward contracts and other hedging instruments related to NIS, based on market conditions.

On June 30, 2004, the Company's liquid assets were comprised of bank deposits, and it had no investments in liquid equity securities that were subject to market fluctuations. The Company's deposits and loans are based on variable interest rates, and their value as of June 30, 2004 was therefore not exposed to changes in interest rates. Should interest rates either increase or decrease, such change may affect the Company's results of operations due to changes in the cost of its liabilities and the return on its assets that are based on variable rates.

The Company's functional currency is the U.S. dollar. On June 30, 2004, the Company had exposure due to liabilities denominated in NIS of \$63 million in excess of its NIS denominated assets. These liabilities represent mostly wages, trade payables. The amount of the Company's exposure to the changes in the NIS-U.S. dollar exchange rate varies from time to time. On June 30, 2004, the Company had options for hedging future cash flows in the amount of \$57 million. The fair market value of the options as of June 30, 2004 amounted to \$0.49 million.

Most of the Company's assets and liabilities which are denominated in currencies other than the NIS and the U.S. dollar were covered as of June 30, 2004 by forward contracts. On June 30, 2004, the Company had contracts for the sale and purchase of such foreign currencies totaling \$28.6 million. The results of financial derivative activities in this quarter were not material.

L. Dividends

The Board of Directors declared on August 8, 2004 an extraordinary dividend of \$1.80 per share.

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