16.11.04

לכבוד
הרשות לניירות ערך
www.isa.gov.il

לכבוד
הבורסה לניירות ערך
www.tase.co.il

א.ג.נ.,

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

מצ"ב הדוחות הכספיים ודו"ח ההנהלה על תוצאות פעילות החברה ברבעון השלישי 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 SEPTEMBER 30, 2004
(Unaudited)
(In thousands of U.S. dollars)

C O N T E N T S

# # # # # #

15212046.doc

ERNST & YOUNG

- **Kost Forer Gabbay & Kasierer**
  2 Pal – Yam Ave.,
  Brosh Building
  Haifa 33095, Israel

- Phone: 972-4-8654000
  Fax: 972-4-8654022

The Board of Directors of
Elbit Systems Ltd.

REPORT OF INDEPENDENT REGISTRATED PUBLIC ACCOUNTING FIRM

We have reviewed the condensed consolidated balance sheet of Elbit Systems Ltd. and its subsidiaries as of September 30, 2004, and the related condensed consolidated statements of income for the three-month and nine-month periods ended September 30, 2004 and 2003, and the condensed consolidated statements of cash flows for the nine-month periods ended September 30, 2004 and 2003. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated interim financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Elbit Systems Ltd. and its subsidiaries as of December 31, 2003 and the related consolidated statements of income, shareholders' equity and cash flows for the year then ended, and in our report dated March 9, 2004 we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2003 and in the related consolidated statements of income, shareholders' equity and cash flows for the year then ended, is fairly stated, in all material respects, in relation to the consolidated financial statements from which they have been derived.

Kost Forer Gabbay & Kasierer
A Member of Ernst & Young Global

Haifa, Israel
November 15, 2004

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

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

	September 30, 2004	December 31, 2003
	(Unaudited)	(Audited)
CURRENT ASSETS		
Cash and cash equivalents	$ 59,623	$ 76,156
Short-term bank deposits	654	690
Trade receivables, net	183,188	203,281
Other receivables and prepaid expenses	47,833	48,363
Inventories, net of advances	267,652	249,225
Total current assets	558,950	577,715
INVESTMENTS AND LONG-TERM RECEIVABLES		
Investments in affiliated companies and partnership	26,516	26,478
Investments in other companies	11,745	11,745
Long-term bank deposits and loan	1,749	2,347
Severance pay fund	78,023	76,218
	118,033	116,788
PROPERTY, PLANT AND EQUIPMENT, NET	233,686	229,221
INTANGIBLE ASSETS, NET		
Goodwill	32,844	32,576
Other intangible assets, net	63,345	67,436
	96,189	100,012
	$ 1,006,858	$1,023,736

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

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

	September 30, 2004	December 31, 2003
	(Unaudited)	(Audited)
CURRENT LIABILITIES		
Short-term bank credit and loans	$ 7,682	$ 8,509
Current maturities of long-term loans	4,045	6,532
Trade payables	113,944	106,252
Other payables and accrued expenses	162,527	157,820
Customers advances and amounts in excess of costs incurred on contracts in progress	95,066	99,618
Total current liabilities	383,264	378,731
LONG-TERM LIABILITIES		
Long-term loans	66,705	62,324
Advances from customers	12,480	7,592
Deferred income taxes	25,944	24,916
Accrued severance pay	93,075	93,979
	198,204	188,811
MINORITY INTERESTS	3,699	4,115
SHAREHOLDERS' EQUITY		
Share capital		
Ordinary shares of New Israeli Shekels (NIS) 1 par value; Authorized – 80,000,000 shares as of September 30, 2004 and December 31, 2003; Issued –40,661,492 and 39,746,125 shares as of September 30, 2004 and December 31, 2003, respectively; Outstanding – 40,252,671 and 39,337,304 shares as of September 30, 2004 and December 31, 2003, respectively	11,477	11,273
Additional paid-in capital	272,376	259,033
Accumulated other comprehensive loss	(3,717)	(3,992)
Retained earnings	145,876	190,086
Treasury shares – 408,821 shares as of September 30, 2004 and December 31, 2003.	(4,321)	(4,321)
	421,691	452,079
	$ 1,006,858	$1,023,736

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)

	Nine months ended September 30,		Three months ended September 30,		Year ended December 31,
	2004	**2003**	**2004**	**2003**	**2003**
	(Unaudited)		**(Unaudited)**		**(Audited)**
Revenues	$ 669,150	$ 635,223	$ 223,833	$ 214,275	$ 897,980
Cost of revenues	492,198	464,062	162,319	157,129	672,712
Gross profit	176,952	171,161	61,514	57,146	225,268
Research and development costs, net	43,639	43,006	16,518	14,518	54,919
Marketing and selling expenses	50,932	50,696	15,488	15,573	69,943
General and administrative expenses	35,307	33,924	12,103	11,035	46,077
	129,878	127,626	44,109	41,126	170,939
Operating income	47,074	43,535	17,405	16,020	54,329
Financial expenses, net	(2,878)	(3,467)	(1,577)	(161)	(4,870)
Other income (expenses), net	(61)	(488)	23	(708)	54
Income before taxes on income	44,135	39,580	15,851	15,151	49,513
Taxes on income	11,432	10,502	4,031	3,900	11,334
	32,703	29,078	11,820	11,251	38,179
Equity in net earnings of affiliated companies and partnership	4,585	3,938	1,616	989	7,209
Minority interests in losses (earnings) of subsidiaries	458	456	271	(234)	557
Net income	$ 37,746	$ 33,472	$ 13,707	$ 12,006	$ 45,945
Earnings per share basic net earnings per share	$ 0.95	$ 0.86	$ 0.34	$ 0.31	$ 1.18
Weighted average number of shares used in computation (in thousands)	39,822	38,994	40,060	39,168	39,061
Diluted earnings per share	$ 0.92	$ 0.83	$ 0.33	$ 0.30	$ 1.14
Weighted average number of shares used in computation (in thousands)	40,924	40,198	41,161	40,406	40,230

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

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								$ 44,835
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	915,367	204	8,365	-	-	-	8,569	
Tax benefit in respect of options exercised	-	-	805	-	-	-	805	
Amortization of stock based compensation	-	-	4,173	-	-	-	4,173	
Dividends paid	-	-	-	-	(81,956)	-	(81,956)	
Comprehensive income (loss):								
Unrealized gains on derivative instruments	-	-	-	292	-	-	292	$ 292
Foreign currency translation differences	-	-	-	(17)	-	-	(17)	(17)
Net income	-	-	-	-	37,746	-	37,746	37,746
Total comprehensive income								$ 38,021
Balance as of September 30, 2004 (Unaudited)	40,252,671	$ 11,477	$ 272,376	$ (3,717)	$ 145,876	$ (4,321)	$ 421,691	

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

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	397,219	88	3,808	-	-	-	3,896	
Tax benefit in respect of options exercised	-		477	-	-	-	477	
Amortization of deferred stock compensation	-		3,034	-	-	-	3,034	
Dividends paid	-		-		(10,962)	-	(10,962)	
Comprehensive income (loss):								
Unrealized gains on derivative instruments	-	-	-	857	-	-	857	$ 857
Net income	-	-	-	-	33,472	-	33,472	33,472
Total comprehensive income								$ 34,329
Balance as of September 30, 2003 (Unaudited)	39,200,726	$ 11,242	$ 255,706	$ (2,025)	$ 181,533	$ (4,321)	$ 442,135	
Balance as of July 1, 2004 (Unaudited)	39,928,551	$ 11,405	$ 269,047	$ (3,584)	$ 205,429	$ (4,321)	$ 477,976	
Exercise of options	324,120	72	2,781	-	-	-	2,853	
Tax benefit in respect of options exercised	-	-	114	-	-	-	114	
Amortization of deferred stock compensation	-	-	434	-	-	-	434	
Dividends paid	-	-	-	-	(73,260)	-	(73,260)	
Comprehensive income (loss):								
Unrealized gains on derivative instruments	-	-	-	(136)	-	-	(136)	$ (136)
Foreign currency translation differences	-	-	-	3	-	-	3	3
Net income	-	-	-	-	13,707	-	13,707	13,707
Total comprehensive income								$ 13,574
Balance as of September 30, 2004 (Unaudited)	40,252,671	$ 11,477	$ 272,376	$ (3,717)	$ 145,876	$ (4,321)	$ 421,691	

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

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 July 1, 2003 (Unaudited)	39,152,148	$ 11,231	$ 258,580	$ (738)	$ 173,438	$ (4,321)	$ 438,190	
Exercise of options	48,578	11	470				481	
Tax benefit in respect of options exercised	-	-	43	-	-	-	43	
Amortization of deferred stock compensation	-	-	(3,387)	-	-	-	(3,387)	
Dividends paid	-	-	-	-	(3,911)	-	(3,911)	
Comprehensive income (loss):								
Unrealized losses on derivative instruments	-	-	-	(1,287)	-	-	(1,287)	$ (1,287)
Net income	-	-	-	-	12,006	-	12,006	12,006
Total comprehensive income								$ 10,719
Balance as of September 30, 2003 (Unaudited)	39,200,726	$ 11,242	$ 255,706	$ (2,025)	$ 181,533	$ (4,321)	$ 442,135	

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of U.S. dollars)

	Nine months ended September 30, 2004	Nine months ended September 30, 2003	Year ended December 31, 2003
	(Unaudited)	(Unaudited)	(Audited)
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 37,746	$ 33,472	$ 45,945
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	31,494	27,966	37,890
Amortization of deferred stock compensation	4,173	3,034	4,741
Deferred income taxes, net	1,505	(199)	35
Accrued severance pay, net	(2,709)	(2,538)	(1,240)
Gain (loss) on sale of property, plant and equipment	25	(870)	(915)
Tax benefit in respect of options exercised	805	477	758
Minority interests in losses of subsidiaries	(458)	(456)	(557)
Equity in net losses (earnings) of affiliated companies and partnership, net of dividend received (*)	3,065	(2,773)	(4,995)
Changes in operating assets and liabilities:			
Decrease in short and long-term receivables and prepaid expenses	20,759	35,339	45,297
Increase in inventories	(24,222)	(52,909)	(38,651)
Increase in trade payables, other payables and accrued expenses	9,882	27,740	32,147
Increase (decrease) in advances received from customers	7,125	(55,607)	(27,855)
Settlement of royalties with the Office of the Chief Scientist	(3,714)	(447)	(1,581)
Other adjustments	(112)	472	337
Net cash provided by operating activities	85,364	12,701	91,356
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property, plant and equipment	(32,614)	(43,494)	(61,287)
Acquisition of activity (Schedule A)	(2,315)	(2,458)	(2,458)
Investments in affiliated companies and subsidiaries	(559)	-	(1,049)
Proceeds from sale of property, plant and equipment	1,741	4,831	5,815
Repayment of short-term loan	-	2,050	2,400
Investment in long-term bank deposits	(1,203)	(1,064)	(1,750)
Proceeds from sale of long-term deposits	1,508	1,820	3,568
Short-term bank deposits, net	36	955	960
Net cash used in investing activities	(33,406)	(37,360)	(53,801)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from exercise of options	8,569	3,896	5,266
Repayment of long-term bank loans	(15,687)	(23,212)	(27,066)
Proceeds from long-term bank loans	21,410	10,000	10,000
Dividends paid	(81,956)	(10,962)	(14,882)
Change in short-term bank credit and loans, net	(827)	14,604	(10,997)
Net cash used in financing activities	(68,491)	(5,674)	(37,679)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(16,533)	(30,333)	(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	$ 59,623	$ 45,947	$ 76,156
(*) Dividend received	$ 7,650	$ 1,165	$ 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)

	Nine months ended September 30, 2004	Nine months ended September 30, 2003	Year ended December 31, 2003
	(Unaudited)	(Unaudited)	(Audited)
SUPPLEMENTARY CASH FLOWS ACTIVITIES:			
Cash paid during the period for:			
Income taxes	$ 9,015	$ 11,144	$ 14,666
Interest	$ 1,460	$ 2,645	$ 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)	$ (707)	$ 657	$ 657
Property, plant and equipment	(10)	(249)	(249)
Goodwill, know-how and other intangible assets	(1,598)	(1,334) (1,309)	(1,334)
Deferred income taxes	-	(1,765)	(1,765)
Long-term liabilities	-	198	198
Minority interest	-	35	35
	$ (2,315)	$ (2,458)	$ (2,458)

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

(In thousands of U.S. dollars)

Note 1 - GENERAL

The accompanying financial statements have been prepared in a condensed format as of September 30, 2004, and for the nine 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 6 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 nine months ended September 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.

(In thousands of U.S. dollars)

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 September 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

	September 30, 2004 (Unaudited)	**December 31, 2003 (Audited)**
Cost of long-term contracts in progress	$ 274,544	$ 253,663
Raw materials	76,384	78,504
Advances to suppliers and subcontractors	22,773	20,137
	373,701	352,304
Less - Cost incurred on contracts in progress deducted from customer advances	14,062	14,581
	359,639	337,723
Less - Advances received from customers	84,790	77,482
Provision for losses	7,197	11,016
	$ 267,652	$ 249,225

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:

	Nine months ended September 30,		Three months ended September 30,		Year ended December 31,
	2004	2003	2004	2003	2003
	(Unaudited)		(Unaudited)		(Audited)
Net income as reported	$ 37,746	$ 33,472	$ 13,707	$ 12,006	$ 45,945
Add – Stock based compensation expense net of related tax effects as reported (intrinsic method)	3,338	2,710	347	(2,427)	3,793
Deduct – Stock based compensation expense under fair value based method of SFAS 123 net of related tax effects	(2,217)	(2,217)	(739)	(739)	(2,956)
Pro forma net income	$ 38,867	$ 33,965	$ 13,315	$ 8,840	$46,782
Net earnings per share:					
Basic net earnings per share as reported	$ 0.95	$ 0.86	$ 0.34	$ 0.31	$ 1.18
Diluted net earnings per share as reported	$ 0.92	$ 0.83	$ 0.33	$ 0.30	$ 1.14
Pro forma basic net earnings per share	$ 0.98	$ 0.87	$ 0.33	$ 0.23	$ 1.20
Pro forma diluted net earnings per share	$ 0.95	$ 0.84	$ 0.32	$ 0.22	$ 1.16

(In thousands of U.S. dollars)

Note 5 - AMENDMENT TO THE INCOME TAX ORDINANCE

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. Accordingly, the Company recorded the effect of the change in the tax rate in the third quarter of 2004. The adoption of the Amendment did 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

	Nine months ended September 30,		Year ended December 31,
	2004	2003	2003
	(Unaudited)		(Audited)
Net income as reported according to U.S. GAAP	$37,746	$ 33,472	$ 45,945
Adjustments to Israeli GAAP	(1,765)	847	595
Net income according to Israeli GAAP	$35,981	$ 34,319	$ 46,540

2. Effect on shareholders' equity

	As reported	Adjustments	As per Israeli GAAP
As of September 30, 2004 (Unaudited)			
Shareholders' equity	$ 421,691	(12,929)	$ 408,762
As of December 31, 2003 (Audited)			
Shareholders' equity	$ 452,079	(10,367)	$ 441,712

Elbit Systems Ltd.
Management's Report
For The Three and Nine-Month Period Ended September 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 September 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 ("C^4ISR") 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 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 August 10, 2004, the Company announced that Vision Systems International, LLC ("VSI"), Elbit Systems' joint venture with Rockwell Collins, was awarded a $75.6 million contract for over 300 Joint Helmet Mounted Cueing Systems ("JHMCS") from the Boeing Company. This award is the first Full Rate Production ("FRP") of "JHMCS" following four Low Rate Initial Production ("LRIP") lot deliveries.

- On August 31, 2004, a subsidiary of EFW Inc., the Company's wholly-owned U.S. subsidiary, acquired most of the assets of Computer Instruments Corporation Inc. of Westbury, New York for a price of approximately $2 million. The acquired assets relate to the design and manufacture of aviation pressure transducers, air data probes and air data computers. EFW is in the process of moving the operations of the acquired assets to one of its manufacturing facilities in the United States.

- 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. Accordingly, the Company recorded the effect of the change in the tax rate in the third quarter of 2004. The adoption of the Amendment did not have a material effect on the Company's financial statements.

- On November 8, 2004, the Company announced that it was awarded a contract in an amount of approximately $300 million by the Israeli Ministry of Defense to supply advanced systems. The contract will be performed over a multi-year period. Elbit Systems will supply under this contract airborne systems, command and control systems, logistic support and training. The contract includes integration of various systems, part of whose purpose includes providing advanced solutions in the area of homeland security.

- On November 8, 2004, the Company's Annual General Meeting of Shareholders approved various modifications to the Company's Articles of Association, which modifications were described in the Proxy Statement filed by the Company with the U.S. Securities and Exchange Association and the Israel Securities Authority on October 18, 2004.

- On November 10, 2004, the Company announced that it was awarded, in cooperation with the Romanian aircraft manufacturer Avioane Craiova, a $43 million contract from the Romanian Defense Ministry to supply eight IAR-99 lead-in trainer aircraft, to be executed over a period of approximately three years. As part of the contract, the Company will supply an advanced avionics package which will contribute to savings in pilot training costs and also ACTS, an Advanced Combat Training System, which will aid pilot training and the transition to upgraded MiG-21 aircraft and other future fighters.

Financial Highlights

The Company's revenues increased by 4.5% and reached $223.8 million in the third quarter of 2004, as compared to $214.3 million in the third quarter of 2003.

Net earnings in the third quarter of 2004 were $13.7 million and the diluted earnings per share ("EPS") were $0.33, as compared to $12.0 million and $0.30 in the third quarter of 2003. Excluding the phantom option plan non-cash expenses, net earnings in the quarter ended September 30, 2004 were $14.1 million, and EPS was $0.34, as compared to $9.6 million and $0.24 in the third quarter of 2003.

The Company's backlog as of September 30, 2004 reached $1.96 billion, as compared to $1.75 billion as of December 31, 2003.

The Company's cash flow generated from operations in the nine-month period ended September 30, 2004 was $85.4 million, as compared to $12.7 million in the nine-month period ended September 30, 2003.

During the third quarter of 2004, the Company distributed an extraordinary dividend of $1.80 per share.

The Board of Directors declared a dividend of $0.13 per share for the third quarter of 2004.

B. Backlog of Orders

The Company's backlog of orders as of September 30, 2004 reached $1,958 million, of which 66% 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 53% of the Company's backlog as of September 30, 2004 is scheduled to be performed in the last quarter of 2004 and during 2005. The majority of the 47% 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 unaudited consolidated financial statements for the quarter ended September 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 three 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 applied 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 Standard Board (“FASB”) issued 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 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. The actual number of options granted as of September 30, 2004 was approximately 4.8 million, and the number of outstanding options was approximately 2.5 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 third quarter of 2004 was approximately \$0.4 million, and approximately \$3.3 million for the three quarters ended September 30, 2004 (see the Non-U.S. GAAP disclosure below).

I. Summary of Financial Results

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

	For the nine months ended September 30				For the three months ended September 30			
	2004		2003		2004		2003	
	$	%	$	%	$	%	$	%
	(In thousands of U.S. dollars except per share data)							
Total revenues	**669,150**	100.0	**635,223**	100.0	**223,833**	100.0	**214,275**	100.0
Cost of revenues	**492,198**	73.6	**464,062**	73.1	**162,319**	72.5	**157,129**	73.3
Gross profit	**176,952**	26.4	**171,161**	26.9	**61,514**	27.5	**57,146**	26.7
Research and development expenses, net	**43,639**	6.5	**43,006**	6.8	**16,518**	7.4	**14,518**	6.8
Marketing and selling expenses	**50,932**	7.6	**50,696**	8.0	**15,488**	6.9	**15,573**	7.3
General and administrative expenses	**35,307**	5.3	**33,924**	5.3	**12,103**	5.4	**11,035**	5.1
	129,878	19.4	**127,626**	20.1	**44,109**	19.7	**41,126**	19.2
Operating income	**47,074**	7.0	**43,535**	6.9	**17,405**	7.8	**16,020**	7.5
Finance expenses, net	**(2,878)**	(0.4)	**(3,467)**	(0.5)	**(1,577)**	(0.7)	**(161)**	(0.1)
Other income (expenses), net	**(61)**	0.0	**(488)**	(0.1)	**23**	0.0	**(708)**	(0.3)
Income before income taxes	**44,135**	6.6	**39,580**	6.3	**15,851**	7.1	**15,151**	7.0
Taxes on income	**11,432**	1.7	**10,502**	1.7	**4,031**	1.8	**3,900**	1.8
	32,703	4.9	**29,078**	4.6	**11,820**	5.3	**11,251**	5.2
Minority interest in losses (earnings) of subsidiaries	**458**	0.1	**456**	0.1	**271**	0.1	**(234)**	(0.1)
Equity in net earnings of affiliated companies and partnerships	**4,585**	0.7	**3,938**	0.6	**1,616**	0.7	**989**	0.5
Net earnings	**37,746**	5.6	**33,472**	5.3	**13,707**	6.1	**12,006**	5.6
Diluted net earnings per share	**0.92**		**0.83**		**0.33**		**0.30**	

Non –U.S. GAAP Disclosure

The Company records non-cash expenses related to its employees option plans, consisting mainly of expenses related to the "phantom" share option plan (See Note 17C to the audited consolidated financial statements for the year ended December 31, 2003). The "phantom" plan expenses are calculated based on the vesting period and the exercise price (set on the date of the options grant) and the Company share price at the end of each period and are not affected directly from the results of operations or the condition of the Company. Accordingly, abnormal costs have been reported due to significant changes in the Company's share price.

The Company believes that the non-cash expenses (income) related to the employees' option plans, do not reflect properly the Company's performance on a period-to-period basis.

The following table sets forth the Company's results of operations excluding the effect of the Company's "Phantom" share option plan, reflecting the manner in which the Company's management evaluates its results of operations.

	For the nine months ended September 30				For the three months ended September 30			
	2004		2003		2004		2003	
	$	%	$	%	$	%	$	%
	(In thousands of U.S. dollars except per share data)							
Gross profit as reported	**176,952**	26.4	**171,161**	26.9	**61,514**	27.5	**57,146**	26.7
Non-cash expense (income) related to phantom plan	**2,295**	0.4	**1,863**	0.3	**239**	0.1	**(1,669)**	(0.8)
Gross profit excluding phantom plan effect in 2004 and 2003	**179,247**	26.8	**173,024**	27.2	**61,753**	27.6	**55,477**	25.9
Operating profit as reported	**47,074**	7.0	**43,535**	6.9	**17,405**	7.8	**16,020**	7.5
Non-cash expense (income) related to phantom plan	**4,173**	0.7	**3,387**	0.5	**434**	0.2	**(3,034)**	(1.4)
Operating profit excluding phantom plan	**51,247**	7.7	**46,922**	7.4	**17,839**	8.0	**12,986**	6.1
Net earnings as reported	**37,746**	5.6	**33,472**	5.3	**13,708**	6.1	**12,006**	5.6
Non-cash expense (income) related to phantom plan	**3,339**	0.5	**2,710**	0.4	**347**	0.2	**(2,427)**	(1.1)
Net earnings excluding phantom plan effect	**41,085**	6.1	**36,182**	5.7	**14,055**	6.3	**9,579**	4.5
Diluted net earnings per share as reported	**0.92**		**0.83**		**0.33**		**0.30**	
Diluted net earnings per share excluding phantom plan effect	**1.00**		**0.90**		**0.34**		**0.24**	

Revenues

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

The consolidated revenues increased by 4.5% from $214.3 million in the third quarter of 2003 to $223.8 million in the third quarter of 2004.

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

	Three-Month Period ended			
	September 30, 2004		September 30, 2003	
	$ millions	%	$ millions	%
Airborne systems	97.2	43.4	103.6	48.3
Land systems	46.3	20.7	42.6	19.9
C^4I systems	36.2	16.2	30.8	14.4
Electro-optics	29.7	13.3	24.4	11.4
Other (mainly non-defense engineering and production services)	14.4	6.4	12.9	6.0
Total	223.8	100.0	214.3	100.0

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

	Three-Month Period ended			
	September 30, 2004		September 30, 2003	
	$ millions	%	$ millions	%
Israel	52.9	23.7	74.5	34.8
United States	91.5	40.9	85.1	39.7
Europe	29.2	13.0	22.7	10.6
Other countries	50.2	22.4	32.0	14.9
Total	223.8	100.0	214.3	100.0

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.

Nine Months Ended on September 30, 2004, Compared to Nine Months Ended on September 30, 2003

The Company's consolidated revenues increased by 5.3%, from $635.2 million in the nine months ended September 30, 2003, to $669.2 million in the nine months ended September 30, 2004.

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

	Nine-Month Period ended			
	September 30, 2004		September 30, 2003	
	$ millions	%	$ millions	%
Airborne systems	284.5	42.5	304.8	48.0
Land systems	154.0	23.0	118.4	18.6
C^4I systems	93.5	14.0	95.4	15.0
Electro-optics	98.9	14.8	79.1	12.5
Other (mainly non-defense engineering and production services)	38.2	5.7	37.5	5.9
Total	669.2	100.0	635.2	100.0

The decrease in the airborne systems sales was mainly a result of completion of certain upgrade programs and a temporary reduction of commercial avionics systems.

The increase in the land systems revenues of approximately 30% was mainly due to revenues from various fire control systems sold for new land systems projects, the M-60 project in Europe and the Bradley project in the U.S..

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

	Nine-Month Period ended			
	September 30, 2004		September 30, 2003	
	$ millions	%	$ millions	%
Israel	163.4	24.4	186.3	29.3
United States	258.2	38.6	244.7	38.5
Europe	94.9	14.2	71.7	11.3
Other countries	152.7	22.8	132.5	20.9
Total	669.2	100.0	635.2	100.0

Revenues from sales to Europe increased by 32%, from $71.7 million to $94.9 million. The increase derived mainly from sales of Night Sight products and the M-60 project.

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.

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

Reported gross profit in the quarter ended September 30, 2004 was $61.5 million as compared to $57.1 million in the quarter ended September 30, 2003. The reported gross profit margin in the third quarter of 2003 was 27.5% as compared to 26.7% in the same period last year.

The Company's cost of goods sold in the third quarter of 2004 included $0.2 million in non-cash expenses resulting from its phantom option plan, as compared to income of $1.7 million in the third quarter of 2003.

Excluding non-cash expenses related to the Company's phantom option compensation costs, gross profit in the quarter ended September 30, 2004 was $61.8 million, or 27.6% of revenues, as compared to $55.5 million, or 25.9% of revenues in the quarter ended September 30, 2003.

Nine Months Ended on September 30, 2004, Compared to Nine Months Ended on September 30, 2003

Reported gross profit in the nine months ended September 30, 2004 was $177.0 million as compared to $171.2 million in the nine months ended September 30, 2003. The reported gross profit margin in the nine months ended September 30, 2004 was 26.4% as compared to 26.9% in the corresponding period of the previous year.

The Company's cost of goods sold in the nine months ended September 30, 2004 included $2.3 million in non-cash expenses resulting from its phantom option plan, as compared to $1.9 million in the nine months ended September 30, 2003.

Excluding non-cash expenses related to the Company's phantom option, gross profit in the nine months ended September 30, 2004 was $179.2 million, or 26.8% of revenues, as compared to gross profit of $173.0 million, or 27.2% of revenues in the nine months ended September 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.

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

Gross R&D expenses in the quarter ended September 30, 2004 totaled $21.3 million (9.5% of revenues), as compared to $16.2 million (7.6% of revenues) in the quarter ended September 30, 2003.

Net R&D expenses (after deduction of the OCS and other participations) in the quarter ended September 30, 2004 totaled $16.5 million (7.4% of revenues), as compared to $14.5 million (6.8% of revenues) in the third quarter of 2003.

Nine Months Ended on September 30, 2004, Compared to Nine Months Ended on September 30, 2003

Gross R&D expenses in the nine months ended September 30, 2004 totaled $54.1 million (8.1% of revenues), as compared to $47.1 million (7.4% of revenues) in the nine months ended September 30, 2003.

Net R&D expenses (after deduction of the OCS and other participations) in the nine months ended September 30, 2004 totaled $43.6 million (6.5% of revenues), as compared to $43.0 million (6.8% of revenues) in the nine months ended September 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 plans.

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

Marketing and selling expenses in the quarter ended September 30, 2004 were $15.5 million (6.9% of revenues), as compared to $15.6 million (7.3% of revenues) in the quarter ended September 30, 2003.

Nine Months Ended on September 30, 2004, Compared to Nine Months Ended on September 30, 2003

Marketing and selling expenses in the nine months ended September 30, 2004 were $50.9 million (7.6% of revenues), as compared to $50.7 million (8.0% of revenues) in the nine months ended September 30, 2003.

General and Administrative ("G&A") Expenses

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

G&A expenses were $12.1 million (5.4% of revenues) in the quarter ended September 30, 2004, as compared to $11.0 million (5.1 % of revenues) in the quarter ended September 30, 2003.

Excluding the phantom option plan non-cash expenses, G&A expenses in the three months ended September 30, 2004 were $12.0 million (5.4% of revenues), as compared to $11.8 million (5.5% of revenues) in the three months ended September 30, 2003.

Nine Months Ended on September 30, 2004, Compared to Nine Months Ended on September 30, 2003

G&A expenses were $35.3 million (5.3% of revenues) in the nine months ended September 30, 2004, as compared to $33.9 million (5.3% of revenues) in the nine months ended September 30, 2003.

Excluding the phantom option plan non-cash expenses, G&A expenses in the nine months ended September 30, 2004 were $34.3 million (5.1% of revenues), as compared to $33.1 million (5.2% of revenues) in the nine months ended September 30, 2003.

Operating Profit

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

As a result of all of the above, reported operating profit in the quarter ended September 30, 2004 was $17.4 million (7.8% of revenues), as compared to $16.0 million (7.5% of revenues) in the quarter ended September 30, 2003.

During the third quarter of 2004, the Company's operating profit included $0.4 million in non-cash expense associated with the Company's phantom option plan, as compared to an income of $3.0 million in the third quarter of 2003.

Excluding phantom share compensation costs in 2004, operating profit totaled $17.8 million (8.0% of revenues) in the quarter ended September 30, 2004, as compared to $13.0 million (6.1% of revenues) in the quarter ended September 30, 2003.

Nine Months Ended on September 30, 2004, Compared to Nine Months Ended on September 30, 2003

As a result of all of the above, reported operating profit in the nine months ended September 30, 2004 was $47.1 million (7.0% of revenues), as compared to $43.5 million (6.9% of revenues) in the nine months ended September 30, 2003.

For the nine months ended September 30, 2004, the Company's operating profit included $4.2 million in non-cash expenses associated with the Company's phantom option plan, as compared to $3.4 million in the nine months ended September 30, 2003.

Excluding phantom share compensation costs, operating profit totaled $51.2 million (7.7% of revenues) in the nine months ended September 30, 2004, as compared to $46.9 million (7.4% of revenues) in the nine-month period ended September 30, 2003.

Finance Expense (Net)

Three Months Ended on September 30, 2003, Compared to Three Months Ended on September 30, 2002

Net finance expense in the quarter ended September 30, 2004 was $1.6 million (0.7% of revenues), as compared to $0.2 million (0.1% of revenues) in the quarter ended September 30, 2003.

The increase in the net finance expense resulted from exchange rate differences in the third quarter of 2004, as well as from the finance income recognized in the third quarter of 2003.

Nine Months Ended on September 30, 2004, Compared to Nine Months Ended on September 30, 2003

Net finance expense in the nine months ended September 30, 2004 was $2.9 million (0.4% of revenues), as compared to $3.5 million (0.5% of revenues) in the nine months ended September 30, 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 to the mix of the tax rates in the various tax jurisdictions in which the Group's companies generating the taxable income operate.

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

Provision for taxes in the quarter ended September 30, 2004 was $4.0 million (effective tax rate of 25.4%), as compared to a provision for taxes of $3.9 million (effective tax rate of 25.7%) in the quarter ended September 30, 2003.

Nine Months Ended on September 30, 2004, Compared to Nine Months Ended on September 30, 2003

Provision for taxes in the nine months ended September 30, 2004 was $11.4 million (effective tax rate of 25.9%), as compared to a provision for taxes of $10.5 million (effective tax rate of 26.5%) in the nine months ended September 30, 2003.

Company's Share in Earnings of Affiliated Companies and Partnerships

The companies and partnerships, in which the Company holds 50% or less in shares or voting rights and are therefore not consolidated in its financial statements, operate in complementary areas to the Company's core business activities, including electro-optics and airborne systems. The Company believes that its affiliates will continue to contribute significantly to the Company's earnings.

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

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

Nine Months Ended on September 30, 2004, Compared to Nine Months Ended on September 30, 2003

In the nine months ended September 30, 2004 the Company had net income of $4.6 million from its share in earnings of affiliated companies and partnerships, as compared to $3.9 million in the nine months ended September 30, 2003.

Net Earnings and Earnings per Share ("EPS")

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

Reported net earnings in the quarter ended September 30, 2004 were $13.7 million (6.1% of revenues), as compared to reported net earnings of $12.0 million (5.6% of revenues) in the quarter ended September 30, 2003. Diluted EPS in the quarter ended September 30, 2004 was $0.33, as compared to $0.30 in the quarter ended September 30, 2003.

Excluding the phantom option plan non-cash expenses in 2004, net earnings in the quarter ended September 30, 2003 were $14.1 million (6.3% of revenues) and the EPS was $0.34, as compared to $9.6 million (4.5% of revenues), and an EPS of $0.24 in the quarter ended September 30, 2003.

The number of shares used for computation of diluted EPS in the quarter ended September 30, 2004 was 41,161 thousand shares, as compared to 40,406 thousand shares in the quarter ended September 30, 2003. The increase in the number of shares used for computation of diluted EPS was due mainly to exercise of options by employees during the period.

Nine Months Ended on September 30, 2004, Compared to Nine Months Ended on September 30, 2003

Reported net earnings in the nine months ended September 30, 2004 were $37.7 million (5.6% of revenues), as compared to reported net earnings of $33.5 million (5.3% of revenues) in the nine months ended September 30, 2003. Diluted EPS in the nine months ended September 30, 2004 was

$0.92, as compared to $0.83 per share in the nine months ended September 30, 2003.

Excluding the phantom option plan non-cash expenses in 2004, net earnings in the nine months ended September 30, 2004 were $41.1 million (6.1% of revenues) and the EPS was $1.0, as compared to $36.2 million (5.7% of revenues) and an EPS of $0.90 in the nine-month period ended September 30, 2003.

The number of shares used for computation of diluted EPS in the nine months ended September 30, 2004 was 40,924 thousand shares, as compared to 40,198 thousand shares in the nine months ended September 30, 2003. The increase in the number of shares used for computation of diluted EPS was due mainly to the 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 nine-month period ended September 30, 2004 were $85.4 million, resulting mainly from net income for the period and collection of accounts receivable, which was partly offset by an increase in inventories.

Net cash flows used for investment activities in the quarter ended September 30, 2004 were $33.4 million, which were used mainly for procurement of property, plant 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.

Net cash flows used for financing activities in the nine-month period ended September 30, 2004 were $68.5 million, which were used mainly for paying dividends.

On September 30, 2004, the Company had total borrowings in the amount of $78.4 million, including $66.7 million in long-term loans, and $397 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 September 30, 2004, the Company had a cash balance amounting to $59.6 million.

As of September 30, 2004, the Company had working capital of $175.7 million, and its current ratio was 1.46. The Company's ratio of equity to total assets was 41.9%.

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 September 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 September 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 September 30, 2004, the Company had exposure due to liabilities denominated in NIS of $62 million in excess of its NIS denominated assets. These liabilities represent mostly wages and 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 September 30, 2004, the Company had options for hedging future cash flows denominated in NIS in the amount of $21 million and denominated in GBP in the amount of $144 million. The fair market value of the options as of September 30, 2004 and 2003 amounted to $0.5 million and $0.4 million respectively.

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 September 30, 2004 by forward contracts. On September 30, 2004, the Company had contracts for the sale and purchase of such foreign currencies totaling $32.3 million. The results of financial derivative activities in this quarter were not material.

L. **Dividends**

The Board of Directors declared on November 15, 2004 a dividend of $0.13 per share.

* * *
