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א.ג.נ.,

הנדון: **אלביט מערכות בע"מ ("החברה") – דוחות כספיים לרבעון השני של שנת 2005**

מצ"ב הדוחות הכספיים ודו"ח ההנהלה על תוצאות פעילות החברה ברבעון השני של שנת 2005.

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, 2005

(Unaudited)

(In thousands of U.S. dollars)

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

AS OF JUNE 30, 2005
(Unaudited)
(In thousands of U.S. dollars)

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. dollars (in thousands)

	June 30, 2005 (Unaudited)	December 31, 2004 (**)
CURRENT ASSETS:		
Cash and cash equivalents	$ 53,855	$ 34,109
Short-term bank deposits	1,196	738
Trade receivables, (net of allowance for doubtful accounts in the amount of $2,890 and $3,064 as of June 30, 2005 and December 31, 2004, respectively)	189,599	214,816
Other receivables and prepaid expenses	54,055	*53,087
Inventories, net of advances	296,603	249,041
Total current assets	595,308	551,791
INVESTMENTS AND LONG-TERM RECEIVABLES:		
Investments in affiliated companies and a partnership	117,397	*47,873
Investments in other companies	11,745	11,745
Long-term bank deposits and trade receivables	1,595	2,102
Severance pay fund	81,241	82,998
	211,978	144,718
PROPERTY, PLANT AND EQUIPMENT, NET	252,990	244,288
INTANGIBLE ASSETS:		
Goodwill	33,716	33,706
Other intangible assets, net	60,301	62,281
	94,017	95,987
	$ 1,154,293	$ 1,036,784

* Restated (See Note 1B)

** Derived from the Company's 2004 audited financial statements

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

CONSOLIDATED BALANCE SHEETS

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

	June 30, 2005 (Unaudited)	December 31, 2004 (**)
CURRENT LIABILITIES:		
Short-term bank credit and loans	$ 8,581	$ 8,592
Current maturities of long-term loans	2,914	1,656
Trade payables	111,006	118,391
Other payables and accrued expenses	159,261	169,702
Customers advances and amounts in excess of costs incurred on contracts in progress	152,248	80,109
Total current liabilities	434,010	378,450
LONG-TERM LIABILITIES:		
Long-term loans	128,681	86,234
Advances from customers	19,099	10,320
Deferred income taxes	24,082	24,516
Accrued termination liability	97,381	100,740
	269,243	221,810
MINORITY INTERESTS	4,067	4,340
SHAREHOLDERS' EQUITY:		
Share capital		
Ordinary shares of New Israeli Shekels (NIS) 1 par value; Authorized 80,000,000 shares as of June 30, 2005 and December 31, 2004; Issued – 41,154,632 and 40,969,947 shares as of June 30, 2005 and December 31, 2004 respectively; Outstanding – 40,745,711 and 40,561,026 shares as of June 30, 2005 and December 31, 2004, respectively	11,590	11,548
Additional paid-in capital	276,461	274,432
Accumulated other comprehensive loss	(5,064)	*(4,742)
Retained earnings	168,307	*155,267
Treasury shares - 408,921 shares as of June 30, 2005 and December 31, 2004	(4,321)	(4,321)
	446,973	*432,184
	$ 1,154,293	$ 1,036,784

* Restated (See Note 1B)

** Derived from the Company's 2004 audited financial statements

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

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

	Six months ended June 30,		Three months ended June 30,		Year ended December 31,
	2005	**2004	2005	**2004	2004
	(Unaudited)		(Unaudited)		(***)
Revenues	$ 474,470	$ 445,317	$ 243,782	$ 231,645	$ 939,925
Cost of revenues	346,821	328,839	177,695	171,759	689,626
Gross profit	127,649	116,478	66,087	59,886	250,299
Research and development costs, net	32,961	27,027	17,795	13,733	66,846
Marketing and selling expenses	34,386	35,160	17,740	18,662	69,912
General and administrative expenses	25,424	22,731	12,932	11,169	47,832
	92,771	84,918	48,467	43,564	184,590
Operating income	34,878	31,560	17,620	16,322	65,709
Financial expenses, net	(3,197)	(1,301)	(1,466)	(822)	(5,852)
Other income (expenses), net	(185)	(84)	(75)	(299)	770
Income before taxes on income	31,496	30,175	16,079	15,201	60,627
Taxes on income	8,043	7,779	4,056	3,704	15,219
	23,453	22,396	12,023	11,497	45,408
Equity in net earnings of affiliated companies and partnership	(127)	2,970	(1,168)	1,612	*6,645
Minority interests in losses (earnings) of subsidiaries	273	188	54	193	(180)
Net income	$ 23,599	$ 25,554	$ 10,909	$ 13,302	*$ 51,873
Earnings per share					
Basic net earnings per share	$ 0.58	$ 0.64	$ 0.27	$ 0.33	*$ 1.30
Diluted net earnings per share	$ 0.57	$ 0.63	$ 0.26	$ 0.33	* $ 1.26
Number of shares used in computation of basic net earnings per share	40,675	39,704	40,705	39,828	39,952
Number of shares used in computation of Diluted net earnings per share	41,617	40,805	41,617	40,892	41,041

* Restated (See Notes 1B)
** Restated (See Note 3)
*** Derived from the Company's 2004 audited financial statements

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars (in thousands, except share data)

	Number of outstanding shares	Share capital	Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained earnings	Treasury shares	Total shareholders' equity	Total comprehensive income (loss)
Balance as of January 1, 2004	39,337,204	$ 11,273	$ 259,033	$ (3,992)	$ 190,086	$ (4,321)	$ 452,079	
Exercise of options	1,223,822	275	10,985	-	-	-	11,260	
Cumulative effect of first time adoption of the fair value based method for stock based compensation expenses			(152)				(152)	
Tax benefit in respect of options exercised	-	-	1,179	-	-	-	1,179	
Stock based compensation	-	-	3,387	-	-	-	3,387	
Dividends paid	-	-	-	-	(86,692)	-	(86,692)	
Other comprehensive income (loss):								
Unrealized gains on derivative instruments	-	-	-	(299)	-	-	(299)	$ (299)
Foreign currency translation differences	-	-	-	450	-	-	450	450
Minimum pension liability	-	-	-	(901)	-	-	(901)	(901)
Net income	-	-	-	-	51,873	-	51,873	51,873
Total comprehensive income								$ 51,123
Balance as of December 31, 2004	40,561,026	$ 11,548	$ 274,432	$ (4,742)	$ 155,267	$ (4,321)	$ 432,184	
Exercise of options	184,685	42	1,545	-	-	-	1,587	
Tax benefit in respect of options exercised	-	-	484	-	-	-	484	
Dividends paid	-	-	-	-	(10,559)	-	(10,559)	
Other comprehensive income (loss):								
Unrealized gains on derivative instruments	-	-	-	293	-	-	293	$ 293
Foreign currency translation differences	-	-	-	(615)	-	-	(615)	(615)
Net income	-	-	-	-	23,599	-	23,599	23,599
Total comprehensive income								$23,277
Balance as of June 30, 2005 (Unaudited)	40,745,711	$ 11,590	$ 276,461	$ (5,064)	$ 168,307	$ (4,321)	$ 446,973	

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars (in thousands, except share data)

	Number of outstanding shares	Share capital	Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained earnings	Treasury shares	Total shareholders' equity	Total comprehensive income (loss)
Balance as of January 1, 2004	39,337,204	$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	
Stock based compensation	-	-	1,845	-	-	-	1,845	
Dividends paid	-	-	-	-	(8,696)	-	(8,696)	
Other comprehensive income (loss):								
Unrealized gains on derivative instruments	-	-	-	428	-	-	428	$ 428
Foreign currency translation differences	-	-	-	(20)	-	-	(20)	(20)
Net income	-	-	-	-	25,554	-	25,554	25,554
Total comprehensive income								$24,448
Balance as of June 30, 2004 (Unaudited)	39,928,451	$ 11,405	$ 267,153	$ (3,584)	$ 206,944	$ (4,321)	$ 477,597	
Balance as of April 1, 2005 (Unaudited)	40,682,842	$ 11,576	$ 275,766	$ (4,705)	$ 162,661	$ (4,321)	$ 440,977	
Exercise of options	62,869	14	498	-	-	-	512	
Tax benefit in respect of options exercised	-	-	197	-	-	-	197	
Dividends paid	-	-	-	-	(5,263)	-	(5,263)	
Other comprehensive income (loss):								
Unrealized gains on derivative instruments				81			81	$ 81
Foreign currency translation differences				(440)			(440)	(440)
Net income	-	-	-	-	10,909	-	10,909	10,909
Total comprehensive income								$ 10,550
Balance as of June 30, 2005 (Unaudited)	40,745,711	$ 11,590	$ 276,461	$ (5,064)	$ 168,307	$ (4,321)	$ 446,973	

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars (in thousands, except share data)

	Number of outstanding shares	Share capital	Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained earnings	Treasury shares	Total shareholders' equity	Total comprehensive income (loss)
Balance as of April 1, 2004 (Unaudited)	39,718,313	$11,358	$263,919	$(3,942)	$198,010	$(4,321)	$465,025	
Exercise of options	210,138	47	2,032	-	-	-	2,079	
Tax benefit in respect of options exercised	-	-	280	-	-	-	280	
Amortization of deferred stock compensation	-	-	922	-	-	-	922	
Dividend paid	-	-	-	-	(4,369)	-	(4,369)	
Other comprehensive income (loss):								
Unrealized gains on derivative instruments				522	-	-	522	$ 522
Foreign currency translation differences	-	-	-	(164)	-	-	(164)	(164)
Net income	-	-	-	-	13,302	-	13,302	13,302
Total comprehensive income								$ 13,660
Balance as of June 30, 2004 (Unaudited)	39,928,451	$11,405	$ 267,153	$ (3,584)	$ 206,944	$ (4,321)	$ 477,597	

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars (in thousands)

	Six months ended June 30, 2005	Six months ended June 30, 2004	Year ended December 31, 2004
	(Unaudited)	(Unaudited)	(***)
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 23,599	$ 25,554	**$ 51,873
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	24,102	20,304	42,261
Stock based compensation	-	1,845	3,387
Deferred income taxes	(1,804)	1,653	153
Accrued severance pay, net	(1,725)	(833)	(2,304)
Loss (gain) on sale of property and equipment	(304)	16	143
Tax benefit in respect of options exercised	484	691	1,179
Minority interests in earnings (losses) of subsidiaries	(273)	(187)	180
Equity in net losses (earnings) of affiliated companies and partnership, net of dividend received (*)	4,265	681	**1,505
Changes in operating assets and liabilities:			
Decrease (increase) in short and long-term receivables and prepaid expenses	25,732	24,603	(16,871)
Decrease (increase) in inventories	(63,529)	(5,062)	2,932
Increase (decrease) in trade payables, other payables and accrued expenses	(21,262)	(5,216)	20,522
Increase (decrease) in advances received from customers	96,507	(7,308)	(18,535)
Settlement of royalties with the Office of the Chief Scientist	-	(1,247)	(3,714)
Other adjustments	45	(91)	(1,228)
Net cash provided by operating activities	85,837	55,403	81,483
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property, plant and equipment	(30,017)	(26,262)	(53,008)
Acquisition of subsidiaries and businesses (Schedule A)	(318)	-	(2,315)
Investments in affiliated companies and subsidiaries	(74,782)	(250)	(18,391)
Proceeds from sale of property, plant and equipment	1,001	1,351	2,560
Proceeds from sale of investment	3,100	-	-
Investment in long-term bank deposits	(551)	(167)	(1,203)
Proceeds from sale of long-term bank deposits	945	317	1,507
Short-term bank deposits, net	(458)	125	(48)
Net cash used in investing activities	(101,080)	(24,886)	(70,898)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from exercise of options	1,587	5,716	11,260
Repayment of long-term bank loans	(51,652)	(12,222)	(35,826)
Receipt of long-term bank loans	95,500	-	58,410
Dividends paid	(10,559)	(8,696)	(86,692)
Change in short-term bank credit and loans, net	113	(1,135)	216
Net cash provided by (used in) financing activities	34,989	(16,337)	(52,632)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	19,746	14,180	(42,047)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	34,109	76,156	76,156
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	$ 53,855	$ 90,336	$ 34,109
(*) Dividend received	$ 4,138	$ 3,651	$ 8,150

(**) Restated (See Notes 1B and 3)

(***) Derived from the Company's 2004 audited financial statements

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars (in thousands)

	Six months ended June 30,		Year ended December 31,
	2005	2004	2004
	(Unaudited)		(*)
SUPPLEMENTARY CASH FLOWS ACTIVITIES:			
Cash paid during the period for:			
Income taxes	$ 13,233	$ 6,614	$ 13,305
Interest	$ 3,193	$ 844	$ 3,122
SCHEDULE A:			
Subsidiaries and businesses acquired			
Estimated net fair value of assets acquired and liabilities assumed at the date of acquisition:			
Working capital, net (excluding cash and cash equivalents)	$ (3,281)	-	$ (707)
Property, plant and equipment	-	-	(10)
Goodwill, customer contracts and other intangible assets	(1,514)	-	(1,598)
Long-term liabilities – mainly advances from customers	4,477	-	-
	$ (318)	-	$ (2,315)

* Derived from the Company's 2004 audited financial statements

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

Note 1 - GENERAL

A. The accompanying unaudited interim consolidated financial statements have been prepared in a condensed format as of June 30, 2005, and for the three and six 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 7 for the reconciliation from U.S. GAAP to accounting principles generally accepted in Israel (Israeli GAAP).

These statements should be read in conjunction with the Company's annual financial statements and accompanying notes as of December 31, 2004, included in the Form 20-F for the year ended December 31, 2004.

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. Reclassifications have been made to comparative data in the balance sheet as of December 31, 2004 in order to conform to the current period presentation.

Comparative data in the condensed interim financial statements for the three and six months ended June 30, 2004, for the year ended December 31, 2004 and for the three months ended March 31, 2005 have been restated (see Notes 1B and 3).

Operating results for the three and six months ended June 30, 2005, are not necessarily indicative of the results that may be expected for the year ending December 31, 2005.

B. On December 27, 2004, the Company reached an agreement with Koor Industries Ltd. ("Koor") to purchase all of Koor's holdings in Tadiran Communications Ltd. ("Tadiran Communications"), which represents approximately a 32% interest in Tadiran Communications, at a price of $37 per share. This purchase was to be made concurrently with Koor's purchase of approximately 9.8% of the Company's shares from Federmann Enterprises Ltd ("Federmann"). Tadiran Communications is an Israeli company, whose shares are traded on the Tel Aviv Stock Exchange. The purchase of the interest in Tadiran Communications was to have been made in two stages, subject to the terms agreed upon between the parties.

On April 18, 2005, the Company completed the first stage of the transaction to purchase shares of Tadiran Communications from Koor. The first stage of the transaction was completed after all the precedent conditions were met and all the required approvals for this stage were obtained.

According to the transaction agreements, Elbit Systems purchased from Koor, in this stage, approximately 13.7% of the outstanding shares of Tadiran in consideration for $62.5 million. In addition to the shares previously purchased by Elbit Systems in the stock market, it now holds approximately 21% of Tadirans' shares. The total consideration paid by the Company for the purchase of Tadiran shares from Koor and in the stock market amounted to approximately $90 million.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

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

Note 1 - GENERAL (CONT.)

The excess of the amount paid for the Tadiran shares acquired until the end of the second quarter of 2005 over their book value is approximately $62 million. Based on a purchase price allocation analysis ("PPA") performed by independent advisors, this excess was attributed as follows:

	$M	Expected useful lives
In Process R&D ("IPR&D")	5.0	immediate write-off
Inventory	1.5	Up to a quarter
Other tangible assets and liabilities	0.5	5 years
Brand name	4.0	15 years
Customer base and backlog	20.0	2-12 years
Technology	12.0	10 years
Goodwill	19.0	Indefinite – subject to annual impairment test
	62.0	

As a result of the acquisition in the second quarter of 2005, the Company is able to execise significant influence in Tadiran. In accordance with APB 18, "The Equity Method of Accounting for Investments in Common Stock", the Company's interest in Tadiran, which was previously accounted for as available-for-sale securities, is accounted retroactively under the equity method of accounting ("step-by-step acquisition"). Implementing the step-by-step acquisition method resulted in a restatement of the Company's financial statements for all prior periods, in which the Company's investment in Tadiran Communications was accounted for as available-for-sale securities.

The following are the effects of the restatement:

(1) Consolidated balance sheet

	December 31, 2004		
	As reported	Effect by restatement	As restated
Other receivables and prepaid expenses	$ 52,335	$ 752	$ 53,087
Investment in affiliated companies and partnership	33,124	14,748	47,873
Available for sale securities	18,017	(18,017)	-
Accumulated other comprehensive loss	(3,346)	(1,396)	(4,742)
Retained earnings	156,387	(1,120)	155,267
Total shareholders' equity	434,700	(2,516)	432,184

(2) Consolidated statement of income

	Year ended December 31, 2004		
	As reported	Effect by restatement	As Restated
Equity in net earnings of affiliated companies and partnership	$ 7,765	$ (1,120)	$ 6,645
Net income	52,993	(1,120)	51,873
Basic net earnings per share	1.33	(0.03)	1.30
Diluted net earnings per share	1.29	(0.03)	1.26

Note 1 - GENERAL (CONT.)

C. On July 6, 2005, the Company reported that it signed an agreement with Koor to acquire all of Koor's 70% holdings in Elisra Electronic Systems Ltd. ("Elisra"), in consideration for $70 million to be paid in the form of cash. The parties also agreed on an additional contingent consideration as a result of future insurance proceeds relating to the fire at Elisra's plant in 2001. As part of the transaction, Koor may purchase Dekolink Wireless Ltd. from Elisra at an agreed upon price. Dekolink Wireless Ltd. is a start-up company engaged in the cellular networks area that is wholly-owned by Elisra. The acquisition agreement relating to Elisra is subject to receipt of the Company's shareholders approval as well as approvals from governmental authorities, including the Israel Antitrust Authority.

Concurrently with signing the agreement to acquire Koor's holdings in Elisra, the Company and Koor agreed to amend their agreements regarding the Company's purchase of Tadiran shares held by Koor. Pursuant to the amendment, the Company will accelerate the acquisition from Koor of approximately 5% of Tadiran's outstanding shares, out of a total of 18.2% of Tadiran outstanding shares that the Company agreed to acquire as part of the second stage of the aforementioned agreement. Upon completion of the acquisition of the 5% interest in Tadiran, the Company and Koor will have equal representation on Tadiran's board of directors, Joseph Ackerman, Elbit Systems President, will be appointed as Chairman of Tadiran's Board of Directors and the provisions of the shareholders' agreement relating to joint control in Tadiran will enter into effect.

The price to be paid by the Company for the Tadiran shares will be the price agreed upon in the original agreement with Koor signed on December 27, 2004.

The agreement for acquiring Koor's holdings in Elisra and the amendments regarding the acquisition of Koor's shares in Tadiran, were signed following the approval of the transactions by the Company's Audit Committee and Board of Directors, who obtained a fairness opinion from an independent appraiser regarding the consideration to be paid for the Elisra shares.

The purchase of the approximately 5% interest in Tadiran by Elbit Systems will take place following the approval of the Company's shareholders for the acquisition of Elisra and the amendments to the Tadiran acquisition agreements. Following the acquisition of the 5% interest in Tadiran, the Company will hold a total of approximately 26% of Tadiran's shares, including approximately 7% that were purchased on the stock market. Upon completion of the Elisra transaction, the Company will complete the purchase of Koor's remaining shares in Tadiran – approximately 13% - reaching a total of approximately a 39% interest in Tadiran based on the Company's current shareholdings.

Note 1 - GENERAL (CONT.)

D. In March 2005, the Company, through its wholly-owned subsidiary Cyclone Aviation Products Ltd. ("Cyclone"), acquired from Israel Military Industries Ltd. ("IMI") the assets and customer contracts related to the Aircraft Systems Division of IMI ("the Aircraft Division") in consideration for approximately $7 million, to be paid in cash (approximately $1 million out of which $318 was paid through balance sheet date) and assumed liabilities of approximately $6 million. The excess of the purchase price over the fair value of net tangible assets acquired in the amount of approximately $1,500 was allocated to customers' contracts to be amortized over an estimated period of four years.

The Aircraft Division manufactures weapon payloads and external fuel tanks for fighter aircrafts.

The financial results of the business acquired are included in the Company's consolidated financial statements from the date of acquisition.

Pro forma information in accordance with SFAS No. 141 has not been provided, since the revenues and net income of the Aircraft Division are not material in relation to the total consolidated revenues and net income of the Company.

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.

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 - STOCK-BASED COMPENSATION

As mentioned in Note 2X to the Company's annual financial statements, effective January 1, 2004, the Company adopted the fair value recognition provisions of SFAS 123. Under the modified prospective method of adoption selected by the Company under the provisions of SFAS No. 148, the fair value recognition provisions are applied from January 1, 2004 to all employee awards granted, modified or settled subsequent to January 1, 2004, and to previously granted awards that were not fully vested on the date of adoption. The aforementioned decision to adopt the fair value recognition provisions of SFAS 123 took place in December 2004. SFAS 123 fair value recognition provisions were adopted effective January 1, 2004 and the results of the first three quarters of 2004 were restated accordingly. The restatement reflects the change in stock-based compensation expense calculated under the intrinsic value based method as compared to the expense calculated under the fair value based method.

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

Note 3 - STOCK-BASED COMPENSATION (CONT.)

The following is the effect of the restatement of stock-based compensation expense on the financial statements for the three and six months ended June 30, 2004:

	Three months ended June 30, 2004		
	As reported	Effect by restatement	As restated
Gross profit	$ 58,518	$ 1,368	$ 59,886
Operating income	13,835	2,487	16,322
Net income	11,312	1,990	13,302
Basic net earnings per share	0.28	0.05	0.33
Diluted net earnings per share	0.28	0.05	0.33

	Six months ended June 30, 2004		
	As reported	Effect by restatement	As restated
Gross profit	$ 115,438	$ 1,040	$ 116,478
Operating income	29,669	1,891	31,560
Net income	24,039	1,515	25,554
Basic net earnings per share	0.61	0.03	0.64
Diluted net earnings per share	0.59	0.04	0.63

Note 4 - INVENTORIES, NET OF ADVANCES

	June 30, 2005	**December 31, 2004**
	(Unaudited)	**(*)**
Cost of long-term contracts in progress	$ 309,308	$ 254,009
Raw materials	78,426	71,813
Advances to suppliers and subcontractors	27,549	21,164
	415,283	346,986
Less - Cost incurred on contracts in progress deducted from customer advances	34,512	14,533
	380,771	332,453
Less - Advances received from customers	77,104	75,776
Provision for losses	7,064	7,636
	$ 296,603	$ 249,041

* Derived from the Company’s 2004 audited financial statements

Note 5 - RECENTLY ISSUED ACCOUNTING STANDARDS

A. In March 2005, the SEC released SEC Staff Accounting Bulletin No. 107, "Share-Based Payment" ("SAB 107"). SAB 107 provides the SEC staff's position regarding the application of Statement 123R and contains interpretive guidance related to the interaction between Statement 123R and certain SEC rules and regulations and also provides the SEC staff's views regarding the valuation of share-based payment arrangements for public companies. SAB 107 highlights the importance of disclosures made related to the accounting for share-based payment transactions. The Company is currently reviewing the effect of SAB 107; however, it does not believe that SAB 107 will have a material impact on its financial position, results of operations or cash flows.

B. In May 2005, the FASB issued Statement of Financial Accounting Standard No. 154 ("FAS 154"), "Accounting Changes and Error Corrections" - a replacement of APB No. 20, Accounting Changes" and FAS No. 3, "Reporting Accounting Changes in Interim Financial Statements". FAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. APB Opinion 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. FAS 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable to do so. FAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company estimates that the adoption of FAS 154 will not have a significant impact on its results of operations, financial condition and cash flows.

C. FASB Statements No. 123 (revised 2004), "Share-based Payment" (FASB 123(R)) (See Note 2AA(3)) to the Company's annual financial statements for 2004, was to have been effective as of the beginning of the first interim or annual reporting period that commences after June 15, 2005 (July 1, 2005 for the Company); however, on April 14, 2005, the United States Securities and Exchange Commission ("SEC") delayed effectiveness of FAS 123(R) for companies with fiscal years ending December 31 (such as the Company) to January 1, 2006.

Note 6 - TAXES ON INCOME

On July 25, 2005, the Knesset (Israeli Parliament) approved the Law for the Amendment of the Income Tax Ordinance (No. 147), 2005, which prescribes, among other provisions, a gradual decrease in the corporate tax rate in Israel to the following tax rates: in 2006 - 31%, in 2007 - 29%, in 2008 - 27%, in 2009 - 26% and in 2010 and thereafter - 25%. The Company estimates that the change in tax rate is not expected to have a material effect on the Company's financial position and results of operations in 2005.

Note 7 - 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 2004 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.

A. Effect on net income

	Three months ended June 30, 2005	Three months ended June 30, 2004	Year ended December 31, 2004
	(Unaudited)		(*)
Net income as reported according to U.S. GAAP	$ 23,599	$ 25,554	$ 51,873
Adjustments to Israeli GAAP	(3,004)	(1,907)	662
Net income according to Israeli GAAP	$ 20,595	$ 23,647	$ 52,535

B. Effect on shareholders' equity

	As reported	Adjustments	As per Israeli GAAP
As of June 30, 2005 (Unaudited)			
Shareholders' equity	$ 446,973	$ (17,143)	$ 429,830
As of December 31, 2004 (*)			
Shareholders' equity	$ 432,184	$ (12,004)	$ 420,180

* Derived from the Company's 2004 audited financial statements

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Elbit Systems Ltd.
Management's Report
For The Three and Six-Month Period Ended June 30, 2005

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, 2005, the Company's audited consolidated financial statements and related notes for the year ended December 31, 2004, the Company's management report for the year ended December 31, 2004 and the Company's Form 20-F for the year ended December 31, 2004, 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 and its subsidiaries (the "Group") operate in the area of upgrading existing airborne, ground and naval defense platforms and are 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 provides support services for such platforms, systems and products.

The Group is engaged in leading projects in Israel and worldwide, in areas such as air, ground 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 and products, systems for Homeland Defense products, surveillance products and systems and electric drive systems.

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

The Group 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 Group provides customers with cost-effective solutions, and its customers are able to improve their technological and operational capabilities within limited defense budgets.

The Group 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. In addition, its competitive position sometimes is affected by specific requirements in particular markets.

Financial Highlights

The Company's revenues increased by 5.2% and reached $243.8 million in the second quarter of 2005, as compared to $231.6 million in the second quarter of 2004.

Net earnings in the second quarter of 2005 were $10.9 million and the diluted earnings per share were $0.26, as compared to $13.3 million and $0.33 in the second quarter of 2004. Excluding the In Process Research and Development ("IPR&D") write-off of approximately $3.5 million related to the acquisition of Tadiran Communications Ltd.'s shares, net earning in the quarter ended June 30, 2005 were $ 14.4 million, and the diluted EPS was $0.35.

The Company's backlog as of June 30, 2005 reached $2.4 billion, as compared to $2.15 billion as of December 31, 2004.

The Company's cash flow generated from operations in the six-month period ended June 30, 2005 was $85.8 million, as compared to $55.4 million in the six-month period ended June 30, 2004.

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

B. Recent Events

On August 4, 2005, the UK Ministry of Defence (MoD) and Thales UK signed a contract worth £700 million for the Development, Manufacture and Initial Support phases of the WATCHKEEPER programme. Elbit Systems and Thales UK are establishing a Joint Venture aimed at executing a significant part of the WATCHKEEPER programme and addressing the rapidly growing UAV market worldwide.

The Elbit Systems Group expects to receive a significant part of the contract, valued at around £300 million, the majority to be executed by the Leicester-based Joint Venture. The Joint Venture's contract is expected to be signed this year.

WATCHKEEPER will provide the UK armed forces with an essential Intelligence, Surveillance, Target Acquisition and Reconnaissance (ISTAR) capability based on the Hermes 450 UAV system and will be a key component of the UK's Network Enabled Capability (NEC). This programme will deliver equipment, training and facilities, with the capability coming into service from 2010.

C. Backlog of Orders

The Company's backlog of orders as of June 30, 2005 reached $2,401 million, of which 65% was for orders outside Israel. The Company's backlog as of December 31, 2004 was $2,154 million, of which 66% was for orders outside Israel.

Approximately 60% of the Company's backlog as of June 30, 2005 is scheduled to be performed in the following two quarters of 2005 and during 2006. The majority of the 40% of the Company's backlog balance is scheduled to be performed in 2007 and 2008.

D. 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, 2004. See also the Company's management report for the year ended December 31, 2004.

E. Stock-Based Compensation

Effective January 1, 2004, the Company adopted the fair value recognition provision of SFAS No. 123. Following the adoption of SFAS No. 123, the financial results are no longer materially affected by the impact of changes in the Company's share price on employee stock-based compensation.

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

	Q1/04	Q2/04	1-6/04
Net income as previously reported in 2004	$ 12,727	$ 11,311	$ 24,038
Restated net income (according to SFAS No. 123)	$ 12,252	$ 13,302	$ 25,554
Diluted net earnings per share as reported in 2004	$ 0.31	$ 0.28	$ 0.59
Restated diluted net earnings per share (according to SFAS No. 123)	$ 0.30	$ 0.33	$ 0.63

F. Tadiran Communications Ltd. Share Purchase Effect

On April 18, 2005, the Company completed the first stage of the transaction to purchase shares of Tadiran Communications Ltd. ("Tadiran") from Koor Industries Ltd. ("Koor"). The first stage of the transaction was completed after all the conditions precedent and all the required approvals for this stage were obtained.

According to the transaction agreements, Elbit Systems purchased from Koor, in this stage, approximately 13.7% of the share equity of Tadiran. In addition to the shares previously purchased by Elbit Systems in the stock market, it now holds approximately 21% of Tadirans' shares. The Company purchased Tadiran shares from Koor in consideration for approximately $62.5 million. As a result of the Company obtaining shareholder rights to exercise significant influence over Tadiran, as defined in the applicable accounting standards, the Company's investment in Tadiran, which had been previously accounted for as "available-for-sale securities", were accounted for, retroactively, under the equity method of accounting ("step-by-step acquisition"). Implementing the step-by-step acquisition method resulted in a restatement of the Company's prior financial results for the last quarter of 2004 and the first quarter of 2005, in which the Company's investment in Tadiran was accounted for as available-for-sale securities.

Accordingly, the Company's net income for the fourth quarter of 2004 and the first quarter of 2005 were reduced by approximately $1.1 million and $0.5 million, respectively. As a result, the Company's net income was restated as $13 million for the fourth quarter of 2004 and $12.6 million for the first quarter of 2005, rather than the reported net income of $14.1 million and $13.1 million, respectively.

The excess of the amount paid for the Tadiran shares acquired until the end of the second quarter of 2005 over their book value is approximately $62 million. Based on a purchase price allocation analysis ("PPA") performed by independent advisors, this excess was attributed as follows:

	$M	Expected useful lives
In Process R&D ("IPR&D")	5.0	immediate write-off
Inventory	1.5	Up to a quarter
Other tangible assets net of liabilities	0.5	5 years
Brand name	4.0	15 years
Customer base and backlog	20.0	2-10 years
Technology	12.0	10 years
Goodwill	19.0	Indefinite – subject to annual impairment test
	62.0	

The effect of the above transaction on the Company's results for the last quarter of 2004 and for the first and the second quarters of 2005, which were reflected as part of the Company's equity in net earnings of affiliated companies, was as follows:

	Q4/04	Q1/05	Q2/05	Total
IPR&D write-off	(1.0)	(0.5)	(3.5)	(5.0)
Inventory amortization	(0.2)	(0.2)	(1.1)	(1.5)
Other tangible and intangible assets amortization	(0.2)	(0.4)	(1.0)	(1.6)
	(1.4)	(1.1)	(5.6)	(8.1)
Company's portion in Tadiran's profit (according to US GAAP)	0.3	0.6	2.4	3.3
Net effect	(1.1)	(0.5)	(3.2)	(4.8)

Further effects on the Company's financial results are expected to occur in the event of the consummation of the additional purchases of Tadiran shares from Koor in accordance with the amendments to the agreements with Koor, announced on July 6, 2005, as well as the purchase of Koor's shares in Elisra Electronic Systems Ltd. ("Elisra") (see section G below), subject to receipt of the required approvals. The effect on the Company's financial results of future purchases of shares of Tadiran as well as the anticipated purchase of shares in Elisra will be reported following completion of the respective purchases.

G. <u>Acquisition of Elisra Shares and Amendment to the Tadiran Acquisition</u>

On July 6, 2005, the Company reported that it signed an agreement with Koor to acquire all of Koor's 70% holdings in Elisra, in consideration of $70 million in cash. In addition, the parties agreed on additional conditional consideration as a result of future insurance proceeds relating to the fire at Elisra's plant in 2001. Moreover, Koor received the right to purchase from Elisra, at an agreed upon price, Dekolink Wireless Ltd., a start-up company engaged in the cellular networks area, that is wholly-owned by Elisra. The acquisition agreement relating to Elisra is subject to the receipt of the approval of Elbit Systems' shareholders as well as governmental authorities, including the Israel Antitrust Authority.

Concurrently with the signing of the agreement to acquire Koor's holdings in Elisra, Elbit Systems and Koor agreed to amend their agreements regarding the purchase of Koor’s holdings of Tadiran. Pursuant to the amendment, Elbit Systems will accelerate the acquisition from Koor of approximately 5% of Tadiran's shares, out of a total of 18.2% of Tadiran's shares that Elbit Systems agreed to acquire as part of the second stage of the agreement entered into between Elbit Systems and Koor on December 27, 2004. Upon completion of this step, Elbit Systems and Koor will have equal representation on Tadiran's board of directors. Joseph Ackerman, Elbit Systems President, will be appointed as Chairman of Tadiran's Board for a 24-month period and the provisions of the shareholders agreement relating to joint control in Tadiran will enter into effect.

The price to be paid by Elbit Systems for the Tadiran shares will be the price agreed to in the original agreement with Koor.

The agreement for the acquisition of Koor’s holdings in Elisra and the amendments regarding the acquisition of Koor’s shares in Tadiran, were signed following receipt of approval of Elbit Systems’ Audit Committee and Board of Directors that obtained a fairness opinion from an independent appraiser regarding the consideration to be paid for the Elisra shares.

The purchase of the approximately 5% of Tadiran's shares by Elbit Systems will take place following approval of Elbit Systems' shareholders at a general shareholders meeting of the Elisra transaction and the amendments to Tadiran transaction agreements. Upon completion of that stage, Elbit Systems will hold a total of approximately 26% of Tadiran’s shares, including approximately 7% that were purchased on the stock market.

Upon completion of the Elisra transaction, Elbit Systems will complete the purchase of Koor’s remaining shares in Tadiran – approximately 13% - reaching a total of approximately 39% of Tadiran's shares based on Elbit Systems' current shareholdings.

H. **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, 2005 and June 30, 2004. The results of the three and six months of 2004 and of the first quarter of 2005 reflect restatements, regarding the Tadiran's share acquisition and the stock-based compensation (see above).

	For the six months ended June 30				For the three months ended June 30			
	2005		2004		2005		2004	
	$	%	$	%	$	%	$	%
	(In thousands of U.S. dollars except per share data)							
Total revenues	**474,470**	100.0	**445,317**	100.0	**243,782**	100.0	**231,645**	100.0
Cost of revenues	**346,821**	73.1	**328,839**	73.8	**177,695**	72.9	**171,759**	74.1
Gross profit	**127,649**	26.9	**116,478**	26.2	**66,087**	27.1	**59,886**	25.9
Research and development (R&D) expenses	**42,053**	8.9	**32,697**	7.3	**22,153**	9.1	**16,236**	7.0
Less – participation	**(9,092)**	(1.9)	**(5,670)**	(1.3)	**(4,358)**	(1.8)	**(2,503)**	(1.1)
R&D expenses, net	**32,961**	7.0	**27,027**	6.1	**17,795**	7.3	**13,733**	5.9
Marketing and selling expenses	**34,386**	7.2	**35,160**	7.9	**17,740**	7.3	**18,662**	8.1
General and administrative expenses	**25,424**	5.4	**22,731**	5.1	**12,932**	5.3	**11,169**	4.8
	92,771	19.6	**84,918**	19.1	**48,467**	19.9	**43,564**	18.8
Operating income	**34,878**	7.3	**31,560**	7.1	**17,620**	7.2	**16,322**	7.0
Finance expenses, net	**(3,197)**	(0.7)	**(1,301)**	(0.3)	**(1,466)**	(0.6)	**(822)**	(0.4)
Other expenses, net	**(185)**	-	**(84)**	-	**(75)**		**(299)**	(0.1)
Income before taxes on income	**31,496**	6.6	**30,175**	6.8	**16,079**	6.6	**15,201**	6.6
Taxes on income	**8,043**	1.7	**7,779**	1.8	**4,056**	1.7	**3,704**	1.6
	23,453	4.9	**22,396**	5.0	**12,023**	4.9	**11,497**	5.0
Minority interest in losses (gains) of subsidiaries	**273**	0.1	**188**	-	**54**	-	**193**	0.1
Equity in net earnings of affiliated companies and partnership	**(127)**	-	**2,970**	0.7	**(1,168)**	(0.4)	**1,612**	0.7
Net earnings	**23,599**	5.0	**25,554**	5.7	**10,909**	4.5	**13,302**	5.7
Diluted earnings per share	**0.57**		**0.63**		**0.26**		**0.33**	

Revenues

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 changes in revenues by geographic distribution, other than standard quarterly fluctuations, were in the revenues from customers in Europe, which decreased mainly as a result of the temporary reduction in the land systems area of operations, while revenues in all other geographical regions increased.

Three Months Ended on June 30, 2005, Compared to Three Months Ended on June 30, 2004

The consolidated revenues increased by 5.2% from $231.6 million in the second quarter of 2004 to $243.8 million in the second quarter of 2005.

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

	Three-Month Period ended			
	June 30, 2005		June 30, 2004	
	$ millions	%	$ millions	%
Airborne systems	93.4	38.3	94.4	40.7
Land systems	33.2	13.6	48.7	21.0
C^4ISR systems	44.1	18.1	27.8	12.0
Electro-optics	56.3	23.1	44.6	19.3
Other (mainly non-defense engineering and production services)	16.8	6.9	16.1	7.0
Total	243.8	100.0	231.6	100.0

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

	Three-Month Period ended			
	June 30, 2005		June 30, 2004	
	$ millions	%	$ millions	%
Israel	77.9	31.9	56.6	24.4
United States	87.9	36.1	87.3	37.7
Europe	18.4	7.5	33.6	14.5
Other countries	59.6	24.5	54.1	23.4
Total	243.8	100.0	231.6	100.0

Six Months Ended on June 30, 2005, Compared to Six Months Ended on June 30, 2004

The Company's consolidated revenues increased by 6.6%, from $445.3 million in the first six months of 2004 to $474.5 million in the first six months of 2005.

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

	Six-Month Period ended			
	June 30, 2005		June 30, 2004	
	$ millions	%	$ millions	%
Airborne systems	194.4	41.0	178.7	40.1
Land systems	59.2	12.5	100.5	22.6
C^4ISR systems	88.1	18.5	57.3	12.9
Electro-optics	99.5	21.0	85.0	19.1
Other (mainly non-defense engineering and production services)	33.3	7.0	23.8	5.3
Total	474.5	100.0	445.3	100.0

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

	Six-Month Period ended			
	June 30, 2005		June 30, 2004	
	$ millions	%	$ millions	%
Israel	145.1	30.6	110.5	24.8
United States	177.5	37.4	166.7	37.4
Europe	34.5	7.3	65.7	14.8
Other countries	117.4	24.7	102.4	23.0
Total	474.5	100.0	445.3	100.0

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 June 30, 2005, Compared to Three Months Ended on June 30, 2004

The Company's gross profit in the quarter ended June 30, 2005 was $66.1 million as compared to $59.9 million in the quarter ended June 30, 2004. The gross profit margin in the second quarter of 2005 was 27.1% as compared to 25.9% 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, which included in the second quarter of 2005 certain programs with a relatively higher gross profit.

Six Months Ended on June 30, 2005, Compared to Six Months Ended on June 30, 2004

The Company's gross profit in the six months ended June 30, 2005 was $127.6 million as compared to $116.5 million in the six months ended June 30, 2004. The gross profit margin in the six months ended June 30, 2005 was 26.9% as compared to 26.2% 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.

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 strategy 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.

Further to the trend that began in the fourth quarter of 2004, the Company increased its R&D efforts, mainly in the areas of Airborne, Land and Electro-Optics Systems, for the development of advanced technologies and products to meet expected market requirements.

Three Months Ended on June 30, 2005, Compared to Three Months Ended on June 30, 2004

Gross R&D expenses in the quarter ended June 30, 2005 totaled $22.2 million (9.1% of revenues), as compared to $16.2 million (7.0% of revenues) in the quarter ended June 30, 2004.

Net R&D expenses (after deduction of third party participation, including the IMOD and the OCS) in the quarter ended June 30, 2005 totaled $17.8 million (7.3% of revenues), as compared to $13.7 million (5.9% of revenues) in the quarter ended June 30, 2004.

Six Months Ended on June 30, 2005, Compared to Six Months Ended on June 30, 2004

Gross R&D expenses in the six months ended June 30, 2005 totaled $42.1 million (8.9% of revenues), as compared to $32.7 million (7.3% of revenues) in the six months ended June 30, 2004.

Net R&D expenses (after deduction of third party participation, including the IMOD and the OCS) in the six months period ended June 30, 2005 totaled $33.0 million (6.9% of revenues), as compared to $27.0 million (6.1% of revenues) in the six months period ended June 30, 2004.

Marketing and Selling Expenses

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

Three Months Ended on June 30, 2005, Compared to Three Months Ended on June 30, 2004

Marketing and selling expenses in the quarter ended June 30, 2005 were $17.7 million (7.3% of revenues), as compared to $18.7 million (8.1% of revenues) in the quarter ended June 30, 2004.

Six Months Ended on June 30, 2005, Compared to Six Months Ended on June 30, 2004

Marketing and selling expenses in the six months ended June 30, 2005 were $34.4 million (7.2% of revenues), as compared to $35.2 million (7.9% of revenues) in the six months ended June 30, 2004.

General and Administrative ("G&A") Expenses

Three Months Ended on June 30, 2005, Compared to Three Months Ended on June 30, 2004

G&A expenses were $12.9 million (5.3% of revenues) in the quarter ended June 30, 2005, as compared to $11.2 million (4.8% of revenues) in the quarter ended June 30, 2004.

Six Months Ended on June 30, 2005, Compared to Six Months Ended on June 30, 2004

G&A expenses were $25.4 million (5.4% of revenues) in the six months ended June 30, 2005, as compared to $22.7 million (5.1% of revenues) in the six months ended June 30, 2004.

Finance Expense (Net)

The increase in the net finance expense resulted mainly from a higher level of long-term loans, currency exchange rate differences and an increase in market interest rates.

Three Months Ended on June 30, 2005, Compared to Three Months Ended on June 30, 2004

Net finance expense in the quarter ended June 30, 2005 was $1.5 million, as compared to $0.8 million of finance expense in the quarter ended June 30, 2004.

Six Months Ended on June 30, 2005, Compared to Six Months Ended on June 30, 2004

Net finance expense in the six months ended June 30, 2005 was $3.2 million, as compared to $1.3 million of finance expense in the six months ended June 30, 2004.

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 change in the effective tax rate is 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 and the recent decrease in the tax rate in Israel.

On July 25, 2005, the Knesset (Israeli Parliament) passed the Law for the Amendment of the Income Tax Ordinance (No. 147), 2005, which prescribes, among other provisions, a gradual decrease in the corporate tax rate in Israel to the following tax rates: in 2006 - 31%, in 2007 - 29%, in 2008 - 27%, in 2009 - 26% and in 2010 and thereafter - 25%. According to US GAAP accounting rules, the effect of the amendment will be included in the third quarter of 2005. The Company estimates that the amendment is not expected to have a material effect on the Company's financial position and results of operations in 2005.

Three Months Ended on June 30, 2005, Compared to Three Months Ended on June 30, 2004

Provision for taxes in the quarter ended June 30, 2005 was $4.1 million (effective tax rate of 25.2%), as compared to a provision for taxes of $3.7 million (effective tax rate of 24.4%) in the quarter ended June 30, 2004.

Six Months Ended on June 30, 2005, Compared to Six Months Ended on June 30, 2004

Provision for taxes in the six months ended June 30, 2005 was $8.0 million (effective tax rate of 25.5%), as compared to a provision for taxes of $7.8 million (effective tax rate of 25.8%) in the six months ended June 30, 2004.

Company's Share in Earnings of Affiliated Entities

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. This includes the Company's share in the earnings of Tadiran, and reflects the impact of the corresponding purchase price allocation adjustments described above.

Three Months Ended on June 30, 2005, Compared to Three Months Ended on June 30, 2004

In the second quarter of 2005 the Company had net expense of $1.2 million from its share in earnings of affiliated companies and partnership, as compared to net income of $1.6 million in the second quarter of 2004.

Six Months Ended on June 30, 2005, Compared to Six Months Ended on June 30, 2004

In the six months ended June 30, 2005 the Company had net expense of $0.1 million from its share in earnings of affiliated companies and partnership, as compared to net income of $3.0 million in the six months ended June 30, 2004.

Net Earnings and Earnings Per Share ("EPS")

Three Months Ended on June 30, 2005, Compared to Three Months Ended on June 30, 2004

Net earnings in the quarter ended June 30, 2005 were $10.9 million (4.5% of revenues), as compared to reported net earnings of $13.3 million (5.7% of revenues) in the quarter ended June 30, 2004. Diluted EPS in the quarter ended June 30, 2005 was $0.26, as compared to $0.33 in the quarter ended June 30, 2004.

Excluding the IPR&D write-off related to Tadiran, which amounted to approximately $3.5 million, net earnings in the quarter ended June 30, 2005 were $14.4 million (5.9% of revenues), and the diluted EPS was $0.35.

The number of shares used for computation of diluted EPS in the quarter ended June 30, 2005 was 41,617 thousand shares, as compared to 40,892 thousand shares in the quarter ended June 30, 2004.

Six Months Ended on June 30, 2005, Compared to Six Months Ended on June 30, 2004

Net earnings in the six months ended June 30, 2005 were $23.6 million (5.0% of revenues), as compared to net earnings of $25.6 million (5.7% of revenues) in the six months ended June 30, 2004. Diluted EPS in the six months ended June 30, 2005 was $0.57, as compared to $0.63 per share in the six months ended June 30, 2004.

Excluding the IPR&D write-off related to Tadiran, which amounted to approximately $4.0 million, net earnings in the six months ended June 30, 2005 were $27.6 million (5.8% of revenues), and the diluted EPS was $0.66.

The number of shares used for computation of diluted EPS in the six months ended June 30, 2005 was 41,617 thousand shares, as compared to 40,805 thousand shares in the six months ended June 30, 2004.

I. Liquidity and Capital Resources

The Company's net cash flow generated from operating activities in the six months ended June 30, 2005 was $85.8 million, resulting mainly from net income and advances received from customers. The cash inflows were partially offset, mainly by an increase in inventories and by payments of trade payables.

Net cash flow used for investment activities in the six months ended June 30, 2005 was $101.1 million, which was used mainly for acquisition of Tadiran's shares and for procurement of various assets and equipment.

Net cash flow from financing activities in the six months ended June 30, 2005 was $35.0 million, which was mainly from receipt of long-term loans.

On June 30, 2005, the Company had total borrowings in the amount of $140.2 million, including $128.7 million in long-term loans, and $440.9 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, 2005, the Company had a cash balance amounting to $53.9 million.

The Company and some of its subsidiaries operate with loan and credit agreements that contain certain covenants. Such covenants include requirements for shareholders' equity, current ratio, operating profit margin, tangible net worth, EBITDA, interest coverage ratio and total leverage. As of June 30, 2005, the Company and its subsidiaries are in full compliance with all such covenants.

As of June 30, 2005, the Company had working capital of $161 million and its current ratio was 1.37. The Company's ratio of equity to total assets was 38.7%.

J. 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 related to NIS, based on market conditions.

On June 30, 2005, 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, except for the Tadiran Communications shares acquired as mentioned above. The Company's deposits and loans are based on variable 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 the liabilities and the return on the assets that are based on variable rates.

The Company’s functional currency is the U.S. dollar. On June 30, 2005, the Company had exposure due to liabilities denominated in NIS of $62.8 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.

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, 2005 by forward contracts and options. On June 30, 2005, the Company had forward contracts for the sale and purchase of such foreign currencies totaling $32.2 million ($19.2 million in Euro, $5.9 million in GBP and $7.1 million in other currencies). The results of financial derivative activities in this quarter were not material.

K. Resignation of a Director

On August 2, 2005, the Company reported that Mr. Aharon Beth-Halachmi submitted his resignation from the Company's Board of Directors effective as of July 31, 2005. The resignation was submitted in connection with the Company's compliance with Sarbanes-Oxley Act and Nasdaq Listing Requirements relating to independence criteria for boards of directors. Mr. Beth-Halachmi will serve as a special advisor to the Chairman of the Company's Board of Directors.

L. Dividends

The Board of Directors declared on August 8, 2005 dividend of $0.13 per share.

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