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א.ג.נ.,

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

מצ"ב הדוחות הכספיים ודו"ח ההנהלה על תוצאות פעילות החברה ברבעון השלישי 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 SEPTEMBER 30, 2005

(Unaudited)

(In thousands of U.S. dollars)

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

AS OF SEPTEMBER 30, 2005

(Unaudited)

(In thousands of U.S. dollars)

C O N T E N T S

	<u>P a g e</u>
CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS	
Consolidated Balance Sheets	2 - 3
Consolidated Statements of Income	4
Consolidated Statements of Changes in Shareholders' Equity	5 -7
Consolidated Statements of Cash Flows	8 - 9
Notes to the Consolidated Financial Statements	10 - 15

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. dollars (in thousands)

	September 30, 2005 (Unaudited)	December 31, 2004 (**)
CURRENT ASSETS:		
Cash and cash equivalents	\$ 150,063	\$ 34,109
Short-term bank deposits	886	738
Trade receivables, (net of allowance for doubtful accounts in the amount of \$3,451 and \$3,064 as of September 30, 2005 and December 31, 2004, respectively)	231,928	214,816
Other receivables and prepaid expenses	56,704	*53,087
Inventories, net of advances	294,069	249,041
Total current assets	<u>733,650</u>	<u>551,791</u>
INVESTMENTS AND LONG-TERM RECEIVABLES:		
Investments in affiliated companies and a partnership	138,873	*47,873
Investments in other companies	11,745	11,745
Long-term bank deposits and trade receivables	2,341	2,102
Severance pay fund	82,900	82,998
	<u>235,859</u>	<u>144,718</u>
PROPERTY, PLANT AND EQUIPMENT, NET	<u>252,311</u>	<u>244,288</u>
INTANGIBLE ASSETS:		
Goodwill	34,057	33,706
Other intangible assets, net	59,346	62,281
	<u>93,403</u>	<u>95,987</u>
	<u>\$ 1,315,223</u>	<u>\$ 1,036,784</u>

* 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 BALANCE SHEETS

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

	September 30, 2005 (Unaudited)	December 31, 2004 (**)
CURRENT LIABILITIES:		
Short-term bank credit and loans	\$ 9,471	\$ 8,592
Current maturities of long-term loans	3,284	1,656
Trade payables	128,728	118,391
Other payables and accrued expenses	161,704	169,702
Customers advances and amounts in excess of costs incurred on contracts in progress	151,424	80,109
Total current liabilities	<u>454,611</u>	<u>378,450</u>
LONG-TERM LIABILITIES:		
Long-term loans	253,637	86,234
Advances from customers	26,896	10,320
Deferred income taxes	24,475	24,516
Accrued termination liability	92,229	100,740
	<u>397,237</u>	<u>221,810</u>
MINORITY INTERESTS	<u>3,915</u>	<u>4,340</u>
SHAREHOLDERS' EQUITY:		
Share capital		
Ordinary shares of New Israeli Shekels (NIS) 1 par value;		
Authorized 80,000,000 shares as of September 30, 2005 and December 31, 2004;		
Issued – 41,227,091 and 40,969,947 shares as of September 30, 2005 and December 31, 2004, respectively;		
Outstanding – 40,818,170 and 40,561,026 shares as of September 30, 2005 and December 31, 2004, respectively	11,604	11,548
Additional paid-in capital	277,137	274,432
Accumulated other comprehensive loss	(2,522)	*(4,742)
Retained earnings	177,562	*155,267
Treasury shares - 408,921 shares as of September 30, 2005 and December 31, 2004	(4,321)	(4,321)
	<u>459,460</u>	<u>*432,184</u>
	<u>\$ 1,315,223</u>	<u>\$ 1,036,784</u>

* 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)

	Nine months ended September 30,		Three months ended September 30,		Year ended December 31,
	2005	**2004	2005	**2004	2004
	(Unaudited)		(Unaudited)		(***)
Revenues	\$ 748,116	\$ 669,150	\$ 273,646	\$ 223,833	\$ 939,925
Cost of revenues	546,790	491,427	199,969	162,588	689,626
Gross profit	201,326	177,723	73,677	61,245	250,299
Research and development costs, net	53,443	43,570	20,482	16,543	66,846
Marketing and selling expenses	54,695	50,722	20,309	15,562	69,912
General and administrative expenses	38,262	34,957	12,838	12,226	47,832
	146,400	129,249	53,629	44,331	184,590
Operating income	54,926	48,474	20,048	16,914	65,709
Financial expenses, net	(6,273)	(2,878)	(3,076)	(1,577)	(5,852)
Other income (expenses), net	(192)	(61)	(6)	23	770
Income before taxes on income	48,461	45,535	16,966	15,360	60,627
Taxes on income	12,289	11,712	4,246	3,933	15,219
	36,172	33,823	12,720	11,427	45,408
Equity in net earnings of affiliated companies and partnership	1,339	4,586	1,465	1,616	*6,645
Minority interests in losses (earnings) of subsidiaries	652	459	379	271	(180)
Net income	<u>\$ 38,163</u>	<u>\$ 38,868</u>	<u>\$ 14,564</u>	<u>\$ 13,314</u>	<u>*\$ 51,873</u>
Earnings per share					
Basic net earnings per share	<u>\$ 0.94</u>	<u>\$ 0.98</u>	<u>\$ 0.36</u>	<u>\$ 0.33</u>	<u>*\$ 1.30</u>
Diluted net earnings per share	<u>\$ 0.92</u>	<u>\$ 0.95</u>	<u>\$ 0.35</u>	<u>\$ 0.32</u>	<u>*\$ 1.26</u>
Number of shares used in computation of basic net earnings per share	<u>40,709</u>	<u>39,822</u>	<u>40,775</u>	<u>40,060</u>	<u>39,952</u>
Number of shares used in computation of Diluted net earnings per share	<u>41,616</u>	<u>40,924</u>	<u>41,614</u>	<u>41,161</u>	<u>41,041</u>

* 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.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

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	257,144	56	2,128	-	-	-	2,184	
Tax benefit in respect of options exercised	-	-	477	-	-	-	477	
Stock based compensation	-	-	100	-	-	-	100	
Dividends paid	-	-	-	-	(15,868)	-	(15,868)	
Other comprehensive income (loss):								
Unrealized gains on derivative instruments	-	-	-	2,959	-	-	2,959	\$ 2,959
Foreign currency translation differences	-	-	-	(739)	-	-	(739)	(739)
Net income	-	-	-	-	38,163	-	38,163	38,163
Total comprehensive income								\$ 40,383
Balance as of September 30, 2005 (Unaudited)	40,818,170	\$ 11,604	\$ 277,137	\$ (2,522)	\$ 177,562	\$ (4,321)	\$ 459,460	

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

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	915,367	204	8,365				8,569	
Tax benefit in respect of options exercised	-	-	805	-	-	-	805	
Stock based compensation	-	-	2,772	-	-	-	2,772	
Dividends paid	-	-	-	-	(81,956)	-	(81,956)	
Other comprehensive income (loss):								
Unrealized gains on derivative instruments	-	-	-	292	-	-	292	\$292
Foreign currency translation differences	-	-	-	(17)	-	-	(17)	(17)
Net income	-	-	-	-	38,868	-	38,868	38,868
Total comprehensive income								<u>\$39,143</u>
Balance as of September 30, 2004 (Unaudited)	<u>40,252,571</u>	<u>\$11,477</u>	<u>\$270,975</u>	<u>\$(3,717)</u>	<u>\$146,998</u>	<u>\$(4,321)</u>	<u>\$421,412</u>	
Balance as of July 1, 2005 (Unaudited)	40,745,711	\$11,590	\$276,461	\$(5,064)	\$168,307	\$(4,321)	\$445,973	
Exercise of options	72,459	14	583	-	-	-	597	
Tax benefit in respect of options exercised	-	-	(7)	-	-	-	(7)	
Stock based compensation	-	-	100	-	-	-	100	
Dividends paid	-	-	-	-	(5,309)	-	(5,309)	
Other comprehensive income (loss):								
Unrealized gains on derivative instruments	-	-	-	2,666	-	-	2,666	\$2,666
Foreign currency translation differences	-	-	-	(124)	-	-	(124)	(124)
Net income	-	-	-	-	14,564	-	14,564	14,564
Total comprehensive income								<u>\$17,106</u>
Balance as of September 30, 2005 (Unaudited)	<u>40,818,170</u>	<u>\$11,604</u>	<u>\$277,137</u>	<u>\$(2,522)</u>	<u>\$177,562</u>	<u>\$(4,321)</u>	<u>\$459,460</u>	

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

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

	<u>Number of outstanding shares</u>	<u>Share capital</u>	<u>Additional paid-in capital</u>	<u>Accumulated other comprehensive income (loss)</u>	<u>Retained earnings</u>	<u>Treasury shares</u>	<u>Total shareholders' equity</u>	<u>Total comprehensive income (loss)</u>
Balance as of July 1, 2004								
(Unaudited)	39,928,451	\$ 11,405	\$ 267,153	\$ (3,584)	\$ 206,944	\$ (4,321)	\$ 477,597	
Exercise of options	324,120	72	2,781	-	-	-	2,853	
Tax benefit in respect of options exercised	-	-	114	-	-	-	114	
Amortization of deferred stock compensation	-	-	927	-	-	-	927	
Dividend paid	-	-	-	-	(73,260)	-	(73,260)	
Other comprehensive income (loss):								
Unrealized losses on derivative instruments	-	-	-	(136)	-	-	(136)	\$ (136)
Foreign currency translation differences	-	-	-	3	-	-	3	3
Net income	-	-	-	-	13,314	-	13,314	13,314
Total comprehensive income								<u>\$ 13,181</u>
Balance as of September 30, 2004								
(Unaudited)	<u>40,252,571</u>	<u>\$ 11,477</u>	<u>\$ 270,975</u>	<u>\$ (3,717)</u>	<u>\$ 146,998</u>	<u>\$ (4,321)</u>	<u>\$ 421,412</u>	

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars (in thousands)

	<div> <div>Nine months ended</div> <div>September 30,</div> <div>2005</div> <div>2004</div> <div>(Unaudited)</div> </div>		<div> <div>Year ended</div> <div>December 31,</div> <div>2004</div> <div>(***)</div> </div>
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	\$ 38,163	\$ 38,868	***\$ 51,873
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	37,772	31,494	42,261
Stock based compensation	100	2,772	3,387
Deferred income taxes	(602)	1,784	153
Accrued severance pay, net	(8,536)	(2,709)	(2,304)
Loss (gain) on sale of property and equipment	(400)	25	143
Tax benefit in respect of options exercised	477	805	1,179
Minority interests in earnings (losses) of subsidiaries	(652)	(458)	180
Equity in net losses (earnings) of affiliated companies and partnership, net of dividend received (*)	6,706	3,065	**1,505
Changes in operating assets and liabilities:			
Decrease (increase) in short and long-term receivables and prepaid expenses	(17,070)	20,759	(16,871)
Decrease (increase) in inventories	(59,474)	(24,222)	2,932
Increase in trade payables, other payables and accrued expenses	(2,118)	9,882	20,522
Increase (decrease) in advances received from customers	101,959	7,125	(18,535)
Settlement of royalties with the Office of the Chief Scientist	-	(3,714)	(3,714)
Other adjustments	117	(112)	(1,228)
Net cash provided by operating activities	<u>96,442</u>	<u>85,364</u>	<u>81,483</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property, plant and equipment	(41,437)	(32,614)	(53,008)
Acquisition of subsidiaries and businesses (Schedule A)	(318)	(2,315)	(2,315)
Investments in affiliated companies and subsidiaries	(99,024)	(559)	(18,391)
Proceeds from sale of property, plant and equipment	1,381	1,741	2,560
Proceeds from sale of investment	3,100	-	-
Investment in long-term bank deposits	(551)	(1,203)	(1,203)
Proceeds from sale of long-term bank deposits	963	1,508	1,507
Grant of long-term loans	(790)	-	-
Short-term bank deposits, net	(148)	36	(48)
Net cash used in investing activities	<u>(136,824)</u>	<u>(33,406)</u>	<u>(70,898)</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from exercise of options	2,184	8,569	11,260
Repayment of long-term bank loans	(51,712)	(15,687)	(35,826)
Receipt of long-term bank loans	220,400	21,410	58,410
Dividends paid	(15,868)	(81,956)	(86,692)
Change in short-term bank credit and loans, net	1,332	(827)	216
Net cash provided by (used in) financing activities	<u>156,336</u>	<u>(68,491)</u>	<u>(52,632)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	115,954	(16,533)	(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	<u>\$ 150,063</u>	<u>\$ 59,623</u>	<u>\$ 34,109</u>
(*) Dividend received	<u>\$ 8,045</u>	<u>\$ 7,650</u>	<u>\$ 8,150</u>

(**) 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.

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

U.S. dollars (in thousands)

	Nine months ended September 30,		Year ended December 31,
	2005	2004	2004
	(Unaudited)		(*)
SUPPLEMENTARY CASH FLOWS			
ACTIVITIES:			
Cash paid during the period for:			
Income taxes	<u>\$ 17,640</u>	<u>\$ 9,015</u>	<u>\$ 13,305</u>
Interest	<u>\$ 5,812</u>	<u>\$ 1,460</u>	<u>\$ 3,122</u>
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)	\$ (707)
Property, plant and equipment	-	(10)	(10)
Goodwill, customer contracts and other intangible assets	(1,514)	(1,598)	(1,598)
Long-term liabilities – mainly advances from customers	<u>4,477</u>	<u>-</u>	<u>-</u>
	<u>\$ (318)</u>	<u>\$ (2,315)</u>	<u>\$ (2,315)</u>

* 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

U. S. dollars (In thousands)

Note 1 - GENERAL

- A. The accompanying unaudited interim consolidated financial statements have been prepared in a condensed format as of September 30, 2005, and for the three and nine 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 U.S. GAAP 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 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 nine months ended September 30, 2004, for the year ended December 31, 2004 and for the six months ended June 30, 2005 have been restated (see Notes 1B and 3).

Operating results for the three and nine months ended September 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"), which represented approximately a 32% interest in Tadiran, at a price of \$37 per share. This purchase was to be made concurrently with Koor's purchase a portion of the Company's shares from Federmann Enterprises Ltd. ("Federmann"). Tadiran is an Israeli company, whose shares are traded on the Tel Aviv Stock Exchange. The purchase of the interest in Tadiran was to have been made in two stages, subject to the terms agreed upon between the parties.

On July 6, 2005, the Company reported that it signed an agreement with Koor to acquire all of Koor's 70% holdings in Elisra Electronics Systems Ltd. ("Elisra"), an Israeli company, in consideration for \$70 million in 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 purchased 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, which was received in August 2005, as well as approvals from governmental authorities, including the Israel Antitrust Authority.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

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

Note 1 - GENERAL (CONT.)

Concurrently with signing of the agreement to acquire Koor's holdings in Elisra, as indicated above, 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 accelerated 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, which occurred on August 25, 2005, the Company and Koor have equal representation on Tadiran's board of directors. Following this purchase, the Company currently holds approximately 26% of Tadiran's shares.

The price paid and remaining to be paid by the Company to Koor for the Tadiran shares is 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.

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.

The results of the third quarter of 2005 include a write-off of In Process Research and Development ("IPR&D") which amounts to approximately \$1.2 million related to the shares acquired in the third quarter of 2005.

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 above mentioned amendments to the agreements with Koor, as well as the purchase of Koor's shares in Elisra, 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.

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 an independent advisor, this excess was attributed as follows:

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

U. S. dollars (In thousands)

Note 1 - GENERAL (CONT.)

	<u>\$M</u>	<u>Expected useful lives</u>
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
	<u>62.0</u>	

As a result of the acquisition in the second quarter of 2005, the Company is able to exercise 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 was accounted for as available-for-sale securities.

The following are the effects of the restatement:

(1) Consolidated balance sheet

	December 31, 2004		
	<u>As reported</u>	<u>Effect of restatement</u>	<u>As restated</u>
Other receivables and prepaid expenses	\$ 52,335	\$ 752	\$ 53,087
Investment in affiliated companies and partnership	33,124	14,749	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		
	<u>As reported</u>	<u>Effect of restatement</u>	<u>As Restated</u>
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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS – UNAUDITED

U. S. dollars (In thousands)

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 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.

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

	Three months ended September 30, 2004		
	As <u>reported</u>	Effect of <u>restatement</u>	As <u>restated</u>
Gross profit	\$ 61,514	\$ (269)	\$ 61,245
Operating income	17,405	(491)	16,914
Net income	13,707	(393)	13,314
Basic net earnings per share	0.34	(0.01)	0.33
Diluted net earnings per share	0.33	(0.01)	0.32

	Nine months ended September 30, 2004		
	As <u>reported</u>	Effect of <u>restatement</u>	As <u>restated</u>
Gross profit	\$ 176,952	\$ 771	\$ 177,723
Operating income	47,074	1,400	48,474
Net income	37,746	1,122	38,868
Basic net earnings per share	0.95	0.03	0.98
Diluted net earnings per share	0.92	0.03	0.95

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS – UNAUDITED

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

Note 4 - INVENTORIES, NET OF ADVANCES

	September 30, 2005 (Unaudited)	December 31, 2004 (*)
Cost of long-term contracts in progress	\$ 304,999	\$ 254,009
Raw materials	78,801	71,813
Advances to suppliers and subcontractors	26,878	21,164
	<u>410,678</u>	<u>346,986</u>
Less - Cost incurred on contracts in progress deducted from customer advances	32,016	14,533
	<u>378,662</u>	<u>332,453</u>
Less - Advances received from customers	78,079	75,776
Provision for losses	6,514	7,636
	<u>\$ 294,069</u>	<u>\$ 249,041</u>

* 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 provide 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.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

U. S. dollars (In thousands)

Note 5 - RECENTLY ISSUED ACCOUNTING STANDARDS (CONT.)

- 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 - 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

	Nine months ended September 30,		Year ended December 31,
	2005	2004	2004
	(Unaudited)		(*)
Net income as reported according to U.S. GAAP	\$ 38,163	\$38,868	\$ 51,873
Adjustments to Israeli GAAP	(4,336)	(1,765)	662
Net income according to Israeli GAAP	<u>33,827</u>	<u>\$37,103</u>	<u>\$ 52,535</u>

B. Effect on shareholders' equity

	As reported	Adjustments	As per Israeli GAAP
As of September 30, 2005 (Unaudited)			
Shareholders' equity	<u>\$459,360</u>	<u>\$ (17,043)</u>	<u>\$ 442,317</u>
As of December 31, 2004 (*)			
Shareholders' equity	<u>\$ 432,184</u>	<u>\$ (12,004)</u>	<u>\$ 420,180</u>

* Derived from the Company's 2004 audited financial statements

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Elbit Systems Ltd.
Management's Report
For The Three and Nine-Month Period Ended September 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 September 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 ("C⁴ISR") systems, digital maps, night vision systems, pilot helmet mounted systems, display and data processing systems, unmanned air vehicles ("UAVs"), computerized simulators, communication systems, thermal imaging products, laser products, optical systems for space applications, airborne reconnaissance systems, optic communication systems 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 22.3% and reached \$273.6 million in the third quarter of 2005, as compared to \$223.8 million in the third quarter of 2004.

Net earnings in the third quarter of 2005 were \$14.6 million and the diluted earnings per share were \$0.35, as compared to \$13.3 million and \$0.32 in the third quarter of 2004. Excluding the In Process Research and Development ("IPR&D") write-off of approximately \$1.2 million related to the acquisition of approximately 5% Tadiran Communications Ltd.'s shares in the third quarter of 2005, net earnings in the quarter ended September 30, 2005 were \$15.8 million, and the diluted EPS was \$0.38.

The Company's backlog as of September 30, 2005 reached \$2.41 billion, as compared to \$2.15 billion as of December 31, 2004.

The Company's cash flow generated from operations in the nine-month period ended September 30, 2005 was \$96.4 million, as compared to \$85.4 million in the nine-month period ended September 30, 2004.

The Board of Directors declared a dividend of \$0.14 per share for the third quarter.

B. Recent Events

- On August 23, 2005, the Company's Extraordinary General Meeting of Shareholders passed a resolution approving and ratifying the agreements entered into by the Company on July 6, 2005 regarding the purchase from Koor Industries Ltd. ("Koor") of Koor's ordinary shares in Elisra Electronic Systems Ltd. ("Elisra"), as well as ratifying the amendment agreement entered into on July 6, 2005 by the Company and Koor amending the original share transfer deed and shareholders agreements entered into on December 27, 2004 regarding the Company's purchase of Koor's ordinary shares in Tadiran Communications Ltd. ("Tadiran").
- On August 25, 2005, the Company completed the second stage of the transaction to purchase shares of Tadiran from Koor, and purchased from Koor, in this stage, approximately 5% of the share equity of Tadiran. In addition to the shares previously purchased by the Company in the transaction's first stage and on the stock market, the Company currently owns approximately 26% of Tadiran's shares.

The results of the third quarter of 2005 include a write-off of IPR&D in the amount of approximately \$1.2 million related to the Tadiran shares acquired in the third quarter of 2005, and further effects on the Company's financial results are expected to occur in the event of additional purchases of Tadiran shares either from Koor in accordance with the amendments to the agreements with Koor, announced on July 6, 2005 or on the stock market, as well as the purchase of Koor's shares in Elisra, 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.

- On September 1, 2005, the Company announced, further to its announcement dated April 18, 2005, the entering into effect of the contract to supply the Turkish Army with UAV systems, signed in May 2005 by IUP, an equally-owned partnership between the Company and Israel Aircraft Industries Ltd. ("IAI"). IUP will act as the major subcontractor to the TUSAS Aerospace Industry for this program and will deliver the UAV systems to the Turkish MOD over a three-year period. IUP's contract is valued at \$150 million and will be divided equally between the Company and IAI.
- On October 6, 2005, the Company reported that its wholly-owned subsidiary EFW Inc. ("EFW") was awarded a \$57 million framework contract by the US Government to supply ANVIS/HUD systems for U.S. Army utility helicopters and other DOD rotary-wing platforms. Under this contract, which will cover up to a five-year period, the Army may place purchase orders with EFW for ANVIS/HUD systems from time to time for up to the aggregate amount of the contract.
- On October 28, 2005, the Company reported that its joint venture company with Thales UK, UAV Tactical Systems Limited ("U-TacS"), was awarded by Thales UK over \$500 million in orders to be performed over an eight-year period. U-TacS' financial statements will be consolidated within the Company's financial reports. This order is part of the WATCHKEEPER program for which the UK Ministry of Defense and Thales UK signed a £700 million contract in August 2005. U-TacS will execute significant portions of the WATCHKEEPER Program for Thales UK, the WATCHKEEPER prime contractor. The majority of U-TacS' activity will be executed in the UK with a significant amount of its work sub-contracted to small and medium sized enterprises across the UK. Elbit Systems is U-TacS' largest subcontractor with approximately one-third of this contract's value. U-TacS is expected to employ, during the initial stages, dozens of workers, most of whom will be recruited locally. U-TacS is currently in the process of establishing its facilities in the UK city of Leicester. In addition to executing the WATCHKEEPER Program, Elbit Systems and Thales have agreed to jointly market tactical UAV projects in other countries worldwide.
- On November 1, 2005, the Company's subsidiary jointly owned with Rockwell Collins, Vision Systems International, LLC ("VSI"), a leader in advanced Helmet Mounted Display technology, announced the receipt of several new contracts with a total potential value of more than \$100 million. The Boeing Company awarded VSI a contract for the delivery of more than 500 additional Joint Helmet Mounted Cueing Systems ("JHMCS"). VSI also received direct contracts from the United States Navy and Air Force for spares and test equipment in support of the JHMCS program.
- On November 6, 2005, the Company reported that EFW was awarded a contract from the U.S. Marine Corps Systems Command in response to a compelling and urgent need for an operational capability. The program requires EFW's team to develop, design, integrate, test, produce and install equipment into a variety of USMC vehicles. The value of this order is approximately \$70M and is expected to be completed in 2006.
- During the first week of November 2005, a wholly-owned subsidiary of the Company, received notice from a customer informing it that unless certain deficiencies identified by the customer in an airborne system are remedied within a short time period, the customer intends to terminate the contract. The amount of the contract is approximately \$35 million. The Company is engaged in clarifications with the customer in order to address the customer's concerns in a satisfactory manner. The Company believes that the potential outcome relating to the notice received will not have a material adverse effect on the Company's financial statements.

C. Backlog of Orders

The Company's backlog of orders as of September 30, 2005 reached \$2,405 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 50% of the Company's backlog as of September 30, 2005 is scheduled to be performed in the last quarter of 2005 and during 2006. The majority of the 50% 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:

	<u>Q1/04</u>	<u>Q2/04</u>	<u>Q3/04</u>	<u>1-9/04</u>
Net income as previously reported in 2004	<u>\$ 12,727</u>	<u>\$ 11,311</u>	<u>\$ 13,707</u>	<u>\$ 37,746</u>
Restated net income (according to SFAS No. 123)	<u>\$ 12,252</u>	<u>\$ 13,302</u>	<u>\$ 13,314</u>	<u>\$ 38,868</u>
Diluted net earnings per share as reported in 2004	<u>\$ 0.31</u>	<u>\$ 0.28</u>	<u>\$ 0.33</u>	<u>\$ 0.92</u>
Restated diluted net earnings per share (according to SFAS No. 123)	<u>\$ 0.30</u>	<u>\$ 0.33</u>	<u>\$ 0.32</u>	<u>\$ 0.95</u>

F. Summary of Financial Results

The following table sets forth the reported consolidated statements of income of the Company for the three and nine-month periods ended September 30, 2005 and September 30, 2004. The results of the three and nine-month periods of 2004 and of the first quarter of 2005 reflect restatements regarding the Tadiran share acquisition and the stock-based compensation (see above).

	For the nine months ended September 30				For the three months ended September 30			
	2005		2004		2005		2004	
	\$	%	\$	%	\$	%	\$	%
	(In thousands of U.S. dollars except per share data)							
Total revenues	748,116	100.0	669,150	100.0	273,646	100.0	223,833	100.0
Cost of revenues	546,790	73.1	491,427	73.4	199,969	73.1	162,588	72.6
Gross profit	201,326	26.9	177,723	26.6	73,677	26.9	61,245	27.4
Research and development (R&D) expenses	66,893	8.9	53,998	8.1	24,840	9.1	21,301	9.5
Less – participation	(13,450)	(1.8)	(10,428)	(1.6)	(4,358)	(1.6)	(4,758)	(2.1)
R&D expenses, net	53,443	7.1	43,570	6.5	20,482	7.5	16,543	7.4
Marketing and selling expenses	54,695	7.3	50,722	7.6	20,309	7.4	15,562	7.0
General and administrative expenses	38,262	5.1	34,957	5.2	12,838	4.7	12,226	5.5
	146,400	19.6	129,249	19.3	53,629	19.6	44,331	19.8
Operating income	54,926	7.3	48,474	7.2	20,048	7.3	16,914	7.6
Finance expenses, net	(6,273)	(0.8)	(2,878)	(0.4)	(3,076)	(1.1)	(1,577)	(0.7)
Other expenses, net	(192)	-	(61)	-	(6)	-	23	0.0
Income before taxes on income	48,461	6.5	45,535	6.8	16,966	6.2	15,360	6.9
Taxes on income	12,289	1.7	11,712	1.7	4,246	1.6	3,933	1.8
	36,172	4.8	33,823	5.1	12,720	4.6	11,427	5.1
Minority interest in losses (gains) of subsidiaries	652	0.1	459	0.1	379	0.1	271	0.1
Equity in net earnings of affiliated companies and partnership	1,339	0.2	4,586	0.7	1,465	0.5	1,616	0.7
Net earnings	38,163	5.1	38,868	5.8	14,564	5.3	13,314	5.9
Diluted earnings per share	0.92		0.95		0.35		0.32	

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.

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

The consolidated revenues increased by 22.3% from \$223.8 million in the third quarter of 2004 to \$273.6 million in the third quarter of 2005.

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

	Three-Month Period ended			
	September 30, 2005		September 30, 2004	
	\$ millions	%	\$ millions	%
Airborne systems	114.9	42.0	91.8	41.0
Land systems	39.5	14.4	39.2	17.6
C ⁴ ISR systems	44.9	16.4	36.2	16.2
Electro-optics	54.4	19.9	42.2	18.8
Other (mainly non-defense engineering and production services)	<u>19.9</u>	<u>7.3</u>	<u>14.4</u>	<u>6.4</u>
Total	<u>273.6</u>	<u>100.0</u>	<u>223.8</u>	<u>100.0</u>

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

	Three-Month Period ended			
	September 30, 2005		September 30, 2004	
	\$ millions	%	\$ millions	%
Israel	61.3	22.4	52.9	23.7
United States	114.5	41.8	91.4	40.9
Europe	31.1	11.4	29.2	13.0
Other countries	<u>66.7</u>	<u>24.4</u>	<u>50.3</u>	<u>22.4</u>
Total	<u>273.6</u>	<u>100.0</u>	<u>223.8</u>	<u>100.0</u>

Nine Months Ended on September 30, 2005, Compared to Nine Months Ended on September 30, 2004

The Company's consolidated revenues increased by 11.8%, from \$669.2 million in the first nine months of 2004 to \$748.1 million in the first nine months of 2005.

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

	Nine-Month Period ended			
	September 30, 2005		September 30, 2004	
	\$ millions	%	\$ millions	%
Airborne systems	309.3	41.3	270.5	40.4
Land systems	98.7	13.2	139.8	20.9
C ⁴ ISR systems	133.1	17.8	93.6	14.0
Electro-optics	153.8	20.6	127.1	19.0
Other (mainly non-defense engineering and production services)	<u>53.2</u>	<u>7.1</u>	<u>38.2</u>	<u>5.7</u>
Total	<u>748.1</u>	<u>100.0</u>	<u>669.2</u>	<u>100.0</u>

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

	Nine-Month Period ended			
	September 30, 2005		September 30, 2004	
	\$ millions	%	\$ millions	%
Israel	206.3	27.6	163.4	24.4
United States	291.9	39.0	258.2	38.6
Europe	65.7	8.8	94.9	14.2
Other countries	<u>184.2</u>	<u>24.6</u>	<u>152.7</u>	<u>22.8</u>
Total	<u>748.1</u>	<u>100.0</u>	<u>669.2</u>	<u>100.0</u>

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.

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

The Company's gross profit in the quarter ended September 30, 2005 was \$73.7 million as compared to \$61.2 million in the quarter ended September 30, 2004. The gross profit margin in the third quarter of 2005 was 26.9% as compared to 27.4% 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 third quarter of 2004 certain programs with a relatively higher gross profit.

Nine Months Ended on September 30, 2005, Compared to Nine Months Ended on September 30, 2004

The Company's gross profit in the nine months ended September 30, 2005 was \$201.3 million as compared to \$177.7 million in the nine months ended September 30, 2004. The gross profit margin in the nine months ended September 30, 2005 was 26.9% as compared to 26.6% 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 strategic 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 September 30, 2005, Compared to Three Months Ended on September 30, 2004

Gross R&D expenses in the quarter ended September 30, 2005 totaled \$24.8 million (9.1% of revenues), as compared to \$21.3 million (9.5% of revenues) in the quarter ended September 30, 2004.

Net R&D expenses (after deduction of third party participation, including the IMOD and the OCS) in the quarter ended September 30, 2005 totaled \$20.5 million (7.5% of revenues), as compared to \$16.5 million (7.4% of revenues) in the quarter ended September 30, 2004.

Nine Months Ended on September 30, 2005, Compared to Nine Months Ended on September 30, 2004

Gross R&D expenses in the nine months ended September 30, 2005 totaled \$66.9 million (8.9% of revenues), as compared to \$54.0 million (8.1% of revenues) in the nine months ended September 30, 2004.

Net R&D expenses (after deduction of third party participation, including the IMOD and the OCS) in the nine-month period ended September 30, 2005 totaled \$53.4 million (7.1% of revenues), as compared to \$43.6 million (6.5% of revenues) in the nine-month period ended September 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 September 30, 2005, Compared to Three Months Ended on September 30, 2004

Marketing and selling expenses in the quarter ended September 30, 2005 were \$20.3 million (7.4% of revenues), as compared to \$15.6 million (7.0% of revenues) in the quarter ended September 30, 2004.

Nine Months Ended on September 30, 2005, Compared to Nine Months Ended on September 30, 2004

Marketing and selling expenses in the nine months ended September 30, 2005 were \$54.7 million (7.3% of revenues), as compared to \$50.7 million (7.6% of revenues) in the nine months ended September 30, 2004.

General and Administrative ("G&A") Expenses

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

G&A expenses were \$12.8 million (4.7% of revenues) in the quarter ended September 30, 2005, as compared to \$12.2 million (5.5% of revenues) in the quarter ended September 30, 2004.

Nine Months Ended on September 30, 2005, Compared to Nine Months Ended on September 30, 2004

G&A expenses were \$38.3 million (5.1% of revenues) in the nine months ended September 30, 2005, as compared to \$35.0 million (5.2% of revenues) in the nine months ended September 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 September 30, 2005, Compared to Three Months Ended on September 30, 2004

Net finance expense in the quarter ended September 30, 2005 was \$3.1 million, as compared to \$1.6 million of finance expense in the quarter ended September 30, 2004.

Nine Months Ended on September 30, 2005, Compared to Nine Months Ended on September 30, 2004

Net finance expense in the six months ended September 30, 2005 was \$6.3 million, as compared to \$2.9 million of finance expense in the nine months ended September 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.

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

Provision for taxes in the quarter ended September 30, 2005 was \$4.2 million (effective tax rate of 25.0%), as compared to a provision for taxes of \$3.9 million (effective tax rate of 25.6%) in the quarter ended September 30, 2004.

Nine Months Ended on September 30, 2005, Compared to Nine Months Ended on September 30, 2004

Provision for taxes in the nine months ended September 30, 2005 was \$12.3 million (effective tax rate of 25.4%), as compared to a provision for taxes of \$11.7 million (effective tax rate of 25.7%) in the nine months ended September 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 September 30, 2005, Compared to Three Months Ended on September 30, 2004

In the third quarter of 2005 the Company had net income of \$1.5 million from its share in earnings of affiliated companies and partnership, as compared to net income of \$1.6 million in the third quarter of 2004.

Nine Months Ended on September 30, 2005, Compared to Nine Months Ended on September 30, 2004

In the nine months ended September 30, 2005 the Company had net income of \$1.3 million from its share in earnings of affiliated companies and partnership, as compared to net income of \$4.6 million in the nine months ended September 30, 2004. The decrease was mainly as a result of the IPR&D write-off related to Tadiran.

Net Earnings and Earnings Per Share (“EPS”)

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

Net earnings in the quarter ended September 30, 2005 were \$14.6 million (5.3% of revenues), as compared to reported net earnings of \$13.3 million (5.9% of revenues) in the quarter ended September 30, 2004. Diluted EPS in the quarter ended September 30, 2005 was \$0.35, as compared to \$0.32 in the quarter ended September 30, 2004.

Excluding the IPR&D write-off related to Tadiran (included in “Equity in net earnings of affiliated companies and partnerships”), which amounted to approximately \$1.2 million, net earnings in the quarter ended September 30, 2005 were \$15.8 million (5.8% of revenues), and the diluted EPS was \$0.38.

The number of shares used for computation of diluted EPS in the quarter ended September 30, 2005 was 41,614 thousand shares, as compared to 41,161 thousand shares in the quarter ended September 30, 2004.

Nine Months Ended on September 30, 2005, Compared to Nine Months Ended on September 30, 2004

Net earnings in the nine months ended September 30, 2005 were \$38.2 million (5.1% of revenues), as compared to net earnings of \$38.9 million (5.8% of revenues) in the nine months ended September 30, 2004. Diluted EPS in the nine months ended September 30, 2005 was \$0.92, as compared to \$0.95 per share in the nine months ended September 30, 2004.

Excluding the IPR&D write-off related to Tadiran, which amounted to approximately \$5.3 million, net earnings in the nine months ended September 30, 2005 were \$43.4 million (5.8% of revenues), and the diluted EPS was \$1.04.

The number of shares used for computation of diluted EPS in the nine months ended September 30, 2005 was 41,616 thousand shares, as compared to 40,924 thousand shares in the nine months ended September 30, 2004.

G. Liquidity and Capital Resources

The Company’s net cash flow generated from operating activities in the nine months ended September 30, 2005 was \$96.4 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 nine months ended September 30, 2005 was \$136.8 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 nine months ended September 30, 2005 was \$156.3 million, which was mainly from receipt of long-term loans.

On September 30, 2005, the Company had total borrowings in the amount of \$263.1 million, including \$253.6 million in long-term loans, and \$453 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, 2005, the Company had a cash balance amounting to \$150.1 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 September 30, 2005, the Company and its subsidiaries are in full compliance with all such covenants.

As of September 30, 2005, the Company had working capital of \$279 million, and its current ratio was 1.61. The Company's ratio of equity to total assets was 35%.

H. 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 September 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 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 September 30, 2005, the Company had exposure due to liabilities denominated in NIS of \$78 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 September 30, 2005 by forward contracts and options. On September 30, 2005, the Company had forward contracts for the sale and purchase of such foreign currencies totaling \$221 million (\$16 million in Euro, \$199 million in GBP and \$6 million in other currencies). The financial derivative activities in this quarter resulted in an unrealized net gain of approximately \$2.9 million, which was recorded as other comprehensive income.

I. Appointment of a Director

On August 25, 2005, the Company reported that Mr. Israel (Izzy) Tapoohi was appointed as a director to the Company's Board.

J. Dividends

The Board of Directors declared on November 14, 2005 a dividend of \$0.14 per share.

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