

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

**CONDENSED INTERIM CONSOLIDATED
FINANCIAL STATEMENTS**

AS OF MARCH 31, 2006

(Unaudited)

(In thousands of U.S. dollars)

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U. S. dollars (In thousands)

	March 31, 2006 (Unaudited)	December 31, 2005 (Audited)
CURRENT ASSETS:		
Cash and cash equivalents	\$ 87,569	\$ 93,887
Short-term bank deposits	454	742
Trading securities	2,236	2,282
Trade receivables, (net of allowance for doubtful accounts in the amount of \$3,038 and \$3,221 as of March 31, 2006 and December 31, 2005, respectively)	344,106	346,689
Other receivables and prepaid expenses	75,218	67,096
Inventories, net of advances	<u>350,493</u>	<u>328,428</u>
Total current assets	<u>860,076</u>	<u>839,124</u>
 INVESTMENTS AND LONG-TERM RECEIVABLES:		
Investments in affiliated companies and a partnership	197,496	194,994
Investments in other companies	6,345	6,345
Compensation receivable in respect of fire damages, net	15,530	15,530
Long-term bank deposits and trade receivables	5,581	2,457
Severance pay fund	<u>135,716</u>	<u>133,570</u>
	<u>360,668</u>	<u>352,896</u>
 PROPERTY, PLANT AND EQUIPMENT, NET	 <u>285,979</u>	 <u>284,997</u>
 INTANGIBLE ASSETS:		
Goodwill	63,957	63,957
Other intangible assets, net	<u>76,701</u>	<u>78,771</u>
	<u>140,658</u>	<u>142,728</u>
	<u>\$ 1,647,381</u>	<u>\$ 1,619,745</u>

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)

	<u>March 31, 2006 (Unaudited)</u>	<u>December 31, 2005 (Audited)</u>
CURRENT LIABILITIES:		
Short-term bank credit and loans	\$ 25,300	\$ 30,296
Current maturities of long-term loans	6,862	7,355
Trade payable	140,278	120,260
Dividend payable	5,818	-
Other payables and accrued expenses	227,521	216,539
Customers advances and amounts in excess of costs incurred on contracts in progress	<u>273,072</u>	<u>237,718</u>
Total current liabilities	<u>678,851</u>	<u>612,168</u>
LONG-TERM LIABILITIES:		
Long-term loans	161,296	224,982
Advances from customers	140,341	122,263
Deferred income taxes	30,324	31,424
Accrued termination liability	<u>164,936</u>	<u>165,224</u>
	<u>496,897</u>	<u>543,893</u>
MINORITY INTERESTS		
	<u>13,570</u>	<u>12,907</u>
SHAREHOLDERS' EQUITY:		
Share capital		
Ordinary shares of New Israeli Shekels (NIS) 1 par value;		
Authorized – 80,000,000 shares as of March 31, 2006		
and December 31, 2005;		
Issued – 41,451,613 and 41,375,545 shares as of March 31, 2006		
and December 31, 2005 respectively;		
Outstanding – 41,042,692 and 40,966,624 shares as of March 31,		
2006 and December 31, 2005, respectively	11,653	11,636
Additional paid-in capital	279,039	278,679
Accumulated other comprehensive loss	(3,081)	(1,340)
Retained earnings	174,773	166,123
Treasury shares - 408,921 shares as of March 31, 2006 and December 31, 2005	<u>(4,321)</u>	<u>(4,321)</u>
	<u>458,063</u>	<u>450,777</u>
	<u>\$ 1,647,381</u>	<u>\$ 1,619,745</u>

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)

	Three months ended March 31,		Year ended December 31,
	2006	2005	2005
	(Unaudited)	(Audited)	(Audited)
Revenues	\$ 334,370	\$ 230,688	\$ 1,069,876
Cost of revenues	246,830	169,126	786,616
Restructuring expenses	-	-	3,488
Gross profit	<u>87,540</u>	<u>61,562</u>	<u>279,772</u>
Research and development costs, net	21,438	15,166	71,903
Marketing and selling expenses	26,248	16,646	78,648
General and administrative expenses	19,007	12,772	54,417
In process research and development write-off	-	-	7,490
	<u>66,693</u>	<u>44,584</u>	<u>212,458</u>
Operating income	20,847	16,978	67,314
Financial expenses, net	(4,241)	(1,732)	(11,472)
Other income (expenses), net	908	169	(5,326)
Income before taxes on income	<u>17,514</u>	<u>15,415</u>	<u>50,516</u>
Taxes on income	4,604	3,987	16,335
	<u>12,910</u>	<u>11,428</u>	<u>34,181</u>
Equity in net earnings of affiliated companies and partnership	2,267	*1,042	(1,636)
Minority interests in losses (earnings) of subsidiaries	(709)	220	(58)
Net income	<u>\$ 14,468</u>	<u>*\$ 12,690</u>	<u>\$ 32,487</u>
Earnings per share			
Basic net earnings per share	<u>\$ 0.35</u>	<u>*\$ 0.31</u>	<u>\$ 0.80</u>
Diluted net earnings per share	<u>\$ 0.35</u>	<u>*\$ 0.30</u>	<u>\$ 0.78</u>
Number of shares used in computation of basic net earnings per share	<u>41,010</u>	<u>40,645</u>	<u>40,750</u>
Number of shares used in computation of diluted net earnings per share	<u>41,736</u>	<u>41,617</u>	<u>41,623</u>

* Restated see Note 1B.

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

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

	Number of outstanding shares	Share capital	Additional paid-in capital	Accumulated other comprehensive loss	Retained earnings	Treasury shares	Total shareholders' equity	Total comprehensive income
Balance as of January 1, 2005								
(Audited)	40,561,026	\$ 11,548	\$ 274,432	\$ (4,742)	\$ 155,267	\$ (4,321)	\$ 432,184	
Exercise of options	405,598	88	3,423	-	-	-	3,511	
Tax benefit in respect of options exercised	-	-	652	-	-	-	652	
Stock based compensation	-	-	172	-	-	-	172	
Dividends paid	-	-	-	-	(21,631)	-	(21,631)	
Other comprehensive income (loss), net of tax:								
Unrealized gains on derivative instruments	-	-	-	6,412	-	-	6,412	6,412
Foreign currency translation differences	-	-	-	(924)	-	-	(924)	(924)
Minimum pension liability adjustment	-	-	-	(2,086)	-	-	(2,086)	(2,086)
Net income	-	-	-	-	32,487	-	32,487	32,487
Total comprehensive income	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Balance as of December 31, 2005								
(Audited)	40,966,624	\$ 11,636	\$ 278,679	\$ (1,340)	\$ 166,123	\$ (4,321)	\$ 450,777	
Exercise of options	76,068	17	438	-	-	-	455	
Tax benefit in respect of options exercised	-	-	(78)	-	-	-	(78)	
Dividends declared	-	-	-	-	(5,818)	-	(5,818)	
Other comprehensive income (loss), net of tax:								
Unrealized losses on derivative instruments	-	-	-	(1,788)	-	-	(1,788)	(1,788)
Foreign currency translation differences	-	-	-	77	-	-	77	77
Minimum pension liability adjustment	-	-	-	(30)	-	-	(30)	(30)
Net income	-	-	-	-	14,468	-	14,468	14,468
Total comprehensive income	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Balance as of March 31, 2006								
(Unaudited)	41,042,692	\$ 11,653	\$ 279,039	\$ (3,081)	\$ 174,773	\$ (4,321)	\$ 458,063	

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (CONT.)

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

	Number of outstanding shares	Share capital	Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained earnings	Treasury shares	Total shareholders' equity	Total other comprehensive income
Balance as of January 1, 2005								
(Audited)	40,561,126	\$ 11,548	\$ 274,432	\$ (4,742)	\$ 155,267	\$ (4,321)	\$ 432,184	
Exercise of options	121,816	28	1,047	-	-	-	1,075	
Tax benefit in respect of options exercised	-	-	287	-	-	-	287	
Stock-based compensation	-	-	-	212	-	-	212	212
Dividends paid	-	-	-		(5,296)	-	(5,296)	
Unrealized gains on derivative instruments				(425)			(425)	(425)
Foreign currency translation differences	-	-	-	(175)	-	-	(175)	(175)
Net income	-	-	-	-	12,690	-	12,690	12,690
Total comprehensive income								\$12,302
Balance as of March 31, 2005								
(Unaudited) (*)	<u>40,682,942</u>	<u>\$ 11,576</u>	<u>\$ 275,766</u>	<u>\$ (5,130)</u>	<u>\$ 162,661</u>	<u>\$ (4,321)</u>	<u>\$ 440,552</u>	

* Restated see Note 1B.

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)

	Three months ended		Year ended
	March 31,		December 31,
	2006	**2005	2005
		(Unaudited)	(Audited)
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	\$ 14,468	\$ 12,690	\$ 32,487
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	14,649	10,794	57,718
Purchased in process R&D	-	-	7,490
Stock based compensation	-	-	172
Deferred income taxes	(1,698)	(527)	6,551
Accrued severance pay, net	(2,464)	(2,114)	(6,707)
Gain on sale of property, plant and equipment	(231)	(250)	(731)
Tax benefit in respect of options exercised	-	287	652
Minority interests in earnings (losses) of subsidiaries	709	(220)	58
Equity in net losses (earnings) of affiliated companies and partnership, net of dividend received (*)	(1,736)	(42)	13,805
Changes in operating assets and liabilities:			
Decrease (increase) in short and long-term receivables and prepaid expenses	(9,806)	5,978	(43,420)
Increase in inventories	(20,933)	(28,778)	(43,679)
Increase (decrease) in trade payable, other payables and accrued expenses	30,251	(21,197)	(37,859)
Increase in advances received from customers	52,300	72,897	202,450
Settlement of royalties with the Office of the Chief Scientist	-	-	(1,371)
Other adjustments	(98)	45	-
Net cash provided by operating activities	<u>75,411</u>	<u>49,563</u>	<u>187,616</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property, plant and equipment	(14,628)	(15,235)	(58,735)
Acquisition of subsidiaries and businesses (Schedule A)	-	(318)	(28,331)
Investments in affiliated companies	-	(9,681)	(160,861)
Proceeds from sale of property, plant and equipment	1,323	829	2,712
Proceeds from sale of investment	-	3,100	3,100
Investment in long-term bank deposits	(215)	(359)	(1,089)
Proceeds from sale of long-term bank deposits	168	535	1,501
Short-term bank deposits, net	334	(525)	(4)
Net cash used in investing activities	<u>(13,018)</u>	<u>(21,654)</u>	<u>(241,707)</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from exercise of options	455	1,075	3,511
Repayment of long-term bank loans	(82,031)	(12,613)	(85,035)
Receipt of long-term bank loans	18,353	-	216,500
Dividends paid	-	-	(21,631)
Change in short-term bank credit and loans, net	(5,488)	(871)	524
Net cash provided by (used in) financing activities	<u>(68,711)</u>	<u>(12,409)</u>	<u>113,869</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(6,318)	15,500	59,778
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	93,887	34,109	34,109
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	<u>\$ 87,569</u>	<u>\$ 49,609</u>	<u>\$ 93,887</u>
* Dividend received	<u>\$ 500</u>	<u>\$ 1,000</u>	<u>\$ 12,169</u>

** Restated see Note 1B.

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOW

U. S. dollars (In thousands)

	Three months ended March 31,		Year ended December 31,	
	2006	2005 (Unaudited)	2005	(Audited)

SUPPLEMENTARY CASH FLOWS ACTIVITIES:

Cash paid during the period for:

Income taxes	\$ 4,218	\$ 4,818	\$ 21,475
Interest	<u>\$ 4,930</u>	<u>\$ 1,695</u>	<u>\$ 13,151</u>

SCHEDULE A:

Subsidiaries and businesses acquired

Estimated net fair value of assets acquired and liabilities at the date of acquisition assumed:

Working capital, net (excluding cash and cash equivalents)	-	\$ (3,281)	\$ 39,273
Property, plant and equipment	-	-	(28,875)
Other long-term assets	-	-	(74,363)
Goodwill and other intangible assets	-	(1,514)	(53,291)
In process R&D	-	-	(7,490)
Deferred income taxes	-	-	5,404
Long-term liabilities	-	4,477	82,730
Minority interest	-	-	8,281
	<u><u>-</u></u>	<u><u>\$ (318)</u></u>	<u><u>\$ (28,331)</u></u>

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 financial statements have been prepared in a condensed format as of March 31, 2006, and for the three months then ended in accordance with generally accepted accounting principles in the United States (U.S. GAAP) relating to the preparation of financial statements for interim periods. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States but which are not required for interim reporting purposes, have been condensed or omitted. See Note 4 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, 2005.

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, 2005 in order to conform to the current year's presentation.

Operating results for the three months ended March 31, 2006, are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

B. During 2004, the Company acquired 4.3% of Tadiran's outstanding shares on the Tel Aviv Stock Exchange in consideration for \$15,900. In 2004 and in the first quarter of 2005 the investment in Tadiran's shares was accounted for as available-for-sale securities.

In the first and the second quarters of 2005, the Company acquired additional 17% of Tadiran's outstanding shares in consideration for \$74,100.

As a result of the acquisition in the second quarter of 2005, the Company was able to exercise significant influence on 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, was accounted retroactively under the equity method of accounting ("step-by-step acquisition"). Implementing the step-by-step acquisition method resulted in an adjustment of the Company's financial statements for the first quarter of 2005, in which the Company's investment in Tadiran was accounted for as available-for-sale securities.

The following are the effects of the adjustments on the consolidated statement of income:

	Three months ended March 31, 2005		
	As reported	Effect of adjustments	As adjusted
Equity in net earnings of affiliated companies and partnership	\$ 1,493	\$ (451)	\$ 1,042
Net income	13,141	(451)	12,690
Basic net earnings per share	0.32	(0.01)	0.31
Diluted net earnings per share	\$ 0.32	\$ (0.02)	\$ 0.30

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, except for the adoption of FASB Statement No. 123 (revised 2004), "Share-Based Payments" ("Statement 123(R)") as follows:

Through December 31, 2005 the Company adopted the fair value based method of recording stock options for all employee stock option grants consistent with SFAS No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123"). Effective January 1, 2006, the Company adopted the provisions of Statement 123(R), using the modified prospective method. The adoption of Statement 123(R) had an immaterial effect on the Company's financial position and results of operations.

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

Note 3 - INVENTORIES, NET OF ADVANCES

	March 31, 2006 (Unaudited)	December 31, 2005 (Audited)
Cost of long-term contracts in progress	\$ 323,920	\$ 311,800
Raw materials	88,533	84,343
Advances to suppliers and subcontractors	45,733	40,095
	458,186	436,238
Less - Cost incurred on contracts in progress deducted from customer advances	20,299	16,178
	437,887	420,060
Less -Advances received from customers	78,830	84,083
Provision for losses	8,564	7,549
	<u>\$ 350,493</u>	<u>\$ 328,428</u>

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

U. S. dollars (In thousands)

Note 4 - RECONCILIATION TO ISRAELI GAAP

As described in Note 1, the Company prepares its financial statements in accordance with U.S. GAAP. See Note 23 to the 2005 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 March 31,		Year ended December 31,
	2006	2005	2005
	(Unaudited)		(Audited)
Net income as reported according to U.S. GAAP	\$ 14,468	\$ 12,690	\$ 32,487
Adjustments to Israeli GAAP	(633)	(1,522)	(9,637)
Net income according to Israeli GAAP	<u>\$ 13,835</u>	<u>\$ 11,168</u>	<u>\$ 22,850</u>

B. Effect on shareholders' equity

	As per		
	As reported	Adjustments	Israeli GAAP
As of March 31, 2006 (Unaudited)			
Shareholders' equity	<u>\$ 458,063</u>	<u>\$ (19,912)</u>	<u>\$ 438,151</u>
As of December 31, 2005 (Audited)			
Shareholders' equity	<u>\$ 450,777</u>	<u>\$ (19,279)</u>	<u>\$ 431,498</u>

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