אלביט מערכות בע"מ

("החברה")

<u>כתב הצבעה לפי תקנות החברות (הצבעה בכתב והודעות עמדה), התשס"ו-2005</u>

<u>חלק ראשון</u>

<u>שם החברה</u>

אלביט מערכות בע"מ

<u>סוג האסיפה הכללית, המועד והמקום לכינוסה</u>

אסיפה כללית שנתית של בעלי מניות החברה אשר תתכנס ביום חמישי ה- 17 באוגוסט 2006 בשעה 10:00 (שעון ישראל) במשרדי החברה במרכז תעשיות מדע (מת"מ) בחיפה. לבירורים ניתן להתקשר לטל': 04-8316632.

<u>פירוט הנושאים שעל סדר היום שלגביהם ניתן להצביע באמצעות כתב ההצבעה</u>

להלן תמצית עיקרי ההחלטות שלגביהם ניתן להצביע באמצעות כתב ההצבעה.

1. <u>החלטה 1 – מינוי שבעה דירקטורים לדירקטוריון החברה.</u>

מוצע למנות שבעה דירקטורים, שאינם דירקטורים חיצוניים, לדירקטוריון חברה. ההצבעה לכל מועמד לכהונת דירקטור תיעשה בנפרד. להלן פרטים בדבר המועמדים לכהונת דירקטור:

(א) מר מיכאל פדרמן. מכהן כיו"ר דירקטוריון החברה מאז שנת 2000.

(ב) מר משה ארד. מכהן כדירקטור בחברה מאז שנת 2005. חבר בועדות הדירקטוריון הבאות: ועדת התגמול.

(ג) מר אברהם אשרי. מכהן כדירקטור בחברה מאז שנת 2000. חבר בועדות הדירקטוריון הבאות: ועדת ביקורת, ועדת מינויים וועדת תגמול.

(ד) גב' רינה באום. מכהנת כדירקטורית בחברה מאז שנת 2001.

(ה) מר יונתן קולבר. מכהן כדירקטור בחברה מאז שנת 2005.

(ו) מר יגאל נאמן. מכהן כדירקטור בחברה מאז שנת 2004. חבר בועדות הדירקטוריון הבאות: ועדת הביקורת וועדת המינויים.

(ז) מר דב נינוה. מכהן כדירקטור בחברה מאז שנת 2004.

פרטים נוספים לגבי המועמדים מופיעים ב – *Proxy Statement* שפרסמה החברה ביום 13 ביולי 2006.

2. <u>החלטה 2 – הארכת המינוי של יעקב ליפשיץ כדירקטור חיצוני בדירקטוריון החברה.</u>

הארכת מינויו של יעקב ליפשיץ כדירקטור חיצוני בשלוש שנים נוספות החל ממועד סיום כהונתו כדירקטור חיצוני בחודש יולי 2006.

מר יעקב ליפשיץ מכהן כדירקטור חיצוני מאז חודש יולי 2003, והוא חבר בועדות הדירקטוריון הבאות: ועדת הביקורת וועדת התיגמול.

3. <u>החלטה 3 – מינוי מחדש של רואה החשבון המבקר של החברה.</u>

מינוי מחדש של רואה החשבון קוסט, פורר, גבאי וקסירר (חבר ברשת העולמית ארנסט אנד יאנג) לשמש כרואה החשבון המבקר של החברה לשנת הכספים שתסתיים ב-31 בדצמבר 2006.

לפרטים נוספים בדבר כל אחת מההחלטות על סדר יום האסיפה ונוסחן המלא של ההחלטות, ראו כתב העמדה (להלן - *Proxy Statement*) בשפה האנגלית אשר פורסם על ידי החברה ביום 13 ביולי 2006.

דירקטוריון החברה ממליץ להצביע בעד כל אחת מההחלטות המפורטות לעיל.

<u>המקום והשעות שניתן לעיין בהם בנוסח המלא של ההחלטות המוצעות</u>

העתק ממסמך ה-*Proxy Statement* (בשפה האנגלית) בעניין האסיפה האמורה, ובו הנוסח המלא של ההחלטות, יעמוד לעיון במשרדי החברה במרכז תעשיות מדע (מת"מ) בחיפה, בימים א'-ה' בין השעות 10:00-16:00, בתיאום מראש בטלפון 04-8316632, וזאת עד מועד כינוס האסיפה הכללית לאישור ההחלטות שעל סדר יום האסיפה. בנוסף, מסמך ה-*Proxy Statement* מפורסם באתר ההפצה של המגנ"א ובאתר הבורסה בכתובות המפורטות בהמשך כתב הצבעה זה להלן.

<u>הרוב הדרוש לקבלת החלטה באסיפה הכללית בכל אחד מן הנושאים שעל סדר היום שלגביהם ניתן להצביע באמצעות כתב ההצבעה</u>

<u>החלטות 1, 3</u>

הרוב הנדרש באסיפה הכללית לאישור כל אחת מההחלטות הינו רוב קולות בעלי המניות הנוכחים והמשתתפים בהצבעה.

<u>החלטה 2</u>

הרוב הנדרש באסיפה הכללית לאישור ההחלטה הינו רוב קולות בעלי המניות הנוכחים והמשתתפים בהצבעה, ובלבד שיתקיים אחד מאלה: (א) במניין קולות הרוב ייכללו לפחות שליש מכלל קולות בעלי המניות שאינם בעלי שליטה בחברה או מי מטעמם, המשתתפים בהצבעה; במניין כלל הקולות של בעלי המניות האמורים לא יובאו בחשבון קולות הנמנעים; או (ב) סך קולות המתנגדים מקרב בעלי המניות האמורים בפסקת משנה (א) לא יעלה על שיעור של אחוז אחד מכלל זכויות ההצבעה בחברה.

<u>הערה בדבר גילוי היות בעל המניות בעל שליטה</u>

בחלק השני של כתב הצבעה זה מוקצה מקום לסימון האם בעל המניות המצביע באמצעות כתב ההצבעה הינו בעל שליטה בחברה או מי מטעמו (להלן – "זיקה"), אם לאו, ולתיאור מהות הזיקה כאמור. מובהר, כי מי שלא יסמן כאמור או לא יתאר את מהות הזיקה כאמור, לא תובא הצבעתו במניין הקולות.

<u>תוקף כתב ההצבעה</u>

לכתב ההצבעה יהיה תוקף רק אם צורף לו אישור בעלות של בעל המניות הלא רשום, או צילום תעודת זהות, דרכון או תעודת התאגדות, אם בעל המניות רשום בספרי החברה.

המועד האחרון להמצאת כתבי הצבעה לחברה הינו 16 באוגוסט 2006 בשעה 10:00 (שעון ישראל).

<u>מען החברה למסירת כתבי ההצבעה והודעות העמדה</u>

מזכיר החברה, אלביט מערכות בע"מ, מרכז תעשיות מדע (מת"מ), ת.ד. 539 חיפה. מיקוד: 31053.

<u>המועד האחרון להמצאת הודעות עמדה לחברה והמועד האחרון להמצאת תגובת הדירקטוריון להודעות העמדה</u>

המועד האחרון להמצאת הודעות עמדה של בעלי מניות לחברה הנו 28 ביולי 2006.

המועד האחרון להמצאת תגובת הדירקטוריון להודעות עמדה הנו 2 באוגוסט 2006.

<u>כתובות אתר ההפצה ואתר האינטרנט של הבורסה שמצויים בהם כתבי ההצבעה והודעות העמדה</u>

כתובת אתר ההפצה של רשות ניירות ערך: *www.magna.isa.gov.il*

כתובת אתר האינטרנט של הבורסה: *maya.tase.co.il*

<u>קבלת אישורי בעלות, כתבי הצבעה והודעות עמדה</u>

בעל מניות זכאי לקבל את אישור הבעלות בסניף של חבר הבורסה או במשלוח בדואר, אם ביקש זאת. בקשה לעניין זה תינתן מראש לחשבון ניירות ערך מסוים.

בעל מניות לא רשום זכאי לקבל בדואר אלקטרוני בלא תמורה קישורית לנוסח כתב ההצבעה והודעות העמדה באתר ההפצה, מאת חבר הבורסה שבאמצעותו הוא מחזיק במניותיו, אלא אם כן הודיע לחבר הבורסה כי אין הוא מעונין לקבל קישורית כאמור או שהוא מעונין לקבל כתבי הצבעה בדואר תמורת תשלום. הודעתו לעניין כתבי ההצבעה תחול גם לעניין קבלת הודעות העמדה.

בעל מניות אחד או יותר המחזיק במניות בשיעור המהווה חמישה אחוזים או יותר מסך כל זכויות ההצבעה בחברה, וכן מי שמחזיק בשיעור כאמור מתוך סך כל זכויות ההצבעה שאינן מוחזקות בידי בעל שליטה בחברה כהגדרתו בסעיף 268 לחוק החברות, זכאי לעיין בכתבי ההצבעה כמפורט בתקנה 10 לתקנות כתבי הצבעה.

כמות המניות המהוות 5% מסך כל זכויות ההצבעה בחברה הנה נכון ליום הקובע כ- 2,062,035 מניות רגילות בנות 1 ש"ח ע"נ כל אחת של החברה.

כמות המניות המהוות 5% מסך כל זכויות ההצבעה בחברה שאינן מוחזקות בידי בעל שליטה הנה נכון ליום הקובע כ- 1,066,263 מניות רגילות בנות 1 ש"ח ע"נ כל אחת של החברה.

<u>ציון אופן ההצבעה בכתב ההצבעה</u>

בעל מניות יציין את אופן הצבעתו לגבי כל נושא שעל סדר היום ושלגביו ניתן להצביע באמצעות כתב הצבעה זה בחלקו השני של כתב ההצבעה.

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אלביט מערכות בע"מ
("החברה")

כתב הצבעה - חלק שני

<u>לפי תקנות החברות (הצבעה בכתב והודעות עמדה), התשס"ו-2005</u>

שם החברה: אלביט מערכות בע"מ

מען החברה (למסירה ומשלוח כתבי הצבעה): מת"מ, ת.ד. 539, חיפה, ישראל

מס' החברה: 52-004302-7

מועד האסיפה: יום חמישי, ה-17 באוגוסט 2006, בשעה 10:00 שעון ישראל.

סוג האסיפה: שנתית

המועד הקובע: 18 ביולי 2006

פרטי בעל המניות:

שם בעל המניות ____________________
מספר זהות ____________________
אם אין לבעל המניות תעודת זהות ישראלית-
מספר דרכון ____________________
המדינה שבה הוצא ____________________
בתוקף עד ____________________
אם בעל המניות הוא תאגיד-
מספר תאגיד ____________________
מדינת ההתאגדות ____________________

אופן ההצבעה

מספר הנושא על סדר היום	**אופן ההצבעה[1]**		
	בעד	**נגד**	**נמנע**
החלטה 1 - מינוי שבעה דירקטורים לדירקטוריון החברה כמפורט להלן:			
1. מיכאל פדרמן			
2. משה ארד			
3. אברהם אשרי			
4. רינה באום			
5. יונתן קולבר			
6. יגאל נאמן			
7. דב נינוה			
החלטה 3 - מינוי מחדש של רואה החשבון המבקר של החברה			

[1] אי סימון ייחשב כהימנות מהצבעה באותו נושא.

מספר הנושא על סדר היום	אופן ההצבעה[1]			האם אתה נמנה עם בעלי השליטה בחברה או מי מטעמם[2]	
	בעד	נגד	נמנע	כן	לא
החלטה 2 – הארכת המינוי של יעקב ליפשיץ כדירקטור חיצוני בשלוש שנים נוספות					

[1] אי סימון ייחשב כהימנעות מהצבעה באותו נושא.
[2] בעל מניות שלא ימלא טור זה או שיסמן "כן" ולא יפרט בהמשך, הצבעתו לא תבוא במנין.

תאריך ______________ חתימה ______________

נא פרט את מהות הזיקה לבעל השליטה או את היותך בעל שליטה ביחס להחלטה 2 אם ציינת בה כי יש לך זיקה כאמור.

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לבעלי מניות המחזיקים במניות באמצעות חבר בורסה (לפי סעיף 177(1)) – כתב הצבעה זה תקף רק בצירוף אישור בעלות.

לבעלי מניות הרשומים במרשם בעלי המניות של החברה – כתב הצבעה זה תקף בצירוף צילום תעודת זהות/דרכון/תעודת התאגדות.

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ELBIT SYSTEMS LTD.
Advanced Technology Center
P.O. Box 539
Haifa 31053, Israel

PROXY STATEMENT

This Proxy Statement is provided to the shareholders of ordinary shares, NIS 1.00 nominal value (the "Shares"), of Elbit Systems Ltd. (the "Company" or "Elbit Systems"), in connection with the Board of Directors' solicitation of proxies for use at the Shareholders' Annual General Meeting to be held on Thursday, August 17, 2006 (the "Meeting"), or at any adjournment of the Meeting, as specified in the accompanying Notice of Annual General Meeting of Shareholders.

It is proposed that the shareholders adopt resolutions concerning the following matters at the Meeting:

(1) election of seven directors to the Company's Board of Directors;

(2) election of Yaacov Lifshitz, who currently serves as an External Director on the Company's Board of Directors, to an additional three-year term as an External Director; and

(3) appointment of the Company's independent auditors for the fiscal year ending December 31, 2006.

In addition, at the Meeting the Company will present or report on the following matters relating to fiscal year 2006.

- its Independent Auditors' Report, Management Report and Consolidated Financial Statements;
- the dividend paid to shareholders;
- the compensation paid to the Company's directors; and
- the compensation arrangement with the Company's independent auditors.

Shares represented by properly signed and unrevoked proxies will be voted in the manner directed by the persons designated as proxies.

QUORUM AND VOTING REQUIREMENTS

Only shareholders of record at the close of business on July 18, 2006 have the right to receive notice and to vote at the Meeting. Due to recent changes in regulations under the Israel Companies Law – 1999 (the “Companies Law”) relating to the timing of establishing record dates for shareholder meetings, the record date has been established at a date after the date of publication of this Proxy Statement with the applicable securities authorities. Distribution of the Proxy Statement will be made following the record date, as was the case with previous shareholders meetings of the Company.

The Company had outstanding on July 1, 2006, 41,240,707 Shares, each giving a right of one vote for each of the matters to be presented at the Meeting. (This amount includes 23,021 Shares held by a wholly-owned subsidiary of the Company but does not include 385,000 Shares held by the Company as treasury shares.) No less than two shareholders present in person or by proxy, and holding or representing between them one-third of the outstanding Shares, will constitute a quorum at the Meeting.

If a quorum is not present within one-half hour after the time set for the Meeting, the Meeting will be adjourned and will be reconvened one week later at the same time and place unless other notice is given by the Board of Directors. If there is not a quorum within one-half hour of the time for the reconvened meeting, a quorum will be considered present as long as at least two shareholders participate in person or by proxy.

Joint holders of Shares should note that according to the Company's Articles of Association the vote, whether in person or by proxy, of the more senior of joint holders of any voted Share will be accepted over vote(s) of the other joint holders of that Share. For this purpose seniority will be determined by the order the joint holders' names appear in the Company’s Register of Shareholders.

A majority of the votes cast at the Meeting either in person or by proxy is required: (a) to elect, under Item 1 of this Proxy Statement, each of the individuals nominated to be a director and (b) to approve Item 3 (appointment of independent auditors) of this Proxy Statement.

Approval of Item 2 of this Proxy Statement (election of Mr. Lifshitz to an additional three-year term as an External Director), requires a majority of the votes cast regarding such election at the Meeting, whether in person or by proxy, provided that (i) that majority includes at least one-third (1/3) of the total votes of non-controlling shareholders or anyone voting on their behalf present at the Meeting in person or by proxy (abstentions will not be taken into account); or (ii) the total number of votes of the shareholders mentioned in (i) above that are voted against such election does not exceed one percent (1%) of the Company’s voting rights.

VOTING AND REVOCATION OF PROXIES

For the purpose of this Proxy Statement:

"U.S. Shares" means Shares traded on the Nasdaq Global Market - i.e., Shares registered on the records of the Company's U.S. transfer agent - American Stock Transfer & Trust Company.

"Israeli Shares" means Shares traded on the Tel Aviv Stock Exchange (the "TASE") - i.e. Shares registered in the Company's Israeli Shareholders' Registry, including but not limited to such shares registered in the name of Israel Discount Bank Nominees Ltd. (the "Nominee Company").

Holders of U.S. Shares

Holders of U.S. Shares may vote their Shares by attending the Meeting and voting their Shares in person, or by completing the enclosed proxy card, signing and dating it and mailing it in the enclosed postage-prepaid envelope. A proxy card for use at the Meeting and a return envelope for the proxy card are enclosed. Shareholders may revoke any proxy card prior to its exercise by filing with the Company a written notice of revocation or a properly signed proxy card of a later date, or by voting in person at the Meeting. In order to be counted for purposes of voting at the Meeting, a properly signed proxy card must be received by the Company at least 24 hours before the Meeting.

Notwithstanding the above, shareholders who hold their Shares in "street name", meaning in the name of a bank, broker or other record holder, must either direct the record holder of their Shares on how to vote their Shares or obtain a legal proxy from the record holder to vote the Shares at the Meeting on behalf of the record holder as well as a statement from such record holder that it did not vote such Shares.

Unless otherwise indicated on the proxy card, Shares represented by a properly signed and received proxy in the enclosed form will be voted in favor of all the above described matters to be presented for voting at the Meeting.

Proxy cards are being mailed to shareholders on or about July 19, 2006 and will be solicited mostly by mail. However, in some cases proxies may be solicited by telephone, telegram or other personal contact.

Holders of Israeli Shares

Holders of Israeli Shares may vote their Shares by attending the Meeting and voting their Shares in person, or by completing, signing, dating and mailing the form of Hebrew proxy that has been prepared in accordance with the Israeli Companies Regulations (Proxy Forms and Opinion Notices - 2005. The Hebrew proxy is available on the following websites: www.magna.isa.gov.il or maya.tase.co.il, and it is also available at the Company's offices. Proxies must be received by the Company no later than 24 hours before the Meeting. Shares represented by executed and unrevoked proxies will be voted at the Meeting.

Holders of Israeli Shares registered in the Company's Shareholders' Registry who vote their Shares by proxy must also provide the Company with a copy of their identity card, passport or certification of incorporation, as the case may be. Holders of Israeli Shares who hold their Shares through the Nominee Company and intend to vote their Shares either in person or by proxy must deliver to the Company an ownership certificate confirming their ownership of the Company's Shares on the record date, which certificate must be approved by a recognized financial institution, as required by the Israeli Companies Regulations (Proof of Ownership of Shares for Voting at General Meeting) - 2000.

Holders of Israeli Shares may revoke their proxies no later than 24 hours before the Meeting by applying to the Company's offices for such revocation and providing proof of their identity to the satisfaction of the Company's Corporate Secretary or other Company representative appointed for that purpose. Holders of Israeli Shares who revoke their proxy may only vote their Shares during the Meeting.

Proxies for holders of Shares registered in the Company's Israeli Shareholders' Registry will be solicited by the Company on or about July 19, 2006 by mail. The Company will pay for the cost of the solicitation of proxies, including the cost of preparing, assembling and mailing the proxy material, and will reimburse the reasonable expenses of brokerage firms and others for forwarding material to shareholders.

Failure to Vote by Proxy or in Person

If a shareholder (either a holder of U.S. Shares or a holder of Israeli Shares) fails to vote by proxy or in person with regard to a specific proposal or if a shareholder does not indicate whether or not he or she has is a controlling shareholder with regard to Item 2 of this Proxy Statement, the Shares represented by such proxy or owned by such shareholder will be deemed not to have been cast for the purpose of the approval of such proposal. Accordingly, such Shares will not be counted in calculating the percentage of affirmative votes required for approval of such proposal. Without derogating from the foregoing and to the extent permitted by law and applicable stock exchange requirements, if a written proxy is signed by a shareholder and returned without instructions, the Shares represented by the proxy will be voted in favor of all of the proposals set forth above. If a shareholder instructs in a proxy that it wishes to abstain from voting its Shares on a specific proposal, the Shares represented by such proxy will be deemed as neither a vote for nor against the proposal considered at the Meeting, although they will be counted in determining whether a quorum is present.

Right to Review Proxy Cards

Following the Meeting, one or more shareholders holding, at the Record Date, at least 1,066,263 Shares, which represent as of the Record Date approximately five percent (5%) of the total voting rights of the Company that are not held by controlling shareholders of the Company, may review the proxy cards submitted to the Company at the Company's offices during normal business hours.

BENEFICIAL OWNERSHIP OF SECURITIES BY CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table shows, as of July 1, 2006, to the best of the Company's knowledge, the number of Shares [(1)] owned by (i) all shareholders known by the Company to own 5% or more of the Company's Shares and (ii) all directors and officers of the Company as a group.

Federmann Enterprises Ltd. 99 Hayarkon Street Tel-Aviv, Israel[(2)]	16,755,448	40.68%
Heris Aktiengesellschaft c/o 99 Hayarkon Street Tel-Aviv, Israel	3,836,458[(3)]	9.31%
Koor Industries Ltd. 14 Hamelacha Street Rosh Ha'ayin, Israel[(4) (5)]	3,160,000	7.67%
All officers and directors as a group (27 persons)	328,358[(6)]	0.80%

(1) The total number of Shares includes 23,091 Shares held by a subsidiary of Elbit Systems but excludes 385,000 Shares held by Elbit Systems as treasury shares.

(2) Federmann Enterprises Ltd. ("FEL") owns the Shares of Elbit Systems directly and indirectly through Heris Aktiengesellschaft ("Heris") which is controlled by FEL. FEL is controlled by Beit Federmann Ltd. ("BFL"). BFL is controlled by Beit Bella Ltd. ("BBL") and Beit Yekutiel Ltd. ("BYL"). Michael Federmann is the controlling shareholder of BBL and BYL. He is also the Chairman of Elbit Systems' Board and the Chairman of the Board and the Chief Executive Officer of FEL. Therefore, Mr. Federmann controls, directly and indirectly, the vote of the Shares owned by Heris and FEL. As of July 1, 2006, 4,655,448 Elbit Systems Shares held by FEL were pledged to

Bank Leumi Le-Israel BM to guarantee loans provided to FEL in connection with FEL's purchase in 2004 of the Elbit Systems Shares held by Elron Electronic Industries Ltd.

(3) The amount of Shares owned by Heris is included in the amount of shares held by FEL as set forth in footnote (2) above.

(4) Koor Industries Ltd. (Koor) is an Israeli multi-industry holding company, whose shares are publicly traded on the TASE, engaged through its direct and indirect wholly and partially owned subsidiaries and affiliates in the following core businesses: telecommunications, defense electronics, agrochemicals and investments in start-ups in the fields of telecommunications and life science. Koor is also involved in tourism, real estate and international trade businesses. The principal shareholders of Koor are Discount Investment Corp. Ltd., a subsidiary of IDB Development Corporation Ltd. ("IDBD"), holding approximately 30.9% of Koor, and IDBD, holding approximately 9.9% of Koor's outstanding ordinary shares.

(5) FEL and Heris (collectively the Federmann Group) and Koor may be deemed for purposes of U.S. securities laws to be joint owners of the aggregate Shares of Elbit Systems beneficially owned by them by virtue of a shareholders agreement dated December 27, 2004, which entered into force on April 18, 2005, as amended, between FEL and Koor, and which provides, among other things, for Koor to vote at general shareholders meetings of Elbit Systems in accordance with FEL's instructions with certain exceptions. The Federmann Group and Koor have each disclaimed beneficial ownership of the other's Shares in Elbit Systems.

(6) This amount does not include any Shares that may be deemed to be beneficially owned by Michael Federmann as described in footnote (2) above. The amount includes 138,694 Shares underlying options that are currently exercisable or that will become exercisable within 60 days of July 1, 2006. A portion of the underlying options are "phantom options" that have been calculated based on Elbit Systems' July 1, 2006 Share closing price on TASE of $27.04.

DIRECTOR INDEPENDENCE CRITERIA AND NOMINATING COMMITTEE

Under Nasdaq rules that are applicable to the Company, a majority of the members of the Board of Directors must meet certain independence criteria. All of the members of the Audit Committee of the Board of Directors (the "Audit Committee") must meet certain independence criteria as well. In addition, in accordance with Nasdaq rules, a Nominating Committee of the Board of the Directors (the "Nominating Committee"), consisting in its entirety of directors meeting the board of directors' independence criteria, has been created in order to nominate candidates to the Board of Directors.

ITEM 1 - ELECTION OF DIRECTORS

At the Meeting, seven directors who are not External Directors (see list of nominees below) are to be elected. Also, if elected to another term as a director, Michael Federmann will continue to serve as Chairman of the Board of Directors. Nathan Sharony, an External Director, will continue to serve as External Director until the end of his term in March 2008.

The Nominating Committee has recommended to the Board of Directors that all of the persons named in the list of nominees below, all of whom currently serve as directors of the Company, be nominated for re-election to the Company's Board of Directors. Three of these nominees (Moshe Arad, Avraham Asheri and Yigal Ne'eman) meet the board of directors' independence criteria under the applicable Nasdaq rules, as do the two current External Directors (Nathan Sharony and Yaacov Lifshitz).

The Board of Directors has approved the recommendation of the Nominating Committee with respect to the list of nominees. Accordingly, the persons named in the proxy card distributed with this Proxy Statement intend to vote for the election of the seven nominees named below.

Each nominee so elected as a director will hold office until the next shareholders' Annual General Meeting and until his or her successor is elected and qualified, unless any director's office is vacated earlier in accordance with the provisions of the Companies Law or the Company's Articles of Association.

The Company is not aware of any reason why any of the nominees, if elected, should be unable to serve as a director. Nevertheless, if any of the nominees should be unable to serve, the proxies will be voted for the election of such other person or persons as determined by the person named in the proxy card in accordance with his or her judgment, provided such other person or persons have been recommended by the Nominating Committee for nomination to the Board of Directors.

The nominees and the current External Directors, their respective ages on July 1, 2006, and the year in which they became directors of the Company are as follows:

Board of Directors

Name	Age	Director Since
Michael Federmann (Chairman)	63	2000
Moshe Arad	71	2005
Avraham Asheri	68	2000
Rina Baum	61	2001
Jonathan Kolber	44	2005
Yaacov Lifshitz (External Director)	62	2003
Yigal Ne'eman	64	2004
Dov Ninveh	59	2000

Nathan Sharony (External Director)	71	2002

Michael Federmann. Michael Federmann has served as Chairman of the Board of Directors since the merger with Elop in 2000. He served as Chairman of the Board of Directors of Elop from 1988 until the merger. He has held managerial positions in the Federmann Group since 1969, and since 2002 he has served as Chairman and CEO of Federmann Enterprises Ltd. ("FEL"). Currently, he also serves as Chairman of the Board of Directors of Dan Hotels Corp. Ltd. ("Dan Hotels"). Mr. Federmann is Deputy Chairman of the Board of Governors of the Hebrew University in Jerusalem (the "Hebrew University") and a member of the Board of Governors and the Executive Committee of the Weizmann Institute of Science. Mr. Federmann holds a bachelor's degree in economics and political science from the Hebrew University.

Moshe Arad. Moshe Arad served as Vice President for External Relations of the Hebrew University from 1994 to 2004. He currently serves on the Board of Directors of Discount Investment Corporation Ltd. From 1994 to 1999, he was member of the Board of Directors of Elbit Ltd. During 1992 and 1993, Mr. Arad served as Director General of the Israel Ministry of Communications. From 1990 to 1992, he was a member of the Tel-Aviv law firm of Herzog, Fox, Ne'eman. Mr. Arad served as Israel's Ambassador to the United States from 1987 to 1990 and as Israel's Ambassador to Mexico from 1983 to 1987. Ambassador Arad holds a bachelor's degree in political science and international relations and a L.L.B. degree from the Hebrew University. Mr. Arad serves on the Compensation Committee of the Company's Board of Directors.

Avraham Asheri. Avraham Asheri has served as an economic advisor and a director of several companies since 1998. He currently serves on the Boards of Directors of Elron Electronic Industries Ltd., Discount Mortgage Bank Ltd., Scailex Corporation Ltd. and Africa Israel Investment Ltd. Mr. Asheri was President and Chief Executive Officer of Israel Discount Bank from 1991 until 1998, and Executive Vice President and member of its management committee from 1983. Prior to that, he served for 23 years at the Israel Ministry of Industry and Trade and at the Israel Ministry of Finance, including as Director General of the Israel Ministry of Industry and Trade, Managing Director of the Israel Investment Center and Trade Commissioner of Israel to the United States. Mr. Asheri holds a bachelor's degree in economics and political science from the Hebrew University. Mr. Asheri serves as Chairman of the Compensation Committee and as a member of the Audit and Nominating Committees of the Company's Board of Directors.

Rina Baum. Rina Baum is Vice President for Investments of FEL and since 1986 has served as Director and General Manager of Unico Investment Company Ltd. and other managerial positions within the Federmann Group She serves as a director of Dan Hotels, Etanit Building Products Ltd. and Harel Mutual Funds Ltd. Mrs. Baum holds an L.L.B. degree from the Hebrew University.

Jonathan B. Kolber. Jonathan Kolber has served as Chief Executive Officer of Koor since 1998. Mr. Kolber served as the Vice Chairman of the Board of Directors of Koor from 1997 to 2003. He served as President of Claridge Israel Ltd. from 1989 to 2001 and as Vice President of Claridge Inc. from 1986 to 1990. Mr. Kolber was associated with Cemp Investments from 1985 to 1987. He serves as a director of several Israeli companies, including ECI Telecom Ltd., Makhteshim-Agan Industries Ltd., Telrad Networks Ltd., Sheraton-Moriah Israel Ltd. and Knafaim – Arkia Holdings Ltd. Mr. Kolber holds a bachelor's degree in near eastern languages and civilizations from Harvard University and a certificate in advanced Arabic from the American University of Cairo.

Yaacov Lifshitz (External Director) - See Item 2 below.

Yigal Ne'eman. Yigal Ne'eman has served since 1994 as the Chairman and President of the Israel College. From 1989 to 1993, he served as Chairman and as a shareholder of several industrial, commercial and service companies. Mr. Ne'eman served as the President and CEO of Tadiran Electronic Industry Ltd. ("Tadiran") from 1981 to 1989. Prior to that he held a number of management positions in the control and finance departments of Tadiran. Mr. Ne'eman is a certified public accountant and holds an accounting degree from the Hebrew University. Mr. Ne'eman serves as a member of the Audit and Nominating Committees of the Company's Board of Directors.

Dov Ninveh. Dov Ninveh has served since 1994 as Chief Financial Officer and a manager in FEL. He serves as a director of Dan Hotels and Etanit Ltd. Mr. Ninveh served as a director of Elop from 1996 until 2000. From 1989 to 1994, he served as Deputy General Manager of Etanit Building Products Ltd. Mr. Ninveh holds a bachelor's degree in economics and management from the Israel Institute of Technology.

Nathan Sharony (External Director). Nathan Sharony has served since 1997 as a director for several companies. He currently serves as a director for Bituach Yashir Ltd., an insurance company, Union Bank, Ormat Industries Ltd., Genoa Technologies Ltd. and Israel Bonds International Inc. From 1997 to 1999, he served as Chairman of Technorov. From 1994 to 1997, he was Chief Executive Officer of Israel Bonds, a U.S. brokerage. Mr. Sharony served as the Director General of the Israel Ministry of Industry and Trade from 1992 to 1994. Prior to that, Mr. Sharony held a number of positions in industry and government including head of the Israeli Government Economic Mission to the U.S., President and Chief Executive Officer of Elop and Vice President for Logistics of Tadiran Ltd. In 1982, Mr. Sharony completed 30 years of service in the Israel Defense Forces, retiring with the rank of Major General. Mr. Sharony participated in the Field Artillery Battery Officers Course in Fort Sill, Oklahoma. Mr. Sharony serves as Chairman of the Audit and Nominating Committees of the Company's Board of Directors.

Directors Fees

At the annual general shareholders meeting held in 2004, the Company's shareholders approved payment to directors thereafter in accordance with maximum regulatory rates payable to External Directors under Israeli law for companies similarly classified based on their shareholding equity. This amount currently includes an annual fee of $10,307 and a per meeting fee of $396. Such payments are made either directly to the director or to his or her employing company.

At the Meeting, the Board of Directors will propose that the following resolution be adopted:

> "RESOLVED, that Messrs. Federmann, Arad, Asheri, Kolber, Ne'eman and Ninveh and Mrs. Baum are elected as directors of the Company."

The Board of Directors recommends a vote FOR all the nominees to the Board of Directors.

ITEM 2 – ELECTION OF YAACOV LIFSHITZ FOR AN ADDITIONAL TERM AS EXTERNAL DIRECTOR

The Company is required under the Companies Law to have at least two External Directors on its Board of Directors. Among other requirements of the Companies Law, a person may not serve as an External Director if such person or such person's relative, partner or employer, or any entity controlled by such person has, at any time during the two years up to the date of appointment, any affiliation with the Company, entities controlling the Company or entities controlled by the Company. The term "affiliation" is broadly defined in the Companies Law. In addition, no person may serve as an External Director if such person's position or other business creates any conflict of interest with or impairs his or her responsibilities as an External Director.

Each committee of the Company's Board of Directors is required to include at least one External Director, and all External Directors must be members of the Board of Directors' Audit Committee. An External Director is entitled to compensation and to reimbursement of expenses as provided in regulations under the Companies Law and is otherwise prohibited from receiving any other compensation, directly or indirectly, in connection with services provided as an External Director. External Directors are elected at a General Shareholders Meeting and serve for a three-year term. The term may be extended for an additional three-year term if the extension is approved by a General Shareholders Meeting.

Nathan Sharony and Yaacov Lifshitz currently serve as the Company's External Directors. Mr. Sharony has served as an External Director since March 2002, was re-elected in March 2005, and his term of office as an External Director expires in March 2008. The term of office of Mr. Lifshitz, who was elected as an External Director in July 2003, expires in July 2006.

The Nominating Committee has recommended to the Board of Directors that Mr. Lifshitz be nominated for re-election to an additional three-year term as an External Director, and Mr. Lifshitz has agreed to stand for re-election.

The Company's Board of Directors has approved the recommendation of the Nominating Committee with respect to the re-election of Mr. Lifshitz for an additional three-year term as an External Director.

The Companies Law provides that a General Shareholders Meeting at which the appointment of an External Director is to be considered will not be held unless the nominee has declared to the Company that he or she complies with the qualifications for appointment as an External Director. The proposed nominee, Mr. Lifshitz, has represented to the Company that he complies with the qualifications for re-appointment as an External Director. If elected for an additional term as an External Director, he will hold office for a further three-year period unless his office is vacated earlier in accordance with the provisions of the Companies Law or the Company's Articles of Association. If for any reason Mr. Lifshitz should be unable to serve, another person will be elected in accordance with applicable law.

Background information regarding Mr. Lifshitz, who is 62 on the date of this Proxy Statement, is as follows:

Yaacov Lifshitz serves as a director of several companies and as a lecturer in the fields of economics, public policy and management. He currently is a lecturer at the Department of Economics and the Department of Public Policy and Management of Ben-Gurion University and at the Department of Political Science of the Tel-Aviv University. He also currently serves on the Boards of Directors of Kali – Insurance Agencies Ltd., Carmel Investments Ltd. and Tesnet Software Testing Ltd. During the period from 1994 to 2002, Mr. Lifshitz served at various times as the Chairman of the Boards of Directors of Hamashbir Lazarchan Israel Ltd., Israel Military Industries Ltd., Spectronix Ltd., Dor Chemicals Ltd., Dor Energy Ltd., DorGas Ltd. and the Israeli Foreign Trade Risk Insurance Corp. Ltd. He also served from 1995 to 2002 as the Chairman of the Executive Board of the Israel Management Center. Prior to that he held various senior positions in government, banking and industry, including Director General of the Israel Ministry of Finance, Chief Economic Advisor to the Israel Ministry of Defense, Senior Vice President and Chief Credit Officer of Israel Discount Bank and President and CEO of Electra (Israel) Ltd. Mr. Lifshitz holds a bachelor's degree in economics and political science and a master's degree in economics from the Hebrew University. Mr. Lifshitz is a member of the Audit and Compensation Committees of the Company's Board of Directors. Mr. Lifshitz has also been designated by the Company's Board of Directors as the "Audit Committee Financial Expert" under applicable U.S. and Israeli rules and regulations.

At the Meeting, the Board of Directors will propose that the following resolution be adopted:

> "RESOLVED, that Mr. Yaacov Lifshitz be elected for an additional three-year term as an External Director of the Company".

The Board of Directors recommends a vote FOR approval of this resolution.

ITEM 3 - RE-APPOINTMENT OF

THE COMPANY'S INDEPENDENT AUDITORS
FOR FISCAL YEAR 2006

Following the recommendation by the Company's Audit Committee, it is proposed that Kost, Forer, Gabbay & Kasierer, a member of Ernst & Young Global Certified Public Accountants, will be appointed as independent auditors of the Company for the fiscal year ending on December 31, 2006. A representative of the independent auditors will be present at the Meeting and will be available to respond to appropriate questions from the shareholders. Such auditors served as the Company's auditors for fiscal year 2005 and have no relationship with the Company or with any affiliate of the Company, except as auditors.

At the Meeting, the Board of Directors will propose that the following resolution be adopted:

> "RESOLVED, that the Company's independent auditors, Kost, Forer, Gabbay & Kasierer, a member of Ernst & Young Global, are re-appointed as independent auditors of the Company for the fiscal year ending December 31, 2006."

The Board of Directors recommends a vote FOR approval of this resolution.

MATTERS TO BE REPORTED

In addition, at the Meeting the Company will present or report on the following matters relating to fiscal year 2005:

- its Independent Auditors' Report, Management Report and Consolidated Financial Statements for the fiscal year ended December 31, 2005;
- the dividend paid to shareholders;
- the compensation paid to the Company's directors; and
- the compensation arrangement with the Company's independent auditors.

By Order of the Board of Directors

MICHAEL FEDERMANN
Chairman of the Board of Directors

JOSEPH ACKERMAN
President and Chief Executive Officer

Date: July 13, 2006

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

as of December 31, 2005

(In U.S. dollars)

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS
as of December 31, 2005
In U.S. dollars

C O N T E N T S

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ERNST & YOUNG

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Haifa-33095, Israel

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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders of
Elbit Systems Ltd.

We have audited the accompanying consolidated balance sheets of Elbit Systems Ltd. ("the Company") and its subsidiaries as of December 31, 2005 and 2004 (as adjusted – see Note 1(G)), and the related consolidated statements of income, changes in shareholders' equity and cash flows for the each of the three years in the period ended December 31, 2005. Our audits also included the financial statement schedule listed in the Index at Item 19a. These consolidated financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audits. We did not audit the financial statements of a majority-owned subsidiary, which statements reflect total assets constituting 16.3% in 2005, of the related consolidated total assets. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for this subsidiary, is based solely on the report of the other auditors.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 2(X) to the consolidated financial statements, on January 1, 2004 the Company adopted SFAS No. 123 "Accounting for Stock-Based Compensation."

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

Haifa, Israel
March 14, 2006

CONSOLIDATED BALANCE SHEETS

U. S. dollars (In thousands)

	Note	December 31, 2005	December 31, 2004 (*)
CURRENT ASSETS:			
Cash and cash equivalents		$ 93,887	$ 34,109
Short-term bank deposits		742	738
Trading securities		2,282	-
Trade receivables, (net of allowance for doubtful accounts in the amount of $3,221 and $3,064 as of December 31, 2005 and 2004, respectively)	(3)	346,689	214,816
Other receivables and prepaid expenses	(4)	67,096	51,794
Inventories, net of advances	(5)	328,428	248,041
Total current assets		839,124	549,498
INVESTMENTS AND LONG-TERM RECEIVABLES:			
Investments in affiliated companies and a partnership	(6A)	194,994	47,873
Investments in other companies	(6B)	6,345	11,745
Compensation receivable in respect of fire damages, net	(7)	15,530 -	-
Long-term bank deposits and trade receivables	(8)	2,457	2,102
Severance pay fund	(2P)	133,570	82,998
		352,896	144,718
PROPERTY, PLANT AND EQUIPMENT, NET	(9)	284,997	244,288
INTANGIBLE ASSETS:	(10)		
Goodwill		63,957	33,706
Other intangible assets, net		78,771	62,281
		142,728	95,987
		$ 1,619,745	$ 1,034,491

* Adjusted (See Note 1G)

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)

	Note	December 31, 2005	December 31, 2004 (*)
CURRENT LIABILITIES:			
Short-term bank credit and loans	(11)	$ 30,296	$ 8,592
Current maturities of long-term loans	(14)	7,355	1,656
Trade payables		120,260	113,691
Other payables and accrued expenses	(12)	216,539	172,109
Customers advances in excess of costs incurred on contracts in progress	(13)	237,718	80,109
Total current liabilities		612,168	376,157
LONG-TERM LIABILITIES:			
Long-term loans	(14)	224,982	86,234
Advances from customers	(13)	122,263	10,320
Deferred income taxes	(16)	31,424	24,516
Accrued termination liability	(15, 2P)	165,224	100,740
		543,893	221,810
COMMITMENTS AND CONTINGENT LIABILITIES	(17)		
MINORITY INTERESTS		12,907	4,340
SHAREHOLDERS' EQUITY:	(18)		
Share capital			
Ordinary shares of New Israeli Shekels (NIS) 1 par value; Authorized – 80,000,000 shares as of December 31, 2005 and 2004; Issued – 41,375,545 and 40,969,947 shares as of December 31, 2005 and 2004, respectively; Outstanding – 40,966,624 and 40,561,026 shares as of December 31, 2005 and 2004, respectively		11,636	11,548
Additional paid-in capital		278,679	274,432
Accumulated other comprehensive loss		(1,340)	(4,742)
Retained earnings		166,123	155,267
Treasury shares - 408,921 shares as of December 31, 2005 and 2004		(4,321)	(4,321)
		450,777	432,184
		$ 1,619,745	$ 1,034,491

* Adjusted (See Note 1G)

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

CONSOLIDATED STATEMENTS OF INCOME

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

	Note	Year ended December 31, 2005	2004 (*)	2003
Revenues	(19)	$ 1,069,876	$ 939,925	$ 897,980
Cost of revenues		786,616	689,626	672,711
Restructuring expenses (pre-contract costs and equipment write-off)	(1H)	3,488	-	-
Gross profit		279,772	250,299	225,269
Research and development expenses, net	(20)	71,903	66,846	54,919
Marketing and selling expenses		78,648	69,912	69,943
General and administrative expenses		54,417	47,832	46,077
In process research and development write-off	(1H)	7,490	-	-
		212,458	184,590	170,939
Operating income		67,314	65,709	54,330
Financial expenses, net	(21)	(11,472)	(5,852)	(4,870)
Other income (expenses), net	(6B)	(5,326)	770	53
Income before taxes on income		50,516	60,627	49,513
Taxes on income	(16)	16,335	15,219	11,334
		34,181	45,408	38,179
Equity in net earnings (losses) of affiliated companies and partnership **	(1G)	(1,636)	6,645	7,209
Minority interests in losses (earnings) of subsidiaries		(58)	(180)	557
Net income		$ 32,487	$ 51,873	$ 45,945
Earnings per share				
Basic net earnings per share		$ 0.80	$ 1.30	$ 1.18
Diluted net earnings per share		$ 0.78	$ 1.26	$ 1.14
Number of shares used in computation of basic net earnings per share		40,750	39,952	39,061
Number of shares used in computation of diluted net earnings per share		41,623	41,041	40,230

* Adjusted (See Notes 1G)

** Includes in process research and development write-off of $8,500 in 2005

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

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
Balance as of January 1, 2003	38,803,507		$ 248,387	$ (2,882)	$ 159,023	$ (4,321)	$ 411,361	
		11,1						
Exercise of options	533,797	119	5,147	-	-	-	5,266	
Tax benefit in respect of options exercised	-	-	758	-	-	-	758	
Stock based compensation	-	-	4,741	-	-	-	4,741	
Dividends paid	-	-	-	-	(14,882)	-	(14,882)	
Other comprehensive income (loss) net of tax:	-	-	-	-	-	-	-	
Unrealized loss on derivative instruments	-	-	-	(578)	-	-	(578)	$ (578)
Foreign currency translation differences	-	-	-	340	-	-	340	340
Minimum pension liability adjustment	-	-	-	(872)	-	-	(872)	(872)
Net income	-	-	-	-	45,945	-	45,945	45,945
Total comprehensive income								$ 44,835
Balance as of December 31, 2003	39,337,304	$ 11,273	$ 259,033	$ (3,992)	$ 190,086	$ (4,321)	$ 452,079	
Exercise of options	1,223,722	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) net of tax:	-	-	-	-	-	-		
Unrealized loss on derivative instruments	-	-	-	(299)	-	-	(299)	$ (299)
Foreign currency translation differences	-	-	-	450	-	-	450	450
Minimum pension liability adjustment	-	-	-	(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	

* Adjusted (see Note 1G)

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

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (CONT.)

U. S. dollars (In thousands, except 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	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 gain 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								$ 35,889
Balance as of December 31, 2005	40,966,624	$ 11,636	$ 278,679	$ (1,340)	$ 166,123	$ (4,321)	$ 450,777	

Accumulated other comprehensive loss (net of taxes)

	December 31, 2005	December 31, 2004
Accumulated gains (losses) on derivative instruments	$ 5,535	$ (877)
Accumulated foreign currency translation differences	(134)	790
Accumulated minimum pension liability adjustment	(6,741)	(4,655)
Accumulated other comprehensive loss	$ (1,340)	$ (4,742)

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)

	Year ended December 31,		
	2005	**2004****	**2003**
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 32,487	$ 51,873	$ 45,945
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	57,718	42,261	37,890
Purchased in process R&D	7,490	-	-
Stock based compensation	172	3,387	4,741
Deferred income taxes	6,551	153	35
Accrued severance pay, net	(6,707)	(2,304)	(1,240)
Loss (gain) on sale of property, plant and equipment	(731)	143	(915)
Tax benefit in respect of options exercised	652	1,179	758
Minority interests in earnings (losses) of subsidiaries	58	180	(557)
Equity in net losses (earnings) of affiliated companies and partnership, net of dividend received (*)	13,805	1,505	(4,995)
Changes in operating assets and liabilities:			
Decrease (increase) in short and long-term trade receivables, and prepaid expenses	(43,420)	(16,871)	45,297
Decrease (increase) in inventories	(43,679)	2,932	(38,651)
Increase (decrease) in trade payables, other payables and accrued expenses	(37,859)	20,522	32,147
Increase (decrease) in advances received from customers	202,450	(18,535)	(27,855)
Settlement of royalties with the Office of the Chief Scientist	(1,371)	(3,714)	(1,581)
Other adjustments	-	(1,228)	337
Net cash provided by operating activities	187,616	81,483	91,356
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property, plant and equipment	(58,735)	(53,008)	(61,287)
Acquisition of subsidiaries and businesses (Schedule A)	(28,331)	(2,315)	(2,458)
Investments in affiliated companies	(160,861)	(18,391)	(1,049)
Proceeds from sale of property, plant and equipment	2,712	2,560	5,815
Proceed from sale of investment	3,100	-	-
Investment in long-term bank deposits	(1,089)	(1,203)	(1,750)
Proceeds from sale of long-term bank deposits	1,501	1,507	3,568
Collection of long-term loan	-	-	2,400
Short-term bank deposits, net	(4)	(48)	960
Net cash used in investing activities	(241,707)	(70,898)	(53,801)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from exercise of options	3,511	11,260	5,266
Repayment of long-term bank loans	(85,035)	(35,826)	(27,066)
Receipt of long-term bank loans	216,500	58,410	10,000
Dividends paid	(21,631)	(86,692)	(14,882)
Change in short-term bank credit and loans, net	524	216	(10,997)
Net cash provided by (used in) financing activities	113,869	(52,632)	(37,679)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	59,778	(42,047)	(124)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR	34,109	76,156	76,280
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	$ 93,887	$ 34,109	$ 76,156
(*) Dividend received	$ 12,169	$ 8,150	$ 2,214

(**) Adjusted (See Notes 1G)

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

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONT.)

U. S. dollars (In thousands)

	Year ended December 31,		
	2005	2004	2003
SUPPLEMENTAL CASH FLOW ACTIVITIES:			
Cash paid during the year for:			
Income taxes	$ 21,475	$ 13,305	$ 14,666
Interest	$ 13,151	$ 3,122	$ 4,034
SCHEDULE A:			
Subsidiaries and businesses acquired (*)			
Estimated net fair value of assets acquired and liabilities assumed at the date of acquisition was as follows:			
Working capital, net (excluding cash and cash equivalents)	$ 39,273	$ (707)	$ 657
Property, plant and equipment	(28,875)	(10)	(249)
Other long term assets	(74,363)	-	-
Goodwill and other intangible assets	(53,291)	(1,598)	(1,334)
In process R&D	(7,490)	-	-
Deferred income taxes	5,404	-	(1,765)
Long-term liabilities	82,730	-	198
Minority interest	8,281	-	35
	$ (28,331)	$ (2,315)	$ (2,458)

(*) In 2003 a European subsidiary (see Note 1(C)) and AD&D (see Note 1(D)).
In 2004 the assets of Computer Instruments Corporation Inc. (see Note 1(E))
In 2005 the assets of IMI (see Note 1(F)) and the shares of Elisra (see Note 1(H))

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

U. S. dollars (In thousands)

Note 1 - GENERAL

A. Elbit Systems Ltd. (the "Company") is an Israeli corporation, 40.6% owned by the Federmann Group, and 7.6% owned by Koor Industries Ltd. (Koor"). The Company's shares are traded on the Tel Aviv Stock Exchange and on the Nasdaq National Market in the United States. The Company and its subsidiaries (the "Group") are engaged mainly in the field of defense electronics. The Company's principal wholly-owned subsidiaries are the Elbit Systems of America ("ESA") companies and Elbit Systems Electro-Optics Industries El-Op Ltd. ("El-Op").

B. A majority of the Group's revenues are derived from direct or indirect sales to governments or to governmental agencies. As a result, a substantial portion of the Group's sales is subject to the special risks associated with sales to governments or to governmental agencies. These risks include, among others, the dependency on the resources allocated by governments to defense programs, changes in governmental priorities and changes in governmental approvals regarding export licenses required for the Group products and for its suppliers. As for major customers, refer to Note 19(C).

C. In June 2003, the Company (through El-Op) acquired all of the outstanding ordinary shares of a European entity, a company registered in Belgium, in consideration for $1,846 in cash, which were allocated to the fair value of net tangible asset acquired. The acquisition was accounted for by the purchase method of accounting.

This subsidiary develops, manufactures and supports electro-optical products, mainly for the defense and space markets.

The results of this subsidiary's operations have been included in the 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 this subsidiary were not material in relation to total consolidated revenues and net income for the year 2003.

D. In July 2003, the Company acquired approximately 54% of the outstanding shares of Aero Design Development Ltd. ("AD&D") an Israeli company in consideration for $1,406 in cash. The acquisition was accounted for by the purchase method of accounting.

AD&D develops, manufactures and builds airborne models and other engineered products.

The excess of the purchase price over the fair value of net tangible assets acquired in the amount of approximately $1,334 was allocated to technology ($1,000) to be amortized by the straight-line method over a period of ten years and to goodwill ($334).

The results of AD&D's operations have been included in the consolidated financial statements from the date of acquisition.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

Note 1 - GENERAL (Cont.)

On July 2005, the Company completed the purchase of the remaining shares of AD&D in consideration for $1,025 in cash. The excess of the purchase price over the fair value of net tangible assets acquired in the amount of approximately $1,214 was allocated to technology ($900) to be amortized by the straight-line method over a period of eight years and to goodwill ($341).

Pro forma information in accordance with SFAS No. 141 has not been provided, since the revenues and net income of AD&D were not material in relation to total consolidated revenues and net income for the years 2003, 2004 and 2005.

E. In August 2004, the Company (through a subsidiary of ESA) acquired a business from Computer Instruments Corporation Inc. (“CIC”) of Westbury, New York in consideration for approximately $2,315 in cash. The acquired assets relate to the design and manufacture of aviation pressure transducers, air data probes and air data computers.

The acquisition was accounted for by the purchase method of accounting. The excess of the purchase price over the fair market value of the net tangible assets acquired in the amount of approximately $1,598 was allocated to technology and other intangible assets to be amortized over a weighted average period of seven years.

The results of CIC’s operations have been included in the 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 CIC were not material in relation to total consolidated revenues and net income for the years 2003 and 2004.

F. 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 customers’ contracts related to the Aircraft Systems Division of IMI (“the Aircraft Division”) in consideration for approximately $7 million, paid in cash (approximately $1 million out of which $718 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 aircraft.

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 for the years 2004 and 2005.

U. S. dollars (In thousands)

Note 1 - GENERAL (Cont.)

G. On December 27, 2004, the Company reached an agreement with 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 of 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 made in several stages as detailed below.

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 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 a adjustments of the Company's financial statements for 2004, in which the Company's investment in Tadiran was accounted for as available-for-sale securities.

The following are the effects of the adjustments:

(1) Consolidated balance sheet

	December 31, 2004		
	As reported	Effect of adjustments	As adjusted
Other receivables and prepaid expenses	$ 51,042	$ 752	$ 51,794
Investment in affiliated companies and partnership	33,124	14,749	47,873
Available for sale securities	18,017	(18,017)	-
Accumulated other comprehensive loss, net of tax	(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 of adjustments	As adjusted
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

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

Note 1 - GENERAL (Cont.)

On August 25, 2005, the Company purchased an additional 5.2% of Tadiran's outstanding shares in consideration for $23,000. Following this purchase, the Company held approximately 26.5% of Tadiran's shares.

On November 30, 2005, , the Company completed the purchase of the remaining shares held by Koor in Tadiran, for approximately $59.3 million in cash. As of December 31, 2005, the Company holds approximately 40% of Tadiran's shares.

The excess of the amounts paid for the Tadiran shares acquired during 2004 and 2005 over their book value is detailed below. Based on a purchase price allocation analysis ("PPA") performed by an independent advisor, this excess was attributed as follows:

	Until the end of 2004	In the first half of 2005	In the third quarter of 2005	In the fourth quarter of 2005	Total	Expected useful lives
In Process R&D ("IPR&D")	$ 1,000	$ 4,000	$ 1,200	$ 3,300	$ 9,500	immediate write-off
Inventory	300	1,200	400	900	2,800	up to a quarter
Other tangible assets and liabilities	100	300	100	200	700	5 years
Brand name	800	3,200	1,000	2,500	7,500	15 years
Customer base and backlog	4,100	16,000	4,900	12,700	37,700	2-12 years
Technology	2,400	9,500	2,900	7,500	22,300	10 years
Goodwill	1,600	17,600	5,800	14,600	39,600	indefinite–subject to annual impairment test
Total excess of consideration over book value	$10,300	$51,800	$16,300	$41,700	$120,100	
Percentage of interest acquired in Tadiran	4.3%	17%	5.2%	13.5%	40%	

H. On July 6, 2005, the Company signed an agreement with Koor to acquire all of Koor's 70% holdings in Elisra Electronic Systems Ltd. ("Elisra"), an Israeli company, in consideration for $70 million ($68.8 million after certain adjustments) 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 (see Note 7).

The agreement for acquiring Koor's holdings in Elisra was signed following the approval of the transaction 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 and following the Company's shareholders approval in August 2005.

On November 30, 2005, simultaneously with the acquisition of Koor's shares in Tadiran, the Company completed the purchase of all of the shares of Koor in Elisra for approximately $68.8 million in cash. Following the completion of the transaction, the Company owns 70% of Elisra.

U. S. dollars (In thousands)

Note 1 - GENERAL (Cont.)

The completion of the purchase of the Elisra shares was made possible following the receipt of all required approvals, including that of the Israeli Antitrust Authorities. In accordance with the Israeli antitrust approval, the Company has agreed to fulfill conditions imposed by the Antitrust Authorities related to the market environment between the Company and Israel Aircraft Industries Ltd. ("IAI"), which holds the balance of Elisra's shares. Should the Antitrust Authorities conclude, during the course of a five-year period following the acquisition, that the Company has not complied with such conditions, the Antitrust Authorities may take various measures, including steps that could result in the cessation of the joint holdings in Elisra by the Company and IAI.

Elisra has significant complementary technologies and customer installment base to those of the Group in areas including ELINT systems, EW suites, airborne warning systems and data links. The Company's management believes that such technologies and customer installment base will enable the Group to offer more comprehensive turnkey solutions to its customers and strengthen its competitive position.

The excess of the amount paid for the Elisra shares acquired over their book value is approximately $60.2 million. Based on a PPA performed by an independent advisor, this excess was attributed as follows:

		Expected useful lives
IPR&D	$7,500	immediate write-off
Inventory	1,200	up to 2 quarters
Land and buildings	5,700	20 years
Customer base and backlog	11,800	10 years
Technology	9,500	10 years
Deferred taxes	(5,400)	According to the relevant item above
Goodwill	29,900	indefinite – subject to annual impairment test
	$60,200	

The results of Elisra's operations have been included in the consolidated financial statements from the date of acquisition. Regarding performance information in accordance with SFAS 141, see below.

The following unaudited proforma data is based on historical financial statements of the Company and Elisra and is provided for comparative purposes only. The proforma information does not purport to be indicative of the results that actually would have occurred had the purchase of the shares have been consummated prior to the beginning of the reported periods.

The proforma information reflects the results of the Company's operations assuming that Elisra's results were included in the Company's consolidated results prior to each of the reported periods, and under the following assumptions:

Note 1 - GENERAL (Cont.)

U. S. dollars (In thousands)

(1) Intangible assets (customer base, backlog and technology) arising from the acquisition of Elisra’s shares of approximately $21,300, net of related deferred taxes of approximately $4,300, is amortized over a period of 10 years.

(2) Excess of cost over equity purchased allocated to real estate assets of approximately $5,700, net of related deferred taxes of approximately $1,100, is amortized over a period of 20 years.

(3) The cost attributed to purchase IPR&D projects, in the amount of approximately $7,500 has been charged to operations immediately as a non-recurring item and is not included in the proforma consolidated results.

(4) Intercompany balances and transactions, if any, have been eliminated.

(5) Management fees which were paid to Elisra’s shareholders and will be paid in the future to the Company were eliminated in the proforma statements.

	For the year ended December 31	
	2005	**2004**
Revenues	$ 1,264,375	$ 1,181,110
Net income as reported	$ 32,487	$ 51,873
Adjustments:		
Elimination of the charge to operations for IPR&D	7,490	-
Other adjustments, net	(21,337)	126
Net income - proforma (*)	$ 18,640	$ 51,999
Basic earnings per share – proforma	$ 0.46	$ 1.33
Diluted earnings per share – proforma	$ 0.45	$ 1.29

(*) The proforma net income for the year ended December 31, 2005 includes a write-off of pre contract costs and equipment, net in the amount of $2,616 in the Company and expenses related to cutback in personnel in the amount of $19,103 in Elisra.

Following the acquisition of Elisra’s shares in the fourth quarter of 2005, the Company identified and wrote-off duplicated inventories and equipment in the amount of $3,488 which was recorded as restructuring costs in the cost of revenues.

I. In October 2005, the Company invested an amount of $2.5 million in Chip PC Ltd. (“Chip PC”), an Israeli company, for a 20% interest in Chip PC.

Chip PC develops and manufactures “Post PC” solutions, focused on enabling server-based-computing technologies to replace traditional PCs and deploy and control large numbers of workstations.

The excess of the amount paid for the Chip PC shares acquired over their book value is approximately $2.4 million. Based on a PPA performed by an independent advisor, this excess was allocated mainly to technology ($1.6 million) to be amortized by a straight-line method over a period of 5 - 8 years and to goodwill ($1.1 million).

J. The financial results of the business acquired are included in the Company's consolidated financial statements from the date of acquisition. In October 2005, the Company established a U.K. subsidiary – UAV Tactical Systems Ltd. ("U-Tacs"), in which the Company holds 51% and the rest of the shares are held by Thales U.K.. U-Tacs will be the manufacturing and support center of the Watchkeeper program – an Unmanned Air Vehicle (UAV) program for the U.K. MOD.

U-Tacs will establish the capabilities to design, manufacture, integrate and fly tactical UAV systems, consisting of air vehicles, ground control stations, data links, payloads and launch and recovery subsystems.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP"). As applicable to the consolidated financial statements of the Group, such principles are substantially identical to accounting principles generally accepted in Israel, except as described in Note 23.

A. USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported and disclosure of contingent assets and liabilities in the financial statements and accompanying notes. Actual results could differ from those estimates.

B. FINANCIAL STATEMENTS IN U.S. DOLLARS

The Company's revenues are generated mainly in U.S. dollars. In addition, most of the Company's costs are incurred in U.S. dollars. The Company's management believes that the U.S. dollar is the primary currency of the economic environment in which the Company operates. Thus, the functional and reporting currency of the Company is the U.S. dollar.

Transactions and balances originally denominated in U.S. dollars are presented at their original amounts. Transaction and balances in other currencies have been remeasured into U.S. dollars in accordance with principles set forth in SFAS No. 52 "Foreign Currency Translation". All exchange gains and losses from the remeasurement mentioned above are reflected in the statement of income in financial income or expenses.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

B. FINANCIAL STATEMENTS IN U.S. DOLLARS (Cont.)

For those foreign subsidiaries whose functional currency has been determined to be other than the U.S. dollar, assets and liabilities are translated at year-end exchange rates and statement of income items are translated at average exchange rates prevailing during the year. Resulting translation adjustments are recorded as a separate component of accumulated other comprehensive income in shareholders' equity.

C. PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly and majority-owned subsidiaries.

The consolidated subsidiaries include El-Op, ESA and other Israeli and non-Israeli subsidiaries.

Intercompany transactions and balances including profit from intercompany sales not yet realized outside the Group have been eliminated upon consolidation.

D. CASH EQUIVALENTS

Cash equivalents, are short-term highly liquid investments that are readily convertible to cash with maturities of three months or less at the date of acquisition.

E. SHORT-TERM BANK DEPOSITS

Short-term bank deposits are deposits with maturities of more than three months but less than one year. The short–term bank deposits are presented at their cost.

F. MARKETABLE SECURITIES

Investments in a marketable securities are classified as trading securities according to Statement of Financial Accounting Standard No. 115 "Accounting for Certain Investments in Debt and Equity Securities", ("SFAS No. 115"). Accordingly, these securities are stated at fair market value, with gains and losses, net of taxes, reported as finance income (loss).

G. INVENTORIES

Inventories are stated at the lower of cost or net realizable value. Inventory write-offs are provided for slow-moving items or technological obsolescence for which recoverability is not probable.

Cost is determined as follows:

- Raw materials using the average cost method.

G. INVENTORIES (Cont.)

- Costs incurred on long-term contracts in progress include direct labor costs, material costs, subcontractors, other direct costs and overheads. These costs represent recoverable costs incurred for production, allocable operating overhead cost and, where appropriate, research and development costs (refer to Note 2(T)).
- Labor overhead is generally included in our hourly rate and is allocated to each project according to the amount of hours invested. Material overhead is allocated to each project based on the value of direct material that is charged to the project.

Advances from customers are allocated to the applicable contract inventories and are presented as net amounts. Advances in excess of related inventories are classified as liabilities.

H. INVESTMENT IN AFFILIATED COMPANIES, PARTNERSHIP AND OTHER COMPANIES

Investments in non-marketable shares of companies in which the Group holds less than 20% and the Group does not have the ability to exercise significant influence over operating and financial policies of the companies are recorded at cost.

Investments in companies and partnership over which the Group can exercise significant influence (generally, entities in which the Group holds between 20% and 50% of voting rights) are presented using the equity method of accounting. Profits on intercompany sales, not realized outside the Group, were eliminated. The Group discontinues applying the equity method when its investment (including advances and loans) is reduced to zero and it has not guaranteed obligations of the affiliate or otherwise committed to provide further financial support to the affiliate.

A change in the Company's proportionate share of a subsidiary's or investee's equity, resulting from issuance of shares by the subsidiary or investee to third parties, is recorded as a gain or loss in the consolidated income statements. If the realization is not assured, such as when the issuing company is a development stage company, the gain from issuance is accounted for as an equity transaction pursuant to SAB 51 "Accounting Sales of Stock by a Subsidiary".

Management evaluates investments in affiliates and other companies for evidence of other than temporary declines in value. When relevant factors indicate a decline in value that is other than temporary the Company records a provision for the decline in value. A judgmental aspect of accounting for investments involves determining whether an other-than-temporary decline in value of the investment has been sustained. Such evaluation is dependent on the specific facts and circumstances. Accordingly, management evaluates financial information (e.g. budgets, business plans, financial statements, etc.) in determining whether an other-than-temporary decline in value exists. Factors indicative of an other-than-temporary decline include recurring operating losses, credit defaults and subsequent rounds of financings at an amount below the cost basis of the investment. This list is not all inclusive and management weighs all quantitative and qualitative factors in determining if an other-than-temporary decline in value of an investment has occurred. The results of 2005 include impairment loss related to its investment in ISI (see Note 6(B)2)).

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

I. LONG-TERM TRADE RECEIVABLES

Long-term trade receivables, from extended payment agreements, are recorded at their estimated present values (determined based on the original market rates of interest).

J. LONG-TERM BANK DEPOSITS

Long-term bank deposits are deposits with maturities of more than one year. These deposits are presented at cost including accumulated interest.

K. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost, net of accumulated depreciation and investment grants. For equipment produced for the Group's own use, cost includes materials, labor and overhead, but not in excess of the fair value of the equipment.

Depreciation is calculated by the straight-line method over the estimated useful life of the assets at the following annual rates:

	%	
Buildings	2-4	
Instruments, machinery and equipment	6-33	
Office furniture and other	6-33	
Motor vehicles	12-33	(mainly 15%)

Land rights and leasehold improvements – generally over the term of the lease.

L. INVESTMENT GRANTS

As a governmental incentive for industrial companies in Israel, the "Investment Center", which is a branch of the Israel Ministry of Industry and Trade, permits industrial companies to submit a request to qualify as an "Approved Enterprise". An Approved Enterprise is entitled to certain benefits in respect of capital investments. The benefits may be in the form of reduced tax rates and of capital grants received as a percentage of the investments of the Approved Enterprise. The amount of a capital grant is determined as a percentage of the Approved Enterprise investment in property, plant and equipment. As a condition to the granting of these benefits, the Approved Enterprise is obligated to perform the applicable industrial plan as detailed in the request to the Investment Center (see Note 16(A)(3) and 17(J)). These capital grants are non-royalty bearing and are not conditioned on the results of operations. As the capital grants are a direct participation in the cost of the acquisition of property, plant and equipment they are offset against property, plant and equipment.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

M. IMPAIRMENT OF LONG-LIVED ASSETS

The Group's long-lived assets and identifiable intangible assets are reviewed for impairment in accordance with SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If an asset is determined to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value.

N. INTANGIBLE ASSETS

Intangible assets are stated at cost net of accumulated amortization. Intangible assets are being amortized over their useful life using the straight-line method.

O. GOODWILL

Goodwill represents the excess of the cost of acquired businesses over the net fair values of the assets acquired and liabilities assumed. Under SFAS No. 142, effective as of January 1, 2002, goodwill is no longer amortized, but is instead tested for impairment at least annually (or more frequently if impairments indicators arise).

SFAS 142 prescribes a two phase process for impairment testing of goodwill. The first phase screens for impairment, while the second phase (if necessary) measures impairment.

In the first phase of impairment testing, goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. If the carrying value of the reporting unit exceeds its fair value, the second phase is then performed. The second phase of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess.

Fair value of a reporting unit is determined using the discounted future cash flows method. Significant estimates used in the methodology include estimates of future cash flows, future short-term and long-term growth rates and weighted average cost of capital for each of the reporting units.

As of December 31, 2005, no impairment losses have been identified.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

P. SEVERANCE PAY

Under Israeli law and employment agreements, the Group's companies in Israel are required to make severance payments and, in certain situations, pay pensions to terminated employees. The calculation is based on the employee's latest salary and the period of his/her employment.

The Group's companies in Israel records a liability for the amount that would have to be paid to the employees as severance payment in the event of the companies shut down

The companies' obligation for severance pay and pension is provided by monthly deposits with insurance companies, pension funds and by an accrual. The value of severance pay funds is presented in the balance sheet and includes profits accumulated to balance sheet date. The amounts deposited may be withdrawn only after fulfillment of the obligations pursuant to Israeli severance pay law or labor agreements. The values of the deposited funds are based on the cash surrendered value of these funds and include immaterial profits.

Severance pay expenses for the years ended December 31, 2005, 2004 and 2003, amounted to approximately $17,500, $15,574 and $11,491, respectively.

Q. REVENUE RECOGNITION

The Group generates revenues from long-term contracts involving the design, development, manufacture and integration of defense systems and products and providing support and services for such systems and products.

Revenues from long-term contracts are recognized based on Statement of Position 81-1 "Accounting for Performance of Construction-Type and Certain Production-Type Contracts" ("SOP 81-1") according to which revenues are recognized on the percentage-of-completion basis.

Sales under long-term fixed-price contracts which provide for a substantial level of development efforts in relation to total contract efforts are recorded using the cost-to-cost method of accounting as the basis to measure progress toward completing the contract and recognizing revenues. According to this method, sales and profits are recorded based on the ratio of costs incurred to estimated total costs at completion. In certain circumstances, when measuring progress toward completion, the Company considers other factors, such as achievement of performance milestones.

Sales and anticipated profit under long-term fixed-price production type contracts are recorded on a percentage-of-completion basis, using the units-of-delivery as the basis to measure progress toward completing the contract and recognizing revenues.

Sales and anticipated profit under long-term fixed-price contracts that involve both development and production are recorded on a percentage-of-completion basis, using the cost-to-cost method and units-of-delivery method as applicable. In certain circumstances, when

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Q. REVENUE RECOGNITION (Cont.)

measuring progress toward completion under the development portion of the contract, the Company considers other factors, such as achievement of performance milestones.

The percentage-of-completion method of accounting requires management to estimate the cost and gross profit margin for each individual contract. Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original estimated forecasts. Such changes in estimated gross profit are recorded in results of operations when they are reasonably determinable by management, on a cumulative catch-up basis. Anticipated losses on contracts are charged to earnings when determined to be probable.

Sales under cost-reimbursement-type contracts are recorded as costs are incurred. Applicable estimated profits are included in earnings in the proportion that incurred costs bear to total estimated costs.

Amounts representing contract change orders, claims or other items are included in sales only when they can be reliably estimated and realization is probable. Penalties and awards applicable to performance on contracts are considered in estimating sales and profit rates and are recorded when there is sufficient information to assess anticipated contract performance.

The Group believes that the use of the percentage-of-completion method is appropriate as the Group has the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, contracts executed include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged and the manner and terms of settlement. In all cases the Group expects to perform its contractual obligations, and its customers are expected to satisfy their obligations under the contract

In cases where the contract involves the delivery of products and performance of services, the Group follows the guidelines specified in EITF 00-21, “Revenue Arrangements with Multiple Deliverables” in order to allocate the contract fees between the products accounted for under SOP 81-1 and the services accounted for under SAB 104. The services are recognized throughout the service period.

In certain circumstances, sales under short-term fixed-price production type contracts are accounted for in accordance with SAB No. 104, "Revenue Recognition in Financial Statements" ("SAB 104"), and recognized when the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the seller's price to the buyer is fixed or determinable, no further obligation exists and collectability is reasonably assured.

As for research and development costs accounted for as contract costs refer to Note 2(T).

U. S. dollars (In thousands)

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

R. PRE-CONTRACT COSTS

Pre-contract costs are deferred and included in inventory, only when such costs can be directly associated with a specific anticipated contract and if their recoverability from the specific contract is probable according to the guidelines of SOP 81-1.

S. WARRANTY

The Group estimates the costs that may be incurred under its basic warranty and records a liability in the amount of such costs at the time revenue is recognized. The specific terms and conditions of those warranties vary depending upon the product sold and the country in which the Group does business. Factors that affect the Group's warranty liability include the number of delivered products, engineering estimates and anticipated rates of warranty claims. The Group periodically assesses the adequacy of its recorded warranty liability and adjusts the amount as necessary.

Changes in the Group's provision for warranty, which is included in the Company's balance sheet, during the years, are as follows:

	2005	2004
Balance, at January 1	$ 34,230	$ 36,653
Warranties issued during the year	19,223	17,907
Warranties forfeited or exercised during the year	(21,656)	(20,330)
Balance, at December 31	$ 31,797	$ 34,230

T. RESEARCH AND DEVELOPMENT COSTS

Research and development costs, net of participations, are charged to operations as incurred. Group sponsored research and development costs primarily include independent research and development and bid and proposal efforts.

Under certain arrangements in which a customer participates in product development costs, the Group's portion of such unreimbursed costs is expensed as incurred. Customer-sponsored research and development costs incurred pursuant to contracts are accounted for as part of the contract costs.

Certain Group companies in Israel receive grants (mainly royalty-bearing) from the Government of Israel and from other sources for the purpose of funding approved research and development projects. These grants are recognized as a deduction from research and development costs at the time the applicable company is entitled to such grants on the basis of the research and development costs incurred.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

U. INCOME TAXES

The Group accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes". This Statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Group provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

V. CONCENTRATION OF CREDIT RISKS

Financial instruments that potentially subject the Group to concentrations of credit risk consist principally of cash and cash equivalents, short and long-term deposits and trade receivables.

The majority of the Group’s cash and cash equivalents and deposits are invested in dollar instruments with major banks in Israel and in the United States Management believes that the financial institutions that hold the Group investments are financially sound, and accordingly, minimal credit risk exists with respect to these investments.

The Group’s trade receivables are derived primarily from sales to large and stable customers and governments located mainly in Israel, the United States and Europe. The Group performs ongoing credit evaluations of its customers and to date, has not experienced any unexpected material losses except for a one-time loss in 2002 of approximately $4,600 due to the insolvency of one of the Group’s customers. An allowance for doubtful accounts is determined with respect to those amounts that the Group has determined to be doubtful of collection.

W. DERIVATIVE FINANCIAL INSTRUMENTS

Financial Accounting Standards Board Statement No. 133, “Accounting for Derivative Instruments and Hedging Activities” (“SFAS No. 133”), requires companies to recognize all derivative instruments as either assets or liabilities in the statement of financial position at fair value. The accounting for changes in the fair value (i.e. gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operation.

For derivative instruments that are designated and qualify as a fair value hedge (i.e., hedging the exposure to changes in the fair value of an asset or a liability or an identified portion thereof that is attributable to a particular risk), the effective portion of the gain and loss on the

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

W. DERIVATIVE FINANCIAL INSTRUMENTS (Cont.)

derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in the same line item associated with the hedged item in current earnings during the period of the change in fair value. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the fair value of the asset or liability hedge, if any, is recognized as financial expense in current earnings during the period of change. For derivative instruments that are designated and qualify as a cash flow hedge (i.e. hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same line item associated with the forecasted transaction in the same period or periods during which the hedged transaction affects earnings.

The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized as a financial expense in current earnings during the period of change.

For derivative instruments not designated as hedging instruments, the gain or loss is recognized as a financial expense in current earnings during the period of change.

As part of its hedging strategy, the Group enters into forward exchange contracts in order to protect the Group from the risk that the eventual dollar cash flows from the sale of products to international customers will be adversely affected by changes in the exchange rates.

As part of its cash flow hedging strategy the Group enters into forward exchange contracts to hedge forecasted salary expenses denominated in a currency other than the U.S. dollar.

As of December 31, 2005, the Group had forward contracts with a notional amount of approximately $220,000 to purchase and sell foreign currencies ($22,000 in Euro, $194,000 in Great Britain Pounds (“GBP”) and $4,000 in other currencies).

The fair value of the foreign exchange contracts and the options as of December 31, 2005 is approximately $6,300.

X. STOCK-BASED COMPENSATION

Up until January 1, 2004, the Company elected to follow Accounting Principles Board Opinion No. 25 (“APB 25”) “Accounting for Stock Issued to Employees” and FASB Interpretation No. 44 (“FIN 44”) “Accounting for Certain Transactions Involving Stock Compensation” in accounting for its employee stock option plans. Under APB 25, the Company accounted for stock option grants using the intrinsic value method whereby compensation expense is equal to the excess, if any, of the quoted market price of the stock over the exercise price at the grant date of the award or if applicable at a subsequent measurement date. The Company recognized the expense over the vesting period of the award

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

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

X. STOCK-BASED COMPENSATION (Cont.)

on a straight-line basis. Phantom options were accounted for as variable awards and accordingly, compensation expenses were measured at the end of each reporting period and amortized on an accelerated basis over the remaining vesting period (See Note 18).

Effective January 1, 2004, the Company adopted the fair value recognition provisions of SFAS No. 123. Under the modified prospective method of adoption selected by the Company under the provisions of SFAS No. 148, the recognition provisions are applied to all employee awards granted, modified, or settled after January 1, 2004, and to previously granted awards that were not fully vested on the date of adoption. Compensation cost is recorded over the vesting period on a straight-line basis.

The cumulative effect on deferred taxes relating to stock based compensation resulting from the adoption of SFAS No. 123 amounted to a reduction of $152 and was recorded as a one-time adjustment to additional paid-in capital in 2004.

If the Company had elected to adopt the fair value recognition provisions of SFAS No. 123 as of its original effective date, pro forma net income and pro forma basic diluted net income per share for the three years ended December 31, 2005 would be as follows:

	Year ended December 31,		
	2005	2004	2003
Net income as reported	$ 32,487	$ 51,873	$ 45,945
Add - Stock based compensation expense (income), net of related tax effects as reported (intrinsic method in 2003)	172	2,710	3,793
Deduct – Stock based compensation expense under fair value based method of SFAS 123 net of related of tax effects	(172)	(2,710)	(2,956)
Pro forma net income	$ 32,487	$ 51,873	$ 46,782
Net earnings per share:			
Basic net earnings per share as reported	$ 0.80	$ 1.30	$ 1.18
Diluted net earnings per share as reported	$ 0.78	$ 1.26	$ 1.14
Pro forma basic net earnings per share	$ 0.80	$ 1.30	$ 1.20
Pro forma diluted net earnings per share	$ 0.78	$ 1.26	$ 1.16

U. S. dollars (In thousands)

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

X. STOCK-BASED COMPENSATION (Cont.)

The fair value for these options was estimated using a Black-Scholes option pricing model with the following weighted average assumptions:

	2005	2004	2003
Divided yield	2.25%	2.2%	2.19%
Expected volatility	25.6%	26.7%	19.03%
Risk-free interest rate	4.5%	4%	1.20%
Expected life	4 years	4 years	6 years

Y. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount reported in the balance sheet for cash and cash equivalents, short-term bank deposits, trade receivables, short-term bank credit and loans and trade payables approximate their fair values due to the short-term maturities of such instruments.

The carrying amount of the trading securities is recorded according to its fair market value, as determined by quoted market prices on the stock exchange.

Long-term loans are estimated by discounting the future cash flows using current interest rates for loans of similar terms and maturities. The carrying amount of the long-term loans approximates their fair value.

The fair value of foreign currency contracts (used for hedging purposes) is estimated by obtaining current quotes from investment bankers.

It was not practicable to estimate the fair value of the Group's investments in shares of non-public companies that are accounted for under the cost and equity method because of the lack of a quoted market price and the inability to obtain valuation of each company without incurring excessive costs. The carrying amounts of these companies as of December 31, 2004 and 2005 were $44,869 and $45,197, respectively, and represent the original cost of acquisition, and in the case of affiliates also the Company's equity in the earnings/losses of the affiliates and its share in the changes of the affiliates' equity since the dates of acquisition. As noted in Note H above, management is constantly monitoring such investments for other-than-temporary decline in value.

Z. BASIC AND DILUTED NET EARNINGS PER SHARE

Basic net earnings per share are computed based on the weighted average number of ordinary shares outstanding during each year. Diluted net earnings per share is computed based on the weighted average number of ordinary shares outstanding during each year, plus dilutive potential ordinary shares considered outstanding during the year. Outstanding stock options are excluded from the calculation of the diluted net earnings per ordinary share when such securities are anti-dilutive. In all the years presented no stock options were excluded.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

AA. VARIABLE INTEREST ENTITIES

FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulleting No. 51" ("FIN 46") provides a new framework for identifying Variable Interest Entities ("VIE's") and determining when a company should include the assets, liabilities, non-controlling interests and results of activities of a VIE in its consolidated financial statements.

In general, a VIE is an entity that either (1) has an insufficient amount of equity to carry out its principal activities, without additional subordinated financial support, (2) has a group of equity owners that are unable to make significant decisions about the entity's activities, or (3) has a group of equity owners that do not have the obligation to absorb the entity's losses or the right to receive returns generated by its operations. FIN 46 requires the consolidation of a VIE by the primary beneficiary. The primary beneficiary is the entity that absorbs a majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity.

U-TacS is considered to be a variable interest entity. As the Company is the primary beneficiary, U-TacS is consolidated in the Company's financial statements.

AB. IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

(1) On December 2004, the FASB issued the revised FAS No. 123, "Share-Based Payment" ("FAS 123(R)"), which addresses the accounting for share-based payment transactions in which the Company obtains employee services in exchange for: (a) equity instruments of the Company; or (b) liabilities that are based on the fair value of the Company's equity instruments or that may be settled by the issuance of such equity instruments. This Statement eliminates the ability to account for employee share-based payment transactions using APB 25, "Accounting for Stock Issued to Employees", and requires instead that such transactions be accounted for using the grant-date fair value based method. This Statement 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 for companies with fiscal years ending December 31 (such as the Company) to January 1, 2006. This Statement applies to all awards granted or modified after the Statement's effective date. In addition, compensation cost for the unvested portion of previously granted awards that remain outstanding on the Statement's effective date shall be recognized on or after the effective date, as the related services are rendered, based on the awards' grant-date fair value as previously calculated for the pro-forma disclosure under SFAS 123. In March 2005, the SEC released SEC staff Accounting Bulletin No.107 (SAB 107), "Share-Based Payment" (SAB 107"). SAB 107 provides the SEC staff's position regarding the application of statement 123(R) and contains interpretive guidance related to the interaction between Statement 123(R) 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.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

AB. IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS (Cont.)

(2) The Company adopted the fair-value-based method of accounting for share-based payments effective January 1, 2004 using the “modified prospective method” described in FASB Statement No. 148, “Accounting for Stock-Based Compensation – Transition and Disclosure”. Currently, the Company uses the Black-Scholes-Merton formula to estimate the value of stock options granted to employees. The Company does not anticipate that adoption of SFAS 123(R) and SAB 107 will have a material impact on its results of operations or its financial position. However, SFAS 123(R) also requires that the benefits of tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after the effective date. While the Company cannot estimate what those amounts will be in the future (because they depend on, among other things, when employees exercise stock options), the amount of operating cash flows recognized in prior periods for such excess tax deductions was $652, $1,179 and $758 in 2005, 2004 and 2003, respectively.

(3) 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.

(4) In June 2005, the Emerging Issues Task Force ("EITF") released Issue No. 04-5 "Determining Whether a General Partner, or the General Partner as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights" ("EITF 04-5"). EITF 04-5 provides guidance in determining whether a general partner controls a limited partnership and therefore should consolidate the limited partnership. EITF 04-5 states that the general partner in a limited partnership is presumed to control that limited partnership and that the presumption may be overcome if the limited partners have either (1) the substantive ability to dissolve or liquidate the limited partnership or otherwise remove the general partner without cause or (2) substantive participating rights. The effective date for applying the guidance in EITF 04-5 was (1) June 29, 2005 for all new limited partnerships and existing limited partnerships for which the partnership agreement was modified after that date and (2) no later than the beginning of the first reporting period in fiscal years beginning after December 15, 2005, for all other limited partnerships.

The Company estimates that the adoption of EITF 04-5 will not have a significant impact on its financial position.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

AB. IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS (Cont.)

(5) In November 2005, the FASB issued FSP FAS 115-1. The FSP addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary and the measurement of an impairment loss. The FSP also includes accounting considerations subsequent to the recognition of other than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The guidance in this FSP amends SFAS No. 115, “Accounting for Certain Investments in Debt and Equity”. The FSP replaces the impairment evaluation guidance of EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments", with references to the existing other-than-temporary impairment guidance. The FSP clarifies that an investor should recognize an impairment loss no later than when the impairment is deemed other-than-temporary, even if a decision to sell an impaired security has not been made. The guidance in this FSP is to be applied to reporting periods beginning after December 15, 2005. As of December 31, 2005, adoption of FSP FAS 115-1 has not had a material impact on the Company's financial position or results of operations.

AC. RECLASSIFICATIONS

Certain financial statement data for prior years has been reclassified to conform to current year financial statement presentation.

U. S. dollars (In thousands)

Note 3 - TRADE RECEIVABLES, NET

Trade receivables

	December 31, 2005	December 31, 2004
Open accounts (*)	$ 254,056	$ 176,163
Unbilled receivables	95,854	41,717
Less - allowance for doubtful accounts	(3,221)	(3,064)
	$ 346,689	$ 214,816
(*) Includes affiliated companies	$ 6,283	$ 10,823

Note 4 - OTHER RECEIVABLES AND PREPAID EXPENSES

	December 31, 2005	December 31, 2004
Deferred income taxes	$ 18,708	$ 21,355
Prepaid expenses	22,065	16,621
Government institutions	9,451	5,719
Employees	1,029	1,204
Others	15,843	6,895
	$ 67,096	$ 51,794

Note 5 - INVENTORIES, NET OF ADVANCES

	December 31, 2005	December 31, 2004
Cost incurred on long-term contracts in progress	$ 311,800	$ 254,009
Raw materials	84,343	70,813
Advances to suppliers and subcontractors	40,095	21,164
	436,238	345,986
Less -		
Cost incurred on contracts in progress deducted from customer advances	16,178	14,533
	420,060	331,453
Less -		
Advances received from customers (*)	84,083	75,776
Provision for losses	7,549	7,636
	$ 328,428	$ 248,041

The Company has transferred legal title of inventories to certain customers as collateral for advances received.

(*) Advances are allocated to the relevant inventories on a per-project basis. In cases (projects) where the advances are in excess of the inventories, the net amount is presented as a liability. In cases where the inventories are in excess of advances received, the net amount is included in inventories.

U. S. dollars (In thousands)

Note 6 - INVESTMENTS IN AFFILIATED COMPANIES, PARTNERSHIP AND OTHER COMPANIES

A. Investments in companies accounted for under the equity method:

	December 31, 2005	December 31, 2004
Tadiran (1)	$ 156,142	$ 14,749
SCD (2)	25,059	$ 19,186
VSI (3)	6,451	6,966
RedC (4)	-	3,100
Opgal (5)	3,380	2,873
Chip PC (6)	2,516	-
Others (8)	1,446	999
	$ 194,994	$ 47,873

(1) Tadiran Communications Ltd. ("Tadiran") – a publicly-traded 40%-owned subsidiary registered in Israel, is involved in the worldwide market for military communications systems and equipment and is also active in the civilian communications market.

(2) Semi Conductor Devices ("SCD") is an Israeli partnership, held 50% by the Company and 50% by Rafael Armaments Development Authority Ltd. ("Rafael"). SCD is engaged in the development and production of various thermal detectors and laser diodes. SCD is jointly controlled and therefore is not consolidated in the Company's financial statements.

(3) Vision Systems International LLC ("VSI") based in San Jose, is a California limited liability company that is held 50% by ESA and 50% by a subsidiary of Rockwell Collins Inc. VSI operates in the area of helmet mounted display systems for fixed wing military and paramilitary aircraft. VSI is jointly controlled and therefore is not consolidated in the Company's financial statements.

(4) RedC Optical Networks Inc. ("RedC"), a company registered in Delaware, is engaged in the multi-focal optic communications sector and as of December 31, 2003 was held 36.5% by El-Op. RedC designs develops and manufactures optical amplifiers for dense wave-length multiplexing optical networks for telecommunications.

In November 2004, El-Op acquired all of the outstanding voting Preferred A shares of RedC from MRV Communications Inc. for a consideration of $2,000, in accordance with El-Op's right of first refusal based on the Preferred A shares investment agreement. Prior to the acquisition, El-Op held 57% of the ordinary shares of RedC which reflected 36.5% of its voting rights. Following the acquisition, El-Op held 57% of the ordinary shares and 100% of the Preferred A shares, which reflected 72.5% of RedC's voting rights.

Note 6 - INVESTMENTS IN AFFILIATED COMPANIES, PARTNERSHIP AND OTHER COMPANIES (Cont.)

A. Investments in companies accounted for under the equity method (Cont.)

In December 2004, El-Op signed a Transfer Agreement for selling all of its holdings in RedC, including the Ordinary shares and Preferred A shares, in consideration for $3,100, which was paid in cash on the closing date in January 2005. The closing was subject to certain conditions, which were all met by January 21, 2005. In January 2005, El-Op sold its shares in RedC for $3,100 in cash.

El-Op allocated the purchase price to the fair value of the assets acquired and liabilities assumed.

Such allocation resulted in negative goodwill amounting to approximately to $1,100. Since RedC had no assets which could be reduced by the negative goodwill, according to the provisions of FAS 141, this goodwill was recorded as other income in the financial statements.

(5) Opgal Optronics Industries Ltd. (“Opgal”) is an Israeli company owned 50.1% by the Company and 49.9% by a subsidiary of Rafael. Opgal focuses mainly on commercial applications of thermal imaging and electro-optic technologies. The Company jointly controls Opgal with Rafael, and therefore Opgal is not consolidated in the Company’s financial statements.

(6) Chip PC is an Israeli company, of which approximately 20% is held by the Company. Chip PC develops and manufactures “Post PC” solutions, focused on enabling server-based-computing technologies to replace traditional PCs and deploy and control large numbers of workstations.

(7) Mediguide Inc. (“Mediguide”) and its Israeli subsidiary, Mediguide Ltd., were established in 2000 as a spin-off from the Company. The share capital of Mediguide consists of Common shares and Preferred A, B, C and D shares. The Common shares and the Preferred shares, both have voting rights. The Company holds all of the Common shares of Mediguide which constitute approximately 55% (41% on a fully diluted basis) of the voting rights of Mediguide. During 2001 - 2004, Mediguide issued Preferred shares to other investors in consideration for approximately $34,355. The Preferred shares issued entitle the other investors to preference rights senior to all other classes of shares previously issued by Mediguide in a liquidation or a deemed liquidation event. Therefore, the Company did not record any gain as a result of the above transaction. In addition, the Preferred shares entitle their holders to certain participating rights. Accordingly, based on the guidance in EITF 96-16, the Company does not consolidate Mediguide. The carrying value of the investment in Mediguide is zero.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

U. S. dollars (In thousands)

Note 6 - INVESTMENTS IN AFFILIATED COMPANIES, PARTNERSHIP AND OTHER COMPANIES (Cont.)

A. Investments in companies accounted for under the equity method (Cont.)

(8) The summarized financial information regarding Tadiran (see Note 1(G)) is as follows:

Balance Sheet Information:

	December 31, 2005	December 31, 2004
Current assets	$ 312,093	$ 296,668
Non-current assets	104,118	117,716
Total assets	416,211	414,384
Current liabilities	243,972	258,138
Non-current liabilities	43,840	36,097
Shareholders' equity	128,399	120,149
	$ 416,211	$ 414,384

Income Statement Information:

	Year ended December 31, 2005	Year ended December 31, 2004
Revenues	$ 271,424	$ 316,036
Gross profit	120,510	158,981
Net income	29,879	47,992

U. S. dollars (In thousands)

Note 6 - INVESTMENTS IN AFFILIATED COMPANIES, PARTNERSHIP AND OTHER COMPANIES (Cont.)

A. Investments in companies accounted for under the equity method (Cont.)

(9) The summarized aggregate financial information of companies accounted for under the equity method, excluding Tadiran (see Note 6(A) (8)) is as follows:

Balance Sheet Information:

	December 31, 2005	December 31, 2004
Current assets	$ 138,312	$ 124,352
Non-current assets	19,115	21,646
Total assets	157,427	145,998
Current liabilities	59,067	68,655
Non-current liabilities	13,622	3,868
Shareholders' equity	84,738	73,475
	$ 157,427	$ 145,998

Income Statement Information:

	Year ended December 31, 2005	2004	2003
Revenues	$ 266,841	$ 213,680	$ 183,426
Gross profit	63,938	55, 285	45,616
Net income	13,345	15,195	13,976

(10) See Note 17(F) for guarantees.

U. S. dollars (In thousands)

Note 6 - INVESTMENTS IN AFFILIATED COMPANIES, PARTNERSHIP AND OTHER COMPANIES (Cont.)

B. Investments in companies accounted for under the cost method

	December 31, 2005	December 31, 2004
Sultam (1)	$ 3,500	$ 3,500
ISI (2)	1,830	7,230
AAI (3)	1,000	1,000
Others	15	15
	$ 6,345	$ 11,745

(1) Sultam Systems Ltd. (“Sultam”), held 10%, is an Israeli company engaged in the development and manufacturing of military systems in the artillery sector.

(2) ImageSat International N.V. (“ISI”), held 14% (10% on a fully diluted basis), is engaged in the operation of satellite photography formations and commercial delivery of satellite photography for civil purposes. During the fourth quarter of 2005, the fair value of ISI decreased as a result of a decrease in ISI’s backlog and estimated future cash flows. Based on a valuation performed by an independent advisor, the Company wrote-off approximately $5,400 of its investment in ISI.

(3) AeroAstro Inc. (“AAI”), held 8.33% (on a fully diluted basis) is a Delaware corporation engaged in innovative micro and nanospacecraft applications. AAI manufactures low-cost satellite systems and components, used in its own spacecraft and for spacecraft development in and outside the U.S.

Note 7 - COMPENSATION RECEIVABLES IN RESPECT OF FIRE DAMAGE

	December 31, 2005
Receivables from insurance company (A)	25,884
Net of contingent to Koor (B)	10,354
	15,530

A. On March 17, 2001, a fire broke out in the manufacturing plants in two of Elisra’s subsidiaries ("the companies"). The fire caused damage to equipment, building, inventory and work in progress. The book value of the equipment, inventory and costs invested in the work in progress damaged by the fire together with the costs of repairing the building and other costs, are estimated at approximately $36 million. Up to December 31, 2005, advances were received from the insurance company in the aggregate amount of approximately $10 million.

Note 7 - COMPENSATION RECEIVABLES IN RESPECT OF FIRE DEMAGE (Cont.)

The claim submitted by the companies to the insurance company and which is based on the terms of the insurance policy, also includes a demand for consequential damages along with other damages that the companies believe are covered by the insurance policy. Therefore, the total amount of the claim is much higher than the book value of the damage and the cost of repairing the building.

The companies are taking legal action in order to receive the insurance amounts and they have also submitted a claim to the District Court of Tel-Aviv against the insurance company and its assessors, in the aggregate amount of $96 million. In light of the duration of the proceedings, the managements of the companies decided to classify the balance of the compensation receivable from the insurance company as a long-term receivable.

In April 2004, the companies filed a request with the Court, for issuance of a partial judgment, in the amount of $33 million (in excess of the advances already paid by the insurance company) based on the admission made by the insurance company and its representatives of an obligation deriving from the insurance event, while the dispute is regarding the amount of the damages.

In December 2004, a hearing was held in the Court wherein the force of a judgment was given to an agreement of the parties pursuant to which a separate bank account will be opened, in which the insurance company will deposit $15 million. Every withdrawal from such account requires approval of the Court until the proceedings on the claim are concluded. In accordance with the aforesaid agreement, the claim was transferred for mediation, and during this time the Court proceedings in the matter have been postponed. At the balance sheet date the mediation process has not yet been concluded.

In the opinion of the companies, based on, among other things, the opinion of their legal advisors regarding this matter, it is difficult at this stage to estimate the chances that the companies will receive the full amount of the claim, even though it is considered to be well founded. Nonetheless, the managements of the companies estimate, based, on the opinion of their legal advisors that the chances are good of receiving indemnification from the insurance company, in an amount greater than the balance of the receivable which they recorded as an asset in the financial statements.

B. In the agreement the Company signed with Koor, for the purchase of Elisra’s shares, it was agreed that the Company will pay Koor 40% of the consideration received from the insurance company, up to consideration of $30 million and 25-27.5% for additional consideration received (see Note 1(H)).

U. S. dollars (In thousands)

Note 8 - LONG–TERM BANK DEPOSITS AND TRADE RECEIVABLES

	December 31, 2005	December 31, 2004
Deposits with banks for loans granted to employees (*)	$ 1,200	$ 1,603
Long-term trade receivables	1,219	452
Other deposits with banks	38	47
	$ 2,457	$ 2,102

(*) The deposits are linked to the Israeli CPI, bear annual interest of 4% and are presented net of current maturities of $539 (2004 - $534).

Note 9 - PROPERTY, PLANT AND EQUIPMENT, NET

	December 31, 2005	December 31, 2004
Cost (1):		
Land, buildings and leasehold improvements (2)	$ 177,434	$ 151,432
Instruments, machinery and equipment (3)	333,527	222,313
Office furniture and other	37,836	26,521
Motor vehicles	49,538	37,308
	598,335	437,574
Accumulated depreciation	(313,338)	(193,286)
Depreciated cost	$ 284,997	$ 244,288

Depreciation expenses for the years ended December 31, 2005, 2004 and 2003 amounted to $44,576, $35,001 and $30,775, respectively.

(1) Net of investment grants received (mainly for instruments, machinery and equipment) in the amounts of approximately $ 32,879 and $29,800 as of December 31, 2005 and 2004, respectively.

(2) Includes, rights in approximately 9,225 square meters of land in Tirat Hacarmel, Israel. The land is leased from the Israel Land Administration until the years 2014 to 2024 with a renewal option for additional periods of up to 49 years. The Company's rights in the land have not yet been registered in its name.

Includes rights in approximately 10,633 square meters of land in Rehovot, Israel. The land is leased from the Israel Land Administration until the year of 2043 with a renewal option for additional periods of up to 49 years. The Company's rights in the land have not yet been registered in its name.

Includes rights in approximately 10,386 square meters of land in Bnei Brak, Israel. The land is leased from the Israel Land Administration until the year of 2022 with a renewal option for additional periods of up to 49 years. The Company's rights in the land have not yet been registered in its name.

U. S. dollars (In thousands)

Note 9 - PROPERTY, PLANT AND EQUIPMENT, NET (Cont.)

(3) Includes equipment produced by the Group for its own use in the aggregate amount of $82,518 and $69,146 as of December 31, 2005 and 2004, respectively.

(4) As for pledges of assets – see Note 17(I).

Note 10 -INTANGIBLE ASSETS, NET

A.

	Weighted average number of years of amortization	December 31, 2005	December 31, 2004
Original cost:			
Technology (1)	14	$ 108,786	$ 84,554
Trade marks (2)	17	8,000	8,000
		116,786	92,554
Accumulated amortization:			
Technology		35,707	28,365
Trade marks		2,308	1,908
		38,015	30,273
Amortized cost		$ 78,771	$ 62,281
Goodwill (3)		$ 63,957	$ 33,706

(1) The technology acquired consists of five major items as follows:

In 2000, the Company completed a merger with El-Op. A portion of the purchase price was allocated to technology ($45,000), based on an independent appraisal. The technology acquired in the merger with El-Op comprises various technologies relating to:

a. Diode pumped and other advanced solid-state lasers incorporating add-on eye-safety options.
b. Detectors for thermal imaging devices, including 2-D arrays for second and third generation forward looking infrared sensors.
c. Line of sight command, control and stabilization systems employing computerized digital controllers.
d. Sophisticated image and signal processing, utilizing modern equipment and software.
e. High precision mechanical and optical component design and manufacturing for the visible, ultraviolet and infrared–spectra, including special and exotic materials, diffractive and planar optics, space borne lightweight optics and multi-layer coatings.
f. Aviation instruments such as precision altimeters and air speedometers.

U. S. dollars (In thousands)

Note 10 -INTANGIBLE ASSETS, NET (Cont.)

In 2000, EFW Inc. acquired from Honeywell Inc., Honeywell's business relating to head-up displays and tracking systems for pilot helmets. An amount of $9,300 was allocated to the acquired technology based on its estimated fair value as prepared by the Company.

In 2001 and 2002, the Company acquired a Brazilian company which serves as a center for the production and logistic support of defense electronics programs in Brazil. An amount of $5,500 was allocated to technology related to the maintenance and support of avionic equipment.

In 2002, the Company acquired the business of the Defense Systems Division of Elron Telesoft in consideration for $5,700. An amount of $5,100 was allocated to the technology related to the government information technology control systems software developed by Elron Telesoft.

In 2005, the Company acquired 70% of Elisra's shares as detailed in Note 1(H) above, in consideration for $68,800. An amount of $21,300 was allocated to the technology related to electronic warfare (EW) systems, command communication (C^2) systems and data link products.

(2) Includes trade marks acquired in the merger with El-Op in 2000.

(3) Includes mainly goodwill resulting from the merger with El-Op ($34,200) in 2000, goodwill acquired from Honeywell Inc. ($1,800) in 2000 and goodwill resulting from the acquisition of Elisra ($29,900) in 2005.

B. Amortization expenses amounted to $7,742, $7,260 and $7,222 for the years ended December 31, 2005, 2004 and 2003, respectively.

C. The annual amortization expense relating to intangible assets other then goodwill existing as of December 31, 2005 is estimated to be approximately as follows:

2006	$ 8,200
2007	8,100
2008	7,800
2009	7,200
2010	6,500
Thereafter	41,000
Total	$ 78,800

U. S. dollars (In thousands)

Note 11 -SHORT-TERM BANK CREDIT AND LOANS

	December 31,			
	2005	2004	2005	2004
Short-term bank loans:	Interest Rate			
In U.S. dollars	6-6.2%	4.2-4.6%	$ 17,491	$ 3,967
Short-term bank credit:				
In NIS unlinked	5.8%	5.7-8.1%	2,828	2,120
In U.S. dollars	6-6.4%	4.4%	9,977	2,505
			12,805	4,625
			$ 30,296	$ 8,592
Weighted Average Interest Rate	5.9%	4.7%		

Note 12 -OTHER PAYABLES AND ACCRUED EXPENSES

	December 31,	
	2005	2004
Payroll and related expenses	$ 65,400	$ 42,491
Provision for vacation pay	32,879	26,936
Provision for income taxes, net of advanced paid	8,041	14,681
Provisions for royalties	22,943	20,638
Provision for warranty	31,797	34,230
Deferred income taxes	2,140	-
Cost provisions and others (*)	53,339	33,133
	$ 216,539	$ 172,109

(*) The other cost provision, primarily includes provisions for estimated future costs in respect of potential contractual penalties and the probable loss from claims (legal or unasserted) in the ordinary course of business (e.g. damages caused by the items sold and claims as to the specific products ordered).

Note 13 -CUSTOMERS ADVANCES AND AMOUNTS IN EXCESS OF COSTS INCURRED ON CONTRACTS IN PROGRESS

	December 31,	
	2005	2004
Advances received	$ 460,242	$ 180,738
Less -		
Advances presented under long-term liabilities	122,263	10,320
Advances deducted from inventories	84,083	75,776
	253,896	94,642
Less -		
Costs incurred on contracts in progress	16,178	14,533
	$ 237,718	$ 80,109

As for guarantees and liens see Note 17(F).

U. S. dollars (In thousands)

Note 14 -LONG-TERM LOANS

	Currency	Interest %	Years of maturity	December 31, 2005	December 31, 2004
Banks	U.S. dollars	Libor + 0.8%-2.3%	mainly 2-3	$ 229,370	$ 83,469
Office of Chief Scientist	NIS-linked to the Israeli-CPI	3.2%	2	2,713	4,131
Other				254	290
				232,337	87,890
Less-current maturities				7,355	1,656
				$ 224,982	$ 86,234

The Libor rate as of December 31, 2005 was 3.2%.

The maturities of these loans after December 31, 2005 are as follows:

2006 – current maturities	$ 7,355
2007	210,161
2008	9,865
2009	2,170
2010 and thereafter	2,611
	$ 232,337

See Note 17(G) for covenants.

During 2004, a subsidiary of the Company consolidated its long-term debt. As a result, all of the prior bank loans outstanding were paid in full. The Company's subsidiary increased this line during 2005 and maintains a single revolving credit facility of $120,000. The outstanding balance as of December 31, 2005 was $5,700. The stated interest rate on this facility is 7.25% Prime on $2,200 and Euro/Libor rate 4.4 + .75% on the Euro Loan Balance of $3,500. The note is scheduled to be renewed in 2007.

Note 15 -BENEFIT PLANS

ESA, the Company's subsidiaries in the U.S., has adopted for its employees in the U.S. benefits plans as follows:

Defined Benefit Retirement Plan

ESA has two defined benefit pension plans (the "Plans") substantially covering its employees in the U.S. Monthly benefits are based on years of benefit service and annual compensation. Annual contributions to the Plans are determined using the unit credit actuarial cost method and are equal to or exceed the minimum required by law. Pension fund assets of the Plans are invested primarily in stock, bonds and cash by a financial institution, as the investment manager of the Plans' assets.

U. S. dollars (In thousands)

Note 15 -BENEFIT PLANS (Cont.)

The following table reconciles the benefit obligations, Plans assets, funded status and net asset (liability) information of the Plans:

	December 31, 2005	December 31, 2004
Benefit obligation at beginning of year	$ 42,698	$ 34,965
Service cost	3,242	3,000
Interest cost	2,543	2,191
Amendments	321	-
Actuarial losses	3,516	2,308
Unrecognized transition obligation	-	1,056
Benefits repaid	(1,015)	(822)
Benefit obligation at end of year	$ 51,305	$ 42,698
Plans assets at beginning of year	25,102	21,196
Actual return on Plan assets	1,215	1,756
Contributions by employer	8,042	2,972
Benefits repaid	(1,015)	(822)
Plans assets at end of year	$ 33,344	$ 25,101
Funded status of Plans (underfunded)	(17,962)	(17,595)
Unrecognized prior service cost	156	180
Unrecognized transition obligation	-	1,056
Unrecognized net actuarial loss	15,480	11,447
Net amount recognized	$ (2,326)	$ (5,272)
Net asset (liability) consists of:		
Accrued benefit liability	$ (13,700)	$ (13,899)
Intangible asset	157	895
Accumulated other comprehensive income	11,217	7,732
Net amount recognized	$ (2,326)	$ (5,272)
Weighted average assumptions:		
Discount rate as of December 31,	5.75%	6.00%
Expected long-term rate of return on Plan's assets	8.50%	8.50%
Rate of compensation increase	3.00%	3.00%

	Year ended December 31, 2005	2004	2003
Components of net periodic pension cost:			
Service cost	$ 3,242	$ 3,000	$ 2,480
Interest cost	2,543	2,191	1,921
Expected return on Plans' assets	(2,133)	(1,951)	(1,573)
Amortization of prior service cost	(15)	(15)	(15)
Amortization of transition amount	69	-	-
Recognized net actuarial loss	569	451	339
Net periodic pension cost	$ 4,275	$ 3,676	$ 3,152

U. S. dollars (In thousands)

Note 15 -BENEFIT PLANS (Cont.)

	Year ended December 31,		
	2005	2004	2003
Additional information:			
Accumulated benefit obligation	$ 47,043	$ 39,001	$ 32,207
Increase in minimum liability included in otl comprehensive income	$ 3,486	$ 1,341	$ 1,392

Asset Allocation by Category

	2005	2004
Asset Category		
Equity Securities	65.9%	62.4%
Debt Securities	26.4%	28.5%
Other	7.7%	9.1%
Total	100.0%	100.0%

The investment policy of ESA is directed toward a broad range of securities. The diversified portfolio seeks to maximize investment return while minimizing the risk levels associated with investing. The investment policy is structured to consider the retirement plan's obligations and the expected timing of benefit payments. The target asset allocation for the Plan years presented is as follows:

	2005	2004
Asset Category		
Equity Securities	60.0%	60.0%
Debt Securities	37.0%	37.0%
Other	3.0%	3.0%
Total	100.0%	100.0%

In developing the overall expected long-term rate of return on assets assumption, ESA used a building block approach in which rates of return in excess of inflation were considered separately for equity securities, debt securities, real estate and all other assets. The excess returns were weighted by the representative target allocation and added along with an approximate rate of inflation to develop the overall expected long-term rate of return.

It is the policy of ESA to, at least, meets the ERISA minimum contribution requirements for a plan year. The minimum contribution requirements for the 2005 Plan year and the quarterly contributions requirements for the 2005 Plan year have been satisfied as of December 31, 2005. However, ESA anticipates that it will make an additional discretionary contribution of approximately $3,400 during 2006 in order to increase the Plan's funded current liability percentage. Benefit payments over the next five years are expected to be $1,384 in 2006; $1,566 in 2007; $1,744 in 2008; $2,024 in 2009 and $2,334 in 2010.

Note 15 -BENEFIT PLANS (Cont.)

Defined Contribution Plan

The 401(k) savings plan ("401(k) plan") is a defined contribution retirement plan that covers all eligible employees, as defined in section 401(k) of the U.S. Internal Revenue Code. ESA's employees may elect to contribute a percentage of their annual gross compensation to the 401(k) plan. ESA may make discretionary matching contributions as determined by the subsidiary. Total expense under the 401(k) plan amounted to $1,984 for the year ended December 31, 2005 (2004 - $1,744, 2003 - $1,629).

Note 16 -TAXES ON INCOME

A. APPLICABLE TAX LAWS

(1) Measurement of taxable income under Israel's Income Tax (Inflationary Adjustments) Law, 1985:

Results for tax purposes for the Company and certain of its Israeli subsidiaries are measured and reflected in accordance with the change in the Israeli Consumer Price Index ("CPI"). As explained above in Note 2(B), the consolidated financial statements are presented in U.S. dollars. The differences between the change in the Israeli CPI and in the NIS/U.S. dollar exchange rate cause a difference between taxable income and the income before taxes reflected in the consolidated financial statements.

In accordance with paragraph 9(f) of SFAS No. 109, the Company has not provided deferred income taxes on the above differences resulting from changes in exchange rates and indexing for tax purposes.

(2) Tax benefits under Israel's Law for the Encouragement of Industry (Taxes), 1969:

The Company and certain subsidiaries in Israel (mainly El-Op and Cyclone Aviation Products Ltd.) are "Industrial Companies", as defined by the Law for the Encouragement of Industry (Taxes), 1969, and as such, these companies are entitled to certain tax benefits, mainly amortization of costs relating to know-how and patents over eight years, accelerated depreciation and the right to deduct public issuance expenses for tax purposes.

(3) Tax benefits under Israel's Law for the Encouragement of Capital Investments, 1969:

Several expansion programs of the Company and certain of its Israeli subsidiaries ("the companies") have been granted "Approved Enterprise" status under Israel's Law for the Encouragement of Capital Investments, 1959. For some expansion programs, the companies have elected the grants track and for others they have elected the alternative tax benefits track, waiving grants in return for tax exemptions.

Note 16 -TAXES ON INCOME (Cont.)

(3) Tax benefits under Israel's Law for the Encouragement of Capital Investments, 1969 (Cont.):

Accordingly, certain income of the companies, derived from the "Approved Enterprise" expansion programs is tax exempt for two-years and subject to reduced tax rates of 25% for a five-year to eight-year period or tax exempt for a ten-year period commencing in the year in which the companies had taxable income (limited to twelve years from commencement of production or fourteen years from the date of approval, whichever is earlier). As of December 31, 2005, the tax benefits for these exiting expansion programs will expire within the period of 2006 to 2012.

The entitlement to the above benefits is subject to the companies fulfilling the conditions specified in the above referred law, regulations published hereunder and the letters of approval for the specific investments in "Approved Enterprises". In the event of failure to comply with these conditions, the benefits may be canceled and the companies may be required to refund the amount of the benefits, in whole or in part, including interest. (For liens – see Note 17(J)). As of December 31, 2005, Management believes that the companies are meeting all conditions of the approvals.

As of December 31, 2005, retained earnings included approximately $126,400 in tax-exempt profits earned by the companies' "Approved Enterprises". If the retained tax-exempt income is distributed, it would be taxed at the corporate tax rate applicable to such profits as if the Company had not elected the alternative tax benefits track (currently - 25%), and an income tax liability would be incurred of approximately $31,600 as of December 31, 2005.

The companies' boards of directors have decided that their policy is not to declare dividends out of such tax-exempt income. Accordingly, no deferred income taxes have been provided on income attributable to the companies' "Approved Enterprises", as such retained earnings are essentially permanent in duration.

In Israel, income from sources other than the "Approved Enterprise" during the benefit period will be subject to tax at the regular corporate tax rate of 34% (see also Note 16(H)).

Since the companies are operating under more than one approval, and since part of their taxable income is not entitled to tax benefits under the above mentioned law and is taxed at the regular tax rate of 34%, the effective tax rate is the result of a weighted combination of the various applicable rates and tax exemptions, and the computation is made for income derived from each approval on the basis of formulas specified in the law and in the approvals.

U. S. dollars (In thousands)

Note 16 -TAXES ON INCOME (Cont.)

B. NON – ISRAELI SUBSIDIARIES

Non-Israeli subsidiaries are taxed based on tax laws in their countries of residence (mainly in the U.S.).

C. INCOME BEFORE TAXES ON INCOME

	Year ended December 31, 2005	2004	2003
Income before taxes on income:			
Domestic	$ 27,391	$ 43,642	$ 38,423
Foreign	23,125	16,985	11,090
	$ 50,516	$ 60,627	$ 49,513

D. TAXES ON INCOME

	Year ended December 31, 2005	2004	2003
Taxes on income:			
Current taxes:			
Domestic	$ 5,161	$ 7,415	$ 12,346
Foreign	4,506	7,651	718
	9,667	15,066	$ 13,064
Deferred income taxes:			
Domestic	4,029	709	(4,672)
Foreign	2,639	(556)	2,942
	6,668	153	(1,730)
	$ 16,335	$ 15,219	$ 11,334

U. S. dollars (In thousands)

Note 16 -INCOME TAXES (Cont.)

E. DEFERRED INCOME TAXES

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of net deferred tax assets and liabilities are as follows:

		Deferred (1) Tax asset (liability)	
	Total	**Current**	**Non-current**
As of December 31, 2005			
Deferred tax assets:			
Reserves and allowances	$ 20,150	$ 15,520	$ 4,630
Inventory	8,059	8,059	-
Intangible assets	562	562	-
Net operating loss carryforwards	10,233	134	10,099
	39,004	24,275	14,729
Valuation allowance	(18,774)	(5,567)	(13,207)
Net deferred tax assets	20,230	18,708	1,522
Deferred tax liabilities:			
Reserves and allowances	1,480	3,295	(1,815)
Inventory	(5,435)	(5,435)	-
Property, plant and equipment	(15,842)	-	(15,842)
Intangible assets	(16,330)	-	(16,330)
	(36,127)	(2,140)	(33,987)
Valuation allowance	1,041	-	1,041
	(35,086)	(2,140)	(32,946)
Net deferred tax assets (liabilities)	$ (14,856)	$ 16,568	$ (31,424)
As of December 31, 2004			
Deferred tax assets:			
Reserves and allowances	$ 12,797	$ 13,191	$ (394)
Inventory	5,376	5,376	-
Intangible assets	2,639	2,639	-
Net operating loss carryforwards	5,395	149	5,246
	26,207	21,355	4,852
Valuation allowance	(3,445)	-	(3,445)
Net deferred tax assets	22,762	21,355	1,407
Deferred tax liabilities:			
Property, plant and equipment	(12,999)	-	(12,999)
Intangible assets	(12,924)	-	(12,924)
	(25,923)	-	(25,923)
Net deferred tax assets (liabilities)	$ (3,161)	$ 21,355	$ (24,516)

(1) The current tax asset is included in other receivables. Noncurrent tax liability is included as a long-term liability.

U. S. dollars (In thousands)

Note 16 -INCOME TAXES (Cont.)

F. As of December 31, 2005, The Group's Israeli subsidiaries have estimated total available carryforward tax losses of approximately $30,100, and the Group's non-Israeli subsidiaries have estimated available carryforward tax losses of approximately $7,400. These losses can be offset against future taxable profits for an indefinite period. Deferred tax assets in respect of the above carryforward losses amount to approximately $1,700 in respect of which a valuation allowance has been recorded in the amount of approximately $8,600.

G. Reconciliation of the theoretical tax expense, assuming all income is taxed at the statutory rate applicable to income of the Group, and the actual tax expense as reported in the statements of operations, is as follows:

	Year ended December 31,		
	2005	**2004**	**2003**
Income before taxes as reported in the consolidated statements of operations	$ 50,516	$ 60,627	$ 49,513
Statutory tax rate	34%	35%	36%
Theoretical tax expense	$ 17,175	$ 21,219	$ 17,825
Tax benefit arising from reduced rate as an "Approved Enterprise" and other tax benefits	(4,515)	(7,196)	(8,391)
Tax adjustment in respect of different tax rates for foreign subsidiaries	654	496	279
Operating carryforward losses for which valua allowance was provided	(818)	(434)	126
Increase (decrease) in taxes resulting from nondeductible expenses	1,309	1,095	993
Difference in basis of measurement for financi reporting and tax return purposes	2,547	(210)	846
Taxes in respect of prior years		-	-
Other differences, net	(17)	248	(344)
Actual tax expenses	$ 16,335	$ 15,219	$ 11,334
Effective tax rate	32.3%	25.1%	22.9%

H. AMENDMENT TO THE INCOME TAX ORDINANCE

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 change in the future tax rates, did not have a material effect on the Company's financial position and results of operations in 2005.

Note 17 -COMMITMENTS AND CONTINGENT LIABILITIES

A. ROYALTY COMMITMENTS

1. The Company and certain Israeli subsidiaries partially finance their research and development expenditures under programs sponsored by the OCS for the support of research and development activities conducted in Israel. At the time the participations were received, successful development of the related projects was not assured.

   In exchange for participation in the programs by the OCS, the Company and the subsidiaries agreed to pay 2% - 5% of total sales of products developed within the framework of these programs. The royalties will be paid up to a maximum amount equaling 100% to 150% of the grants provided by the OCS, linked to the dollar and for grants received after January 1, 1999, also bearing annual interest at a rate based on LIBOR. The obligation to pay these royalties is contingent on actual sales of the products, and in the absence of such sales payment of royalties is not required.

   In some cases, the Government of Israel participation (through the OCS) is subject to export sales or other conditions. The maximum amount of royalties is increased in the event of production outside of Israel.

   The Company and certain of its subsidiaries may also be obligated to pay certain amounts to the Israeli Ministry of Defense and others on certain sales including sales resulting from the development of certain technologies.

   Royalties expensed amounted to $4,849, $5,423 and $7,812 in 2005, 2004 and 2003, respectively.

2. In September 2001, the OCS issued “Regulations for the Encouragement of Research and Development in Industry” (rules for determining the level and payment of royalties) (the “regulations”). The regulations allow large R&D intensive companies to reach certain agreements with the OCS regarding determination of the amount and payment schedule of royalties, subject to certain conditions.

   If the Company elects to adopt the regulations, it will have to record a significant one-time expense resulting from accruing a liability for an absolute amount of royalties.

   In 2002, El-Op’s Board of Directors approved an arrangement, proposed by the OCS, according to which El-Op pays commencing in 2002, an agreed amount of $10,632 in exchange for a release from all obligations to pay royalties in the future. As a result, El-Op recorded an expense for the agreed amount net of the accrual for royalties previously recorded by El-Op in the amount of $9,801. This expense is included cost of revenues.

U. S. dollars (In thousands)

Note 17 -COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

B. COMMITMENTS IN RESPECT OF LONG-TERM PROJECTS

In connection with long-term projects in certain countries, the Company and certain subsidiaries undertook to use their respective best efforts to make or facilitate purchases or investments in those countries at certain percentages of the amount of the projects. The companies' obligation to make or facilitate third parties making such investments and purchases is subject to commercial conditions in the local market, typically without a specific financial penalty. The maximum aggregate undertaking as of December 31, 2005 amounted to $682,000 to be performed over a period of up to 10 years. This amount is typically tied to a percentage (up to 100%) of the amount of a specific contract.

In the opinion of the Company's Management, the actual amount of the investments and purchases is anticipated to be less than that mentioned above, since certain investments and purchases can result in reducing the overall undertaking on more than a one-to-one basis.

C. LEGAL CLAIMS

The Company and its subsidiaries are involved in legal claims arising in the ordinary course of business, including claims by employees, consultants and others. Company's Management, based on the opinion of its legal counsel, believes that the financial impact for the settlement of such claims in excess of the accruals recorded in the financial statements will not have a material adverse effect on the financial position or results of operations of the Group.

For information on Elisra's insurance claim for damage, as a result of a fire in 2001, see Note 7.

D. LEASE COMMITMENTS

The future minimum lease commitments of the Group under various non-cancelable operating lease agreements in respect of premises, motor vehicles and office equipment are as of December 31, 2005 as follows:

2006	$ 13,081
2007	10,348
2008	8,607
2009	8,047
2010 and thereafter	17,596
	$ 57,679

Rent expenses for the years ended December 31, 2005, 2004 and 2003 amounted to $ 8,055, $6,842 and $9,177, respectively.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

Note 17 -COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

E. PUT OPTION

Three founding employees (the “Founders”), who collectively hold approximately 32.3% of the outstanding shares of Kinetics Ltd. (“Kinetics”), a 51%-owned Israeli subsidiary, had a put option to jointly sell all of their shares in Kinetics to the Company. Two private investors holding in the aggregate approximately 16.7% of Kinetics' outstanding shares had "tag along" rights in the event the Founders exercise the put option.

The put option was exercisable from January 1, 2005 until December 31, 2005 at a price equal to the higher of the Founder’s pro-rata share (corresponding to the Founder’s shareholding percentage) of:

(1) The value of Kinetics as of the option exercise date as determined by a third party appraiser mutually acceptable to the Founders and to the Company. The appraiser was to value Kinetics as if Kinetics had distributed as dividends net profits accumulated up to the option exercise date; or

(2) $12,077, reduced by 3% per annum, or pro-rata part thereof, for the period beginning on July 1, 2003 and ending on the option exercise date.

The aforementioned option expired as of December 31, 2005.

F. GUARANTEES

1. As of December 31, 2005, guarantees in the amount of approximately $667,000 were issued by banks on behalf of Group companies in order to secure certain advances from customers and performance bonds.

2. The Company has provided, on a proportional basis to its ownership interest, guarantees for three of its investees in respect of credit lines granted to them from banks amounting to $13,300 (2004 - $12,000), of which $12,500 (2004 - $11,500) relates to a 50%-owned foreign investee. The guarantees will exist as long as the credit lines are in effect. The Company would be liable under the guarantee for any debt for which the investee would be in default under the terms of the credit line. The fair value of such guarantees as of December 31, 2005 is not material.

G. COVENANTS

In connection with bank credits and loans, including performance guarantees issued by banks and bank guarantees in order to secure certain advances from customers, the Company and certain subsidiaries are obligated to meet certain financial 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 December 31, 2005, the Company and its subsidiaries except Elisra were in full compliance with all covenants.

Note 17 -COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

G. COVENANTS (Cont.)

As at December 31, 2005, Elisra did not comply with some of the above-mentioned financial covenants. Nonetheless, subsequent to the balance sheet date, a letter was received from one of the banks, waving its demand for repayment of the loan for a period of 15 months from the balance sheet date. In addition, a letter was also received from the other bank that retroactively updates the financial covenants as at December 31, 2005 (based on the actual ratios at that time) and also provides updated financial covenants for the coming years. The bank will examine these updated financial covenants on December 31, 2006, and in Management's estimation Elisra will comply with those covenants at that date. Accordingly, loans, in the amount of $10 million, are classified as long-term loans.

H. CONTRACTUAL OBLIGATIONS

Substantially all of the purchase commitments relate to obligations under purchase orders and subcontracts entered into by the Company. These purchase orders and subcontracts are typically in a standard format proposed by the Company, with the subcontracts and purchase orders also reflecting provisions from the Company's applicable prime contract that are appropriate to flow down to subcontractors and vendors. The terms typically included in these purchase orders and subcontracts are consistent with Uniform Commercial Code provisions in the United States for sales of goods, as well as with specific terms called for by its customers in international contracts. These terms include the Company's right to terminate the purchase order or subcontract in the event of the vendor's or subcontractor's default, as well as the Company's right to terminate the order or subcontract for the Company's convenience (or if the Company's prime contractor has so terminated the prime contract). Such purchase orders and subcontracts typically are not subject to variable price provisions. As of December 31, 2005 and 2004 the purchase commitments were $661,000 and $345,000 respectively.

I. In order to secure bank loans and bank guarantees in the amount of $8,600 as of December 31, 2005, certain Group companies recorded fixed liens on most of their machinery and equipment, mortgages on most of their real estate and floating charges on most of their assets.

J. A lien on the Group's Approved Enterprises has been registered in favor of the State of Israel (see Note 16(A)(3) above).

Note 18 - SHAREHOLDER'S EQUITY

A. SHARE CAPITAL

Ordinary shares confer upon their holders voting rights, the right to receive dividends and the right to share in equity upon liquidation of the Company.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

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

Note 18 -SHAREHOLDER'S EQUITY (Cont.)

B. 2000 EMPLOYEE STOCK OPTION PLAN

In 2000, the Company adopted an employee stock option plan for employees comprising options to purchase up to 2,500,000 ordinary shares. The exercise price approximates the market price of the shares at the grant date. The plan includes an additional 2,500,000 options to be issued as "phantom" share options that grant the option holders a number of shares reflecting the benefit component of the options exercised, as calculated at the exercise date, in consideration for their par value only. Options vest over a period of one to four years from the date of grant and expire no later than six years from the date of grant.

Any options which are canceled or forfeited before expiration become available for future grants. As of December 31, 2005, 405,794 options of the Company were still available for future grants.

C. "PHANTOM" SHARE OPTIONS

Until January 1, 2004, the Company applied the provision of APB No. 25, under which the phantom share options were considered to be part a variable awards as defined in APB No. 25, and accordingly the compensation cost of the options was measured at the end of each reporting period and amortized by the accelerated method over the remaining vesting period. Starting January 1, 2004, the Company accounts for its stock based compensation awards under the fair value based method.

D. A summary of the Company's share option activity under the plans is as follows:

	2005		2004		2003	
	Number of options	**Weighted average exercise price**	**Number of options**	**Weighted average exercise price**	**Number of options**	**Weighted average exercise price**
Outstanding – beginning of the year	2,130,257	$ 12.(	3,735,602	$ 12.30	4,511,724	$ 12.26
Granted	22,000	$ 19.3(	130,500	15.67	13,000	14.91
Exercised	(549,505)	$ 12.3:	(1,666,774)	12.12	(757,947)	12.13
Forfeited	-	-	(69,071)	12.10	(31,175)	12.29
Outstanding – end of the year	1,602,752	$ 12.8	2,130,257	$ 12.60	3,735,602	$ 12.30
Options exercisable at the end of the year	1,470,752	$ 12.4	1,950,903	$ 12.36	2,547,196	$ 12.23

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

Note 18 -SHAREHOLDER'S EQUITY (Cont.)

E. The options outstanding as of December 31, 2005, have been separated into ranges of exercise prices, as follows:

	Options outstanding			Options exercisable	
Exercise price	Number outstanding as of December 31, 2005	Weighted average remaining contractual li (years)	Weighted average exercise price per shai	Number outstanding a of December 31, 2005	Weighted average exercise price per share
$12.18 – $19.:	1,602,752	$ 1.34	$ 12.83	1,470,752	$ 12.47

Compensation expense (income) amounting to $172, $3,387 and $4,741 was recognized during the years ended December 31, 2005, 2004 and 2003, respectively. All the compensation expenses stet in the year 2003 were related to the phantom share options under the stock option plan. The expenses in 2004 were recorded based on SFAS No. 123 and SFAS No. 148 according to the modified prospective method. The expenses (income) were recorded as follows:

	Year ended December 31,		
	2005	2004	2003
Cost of revenues	$ 96	$ 1,863	$ 2,608
R&D and marketing expenses	34	677	948
General and administration expenses	42	847	1,185
	$ 172	$ 3,387	$ 4,741

F. The weighted average exercise price and fair value of options granted during the years ended December 31, 2005, 2004 and 2003 were:

	Less than market price		
	Year ended December 31,		
	2005	2004	2003
Weighted average exercise price	$ 19.36	$ 15.67	$ 14.91
Weighted average fair value on grant date	$ 6.47	$ 6.62	$ 4.63

Note 18 -SHAREHOLDER'S EQUITY (Cont.)

G. Computation of basic and diluted net earnings per share:

	Year ended December 31, 2005			Year ended December 31, 2004			Year ended December 31, 2003		
	Net income to shareholders of Ordinary shares	**Weighted averaged number of shares (*)**	**Per share amount**	**Net income to shareholders of ordinary shares**	**Weighted averaged number of shares (*)**	**Per share amount**	**Net income to shareholders of ordinary shares**	**Weighted averaged number of shares (*)**	**Per share amount**
Basic net earnings	$ 32,487	40,750	$0.80	$ 51,873	39,952	$1.30	$ 45,945	39,061	$1.18
Effect of dilutive securities:									
Employee stock options	-	873		-	1,089		-	1,169	
Diluted net earnings	$ 32,487	41,623	$ 0.78	$ 51,873	41,041	$1.26	$ 45,945	40,230	$1.14

* In thousands

H. TREASURY SHARES

The Company's shares held by the Company and its subsidiaries are presented at cost and deducted from shareholders' equity.

I. DIVIDEND POLICY

Dividends declared by the Company are paid subject to statutory limitations. The Company's board of directors has determined not to declare dividends out of tax exempt earnings.

U. S. dollars (In thousands)

Note 19 -MAJOR CUSTOMER AND GEOGRAPHIC INFORMATION

The Group applies Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS No. 131"). The Group operates in one reportable segment (see Note 1 for a brief description of the Group's business).

A. Revenues are attributed to geographic areas based on location of the end customers as follows:

	Year ended December 31,		
	2005	2004	2003
Europe	$ 104,239	$ 124,130	$ 109,409
U.S.	397,479	348,509	332,323
Israel	315,376	241,601	255,742
Others	252,782	225,685	200,506
	$ 1,069,876	$ 939,925	$ 897,980

B. Revenues are generated by the following product lines:

	Year ended December 31,		
	2005	**2004**	**2003**
Airborne systems	$ 420,815	$ 367,927	$ 373,580
Land vehicles systems	117,358	199,224	199,800
Command, control, communications, computers, intelligence, surveillance ai reconnaissance systems (C^4ISR)	217,343	108,925	133,900
Electro-optical systems	242,274	200,322	140,500
Others	72,086	63,527	50,200
	$ 1,069,876	$ 939,925	$ 897,980

C. Revenues from single customers, which exceed 10% of total revenues in the reported years:

	Year ended December 31,		
	2005	**2004**	**2003**
IMOD	26%	18%	21%
U.S. Government	10%	10%	*

*Less than 10%

D. Long-lived assets by geographic areas:

	Year ended December 31,		
	2005	**2004**	**2003**
Israel	$ 322,521	$ 237,887	$ 229,396
U.S.	87,998	84,701	81,261
Others	17,206	17,687	18,576
	$ 427,725	$ 340,275	$ 329,233

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

U. S. dollars (In thousands)

Note 20 -RESEARCH AND DEVELOPMENT EXPENSES, NET

	Year ended December 31,		
	2005	2004	2003
Total expenses	$ 92,375	$ 86,368	$ 65,487
Less – participations	(20,472)	(19,522)	(10,568)
	$ 71,903	$ 66,846	$ 54,919

Note 21 -FINANCIAL EXPENSES, NET

	Year ended December 31,		
	2005	2004	2003
Expenses:			
On long-term bank debt	$ (6,359)	$ (1,544)	$ (2,215)
On short-term bank credit and loans	(3,433)	(2,309)	(2,182)
Others	(5,147)	(3,181)	(3,905)
	(14,939)	(7,034)	(8,302)
Income:			
Interest on cash, cash equivalents and bank deposits	2,205	628	309
Others	-	1,115	4,397
	2,205	1,743	4,706
Gain (loss) from exchange rate differences	1,262	(561)	(1,274)
	$ (11,472)	$ (5,852)	$ (4,870)

Note 22 - RELATED PARTIES TRANSACTIONS AND BALANCES

	Year ended December 31,		
	2005	2004	2003
Income -			
Sales to affiliated companies (*)	$ 63,007	$ 56,346	$ 34,674
Participation in expenses	$ 3,630	$ 2,594	$ 1,773
Cost and expenses -			
Supplies and services from affiliated compan (**)	$ 19,031	$ 16,338	$ 21,606
Participation in expenses	$ 91	$ 627	$ 1,751
Financial expenses	-	$ 3	$ 23

	December 31,	
	2005	2004
Trade receivables and other receivables (*)	$ 4,914	$ 13,214
Trade payables (**)	$ 2,574	$ 5,445

Note 22 - RELATED PARTIES TRANSACTIONS AND BALANCES (Cont.)

The purchases from our related parties are made at prices and on terms equivalent to those used in transacting business with unrelated parties under similar conditions. The sales to our related parties in respect with government defense contracts are made on the basis of costs incurred.

(*) The significant sales include sales of helmet mounted cueing systems purchased from the Company by VSI.
(**) Includes electro-optics components and sensors, purchased by the Company from SCD, and electro-optics products purchased by the Company from Opgal.

Note 23 - RECONCILIATION TO ISRAELI GAAP

As described in Note 2, the Company prepares its financial statements in accordance with U.S. GAAP. The effects of the differences between U.S. GAAP and generally accepted accounting principles in Israel ("Israeli GAAP") on the Company's financial statements are detailed below.

A building purchased from Elbit Ltd.

According to Israeli GAAP, the Company charged to additional paid-in capital reserves the excess of the amount paid over net book value of a building acquired from Elbit Ltd in 1999. According to U.S. GAAP, the entire amount paid is considered as the cost of the building acquired.

Proportional consolidation method

According to Israeli GAAP, a jointly controlled company should be included according to the proportional consolidation method. According to U.S. GAAP, the investment in such a company is recorded according to the equity method.

Tax benefit in respect of options exercised

According to Israeli GAAP, tax benefits from employee options exercised are recorded as a reduction of tax expense. According to U.S. GAAP, the difference between the above mentioned tax benefits and the benefits recorded in respect of compensation expense in the financial statements are credited to additional paid-in capital.

Goodwill

Effective January 1, 2002, the Company adopted SFAS 142, "Goodwill and Other Intangible Assets" according to which goodwill and intangible assets with indefinite lives are no longer amortized periodically but are reviewed annually for impairment (or more frequently if impairment indicators arise). According to Israeli GAAP, all intangibles, including goodwill, should be amortized.

U. S. dollars (In thousands)

Note 23 - RECONCILIATION TO ISRAELI GAAP (Cont.)

Investment in marketable securities – Tadiran

Pursuant to SFAS 115, marketable securities which are available-for-sale are presented on the basis of their market value, and changes in such value are charged (or credited) to other comprehensive income. According to Israeli GAAP non-current investments in marketable securities are presented at cost

1. Effect on net income and earnings per share

	Year ended December 31,		
	2005	**2004**	**2003**
Net income as reported according to U.S. GAAP	$ 32,487	$ 51,873	$ 45,945
Adjustments to Israeli GAAP	(9,637)	(458)	595
Net income according to Israeli GAAP	$ 22,850	$ 51,415	$ 46,540

2. Effect on shareholders' equity

	As reported	**Adjustments**	**As per Israeli GAAP**
As of December 31, 2005			
Shareholders' equity	$ 450,777	$ (19,279)	$ 431,498
As of December 31, 2004			
Shareholders' equity	$ 432,184	$ (13,124)	$ 419,060

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