

**ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES**  
**CONDENSED INTERIM CONSOLIDATED**  
**FINANCIAL STATEMENTS**

**AS OF JUNE 30, 2010**

(Unaudited)

(In thousands of U.S. dollars)

# **ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES**

## **CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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### **C O N T E N T S**

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**ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

U.S. dollars (in thousands)

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
	<b>(Unaudited)</b>	<b>(Audited)</b>
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 243,781	\$ 140,709
Short-term bank deposits	107,146	115,924
Available for sale marketable securities	16,721	23,639
Trade receivables, net	604,238	659,524
Other receivables and prepaid expenses	149,447	115,856
Inventories, net of advances	617,602	569,848
Total current assets	<u>1,738,935</u>	<u>1,625,500</u>
<b>LONG-TERM INVESTMENTS AND RECEIVABLES:</b>		
Investments in affiliated companies, partnership and other companies	95,162	88,759
Available for sale marketable securities	7,250	12,941
Long-term bank deposits and receivables	51,115	36,338
Deferred income taxes, net	13,181	7,992
Severance pay fund	263,692	274,136
	<u>430,400</u>	<u>420,166</u>
<b>PROPERTY, PLANT AND EQUIPMENT, NET</b>	<u>428,601</u>	<u>404,675</u>
<b>GOODWILL</b>	<u>355,595</u>	<u>336,910</u>
<b>OTHER INTANGIBLE ASSETS, NET</b>	<u>268,707</u>	<u>266,426</u>
	<u><u>\$ 3,222,238</u></u>	<u><u>\$ 3,053,677</u></u>

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

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

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

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
	<b>(Unaudited)</b>	<b>(Audited)</b>
<b>CURRENT LIABILITIES:</b>		
Current maturities of long-term loans and Series A Notes	\$ 36,857	\$ 2,663
Trade payables	294,283	299,238
Other payables and accrued expenses	546,228	552,806
Customers advances in excess of costs incurred on contracts in progress	381,120	367,137
Total current liabilities	<u>1,258,488</u>	<u>1,221,844</u>
<b>LONG-TERM LIABILITIES:</b>		
Long-term loans, net of current maturities	192,657	386,534
Series A Notes	247,559	-
Accrued termination liability	342,023	351,278
Deferred income taxes and tax liability, net	59,172	59,602
Customers advances in excess of costs incurred on contracts in progress	138,662	142,566
Other long-term liabilities	50,665	34,659
	<u>1,030,738</u>	<u>974,639</u>
<b>COMMITMENTS AND CONTINGENT LIABILITIES</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
Share capital:		
Ordinary shares of New Israeli Shekels (NIS) 1 par value; Authorized – 80,0000 shares as of June 30, 2010 and December 31, 2009 ; Issued 43,075,034 and 42,939,816 shares as of June 30, 2010 and December 31, 2009, respectively; Outstanding 42,666,113 and 42,530,895 shares as of June 30, 2010 and December 31, 2009, respectively	12,042	12,006
Additional paid-in capital	277,603	272,127
Treasury shares - 408,921 shares as of June 30, 2010 and December 31, 2009	(4,321)	(4,321)
Accumulated other comprehensive loss	(18,356)	(22,413)
Retained earnings	637,527	575,469
Total Elbit Systems Ltd. shareholders' equity	<u>904,495</u>	<u>832,868</u>
Non-controlling interests	28,517	24,326
	<u>933,012</u>	<u>857,194</u>
Total liabilities and shareholders' equity	<u>\$ 3,222,238</u>	<u>\$ 3,053,677</u>

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

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

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

	Six months ended June 30,		Three months ended June 30,		Year ended December 31,
	2010	2009	2010	2009	2009
	(Unaudited)		(Unaudited)		(Audited)
Revenues	\$ 1,221,478	\$ 1,385,221	\$ 603,277	\$ 728,289	\$ 2,832,437
Cost of revenues	853,372	965,084	419,716	516,420	1,982,954
Gross profit	368,106	420,137	183,561	211,869	849,483
Operating expenses:					
Research and development, net	109,511	98,888	56,846	53,008	216,752
Marketing and selling	104,931	124,465	50,336	67,549	250,963
General and administrative	60,141	58,286	32,056	29,398	119,311
Other income, net	(4,756)	-	(4,756)	-	-
Total operating expenses	269,827	281,639	134,482	149,955	587,026
Operating income	98,279	138,498	49,079	61,914	262,457
Financial income (expenses), net	(4,137)	(7,602)	(1,002)	11,437	(15,585)
Other income (expenses), net	13,089	(646)	108	(551)	458
Income before taxes on income	107,231	130,250	48,185	72,800	247,330
Taxes on income	16,816	26,248	6,489	14,036	38,109
	90,415	104,002	41,696	58,764	209,221
Equity in net earnings of affiliated companies and partnership	9,301	8,193	5,389	3,417	19,292
Consolidated net income	99,716	112,195	47,085	62,181	228,513
Less: net income attributable to non-controlling interests	(5,155)	(9,221)	(2,306)	(2,461)	(13,566)
Net income attributable to Elbit Systems Ltd.'s shareholders	\$ 94,561	\$ 102,974	\$ 44,779	\$ 59,720	\$ 214,947
Earnings per share attributable to Elbit Systems Ltd.'s shareholders					
Basic net earnings per share	\$ 2.22	\$ 2.44	\$ 1.05	\$ 1.42	\$ 5.08
Diluted net earnings per share	\$ 2.19	\$ 2.41	\$ 1.04	\$ 1.39	\$ 5.00
Number of shares used in computation of basic net earnings per share	42,611	42,149	42,645	42,200	42,305
Number of shares used in computation of diluted net earnings per share	43,257	42,729	43,234	42,924	42,983

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

**ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

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

	Number of Outstanding Shares	Share Capital	Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained earnings	Treasury shares	Non controlling interest	Total shareholders' equity	Total comprehensive income
<b>Balance as of January 1, 2009</b>	42,079,452	\$ 11,892	\$ 300,227	\$ (13,573)	\$ 429,608	\$ (4,321)	\$ 76,475	\$ 800,308	
Exercise of options	451,443	114	9,757	-	-	-	-	9,871	
Stock based compensation	-	-	5,134	-	-	-	-	5,134	
Dividends paid	-	-	-	-	(76,172)	-	-	(76,172)	
Purchase of subsidiary shares from non-controlling interest	-	-	(42,991)	-	-	-	(67,259)	(110,250)	
Other comprehensive income, net of tax:									
Unrealized loss on derivative instruments, net of \$749 tax income	-	-	-	(11,381)	-	-	(97)	(11,478)	\$ (11,478)
Foreign currency translation differences	-	-	-	1,367	-	-	1,517	2,884	2,884
Unrealized pension income, net of \$1,473 tax expense	-	-	-	1,910	-	-	-	1,910	1,910
Unrealized income on available for sale securities, net of \$1,103 tax expense	-	-	-	6,350	-	-	124	6,474	6,474
Cumulative effect from adoption of FSP 115-2 (codified in ASC 320-10, Investments – Debt and Equity Securities), net of \$1,772 tax expense	-	-	-	(7,086)	7,086	-	-	-	-
Net income attributable to non-controlling interests	-	-	-	-	-	-	13,566	13,566	13,566
Net income attributable to Elbit Systems Ltd. shareholders	-	-	-	-	214,947	-	-	214,947	214,947
Total comprehensive income									<u>\$ 228,303</u>
<b>Balance as of December 31, 2009</b>	<u>42,530,895</u>	<u>\$ 12,006</u>	<u>\$ 272,127</u>	<u>\$ (22,413)</u>	<u>\$ 575,469</u>	<u>\$ (4,321)</u>	<u>\$ 24,326</u>	<u>\$ 857,194</u>	
Exercise of options	135,218	36	2,872	-	-	-	-	2,908	
Stock based compensation	-	-	2,604	-	-	-	-	2,604	
Dividends paid	-	-	-	-	(32,503)	-	-	(32,503)	
Other comprehensive income, net of tax:									
Unrealized income on derivative instruments, net of \$406 tax income	-	-	-	7,485	-	-	(199)	7,286	7,286
Foreign currency translation differences	-	-	-	(307)	-	-	(765)	(1,072)	(1,072)
Unrealized pension loss, net of \$572 tax expense	-	-	-	(878)	-	-	-	(878)	(878)
Unrealized loss on available for sale securities, net of \$54 tax income	-	-	-	(2,243)	-	-	-	(2,243)	(2,243)
Net income attributable to non-controlling interests	-	-	-	-	-	-	5,155	5,155	5,155
Net income attributable to Elbit Systems Ltd. shareholders	-	-	-	-	94,561	-	-	94,561	94,561
Total comprehensive income									<u>\$ 102,809</u>
<b>Balance as of June 30, 2010 (Unaudited)</b>	<u>42,666,113</u>	<u>\$12,042</u>	<u>\$ 277,603</u>	<u>\$ (18,356)</u>	<u>\$ 637,527</u>	<u>\$ (4,321)</u>	<u>\$ 28,517</u>	<u>\$ 933,012</u>	

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

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars (in thousands)

	Six Months Ended June 30,		Year Ended December 31,
	2010	2009	2009
	(Unaudited)		(Audited)
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	\$ 99,716	\$ 112,195	\$ 228,513
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	60,988	63,196	123,473
Write-off impairment	717	-	3,017
Stock based compensation	2,604	2,563	5,134
Amortization of Series A Notes discount and deferred financing costs	25	-	-
Deferred income taxes and reserve	(9,029)	(4,321)	7,606
Severance, pension and termination indemnities, net	(212)	(8,900)	(16,773)
Gain on sale of property, plant and equipment	(698)	208	(723)
Gain on sale of investments	(18,713)	-	(2,734)
Equity in net earnings of affiliated companies and partnership, net of dividend received (*)	(929)	(1,630)	(1,824)
Change in operating assets and liabilities:			
Decrease (increase) in short and long-term trade receivables, and prepaid expenses	(3,980)	17,103	(136,224)
Decrease (increase) in inventories, net	(44,993)	10,672	75,431
Decrease in trade payables, other payables and accrued expenses	6,163	4,046	20,223
Increase (decrease) in advances received from customers	9,968	(101,543)	(95,397)
Net cash provided by operating activities	101,627	93,589	209,722
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchase of property, plant and equipment	(67,484)	(47,065)	(107,893)
Acquisition of subsidiaries and business operations (Schedule A)	(34,566)	(13,783)	(48,234)
Investments in affiliated companies and other companies	(59)	(18,575)	(19,415)
Proceeds from sale of property, plant and equipment	5,139	4,238	9,055
Proceeds from sale of investments	12,751	-	33,026
Investment in available for sales debt-securities and long-term deposits, net	6,718	3,351	(11,010)
Investment in short-term deposits, net	16,016	(44,867)	(52,832)
Net cash used in investing activities	(61,485)	(116,701)	(197,303)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Proceeds from exercise of options	2,908	5,692	9,871
Purchase of non-controlling interests	-	(110,250)	(110,250)
Repayment of long-term bank loans	(243,525)	(20,113)	(148,652)
Proceeds from issuance of Series A Notes, net	283,213	-	-
Deferred financing costs related to issuance of Series A Notes	(2,163)	-	-
Receipt of long-term bank loans	55,000	170,167	256,354
Dividends paid	(32,503)	(45,839)	(76,172)
Change in short-term bank credit and loans, net	-	(6,854)	(7,531)
Net cash provided by (used in) financing activities	62,930	(7,197)	(76,380)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	103,072	(30,309)	(63,961)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	140,709	204,670	204,670
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	\$ 243,781	\$ 174,361	\$ 140,709
* Dividend received	\$ 8,372	\$ 7,324	\$ 17,468

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

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

U.S. dollars (in thousands)

Six months ended June 30,		Year ended December 31,
2010	2009	2009
(Unaudited)		(Audited)

**SUPPLEMENTARY CASH FLOW ACTIVITIES:**

Cash paid during the period for:

Income taxes	\$ 35,722	\$ 16,885	\$ 47,946
Interest	\$ 4,229	\$ 3,158	\$ 11,665

**SCHEDULE A:**

Acquisitions of subsidiaries and business operations (\*)

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)	\$ 1,360	\$ (2,152)	\$ (3,979)
Property, plant and equipment	1,565	641	1,303
Other long-term assets	1,157	855	855
Goodwill and other intangible assets	35,613	15,811	51,427
Deferred income taxes, net	(3,449)	-	-
Long-term liabilities	(1,680)	(1,372)	(1,372)
	<u>\$ 34,566</u>	<u>\$ 13,783</u>	<u>\$ 48,234</u>

(\*) In 2010, the Company acquired the remaining 81% of Azimuth Technologies Ltd.'s shares, of which 19% of the shares were held by the Company prior to the acquisition (See Note 1C).

In 2009, the Company acquired the shares of Shiron and the assets and business of BVR Systems (1998) Ltd.

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



## ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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U. S. dollars (In thousands)

#### Note 1 - GENERAL

- A. The accompanying interim condensed financial statements have been prepared in a condensed format as of June 30, 2010, and for the three and six months then ended in accordance with United States generally accepted accounting principles ("U.S. GAAP") relating to the preparation of financial statements for interim periods. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. These condensed interim consolidated financial statements are unaudited and should be read in conjunction with the annual audited consolidated financial statements and accompanying notes as of December 31, 2009, included in the Company's annual report for the year ended December 31, 2009, filed on Form 20-F on March 10, 2010. The interim financial statements reflect all adjustments, which are, in the opinion of management, necessary for a fair presentation. All such adjustments were of a normal recurring nature.

Operating results for the six-month period ended June 30, 2010, are not necessarily indicative of the results that may be expected for the year ending December 31, 2010.

- B. Reclassifications have been made to comparative data in the balance sheet as of December 31, 2009 in order to conform to the current year's presentation.
- C. On May 11, 2010, the Company's subsidiary, Elbit Security Systems Ltd. ("Elsec"), completed the acquisition of the balance of shares (81%) in Azimuth Technologies Ltd. ("Azimuth"), an Israeli based company, pursuant to the merger agreement signed by Azimuth and Elsec in January 2010. In November 2008, the Company purchased 19% of Azimuth shares. The purchase price for the 81% balance of Azimuth's shares was approximately \$41,500, and the Company remeasured its previously held 19% to \$8,500 using the share price of Azimuth on the Tel-Aviv Stock Exchange at the acquisition, resulting in an aggregate purchase price of approximately \$50,000.

Azimuth and its wholly-owned subsidiary, Instro Precision Ltd., a U.K. based company, specialize in the development of military systems that provide for improved target acquisition, fire coordination, navigation and orientation.

The acquisition was accounted for using the purchase method as a business combination achieved in stages. The Company remeasured its previously held equity interest in Azimuth at its acquisition date fair value, using the quoted share price of Azimuth on Tel-Aviv Stock Exchange, and recognized gain of approximately \$5,000 in earnings, net. The gain is included in "Other income, net."

The results of Azimuth were consolidated in the Company's condensed interim consolidated financial statements commencing on the date of acquisition.

- D. On June 9, 2010, the Company completed a public offering on the Tel-Aviv Stock Exchange of NIS 1.1 billion (approximately \$284,000) Series A Notes (the "Series A Notes"). The Series A Notes were offered and sold in 2010 pursuant to a shelf prospectus that the Company filed in May 2010 with the Israeli Securities Authority and the Tel-Aviv Stock Exchange. The shelf prospectus allows the Company to offer and sell debt in Israel, from time to time, subject to a supplemental shelf offering report describing the terms of the securities offered and the specific details of the offering. See Note 4.

#### Note 2 - SIGNIFICANT ACCOUNTING POLICIES

- A. The significant accounting policies followed in the preparation of these statements are identical to those applied in preparation of the latest annual consolidated financial statements, except as detailed in the following Notes 2(C) and 2(D).

## ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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U. S. dollars (In thousands)

#### **Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)**

##### **B. 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 in the financial statements and accompanying notes. Actual results could differ from those estimates.

##### **C. DERIVATIVE FINANCIAL INSTRUMENTS**

The Company accounts for derivatives and hedging based on ASC 815, "Derivatives and Hedging", which requires the Company to recognize all derivatives on the balance sheet at fair value.

In connection with the issuance of the Series A Notes, the Company entered into cross-currency interest rate swaps to convert the NIS fixed rate debt into a USD LIBOR (6 months) plus average of 1.65% rate obligation. The Company designates the cross-currency interest rate swaps as a fair value hedge to hedge the changes in the fair value of the Series A Notes due to both interest and foreign exchange rates.

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 gain or loss on the 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 (i.e., in "Financial income (expenses), net" as the hedged item is the Company's fixed-rate Series A Notes). See also Note 7.

##### **D. SERIES A NOTES**

The Company accounts for the outstanding principal amount of its Series A Notes as long-term liability, in accordance with ASC 470, "Debt". The Series A Notes are classified as a long-term liability, with current maturities classified in short-term liabilities. Debt issuance costs are capitalized and reported as deferred financing costs, which are amortized over the life of the Series A Notes using the effective interest rate method. See also Note 4.

##### **E. RECENTLY ISSUED ACCOUNTING STANDARDS**

In July 2010, the FASB issued ASU 2010-20, "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses". ASU 2010-20 is an update of ASC 310, "Receivables". This update requires enhanced disclosures on a disaggregated basis about:

1. The nature of the credit risk inherent in the portfolio of financing receivables.
2. How that risk is analyzed and assessed in arriving at the allowance for credit losses.
3. The changes and reasons for those changes in the allowance for credit losses.

The disclosures required under ASU 2010-20 as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. Disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The Company is currently evaluating the impact of ASU 2010-20 on the consolidated financial statements.

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

U. S. dollars (In thousands)

### Note 3 - INVENTORIES, NET OF ADVANCES

	<u>June 30,</u> <u>2010</u> <u>(Unaudited)</u>	<u>December 31,</u> <u>2009</u> <u>(Audited)</u>
Cost incurred on long-term contracts in progress	\$ 765,736	\$ 718,134
Raw materials	64,578	61,175
Advances to suppliers and subcontractors	40,410	36,638
	<u>870,724</u>	<u>815,947</u>
Less -		
Cost incurred on contracts in progress deducted from customer advances	76,212	71,740
Advances received from customers (*)	107,579	113,511
Provision for losses on long-term contracts	69,331	60,848
	<u>\$ 617,602</u>	<u>\$ 569,848</u>

(\*) 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 where advances are in excess of the inventories, the net amount is presented in customer advances.

### Note 4 - SERIES A NOTES

	<u>June 30,</u> <u>2010</u> <u>(Unaudited)</u>
Series A Notes	\$ 281,732
Less –	
Current maturities	(27,744)
Fair value adjustments resulting from cross-currency interest rate swaps	(6,429)
	<u>\$ 247,559</u>

In June 2010, the Company issued Series A Notes in the aggregate principle amount of NIS 1.1 billion (approximately \$284,000), payable in 10 equal annual installments on June 30 of each of the years 2011 through 2020. The Series A Notes bear a fixed interest rate of 4.84% per annum, payable on June 30 and December 30 of each of the years 2010 through 2020 (the first interest payment will be made on December 30, 2010, and the last interest payment will be made on June 30, 2020). As of June 30, 2010, the Company recorded \$389 as interest payable, which is included in accrued expenses and other accounts payable. Debt issuance costs were approximately \$2,529, of which \$2,163 was allocated to the Series A Notes discount, and \$366 was allocated to deferred financing costs and are amortized as financial expense over the term of the Series A Notes due in 2020.

The Series A Notes (principal and interest) are not linked to any currency or index. The Series A Notes are unsecured, non convertible and do not restrict the Company's ability to issue additional notes of any class or distribute dividends in the future. There are no covenants on the Series A Notes. The Series A Notes are listed for trading on the Tel-Aviv Stock Exchange.

On May 13, 2010, Midroog Ltd., an Israeli rating agency, announced that it assigned its "Aa1" rating (local scale) to unsecured notes to be issued by the Company, which include the Series A Notes.

The Series A Notes will not be registered under the U.S. Securities Act of 1933, as amended (the "Securities Act"), and may not be offered or sold in the United States or to U.S. Persons (as defined in Regulation "S" promulgated under the Securities Act) without registration under the Securities Act or an exemption from the registration requirements of the Securities Act.

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

U. S. dollars (In thousands)

### Note 4 - SERIES A NOTES (Cont.)

The Company also entered into ten-year cross currency interest rate swap transactions in order to effectively hedge the effect of interest and exchange rate differences resulting from the NIS Series A Notes.

Under the cross currency interest rate swaps, the Company will receive fixed NIS at a rate of 4.84% on NIS 1.1 billion and pay floating six-month USD LIBOR + an average spread of 1.65% on \$287,000, which reflects the U.S. dollar value of the Series A Notes on the specific dates the transactions were entered. Both the debt and the swaps instruments will pay semi-annual coupons on June 30 and December 31. The purpose of these transactions was to convert the NIS fixed rate Series A Notes into a USD LIBOR (6 months) floating rate obligations. As a result of these agreements, the Company is currently paying an effective interest rate of six-month LIBOR (0.7% at June 30, 2010) plus an average of 1.65% on the principal amount, as compared to the original 4.84% fixed rate. The above transactions qualify for fair value hedge accounting.

### Note 5 - COMPUTATION OF BASIC AND DILUTED NET EARNINGS PER SHARE

	Six months ended June 30, 2010 (Unaudited)			Six months ended June 30, 2009 (Unaudited)			Year ended December 31, 2009		
	Net income to shareholders of ordinary shares	Weighted average number of shares (*)	Per Share amount	Net income to shareholders of ordinary shares	Weighted average number of shares (*)	Per Share amount	Net income to shareholders of ordinary shares	Weighted average number of shares (*)	Per Share amount
Basic net earnings	\$ 94,561	42,611	\$ 2.22	\$ 102,974	42,149	\$ 2.44	\$ 214,947	42,305	\$ 5.08
Effect of dilutive securities: Employee stock options	-	646		-	580		-	678	
Diluted net earnings	\$ 94,561	43,257	\$ 2.19	\$ 102,974	42,729	\$ 2.41	\$ 214,947	42,983	\$ 5.00

  

	Three months ended June 30, 2010 (unaudited)			Three months ended June 30, 2009 (Unaudited)		
	Net income to shareholders of ordinary shares	Weighted average number of shares (*)	Per Share amount	Net income to shareholders of ordinary shares	Weighted average number of shares (*)	Per Share amount
Basic net earnings	\$ 44,779	42,645	\$ 1.05	\$ 59,720	42,200	\$ 1.42
Effect of dilutive securities: Employee stock options	-	589		-	724	
Diluted net earnings	\$ 44,779	43,234	\$ 1.04	\$ 59,720	42,924	\$ 1.39

(\*) In thousands

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

U. S. dollars (In thousands)

### Note 6 - FAIR VALUE MEASUREMENTS

The carrying amount of 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 Company accounts for certain assets and liabilities at fair value under ASC 820, "Fair Value Measurements and Disclosures". Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability.

The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. The Company categorizes each of its fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety.

The three levels of inputs that may be used to measure fair value are as follows:

Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets;

Level 2 - Includes other inputs that are directly or indirectly observable in the marketplace, other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets with insufficient volume or infrequent transactions, or other inputs that are observable (model-derived valuations in which significant inputs are observable), or can be derived principally from or corroborated by observable market data; and

Level 3 - Unobservable inputs which are supported by little or no market activity.

The Company measures its marketable equity securities, debt securities and foreign currency derivative instruments at fair value. Marketable equity securities and government debt securities are classified within Level 1. The Company's investments in Auction Rate Securities ("ARS") and Collateralized Debt Obligations ("CDOs") are classified within Level 3 because they are valued using valuation techniques with significant unobservable inputs. The Company's foreign currency derivative instruments are classified within Level 2 when the valuation inputs are based on quoted prices and market observable data of similar instruments and in Level 3 when valuation inputs are based on significant unobservable data.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

Description of Assets	Fair value measurement at December 31, 2009 using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Marketable equity securities	\$ 5,496	\$ -	\$ -
Debt securities:			
Government bonds	23,639	-	-
ARS and CDOs	-	-	7,445
Foreign currency option contracts	-	17,915	304
<b>Liabilities</b>			
Foreign currency derivative contracts	-	(10,699)	-
<b>Total</b>	<u>\$ 29,135</u>	<u>\$ 7,216</u>	<u>\$ 7,749</u>

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

U. S. dollars (In thousands)

### Note 6 - FAIR VALUE MEASUREMENTS (Cont.)

Description of Assets	Fair value measurement at June 30, 2010 (Unaudited) using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt securities:			
Government bonds	\$ 16,721	\$ -	\$ -
ARS and CDOs	-	-	7,256
Foreign currency forward and option contracts	-	24,162	-
Cross-currency interest rate swaps	-	6,367	-
<b>Liabilities</b>			
Foreign currency derivative contracts	-	(11,339)	(65)
Cross-currency interest rate swaps	-	(16,109)	-
<b>Total</b>	<b>\$ 16,721</b>	<b>\$ 3,081</b>	<b>\$ 7,191</b>

The following table presents our assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at June 30, 2010 (unaudited):

	Level 3
Balance, at December 31, 2009	\$ 7,749
Net change for fair value included in other comprehensive income	(558)
Balance, at June 30, 2010	\$ 7,191

For ARS and CDO debt securities, their fair value was determined using an independent third party valuator. The fair value was based on a trinomial discount model employing assumptions that market participants would use in their estimates of fair value. The assumptions included among others, the following: the underlying structure of the security, the financial standing of the issuer, stated maturities, estimates of the probability of the issue being called at par prior to final maturity, estimates of the probability of defaults and recoveries, auctions failure and successful auction or repurchase at par for each period, expected changes in interest rates paid on the securities, interest rates paid on similar instruments, and an estimated illiquidity discount due to extended redemption periods. Finally, the present value of the future principal and interest payments was discounted at rates considered to reflect current market conditions for each security.

The fair value of long-term loans is 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.

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

U. S. dollars (In thousands)

### Note 7 - DERIVATIVE FINANCIAL INSTRUMENTS

- A. Derivative financial instruments are presented as other assets or other payables. For asset derivatives and liability derivatives, respectively, the fair value of the Company's outstanding derivative instruments as of June 30, 2010 and December 31, 2009 is summarized below:

	Asset Derivatives (*)		Liability Derivatives (**)	
	June 30, 2010	December 31, 2009	June 30, 2010	December 31, 2009
	(Unaudited)	(Audited)	(Unaudited)	(Audited)
Derivatives designed as hedging instruments				
Foreign exchange contracts	\$ 17,782	\$ 10,819	\$ 9,712	\$ 6,292
Cross-currency interest rate swaps	6,367	-	16,109	-
	<u>24,149</u>	<u>10,819</u>	<u>25,821</u>	<u>6,292</u>
Derivatives not designed as hedging instruments				
Foreign exchange contracts	6,379	7,096	1,560	4,407
Options exchange contracts	-	304	65	-
	<u>\$ 6,379</u>	<u>\$ 7,400</u>	<u>\$ 1,625</u>	<u>\$ 4,407</u>

(\*) Presented as part of other assets.

(\*\*) Presented as part of other payables.

- B. The effect of derivative instruments on cash flow hedging and the relationship between income and other comprehensive income for the six-month period ended June 30, 2010 and the year ended December 31, 2009, is summarized below:

	Gain (Loss) Recognized in Other Comprehensive Income on Effective Portion of Derivative, net		Gain (Loss) on Effective Portion of Derivative Reclassified from Accumulated Other Comprehensive Income (*)		Ineffective Portion of Gain (Loss) of Derivative and Amount Excluded from Effectiveness Testing Recognized in Income (**)	
	June 30, 2010	December 31, 2009	June 30, 2010	December 31, 2009	June 30, 2010	December 31, 2009
	(Unaudited)	(Audited)	(Unaudited)	(Audited)	(Unaudited)	(Audited)
Derivatives designed as hedging instruments						
Foreign exchange contracts	\$ 10,638	\$ (10,339)	\$ 3,542	\$ 5,102	\$ -	\$ -
Cross-currency interest rate swap (***)	-	-	-	-	(3,313)	-
Others	-	-	(427)	(152)	-	(3,062)
	<u>\$ 10,638</u>	<u>\$ (10,339)</u>	<u>\$ 3,115</u>	<u>\$ 4,950</u>	<u>\$ (3,313)</u>	<u>\$ (3,062)</u>
Derivatives not designed as hedging instruments						
Foreign exchange Contracts	\$ -	\$ -	\$ -	\$ -	\$ 4,992	\$ 678

(\*) Presented as part of revenues/cost of sales

(\*\*) Presented as part of financial expenses

(\*\*\*) The Company has recognized an additional loss in the amount of \$6,429, which was attributable to a hedge risk (See Note 4).

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

U. S. dollars (In thousands)

### Note 7 - DERIVATIVE FINANCIAL INSTRUMENTS (Cont.)

- C. The notional amounts of outstanding foreign exchange forward contracts at June 30, 2010 and December 31, 2009, is summarized below:

	Forward contracts			
	Buy		Sell	
	June 30, 2010	December 31, 2009	June 30, 2010	December 31, 2009
	(Unaudited)	(Audited)	(Unaudited)	(Audited)
Euro	\$ 15,881	\$ 22,313	\$ 161,998	\$ 152,603
GBP	20,303	21,086	67,540	78,725
New Israeli Shekel	266,250	219,200	-	-
Other	-	-	10,391	15,613
	<u>\$ 302,434</u>	<u>\$ 262,599</u>	<u>\$ 239,929</u>	<u>\$ 246,941</u>

	Options			
	Buy		Sell	
	June 30, 2010	December 31, 2009	June 30, 2010	December 31, 2009
	(Unaudited)	(Audited)	(Unaudited)	(Audited)
New Israeli Shekel	\$ 3,000	\$ 42,650	\$ 3,000	\$ 42,650

### Note 8 - COMMITMENTS AND CONTINGENT LIABILITIES

#### A. LEGAL CLAIMS

- (1) Elbit Systems and its subsidiaries are involved in legal claims arising in the ordinary course of business, including claims by employees, consultants and others. The 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 Company.
- (2) The Company and its wholly-owned Israeli subsidiary, Elbit Systems Electro-Optics Elop Ltd. ("Elop"), are involved in a series of claims relating to ImageSat International N.V. ("ImageSat"), in which Elop holds an approximately 14% interest (7% on a fully diluted basis) and is entitled to nominate one director to ImageSat's board of directors. ImageSat's largest shareholder is Israel Aerospace Industries Ltd. ("IAI"). ImageSat is engaged in the operation of satellites and in providing satellite imagery. IAI has manufactured and supplied satellites to ImageSat, and Elop manufactured and supplied the cameras for those satellites as IAI's subcontractor.



## ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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U. S. dollars (In thousands)

#### **Note 8 - COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)**

##### **A. LEGAL CLAIMS (Cont.)**

The claims were filed by certain minority shareholders and debt holders of ImageSat against IAI, the Company and Elop. Some of the claims also named as defendants ImageSat and certain individuals who have served on ImageSat's Board of Directors at various times including, among others, Michael Federmann, Joseph Ackerman and Joseph Gaspar, the Company's Board Chairman, President and Chief Financial Officer, respectively. The claims allege that the defendants breached their fiduciary and/or contractual obligations to the detriment of the plaintiffs, alleging various causes of actions and damages aggregating hundreds of millions of dollars, not all of which were alleged against the Company, Elop and/or the above-mentioned individual defendants. Five such claims were filed: (1) in July 2007 in the United States District Court for the Southern District of New York (the "N.Y. Southern District") (the "July 2007 Claim"); (2) in August 2008 in the N.Y. Southern District (the "August 2008 Claim"); (3) in December 2008 in the N.Y. Southern District (the "December 2008 Claim"); (4) in January 2010 in the Supreme Court of the State of New York, County of New York ("New York County Supreme Court") (the "January 2010 Claim"); and (5) in April 2010 in the District Court of Petach Tikva, Israel (the "April 2010 Claim").

The July 2007 Claim was dismissed on the grounds of forum conveniens by the N.Y. Southern District in July 2008. The plaintiffs' appeal to the U.S. Federal Court for the Second Circuit (the "Second Circuit") was denied in November 2009, and the time for filing a petition to the Supreme Court of the United States has expired. Therefore, the July 2007 Claim is considered closed. The August 2008 Claim was dismissed by the N.Y. Southern District on the grounds of forum non-conveniens in January 2010 and also is considered closed. The December 2008 Claim was withdrawn, and in April 2009 re-filed in the New York County Supreme Court. In December 2009, all of the plaintiffs claims in the December 2008 Claim were dismissed by the New York County Supreme Court on the grounds of forum non-conveniens, except a single cause of action based on an alleged breach of a security holders agreement between various security holders of ImageSat (the "Security Holders Agreement"), due to an alleged failure to appoint independent directors to ImageSat's board of directors. In July 2010, the New York County Supreme Court dismissed the January 2010 Claim as to one of the plaintiffs and limited the claim by the rest of the plaintiffs solely to the claim of an alleged breach of the Security Holders Agreement with respect to the nomination of independent directors to ImageSat's board. In July 2010, the defendants filed a motion to dismiss the April 2010 Claim, which is currently pending before the District Court of Petach Tikva.

The Company believes that there is no merit or basis to the allegations made in the remaining above-mentioned legal proceedings against it, Elop or the former ImageSat directors who were nominated by Elop. IAI has agreed to indemnify the Company, Elop and the directors nominated by Elop to ImageSat's board, for any losses arising out of any of the foregoing claims or legal proceedings, net of insurance proceeds received from ImageSat's insurance policies and any indemnification proceeds received from ImageSat.

## ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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U. S. dollars (In thousands)

#### Note 8 - COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

##### A. LEGAL CLAIMS (Cont.)

- (3) In December 2009, a claim in the amount of approximately \$10,000 was filed in the District Court – Central District of Israel by Pinpoint Advance Corporation (“Pinpoint”) and four of its founders against two of the Company's Israeli subsidiaries, Elbit Systems Holdings (1997) Ltd. and Kinetics Ltd. (“Kinetics”), as well as against one of Elbit Systems’ officers, Jacob Gadot. Pinpoint is a special purpose acquisition company that was in negotiations with said subsidiaries and other Kinetics’ shareholders regarding the sale of shares in Kinetics during 2008. The transaction was not completed, and negotiations were terminated. Pinpoint claims that the agreement was completed, and thus entered into effect. Alternatively, Pinpoint claims that the Company's decision not to complete the agreement was made in bad faith, and that under the circumstances Pinpoint and its founders are entitled to pecuniary compensation equal to their rights and entitlements under the alleged breached contract. Elbit Systems believes there is no merit to the allegations made in the claim, and the defendants have responded accordingly to the Court. At the request of the Court, the parties are currently pursuing a mediation process.

##### B. COVENANTS

- (1) 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, 2009, Elbit Systems and its subsidiaries, except Elisra, were in full compliance with all covenants.
- (2) Elisra’s liabilities to banks, including performance guarantees issued by banks and bank guarantees in order to secure certain advances from customers, are secured, with first priority liens and/or floating liens on all of Elisra’s property and assets, with no limitations as to amount, and by negative pledges. According to the agreement with the banks, Elisra committed to comply with certain financial covenants (to be measured based on Elisra’s stand-alone financial statements), which include, among others, a minimum ratio of shareholders’ equity to total assets (as defined in the agreement), a minimum current ratio, a minimum amount of shareholders’ equity and a minimum amount of pre-tax income. In addition, certain restrictions have been imposed on Elisra regarding the provision of guarantees to third parties, creating new liens and on selling or transferring assets in material amounts. During the six months ended June 30, 2010, Elisra received new financial covenants from two banks, which replaced the previous covenants.

As of June 30, 2010, Elisra is in full compliance with the new financial covenants, regarding two banks, but did not comply with the covenants of another bank, and that may have a negative effect on Elisra's repayment ability. In the opinion of Elisra's and the Company's management, Elisra's anticipated cash flows from operating activities and/or available sources of financing, in the twelve months following the balance sheet date, will enable Elisra to meet its current liabilities.

#### Note 9 - SUBSEQUENT EVENTS

On August 5, 2010, the Company announced, further to its announcements of July 15, 2010 and July 29, 2010, that the requirements for implementing the tender offer ("Tender Offer") issued by its wholly-owned subsidiary, Elbit Security Systems Ltd., to acquire the ordinary shares of I.T.L Optronics Ltd. held by the public were not met, and the Tender Offer was not implemented.

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