

**-EARNINGS RELEASE-**

**ELRON ELECTRONIC INDUSTRIES ANNOUNCES THIRD QUARTER 2006 RESULTS**

**Tel Aviv, Israel, November 14, 2006 - Elron Electronic Industries Ltd. (NASDAQ & TASE: ELRN)** today reported a net loss for the third quarter and for the first nine months of 2006 of \$4.4 million, or \$0.16 per share, and \$14.4 million, or \$0.5 per share, respectively. In the third quarter and first nine months of 2005, Elron reported net income of \$4.8 million, or \$0.16 per share, and \$46.9 million, or \$1.59 per share, respectively.

Elron's net loss in the third quarter and the first nine months of 2006 resulted primarily from Elron's share in the net losses of its group companies, amounting to \$7.2 million and \$19.1 million, respectively.

The net income Elron reported in the first nine months of 2005 was mainly due to gains resulting from the sale of shares of Partner Communications Ltd. (NASDAQ: PTNR), which were partially offset by losses, net, which Elron recorded with respect to its group companies in the amount of \$18.2 million. Losses, net, recorded with respect to Elron's group companies in the third quarter of 2005 amounted to \$6.0 million.

**Liquidity and Shareholders Equity**

As of September 30, 2006, Elron's cash, debentures and deposits amounted to approximately \$98.7 million compared with \$133.8 million at December 31, 2005. During the first nine months of 2006, Elron invested approximately \$36.9 million in new and existing group companies, including a \$10 million purchase of additional shares of Given Imaging.

Shareholders' equity at September 30, 2006, was approximately \$292.5 million, representing approximately 87% of total assets compared with \$302.1 million, representing approximately 85% of total assets at December 31, 2005.

**Investment completed during the third quarter and subsequently:**

**Neurosonix Ltd.** ("Neurosonix"). On August 27, 2006, Elron completed an investment of \$5 million, in two tranches, in Neurosonix Ltd. out of an aggregate financing round of \$12 million, for approximately 18% of Neurosonix on a fully diluted basis. Neurosonix, based in Israel, is engaged in the development and commercialization of medical devices for the prevention of acute cerebral embolism during open-heart cardiac surgery as well as other invasive and minimally-invasive procedures.

**Atlantium Inc.** ("Atlantium"). On October 23, 2006, Elron completed first investment in the water technology field by investing \$10 million in Atlantium Inc., out of an aggregate financing round of \$17 million for approximately 26% of Atlantium on a fully diluted basis. Atlantium, headquartered in Israel, provides innovative water disinfection solutions employing its proprietary Hydro-Optic Disinfection (HOD) technology. Atlantium offers a cost-effective and environment-friendly process, which delivers unprecedented microbe inactivation, at industrial and municipal water flow rates.

**Enure Networks Ltd.**, 34% held by Elron, completed a \$4 million financing round of which Elron invested \$0.5 million and \$3.5 million was invested by a new investor.

**Other developments in our group companies:**

**3DV Systems Ltd, 3DV Systems Ltd ("3DV")**., 62% held by Elron directly and through its subsidiary, RDC-Rafael Development Corporation Ltd., is in advanced negotiations to complete a substantial round of financing from leading new investors with one of whom 3DV has reached a conditional definitive agreement.

**ChipX, Inc.**, 29% held by Elron, is in advanced negotiations to acquire a business unit with annual sales of approximately \$20 million which, if consummated, is expected to position ChipX as an important supplier in the Application Specific IC market in North America.

There is no assurance that any of the above potential transactions will be completed.

"In 2006, we are mainly focusing on building our group companies and have seen an increased level of business activity, evidenced by private placements, the launch of new products, and progress in product development including human clinical trials in our medical device start-ups. These activities will pave the way towards building value in 2007" said Doron Birger Elron's President & CEO. "In addition, we continue to invest in new companies and entered the new promising field of water technology."

Investors may access Elron's third quarter financial report and a detailed management report on the company's web site: [www.elron.com](http://www.elron.com)

Conference call details:

Wednesday, November 15, 2006 10:00 a.m. (EST); 17:00 p.m. Israel

Dial in numbers:

**In the US: 1-800 994 4498**

**In the UK: 0 800 917 5108**

**In Israel: 03 918 0688**

**International Participants: +972 3 918 0688**

For your convenience, a **replay of the call** will be available starting two hours after the call ends until Wednesday, November 17, 2006. To access the replay please dial:

**1-866-276-1485 (US), 972-3-925-5942 (Israel) and 0-800-917-4256 (UK).**

A replay of the call will also be available for three months on the company website.

*Elron Electronic Industries Ltd., a member of the IDB Holding group, is a leading Israel-based technology holding company directly involved in the long-term performance of its group companies. Elron identifies potential technologies, creates strategic partnerships, secures financing, and recruits senior management teams. Elron's group companies currently comprise a diverse range of publicly-traded and privately held companies primarily in the fields of medical devices, information & communications technology, semiconductors and clean technology. For further information, please visit [www.elron.com](http://www.elron.com)*

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(Any statements in this press release that may be considered forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially. Actual results may differ from such forward-looking statements due to the risk factors discussed in periodic reports filed by the Company with the Securities and Exchange Commission, which the Company urges investors to consider.)

Tables to follow

# ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

In thousands of U.S. Dollars

	<b>September 30, 2006</b>	<b>December 31, 2005</b>
	<u><b>Unaudited</b></u>	
<b>ASSETS</b>		
Total current assets	\$ 115,215	\$ 155,201
<b>INVESTMENTS AND LONG-TERM RECEIVABLES</b>		
Investments in affiliated companies	105,941	102,780
Investments in other companies and long-term receivables	93,727	73,931
Deferred taxes	5,839	6,521
Severance pay deposits	2,420	1,971
Total investments and long-term receivables	207,927	185,203
<b>PROPERTY AND EQUIPMENT, NET</b>	7,770	7,809
<b>INTANGIBLE ASSETS</b>	5,547	5,560
Total assets	<u>\$ 336,459</u>	<u>\$ 353,773</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Total current liabilities	\$ 16,620	\$ 19,044
<b>LONG-TERM LIABILITIES</b>		
Long-term loans from banks and others	3,863	1,477
Accrued severance pay and retirement obligations	3,294	2,635
Deferred taxes	9,656	9,494
Total long-term liabilities	16,813	13,606
<b>MINORITY INTEREST</b>	10,511	19,007
Total Shareholders' Equity	292,515	302,116
Total liabilities and shareholders' equity	<u>\$ 336,459</u>	<u>\$ 353,773</u>

# ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

In thousands of U.S. Dollars, except share and per share data

	Nine months ended		Three months ended		Year ended
	September 30,		September 30,		December 31,
	2006	2005	2006	2005	2005
	Unaudited				
INCOME					
Net revenues	\$ 9,522	\$ 9,131	\$ 2,384	\$ 2,885	\$ 12,646
Equity in losses of affiliated companies	(16,566)	(13,074)	(4,701)	(5,254)	(17,522)
Gain (loss) from disposal of businesses and affiliated companies and changes in holdings in affiliated companies, net	2,278	23,513	2,283	1,124	23,328
Other income, net	4,012	58,024	645	1,491	58,648
Financial income, net	3,410	5,238	1,133	977	5,483
	<u>2,656</u>	<u>82,832</u>	<u>1,744</u>	<u>1,223</u>	<u>82,583</u>
COSTS AND EXPENSES	<u>25,927</u>	<u>18,961</u>	<u>8,137</u>	<u>6,875</u>	<u>26,097</u>
Income (loss) before taxes on income	(23,271)	63,871	(6,393)	(5,652)	56,486
Tax benefit (Taxes on income)	(122)	(16,183)	(23)	9,684	(10,461)
Income (loss) from continuing operations after taxes on income	(23,393)	47,688	(6,416)	4,032	46,025
Minority interest in losses of subsidiaries	9,021	2,104	1,982	1,459	5,160
Income (loss) from continuing operations	(14,372)	49,792	(4,434)	5,491	51,185
Loss from discontinued operations	-	(2,943)	-	(729)	(3,850)
Net income (loss)	<u>\$ (14,372)</u>	<u>\$ 46,849</u>	<u>\$ (4,434)</u>	<u>\$ 4,762</u>	<u>\$ 47,335</u>
Income (loss) per share:					
Basic:					
Income (loss) from continuing operations	\$ (0.49)	\$ 1.69	\$ (0.15)	\$ 0.18	\$ 1.74
Loss from discontinued operations	-	(0.10)	-	(0.02)	(0.13)
Net income (loss)	<u>\$ (0.49)</u>	<u>\$ 1.59</u>	<u>\$ (0.15)</u>	<u>\$ 0.16</u>	<u>\$ 1.61</u>
Diluted:					
Income (loss) from continuing operations	\$ (0.50)	1.69	\$ (0.16)	\$ 0.18	\$ 1.73
Loss from discontinued operations	-	(0.10)	-	(0.02)	(0.13)
Net income (loss)	<u>\$ (0.50)</u>	<u>\$ 1.59</u>	<u>\$ (0.16)</u>	<u>\$ 0.16</u>	<u>\$ 1.60</u>
Weighted average number of ordinary shares used in computing basic net income(loss) per share (thousands)	<u>29,526</u>	<u>29,421</u>	<u>29,533</u>	<u>29,433</u>	<u>29,437</u>
Weighted average number of ordinary shares used in computing diluted net income(loss) per share (thousands)	<u>29,526</u>	<u>29,537</u>	<u>29,533</u>	<u>29,523</u>	<u>29,550</u>

## **MANAGEMENT REPORT FOR THE THIRD QUARTER ENDED SEPTEMBER 30, 2006**

The following discussion should be read in conjunction with our Condensed Interim Consolidated Financial Statements as of September 30, 2006 and notes thereto and with our Annual Consolidated Financial Statements as of December 31, 2005 and notes thereto, filed with the Securities and Exchange Commission under item 18 to our annual report on Form 20-F for the year ended December 31, 2005 ("2005 20-F"). This report contains forward-looking statements that involve risks and uncertainties. Such forward-looking statements may be identified by the words "anticipate", "believe", "estimate", "expect", "plan" and similar expressions. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those discussed in our filings with the Securities and Exchange Commission from time to time.

### **OVERVIEW**

We are a high technology operational holding company that operates through subsidiaries and affiliated companies, referred to as our group companies. Founded in 1962, we have been a major force in the development of the Israeli high technology industry by building Israeli and Israel-related companies with technologies in the fields of medical devices, communications, semiconductors, software products and services and clean technology.

Our group companies include both publicly traded and privately held companies.

Our activities range from operational control over the business to involvement in the management of our group companies in which we maintain controlling or significant holdings, and, in a limited number of cases, non-significant holdings. We participate in the management of most of our group companies by means of active membership on their boards of directors and board committees. As a result, we are involved in matters of policy, strategic planning, marketing, selecting and manning senior management positions, approving investments and budgets, financing and the overall ongoing monitoring of our group companies' performance. In addition to our representation on the boards of directors of our group companies, we provide hands-on assistance to the group companies' management in support of their growth. We view our hands-on involvement in the operations of our group companies as a key element of our business. Our group companies therefore benefit from the experience of our management team in various areas in which they need support and leadership, including, but not limited to, strategic planning, research and development guidance, identifying joint venture opportunities, introductions to potential customers and investors, risk management, market analysis, business plan preparation, budgetary control, and legal support.

Technology industries are characterized by the high degree of risk inherent in their products, their continuous technological innovation and their penetration into world markets, which requires investment of considerable resources and continuous development efforts. The future success of our group companies is dependent upon their technological quality, prices and nature of their products in comparison to their competitors and their ability to introduce new products to the markets at the right time, while offering cost effective solutions suitable to their customers' needs as well as their ability to raise financing and the condition of the capital markets.

We expect to continue to build and realize value for our shareholders through the sale to third parties of a portion or all of our holdings in, or the issuance of shares by, our group companies, while simultaneously pursuing the acquisition of, or investment in, new and existing companies at different stages of development including early stage and more mature companies. We believe that this strategy provides the ability to increase shareholder value as well as to create capital to support the growth of our group companies and to invest in new opportunities. The nature of our business, therefore, will result in some volatility in our results of operations, depending on the transactions that occur within a particular period.

Our net income (or loss) in any given period is due, for the most part, to the results of operations of those of our group companies which are accounted by us under the consolidation or equity method of accounting and dispositions and changes in our holdings of group companies. As most of our group companies are technology companies which have not yet generated significant revenues and which invest considerable resources in research and development and in marketing activities, we have experienced, and expect to continue to experience, losses in respect of these companies to the extent they are accounted by us under the consolidation or equity method of accounting.

Our capital resources in any given period are primarily affected by the extent of our investment in existing and new companies and the realization of certain holdings as well as the impact of any dividends or distributions to our shareholders. The results of operations of our group companies, and consequently, our results of operations and capital resources, are affected by general economic conditions as well as by factors specifically related to the technology markets, which also affect the ability of our group companies to raise financing and our ability to dispose of holdings and realize gains from our holdings.

### **TREND INFORMATION**

Technology industries are affected by economic trends and the condition of the capital markets. Since the second half of 2003, there has been a recovery in the technology sectors and capital markets from the downturn which commenced in 2001. This trend was reflected in the improvement in the results of operations of most of our group companies as well as the raising of funds from new strategic and other investors in private placements completed by some of our group companies. In addition, we recorded

significant gains from realizing certain of our holdings, mainly in 2004 as a result of the sale of our holdings in Elbit Systems Ltd. (Nasdaq: ESLT) ("Elbit Systems"), and in the second quarter of 2005 from the sale of most of our shares in Partner Communications Company Ltd. (Nasdaq: PTNR) ("Partner") and the sale of all of our shares in Oren Semiconductor, Inc. ("Oren"). Total proceeds from these transactions amounted to approximately \$310 million. We have used the proceeds to distribute a dividend, in 2005, of \$88.5 million to our shareholders and to continue investing in existing and new group companies. Since 2004 we and our subsidiary, RDC – Rafael Development Corporation Ltd. ("RDC") invested \$76.2 million in 11 new companies. Should the improvement in the technology sectors and capital markets continue, we anticipate that it will have a positive effect on our group companies and their ability to raise additional capital.

## RECENT DEVELOPMENTS

***Investment in Safend Ltd. ("Safend").*** On January 2, 2006, we completed an investment of approximately \$3.7 million in Safend, as part of an aggregate investment of approximately \$7.4 million, in consideration for approximately 22% of Safend's equity on a fully diluted basis and on an as converted basis. Safend is an Israeli company which develops comprehensive desktop and laptop endpoint security solutions.

***Investment in NuLens Ltd. ("NuLens").*** On March 9, 2006 we made an additional investment of approximately \$1.5 million in NuLens, an Israeli medical device company operating in the field of intra-ocular lenses, mainly for cataract and presbyopia procedures. Our investment was part of an aggregate new investment of approximately \$6.0 million, led by Warburg Pincus, a leading global private equity fund. Simultaneously with this round we invested the second installment of our initial investment in NuLens in April 2005, amounting to \$1.1 million. Following the above investments, we hold 25% of NuLens' equity, on a fully diluted and on an as converted basis.

***Investment in Advanced Metal Technology Ltd. ("AMT").*** The AMT group develops technologies and products based on amorphous metals. In June 2006, AMT completed a financing round of \$14 million led by Shamrock Israel Growth Fund, an Israeli private equity fund. We committed to invest an amount of \$5 million in two installments, the first of \$2.5 million was invested immediately, and an additional \$2.5 million is subject to certain conditions. In addition, we and other shareholders converted into equity previously granted loans in the amount of \$1.0 million, of which our share was \$0.5 million. In connection with the above financing round, AMT issued convertible notes to certain minority shareholders of its affiliates and subsidiaries, in consideration for their holdings in those companies (the "SWAP"). As a result of the SWAP, Elron recorded in the third quarter a gain of approximately \$1.7 million. Following the above financing round and SWAP, our holdings in AMT decreased from approximately 42% to 34% on an as converted basis.

***Purchase of Given Imaging Ltd. ("Given Imaging") Shares.*** During August 2006, we purchased 539,721 shares of Given Imaging on the open market for an aggregate purchase price of approximately \$10 million. As a result, our direct and indirect (through RDC) interest in Given Imaging increased from approximately 19.3% to approximately 21.2% of the outstanding shares of Given Imaging. Discount Investment Corporation Ltd. ("DIC"), currently a 48% shareholder of Elron (see disclosure below regarding DIC's current tender offer for additional shares of Elron), simultaneously purchased the same number of shares of Given Imaging for the same aggregate purchase price and now owns 14.3% of the outstanding shares of Given Imaging. The excess cost of the purchase price over our share in the equity acquired amounted to approximately \$8.1 million and was allocated as follows: \$6.3 million to intangible assets other than goodwill, such as customer base and technology, \$1.0 million to in-process research and development activities, and \$0.8 million to goodwill. Products which did not receive marketing clearance by regulatory authorities as of the acquisition date, were considered to be incomplete and accordingly the amount allocated to such products is considered to be in-process research and development activities ("IPR&D"). The amount allocated to IPR&D was charged immediately to the Company's results of operations in accordance with FASB Interpretation No. 4, "Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method" ("FIN 4"). The amounts allocated to intangible assets other than goodwill are being amortized on a straight-line basis over their expected useful life of 8.5-13.5 years.

***Investment in Enure Networks Ltd. ("Enure").*** On August 10, 2006, Enure completed an additional \$4 million financing round, of which we invested \$0.5 million and \$3.5 million was invested by a new investor. This financing round was a continuation of the financing round of \$4 million invested by us on October 2, 2005 for a consideration for 44% of Enure on a fully diluted basis and on an as converted basis. Following the above financing round, our interest in Enure decreased from 44% to 34% on a fully diluted basis and on an as converted basis.

***Investment in Neurosonix Ltd. ("Neurosonix").*** On August 27, 2006, we completed an investment of \$5 million in Neurosonix as part of an aggregate investment of \$12 million. The investment was in two installments: the first of \$2.9 million was invested immediately, and an additional \$2.1 million is subject to the fulfillment of a milestone by Neurosonix. Following our aggregate investment, we will hold approximately 18% of Neurosonix on a fully diluted basis and on an as converted basis. Neurosonix is an Israeli company which is engaged in the development and commercialization of medical devices for the prevention of acute cerebral embolism during open-heart cardiac surgery as well as other invasive and minimally-invasive procedures.

***Investment in Atlantium Inc. ("Atlantium").*** On October 23, 2006, we completed an investment of \$10 million in Atlantium in consideration for approximately 25.7% of Atlantium's equity on a fully diluted basis and on an as converted basis. Atlantium, an Israeli-based water technology company, provides innovative water disinfection solutions employing its proprietary Hydro-Optic Disinfection (HOD) technology.

## Other developments in our group companies:

**3DV Systems Ltd ("3DV")**, 62% held by us directly and through RDC, is in advanced negotiations to complete a substantial round of financing from leading new investors with one of whom 3DV has reached a conditional definitive agreement.

**ChipX, Inc.**, 29% held by us, is in advanced negotiations to acquire a business unit with annual sales of approximately \$20 million which, if consummated, is expected to position ChipX as an important supplier in the Application Specific IC market in North America.

There is no assurance that any of the above potential transactions will be completed.

**DIC tender offer.** On October 25, 2006 DIC commenced a tender offer (the "Offer") to purchase up to 4,440,000 ordinary shares of Elron for \$12 per share, net to the seller in cash, less any required withholding taxes and without interest. Currently, DIC owns approximately 48% of our outstanding shares. Following the consummation of the tender offer, DIC would own approximately 63% of our outstanding shares. On October 31, 2006, our Board of Directors determined not to make any recommendation to Elron's shareholders as to whether they should tender their shares in the Offer. Among other reasons set forth in Elron's Schedule 14D-9 Solicitation/Recommendation Statement filed with the Securities and Exchange Commission, our Board of Directors stated that it believes that a shareholder's decision on whether or not to tender shares in the Offer and, if so, how many shares to tender, is a personal investment decision based upon each individual shareholder's particular circumstances.

**Claim by Rafael.** On September 20, 2006 Rafael Armaments Development Authority Ltd. ("Rafael") filed a claim with the Tel Aviv District Court against our 100% subsidiary, DEP Technology Holdings Ltd. ("DEP"), and RDC, 50.1% held by DEP and 49.9% held by Rafael, requesting the court to issue a declaratory order that Rafael is entitled to terminate the rights granted to RDC to commercialize technologies of Rafael for future development of products for use in non-military markets, pursuant to an agreement between DEP, RDC and Rafael. We strongly believe, based on legal advice, that there is no basis for Rafael's claim and intend to vigorously defend the claim.

### Additional claims

During September 2006, two claims were filed by a certain individual in the Haifa District Court against the same defendants (including Elron and certain of its officers and former officers) of the action filed by institutional investors and others in 1999 (see Note 5(2) in our Condensed Interim Consolidated Financial Statements as of September 30, 2006) and based substantially on the same facts of such action. The claims are for an undisclosed amount and also include a request to recognize the claims as class actions. The claims have not yet been formally served upon the Company and the Court has determined that the defendants do not yet have to file statements of defense. A preliminary hearing is scheduled for January 2007 in order to consider the status of the claims. We deny the allegations set forth in the claims and based on legal advice received, our management is of the opinion that we have good defense arguments which, if accepted, will cause dismissal of the allegations.

## CERTAIN U.S. FEDERAL INCOME TAX CONSIDERATIONS

See our 2005 20-F under Item 10 "Additional Information – Taxation – U.S. Federal Income Tax Considerations - Tax Consequences if we are a Passive Foreign Investment Company ("PFIC")", concerning Elron's status with respect to the U.S. tax provisions regarding PFIC.

## CRITICAL ACCOUNTING POLICIES

We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the United States ("US GAAP"). Our significant accounting policies are more fully described in Note 2 of the Notes to our 2005 Annual Consolidated Financial Statements. The accounting policies which are particularly important to the assessment of our financial position and results of operations are described under item 5 to our 2005 20-F under "Critical Accounting Policies". Following DIC tender offer discussed above, the Company intends to bring to a shareholders approval the resolution to report according to Israeli GAAP including reconciliation to US GAAP in a separate note to the financial statements. The material differences between US GAAP and Israeli GAAP are detailed in Note 26 to 2005 annual report. In November 2005, the Israeli Accounting Standard Board determined that, effective January 1, 2008, financial statements of Israeli public companies will be prepared in accordance with International Financial Reporting Standards (IFRS).

## BASIS OF PRESENTATION

**Consolidation.** Our consolidated financial statements include the accounts of Elron and all of our direct or indirect (through Elbit, DEP and RDC) controlled subsidiaries. The following are our main subsidiaries:

Three and nine months ended September 30,				
2006			2005	
RDC	Starling	Enure <sup>3</sup>	Elron TeleSoft <sup>1</sup>	SELA
Galil Medical	3DV		RDC	3DV
SELA	Medingo <sup>2</sup>		Galil Medical	Starling



<sup>1</sup> Sold on December 29, 2005.

<sup>2</sup> Medingo was established by RDC in the fourth quarter of 2005.

<sup>3</sup> Enure has been consolidated since its acquisition, in the beginning of the fourth quarter of 2005 and ceased to be consolidated from August 10, 2006 as a result of an investment of \$3.5 million by a third party in Enure, which resulted in a decrease in our share from 57% to 41% of Enure's outstanding shares.

**Equity Method.** Our main group companies held by us or through Elbit, DEP, Galil Medical and/or RDC accounted for under the equity method of accounting include:

Three and nine months ended September 30,					
	2006			2005	
Given Imaging	Wavion	CellAct	Given Imaging	ChipX	Pulsicom
Oncura	AMT		Oncura	Wavion	CellAct
NetVision	Notal Vision		NetVision	AMT	
ChipX	Pulsicom		Oren Semiconductor <sup>1</sup>	Notal Vision	

<sup>1</sup> Sold on June 10, 2005.

**Other investments.** Our main group companies held by us which are accounted for under the cost method or as available-for-sale as of September 30, 2006 include:

Cost - Jordan Valley, Teledata, Impliant, BrainsGate, NuLens, Safend, Neurosonix and Enure (from August 10, 2006).

Available-for-sale Securities – Partner and EVS.

## RESULTS OF OPERATIONS

### Three and nine months ended September 30, 2006 compared to three and nine months ended September 30, 2005.

The following tables set forth our results of operations in the reported period:

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
	(millions of \$, except per share data)			
Net income (loss)	(4.4)	4.8	(14.4)	46.8
Net income (loss) per share	(0.15)	0.16	(0.49)	1.59

The net loss we reported in the three and nine months ended September 30, 2006 resulted from our share in the net loss of our group companies in the amount of \$7.2 million and \$19.1 million, respectively, which included a \$1.0 million write-off of IPR&D related to the acquisition of additional shares of Given Imaging and \$1.7 million gain from the decrease in holding in AMT (see under recent developments). In addition, the net loss for the period of nine months ended September 30, 2006 included our share in an impairment charge related to Galil Medical's investment in Oncura in the amount of \$6.1 million (\$2.5 million after minority interest).

The net income we reported in the nine months ended September 30, 2005 was mainly due to the following gains from changes in holding and dispositions of group companies:

- (i) a gain, net of tax, of approximately \$45.4 million resulting from the sale of Partner's shares in consideration for \$94.0 million in the second quarter of 2005. This gain includes approximately \$9.4 million, which was recorded in the third quarter of 2005, resulting from a decrease in our previous valuation allowance in respect of losses incurred in prior periods, following our receipt of a final tax assessment;
  - (ii) a gain, net of tax, of approximately \$17.2 million resulting from the sale of Oren Semiconductor Inc. shares in consideration for \$20.3 million in cash and Zoran Corporation shares; and
  - (iii) a gain of approximately \$3.0 million from the decrease in our interest in NetVision following its initial public offering.
- The above gains were offset by losses, net, which we recorded with respect to our group companies in the amount of \$6.0 million and \$18.2 million in the three and nine month periods ended September 30, 2005, respectively.

The following table summarizes our operating results:

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
	(millions of \$)			
Net revenues	2.4	2.9	9.5	9.1
Net loss from equity investments	(4.7)	(5.3)	(16.6)	(13.0)
Gains from disposal of business and affiliated companies and changes in holdings in affiliated companies	2.3	1.1	2.3	23.5
Other income, net	0.6	1.5	4.0	58.0
Finance income, net	<u>1.1</u>	<u>1.0</u>	<u>3.4</u>	<u>5.2</u>
Total income	<u>1.7</u>	<u>1.2</u>	<u>2.6</u>	<u>82.8</u>

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
	(millions of \$)			
Cost of revenues	1.3	1.8	5.2	5.7
Operating expenses**	6.8	5.1	20.8	13.1
Amortization of other assets	<u>–</u>	<u>–</u>	<u>–</u>	<u>0.1</u>
Total costs and expenses	<u>8.1</u>	<u>6.9</u>	<u>25.9</u>	<u>18.9</u>
Gain (loss) from continuing operations before income taxes	(6.4)	(5.7)	(23.3)	63.9
Tax benefit (Income taxes)	–	9.7	(0.1)	(16.2)
Minority interest	<u>2.0</u>	<u>1.5</u>	<u>9.0</u>	<u>2.1</u>
Net income (loss) from continuing operations	(4.4)	5.5	(14.4)	49.8
Discontinued operations of the Elron Telesoft group*	<u>–</u>	<u>(0.7)</u>	<u>–</u>	<u>(2.9)</u>
Net income (loss)	<u>(4.4)</u>	<u>4.8</u>	<u>(14.4)</u>	<u>46.9</u>

\* In December 2005, we sold all our holdings in the Elron Telesoft group which was focused on telecom network management products and services, and accordingly the prior period results have been reclassified as discontinued operations.

\*\* Excluding amortization of intangible assets which are presented separately.

## Income

**Net revenues.** Net revenues consisted of sales of products and services by our subsidiaries, mainly Galil Medical and SELA. The following table sets forth these revenues:

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
	(millions of \$)			
Galil Medical	1.8	1.9	5.9	6.0
SELA	0.6	0.9	3.5	2.9
Other	<u>–</u>	<u>0.1</u>	<u>0.1</u>	<u>0.2</u>
	<u>2.4</u>	<u>2.9</u>	<u>9.5</u>	<u>9.1</u>

Galil Medical's revenues derived mainly from the supply of cryo products and R&D services to Oncura, in which it has a 25% ownership interest.

**Share in net losses of affiliated companies.** Our share in net losses of affiliated companies resulted from our holdings in certain investments that are accounted for under the equity method (see above under “Basis of Presentation”). Our share in net losses of affiliated companies amounted to \$4.7 million and \$16.6 million in the three and nine month periods ended September 30, 2006, compared to \$5.3 million and \$13.0 million in the same periods in 2005. Our share in the net losses of affiliated companies in the three and nine month periods ended September 30, 2006 included a \$1.0 million write-off of IPR&D relating to the acquisition of additional shares of Given Imaging. Our share in the net losses of affiliated companies in the nine months period ended September 30, 2006 included a \$6.1 million impairment charge in Galil Medical's investment in Oncura (\$2.5 million after minority interest).

## Highlights of the Results of Operations of Our Major Affiliates:

**Given Imaging (Nasdaq: GIVN) (a 21.2% holding directly and indirectly through RDC).** Given Imaging Ltd. (“Given Imaging”), a medical device company that develops, manufactures and markets innovative diagnostic systems for visualizing the gastrointestinal tract, using a disposable miniature swallowable video capsules. Given Imaging's revenues in the three and nine month periods ended September 30, 2006, increased by 21.2% and 8.3% respectively, to \$24.0 million and \$67.6 million, compared to \$19.8 million and \$62.4 million in the same periods in 2005. On a US GAAP basis, Given Imaging recorded net income of \$0.7 million in the three months period ended September 30, 2006 and net loss in the nine months period ended September 30, 2006 of \$3.0 million, compared to net income of \$1.9 million and net income of \$2.8 million in the same periods in 2005. Given Imaging's results in the three and nine month periods ended September 30, 2006 included the impact of \$1.1 million and \$4.1 million respectively in compensation expenses due to the impact of FAS 123R, which was adopted by Given Imaging as of the beginning of 2006.

**Oncura (a 25% holding by Galil).** Oncura, which markets and sells therapeutic device systems and related consumables used primarily in the performance of minimally-invasive, urologic cancer treatment, recorded revenues in the three and nine month periods ended September 30, 2006 of approximately \$15 million and \$48 million, compared to \$16.6 million and \$54.9 million in the same periods in 2005. Oncura's net loss in the three and nine month periods ended September 30, 2006 amounted to approximately \$3.4 million and \$6.9 million, compared to \$1.9 million and \$4.1 million in the same periods in 2005. The increase in the net loss resulted primarily due to the decrease in revenues. In light of Oncura's results of operations, an

impairment charge of \$6.1 million was recorded in the second quarter of 2006 (\$2.5 million after minority interest). In August 2006 Oncura's shareholders provided to Oncura a letter in which they confirmed their intention to continue providing financial support to Oncura through August 2007 or such later date, as may be agreed by Oncura's shareholders.

**NetVision (a 38% holding) (TASE: NTSN).** NetVision provides Internet services and solutions in Israel and commencing the fourth quarter of 2004 international telephony services through Voice over IP technology (VoIP). NetVision's revenues in the three and nine month periods ended September 30, 2006 increased by 18.7% and 17.6% to \$24.1 million and \$69.1 million from \$20.3 million and \$58.8 million in the same periods in 2005 and its customer base at September 30, 2006 reached approximately 445,000 (of which approximately 302,000 were broadband) compared to 425,000 at the end of 2005 (of which approximately 272,000 were broadband). NetVision's operating income in the three and nine month periods ended September 30, 2006 increased by 26.8% and 45.7% to \$4.0 million and \$10.4 million, compared to \$3.2 million and \$7.2 million in the same periods in 2005, mainly as a result of the increase in Internet services operating income, and its net income increased in the three and nine month periods ended September 30, 2006 to \$3.5 million and \$8.5 million from \$2.1 million and \$3.5 million in the same periods in 2005. NetVision's operating currency is the New Israeli Shekel (NIS) and accordingly, all figures above are translations for convenience purposes of NetVision's NIS figures into US dollars at the representative rate of exchange prevailing at September 30, 2006 according to which \$1.00 equaled NIS 4.302.

On September 6, 2006, NetVision signed definitive agreements with each of Barak I.T.C. (1995) International Telecommunications Services Corp. Ltd. ("Barak") and GlobeCall Communications Ltd. ("GlobeCall") and their shareholders, whereby NetVision will purchase from the Barak shareholders all of Barak's issued share capital in exchange for approximately 46.5% of NetVision's share capital immediately after the transaction ("Barak Merger"), and NetVision will purchase from DIC, the other major shareholder of NetVision, all of GlobeCall's issued share capital in exchange for approximately 7% of NetVision's share capital immediately after the Barak Merger and the transaction ("GlobeCall Merger"). The above mentioned exchange ratios were based upon company valuations, that were issued to the parties by independent appraisers, according to which NetVision's valuation was estimated to be between 533 million NIS (approximately \$122 million) and 621 million NIS (approximately \$142 million), Barak's valuation was estimated to be between 456 million NIS (approximately \$105 million) and 529 million NIS (approximately \$121 million), and GlobeCall's valuation was estimated to be between 67 million NIS (approximately \$15 million) and 90 million NIS (approximately \$21 million). Barak is a subsidiary of Clal Industries and Investments Ltd. ("Clal"). Elron, Clal and DIC, are all part of the IDB group. The GlobeCall Merger will close immediately after the Barak Merger, and is dependent upon it. If these transactions occur, Elron's holding in NetVision would be reduced from approximately 38% to approximately 19%.

The transactions are subject to the receipt of certain approvals required under the applicable laws. Netvision's Board of Directors approved the transaction on September 11, 2006. There is no assurance that the transactions will be consummated.

**Wavion (a 38% holding).** Wavion is a developer of broadband wireless access systems for Wi-Fi networks. Wavion's net loss amounted to \$1.9 million and \$5.7 million in the three and nine month periods ended September 30, 2006 compared to \$1.5 million and \$4.6 million in the same periods in 2005. The increase in Wavion's loss resulted mainly from increase in Wavion's marketing expenses relating to the launch of its product. In May 2006, Wavion completed a private placement of \$3.6 million from existing shareholders.

**ChipX (a 29% holding).** ChipX is a manufacturer of late stage programmable application-specific integrated circuits, or structured ASICs. ChipX's revenues in the three and nine month periods ended September 30, 2006 amounted to \$4.1 million and \$11.4 million, compared to \$2.3 million and \$11.3 million in the same periods in 2005, and its net loss amounted to \$1.4 million and \$4.6 million, compared to \$2.6 million and \$4.4 million in the same periods in 2005. In May 2006, ChipX completed a private placement of \$6.0 million from existing shareholders, the proceeds of which will be used to finance its sales and marketing activities. We invested approximately \$2.3 million in this round resulting in the increase in our interest in ChipX to 26%, on a fully diluted basis.

**AMT (a 34% holding).** AMT's consolidated revenues in the three and nine month periods ended September 30, 2006, amounted to \$0.8 million and \$2.5 million, compared to \$0.7 million and \$2.5 million in the same periods in 2005 and its consolidated net loss amounted to \$2.1 million and \$5.2 million in the three and nine month periods ended September 30, 2006, compared to \$0.9 million and \$2.3 million in the same periods in 2005.

We expect that most of our group companies as well as new companies in which we will invest will continue to recognize losses in future periods, as they invest significant resources in research and development and sales and marketing activities and have not yet generated significant revenues. Our results of operations will therefore be affected by the extent of our share in their net losses (to the extent they are reported under the equity or consolidation method of accounting).

**Gains from Disposal of Businesses and Affiliated Companies and Changes in Holdings in Affiliated Companies.** Gains from disposal of businesses and affiliated companies and changes in our holdings in affiliated companies, amounted to \$2.3 million in the both of the three and nine month periods ended September 30, 2006, compared to \$1.1 million and \$23.5 million in the same periods in 2005. The gain in the three and nine month periods ended September 30, 2006 resulted primarily from \$1.7 million gain from the SWAP in AMT (see above under recent developments) and decrease in our holding in NetVision as a result of option exercises and debenture conversions. The gain in the nine months period ended September 30, 2005 resulted primarily from the following: (i) a gain of approximately \$19.7 million (which after income taxes amounted to \$17.2 million) resulting from

the sale of Oren's shares in consideration for \$20.3 million; and (ii) a gain of approximately \$3.0 million from the decrease in our interest in NetVision following its initial public offering and (iii) a gain of \$1.2 million (which after minority interest and income taxes amounted to \$0.5 million) resulting from the exercise of a call option granted to a former senior executive of RDC to purchase 70,200 shares of Given Imaging for the aggregate exercise price of approximately \$12 thousand.

**Other Income, net.** Other income, net, amounted to \$0.6 million and \$4.0 million in the three and nine month periods ended September 30, 2006 compared to \$1.5 million and \$58.0 million in the same periods in 2005. The gain for the nine months period ended September 30, 2006 derived mainly from a \$2.7 million gain resulting from the settlement of Mediagate's bank loan and from a dividend distributed by Partner in the amount of \$1.4 million.

The gain in the nine months period ended September 30, 2005 was primarily due to a \$56.4 million gain (which after income taxes amounted to \$45.4 million) from the sale of 12,765,190 shares of Partner for approximately \$94.0 million and gain in the third quarter of 2005 of \$1.1 million (\$0.7 million net of tax) from the sale of Zoran's shares received as part of the consideration for Oren's shares.

**Finance income, net.** Finance income, net, in the three and nine month periods ended September 30, 2006 amounted to \$1.1 million and \$3.4 million, compared to \$1.0 million and \$5.2 million in the same periods in 2005. The decrease in finance income is mainly due to the effect of lower cash and debenture balances, which was partially offset by an increase in interest rates, during the nine months of 2006 as compared to the nine months of 2005.

## Expenses

**Cost of revenues.** Cost of revenues consisted primarily of expenses related to salaries and hardware associated with delivering products and services of our subsidiaries, mainly Galil Medical and SELA. Cost of revenues in the three and nine month periods ended September 30, 2006 amounted to \$1.3 million and \$5.2 million, compared to \$1.8 million and \$5.7 million in the same periods in 2005.

**Operating expenses.** Operating expenses are comprised of research and development expenses, sales and marketing and general and administrative expenses of our and RDC's corporate operations and our subsidiaries, mainly Galil Medical, SELA, Starling, Medingo, 3DV and Enure (through August 10, 2006). The following table sets forth the operating expenses:

	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
	(millions of \$)			
Corporate	1.3	1.7	4.6	5.6
Galil Medical	0.9	0.8	2.4	2.0
SELA	0.5	0.8	2.6	2.4
Starling	2.0	0.7	4.3	1.8
3DV	0.4	0.5	1.9	1.3
Enure*	0.4	-	1.9	-
Medingo**	0.8	-	2.0	-
RDC	<u>0.4</u>	<u>0.6</u>	<u>1.1</u>	<u>-</u>
	<u>6.8</u>	<u>5.1</u>	<u>20.8</u>	<u>13.1</u>

\* Consolidated since the forth quarter of 2005 and up to August 10, 2006.

\*\* Consolidated since the forth quarter of 2005

Corporate operating expenses in the three and nine month periods ended September 30, 2006 amounted to \$1.3 million and \$4.6 million, compared to \$1.7 million and \$5.6 million in the comparable periods of 2005. The decrease resulted mainly from a decrease in salaries and related expenses.

Operating expenses of Galil Medical in the three and nine month periods ended September 30, 2006 amounted to \$0.9 million and \$2.4 million, compared to \$0.8 million and \$2.0 million in the same periods in 2005 and its operating loss amounted to \$0.1 million and \$0.2 million compared to \$0.3 million and \$0.4 million in the same periods in 2005. Galil is currently focused on the development of the cryotherapy technology for application in the women's health field. In November 2005, Galil Medical's Cryo products received FDA clearance for the treatment of breast fibroadenoma (non cancerous breast lumps).

SELA's operating expenses amounted to \$0.5 million and \$2.6 million in the three and nine month periods ended September 30, 2006, compared to \$0.8 million and \$2.4 million in the same periods in 2005 and its operating loss amounted to \$0.3 million and \$0.6 million, the same as in the comparable periods in 2005.

Starling's operating expenses and operating loss amounted to \$2.0 million and \$4.3 million in the three and nine month periods ended September 30, 2006, compared to \$0.7 million and \$1.8 million in the same periods in 2005. The increased loss resulted mainly from the increase in development expenses.

**Income Taxes.** Income taxes, net, amounted in the three and nine month periods ended September 30, 2006 to \$23 thousands and \$0.1 million, compared to tax benefit of \$9.7 million and tax expenses of \$16.2 million in the same periods of 2005. The income taxes in the nine months ended September 30, 2005 resulted mainly from the sale of Partner shares and the sale of Oren Shares. In

the third quarter of 2005 we recorded a tax benefit of \$9.4 million, mainly as a result of a decrease in our previous valuation allowance in respect of losses incurred in prior periods following our receipt of a final tax assessment

## **LIQUIDITY AND CAPITAL RESOURCES**

Consolidated cash, debentures and deposits at September 30, 2006, were approximately \$104.2 million compared with \$143.8 million at December 31, 2005. At September 30, 2006, corporate cash, debentures and deposits were \$98.7 million compared with \$133.8 million at December 31, 2005.

The main uses of the corporate cash and other liquid instruments in the nine months period ended September 30, 2006, were \$36.9 million of investments in our group companies, which included the purchase of 539,721 shares of Given Imaging for an aggregate purchase price of approximately \$10 million, the purchase of an additional 0.6% of Partner shares from one of the other Israeli founding shareholders of Partner for approximately \$5.3 million, a \$3.5 million investment in Safend, a \$2.6 million investment in NuLens, a \$2.3 million investment in ChipX, a \$2.5 million investment in AMT, a \$3 million loan to our subsidiary RDC, a \$1.4 million investment in Wavion and \$2.9 million investment in Neurosonix.

In October 2006 we invested \$10 million in Atlantium.

Consolidated working capital at September 30, 2006 amounted to \$98.6 million compared to \$136.2 million at December 31, 2005. The decrease is mainly due to the decrease in corporate cash and other liquid instruments which were used to invest in our group companies and in new companies.

Consolidated loans at September 30, 2006, were approximately \$6.8 million, compared to \$7.3 million at December 31, 2005. In the first quarter of 2006 MediaGate's bank loan in the amount of approximately \$2.8 million was settled in consideration for \$0.1 million.

All of the Partner shares held by us, amounting to approximately 3.9 million shares, are subject to certain transfer restrictions under Partner's Israeli communications license.

Our investment policy for managing our funds is in general to invest in bank deposits and U.S. government as well as high grade corporate debentures with high liquidity.

We believe that our existing capital will be sufficient to fund our and our subsidiaries' operations and our investment plan in existing and new companies for at least the next twelve months.

Shareholders' equity at September 30, 2006, was approximately \$292.5 million, representing approximately 87% of the total assets compared with \$302.1 million representing approximately 85% of total assets at December 31, 2005.

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**ELRON ELECTRONIC INDUSTRIES LTD.  
AND ITS SUBSIDIARIES**

**CONDENSED INTERIM CONSOLIDATED  
FINANCIAL STATEMENTS**

**As of September 30, 2006**  
(Unaudited)

**ELRON ELECTRONIC INDUSTRIES LTD.  
AND ITS SUBSIDIARIES**

**CONDENSED INTERIM CONSOLIDATED**

**FINANCIAL STATEMENTS**

**AS OF SEPTEMBER 30, 2006**

**UNAUDITED**

**INDEX**

	<b>Page</b>
<b>Consolidated Balance Sheets</b>	<b>1-2</b>
<b>Consolidated Statements of Operations</b>	<b>3</b>
<b>Statements of Shareholders' Equity</b>	<b>4-5</b>
<b>Consolidated Statements of Cash Flows</b>	<b>6-7</b>
<b>Notes to the Consolidated Financial Statements</b>	<b>8-16</b>
<b>Annex to the Consolidated Financial Statements</b>	<b>17</b>

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**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

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

	<b>September 30, 2006</b>	<b>December 31, 2005</b>
	<b>Unaudited</b>	
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 14,994	\$ 26,520
Short-term investments	21,797	54,661
Available-for-sale marketable debentures	67,369	62,617
Trade receivables (net of allowance for doubtful accounts of \$40 and of \$426 at September 30, 2006 and at December 31, 2005)*	5,222	6,440
Other receivables and prepaid expenses*	2,861	2,846
Inventories	2,972	2,117
Total current assets	<u>115,215</u>	<u>155,201</u>
<b>INVESTMENTS AND LONG-TERM RECEIVABLES</b>		
Investments in affiliated companies	105,941	102,780
Investments in other companies and long-term receivables*	93,727	73,931
Deferred taxes	5,839	6,521
Severance pay deposits	2,420	1,971
Total investments and long-term receivables	<u>207,927</u>	<u>185,203</u>
<b>PROPERTY AND EQUIPMENT, NET</b>	<u>7,770</u>	<u>7,809</u>
<b>INTANGIBLE ASSETS</b>		
Goodwill	2,742	2,742
Other intangible assets	2,805	2,818
Total intangible assets	<u>5,547</u>	<u>5,560</u>
Total assets	<u><u>\$ 336,459</u></u>	<u><u>\$ 353,773</u></u>

\* Includes short term receivables from related parties in the aggregate amount of \$4,801 and \$5,043 as of September 30, 2006 and December 31, 2005, respectively, and long term receivables from related parties in the aggregate amount of \$458 and \$434 as of September 30, 2006 and December 31, 2005, respectively.

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



**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

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

	<b>September 30, 2006</b>	<b>December 31, 2005</b>
	<b>Unaudited</b>	
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Short-term loans from banks	\$ 685	\$ 3,808
Current maturities of long-term loans from banks and others	2,209	2,065
Trade payables	3,109	2,146
Other payables and accrued expenses	10,617	11,025
Total current liabilities	16,620	19,044
<b>LONG-TERM LIABILITIES</b>		
Long-term loans from banks and others	3,863	1,477
Accrued severance pay and retirement obligations	3,294	2,635
Deferred taxes	9,656	9,494
Total long-term liabilities	16,813	13,606
<b>MINORITY INTEREST</b>	10,511	19,007
<b>SHAREHOLDERS' EQUITY:</b>		
Ordinary shares of NIS 0.003 par value; Authorized - 35,000,000 shares as of September 30, 2006 and December 31, 2005; Issued and outstanding – 29,534,955 and 29,483,455 shares as of September 30, 2006 and as of December 31, 2005, respectively	9,572	9,572
Additional paid-in capital	272,662	271,132
Accumulated other comprehensive income	13,982	10,741
Retained earnings (accumulated deficit)	(3,701)	10,671
Total shareholders' equity	292,515	302,116
Total liabilities and shareholders' equity	\$ 336,459	\$ 353,773

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

**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

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

	Nine months ended September 30,		Three months ended September 30,		Year ended December 31,
	2006	2005***	2006	2005***	2005
	Unaudited				
INCOME					
Net revenues*	\$ 9,522	\$ 9,131	\$ 2,384	\$ 2,885	\$ 12,646
Equity in losses of affiliated companies	(16,566)	(13,074)	(4,701)	(5,254)	(17,522)
Gain from disposal of businesses and affiliated companies and changes in holdings in affiliated companies, net	2,278	23,513	2,283	1,124	23,328
Other income, net	4,012	58,024	645	1,491	58,648
Financial income, net	3,410	5,238	1,133	977	5,483
	2,656	82,832	1,744	1,223	82,583
COSTS AND EXPENSES					
Cost of revenues	5,150	5,721	1,288	1,761	7,907
Research and development costs, net	8,871	4,574	2,993	1,931	6,163
Marketing and selling expenses, net	3,100	1,655	970	565	2,386
General and administrative expenses	8,792	6,860	2,881	2,612	9,249
Amortization of intangible assets	14	151	5	6	392
	25,927	18,961	8,137	6,875	26,097
Income (loss) before taxes on income	(23,271)	63,871	(6,393)	(5,652)	56,486
Tax benefit (taxes on income)	(122)	(16,183)	(23)	9,684	(10,461)
Income (loss) after taxes on income	(23,393)	47,688	(6,416)	4,032	46,025
Minority interest in losses of subsidiaries	9,021	2,104	1,982	1,459	5,160
Income (loss) from continuing operations	(14,372)	49,792	(4,434)	5,491	51,185
Loss from discontinued operations**	-	(2,943)	-	(729)	(3,850)
Net income (loss)	\$ (14,372)	\$ 46,849	\$ (4,434)	\$ 4,762	\$ 47,335
Income (loss) per share:					
Basic :					
Income (loss) from continuing operations	\$ (0.49)	\$ 1.69	\$ (0.15)	\$ 0.18	\$ 1.74
Loss from discontinued operations	-	(0.10)	-	(0.02)	(0.13)
Net income (loss)	\$ (0.49)	\$ 1.59	\$ (0.15)	\$ 0.16	\$ 1.61
Diluted:					
Income (loss) from continuing operations	\$ (0.50)	\$ 1.69	\$ (0.16)	\$ 0.18	\$ 1.73
Loss from discontinued operations	-	(0.10)	-	(0.02)	(0.13)
Net income (loss)	\$ (0.50)	\$ 1.59	\$ (0.16)	\$ 0.16	\$ 1.60
Weighted average number of ordinary shares used in computing basic net income (loss) per share (thousands)					
	29,526	29,421	29,533	29,433	29,437
Weighted average number of ordinary shares used in computing diluted net income (loss) per share (thousands)					
	29,526	29,537	29,533	29,523	29,550

\* Includes revenues from related parties, in the amount of \$5,132 and \$5,999 for the nine months ended September 30, 2006 and 2005, respectively, an amount of \$1,626 and \$1,889 for the three months ended September 30, 2006 and 2005, respectively, and an amount of \$8,046 for the year ended December 31, 2005.

\*\* Includes revenues from related parties in the amount of \$143 for the nine months ended September 30, 2005, an amount of \$0 for the three months ended September 30, 2005, and an amount of \$174 for the year ended December 31, 2005.

\*\*\* Reclassified due to discontinued operations.

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

**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**STATEMENTS OF SHAREHOLDERS' EQUITY**

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

	Number of shares	Share capital	Additional paid-in capital	Accumulated other comprehensive income	Retained earnings (Accumulated deficit)	Total Shareholders' equity	Total comprehensive income (loss)
<b>Balance as of January 1, 2005</b>	29,414,424	\$ 9,572	\$ 270,005	\$ 57,717	\$ 51,786	\$ 389,080	
Exercise of options	69,031	-	697	-	-	697	
Stock - based compensation	-	-	405	-	-	405	
Tax benefit in respect of options exercised	-	-	25	-	-	25	
Dividend paid	-	-	-	-	(88,450)	(88,450)	
Other comprehensive income, net of tax:							
Unrealized loss on available for sale securities	-	-	-	(10,450)	-	(10,450)	\$ (10,450)
Reclassification adjustment for gain realized and other than temporary impairment included in net income	-	-	-	(36,335)	-	(36,335)	(36,335)
Foreign currency translation adjustments	-	-	-	(191)	-	(191)	(191)
Net income	-	-	-	-	47,335	47,335	47,335
<b>Balance as of December 31, 2005</b>	29,483,455	\$ 9,572	\$ 271,132	\$ 10,741	\$ 10,671	302,116	
Total comprehensive income							<u>\$ 359</u>
<b>Unaudited</b>							
Exercise of options	51,500	-	257	-	-	257	
Stock - based compensation	-	-	284	-	-	284	
Issuance of shares in a development stage investee (see Note 3h)	-	-	989	-	-	989	
Other comprehensive loss, net of tax:							
Unrealized loss on available for sale securities	-	-	-	1,959	-	1,959	\$ 1,959
Reclassification adjustment for loss realized and other than temporary impairment included in net loss	-	-	-	761	-	761	761
Foreign currency translation adjustments	-	-	-	521	-	521	521
Net loss	-	-	-	-	(14,372)	(14,372)	(14,372)
<b>Balance as of September 30, 2006</b>	29,534,955	\$ 9,572	\$ 272,662	\$ 13,982	\$ (3,701)	\$ 292,515	
Total comprehensive loss							<u>\$ (11,131)</u>
<b>Unaudited</b>							
<b>Balance as of January 1, 2005</b>	29,414,424	\$ 9,572	\$ 270,005	\$ 57,717	\$ 51,786	\$ 389,080	
Exercise of options	69,031	-	697	-	-	697	
Stock based compensation	-	-	284	-	-	284	
Tax benefit in respect of options exercised	-	-	25	-	-	25	
Dividend paid	-	-	-	-	(88,450)	(88,450)	
Other comprehensive loss, net of tax:							
Unrealized loss on available-for-sale securities	-	-	-	(9,770)	-	(9,770)	\$ (9,770)
Reclassification adjustment for gain realized included in net income	-	-	-	(36,980)	-	(36,980)	(36,980)
Foreign currency translation adjustments	-	-	-	(185)	-	(185)	(185)
Net income	-	-	-	-	46,849	46,849	46,849
<b>Balance as of September 30, 2005</b>	29,483,455	\$ 9,572	\$ 271,011	\$ 10,782	\$ 10,185	\$ 301,550	
Total comprehensive loss							<u>\$ (86)</u>

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

**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**STATEMENTS OF SHAREHOLDERS' EQUITY**

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

	Number of shares	Share capital	Additional paid-in capital	Accumulated other comprehensive income	Retained earnings (Accumulated deficit)	Total Shareholders' equity	Total comprehensive income (loss)
<b>Unaudited</b>							
<b>Balance as of July 1, 2006</b>	29,531,955	\$ 9,572	\$ 271,564	\$ 9,553	\$ 733	\$ 291,422	
Exercise of options	3,000	-	15	-	-	15	
Stock based compensation	-	-	94	-	-	94	
Issuance of shares in a development stage investee (see Note 3h)	-	-	989	-	-	989	
Other comprehensive income (loss), net of tax:							
Unrealized gain on available for sale securities	-	-	-	3,791	-	3,791	\$ 3,791
Reclassification adjustment for loss realized included in net loss and other than temporary impairment included in net loss	-	-	-	375	-	375	375
Foreign currency translation adjustments	-	-	-	263	-	263	263
Net loss	-	-	-	-	(4,434)	(4,434)	(4,434)
<b>Balance as of September 30, 2006</b>	<u>29,534,955</u>	<u>\$ 9,572</u>	<u>\$ 272,662</u>	<u>\$ 13,982</u>	<u>\$ (3,701)</u>	<u>\$ 292,515</u>	
Total comprehensive loss							<u>\$ (5)</u>
<b>Unaudited</b>							
<b>Balance as of July 1, 2005</b>	29,416,924	\$ 9,572	\$ 270,187	\$ 7,937	\$ 93,873	\$ 381,569	
Exercise of options	66,531	-	678	-	-	678	
Stock based compensation	-	-	121	-	-	121	
Tax benefit in respect of option exercised	-	-	25	-	-	25	
Dividend paid	-	-	-	-	(88,450)	(88,450)	
Other comprehensive income, net of tax:							
Unrealized losses on available-for-sale securities	-	-	-	3,482	-	3,482	\$ 3,482
Reclassification adjustment for gain realized included in net income	-	-	-	(615)	-	(615)	(615)
Foreign currency translation adjustment	-	-	-	(22)	-	(22)	(22)
Net income	-	-	-	-	4,762	4,762	4,762
<b>Balance as of September 30, 2005</b>	<u>29,483,455</u>	<u>\$ 9,572</u>	<u>\$ 271,011</u>	<u>\$ 10,782</u>	<u>\$ 10,185</u>	<u>\$ 301,550</u>	
Total comprehensive income							<u>\$ 7,607</u>

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

**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**U.S. dollars in thousands**

	<b>Nine months ended September 30,</b>		<b>Year ended December 31,</b>
	<b>2006</b>	<b>2005</b>	<b>2005</b>
	<b>Unaudited</b>		
<u>Cash flows from operating activities</u>			
Net income (loss)	\$ (14,372)	\$ 46,849	\$ 47,335
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Equity in losses of affiliated companies	16,566	13,074	17,522
Minority interest in losses of subsidiaries	(9,021)	(2,104)	(5,160)
Gain from disposal of businesses and affiliated companies and changes in holdings in affiliated companies, net	(2,278)	(23,513)	(23,328)
Loss (gain) from sale of investments and other than temporary decline in available for sale securities	322	(57,355)	(56,515)
Gain from settlement of a subsidiary's loan	(2,708)	-	-
Gain from disposal of business included in discontinued operations	-	-	(213)
Depreciation and amortization	848	978	1,513
Impairment of intangible assets (discontinued operations)	-	1,329	1,329
Decline in value of other investments	-	636	636
Equity in losses (gains) of partnerships	521	(207)	(174)
Stock-based compensation and changes in liability in respect of call options	811	(908)	(811)
Deferred taxes, net	(87)	(4,179)	(7,288)
Changes in operating assets and liabilities			
Decrease (increase) in trade receivables	1,014	(514)	(947)
Decrease (increase) in other receivables and prepaid expenses	(28)	178	(38)
Decrease in trading securities, net	(2)	1	4
Increase in inventories	(855)	(517)	(519)
Increase (decrease) in trade payables	1,102	(736)	(834)
Increase (decrease) in other payables and accrued expenses	119	(8,943)	(12,139)
Other	795	10	(753)
Net cash used in operating activities	(7,253)	(35,921)	(40,380)
<u>Cash flows from investing activities</u>			
Investment in affiliated companies	(16,673)	(3,333)	(3,823)
Investment in other companies	(9,795)	(25,519)	(27,651)
Proceeds from sale of affiliated companies shares	992	10,510	10,522
Proceeds from repayment of loan granted to an affiliate company	-	2,253	2,253
Purchase of treasury stock from the minority by a subsidiary	-	(823)	(823)
Cash and cash equivalents resulting from newly consolidated subsidiaries (Sch. A)	-	-	-
Change in cash and cash equivalents resulting from disposal of businesses and decrease in holdings in formerly consolidated subsidiaries (Sch. B)	(1,056)	-	1,800
Proceeds from sale of available for sale securities	25,384	118,963	119,888
Proceeds from sale of other investments	-	93	237
Investments in deposits	(35,457)	(59,185)	(59,185)
Investment in available for sale securities	(35,227)	(35,405)	(35,405)
Proceeds from deposits	66,229	105,261	105,802
Purchase of property and equipment	(907)	(619)	(995)
Proceeds from sale of property and equipment	16	126	197
Net cash provided by (used in) investing activities	(6,494)	112,322	112,817
<u>Cash flows from financing activities</u>			
Proceeds from options exercised	257	697	697
Proceeds from exercise of options in a subsidiary	-	-	8
Receipt of long-term loans from banks	381	-	-
Repayment of long-term loans	(2)	(63)	(777)
Increase (decrease) in short-term bank loan, net	(415)	313	(1,079)
Receipt of short-term loans, convertible loans and long-term loans from minority shareholders of a subsidiary	2,000	500	1,003
Issuance of shares to the minority of a subsidiary	-	145	145
Issuance expenses in a subsidiary	-	(67)	(75)
Dividend paid	-	(84,839)	(88,450)
Net cash provided by (used in) financing activities	2,221	(83,314)	(88,528)
DECREASE IN CASH AND CASH EQUIVALENTS	(11,526)	(6,913)	(16,091)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	26,520	42,611	42,611
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	14,994	35,698	26,520
LESS CASH AND CASH EQUIVALENTS ATTRIBUTED TO DISCONTINUED OPERATIONS	-	(139)	-
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	\$ 14,994	\$ 35,559	\$ 26,520

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

**ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**U.S. dollars in thousands**

	<b>Nine months ended September 30,</b> <b>2006</b> <b>2005</b> <b>Unaudited</b>		<b>Year ended December 31,</b> <b>2005</b>
Supplemental cash flow information:			
Cash paid for:			
Income taxes	\$ 707	\$ 26,559	\$ 30,591
Interest	\$ 58	\$ 204	\$ 203
Proceeds from sale of an affiliate not yet received	\$ -	\$ 1,958	\$ 1,958
Proceeds from sale of an affiliate received in Zoran shares	\$ -	\$ 7,700	\$ 7,700

**SCHEDULE A:**

**Cash and cash equivalents resulting from newly consolidated subsidiaries**

Assets acquired and liabilities assumed at the purchase date:

Working capital deficiency, net (except cash and cash equivalents)	\$ -	\$ -	\$ 75
Property and equipment	-	-	(14)
Intangible assets	-	-	(237)
Accrued severance pay, net	-	-	27
Liability incurred	-	-	149
Cash and cash equivalents acquired	\$ -	\$ -	\$ -

**SCHEDULE B:**

**Change in cash and cash equivalents resulting from disposal of businesses and decrease in holdings in formerly consolidated subsidiaries**

Assets and liabilities at date of sale:

Working capital deficiency, net (except cash and cash equivalents)	\$ 735	\$ -	\$ (671)
Property and equipment	99	-	40
Investment in other companies	(2,702)	-	-
Minority interest	(135)	-	-
Capital reserve from issuance of shares in a development stage company	989	-	-
Intangible assets	-	-	2,389
Accrued severance pay, net	(42)	-	(171)
Gain resulting from sale of businesses	-	-	213
Net increase (decrease) in cash and cash equivalents	\$ (1,056)	\$ -	\$ 1,800

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

## ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

#### NOTE 1:- GENERAL

The accompanying unaudited condensed interim consolidated financial statements have been prepared as of September 30, 2006, and for the three and nine months then ended in accordance with accounting principles generally accepted in the United States (U.S. GAAP) relating to the preparation of financial statements for interim periods. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States but which are not required for interim reporting purposes, have been condensed or omitted. See Note 6 for the reconciliation from U.S. GAAP to accounting principles generally accepted in Israel ("Israeli GAAP").

These financial statements should be read in conjunction with the Company's annual financial statements and accompanying notes as of December 31, 2005, included in Form 20F for the year ended December 31, 2005 filed with the Securities and Exchange Commission ("the Company's annual financial statements").

The condensed interim consolidated financial statements reflect all adjustments which are, in the opinion of management considered, necessary to present fairly the financial position, results of operations and cash flows for the periods presented.

Results for the three and nine months ended September 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

#### NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

- a. The significant accounting policies followed in the preparation of these financial statements are identical to those applied in preparation of the latest annual financial statements, except as included in c below.
- b. The financial statements have been prepared in U.S. dollars, since the functional currency of the Company and its principal subsidiaries is the U.S. dollar.
- c. Effective January 1, 2006 ("the effective date"), the Company applied SFAS No. 123(R), "Share-Based Payment", which revises the previously effective SFAS No. 123 and supersedes APB No. 25. Generally, the approach in SFAS 123(R) is similar to the approach described in SFAS 123. However, SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

The company, its subsidiaries and its affiliated companies adopted SFAS 123(R) using the modified-prospective method. According to the modified-prospective method, compensation cost is recognized beginning with the effective date (a) based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R) for all share-based payments granted after the effective date and (b) based on the grant date fair value estimated in accordance with the provisions of SFAS 123 "Accounting For Stock-Based Compensation" ("SFAS 123") for all awards granted to employees prior to the effective date of SFAS 123(R) that remain unvested on the effective date.

Previously, the Company and its subsidiaries adopted the fair-value-based method of accounting based on the provisions of SFAS 123 for share-based payments effective January 1, 2003 using the prospective methods described in SFAS 148, "Accounting for Stock- Based Compensation- Transition and Disclosure".

Because 1) SFAS 123(R) must be applied not only to new awards but also to previously granted awards that are not fully vested on the effective date, 2) the Company adopted

## ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

#### NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

c. (cont.)

SFAS 123 using the prospective transition method (which applied only to awards granted, modified or settled after January 1, 2003), and 3) prior to January 1, 2006, the Company's affiliated companies applied APB 25 whereby compensation cost measured based on the intrinsic value of the options granted, compensation cost for some previously granted awards in the Company, its subsidiaries and in its affiliated companies that were not previously recognized are recognized under SFAS 123(R).

As a result of adopting the provisions of SFAS 123(R) on January 1, 2006 by the Company, its subsidiaries and its affiliated companies, the Company recorded compensation expenses in the amount of approximately \$460 and \$1,600 during the three and nine month periods ended September 30, 2006, respectively.

d. Recently accounting pronouncements:

1. In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 utilizes a two-step approach for evaluating tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) is only addressed if step one has been satisfied (i.e., the position is more-likely-than-not to be sustained). Under step two, the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis that is more-likely-than-not to be realized upon ultimate settlement.

FIN 48 applies to all tax positions related to income taxes subject to the Financial Accounting Standard Board Statement No. 109, "Accounting for Income Taxes" ("FAS 109"). This includes tax positions considered to be "routine" as well as those with a high degree of uncertainty.

FIN 48 has expanded disclosure requirements, which include a tabular roll forward of the beginning and ending aggregate unrecognized tax benefits as well as specific detail related to tax uncertainties for which it is reasonably possible the amount of unrecognized tax benefit will significantly increase or decrease within twelve months. These disclosures are required at each annual reporting period unless a significant change occurs in an interim period.

FIN 48 is effective for fiscal years beginning after December 15, 2006. The cumulative effect of applying FIN 48 will be reported as an adjustment to the opening balance of retained earnings.

The Company will evaluate the effect of the adoption of FIN 48 on its financial statements.

2. In September 2006, the FASB issued FASB No. 157, "Fair Value Measurements". FASB 157 establishes a single authoritative definition of fair value, sets out a framework for measuring fair value, and requires additional disclosures about fair value measurements. FASB 157 applies only to fair value measurements that are already required or permitted by other accounting standards. FASB 157 is effective for fiscal years beginning after November 15, 2007. The Company will evaluate the impact that adopting FASB 157 will have on its financial statements.



## ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

#### NOTE 3:- MAJOR TRANSACTIONS

a. **Partner Communications Company Ltd. ("Partner")**

On March 21, 2006, Elron completed the acquisition of approximately 823,000 shares of Partner from one of the other Israeli founding shareholders of Partner for approximately \$5,300, reflecting approximately 15% discount from the market price at the date of the agreement. Upon completion of the acquisition, Elron holds approximately 2.6% of Partner.

All of Partner shares held by the Company are subject to certain transfer restrictions under Partner's Israeli Communications license. The shares are accounted for as available-for-sale securities.

b. **Nulens**

As described in Note 8 (c) to the Company's annual financial statements, on April 21, 2005, Elron completed an investment of approximately \$2,900 in Nulens Ltd. ("Nulens"), in consideration for 763,584 Series A preferred shares, as part of an aggregate investment of approximately \$3,400. Elron's investment was in two installments, the first of approximately \$1,700 was invested immediately for approximately 17% of Nulens on a fully diluted and on an as converted basis and an additional amount of approximately \$1,100 was invested on March 9, 2006. Simultaneously with the \$1,100 investment, Elron invested an additional amount of \$1,500 in 241,158 Series B preferred shares. The investment in preferred B shares was part of a new round of investment in the aggregate amount of approximately \$6,000. The new round was led by Warburg Pincus, a leading global private equity fund. Following the above investments, Elron holds 25% of Nulens, on a fully diluted and on an as converted basis. Nulens is an Israeli medical device company operating in the field of intra-ocular lenses mainly for cataract and presbyopia procedures.

Since the investments in preferred A and B shares are not considered to be investments that are in-substance-common stock, the investment in Nulens is accounted for under the cost method.

c. **Safend**

On January 2, 2006, Elron completed an investment of approximately \$3,700 in Safend Ltd. ("Safend"), in consideration for 1,942,261 Series B preferred shares, as part of an aggregate investment of approximately \$7,400. Following Elron's investment, Elron holds approximately 22% of Safend on a fully diluted and on an as converted basis. Safend is an Israeli company which develops comprehensive desktops and laptops endpoint security solutions.

Since the investment in preferred B shares is not considered to be an investment that is in-substance-common stock, the investment in Safend is accounted for under the cost method.

## ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

#### NOTE 3:- MAJOR TRANSACTIONS (Cont.)

d. **Mediagate**

In February 2006, Mediagate's bank loan in the amount of approximately \$2,800 was settled in consideration for \$100. As a result, according to the provisions of FAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", Elron recorded in the first quarter of 2006 a gain of approximately \$2,700 which is included in other income in the statements of operations.

e. **AMT**

On June 8, 2006, Elron completed an investment of \$5,000 in convertible A1 notes of Advanced Metal Technology Ltd. (AMT), as part of a financing round of \$14,000 led by Shamrock Israel Growth Fund, an Israeli private equity fund. The investment in AMT was in two installments, the first of \$2,500 was invested immediately, and the additional \$2,500 investment is subject to certain conditions. In addition, Elron and other shareholders of AMT converted previously granted loans in the amount of \$1,000 into convertible A1 notes of AMT, of which Elron's share is \$500. In connection with the above financing round, AMT issued convertible A7 notes to certain minority shareholders in its affiliates and subsidiaries, in consideration for their holdings in those companies (the "SWAP"). As a result of the SWAP, Elron recorded in the third quarter a gain of approximately \$1,700. Following the above financing round and SWAP, Elron's holdings in AMT decreased from approximately 42% to 34% on an as converted basis.

f. **Given**

During August 2006, Elron purchased, in a series of open market transactions, 539,721 ordinary shares of Given Imaging Ltd. ("Given"), for an aggregate purchase consideration of approximately \$10,000. As a result of the transactions, Elron's direct and indirect ownership interest in Given (through its direct holdings and its holdings in its subsidiary, RDC-Rafael Development Corporation Ltd. ("RDC")) increased from approximately 19.3% to approximately 21.2% of Given outstanding ordinary shares.

In parallel transactions, Discount Investment Corporation Ltd. ("DIC"), which currently holds approximately 48% of Elron's outstanding shares, purchased the same number of shares of Given for the same aggregate consideration, increasing its holding from approximately 12.4% to approximately 14.3% of Given's outstanding ordinary shares.

The excess of the purchase price over the Company's share in the equity acquired amounted to approximately \$8,100 and was allocated as follows: approximately \$6,300 to intangible assets other than goodwill, such as customer base and technology, approximately \$1,000 to in-process research and development activities ("IPR&D") and approximately \$800 to goodwill. Products which did not receive marketing clearance by regulatory authorities as of the acquisition date are considered to be incomplete and accordingly the amount allocated to such products is considered to be IPR&D. The amount allocated to IPR&D was charged immediately to the Company's results of operations in accordance with FASB Interpretation No. 4, "Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method" ("FIN 4"). The amounts allocated to intangible assets other than goodwill are amortized on a straight-line basis over their weighted average expected useful life of 10 years. The amortization of the identifiable intangible assets as well as the write-off of the IPR&D are included as part of the line item "Equity in losses of affiliated companies" in the statements of operations.

## ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

#### NOTE 3:- MAJOR TRANSACTIONS (Cont.)

g. **Oncura**

In light of Oncura's results, the Company recorded in the second quarter of 2006 an impairment loss on the investment in Oncura in the amount of \$6,100 (\$2,500 net of minority interest), due to an other than temporary decline in value of such investment. The impairment loss was presented in the statement of operations in the line item "equity in losses of affiliated companies".

h. **Enure**

On August 10, 2006 ("the transaction date"), Enure Networks Ltd. ("Enure") completed an additional \$4,000 financing round ("The additional financing round"), of which Elron invested \$500 and \$3,500 was invested by a new investor. This round was a continuation of the financing round of \$4,000 invested by Elron on October 2, 2005. Elron's investment in October 2005 was in consideration for 44% of Enure on a fully diluted basis and on an as converted basis (approximately 57% on an outstanding basis). As a result of the additional financing round, Elron's interest in Enure decreased from 44% to 34% on a fully diluted basis and on an as converted basis (to approximately 41% on an outstanding basis). The aggregate investment of \$8,000 was in consideration for 17,095,200 Series A preferred shares, of which Elron received 9,616,050 Series A preferred shares of Enure.

Enure is considered to be a variable interest entity, however, the Company is not the primary beneficiary of Enure. As of September 30, 2006, Elron's maximum exposure to loss as a result of its investment in Enure does not exceed the carrying value of its investment in Enure in the amount of approximately \$2,700. In addition, as a result of the decrease in Elron's interest in Enure, and since Elron is not the primary beneficiary of Enure, Elron ceased to consolidate Enure's financial statements since the transaction date of 2006. Since the investment in preferred A shares is not considered to be an investment that is in-substance-common stock, the investment in Enure is accounted for as of the transaction date under the cost method.

Enure is considered a development stage company. Accordingly, the changes in Elron's proportionate share of Enure's equity, resulting from the decrease in Elron's share in Enure, have been accounted for as an equity transaction and as a result a capital reserve of approximately \$1,000 was recorded.

i. **Neurosonix**

On August 27, 2006, Elron completed a new investment of \$5,000 in Neurosonix Ltd. ("Neurosonix") as part of an aggregate investment of \$12,000 in two installments. The first installment in the amount of \$6,840 was invested immediately and the second installment in the amount of \$5,160 will be invested upon completion of a certain milestone by Neurosonix. Elron's first installment in the amount of \$2,850 was in consideration for 9,300 Series C shares of Neurosonix. Following Elron's aggregate investment, Elron will hold approximately 18% of Neurosonix on a fully diluted basis and on an as converted basis. Neurosonix is an Israeli company which engaged in the development and commercialization of medical devices for the prevention of acute cerebral embolism during open-heart cardiac surgery as well as other invasive and minimally-invasive procedures.

## ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

#### NOTE 3:- MAJOR TRANSACTIONS (Cont.)

i. Neurosonix (Cont.)

Since the investment in preferred C shares is not considered to be an investment that is in-substance-common stock, the investment in Neurosonix is accounted for under the cost method.

j. NetVision

On September 6, 2006, NetVision Ltd. ("NetVision"), 38% held by Elron, signed definitive agreements with each of Barak I.T.C. (1995) International Telecommunications Services Corp. Ltd. ("Barak") and GlobeCall Communications Ltd. ("GlobeCall") and their shareholders, whereby NetVision will purchase from Barak shareholders all of Barak's issued share capital in exchange for approximately 46.5% of NetVision's share capital immediately after the transaction ("Barak Merger"), and NetVision will purchase from DIC, the other major shareholder of NetVision, all of GlobeCall's issued share capital in exchange for approximately 7% of NetVision's share capital immediately after the Barak Merger and the transaction ("GlobeCall Merger"). Barak is a subsidiary of Clal Industries and Investments Ltd. ("Clal"). Elron, Clal and DIC, are all part of the IDB group. The GlobeCall Merger will close immediately after the Barak Merger, and is dependent upon it. If these transactions occur, Elron's holding in NetVision would be reduced from approximately 38% to approximately 19%.

The transactions are subject to obtaining certain approvals required under the applicable laws. Netvision's Board of Directors approved the transaction on September 11, 2006. There is no assurance that the transactions will be consummated.

#### NOTE 4:- SUBSEQUENT EVENTS

a. Atlantium

On October 23, 2006, Elron completed a new investment of \$10,000 in Atlantium Inc. ("Atlantium") in consideration for 1,494,766 Series B Preferred shares, as part of an aggregate investment of \$17,000. Following Elron's investment, Elron holds approximately 25.7% of Atlantium on a fully diluted basis and on an as converted basis. Atlantium an Israeli-based water technology company provides innovative water disinfection solutions employing its proprietary Hydro-Optic Disinfection (HOD) technology.

b. DIC tender offer

On October 25, 2006, DIC commenced a tender offer to purchase up to 4,440,000 ordinary shares of Elron for \$12 per share, net to the seller in cash, less any required withholding taxes and without interest. Currently, DIC beneficially owns 14,048,613 ordinary shares of Elron, representing approximately 48% of Elron's outstanding shares. Upon completion of the tender offer DIC would own approximately 63% of Elron's outstanding shares. There is no assurance that the transactions will be consummated.

## ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

#### NOTE 5:- CONTINGENT LIABILITIES

1. During September 1999, the Company received copies of two claims and a request to approve such claims as a class action on behalf of public shareholders of Elscint (formerly an affiliated company) against the Company and others. The allegation raised by the claimants related to the decision regarding the sale of Elscint's substantial assets. The claim has been stayed pursuant to an arrangement reached by the parties pending the outcome of the appeal in the claim described in paragraph 2 below. The arrangement provides that if the appeal as described in paragraph 2 below is accepted, then the proceedings to recognize the lawsuit as a class action will proceed. Otherwise, the application to recognize the claim as a class action suit will be dismissed.
2. On November 2, 1999, the Company received a copy of a claim, and a request to approve such a claim, as a class action on behalf of some institutional investors and others and those who held shares in Elscint on September 6, 1999. The allegations raised against the Company and certain of its officers including former officers, among others, relate to the period prior to the sale of the Company's holdings in Elbit Medical Imaging ("EMI") (the parent company of Elscint and formerly an affiliated company). The claimants seek a court order pursuant to which EMI would be compelled to execute the alleged buy-out of Elscint's share at \$14 per share or other remedies. On August 16, 2000, the Haifa District court dismissed the application to recognize the claim as a class action. Some of the claimants applied for and have been granted permission to appeal to the Supreme Court in Israel, which appeal is currently pending.

In addition, in February 2001, the claimants submitted a revised claim similar to the previous one but not as a class action. It has not been determined when the defendants are required to file their statements of defense to the claim. The claimants and the defendants are currently involved in various proceedings, mostly regarding the disagreement concerning the court fees.

3. During September 2006, two claims were filed by a certain individual in the Haifa District Court against the same defendants (including the Company and certain officers and former officers of the Company) of the action described in paragraph 2 above and based substantially on the same facts of such action. The claims are for an undisclosed amount and also include a request to recognize the claims as class actions. The claims have not yet been formally served upon the Company and the Court has determined that the defendants do not yet have to file statements of defense. A preliminary hearing is scheduled for January 2007 in order to consider the status of the claims.

The Company denies all the allegations set forth as described in paragraphs 1, 2 and 3, and based on legal advice received, management is of the opinion that the Company has good defense arguments which, if accepted, will cause dismissal of the above allegations.

4. On September 20, 2006 Rafael Armaments Development Authority Ltd. ("Rafael") filed a claim with the Tel Aviv District Court against the company's 100% subsidiary, DEP Technology Holdings Ltd. ("DEP"), and RDC, 50.1% held by DEP and 49.9% held by Rafael, requesting the court to issue a declaratory order that Rafael is entitled to terminate the rights granted to RDC to commercialize technologies of Rafael for future development of products for use in non-military markets, pursuant to an agreement between DEP, RDC and Rafael.

Elron strongly believes, based on legal advice, that there is no basis for Rafael's claim and intends to vigorously defend the claim.

# ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

### NOTE 6:- RECONCILIATION TO ISRAELI GAAP

The consolidated financial statements of the Company have been prepared in accordance with U.S. GAAP. Had the consolidated financial statements been prepared in accordance with Israeli GAAP, the effects on the financial statements would have been as follows:

#### a. Effect on the statement of operations:

Nine months ended September 30, 2006			
	As reported	Adjustments Unaudited	As per Israeli GAAP
Net loss	\$ (14,372)	\$ (11,602)	\$ (25,974)
Basic net loss per share	(0.49)	(0.39)	(0.88)
Diluted net loss per share	(0.50)	(0.40)	(0.90)
Nine months ended September 30, 2005			
	As reported	Adjustments Unaudited	As per Israeli GAAP
Net income	\$ 46,849	\$ 13,149	\$ 59,998
Basic net income per share	1.59	0.45	2.04
Diluted net income per share	1.59	0.45	2.04
Three months ended September 30, 2006			
	As reported	Adjustments Unaudited	As per Israeli GAAP
Net loss	\$ (4,434)	\$ (3,575)	\$ (8,009)
Basic net loss per share	(0.15)	(0.12)	(0.27)
Diluted net loss per share	(0.16)	(0.12)	(0.28)
Three months ended September 30, 2005			
	As reported	Adjustments Unaudited	As per Israeli GAAP
Net income (loss)	\$ 4,762	\$ (5,067)	\$ (305)
Basic net income (loss) per share	0.16	(0.17)	(0.01)
Diluted net income (loss) per share	0.16	(0.17)	(0.01)
Year ended December 31, 2005			
	As reported	Adjustments Audited	As per Israeli GAAP
Net income	\$ 47,335	\$ 7,147	\$ 54,482
Basic net income per share	1.61	0.24	1.85
Diluted net income per share	1.60	0.24	1.84

# ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

### NOTE 6:- RECONCILIATION TO ISRAELI GAAP (Cont.)

b. Effect on the balance sheet:

September 30, 2006			
	As reported	Adjustments	As per Israeli GAAP
		Unaudited	
Total assets	\$ 336,459	\$ (86,809)	\$ 249,650
Total liabilities including minority interest	43,944	(17,270)	26,674
Total equity	292,515	(69,539)	222,976

  

December 31, 2005			
	As reported	Adjustments	As per Israeli GAAP
		Audited	
Total assets	\$ 353,773	\$ (75,361)	\$ 278,412
Total liabilities including minority interest	51,657	(21,145)	30,512
Total equity	302,116	(54,216)	247,900

c. Material adjustments:

The abovementioned adjustments result primarily from the differences between U.S. GAAP and Israeli GAAP detailed in Note 26 to the Company's annual financial statements for 2005 and from the following changes:

1. As described in Note 3(h) since Enure is considered a development stage company and as a result of the decrease in Elron's share in Enure, the changes in the Company's proportionate share of Enure's equity, according to US GAAP have been accounted for as an equity transaction and as a result a capital reserve of approximately \$1,000 was recorded. According to Israeli GAAP, the changes in the Company's proportionate share of Enure's equity will be recorded as gain from changes in holdings in affiliated companies in the higher amount between the accumulated losses to be recorded and a portion of the gain over a period of three years.

# ELRON ELECTRONIC INDUSTRIES LTD. AND ITS SUBSIDIARIES

## ANNEX TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

Details relating to major investments as of September 30, 2006:

	% of ownership interest <sup>(1)</sup>	Carrying value of the investment as of September 30, 2006 <sup>(2)</sup>	Market value of the publicly traded investments as of:	
			September 30, 2006	November 10, 2006
<b><u>Consolidated Companies:</u></b>				
Galil Medical Ltd. <sup>(3)</sup>	40%	1,851	-	-
3DV Systems Ltd. <sup>(3)</sup>	62%	(164)	-	-
Starling <sup>(3)</sup>	50%	(19)	-	-
SELA <sup>(3)</sup>	39%	744	-	-
Mendingo <sup>(3)</sup>	50%	25	-	-
<b><u>Affiliated Companies (equity):</u></b>				
Given Imaging Ltd. (Nasdaq: GIVN) <sup>(3)</sup>	21%	69,723	113,708	134,019
NetVision Ltd. (TASE: NTSN)	38%	10,257	46,578	50,682
ChipX	29%	3,127	-	-
CellAct Ltd.	45%	357	-	-
Oncura <sup>(4)</sup>	10%	5,633	-	-
AMT	34%	3,022	-	-
Wavion, Inc.	38%	512	-	-
Pulsicom Israel Technologies Ltd.	18%	1	-	-
Notal Vision, Inc.	23%	454	-	-
<b><u>Available for sale:</u></b>				
Partner (Nasdaq: PTNR)	3%	35,223	38,286	44,881
EVS (Nasdaq: EVSNF.OB)	9%	1,070	1,173	1,093
<b><u>Partnership:</u></b>				
Gemini Israel Fund L.P.	5%	33	-	-
InnoMed Ventures L.P.	14%	3,444	-	-
<b><u>Cost:</u></b>				
Jordan Valley	28%	8,137	-	-
Impliant	22%	8,340	-	-
Teledata Ltd.	21%	16,000	-	-
Nulens Ltd.	29%	4,360	-	-
Brainsgate Ltd.	22%	6,947	-	-
Safend Ltd.	26%	3,700	-	-
Neurosonix	16%	2,850	-	-
Enure (formerly: Gaia)	41%	2,702	-	-

<sup>(1)</sup> On the basis of the outstanding share capital.

<sup>(2)</sup> Includes loans and convertible notes.

<sup>(3)</sup> Represents the carrying value and the ownership interest of the investment in Elron's books and Elron's share in the carrying value and ownership interest of the investment in RDC's books.

<sup>(4)</sup> Represents Elron's share in the carrying value and the ownership interest of the investment in Galil's books.