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

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CONSOLIDATED BALANCE SHEETS

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

	September 30, 2006	December 31, 2005
	Unaudited	
ASSETS		
CURRENT ASSETS		
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	115,215	155,201
INVESTMENTS AND LONG-TERM RECEIVABLES		
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
PROPERTY AND EQUIPMENT, NET	7,770	7,809
INTANGIBLE ASSETS		
Goodwill	2,742	2,742
Other intangible assets	2,805	2,818
Total intangible assets	5,547	5,560
Total assets	$ 336,459	$ 353,773

* 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.

CONSOLIDATED BALANCE SHEETS

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

	September 30, 2006	December 31, 2005
	Unaudited	
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
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
LONG-TERM LIABILITIES		
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
MINORITY INTEREST	10,511	19,007
SHAREHOLDERS' EQUITY:		
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.

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Nine months ended September 30, 2006	Nine months ended September 30, 2005***	Three months ended September 30, 2006	Three months ended September 30, 2005***	Year ended December 31, 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.

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)
Balance as of January 1, 2005	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
Balance as of December 31, 2005	29,483,455	$ 9,572	$ 271,132	$ 10,741	$ 10,671	302,116	
Total comprehensive income							$ 359
Unaudited							
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)
Balance as of September 30, 2006	29,534,955	$ 9,572	$ 272,662	$ 13,982	$ (3,701)	$ 292,515	
Total comprehensive loss							$ (11,131)
Unaudited							
Balance as of January 1, 2005	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
Balance as of September 30, 2005	29,483,455	$ 9,572	$ 271,011	$ 10,782	$ 10,185	$ 301,550	
Total comprehensive loss							$ (86)

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

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)
Unaudited							
Balance as of July 1, 2006	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)
Balance as of September 30, 2006	29,534,955	$ 9,572	$ 272,662	$ 13,982	$ (3,701)	$ 292,515	
Total comprehensive loss							$ (5)
Unaudited							
Balance as of July 1, 2005	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
Balance as of September 30, 2005	29,483,455	$ 9,572	$ 271,011	$ 10,782	$ 10,185	$ 301,550	
Total comprehensive income							$ 7,607

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Nine months ended September 30, 2006 (Unaudited)	Nine months ended September 30, 2005 (Unaudited)	Year ended December 31, 2005
Cash flows from operating activities			
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)
Cash flows from investing activities			
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
Cash flows from financing activities			
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.

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Nine months ended September 30, 2006	Nine months ended September 30, 2005	Year ended December 31, 2005
	Unaudited	Unaudited	
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

	Nine months ended September 30, 2006	Nine months ended September 30, 2005	Year ended December 31, 2005
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

	Nine months ended September 30, 2006	Nine months ended September 30, 2005	Year ended December 31, 2005
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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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-Base 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

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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.

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.

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 Neursonix 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.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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.

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	As per Israeli GAAP
		Unaudited	
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	As per Israeli GAAP
		Unaudited	
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	As per Israeli GAAP
		Unaudited	
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	As per Israeli GAAP
		Unaudited	
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	As per Israeli GAAP
		Audited	
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

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.

ANNEX TO THE CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands

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

	% of ownership interest [1]	Carrying value of the investment as of September 30, 2006 [2]	Market value of the publicly traded investments as of: September 30, 2006	November 10, 2006
Consolidated Companies:				
Galil Medical Ltd. [3]	40%	1,851	-	-
3DV Systems Ltd. [3]	62%	(164)	-	-
Starling [3]	50%	(19)	-	-
SELA [3]	39%	744	-	-
Mendingo [3]	50%	25	-	-
Affiliated Companies (equity):				
Given Imaging Ltd. (Nasdaq: GIVN) [3]	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 [4]	10%	5,633	-	-
AMT	34%	3,022	-	-
Wavion, Inc.	38%	512	-	-
Pulsicom Israel Technologies Ltd.	18%	1	-	-
Notal Vision, Inc.	23%	454	-	-
Available for sale:				
Partner (Nasdaq: PTNR)	3%	35,223	38,286	44,881
EVS (Nasdaq: EVSNF.OB)	9%	1,070	1,173	1,093
Partnership:				
Gemini Israel Fund L.P.	5%	33	-	-
InnoMed Ventures L.P.	14%	3,444	-	-
Cost:				
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	-	-

(1) On the basis of the outstanding share capital.

(2) Includes loans and convertible notes.

(3) 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.

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

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