MANAGEMENT REPORT FOR THE FIRST QUARTER ENDING MARCH 31, 2002

The following management report should be read in conjunction with our Interim Consolidated Financial Statements as of March 31, 2002 and Notes thereto, which are filed on a form 6-K with the Securities and Exchange Commission and in conjunction with our Annual Consolidated Financial Statements as of December 31, 2001 and Notes thereto. 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. The Company’s 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.

GENERAL

We are a multi-national high technology operational holding company that operates through subsidiaries and affiliated companies referred to as group companies. Founded in 1962, we have been a major force in the development of the Israeli high technology industry by building Israeli and Israeli-related companies with technologies in the fields of advanced defense electronics, communications, semiconductors and medical imaging. In recent years, we have pursued a strategy of focusing our holdings on defense electronics; information technology software products and services; communication; medical devices and semiconductors and increasing our direct involvement in these areas. Our group companies include both publicly traded and privately held companies.

Our activities range from complete operational control over the business of our group companies to involvement in the management of our group companies in which we maintain controlling or significant holdings, and in a limited number of cases, to passive minority 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 policies, selecting and manning senior management positions, the approval of investments and budgets, financing policies and the overall ongoing monitoring of our group companies’ performance. In addition to our representation on the board 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 their operations 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, budgetary control, market analysis, risk management, identifying joint venture opportunities, introduction to potential customers and investors, business plan preparation, strategic planning and research and development guidance.

We expect to continue to build and realize value to our shareholders from our group companies and simultaneously pursue the acquisition of, or the investment in, new and existing companies. However, as we hold interests in early-stage technology companies, which invest considerable resources in research and development and in marketing and which have not reached the income-producing stage, we have experienced, and expect to continue to experience, losses in respect of these companies. Therefore our net income (or loss) in any given period is due, in the most part, to the results of operations of our group companies and dispositions and changes in our holdings of group companies.

RECENT DEVELOPMENTS

On May 9, 2002, we announced the approval of our merger with Elbit Ltd. by the district court of Tel Aviv-Jaffa. The closing of our merger with Elbit will take place on May 15, 2002.

Pursuant to the merger agreement Elbit will be merged with Elron and Elron will issue to Elbit’s shareholders (other than Elron) approximately 5,600,000 Elron shares, based on an exchange ratio of 0.45 ordinary shares of Elron for each ordinary share of Elbit. Elron and Elbit received written opinions from their respective financial advisors that the exchange ratio was fair from a financial point of view.

The merger was approved by the shareholders, creditors and optionholders of Elron and Elbit at a special meeting held on April 28, 2002 and April 29, 2002, respectively. At the end of trading on May 15 2002, Elbit shares will cease trading on Nasdaq and the TASE.

On May 6, 2002, we announced the closing of the Share Purchase of DEP Technology holdings Ltd. ("DEP"). Pursuant to the share purchase agreement signed on November 19, 2001 with Discount Investment Corporation Ltd., or DIC, we issued 2,261,843 ordinary shares to DIC in exchange for all of the shares held by DIC in DEP including DIC's rights to loans provided by DIC to a subsidiary of DEP, RDC Rafael Development Corporation Ltd. RDC is a joint venture in which DEP holds 48% of the outstanding shares. Elron and DIC received a written opinion from a joint financial advisor regarding the economic fairness of a range amounts of Elron shares to be issued to DIC, and the ordinary shares issued were within that range. In addition, Elron received an opinion from an independent financial advisor that the number of Elron shares to be issued to DIC was fair from a financial point of view, to Elron. DEP is a technology holding company in which Elron previously held 33% of the outstanding share capital and in which DIC held the remaining 67% of the outstanding share capital. The transaction was approved by Elron's shareholders at a special meeting held on April 28, 2002.

The merger with Elbit and the share purchase of DEP will be accounted under the purchase method of accounting. We are currently evaluating both of these acquisitions for the purpose of determining the amount ,if any, that should be allocated to identifiable intangibles and goodwill.

Following the closing of the two transactions, Elbit and DEP became wholly owned subsidiaries of Elron. We believe these transactions will enable us to optimize our holding structure, combine resources, benefit from potential synergies and achieve cost savings.

CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are more fully described in Note 2 to our Annual Consolidated Financial Statements. However, certain of our accounting policies are particularly important to the description of our financial position and results of operations. In applying these critical accounting policies, our management uses its judgment to determine the appropriate assumptions to be used in making certain estimates. These estimates are subject to an inherent degree of uncertainty. Estimates are used for, but are not limited to, the accounting for impairments of investment and goodwill and other intangible assets. Actual results could differ from these estimates.

Our critical accounting policies include:

Revenue recognition. Our revenues are derived from our subsidiaries, Elron Software and Elron TeleSoft. Revenues from sales of software products and services are recognized after all of the following occurs: the software is delivered, collection is probable, fees are fixed or determinable, vendor-specific objective evidence exists to allocate total fee to elements of an arrangement and persuasive evidence of an arrangement exists. Maintenance revenue is recognized over the term of the contract period, which is generally one year. Training revenue is recognized as the services are provided. Reserves for estimated returns and allowances are provided at the time revenue is recognized. Such reserves are recorded based upon historical rates of returns, distributor inventory levels and other factors. Income derived from projects related to software development is recognized upon the percentage of completion method, provided that a material portion of costs have been incurred or that a material portion of milestones have been achieved and where contract results can reasonably be estimated. Provision for losses, if any, on uncompleted contracts are made in the period when such losses are apparent.

Principles of Accounting for Holdings in Group companies. The various holdings that we have in our group companies are accounted for under several broad methods as described below. The applicable accounting method is generally determined based on our voting interest in the entity.

Consolidation. Companies in which we directly or indirectly own more than 50% of the outstanding voting securities are accounted for under the consolidation method of accounting. Under the consolidation method, a company's assets and liabilities are included within our consolidated balance sheet and its income and expense items are included within our consolidated statements of operations. The share of other shareholders in the net income or losses of a consolidated company is reflected in minority interest in our consolidated statements of operations. The minority interest amount adjusts our consolidated net income (loss) to reflect only our share in the earnings or losses of the consolidated company. Elron Software and Elron TeleSoft were consolidated in 2002 and 2001.

Equity Method. Group companies whose results we do not consolidate, but over whom we exercise significant influence, are accounted for under the equity method of accounting. Whether or not we exercise significant influence with respect to a group company depends on an evaluation of several factors, including, among others, our representation on the group company's board of directors and ownership level, and our interest in the voting securities of the group company. Significant influence is usually assumed when we hold 20% or more of a group company's voting securities. Under the equity method of accounting, a group company's assets and liabilities are not included within our consolidated balance sheet and their results of operations are not reflected within our consolidated statements of operations; however, our share in the net income or losses of the group company is reflected as an equity income (loss) in our consolidated statements of operations.

The effect of an affiliated company's net results of operations on our results of operations is the same under either the consolidation method of accounting or the equity method of accounting, as under each of these methods only our share in the net income or losses of an affiliated company is reflected in our net results of operations in the consolidated statements of operations. The following companies are accounted for under the equity method: Elbit Systems, Elbit Ltd., NetVision, MediaGate N.V., Chip Express Corporation, DEP, Wavion, Elron-Kidum IT (KIT) and Pulsicom.

Other Methods. Group companies that we do not account for under either the consolidation or the equity method of accounting are accounted for under three different methods: Non-marketable group companies are presented at cost. Under this method, our share in the income or losses of these entities is not included in our consolidated statements of operations. Marketable group companies, which are classified as trading securities, are presented at fair market value and the changes in the market value are reflected in our results of operations during each reporting period. Marketable group companies which are classified as available-for-sale are presented at fair market value and the effect of any change in market value is reflected in our comprehensive income (loss).

Goodwill and other intangible assets. In 2002, Statement of Financial Accounting Standards No. 142, “Goodwill and Other Intangible Assets” (“SFAS 142”) became effective, and as a result, commencing at January 1, 2002, goodwill is no longer being amortized. In lieu of amortization, we have performed goodwill impairment tests at a level referred to each reporting unit (subsidiary) . We have estimated the fair value of the reporting unit and compared it to the reporting unit carrying amount. Based on this comparison, as of January 1,2002 , no goodwill impairment loss should be recorded . There can be no assurance that future goodwill impairment tests will not result in a charge to earnings.

Investment impairments. We evaluate the carrying value of our holding in our group companies for possible impairment based on achievement of business plan objectives and milestones, the fair value of each ownership interest relative to its carrying value, the financial condition and prospects of the group company and other relevant factors. We then determine whether there has been an other than temporary decline in the carrying value of the group company. Impairment charges are determined by comparing the estimated fair value of a group company with its carrying value. The fair value of our holdings in privately held companies is generally determined based on the value at which independent third parties have invested or have committed to invest in these companies. As we operate in an industry which is rapidly evolving and extremely competitive, it is reasonably possible that our accounting estimates with respect to the useful life and ultimate recoverability of the carrying value, including goodwill, could change in the near term. While we believe that the current recorded carrying values of our group companies are not impaired, there can be no assurance that a write-down or write-off of the carrying value will not be required in the future.

RESULTS OF OPERATIONS

Three months ended March 31, 2002 compared to three months ended March 31, 2001.

Our net loss for the first quarter of 2002 was $7.5 million, or $0.36 per share, compared to $9.4 million, or $0.44 per share, in the first quarter of 2001. Our net loss for the first quarter of 2001, adjusted to exclude amortization expenses related to items that are no longer being amortized commencing January 1, 2002, in accordance to the new accounting standard, SFAS 142, was $8.9 million, or $0.42 per share.

The general slowdown in spending for technology products continues to affect the results of operations of our group companies. The current economic conditions continue to limit our ability to successfully exit some of our group companies and to record capital gains. However, although we continue to record net losses mainly as a result of the net losses of our subsidiary Elron Software and our share in the net losses of Elbit and our other affiliated companies, the restructuring plans and cost reductions programs taken by some of our group companies during 2001, enabled these companies to significantly reduce their losses and for some of the more matured companies, such as Elron TeleSoft, NetVision and Chip Express to report positive EBITDA (earnings before interest, taxes, depreciation and amortization).

Income

Net Revenues. Net revenues consisted of sales of products and services by our subsidiaries, Elron Software and Elron TeleSoft.

Net revenues of Elron TeleSoft in the first quarter of 2002 decreased by $3.4 million, or 46%, to $4.0 million from $7.4 million in the first quarter of 2001 as a result of the sale of non-core activities of Elron Telesoft as part of its restructuring program to focus its operations on core areas of its business which is development and marketing of products to the telecommunications market.

Net revenues of Elron Software in the first quarter of 2002 decreased by $0.3 million, or 14%, to $1.9 million from $2.2 million in the first quarter of 2001. The decrease was primarily due to the continued economic slowdown, which continues to cause customers to delay or postpone purchases of IT products.

As a result of the above, consolidated net revenues decreased by $3.7 million, or 38%, to $5.9 million in the first quarter of 2002 from $9.6 million in the first quarter of 2001.
The ability of Elron TeleSoft and Elron Software to increase their revenues in the near future is dependent upon general economic conditions and, in particular, on an increase in IT spending and the success of their development efforts to bring enhanced and new products to the market.

Our share in net losses of subsidiaries. Operating losses of our subsidiaries, Elron Software and Elron TeleSoft, were $2.8 million in the first quarter of 2002 compared to approximately $5.6 million in the first quarter of 2001. This decrease is attributed to Elron TeleSoft which reached operating breakeven as a result of restructuring and cost reduction programs adopted by it during 2001. The operating loss of our subsidiaries in first quarter of 2001, adjusted to exclude goodwill amortization, was $5.2 million. The results of operations of Elron Software and Elron TeleSoft are included within our consolidated statement of operations.

Our 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. Our share in net losses of affiliated companies was $5.0 million in the first quarter of 2002 compared to $2.2 million in the first quarter of 2001.

The Contribution of Our Major Affiliates:

Our share in net earnings of Elbit Systems Ltd. (Nasdaq: ESLT) was $2.5 million in the first quarter of 2002 compared to $2.4 million in the first quarter of 2001.

The following are highlights of the results of operations of Elbit Systems:

- Elbit Systems' revenues increased from $181.7 million in the first quarter of 2001 to $185.8 million in the first quarter of 2002. As of March 31, 2002, Elbit Systems' backlog of orders was $1,603 million, of which approximately 74% was scheduled to be performed in the following three quarters of 2002 and 2003 compared to backlog of orders of $1,566 million on December 31, 2001.

- Elbit Systems' operating income in the first quarter of 2002 was $14.7 million (7.9% of revenues) compared to $16.0 million in the first quarter of 2001 (8.8% of revenues). The decrease in operating income resulted primarily from the increase in marketing and selling expenses by $2.0 million mainly due to the need to invest a higher level of resources in new business generation, and the length of time required for marketing efforts until orders are received. In addition, Elbit Systems' general and administrative expenses increased by $1.4 million, mainly due to the consolidation of new subsidiaries acquired by it during 2001 and 2002.

- Elbit Systems' net income in the first quarter of 2002 was $11.7 million (6.3% of revenues) compared to $10.6 million (5.9% of revenues) in the first quarter of 2001. Elbit Systems's net income in the first quarter of 2001, adjusted to exclude goodwill amortization, was $11.3 million (6.2% of revenues).

Our share in net loss of Elbit Ltd. was $5.3 million in the first quarter of 2002 compared to $1.0 million in the first quarter of 2001. Elbit's results of operations are affected by its holdings in early-stage technology companies that have not reached the income-producing stage and that recorded net losses. Upon the completion of the merger Elbit will become a wholly-owned subsidiary of Elron and its results of operations will be included within our consolidated statements of operations.

The following are highlights of the results of operation of Elbit:

- Elbit's consolidated revenues in the first quarter of 2002 were $0.2 million.

- Elbit's operating loss increased from $3.3 million in the first quarter of 2001 to $6.9 million in the first quarter of 2002, resulting primarily from Elbit Vflash, whose results had been consolidated from the third quarter of 2001. The results of operations of the following companies are included within Elbit's consolidated statement of operations: Dealigence and Textology in 2001 and 2002 and ICC and Elbit VFlash in 2002.

- Elbit's share in net losses of affiliated companies was $1.3 million in the first quarter of 2002 and $1.6 million in the first quarter of 2001 consisting primarily of Elbit's equity in net losses of Cellenium (held 50% by Elbit), a provider of mobile-commerce applications. Elbit accounts for the following companies under the equity method of accounting: Cellenium, StarkeyNET, AdreAct and CellAct.

- Elbit's consolidated net loss in the first quarter of 2002 was $12.1 million compared to $2.4 million in the first quarter of 2001. The net loss in the first quarter of 2002 included merger expenses of $3.6 million, consisting of termination costs to its employees, insurance costs and professional fees to its financial advisors, accountants and legal advisors.

- In addition to companies accounted by Elbit under the equity method, Elbit holds a 12.4% interest in Partner Communications Company (Nasdaq: PTNR), which is accounted for as available-for-sale securities and whose results do not affect Elbit's results of operations. At March 31, 2002, Elbit's investment in Partner represented approximately 69% of Elbit's assets. Partner is the first Global System for Mobile Communications, or GSM, mobile telephone network operator in Israel. The following are highlights of the results of operations of Partner for the first quarter of 2002:

  - Partner's revenues for the first quarter of 2002, driven primarily by subscriber growth, increased 32% to $199.1 million from $150.8 million in the first quarter of 2001. Partner's subscriber base at the end of the first quarter of 2002 was 1,596,000 compared to 1,004,000 at the end of the first quarter of 2001.

  - Partner's operating profit for the first quarter of 2002 increased to $22.2 million, from an operating loss of $9.4 million in the first quarter of 2001. Operating profit for the first quarter of 2002 was affected by reduced quarterly amortization costs of approximately $5.4 million resulting from the extension of the Company's license from 2008 to 2017.

  - Partner's net loss for the first quarter was $4.9 million compared to $29.2 million for the first quarter of 2001.

Our share in net losses of our other affiliated companies. Our share in net losses of our other affiliated companies amounted to approximately $2.2 million in the first quarter of 2002 compared to $3.6 million in the first quarter of 2001. The decrease in our share in net losses of our other affiliated companies resulted mainly from the significant improvements in NetVision's results and the restructuring programs implemented by our group companies in order to reduce costs.

NetVision recorded in the first quarter of 2002 net income of $1.6 million compared to net loss of $1.3 million in the first quarter of 2001. NetVision's revenues in the first quarter of 2002 decreased 6% to $14.3 million from $15.2 million in the first quarter of 2001. Operating expenses decreased by $3.5 million, or 21%, from $16.8 million in the first quarter of 2001 to $13.3 million in the first quarter of 2002 due to restructuring programs implemented by NetVision. NetVision's operating income in the first quarter of 2002 was $1.0 million compared to a $1.6 million operating loss in the first quarter of 2001.

Wavion's net losses in the first quarter of 2002 amounted to $0.4 million compared to $1.1 million for the first quarter of 2001, mainly as a result of a $0.6 million decrease in research and development expenses as a result of the cost reduction program implemented by Wavion in light of the downturn in the broadband wireless commercial market which had delayed the release of its products. It is difficult to predict when Wavion will be able to market its product successfully. Consequently, at the beginning of 2002, Wavion began selling development services for communication systems to customers and recorded revenues from such services in the amount of $0.2 million.

KIT's net losses in the first quarter of 2002 amounted to $0.7 million compared to $0.8 million in the first quarter of 2001. KIT's revenues increased by $0.4 million from $0.1 million in the first quarter of 2001 to $0.5 million in the first quarter of 2002.

The aggregate revenues of the **RDC group companies** increased to approximately $8.1 million in the first quarter of 2002 compared to approximately $2.1 million in the first quarter of 2001, resulting primarily from the revenues of Given Imaging which initiated sales in the third quarter of 2001. Sales and marketing expenses of the RDC group companies in the first quarter of 2002 were approximately $7.6 million compared to approximately $4.2 million in the first quarter of 2001, and research and development expenses of RDC group companies in the first quarter of 2002 were approximately $5.1 million compared to $5.5 million in the first quarter of 2001.

Given Imaging (Nasdaq: GIVN), the most significant company in the RDC group, recorded revenues of $5.2 million for the first quarter of 2002. The first quarter of 2002 represents the second full quarter of sales for Given Imaging following the FDA clearance of its product in August 2001. Given Imaging's gross profit represented 52% of revenues. Given Imaging's net loss in the first quarter of 2002 was $5.8 million compared to $2.7 million in the first quarter of 2001. The increase in Given Imaging's net loss was due to the increase in its operating expenses by $5.0 million, which included a $3.4 million increase in selling and marketing expenses resulting from its marketing efforts to launch its product.

Chip Express continues to be affected in 2002 by the slowdown in the semiconductor industry and its revenues decreased by $5.2 million, or 47%, from $11.1 million in the first quarter of 2001 to $5.9 million in the first quarter of 2002. However, as a result of the implementation of cost reduction programs during 2001 in order to adjust its operations to the slowdown in the semiconductors industry, Chip Express' operating expenses in the first quarter of 2002 decreased by 27% to $2.4 million compared to $3.3 million in the first quarter of 2001. As a result, Chip Express' net losses in the first quarter of 2002 amounted to $0.1 million compared to net income of $0.3 million in the first quarter of 2001. It is anticipated that Chip Express' revenues will continue to be affected by the slowdown in the semiconductor industry.

MediaGate was affected by the slowdown in the communications market and particularly in the unified messaging market and its revenues in the first quarter of 2002 remain at the same level of $0.1 million as in the first quarter of 2001. However, due to cost reductions programs implemented by MediaGate, operating expenses in the first quarter of 2002 decreased by $1.3 million, or 49%, from $2.7 million in the first quarter of 2001 to $1.4 million in the first quarter of 2002 and its net losses in the first quarter of 2002 decreased to $1.4 million from $2.8 million in the first quarter of 2001. MediaGate's future revenues are dependent upon the development of the unified messaging market, which is currently small and has not yet matured.

Pulsicom commenced its operations in 2001. In the first quarter of 2002, its net losses amounted to $0.2 million, consisting mainly of research and development costs. Pulsicom is an early stage company and it is difficult to predict when it will be able to start marketing its product.

Since many of our group companies we account for under the equity method of accounting are early-stage development companies that invest heavily in research, development and marketing their products that have not yet generated significant revenues and which incurred losses in the first quarter of 2002, we expect that they will continue to recognize losses in the following three quarters of 2002. Furthermore, following the closing of the merger with Elbit and the purchase of the remaining share of DEP, we expect that our share in the net losses of affiliated companies in future periods will increase, as most of Elbit's and DEP holdings are development-stage technology companies that invest significant resources in developing their products and markets and as a result record losses. In addition, as a result of the DEP share purchase, our interest in Given Imaging, Galil Medical, Witcom and 3DV Systems, in which we also have a direct interest, will increase and enable us to exercise significant influence in these companies. As a result, and in accordance with APB 18, our direct holdings in these companies, which are currently recorded by us at cost, will be accounted for retroactively under the equity method ("step by step acquisition"). The effect of implementing step by step acquisition will result in restatement of our financial statements for all prior periods in which our investments in these companies where recorded at cost. As the acquisition was finalized subsequent to March 31, 2002 the restatement of prior period data will be reflected in the financial statements commencing for the period ended June 30, 2002. We anticipate that the effect of the aforementioned restatement on the results of operations for the year ended December 31, 2001, and for the three months ended March 31, 2001 and 2002, will be an increase in net loss of approximately $2.7 million $ 0.6 million and $ 0.75 million, respectively.

In addition to companies accounted for under the equity method, we have several investments in companies which we account for on a cost basis and whose results do not affect our results of operations. These companies are not material to us , except for our interest in Oren Semiconductor. During the first quarter of 2002, we invested $1.1 million in Oren by way of bridge loans, bringing the

book value of our holding in Oren on March 31, 2002 to $6.6 million compared to $5.5 million on December 31, 2001. In the first quarter of 2002, Oren's revenues were $0.3 million compared to $0.7 million in the first quarter of 2001. Operating expenses in the first quarter of 2002 decreased to $1.7 million from $2.8 million in the first quarter of 2001, mainly due to the decrease in research and development costs as a result of cost reduction programs. Oren's net losses in the first quarter of 2002 amounted to $1.6 million compared to $2.4 million in the first quarter of 2001.

Gains from Sale of Shares and Changes in Holdings in Related Companies. Our gains from the sale of shares and changes in our holdings in related companies in the first quarter of 2002 amounted to $0.1 million compared to losses of $0.1 million in the first quarter of 2001.

Other Income, net. Other income, net, in the first quarter of 2002 amounted to $0.5 million mainly as a result of a $0.6 million gain from the sale of shares of NetManage (Nasdaq: NETM). The loss in the first quarter of 2001 amounted to $3.2 million mainly as a result of a $4.2 million decrease in the market value of BroadBase Software's shares held by us. The loss in the first quarter of 2001 was partially offset by a $1.0 million gain from the sale of the remaining shares of Zoran during the first quarter of 2001.

Finance Income. Finance income decreased by $0.9 million, or 50%, to approximately $0.9 million in the first quarter of 2002 from $1.8 million in the first quarter of 2001, primarily due to the decrease in interest rates.

Expenses

Cost of revenues. Cost of revenues consisted primarily of expenses related to salaries and hardware associated with delivering Elron Software's and Elron TeleSoft's products and services. Cost of revenues decreased by $3.8 million, or 56%, to $3.0 million in the first quarter of 2002 from $6.8 million in the first quarter of 2001, mainly as a result of the decrease in revenues as well as the restructuring programs implemented in order to increase efficiency. Cost of revenues of Elron Software were $0.2 million in the first quarter of 2001 and first quarter of 2002, representing a gross margin of 89% and 88%, respectively. Cost of revenues of Elron TeleSoft in the first quarter of 2002 was $2.8 million, representing a gross margin of 31%, compared to $6.6 million in the first quarter of 2001, representing a gross margin of 11%. The improvement in Elron Telesoft's gross margin rate is a result of the restructuring program undertaken by the company in 2001, which included mainly workforce reductions and as a result of Elron Telesoft focus on core areas of its business.

Research and development. Research and development expenses consisted primarily of salaries and related costs to develop and enhance Elron Software's and Elron TeleSoft's products and services. In light of the slowdown in spending for IT products, both companies reduced their development costs and their consolidated research and development expenses decreased by $0.4 million, or 17%, to $1.9 million in the first quarter of 2002 from $2.3 million in the first quarter of 2001.

Sales and Marketing. Sales and marketing expenses consisted primarily of salaries and related costs, pre-sale efforts including, advertising and trade show expenses, technical support and travel costs to promote the sale of Elron Software's and Elron TeleSoft's products and services and to strengthen their brand names. Sales and marketing expenses decreased by $0.8 million, or 25%, to approximately $2.4 million in the first quarter of 2002 from approximately $3.2 million in the first quarter of 2001. The decrease resulted primarily from the restructuring of Elron Software's sales and marketing operations. The restructuring programs included a reduction of employees in 2001, mainly in the enterprise sales, sales support and marketing group due to the decision to transition Elron Software from a direct to an indirect sales model, utilizing value added resellers and distributors.

General and Administrative. General and administrative expenses include both Elron Software and Elron TeleSoft's costs as well as our headquarters' costs. These costs consisted primarily of salaries and related costs, facilities costs, and insurance, legal, accounting and consulting expenses. General and administrative expenses decreased by $0.8 million, or 25%, to $2.4 million in the first quarter of 2002 from approximately $3.2 million in the first quarter of 2001.

Elron Software's and Elron TeleSoft's general and administrative expenses decreased by $0.7 million, or 39%, to $1.1 million in the first quarter of 2002 from approximately $1.8 million in the first quarter of 2001. The decrease is primarily due to the implementation of restructuring programs by Elron Software and Elron TeleSoft during 2001. The restructuring programs included a workforce reduction and cost reduction programs, mainly in facilities related expenses, communication, maintenance and travel expenses.
Our headquarters' costs decreased by $0.1 million, or 8%, to $1.2 million in the first quarter of 2002 from approximately $1.3 million in the first quarter of 2001.

Finance Expenses. Finance expenses decreased by $0.6 million, or 45%, to $0.7 million in the first quarter of 2002 from approximately $1.2 million in the first quarter of 2001. The decrease in finance expenses, despite an increase in loans received, is attributed primarily to the decrease in interest rates.

Amortization of Other Assets. Amortization of other assets was approximately $0.4 million and $1 million in the first quarter of 2002 and 2001, respectively. The decrease in the first quarter of 2002 is due to realization of intangible assets attributed to non-core activities sold by Elron TeleSoft and due to the implementation of SFAS 142 in January 2002, according to which we no longer amortize goodwill. This has no material effect on our operating results. In the first quarter of 2001, amortization of goodwill was $0.4 million.

Restructuring Charges. In response to the economic conditions, and, in particular, the slowdown in IT spending, Elron Software and Elron TeleSoft underwent restructuring programs in 2001 in order to focus their operations on core areas of their business, and to reduce expenses and improve efficiency. These restructuring programs mainly include workforce reductions and facilities related expenses.

Restructuring charges in the first quarter of 2002 amounted to $22 thousands. As part of the restructuring programs, Elron TeleSoft completed the sale in the first quarter of 2002 of its non-core activity in the government field to Elbit Systems for $5.7 million and recorded a gain of $0.3 million. The gain was offset by $0.4 million restructuring charges resulting primarily from an additional workforce reduction in Elron Telesoft at the beginning of 2002 as well as consolidation of excess facilities that involved relocation costs and write-off of leasehold improvements in the vacated facilities. All termination and relocation costs were paid as of March 31, 2002. The remaining accrued restructuring liability as of March 31, 2002 is $0.5 million and is primarily related to lease obligations.

LIQUIDITY AND CAPITAL RESOURCES

Cash, debentures, deposits and marketable securities at March 31, 2002, were $110.6 million compared with $112.8 million at December 31, 2001.

Main cash and other liquid instruments resources in the first quarter of 2002 were proceeds from the sale of marketable securities of NetManage, ArelNet and Kana of $0.8 million and net proceeds received from the sale of certain non-core activities of Elron TeleSoft in the amount of $3.8 million.

Main cash and other liquid instruments applications in the first quarter of 2002 were investments in our existing group companies to secure their cash needs for future growth of $2.6 million, net cash used in operating activities (including interest) by Elron Software and Elron TeleSoft of $3.0 million, net cash used in our headquarter activities of $0.4 million, $0.5 million merger expenses, the net decrease in Elron Software's and Elron TeleSoft's loans of $0.2 million and the purchase of fixed assets of $0.2 million.

Our trading securities portfolio decreased in the first quarter of 2002 as a result of a decrease of $0.2 million due to the sale of most of Kana shares held by us. Marketable securities at March 31, 2002 amounted to $55 thousands, representing the market value of approximately 3,000 Kana's shares.

Working capital on March 31, 2002 was $92.9 million compared to $91.3 million at December 31, 2001.

At March 31, 2002, Elron Software and Elron Telesoft had bank credits and bank loans of $68 million, most of which were secured or guaranteed by us to the lending banks. In addition, in connection with some of Elron TeleSoft's bank loans, we have provided to the lending bank a comfort letter, pursuant to which we undertake not to dilute our holdings in Elron TeleSoft below 65%. We also agreed to subordinate any amounts owed to us by Elron TeleSoft, other than interest on outstanding loans and payments in the ordinary course of business. Payments of bank credits and bank loans are due in future periods as follows: $14.4 million in 2002, $53.2 million in 2003, $0.2 million in 2004, $0.2 million in 2005.

In 2001, we provided a letter of comfort in connection with 50% of the credit line granted to NetVision by banks. The comfort letters were jointly provided with the other major shareholder of NetVision.

We believe that our existing capital will be sufficient to fund our and our subsidiaries' operations and our investment activities in existing and new companies.

Shareholders' equity at March 31, 2002, was approximately $225.3 million representing about 72% of the total assets compared with $248.2 million representing 73% of total assets at December 31, 2001.

QUALITIVE AND QUANTITIVE DISCLOSURE ABOUT MARKET RISK

Market risks relating to our operations result primarily from changes in interest rates, exchange rates and equity prices. In order to limit our exposure, we may enter, from time to time, into various derivative transactions. In 2002 we have no derivative transactions. Our objective is to reduce exposure and fluctuations in earnings and cash flows associated with changes in interest rates, foreign currency rates and equity prices. We do not use financial instruments for trading purposes. It is our policy and practice to use derivative financial instruments only to limit exposure.

During the first quarter of 2002, we sold our remaining shares of NetManage and ArelNet and a significant portion of our shares of Kana. At March 31, 2002, we held approximately 3,000 shares of Kana. The market value of Kana's shares held by us at March 31, 2002 was $55,000. Therefore, the maximum exposure is not material to our results of operations or our financial condition.

Except those mentioned above, there were no significant changes in our market risks nor in our policy to reduce risks in comparison to those described in our 2001 management report.

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