MANAGEMENT REPORT FOR THE SECOND QUARTER ENDING JUNE 30, 2002

The following management report should be read in conjunction with our Interim Consolidated Financial Statements as of June 30, 2002 and Notes thereto and 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. 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.

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

Merger with Elbit and Share Purchase of DEP

On May 15, 2002, we completed our merger with Elbit Ltd. Pursuant to the merger agreement signed on October 31, 2001, we issued to Elbit’s shareholders (other than Elron) 5,617,601 ordinary shares, based on an exchange ratio of 0.45 ordinary shares of Elron for each ordinary share of Elbit and assumed options to purchase Elbit ordinary shares, which after the merger entitled the holders to purchase 240,525 ordinary shares of Elron. As a result of the merger, Elbit became a wholly owned subsidiary of Elron. The transaction was accounted for as a purchase, and accordingly, our results of operations include the revenues and expenses of Elbit subsequent to the acquisition date. The aggregate purchase price of approximately $74 million consisted of the consideration of 5,617,601 Elron ordinary shares valued at an average market price of $12.50 per ordinary share, which was based on the average closing price of

Elron's ordinary shares during the period commencing from the date of the announcement of the exchange ratio and ending five days thereafter, $1.0 million of assumed options and $2.7 million of transaction and integration costs. The purchase price has been allocated to Elbit's assets based on their estimated fair value according to a preliminary analysis made by an independent valuation appraiser. Of the total purchase price, $55 million has been allocated to Elbit's identifiable net assets and the remaining $19 million has been allocated to goodwill. The goodwill recorded reflects the anticipated synergies that will result from the combined entity, including anticipated reductions in operational and management costs, the creation of a better platform and a more simplified and efficient organizational structure and greater resources and scope of operations, which will benefit the group companies.

On May 6, 2002, we issued 2,261,843 ordinary shares to Discount Investment Corporation Ltd. ("DIC") (which held at that time 42% of the shares of Elron), pursuant to the share purchase agreement signed on November 19, 2001 with DIC in exchange for all of the shares held by DIC in DEP Technology Holdings Ltd. ("DEP"), including DIC's rights to loans provided by DIC to a subsidiary of DEP, RDC Rafael Development Corporation Ltd. ("RDC"). RDC is a joint venture, controlled and consolidated by DEP, in which DEP holds 48% of the outstanding shares. 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. Following the closing of the transaction, DEP became a wholly owned subsidiary of Elron. The transaction was accounted for as a purchase and accordingly our results of operations include the revenues and expenses of DEP subsequent to the acquisition date. The aggregate purchase price of approximately $29.4 million consisted of 2,261,843 Elron's ordinary shares valued at an average market price of $13.02 per ordinary share, which was based on the average closing price of Elron's ordinary shares on a few days before and after the announcement date of the number of shares to be issued to DIC. The purchase price has been allocated to DEP's assets acquired, primarily long-term investments, in the amount of $41.0 million, loans from DIC to RDC in the amount of $3.5 million and liabilities assumed in the amount of $15.1 million. The allocation to DEP's assets, was based on preliminary analysis made by an independent valuation appraiser. Of the total purchase price allocated to DEP's assets acquired, an aggregate amount of $16.5 million was allocated to identifiable net intangible assets related to equity investments, with a weighted average amortization period of approximately 11 years and an aggregate amount of $6.5 million was allocated to each equity investment's goodwill.

In accordance with generally accepted accounting principles in the U.S., goodwill recorded in these transactions will not be amortized and will be reviewed annually (or more frequently if impairment indicators arise) for impairment.

We believe that these transactions will enable us to further enhance our position in the high technology markets, allow us to pursue additional investment opportunities, optimize our holding structure, combine resources, benefit from potential synergies and achieve management cost savings at the corporate operations.

Following the two transactions, our holdings include direct and indirect holdings through Elbit, DEP and DEP's subsidiary, RDC (collectively referred to as "group companies"). As most of Elbit, DEP and RDC group companies are technology-related companies which have not yet generated significant revenues and earnings, we expect that they will continue to recognize losses in the near future and therefore, our share in their losses will continue to constitute a significant portion of our results of operations. For more details regarding our group companies following the two transactions, please see our annual report on Form 20-F for the year ended December 31, 2001 filed with the Securities and Exchange Commission.

Investment in Galil Medical

During the second quarter of 2002 we and RDC invested in Galil Medical Ltd. ("Galil") $2.2 million and converted notes of approximately $3.2 million.

On June 27, 2002, we purchased an additional 10.75% of Galil Medical's outstanding shares from Lumenis Ltd., in consideration for $0.9 million. Lumines also received the right to receive a future earn-out payment, conditioned upon the occurrence of certain events on or before May 27, 2004.

As a result of these transactions, we hold directly 15.09% of Galil share capital and RDC holds 37.4%, therefore having directly and indirectly through RDC, a controlling voting interest in Galil and accordingly Galil's assets and liabilities are included within our consolidated balance sheet as of June 30, 2002.

Investment in Mediagate

In August 2002, we converted notes of Mediagate N.V.in the amount of approximately $3.6 million to preferred shares. Additionally, we invested, through a rights offering, an additional $2.5 million. As a result of these transactions our interest in MediaGate increased to 68% and MediaGate's results of operations will be included in our consolidated financial statements as of that date.

As a result of the transactions mentioned above, our subsidiaries include, Elron Software, Elron TeleSoft, VFlash , Textology, ICC, Dealigence, RDC and Galil Medical , each of which is, included in our consolidated financial statements as of the date of its acquisition. Our affiliates, which are accounted for under the equity method of accounting, include, Elbit Systems (Nasdaq: ESLT), Elbit (through the completion of our merger with Elbit), NetVision, MediaGate, Chip Express, DEP (through the completion of the share purchase), Wavion, KIT, Pulsicom, Given Imaging Ltd. (Nasdaq: GIVN), Galil Medical (through June 30, 2002), Witcom Ltd., 3DV Ltd., Sela, Ingenio, Cellenium and CellAct. We also own a 12% of Partner Communications Company’s (Nasdaq: PTNR) outstanding share capital through Elbit.

For comparison purposes, we have provided pro forma information in accordance with SFAS 141, which gives effect to the merger with Elbit and the share purchase of DEP as if these transactions had occurred at the beginning of each reporting period presented (see Note 4 to the Interim Consolidated Financial Statements as of June 30, 2002).

CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are more fully described in Note 2 to our Annual Consolidated Financial Statements. The accounting policies which are particularly important to the description of our financial position and results of operations are described in our annual report on Form 20-F for the year ended December 31, 2001 filed with the Securities and Exchange Commission. There have been no changes in our accounting polices except as described below.

As a result of the DEP share purchase, our interest in Given Imaging, Galil Medical, Witcom and 3DV Systems, in which we had direct and indirect interests through RDC, increased. This enables us to exercise significant influence over these companies. As a result, and in accordance with APB 18, our direct holdings in these companies, which were previously accounted for at cost, were accounted for retroactively under the equity method (“step by step acquisition”). In accordance with APB18, we have restated our financial statements for all prior periods in which our investments in these companies where recorded at cost. The aforementioned restatements resulted in increased net losses of approximately $2.5 million, $0.7 million and $1.3 million, for the year ended December 31, 2001 and for the three months and six months ended June 30, 2001, respectively. The effect on our results of operations for the three months ended March 31, 2002 was the increase in the net loss of approximately $0.7 million.

RESULTS OF OPERATIONS

Three and six months ended June 30, 2002 compared to three and six months ended June 30, 2001.

Our net loss for the three and six month periods ended June 30, 2002 was $15.2 million, or $0.59 per share, and $23.4 million, or $1.0 per share, respectively. Our net loss in the three and six month periods ended June 30, 2001, as restated (see “Critical Accounting Policies" above) was $11.1 million, or $0.52 per share, and $21.0 million, or $0.99 per share, respectively. Our net loss for the three and six month periods ended June 30, 2001, adjusted to exclude amortization expenses related to goodwill that is no longer being amortized commencing January 1, 2002 in accordance with SFAS 142, was $10.6 million, or $0.5 per share, and $20.2 million, or $0.95 per share, respectively.

Pro forma net loss for the three and six month periods ended June 30, 2002, which gives effect to the merger with Elbit and the share purchase of DEP as if it had occurred at the beginning of each of the reporting periods, was $19.9 million, or $0.69 per share, and $36.7 million, or $1.26 per share, respectively, compared to pro forma net loss of $17 million, or $0.58 per share, and $30.4 million, or $1.05 per share, for the same periods in 2001, respectively.

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 report net losses mainly as a result of the net losses of our subsidiaries and our share in the losses of our 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 mature companies, such as Elron TeleSoft and NetVision, to report positive EBITDA (earnings before interest, taxes, depreciation and amortization).

Operating results of Elron Telesoft

Elron Telesoft is focused on telecom network and service management products and solutions. Elron Telesoft’s net revenues were $3.4 million and $7.4 million for the three and six month periods ended June 30, 2002, compared to $7.7 million and $15.1 million for the same periods of 2001. The decrease was as a result of the sale of non-core activities of Elron Telesoft during the second half of 2001 as part of its restructuring program to focus its operations on core areas of its business, which are development and marketing of products to the telecommunications market. Elron Telesoft's revenues resulting from products and services to the telecommunication market in the three and six month period ended June 30, 2001 were $3.9 million and $7.4 million.

Cost of revenues of Elron TeleSoft in the three and six month periods ended June 30, 2002 was $2.3 million and $5.1 million, representing a gross margin of 31% in both periods, compared to $6.7 million and $13.3 million in the same periods in 2001, representing a gross margin of 13% and 12%, respectively. The improvement in Elron Telesoft's gross margin is a result of its restructuring program, which included mainly workforce reductions, and a result of its focus on core areas of its business.

Elron Telesoft’s operating loss was $1.2 million and $1.5 million for the three and six month periods ended June 30, 2002, compared to $2.8 million and $5.5 million for the same periods of 2001. However, Elron Telesoft reported its second consecutive quarter of operating breakeven and positive EBITDA from its core telecommunication business, excluding the effect of amortization of intangible assets and restructuring charges. These results reflect Elron Telesoft’s successful effort to reduce its costs and restructure its operations to focus on the telecommunication market.

Operating results of Elron Software

Elron Software is focused on web access control and email content filtering for organizations. Elron Software’s net revenues were $2.4 million and $4.3 million for the three and six month periods ended June 30, 2002, compared to $2.5 million and $4.7 million for the same periods of 2001, representing a decrease of 4% and 9% for the respective periods. The decrease was primarily due to the continued economic slowdown, which continues to cause customers to delay or postpone purchases of IT products. However, revenues in the second quarter of 2002 increased by $0.5 million, or 26%, from their level of $1.9 million in the first quarter of 2002, which was primarily due to the launch of Elron Software's enhanced Internet Policy Management (IPM) products at the end of the first quarter of 2002.

Cost of revenues of Elron Software were $0.2 million and $0.4 million in the three and six month periods ended June 30, 2002, compared to $0.3 million and $0.5 million for the same periods in 2001, representing a gross margin of 90% and 91% for these periods.

Elron Software's operating loss was $2.1 million and $4.7 million for the three and six month periods ended June 30, 2002, compared to $2.0 million and $4.9 million for the same periods of 2001. Excluding the effect of amortization of intangible assets, deferred compensation and restructuring charges, the operating loss of Elron Software was $1.4 million and $3.6 million for the three and six month periods ended June 30, 2002, compared to $1.7 million and $4.3 million for the same periods of 2001. The decrease in losses was a result of the cost reductions implemented by Elron Software.

Consolidated Results of Operations

Income

Net Revenues

Net revenues consisted of sales of products and services by our subsidiaries, Elron Software and Elron TeleSoft, as explained above, and Vflash and ICC, which have been consolidated subsequent to the completion of the merger with Elbit in May 2002 and contributed $0.1 million to the consolidated revenues.

Our share in net losses of affiliated companies

Our share in net losses of affiliated companies resulted from our holdings in investments that are accounted for under the equity method. Our share in net losses of affiliated companies was $9.6 million and $15.3 million for the three and six month periods ended June 30, 2002, compared to a restated net loss of $5.4 million and $8.2 million for the same periods of 2001. The increase in our share in net losses of our affiliated companies resulted mainly from the increase in our indirect share in the losses of Elbit's and DEP's group companies, as a result of the merger and the share purchase, as most of their group companies are early-stage companies which have not yet generated significant revenues and therefore have incurred significant losses. In addition, we recorded a loss of approximately $3.7 million primarily as a result of Elbit and DEP adjusting down certain investments, mainly with regard to investments in Vflash, Textology and ICC.

Highlights of the Results of Operations of Our Major Affiliates:

Elbit Systems Ltd. (a 21% holding)

Elbit Systems develops, manufactures and integrates advanced, high-performance defense electronic systems.

Elbit Systems' revenues increased from $170.0 million and $351.8 million in the three and six month periods ended June 30, 2001, to $193.2 million and $379.0 million in the same periods in 2002. As of June 30, 2002, Elbit Systems' backlog of orders was $1,650 million, of which approximately 66% was scheduled to be performed in the two following quarters of 2002 and in 2003 compared to backlog of orders of $1,566 million on December 31, 2001.

Elbit Systems' operating income in the three and six month periods ended June 30, 2002 was $4.9 million and $19.6 million (2.6% and 5.2% of revenues) compared to $14.3 million and $30.2 million in the same periods in 2001 (8.4% and 8.6% of revenues). The decrease in operating income resulted primarily from a one-time charge of approximately $9.8 million (before tax) in connection with El-

Op's (Elbit Systems' wholly-owned subsidiary) agreement to repay the Office of the Chief Scientist of the Israeli Ministry of Industry and Trade ("OCS") an agreed amount of $10.6 million in exchange for a release by the OCS from all obligations to pay royalties in the future.

Elbit Systems' net income in the three and six month periods ended June 30, 2002 was $4.8 million and $16.5 million (2.5% and 4.4% of revenues) compared to $11.2 million and $21.8 million (6.6% and 6.2% of revenues) in the same periods in 2001. The decrease resulted primarily from the one time charge of $9.8 million described above.

NetVision (a 46% holding)

NetVision, an Internet service and solutions providers in Israel, recorded revenues in the three and six month periods ended June 30, 2002 of $14.4 million and $28.8 million compared to $14.4 million and $29.7 million in the same periods in 2001. Operating expenses decreased by $3.2 million and $6.7 million, or 19% and 20%, from $16.3 million and $33.1 million in the three and six month periods ended June 30, 2001, to $13.1 million and $26.4 million in the same periods of 2002, due to cost reduction programs implemented by NetVision. As a result, NetVision's operating income in the three and six month periods ended June 30, 2002 was $1.3 million and $2.3 million compared to an operating loss of $1.8 million and $3.4 million in the same periods in 2001. Netvision's net income was $1.4 million and $3.1 million in the three and six month periods ended June 30, 2002 compared to a net loss of $2.7 million and $4.0 million in the same periods in 2001.

Chip Express (a 35% holding)

Chip Express, a manufacturer of late stage programmable gate array ASICs (Application Specific Integrated Circuits), continues to be affected in 2002 by the slowdown in the semiconductor industry and its revenues decreased by $2.8 million and $8.0 million, or 42% and 45%, from $6.8 million and $17.9 million in the three and six month periods ended June 30, 2001, to $4.0 million and $9.9 million in the same periods in 2002. However, the effect of the decline in revenues on Chip Express' net loss was less significant as a result of the implementation of its cost reduction programs during 2001 , which resulted in a 20% and 37% decrease in Chip Express' operating expenses in the three and six month periods ended June 30, 2002 to $5.7 million and $11.2 million compared to $7.1 million and $18.5 million in the same periods in 2001. Chip Express' net losses in the three and six month periods ended June 30, 2002 amounted to $1.7 million and $1.8 million compared to $1.1 million and $0.1 million in the same periods in 2001. It is anticipated that Chip Express' revenues will continue to be affected by the slowdown in the semiconductor industry.

During the second quarter of 2002, Chip express raised $16 million, of which we invested $5 million. Consequently, our ownership percentage in Chip Express decreased from 35% to 33.5%. The amount raised is expected to be used for research and development to expand global marketing activities and to increase Chip Express sales efforts, primarily in Asia. As a result, Chip Express losses are expected to increase in the following quarters.

MediaGate (a 29% holding)

MediaGate, which develops and markets carrier-class universal communications server, continues to be affected by the slowdown in the communications and universal messaging markets. MediaGate's revenues were $0.4 million and $0.5 million in the three and six month periods ended June 30, 2002 compared to no revenues in the same periods in 2001. Due to cost reductions programs implemented by MediaGate, operating expenses decreased by $1.0 million and $2.3 million, or 45% and 47%, from $2.1 million and $4.9 million in the three and six month periods ended June 30, 2001, to $1.2 million and $2.6 million in the same periods in 2002. Its net losses decreased to $0.8 million and $2.2 million in the three and six month periods ended June 30, 2002 from $2.2 million and $5.0 million in the same periods in 2001. MediaGate's future revenues are dependent upon the development of the unified messaging market.

Pulsicom (a 17% holding)

Pulsicom commenced its operations in 2001 and develops high accuracy real time location and tracking systems. In the three and six month periods ended June 30, 2002, its net losses amounted to $0.2 million and $0.4 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 and selling its product.

Cellenium (a 50% holding through Elbit)

Cellenium is engaged in the development of technology for the transfer of short messages over communications network, particularly the various type of cellular networks. Cellenium's net revenues in the three and six month periods ended June 30, 2002 were $0.2 million and $0.6 million compared to $0.1 million for the same periods in 2001. Cellenium’s net losses in the three and six month periods ended June 30, 2002 were $1.3 million and $2.3 million compared to $1.4 million and $2.8 million for the same periods in 2001. Cellenium’s future revenues are largely dependent on the development of the mobile commerce market and the penetration of new value-added services and applications.

Wavion (a 48% holding)

Wavion, a developer of broadband wireless access systems, recorded a net loss in the three and six month periods ended June 30, 2002 of $0.4 million and $0.8 million compared to $1.1 million and $2.2 million for the same periods in 2001. In light of the downturn in the broadband wireless commercial market which has delayed the release of Wavion’s products, Wavion began at the beginning of 2002, to sell development services for communication systems, recording $0.2 million and $0.4 million revenues in the three and six month periods ended June 30, 2002, and reduced its research and development expenses as part of a cost reduction program . It is difficult to predict when Wavion will be able to market its product successfully.

KIT (a 28% holding)

KIT’s revenues increased by $0.6 million and $1.0 million from $0.3 million and $0.4 million in the three and six month periods ended June 30, 2001 to $0.9 million and $1.5 million in the same periods in 2002. KIT is an online academic program company. KIT’s net loss in the three and six month periods ended June 30, 2002 was $1.7 million and $2.4 million compared to $0.7 million and $1.4 million in the same periods in 2001. The increase in KIT’s net loss resulted primarily from higher sales and marketing expenses in order to attract new students.

Given Imaging (a 20% holding directly and indirectly through RDC)

Given Imaging (Nasdaq: GIVN), a medical device company using a disposable miniature video camera in a capsule to examine the gastrointestinal tract, recorded revenues of $7.2 million and $12.4 million for the three and six month periods ended June 30, 2002 and a gross profit of 54.4% and 53% of revenues, respectively. The second quarter of 2002 represents the third full quarter of sales for Given Imaging following FDA clearance of its product in August 2001 and the third consecutive quarter of increased revenues. Given Imaging’s net loss in the three and six month periods ended June 30, 2002 was $4.9 million and $10.7 million compared to $4.7 million and $7.4 million in the same periods of 2001. The increase in Given Imaging’s net losses was due to an increase in its operating expenses, mainly marketing expenses resulting from its marketing efforts to launch its product. The increase in operating expenses was offset by revenues recorded by Given Imaging.

Galil Medical (a 34% holding directly and indirectly through RDC)

Galil Medical, a medical device company for performing minimal invasive cryotherapy, recorded revenues of $1.0 million and $2.0 million for the three and six month periods ended June 30, 2002 compared to $0.7 million and $1.2 million in the same period of last year. Net loss for the three and six month periods ended June 30, 2002 was $2.2 million and $4.4 million compared to $2.0 million and $3.8 million in the same periods of 2001. The increase in net loss resulted primarily from higher operating expenses, including sales and marketing expenses, which were partially offset by an increase in revenues.

Witcom (a 20% holding directly and indirectly through RDC)

Witcom, a company operating in the field of radio-based point-to-point digital networking solutions, recorded revenues of $1.5 million and $2.8 million for the three and six month periods ended June 30, 2002 compared to $1.3 million and $1.9 million in the same period of 2001. Witcom's net loss in the three and six month periods ended June 30, 2002 was $2.1 million and $3.6 million compared to $1.7 million and $3.7 million in the same period in 2001. Witcom's revenues in the future will be affected by the slowdown in the telecommunications industry.

3DV (a 24% holding directly and indirectly through RDC)

3DV, a developer of products in the field of 3-D cameras, recorded net losses of $1.2 million and $2.6 million for the three and six month periods ended June 30, 2002 compared to $2.2 million and $4.2 million in the same period in 2001. The decrease in 3DV's net losses was the result of restructuring and cost reduction programs. It is difficult to predict when 3DV will be able to start marketing and selling its product.

We expect that our group companies will continue to recognize losses in the following quarters and therefore will negatively affect our net results of operations.

In addition to companies accounted under the equity method, we have several significant investments in companies which we account for on a cost basis or as available-for-sale and whose results do not affect our results of operations. These significant investments mainly include our holding in Partner through Elbit, which is accounted for as available-for-sale securities, and Oren Semiconductor, which is presented at cost.

Partner (a 12% holding through Elbit)

At June 30, 2002, our investment in Partner amounted to $93.0 million. Partner is a Global System for Mobile Communications, or GSM, mobile telephone network operator in Israel. In the second quarter of 2002, Partner reached a significant milestone and reported for the first time, quarterly net income. The following are highlights of the results of operations of Partner for the second quarter of 2002:

Partner's revenues for the second quarter of 2002, driven primarily by subscriber growth, higher usage, and increased data and content revenues, increased by 24% to $207.9 million from $167.1 million in the second quarter of 2001 and by 7% from the first quarter of 2002. Partner's subscriber base at the end of the second quarter of 2002 was 1,703,000 compared to 1,147,000 at the end of the second quarter of 2001.

Partner's operating profit for the second quarter of 2002 increased to $28.9 million from $9.3 million in the second quarter of 2001, an increase of 210%. Operating income in the second quarter, as a percentage of revenues, reached 14% versus 6% in the second quarter of 2001 and 11% in the first quarter of 2002.

Partner's net income for the second quarter of 2002 was $5.3 million compared to a loss of $9.4 million for the second quarter of 2001.

Oren Semiconductor (a 17% holding)

During the first half of 2002, we invested $1.1 million in Oren by way of bridge loans, bringing the book value of our holding in Oren on June 30, 2002 to $6.6 million compared to $5.5 million on December 31, 2001. Oren is a developer of integrated circuits for digital broadcasting.

In the three and six month periods ended June 30, 2002, Oren's revenues were $0.7 million and $1.0 million compared to $0.6 million and $1.3 million in the same periods in 2001. Operating expenses in the three and six month periods ended June 30, 2002 decreased to $1.9 million and $3.8 million from $2.5 million and $5.6 million in the same periods in 2001, mainly due to the decrease in research and development costs as a result of cost reduction programs. Oren's net loss in the three and six month periods ended June 30, 2002 was $1.7 million and $3.3 million compared to $1.9 million and $4.3 million in the same periods in 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 three and six month periods ended June 30, 2002 was $1.9 million and $2.0 million compared to insignificant losses in the same periods in 2001. The gain in the second quarter of 2002 resulted primarily from the sale of approximately 200,000 shares of Given Imaging held by RDC. As a result, our direct and indirect share in Given Imaging decrease from 20.1% to 19.7%.

Other Income (loss), net

Other income (loss), net, in the three and six month periods ended June 30, 2002 amounted to a loss of $0.2 million and a gain of $0.3, respectively, compared to a gain of $0.5 million and a loss of $2.7 million for the same periods in 2001. The $0.2 million loss in the second quarter of 2002 resulted from the write-down of investments, which was offset in the six month period of 2002 by a $0.6 million gain from the sale of shares of NetManage (Nasdaq: NETM). The loss in the first half of 2001 resulted primarily from a $4.3 million decrease in the market value of BroadBase Software's shares held by us at that time, which was partially offset by a $1.0 million gain from the sale of the remaining shares of Zoran Corporation during the first quarter of 2001.

Finance Income

Finance income decreased by $0.3 million and $1.2 million, or 33% and 44%, to approximately $0.6 million and $1.5 million in the three and six month periods ended June 30, 2002 from $0.9 million and $2.7 million in the same periods in 2001, due to the decrease in interest rates and the decrease in our cash resources which were used for investment purposes.

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 as well as those of Vflash, Textology and ICC, which have been consolidated as a result of the merger with Elbit. Cost of revenues decreased by $4.1 million and $8.0 million, or 60% and 58%, to $2.8 million and $5.8 million in the three and six month periods ended June 30, 2002 from $6.9 million and $13.8 million for the same periods of 2001, mainly as a result of a decrease in revenues resulting from the sale of non-core activities by Elron Telesoft in order to focus on the telecommunication markets (see "Operating Results of Elron Telesoft") as well as the restructuring programs implemented by our subsidiaries in order to increase efficiency.

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 and those of Vflash, Textology and ICC which have been consolidated as a result of the merger with Elbit.

Consolidated research and development expenses decreased by $0.2 million and $0.6 million, or 8% and 13%, to $2.3 million and $4.2 million in the three and six month periods ended June 30, 2002 from $2.5

million and $4.8 million in the same periods in 2001, primarily as a response to the slowdown in spending for IT products.

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 and those of Vflash, Textology and ICC.

Consolidated sales and marketing expenses increased by $0.4 million, or 15%, to $2.8 million in the second quarter of 2002 from $2.4 in the same period of 2001. The increase resulted mainly from the inclusion of the sales and marketing expenses of Vflash, Textology and ICC which were consolidated for the first time in the second quarter of 2002. Consolidated sales and marketing expenses decreased by $0.4 million, or 7%, to $5.2 million in the first half of 2002 from $5.6 million in the same period of 2001. The decrease is attributed to Elron Telesoft.

General and Administrative

General and administrative expenses include our management and headquarter costs, the expenses of our subsidiaries, Elron Software and Elron TeleSoft's and, since the completion of the merger and the DEP share purchase, the expenses of Vflash, Textology, ICC and RDC. These costs consisted primarily of salaries and related costs, facilities costs, and insurance, legal, accounting and consulting expenses.

Consolidated general and administrative expenses increased by $0.1 million from $2.7 million in the second quarter of 2001 to $2.8 million in the second quarter of 2002. Consolidated general and administrative expenses in first half of 2002 decreased by $0.7, or 11%, to $5.2 million from approximately $5.9 million in the same periods in 2001.

Our subsidiaries' general and administrative expenses decreased by $0.2 million and $0.4 million, or 14% and 12%, to $1.2 million and $2.8 million in the three and six month periods ended June 30, 2002 from approximately $1.4 million and $3.2 million in the same periods in 2001. The decrease is primarily due to the implementation of restructuring programs by Elron Software and Elron TeleSoft during 2001. The restructuring programs included workforce and cost reduction programs, including reductions in facilities related expenses, communication, maintenance and travel expenses.

Our management and headquarter costs increased by $0.4 million and $0.2 million, or 30% and 10%, to $1.6 million and $2.8 million in the three and six month periods ended June 30, 2002 from approximately $1.2 million and $2.6 million in the same periods in 2001. Since the merger with Elbit, management and headquarter cost reflect the costs of the combined management. We expect that the potential cost savings as a result of the merger commencing in the third quarter of 2002, will be approximately $4 million per year.

Finance Expenses

Consolidated finance expenses increased by $0.1 million, or 10%, to $1.1 million in the second quarter of 2002 compared to $1.0 in the second quarter of 2001. Consolidated finance expenses decreased by $0.5 million, or 22%, to $1.8 million, compared to $2.3 million in the first half of 2001. The majority of the finance expenses are attributable to Elron Telesoft. The decrease in finance expenses, despite an increase in loans, is primarily due to the decrease in interest rates.

Amortization of Other Assets

Amortization of other assets was approximately $0.5 million and $0.9 million in the three and six month periods ended June 30, 2002 compared to $1.0 million and $2.0 million in the same periods in 2001. The decrease in 2002 is mainly due to the implementation of SFAS 142 in January 2002, as a result of which we no longer amortize goodwill. Amortization of goodwill in the three and six month periods ended June 30, 2001 was $0.4 million and $0.8 million.

The $16.5 million of identifiable intangible assets that have been allocated to DEP's equity investments, (including investments through RDC) will be amortized over a weighted average period of approximately 11 years, according to the economic benefit of the underlying assets. The amortization is included in our share of the net losses of each equity investment except for Galil Medical, which will be consolidated in future periods.

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. Due to the continuation of the slowdown in IT spending in 2002, the companies implemented additional restructuring programs in 2002 which included mainly workforce reductions in order to further adjust their operations to the current economic conditions.

As part of Elron Telesoft's restructuring program in 2001, Elron TeleSoft completed in the first quarter of 2002, the sale of its non-core activity in the government field to Elbit Systems for $5.7 million. Elron Telesoft's restructuring charges in the first half of 2002 amounted to $0.7 million, of which $0.5 million was due to workforce reductions as well as the consolidation of excess facilities that involved write-off of leasehold improvements in the vacated facilities.

Elron Software recorded $0.3 million of restructuring charges in the second quarter of 2002 primarily due to an additional workforce reduction in its research and development division.

Vflash is also undergoing a restructuring program in response to a slowdown in Internet and cellular value added services. In connection with this restructuring, Vflash recorded in the second quarter of 2002, $0.6 million of restructuring charges.

Upon the completion of the merger with Elbit, we recorded $0.4 million of restructuring charges, primarily due to costs incurred in connection with merging Elbit into Elron. .

As a result of the above, consolidated restructuring charges in the three and six month periods ended June 30, 2002 amounted to $2.1 million and $2.2 million. Consolidated restructuring charges in the second quarter of 2001 and in the first half of 2002 amounted to $0.9 million.

All termination and exit costs were paid as of June 30, 2002, except $1.0 million. The remaining accrued restructuring liability as of June 30, 2002 is $1.2 million and is primarily related to lease obligations.

Further restructuring program in our group companies may be needed in the future depending upon market conditions, their future results of operations and the demand for their products.

LIQUIDITY AND CAPITAL RESOURCES

Consolidated cash, debentures, deposits and marketable securities at June 30, 2002 were $114.0 million (of which $108.6 million are held by Elron), compared with $112.8 million at December 31, 2001 (of which $111.5 million was held by Elron). At June 30, 2002, cash, debentures, deposits and marketable securities held by Elron includes those of Elbit following the completion of the merger in May 2002.

Main cash and other liquid instruments resources in the first half of 2002 were proceeds from the sale of marketable securities of NetManage, ArelNet and Kana of $0.8 million, a $1.3 million dividend received from Elbit Systems, and net proceeds received from the sale of certain non-core activities of Elron TeleSoft in the amount of $6.1 million. In addition, our cash and other liquid instruments increased by approximately $21.0 million, mainly as a result of the merger with Elbit, which was consolidated within our financial report for the first time in the first half of 2002.

Main cash and other liquid instruments applications in the first half of 2002 were investments in our existing group companies to secure their cash needs for future growth of $11.1 million, net cash used in operating activities (including interest) by our subsidiaries of approximately $8.0 million, $2.1 million headquarter costs, net, $5.8 million of merger expenses, the net decrease in Elron Software's and Elron TeleSoft's loans of $0.9 million and the purchase of fixed assets of $0.3 million.

Working capital on June 30, 2002 was $37.9 million compared to $91.3 million at December 31, 2001. The decrease was primarily due to classification as short-term loans of $36.6 million of previously classified long-term loan.

At June 30, 2002, Elron Software and Elron Telesoft had bank credits and bank loans of $67.4 million, most of which were secured or guaranteed by us to the lending banks.

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 for the next twelve months.

Shareholders’ equity at June 30, 2002, was approximately $292.1 million representing about 66% of our total assets compared with $238.7 million representing 73% of our total assets at December 31, 2001. The increase in shareholders' equity during the first half 2002 was a result of the share issuance pursuant to the merger agreement and the DEP share purchase agreement.

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