MANAGEMENT REPORT FOR THE THIRD QUARTER ENDING SEPTEMBER 30, 2002

The following management report should be read in conjunction with our Interim Consolidated Financial Statements as of September 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 our group companies. Founded in 1962, we have been a major force in the development of the Israeli high technology industry by building Israeli and 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, and increasing our direct involvement in defense electronics; information technology; software products and services; communications; medical devices; and semiconductors. In addition, we have recently invested in the field of amorphous metals (see below under "Recent Developments"). 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, 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, selecting and manning senior management positions, approving investments and budgets, financing and the overall ongoing monitoring of our group companies' performance. In addition to our representation on the boards of directors of our group companies, we provide hands-on assistance to the group companies' management in support of their growth. We view our hands-on involvement in the operations of our group companies as a key element of our business. Our group companies therefore benefit from the experience of our management team in various areas in which they need support and leadership, including, but not limited to, budgetary control, market analysis, risk management, identifying joint venture opportunities, introductions 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 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 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. ("Elbit"). Pursuant to the merger agreement signed on October 31, 2001, we issued 5,617,601 ordinary shares to Elbit's shareholders (other than Elron), 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 $74.0 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 an analysis made by an independent valuation appraiser. Of the total purchase price, $55.0 million has been allocated to Elbit's identifiable net assets and the remaining $19.0 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 an enhanced platform, a more simplified and efficient organizational structure and greater resources and scope of operations, which will benefit the group companies. In accordance with generally accepted accounting principles in the United States, goodwill recorded in this transaction will not be amortized and will be reviewed annually (or more frequently if impairment indicators arise).

On May 6, 2002, we issued 2,261,843 ordinary shares to Discount Investment Corporation Ltd. ("DIC") (which at that time held 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 RDC Rafael Development Corporation Ltd. ("RDC"), a subsidiary of DEP. RDC is a joint venture, controlled by and consolidated with 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%. 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 $29.5 million consisted of 2,261,843 ordinary shares of Elron 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 a few days before and after the date that the number of shares to be issued to DIC was announced. 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 an 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, according to the economic benefit of the underlying assets, and an aggregate amount of $6.5 million was allocated to each equity investment's goodwill. The amortization of the identifiable intangible assets is included in our share of the net losses of each equity investment, except for Galil Medical, which is consolidated in our financial statements, and therefore the amortization will be included under "Amortization of other assets".

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 our group companies with potential synergies and help us achieve management cost savings in respect of our corporate operations.

Following the two transactions, our holdings include direct and indirect holdings through Elbit, DEP and DEP's subsidiary, RDC. As most 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 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 converted notes of Galil Medical Ltd. (“Galil”) in the amount of approximately $3.2 million into preferred shares and invested approximately $2.5 million in new convertible notes.

On June 27, 2002, we purchased an additional 10.75% of Galil’s outstanding shares from Lumenis Ltd., in consideration for $0.8 million. Lumenis also received the right to receive a future earn-out payment, conditioned upon the occurrence of certain events on or before May 27, 2004. In the same transaction, DIC also purchased an additional 10.75% of Galil’s outstanding shares from Lumenis on the same terms and conditions.

As a result of these transactions, we hold 15.09% directly and RDC holds 37.4% of Galil’s outstanding shares, thereby giving us directly and indirectly, through RDC, a controlling voting interest in Galil, and accordingly, Galil's financial results are consolidated into our results of operations subsequent to June 30, 2002.

Investment in MediaGate

In July 2002, we converted notes of MediaGate N.V. (“MediaGate”) in the amount of approximately $3.6 million into preferred shares and invested, through a rights offering, an additional $2.5 million in preferred shares. As a result of these transactions, our interest in MediaGate increased to 68.3% of its outstanding shares and therefore MediaGate's financial results are consolidated into our results of operations subsequent to that date.

For comparison purposes, we have provided pro forma information in accordance with SFAS 141, which gives effect to the merger with Elbit, the share purchase of DEP and the acquisition of a controlling interest in Galil and in MediaGate 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 September 30, 2002).

Investment in A.M.T. Advanced Metal Technologies Ltd. ("AMT")

In August 2002, we invested approximately $5.0 million in convertible notes of AMT, an Israeli private company which develops, markets and licenses technologies, through its group companies, for amorphous and nano-crystalline advanced materials, as methods and solutions for a wide range of commercial applications. Currently, AMT is focusing on two of its group companies, A.H.T. Advanced Heating Technologies Ltd., which uses amorphous metals for heating products and A.C.S. Advanced Coding Systems Ltd., which develops, markets and sells products using amorphous materials for brand protection against counterfeiting and diversion and anti-shoplifting electronic article surveillance. The investment formed part of an aggregate investment in AMT of approximately $8.7 million, of which the existing shareholders of AMT invested $3.7 million. The convertible notes are convertible into preferred shares of AMT or its group companies. Following the investment, Elron holds 29% of AMT on a fully diluted and as converted basis (excluding warrants). The investment in AMT is being accounted for under the equity method.
In addition, we and the other investors in AMT were issued warrants to purchase up to an additional $19.1 million in convertible notes, over different periods of up to a maximum of 48 months from the closing. We also have an option to invest up to $5 million in AMT on the same terms and conditions as the original investment for a period of eight months from the closing.

We are entitled to voting and other rights attached to the convertible notes on an as converted basis as a shareholder of AMT, and to special rights in certain specific circumstances.

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 APB 18, we have restated our financial statements for all prior periods in which our investments in these companies were recorded at cost. The aforementioned restatements resulted in increased net losses of approximately $2.5 million, or $0.12 per share, $0.6 million, or $0.03 per share, and $1.9 million, or $0.09 per share, for the year ended December 31, 2001 and for the three months and nine months ended September 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, or $0.03 per share.

RESULTS OF OPERATIONS

Three and nine months ended September 30, 2002 compared to three and nine months ended September 30, 2001.

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

	Three month period ended September 30,		Nine month period ended September 30,	
	2002	2001	2002	2001
	(millions of $, except per share data)			
Net loss	(7.9)	(11.2)*	(31.4)	(32.3)*
Net loss per share	(0.27)	(0.53)*	(1.24)	(1.52)*

* Restated -see "Critical Accounting Policies" above.

Our net loss adjusted to exclude amortization expenses related to goodwill that is no longer being amortized commencing January 1, 2002 in accordance with SFAS 142 was as follows:

	Three month period ended September 30,		Nine month period ended September 30,	
	2002	2001	2002	2001
	(millions of $, except per share data)			
Net loss	(7.9)	(10.9)*	(31.4)	(31.1)*
Net loss per share	(0.27)	(0.51)*	(1.24)	(1.46)*

* Restated -see "Critical Accounting Policies" above.

Pro forma net loss, which gives effect to the merger with Elbit, the share purchase of DEP and the acquisition of a controlling interest in Galil and in MediaGate as if these transactions had occurred at the beginning of each reporting period presented, is as follows:

	Three month period ended September 30,		Nine month period ended September 30,	
	2002	2001	2002	2001
	(millions of $, except per share data)			
Net loss	(7.9)	(19.1)	(44.3)	(55.1)
Net loss per share	(0.27)	(0.66)	(1.52)	(1.89)

The general slowdown in spending for technology products continues to affect the results of operations of our group companies which continue to report net losses. The current economic conditions continue to limit our ability to successfully "exit" some of our group companies and to record capital gains. However, as reflected on a more comparable basis in the pro forma information, we reported a decrease in our share in the losses of our affiliated companies as a result of the restructuring plans and cost reduction programs taken by some of our group companies during 2001 and 2002 which enabled these companies to reduce their losses notwithstanding the adverse economic and market conditions.

For the reported periods, subsidiaries include our majority owned subsidiaries Elron Software and Elron TeleSoft, and ICC, RDC, Galil Medical and MediaGate (collectively referred to as "other subsidiaries"), each of which is included in our consolidated financial statements as of the date of its acquisition. The results of operations of VFlash and Textology (through August 2002) were included in the consolidated results under discontinued operations, as a significant portion of VFlash's operations and Textology were sold during the third quarter of 2002 (see under "Gain from discontinued operations"). Our affiliates, which are accounted for under the equity method of accounting, include Elbit Systems Ltd. (Nasdaq: ESLT), Elbit (through the completion of our merger with Elbit), NetVision Ltd., MediaGate (through August 2002), Chip Express Corp., 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 Systems Ltd., Sela, Ingeneo, Cellenium, CellAct and AMT (since August 2002).

Operating results of Elron TeleSoft

Elron TeleSoft is focused on telecom network and service management products and solutions. Elron TeleSoft's net revenues were $0.8 million and $8.2 million in the three and nine month periods ended September 30, 2002, compared to $4.6 million and $19.7 million for the same periods of 2001. The decrease of $3.8 million and $11.5 million between the reported periods resulted in part from a $2.7 million and $10.4 million decrease in revenues due to 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, the development and marketing of products to the telecommunications market. The balance of the decrease of $1.1 million in both periods resulted from reduced sales of products and services to the telecommunications market due to a slowdown in telecom capital expenditures as well as longer sales cycles as telecom service providers postponed purchase decisions.

Elron TeleSoft reported an operating loss in the three and nine month periods ended September 30, 2002 of $1.8 million and $3.3 million, respectively, compared to $2.7 million and $8.2 million for the same periods of 2001. The pro forma operating loss in the third quarter of 2002 and 2001, which excludes the effect of amortization of intangible assets and restructuring charges and other one-time charges in the aggregate amount of $0.6 million and $0.8 million, was $1.2 million and $1.9 million. Pro forma operating loss in the nine month period ended September 30 in 2002 and 2001, which excludes the effect of amortization of intangible assets and restructuring charges in the amount of $2.0 million and $2.7 million, was $1.3 million and $5.5 million, respectively.

Operating results of Elron Software

Elron Software is focused on web access control and e-mail content filtering for organizations. Elron Software's net revenues were $2.0 million and $6.3 million for the three and nine month periods ended September 30, 2002 compared to $2.0 million and $6.7 million for the same periods of 2001, representing the same level of revenues for the three month period and a decrease of 7% for the nine month period. The decrease was primarily due to the continued economic slowdown, which continues to cause customers to delay or postpone purchases of IT products.

Elron Software's operating loss was $1.8 million and $6.5 million for the three and nine month periods ended September 30, 2002, compared to $2.5 million and $7.5 million for the same periods of 2001. Excluding the effect of amortization of intangible assets, deferred compensation and restructuring charges in the amount of $0.5 million and $1.6 million, pro forma operating loss of Elron Software was $1.3 million and $4.9 million for the three and nine month periods ended September 30, 2002, respectively, compared to $1.9 million and $6.1 million for the same periods of 2001, which excluded the effect of amortization of intangible assets, deferred compensation and restructuring charges in the amount of $0.6 million and $1.4 million. The decrease in losses was a result of the restructuring and cost reduction programs implemented by Elron Software.

Consolidated Results of Operations

Income

Net Revenues

Net revenues consisted of sales of products and services by Elron Software, Elron TeleSoft and our other subsidiaries, each of which is included in our consolidated financial statements as of the date of its acquisition. The following table reflects consolidated revenues:

	Three month period ended September 30,		Nine month period ended September 30,	
	2002	2001	2002	2001
	Millions of $			
Elron Software	2.0	2.0	6.3	6.7
Elron TeleSoft	0.8	4.6	8.2	19.7
Other	2.9	-	2.9	-
	5.7	6.6	17.4	26.4

Galil Medical, a medical device company performing minimally invasive cryotherapy, recorded revenues of $1.3 million and $3.3 million for the three and nine month periods ended September 30, 2002 compared to $0.7 million and $1.9 million in the same periods last year. Galil Medical's revenues are included in our consolidated revenues for the first time in the third quarter of 2002.

MediaGate's revenues were $1.4 million and $1.8 million in the three and nine month periods ended September 30, 2002, respectively, compared to no revenues and $0.1 million in the same periods in 2001. MediaGate develops and markets a carrier-class universal communications server. MediaGate's revenues are included in our consolidated revenues for the first time in the third quarter of 2002.

Our share in net losses of affiliated companies

Our share in net losses of affiliated companies, which resulted from our holdings in investments that are accounted for under the equity method, was $3.5 million and $18.8 million for the three and nine month periods ended September 30, 2002, respectively, compared to a restated net loss of $5.1 million and $13.3 million for the same periods of 2001. The increase in our share in net losses of our affiliated companies in the nine month period of 2002 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 have not yet generated significant revenues and therefore have incurred significant losses. In addition, Elbit and DEP wrote down certain investments, mainly with regard to VFlash, Textology and ICC, resulting in a net loss for Elron of approximately $2.8 million.
The decrease in our share in net losses of our affiliated companies in the third quarter of 2002 resulted mainly from the increase in our share in Elbit Systems' net income and from the decrease in the losses of most of our group companies as a result of cost reduction plans implemented by them.

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 by 12% and 9% from $188 million and $540 million in the three and nine month periods ended September 30, 2001, respectively, to $210.2 million and $589.1

million in the same periods in 2002. As of September 30, 2002, Elbit Systems' backlog of orders was $1,677 million, of which approximately 55% is scheduled to be performed in the fourth quarter 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 nine month periods ended September 30, 2002 was $16.0 million and $35.6 million, respectively, (7.6% and 6.0% of revenues) compared to $12.4 million and $42.6 million in the same periods in 2001 (6.6% and 7.9% of revenues). The increase in operating income for the third quarter resulted primarily from the increase in revenues. The decrease in operating income for the nine month period 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 nine month periods ended September 30, 2002 was $15.5 million and $32.0 million, respectively, (7.4% and 5.4% of revenues) compared to $11.3 million and $33.1 million (6.0% and 6.2% of revenues) in the same periods in 2001. The increase in the third quarter resulted primarily from the decrease in tax expenses, which included a $2.8 million adjustment in respect of prior years following tax assessments completed by tax authorities in various tax jurisdictions during the period. The decrease in the nine month period resulted primarily from a one time charge of $9.8 million described above.

NetVision (a 46% holding)

NetVision, an Internet service and solutions provider in Israel, recorded revenues in the three and nine month periods ended September 30, 2002 of $13.8 million and $42.5 million, respectively, compared to $14.4 million and $44.1 million in the same periods in 2001. Operating expenses decreased by $1.4 million and $8.1 million, respectively, or 10% and 17%, from $14.4 million and $47.5 million in the three and nine month periods ended September 30, 2001, to $13.0 million and $39.4 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 nine month periods ended September 30, 2002 was $0.8 million and $3.1 million compared to an operating breakeven and operating loss of $3.4 million in the same periods in 2001. NetVision's net income was $0.4 million and $3.5 million in the three and nine month periods ended September 30, 2002 compared to net income of $0.8 million and a net loss of $3.2 million in the same periods in 2001.

Netvision expects lower operating income and net income in the fourth quarter of 2002 primarily due to the economic slowdown affecting consumer spending in its industry.

Chip Express (a 34% 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. Revenues decreased by $3.0 million and $11.0 million, or 49% and 46%, from $6.0 million and $23.9 million in the three and nine month periods ended September 30, 2001, to $3.0 million and $12.9 million in the same periods in 2002. In response to the slowdown in its industry, Chip Express implemented cost reduction programs beginning in 2001 which resulted in a 11% and 20% decrease in Chip Express' operating expenses in the three and nine month periods ended September 30, 2002 to $2.4 million and $7.3 million compared to $2.7 million and $9.1 million in the same periods in 2001. Chip Express' net losses in the three and nine month periods ended September 30, 2002 amounted to $1.8 million and $3.6 million compared to $0.9 million and $1.7 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 $16.0 million, of which we invested $5.0 million. Consequently, our ownership percentage in Chip Express decreased from approximately

35% to approximately 34%. 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.

Pulsicom (a 17% holding)

Pulsicom commenced its operations in 2001 and develops high accuracy real time location and tracking systems. In the nine month period ended September 30, 2002 and 2001, its net losses amounted to $0.6 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 market and sell its product.

Cellenium (a 50% holding through Elbit)

Cellenium is engaged in the development of technology for the transfer of short messages over communications networks, particularly the various types of cellular networks. Cellenium's net revenues in the three and nine month period ended September 30, 2002 were $0.4 million and $1.0 million compared to no revenues and $0.1 million for the same periods in 2001. Cellenium's net losses in the three and nine month periods ended September 30, 2002 were $1.1 million and $3.4 million compared to $1.5 million and $4.2 million for the same periods in 2001. Cellenium's future operations are largely dependent on the development of the mobile commerce market and the penetration of new value-added services and applications, as well as Cellenium's ability to secure the cash needed to finance its operations.

Wavion (a 48% holding)

Wavion, a developer of broadband wireless access systems, recorded a net profit in the three month period ended September 30, 2002 of $32,000 and a net loss in the nine month period then ended of $0.8 million compared to net losses of $1.0 million and $3.2 million for the same periods in 2001. In light of the downturn in the broadband wireless communications market which delayed the release of Wavion's products, at the beginning of 2002, Wavion began to sell development services for communication systems, recording revenues of $0.6 million and $1.0 million in the three and nine month periods ended September 30, 2002, and reduced its research and development expenses as part of a cost reduction program. The increase in the revenue enabled Wavion to record a net profit in the three month period ended September 30, 2002. It is difficult to predict when Wavion will be able to market its product successfully.

KIT (a 28% holding)

KIT's revenues increased by $0.3 million and $1.2 million from $0.4 million and $0.8 million in the three and nine month periods ended September 30, 2001 to $0.7 million and $2.0 million in the same periods in 2002. KIT is an online academic program company. KIT's net loss in the three and nine month periods ended September 30, 2002 was $1.0 million and $3.1 million compared to $0.5 million and $1.7 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 and to support the increase in revenues.

Given Imaging (a 18% 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 $7.5 million and $19.9 million for the three and nine month periods ended September 30, 2002 and a gross profit of 59% and 55% of revenues, respectively. The third quarter of 2002 represents the fourth full quarter of sales for Given Imaging following FDA clearance of its product in August 2001 and the fourth consecutive quarter of increased revenues. Given Imaging's net loss in the three and nine month periods ended September 30, 2002 was $3.9 million and $14.6 million compared to $4.8 million and $12.2 million in the same periods of 2001. The increase in Given Imaging's net losses for the nine month period 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.

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 $0.8 million and $3.6 million for the three and nine month periods ended September 30, 2002 compared to $1.3 million and $3.2 million in the same period of 2001. Witcom's revenues were affected by the slowdown in the telecommunications industry. Witcom's net loss in the three and nine month periods ended September 30, 2002 was $1.1 million and $4.7 million compared to $1.6 million and $5.3 million in the same period in 2001. The decrease in net losses resulted from a cost reduction program implemented by Witcom beginning in 2001.

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 $1.5 million and $4.0 million for the three and nine month periods ended September 30, 2002 compared to $1.7 million and $5.9 million in the same period in 2001. The decrease in 3DV's net losses was the result of restructuring and cost reduction programs. 3DV is a development stage company and its future revenues are largely depended on its ability to penetrate to the three-dimensional video game market.

Despite the decrease in net losses in most of our group companies, we expect that our group companies will continue to recognize losses in the fourth quarter of 2002 and in 2003 and therefore will negatively affect our net results of operations.

In addition to companies accounted for 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 (Nasdaq: PTNR) 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 September 30, 2002, the market value of our investment in Partner amounted to $87.7 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, which was doubled in the third quarter of 2002. The following are highlights of the results of operations of Partner for the third quarter of 2002:

Partner's revenues for the third quarter of 2002, driven primarily by subscriber growth, increased by 24% to $220.0 million from $178.1 million in the third quarter of 2001 and by 8% from $203.6 million in the second quarter of 2002. Partner's subscriber base at the end of the third quarter of 2002 was 1,758,000 compared to 1,300,000 at the end of the third quarter of 2001.

Partner's operating income for the third quarter of 2002 increased to $33.3 million from $9.9 million in the third quarter of 2001, an increase of 237%, and from $28.3 million in the second quarter of 2002, an increase of 18%. Operating income in the third quarter, as a percentage of revenues, reached 15% as compared to 6% in the third quarter of 2001 and 14% in the second quarter of 2002.

Partner's net income for the third quarter of 2002 was $10.5 million compared to a net loss of $18.1 million for the third quarter of 2001, and twice the net income in the second quarter of 2002 of $5.2 million.

Partner has a line of credit agreement with a consortium of banks that provides for borrowings of up to $750 million. As of September 30, 2002, the outstanding balance of this line of credit was approximately $531 million. The line of credit is guaranteed by shares held by the original shareholders of Partner, pro rata to their respective holdings. In connection with this guarantee, Elbit has pledged approximately 70% of the Partner shares held by it.

Partner expects lower operating income and net income in the fourth quarter of 2002 primarily due to the economic slowdown affecting consumer spending in its industry.

Oren Semiconductor (a 17% holding)

Oren is a developer of integrated circuits for digital broadcasting. During the first nine months of 2002, we invested $1.4 million in Oren by way of bridge loans, bringing the book value of our holding in Oren at September 30, 2002 to $6.9 million compared to $5.5 million at December 31, 2001.

In the three and nine month periods ended September 30, 2002, Oren’s revenues were $0.5 million and $1.5 million compared to $0.6 million and $1.8 million in the same periods in 2001. Operating expenses in the three and nine month periods ended September 30, 2002 decreased to $1.8 million and $5.4 million from $2.2 million and $7.2 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 nine month periods ended September 30, 2002 was $2.2 million and $5.6 million compared to $2.1 million and $6.5 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 nine month periods ended September 30, 2002 were $3.2 million and $5.3 million compared to a minor gain or loss in the same periods in 2001. The gain in the nine month period ended September 30, 2002 resulted primarily from a $5.3 million gain from the sale of approximately 98,700 and 500,000 shares of Given Imaging held by Elron and RDC, respectively (of which 98,700 and 288,700 were in the third quarter of 2002) and the exercise of call option by a former senior executive of RDC, to purchase 172,800 shares of Given Imaging from RDC. As a result, our direct and indirect holdings in Given Imaging decreased to 18.3%.

Other Income (expenses), net

Other income (expenses), net, in the three and nine month periods ended September 30, 2002 amounted to insignificant income and $ 0.3 million, respectively, compared to a net loss of $1.9 million and $4.6 million for the same periods in 2001. The loss in the three month and nine month periods of 2001 resulted primarily from losses in respect of the decrease in the market value of publicly traded shares held by us at that time.

Finance Income

Finance income decreased by $0.9 million and $2.1 million, or 58% and 49%, to approximately $0.7 million and $2.2 million in the three and nine month periods ended September 30, 2002 from $1.6 million and $4.3 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 our other subsidiaries, each of which is included in our consolidated financial statements as of the date of its acquisition.

Cost of revenues decreased by $0.9 million and $8.9 million, or 21% and 49%, to $3.4 million and $9.2 million in the three and nine month periods ended September 30, 2002 from $4.3 million and $18.1 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 our other subsidiaries, each of which is included in our consolidated financial statements as of the date of its acquisition.
Consolidated research and development expenses increased by $0.2 million, or 8%, to $2.3 million in the third quarter of 2002 from $2.1 million in the third quarter of 2001, mainly as a result of the inclusion of the development expenses of Galil Medical and MediaGate, which were consolidated for the first time in the third quarter of 2002. Consolidated research and development expenses decreased by $0.9 million, or 14%, to $6.0 million in the nine month period ended September 30, 2002 from $6.9 million in the same period in 2001, primarily as Elron Software and Elron Telesoft 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 our other subsidiaries, each of which is included in our consolidated financial statements as of the date of its acquisition.

Consolidated sales and marketing expenses increased by $2.1 million and by $1.4 million, or 84% and 17%, to $4.6 million and $9.5 million in the three and nine month period ended September 30, 2002 from $2.5 and $8.1 million in the same periods of 2001. The increase resulted mainly from the inclusion of the sales and marketing expenses of Galil Medical which were consolidated for the first time in the third quarter of 2002.

General and Administrative

General and administrative expenses include our management and headquarter costs and the expenses of Elron Software, Elron TeleSoft, and our other subsidiaries, each of which is included in our consolidated financial statements as of the date of its acquisition.

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 $0.6 million, or 23%, from $2.6 million in the third quarter of 2001 to $3.2 million in the third quarter of 2002. Consolidated general and administrative expenses in first nine months of 2002 decreased by $0.4, or 5%, to $8.0 million from approximately $8.4 million in the same periods in 2001.

In the third quarter of 2002, our subsidiaries' general and administrative expenses increased by $0.1 million, from $1.6 million in the third quarter of 2001 to $1.7 million. In the nine month period ended September 30, 2002, our subsidiaries' general and administrative expenses decreased by $1.1 million to $3.7 million from $4.8 million in the same period 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 $0.5 million and $0.7 million, or 50% and 19%, to $1.5 million and $4.3 million in the three and nine month periods ended September 30, 2002 from approximately $1.0 million and $3.6 million in the same periods in 2001. Since the merger with Elbit, management and headquarter costs 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 more than $4.0 million per year.

Finance Expenses

Consolidated finance expenses in the three and nine month periods ended September 30, 2002 decreased by $0.1 million and $0.6 million, or 11% and 19%, to $0.8 million and $2.5 million compared to $0.9 million and $3.1 million in the same periods in 2001. The majority of the finance expenses are attributable to Elron TeleSoft. The decrease in finance expenses is primarily due to the decrease in interest rates.

Amortization of Other Assets

Amortization of other assets was approximately $0.7 million and $1.6 million in the three and nine month periods ended September 30, 2002 compared to $0.9 million and $2.8 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 nine month periods ended September 30, 2001 was $0.4 million and $1.2 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 included 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 mainly included workforce reductions in order to further adjust their operations to the current economic conditions. Some of the restructuring programs took place in October 2002 and their financial effect will be reflected in the consolidated results for the fourth quarter of 2002.

As part of Elron TeleSoft’s restructuring program in 2001, in the first quarter of 2002, Elron Telesoft completed 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 nine months of 2002 amounted to $0.8 million, of which $ 0.3 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. In October 2002, the company adopted an additional restructuring plan the costs of which are estimated at this stage at $0.3 million.

Elron Software recorded $0.3 million of restructuring charges in the nine month period of 2002 primarily due to an additional workforce reduction in its research and development division. In October 2002, the company adopted an additional restructuring plan, the costs of which are estimated at this stage to be $0.2 million.

In the second quarter of 2002 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 nine month periods ended September 30, 2002 amounted to $0.1 million and $1.5 million. Consolidated restructuring charges in the third quarter of 2001 and in the nine months period of 2002 amounted to 0.4 million and $1.3 million.

Gain or loss from Discontinued Operations

As part of VFlash's restructuring program in response to a slowdown in the market of Internet and cellular value added services, VFlash sold on September 23, 2002, a significant portion of its business to 24/7 Real Media Inc. (Nasdaq: TFSM) ("24/7") in exchange for 4,100,000 shares of 24/7 common stock. The market value of these shares on September 23, 2002 was $1.6 million, based on the then closing price of the share of 24/7. 24/7 provides marketing and technology solutions to online marketers and publisher.

In conjunction with the above sale, we invested through Elbit, $1 million in consideration for 100,000 shares of 24/7 convertible preferred stock. Each share of preferred stock is convertible at any time into 48.40271 shares of common stock of 24/7,subject to adjustment upon certain events determined in the investment agreement. The fair value of the 100,000 shares of preferred stock was approximately $1.9 million.

As a result of the above mentioned sale, we recorded a gain of $2.1 million. This gain was partially offset by the results of operations of VFlash.

Also included in this item is our share in the net losses of Textology which was sold, with no gain recognized, during the third quarter of 2002.

LIQUIDITY AND CAPITAL RESOURCES

Consolidated cash, debentures, deposits and marketable securities at September 30, 2002 were $101.0 million (of which $98.2 million are held by Elron), compared with $112.8 million at December 31, 2001 (of which $111.5 million was held by Elron). (At September 30, 2002, cash, debentures, deposits and marketable securities held by Elron include those of Elbit following the completion of the merger in May 2002).

Main resources of cash and other liquid instruments in the first nine months of 2002 included mainly proceeds from our sale of Given Imaging shares of $1.1 million, the sale of other marketable securities of NetManage, ArelNet and Kana of $0.8 million and a $2.0 million dividend received from Elbit Systems. In addition, our cash and other liquid instruments increased by approximately $16.6 million, mainly as a result of the merger with Elbit.

Main applications of cash and other liquid instruments in the first nine months of 2002 included mainly investments in our existing group companies to secure their cash needs for future growth, as well as in new companies in the aggregate amount of $26.7 million.

Working capital at September 30, 2002 was $31.8 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 previously classified as long-term loans, and investments made by us in existing and new group companies of approximately $26.7 million.

At September 30, 2002, Elron Software and Elron TeleSoft had bank credit and bank loans of $68.7 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 September 30, 2002, was approximately $280.0 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 nine months of 2002 was a result of the share issuance pursuant to the merger agreement and the DEP share purchase agreement.

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